

**FISCAL COUNCIL OF ESTONIA
REPORT FOR 2022**

April 2023

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CHAIRMAN'S FOREWORD

The year 2022 was in many ways similar to the previous two years for public finances, as the fiscal rules remained suspended, there was extreme uncertainty around economic forecasts, a supplementary budget was passed in the spring that increased spending, society continued to expect support measures from the state, and the actual budget deficit eventually proved smaller than had been expected.

There were also important differences however. Estonia had not for a long time seen such high inflation or such an immediate threat of war as it did in 2022. High inflation mainly impacted the state finances by bringing in large additional tax receipts, but the threat of war caused unavoidable extra spending on refugees, internal security and defence.

It was also the first time that the Fiscal Council decided not to endorse the economic forecast of the Ministry of Finance. We felt obliged to follow that course in autumn 2022 as we considered that the assumptions for state expenditures had not been sufficiently updated to reflect high inflation, nor that the budget policy plans announced in the summer had been accounted for. An additional scenario was appended to the summer forecast at the recommendation of the Fiscal Council. At a time when forecasting has been made more difficult than usual by external factors, it is reasonable to try to improve forecast accuracy by at least taking account of all the internal factors that are known.

The budget deficit proved much smaller in 2022 than had been forecast, as the estimate by Statistics Estonia is that expenditures exceeded revenues by only 355 million euros. This is in total about as much as the 220 million euros that covered the immediate costs of the refugees from Ukraine plus the 130 million euros for the state support measures for electricity prices. It would evidently be wrong to assume though that without those additional expenses the Estonian state budget would have been close to balance by now.

The improvement in the state finances in 2022 was only short lived and driven by factors that will not be repeated in subsequent years. The cost pressures caused by higher inflation will mainly emerge in the state finances from 2023, when indexing and government policy measures widen the fiscal deficit sharply again. The state of public finances will consequently deteriorate again before it can start to improve, as the forecast for the nominal budget deficit for 2023 is as high as 1.66 billion euros.

There was lively discussion this spring about whether the difficult state of the Estonian public finances really was an unpleasant surprise that did not show up in earlier forecasts. As the institution that regularly assesses the fiscal forecasts, we can state that the outlook for public finances has been difficult for some time by now. Difficulties would have faced whichever party became the government this spring.

The main fiscal policy measures in recent years have all either increased state spending or reduced revenues, and so nobody who looks at the state finances should be surprised to see increased divergence from budget balance. It is by now clear that the government expenditures are consistently higher than the revenues, and it will remain necessary to borrow money each year that a budget deficit is forecast. The Fiscal Council emphasised repeatedly in 2022 that if permanent additional costs are created, permanent additional revenues must be found to cover them.

The Fiscal Council welcomes the discussions that started this spring around finding new permanent sources of tax revenue and around a long-term plan to put the state finances in order. Such a course is also demanded by the fiscal rules, which will come back into force in 2024 after a pause of four years.

Chairman of the Fiscal Council
Raul Eamets
Tallinn, 28 April 2023

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.

Since 2022 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;
- in April 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;
- in September 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 chairman and the vice-chairman (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 2022

Raul Eamets	Chair	Dean of the Faculty of Social Sciences of the University of Tartu, Professor of Macroeconomics
Andrus Alber	Vice Chair	Chairman of Finora Group
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 2022, and four of the meetings were held online. Four of the five meetings were attended by all of the members of the council.

14 April

At its first meeting in 2022, the Fiscal Council set out its position on the spring economic forecast 2022 of the Ministry of Finance. The Fiscal Council found that the projection for growth in the spring forecast was justifiably conservative.

The opinion of the Fiscal Council on the spring forecast 2022 of the Ministry of Finance was published on 20 April (see the summary of the opinion in Appendix 1).

25 April

At its second meeting in 2022, the Fiscal Council set out its position on the budgetary targets for 2023-2026 set in the stability programme. The Fiscal Council found that the targets set in the spring complied with the State Budget Act.

The opinion of the Fiscal Council on the achievement of the target for the structural budget position in 2021 and on the targets in the stability programme for 2023-2026 was published on 28 April (see the summary of the opinion in Appendix 2).

31 August

At its third meeting of the year, the Fiscal Council discussed its opinion on the summer forecast 2022 of the Ministry of Finance. The Fiscal Council did not endorse the forecast of the Ministry of Finance as it did not use the most probable assumptions about general government expenditures.

The opinion of the Fiscal Council on the summer forecast 2022 was published on 6 September (see the summary of the opinion in Appendix 3).

