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INTRODUCTION

According to EU rules on the coordination of budgetary policies the Member States of the European Union must annually submit updated stability and convergence programmes (members of the eurozone and the Member States who are not using the euro, respectively). Estonia is a full member of the European Economic and Monetary Union (EMO) since 1 January 2012 and submits its Stability Programme to the European Commission and the Council of the European Union for the tenth time.

Current Stability Programme 2020 is conducted by the Ministry of Finance of Estonia. The programme is based on the Supplementary Budget 2020, that was adopted by the Parliament on 16. April 2020. For the year 2021 this is a no-policy-change Programme and is based on the Spring Forecast of the Ministry of Finance and the Supplementary Budget 2020 measures, if they have multi-annual fiscal impact.

The Programme consists of three parts, providing an overview of fiscal response to the COVID-19 outbreak, the economic situation and future prospects and the fiscal framework.

1. BUDGETARY POLICY RESPONSE TO THE COVID-19 OUTBREAK

The Parilament has adopted the Supplementary Budget 2020 with the focus to quickly support Estonian workers and entrepreneurs and to alleviate the economic recession caused by the coronavirus outbreak. The aim is to support those people and businesses that are most affected by the current difficulties. The Government is going to have a look at the medium term plans in autumn along with making the Draft 2021 Budget.

To support businesses, the Ministry of Economic Affairs and Communications provides assistance in the supplementary budget through KredEx SA. This will help to alleviate the economic difficulties caused by the spread of the coronavirus. KredEx's packages have been developed in accordance with various possible scenarios of the crisis and with the aim of helping to prevent or mitigate liquidity problems of businesses. KredEx will offer loan guarantees, working capital loans and investment loans. Small enterprises and the tourism sector will be supported separately through Enterprise Estonia. In the field of the Ministry of Economic Affairs and Communications, additional funds will also be directed to road construction and the construction of the last mile of high-speed internet connection. 300 million euros will be directed for capital injections to the strategic companies; the transport sector will be supported separately.

In order to support employment, 250 million euros will be directed to a measure through the Estonian Unemployment Insurance Fund, which will help maintain the income of employees during the emergency situation.

To help the medical system, the Health Insurance Fund is provided with funds to compensate for the first three days of illness. In addition, the medical system will receive an additional 206 million to cover the cost of extra workload in hospitals, ambulances and other exceptional expenditure related to the coronavirus outbreak.

Tax and excise concessions reduce costs and alleviate deadlines and interest rates. In order to alleviate transport and household costs, the government will lower excise duty rates on several fuels for two years, from 1 May this year to 30 April 2022.

The Tax and Customs Board disregards interest on the tax debt in March and April. In addition, the interest rate calculated on the tax debt will be reduced from today's 0.06 per cent to 0.03 per cent per day and the tax administrator will be given the right to reduce the interest to zero during the rescheduling period. The state pays the advance social tax of the first quarter for self-employed persons. In order to alleviate the tax burden on employers, the requirement of a minimum social tax liability will be abolished for three months.

The state will suspend pension payments to the second pillar, that are made at the expense of social tax from 1 July this year until 31 August 2021. In October 2020, everyone who has joined the mandatory funded pension, will be able to decide whether to waive their contribution as well. To do this, an application must be submitted in October. There is a compensation mechanism for people who decide to continue their contributions.

Local governments will receive a financial support of 100 million euros for investments and to cover other expenditure. For example, to repair roads, improve the energy efficiency of buildings needed to provide local services, demolish unnecessary buildings etc. In addition, 30 million euros will be provided to local governments to alleviate the effects of the coronavirus crisis. To a greater extent, the renovation of residential buildings will also be started through KredEx.

Rural life is supported through loans from the Rural Development Foundation in the amount of 200 million euros. The budget for support for the agricultural producer replacement service will be increased.

In the field of education and science, 4 million euros will be provided to support research and development activities related to COVID-19, including investments in the third level biolab of the University of Tartu. In addition, private schools, kindergartens, hobby education, etc. are supported to cover expenses.

