RAHANDUS-
MINISTEERIUM
MINISTRY of FINANCE of the REPUBLIC of ESTONIA

2022 Draft Budgetary Plan of Estonia

Tallinn, 15. October 2021

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Introduction

According to the European Parliament and Council Regulation (EU) No 473/2013 entered into force on 30 May 2013 about the common rules of monitoring and evaluation of Member States budget plans and ensuring the correction of their excessive deficit (EU OJ L 140, 27.05.2013) all euro area Member States must submit next year's draft budgetary plans (DBP) by 15 October.

Preparation and assessment of budgetary plans in autumn is an additional step in a framework of coordinated surveillance, which already included presenting and assessing the Stability Programmes by the Council and the Commission in spring. This contributes to coordination of policies between the euro area member states and ensures that the recommendations of the Council and of the Commission are taken into account accordingly in the budgetary processes of the member states. The information provided in the DBP should allow identifying possible discrepancies of the budgetary strategy from the one presented in the last Stability Programme.

This spring Estonia reverted to its normal fiscal planning cycle despite the continuation of the COVID-19 pandemics. The State Budget Strategy for the next four years and the 2021 Stability Programme was approved by the Government on 29 April 2021. **The draft 2022 State Budget with explanatory memorandum was approved on 30 September in the meeting of the Government and it was given for proceeding to Parliament.**

The draft 2022 State Budget of the Republic of Estonia is based on State Budget Strategy 2022–2025, The Government's Action Programme and the planned activities take into account the Government's Action Programme and The European Commission and the Council recommendations[1] (given according to the Stability Programme 2021). In the formulation of the fiscal policy, national requirements and the Stability and Growth Pact requirements on the budgetary policy of the EU Member States are being respected.

In 2022, Estonia's general government structurally adjusted budgetary position is planned in a deficit of 2.6% of GDP. From 2020 to 2022, the general escape clause of the SGP will apply. From 2023, the requirement of the Estonian State Budget Act to improve the structural budgetary position at least by 0.5% of GDP will be applied again. The MTO remains at -0.5% of GDP.

[1] Estonia's country-specific recommendations 2021:

(1) In 2022, maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.

(2) When economic conditions allow, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, enhance investment to boost growth potential.

(3) Pay particular attention to the composition of public finances, both on the revenue and expenditure sides of the budget, and to the quality of budgetary measures, to ensure a sustainable and inclusive recovery. Prioritise sustainable and growth-enhancing investment, notably supporting the green and digital transition. Give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including by strengthening the coverage, adequacy, and sustainability of health and social protection systems for all.

1. Macroeconomic forecast

The Draft 2022 State Budget of the Republic of Estonia is based on the summer forecast of the Ministry of Finance (MoF), published on 9 September 2021. External assumptions of the forecast were fixed in mid August 2021. Economic forecasts of the Ministry of Finance are public and can be found from the web page of the ministry (https://www.rahandusministeerium.ee/et/riigieelarve-ja-majandus/majandusprognoosid).

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The Ministry of Finance is forecasting that the Estonian economy will be at higher level compared to pre-crisis forecasts. The robust expansion in the first half of 2021 will provide 9,5% GDP growth for 2021. In 2022, growth rate will slow down to 4% and thereafter slightly below 3%. Estonian economy has adjusted with local and foreign restrictions and even if the restrictions should be reinforced, no considerable negative impact would be expected from that on the economy.

The exporting manufacturing sector is navigating on the breeze of trade partners vigorous imports. ICT services will remain very competitive globally and returning foreign tourists should ensure work for smaller qualification labour force in next years. The exports of goods and services will grow 13,8% in 2021, exceeding markedly the growth rate of foreign demand. The external balance is being affected by one-off large-scale imports of intellectual property in ICT sector. As a result of this, current account turned slightly negative in 2020 and will remain close to balance in 2021 as well.

Investments will be supported by higher investment activity of public sector and the savings of residents. Pension savings of residents from II pillar are driving the housing investments. New construction projects in the pipeline will result in growing public investments in coming years.

The situation in labour market is controversial – companies are complaining about labour shortages while unemployment is still significantly above pre-crisis levels. Despite an upswing in economic activity, unemployment has gone down by a quarter only from its peak in late 2020. Registered unemployment surged by 20 thousand persons in the first months of the crisis and in September 2021 it was still higher by 16 thousand persons when compared with 2019. Employment has increased primarily in ICT and health care, but when compared with pre-crisis levels, most of the economic activities are having lower employment levels. Rapid economic growth and high unemployment lead to strong productivity growths, but with negative consequences for some sectors and persons. Unemployment is unable to return to the pre-crisis levels without foreign tourism, what takes time to recover.

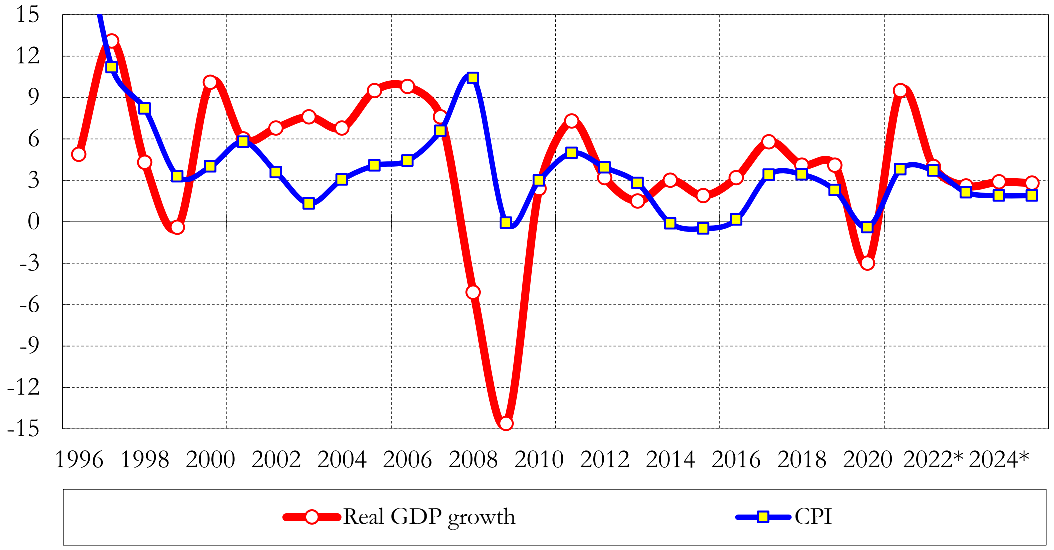
Private consumption growth in 2022 will be influenced (in addition to fast labour income growth) by high inflation (3,7%) and the use of II pillar pension funds, which were released in September 2021. If government-imposed restrictions will be further released and uncertainty about future developments decreases, some of the enforced savings which have accumulated on deposit accounts can also be spent. This would be a positive risk and is not part of the base scenario.

Sharp increase in consumer prices is mostly caused by foreign factors and this will grasp more than half of nominal wage increases in 2021 and 2022. In relation to fast recovery of the global economy, more than half of the increase in consumer prices comes from mainly imported energy prices. The contribution of core inflation will increase as well, but about half from this is caused by imported industrial goods. Considering very low comparison base a year ago, inflation will be accelerating until the end of the year and should remain slightly below 4% in 2021 and 2022.

Figure 1

Estonia's economic growth and the change of consumer price index

(per cent)

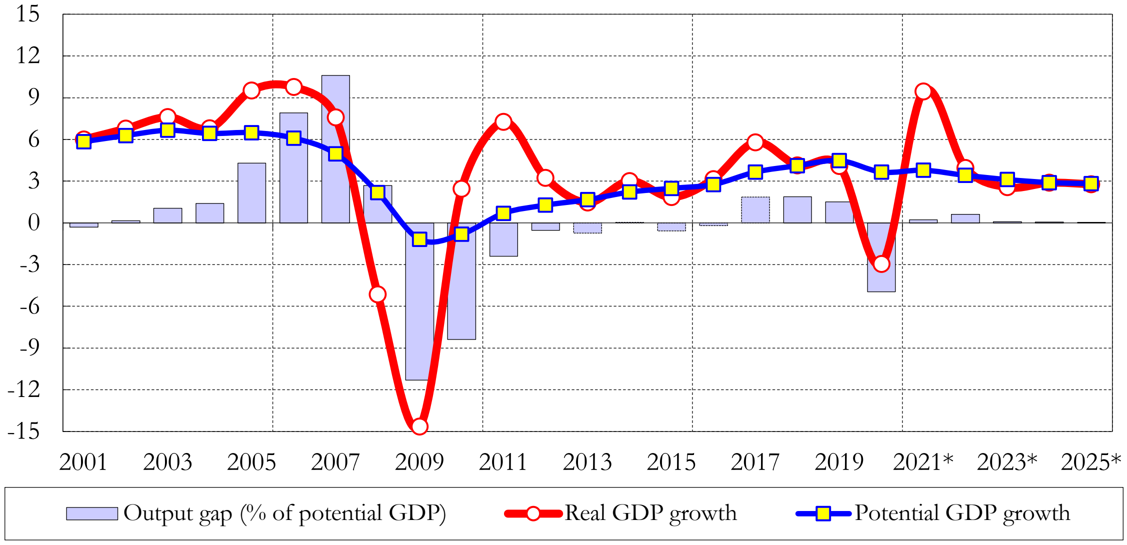


Source: Statistics Estonia, Ministry of Finance.

