EELARVENÕUKOGU
FISCAL COUNCIL

FISCAL COUNCIL OPINION ON THE SPRING FORECAST 2020 OF THE MINISTRY OF FINANCE

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Contents

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Opinion

Forecasters are all now in agreement that the emergency situation caused by the spread of the coronavirus will push the Estonian economy into recession. The only question is the depth of the recession. The spring forecast 2020 of the Ministry of Finance projects that GDP in Estonia will be 8% lower in 2020 than in the previous year and private consumption will be down 11.8%. The rapid wage growth of previous years will stop almost entirely this year, and inflation will be braked.

The ministry forecast assumes that the emergency situation and the current restrictions will remain in place until the end of May, and that economic activity will recover relatively quickly after that. The Fiscal Council finds that the recovery from the crisis could take longer though, as the production capacity of the economy and trade relations may be interrupted for longer. Given the current circumstances it should be remembered that the assumptions used for any economic forecast become out of date quickly, and any possible extension of the emergency situation will make it necessary to update forecasts.

The spring forecast 2020 of the Ministry of Finance served as the starting point for the supplementary budget. The government is not planning to produce a state budget strategy with a four-year outlook this spring because of the general uncertainty. For this reason the spring forecast only describes the possible developments in the economy and in state finances for this year and next. The Fiscal Council finds that the forecast of the Ministry of Finance is a suitable base for the supplementary budget, but that there is understandably a large amount of uncertainty surrounding the forecast.

The supplementary budget contained a stimulus package of measures designed to ease the economic impact of the coronavirus that the Ministry of Finance did not consider in its macroeconomic forecast but that should lessen the extent of the recession all else being equal.

The government has decided to take loans to fund the stimulus package. The Ministry of Finance considers that the debt level of the Estonian general government could climb from its current 8% of GDP to 22% of GDP after the crisis has passed. To avoid the state taking on more liabilities than it can handle, the Fiscal Council finds that the stimulus package for the economy should be well targeted and focus on the measures with the largest short-term impact.

The general government fiscal position for 2020 will be made worse by the weaker economic environment and by the stimulus package for the economy. The Ministry of Finance estimates that the changes to the economic environment will increase the budget deficit by 1.5 billion euros, while the stimulus package will cost the 2020 fiscal position more than 1.1 billion euros. The spring forecast notes that rather than nominal balance, there will be a nominal deficit of 10% of GDP in 2020. On top of the pressure put on state finances by the restrictions, the Fiscal Council finds that an additional negative risk on the revenue side of the budget is an increase in tax arrears and weaker tax discipline, as is generally the case in a recession.

As the budget deficit was larger than permitted in 2018, the planning for the structural fiscal position of the Estonian general government has since 2019 had to allow for an improvement of at least 0.5% over the previous year. The application of the escape clause in the fiscal rules allows this requirement to be overlooked in 2020. The spring forecast projects a structural deficit for 2020 of more than 5% of GDP. If the recession harms the potential production capacity of the Estonian economy, the structural deficit will be larger.

Chairman of the Fiscal Council
Raul Eamets
Tartu, 15 April 2020

Explanatory Report

The emergency situation has also changed the timeline for forecasting and for planning fiscal policy. The spring economic forecast of the Ministry of Finance normally appears in the first half of April and is used as the basis for the state budget strategy for the next four years, but this year the government announced that there was no point in making such long-term forecasts and budget plans, and the state budget strategy has been pushed back until the autumn. For this reason the spring forecast focuses only on possible developments in 2020 and 2021.

The Ministry of Finance has already published two economic forecasts in abbreviated form this spring. The first was on 30 March using forecast assumptions as of 18 March, and the second on 2 April using assumptions from 31 March. The first of these projected a contraction of 3% in the Estonian economy in 2020, but the second increased this to 8%. The second forecast was used as the basis for a supplementary budget for 2020, which the government presented to the Riigikogu on 2 April. The supplementary budget was needed for the measures taken to ease the economic consequences of the coronavirus and the related changes to the law. It is the task of the Fiscal Council to assess the official economic forecasts used as the basis for state budgetary documents, and so it analysed the key indicators in the macroeconomic and fiscal forecast submitted together with the supplementary budget.

Assessment of the macroeconomic forecast

Macroeconomic outlook for 2020

The Estonian economy has grown faster than expected in recent years, and has performed at above its estimated potential level. Growth in the economy was broadly based in 2019 and was faster than its long-term potential, with nominal GDP growing by almost 8% over the year, and real growth reaching 4%. It was expected that growth in the economy would slow gradually this year and in the years ahead. The Ministry of Finance forecast in autumn assumed that real GDP growth would slow to 2.2% in 2020. The outbreak of the coronavirus entirely changed the outlook for the global economy and for the Estonian economy. The debates are no longer about the speed of growth in the economy, but about how deep the recession will be. The Ministry of Finance forecasts that the Estonian economy will decline by 8% in 2020 (see Table 1).

