



RAHANDUS- MINISTEERIUM

MINISTRY of FINANCE of the REPUBLIC of ESTONIA

Estonian 2014 Draft Budgetary Plan

Tallinn, 11 October 2013

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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. The information provided in DBP should allow to identify possible discrepancies from the budget strategy in the last Stability Program. Mainly, the DBP should consist of stability program standard tables with updated data, and include detailed information on measures in DBP.

The draft 2014 State Budget of the Republic of Estonia is based on State Budget Strategy 2014–2017, The Government's Action Program and The European Commission and the Council recommendations¹ (given according to Stability Program and Estonian 2020 Competitiveness plan) and designed activities according to these. Budgetary policy formulation respects the Stability and Growth Pact requirements of the EU Member States budgetary policy.

In compliance with State Budget Strategy the structurally adjusted budgetary position of general government will be in surplus (0.7% of forecasted GDP) in 2014. Thus Estonia holds its medium-term objective (MTO), the structural surplus since 2007.

State Budget Strategy with Stability Program was approved by the Government on 25 April 2013. **The draft 2014 State Budget with explanatory memorandum was approved on 24 September meeting of the Government and was given for proceeding to Parliament on 25 September.**

¹ Estonia's country-specific recommendations shortly:

- (1) Maintaining sound budgetary condition.
- (2) Changing social benefit system more effective and stimulating employment.
- (3) Better binding of education with the needs of labour market.
- (4) Increasing saving energy and resources.
- (5) Improving efficiency of local authorities in providing services.

Activities to comply with the recommendations of European Commission are Publisher annually <http://valitsus.ee/et/riigikantselei/eesti2020>.

1. Macroeconomic forecast

The State Budget 2014 of the Republic of Estonia is based on the summer forecast of the Ministry of Finance, published on 2 September 2013. Economic forecasts of the Ministry of Finance are public and can be found from the web page of the ministry (<http://www.fin.ee/economic-policy>).

The assumptions of this forecast were fixed as of the end of July 2013. Since the Ministry of Finance's last, spring 2013 forecast, the development of economic sentiment indicators has improved and its trend is positive. However, Estonian economic sentiment of consumers, manufacturing and construction has weakened somewhat compared to the spring level. After the one and half years of decline, EU economy showed positive growth rate in Q2. Moreover, Latvia and Lithuania keep recovering fast from the crisis. However, GDP forecasts of Finland and Russia have been revised downwards lately. US stock market indices have shown faster increase during the last six months compared to EU stock market indices. The forecast of Estonian export demand for 2013 has been cut during the last two years and currently it is lower than in spring projection. At the same time, the growth of export markets for 2014 has not changed compared to spring. Current economic forecast is based on a gradual recovery of foreign demand.

The **gross domestic product** of Estonia will increase by 1.5% in 2013 and 3.6% in 2014. In 2015 3.5% growth can be expected. Ministry of Finance has cut the GDP forecast of this year compared to the spring forecast mainly due to weak growth rate of the first half of 2013. Economic growth forecast for 2014 and 2015 has not been revised compared to spring projection. GDP growth will be supported by the increase of foreign and domestic demand in coming years. Growth of exports will be faster compared to imports and therefore the contribution of net exports will turn positive. During 2016–2017 economic growth will accelerate to 3.6% and 3.8% respectively. The main drag to growth will be exports, but the contribution of domestic demand should increase as well.

Domestic demand growth rate will decelerate in 2013 after two years of rapid growth. This is mainly caused by marginal growth expectations of investment, mostly because of the very high base level last year, as growth rates during the past two years exceeded 20%. During the coming years a negative contribution to investment growth comes from the government sector because of the decline in the use of both CO₂ quota revenues and EU structural funds. Business investment will be constrained by low demand and enough spare resources, but as foreign demand is expected to pick up next year, their contribution should turn positive again. Housing investment by households is still subdued because of low confidence in taking new loans and limited capacity to increase the aggregate loan stock. Investment should grow 1.2% in 2013 and 3% in 2014.

Private consumption growth decelerates to 3.5% this year, which is faster than GDP growth but remains lower than real wage growth. The decline in households' saving rate since the peak of the crisis may have stopped and nominal consumption growth will not exceed income growth during the following years, but lower inflation rate permits acceleration of consumption next year. In 2015 consumption possibilities are increased by income tax rate reduction.

Exports of goods and services will grow by 6% in 2013. Although foreign demand is weaker this year compared to year ago this will not lead to smaller growth rate of exports. Strong exports in the first half of 2013 indicates to strengthening of Estonian export position in main trading markets. In the second half of the year foreign demand will be supported by better

economic outlook of the euro zone. Main export markets will show faster recovery in 2014, thereby increasing growth opportunities of our manufacturing companies. Growth of exports will accelerate gradually and will stabilize below 7% in the end of forecast horizon. Growth of **imports** of goods and services will slow to 6.8% in 2013 due to weaker investment activity of companies and general government. During 2014-2015 exports will show higher growth rate compared to imports and therefore the contribution of net exports will turn positive.

Capacious investment activity together with the deteriorating foreign environment caused the **current account** turning into deficit in 2012. Current account deficit will narrow in coming years as a result of weaker investment activity and increasing income from investments made abroad by residents. Foreign balance will be affected by slight decline of services surplus as well, largely related to weakness of exports of transport services.

Consumer price (CPI) increase will slow down from 3.9% in 2012 to 3.2% in 2013 and to 2.7% in 2014. Deceleration in inflation in the second half of the year is favoured by the decreasing effect of foreign factors due to the strong base effect from a year ago and due to fall in prices of education services. Food inflation will be higher this year as a result of unfavourable weather conditions, which caused the price increases in fruits and vegetables. In 2014, inflation will decelerate due to receding price pressures coming from energy prices. Dropping out the impact from electricity market opening will be the biggest factor in the beginning of next year. On the other hand, core inflation will accelerate during 2014, contributing from stronger wage increases and the ending of one-off price decreases of some services. Taking into consideration that there will not be any large price fluctuations in commodity prices, consumer price increase will stabilize below 3% in following years.

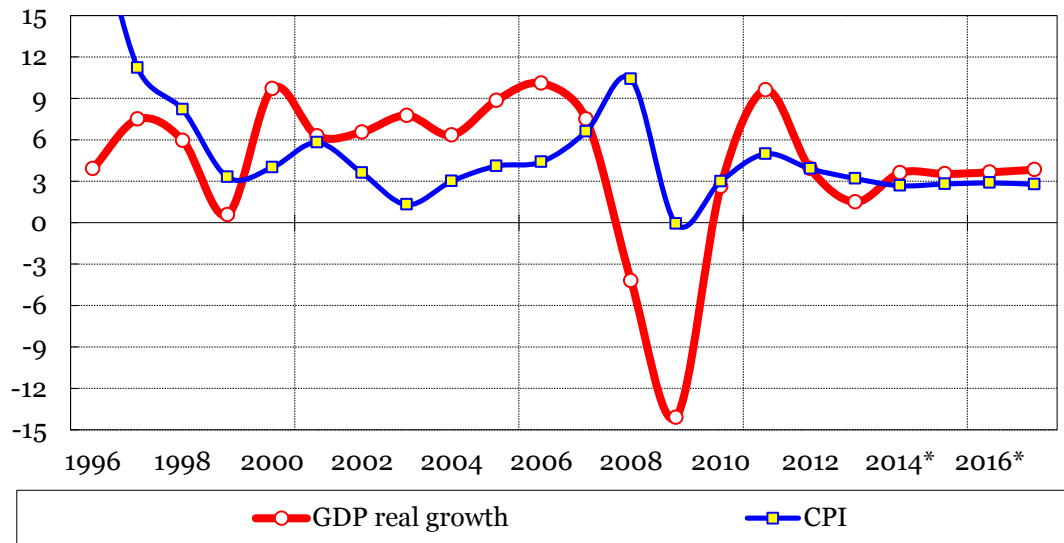
Despite the deceleration of economic growth, the average **wage** growth in the first half of 2013 was fast. Wage growth in 2013 will be at 6%, which increases in 2014 to 6.2% due to acceleration of economic growth and improvement of the situation in the main partner countries. The slowdown of consumer price growth will support the increase of real wage growth, which will remain slightly below 3% in 2013, but accelerate in the following years.

