

**FISCAL COUNCIL OF ESTONIA
REPORT FOR 2021**

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CHAIRMAN'S FOREWORD

How can we monitor whether the management of state finances complies with the fiscal rules if those rules have temporarily been suspended? How can we approve official economic forecasts when the surrounding economic environment appears unforecastable? How can we assess the long-term fiscal targets of the government without knowing when and in what form the rules will start to apply again? It is under these circumstances that the Fiscal Council has had to do its main work for the past two years now.

For the second consecutive spring the positive observation can be made that the budgetary position proved eventually stronger than was assumed in the forecasts made during the year. Even so, the spending by the state exceeded its revenues in 2021 and by a larger amount than we were used to seeing before the pandemic. Unfortunately though, the challenges to the state finances did not end in 2021, and nor as the pandemic faded.

A year ago the Fiscal Council considered that the Estonian economy would perform better in the coming years than was assumed in the spring forecast of that time. This proved the case for 2021, as growth in the economy reached 8% by the end of the year. In autumn though we considered that growth could prove slower in the coming years than was predicted in the summer forecast of the Ministry of Finance. This is now proving the case in 2022, as the latest forecasts show growth in the Estonian economy stalling. We were of course not able to foresee all of the factors that have caused growth to slow.

As this foreword is written in spring 2022, we are in the middle of another serious challenge impacting the state finances. Firstly, inflation has jumped from its target of 2% to an unexpected double digit rate. Secondly, Estonia's eastern neighbour has started a war that is only a thousand kilometres away from us.

Faster inflation than expected will inevitably slow growth in the economy, but it will have an immediate impact on the state finances in two ways. One is that investment by the state will become more expensive, while the other is that higher prices will lead to higher tax revenues from consumption. How much of the impact of inflation should be eased by state support measures is a political decision.

The war in Ukraine has led to a rapid rethink about the need to spend on Estonia's defence. The target so far has been to keep defence spending at 2% of GDP at least, but in the changed security climate this is no longer considered sufficient. Permanently enhanced defence capacity is not a one-off expense though, like the support measures for the pandemic or for energy prices were, but it assumes further expenditures each year.

The state cannot endlessly take on new spending, however justified they are, or give up sources of revenues without that affecting the sustainability of public finances. The key message of the Fiscal Council in spring 2022 is that permanent additional revenues, not loans, must be found to cover permanent additional expenditures. The escape clause does not exempt us from a responsible fiscal policy.

Under the current uncertain circumstances, it is certain at least that Estonia will exit the years of crisis with a much larger government debt and that today's interest rates can only move upwards. Paying off the debt accumulated during the crisis, not simply replacing it with new debt, needs fiscal surpluses to be built up. The observation of a year ago unfortunately needs to be repeated here, that there is no sign under current forecasts of budget balance being achieved.

Chairman of the Fiscal Council
Raul Eamets
Tallinn, 30 April 2022

1. BRIEF INTRODUCTION TO THE FISCAL COUNCIL

The Fiscal Council of Estonia is an independent advisory council established in 2014 under the State Budget Act, whose function is to give opinions on the macroeconomic and fiscal forecasts on which Estonia's fiscal policy is based and to observe compliance with national fiscal rules. European Union law makes mandatory for members of the euro area to establish a fiscal council that performs similar functions. In Estonia, the legal basis for the establishment of the Fiscal Council and its functions is the State Budget Act adopted on 19 February 2014¹. The statutes of the Fiscal Council were approved at the meeting of the Supervisory Board of Eesti Pank held on 9 April 2014². Information is exchanged between the Fiscal Council and the Ministry of Finance under a cooperation agreement signed in February 2018 and reviewed in spring 2021³.

The Fiscal Council gives its opinion as follows:

- in April on the spring economic and fiscal forecast of the Ministry of Finance;
- in April on the achievement of the target for the structural budget position in the previous year and on the budgetary targets set out in the stability programme for subsequent years;
- in September on the summer economic and fiscal forecast of the Ministry of Finance and on the budgetary targets set out in the state budget strategy for subsequent years.

