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MINISTEERIUM

MINISTRY of FINANCE of the REPUBLIC of ESTONIA

2017 Draft Budgetary Plan of Estonia

Tallinn, 17. October 2016

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Introduction

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

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

The State Budget Strategy for the next four years along with the Stability Programme was approved by the Government on 28 April 2016. **The draft 2017 State Budget with explanatory memorandum was approved on 27 September in the meeting of the Government and was given for proceeding to Parliament on 28 September.**

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

In compliance with the State Budget Strategy the structurally adjusted budgetary position of general government will be in surplus (0.2% of GDP) in 2017. Thus Estonia holds its MTO set in 2007 – a structural surplus.

¹ Estonia's country-specific recommendations shortly:

- (1) Improve services provided at local level. Take measures to narrow gender pay gap.
- (2) Promote private investment in research, development and innovation.

More detailed country-specific recommendations and accompanying analysis can be found from European Commission's website: http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

Activities to comply with the recommendations of European Commission are published annually: <https://riigikantselei.ee/en/supporting-government/national-reform-programme-estonia-2020>.

1. Macroeconomic forecast

The Draft of State Budget 2017 of the Republic of Estonia is based on the summer forecast of the Ministry of Finance (MoF), published on 15 September 2016. External assumptions of the forecast were fixed in late August 2016. 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>).

Resulting from a continual weak sentiment in most of the sectors and deteriorating growth outlook, we have revised downwards economic forecast for Estonia. The main forecast scenario, which was based on recovering external environment, has not fully realised in past two quarters, and export growth remained narrow-based. Both experts and entrepreneurs do not foresee a considerable pick-up of economic growth in next six months. Nevertheless, Russia's recession has bottomed out and Finnish economy has managed to get out of the three year long stagnation, giving reason to expect higher external demand for Estonia. Investment activity has been subdued due to low external demand and deflation, both of which have depressed sales growth. In spite that private consumption growth remained strong in the light of sluggish GDP developments, households' saving rate has reached historical high. Labour market tensions have continued as wage growth has exceeded productivity developments in past four years. Inflation has remained very limited due to low commodity prices and is forecast to recur late this year only.

According to the main scenario **Estonia's GDP** is forecast to grow by 1.3% in 2016. Economic growth is expected to pick up in the following years, reaching 2.5% in 2017 and 3% in 2018. The Ministry of Finance has revised downwards GDP forecast throughout the whole forecast horizon due to weaker growth outlook of the main trading partners. Domestic demand and private consumption in particular remains the main growth driver in 2016. Investment activity is expected to resume this year with increasing impact in the following years. Export is picking up, too, and from 2017 onwards follows export demand growth. In 2019-2020 Estonia's economy is forecast to grow by 2.7%, supported both by export and domestic demand.

Domestic demand is mostly supported by **private consumption** in 2016, which relies on continuous strong labour income growth. The purchasing power of households was also supported by decreasing prices during the first half of the year. Starting from the second half of the year, inflation picks up rapidly and starts to erode the real value of incomes. Raises in social transfers support significantly households' disposable income also during the following years. Although private consumption growth has been rapid compared with GDP growth in real terms during the past years, the saving rate of households has still been increasing, although already at a high level. Taking into account the generally uncertain situation in the economy and geopolitically, the saving rate is not expected to decrease significantly in the near future, as no good news are expected concerning different crisis. Private consumption growth is forecast to slow down to 3.3% in 2016 and 2.7% in 2017.

Investments have been falling for the past three years, but this trend should turn in 2016 with the support from businesses and households. Two thirds of the investments is done by businesses, which means that the recovery is dependent on the improvement of the general economic environment, about which there is some hope related to improved export demand prospects. For the past five years the economic sentiment has been flat without any positive or negative trend, which explains weak investment. Sales revenues have been decreasing or

been very weak also, partly because of energy price decreases and there has been enough spare capacity to meet the demand. Capacity utilization has been improving in some segments lately. In next year the government sector should contribute significantly to investment growth also, as the use of EU structural funds should finally start off. Investment growth should recover to about 1% in 2016 and accelerate with the help of the government sector to almost 7% in 2017, dropping back to 3–4% after that.

After a weak performance and decline of the **export** footprint last year, export of goods and services will turn to 2.7% growth in 2016. Growth will be driven by goods exports, being supported by the increase of export volumes of some commodity groups (electrical and communication equipment, articles of wood). Moreover, fluctuation of export orders of communication equipment is causing volatility between quarters. Export of services will strengthen as well as a result of increasing export income from travel services and business services. In 2017, gradual recovery of global growth outlook and thereby stronger economic growth and import demand of trading partners is expected. Growth of exports will pick up with a similar pace of foreign demand, reaching 3.5% in 2017 and 4.0% in 2018. Growth of imports will show faster growth rate compared to exports this year, as the investment activity, which has declined during the last three years, is expected to recover.

After peaking in 2015, the surplus of **current account** will narrow to 1.1% of GDP this year and remain at similar level in coming years as well. Increasing imports of capital goods and the recovery of profits of foreign owned companies will reduce the surplus this year. In forecast horizon the growth of export volumes is increasing, which will compensate the impact of stronger investment activity and altogether does not worsen the external balance.

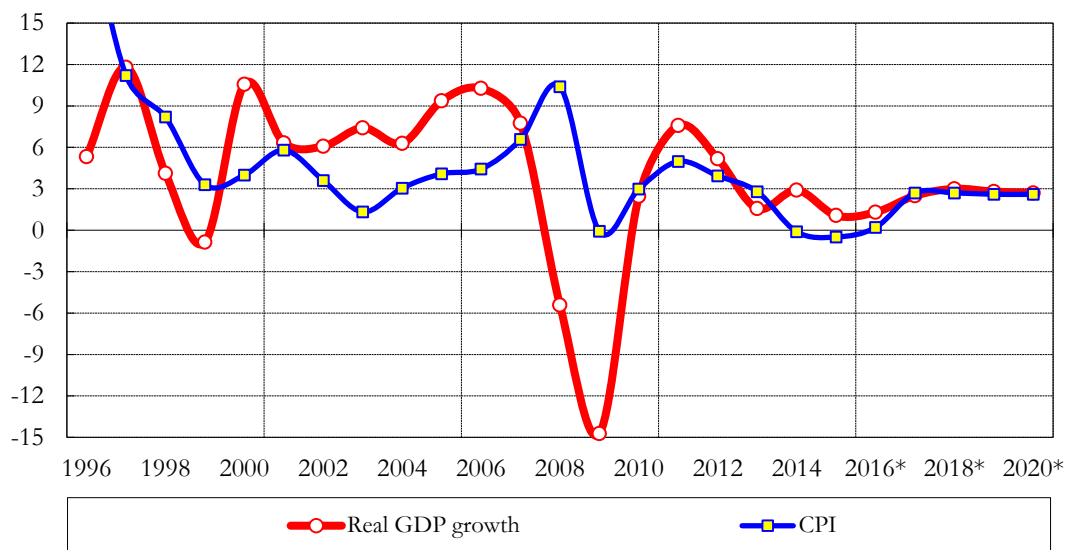
The increase of **consumer prices** (CPI) will be low due to external factors, reaching 0.2% in 2016. In 2017, CPI growth is forecast to pick up to 2.7% and remain at the same rate in 2018 as well. While in the first half of this year declining energy prices were behind the deflation, then from the end of summer the negative contribution of energy prices will start to recede, causing the consumer prices to turn positive. Indirect taxes will raise the inflation by 0.8pp this year and the biggest contribution comes from alcohol and fuel excise duty increases. Without tax changes the prices are still declining. In 2017, inflation is expected to pick up as a result of the increase of external factors, higher services' inflation and additional excise duty increases. From external factors, the impact of declining oil prices will fade out and food prices will increase. Somewhat higher services inflation comes partly from the fading out of indirect effect of low oil prices and from fading out of free higher education as well. At the end of the forecast period CPI inflation will slow down slightly to 2.6% as a result of smaller tax impact.