Table 1. Key macroeconomic indicators in the spring forecast 2020 of the Ministry of Finance (%)

	Spring forecast 2020			Difference from the summer 2019 forecast		
	2019	*2020*	*2021*	*2019*	*2020*	*2021*
GDP at current prices (billion euros)	28.0	25.9	28.6	0.2	−3.3	−2.1
Real GDP growth	4.3	−8.0	8.0	1.0	−10.2	5.4
Nominal GDP growth	7.7	−7.6	10.6	0.9	−12.7	5.4
Consumer price index	2.3	0.6	2.1	0.1	−1.6	0.0
Employment (thousand people)	671.3	616.1	633.2	0.2	−55.8	−38.8
Nominal growth in the average wage	7.5	0.6	5.0	0.3	−5.1	−0.1
Private consumption	3.1	−11.8	9.1	−0.5	−14.6	6.7
General government consumption	2.9	0.3	0.1	1.3	0.2	0.0
Gross fixed capital formation	13.1	−5.7	5.6	2.1	−7.2	1.1
Domestic demand	5.2	−9.6	7.9	0.2	−11.5	5.3
Exports of goods and services	4.9	−12.3	12.0	1.5	−14.7	8.7
Imports of goods and services	3.7	−14.4	12.8	−0.7	−16.5	9.4

Source: Ministry of Finance

Although the adjustment to the growth forecast from where it was last summer and in the first forecast of this year has been much larger than is usually the case, it may still not necessarily be enough. The current forecast has been made at a point where there is more uncertainty about the future than ever before, and there are several reasons for this.

The first reason is that the greatest uncertainty comes not from traditional economic indicators, but from the coronavirus. The first forecast by the Ministry of Finance was based on assumptions from the third week of March on 18.03, when it was still not known how many people in central and northern Europe would be infected. The head of the World Health Organisation had by that point already declared a pandemic, or a worldwide epidemic. There had already been more deaths by then in Italy than in China, while calmer news was coming from China that the number of infections was falling or that there were no new infections at all. The number of new cases in Estonia was running at around 30 people a day and nobody was seriously ill yet. Chinese data also indicated that the mortality rate was lower than that for SARS. This all suggested that the impact of the pandemic on the global economy would not be as bad as suggested by some of the most extreme scenarios[1]. The second forecast from the Ministry of Finance using assumptions from the end of the month was produced once some good news had come from Italy, but the situation around the whole world and in Estonia had deteriorated rapidly[2]. At the time the Fiscal Council produced its opinion, it was not yet clear when the epidemic would start to ease.

The second cause of uncertainty is that extraordinary measures have been taken to protect public health, and they have also changed rapidly over time. The main measures taken in Estonia and in other countries have been restrictions on movement and on meeting in public places. The restrictions were introduced in Estonia a week before the first forecast of the Ministry of Finance was prepared, and as in other countries they have been tightened since then. Unfortunately these restrictions have substantially hampered the economy. The assumption in the forecast that the pandemic will fade after some months means that the restrictions on economic activity will last until the end of May. This is an important assumption. The OECD estimates that extending tight restrictions by one month could cut annual growth in GDP by up to 2 percentage points, all else being equal[3].

The third cause of uncertainty is that the relationships between economic variables based on prior experience that are used in forecasting may not remain the same during the emergency. Supply-side and demand-side factors are combining in extraordinary ways. Countries around the world are more interlinked than during previous crises and unexpected behaviour by one part of a supply chain could amplify the shock to the supply side and the demand side. At the same time, communications and options for remote working are much better than ever before, and online purchases are much more common. People in Estonia have become wealthier and can maintain their consumption at least to some extent from their savings. How people will behave in unprecedented circumstances is an important factor.

In its previous opinions on the macro forecasts of the Ministry of Finance, the Fiscal Council has usually compared them with those of other forecasters. It does not make sense to do this in the extraordinary circumstances of this spring. Only a few economic forecasts concerning Estonia have been produced

[1] At the start of March, the Australian researchers Warwick McKibbin and Roshen Fernando published a forecast for how the pandemic would affect the global economy in different regions and leading countries. They produced three scenarios for what would happen if the epidemic spread around the world. They estimated that the recession in the euro area countries in 2020 caused by illness and death would be from 0.5% to 7% (https://voxeu.org/article/economics-time-covid-19-new-ebook).