26 September

At its fourth meeting, the Fiscal Council set out its position on the state budget strategy for 2023-2026 and the additional macroeconomic scenario contained within it. The Fiscal Council found that the budgetary targets for 2024-2026 did not comply with the fiscal rules as the target was not to reduce the budget deficit but to maintain the structural budget deficit at 2.6% of GDP. The Fiscal Council endorsed the additional scenario of the macroeconomic forecast.

The opinion of the Fiscal Council on the additional scenario of the summer forecast 2022 was published on 30 September (see the summary of the opinion in Appendix 4).

The opinion of the Fiscal Council on the targets for the structural budget position set in the state budget strategy 2023-2026 was published on 30 September (see the summary of the opinion in Appendix 5).

21 December

The main topic of the fifth meeting of the Fiscal Council was a review of the European Union fiscal rules and their possible impact on the national fiscal rules and the role of the Fiscal Council.

Other meetings and presentations

27–28 January

Fiscal Council analyst Lauri Punga attended a meeting of the network of EU Independent Fiscal Institutions that discussed issues around the organisation of the work of the network, developments around the review of the EU fiscal rules, and the budgetary impact of climate goals.

Fiscal Council analyst Lauri Punga attended a seminar organised by the IMF that discussed how the pandemic had impacted state finances and the fiscal rules.

25 February

Several members and analysts of the Fiscal Council attended the annual conference of the European Fiscal Board, which discussed the challenges for state finances posed by climate change. A representative of the network of EU Independent Fiscal Institutions presented analysis to the conference that contained a contribution from Fiscal Council analyst Ricardo Vicente.

1 March

Chair of the Fiscal Council Raul Eamets 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 contingent liabilities and state guarantees.

2 March

Chair of the Fiscal Council Raul Eamets attended the 16th meeting of the EU Network of Independent Fiscal Institutions (EUNIFI) organised by the European Commission. The European Fiscal Board presented its annual report for 2021 to the meeting, and it was discussed how national fiscal rules help support compliance with the EU fiscal rules and the form of the feedback of the fiscal councils to the review of the EU fiscal rules.

6 April

Staff from the Ministry of Finance presented the spring macroeconomic and fiscal forecast 2022 of the ministry to the Fiscal Council.

28 April

Vice Chair of the Fiscal Council Andrus Alber 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 fiscal position before the stability programme was approved.

5–6 May

Vice Chair of the Fiscal Council Andrus Alber attended the 14th annual meeting of parliamentary budget officials and independent fiscal institutions organised by the OECD in Dublin. The meeting discussed the challenges for state finances posed by climate change, assessment of the fiscal impact of policy measures, and lessons for fiscal councils in media communication.

Chair of the Fiscal Council Raul Eamets met the IMF article IV delegation at Eesti Pank to discuss the Estonian economy and state finances.

9 May

Chair of the Fiscal Council Raul Eamets attended a meeting of the Finance Committee of the Riigikogu to present the opinions of the Fiscal Council written in spring.

10–11 May

Vice Chair of the Fiscal Council Andrus Alber attended a conference on fiscal rules and a meeting of the network of EU Independent Fiscal Institutions in Paris. The meeting heard examples of the support measures taken by states faced with high inflation.

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 2022 and the 2021 report on the activities of the council.

7–8 June

Members and analysts of the Fiscal Council attended the annual meeting of the Baltic and Nordic independent fiscal institutions in Helsinki. At the meeting Chair of the Fiscal Council Raul Eamets presented a review of the recent activities of the Fiscal Council, and analyst Lauri Punga gave a presentation on state support measures during the pandemic.

15 June

Fiscal Council analyst Lauri Punga attended a seminar organised by the European Commission on one-off and temporary budgetary measures used in the calculation of structural budget balances.

16 June

Members and analysts from the Fiscal Council met staff of the Ministry of Finance to hear a review of the planned changes to the budgeting process for the Estonian state and the possible contribution of the Fiscal Council.

9 August

Chair of the Fiscal Council Raul Eamets met representatives of the Fitch rating agency at Eesti Pank to discuss the Estonian economy and state finances.

22 August

Staff from the Ministry of Finance presented the summer macroeconomic and fiscal forecast 2022 of the ministry to the Fiscal Council.

7 September

The Fiscal Council met staff of the Ministry of Finance to discuss the recent opinion of the Fiscal Council, in which the Fiscal Council did not endorse the summer forecast 2022 of the Ministry of Finance.

12 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 2022 of the Ministry of Finance.