Figure 2

Development of potential GDP and output gap

(per cent)



Source: Statistics Estonia, Ministry of Finance.

Table 0.i) Basic assumptions

	2020	2021*	2022*
Short-term interest rate (annual average)	-0.4	-0.5	-0.5
Long-term interest rate (annual average)	-0.5	-0.4	-0.2
USD/€ exchange rate (annual average)	0.877	0.838	0.847
Nominal effective exchange rate	2.6	1.0	0.0
World excluding EU, GDP growth	-2.4	6.2	4.5
Eurozone GDP growth	-6.1	4.7	4.5
Growth of relevant foreign markets	-7.2	8.3	6.5
World import volumes, excluding EU	-8.5	11.0	6.2
Oil prices (Brent, USD/barrel)	42.0	68.4	67.7

Source: Ministry of Finance.

Table 1.a. Macroeconomic prospects

		2020 Level	2020 rate of change	2021 rate of change	2022 rate of change
1. Real GDP	B1*g	23685.9	-3.0	9.5	4.0
of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth (1/)		–	–	–	–
2. Potential GDP			3.7	3.8	3.4
contributions:					
- labour			0.0	0.0	-0.1
- capital			1.1	1.4	1.7
- total factor productivity			2.6	2.3	1.8
3. Nominal GDP	B1*g	26834.6	-3.2	12.4	7.4
Components of real GDP					
4. Private final consumption expenditure	P.3	11565.8	-2.7	4.4	3.2
5. Government final consumption expenditure	P.3	4523.3	3.0	3.4	-1.0
6. Gross fixed capital formation	P.51	7690.9	20.0	6.7	-2.0
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-152.5	-0.4	1.5	1.5
8. Exports of goods and services	P.6	18452.2	-5.0	13.8	6.5
9. Imports of goods and services	P.7	18581.8	0.9	12.5	2.3
Contributions to real GDP growth					
10. Final domestic demand			4.4	5.0	0.8
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		-1.2	2.5	0.0
12. External balance of goods and services	B.11		-4.3	1.0	3.1

1/ Implementation of budgetary measures were decided after the completion of macroeconomic forecast and therefore their impact on economic growth is not included in the forecast.

Source: Statistics Estonia, Ministry of Finance.

Table 1.b. Price developments

	ESA code	2020 *level 2010=100*	2020 rate of change	2021* rate of change	2022* rate of change
1. GDP deflator		113.3	-0.3	2.6	3.3
2. Private consumption deflator		111.4	-0.7	3.8	3.7
3. HICP		109.8	-0.6	3.8	3.7
4. Public consumption deflator		126.1	2.2	3.9	2.5
5. Investment deflator		107.1	-2.7	0.6	3.0
6. Export price deflator (goods and services)		103.5	-2.1	5.0	3.1
7. Import price deflator (goods and services)		102.1	-3.0	5.2	3.0

Source: Statistics Estonia, Ministry of Finance.

Table 1.c. Labour market developments

	ESA code	2020 *Level*	2020 *rate of change*	2021* *rate of change*	2022* *rate of change*
1. Employment, persons		656.6	-2.2	-0.3	1.4
2. Employment, hours worked			-2.2	-0.3	1.4
3. Unemployment rate (%)		47.9	6.8	6.7	5.8
4. Labour productivity, (real GDP per employed person)		36.1	-0.8	9.8	2.5
5. Labour productivity, hours worked			-0.8	9.8	2.5
6. Compensation of employees	D.1	13894.8	2.5	7.3	7.9
7. Compensation per employee		21.2	4.8	7.7	6.3

Source: Statistics Estonia, Ministry of Finance.

Table 1.d. Sectoral balances

	ESA code	2020 *% of GDP*	2021* *% of GDP*	2022* *% of GDP*
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	1.5	2.6	5.1
of which:				
- balance on goods and services		0.3	1.1	4.1
- balance of primary incomes and secondary incomes		-0.9	-0.8	-1.2
- capital account		2.1	2.4	2.2
2. Net lending/net borrowing of the private sector	B.9			
3. Net lending/net borrowing of general government	B.9	-5.0	-3.3	-2.2
4. Statistical discrepancy		-1.5	-	-

Source: Statistics Estonia, Ministry of Finance.

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Economic forecast of the Ministry of Finance is prepared by analysts from the Fiscal Policy Department, who belong to the personnel of the Ministry. The objectivity and independence of the forecast is assured through the transparency of forecasting process, the involvement of different external economists and through continuous comparison of forecasting results. A preliminary version of the forecast will be discussed with the forecasting team of Bank of Estonia. Before finalisation of the forecast of the Ministry of Finance, its main assumptions and results will be discussed in a joint seminar with different forecasters in Estonia, who belong to the central bank, commercial banks and other institutions dealing with economic analysis. There are approximately ten institutions taking part from this seminar. In addition, different comparative tables and figures with the outcome of different independent forecasters can be found from the document of Ministry's economic forecast. On the basis of this it is easy to be convinced of systemic inducement by some forecasters.

The opinion of the Fiscal Council on the summer 2021 economic forecast of the Ministry of Finance

Pursuant to §18 of the State Budget Act, the Fiscal Council issued an opinion on the summer 2021 economic forecast of the Ministry of Finance on 23 September.[2] After consulting with the Fiscal Council, the Ministry of Finance interprets the Fiscal Council's opinion as an endorsement of the Ministry of Finance's summer forecast with some concessions, and that those risks and threats are presented in the Fiscal Council's opinion.

The Fiscal Council recommends that the preparation of the 2022 state budget should not be based on the baseline forecast only, but also on the negative risk scenario of the forecast, which envisages a clear slowdown in economic growth next year. In addition to the possibility of a slower growth, the Fiscal Council also points to the risk that the economy may start showing signs of overheating in the near future. In its opinion, the Fiscal Council has also addressed the complexity of assessing growth potential, the business cycle and the output gap. The estimate of the government's structural budget position depends on the latter. However, the structural deficit estimates of the Fiscal Council itself are very similar to the Ministry of Finance's calculations and they are even slightly more positive in 2021 and 2022, pointing to a more negative output gap assessment, i.e. a weaker cyclical state of the economy.

In addition to highlighting the risks, the Fiscal Council confirms that the summer economic forecast of the Ministry of Finance does not differ significantly from other institutions, which were able to take into account faster-than-expected growth in the second quarter of 2021 when preparing the forecast. The Fiscal Council also confirms that the forecast is methodologically balanced and notes that, given the persistency of the coronavirus, making a reliable economic forecast remains difficult and that the forecast errors may be higher than during normal times.

The Ministry of Finance agrees with the assessment that in the context of the corona crisis, the preparation of economic forecasts is more complicated than usually. The Ministry of Finance agrees that there is a lot of uncertainty related to the forecast assumptions. However, according to the Ministry of Finance, there are both upside and downside risks to the forecast assumptions. Economic growth may end up faster than forecast due to additional consumption demand from savings accumulated during the crisis and the disbursement of the second pillar pension funds. Negative growth risks are related to global supply constraints and bottlenecks and already high level of capacity utilisation. The Ministry of Finance is of the opinion that upside and downside risks are balanced, and shares the conclusion of the Fiscal Council that the summer economic forecast of the Ministry of Finance does not differ significantly from the recent economic forecasts of other institutions. Therefore, the Ministry of Finance does not consider it expedient to base the 2022 draft budget on the negative risk scenario of the forecast.

[2] More detailed analysis is found on the web page of the Fiscal Council: https://eelarvenoukogu.ee/news/the-state-budget-should-be-prepared-on-the-assumption-of-slower-economic-growth

We also note that the impact of the risk scenario on the structural balance of the general government budget would be relatively small, as lower tax revenues are offset by a weaker cyclical situation. In both 2022 and 2023, the risk scenario would improve the structural budget deficit by 0.1% of GDP compared to the baseline scenario.

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In the following, there are pointed out most relevant differences between Ministry of Finance's 2021 summer forecast and other institutions latest public macroeconomic forecasts. Comparing them, one should keep in mind that forecasts are compiled in different periods and are therefore based on different information, which causes variations in assumptions and results of the forecasts. This is particularly important factor in the current situation as pandemics-related restrictions could change by days and this has significant impact on short-term growth prospects.