[2] See for example: https://www.worldometers.info/coronavirus/coronavirus-cases/

[3] See also: https://www.austaxpolicy.com/news/oecd-evaluating-the-initial-impact-of-covid-containment-measures-on-activity/

during the pandemic and they have started from different assumptions, with the Fitch rating agency for example producing a forecast at the end of March that differed from other forecasts by including a government assistance package that they put at around 600 million euros. All that the economic forecasts published in March show is that estimates of the situation change every day (see Figure 1).

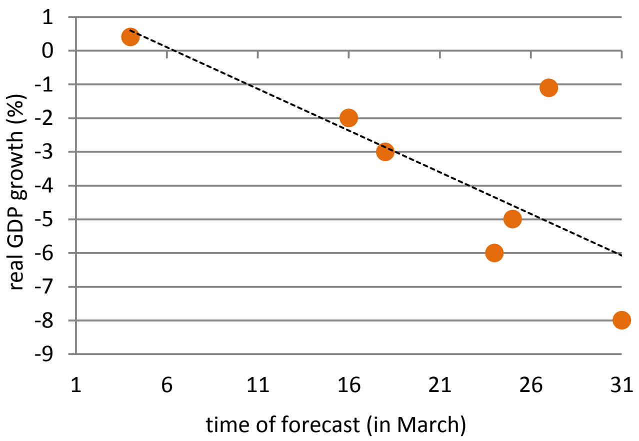

Figure 1. The fall in the Estonian economy expected in 2020 by different forecasts made in March

Sources: Eesti Pank, Fitch, Luminor, Ministry of Finance, Swedbank

The forecast of the Ministry of Finance starts from the political measures that were in place at the time it was written, and does not consider the impact of measures to ease the crisis. As it can be assumed that the government's crisis measures will ease the economic impact, the actual downturn will be smaller than in the spring forecast all else remaining equal. At the time the Fiscal Council opinion is written, new information has been received on the extension of the crisis measures in Estonia's neighbours and elsewhere in Europe, which means that the outlook for the economic environment has worsened. In these circumstances the estimate by the Ministry of Finance for the depth of the recession may turn out to have been optimistic.

In its previous opinions on the macro forecast of the Ministry of Finance, the Fiscal Council has generally found them to be as reliable as those by any other forecasters. In principle the same applies to the current spring forecast, which gives an approximate picture of the possible developments in the Estonian economy in 2020 and so supports the planning of fiscal policy this spring. It should be remembered that there is an emergency situation where the main assumptions underpinning the economic forecast, including those about the epidemic and the countermeasures taken by the government, can change from day to day.

Outlook for the recovery of the economy

The forecast of the Ministry of Finance assumes a deep fall in 2020 and a rapid recovery next year. The main cause of the crisis is considered to be the coronavirus, and it is assumed that normal economic activity will restart once the threat to public health has eased and the potential growth of the Estonian economy will not suffer. The main indicators for demand measured at constant prices will be only 2%-4% lower in 2021 than they were in 2019 before the fall in the baseline scenario. This marks a difference between the current recession and the crisis of 2008-2009 (see Figure 2)[4].

[4] Although the two crises are very different in their nature and in the measures taken, the economic crisis of 2008-2009 is discussed here to give a basis of comparison for the recession caused by the corona crisis.

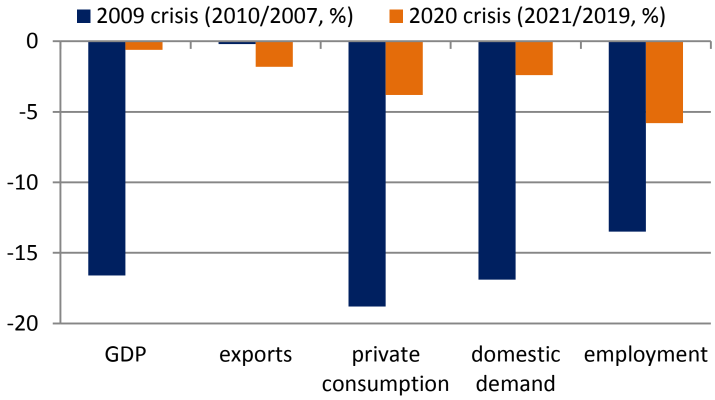

Figure 2. Recovery of economic indicators after the downturn in this economic crisis and the previous one

Sources: Ministry of Finance, Statistics Estonia

This scenario of a rapid or V-shaped recovery (see also Figure 4) is generally used as the baseline scenario for forecasts in other countries in the European Union. There has been public debate about whether the current crisis and the recovery from it may not instead be U-shaped, or even L-shaped, caused by the changes in public behaviour and the service economy.