The increase of **employment** accelerated in the first half of 2013, but compared to last year, the increase will slow to 1.3%. In 2014, employment growth will decline further to 0.4% and is forecasted stop in the following years. This is due to demographic reasons, which in the immediate years are compensated by the activity level rising above 68%. Unemployment will continue to fall with the unemployment rate expected to reach 9.3% in 2013 and 8.3% in 2014.

On 9 September Statistics Estonia released the regular revision of 2009–2012 national accounts data. The summer economic forecast of the Ministry of Finance is based on earlier time series of national accounts. Therefore the summer forecast has been adjusted technically so that the forecast would be comparable to historical time series.

Figure 1

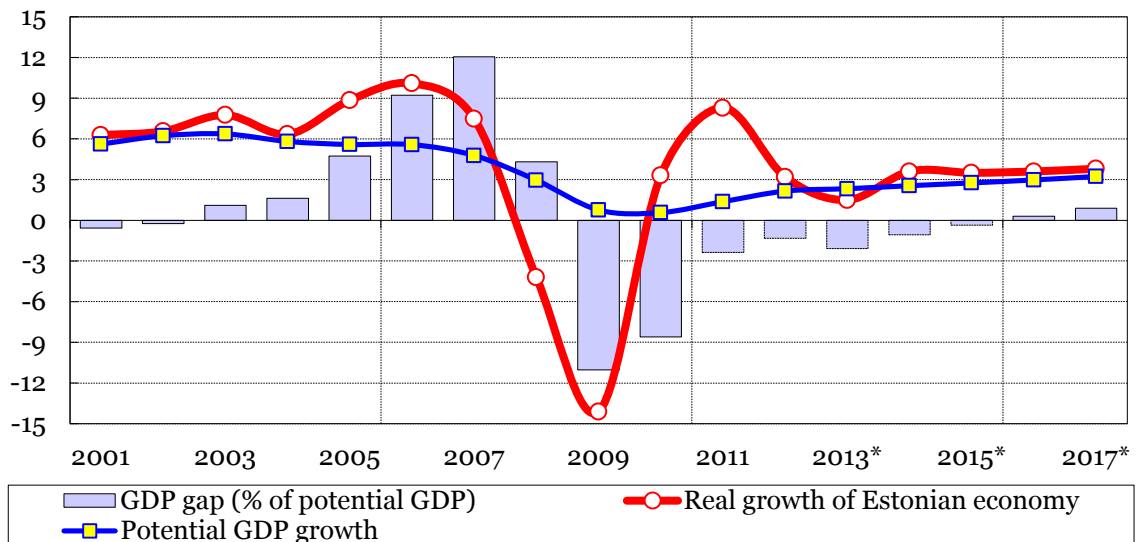
Estonian economic growth and the change of consumer price index
(per cent)



Source: Statistics Estonia, Ministry of Finance.

Figure 2

Development of potential GDP and GDP gap
(per cent)



Source: Statistics Estonia, Ministry of Finance.

Table o.i) Basic assumptions

	2012	2013*	2014*
Short-term interest rate¹ (annual average)	0.6	0.2	0.3
Long-term interest rate (annual average)	1.6	1.5	2.0
USD/€ exchange rate (annual average)	0.78	0.76	0.76
Nominal effective exchange rate	-1.5	0.7	0.0
World excluding EU, GDP growth	3.9	4.0	4.4
EU GDP growth	-0.3	0.0	1.4
Growth of relevant foreign markets	1.5	1.3	2.0
World import volumes, excluding EU	3.9	4.5	6.2
Oil prices (Brent, USD/barrel)	111.6	107.5	102.5

Source: Ministry of Finance.

Table 1.a. Macroeconomic prospects

	ESA Code	2012	2012	2013*	2014*
		Level	rate of change	rate of change	rate of change
1. Real GDP	B1*g	12,725.4	3.9	1.5	3.6
Of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth (1/)		-	-	-	-
2. Potential GDP			2.2	2.3	2.5
contributions:					
- labour			0.3	0.3	0.3
- capital			1.7	1.6	1.5
- total factor productivity			0.2	0.5	0.8
3. Nominal GDP	B1*g	17,415.1	7.4	6.0	6.8
Components of real GDP					
4. Private final consumption expenditure	P.3	8,356.7	4.9	3.5	4.1
5. Government final consumption expenditure	P.3	3,233.0	3.8	0.3	0.2
6. Gross fixed capital formation	P.51	4,247.3	10.8	1.2	3.0
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	437.6	2.9	2.8	3.0
8. Exports of goods and services	P.6	15,501.8	5.6	6.0	6.2
9. Imports of goods and services	P.7	15,325.6	8.8	6.8	5.5
Contributions to real GDP growth					
10. Final domestic demand			5.8	2.2	2.9
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		-0.5	0.0	-0.1
12. External balance of goods and services	B.11		-2.6	-0.7	0.7

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	2012	2012	2013*	2014*
		Level 2005=100	rate of change	rate of change	rate of change
1. GDP deflator		136.9	3.3	4.4	3.0
2. Private consumption deflator		135.9	3.7	3.2	2.7
3. HICP		139.0	4.2	3.5	3.0
4. Public consumption deflator		146.3	3.5	4.8	3.9
5. Investment deflator		121.6	3.5	3.9	2.7
6. Export price deflator (goods and services)		128.7	1.7	0.7	1.4
7. Import price deflator (goods and services)		127.0	2.7	-0.2	1.5

Source: Statistics Estonia, Ministry of Finance.

Table 1.c. Labour market developments

	ESA Code	2012	2012	2013*	2014*
		Level	rate of change	rate of change	rate of change
1. Employment, persons¹		624.4	2.5	1.3	0.4
2. Employment, hours worked ²					
3. Unemployment rate (%)³		70.6	10.2	9.3	8.3
4. Labour productivity, persons⁴		20,380	1.4	0.2	3.2
5. Labour productivity, hours worked					
6. Compensation of employees	D.1	8,064.3	8.6	7.4	7.2
7. Compensation per employee		1,076.3	5.7	6.0	6.2

Source: Statistics Estonia, Ministry of Finance.

Table 1.d. Sectoral balances

	ESA Code	2012	2013*	2014*
		% GDP	% GDP	% GDP
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	1.7	2.7	2.5
<i>of which:</i>				
- Balance on goods and services		2.5	1.9	2.5
- Balance of primary incomes and transfers		-4.3	-2.7	-2.8
- Capital account		3.5	3.5	2.8
2. Net lending/net borrowing of the private sector	B.9			
3. Net lending/net borrowing of general government	B.9	-0.2	-0.6	-0.4
4. Statistical discrepancy		0.0	-	-

Source: Statistics Estonia, Ministry of Finance.

Economic forecast of the Ministry of Finance is prepared by analysts from Fiscal Policy Department, who belong to personnel of the Ministry. The objectivity and independence of the forecast is assured through the transparency of forecast process, involvement of different outdoor economists and through continuous comparison of forecasting results. The preliminary version of forecast will be discussed with the forecasting team of Bank of Estonia. Before the finalization of the forecast of Ministry of Finance, its main assumptions and results will be discussed in joint seminar with different forecasters of Estonia, who belong to central bank, commercial banks and other institutions dealing with economic analysis. There are approximately 10 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 systematical inducement by some forecasters. Since 2014, Bank of Estonia will regularly evaluate the realisticness of the economic and fiscal forecasts of the Ministry of Finance.

Table 1.e. presents the differences between the economic forecast of the Ministry of Finance for summer 2013 and the most recent known growth expectations of the other institutions that prepare macro-economic forecasts. As these forecasts are compared, it must be kept in mind that they were made at different times and thus on the basis of different information, which is the cause of the differences in the assumptions and results of the forecast. Forecasts must be regarded in light of the assumptions that prevailed at the time they were prepared, as the external environment is uncertain and future prospects are not the same as they were some months ago.

While in spring the estimations of different forecasting institutions for 2013 were relatively evenly around 3%, then newer forecasts published during summer and autumn have been revised markedly downwards, presenting economic growth between 1.5% and 2%. This is mostly caused by low GDP growth rate during the first half of 2013 and by weak foreign demand.