Labour market situation is tightening further and wage pressures continue. **Employment** has increased in spite of low economic activity, exceeding spring forecast expectations. The number of employed persons increased by 2.6% in the second quarter of this year and most of them were in the age group 50+. This is a result of increasing retirement age for women, but also due to generally higher activity rate of pension aged persons. Employment rate is at its historical high (65.8% in 2016), which in combination with declining working age population restrains further increase in the number of employed persons. The **unemployment** rate has remained at 2015 level due to higher activity rates, reaching 6.2% in 2016. Labour market developments are strongly affected by Work Ability Reform, which gradually started as of mid-2016. The reform helps people with partial work ability to return to the labour market. It is assumed that the remained skills of the people, who are being activated by the reform, are not in line with the labour market needs and employers' capability to hire such people is low, resulting in an increasing unemployment as of 2017. Positive effects from the Work Ability Reform via increased labour supply are expected to gradually increase in time.

Wage growth has not reacted sufficiently to a slowdown in nominal GDP growth, remaining at around 6% in the first half of 2016 according to the Tax Office. However, according to wage survey, average wage growth picked up to 7.8% in the first half-year. This was partly due to significantly higher bonuses, but wage growth picked up without bonuses, too, reaching 7.3%. Rapid wage growth has reduced profits, which is not sustainable. Nevertheless, companies' financial situation is still good despite falling profits as their financing needs are somewhat lower than usual due to low investment activity. Shrinking working age population and proximity of advanced economies, Finland in particular, results in continuing wage pressures. Therefore it is expected that labour share in value added stabilises at the current level, while there are some gains from labour tax cuts. Real wage growth is forecast to slow down from 6.2% in 2016 to below 3% in the following years.

Figure 1

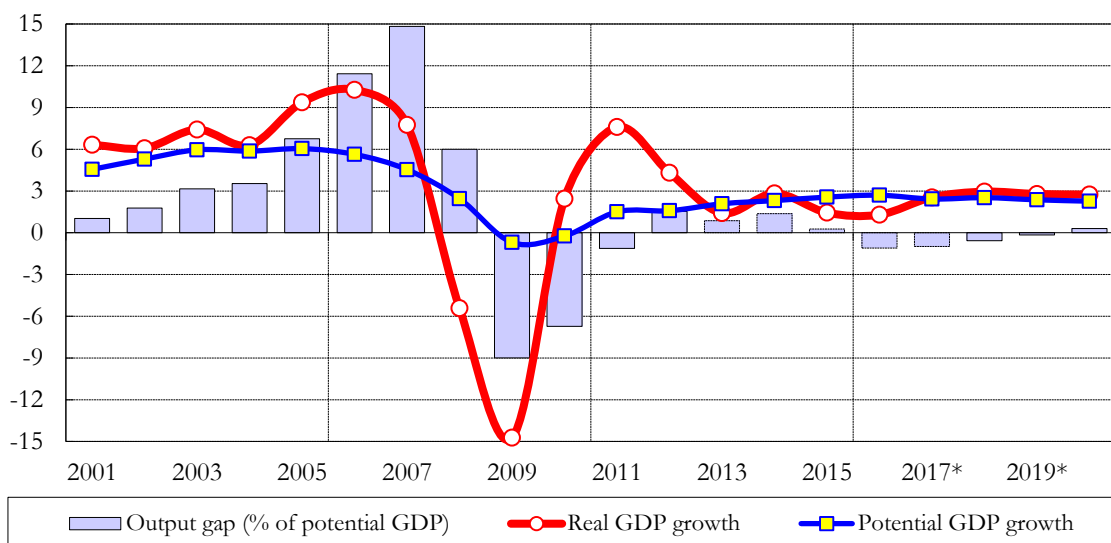
Estonia's economic growth and the change of consumer price index (per cent)



Source: Statistics Estonia, Ministry of Finance.

Figure 2**Development of potential GDP and output gap**

(per cent)



Source: Statistics Estonia, Ministry of Finance.

Table o.i) Basic assumptions

	2015	2016*	2017*
Short-term interest rate (annual average)	0,0	-0,3	-0,3
Long-term interest rate (annual average)	0,5	0,1	0,1
USD/€ exchange rate (annual average)	0,902	0,897	0,897
Nominal effective exchange rate	0,8	0,0	0,0
World excluding EU, GDP growth	3,2	3,2	3,6
EU GDP growth	2,0	1,8	1,7
Growth of relevant foreign markets	0,2	2,2	3,5
World import volumes, excluding EU	0,5	1,8	3,1
Oil prices (Brent, USD/barrel)	52,4	42,6	48,2

Source: Ministry of Finance.

Table 1.a. Macroeconomic prospects

	ESA code	2015	2015	2016*	2017*
		Level	rate of change	rate of change	rate of change
1. Real GDP	B1*g	17 472,0	1,4	1,3	2,5
of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth (1/)		-	-	-	-
2. Potential GDP			2,6	2,7	2,4
contributions:					
- labour			0,6	0,6	0,2
- capital			1,0	1,0	1,0
- total factor productivity			0,8	1,1	1,2

3. Nominal GDP	B1*g	20 251,7	2,5	3,1	5,2
Components of real GDP					
4. Private final consumption expenditure	P.3	9 343,9	4,6	3,3	2,7
5. Government final consumption expenditure	P.3	3 348,4	3,4	0,1	0,7
6. Gross fixed capital formation	P.51	4 085,6	-3,4	1,2	6,8
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	220,4	1,1	1,8	1,0
8. Exports of goods and services	P.6	15 066,9	-0,6	2,7	3,5
9. Imports of goods and services	P.7	14 678,6	-1,4	5,0	3,7
Contributions to real GDP growth					
10. Final domestic demand			2,3	2,1	3,2
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		-1,6	0,7	-0,6
12. External balance of goods and services	B.11		0,6	-1,6	0,0

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	2015	2015	2016*	2017*
		level 2010=100	rate of change	rate of change	rate of change
1. GDP deflator		115,9	1,0	1,8	2,6
2. Private consumption deflator		113,5	0,0	0,7	2,8
3. HICP		113,7	0,1	0,9	2,9
4. Public consumption deflator		122,6	4,0	4,1	4,1
5. Investment deflator		117,3	2,9	-0,6	2,3
6. Export price deflator (goods and services)		106,6	-1,5	-0,1	1,3
7. Import price deflator (goods and services)		103,7	-1,8	-1,1	1,4

Source: Statistics Estonia, Ministry of Finance.

Table 1.c. Labour market developments

	ESA code	2015	2015	2016*	2017*
		Level	rate of change	rate of change	rate of change
1. Employment, persons		640,9	2,6	0,9	-0,1
2. Employment, hours worked					
3. Unemployment rate (%)		42,3	6,2	6,2	7,2
4. Labour productivity, (real GDP per employed person)		27 262	-1,1	0,4	2,6
5. Labour productivity, hours worked					
6. Compensation of employees	D.1	9 731,0	8,9	6,0	5,1
7. Compensation per employee		15 183	6,1	5,1	5,2

Source: Statistics Estonia, Ministry of Finance.

Table 1.d. Sectoral balances

	ESA code	2015	2016*	2017*
		<i>% of GDP</i>	<i>% of GDP</i>	<i>% of GDP</i>
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	4,3	2,9	3,4
<i>of which:</i>				
- balance on goods and services		4,2	3,2	3,0
- balance of primary incomes and secondary incomes		-1,9	-2,1	-2,2
- capital account		2,1	1,7	2,5
2. Net lending/net borrowing of the private sector	B.9			
3. Net lending/net borrowing of general government	B.9	0,1	0,3	-0,6
4. Statistical discrepancy		0,7	-	-

Source: Statistics Estonia, Ministry of Finance.

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

Changes to the framework of co-ordination of economic and fiscal policies of EU Member States provide the creation of independent fiscal councils in all euro area member states, which monitor the accordance of fiscal policy to fiscal rules and assess the need to use the correction mechanisms implemented in the framework. Estonia's Fiscal Council, which is attached to the Central Bank, was established in 2014. According to the Treaty of the Fiscal Council, it must provide an assessment of government's economic and fiscal forecast, medium-term budgetary strategy and of achievement of the structural budget balance objective.