Trends in the global economy before the crisis, which caused geopolitical and international trade tensions, have not turned either. National economic policies may change as a consequence of the corona crisis, as critical goods and inputs for local production start to be produced more domestically. For Estonia as a very open exporting economy, this could mean a loss of potential for growth.

The Fiscal Council agrees that it is extremely difficult under current circumstances to produce a reliable economic forecast looking forward several years. It will not be possible to avoid having a multi-year outlook in the next forecast, published in the autumn, which will serve as a basis for the draft state budget for 2021 and probably for a package of policy measures to support the recovery of the economy from the crisis. It is hoped that when the next economic forecast is made it will already be possible to estimate whether the forecast of a fall of 8% in the economy in 2020 and a rapid recovery next year is suitable for use in the baseline scenario for drafting the budget or not. Unfortunately the general uncertainty may not be less during the next round of forecasting. The Fiscal Council recommends that the fiscal forecast should consider producing several scenarios to support the government in choosing which principles to base the package of measures for exiting the crisis on.

Assessment of the fiscal forecast

Changes to the revenue forecast for 2020-2021

Forecasting generally focuses on the years ahead, but the current spring forecast has needed to change fundamentally its opinions for the current year. When the forecast was written there was not a clear enough view of the economy and the position of the state finances in the first quarter, nor of the initial extent of the impact of the coronavirus on the economy. At that time, tax revenues were known only for the first two months of 2020[5]. It is now apparent that the deterioration in the economic environment will reduce general government revenues substantially both this year and next (see Table 2).

Table 2. Changes in the forecast for general government revenues in 2020-2021 (million euros)

	Forecast for 2020			Forecast for 2021		
	State budget 2020	Spring forecast 2020	*change*	Forecast in autumn 2019	Spring forecast 2020	*change*
Tax revenues	8210	7122	*−1087*	8663	7811	*−852*
Personal income tax	401	304	*−97*	474	370	*−104*
Corporate income tax	439	392	*−47*	459	426	*−33*
Social tax	3581	3120	*−461*	3770	3370	*−400*
VAT	2648	2320	*−328*	2782	2505	*−277*
Excises	1055	912	*−142*	1090	1057	*−33*
.. alcohol	229	207	*−22*	230	223	*−7*
.. tobacco	220	225	*5*	226	233	*7*
.. fuel	569	444	*−125*	597	564	*−33*
.. electricity	36	36	*0*	37	37	*0*
Transferable revenues	1776	1552	*−224*	1865	1667	*−198*
Non-tax revenues	1841	1775	*−67*	1700	1706	*6*
Total revenues	11826	10449	*−1378*	12228	11184	*−1044*

Source: Ministry of Finance

The spring forecast of the Ministry of Finance projects that the tax revenues in the state budget will be almost 1.1 billion euros less than was expected in the 2020 state budget forecast written in the autumn, and that they will be 850 million euros less in 2021. The forecast for revenues in the state budget as a whole has been cut by around 1.4 billion euros for 2020 and around 1 billion euros for 2021. This will reduce the revenues available to the government by more than a tenth from what was calculated in the state budget.

The change in the nominal size of the economy is usually a good indicator for movements in tax revenues. Reduced production volumes in the economy will reduce the tax revenues available to the state. The spring forecast estimates that social tax receipts will be 6.8% lower in 2020 than the actual tax receipts for 2019 and VAT receipts will be 6.5% lower, but growth of 8% is expected in both types of tax for 2021. Nominal growth in the economy is expected at the same time to be -7.6% this year, and 10.6% next[6]. This will leave the nominal size of the Estonian economy 11.3% smaller in the spring forecast than in the forecast from last autumn, and 6.8% smaller in 2021. Tax revenues in the state budget are 13.2% lower

[5] Cash-based tax receipts showed no sign in January that the economy was cooling, but in February the growth in VAT was only 1.0% and growth in state budget tax revenues was down to 0.9%.

[6] Social tax receipts were 10.3% lower in 2009 than in the previous year, and VAT receipts were 8.5% down. The economy shrank by 14.6% at current prices in that case. The sharp drop in corporate income tax arrived a year later as tax receipts dropped by around a quarter in 2010.

than in the previous forecast and 9.8% lower in 2021, and total revenues are down 11.6% in 2020 and 8.5% in 2021. This shows the forecast reduction in revenues in the state budget to be generally aligned with the reduction in economic activity expected in the spring forecast.