The majority of institutions expect growth to accelerate above 3% in 2014. This is based on the recovery of our main trading partners, continuous growth of consumer sentiment of the EU and on the easing of the euro zone debt crisis. In the forecasts, published in October, some institutions have lowered Estonian economic growth expectations to around 2.5%. The expectations of the Ministry of Finance belong to the middle level compared to other forecasters.

Table 1.e. Comparison of economic forecasts

	Real GDP growth, %			Nominal GDP growth, %		
	2013*	2014*	2015*	2013*	2014*	2015*
Ministry of Finance	1.5	3.6	3.5	5.8	6.8	6.5
European Commission	3.0	4.0	–	–	–	–
Bank of Estonia	2.0	4.2	4.3	5.3**	7.3**	7.8**
IMF	1.5	2.5	–	–	–	–
OECD	1.5	3.6	–	–	–	–
SEB	1.3	2.6	2.9	–	–	–
Swedbank	1.9	3.9	4.2	5.9**	6.7**	7.3**
Nordea	1.9	3.6	3.7	5.3**	6.1**	7.9**
Estonian Institute of Economic Research	2.0	–	–	–	–	–
Danske	2.0	4.3	–	–	–	–

	Consumer price index, % (in brackets Harmonised Consumer Price Index)			Current account, % of GDP		
	2013*	2014*	2015*	2013*	2014*	2015*
Ministry of Finance	3.2 (3.5)	2.7 (3.0)	2.8 (3.0)	-1.7	-1.2	-1.5
European Commission	(3.6)	(3.1)	–	-2.2	-2.0	–
Bank of Estonia	3.0 (3.3)	2.5 (2.7)	2.7 (3.0)	-0.8	-0.8	-0.2
IMF	(3.5)	(2.8)	–	-0.7	-0.2	–
OECD	(3.4)	(2.9)	–	-3.0	-2.6	–
SEB	3.2	2.7	2.6	-0.3	0.7	0.7
Swedbank	3.3	2.8	2.9	-1.8	-2.1	-1.4
Nordea	3.3	2.8	3.1	-0.8	-1.2	-1.3
Estonian Institute of Economic Research	3.2	–	–	–	–	–
Danske	2.9	1.5	–	-3.7	-2.9	–

** calculated from the forecast of nominal GDP volume.

Sources:

Ministry of Finance Economic Forecast. Summer 2013. 2.09.2013.

European Commission. European Economic Forecast. Spring 2013. 3.05.2013.

IMF. World Economic Outlook. October 2013. 8.10.2013.

OECD Economic Outlook No 93. May 2013, 29.05.2013.

Bank of Estonia. Monetary policy and economy. 12.06.2013.

Estonian Institute of Economic Research. Konjunktuur No 3 (186) 2013. 7.10.2013.

SEB. Eastern European Outlook. October 2013. 9.10.2013.

Swedbank. Swedbank Economic Forecast. 27.08.2013.

Nordea Economic Outlook. September 2013. 4.09.2013.

Danske Markets. Emerging Markets Briefer. 15.04.2013.

2. Budgetary targets

The Governments medium-term objective (MTO) is the general government structural surplus. Estonia managed to achieve its MTO until the global economic crisis, but in 2008² the budgetary position of general government fell into a structural deficit. Since 2009, Estonian general government has been in structural surplus and the MTO is therefore met.

The budgetary position of 2013 will slightly deteriorate, but will still remain in structural surplus of 0.4% of GDP. The general goal of fiscal policy is to preserve neutral or countercyclical budget policy, however, until the correction of the nominal deficit the government intends to implement fiscal policy stricter than economic cycle requires. For coming years the structurally adjusted budgetary position will remain in surplus. **In compliance with State Budget Strategy the structurally adjusted budgetary position of general government will be in surplus (0.7% of forecasted GDP) in 2014.** Structural surplus indicates that there are no sustainability problems in state budget and the next year's nominal deficit is caused by temporary factors. **Thus Estonia holds its MTO set in 2007 – the structural surplus.**

In 2012, the budgetary surplus of the general government enjoyed in the two post-crisis years was replaced with a deficit of 41.2 million Euros or 0.2% of GDP. The central government and local governments ended the year with a deficit of 0.7% and 0.2% of GDP respectively; social security funds were in a surplus of 0.7% of GDP. The deficit and a weaker result compared to 2011 were mainly caused by the active use of the revenues from the AAU trading in earlier years (expenditures exceeded revenue by 172 million Euros).

According to the forecast in draft State Budget of 2014, the nominal budget deficit in 2013 will amount to 0.6% of GDP. The deficit is attributed mainly to the central government, but also the local governments will be in deficit according to forecast. Social security funds are continually in surplus of 0.3% of GDP due to Unemployment Insurance Fund. For 2014 the draft budget foresees the general government nominal deficit of 0.4% of GDP.

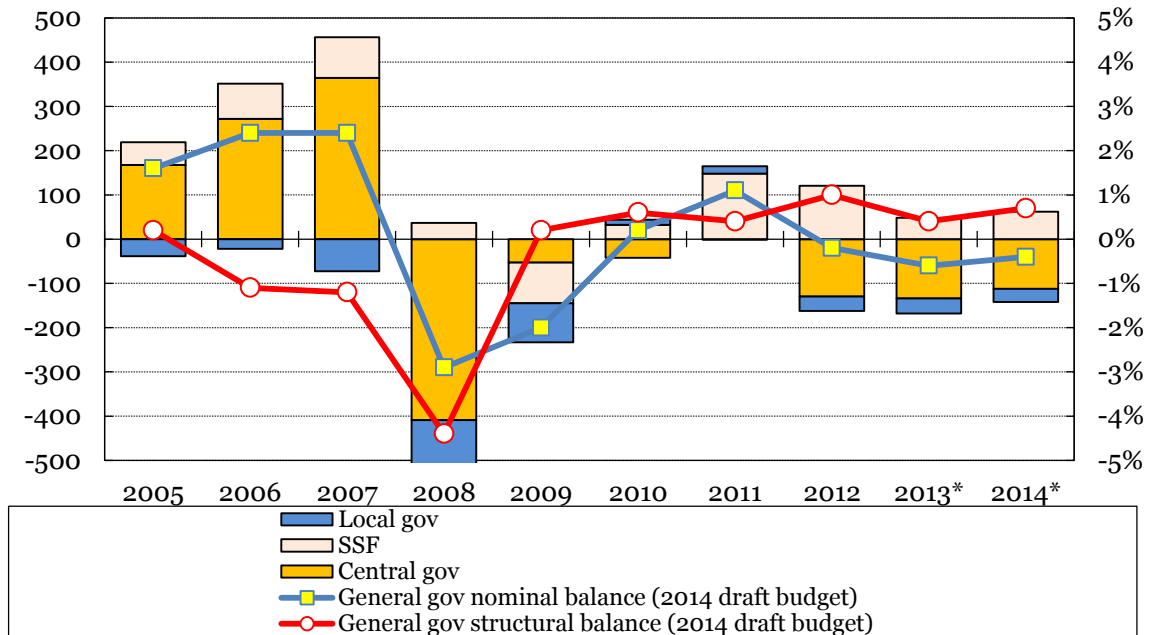
In 2012 general government debt increased from 6.1% to 9.9% of GDP, amounting to 1,724 million Euros. The main reasons for the government debt increasing were an increase in impact of the European Financial Stability Fund (EFSF) and the use of the credit from the European Investment Bank to co-finance structural funds. The general government debt can be expected to increase to 10.1% of GDP in 2013 as a result of the EFSF's activities; in 2014 debt will decrease to 10% of GDP.

² Due to later reassessments, structural deficit was also identified in 2006 and 2007.

