EUROPEAN
COMMISSION

Brussels, 26.11.2024
C(2024) 9052 final

COMMISSION OPINION

of 26.11.2024

on the Draft Budgetary Plan of Estonia

{SWD(2024) 950 final}

(only the Estonian text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 lays down provisions for enhanced monitoring of budgetary policies in the euro area, in order to ensure that national budgets are consistent with the economic policy guidance issued in the context of the EU economic governance framework.

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

3. On 30 April 2024, the new economic governance framework entered into force. The main objectives of the new framework are to promote sound and sustainable public finances, sustainable and inclusive growth and resilience through reforms and investments. The framework helps to make the EU more competitive and better prepared for future challenges by supporting progress towards a green, digital, inclusive, and resilient economy.

4. In order to simplify the Union fiscal framework and increase transparency, a single operational indicator, anchored in debt sustainability, serves as a basis for setting the fiscal path and for carrying out annual fiscal surveillance for each Member State. That single operational indicator is the nominal growth rate of net expenditure[1].

5. The Recovery and Resilience Facility[2] provides financial support for the implementation of reforms and investments, notably to promote the green and digital transitions. The Facility also aims at increasing the resilience of the Union's energy system by reducing dependence on fossil fuels and diversifying energy supply at Union level ('REPowerEU objectives'). The Facility is expected to strengthen the resilience and potential growth of Member States' economies, which contributes to job creation and sustainable public finances. Part of this support takes the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the Union. Together with cohesion policy funds and the Just Transition Mechanism, the Facility is supporting a fair and inclusive recovery in the EU, in line with the European Pillar of Social Rights.

[1] According to Article 2(2) of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.

[2] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, OJ L 57, 18.2.2021, p. 17–75.

CONSIDERATIONS CONCERNING ESTONIA

6. On 15 October 2024, Estonia submitted its Draft Budgetary Plan for 2025 to the Commission and to the Eurogroup. On that basis, the Commission adopts this opinion in accordance with Article 7 of Regulation (EU) No 473/2013, and taking into account the Council Recommendation on economic, budgetary, employment and structural policies of Estonia of 21 October 2024[3]. This opinion is adopted by the Commission together with the Commission Recommendation for a Council Recommendation setting the net expenditure path of Estonia for the years 2025 to 2028[4], which the Commission expects the Council to act upon a timely manner.

7. On 21 October 2024, upon the Commission recommendation for Council Recommendation on the economic, social, employment, structural and budgetary policies of Estonia of 19 June 2024[5], the Council recommended Estonia, in line with the requirements of the reformed Stability and Growth Pact, to limit the growth in net expenditure in 2025 to a rate consistent with, inter alia, reducing the general government deficit below the 3% of GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term.

8. On 11 October 2024, Estonia submitted to the Commission its medium-term fiscal-structural plan in line with Regulation (EU) 2024/1263[6]. The plan commits to net expenditure growth not exceeding 7.1% in 2025, 5.1% in 2026, 3.6% in 2027 and 3.2% in 2028. The Commission has assessed the medium-term fiscal-structural plan of Estonia and recommended to the Council to adopt a recommendation setting the net expenditure growth ceilings contained therein. The Draft Budgetary Plan for 2025 is the first step in the implementation of the medium-term fiscal-structural plan.

9. According to the Draft Budgetary Plan, Estonia's real GDP is projected to grow by 2.1% in 2025 (-1.0% in 2024), while inflation is forecast at 4.1% in 2025 (4.0% in 2024). According to the European Commission Autumn 2024 Forecast, Estonia's real GDP is projected to grow by 1.1% in 2025 (-1.0% in 2024), while inflation is forecast at 3.6% in 2025 (3.6% in 2024). While there are some composition differences for real GDP growth in 2024, the projected rate of contraction is the same. For 2025, the main differences between both sets of projections reflect the more positive contribution of foreign demand and inventories in the Draft Budgetary Plan compared to the Commission's forecast. The Draft Budgetary Plan also projects higher inflation in Estonia in both years, with the more pronounced difference in 2025 stemming from a higher envisaged motor vehicle tax impact on inflation. As regards potential output, according to the Draft Budgetary Plan, Estonia's potential GDP is projected to grow by 0.8% in 2025 (0.2% in 2024). According to the European Commission Autumn 2024 Forecast, Estonia's potential GDP is projected to grow by 0.2% in 2025 (0.1% in 2024). The different estimates between the Draft Budgetary Plan and the Commission's forecast stem from a higher expected capital

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[3] Not yet published.