The Fiscal Council finds that the changes made to the forecast for state budget revenues are in line with the scenario for the economic downturn presented in the macro forecast. As the economic forecast did not consider measures taken to ease the crisis though, and further measures may be introduced later on, then the outlook for revenues in the spring forecast does not represent the best estimate of the Ministry of Finance for the probable development of the state finances in 2020-2021.

Changes to the budget position for 2020-2021

The spring economic forecast 2020 of the Ministry of Finance was written at a time when the impact of the coronavirus on the Estonian economy was not yet fully evident, and the package of measures taken to ease the negative impact on the economic environment was only starting to be introduced for decided on. For this reason the forecast does not take account of how the support measures will affect economic indicators, nor of all the changes in the state finances that will follow from the measures. It is assumed in the current forecast that the government will largely continue with its spending and investment plans that were in the state budget for 2020.

The state budget was drafted last autumn under the assumption that the general government fiscal position would be in nominal balance and structural deficit of 0.7% of GDP (see Figure 3). The spring forecast 2020 of the Ministry of Finance shows a nominal deficit this year of around 1.5 billion euros, or 5.7% of GDP, and of almost 850 million euros or 2.9% of GDP in 2021[7].

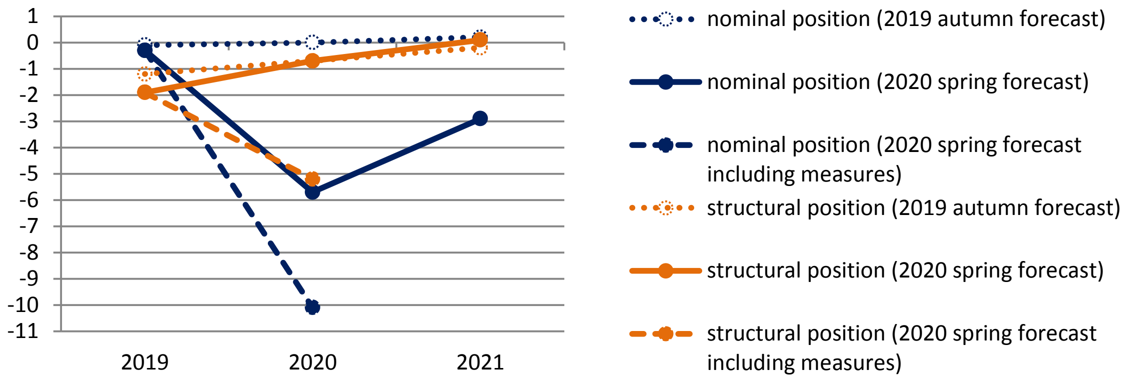

Figure 3. The nominal and structural budget positions of the general government in 2019-2021 (% of GDP)
Source: Ministry of Finance

The forecast for the structural fiscal position of the general government, which accounts for the changes in the economic environment, is not particularly changed since the autumn. Although the economic forecast does not cover the package of measures passed by the government, the supplementary budget 2020 gave an initial estimates of how those measures would affect the fiscal position for 2020. The spring forecast finds that the nominal budget deficit of the general government for 2020 including the measures to ease the crisis will be 2.6 billion euros, or 10% of GDP.

[7] For comparison the nominal budget deficit during the previous economic crisis was of 440 million euros or 2.6% of GDP in 2008, and 310 million euros or 2.2% of GDP in 2009.

The Estonian state has already issued 200 million euros of short-term bonds to fund the budget deficit and has increased the maximum amount of short-term bonds that can be issued to 1 billion euros. A 15-year loan agreement for 750 million euros has also been signed with the Nordic Investment Bank[8]. Preparations are known to be under way for issuing long-term bonds and for applying to the European Investment Bank for an additional long-term loan. The government has also proposed to the Riigikogu that the whole of the Stabilisation Reserve Fund could be used if necessary. The Stabilisation Reserve Fund was worth around 415 million euros at the end of 2019[9]. The government can also use the Liquidity Reserve as financial buffer, which had market value of around 845 million euros in February.

Statistics Estonia estimates that the debt of the Estonian general government at the end of 2019 was 2.36 billion euros or 8.4% of GDP. The debt rose in nominal terms last year as the general government borrowed 215 million euros from the European Investment Bank for co-funding of European Union projects and it issued 200 million euros of short-term bonds in the summer, of which half had been paid back by the end of the year. The Ministry of Finance estimates that general government debt could grow to 22% of GDP as a consequence of the crisis (see Figure 4).

