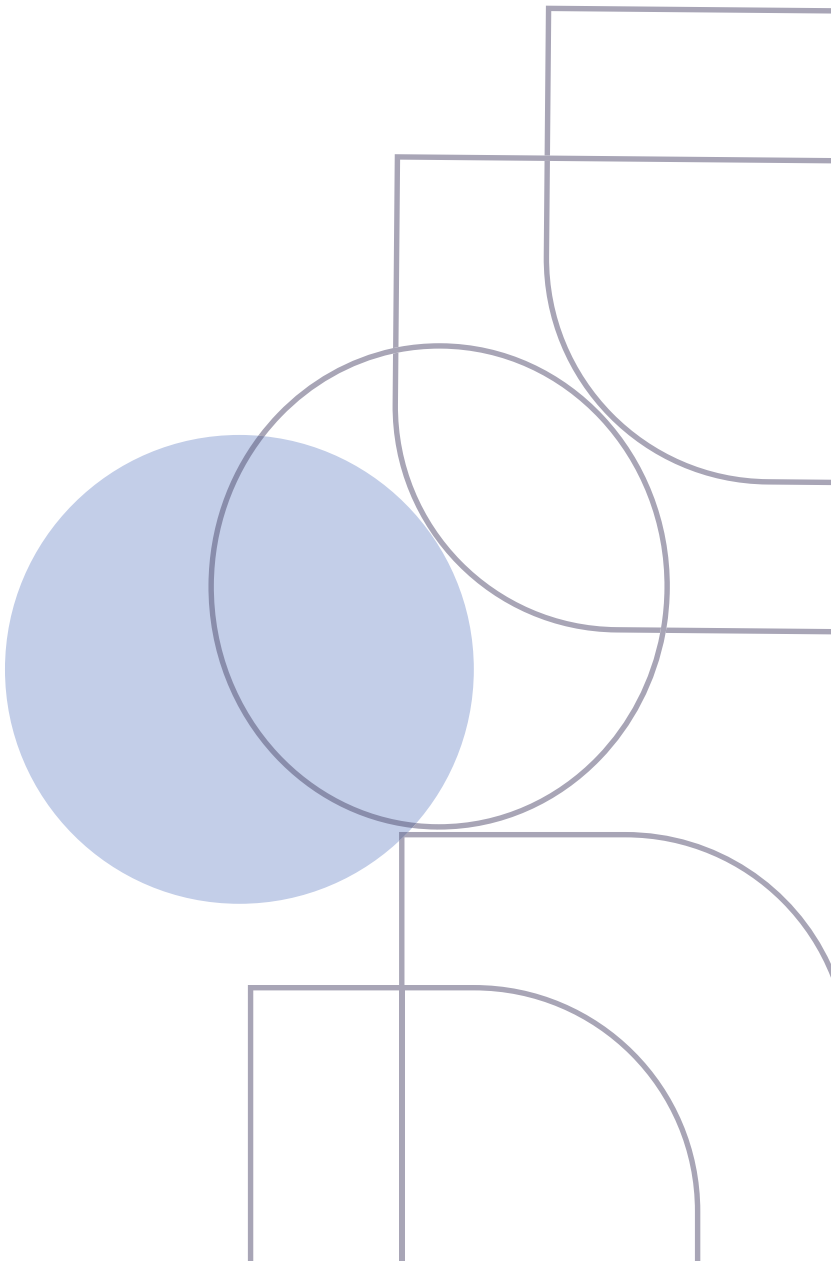
Fiscal Council

Opinion of the Fiscal Council on the targets for the budget position for 2027–2030



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Opinion

According to the Ministry of Finance's summer forecast, the outlook for Estonia's public finances is difficult. Defence expenditure, which has increased rapidly in recent years, and the costly income tax reform of 2026 have put Estonia's public finances on a path where the budget deficit will remain at 4–4.5% of GDP and the government debt burden and interest expenditure will increase rapidly.

In the State Budget Strategy, the government has set a target for the nominal budget deficit not to exceed 4% of GDP in 2027. To this end, the budget position has been improved by approximately 220 million euros compared with the summer forecast, but these are mainly minor adjustments to government investment, EU funds and accounting, rather than a permanent improvement in the structure of government revenue and expenditure.

Contrary to the Fiscal Council's recommendation, the general government budget deficit will remain at 4% of GDP also in 2028 and 2029. However, achieving these targets depends on the implementation of several revenue and expenditure measures planned by the government, which are still subject to considerable uncertainty. The recent rise in interest rates may also make servicing government debt more costly.