The size of the crisis package in the field of culture and sport is 25 million euros. The package is divided into two: income support for natural persons in the field of culture and sport, and partial compensation for costs already incurred and unavoidable fixed costs in the case of cancelled cultural and sports events.

The state also helps to support the churches and ministers of religion in the supplementary budget whose activities have been severely disrupted during the crisis, but who continue to provide assistance to people.

The nominal deficit of the general government, together with the economic support measures of the government, will be 2.62 billion euros this year. The impact of the measures on the nominal general government budgetary position is 1.15 billion euros. According to the supplementary budget, reduction in the state budget revenues is 1.63 billion compared to this year's budget. The impact of the supplementary budget measures on the expenditure of the current state budget totals 513 million. In addition to the measures, the supplementary budget also includes an increase of the reserve of the Government of the Republic by 150 million euros, and the establishment of a targeted reserve of 80 million euros to cover the costs of COVID-19.

Table 1. 2020 Supplementary Budget revenue and expenditure measures for 2020–2021

	2020*	2021*
	EUR million	*EUR million*
Ministry of Finance / Estonian Tax and Customs Board	**-168,2**	**216,0**
Reduction of the interest rate on tax arrears rescheduling up to 100% instead of 50%	-141,0	215,0
Suspension of calculation of interest on tax debt for two months	-2,0	2,0
Reduction of tax interest from 0,06% to 0,03%	-5,0	0,0
The state pays the advance payment of social tax for self-employed persons for the first quarter of 2020	-3,3	3,3
Temporary cancellation of social tax minimum for employers for three months	-6,0	6,0
Reduction of fuel excise duties (diesel, liquid gas, natural gas, electricity)	-76,6	-57,9
Forest sales income tax credit	-0,5	-5,1
VAT reduced rate for digital publications	-0,8	-0,8
Temporary suspension of contributions to the second pillar pension funds	142,0	-21,5
Local government support measure	-75,0	75,0
Ministry of Education and Science	**-19,0**	**19,0**
Private schools, private interest education, private kindergartens, private childcare	-15,0	15,0
Construction of the third level biolab of the University of Tartu	-4,0	4,0
Ministry of Culture	**-25,0**	**25,0**
State support measure for culture and sports, including partial compensation of direct costs of canceled events	-25,0	25,0
Ministry of Economic Affairs and Communications/ Kredex and	**-385,9**	**96,4**

Enterprise Estonia (EAS)		
Support scheme for passenger ships	-3,7	-4,0
Exemption of waterway charges for ships entering the port for 1 year	-13,5	9,0
Reimbursement of 75% of all types of port dues for passenger ships by 2020	-20,0	20,0
Support purchases of shares in strategic companies or capital expansion of state-owned companies	-17,0	17,0
Demolition of abandoned houses	-5,0	5,0
Renovation support measure for apartment buildings and private houses via Kredex	-100,0	100,0
Reconstruction of local government and Road Administration roads	-20,0	0,0
Based on EAS activities, design a micro and small business measure through capital injections	-10,0	10,0
Based on EAS activities, support measure in the tourism sector (grant scheme)	-25,0	25,0
Last mile support for sparsely populated areas	-15,0	15,0
Loan guarantees for bank loans already issued in order to allow for repayment schedule adjustments (Kredex)	-103,5	-69,5
Operating loan (Kredex)	-48,4	-28,2
Investment loan (Kredex)	-4,8	-2,9
Ministry of Social Affairs (Employment Insurance Fund/Health Insurance Fund)	**-267,8**	**267,8**
Unemployment Insurance Fund measure for labor market support within 2 months (wage support measure)	-250,0	250,0
State reimbursement of sick days for workers from the first to the third day of sickness insurance (currently without pay) from March to May 2020	-7,1	7,1
Additional funds for Social Insurance Board to provide care certificate for parents of children with special educational needs	-10,0	10,0
Automatic extension of ability to work and severity of disability assessment	-0,7	0,7
Ministry of Rural Affairs/ Rural Development Foundation (MES)	**-47,5**	**35,5**
Loan guarantees for bank loans already issued, increase of the guarantee reserve and reduction of guarantee fees (MES)	-17,0	15,0
Operating and investment loans for companies (MES)	-30,0	20,0
Arable land sale and lease-back transactions (finance lease) (MES)	0,0	0,0
Replacement service for farmers	-0,5	0,5
Ministry of the Interior	**-2,0**	**2,0**
Support measure for churches and congregations	-2,0	2,0
State Government	**-230,0**	**230,0**
COVID-19 reserve	-80,0	80,0
Increase of the government reserve	-150,0	150,0

Source: Ministry of Finance, Statistics Estonia.