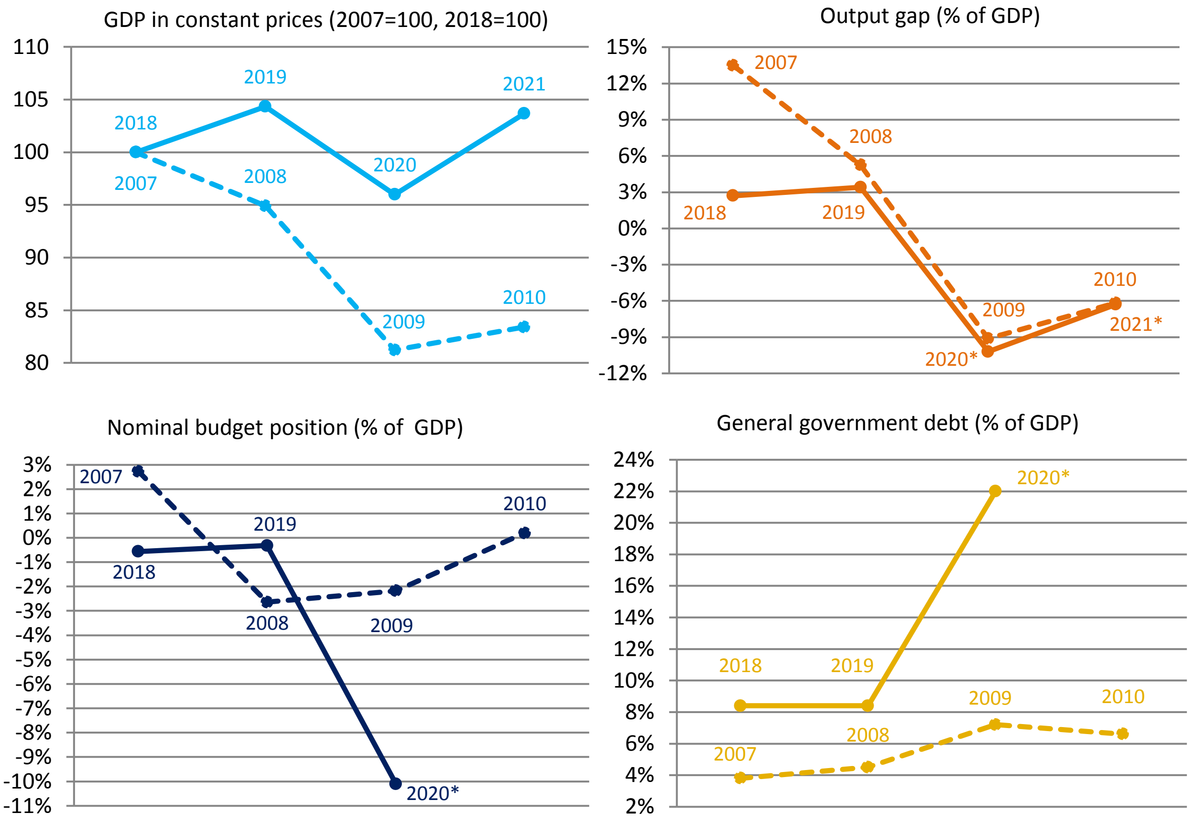

Figure 4. Indicators for the macroeconomy and state finances in 2007-2010 and 2018-2021

Sources: Ministry of Finance, Statistics Estonia, calculations of the Fiscal Council

The spring forecast puts the general government structural deficit at 0.7% of GDP in 2020 if no measures are taken, and at 5.2% of GDP with the planned measures. The estimate of the structural position by the Ministry of Finance is based this time on the estimate of the output gap, which suggests that the output gap could be the same negative size as it was in the worst year of the previous economic crisis in 2009. It

[8] Alongside Estonia, Latvia has recently borrowed 500 million euros from the Nordic Investment Bank, and Lithuania has borrowed 400 million euros.

[9] During the last economic crisis, 224 million euros was used from the Stabilisation Reserve Fund.

is clear by now that the Estonian economy will produce less in 2020 than it is capable of and that growth in the economy will be negative, so it may be assumed that the output gap will be negative. The exact size of the gap will depend on estimates of the cyclical position of the economy for last year and the coming years. This is extremely difficult to forecast under present circumstances, as the extent of the coronavirus crisis and the scenarios for recovery from it are not yet clear.

The spring forecast of the Ministry of Finance assumes that the total output of the Estonian economy at constant prices will recover quickly and will already be close to its 2019 level in 2021. The Fiscal Council finds it possible under current conditions that even a short-term downturn in the economy may reduce the potential production capacity of the Estonian economy in the longer term. Although it is too early to say this with any accuracy yet, the output volumes and sales of some parts of the economy may remain below their pre-crisis levels for some years yet. If the potential output capacity of the economy is reduced for a short time following the crisis, the negative output gap may turn out smaller than is assumed in the forecast of the Ministry of Finance. This means though that the structural deficit of the Estonian general government will be even larger if the other assumptions are similar.

