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ANNEX 6

ANNEX

Country annex

ESTONIA

to the

REPORT FROM THE COMMISSION

presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

ESTONIA

Estonia deposited its instruments of ratification of the Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG) with the General Secretariat of the Council of the European Union on 5 December 2012.

The national provisions considered in the assessment are mostly those provided for by:

- the State Budget Act (SBA), which was adopted on 19 February 2014 and entered into force in March 2014,
- the Bank of Estonia Act and the Statute of the Fiscal Council approved in April 2014.

1. Legal status of the provisions

The SBA sets out the fiscal framework in general, and the conditions and procedures for the State budget in particular. The SBA is a constitutional law pursuant to Article 104 of the Estonian Constitution. Constitutional laws require an absolute majority of the members of Parliament (i.e. abstentions count as a negative vote) to be adopted or changed. The State's annual budgets are adopted under the SBA and the SBA cannot be changed by the annual budget.

Against that background, Estonia's provisions comply with the criterion of being of "binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes".

2. Balanced budget rule

Formulation: The balanced budget rule is set out in Article 5 and 6 of the SBA.

In line with the requirements of the TSCG, Article 5 of the SBA provides that the budgetary position of the general government shall respect the medium-term objective (MTO), as defined in the Stability and Growth Pact (SGP). Moreover, Article 6 implements a lower limit for the structural balance of the general government that is more stringent than the TSCG-specific lower limits. Article 6 of the SBA specifies that *"the State budget shall be drawn up such as the structural budgetary position of the general government is balanced or in surplus"*. The definitions of the general government and of the structural balance are contained in Articles 2 and 5 of the SBA and are consistent with the SGP.

Convergence towards the MTO: Estonia was already at the MTO when the SBA entered in force. Therefore, deviations from the MTO are catered for by the correction mechanism.

Escape clauses: The notion of "escape clause" is defined in Article 9 of the SBA and provides that "exceptional circumstances" are to be set in line with the SGP.

Overall, the balanced budget rule complies with the TSCG requirements.

3. The correction mechanism

The provisions relating to the correction mechanism are mostly found in Article 7 of the SBA, complemented by the provisions of Article 8 thereof on the compensation mechanism.

Activation: The correction mechanism may be activated in a preventive manner when the forecast from the Ministry of Finance projects a structural deficit (Article 7(1)), and it has to be activated when the forecast structural deficit exceeds 0.5% of GDP (Article 7(2)). Ex post, Article 7(2) specifies that the correction mechanism is automatically triggered once the European Commission and the Council identify a significant deviation from the MTO or the adjustment path thereto under Regulation (EC) No 1466/97. Moreover, the compensation mechanism (Article 8) is also activated ex post when the Ministry of Finance identifies a structural deficit over 0.5% of GDP in the year preceding the drafting of the State budget. Finally, the Fiscal Council is tasked with assessing both the fiscal forecast (ex-ante: Article 18) and the structural fiscal position (ex post: Article 79(5); ex ante targets: Article 14), verifying thereby the existence of a significant deviation.

Substance of the correction: The correction mechanism *stricto sensu* requires that the government takes measures to ensure compliance with the requirements of the Stability and Growth Pact (Article 7(2)) with a minimum structural improvement of at least 0.5% of GDP per year until structural balance is achieved (Article 7(4)). That provision ensures consistency with Union rules and recommendations from the Union institutions.

In addition, the compensation mechanism (Article 8) requires that a structural surplus of at least 0.5% of GDP is planned for the years subsequent to the re-establishment of the MTO until the cumulated impact of the past deviation in nominal terms has been compensated. In practice, full compensation may not occur before a number of years, especially in the event of a large deviation. The monitoring by the Fiscal Council of the implementation of the compensation mechanism is not explicitly stated in the legislation, though that competence may be covered by the general notion of surveillance of the structural fiscal position.

Overall: The correction mechanism is compliant with the TSCG requirements and the common principles. It combines a correction mechanism *stricto sensu* stressing consistency with the Union budgetary surveillance framework, together with a compensation mechanism on cumulated deviations.

4. The monitoring institution

The Estonian monitoring institution is the Fiscal Council.