Table 2. Impact of fiscal policy decisions on general government revenue and expenditure

	2019	2020*	2021*
	% of GDP	*% of GDP*	*% of GDP*
General government revenue forecast (no policy change)	38,7	40,1	38,8
Revenue policy measures	0,0	-1,0	-0,2
General government expenditure forecast (no policy change)	39,0	45,8	41,8
Expenditure measures	0,0	3,5	0,6

Source: Ministry of Finance, Statistics Estonia.

2. ESTONIAN ECONOMIC DEVELOPMENT AND OUTLOOK

2.1. Forecast assumptions

The basis for every forecast are the assumptions, including the economic developments of our export partners, commodity prices and the eurozone inflation. In the current phase of pandemics fixing the assumptions is nearly impossible, as every day brings a new situation and new political and bahavioural decisions. The forecast originates from the estimate of conjuncture as of 31. March 2020.

As the Government relief measures will soften the impact of corona crisis on the economy, the actual economic developments could be more positive as being forecast currently. We have assumed that emergency situation with the restrictive measures on the economy will last till the end of May and thereafter gradual pickup in economic activity will begin. The pace of recovery differs among economic sectors, but in the aggregate reaching about 90% level of nominal GDP growth trend is assumed (for which annual growth rate was around 5% according to previous forecast).

Table 3. Most important foreign assumptions of the forecast (%)

	Assumptions in the Ministry's forecast for spring 2020			European Commission		
	2019	2020*	2021*	2019	2020*	2021*
1. Euribor, 3 months (annual average)	-0,4	-0,4	-0,4	-0,4	-0,4	-0,4
2. Eurozone's long-term interest rate (annual average)	-0,2	-0,3	-0,1	-0,2	-0,4	-0,3
3. USD/EUR exchange rate (annual average)	1,12	1,11	1,11	1,12	1,09	1,09
4. Nominal effective exchange rate	0,0	-0,3	0,0	-	-	-
5. World GDP growth (excluding EU)	-	-	-	3,1	-1,9	4,4
8. World import growth (excluding EU)	-	-	-	0,0	-8,3	4,7
9. Oil prices (Brent, USD/barrel)	64,3	36,3	40,0	64,1	39,0	40,2

Sources: Historical data was obtained from Eurostat, Eesti Pank, the U.S. Energy Information Administration (EIA); forecasts are based on the European Commission (COM), Consensus Economics (CF), IMF and NYMEX Brent futures, if possible, which have been adjusted according to the most recent developments and the expert opinions of the Ministry of Finance.

The public finance forecast is based on the macroeconomic forecast and additionally takes into account the fiscal impact of measures decided in the 2020 Supplementary Budget. For 2021, it is a no-policy-change forecast.

2.2. Economic forecast

Estonian economy has been in a good shape in recent years in terms of labour market, growing income and export performance. Economic growth has surprised positively, reaching 5% on average in real terms during past three years. There should not be any considerable internal imbalances in Estonian economy despite the fast growth rate. Without any external shocks, economic growth could be around 2.5% in coming years. Taking into account recent pandemics and mobility and other restrictions related to this, economic recession cannot be avoided in 2020. For compensating this temporary and extraordinary downturn, growth rates of output can be more rapid than assumed before, in particular during the recovery phase.

Unlike previous crisis, this downturn has both **demand and supply side factors**. Supply side of the economy will suffer from the interruption of global supply chains and the absence of employees. Demand side will be affected by physical restrictions set for consumption and higher savings coming from the cautiousness of consumers. As the share of foreign trade in Estonian economy is bigger compared to most EU countries, then there will be bigger impact on the economy via this channel compared to others.