A further negative risk to the revenue side of the budget is that tax arrears increase in a downturn, and tax discipline is worse, meaning there is more tax evasion. This could reduce tax receipts in the state budget. There is also a risk on the expenditure side that the restrictions passed to stop the spread of the coronavirus mean that not all the costs that were planned in the state budget will be processed. The current working environment also means that some types of expenditure are no longer necessary at all.

Although the spring fiscal forecast assumes no great savings are planned in government expenditure beyond stopping contributions to the second pension pillar, it is apparent that every extra month that the emergency continues will increase the pressure on state finances. If the crisis turns out deeper than forecast, the outlook for revenues in the state budget will also deteriorate and the spending obligations of the state on social protections will increase. Given current assumptions, the nominal general government budget deficit will reach 10% of GDP.

Measures to alleviate the crisis in the supplementary budget for 2020

In the middle of March the government announced that it was deciding on a package of assistance of 1.5-2 billion euros, or 5.5%-7% of the GDP of 2019, to ease the emergency situation caused by the coronavirus and the consequent downturn in the economy. An important role in the package was given to the wage support measures of Töötukassa and to improving the liquidity of companies and their access to loans through KredEx and the Rural Development Foundation (MES). The supplementary budget submitted to the Riigikogu on 2 April contained a package of measures to support the economy that could see over 2.5 billion euros injected into it[10].

The assistance package in the supplementary budget contained several measures (see Table 3) that had not previously been discussed in detail in the media. The ones that would cost most for the budget were a cut in the interest rate for rescheduled tax arrears, renovation of apartments and private houses, cuts in fuel excise, and support for local governments and the tourism sector. The expenditure measures in Table 3 taken together will increase the government's budget deficit in 2020 by more than 1 billion euros. The

[10] It should be noted for guarantees that their total volume for the state is not equal to state spending on them, as some of them may not be realised, and for loan measures it should be noted that companies may not apply to use them to the extent expected. Businesses will also need to repay the loans to the state later. This means the obligations in the assistance package are not equal in size to the additional funds pumped directly into the economy, nor to the additional budget deficit.

table does not show measures that will have a lesser impact on the budget, nor the 230 million euros that creating a new reserve will cost, and so the total cost of the package of assistance in 2020 will be around 1.3 billion euros.

The package of measures also included a temporary halt in contributions by the state to the second pension pillar, which would free up 142 million euros of state funds in 2020. The estimated total impact on the budget of the measures in the supplementary budget to ease the crisis is 1.145 billion euros this year. It is not yet known whether the package of assistance will be passed in exactly this form, whether other budget measures will be added in further supplementary budgets, or how assistance measures will affect the budget in 2021.

Table 3. Measures to ease the crisis that will have the largest impact on the budget in 2020 (million euros)

Measure	Cost to the budget in 2020
Wage support measure from Töötukassa (30-30-30 measure)	–250
Reduction of the interest rate on tax arrears rescheduling up to 100% instead of 50%	–141
Loan guarantees for bank loans already issued in order to allow for repayment schedule adjustments (KredEx)	–103.5
Renovation support measure for apartment buildings and private houses (KredEx)	–100
Reduction of fuel excise duties (diesel, liquid gas, natural gas, electricity)	–76.6
Local government support measure	–75
Operating loan measure (KredEx)	–48.4
Operating and investment loan measures for rural companies (MES)	–30
Support measures for the tourism sector (Enterprise Estonia)	–25
Support for culture and sport, including partial compensation of the costs of cancelled events	–25
Reimbursement of 75% of all types of port dues for passenger ships	–20
Reconstruction of local government and Road Administration roads	–20
Purchases of shares in strategic companies or capital expansion of state-owned companies	–17
Loan guarantees for bank loans already issued, increase of the guarantee reserve and reduction of guarantee fees (MES)	–17
Private schools, private interest education, private kindergartens, private childcare	–15
Last mile support for sparsely populated areas	–15
Exemption of waterway charges for ships entering the port for 1 year	–13.5
Capital injection measures for micro and small enterprises (Enterprise Estonia)	–10
Additional funds for Social Insurance Board to provide care certificate for parents of children with special educational needs	–10
State reimbursement of sick days for workers from the first to the third day of sickness insurance (currently without pay)	–7.1
Temporary cancellation of social tax minimum for employers for three months	–6
Reduction of tax interest from 0.06% to 0.03%	–5
Demolition of abandoned houses	–5
Investment loan measure (KredEx)	–4.8
Construction of the third level biolab of the University of Tartu	–4
Support scheme for passenger ships	–3.7
The state pays the advance payment of social tax for self-employed persons for Q1 2020	–3.3
Suspension of calculation of interest on tax debt for two months	–2
Support measure for churches and congregations	–2