Thus, according to the State Budget Strategy, the reduction in the budget deficit will not continue after 2027, nor will it resume in 2029, as might have been expected with the expiry of the escape clause. Here, the government proceeds from the interpretation that, although the national fiscal rules will reapply from 2029, deliveries arriving later under defence contracts concluded during the 2025–2028 escape clause may be taken into account when complying with the required adjustment. In other words, if such defence expenditure amounts to 0.5% of GDP or more, the requirement to reduce the budget deficit by 0.5% of GDP per year does not have to be met either.

According to the Fiscal Council, the budgetary targets set in the State Budget Strategy for 2027–2030 comply with the requirements of the fiscal rules, based on a flexible interpretation of those rules. However, the Fiscal Council recommends that the fiscal adjustment should not be postponed for as long as the temporarily relaxed fiscal rules allow but should instead continue immediately after 2027.

Even if the budgetary targets set by the government are achieved, the government debt burden and interest expenditure would increase rapidly in the coming years. By 2030, the debt ratio would already reach 37.4% of GDP, and almost 2 billion euros would need to be allocated for interest expenditure over the next four years. If the fiscal adjustment were to continue only from 2030, government debt would not begin to decline until it had exceeded 40% of GDP.

Overall, the four-year outlook for public finances prepared this autumn still does not contain a plan for finding a permanent source of funding in the state budget for permanently higher defence expenditure that would not rely on borrowing. A flexible interpretation of the fiscal rules has allowed the necessary fiscal adjustment to be postponed, but the later it is addressed, the more costly it will become for both the government and taxpayers.

Chair of the Fiscal Council
Peter Lõhmus
28 September 2026

Explanatory report

The State Budget Strategy prepared in autumn 2026 describes the government's budgetary targets for 2027–2030. The Fiscal Council is tasked with assessing the achievement of those targets and their compliance with the requirements of the fiscal rules. In formulating fiscal policy for the next four years and assessing the objectives set by the government, account must be taken of the fact that Estonia has applied for an escape clause from the European Union's fiscal rules in connection with increased defence expenditure and has suspended the requirements of its national fiscal rules.

Assessment of the budgetary targets for 2027–2030

Overview of the fiscal outlook

According to the Ministry of Finance's summer 2026 forecast, the general government budget deficit will widen sharply this year and, under no-policy-change scenario, would subsequently remain at 4–4.5% of GDP, leading to rapid growth in the government debt burden and interest expenditure. The Ministry of Finance's spring forecast presented a similarly difficult outlook. In essence, the unresolved issue in Estonia's public finances is how to find a permanent source of funding for permanently higher defence expenditure. Both national and international experts have emphasised the importance of decisively reducing the budget deficit in their analyses of Estonia's public finances.

In preparing the State Budget Strategy (SBS) for 2027–2030, the government has set a target for the nominal budget deficit in 2027 not to exceed 4% of GDP (see Figure 1). As the Ministry of Finance's summer forecast projected a budget deficit of 4.5% of GDP for 2027, measures improving the budgetary position by approximately 220 million euros were adopted during the budget discussions to achieve this target. Unfortunately, the strategy does not foresee a continued improvement in the budgetary position in subsequent years, as the budget deficit will remain at 4% of GDP also in 2028 and 2029.

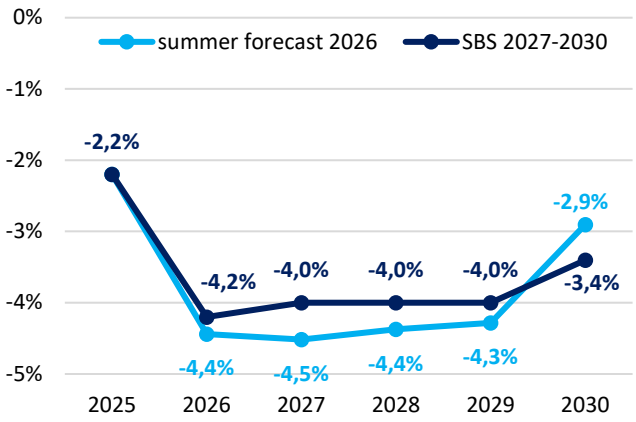


Figure 1. General government nominal budget deficit in 2025–2030 (% of GDP)

Source: Ministry of Finance

Although the strategy does not target a further gradual reduction in the budget deficit, the budgetary position in the coming years is nevertheless somewhat stronger than in the summer forecast, which was prepared on the assumption of unchanged fiscal policy. To this end, the government identified both revenue-increasing and cost-decreasing budgetary measures during the budget discussions (see Figure 2). It can be noted at the outset that no new changes to Estonia's tax system are envisaged in the budget strategy. In the analysis below, the Fiscal Council focuses first on the budgetary measures for 2027 and then on the longer-term outlook.