The opinion of the Fiscal Council on the summer 2015 economic forecast of the Ministry of Finance on 29.09.2015 says:²

- „ The summer 2016 forecast of the Ministry of Finance finds that GDP growth in Estonia in the short term will be lower than was earlier forecast, and that the economy will grow by 1.3% this year and 2.5% in 2017. Actual GDP and its potential level have been corrected downwards, and so has inflation. The Fiscal Council finds that this is in line with the changes that have occurred in the Estonian economic environment.“
- „ The continuing rapid wage growth means that the updated fiscal forecast for tax receipts in the 2017 state budget is in fact better than it was in the spring. Unfortunately this will

² More detailed analysis is found on the web page of the Fiscal Council: <http://eelarvenoukogu.ee/files/Opinion%20Summer%20Forecast%202016.pdf>

not lead to an improvement in the nominal budget position. The nominal general government deficit is 0.3 percentage point larger than in the state budget strategy for 2017–2020, and the structural surplus is 0.2 percentage point smaller. Although these differences are relatively small, increasing spending in the state budget for next year from what was in the spring budget strategy is not good practice. With domestic demand strong and tax receipts good, we find no justification for weakening the budget position.“

- „ For this reason the Fiscal Council recommends that a state budget be passed that sets a target of a small structural surplus for 2017.“

In the following, there are pointed out most relevant differences between Ministry of Finance’s 2016 summer forecast and other institutions latest public macroeconomic forecasts. Comparing them, one should keep in mind that forecasts are compiled in different periods and therefore based on different information, which causes variations in assumptions and results of the forecasts. As the foreign environment is uncertain and Statistical Office published revised GDP time series in September, then one should consider the assumptions of that time while estimating earlier forecasts.

During last months, economic growth expectations of the institutions for 2016 have been converged between 1.5-1.8%. Differences in the forecasts are partly resulting from the fact that if the forecast is taking into account weaker than expected GDP growth in Q2 and the uncertainty regarding Brexit. Ministry of Finance’s summer forecast for 2016 is the lowest, because it is also taking into account the GDP time series revision published in September.

For 2017, institutions expect a pickup in economic growth driven by stronger foreign demand and the recovery of investments. Forecasts vary between 2.4- 3%. Ministry of Finance expects economic growth to pick up to 2.5%, which is at the lower end of the forecast range.

Table 1.e. Comparison of economic forecasts

	Real GDP growth, %			Nominal GDP growth, %		
	2016*	2017*	2018*	2016*	2017*	2018*
Ministry of Finance	1,3	2,5	3,0	3,1	5,2	5,8
European Commission	1,9	2,4	–	3,6**	5,2**	–
Bank of Estonia	1,8	2,9	3,0	4,0**	5,3**	5,6**
IMF	1,5	2,5	2,9	2,8	3,8	4,7
OECD	1,8	3,0	–	2,6	4,8	–
SEB	1,7	2,4	3,0	–	–	–
Swedbank	1,5	2,5	2,7	3,9	5,0	5,4
Nordea	1,7	2,6	2,7	–	–	–
DNB	2,0	3,0	3,0	–	–	–
Consensus Forecasts	1,7	2,5	–	–	–	–
Estonian Institute of Economic Research	2,1	–	–	–	–	–

	Consumer price index, % (in brackets Harmonised Consumer Price Index)			General government position, % of GDP		
	2016*	2017*	2018*	2016*	2017*	2018*
Ministry of Finance	0,2 (0,9*)	2,7 (2,9*)	2,7 (2,9*)	0,1	0,3	-0,6
European Commission	0,8*	2,9*	–	-0,1	-0,2	–
Bank of Estonia	0,0 (0,6*)	2,7 (2,9*)	2,2 (2,6*)	0,0	-0,1	-0,2
IMF	0,5*	1,4*	1,8*	0,2	0,2	0,1
OECD	0,4*	1,8*	–	-0,4	0,3	–
SEB	0,5*	2,4*	2,8*	–	–	–
Swedbank	-0,1	2,5	2,0	0,2	-0,2	-0,2
Nordea	0,2	2,6	2,3	0,0	-0,1	-0,2
DNB	0,6*	2,2*	2,5*	–	–	–
Consensus Forecasts	0,3	2,1	–	–	–	–
Estonian Institute of Economic Research	0,3	–	–	–	–	–

* Harmonised Consumer Price Index.

** calculated from the forecast of nominal GDP volume.

Sources:

Ministry of Finance. 2017 Draft Budgetary Plan of Estonia. 17.10.2016.

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2. Budgetary targets

The Government's medium-term objective (MTO) is the general government structural balance or surplus.³ Since 2009, after the global economic crisis, the budgetary position of general government has been in a structural surplus or balance (except in 2013 when there was deficit 0.3% of GDP) and the MTO is therefore met.

In 2016, the structurally adjusted budgetary position of general government will remain in a considerable surplus (1.1% of GDP) because of the impact of economic cycle, good tax revenue collection and modest investments. General goal of the fiscal policy is to preserve neutral or countercyclical budget policy. For coming years the structurally adjusted budgetary position will remain in a surplus. **In 2017, the structurally adjusted budgetary position of general government will be in a surplus of 0.2% of GDP, which is in compliance with targeted outcome set by the State Budget Strategy.** Structural surplus indicates that there are no sustainability problems in the state budget and the next year nominal deficit is caused by temporary factors. **Thus, Estonia holds its MTO during 2016-2020 – a structural balance or surplus.**

According to Statistics Estonia the budgetary position of the general government remained in a surplus of 0.1% of GDP or EUR 27 million in 2015. Social security funds and local governments were in surplus of respectively 0.1% and 0.3% of GDP. Although tax revenue exceeded expectations mainly in case of CIT, PIT and social tax, and investments and pension costs were lower than expected, central government was in a deficit of 0.3% of GDP due to nonrecurrent expenditure. The result of social security funds was better than expected mainly because of lower than forecasted expenditure on active labour market measures. The general government structurally adjusted budgetary position was in a surplus of 0.6% of GDP in 2015.

In 2016, the nominal budgetary position of general government, taking account 2017 draft budget measures, reaches a surplus of 0.3% of GDP. All the levels of government are in surplus. In 2017, according to the draft budget, the nominal budgetary position of the general government will be in deficit of 0.6% of GDP.

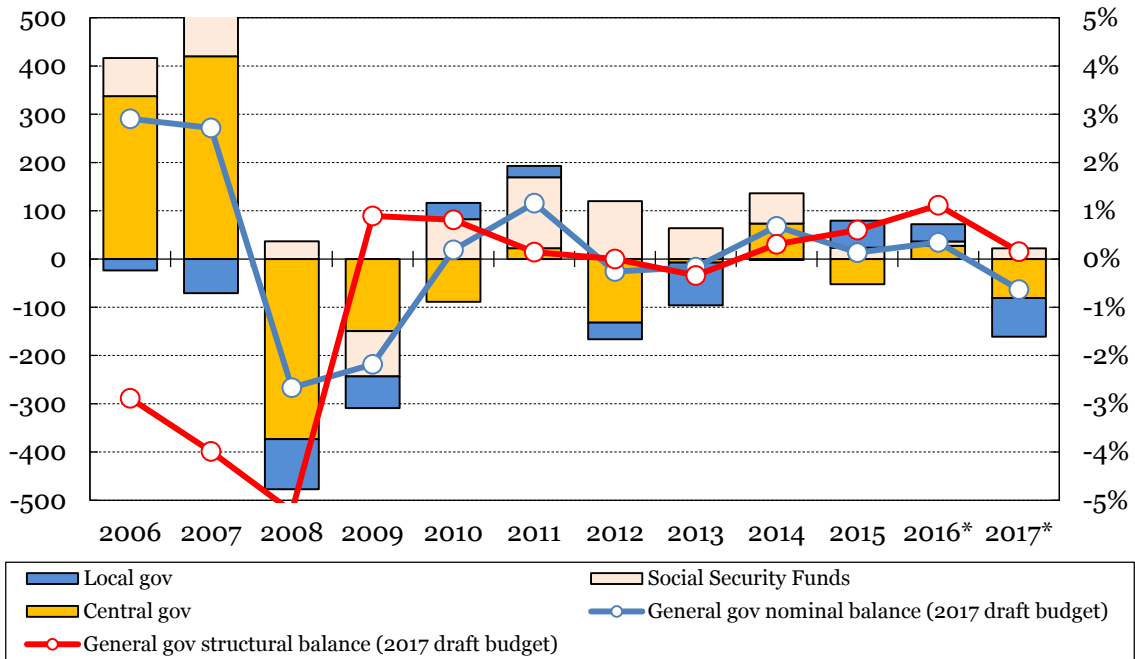
In 2015, general government debt decreased to 10.1 % of GDP, amounting to EUR 2 036 million. The main reasons for the decline were the decrease in loans issued by the European Financial Stability Fund (EFSF) and the decrease of debt of local governments. As according to the forecast there is a need to take a new loan in next year, the debt burden increases in 2017 to 10.3% of GDP.