[4] Commission Recommendation for a Council Recommendation endorsing the national medium-term fiscal-structural plan of Estonia, 26.11.2024, COM(2024)713 final.

[5] Commission Recommendation for a Council Recommendation on the economic, social, employment, structural and budgetary policies of Estonia, 19.6.2024, COM(2024)606 final.

[6] Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, OJ L, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

accumulation contribution and the higher forecast of real GDP growth. Overall, the macroeconomic scenario underpinning the budgetary projections in the Draft Budgetary Plan appears to be more favourable than the Commission's forecast for 2025 (while it is in line for 2024). Estonia complies with the requirement of Article 4(4) of Regulation (EU) No 473/2013, since the Draft Budgetary Plan is based on independently endorsed macroeconomic forecasts.

10. Based on the Commission's estimates, the fiscal stance[7] is projected to be contractionary by 0.2% of GDP in 2025, following a contractionary fiscal stance of 0.7% in 2024. This measure of fiscal stance appropriately considers the impact on aggregate demand of expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds.

11. According to the Draft Budgetary Plan, Estonia's general government deficit is projected to increase to 3.0% of GDP in 2025 (2.9% in 2024), while the general government debt-to-GDP ratio is set to increase to 25% at the end of 2025 (23.7% at the end of 2024). According to the Draft Budgetary Plan, net expenditure is projected to grow by 2.0% in 2024 and 1.3% in 2025. The growth rate of net expenditure in 2025 according to the Draft Budgetary Plan is lower than the growth rate in the medium-term fiscal-structural plan submitted by Estonia on 11 October 2024. In turn, according to the European Commission Autumn 2024 Forecast, Estonia's general government deficit is projected to remain at 3.0% of GDP in 2025 (3.0% in 2024), while the general government debt-to-GDP ratio is set to increase to 24.2% at the end of 2025 (23.2% at the end of 2024). According to the European Commission Autumn 2024 Forecast, net expenditure is projected to grow by 5.1% both in 2024 and 2025. Even though total expenditure is forecasted at similar levels, the differences in net expenditure growth between both sets of projections reflect the Draft Budgetary Plan's lower projected increase in interest expenditure and a higher estimate of the impact of discretionary measures compared to the European Commission Autumn 2024 Forecast. Some of the revenue measures mentioned in the Draft Budgetary Plan for 2024 and 2025 could not be taken into account in the Commission Autumn 2024 Forecast, due to a lack of sufficient information. The risks to achieving the fiscal objectives for 2025 set out in the Draft Budgetary Plan are tilted to the downside, and mainly relate to the fiscal adjustment being partly based on discretionary revenue increases. Given the slow forecasted recovery in growth, the tax revenue collection risks being lower than assumed in the Draft Budgetary Plan.

12. The Draft Budgetary Plan assumes that expenditure amounting to 0.6% of GDP will be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.8% of GDP in 2024. Expenditure financed by Recovery and Resilience Facility grants enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Estonia.

13. The Draft Budgetary Plan includes several policy measures with a fiscal impact in 2025. On the revenue side, these include changes to the Income Tax Act –

[7] The fiscal stance is measured as the change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures, excluding one-off and cyclical unemployment expenditure, but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term (10-year) average potential GDP growth rate, expressed as a ratio to nominal GDP.

comprising mainly an increase in the personal and corporate income tax rates from 20% to 22%, increases in excise duty rates, the introduction of a motor vehicle tax, as well as the introduction of a security surcharge[8]. On the expenditure side, the measures include cuts to operating expenses and research and development costs across all areas of government, and a postponement of non-defence related public investment projects. On the other hand, the Draft Budgetary Plan also includes additional expenditures for national defence and for ensuring broader security. According to the Commission estimates, the overall additional impact of the revenue measures decreases the general government deficit and amounts to 1.5% of GDP in 2025.

14. According to the European Commission Autumn 2024 Forecast, Estonia's net expenditure is projected to increase by 5.1% in 2025, which corresponds to a cumulative growth of 10.5% in 2024 and 2025 taken together. The Commission is of the view that these net expenditure growth rates are not fully in line with the Council recommendation of 21 October 2024 to limit the growth in net expenditure in 2025 to a rate consistent with reducing the general government deficit below the 3% of GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term. Those net expenditure growth rates would not be fully appropriate initial steps towards the implementation of the medium-term fiscal structural plan[9].

