Recommendation for a

COUNCIL RECOMMENDATION

on the 2019 National Reform Programme of Estonia and delivering a Council opinion on the 2019 Stability Programme of Estonia

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[[1]](#footnote-1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Estonia as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the recommendation on the economic policy of the euro area (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Estonia should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendation (3) below. In particular, measures focusing economic policy related to investment in the specified areas will help address the second euro area recommendation as regards supporting investment.

(3) The 2019 country report for Estonia[[2]](#footnote-2) was published on 27 February 2019. It assessed Estonia’s progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and Estonia's progress towards its national Europe 2020 targets.

(4) On 30 May 2019, Estonia submitted its 2019 National Reform Programme and, on 30 April 2019, its 2019 Stability Programme.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[[3]](#footnote-3), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance[[4]](#footnote-4).

(6) Estonia is currently in the preventive arm of the Stability and Growth Pact. The 2019 Stability Programme was submitted on a no-policy-change basis. The government plans to move from a general government deficit of 0.6% of GDP in 2018 to a deficit of 0.2% of GDP in 2019, 0.3% of GDP in 2020 and register a deficit of 0.7% of GDP by 2022. Based on the recalculated structural balance[[5]](#footnote-5), the medium-term budgetary objective, set at a deficit of 0.5% of GDP in structural terms, is not planned to be achieved over the period covered by the 2019 Stability Programme. The general government debt-to-GDP ratio is projected to decline to 5.3% of GDP by 2022. The macroeconomic scenario underpinning those budgetary projections is favourable. The measures needed to support the planned deficit targets have not been specified posing a risk to the revenue yield assumptions.

(7) On 13 July 2018, the Council recommended Estonia to ensure that the nominal growth rate of net primary government expenditure[[6]](#footnote-6) does not exceed 4.1% in 2019, corresponding to an annual structural adjustment of 0.6% of GDP. In view of the Commission autumn 2018 forecast, which projected a closer position to the medium term budgetary objective in 2019, and consistent with the rules for unfreezing the required adjustment, the nominal growth rate of net primary government expenditure should not exceed 4.9%, corresponding to an annual structural adjustment of 0.3% in 2019. Based on the Commission 2019 spring forecast, there is a risk of significant deviation from that requirement in 2019.

(8) In 2020, in view of Estonia's projected output gap of 2.7% of GDP and with projected GDP growth below to the estimated potential growth rate, the nominal growth rate of net primary government expenditure should not exceed 4.1%, in line with the structural adjustment of 0.6% of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of significant deviation from that requirement in 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact.

(9) Preventing money laundering has become a priority for Estonia against the background of large money-laundering scandals. Estonia has strengthened its anti-money laundering framework and the proportion of non-resident deposits in the Estonian banking sector has significantly decreased. However, challenges remain. While the Estonian government introduced additional measures and guidelines on how to further strengthen the prevention in this area, a legislative initiative aiming at increasing the capacities of the anti-money laundering supervision has not yet been adopted by the Estonian Parliament. Attention should be paid to the effective implementation of these measures, once adopted.

(10) Skills shortages and mismatches are among the main obstacles to business investment and limit greater productivity gains. In recent years, Estonia has implemented comprehensive reforms but labour market trends and the decrease in the working-age population present long-term challenges to the education and training system. These challenges include a still high rate of early school leaving, incomplete reorganisation of the school network; the insufficient labour market relevance of higher education and vocational education and training; and the challenges linked to the ageing of teachers and the low attractiveness of the profession. Although participation in adult learning is improving, the upskilling and reskilling of the workforce is not occurring fast enough to keep up with labour market trends. The insufficient capacity to innovate is at the centre of the identified skills needs. In spite of the high percentage of information and communication technology specialists, there is limited digital skills training provided by enterprises. Improving the labour market relevance of the education and training system, including by investing in career guidance, tackling early school leaving and better anticipating skills needs, would help ensure that people are equipped with the rights skills. In addition, enhancing the working conditions of teachers, the quality of teaching and the education policies in response to demographic and economic trends would strengthen the capacity of the education and training system.

(11) Despite improvements, poverty, social exclusion and income inequality remain high, particularly among older people. Around 42% of those aged 65 and above were at risk of poverty and social exclusion in 2017 compared to the European Union average of 15%. Social benefits are still not effective in reducing poverty and the social safety net is weak. The provision of good quality and affordable social services is hampered by the weak coordination between the health and social care services and by the wide variation in municipalities' ability to identify the needs for social services and deliver them. Individuals also have to cover a large part of the costs of the services provided by the authorities. Estonia’s public spending on long-term care was less than half of the EU average (0.6% of GDP compared with 1.6% of GDP in 2016). There are no preventive measures or a support system to alleviate the burden on informal carers. The proportion of people with unmet medical needs remains one of the highest in the EU (11.7%) indicating problems with the accessibility and effectiveness of the health care system. These challenges point to the need to deliver affordable and good quality social and health care services in an integrated way and to develop a comprehensive long-term care framework. Investments supporting social inclusion, including in social infrastructure, would foster inclusive growth.