Set-up and statutory regime: The Fiscal Council was set up pursuant to Articles 4 and 85 of the SBA, and corresponding amendments to the Bank of Estonia Act (Article 4^2 thereof). It is defined in the law as an independent advisory body, which is charged with monitoring compliance with fiscal rules and providing assessments of economic forecasts underlying fiscal policy. The Fiscal Council consists of six members, who were appointed in May 2014, and is supported by the Secretary, as well as other human and technical resources of the Bank of Estonia as necessary. The statute of the Fiscal Council was approved in April 2014 by the Supervisory Board of the Bank of Estonia.

Mandate: The Fiscal Council's general mandate provides the necessary basis for carrying out the tasks foreseen by the Fiscal Compact and the common principles. The Fiscal Council is responsible for monitoring compliance with national fiscal rules in line with requirements in the SBA and Union law and for assessing economic forecasts underlying Estonia's economic policy. By being entrusted with assessing the fiscal forecast (ex ante) and the achievement of the structural fiscal balance (both ex ante and ex post), the Fiscal Council verifies the existence of a significant deviation. According to Article 4 of the SBA, the Fiscal Council monitors the compliance with the budgetary rules specified in Chapter 2 of the SBA, which includes the structural balanced-budget rule in Article 6, the correction mechanism in Article

7, the compensation mechanism in Article 8 and the escape clause in Article 9. The Statute of the Fiscal Council builds on the mandate given in the SBA, defining in more detail jurisdiction of the Fiscal Council in relation to monitoring the implementation of Chapter 2 of the SBA (budgetary rules). Practical steps that the Fiscal Council would undertake in the process of ensuring compliance with the national budgetary rules are not, however, explained in detail.

Comply-or-explain principle: Article 4 of the SBA specifies that, in case of disregarding the Fiscal Council's opinion, the government must publicly explain the reasons thereof.

Freedom from interference and capacity to communicate: According to Article 4^2 of the Bank of Estonia Act, the Fiscal Council is independent in the performance of its tasks and accepts no instructions from the Bank of Estonia, Government, or any other private or public institution. The same article also requires that the evaluations and opinions of the Fiscal Council are published on its website[1].

Nomination procedure: According to Article 4^2 of the Bank of Estonia Act and the statute of the Fiscal Council, the Council's Chair, Vice-Chair and the other four members are nominated to office for a period of five years by the Bank of Estonia's Supervisory Board at the proposal of the Governor of the Bank of Estonia. Members must have unblemished reputations, at least a Master's degree (or equivalent) in economics, and experience required for the performance of the Fiscal Council's tasks. They can only be discharged by the Supervisory Board in case of taking up a job or position or participating in activities which could affect the independence of the Council, or in case the member has not participated in the work of the Fiscal Council for more than half a year.

Resources and access to information: According to Article 4^2 of the Bank of Estonia Act, the Fiscal Council is entitled to receive, from any ministry or any institution in the government sector or from the Bank of Estonia, the information which it needs for the performance of its tasks. Article 4^2 also requires that the Bank of Estonia provides the Fiscal Council with the means required for the performance of its tasks. On the request of the Bank of Estonia, the Government compensates the Bank of Estonia for any direct expenses which the latter has incurred in relation to the work of the Fiscal Council. In line with the Statute, the Fiscal Council gets assistance in its technical tasks from a secretary who is an employee of the Bank of Estonia and, with the agreement of the Governor of the Bank of Estonia, the Fiscal Council can use other employees temporarily if necessary for its work. Currently, the work of the Fiscal Council is supported by two economists from the Bank of Estonia, one of whom also performs the tasks of the secretary of the Fiscal Council. The Fiscal Council also receives assistance from the Bank of Estonia with regard to the technical tasks such as editing and translation of published materials, website administration and in other organisational issues.

Overall, the set-up of the Estonian monitoring institution is compliant with the TSCG requirements and common principles. The Fiscal Council is grounded in law with a broadly delineated mandate providing the basis for carrying out the tasks foreseen by the Fiscal Compact and the common principles; the mandate is further elaborated in the Statute of the Fiscal Council. The legal framework includes appropriate safeguards for functional autonomy. The comply-or-explain principle is explicitly provided for in the law. Adequate provisions on the Fiscal Council's endowment with resources and access to information are in place.

[1] http://eelarvenoukogu.ee/en

5. Conclusion

The national provisions adopted by Estonia are compliant with the requirements set in Article 3(2) of the TSCG and in the common principles.