# COUNCIL RECOMMENDATION

## of 12 July 2011

## on the National Reform Programme 2011 of Estonia and delivering a Council opinion on the Stability Programme of Estonia, 2011-2015

(2011/C 213/02)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States [2], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their stability or convergence programmes and national reform programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments on time for their inclusion in their stability or convergence programmes and their national reform programmes.

(6) On 29 April 2011, Estonia submitted its 2011 stability programme covering the period 2011-2015 and its 2011 national reform programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) Estonia was particularly hard-hit by the global financial crisis, which amplified the reversal of the domestic real estate and consumption boom. The cumulative loss of GDP reached 19 % in 2008-2009 and the unemployment rate increase almost four fold to 16,8 % by 2010. However, the economy has bounced back quickly and the real GDP growth is expected to accelerate in the coming years. The recovery has been driven mainly by exports, but domestic demand is gaining ground mostly through strong investment. The improved growth outlook has provided a positive impetus to the labour market. Employment rate has risen markedly recently, although long-term unemployment remains high. While inflation accelerated compared to last year, it is expected to moderate in line with developments in the global commodity prices.

(8) Based on the assessment of the stability programme pursuant to Regulation (EC) No 1466/97, the Council

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[1] OJ L 209, 2.8.1997, p. 1.

[2] Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011 on guidelines for the employment policies of the Member States (OJ L 138, 26.5.2011, p. 56).

is of the opinion that the macroeconomic scenario underpinning the budgetary projections is plausible. The medium-term budgetary strategy of the stability programme is to achieve the medium-term objective, defined as structural balance, by 2013, and to maintain it throughout the rest of the stability programme period, by aiming at structural surpluses in 2013 and beyond. The headline general government budgetary position is projected to reach surplus by 2013, while in the short term the headline deficit is expected to deteriorate somewhat due to the one-off impact of environmental investments on carbon credits. The budgetary adjustment of the stability programme relies on holding back growth in government consumption expenditure. The stability programme provides some information regarding measures to reach the targeted position and the previous track record of meeting the fiscal targets mitigates the risk of missing them in the coming years. In particular, the envisaged reforms seek efficiency gains in several areas, such as education and active labour market policies. Risks to the budgetary targets thus appear to be broadly balanced. Nevertheless, it will be important for the upcoming budgets to provide the key details of measures to further enhance the efficiency of public spending, thus underpinning the implementation of the stability programme.

(9) Long-term unemployment remains high and unemployment rates across regions have been rather diverging and persistent. Despite considerable increases since 2009, financing of active labour market policies remains one of the lowest in the EU, and results in a low share of the unemployed receiving active support. The Estonian labour market is relatively flexible, reinforced by the decision to postpone increases in the unemployment insurance benefit coverage in the Labour Law package to 2013. Despite this flexibility, Estonia has a relatively high labour tax wedge, which could have negative consequences for labour supply and demand. This problem is particularly acute in view of the high unemployment rate of the young and the low-skilled, who are exposed to a risk of poverty. Reforms envisaged to reduce social insurance contributions address the right issues, but need to take place while strengthening the budgetary position. There is potential for efficiency gains through a stricter means testing to better target other benefits.

(10) Estonia's resource intensity is among the highest in the EU. This is partly the result of a production structure concentrated on energy-intensive sectors and industries. Another determinant is the low energy efficiency performance at sectoral level. In its national reform programme, Estonia indicates a national energy savings target of 9 % in 2016 compared to projections (16 % by 2020 in the NRP). Besides, there is little information on how and when measures will be implemented and their expected results. Hence, improving energy efficiency has further potential. Increasing energy efficiency is likely to have a positive impact on the environment and on the security of energy supply, but also to reduce inflationary pressures and improve cost competitiveness.

(11) Notwithstanding the overall high share of people with tertiary education, further reform of the education system at all levels could help address skill gaps, a large number of schools and tertiary education institutions, and a lack of focus in professional education resulting in the high share of people with no professional qualification. Given current demographic trends, improving the quality of human capital is important for raising potential growth in the medium term. In particular, ensuring that tertiary education is aimed at fields of key importance to the economy (e.g. engineering) could support the ongoing rebalancing towards tradable sectors. Implementing the education reform would also contribute to improving public sector efficiency, as the current system of managing education is too fragmented at the local level, leading to both inefficient subsidies and low-quality services.

(12) Estonia has made a number of commitments under the Euro Plus Pact. These contain measures to address public finance sustainability, employment, and competitiveness. On the fiscal side, the Pact commits to achieve budget balance by 2013 and a surplus in 2014; to include a public sector budget balance requirement in the state budget base law; as well as first steps to reform special pension schemes. In order to promote employment, some tax incentives are envisaged. For competitiveness, measures focus on innovation, higher education, and public service reform. The Pact commitments reflect the agenda presented in the national reform programme. The objectives set out in the Pact would benefit from further measures to strengthen labour market policies, as well as addressing resource efficiency and the energy market. The Euro Plus Pact commitments have been assessed and taken into account in the recommendations.

(13) The Commission has assessed the stability programme and national reform programme, and the Euro Plus Pact commitments. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Estonia but also their conformity with EU rules and guidance, given the need to reinforce the overall economic governance of the EU by providing EU-level input into future national decisions. It considers that while measures to reach the targeted budgetary position would have to be specified in forthcoming budgets, the track record of the Estonian authorities mitigates the risk of missing the fiscal targets. Further steps should be taken to strengthen labour market policies and provide better incentives to work, to enhance human capital through a large scale education reform as well as addressing resource efficiency and the energy market.

(14) In light of this assessment, the Council has examined the 2011 stability programme of Estonia and its opinion ([1]) is reflected in particular in its recommendation 1 below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the national reform programme of Estonia,

HEREBY RECOMMENDS that Estonia take action within the 2011-2012 period to:

1. Achieve structural surplus by 2013 at the latest, while limiting deficit in 2012 to at most 2,1 % of GDP, keeping tight control over expenditure and enhancing the efficiency of public spending.

2. Take steps to support labour demand and to reduce the risk of poverty, by reducing the tax and social security burden in a budgetary neutral way, as well as through improving the effectiveness of active labour market policies, including by targeting measures on young people and the long-term unemployed, especially in areas of high unemployment.

3. Ensure implementation of planned incentives to reduce energy intensity and improve the energy efficiency of the economy, targeted on the buildings and transportation sectors, including by ensuring better market functioning.

4. While implementing the education system reform, give priority to measures improving the availability of pre-school education, and enhance the quality and availability of professional education. Focus education outcomes more on labour market needs, and provide opportunities for low-skilled workers to take part in lifelong learning.

Done at Brussels, 12 July 2011.

*For the Council*

*The President*

J. VINCENT-ROSTOWSKI

([1]) Foreseen in Article 5(3) of Regulation (EC) No 1466/97.