15. According to the European Commission Autumn 2024 Forecast, nationally financed public investment is projected to increase to 7.4% of GDP in 2025 (from 6.4% of GDP in 2024). In turn, public expenditure on EU funded programmes, including Recovery and Resilience Facility grants, is expected to decrease to 1.7% of GDP in 2025 (from 1.9% of GDP in 2024).

16. Finally, the Council also recommended Estonia to broaden the tax base and improve access to and financing of healthcare and long-term care. The Draft Budgetary Plan includes a set of tax amendments to broaden the tax base, such as the new motor vehicle tax and the taxation of corporate profits by 2%[10], both of which are tax base broadening measures. To improve access to and financing of healthcare, the model of healthcare management will be updated. Similarly, to improve access to and financing of long-term care, Estonia plans to continue with the implementation of the care reform. According to the Draft Budgetary Plan, Estonia will also transfer the organisation and financing of the 24-hour special care nursing service to the Health Insurance Fund as of 2025.

17. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Estonia is not fully in line with the Council Recommendation of 21 October 2024. According to the European Commission Autumn 2024 Forecast, Estonia's net expenditure in 2024 and 2025 cumulatively is not fully consistent with what was recommended by the

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8 From July 2025, the standard VAT rate will be increased by two percentage points, to 24%. The other two elements of the security tax - introducing a corporate profit tax of two per cent and increasing the personal income tax by two percentage points - only come into effect in 2026.

9 According to the European Commission Autumn 2024 Forecast, the cumulative growth of net expenditure in 2024 and 2025 taken together exceeds by 0.4% of GDP the maximum from the medium-term fiscal structural plan of Estonia.

10 In Estonia, the corporate income tax is not levied when profit is earned but when it is distributed. From 2025, the standard tax rate is 22% (calculated as 22/78 of the net distribution). Hence, the introduction of a corporate income tax of 2% is a tax-base broadening.

Council on 21 October 2024, entirely driven by high expenditure growth rates in 2024. Therefore, the Commission invites Estonia to take the necessary measures within the national budgetary process to ensure that fiscal policy in 2025 is in line with the Council Recommendation of 21 October 2024. The progress made with the implementation of the Council's country-specific recommendations will be assessed by the Commission in spring 2025, in the context of the European Semester Spring Package.

Table 1. Key macroeconomic and fiscal figures

#	Variables		2023	2024		2025	
			Outturn	DBP	COM	DBP	COM
1	Real GDP	% change	-3.0	-1.0	-1.0	2.1	1.1
2	HICP inflation	% change	9.1	4.0	3.6	4.1	3.6
3	General government balance	% GDP	-2.8	-2.7	-3.0	-3.0	-3.0
4	Primary balance	% GDP	-2.5	-2.3	-2.4	-2.4	-2.4
5	General government gross debt	% GDP	20.2	23.7	23.2	25.0	24.2
6	Fiscal stance (**)	% GDP	-1.3		0.7		0.2
7	Net expenditure growth (annual)	% change		2.0	5.1	1.3	5.1
8	Net expenditure growth (cumulative)	% change				3.3	10.5
			Commission Recommendation for a Council Recommendation setting the net expenditure path of Estonia				
9	Maximum growth rates of net expenditure (*)	% change			Annual	**7.1**	
10		% change			Cumulative	**9.2**	

Notes :

* According to the Commission Recommendation for a Council Recommendation setting the net expenditure path of Estonia for the years 2025 to 2028.

** The fiscal stance is measured as the change in general government primary expenditure, net of the incremental budgetary impact of both discretionary revenue measures and COVID-19 pandemic-related temporary emergency measures, excluding cyclical unemployment expenditure, but including the change in expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential GDP growth rate in nominal terms. A negative (positive) sign indicates an excess (shortfall) of primary expenditure growth over medium-term potential GDP growth, which corresponds to an expansionary (contractionary) fiscal stance. For more details, see Box 1 of the Fiscal Statistical Tables.

Source : European Commission Autumn 2024 Forecast and Draft Budgetary Plan for 2025

Done at Brussels, 26.11.2024

For the Commission
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