Beyond the opinions required by law, the Fiscal Council is independent in planning its work and may at its own initiative publish opinions or research on the Estonian economy or fiscal policy. The opinions of the Fiscal Council and accompanying press releases, opinion pieces and occasional papers are published in Estonian and English on the website of the Fiscal Council at www.eelarvenoukogu.ee.

The Fiscal Council has six members and is led by the Chair and the Vice Chair (see Table 1). The first members of the Fiscal Council were appointed to office on 14 May 2014. Members of the Fiscal Council are appointed at the proposal of the Governor of Eesti Pank and are confirmed in office for five years by the Eesti Pank Supervisory Board. On 26 March 2019 the current composition of the Fiscal Council was confirmed for a second five-year term of office.

Table 1. Members of the Fiscal Council in 2021

Raul Eamets	Chair	Dean of the Faculty of Social Sciences of the University of Tartu, Professor of Macroeconomics
Andrus Alber	Vice Chair	CEO of Finora Capital
Ülo Kaasik	Member	Deputy Governor of Eesti Pank
Martti Randveer	Member	Head of Economics and Research Department of Eesti Pank
Urmas Varblane	Member	Professor of International Business at the University of Tartu
Andres Võrk	Member	Analyst at the Johan Skytte Institute of Political Studies at the University of Tartu

Members of the Fiscal Council are expected to have an unblemished reputation, a Master's degree or equivalent in economics, and experience that will help the Fiscal Council in its work. Members of the Fiscal Council may not have a job or other position that could affect the independence of the Council in its work. The work of the Fiscal Council is funded by Eesti Pank. Two economists from Eesti Pank support the work of the Council, one of them in the role of secretary to the Council. The Fiscal Council gets help from Eesti Pank in editing and translating its publications, administering its website and other organisational issues.

¹ <https://www.riigiteataja.ee/en/eli/ee/504072014004/consolide/current>

² <https://eelarvenoukogu.ee/about-the-council/statutes>

³ <https://eelarvenoukogu.ee/news/the-fiscal-council-and-the-ministry-of-finance-have-signed-a-cooperation-agreement>

2. ACTIVITY OVERVIEW

Meetings and opinions of the Fiscal Council

The statutes of the Fiscal Council require it to meet whenever necessary, but at least five times a year. The Fiscal Council met five times in 2021, and four of the meetings were held online. All of the meetings were attended by all of the members of the Fiscal Council.

13 April

At its first meeting in 2021, the Fiscal Council set out its position on the spring economic forecast 2021 of the Ministry of Finance, and the structural fiscal position for 2020. The council considered that the spring forecast was an appropriate base for planning fiscal policy.

The opinion of the Fiscal Council on the spring forecast 2021 of the Ministry of Finance was published on 16 April (see the summary of the opinion in Appendix 1). The opinion of the Fiscal Council on the achievement of the target for the public sector structural budget position in 2020 was published on 22 April (see the summary of the opinion in Appendix 2).

28 April

At its second meeting of the year, the Fiscal Council discussed its opinion on the targets for the structural budget position set in the state budget strategy. The council found that there was no reason for the budget deficit to exceed the 3% limit from 2022.

The opinion of the Fiscal Council on the targets for the structural budget position 2022-2025 was published on 29 April (see the summary of the opinion in Appendix 3).

7 June

At its third meeting of the year, the Fiscal Council agreed its opinion on the analysis of the macroeconomic impact of the Estonian recovery programme. The concerns of the Fiscal Council were mainly connected to the economic forecast risks, not to the methodological toolkit used in the impact analysis.

The opinion of the Fiscal Council on the analysis of the macroeconomic impact of the recovery programme was published on 15 June and it was included in full in the Estonian recovery programme that was passed in autumn 2021⁴.

15 September

At its fourth meeting of the year, the Fiscal Council discussed its opinion on the summer forecast 2021 of the Ministry of Finance. The council approved the forecast with reservations and recommended that the government assume slower growth in the economy when writing the state budget for 2022.

The opinion of the Fiscal Council on the summer forecast of the Ministry of Finance was published on 23 September (see the summary of the opinion in Appendix 4).

6 December

The main topic at the fifth meeting of the Fiscal Council was the procedure of endorsing economic forecasts and the analysis and presentation of risks in the forecasts.

