COMMISSION OPINION

of 22.11.2017

on the Draft Budgetary Plan of Estonia

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GENERAL CONSIDERATIONS

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

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

CONSIDERATIONS CONCERNING ESTONIA

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 16 October 2017 by Estonia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Estonia is subject to the preventive arm of the SGP and should preserve a sound fiscal position which ensures compliance with the medium term budgetary objective (MTO) of -0.5% of GDP.

5. Overall, the Draft Budgetary Plan’s outlook is based on plausible macroeconomic assumptions. Estonia's real GDP growth reached 2.1% in 2016. The Draft Budgetary Plan projects GDP growth to accelerate to 4.3% in 2017, on the back of a surge in private and public investment and an improving external environment. In 2018, growth is forecast to abate to 3.3%, as investment growth is expected to return to more sustainable levels. The forecast for 2017 has been revised significantly upwards (+ 1.9 percentage points) compared to the Stability Programme presented in spring 2017. Growth for 2018 has been revised upwards slightly (+ 0.2 percentage point), reflecting a stronger external outlook and higher business confidence. This scenario is broadly in line with the Commission 2017 autumn forecast, which expects similar real GDP growth. The main tax bases (consumption and labour market) are projected to develop similarly in the two forecasts.

6. Estonia complies with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecast underlying the Draft Budgetary Plan has been endorsed by the Estonian Fiscal Council. In its endorsement of the forecast the Fiscal Council, however, flagged downside risks to the corporate income tax revenue projection for 2018, which can be considered a downside risk to the budget projections.

7. Estonia’s Draft Budgetary Plan projects that the general government deficit of 0.3% of GDP in 2016 will improve to a balanced position in 2017. The projection for 2017 shows a significant improvement compared to the 2017 Stability Programme (by 0.5 percentage point), which can be mainly explained by lower social expenditure, the
postponement of some investments and somewhat higher tax revenues. In 2018, the
general government balance is projected to slide into a small deficit of 0.1% of GDP.
This is 0.7 percentage point. better than the target set in the Stability Programme,
largely resulting from the carry-over of the improved position in 2017 and measures
improving the fiscal outcome in 2018 (+0.1 percentage point). Reflecting the better-
than-expected economic performance, the output gap estimate has been revised
upwards considerably from close to zero to about 2% of potential GDP in 2017 and
2018. As a consequence, the structural balance\(^1\) is estimated to decline from a
structural deficit of 0.4% of GDP in 2017 to a deficit of 1% of GDP in 2018. The
general government gross debt is projected to decrease to below 9% of GDP in 2018.

8. The measures presented in the Draft Budgetary Plan have a net deficit-increasing
effect of 0.1% of GDP in 2017, and a deficit decreasing effect of 0.1% of GDP in
2018. Most of the fiscal effect comes from postponing some investments in 2018 and
shifting dividend revenue of State-owned companies from 2017 to 2018.

9. The Commission 2017 autumn forecast projects a headline deficit of 0.2% of GDP in
2017. This is a slightly larger deficit than the DBP projection because of higher
expenditure projections. Due to the carry-over, the Commission also projects a
higher deficit for 2018. The worse nominal balance and a somewhat different
assessment of one-off measures also result in lower structural balance projections for
2017 and 2018 in the Commission forecast. Overall, there are negative risks
associated with the Draft Budgetary Plan’s fiscal targets, in particular due to the
revenue assumptions of the corporate income tax reform and the excise increases.

10. According to the Draft Budgetary Plan, the expenditure benchmark is projected to be
adhered to. The recalculated structural balance is estimated to reach a deficit of 0.4%
of GDP in 2017, slightly above the MTO of -0.5% of GDP. However, according to
the Commission 2017 autumn forecast, the structural deficit is estimated to weaken
by 0.6% of GDP, from -0.4% of GDP in 2016 to -1.1% of GDP in 2017.
Nevertheless, this weakening is in line with the requirements of the preventive arm,
which allow for a maximum deterioration of the structural balance by 1.1% of GDP
in 2017. Estonia is therefore assessed to be compliant with the requirements of the

For 2018, according to the Draft Budgetary Plan, the expenditure benchmark
indicator points to compliance with the requirements in 2018. The structural balance
requirements are frozen based on the Commission spring 2017 forecast and allow for
a deterioration of the structural balance by 0.2% of GDP in 2018. However, the
(recalculated) structural deficit is set to deteriorate by 0.6% of GDP (from -0.4% of
GDP in 2017 to -1.0% of GDP in 2018 and thus moving away from the MTO),
exceeding the allowed deterioration by 0.4% of GDP. This calls for an overall
assessment. The difference between the expenditure benchmark and the structural
balance is notably related to the way nationally-financed public investment is
reflected in the two indicators. While it is smoothed over a four-year average in the
expenditure benchmark indicator, annual movements are fully captured by the
structural balance. Therefore, the expenditure benchmark indicator does not fully
capture the budgetary costs of the government’s medium-term investment package
over the period 2018-2020, which is not a temporary fluctuation in investment, but
rather a medium-term level shift. Following an overall assessment, the Draft

\(^1\) Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission
using the commonly agreed methodology
Budgetary Plan points to some deviation from the adjustment path towards the MTO in 2018. The Commission autumn forecast provides a similar picture on the basis of which the conclusion of some deviation is confirmed.

11. Estonia continues to shift the tax burden from labour to consumption taxes. A large income tax cut for low to medium income earners will take effect in 2018, offset by increases in other taxes and excise duties. This measure should reduce significantly the tax-wedge on low-income earners.

12. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Estonia, which is currently under the preventive arm, is broadly compliant with the provisions of the Stability and Growth Pact. The Commission’s autumn forecast projects risk of some deviation from the adjustment path towards the MTO in 2018. The Commission invites the authorities to stand ready to take further measures within the national budgetary process to ensure that the 2018 budget will be compliant with the SGP.

A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Reports and in the context of the country-specific recommendations to be proposed by the Commission in May 2018.

Done at Brussels, 22.11.2017

For the Commission
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Member of the Commission