14 September

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 summer economic forecast 2022 of the Ministry of Finance.

20–21 September

Fiscal Council analyst Lauri Punga attended the 17th meeting of the EU Network of Independent Fiscal Institutions (EUNIFI) organised by the European Commission in Brussels. The meeting discussed the minimum standards for fulfilling the tasks of a fiscal council, the assessment by the European Fiscal Board on the state of public finances in the euro area in 2023, and the impact of the pandemic on the activities of fiscal councils.

27 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 2022 of the Ministry of Finance and the targets for the structural fiscal position set in the state budget strategy 2023-2026.

11 October

Vice Chair of the Fiscal Council Andrus Alber met members of the European Commission's forecasting team for Estonia to discuss the Estonian economy and state finances.

12 October

Chair of the Fiscal Council Raul Eamets attended a meeting of the State Budget Control Select Committee of the Riigikogu, which discussed the Estonian state budget strategy for 2023–2026.

18 October

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 written in autumn 2022.

13 December

Chair of the Fiscal Council Raul Eamets attended a seminar organised by the European Commission on national fiscal frameworks. The seminar discussed budgeting at a time of variable inflation, the resilience of budgetary targets to fluctuations in the economic cycle over the medium term, and ways of developing the capacity of fiscal councils.

Media communications

14 February

Chair of the Fiscal Council Raul Eamets was interviewed by the radio station Vikerraadio about high inflation.

17 April

Chair of the Fiscal Council Raul Eamets was interviewed by the television programme AK Nädal about high inflation.

3 May

Chair of the Fiscal Council Raul Eamets appeared on a news programme on Vikerraadio radio station, which discussed the supplementary budget for 2022 and high inflation.

12 May

Chair of the Fiscal Council Raul Eamets appeared on the radio programme Reporteritund, which discussed high inflation.

31 May

Chair of the Fiscal Council Raul Eamets gave a comment piece to the national broadcaster ERR on the latest statistics for inflation and economic growth.

1 September

Chair of the Fiscal Council Raul Eamets appeared on the Postimees radio programme Riigipirukas, which discussed the causes of high inflation and the general outlook for the Estonian economy.

6 September

Chair of the Fiscal Council Raul Eamets gave an interview to Vikerraadio on the summer 2022 economic forecast of the Ministry of Finance.

7 September

Chair of the Fiscal Council Raul Eamets gave an interview to the television news programme Aktuaalne Kaamera on the summer 2022 economic forecast of the Ministry of Finance.

29 September

Vice Chair of the Fiscal Council Andrus Alber gave an interview to Vikerraadio on the state budget 2023 and the state budget strategy 2023-2026.

3. BUDGET

The Fiscal Council works on a budget that is drawn up annually and approved by the governor of Eesti Pank. The activities of the Fiscal Council are financed by Eesti Pank from its budget on the principle that the funds allocated must be sufficient for the Fiscal Council to be able to perform its functions independently⁴. Table 2 presents a review of the expenses of the Fiscal Council in 2022⁵.

Table 2. Expenses of the Fiscal Council in 2022 (euros)

Remuneration of members	74,375
Business trips	4,330
Seminars and events	745
Other expenses	340
Total expenses	79,790

Actual expenses for 2022 were 90% of the amount budgeted. Expenses on business travel and seminars were lower than expected in 2022, as several of the regular meetings of the EU independent fiscal institutions were held either entirely online or with the option of online participation.

The budget planned for the Fiscal Council for 2023 is 101,900 euros (see Figure 1). The budget is planned larger than in 2022 as the Fiscal Council will be hosting the meeting of the Baltic and Nordic independent fiscal institutions in Tallinn in summer 2023. The remuneration of the members of the Fiscal Council is calculated by indexing in accordance with the Salaries of Higher State Servants Act.

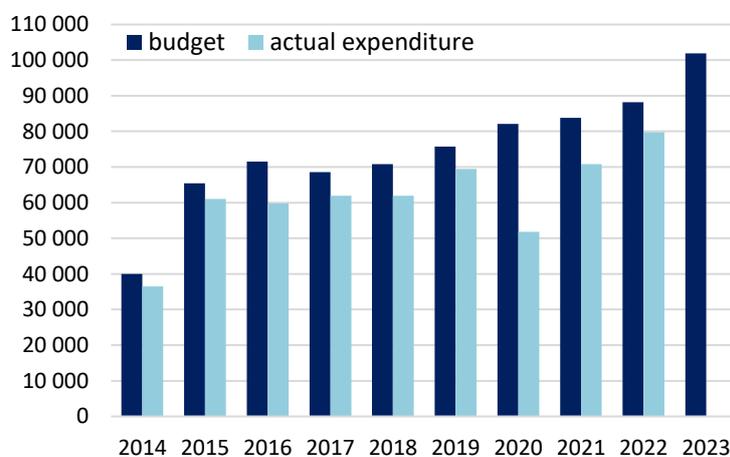


Figure 1. Budget and actual expenditure of the Fiscal Council (euros)

⁴ 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.