³ Surplus goal was set in 2007 Convergence Programme. In 2005 and 2006 Convergence Programmes the goal was budget balance.

Figure 3

General government budgetary position

(% of GDP)

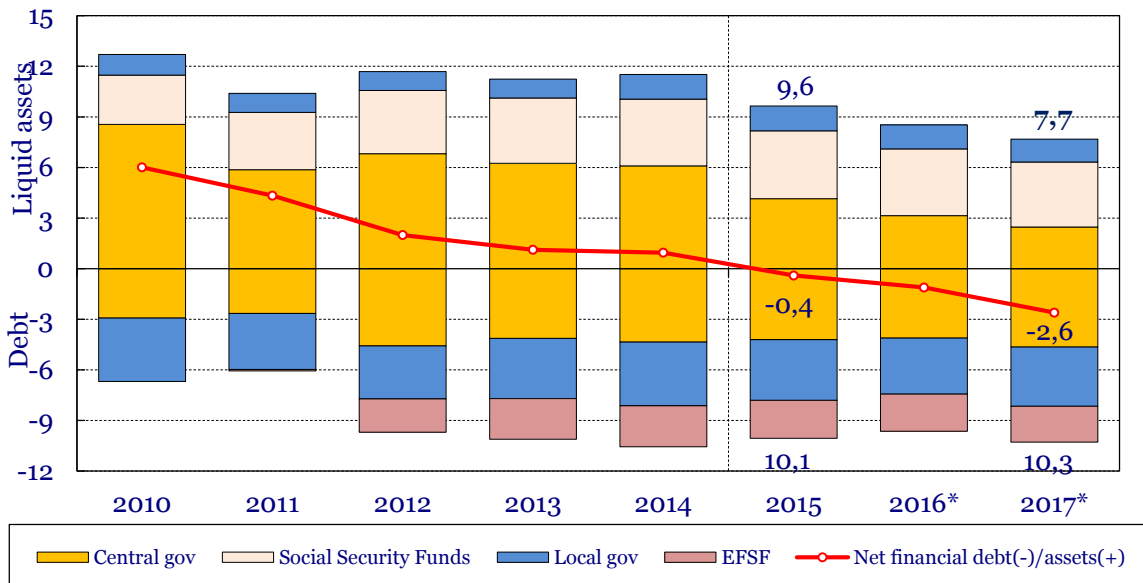


Source: Statistics Estonia, Ministry of Finance.

Figure 4

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

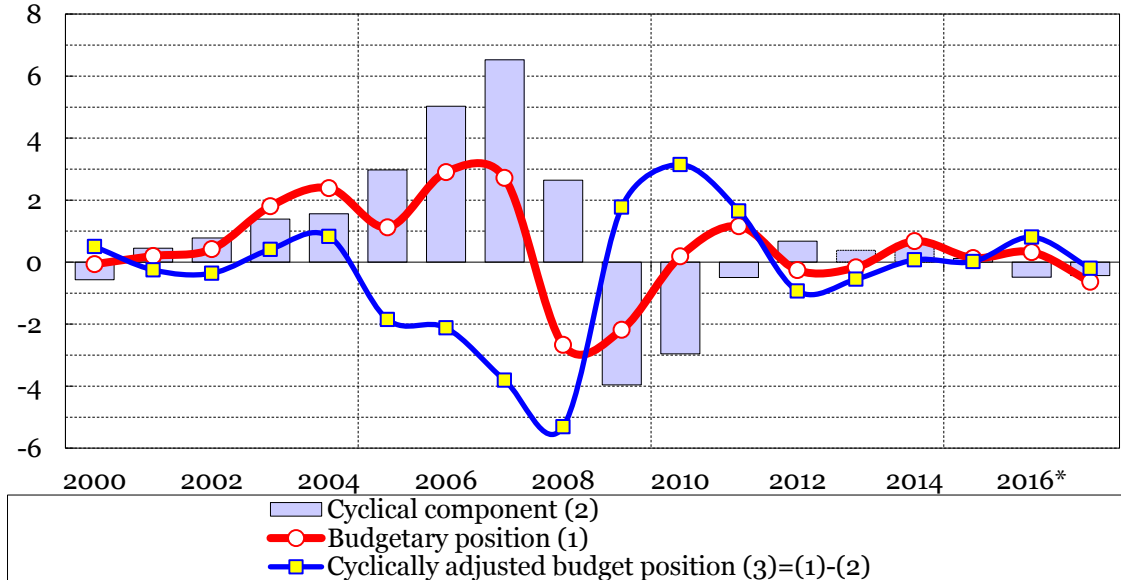
(% of GDP)



Source: Statistics Estonia, Ministry of Finance.

Figure 5

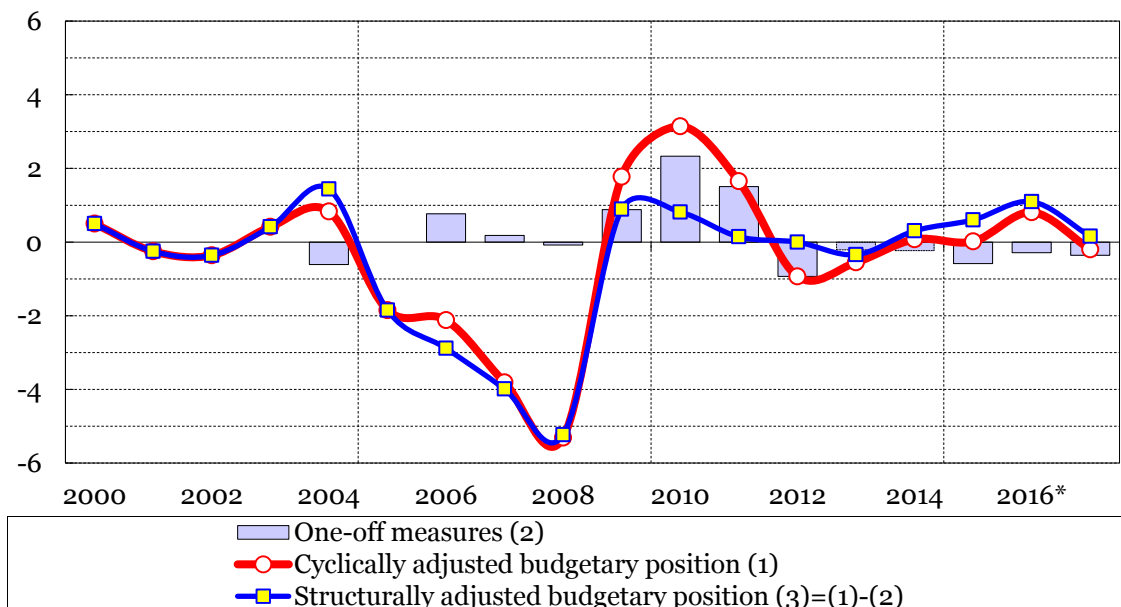
General government cyclically adjusted budgetary position
(% of GDP)



Source: Statistics Estonia, Ministry of Finance.