Figure 3

General government budgetary position

(% of GDP)

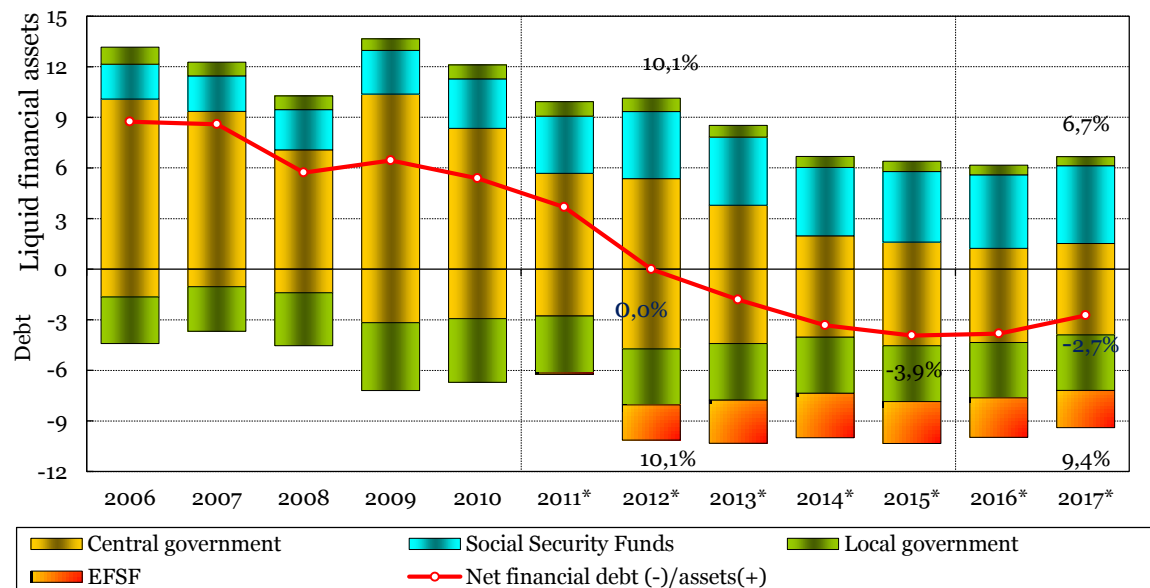


Source: Statistics Estonia, Ministry of Finance.

Figure 4

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

(% of GDP)



Source: Statistics Estonia, Ministry of Finance.

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

	ESA Code	2013 (1/)	2014*
		% GDP	% GDP
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	-0.6	-0.4
2. Central government	S.1311	-0.7	-0.6
3. State government	S.1312	-	-
4. Local government	S.1313	-0.2	-0.2
5. Social security funds	S.1314	0.3	0.3
6. Interest expenditure	D.41	0.2	0.2
7. Primary balance (3/)		-0.4	-0.2
8. One-off and other temporary measures⁴		-0.4	-0.7
9. Real GDP growth (%) (=1. in Table 1a)		1.5	3.6
10. Potential GDP growth (%) (=2 in Table 1.a)		2.1	2.4
contributions:			
- labour		0.3	0.3
- capital		1.5	1.5
- total factor productivity		0.3	0.6
11. Output gap (% of potential GDP)		-2.1	-0.7
12. Cyclical budgetary component (% of potential GDP)		-0.6	-0.3
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		0.0	-0.1
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		0.2	0.1
15. Structural balance (13 - 8) (% of potential GDP)		0.4	0.7

1/ According to State Budget Draft 2014.

2/ TR-TE= B.9.

3/ The primary balance is calculated as (B.9, item 8) plus (D.41, item 9).

4/ A plus sign means deficit-reducing one-off measures.

Source: Ministry of Finance.

Table 2.b. General government debt developments

	ESA code	2013*	2014*
		% of GDP	% of GDP
1. Gross debt ³		10.1	10.0
2. Change in gross debt ratio		0.2	-0.1
Contributions to changes in gross debt			
EFSF		2.5	2.6
3. Primary balance (=item 10 in table 2.a.i))		-0.5	-0.2
4. Interest expenditure	D.41	0.2	0.2
5. Stock-flow adjustment		1.4	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/)		1.7	1.9
Other relevant variables			
6. Liquid financial assets (2/)		7.9	6.6
7. Net financial debt (7=1-6)		2.1	3.4
8. Debt amortization (existing bonds) since the end of the previous year ⁴		0.1	0.1
9. Percentage of debt denominated in foreign currency		0.0	0.0
10. Average maturity ⁵		6.8	5.9

1/ Proxied by interest expenditure divided by the debt level of the previous year.

2/ Liquid assets are here defined as AF.1, AF.2, AF.3 (consolidated for general government, i.e. netting out financial positions between government entities), A.F511, AF.52 (only if quoted in stock exchange).

Source: Ministry of Finance.

Table 2.c. Contingent liabilities

	2013*	2014*
	% of GDP	% of GDP
Public guarantees	0,8	0,8
Of which: linked to the financial sector	0,0	0,0

Source: Ministry of Finance.

³ Forecast before Statistics Estonia Published new general government debt data in September 2013. Forecast and explanatory note of the budget will be updated according to new time series by the end of year 2013.

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.

3. Revenue and expenditure forecasts on assumption of unchanged policies

Summer forecast (Table 3) differs from spring forecast partly because of revenue level forecast changed for 2013 when 2012 data was updated by Statistics Estonia and which also affected the level of expenditures. Indicators as percentage of GDP are not directly comparable as summer forecast is calculated with the revised GDP.

Table 3. General Government expenditure and revenue forecasts on assumption that policies are not changed, by main components

General government (S13)	ESA Code	2013*	2014*
		% GDP	% GDP
1. Total revenue at unchanged policies	TR	38.1	36.0
Of which			
1.1. Taxes on production and imports	D.2	13.6	13.2
1.2. Current taxes on income, wealth, etc	D.5	7.3	7.2
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	11.3	11.1
1.5. Property income	D.4	1.2	1.2
1.6. Other		4.6	3.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		32.4	31.7
2. Total expenditure at unchanged policies	TE	38.3	36.6
Of which			
2.1. Compensation of employees	D.1	10.4	10.1
2.2. Intermediate consumption	P.2	7.1	6.9
2.3. Social payments	D.62 D.632	12.7	12.5
of which Unemployment benefits		0.4	0.3
2.4. Interest expenditure (=9 in Table 2.a)	D.41	0.2	0.2
2.5. Subsidies	D.3	1.0	1.0
2.6. Gross fixed capital formation	P.51	5.2	4.7
2.7. Capital transfers	D.9	0.8	0.8
2.8. Other		0.9	0.4

Source: Ministry of Finance.

4. Expenditure and revenue targets. General Government expenditures by functions

The draft State Budget forecast (Table 4.a) differs from summer forecast (Table 3) because of different revenue and expenditure measures (Table 5.a). In 2013, the revenues declined by 0.4% of GDP because of cut in dividends, expenditures did not change. In 2014, the revenues increased by 0.7% of GDP and expenditures by 0.5% of GDP.

Table 4.a. General Government expenditure and revenue targets by main components

General government (S13)	ESA Code	2013*	2014*
		% GDP	% GDP
1. Total revenue target	TR	37.7	36.7
Of which			
1.1. Taxes on production and imports	D.2	13.6	13.4
1.2. Current taxes on income, wealth, etc.	D.5	7.3	7.3
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	11.3	11.3
1.5. Property income	D.4	0.9	1.4
1.6. Other		4.6	3.4
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		32.3	32.1
2. Total expenditure target	TE	38.3	37.1
Of which			
2.1. Compensation of employees	D.1	10.4	10.2
2.2. Intermediate consumption	P.2	7.1	6.9
2.3. Social payments	D.62 D.632	12.7	12.5
of which Unemployment benefits		0.4	0.3
2.4. Interest expenditure (=9 in Table 2.a)	D.41	0.2	0.2
2.5. Subsidies	D.3	1.0	1.0
2.6. Gross fixed capital formation	P.51	5.2	4.7
2.7. Capital transfers	D.9	0.8	0.8
2.8. Other		0.9	0.7

Source: Ministry of Finance.

In accordance with SGP, the general government expenditure growth of a member state should conform to its GDP growth. This expenditure benchmark is usually the 10 year average potential growth of the member state. According to the EC spring forecast, the potential GDP growth for 2013 in Estonia is 2.3% and 2.1% in 2014. If the member state does not fulfill its MTO (general government surplus for Estonia) for current year, the benchmark for next will be set at a lower level (0.85% for Estonia), which will help the member state to adjust its position and fulfill its MTO.