From **economic sectors** tourism and other recreational activities of residents will be most affected. Production is obstructed by supply difficulties of inputs as well as the drop in foreign demand. If the containment measures of the crisis will be implemented in a couple of months, this might not have a noticeable impact on construction. However, if many companies will struggle with economic difficulties and the downturn will be longer lasting in our export markets, then investments are expected to decline markedly as well, from which construction forms an important part. If the corona crisis will linger, the income of residents will remain lower than expected and the asset prices could decline, resulting in suppressed housing investments.

Labour market will inevitably receive a strong setback, as the sales of personal services and retail trade related sectors has shrunk. In a situation of declining sales, companies have to cut work force. As there is no information on how long the restrictions regarding the virus spread are being applied, companies are facing the dilemma, weather to cut the hours worked temporarily and wait for the assumed recovery or to terminate the work agreements instantly. So, in coming months significant decline in the number of employed persons and the increase in unemployment can be expected. However, the support measures for companies could relieve markedly this situation.

From the domestic demand components, **private consumption** will receive the biggest setback, while compulsory expenditures on basic goods and housing services are the main expenditure items currently. The consumption of recreational services, semi-durable and durable goods consist about one third from the consumer basket and their purchases are significantly restrained. As a result, earlier forecast 3% growth of private consumption can be replaced with 12% decline. The impact of the crisis on **investments** will be felt with a delay and assuming that the crisis remains short-lived, will be more modest.

Foreign trade showed signs of weakness already in the end of last year, but currently double digit decline in exports should be considered in 2020, especially in services exports. If the depression remains short-lived and world output should pick up quickly, then bulk of the decline will be reclaimed next year. In Q2, owing to slump in travel and transport services, services exports should decline by around 40%.

In terms of steep decline in demand and very low crude oil prices, **consumer prices inflation** will slow down markedly, reaching 0,6% this year. In addition to oil prices, energy prices will be affected by the decline in electricity stock prices, resulting from warm winter and weaker usage. Administrative measures are having a negative impact on consumer prices. Considering the recovery of economic activity and the low comparison base, consumer price inflation will pick up to around 2% in 2021. Tax measures planned in the supplementary budget, like the decline in excise duties of diesel fuel, natural gas and electricity, will lower the consumer prices by 0,5pp from May 2020.

Table 4. Gross Domestic Product forecast for 2020–2021 (%)

	2019 level	2019	2020*	2021*
1. Real GDP growth	24653	4,3	-8,0	8,0
2. Nominal GDP growth	28037	7,7	-7,6	10,5
Sources of growth				
3. Private consumption expenditure (incl. NPISH)		3,1	-11,3	9,1
4. Final consumption expenditure of general government		2,9	0,3	0,1
5. Gross fixed capital formation		13,1	-5,7	5,6
6. Changes in inventories (% of GDP)		2,0	-0,9	1,8
7. Export of goods and services		4,9	-12,3	12,0
8. Import of goods and services		3,7	-14,4	12,8
Contribution to GDP growth[1]				
9. Domestic demand (excluding inventories)		5,2	-7,0	5,7
10. Changes in inventories		-0,3	-2,3	1,7
11. Balance of goods and services		1,0	0,9	0,2
Value added growth				
12. Primary sector		23,0	-19,3	16,6
13. Manufacturing		-1,9	-7,8	7,0
14. Construction		-2,8	-5,3	2,6
15. Other services		5,8	-7,4	7,9

1) Contribution to GDP growth indicates the proportions of specific sectors in economic growth. This is calculated by multiplying growth in the area by its proportion in GDP. The sum of the contributions of different sectors amounts to economic growth (the slight difference can be attributed to a statistical error -the part of GDP that cannot be divided between the sectors).
Source: Ministry of Finance, Statistics Estonia.