Figure 6

General government structurally adjusted budgetary position
(% of GDP)



Source: Ministry of Finance.

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

	ESA Code	2016 (1/)	2017*
		% of GDP	% of GDP
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	0.3	-0.6
2. Central government	S.1311	0.1	-0.4
3. State government	S.1312	-	-
4. Local government	S.1313	0.2	-0.4
5. Social security funds	S.1314	0.0	0.1
6. Interest expenditure	D.41	0.1	0.1
7. Primary balance (3/)		0.4	-0.5
8. One-off and other temporary measures (4/)		-0.3	-0.4
9. Real GDP growth (%) (=1. in Table 1a)		1.3	2.5
10. Potential GDP growth (%) (=2 in Table 1.a)		2.7	2.4
contributions:			
- labour		0.6	0.2
- capital		1.0	1.0
- total factor productivity		1.1	1.2
11. Output gap (% of potential GDP)		-1.1	-1.0
12. Cyclical budgetary component (% of potential GDP)		-0.5	-0.4
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		0.8	-0.2
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		0.9	-0.1
15. Structural balance (13 - 8) (% of potential GDP)		1.1	0.2

1/ According to State Budget Draft 2017.

2/ TR-TE= B.9.

3/ The primary balance is calculated as (B.9, item 1) plus (D.41, item 6).

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

Source: Ministry of Finance.

Table 2.b. General government debt developments

	ESA code	2016*	2017*
		% of GDP	% of GDP
1. Gross debt		9.6	10.3
2. Change in gross debt ratio		-0.4	0.6
Contributions to changes in gross debt			
3. Primary balance (=item 10 in table 2.a.i)		0.4	-0.5
4. Interest expenditure	D.41	0.1	0.1
5. Stock-flow adjustment		0.2	0.5
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/)		1.1	1.3
Other relevant variables			
6. Liquid financial assets (2/)		8.5	7.7
7. Net financial debt (7=1-6)		1.1	2.6
8. Debt amortization (existing bonds) since the end of the previous year ⁴		0.1	0.2
9. Percentage of debt denominated in foreign currency		0.0	0.0
10. Average maturity ⁵		4.3	3.6

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

	2016*	2017*
	% of GDP	% of GDP
Public guarantees	0.3	0.3
Of which: linked to the financial sector	0.0	0.0

Source: Ministry of Finance.

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

⁵ Central government without foundations and legal persons governed by public law.

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

Summer forecast (Table 3) differs from the Stability Programme forecast mainly because of downward correction of public gross fixed capital formation. Indicators as a percentage of GDP are not directly comparable as the summer forecast is based on the GDP time series revised on 8.09.2016.

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

General Government (S13)	ESA Code	2016*	2017*
		% of GDP	% of GDP
1. Total revenue at unchanged policies	TR	40.0	39.8
of which			
1.1. Taxes on production and imports	D.2	15.1	15.3
1.2. Current taxes on income, wealth, etc	D.5	7.9	7.6
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	11.9	11.8
1.5. Property income	D.4	0.8	0.9
1.6. Other		4.4	4.2
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		34.8	34.6
2. Total expenditure at unchanged policies	TE	39.7	40.6
of which			
2.1. Compensation of employees	D.1	11.8	11.8
2.2. Intermediate consumption	P.2	6.9	6.9
2.3. Social payments	D.62 D.632	13.7	13.9
of which Unemployment benefits		0.3	0.3
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.1	0.1
2.5. Subsidies	D.3	0.4	0.4
2.6. Gross fixed capital formation	P.51	4.2	5.0
2.7. Capital transfers	D.9	0.6	0.6
2.8. Other		2.0	2.0

Source: Ministry of Finance.

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

The Draft Budgetary Plan (Table 4.a) differs from summer forecast (Table 3) because of revenue and expenditure measures (Table 5.a). In 2016, revenue declined by 0.1% GDP due to CIT on dividends shifting to 2017. In 2017, revenue increased because of the measures by 0.2% GDP. Expenditure did not change markedly in either year.

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

General Government (S13)	ESA Code	2016*	2017*
		% of GDP	% of GDP
1. Total revenue target	TR	40.0	40.0
of which			
1.1. Taxes on production and imports	D.2	15.1	15.3
1.2. Current taxes on income, wealth, etc	D.5	7.8	7.7
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	11.9	11.8
1.5. Property income	D.4	0.8	1.0
1.6. Other		4.4	4.2
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		34.7	34.7
2. Total expenditure target	TE	39.6	40.6
of which			
2.1. Compensation of employees	D.1	11.8	11.8
2.2. Intermediate consumption	P.2	6.9	7.0
2.3. Social payments	D.62 D.632	13.7	13.9
of which Unemployment benefits		0.3	0.3
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.1	0.1
2.5. Subsidies	D.3	0.4	0.4
2.6. Gross fixed capital formation	P.51	4.2	4.9
2.7. Capital transfers	D.9	0.6	0.6
2.8. Other		2.0	2.0

Source: Ministry of Finance.

In accordance with the SGP, the general government expenditure growth⁶ of a member state should conform to its GDP growth. This expenditure benchmark is usually the 10 year

⁶ In accordance with EC methodology, real expenditure growth is used using the GDP deflator.

Excluded are interest expenditure and expenditure from table 4.b, also gross fixed capital formation is smoothed over time.

average potential GDP growth of the member state, which is 2.1% for Estonia according to the EC 2016 Winter Forecast. If the member state does not fulfil its MTO (general government surplus for Estonia) for current year, the benchmark for the next will be set at a lower level (0.9% for Estonia), which will help the member state to adjust its position by at least 0,5% of GDP and fulfil its MTO.

Adjusted expenditure growth will be -3.1% in 2016 which is in line with the benchmark by a large margin. However, in 2017 the expenditure growth will be 6.3% which means that the benchmark will be exceeded by 4.2 pp, assuming that Estonia is at its MTO. Although the yearly growth rate fluctuates considerably and the benchmark is exceeded in 2017, it will not result in a deviation from the long-term budget objective as the structural budget surplus is maintained. Moreover, when years 2016 and 2017 are taken together, they do not show a deviation from the expenditure benchmark. There will be an increase in EU programme spending in 2016 (Table 4.b) which will decrease the 2016 overall expenditure growth. There was a large negative discretionary revenue measures package in 2015 due to labour tax cuts which will lower the base spending for next two years. Increase in discretionary revenue measures in 2016 is caused by excise duty rises and changed timing of dividend distribution from state owned enterprises. There are no significant changes in revenue measures in 2017. Large expenditure growth in 2017 will be because expenditure in 2016 will not be in line with revenue growth.

Table 4.b. Expenditure benchmark

	2015	2015	2016*	2017*
	level (m EUR)	% GDP	% GDP	% GDP
1. Expenditure on EU programmes fully matched by EU funds	389.2	1.9	2.9	2.9
1a. of which investment fully matched by EU funds	229.6	1.1	1.8	1.8
2. Cyclical unemployment benefit expenditure ⁷	0.0	0.00	0.00	0.00
3. Effect of discretionary revenue measures ⁸	-182.0	-0.9	1.2	0.1
4. General government revenue increases mandated by law	0.0	0.00	0.00	0.00

Source: Ministry of Finance.

* Forecast

⁷ Expert assessment assumption is that the level of unemployment rate is normal.

⁸ The measures that have been taken into account: increase of general basic exemption and additional basic exemption of pensions; increase in excise duties and abolishment of lower fuel excise duty; increase in value added tax on accommodation services; increase in penalties; dividends and income tax on them; establishment of health-related special benefit; wage increase in state budget; revenue from CO2 quota sales; taxation of e-cigarettes; change in packaging excise duty; more precise taxation of rental revenue; disengaging the additional basic exemption for the second child; reduction in social tax; restriction of training expenditure deduction; reduction of the upper limit of income tax deduction; change in taxation of foreign business trip pay; changes in resource charges.