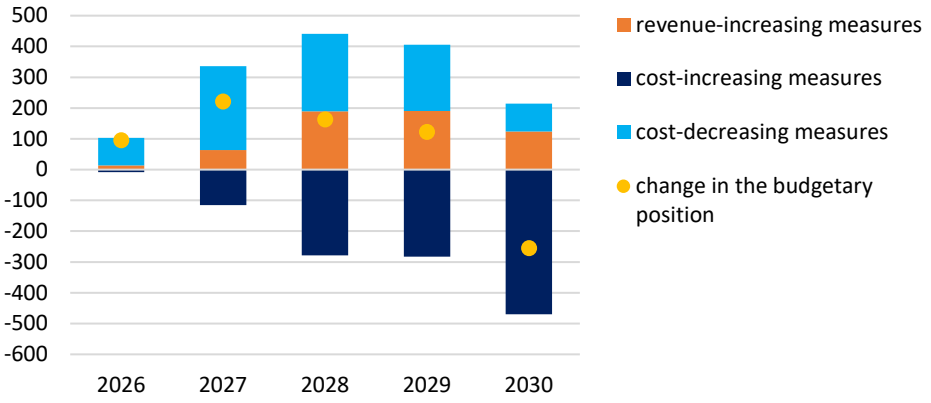


Figure 2. Change in the general government budgetary position in the State Budget Strategy compared with the summer forecast (million euros)

Source: Ministry of Finance

One third of the fiscal adjustment planned for 2027 is based on revenue measures and two thirds on expenditure measures. On the revenue side, the main measure is the prison rental agreement concluded between Estonia and Sweden, which is expected to generate 40 million euros next year. The main expenditure savings are envisaged from the use of funds under the European Union's Recovery and Resilience Plan (80 million euros), finding a private-sector business partner for the ammunition factory (73 million euros), and reducing public investment (36 million euros). The use of the SAFE financing instrument and the rescheduling of Rail Baltica construction will also generate smaller savings next year.

Over the longer horizon of the strategy, measures that weaken the budgetary position will have an increasing impact alongside measures that improve it. According to the Ministry of Finance, the strategy already includes more decisions increasing expenditure than reducing it in 2028–2030. Moreover, the Fiscal Council considers that there is currently greater certainty about decisions that worsen the budget position than about those that improve it. Overall, this means that if not all assumptions relating to the new budgetary measures materialise as described in the strategy, the greater risk is that the fiscal outlook will not improve as planned. In addition, the plans for financing the Health Insurance Fund remain uncertain.

For example, the budget strategy assumes that:

- a private-sector business partner will be found for the state-owned ammunition factory and its start-up costs (a total of 150 million euros in 2026–2028) will be moved outside the government sector and excluded from the calculation of the budget deficit;
- revenue from prison rental services will rise to more than 60 million euros per year, which would mean that the agreement is implemented with the maximum number of prisoners and the corresponding compensation, although the number of prisoners initially admitted to Estonia has been below the possible maximum;
- an additional 175 million euros in tax revenue will be generated in 2028–2029 as a result of government support for the renovation of apartment buildings and for the organisation of major international events;
- government interest expenditure will decrease due to a smaller budget deficit (and also as a result of consolidating the asset management of certain government agencies in the State Treasury), which in turn assumes that all the above expectations materialise as envisaged in the strategy.

Even achieving the budgetary targets set in the State Budget Strategy for 2027–2030 would mean that the government debt burden and interest expenditure will increase rapidly in the future (see Figure 3). According to the strategy, the general government debt burden will reach 37.4% of GDP by 2030, which is only 1.1 percentage points less than in the Ministry of Finance's summer forecast. Although interest expenditure over the next four years would be approximately 100 million euros lower than in the summer forecast, it would still total almost 2 billion euros. Thus, the overall impact of the policy decisions in the strategy is not sufficient to improve the long-term outlook for public finances significantly.

Background information. Sensitivity analysis of interest expenditure

Since the Ministry of Finance's summer 2026 forecast was prepared, on which this autumn's budgetary documents are based, interest rates in financial markets have risen. This particularly affects countries with high government debt and deficits, which need both to refinance existing loans and to obtain new borrowing to cover their current budget deficits. Although Estonia's debt ratio is still relatively low (24% of GDP in 2025), the budget deficit in the coming years, and consequently the need for borrowing, is large. Higher-than-expected interest rates will therefore quickly affect Estonia's public finances, putting further upward pressure on interest expenditure, the budget deficit and the debt burden.