⁴ See more: <https://eelarvenoukogu.ee/news/the-fiscal-council-has-assessed-the-macroeconomic-impact-analysis-of-the-rrf>

Other meetings and presentations

26 January

Fiscal Council analyst Lauri Punga attended a meeting organised by the European Commission between the network of EU Independent Fiscal Institutions and the alternate members of the Economic and Financial Committee (EFC-A) of the Member States. The main topic of the meeting was the operation of national fiscal rules during the pandemic.

27 January

Vice Chair of the Fiscal Council Andrus Alber attended a meeting of the network of EU Independent Fiscal Institutions that approved the leadership of the network and agreed the principles for communication and membership of the network.

3 February

Staff from the Ministry of Finance presented to the Fiscal Council the changes agreed with the European Commission to the methodology for assessing the Estonian output gap. The main change was that the early years were removed from the time series for production capacity utilisation, making the approach similar to that in Latvia and Lithuania.

26 February

Analysts from the Fiscal Council attended the annual conference organised by the European Fiscal Board. The conference focused on public debt, looking at how big the debt burden had become during the pandemic, how large the earlier forecast errors for public debt were, and what the role of fiscal councils could be in assessing the sustainability of the debt.

3 March

Chair of the Fiscal Council Raul Eamets met staff from Fitch rating agency to discuss the current position and the outlook for the Estonian economy and public finances.

11 March

Fiscal Council analyst Lauri Punga attended the 14th meeting of the European Union Network of Independent Fiscal Institutions (EUNIFI) organised by the European Commission. The meeting discussed the Stability and Growth Pact, the role of the media in the effectiveness of fiscal rules, and the current state of preparation of the national recovery programmes.

25 March

Vice Chair of the Fiscal Council Andrus Alber attended a meeting of the network of EU Independent Fiscal Institutions that reviewed the recent activities of the network and its upcoming meetings, considered the contribution of fiscal councils to the preparation of the national recovery programmes, and discussed the network's possible contribution to the review of the European Union's fiscal rules.

31 March

Staff from the Ministry of Finance presented the spring macroeconomic and fiscal forecast 2021 of the ministry to the Fiscal Council.

20 April

Chair of the Fiscal Council Raul Eamets attended a meeting of the Finance Committee of the Riigikogu to present the opinion of the Fiscal Council on the spring economic forecast 2021 of the Ministry of Finance.

29 April

Chair of the Fiscal Council Raul Eamets attended a meeting of the government cabinet of the Republic of Estonia to present the opinion of the Fiscal Council on the targets for the general government structural budget position before the state budget strategy was approved.

3 May

Chair of the Fiscal Council Raul Eamets attended a meeting of the State Budget Control Select Committee of the Riigikogu to present the opinion of the Fiscal Council on the spring economic forecast of the Ministry of Finance and the budgetary targets set in the state budget strategy.

4 May

Chair of the Fiscal Council Raul Eamets attended a meeting of the supervisory board of Eesti Pank to present the opinions of the Fiscal Council published in spring and the 2020 report on the activities of the council.

6 May

Vice Chair of the Fiscal Council Andrus Alber met the IMF Article IV delegation in Tallinn to discuss the Estonian economy and public finances.

10 May

Chair of the Fiscal Council Raul Eamets met a delegation from the OECD that was compiling a report with recommendations for economic policy in Estonia. The meeting discussed the state of the Estonian economy and public finances.

3 June

Fiscal Council analyst Ricardo Vicente attended a seminar on green budgeting organised by the network of EU Independent Fiscal Institutions, at which presentations were made by delegations from Denmark, Switzerland and the OECD on their experience of including climate impact in forecasts.

10 June

Fiscal Council analyst Ricardo Vicente attended a seminar on green budgeting organised by the European Commission, at which presentations were made by delegations from France, Italy, Denmark and the Netherlands on their experience of including climate impact in forecasts.

21 June

Vice Chair of the Fiscal Council Andrus Alber attended a meeting of the network of EU Independent Fiscal Institutions that discussed changes to the website of the network, a review of the cooperation agreement between the network and the CEPS think tank in Brussels, and support from the European Commission for developing the analytical capacity of fiscal councils.

