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REPORT FROM THE COMMISSION

Estonia

Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union

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1. INTRODUCTION

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Data notified by the Estonian authorities on 31 March 2020 and subsequently validated by Eurostat[1] show that the general government deficit in Estonia reached 0.3% of GDP in 2019, while general government gross debt stood at 8.4% of GDP. According to the 2020 Stability Programme, Estonia plans a deficit of 10.1% of GDP in 2020, while debt is planned at 21.9% of GDP.

The planned deficit for 2020 provides *prima facie* evidence of the existence of an excessive deficit as defined by the Stability and Growth Pact.

Against this background, the Commission has therefore prepared this report, which analyses Estonia's compliance with the deficit criterion of the Treaty. The debt criterion can be considered to be met as the debt ratio is below the Treaty reference value of 60% of GDP. It takes into account all relevant factors and gives due consideration to the major economic shock linked to the COVID-19 pandemic.

[1] https://ec.europa.eu/eurostat/documents/2995521/10294648/2-22042020-AP-EN.pdf/6c8f0ef4-6221-1094-fef7-a07764b0369f

Table 1. General government deficit and debt (% of GDP)

		2016	2017	2018	2019	2020 COM	2021 COM
Deficit criterion	General government balance	-0.5	-0.8	-0.6	-0.3	8.3	3.4
Debt criterion	General government gross debt	10.2	9.3	8.4	8.4	20.7	22.6

Source: Eurostat, Commission 2020 spring forecast

2. DEFICIT CRITERION

Based on the plans in the 2020 Stability Programme, Estonia's general government deficit in 2020 is expected to reach 10.1% of GDP, above and not close to the Treaty reference value of 3% of GDP. The sharply rising deficit reflects the planned stimulus of 4.3% of GDP and the effects of the economic crisis.

The planned excess over the Treaty reference value in 2020 is exceptional, as it results from a severe economic downturn. Taking into account the impact of the COVID-19 pandemic, the Commission spring 2020 forecast projects a contraction of real GDP in 2020 by 6.9%.

The planned excess over the 3% of GDP reference value is not temporary based on the Commission 2020 spring forecast, which projects the deficit to remain above the reference value in 2021.

In sum, the planned deficit for 2020 is above and not close to the 3%-of-GDP Treaty reference value. The planned excess is considered to be exceptional but not temporary as defined by the Treaty and the Stability and Growth Pact. Hence, the analysis suggests that *prima facie* the deficit criterion as defined by the Treaty and Regulation (EC) No 1467/97 is not fulfilled based on the Commission 2019 spring forecast and the Stability Programme.

3. RELEVANT FACTORS

Article 126(3) of the Treaty provides that, if a Member State does not fulfil the requirements under one or both of those criteria, the Commission has to prepare a report. That report must also "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Those factors are further clarified in Article 2(3) of Regulation (EC) No 1467/97, which also provides that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission" need to be given due consideration.

In the current situation, a key additional factor to take into consideration regarding 2020 is the economic impact of the COVID-19 pandemic, which has a very substantial impact on the budgetary situation and results in a highly uncertain outlook. The pandemic has also led to the activation of the general escape clause.

3.1. COVID-19 pandemic

The COVID-19 pandemic has led to a major economic shock that is having a significant negative impact throughout the European Union. The consequences for GDP growth will depend on the duration of both the pandemic and of the measures taken by national authorities and at European and global level to slow its spread, protect production capacities and support aggregate demand. Countries have already adopted or are adopting budgetary measures to increase the capacity of health systems and provide relief to those individuals and sectors that are particularly affected. Significant liquidity support measures and other guarantees have also been adopted. Subject to more detailed information, the competent statistical authorities are to examine whether those measures entail an immediate impact on the general government balance or not. Together with the fall in economic activity, those measures will contribute to substantially higher government deficit and debt positions.

3.2 Medium-term economic position

Based on the Commission 2020 spring forecast, Estonia's real GDP is projected to decline by about 7%, followed by a rapid recovery in 2021. In addition to the shock on domestic demand, exports are expected to suffer amid declining foreign demand. The unemployment rate is projected to exceed 9% in 2020, up from 4.4% in 2019.

The Stability Programme's macroeconomic forecast notes high uncertainty regarding the duration of the pandemic and uncertainty of its economic impact. The programme projects GDP to contract by 8% in 2020, but to recover in 2021, under the assumptions that the emergency situation will last until the end of May 2020 and that thereafter a gradual pickup in economic activity will begin. The sharp drop in GDP is a mitigating factor in the assessment of Estonia's compliance with the deficit criterion in 2020.

3.3 Medium-term budgetary position

Estonia was recommended on 13 July 2018 to ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2019 ('the expenditure benchmark'), corresponding to a structural adjustment of 0.6% of GDP[2]. Based on outturn data and the Commission forecast, expenditure growth exceeded that benchmark, with a deviation of 1.7% of GDP in 2019, thus pointing to a significant deviation. The conclusion is also confirmed for 2018-2019 taken together. The structural balance stayed unchanged in

[2] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Estonia and delivering a Council opinion on the 2018 Stability Programme of Estonia (OJ C 320, 10.9.2018, p. 24).

2019, thus pointing to some deviation of 0.3% of GDP in 2019, while pointing to significant deviation over 2018-2019 taken together. The overall assessment points to significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.

The Stability Programme projects that the deficit of 10.1% of GDP in 2020 will decline in 2021, when the economy is expected to recover and most of the budgetary measures expire. The structural fiscal position is projected to improve from a deficit of 5.2% in 2020 to a deficit 0.8% of GDP in 2021[3]. The Stability Programme provides information on substantial measures to contain the pandemic and to support the economy. It estimates the budgetary impact of these direct support measures at 4.3% of GDP in 2020. The medium-term fiscal outlook remains subject to high uncertainty.

3.4 Other factors put forward by the Member State

On 12 May 2020, the Estonian authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities.

4. CONCLUSIONS

According to the Stability Programme, Estonia's general government deficit in 2020 is planned to increase to 10.1% of GDP, above and not close to the 3% of GDP Treaty reference value. The planned excess over the reference value is considered to be exceptional but not temporary.

In line with the Treaty and the Stability and Growth Pact, this report also examined relevant factors.

Overall, since the planned deficit is well above 3% of GDP,the excess is not temporary and taking into account all relevant factors, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

[3] As calculated by the Estonian authorities.