Estonian general government expenditure will decline by 5.7% in 2013 (Table 4.b), which is in line with the benchmark. Expenditure growth in 2014 will be 3.4%, which exceeds the benchmark by 1.3 percentage points, assuming that general government surplus is achieved in 2013. If it is not, the benchmark will be lower and it will be exceeded by 2.6 percentage points. There is a rise in EU programmes spending, fully matched by EU funds in 2013, which will decrease significantly in 2014, affecting the expenditure growth. The unemployment expenditure is relatively stable. Discretionary revenue measures diminished considerably in 2012 mainly due to the decrease in CO₂ emissions trading. The decline in 2013 is mainly the result of unemployment insurance tax rate cut and the rise in 2014 will mainly be the result of excise rises and VAT changes. Complying with the expenditure benchmark is additionally affected by higher than usual government investment in 2012–2014.

Table 4.b. Expenditure benchmark

	2012	2012	2013*	2014*
	<i>level (m EUR)</i>	<i>% GDP</i>	<i>% GDP</i>	<i>% GDP</i>
1. Government expenditure on EU programmes fully matched by EU funds revenue	906.6	5.21	5.54	4.56
2. Non-discretionary change in unemployment benefit expenditure ⁶	48.7	0.28	0.31	0.30
3. Discretionary revenue measures ⁷	-141.4	-0.81	-0.23	0.51
4. Mandated revenue increases	0.0	0.00	0.00	0.00
<i>General government expenditure after adjustments</i>	<i>5,811.2</i>	<i>33.4</i>	<i>31.0</i>	<i>30.9</i>
<i>General government expenditure growth, nominal (%)</i>		<i>9.1</i>	<i>-1.6</i>	<i>6.5</i>
<i>General government expenditure growth, real (%)</i>		<i>5.6</i>	<i>-5.8</i>	<i>3.4</i>

Source: Ministry of Finance.

⁶ Expenditures related to unemployment insurance, redundancy and insolvency benefits.

⁷ The measures accounted for: tobacco, alcohol and shale excise rise; abolition of compensation tax exemption of personal car use; limiting passenger car and related expenditure VAT deductibility; worker registration; VAT declaration form change; additional rights to Tax and Customs Board to fight illicit fuel traffic; pension income tax allowance rise; state budget employee wage rise tax receipts; state duty rise; dividends from state-owned enterprises; opening of an investment account; third pension pillar contributions ceiling; further education not treated as fringe benefit; decrease in unemployment insurance tax rate; increase in excise duties; revenue from CO₂ emissions trading.

Table 4.c. General Government expenditures by function**Table 4.c.i) General Government expenditures on education, health and employment**

	2013*		2014*	
	<i>% GDP</i>	<i>% general government expenditure</i>	<i>% GDP</i>	<i>% general government expenditure</i>
Education	5.9	15.4	5.9	15.9
Health	5.2	13.7	5.4	14.4
Employment	0.2	0.4	0.2	0.5

Table 4.c.ii) General Government expenditures by functions

Functions of the Government	COFOG Code	2013*	2014*
		<i>% GDP</i>	<i>% GDP</i>
1. General public services	1	2.8	2.6
2. Defence	2	2.0	2.0
3. Public order and safety	3	2.2	2.2
4. Economic affairs	4	4.2	4.2
4. Environmental protection	5	0.4	0.4
6. Housing and community amenities	6	1.3	0.0
7. Health	7	5.2	5.4
8. Recreation, culture and religion	8	1.7	1.9
9. Education	9	5.9	5.9
10. Social protection	10	12.7	12.5
11. Total Expenditure (= item 2 in Table 2.c.i)	TE	38.3	37.1

Source: Ministry of Finance

5. Description of discretionary measures included in the draft budget

In years 2014, 2015 and 2016 state budget revenues are influenced by 14 different revenue and expenditure measures. Table 5a and 5b indicate that 9 of the 14 measures have an effect on revenue; four of them effect expenditure and one of them has an effect on both. Main purpose of the measures is to improve budgetary position of the general government. The total positive effect of measures in 2014 amounts to 33.5 million Euros or 0.2% of GDP, by 2016 it will increase to 87.0 million Euros or 0.4% of GDP.

Fringe benefits, abolition of compensation tax exemption of personal car use – increases the costs of private sector and brings more tax receipts to state budget. This measure can have a negative impact on business activity of small enterprises and to companies with lower profitability, marginal impact on profitable companies.

Limiting passenger car and related expenditure VAT deductibility – measure limits the sale of new cars in short-term. Increases expenditures of companies and households, should contribute to economic growth.

Obligation to register employees – this will increase the costs of companies who pay envelope wages, can bring along price increases of their goods and services and the worsening of their competitiveness compared to honest companies. Cleans the enterprise sector.

Collecting more detailed information with VAT declarations – decreases the shadow economy, has a positive impact on economic development.

Additional rights to Tax- and Customs Board to fight illicit fuel traffic – positive effects to legal fuel consumption, tax revenues and therefore economic growth.

Increase of pension income tax allowance – assuming no change in the saving behaviour of pensioners, this measure would induce increase in private consumption or saving. Positive impact on domestic demand and on GDP.

State duty – probably has marginal macro economical effect.

Additional dividends including income tax – will affect the business of state companies, as their liquidity will decline regarding this measure. There might arise the need for additional bank loan for paying out bigger dividends to the owners. This measure will have a rather restrictive impact on business activity.

Asset sales – flow of funds between government sector and private sector (net impact of investments is zero). Will expand the investment opportunities of private sector, macro economical effect could appear in longer time horizon (when the investment will start to create output).

Wage increase of employees paid from the State Budget – this means the increase in private consumption and indirectly in household's investments as well (increases the loan capability in the eyes of commercial banks) and thereby supporting economic growth.

Investment – will increase investments of government sector. Impact on the economy depends on whether the additional investments will be used for imported goods or being aimed to domestic demand related sectors. In the first case this would affect the current account and in the second case would support the economic growth.

Table 5.a. Discretionary measures taken by General Government

List of measures	Detailed description ¹	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact			
					2013*	2014*	2015*	2016*
					% GDP	% GDP	% GDP	% GDP
1) Fringe benefits – abolition of compensation tax exemption of personal car use	Use of a car, bought for business, must be proven.	Revenue, D5, D611, D2	Accrual method	Draft included in the State Budget	–	0.02	0.02	0.02
2) Limiting passenger car and related expenditure VAT deductibility	When a company car is used for private purposes, the right to deduct input VAT incurred on the acquisition, hire or lease of passenger cars and on acquisition of goods and services related to passenger cars is limited to 50% and no more than 2,000 Euros.	Revenue, D2	Accrual method	Draft included in the State Budget	–	0.10	0.19	0.18
3) Obligation to register employees	Employment register will be created where start of work must be registered.	Revenue, D5, D611	Accrual method	Draft is being coordinating	–	0.02	0.04	0.04
4) Collecting more detailed information with VAT declarations	Starting from 1st of July 2014 companies registered for VAT have to submit an electronic appendix with their VAT declaration. On that appendix invoices, broken down by buyers and sellers, are declared when the sum of invoices received from or submitted to a concrete transaction partner is at least 1,000 Euros VAT exclusive. This rule will improve risk analysis and VAT control will become more effective, also the competitiveness of honest entrepreneurs will improve.	Revenue, D2	Accrual method	Draft included in the State Budget	–	0.07	0.14	0.14
5) Additional rights to Tax- and Customs Board to fight illicit fuel traffic	Expanding Estonian Tax and Customs Boards authority in setting guarantees and supervision.	Revenue, D2	Accrual method	Draft included in the State Budget	–	0.01	0.03	0.02
6) Increase of pension income tax allowance	Increase of tax-exemption from 336€ to 354€ in a month.	Revenue, D5	Accrual method	Draft included in the State Budget	–	-0.05	-0.06	-0.06
7) State duty	State duties under the Ministry of Economic Affairs and Communications and Ministry of Agriculture were raised.	Revenue, P11, P12	Accrual method	Draft included in the State Budget	–	0.003	0.003	0.003