COVID-19 crisis has caused higher volatility than usual in the forecasts. Due to the second wave of virus outbreak and strict restrictions in the beginning of 2021, the growth expectations for 2021 were between 2.5% - 3.0%. However, stronger than expected recovery throughout the year has resulted in upward corrections of the forecast. It turned out that companies and residents have managed pretty well with the virus and that it does not suppress the business activity in many economic sectors anymore. After the publication of the record high GDP growth rate for Q2, the forecasts have started to converge close to 10%. As the economic forecast of the Ministry of Finance is based on the strong Q2 outcome, its GDP expectations for 2021 are in the higher end of the forecasts range.

For 2022, the variability of forecasts by the institutions tends to be smaller. GDP growth forecasts for 2022 are roughly between 4% and 5%. It can be noted that when raising the 2021 forecasts, the next year's expectations have been lowered somewhat by different institutions. The same applies to the summer forecast of the Ministry of Finance, where growth expectations have been cut to 4%, being located in the middle of the forecast range.

Table 1.e. Comparison of economic forecasts

	Real GDP growth, %			Nominal GDP growth, %		
	2021*	2022*	2023*	2021*	2022*	2023*
Ministry of Finance	9.5	4.0	2.6	12.4	7.4	4.9
Bank of Estonia	9.5	3.5	3.4	12.2**	7.9**	7.0**
Swedbank	8.0	4.0	3.2	-	-	-
SEB	6.6	4.5	2.5	-	-	-
Consensus Forecasts	7.8	4.3	-	-	-	-
European Commission	4.9	3.8	-	-	-	-
IMF	8.5	4.2	3.7	12.4	8.5	6.2
OECD	2.9	5.0	-	4.2**	6.8**	-
Estonian Institute of Economic Research	9.0	-	-	-	-	-

	Consumer Price Index, % (in brackets Harmonised Consumer Price Index)			General government position, % of GDP		
	2021*	2022*	2023*	2021*	2022*	2023*
Ministry of Finance	3.8 (3.8*)	3.7 (3.7*)	2.1 (2.1*)	-3.3	-2.2	-2.1
Bank of Estonia	3.6 (3.5*)	3.6 (3.6*)	2.5 (2.6*)	-3.4	-1.9	-1.7
Swedbank	3.1	2.6	2.2	-2.4	-2.1	-1.9
SEB	3.2*	2.7*	2.3*	-3.8	-2.5	-2.0
Consensus Forecasts	3.1	2.9	-	-4.7	-3.4	-
European Commission	2.2*	2.4*	-	-	-	-
IMF	3.8*	4.9*	2.2*	-2.9	-2.4	-1.7
OECD	1.9*	2.4*	-	-6.7	-3.7	-
Estonian Institute of Economic Research	3.5	-	-	-	-	-

* Harmonised Consumer Price Index.
** calculated from the forecast of nominal GDP volume or by summing up real GDP and GDP deflator.

Sources:
Ministry of Finance. 2022 Draft Budgetary Plan of Estonia. 15.10.2021.
European Commission. European Economic Forecast. Summer 2021 (Interim). 07.07.2021.
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SEB. Nordic Outlook. September 2021. 31.08.2021.
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Eastern Europe Consensus Forecasts. 20.09.2021.

2. Budgetary targets

The Government's medium-term objective (MTO) is the general government structural deficit up to 0.5% of GDP according to the Stability Programme.

In 2021, the structurally adjusted budgetary position of general government is projected to be in a deficit of 4.4% of GDP. Due to the corona crisis, there is an exceptional economic situation, which caused activation of the general escape clause of the Stability and Growth Pact for years 2020 to 2022. The general escape clause allows a Member State of the European Union to deviate from the medium-term budgetary objective (MTO) or from its path towards the MTO. At the same time, the requirement still applies on the excessive budget deficit, i.e. the nominal budget deficit shall not exceed 3% of GDP. From 2023, the requirement of the Estonian State Budget Act to improve the structural budgetary position at least by 0.5% of GDP will be applied again if in the previous year the general government structural position was in cumulative deficit and the general government structural position was in deficit. In 2020 to 2022, the requirement is exempted according to the general escape clause in the budgetary rules of the State Budget Act.

The government has set the target to reduce the structural deficit to 1.0% of GDP by 2025, reducing the deficit by at least 0.5% of GDP per year. At an aggregate level, the Estonian economy has swiftly recovered from the crisis with reaching the pre-crisis GDP level already in the first quarter of 2021, and, moreover, the negative output gap is expected to be closed by the end of this year. Therefore, there is no need to continue with broad-based economic recovery and activation measures. **In 2022, the government targets a structural budget deficit of 2.6% of GDP**, which is 1.8% of GDP smaller than this year. With this the government ensures that fiscal targets comply with the requirement of the State Budget Act to improve the budgetary position at least by 0.5% of GDP starting from 2022 onwards; this is one year earlier than formally required by the rules in the State Budget Act and at a time when the general escape clause is still in place.

According to Statistics Estonia the budgetary position of the general government was in a deficit of 5.0% of GDP, i.e EUR 1354 million in 2020. Central government and social security funds were in a deficit (3.9 and 1.2% of GDP). The central government deficit was mainly caused by state budget, which was affected on the one hand by the decline in tax revenues and on the other hand by the increase in expenditures related to the crisis mitigation measures planned in the supplementary budget. The deficit of social security funds was also due to a sharp increase in expenditure levels due to the crisis. The financial situation of local governments also suffered because of the crisis due to reduced income tax revenues, but with the help of state support measures and more prudent spending, the year ended with a budget surplus of 9 million euros.

In 2021, the nominal budgetary position of general government, taking into account 2022 draft budget measures, reaches a nominal deficit of 3.3% of GDP, which is 3.4% better than the original state budget mainly due to growing tax revenues. **In 2022, according to the draft budget, nominal deficit will decrease by about EUR 300 million and reach 2.2% of GDP.**

In 2020, the general government debt did increase at a record pace by 9.9 percentage points due to pandemic and reached 18.4% of GDP, amounting to EUR 4 950 million. The increase in the debt level was due to the increase in the debt of Local governments and the State Treasury. This year, the debt burden of the general government can be expected to decrease to 17.7% of

GDP. This is due to a slight nominal rise in the debt level combined with faster nominal growth of GDP. **The general government debt rises to 19.7% of GDP by the end of 2022.**

The opinion of the Fiscal Council on the structural budget position objectives for 2022-2025

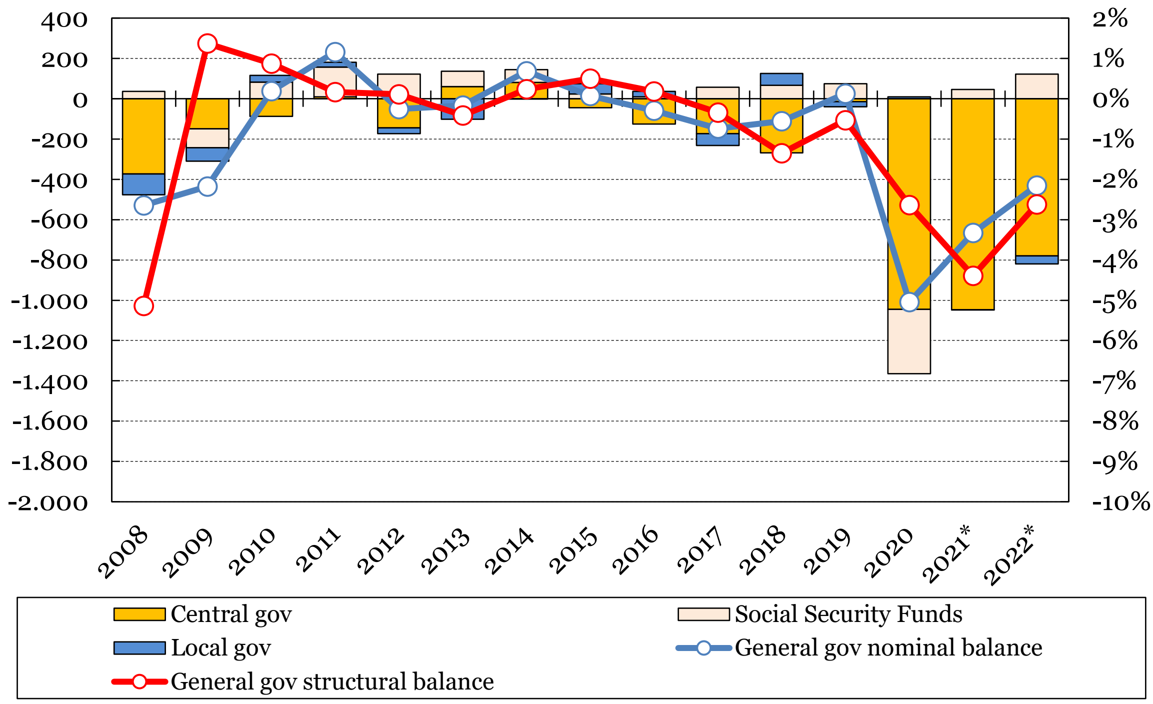
Pursuant to §14 of the State Budget Act, the Fiscal Council issued an opinion on the objectives of the structural budget position for 2022-2025 on 29 April.[3] The Fiscal Council concluded that breaching the 3% of GDP deficit limit is no longer justified starting from 2022 onwards, and the Council therefore recommends reducing the general government deficit in autumn, when drafting the 2022 state budget. In the event of a more positive growth scenario, the Fiscal Council recommends using the windfall tax revenue to restore the budget balance faster, rather than increasing expenditure. The Fiscal Council recommends that the Estonia should adhere to the fiscal rules already in 2022, despite the general escape clause still in place.