2 July

Chair of the Fiscal Council Raul Eamets attended a meeting of the network of EU Independent Fiscal Institutions that discussed the written positions of the network on the review of the European Union's fiscal rules.

6 July

Analysts from the Fiscal Council attended a meeting where the European Fiscal Board presented its opinions on the economic policy positions and recommendations published in the spring by the European Commission.

7 September

Staff from the Ministry of Finance presented the summer macroeconomic and fiscal forecast 2021 of the ministry to the Fiscal Council.

22 September

Chair of the Fiscal Council Raul Eamets attended a seminar organised by the European Commission on analysing the sustainability of public debt.

23 September

Chair of the Fiscal Council Raul Eamets attended the 15th meeting of the EU Network of Independent Fiscal Institutions (EUNIFI) organised by the European Commission. The European Commission gave a review at the meeting of its spring policy recommendations and the European Fiscal Board presented its recent assessment of the appropriate fiscal stance for the euro area in 2022.

27 September

Chair of the Fiscal Council Raul Eamets attended a meeting of the Finance Committee of the Riigikogu to present the opinion of the Fiscal Council on the summer economic forecast 2021 of the Ministry of Finance. Members of the Fiscal Council also met the Ministry of Finance to clarify in greater detail how the forecast opinion was arrived at on this occasion.

28 September

Chair of the Fiscal Council Raul Eamets attended a meeting of the government cabinet of the Republic of Estonia to present the opinion of the Fiscal Council on the summer economic forecast 2021 of the Ministry of Finance.

30 September

Vice Chair of the Fiscal Council Andrus Alber attended a meeting of the network of EU Independent Fiscal Institutions that approved the extension of the cooperation agreement with CEPS, heard a review of the activities of the working groups of the network, and discussed a working paper by the network on fiscal rules.

12 October

Chair of the Fiscal Council Raul Eamets attended a meeting of the supervisory board of Eesti Pank to discuss the opinion of the Fiscal Council on the summer economic forecast 2021 of the Ministry of Finance and the upcoming activities of the council.

5 November

Fiscal Council analyst Lauri Punga attended the annual meeting organised by the OECD for parliamentary budget officials and independent fiscal institutions, which discussed the OECD's peer review assessments of fiscal councils and the need for development, using the examples of Finland, Latvia and Ireland, and the experiences of fiscal councils in analysing forecast errors.

16 November

Member of the Fiscal Council Andres Võrk and analyst Ricardo Vicente attended a seminar organised by the European Commission at which fiscal councils were shown the methodology for assessing the output gap that is officially used by the European Commission and by the member states of the European Union.

25 November

Chair of the Fiscal Council Raul Eamets met a delegation from the OECD to discuss the OECD report on the state of the Estonian economy and the recommendations for economic policy.

29 November

Analysts from the Fiscal Council attended a discussion of the network of EU Independent Fiscal Institutions that heard about the work so far and the future plans of reviewing the fiscal rules of the European Union.

2 and 9 December

The European Commission organised a two-day seminar for fiscal councils as part of the review of the European Union's fiscal rules, to focus on possible changes to the overall architecture of the fiscal rules and the role of fiscal councils. Analysts from the Fiscal Council attended the seminar.

Media communications

27 January

Chair of the Fiscal Council Raul Eamets was interviewed by the main national television news.

5 February

Chair of the Fiscal Council Raul Eamets appeared on a news programme on Vikerraadio radio station.

16 April

Chair of the Fiscal Council Raul Eamets was interviewed by Kuku radio station.

31 May

Chair of the Fiscal Council Raul Eamets was interviewed by the national television news.

3 June

Chair of the Fiscal Council Raul Eamets appeared on a programme Reporteritund on national television.

7 June

Chair of the Fiscal Council Raul Eamets was interviewed by the national television news.

23 September

Chair of the Fiscal Council Raul Eamets was interviewed by the main national television news and Kuku radio station.

1 October

Chair of the Fiscal Council Raul Eamets appeared on a news programme on Vikerraadio radio station.

3. BUDGET

The Fiscal Council works on a budget that is drawn up annually and approved by the Governor of Eesti Pank. The work of the Fiscal Council is paid for by Eesti Pank on the principle that the resources given to the Council should be sufficient to let it do its work independently⁵. Table 2 presents a review of the expenses of the Fiscal Council in 2021⁶.

