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**COMMISSION OPINION**

**of 18.11.2020**

**on the Draft Budgetary Plan of Estonia**

{SWD(2020) 854 final}

(Only the Estonian text is authentic)

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*GENERAL CONSIDERATIONS*

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission[3]. As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[5], Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU[6], alongside the proposal for the reinforced

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1 Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

2 The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

3 https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

4 Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM (2020) 575 final.

5 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

6 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

long-term budget of the EU for 2021-2027[7]. This proposal includes the establishment of a Recovery and Resilience Facility offering large-scale financial support for both public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

*CONSIDERATIONS CONCERNING ESTONIA*

5. On 15 October 2020, Estonia submitted the Draft Budgetary Plan for 2021. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

6. On 20 July 2020, the Council recommended Estonia[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Estonia to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Estonia's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value. The report concluded that, after the assessment of all relevant factors, the deficit criterion was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, the Estonian economy is expected to contract by 4.6% in 2020 and to grow by 3.4% in 2021. According to the macroeconomic scenario underlying the Draft Budgetary Plan, real GDP is projected to fall in 2020 by 5.5% and to rebound in 2021 by 4.5%. As a consequence, GDP levels at the end of 2021 are projected to remain below 2019 levels in both forecasts. While the unemployment rate is projected in the Draft Budgetary Plan to climb to 8% of the labour force in 2021, wage growth is set to turn slightly positive in 2021. Inflation is forecast to be moderate, at around 1.4% in 2021. This scenario is broadly in line with the Commission 2020 autumn forecast, although the Commission expects a smaller GDP decline in 2020 (reflecting more favourable short-term economic developments), but also a smaller rebound in 2021. The projections for unemployment are similar, while the Commission expects slightly higher wage growth in both 2020 and 2021, reflecting recent short-term data. Estonia complies with the requirement of Regulation EU No 473/2013, as the draft budget is based on independently endorsed macroeconomic forecast by the Fiscal Council.

8. The Draft Budgetary Plan projects the general government balance to decline from a surplus of 0.1% of GDP in 2019 to a deficit of 6.6% of GDP in 2020 and of 6.7% in

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[7] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

[8] Council Recommendation of 20 July 2021 on the national Reform Programme of Estonia and delivering a Council opinion on the 2020 Stability Programme of Estonia, OJ C 282, 26.8.2020, p. 33.

2021, reflecting the operation of automatic stabilisers and fiscal measures. The Commission 2020 autumn forecast projects a smaller headline deficit of 5.9% of GDP in both 2020 and in 2021, reflecting the more favourable macroeconomic and labour market projections for 2020, which carry forward to 2021.

The Draft Budgetary Plan includes in its revenue projections grants and expenditure of 0.5% of GDP (137 million euros) under the Recovery and Resilience Facility in 2021. For the time being, as the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes in the budgetary projections for 2021 the 10% pre-financing of Recovery and Resilience Facility grants, and treats it as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. In the case of Estonia, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to 110 million euros in 2021.[9] On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast. [10] The evolution of the deficit in 2021 could turn out more favourable as a result of the higher economic growth from the implementation of measures financed by the Recovery and Resilience Facility.

The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will increase from 18.2% at the end of 2020 to 23.6% in 2021, the latter being close to the Commission's projection of 22.5%.

9. Estonia’s fiscal measures were adopted with the Supplementary Budget on 16 April 2020. The Draft Budgetary Plan contains an updated costing of these measures, estimated to amount to 3% of GDP in 2020. The largest fiscal measures for 2020 include lowering excises on fuels, stopping state payments to the second pillar pension funds, rescheduling and lowering interest rates on tax liabilities, raising healthcare-related spending, a wage subsidy scheme, additional funding for local governments, various additional investments, sectoral support to shipping, education and culture. In addition, guarantee schemes were provided with the take-up of the guarantees as of September 2020 estimated at 0.2% of GDP. Overall, the measures taken by Estonia in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

10. The 2021 Draft Budgetary Plan has allocated additional resources to some specific expenditure programmes, amounting to 1.8% of GDP (partly offset by measures improving the budget balance by 1.1% of GDP). Notably, additional funding is given to a multitude of small-scale investment projects an additional 20 euro monthly rise

[9] Indicative number based on the Council Presidency compromise proposal for the RRF Regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

[10] The treatment of the Recovery and Resilience Facility (RRF) in the Commission’s 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission’s Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). The forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

in pensions above the indexation and additional spending on R&D and defence. The Commission 2020 autumn forecast considers the described measures credibly announced and sufficiently specified and incorporates them with no difference in their assessment. The budget plan does not include an extension of liquidity, guarantee or short term working schemes into 2021. At the same time, some measures for 2021 set out in the Draft Budgetary Plan appear not to be temporary and not matched by offsetting measures, with a planned budgetary cost of 0.5% of GDP. These include the rise in pensions, higher Research and Development spending, and additional defence expenditure.

11. The Commission is of the opinion that the Draft Budgetary Plan of Estonia is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Estonia are supporting economic activity against the background of considerable uncertainty. Estonia is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

It is anticipated that Estonia will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

Done at Brussels, 18.11.2020

*For the Commission*
*Paolo GENTILONI*
*Member of the Commission*