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8) Additional dividends including income tax	Cut in 2013 and additional dividends in 2014.	Revenue, D4, D5	Accrual method	Draft is not required	-0.37	0.33	0.29	0.12
9) Asset sales	Additional assets sales by State Real Estate Company (RKAS).	Revenue, P11, P12	Accrual method	Draft is not required	-	0.04	0,003	-
10) Wage increase of employees paid from the State Budget	Payroll growth of 5.1%.	Expenditure, D1	Accrual method	Draft is not required	-	-0.27	-0.25	-0.23
		Revenue, D5, D611			-	0.11	0.10	0.09
11) Abolishment of supporting recreational expenditures	Decision to support recreational activities from the state budget will not come into force.	Expenditure, D7	Accrual method	Draft is not required	-	0.12	0.11	0.10
12) Investments	Essential real estate investment.	Expenditure, P51	Accrual method	Draft is not required	-	-0.06	-0.11	-0.16
13) One-off expenditures	Temporary investments covered with temporary revenues. For example IT projects, venues in 2014 etc.	Expenditure, P51	Accrual method	Draft is not required	-	-0.24	-	-
Impact of changes in baseline expenditure assumptions								
14) Rise in minimum wage	Minimum wage will be increased from 320 Euros to 355 Euros in 2014.	Expenditure, D1	Accrual method	Draft is under preparation	-	-0.02	-0.04	-0.05
		Revenue, D5, D611			-	0.03	0.11	0.16
15) Impact of changes in baseline expenditure assumptions	Reduction of Government reserve, NIB guaranties and change in expenditures on the basis of Roads Act.	Expenditure, D7	Accrual method	Draft is not required	-	-0.05	0.05	0.03
Total revenue measures					-0.37	0.69	0.87	0.71
Total expenditure measures					-	-0.52	-0.24	-0.32
TOTAL					-0.37	0.17	0.63	0.39

Source: Ministry of Finance.

Table 5.b. Discretionary measures taken by Central Government

List of measures	Detailed description ¹	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact			
					2013*	2014*	2015*	2016*
					% GDP	% GDP	% GDP	% GDP
1) Fringe benefits – abolition of compensation tax exemption of a personal car use	Use of a car, bought for business, must be proved.	Revenue, D5, D611, D2	Accrual method	Draft added to the State Budget	–	0.02	0.01	0.01
2) Limiting passenger car and related expenditure VAT deductibility	When a company car is used for private purposes, the right to deduct input VAT incurred on the acquisition, hire or lease of passenger cars and on acquisition of goods and services related to passenger cars is limited to 50% and no more than 2,000 Euros.	Revenue, D2	Accrual method	Draft added to the State Budget	–	0.10	0.19	0.18
3) Obligation to register employees	Employment register will be created where start of work must be registered.	Revenue, D5, D611	Accrual method	Draft is being coordinating	–	0.01	0.03	0.02
4) Collecting more detailed information with VAT declarations	Starting from 1st of July 2014 companies registered for VAT have to submit an electronic appendix with their VAT declaration. On that appendix invoices, broken down by buyers and sellers, are declared when the sum of invoices received from or submitted to a concrete transaction partner is at least 1,000 Euros VAT exclusive. This rule will improve risk analysis and VAT control will become more effective, also the competitiveness of honest entrepreneurs will improve.	Revenue, D2	Accrual method	Draft added to the State Budget	–	0.07	0.14	0.14
5) Additional rights to Tax- and Customs Board to fight illicit traffic	Expanding Estonian Tax and Customs Boards authority in setting guarantees and supervision.	Revenue, D2	Accrual method	Draft added to the State Budget	–	0.01	0.03	0.02
6) Increase of pension income tax allowance	Increase of tax-exemption from 336€ to 354€ in a month.	Revenue, D5	Accrual method	Draft added to the State Budget	–	-0.05	-0.06	-0.06
7) State duty	State duties under the Ministry of Economic Affairs and Communications and Ministry of Agriculture were raised.	Revenue, P11, P12	Accrual method	Draft added to the State Budget	–	0.003	0.003	0.003

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8) Additional dividends including income tax	Cut in 2013 and additional dividends in 2014.	Revenue, D4, D5	Accrual method	Draft is not required	-0.37	0.32	0.29	0.12
9) Asset sales	Additional assets sales by State Real Estate Company (RKAS).	Revenue, P11, P12	Accrual method	Draft is not required	-	0.04	0.003	-
10) Wage increase of employees paid from the State Budget	Payroll growth of 5.1%.	Expenditure, D1	Accrual method	Draft is not required	-	-0.19	-0.17	-0.16
		Revenue, D5, D611			-	0.08	0.08	0.08
11) Abolishment of supporting recreational expenditures	Decision to support recreational activities from the state budget will not come into force.	Expenditure, D7	Accrual method	Draft is not required	-	0.12	0.11	0.10
12) Investments	Essential real estate investment.	Expenditure, P51	Accrual method	Draft is not required	-	-0.06	-0.11	-0.16
13) One-off expenditures	Temporary investments covered with temporary revenues. For example IT projects, venues in 2014 etc.	Expenditure, P51	Accrual method	Draft is not required	-	-0.24	-	-
Impact of changes in baseline expenditure assumptions								
14) Rise in statutory minimum wage	Minimum wage will be increased from 320 Euros to 355 Euros in 2014.	Expenditure, D1	Accrual method	Draft is under preparation	-	-0.01	-0.02	-0.02
		Revenue, D5, D611			-	0.02	0.08	0.11
16) Impact of changes in baseline expenditure assumptions	Reduction of Government reserve, NIB guaranties and change in expenditures on the basis of Roads Act.	Expenditure, D7	Accrual method	Draft is not required	-	-0.05	0.05	0.03
Total revenue measures					-0.37	0.64	0.79	0.62
Total expenditure measures					-	-0.43	-0.14	-0.22
TOTAL					-0.37	0.22	0.65	0.40

Source: Ministry of Finance.

6. Links between the draft budgetary plan and the targets set by the Union's Strategy for growth and jobs and country specific recommendations

In this chapter information is presented on how the measures in draft budget plan take into account the country-specific recommendations (CSR) and contribute to Europe 2020 objectives for growth and jobs.

Table 6.a. Country-specific recommendations

CSR no	List of measures	Description of direct relevance
1.	a) The new state budget law enters into force	Preconditions are created for better linking of objectives, actions and resources.
	b) The centralisation of support services continues	Information systems are developed for reducing the administrative burden (self-service portal for officials is launched) and public sector organisations are using the SAP, the business management software (which, among other things, leads to unified reporting).
	c) Increasing efficiency of public sector operating costs and personnel costs	The creation of new job posts is avoided. The salary level of current public sector employees is kept competitive; salary increase is planned in the fields where it is most needed.
2.	a) System for supporting the capacity for work system reform	Fostering the capacity to provide activating labour market services for people with partial incapacity for work. In 2014, the piloting and the development of the methodology of the system for supporting the capacity for work is carried out together with IT systems' development, the preparation for cooperation across agencies, and other preparations.
	b) The redesign of occupational health and safety related to the creation of the system for supporting the capacity for work	The rules and regulations for occupational health and safety are updated and improved to have more legal clarity and to be more aligned with the labour market situation.
	c) Cooperation with local authorities and youth centres for delivering labour market services	Cooperation between local authorities and Estonian Unemployment Insurance Fund continues – in order to identify and activate individuals who are not participating in the labour market (including youth) and develop their interests and skills.
	d) Mobile labour market services	For making them more accessible, the services are provided at the sub-national level, at non-stationary labour market service bureaus.
	e) Increasing the supply of pre-school education and childcare	For fostering the return of the parents of young children to labour market, the supply of pre-school education and childcare is increased for children below 3 years. In pre-school institutions, the access to pre-school education is enhanced for children aged 4–6.
	f) The adjustment of education licences system towards registration-based in the Info System of Estonian Education	The quality of life-long learning and adult education is increased.
	g) The preparation of measures for county centres	In the Ministry of the Interior in the field of regional affairs support measures are designed for regional initiatives promoting labour market and entrepreneurship in activity areas. In counties where unemployment is a significant problem, more emphasis is put on activities targeted at employment.