Table 5. Prices' forecast for 2019–2021 (%)

	2019	2019	2020*	2021*
	2010=100	*%*	*%*	*%*
1. GDP deflator	135,0	3,2	0,4	2,3
2. Private consumption deflator	125,7	2,5	0,4	2,3
3. Harmonised consumer price index	125,6	2,3	0,5	2,2
3a. Consumer price index	122,0	2,3	0,6	2,1
4. General government consumption expenditure deflator	154,0	6,1	4,2	2,4
5. Investment deflator	123,2	4,1	-0,2	-1,5
6. Export deflator	114,0	0,4	-0,3	1,5
7. Import deflator	108,6	0,7	-0,3	1,3

Source: Ministry of Finance, Statistics Estonia

3. FISCAL FRAMEWORK

3.1. Budgetary position of the general government

In 2019, the general government budget was in a deficit, which amounted to 90 million euros, i.e. 0.3% of GDP according to initial data from Statistics Estonia. The central government and local governments were in a deficit (0.5% and 0.1% of GDP accordingly), which was partly offset by a surplus from social security funds (0.3% of GDP). The central government deficit was mainly caused by the social expenditure. However, the result of social security funds exceeded expectations both in terms of the Health Insurance Fund and the Unemployment Insurance Fund; this was caused by better than expected collection of social tax and unemployment insurance premium.

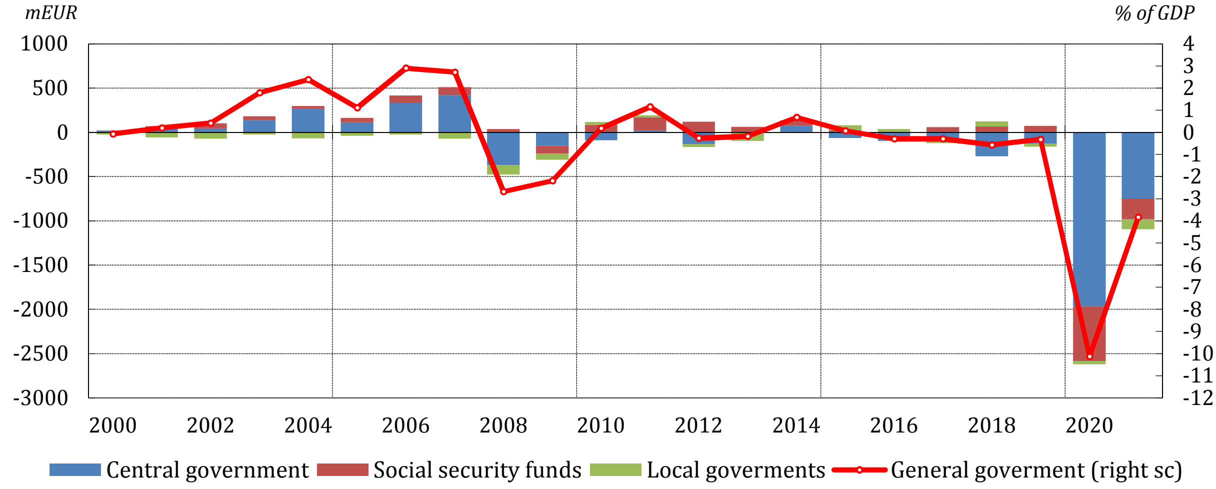
The budget deficit of 2020 is forecast to be 10.1% of GDP, while the state budget targeted a balance. The deficit is mainly caused by lower tax revenue, which affects all government sectors. The tax revenue forecast has been reduced by more than 1.5 billion euros and the biggest drop comes from excise duties (mostly fuel, -31% compared to the budget), personal income tax (-17%), social tax and VAT (-15%). From the expenditure side the biggest growth comes from Health Insurance Fund and from Unemployment Insuranse Fund. The state budget expenditure is much less affected by COVID-19. Investments and operational costs are not expected to change notably and social expenditure like pensions are indexed with last year figures. In 2021, the general government budget deficit is expected to decrease to 3.8% of GDP.