Source: Ministry of Finance

As the spring forecast expects the downturn in the economy to be temporary, the package of assistance for the economy should reflect that. Should it become clear that the crisis will last longer than expected, the short-term measures can be extended in stages as necessary and as far as they can be funded. Estonia has no previous experience of producing such a broad package of economic assistance measures, and there remain many questions about the design and the effectiveness of the measures. To avoid the state taking on more liabilities than it can handle, the Fiscal Council finds that the approach should be well targeted and focus on the measures with the largest short-term impact.

The conservative fiscal policy that Estonia has so far had, which has kept the state debt small, now gives Estonia an advantage over other European countries and allows the government to borrow without risking the sustainability of the state finances. If money is borrowed to ease the downturn though, it will affect spending in the state budget over the long term. As the spring forecast of the Ministry of Finance only describes the developments for this year and next, and even then only in part, the Fiscal Council finds it important that by autumn 2020 at the latest the government submit a long-term outlook for the state finances together with the steps to be taken to return the budget to balance.

Compliance with the fiscal rules

Besides assessing the economic forecasts, it is also the task of the Fiscal Council to monitor compliance with the fiscal rules. As the budget deficit was larger than permitted in 2018, the planning for the structural fiscal position of the general government from 2019 onwards has to allow for the requirements of the correction mechanism until structural balance is again achieved. The correction mechanism requires the structural fiscal position to be improved each year by at least 0.5% of GDP. When the last decisions to improve the fiscal position of 2019 were taken in autumn 2019 and the 2020 state budget was written, the Ministry of Finance started from the estimate of a structural deficit of 1.7% of GDP in 2018. In consequence a structural deficit of 1.2% of GDP was planned for 2019, and one of 0.7% of GDP for 2020.

The nominal budget deficit turned out larger than expected in 2019 though and the economy grew faster than expected, meaning that the structural deficit was larger than planned. The preliminary estimate from Statistics Estonia puts the nominal deficit in 2019 at 90 million euros, or 0.3% of GDP. Taking the estimate for the output gap from the ministry, the structural deficit in 2019 was 1.9% of GDP.

This means that the general government structural fiscal position in 2019 was not an improvement on the previous year[11]. Under normal circumstances it would be necessary to continue improving the fiscal position in 2020, or to start doing so, but the efforts to ease the economic impact of the coronavirus have now put on hold the requirements for state financing contained in the budget rules. In consequence it may be estimated that the structural deficit will deepen further in 2020, and only after that can the fiscal position start to be improved.

Noting that a deep recession may be caused in Europe by the coronavirus, the European Commission proposed for the first time in March 2020 that the general escape clause of the Stability and Growth Pact should be activated, which was approved by the European Council. This general escape clause means that Member States including Estonia are temporarily released from their budgetary adjustment paths to pass economic policy measures to better react to the consequences of the coronavirus. This assumes that there is no long-term threat to the sustainability of state finances. The European Commission will analyse

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[11] The more detailed opinion of the Fiscal Council on the achievement of the target for the structural budget position for 2019 by the general government will be published separately in the coming weeks.

the extent and justification for any possible deviation from the rules after the Member States have submitted their Stability and Convergence Programmes in April.

There is also an escape clause from the budget rules in the Estonian State Budget Act (Chapter 2 §9), which allows compliance with the correction and compensation mechanism to be postponed. The escape clause may only be applied in exceptional circumstances, as defined in the Stability and Growth Pact. This means that the application of the general escape clause means that the escape clause in the Estonian budget rules also applies, which allows the government to overlook the correction mechanism when setting the fiscal position for 2020.

It is not currently clear how long the escape clause to the budget rules will apply for, and when the state finances of Member States will again start to be assessed under the current rules. It may be assumed that once the general escape clause ceases to apply at the European Union level, the escape clause from the Estonian national budget balance rules will also cease to apply. It is not clear though which domestic fiscal rules will return to force in Estonia after the crisis, as the government had already declared in spring 2019 its intention to change the domestic budget balance rules. The aim of the changes was to abandon the calculation of the cumulative structural fiscal position contained in the fiscal rules and the compensation mechanism that requires the government to plan a fiscal surplus once structural balance has been achieved. The European Commission was also planning a thorough review of the fiscal rules at the European level before the coronavirus crisis erupted.