(12) The gender pay gap at 25.6% in 2017 remains among the highest in the Union and is slightly wider than the previous year.Moreover,the impact of parenthood on women’s employment is well above the Union average (25.2 and 9.0% respectively). Long parental leaves often lead to slower career progression for women. Women tend to work in lower-paid economic sectors and occupations even though their education level is higher than men's. Recent measures added flexibility to the parental leave and benefit system with a view to facilitating parents’ return to the labour market. The use of childcare has been improving. However, factors such as economic activity, occupation, age, job experience or working time explain only part of the gender pay gap, leaving an unexplained gap of 20% against the EU average of 11.5%. Pay transparency could help to better understand the reasons behind this high gender wage gap. Continued investment in childcare and active labour market measures would help women’s employment. Furthermore, engaging with the social partners and strengthening their capacity remain important in a broader context.

(13) As a peripheral country with a low population density, a well-functioning and interconnected transport system is key for Estonia’s economic activities and exports. Estonia’s transport infrastructure faces some shortcomings in terms of connectivity and sustainability. Rail and intermodal transport remain underdeveloped. Moreover, greenhouse gas emissions from road transport have increased the last 5 years. Further innovative and sustainable solutions could help address congestion and public transport-related problems. Synchronising Estonia’s electricity system with the continental European network is key to ensuring security of electricity supply in the entire Baltic region. Investment in infrastructure would help improve the competitiveness of the Estonian companies.

(14) With low levels of investment in research and development, especially from the private sector, Estonia’s productivity has been lagging behind. While in 2017 public expenditure on research and development was slightly below the EU average, business investment was only 0.61% of GDP — about half the EU average. There is a low proportion of companies, in particular among small and medium-sized enterprises, reporting research and innovation activities. Non-research and development innovation expenditure is declining and the collaboration between science and businesses is weak. Some of these factors are dragging down the country's innovation performance and productivity. More targeted investment in research, development and innovation, including in the digitalisation and automation of firms would increase Estonia’s productivity and competitiveness. Better prioritisation of research topics in areas of relevance for the economy would do likewise. The Estonian authorities have designed and implemented several measures to address the shortcomings in the research and innovation system but their impact remains limited to date.

(15) Challenges in the areas of resource and energy efficiency remain. Estonia’s eco-innovation performance does not fully reflect the country’s potential, and its composite eco-innovation score of 60 is 40% below the EU average. Despite some improvements in recent years, Estonia performs about three times below the EU average in terms of resource productivity and the gap with the rest of the EU is widening. Only a small proportion of Estonian small and medium-sized enterprises are taking actions to improve their resource efficiency and become greener. Furthermore, the economy is highly energy intensive, with energy consumption levels well above the EU average. All Estonian regions are lagging behind in improving resource and energy efficiency. At 0.4%, Estonia is well below its national targets of 10% share of renewable energy in transport. Fostering resource and energy efficiency, in particular in the buildings sector, and supporting the circular economy, including by increasing investment, would further contribute to a more competitive and sustainable economy.

(16) Insolvency procedures in Estonia take around three years and the recovery rate is slightly above 40%. This traps labour and financial resources in less productive firms. It undermines incentives to invest and provide financing to firms. Reforming the insolvency framework would be important with a view to shorten the duration of insolvency proceedings and increase the recovery rate for creditors. In particular, this could include encouraging the use of pre- and post- insolvency restructuring proceedings and preventing piece-meal liquidation of companies.

(17) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report[[7]](#footnote-7). This would allow Estonia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

(18) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Estonia’s economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Estonia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Estonia, but also their compliance with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion[[8]](#footnote-8) is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that Estonia take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP. Ensure effective supervision and the enforcement of the anti-money laundering framework.

2. Address skills shortages and foster innovation by improving the capacity and labour market relevance of the education and training system. Improve the adequacy of the social safety net and access to affordable and integrated social services. Take measures to reduce the gender pay gap, including by improving wage transparency.

3. Focus investment-related economic policy on sustainable transport and energy infrastructure, including interconnections, on fostering research and innovation, and on resource and energy efficiency, taking into account regional disparities.

Done at Brussels,

 For the Council

 The President

1. OJ L 209, 2.8.1997, p. 1. [↑](#footnote-ref-1)
2. SWD(2019) 1005 final. [↑](#footnote-ref-2)
3. Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320). [↑](#footnote-ref-3)
4. COM(2014) 494 final. [↑](#footnote-ref-4)
5. Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology. [↑](#footnote-ref-5)
6. Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out. [↑](#footnote-ref-6)
7. SWD(2019) 1005 final. [↑](#footnote-ref-7)
8. Under Article 5(2) of Council Regulation (EC) No 1466/97. [↑](#footnote-ref-8)