	h) The creation of monitoring system for labour market needs	Competence based labour market needs monitoring and prognosis system is developed in order to observe qualitative changes in labour market and improve the ability to react to them, using labour market services and education and training measures.
3.	a) The development of qualifications system as a link between education and working life	Qualification standards are prepared and the organisation of qualifications' exams is coordinated.
	b) Curriculum redesign	Vocational education curricula are transformed into outcome-based curricula, and will be connected to Estonian qualification framework; curricula are accredited by employers and entrepreneurs.
	c) The preparation of quality standards for e-study materials.	A standard is created for the creation of digital study materials.
	d) Regionally accessible study and career counselling service	Career and information services provision is developed for youth information and counselling centres.
	e) The access to support services is increased in vocational education institutions	Through career counselling and other services the drop-out rate from vocational education is lowered and studies are better connected to labour market needs.
	f) Cooperation networks are created for the involvement of NEET-youth	The role of vocational education increases in the involvement of NEET-youth.
	g) The implementation of the new management and financing model in higher education	To increase international competitiveness, for each university areas of responsibility are defined and supported based on the society's needs and the specific needs of areas.
	h) Fostering internship arrangement in vocational and higher education	A common internship organisation system is prepared, enabling all students in vocational education system and in the first stages of higher education (i.e. in bachelor studies as well as applied higher education studies) become better prepared for work in their field of study.
	i) Supporting cooperation between private sector and research institutions	The pilot for the support measure called Entrepreneur's development plan is launched which includes creating better opportunities for entrepreneurs to realise their development plans in cooperation with research institutions. Additionally, the implementation of innovation vouchers is to continue with the objective to create opportunities for small and medium size enterprises to get their first experience with development and innovation; that includes cooperation with research institutions.
	j) Implementing smart specialisation approach	Prioritisation is improved as in the new research and development strategy the priorities have been selected based on smart specialisation methodology.
	k) Measures for the internationalisation of research	Activities that target the internationalisation of research are to continue (mobility grants, participation in the framework program, common initiatives, and in the selected European infrastructure objects).
4.	a) The renovation of district heating systems or their replacement with local heating is supported (including transition to renewable energy) together with the reconstruction of buildings to become more energy-efficient	Investing into lowering the end use of energy and the energy costs for the consumers in the field of housing.
	b) Wider use of alternative fuels in transportation sector	Giving preference to renewable energy in public transport, adding the responsibility of supplying bio fuel to suppliers; encouraging the use of alternative fuels, primarily including the use of bio-gas and electric mobility.
	c) Taking into use the new buses (58 vehicles) in Harju county, procured by the state	Improved access to regional public transport.

	d) State support to public transport is increased	In all modes of transport supported by the state it is possible to ensure a more energy efficient public transport service (in comparison with private transportation) without raising ticket prices.
	e) The renovation of tramways in Tallinn is commenced and new trams are added to Line 4	Improving the quality of service of the capital's most intense transport line.
	f) All passenger train lines have new rolling stock	The quality of passenger traffic improves in connection with taking into use the new rolling stock.
	g) The new waste management plan is implemented	Waste minimisation and waste management development strategy and action plan is prepared and implemented.
5.	a) Continuing the implementation of the measures of Operational Programme for the Development of the Living Environment 2007-2013 priority axis" Integral and balanced development of regions"	Various fields are supported via the program, such as the development of local public services, increasing the competitiveness of the regions, the development of urban regions and reorganising the high school network.
	b) Continuing the implementation of "Regional investment grants program"	The improvement of welfare services, study, sports and recreation conditions are supported in order to increase the access to and the quality of public services.
	c) The preparation and implementation of measures targeted at increasing the administrative capacity and the competence of local governments	Cooperation projects of local governments are supported, including the preparation of analyses, research papers and models that enhance local and regional capacity and cooperation with civil society organisations in policy design; and the training activities of civil society organisations at local and regional level which offer regional services.
	d) The new regional development strategy 2020 is in the preparation process	The main focus in the new development plan is set on strengthening the labour market in the regions and making better use of region-specific advantages, developing regional entrepreneurship as well as more efficient organisation of services together with better access to them, and enhancing local and regional capacity for development.
	e) Increase in income for fulfilling the tasks of local governments	Local governments' revenue base improves by 7% due to the contribution of income tax.
	f) Focusing on smaller side roads in road maintenance work	Increased access to services provided by local governments.

Table 6.b. Targets set by the Union's Strategy for growth and jobs

National 2020 headline targets	List of measures	Description of direct relevance to address the target
National 2020 employment target [76%]	1. The implementation of Employment program 2014–2015	In 2014, attention is primarily drawn to youth, the long term unemployed and the elderly.
	2. The preparation of labour market measures of the new Structural Funds	It is planned to extend labour market services to the elderly. In cooperation between the Ministry of Education and Research and the Ministry of Social Affairs a common plan is prepared to decrease youth unemployment.
	3. The preparation and implementation of Entrepreneurship Growth Strategy measures	The measures in the development plan contribute to bringing forward structural changes in labour market by increasing the share of jobs where high additional value is created, leading to increase in employment via growth in productivity.

	4. Measures targeted at labour market awareness raising	Sharing information about knowledge based usage of flexible forms of employment and changing the society's attitude towards elderly labour force, working at a higher age and the employees with health problems.
	5. The development of collective employment relationships	Needs' mapping for regulating the unclear parts in legislation concerning collective employment relationships.
National 2020 R&D target [3% of GDP]	1. Beginning the implementation of the new Research and Development and Innovation Strategy 2014–2020	Setting the goals for the next seven years and identifying the main options for financing that lead towards the goal of 3% of GDP.
	2. The preparation of the measures of the new structural funds	Concrete measures are prepared for supporting research and development activities.
GHG emission reduction target [6 269 thousand tons (+10% compared to 2005)]	1. The preparation of the new Development Plan of the Energy Sector 2030	The strategic objectives in the new development plan include energy saving in all fields and the diversification of the sources of energy. The development plan will be completed by the end of 2014.
Renewable energy target [25%]		
National energy efficiency target [2,818 ktoe]		
National early school leaving target [9.5%]	1. Reorganising national school network	Founding strong county-level gymnasiums, including state gymnasiums, supporting the location program optimisation for basic schools that give up gymnasium level and basic schools that undergo mergers.
	2. New assessment model for educational institutions	The assessment model of educational institutions is renewed to meet contemporary needs.
	3. The implementation of teacher qualification standard	Teachers acquire professional qualification based on new professional standards.
National target for tertiary education [40%]	1. Continuing the implementation of higher education reform	The reform ensures studies with no fee for up to 12 500 students who meet the enrolment criteria for Estonian language based curricula for acquiring one certificate during nominal time. In addition, areas of responsibility are assigned to each higher education institution and they are supported based on the society's needs and the special needs of specific areas.
National poverty target [15% ⁸]	1. Raising the subsistence benefits to 90 € per month	The number of households living in absolute poverty decreases by approximately 28%.
	2. Average increase of pensions 5,8% and increasing the tax free income for persons receiving the pension	This enables to decrease the values of poverty indicators that are higher than average among the elderly.

⁸ Relative poverty rate after social transfers.

7. Comparison with the latest Stability Programme

Estonian Stability Program 2013 was based on spring forecast of the Ministry of Finance, published on 4 April 2013. State budget of 2014 is based on the summer economic forecast, published on 2 September 2013.

According to the spring forecast of the Ministry of Finance **economic growth** for 2013–2014 was expected to be 3.0% and 3.6% respectively. The growth was expected to be around 3.5% in 2015. The baseline scenario of the summer forecast takes into account the weaker GDP growth numbers in the first half of 2013 compared to the spring forecast and somewhat weakening economic conjuncture of Estonia in this year but consumer confidence is not expected to decrease. GDP growth forecast for 2013 has been lowered to 1.5%. Growth of domestic demand will be lower this year; however exports will be somewhat stronger. GDP growth forecast for 2014 has not been changed compared to spring forecast. Forecast for 2016–2017 has been revised upwards, the main reason being the dynamics of government investments due to the use of resources of the next EU financial period. GDP nominal growth forecast has been revised downwards due to corrections in growth expectations of GDP components and prices. Nominal GDP will be smaller compared to previous projection by 0.14 billion Euros in 2013, 0.16 billion Euros in 2014 and 0.2 billion Euros in 2015.