While the summer forecast assumed that the weighted average interest rate on State Treasury debt would be 3% in 2026 and gradually rise to 3.6% by 2030, the state budget strategy also includes a sensitivity analysis of interest rates. According to this analysis, a rise in interest rates by 100 basis points (see Figure 4) would increase interest expenditure by approximately 100 million euros in 2027 and by about 600 million euros in total over four years.

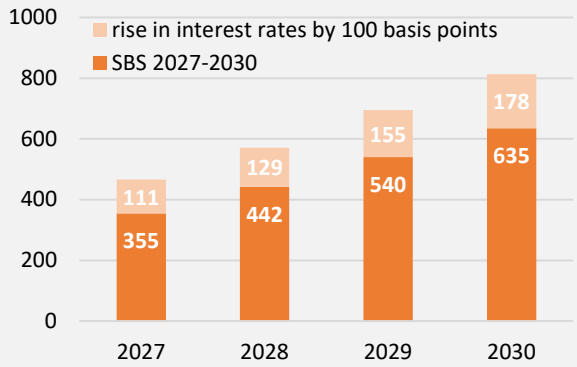


Figure 4. Interest expenditure on government debt in the State Budget Strategy for 2027–2030 (million euros)

Source: Ministry of Finance

Compared with the time when the external environment assumptions were fixed for the summer forecast, euro area government bond yields have risen sharply. For example, the yield on the German government's 10-year bond has increased by almost 50 basis points over this period. Thus, the assumptions made in the first half of August about developments in Estonia's government interest expenditure may be too optimistic, and higher interest expenditure than forecast can be expected.

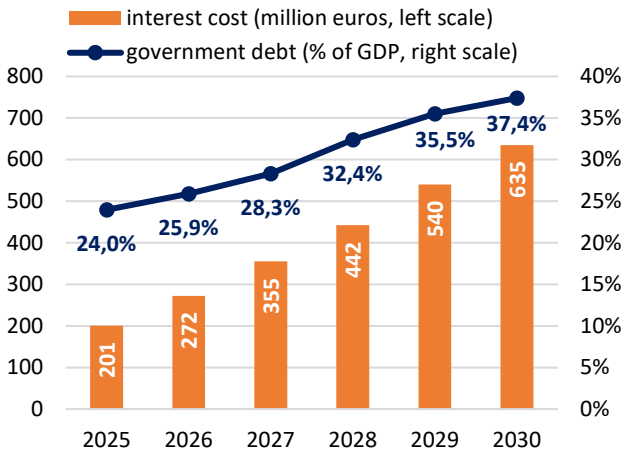


Figure 3. Government debt (% of GDP) and interest expenditure (million euros) in the State Budget Strategy for 2027–2030

Source: Ministry of Finance

Compliance with the fiscal rules

In formulating medium-term fiscal policy, both European Union and national fiscal rules must normally be taken into account. In 2025, the Estonian government applied for an escape clause from the European Union's fiscal rules in connection with increased defence expenditure and also suspended the requirements of national fiscal rules for the duration of the clause. Consequently, the timing of the reapplication of national fiscal rules and the Fiscal Council's role in assessing compliance depends on the time frame of the escape clause under the European Union's fiscal rules.

The escape clause under the European Union's fiscal rules applies to 2025–2028 and allows a budget deficit above 3% of GDP to be planned during this period for the purpose of increasing defence expenditure. The flexibility provided by the escape clause may also be used in later years if defence procurements decided upon in 2025–2028 are delivered later and the additional leeway has not been fully used by the end of 2028. This means that the flexibility provided by the escape clause for increasing defence expenditure does not have a clearly defined end date.

According to the State Budget Strategy for 2027–2030, the Estonian government intends to make maximum use of the flexibility provided by the escape clause by spreading some of the higher defence expenditure over the period after 2028. As a result, the budgetary targets set by the government this autumn do not show an improvement in the budgetary position even in 2029, when the national fiscal rules might have been expected to reapply, and the budget deficit will still exceed 3% of GDP Maastricht criteria in 2030.

Thus, the government proceeds from the interpretation that, although the national rules will reapply from 2029, the later arrival of deliveries contracted during the 2025–2028 defence expenditure escape clause may be taken into account when meeting the required improvement in the budgetary position. In other words, if such defence expenditure amounts to 0.5% of GDP or more, the requirement to reduce the structural budget deficit by 0.5% of GDP per year does not have to be met either. At present, the Fiscal Council does not have an overview of which planned defence expenditure items are expected to have such a budgetary impact after 2028.