The Government of the Republic has examined the opinion of the Fiscal Council. The government has agreed in the State Budget Strategy 2022-2025 on the austerity measures that will reduce the deficit in almost all years. Based on the Ministry of Finance's summer economic forecast, improved tax revenue will be used to reduce the budget deficit. The nominal budget deficit in 2022 will improve by 1.6 percentage points compared to the State Budget Strategy to 2.2% of GDP and the structural deficit will improve to 2.6% of GDP. In the coming years, the structural deficit will continue to decline by at least 0.5% of GDP per year, as required by fiscal rules. Reducing the budget deficit at a moderate pace will ensure that fiscal support to the economy declines gradually and it does not unduly jeopardise the recovery.

Figure 3

General government budgetary position

(% of GDP)



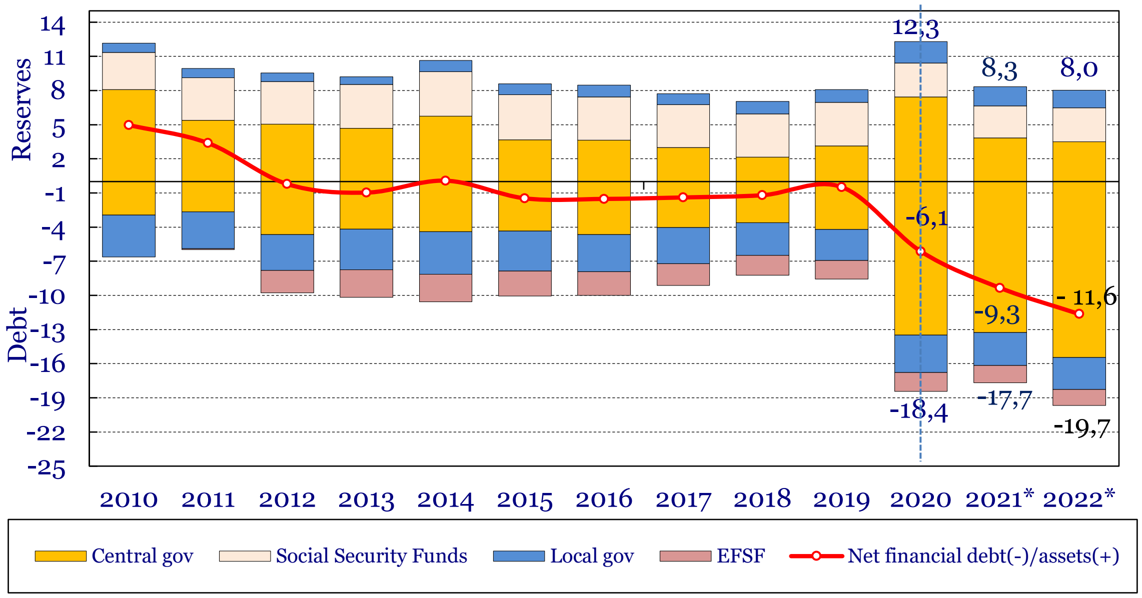
[3] https://eelarvenoukogu.ee/news/budget-deficits-in-the-coming-years-should-not-exceed-3-of-gdp

Source: Statistics Estonia, Ministry of Finance.

Figure 4

General government liquid financial assets, gross debt and net financial debt

(% of GDP)

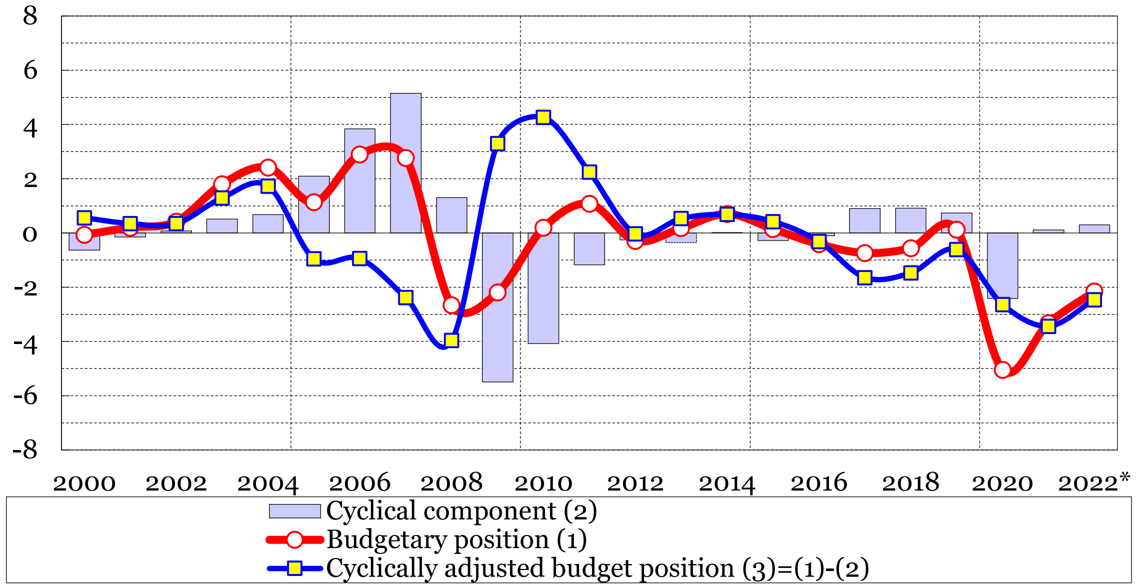


Source: Statistics Estonia, Ministry of Finance.

Figure 5

General government cyclically adjusted budgetary position

(% of GDP)

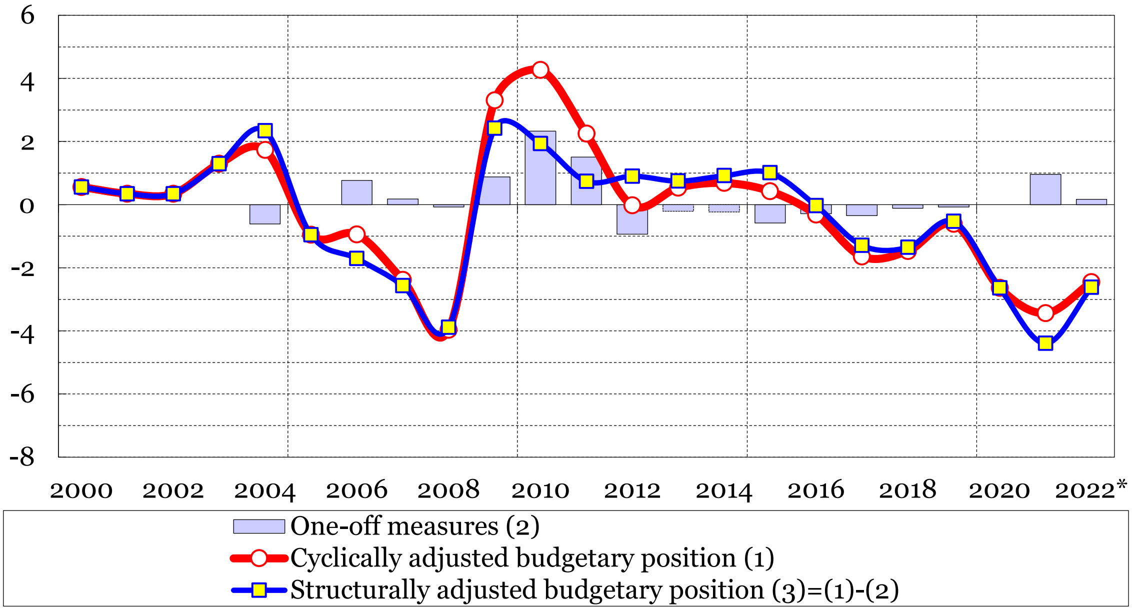


Source: Statistics Estonia, Ministry of Finance.