Table 2. Expenses of the Fiscal Council in 2021 (euros)

Remuneration of members	69 939
Business travel	0
Seminars and events	0
Other expenses	865
Total expenses	70 804

Actual expenses for 2021 were 84% of the amount budgeted. Expenses on business travel and seminars were lower than expected, as the spread of Covid-19 and the restrictions because of it meant that meetings were mostly held online. Remuneration of members accounted for around 99% of the expenses of the Fiscal Council, and other expenses for 1%.

The budget planned for the Fiscal Council for 2022 is 88,200 euros (see Figure 1). The budget was prepared with the assumption that normal work and travel will return in 2022 and the number of business trips will in consequence be similar to what it was in 2019 before the pandemic. The remuneration of the members of the Fiscal Council is calculated by indexing in accordance with the Salaries of Higher State Servants Act. Since 2020, the Fiscal Council also contributes financially to the work of the secretariat of the network of EU Independent Fiscal Institutions.

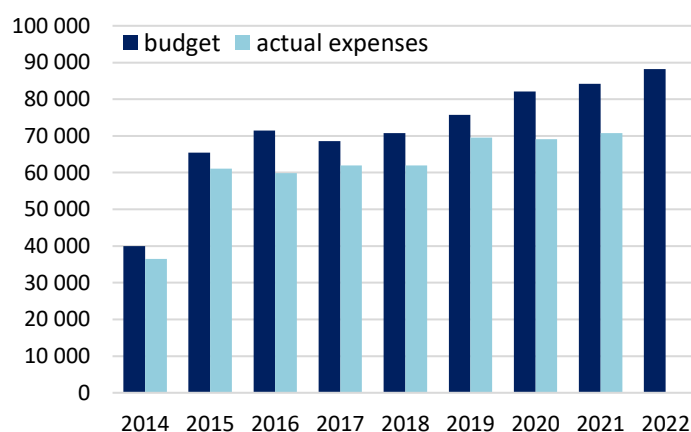


Figure 1. Budget and actual expenses of the Fiscal Council (euros)

⁵ The government of Estonia compensates the direct expenses of the Fiscal Council paid for by Eesti Pank at the request of Eesti Pank. The central bank has not yet made use of this right.

⁶ Table 2 does not contain the costs of the pay of the Eesti Pank economists working to support the Fiscal Council.

APPENDIX 1. Opinion on the spring forecast 2021 of the Ministry of Finance

Opinion

The decline in the Estonian economy and the fiscal deficit in Estonia were both smaller than expected last year. Assuming there is no third wave of Covid-19 and consequent restrictions on economic activity, the spring economic forecast of the Ministry of Finance expects the economy to grow by 2.5% in 2021 and 4.8% in 2022.

The Fiscal Council finds that the economic environment in the years ahead may even be better than forecast. With support from the savings built up earlier and the money withdrawn from the second pension pillar, growth in private consumption could prove faster in the years ahead than is assumed in the spring forecast. Furthermore, the earlier forecasts of the Ministry of Finance have repeatedly underestimated the growth in wages. In consequence receipts of both consumption taxes and labour taxes could be better in future than is forecast. There may also be a bigger boost to economic growth than expected from investment driven by large-scale fiscal transfers.

The government will use the spring economic forecast of the Ministry of Finance as the basis for its draft budget for 2022 and the state budget strategy for 2022-2025. The Fiscal Council considers the forecast of the ministry to be a suitable basis for this.

The spring forecast expects the general government nominal budget deficit to be 6% of GDP in 2021 and then to start narrowing, but considers it will not yet have reached balance by the end of the forecast horizon in 2025. The outlook for the state finances is still better than it was in the autumn. The Covid-19 crisis has had less of an impact on the economy than was feared, and the forecast this time takes account of the pension reform, which will increase tax revenues in the state budget.

The Fiscal Council finds it reasonable that the spring forecast no longer takes account of the spending cuts of around one billion euros that were announced when the previous state budget strategy was drawn up last autumn. Corrections to the fiscal position that are not accompanied by actual measures should be avoided in future.