Source: Ministry of Finance.

Table 4.c. General government expenditures by function**Table 4.c.i) General government expenditure on education, healthcare and employment**

	2016*		2017*	
	% of GDP	% of general government expenditure	% of GDP	% of general government expenditure
Education	5.0	12.6	5.1	12.6
Healthcare	5.5	13.8	5.5	13.6
Employment	0.1	0.3	0.1	0.3

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

Functions of the Government	COFOG Code	2016*	2017*
		% of GDP	% of GDP
1. General public services	1	4.1	4.4
2. Defence	2	2.0	2.0
3. Public order and safety	3	1.9	1.8
4. Economic affairs	4	4.8	5.0
5. Environmental protection	5	0.3	0.3
6. Housing and community amenities	6	0.4	0.4
7. Health	7	5.5	5.5
8. Recreation, culture and religion	8	2.0	2.1
9. Education	9	5.0	5.1
10. Social protection	10	13.7	13.9
11. Total expenditure (=2. in Table 4.a)	TE	39.6	40.6

Source: Ministry of Finance.

5. Description of discretionary measures included in the draft budget

There are 17 measures that have an impact on state budget revenue and expenditure in 2017. Four of them have an impact on state budget revenue, thirteen of them affect state budget expenditure. All expenditure measures (total of EUR 2 million) are temporary in nature and they are used to cover the priority needs of the ministries.

Table 5.a. Discretionary measures taken by General Government

List of measures	Detailed description	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact	
					2016*	2017*
					% of GDP	% of GDP
1) Additional dividends	Additional dividends in 2017	Revenue, D4	Accrual method	Draft is not required	-	0,01
2) Additional income tax (CIT)	CIT on 2016 dividends in 2017	Revenue, D5	Accrual method	Draft is not required	-0,08	0,08
3) Selling 5G frequency permits	Revenue from selling new 5G mobile network frequency permits	Revenue	Accrual method	Draft is not required	-	0,07
4) Additional tax-free allowance for pensions	In order to turn average pension untaxed	Revenue, D5	Accrual method	Submitted with budget	-	-0,01
5) Real estate investments	Recheduling transactions	Expenditure, P51	Accrual method	Draft is not required	-	-0,01
6) Active labour market measures		Expenditure, P2	Accrual method	Draft is not required	-	-0,01
7) Funds for Estonian Railways Ltd	To ensure sustainability of Estonian Railways	Expenditure, P2	Accrual method	Draft is not required	-	-0,02
8) Decrease in co-financing		Expenditure, P51	Accrual method	Draft is not required	-	0,09
9) Funds for EU presidency	Covering the cost of the EU presidency	Expenditure, P2	Accrual method	Draft is not required	-	-0,02
10) Change in budgetary position of Health and Insurance Fund	Budgetary position of HIF with additional measures	Expenditure, P2	Accrual method	Draft is not required	0,04	-0,003
11) Additional wage increase	Compensation of employees in priority areas	Expenditure, D1	Accrual method	Draft is not required	-	-0,03
12) Additional ICT needs	Classified information	Expenditure, P2	Accrual method	Draft is not required	-	-0,005
13) Reschedule of the expenditure of MoE	Rescheduling the expenditure of library materials regarding the Ministry of Education and Research from 2017 to 2016	Expenditure, P2	Accrual method	Draft is not required	-0,02	0,02

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14) Reschedule of the expenditure of MoI	Reschedule of the ICT expenditure regarding Ministry of Interior from 2017 to 2016	Expenditure, P2	Accrual method	Draft is not required	-0,005	0,005
15) Reschedule of the expenditure of Rail Baltic	Cost rescheduling of RB from 2017 to 2018	Expenditure, P2	Accrual method	Draft is not required	-	0,002
16) Renovation of the news studio (EPB)	Renovastion of the news studio of the Estonian Public Broadcasting	Expenditure, P51	Accrual method	Draft is not required	-	0,02
17) Other expenditure measures	Additional funds allocated to different ministries	Expenditure, P2	Accrual method	Draft is not required	-	-0,02
Total revenue measures					-0,08	0,15
Total expenditure measures					0,02	0,01
TOTAL					-0,06	0,16

Source: Ministry of Finance.

Table 5.b. Discretionary measures taken by Central Government

List of measures	Detailed description	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact	
					2016*	2017*
					% of GDP	% of GDP
1) Additional dividends	Additional dividends in 2017	Revenue, D4	Accrual method	Draft is not required	-	0,01
2) Additional income tax (CIT)	CIT on 2016 dividends in 2017	Revenue, D5	Accrual method	Draft is not required	-0,08	0,08
3) Selling 5G frequency permits	Revenue from selling new 5G mobile network frequency permits	Revenue	Accrual method	Draft is not required	-	0,07
4) Additional tax-free allowance for pensions	In order to turn average pension untaxed	Revenue, D5	Accrual method	Submitted with budget	-	-0,01
5) Real estate investments	Recheduling transactions	Expenditure, P51	Accrual method	Draft is not required	-	-0,01
6) Funds for Estonian Railways Ltd	To ensure sustainability of Estonian Railways	Expenditure, P2	Accrual method	Draft is not required	-	-0,02
7) Decrease in co-financing		Expenditure, P51	Accrual method	Draft is not required	-	0,09
8) Funds for EU presidency	Covering the cost of the EU presidency	Expenditure, P2	Accrual method	Draft is not required	-	-0,02
9) Additional wage increase	Compensation of employees in priority areas	Expenditure, D1	Accrual method	Draft is not required	-	-0,03
10) Additional ICT needs	Classified information	Expenditure, P2	Accrual method	Draft is not required	-	-0,005
11) Reschedule of the expenditure of MoE	Rescheduling the expenditure of library materials regarding the Ministry of Education and Research from 2017 to 2016	Expenditure, P2	Accrual method	Draft is not required	-0,02	0,02
12) Reschedule of the expenditure of MoI	Reschedule of the ICT expenditure regarding Ministry of Interior from 2017 to 2016	Expenditure, P2	Accrual method	Draft is not required	-0,005	0,005
13) Reschedule of the expenditure of Rail Baltic	Cost rescheduling of RB from 2017 to 2018	Expenditure, P2	Accrual method	Draft is not required	-	0,002
14) Renovation of the	Renovastion of the news studio of the Estonian	Expenditure,	Accrual method	Draft is not	-	0,02

news studio (EPB)	Public Broadcasting	P51		required		
15) Other expenditure measures	Additional funds allocated to different ministries	Expenditure, P2	Accrual method	Draft is not required	-	-0,02
Total revenue measures					-0,08	0,15
Total expenditure measures					-0,02	0,03
TOTAL					-0,10	0,18

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.⁹

More comprehensive and detailed information on the measures implemented is available in the strategy for competitiveness "Estonia 2020" and its action plan (Estonian national reform programme).