Table 6. Budgetary position of the general government for 2019–2021

	2019	2020*	2021*
Structurally adjusted budgetary position of general government (% of GDP)	**-1.9**	**-5.2**	**-0.8**
Budgetary position of general government (% of GDP)	**-0.3**	**-10.1**	**-3.8**
State budget	-0.7	-6.1	-1.7
Other central government	0.2	-1.5	-0.9
Social security funds	0.3	-2.4	-0.8
Local governments	-0.1	-0.1	-0.4
Budgetary position of general government (EUR million)	**-90**	**-2'620**	**-1'095**
State budget	-189	-1'582	-477
Other central government	58	-383	-271
Social security funds	72	-621	-233
Local governments	-31	-34	-113

Source: Statistics Estonia, Ministry of Finance.

Figure 1. Budgetary position of the general government



Source: Statistics Estonia, Ministry of Finance.

The general government covers public sector entities that are financed mainly via mandatory payments made by entities belonging to other sectors, and whose main activity is the redistribution of national income (so-called non-market producers). The general government in Estonia consists of three sectors: the central government, local governments and social security funds.

General government cyclically adjusted budgetary position

Taking account of the change of EU grants Estonian **budget policy is procyclical in 2021**. Budget policy tightens but output gap is below potential (Table 7).

Table 7. Cyclically adjusted budgetary position, 2019–2021 (% of GDP)

	2019	2020*	2021*
1. Real GDP growth (%)	4,3	-8,0	8,0
2. Budgetary position of the general government	-0,3	-10,1	-3,8
3. Interest payments	0,0	0,1	0,1
4. Potential real GDP growth (%)**	3,5	3,3	3,1
5. Output gap	3,4	-10,2	-6,3
6. Cyclical budget component	1,7	-5,0	-3,1
7. Cyclically adjusted budgetary position (7)=(2)-(6)	-2,0	-5,2	-0,8
8. Cyclically adjusted primary position (8)=(7)+(3)	-2,0	-5,2	-0,8

*** Estimation of Summer 2019 Forecast*
Source: Ministry of Finance, Statistics Estonia.

General government structurally adjusted budgetary position

In 2019–2021 the only one-off measure is merger support for local governments 0,1% of GDP in 2019 (Table 15). The merger was supported in 2017–2019 in sum of 65 million EUR. The costs of this reform are temporary, significant and have positive impact on revenue in long term.

Table 8. One-off measures and their impact, 2019–2021 (EUR million)

	2019	2020*	2021*
Merger support for local governments	-21,4		
Total, EUR million	**-21,4**	**0**	**0**
Total, % of GDP	**-0,1**	**0**	**0**

Source: Ministry of Finance.

Table 9. Structurally adjusted budgetary position, 2019–2021 (% of GDP)

	2019	**2020***	**2021***
1. Cyclically adjusted budgetary position	-2,0	-5,2	-0,8
2. One-off measures	-0,1	0,0	0,0
3. Structurally adjusted budgetary position (3)=(1)-(2)	-1,9	-5,2	-0,8

Source: Ministry of Finance, Statistics Estonia.