As it is forecast that the Estonian economy will return in 2022 to its level from before the pandemic, the Fiscal Council recommends that the fiscal rules should start to apply again from next year. This means that the nominal deficit should not exceed 3% of GDP in 2022 and the structural deficit should start to be reduced year by year.

⁷ The Fiscal Council's opinion and a more thorough explanatory report can be found [here](#).

APPENDIX 2. Opinion on the achievement of the structural budget position target in 2020

Opinion

Besides assessing the official economic forecasts of the state, it is also the task of the Fiscal Council to monitor compliance with the national fiscal rules. To do this the Fiscal Council assesses in the spring whether the structural budget position of the general government for the past year met the targets set for it, and the fiscal rules more broadly. For the first time in the history of the Fiscal Council and the State Budget Act, the general escape clause was activated in 2020 because of the outbreak of the Covid-19 crisis, and the requirement to meet numerical limits in setting fiscal policy was temporarily suspended. The escape clause will remain in place until at least 2021.

Unfortunately the budget position of the Estonian general government was not in structural balance before the pandemic, and so larger fiscal buffers were not built up against the crisis. The larger structural deficit than permitted in 2018 caused the correction mechanism contained in the fiscal rules to be engaged, which required the structural fiscal deficit to be steadily reduced, and the government wanted in consequence to return to close to structural balance in 2021.

This was at least the government's plan in autumn 2019 when the state budget for the next year was first drafted. The state budget for 2020 was drafted so that the nominal budget position of the general government would be in balance, and the structural budget deficit would narrow to 0.7% of GDP.

It became apparent though in spring 2020 that the goal of reducing the structural deficit was not achieved in 2019, and that the coronavirus crisis meant it would not be achieved in 2020 either. The escape clause in the fiscal rules was engaged when the Covid-19 crisis erupted and the Estonian government no longer set a numerical target for the size of the budget deficit in 2020, as budgetary forecasts made in spring and summer were surrounded by great uncertainty. The more pessimistic spring forecast of the Ministry of Finance suggested that the nominal budget deficit of the general government in 2020 could reach 10% of GDP, and the structural deficit could be 5% of GDP.

The Fiscal Council finds that it was reasonable in 2020 to apply the escape clause and to abandon the earlier numerical budgetary targets in order to ease the economic impact of the coronavirus pandemic.

The recession and the budget deficit in 2020 turned out smaller than forecast during the year by the Ministry of Finance. Statistics Estonia put the nominal budget deficit of the general government for 2020 at 1.3 billion euros, or 4.8% of GDP. The assessment by the Ministry of Finance finds that this gives a structural budget deficit of 3.6% of GDP.

The budget for 2020 was knocked out of balance by the reduction in revenues and increase in expenditures. The state budget for 2020 expected that general government revenues and expenses would be 11.5 billion euros, but revenues proved some 600 million euros smaller than this and expenses 700 million euros larger. The Ministry of Finance estimates that the cost to the budget of the state support measures to help the economy in 2020 were 2.8% of GDP. The support measures have continued in 2021.

The state took on both short-term and long-term debt liabilities to fund this unprecedentedly large budget deficit, and by the end of 2020 the general government debt was at its highest ever level at 18.2% of GDP.

⁸ The Fiscal Council's opinion and a more thorough explanatory report can be found [here](#).

APPENDIX 3. Opinion on the targets for the structural budget position for 2022-2025

Opinion

The government has used the spring economic forecast 2021 of the Ministry of Finance as the basis for its state budget strategy for 2022-2025. It is the responsibility of the Fiscal Council to assess the budgetary targets set in the budget strategy, starting from the fiscal rules and the need to improve the budget position. The European Union introduced an escape clause for the fiscal rules in spring 2020, which still applies.

The Ministry of Finance estimates that the budget deficit of the general government will reach 1.7 billion euros, or 6% of GDP in 2021. The state budget strategy plans that the deficit will start to narrow from 2022, but balance will not yet have been reached by 2025 when the forecast horizon ends. Financing the budget deficit will increase the general government debt burden to 28% of GDP.

The government's aim in its budget strategy is to reduce the budget deficit of the coming years to below what was forecast in the spring. Additional revenues and expenditure cuts are planned in order to achieve this, together with a reduction in public sector investment. The state budget strategy puts the general government's nominal deficit at 3.8% of GDP in 2022 and 3.2% of GDP in 2023.