⁵ 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 2022 of the Ministry of Finance

Opinion

Russia's military invasion of Ukraine has made the economic environment very uncertain and forecasting extraordinarily difficult, which is also reflected in the outlook for Estonian public finances. Costs have increased unavoidably for defence and refugee-related spending. Spending is also affected by high inflation, which may lead to some investment being postponed or even cut.

Last year the Estonian economy grew rapidly as it recovered from the Covid-19 pandemic, but this year growth is forecast to stall. The Ministry of Finance is more cautious than other forecasters, projecting a decline of 1% in the economy in 2022 and growth of 1.2% in 2023. The Fiscal Council considers that the projection for growth in the spring forecast is justifiably conservative. The forecast figures for the outer years are even more uncertain than usual.

The outlook for growth in the Estonian economy in the near term is weaker than forecast last autumn because of the side-effects of the war and the high inflation. The Ministry of Finance forecasts that the consumer basket will rise by almost 13% in price in 2022, but the upwards pressure on prices may not stop there. The Fiscal Council sees that the biggest threat to economic growth comes from the uncertainty surrounding prices of commodities on global markets, and from supply-side limits and the general uncertainty about private and public-sector investment. The Fiscal Council also doubts the assumption in the spring forecast that EU funds will be used most intensively in the next few years.

Given the existing risks and the general geopolitical uncertainty, the Fiscal Council considers that the spring 2022 economic forecast of the Ministry of Finance gives a sufficiently reliable picture of the near-term outlook for the Estonian economy.

The outlook for the public finances has deteriorated substantially in the spring forecast. Higher energy prices and a changed security climate have caused unexpected additional costs to the government's spending plans. At the same time, the forecast for state revenues is weaker, assuming a weaker labour market and lower private consumption. In total this points to larger budget deficits than were earlier forecast, an additional need to borrow, and a higher level of general government debt.

The Estonian government is also drawing up an extraordinary supplementary budget in spring 2022, and the spending in it could be 600-800 million euros. The supplementary budget had not yet been passed when the spring forecast was written, and so its impact is not covered in the macroeconomic or fiscal outlooks of the Ministry of Finance. It is also currently difficult to estimate the size of refugee-related spending or their possible contribution to state tax revenues.

The spring forecast is the basis for a stability programme in which the government sets the fiscal targets for the next four years. It is not yet clear in spring 2022 when and in what form the fiscal rules will start to apply again. The Fiscal Council considers it important that the state finances be managed responsibly even when fiscal rules are temporarily suspended. This means that temporary additional expenditures should be fully justified and permanent additional expenditure should be covered by permanent additional revenues. Otherwise there is a danger of a permanent shift in the structure of general government revenues and expenditures and of that combining with high inflation to make the Estonian economy less competitive.

⁶ The Fiscal Council's opinion and a more thorough explanatory report can be found [here](#).

APPENDIX 2. Opinion on the achievement of the general government structural budget position target in 2021 and on the targets for 2023-2026

Opinion

Together with preparing the supplementary budget for 2022, the government has set its targets for the budgetary position for the next four years. Although the budget strategy will be prepared in the autumn, the targets set now are important for coordinating the fiscal policies of the EU member states. Any long-term projection made this spring is understandably very uncertain, making it harder to set fiscal targets.

Estimates by the Ministry of Finance put the structural budget deficit for the general government at 3.8% of GDP for 2021. As the restrictions on the size of the structural deficit have temporarily been suspended, the Fiscal Council cannot assess the fiscal position for last year under the national fiscal rules. The nominal fiscal deficit at 2.4% of GDP did however fall within the requirements of the stability and growth pact.

In 2021 the funds from the European Union were again not used in full to the extent forecast. Although the past year was an extraordinary one, where a new budget period was launched together with the use of the recovery instrument, the Fiscal Council finds that this is a repeating pattern in the planning of Estonia's state finances. To avoid forecast errors of this kind, the use of EU funds should be planned more conservatively, or the administrative capacity of the state for using the funds should be increased.