Table 6.a. Country-specific recommendations

CSR no	List of measures	Description of direct relevance
1.	a) Ensure the provision and accessibility of high-quality public services, especially social services, at local level, inter alia, by adopting and implementing the proposed local government reform.	<p>Government adopted local government reform act in June 2016. According to the law local government reform will be enforced with local government elections in autumn 2017. The purpose of administrative reform is to have local governments that would be able to offer better public services to people, to guarantee the growth of the regions' competitiveness and to fulfil independently the tasks assigned to them by law.</p> <p>Local Government reform act set minimum criteria for mergers- 5000 inhabitants, which enables to guarantee professional capacity of managing basic public services and potential (number of residents) to provide public services. It is encouraged to form local governments bigger than 11 000 inhabitants with additional merger grant of EUR 500 000.</p> <p>In June and August government discussed potential changes in regional administration (including reorganisation of county governments), inter-municipal cooperation and local government tasks. Regional development activities, including supporting the development of entrepreneurial environment in counties and organising regional public transport in cooperation with state was decided to transfer from county governments to municipalities for joint implementation. The discussions over the reorganisations on county governments will continue in upcoming month. The Social Welfare Act, enforced since 2016 aims to unify the quality local government social services by establishing service-based minimum requirements and by setting clear rule that the need for aid has to be assessed and appropriate care has to be offered. The implementation of the new Act has been supported by the dissemination of information for local government social workers and service providers.</p> <p>The further improvement of social services quality is guided by the principle that services must be result-oriented and give the most effective assistance to people in need. The Welfare</p>

⁹ [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0818\(11\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0818(11)&from=EN)

		<p>Development Plan 2016-2023 (adopted in June 2016) foresees the elaboration of comprehensive social services quality policy. In order to assist local governments and service providers, Estonia will elaborate (in 2016) voluntary social services guidelines that specify the requirements established by the Act. The new training programme for social services monitoring (to be elaborated in 2016) and training of monitoring specialists (in 2016-2017) will focus on the use of advisory monitoring principles that contribute to the improvement of social services quality.</p> <p>Improved quality and accessibility of public services is also one of the priorities of local government reform. Until the implementation of the reform, local governments are encouraged for more intense cooperation in the use of ESF to develop joint provision of services and look for innovative solutions to decrease the care burden and improve the independent coping and participation in the labour market of people with special needs. First round of funding has opened recently and local governments have shown great interest in improving their social services in cooperation with other local governments.</p> <p>Estonia has initiated major policy reforms in deinstitutionalisation (starting with services and care of people with special mental needs), rehabilitation and long term-care that help to improve the accessibility and quality of relevant social services.</p>
1.	b) Adopt and implement measures to narrow the gender pay gap, including those foreseen in the Welfare Plan.	<p>On 30th of June 2016, the Government adopted the Welfare Development Plan for 2016-2023 and an action plan for its implementation. Under the sub-goal of gender equality, the plan targets issues of equal economic independence of women and men; reducing gender pay gap; balanced participation of women and men in all levels of decision-making and management in politics and public and private sectors; reducing negative impact of gender stereotypes on decisions and everyday life of women and men; enhancing rights protection concerning equal treatment of women and men and guaranteeing institutional capacity to promote gender equality, including gender mainstreaming. Taking into account the wide range of causes behind our gender pay gap, most of the measures planned under this sub-goal are expected to help to decrease the gap.</p> <p>Measures specifically planned to decrease gender pay gap in the coming years include developing a proposal for a regulation foreseeing equal pay audits in organisations and other efforts to support this activity, preparing a gender pay gap analysis of public service organisations and based on that, drawing up recommendations for specific measures, preparing proposals to increase transparency of pay information in organisations etc.</p> <p>In order to give an additional impetus to the reduction of gender pay gap, preparatory work has started to amend the Gender Equality Act to provide the Labour Inspectorate with a right to exercise state supervision over implementation of the requirement of equal pay for women and men for the same work and work of equal value. Additionally, guidelines will be developed to provide know-how for labour inspectors and employers on evaluation and comparison of jobs. It is also planned that the Inspectorate will provide counselling to employers to support the implementation of the principle of equal pay. The labour inspectors will be provided with a</p>

		relevant training.
2.	Promote private investment in research, development and innovation, including by strengthening cooperation between academia and businesses.	<p>This recommendation is fully in line with Estonian national priorities (National Reform Programme “Estonia 2020”, Estonian RDI strategy “Knowledge-based Estonia 2014-2020”, and Estonian Entrepreneurship Growth Strategy 2014-2020).</p> <p>During the years 2015-2020 more than EUR 600 million will be invested in R&D, innovation and business development, including support for smart specialization growth areas. The main objective is to promote cooperation between businesses and universities and other research institutions. These measures are designed to contribute to the growth of knowledge base of the Estonian economy by supporting cooperation of research institutions and enterprises. It also aims to motivate students to choose study fields through all levels of higher education in the growth areas important for the economy and to support the demand in public sector for innovation. Specific actions are as follows:</p> <ol style="list-style-type: none"> 1) Support for applied research and product development in cooperation between research institutions and businesses in smart specialisation areas (new measure launched in 2016); 2) Support for more flexible opportunities for businesses to participate in technology development centres and clusters; 3) Support for public procurements that foster innovation; 4) Development programme for businesses (so called tailor-made support for companies, including contract research with academia); 5) Doctoral studies in cooperation with enterprises (scholarships in smart specialisation areas). <p>Other measures implemented:</p> <ul style="list-style-type: none"> - Changes in the formula of calculating the base-line financing of public research institutions. Revenue from contract research with businesses is one component of the funding formula of the public research institutions. In 2016 we increased the weight of this component in the funding formula to motivate public research institutions’ cooperation with business sector (in 2016). - Extension of support for technology transfer and cooperation between universities, research institutions and businesses (through measure called ASTRA). - Opening up the infrastructure of research institutions for cooperation with businesses and other external users. - Including companies in the activities of popularisation of research. - Improving the work practice system at all levels of education, including higher education. <p>The statistics show positive trends in the volume of contract research between public R&D institutions and private sector. In 2015 the volume of contract research increased by 24%, reaching EUR 7.7 mln.</p>

Table 6.b. Liidu majanduskasvu ja tööhõive strateegiaga ette nähtud eesmärgid

National 2020 headline targets	List of measures	Description of direct relevance to address the target
National employment target [76%]	1. Implementing Work Ability Reform	Creating a system for assessing work capacity, providing services for the target group, data exchange solutions necessary for service implementation.
	2. Implementation of the employment programmes	Providing active labour market measures. Employment programmes create conditions for piloting services in addition to the ones constituted in the Labour Market Services and Benefits Act.
	3. Supporting staying in and returning to employment	Ensuring accessible and high-quality health services in order to promote staying in and returning to employment.
	4. Maintaining capacity for work	Reorganizing the systems of occupational health and safety and settlement of labour disputes.
National R&D target [3% of GDP]	1. Ensuring the high level and variety of scienceTeaduse	1. Implementation of "Institutional development programme for R&D institutions and universities" (ASTRA). 2. Financing of main instruments: institutional and personal research grants, base financing, activity support for public R&D institutions and infrastructure maintenance costs. 3. Supporting of top science centres for strengthening international competitiveness of science and its top quality. 4. Support for popularisation o science in the society and science collections. 5. Support for science infrastructure with national importance.
	2. Increasing public and economic benefits of RDI	1. Implementation of national programmes "Estonian language and cultural memory II" and "Technology of Estonian language". 2. Support for core infrastructure and opening it for external users. 3. Support for purchasing science databases and for science libraries. 4. Increasing R&D capacity of state institutions (programme RITA).
	3. RDI that changes the structure of the economy is based on smart specialisation	1. Supporting applied research projects in smart specialisation areas. 2. Financing of higher education specialty scholarships in smart specialisation areas.
	4. Increasing Estonia's share and visibility in international RDI cooperation	1. Supporting the internationalisation of science and higher education via support for mobility and successors (programmes DORA Plus and Mobilitas Plus).