Under the fiscal rules of the European Union, the budget deficit may not exceed 3% of GDP under normal circumstances. As the spring forecast of the Ministry of Finance finds that the Estonian economy will have returned to its pre-crisis level from next year, the Fiscal Council finds that there is no longer any reason for the budget deficit to exceed the 3% limit from 2022.

In consequence the Fiscal Council recommends that when the state budget for 2022 is drafted in the autumn, the general government budget deficit should be reduced by at least 220-230 million euros from the current forecast. The budget deficit can be reduced by increasing revenues or reducing expenditures or both.

In its assessment of the spring forecast of the Ministry of Finance, the Fiscal Council found that growth in the economy in the years ahead could prove even faster than expected. This is because of the money paid out from the second pension pillar and the consequent increase in private consumption, and because of wages rising faster than forecast. This will mean that tax revenues may be higher than expected. If this positive growth scenario occurs, the Fiscal Council recommends that the additional tax revenues should be used not for additional expenditures, but for returning faster to budget balance.

⁹ The Fiscal Council's opinion and a more thorough explanatory report can be found [here](#).

APPENDIX 4. Opinion on the summer forecast 2021 of the Ministry of Finance

Opinion

The Estonian economy has recovered better than expected from the Covid-19 pandemic, and the summer forecast 2021 of the Ministry of Finance expects the economy to grow by 9.5% this year and 4% next year. The slow decline in the spread of Covid-19 means it is still difficult to make a reliable economic forecast and forecast errors may be higher than usual.

The Fiscal Council finds that the economy may grow more slowly than forecast in 2021–2022. This is mainly because the expectations for a rapid recovery in the economy due to vaccination in Estonia and the rest of the world may not be realised, and the improvement in the supply chains of production inputs and consumer goods may take longer than expected. For this reason the Fiscal Council recommends that the preparation of the state budget for 2022 should also take into account the risk scenario in the macro forecast of the Ministry of Finance, which foresees a sharper slowdown in economic growth next year.

The summer forecast of the Ministry of Finance expects the nominal and structural budget position of the general government to be close to balance by the end of the forecast horizon in 2025. The budget deficit will start to narrow as the rapid growth in spending during the pandemic years slows next year, and it is assumed that in future the growth in general government revenues will be faster each year than the growth in spending. The Fiscal Council considers that the improvement in economic sentiment and expectations of wage rises in the public sector mean that the risk remains that the growth in expenditures will not be successfully kept so low when the next budgetary plans are prepared. In addition, the planning for expenditures has taken no account of accelerated inflation.

The Ministry of Finance estimates that the Estonian economy will already be running at above its pre-pandemic level this year in both current and constant prices, and that the output gap will close. While it is hard to estimate how the pandemic has affected the growth potential of the economy, the Estonian economy could soon show signs of overheating. The Ministry of Finance's spring forecast expected that the Estonian output gap would only close by 2025.

The improved outlook for the economy and the state finances means that the government should set more demanding budgetary targets than those that were in the State Budget Strategy in the spring. The Fiscal Council considers that it is no longer justified to apply the escape clause of the fiscal rules from next year given the Estonian circumstances, even though it continues to apply in the European Union. Even the earlier recommendation of the Fiscal Council to follow the fiscal deficit requirement of 3% of GDP in planning the state budget for 2022 is no longer ambitious enough.

As tax revenues recover and the state support measures end, the general government budget deficit will decrease in the years ahead, though fiscal policy will remain supportive. The summer forecast of the Ministry of Finance puts the general government nominal budget deficit for the next four years at a total of around one billion euros. The Fiscal Council considers that the Estonian economy does not need any additional fiscal support beyond this by increasing the deficit any further. An additional boost will be given to economic growth in the years ahead by increased fiscal transfers from abroad, which are considered neutral in terms of the budgetary position. Stimulating the economy further at a point where it is already operating at its capacity, or even temporarily beyond it, could in the short term reduce the purchasing power of consumers and in the long term hurt the competitiveness of Estonian companies.

¹⁰ The Fiscal Council's opinion and a more thorough explanatory report can be found [here](#).