Domestic demand growth has been slower in the first half of 2013 than previously expected. Private consumption growth has decelerated from high levels in the end of last year and investment has experienced a decline in all institutional sectors. Public sector investments were pushed up by CO₂ quota revenue spending last year, which is not continuing this year in comparable volumes. Business investment is constrained by low domestic and foreign demand. Real growth of investments has been curbed by pick up in price increases beginning of the year, especially in housing market. Business investment growth should recover next year with better foreign demand prospects. Domestic demand growth has been downgraded from 3.6% to 2.3% in 2013 from 3.5% to 3% in 2014 and will be based mostly on strong private consumption. Nevertheless the expectations about private consumption have not been changed considerably because the lower growth this year should be compensated by acceleration in next year.

Though the GDP growth forecasts of main trading partners have been lowered somewhat, this will not appear in the slowdown in the growth of Estonian exports in 2013. Strong exports in the first half of the year is indicating to that. The growth of **exports** has been raised from 4.5% to 6.0% in 2013 and slightly in next year as well. The growth of imports will turn somewhat lower as a result of weaker domestic demand compared to spring forecast.

The CPI forecast for 2013–2014 is 0.1–0.2% lower compared to previous forecast. Main reason is the fall in fuel and heat energy prices coming from lower oil assumptions. In the end of forecast horizon **inflation** will turn somewhat higher because of higher wage growth and stronger domestic demand.

Labour market developments have been more favourable in 2013 than expected in the spring forecast. Because of rapid employment growth in the first half of the year, the employment growth forecast has been upgraded by 1pp to 1.3% in 2013. Employment growth rates for the following years remain as in the spring forecast. Average wage growth forecast for 2013 stays broadly the same as in spring but is slightly lowered for 2014 and increased thereafter. Increase in aggregated wage income in 2013 exceeds the spring forecast but is somewhat lower in 2014. Forecast for unemployment rate in 2013 has been raised slightly mainly due to different estimation of working age population but there are no big changes for near years.

According to summer forecast the general government budgetary position in 2013 has improved by 0.3 % of GDP to -0.2% of GDP compared to spring forecast. Improvement is caused mainly by increased tax revenues (especially corporate income tax). Also the forecasted pension expenditures have somewhat decreased due to fall in number of pensioners. The general government nominal budgetary position in 2014 has worsened by 0.5% of GDP to -0.6% of GDP compared to last forecast. Like in 2013 the general government budgetary position of 2014 is influenced by increased forecast of tax revenues. However, the general government nominal budgetary position worsens compared to the spring forecast by 103 million Euros. The budgetary position is negatively affected by increase in road construction expenditure, increase in rental costs of State Real Estate Ltd, postponing of investments related to CO₂ quotas (EUA) and increase in unemployment insurance expenditure of Unemployment Insurance Fund (related to increase in average compensation and prolongation of payment period).

Compared to spring forecast, the forecast of tax burden in 2013 and 2014 has increased by 0.4% to 33.3% and 32.5% of GDP respectively. Capital and labour tax revenues have increased and the forecast of consumption tax revenues was revised downwards.

In summer forecast, general government debt forecast has been increased by 0.1% of GDP in years 2013 and 2014, the main reason being increase of local government's debt. According to forecast local government will increase its debt in accordance with its nominal deficit, which is bigger in summer forecast than was expected in spring forecast. Starting from 2015 the difference between general government debt forecasts in summer and in spring is bigger. While in spring it was expected that financing needs could be met by liquid financial assets, summer forecast foresees the usage of external funds.

Table 7.a. Deviation from last Stability Program – structural balance

	ESA Code	2012	2013*	2014*
		% GDP	% GDP	% GDP
General government structural balance (1/ target)	B.9			
Stability Program		0.1	0.1	0.7
Draft Budgetary Plan		1.1	0.4	0.7
Difference		1.0	0.3	0.0
General government structural balance projection at unchanged policies	B.9			
Stability Program		0.1	0.1	0.7
Draft Budgetary Plan		1.1	0.6	0.5
Difference		1.0	0.5	-0.2

1/ Budgetary position is targeted by structural balance.

Source: Statistics Estonia, Ministry of Finance.

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

	ESA Code	2012	2013*	2014*
		<i>% GDP</i>	<i>% GDP</i>	<i>% GDP</i>
General government net lending/ net borrowing target	B.9			
Stability Program		-2.1	-0.7	0.0
Draft Budgetary Plan		-0.2	-0.6	-0.4
Difference		1.9	0.1	-0.4
General government net lending/ net borrowing projection at unchanged policies	B.9			
Stability Program		-2.1	-0.7	0.0
Draft Budgetary Plan (1/)		-0.2	-0.2	-0.6
Difference		1.9	0.5	-0.6

1/ Actual (t-1) and summer forecast (t, t+1).

Source: Statistics Estonia, Ministry of Finance.

8. Distributional effects of main revenue and expenditure measures

Gini coefficient for Estonia, which indicates the income distribution of the population (larger index denominates larger inequality), was 0.319 in 2011, which is rather large compared to EU as a whole. Countries with larger indices in 2011 were as follows: Latvia, Lithuania, Bulgaria, Romania, Greece, Spain, Portugal and the United Kingdom. However, comparison with states with different sizes and development levels might not always be appropriate. S80/S20 income quintile ratio shows a similar picture, the richest 20% earn 5.3 times more than the lowest 20% (in 2011). The same ratio is one of the lowest when considering only the population aged over 65.

Most of the planned revenue and expenditure measures either will not have a distributional effect or the effect is very indirect and non-quantifiable. Examples of these are taking dividends from state-owned enterprises, government investments or changing the VAT declaration form. Of the measures which do effect the income distribution, none has such a large effect that it could change the numerical value of the Estonian Gini coefficient or the S80/S20 ratio. None of the measures has an effect on the poverty ratio. Below is an overview of the distributional effects of the main budgetary measures.

Limiting the VAT deductibility of passenger car and related expenses of companies relates to private consumption done through companies with the aim of tax avoidance. The change has a larger effect on companies (and consequently its employees or owners) with larger passenger car and related expenses. The measure increases the taxation of company-owned passenger cars and related expenses when they are not for sole business use. The change is designed progressively (the new deduction rate has a ceiling), which means that companies with smaller car expenses get a relatively larger tax return, i.e. their implicit tax rate is lower. The measure affects 20,000–40,000 residents who are primarily in the 8th–10th income deciles.

Abolishing the personal car use compensation tax exemption affects, similarly to the car expense measure, residents in the higher income distribution range, which means the change is progressive. Approximately 20,000 people are affected.

The measure of wage increase of state budget employees has no strict terms on how different institutions must use their larger payroll fund in terms of income distribution. So the premise is that the wage increase is distributionally neutral and affects up to 44,000 workers whose wages come directly from the state budget. The whole public sector employs about 138,000 workers. The average wage of state budget employee is 14.4% higher than that of an average member of the working population. Without the payrise, this gap would shrink to 7.8% in 2014, since the nominal general wage growth is projected to be 6.2%. The CPI projection for 2014 is 2.7%. The state budget employee wage increase is 5.1% which falls between the overall wage increase and the price increase, which leaves a wage difference of 12% between state budget employee and the whole working population.

Increase of pension income tax allowance will affect 210,000 pensioners (about half of all), who's income tax obligation would raise after the indexed pension rise. The allowance increase counters the additional tax obligation these pensioners would receive. Even though the measure is regressive (it will decrease the tax burden of pensioners with larger incomes), in essence, the change will keep the income distribution of pensioners unchanged.

Annex: Methodology, economic models and assumptions.

Table 8. Methodological aspects

Estimation Technique	Step of the budgetary process for which it was used	Relevant features of the model / technique used	Assumptions
Expert forecast	Compilation of macroeconomic forecast	GDP forecast is being compiled using the production, expenditure and income approach and the consistency is controlled with MS Excel. Experts are monitoring economic fields (labour market, economic sectors, prices, loan behaviour, consumption, etc.) and are suggesting possible trends, which will be modified consistent through iterations.	<ul style="list-style-type: none"> ○ Saving rate of households has stabilized and will not change over forecast period. ○ Growth of main export markets will speed up gradually. ○ EUR/USD Exchange rate will be constant. ○ Oil prices are declining.