There have been new and unexpected challenges in the past half year that have stopped the government from improving the state finances as the pandemic subsides. The support measures introduced in the pandemic and the additional spending on healthcare have been superseded by the support measures for the energy crisis and the additional spending on defence and security. At the same time, economic growth is forecast to stall in 2022-2023.

The Ministry of Finance estimates that the state finances will deteriorate this year, and accounting for the 2022 supplementary budget puts the general government structural deficit at 4.5% of GDP, and the nominal deficit at 5.3% of GDP. The nominal deficit is forecast to remain above 3% of GDP in 2023-2024 as well.

The government set the target this spring of not letting the structural fiscal deficit exceed 3.5% of GDP in 2023. After that it wants to reduce the deficit by 0.5 percentage point each year until it achieves a structural budget deficit of 2% of GDP in 2026. Extending this plan onwards would see structural balance return by 2030. The general government debt is forecast to reach 11.6 billion euros by 2026, or almost 30% of GDP, meaning it will be double what it is today.

The government has set its targets on the assumption that the fiscal rules will start to apply again from 2023 in unchanged form. This makes the target of 3.5% for next year appropriate if the structural fiscal deficit in 2022 is not smaller than 4% of GDP, though if it is then the target for 2023 should be more demanding. The Fiscal Council finds that if these assumptions are met, the budgetary targets set under the stability programme are in line with the State Budget Act as it stands.

The Fiscal Council considers that fiscal policy must be planned responsibly even when fiscal rules are temporarily suspended and there are severe cost pressures. It is important in this that temporary additional expenditures should be fully justified while permanent additional expenditure should be covered by permanent additional revenues. Otherwise there is a danger of the structure of government revenues and expenditures being shifted out of place and of that combining with high inflation to make the Estonian economy less competitive.

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

APPENDIX 3. Opinion on the summer forecast 2022 of the Ministry of Finance

Opinion

The summer economic forecast 2022 the Ministry of Finance is supposed to give a basis for preparing the state budget 2023 and the state budget strategy 2023–2026 that is up-to-date and is as accurate as possible. It is the task of the Fiscal Council to assess whether the forecast by the Ministry of Finance is suitable for this.

There are two parts to the economic forecast by the Ministry of Finance, with a macroeconomic forecast and the outlook for public finances. Under the State Budget Act, the macroeconomic forecast should describe the national economic environment and probable developments in it, and inform the public of this. The fiscal forecast should be written using the most likely scenario in the macroeconomic forecast, or a more conservative one.

The Fiscal Council does not endorse the summer economic forecast 2022 of the Ministry of Finance as it does not use the most likely expectations about general government spending, which affects the forecasts for both future growth in the economy, and internal and external balance.

First, the summer forecast includes assumptions of general government consumption and wage growth that are based on the previous state budget strategy produced a year and a half ago. These forecast assumptions are now out of date because of high inflation. The budget strategy and its spending forecasts are usually updated every 12 months, but in this case a change to the law meant that there was a longer gap between the two strategies. Second, the summer forecast did not take account of the new spending planned by the government coalition that was announced in July. The summer forecast of the Ministry of Finance consequently underestimates substantially the amount of general government spending, the budget deficits and the debt levels for 2023–2026, and this then affects the other economic indicators that are forecast.

Inflation has increased in Estonia over the past year and has consistently exceeded the expectations of forecasters. Higher inflation than expected raises both the revenues and the expenditures of the general government above the initial plans. The excess revenues from consumption and labour taxes increase the revenues in the state budget immediately, but the impact of inflation on the expenditures side is only felt in full after some delay. Higher tax revenues will consequently leave the fiscal position better than expected this year, but the increase in expenditures caused by inflation should be reflected in the fiscal position in the coming years. The summer forecast by the Ministry of Finance unfortunately does not describe this.

The government has already started discussing the state budget 2023 and the new budget strategy. The Fiscal Council considers it important that the state budget strategy 2023–2026 that will be composed by the end of September contain an updated macroeconomic forecast by the Ministry of Finance for 2022–2026 that uses the most recent information on the budget measures planned by the new government coalition, and an updated estimate of the development of general government wage costs, consumption and investment. This would give the Riigikogu and the public a more up-to-date and accurate view of the fiscal policy planned by the government and its forecast impact on the Estonian economy.

The Fiscal Council recommends that the future forecasts of the Ministry of Finance should contain two scenarios, one based only on budgetary measures that are already legislated, and a second that the ministry estimates to be the most probable scenario for the state finances.