Figure 6

General government structurally adjusted budgetary position

(% of GDP)



Source: Ministry of Finance.

Table 2.a. Budgetary position objective of the general government by sub-sector

	ESA code	**2021 (1/)**	**2022***
		% GDP	*% GDP*
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	-3.3	-2.2
2. Central government	S.1311	-3.5	-2.4
3. State government	S.1312	-	-
4. Local government	S.1313	0.0	-0.1
5. Social security funds	S.1314	0.2	0.4
6. Interest expenditure	D.41	0.0	0.0
7. Primary balance (3/)		-3.3	-2.1
8. One-off and other temporary measures (4/)		1.0	0.2
9. Real GDP growth (%) (=1. in Table 1a)		9.5	4.0
10. Potential GDP growth (%) (=2 in Table 1.a)		3.8	3.4
contributions:			
- labour		0.0	-0.1
- capital		1.4	1.7
- total factor productivity		2.3	1.8
11. Output gap (% of potential GDP)		0.2	0.6
12. Cyclical budgetary component (% of potential GDP)		0.1	0.3
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-3.4	-2.5
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		-3.4	-2.4

15. Structural balance (13 - 8) (% of potential GDP)		-4.4	-2.6

1/ According to Draft 2020 State Budget.
2/ TR-TE= B.9.
3/ The primary balance is calculated as (B.9, item 1) plus (D.41, item 6).
4/ A plus sign means deficit-reducing one-off measures.

Source: Ministry of Finance.

Table 2.b. General government debt developments

	ESA code	**2021***	**2022***
		% of GDP	*% of GDP*
1. Gross debt		17.7	19.7
2. Change in gross debt ratio		-0.8	2.0
Contributions to changes in gross debt			
3. Primary balance (=item 10 in table 2.a.i))		-3.3	-2.1
4. Interest expenditure	D.41	0.0	0.0
5. Stock-flow adjustment		-2.1	1.0
of which:			
- Differences between cash and accruals		-	-
- Net accumulation of financial assets		-	-
of which:			
- privatisation proceeds		-	-
- Valuation effects and other		-	-
p.m.: Implicit interest rate on debt (1/)		0.1	0.2
Other relevant variables			
6. Liquid financial assets (2/)		8.3	8.0
7. Net financial debt (7=1-6)		9.3	11.6
8. Debt amortization (existing bonds) since the end of the previous year [4]		1.6	1.5
9. Percentage of debt denominated in foreign currency		0.0	0.0
10. Average maturity [5]		7.4	10.5

1/ Proxied by interest expenditure divided by the debt level of the previous year.
2/ Liquid assets are here based on the accounting methodology which corresponds to the Consolidated Annual Report of the State. The definition of liquid financial assets covers the use of accounting standards, involving only those assets which are realizable in the short-term (including cash and deposits, debt securities, short-term trading quoted shares and investment fund shares)

Source: Ministry of Finance.

[4] Central government borrowing without foundations and legal persons governed by public law.
[5] Central government without foundations and legal persons governed by public law.

Table 2.c. Contingent liabilities

	2021*	2022*
	% of GDP	*% of GDP*
Public guarantees	8.6	8.0
Of which: linked to the financial sector	8.5	7.9

Source: Ministry of Finance.

3. Revenue and Expenditure Projections under a no-policy change scenario

Summer forecast (Table 3) differs from the Stability Programme forecast mainly because of an upward correction of revenue collection in 2021 and 2022. Expenditure forecast was corrected downwards by 222.41 million euros in 2021 and upwards by 5.3 million euros in 2022. Indicators as a percentage of GDP are not directly comparable as the summer forecast ratios are based on the GDP time series revised on 31.08.2021, but in the Stability Programme were based on earlier GDP data.

Table 3. General government expenditure and revenue projections at unchanged policies broken down by main components

General Government (S13)	ESA Code	2021*	2022*
		% of GDP	*% of GDP*
1. Total revenue at unchanged policies	TR	41.0	39.6
of which			
1.1. Taxes on production and imports	D.2	13.5	13.4
1.2. Current taxes on income, wealth, etc.	D.5	8.6	8.1
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	12.7	12.2
1.5. Property income	D.4	0.3	0.3
1.6. Other		5.9	5.6
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		34.7	33.6
2. Total expenditure at unchanged policies	TE	44.3	41.4
of which			
2.1. Compensation of employees	D.1	12.0	11.5
2.2. Intermediate consumption	P.2	6.6	6.6
2.3. Social payments	D.62 D.632	14.6	14.3
of which Unemployment benefits		0.6	0.6
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.0	0.0
2.5. Subsidies	D.3	1.0	0.3
2.6. Gross fixes capital formation	P.51	6.1	5.9
2.7. Capital transfers	D.9	1.6	0.8
2.8. Other		2.4	2.1

Source: Ministry of Finance.

4. Expenditure and Revenue targets. General government expenditure by function

The Draft Budgetary Plan (Table 4.a) differs from the summer forecast (Table 3) because of revenue and expenditure measures taken during the budget negotiation process and presented in Table 5.a. For 2021, there were no significant changes in revenues or expenditures; revenues decreased by 1.0 million euros and expenditures decreased by 4.2 million euros. For 2022, revenue increased because of the government measures by 0.14% of GDP and expenditure increased by 0.51% of GDP, mainly due to intermediate consumption, compensation of employees and investments.

Table 4.a. General government expenditure and revenue targets, broken down by main components

General Government (S13)	ESA code	**2021***	**2022***
		% of GDP	*% of GDP*
1. Total revenue target	TR	41.0	39.7
of which			
1.1. Taxes on production and imports	D.2	13.5	13.3
1.2. Current taxes on income, wealth, etc	D.5	8.6	8.1
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	12.7	12.3
1.5. Property income	D.4	0.3	0.3
1.6. Other		5.9	5.8
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		34.7	33.6
2. Total expenditure target	TE	44.3	41.9
of which			
2.1. Compensation of employees	D.1	12.0	11.6
2.2. Intermediate consumption	P.2	6.6	6.9
2.3. Social payments	D.62 D.632	14.6	14.3
of which Unemployment benefits		0.6	0.6
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.0	0.0
2.5. Subsidies	D.3	1.0	0.3
2.6. Gross fixes capital formation	P.51	6.1	6.0
2.7. Capital transfers	D.9	1.6	0.6
2.8. Other		2.4	2.0

Source: Ministry of Finance.

In accordance with the SGP, the general government expenditure growth of a member state should be in line with its GDP growth. This expenditure benchmark is usually the 10-year average potential GDP growth (in a period from t-5 to t+4) of the member state, which is 3.3% for Estonia according to the European Commission Spring 2021 Forecast. If the member state does not fulfil its MTO (general government structural deficit of up to 0.5% of GDP for Estonia) for the current year, the benchmark for the next will be set at an agreed upon lower level, which will help the member state adjust its position by at least 0.5% of GDP and fulfil its MTO. This was the case for Estonia in 2019. Due to the activation of the general escape clause of the SGP, no benchmark has been set for 2021 and 2022 so we will set our benchmark using the 10-year (t-5 to t+4) average potential GDP growth estimate, which is 3.4%.

Adjusted expenditure growth[6] in 2020 was 9.4%, which is far higher than the benchmark (difference of 6.0 pp). Estonia will not breach the benchmark in 2021 and 2022 with expenditure growths of 2.5% and 1.2% respectively. However, it should be noted that this expenditure benchmark calculation does not take into account the temporary effect related to crisis mitigation measures in 2020 and 2021 and the following phasing out of these measures from 2022 onwards.

Table 4.b. Expenditure benchmark

	2020	**2020**	**2021***	**2022***
	level (m EUR)	*% GDP*	*% GDP*	*% GDP*
1. Expenditure on EU programmes fully matched by EU funds revenue	563.0	2.10	2.48	2.30
1a. of which investment fully matched by EU funds revenue	259.2	0.97	0.77	1.06
2. Cyclical unemployment benefit expenditure	255.9	0.95	0.31	0
3. Effect of discretionary revenue measures	5.0	0.02	0.75	-0.32
4. General government revenue increases mandated by law	0	0	0	0

Source: Ministry of Finance.

[6] In accordance with the European Commission's methodology, real expenditure growth is used using the GDP deflator. Excluded are interest expenditure and expenditure from table 4.b, also gross fixed capital formation is smoothed over time.