The Fiscal Council notes that although the budgetary targets set in the State Budget Strategy for 2027–2030 comply with the requirements of the fiscal rules under a flexible interpretation of those rules, this has a significant impact on the long-term sustainability of Estonia's public finances and undermines the effectiveness and credibility of the national fiscal framework (if its requirements do not become binding again even from 2029).

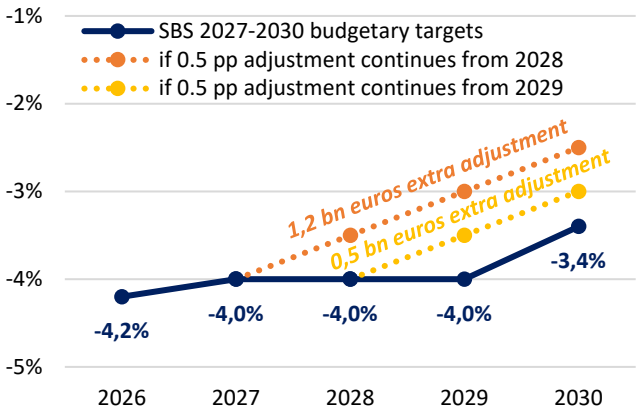


Figure 5. General government nominal budget deficit and fiscal adjustment paths (% of GDP)

Source: Ministry of Finance

Regardless of the scope and timing of the defence expenditure escape clause, the Fiscal Council recommended beginning to reduce the budget deficit gradually from 2027. Although the government has managed to reduce the deficit to 4% of GDP for 2027, the fiscal adjustment will then come to a halt. To reduce the budget deficit by a further 0.5 percentage points in each subsequent year, additional revenue or expenditure measures amounting to approximately 1.2 billion euros would have had to be identified in the budget strategy (see Figure 5). If the reduction in the budget deficit had continued from 2029, which the Fiscal Council considers could have been interpreted as the reapplication of national fiscal rules, additional measures of approximately half a billion euros would have been required.

Although the escape clause lasting (at least) four years was accompanied by an obligation to find, during that period, a permanent source of funding in the state budget for higher defence expenditure, this has not yet been done and is not envisaged in the 2027 state budget either. The fiscal adjustment included in the next year's budget consists predominantly of relatively small adjustments to the timing of government investment and EU funds.

The budget deficit remaining at around 4% of GDP in the coming years, as forecast (see Figure 6), means that decisions on the fiscal adjustment required on a scale comparable to the increase in defence expenditure have been left to the later years of the escape clause or even beyond it. However, a later fiscal adjustment comes at a higher cost, as the government debt burden and interest expenditure will continue to increase rapidly until then. If the fiscal adjustment were to continue only from 2030, government debt would not begin to decline until it has exceeded 40% of GDP.

A persistently large budget deficit set close to the fiscal rules' limit will reduce Estonia's fiscal space in the future. This limits the government's ability to respond to new short-term expenditure needs or unexpected developments without quickly coming into conflict with the requirements of the fiscal rules in an already strained public finance situation. Until a permanent source of funding has been found for higher defence expenditure, no significant fiscal buffer will emerge for other additional needs either.

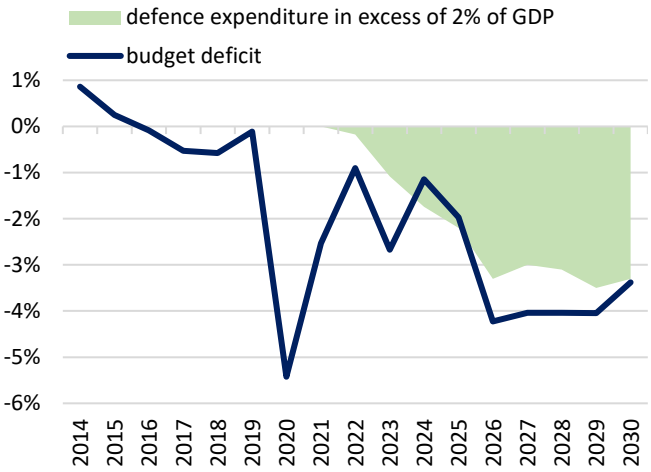


Figure 6. General government nominal budget deficit and defence expenditure (% of GDP)

Source: Ministry of Finance

The Fiscal Council still recommends that the fiscal adjustment be continued immediately after 2027 and that the government return to this task no later than when preparing the 2028 state budget. As Estonia is on course to reach its target level of defence expenditure (at least 5% of GDP) this year and the economy has also returned to growth, an annual fiscal adjustment of 0.5% of GDP is feasible and justified under current conditions. To ensure sound public finances, Estonia should begin its fiscal adjustment before the possibility of avoiding it under the European Union's fiscal framework comes to an end.