		2. Funding of international cooperation agreements and member fees for international science organisations.
GHG emission reduction target [6,269 thousand tons (+10% compared to 2005)]	1. Implementation of the new National Development Plan of the Energy Sector until 2030	The objectives of the National Development Plan of the Energy Sector are: 1) to ensure energy supply in the electricity, heat, transport and housing sectors as well as in the sector of the production of domestic fuels; 2) to reduce the energy intensity of the economy (without compromising competitiveness) and increase energy efficiency; 3) to increase energy security through the development of the business environment required for energy production, infrastructure and connections. The focus is on increasing the use of alternative fuels in transport, the efficiency of heat production and transmission, energy conservation and the share of renewable energy.
Renewable energy target [25%]		
National energy efficiency target [2 818 ktoe]	2. Implementing new structural funds	
Reducing the number of young persons with basic education level or lower who are not studying [9,5%]	1. Flexible learning possibilities and support systems	Development of apprenticeships in vocational education, where additional study places are created for apprentices and development of apprenticeship system. Renewal of support systems in vocational schools.
	2. Academic and career counselling	Implementation of academic and career counselling system in basic schools, upper-secondary schools and vocational schools in cooperation with Rajaleidja centres.
	3. Reorganisation of the national school network	Continuing the programme of building and renovating upper secondary schools in county centres, including state upper secondary schools, and supporting the optimisation of the use of the premises of schools that abolish the upper secondary level and merging basic schools.
	4. Inclusive education and co-learning school	Introduction of principles for inclusive education, according to which pupils with special educational needs are firm and inseparable part of school pupils, they are involved in learning activities according to their capability, and they get sufficient support for learning and coping. A co-learning conception will be composed for supporting the schools where children with different cultural background must learn together.
National target for tertiary education [40%]	1. Means-tested education allowance, performance scholarships and student loans	The provision of means-tested education allowances, performance scholarships and widening the number of students applicable for student loans.
	2. Renewing of the financing	The financing model will be renewed so that universities could implement agreed changes

	model	for ensuring quality and effective higher education.
National poverty target [15%]	1. Supporting families with children	Development of family benefit systems (increasing means-tested family allowance, increasing child allowance, increasing large family allowance, starting maintenance allowance fund etc).
	2. Pensions' increase; the additional tax-free allowance is increased for pensioners	<p>Relative poverty indicators for elderly people are higher than national averages and they have more that doubled by 2014 when compared to 2009. However, the share of elderly people in absolute poverty has lowered from 2.2% in 2012 to 1.3% in 2014 and is significantly lower than the national average (6.3% in 2014).</p> <p>Pension increase continues. The pension index increased by 5.7% on 01.04.2016. The average old age pension has increased to EUR 391.4 by the second quarter of 2016.</p> <p>The additional tax-free allowance for pensioners is EUR 395 per month in 2016. The principle that average pension is not taxed with the PIT is being continued.</p> <p>A draft law on supporting single pensioners is in Riigikogu. According to the draft a pensioner living alone receives support for subsistence in the amount of EUR 115 per year (pensioner allowance) starting from 2017.</p>

7. Divergence from the latest Stability Programme

Estonia's 2016 Stability Programme was based on the spring forecast of the Ministry of Finance, published on 5 April 2016. The 2017 State budget is based on the summer economic forecast, published on 15 September 2016.

According to the spring forecast of the Ministry of Finance economic growth for 2016 was expected to be 2.0%. During 2017–2018 we expected the growth rate to pickup to 3.0% and 3.3%, respectively. However, in the first half of 2016 GDP real growth outcome was weaker than expected in the previous forecast because of worsened main export markets' growth outlook. Therefore economic growth forecast was lowered by 0.7 percentage points for 2016 when compared with the spring forecast. Growth of domestic demand will be lower, however, exports and imports will be somewhat stronger. Import growth is exceeding export growth, so that the contribution of net exports is negative. GDP growth forecast for 2017–2018 was cut by 0.4 and 0.3 percentage points because of lower domestic demand and export growth. Revisions in GDP structure and lower inflation resulted in smaller nominal GDP growth by 1.0 in 2016 and 0.7 to 0.5 percentage points in the following years. Therefore, nominal GDP will be EUR 0.4 billion in 2016, EUR 0.6 billion in 2017 and EUR 0.7 billion smaller in 2018 compared to previous projection.

Private consumption developments in 2016 are in line with spring forecast, although wage income growth has been faster than expected. This is due to increasing households' saving rate, which has accompanied high disposable income growth. Somewhat higher private consumption growth is projected for 2017, while growth forecast for latter years is smaller than previously expected. Investment growth has been revised downwards for 2016 and upwards for 2017, reflecting mainly the postponement of public investment projects.

Growth rates of both exports and imports will be quicker compared to spring forecast. Export of communication equipment, which constitutes large share in total exports, has been stronger than expected in the first half of 2016. Secondly, time series of services export has been revised upwards. In case of import, first half of 2016 turned to be more robust unlike expected in spring forecast. Next year's export forecast has been cut in line with weaker recovery of foreign demand.

Inflation (CPI) forecast for 2016 is 0.1% lower due to smaller services inflation. Forecast for 2018-2020 has been cut as well. This is mainly the result of weaker domestic demand – more modest growth rates of private consumption and wages, wherefore services inflation will be slower.

Spring expectations for labour market developments on employment reverting to decline and on slowing down of wage growth did not materialise according to Statistics Estonia. Nevertheless, according to the revised national accounts data labour market imbalances are less pronounced up to 2014, although they escalate rapidly as of 2015. According to Statistics Estonia, employment increased by 1.9% in the first half of 2016. This is partly due to activation of elderly persons, but current labour intensive domestic demand oriented economic growth has increased labour demand also. Nominal wage growth was 2.4 percentage points higher in the first half of 2016 than forecast in spring, while the value growth of GDP increased moderately to 2.8% from 2.5% in 2015. Developments so far and revision of national accounts data indicate either labour market imbalances are less marked than we know or companies are able to better cope with wage pressures than previously assumed. This is behind the upward revision of wage growth forecast for 2016 and 2017.

Compared with spring forecast, slightly lower wage growth is expected at the end of the forecast horizon, but this is mainly due to a downward correction of GDP growth forecast.

The general government budgetary position in 2016 has improved by 0.7 % of GDP to budgetary surplus 0.3% of GDP compared with spring forecast. Improvement is caused mainly by decreased amount of investments at central government and local governments' level. The general government nominal deficit in 2017 has stayed almost the same level as in the Stability Programme, falling only by 0.1 % of GDP to deficit 0.6 % of GDP. Despite the projected increase in tax revenue (mainly social tax) one-off measures such as shifting earlier the EU presidency and increasing defense expenditure affect general government outcome negatively.

In 2016, tax burden forecast has been increased by 0.5% to 34.7% of GDP compared to the Stability Programme (total tax revenue decreased due to VAT and CIT downward corrections but GDP was revised considerably downwards). In 2017, tax burden increased by 1.1% to 34.7% of GDP (total tax revenue increased mainly because of labour taxes upward correction, GDP was revised considerably downwards).

Forecast of general government debt is at the same level in 2016 compared to the forecast included in the Stability Programme and decreased by 0,1 % of GDP due to a decline in financing activities in 2017.

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

	ESA Code	2015	2016*	2017*
		% of GDP	% of GDP	% of GDP
General government structural balance (1/ target)	B.9			
Stability Programme		0,2	0,6	0,2
Draft Budgetary Plan		0,6	0,6	0,2
Difference		0,4	0,0	0,0
General government structural balance projection at unchanged policies	B.9			
Stability Programme		0,2	0,6	0,2
Draft Budgetary Plan		0,6	0,5	0,0
Difference		0,4	-0,1	-0,2

1/ Budgetary position is targeted by structural balance.

Source: Statistics Estonia, Ministry of Finance.

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

	ESA Code	2015	2016*	2017*
		<i>% of GDP</i>	<i>% of GDP</i>	<i>% of GDP</i>
General government net lending/ net borrowing target	B.9			
Stability Programme		-0,5	-0,1	-0,5
Draft Budgetary Plan		0,1	-0,1	-0,6
Difference		0,6	0,0	-0,1
General government net lending/ net borrowing projection at unchanged policies	B.9			
Stability Programme		-0,5	-0,1	-0,5
Draft Budgetary Plan (1/)		0,1	-0,2	-0,8
Difference		0,6	-0,1	-0,3

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 35.6% in 2014, which was the highest in EU. In 2015, Gini coefficient improved to 34.8%, which was slightly better than in Lithuania, Romania, Bulgaria and Latvia. This is rather large compared to EU as a whole and to the northern neighbours of Estonia and it has increased by 4 percentage points during past seven years. However, comparison with member states with different sizes and economic development levels might not always be appropriate because in larger countries the difference of income levels in different regions is less apparent to residents.

Most of the planned revenue and expenditure measures either will not have a distributional effect or the effect is very indirect and non-quantifiable. Among measures which do have an effect on 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 have an effect on the poverty ratio.