Table 4.c. General government expenditures by function

Table 4.c.i) General government expenditure on education, healthcare and employment

	2021*		2022*	
	% of GDP	*% of general government expenditure*	*% of GDP*	*% of general government expenditure*
Education	6.1	13.7	5.8	13.9
Healthcare	6.4	14.4	6.2	14.7
Employment	0.7	1.5	0.6	1.4

Table 4.c.ii) Classification of the functions of the Government

Functions of the Government	**COFOG code**	**2021***	**2022***
		% of GDP	*% of GDP*
1. General public services	1	4.3	4.2
2. Defence	2	2.4	2.1
3. Public order and safety	3	1.8	1.9
4. Economic affairs	4	6.0	4.7
5. Environmental protection	5	0.7	0.7
6. Housing and community amenities	6	0.4	0.4
7. Health	7	6.4	6.2
8. Recreation, culture and religion	8	2.0	2.1
9. Education	9	6.1	5.8
10. Social protection	10	14.2	14.0
11. Total expenditure (=2. in Table 4.a)	**TE**	**44.3**	**41.9**

Source: Ministry of Finance.

5. Description of discretionary measures included in the draft budget

The discretionary measures that have an impact on state budget revenue and expenditure in 2022, have been compressed to 20 groups, that correspond to similar principles and objectives. Three of them have an impact on state budget revenue, seventeen of them affect state budget expenditure. All expenditure measures (total of EUR -163 million) are temporary in nature and they are used to cover the priority needs of the ministries.

In order to support the economic recovery and cover additional healthcare cost caused by COVID-19 pandemics, the Government has decided in the Draft Budgetary Plan to direct largest additional funds to different measures providing better healthcare services and has decided to extend the temporary lower excise duties on fuels and electricity for a year. The Government has decided also to maintain the defence expenditure on the level of 2% of GDP and public R&D expenditure on the level of 1% of GDP.

Table 5.a. Discretionary measures taken by General Government

List of measures	Detailed description	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact 2021*	Budgetary impact 2022*
					% of GDP	*% of GDP*
1) Rescheduling the rise in fuel excise duty	Excise duty starting from 01.05.2023 and reaching to 2022 level in 4 years. Oil shale exemption	Revenue, D2	Accrual method	Submitted with budget	0,00	-0,17
2) Amendment of Law	Increase in revenue from state fees; Delaying waterways fees by one year; Amendment of Law on value added tax, including taxation of collector coins; Improving efficiency of Competition Authority	Revenue, P11	Accrual method	Submitted with budget	0,00	-0,01
3) Other tax revenues	Indirect tax revenues of all measures	Revenue, D2, D5, D6	Accrual method	Draft is not required	0,00	0,32
4) Allowance for pensioners living alone	Growth of the pensioner's living alone allowance from 115 euros to 200 euros	Expenditure, D62	Accrual method	Submitted with budget	0,00	-0,02
5) COVID-19 Expenses	Vaccination, testing expenses, continuing 1247 crisis phone, Continuing the compensation of sick days starting from second day	Expenditure, D1, P2, D62	Accrual method	Draft is not required	0,00	-0,28
6) Health expenses	Mental health, alcholism treatment, placing in a psychiatric institution	Expenditure, D1, P2, D7	Accrual method	Draft is not required	0,00	-0,02
7) Social services	Implementing system of family mediation and replacement care	Expenditure, D1, P2, D7	Accrual method	Draft is not required	0,00	0,00
8) Defence expenditure	Maintain defence spending as 2% of GDP	Expenditure, P51	Accrual method	Draft is not required	0,00	-0,08
9) Amendment of Law	Amendment of Criminal Code, State Secrets Act, Public Information Act, Enforcement Code, Employment Contracts Act, Copywright Law, Taxation Act,	Expenditure, D1, P2, P51, D7	Accrual method	Submitted with budget	0,00	-0,06

	Pharmaceutical Act, Alcohol, Tobacco, Fuel and Electricity Excise Duty Act, Fiscal Marking of Liquid Fuel Act. Regulation on preventing the dissemination of terrorist content online.					
10) Railway losses	Compensating railway losses	Expenditure, D7	Accrual method	Draft is not required	0,00	-0,04
11) Construction of railways and local roads	State support for local roads, the development of the railway to Rohuküla, the construction of Linnamäe non-motorised traffic routes	Expenditure, D7	Accrual method	Draft is not required	0,00	-0,03
12) Regional planning and development	Population dispersion program and regional planning	Expenditure, P2, D7	Accrual method	Draft is not required	0,00	-0,02
13) Additional wage increase	Compensation of employees in priority areas, incl 2% wage increase of teachers, internal security, information technology cultural and social workers. Salary increase for budgetary helath-care professionals	Expenditure, D1, P2, D7	Accrual method	Draft is not required	0,00	-0,08
14) Cancellation of administrative and salary cost savings	Cancellation of salary cost savings decided in State Budget Strategy	Expenditure, D1, P2	Accrual method	Draft is not required	0,00	-0,03
15) Educational costs	Including language learning in Estonian houses, program for education in Estonian, local government support fund for non-formal education, non-formal education program and managing learning gaps. Not realising coordination of high school network	Expenditure, D1, P2, P51, D7	Accrual method	Draft is not required	0,00	-0,09
16) IT expenses	Compensating information and communication technology expenses	Expenditure, D1, P2	Accrual method	Draft is not required	0,00	-0,10

17) R&D costs as 1% from GDP	Maintaining R&D costs as 1% of GDP to ensure sustainability of science and higer education	Expenditure, D1, P2, P51, D7	Accrual method	Draft is not required	0,00	-0,09
18) Allocating grants for cultural projects and sporting activities	Cultural support for school children, promoting physical movement, developing sports ground and indoor sports facilities. Production of Estonian Film	Expenditure, D1, P2, P51, D7	Accrual method	Draft is not required	0,00	-0,04
19) Other different expenditure measures	Including increasing capabilities of constitutional institutions, strengthening structure of Health Board of Estonia, improving school children healthy eating habits, support for private forests, carrying over costs to the next year, specification of the contribution to the EDF/IDA/EPF funds, support for internal security volunteers	Expenditure, P2, D1, D7	Accrual method	Draft is not required	0,01	-0,03
20) Transferable costs	Decision replace transferable costs	Expenditure, D7	Accrual method	Draft is not required	0,00	0,53
Total revenue measures					**0,00**	**0,14**
Total expenditure measures					**0,01**	**-0,51**
TOTAL					**0,01**	**-0,37**

Source: Ministry of Finance.

Table 5.b. Discretionary measures taken by Central Government

List of measures	Detailed description	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact 2021* % of GDP	Budgetary impact 2022* % of GDP
1) Rescheduling the rise in fuel excise duty	Excise duty starting from 01.05.2023 and reaching to 2022 level in 4 years. Oil shale exemption	Revenue, D2	Accrual method	Submitted with budget	0,00	-0,17
2) Amendment of Law	Increase in revenue from state fees; Delaying waterways fees by one year; Amendment of Law on value added tax, including taxation of collector coins; Improving efficiency of Competition Authority	Revenue, P11	Accrual method	Submitted with budget	0,00	-0,01
3) Other tax revenues	Indirect tax revenues of all measures	Revenue, D2, D5, D6	Accrual method	Draft is not required	0,00	0,32
4) Allowance for pensioners living alone	Growth of the pensioner's living alone allowance from 115 euros to 200 euros	Expenditure, D62	Accrual method	Submitted with budget	0,00	-0,02
5) COVID-19 Expenses	Vaccination, testing expenses, continuing 1247 crisis phone, Continuing the compensation of sick days starting from second day	Expenditure, D1, P2, D62	Accrual method	Draft is not required	0,00	-0,28
6) Health expenses	Mental health, alcholism treatment, placing in a psychiatric institution	Expenditure, D1, P2, D7	Accrual method	Draft is not required	0,00	-0,02
7) Social services	Implementing system of family mediation and replacement care	Expenditure, D1, P2, D7	Accrual method	Draft is not required	0,00	0,00
8) Defence expenditure	Maintain defence spending as 2% of GDP	Expenditure, P51	Accrual method	Draft is not required	0,00	-0,08
9) Amendment of Law	Amendment of Criminal Code, State Secrets Act, Public Information Act, Enforcement Code, Employment Contracts Act, Copywright Law, Taxation Act, Pharmaceutical Act,	Expenditure, D1, P2, P51, D7	Accrual method	Submitted with budget	0,00	-0,06