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

APPENDIX 4. Opinion on the additional scenario of the summer forecast 2022 of the Ministry of Finance

Opinion

Russia's military invasion of Ukraine has made the economic environment very uncertain and forecasting it extraordinarily difficult. Inflation has been notably higher than was expected in spring, and so it has become one of the main risks to the outlook for the Estonian economy. Growth in the Estonian economy is also threatened by supply-side restrictions and general uncertainty.

In its opinion published on 6 September, the Fiscal Council did not endorse the summer forecast 2022 of the Ministry of Finance as it did not use the most probable assumptions about general government expenditures. High inflation made the assumptions for expenditures rapidly become out of date, which then affected all of the key macroeconomic indicators. The misleading impression could be given that a programme of reducing general government expenditures was under way that would cut general government spending as a ratio to GDP by several percentage points by the end of the forecast horizon. The Fiscal Council recommended in consequence that an updated macro forecast for 2022–2026 be attached to the state budget strategy that was being prepared for the end of September, and that it be based on the latest information about the planned budget measures of the new governing coalition.

The Ministry of Finance has followed this recommendation. The Ministry of Finance accompanied the state budget strategy with a new macroeconomic forecast scenario that takes account of the changed economic circumstances and the new coalition agreement. This mainly concerns expenditure measures that affect economic growth and the internal and external balance. Using the new expenditure assumptions makes the forecast more credible.

In summary the additional scenario for the macro forecast prepared to accompany the state budget strategy gives a sufficiently probable picture of the outlook for the Estonian economy in the coming years. The Fiscal Council consequently endorses the new macro scenario of the Ministry of Finance, and considers it an important input for further discussions about the state budget for next year and the budget strategy.

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

APPENDIX 5. Opinion on the targets for the structural budget position for 2023-2026

Opinion

In writing the state budget strategy for 2023-2026, the government has decided not to improve the structural fiscal position or to worsen it from what it would be in 2022. The forecast of the Ministry of Finance puts the structural deficit of the general government for this year at 2.6% of GDP. This means the target of reducing the structural deficit, which was still considered a priority in the stability programme in spring, has been abandoned.

This decision has allowed the government to increase the general government nominal budget deficit by around 2.9 billion euros over the next four years from what was in the summer forecast of the Ministry of Finance. The additional deficit is being justified because of increased spending on defence and family support, and by the need to compensate for the rise in electricity prices.

For this amount of spending decisions to be added during the budget discussions is extraordinary, and so the Fiscal Council recommended that the Ministry of Finance produce an additional macroeconomic forecast scenario to accompany the state budget strategy. The Ministry of Finance has done this, and the Fiscal Council has endorsed it.

The budget strategy contains new spending that is permanent in nature, but no new permanent sources of revenue. The budget deficit for the next four years is forecast at 5.4 billion euros and the debt of the general government will double nominally from what it is today. The Fiscal Council understands that the additional extraordinary spending is necessary this year and next because of the war in Ukraine and high inflation. It is important though that public finances be managed responsibly even when fiscal rules are temporarily suspended and cost pressures are severe. This means that new revenue sources need to be found for the medium term that are not based only on borrowing.

In its assessment of the budgetary targets, the Fiscal Council has assumed that the fiscal rules will start to apply again in their earlier form from 2024. This means that the structural budget deficit will need to be reduced after 2023 by at least 0.5 percentage point each year. The forecast of the Ministry of Finance expects that the outlook for the Estonian economy will have improved sufficiently by that time.

The Fiscal Council consequently finds that only the target for 2023 in the budget strategy 2023-2026 complies with the fiscal rules, while the targets for the structural budgetary position for 2024-2026 do not. If the structural deficit in 2023 is 2.6% of GDP, then the targets for the following years should have been 2.1%, 1.6%, and 1.1% of GDP. This means that the total nominal budget deficit in 2024-2026 should have been 1.3 billion euros smaller.

While the Ministry of Finance forecasts that the structural budget deficit of the general government will not increase in 2023, the nominal budget deficit will be around half a billion euros larger than it is this year. Such a fiscal stance will not support the monetary policy fight against inflation.

Finally, the Fiscal Council does not find the current practice of setting long-term targets for fiscal policy twice a year, in the spring stability programme and the autumn budget strategy, to be appropriate, given that these plans are not binding on one another and the budgetary targets they set are not binding over the longer term. The Fiscal Council consequently finds that the earlier system where both of the medium-term budgetary documents were agreed together worked better.

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