3.2. General government revenue and expenditure

Table 10. General government revenue and expenditure, 2019–2021

	2019	2019	2020*	2021*
	EUR million	*% of GDP*	*% of GDP*	*% of GDP*
Budgetary positions by general government levels				
1. General government	-90,4	-0,3	-10,1	-3,8
2. Central government	-131,0	-0,5	-7,6	-2,6
4. Local governments	-31,1	-0,1	-0,1	-0,4
5. Social security funds	71,7	0,3	-2,4	-0,8
General government				
6. Total revenue	10 848,6	38,7	39,2	38,7
7. Total expenditure	10 939,0	39,0	49,3	42,5
8. Budgetary position	-90,4	-0,3	-10,1	-3,8
9. Interest expenditure	10,2	0,0	0,1	0,1
10. Primary balance	-80,2	-0,3	-10,1	-3,7
11. One-off and temporary measures	-21,4	-0,1	0,0	0,0
Revenue by components				
12. Tax revenue (12=12a+12b+12c)	5 982,5	21,3	20,3	20,2
12a. Taxes on production and imports	3 941,8	14,1	13,3	13,1
12b. Taxes on income and wealth	2 040,7	7,3	7,0	7,1
12c. Capital taxes	0	0,0	0,0	0,0
13. Social security contributions	3 329,4	11,9	12,2	12,4
14. Property income	244,1	0,9	0,8	0,6
15. Other revenue	1 292,7	4,6	6,0	5,4
16.=6. Total revenue	10 848,6	38,7	39,2	38,7
p.m.: Tax burden (D.2 (incl. taxes to the EU)+D.5+D.611+D.91-D.995)	9 297,7	33,2	32,4	32,6
Expenditure by components				
17. Benefits to employees + intermediate consumption	5 033,9	18,0	20,7	18,3
17a. Benefits to employees	3 216,5	11,5	13,5	11,9
17b. Intermediate consumption	1 817,4	6,5	7,1	6,4
18. Social transfers (18=18a+18b)	3 772,5	13,5	16,6	14,4
of this, unemployment benefits	132,8	0,5	1,2	0,7
18a. Non-monetary social transfers	541,8	1,9	3,1	1,7
18b. Monetary social transfers	3 230,7	11,5	13,5	12,7
19.=9. Interest expenditure	10,2	0,0	0,1	0,1
20. Subsidies	112,4	0,4	0,4	0,4
21. Gross capital formation	1 374,1	4,9	6,3	5,8
22. Capital transfers	158,2	0,6	0,8	0,4
23. Other expenditure	477,7	1,7	4,5	3,2
24.=7. Total expenditure	10 939,0	39,0	49,3	42,5
p.m. General government consumption	5 578,7	19,9	22,5	20,9

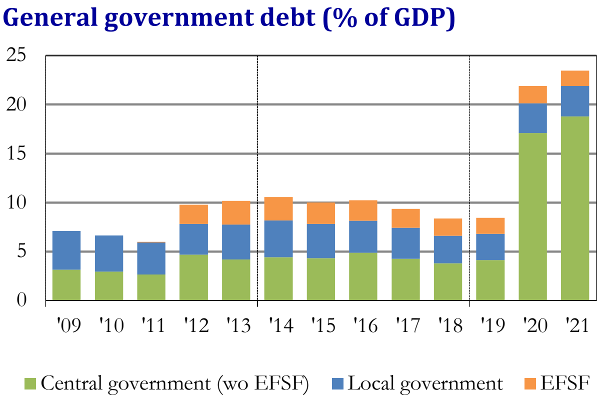
Source: Ministry of Finance, Statistics Estonia.

3.3. General government debt

The main goal of Estonia's fiscal policy since the restoration of independence has been to keep the budgetary position of the general government over the medium term in balance or, if possible, in a surplus, which has been expressed in the low debt burden of the state. The general government debt of Estonia at the end of 2019 amounted to 8,4% of GDP, which is 0,1% more than in 2018. The main reason for the minor increase in the debt ratio, was the nominal increase in the State Treasury debt. Last year, the debt of public law agencies and foundations included in the central government decreased nominally. The central government debt (including the funds received from the EFSF)[1] comprised 1'608 million euros and the debt of local governments 752 million euros[2] of the total general government debt of 2'360 million euros; the share of external debt in total debt was 70%. Without the funds of the EFSF, which amounted to 452 million euros in 2019, the central government debt was 1 156 million euros, i.e. 4,1% of GDP.

This year, the debt burden of the general government can be expected to increase to 21,9% of GDP. The debt increases nominally at both central and local government levels compared to 2019. The debt burden is projected to increase to 23,4% of GDP next year. The negative cash flow of the State Treasury in 2020 and 2021 will be funded mainly by new loans, t-bills and bonds. The deficit of local governments will be covered by external funds as the nominal amount of their debt increase, the debt burden is slightly higher reaching 3,1% of GDP.

Figure 2. Development of debt burden, 2009–2021



Source: Ministry of Finance, Statistics Estonia

[1] The European Financial Stability Facility (EFSF), i.e., the temporary crisis resolution mechanism for countries in the euro area, which was created in June 2010 and no longer issues financial aid, and which was the precursor to the European Stability Mechanism (ESM) – the current financial institution of the euro area.

[2] Consolidated figure at the level of the general government