	Alcohol, Tobacco, Fuel and Electricity Excise Duty Act, Fiscal Marking of Liquid Fuel Act. Regulation on preventing the dissemination of terrorist content online.					
10) Railway losses	Compensating railway losses	Expenditure, D7	Accrual method	Draft is not required	0,00	-0,04
11) Construction of railways and local roads	State support for local roads, the development of the railway to Rohuküla, the construction of Linnamäe non-motorised traffic routes	Expenditure, D7	Accrual method	Draft is not required	0,00	-0,03
12) Regional planning and development	Population dispersion program and regional planning	Expenditure, P2, D7	Accrual method	Draft is not required	0,00	-0,02
13) Additional wage increase	Compensation of employees in priority areas, incl 2% wage increase of teachers, internal security, information technology cultural and social workers. Salary increase for budgetary helath-care professionals	Expenditure, D1, P2, D7	Accrual method	Draft is not required	0,00	-0,08
14) Cancellation of administrative and salary cost savings	Cancellation of salary cost savings decided in State Budget Strategy	Expenditure, D1, P2	Accrual method	Draft is not required	0,00	-0,03
15) Educational costs	Including language learning in Estonian houses, program for education in Estonian, local government support fund for non-formal education, non-formal education program and managing learning gaps. Not realising coordination of high school network	Expenditure, D1, P2, P51, D7	Accrual method	Draft is not required	0,00	-0,09
16) IT expenses	Compensating information and communication technology expenses	Expenditure, D1, P2	Accrual method	Draft is not required	0,00	-0,10

17) R&D costs as 1% from GDP	Maintaining R&D costs as 1% of GDP to ensure sustainability of science and higer education	Expenditure, D1, P2, P51, D7	Accrual method	Draft is not required	0,00	-0,09
18) Allocating grants for cultural projects and sporting activities	Cultural support for school children, promoting physical movement, developing sports ground and indoor sports facilities. Production of Estonian Film	Expenditure, D1, P2, P51, D7	Accrual method	Draft is not required	0,00	-0,04
19) Other different expenditure measures	Including increasing capabilities of constitutional institutions, strengthening structure of Health Board of Estonia, improving school children healthy eating habits, support for private forests, carrying over costs to the next year, specification of the contribution to the EDF/IDA/EPF funds, support for internal security volunteers	Expenditure, P2, D1, D7	Accrual method	Draft is not required	0,01	-0,03
20) Transferable costs	Decision replace transferable costs	Expenditure, D7	Accrual method	Draft is not required	0,00	0,53
Total revenue measures					**0,00**	**0,14**
Total expenditure measures					**0,01**	**-0,51**
TOTAL					**0,01**	**-0,37**

Source: Ministry of Finance.

6. Links between the draft budgetary plan and country specific recommendations

In this chapter information is presented on how the measures in the draft budget plan take into account the country-specific recommendations (CSRs).[7]

7 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021DC0506&qid=1623684082924

Table 6.a. Country-specific recommendations

CSR no	List of measures	Description of direct relevance
1.	In 2022, maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Overall, the economy has recovered with remarkable rebound in economic growth, reaching the pre-crisis GDP level already in the first quarter of 2021 and with the expected closure of negative output gap by the end of this year. Therefore, there is no pressing need for a broad-based fiscal stimulus from 2022 onwards. General Government structural budget deficit of 2.6% of GDP is targeted for 2022. In the following years the deficit is set to decline gradually at least by 0.5% of GDP per year until the MTO is reached. In that way the fiscal policy will support the fragile recovery of the economy. The direct fiscal impulse to the economy in 2022 is expected to be negative as the structural deficit is declining by 1.8% of GDP, which is not offset by 0,3% of GDP increase in the use of EU funds. The measures and activities that help maintain the supportive fiscal stance: - Implementation of RRF - Covering additional cost of COVID-19 crisis – testing vaccination, continuing the compensation of short-term sick leave days, additional labour costs and other supportive activities. - The investments planned in the 2022 state budget will increase by 50% compared to 2021. With the largest share, 84% of the total, real estate investments will grow by almost half. That includes integrated road repair project, Rail Baltic and defence investments. - General Government additional investments are mainly covered from different EU funds, except defence investments that are nationally financed
2.	When economic conditions allow, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, enhance investment to boost growth potential.	The government has set the target to reduce the structural deficit to 1.0% of GDP by 2025, reducing the deficit by at least 0.5% of GDP per year. In 2022 a structural budget deficit of 2.6% of GDP is targeted and the deficit is expected to decrease from 2022 onwards. According to the European Commission's Debt Sustainability Monitor 2020, which already takes into account the negative effect of COVID-19 pandemics on fiscal outlook, the risk level of Estonia's debt was assessed to be low in short, medium and in long term. This year the economic and fiscal situation has improved much faster than initially expected - the debt burden of the general government is expected to decrease to 17.7% of GDP in 2021 from 18.4% of GDP in 2020. In 2022, the debt is expected to increase to 19.7% of GDP and decreases after that, but the debt trajectory is significantly lower than projected a year ago and is also lower than planned in the Stability Programme 2021 in spring. Investments to boost growth potential: - Implementation of RRF with a focus on green transition, digitalisation and on health care and social protection.

		- Maintaining the level of public R&D expenditure at 1% of GDP.
3.	Pay particular attention to the composition of public finances, both on the revenue and expenditure sides of the budget, and to the quality of budgetary measures, to ensure a sustainable and inclusive recovery. Prioritise sustainable and growth-enhancing investment, notably supporting the green and digital transition. Give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including by strengthening the coverage, adequacy, and sustainability of health and social protection systems for all.	The implementation of RRF covers the priorities: GREEN TRANSITION Reform: Green transition of enterprises The objective of the reform is to improve the green transition in the business sector, which is expected to have economic, environmental and social benefits by making existing businesses more efficient and environmentally friendly (resource efficiency, new green transition certificates and market authorisations for products) and by supporting the emergence of new green technology companies (development and deployment of green technologies, new opportunities for the valorisation of bio-resources). The reform shall consist of the set-up of a broad-based Green Transition Task Force to foster cooperation between the green technology stakeholders and the adoption of legislation necessary for the implementation of complementary investments to support the green transition of companies with modernisation of business models, green technology development and the Green Fund. The implementation of the reform shall be completed by 31 December 2022. Energy and energy efficiency (including decarbonising the energy sector) Reform: Energy efficiency promotion The objective of the reform is to reduce the administrative barriers to energy efficient renovations by advising apartment associations, private households and local governments on legislation, technical aspects and financing of renovations. The reform also supports the use of innovative solutions such as renovation using pre-fabricated elements in order to increase renovation capacity and reduce the carbon footprint of the building stock (economising on the materials and ensuring quality). The reform aims to increase renovation rates in areas with lower property value. Reform: Boosting the green transition in the energy economy The aim of this measure is to contribute to decarbonising the energy production and consumption in Estonia by updating targets and actions of Estonian energy policy (including those related to the phase out oil shale) and by removing administrative barriers to renewable energy installations. The National Development Plan of the Energy Sector shall be updated and shall include targets on renewable energy production, energy efficiency and security of supply. The plan will also include actions to reduce dependency on oil shale in the Estonian energy sector and targets on the phase-out of oil shale in the energy sector altogether. Investments support renovation of apartment and small residential buidings, strengthening electricity grids to increase renewable energy production and pilot Energy Storage Programme. Sustainable transport

		Reform: Deploy safe, green, competitive, needs-based and sustainable transport and energy infrastructure The objective of the reform is to reduce the CO_2 emissions of the transport sector and incentivise the uptake of sustainable modes of transport. The measure consists of adoption and implementation of the new Transport and Mobility Development Plan and the related Implementation Plan. The focus of the Plan is to reduce the environmental footprint of transport systems and it shall include measures to develop interconnected and shared mobility in urban areas at the expense of private cars and promote a comprehensive framework of light mobility (on foot or bicycle) in areas outside major urban centres. Railway investments shall be directed towards increasing the speed and safety of journeys and adding connections for both passenger and freight transport. Investments include construction of railways, tramlines, pathways and multimodal joint terminal. DIGITAL <u>Digital transformation of enterprises</u> Reform: Skills reform for the digital transformation of businesses The objective of the reform is to contribute to strengthening the capacity of businesses at management level to steer and foster the digital transition, as well as to ensuring the availability of sufficient ICT professionals possessing up-to-date skills and knowledge, so that Estonian companies can fully seize the opportunities offered by the digital transition. It also aims at offering new career opportunities to both employed and unemployed people through upskilling and retraining in ICT, as well as through a better recognition of skills acquired outside formal learning. The measure also aims to contribute to increasing the participation of women in ICT training and ICT professions. Reform: Supporting the competitiveness of enterprises in foreign markets The objective of the measure is to increase the export capacity and competitiveness of Estonian companies, including notably those of the ICT sector. The measure is expected to be particularly relevant for SMEs. It shall also take advantage of the possibilities offered by digital tools. Investments into digital transformation in enterprises, development of e-construction and digital waybill services. <u>Digital State</u> Reform: Creation and development of a centre of excellence for data governance and open data The objective of the measure is to foster a better management of the data collected and held by the Estonian public authorities. It aims at improving the quality of the data, increase its use for decision-making as well as its availability as open data, so that it may also be reused by other stakeholders. Reform: Development of event services and proactive digital public services for individuals

		The objective of the measure is to improve the efficiency of the delivery of public services and reduce the administrative burden for citizens. Reform: Development of event services and digital gateway for entrepreneurs The objectives of the measure are to improve the efficiency and the quality of the delivery of public services and reduce the administrative burden for entrepreneurs. Reform: Establishing the strategic analysis of money laundering and terrorist financing in Estonia The objective of the reform is to strengthen the capacity of the Financial Intelligence Unit to identify money laundering schemes and channels at an early stage. Investments: 1. #Bürokratt programme (national virtual assistant platform and ecosystem) 2. Reconfiguration of basic digital services and safe transition to cloud infrastructure 3. Information system for real-time strategic analysis of money laundering and terrorist financing 4. Construction of very high capacity broadband networks HEALTHCARE AND SOCIAL PROTECTION Reform: A comprehensive change in the organisation of health care in Estonia The objective of the reform is to improve the resilience of the Estonian health system, including for coping with crises, thus ensuring that people have access to high-quality, integrated healthcare throughout Estonia. Reform: Strengthening primary health care The objective of the reform is to ensure access to general medical care, improve the continuity of treatment and make provision of primary health care more flexible and human-centred. Reform: Renewal of the eHealth Governance The objective of the reform is to update the governance framework for eHealth with a view to better responding to the needs of the health system and ensure the development of digital solutions to support a sustainable health system in Estonia. Reform: Extending the duration of unemployment insurance benefits The objective of the reform is to address the long-standing challenge of improving the adequacy of the social safety net. Reform: Long-term care The objective of the reform is to improve the provision of long-term care. Reform: Reducing gender pay gap The objective of the reform is to reduce the gender pay gap. The reform consists of the adoption of the Welfare Development

		Plan for 2023-2030 and its implementation and the roll out of a digital gender pay gap tool. Investments cover health care and measures reducing youth unemployment.

7. Divergence from the latest Stability Programme

Estonia's Stability Programme 2021 was based on the spring forecast of the Ministry of Finance. The forecast originates from the estimate of economic situation as of 31. March 2021. The 2022 State Budget and the State Budget Strategy for 2022-2025 are based on the summer economic forecast, published on 9. September 2021.

The main reason for revisions in the summer forecast are resulting from a very strong recovery of the economy taking place in the first half of 2021, which was not known when compiling the Spring forecast. This led to a situation where 2019 GDP level was reached already in 2021 Q1 and the pre-crisis growth trend in the second quarter. In Spring, real GDP in 2021 was expected to grow by 2.5% and by 4.8% in 2022, while in Autumn the updated rates are 9.5% and 4%.

The recovery of global trade and the EU economy turned out to be more robust, supporting thereby our export performance. Secondly, the ICT sector has been very competitive, driving the services exports. **Exports of goods and services** is forecast to grow more than two times faster in 2021 compared to spring forecast (13.8% vs 6.0%). In line with the developments of foreign demand, slightly higher growth can be expected in 2022 as well. Due to large-scale investments in ICT sector and strengthening domestic demand, **current account** will be close to balance in 2021. While in the previous forecast current account surplus of 3.4% of GDP was expected.

HICP inflation forecast for 2021-2022 is 1.8% and 1.6% higher respectively compared to the Stability Programme. The global economy has recovered from the pandemics much faster than expected, causing commodity and energy prices to surge. After the restrictions were lifted, higher economic activity has appeared in gradual pick up of services prices as well, especially in sectors suffered the most during pandemics.

Labour market reaction to the crisis has been much softer and faster than initially expected. Governments' crisis mitigation measures, wage subsidy scheme in particular, have played important role in keeping workplaces and curbing initial unemployment rise. The economy is recovering rapidly, resulting in lower unemployment and increasing labour demand from this spring in many sectors. Bulk of the labour market recovery is expected to take place already in 2021. However, for some sectors the recovery continues in 2022 and 2023, in tourism-related activities in particular.

Wage growth has performed better than forecast in spring. This is due to rapid economic recovery, but labour shortages are pushing up wages as well. In autumn forecast continuation of structural shift towards less capital intensive services is expected to continue, which adds to the real unit labour cost growth with no particular negative effects on international competitiveness.

Both nominal and real y-o-y growth rates of **private consumption** for 2022 are slightly lower than forecast in Spring 2021. The biggest difference is still the unexpectedly rapid recovery in 2021 in both GDP and private consumption, which makes the comparison base in 2021 significantly higher and thus the nominal and real levels of consumption in 2022 higher as well. Another important difference is the acceleration of inflation starting in summer 2021 which almost doubles the consumption deflator for 2022.

The general government budgetary position in 2021 has improved by 2.7% of GDP compared with the Stability Programme and is now expected to be in a deficit of 3.3% of GDP. The improvement is mainly due to better tax revenues, which affect all levels of government.

The general government nominal budget projection for 2022 has improved by 1.6% of GDP compared to the Stability Programme.

In 2021, the **tax burden** forecast compared to the Stability Programme has been revised downwards by 0.3 pps to 34.7% of GDP. Tax revenue increased mainly because of labour taxes (PIT and SSC) due to stronger labour market performance. Consumption taxes increased due to VAT. Capital taxes increased because of CIT from private sector dividends growth, and also part of PIT revenues were classified as capital taxes as pension II pillar payments are capital income (these were classified as labour income in Stability Programme). In total GDP upward correction was higher than the tax revenues growth. In 2022, the tax burden has been revised upwards by 0.4 pps to 33,7% of GDP. As in 2021 VAT revenues increased consumption taxes, also sales revenues from CO2 pollution quotas increased. Labour market is projected to be stronger which rises labour taxes. In case of capital taxes same developments occurred as in 2021, the impact of II pillar payments will be much smaller. In total GDP upward correction was lower than the growth of tax revenues.

Forecast of **general government debt** has been decreased by 3.7% of GDP in 2021 and by 5.0% of GDP in 2022, compared to the forecast included in the Stability Programme due to higher projected tax receipts and improved budgetary position in this and next year.

Table 7.a. Deviation from the last Stability Programme – structural budgetary balance

	ESA code	2020	2021*	2022*
		% of GDP	*% of GDP*	*% of GDP*
General government structural balance (1/) target	B.9		B.9	
Stability Programme		-5.7	-5.4	-3.4
Draft Budgetary Plan		-2.6	-4.4	-2.6
Difference		-3.1	1.0	0.8
General government structural balance projection at unchanged policies	B.9		B.9	
Stability Programme		-5.7	-5.4	-3.4
Draft Budgetary Plan		-2.6	-4.4	-2.3
Difference		-3.1	1.0	1.1

1/ Budgetary position is targeted by structural balance.
Source: Statistics Estonia, Ministry of Finance.

Table 7.b. Deviation from the last Stability Programme – net lending/net borrowing

	ESA code	2020	2021*	2022*
		% of GDP	*% of GDP*	*% of GDP*
General government net lending/ net borrowing target	B.9		B.9	
Stability Programme		-6.6	-6.0	-3.8
Draft Budgetary Plan		-5.0	-3.3	-2.2
Difference		1.6	2.7	1.6
General government net lending/ net borrowing projection at unchanged policies	B.9		B.9	
Stability Programme		-6.6	-6.0	-3.8
Draft Budgetary Plan (1/)		-5.0	-3.3	-1,8
Difference		1.6	2.7	2.0

1/ Actual (t-1) and summer forecast (t, t+1).
Source: Statistics Estonia, Ministry of Finance.

Annex

Table 8. Guarantees adopted/announced in response to COVID-19 outbreak

Description of measures	Adoption status	Maximum amount of contingent liability (% of GDP)	Current take-up (actual contingent liability, % of GDP)
Loan guarantees for bank loans already issued in order to allow for repayment schedule adjustments and other (Kredex)	Already adopted	1.5	0.3
Loan guarantees for bank loans already issued, increase of the guarantee reserve and reduction of guarantee fees (MES)	Already adopted	0.8	0.2
	Total	2.33	0.48

Source: Ministry of Finance.

Table 9. Table of the RRF impact on programme's projections

Revenue from RRF grants (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
RRF GRANTS as included in the revenue projections		0.335	0.464	0.770	0.715	0.424	
Cash disbursements of RRF GRANTS from EU		0.418	0.391	0.745	0.355	0.339	

Expenditure financed by RRF grants (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
TOTAL CURRENT EXPENDITURE		0.017	0.086	0.088	0.082	0.048	
Gross fixed capital formation P.51g		0.034	0.138	0.444	0.369	0.158	
Capital transfers D.9		0.035	0.162	0.238	0.264	0.218	
TOTAL CAPITAL EXPENDITURE		0.069	0.300	0.682	0.633	0.376	

Other costs financed by RRF grants (% of GDP)[1]							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Reduction in tax revenue		0	0	0	0	0	
Other costs with impact on revenue		0	0	0	0	0	
Financial transactions		0.249	0.077	0	0	0	

[1] *This covers costs that are not recorded as expenditure in national accounts*