COUNCIL OPINION

of 27 February 2007

on the updated convergence programme of Estonia, 2006-2010

(2007/C 72/02)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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 9(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 27 February 2007 the Council examined the updated convergence programme of Estonia, which covers the period 2006 to 2010.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth abates from a peak of 11 % in 2006 to 8 ¼ % in 2007 and 7 ½ % per year in the outer years. Assessed against currently available information, this scenario appears to be based on cautious growth assumptions. However, the projected medium-term path of a smooth deceleration of growth from the current pace prone to overheating is clearly surrounded by risks. The programme's projections for inflation appear realistic.

(3) For 2006, the general government surplus is estimated at 2,5 % of GDP in the Commission services' autumn 2006 forecast, against a target of 0,3 % of GDP set in the previous update of the convergence programme. The much better outcome, also expected in the new update, arises from carry-over from the better-than-expected outcome in 2005 and from the growth surprise in 2006. Expenditure has been lower than planned in the budget.

(4) The main goals of the medium-term budgetary strategy embodied in the programme are keeping the general government finances at least in balance and securing long-term sustainability in the light of the budgetary impact of population ageing. The budgetary strategy foresees the headline general government surplus to decline from 2 ½ % of GDP in 2006 to around 1 ¼ % in 2007-2008 and rebound to around 1 ½ % of GDP thereafter. The primary balance will follow a similar profile, given the negligible weight of interest expenditure. The drop in the surplus in 2007 is driven by a rise in the expenditure-to-GDP-ratio while the revenue ratio follows a declining trend. From 2008 onwards, the overall revenue and expenditure ratios decline in lock-step, reflecting notably the income tax cuts and expenditure growth remaining below the buoyant nominal GDP growth. The new programme departs from the past practice of always targeting zero balance for general government finances (which were as a rule overachieved over the last years) and targets instead a sizeable surplus over the entire programme period, which is a step forward in responding to the cyclical conditions of the economy. Compared to the previous update, the targets from 2007 onwards have been revised upwards by at least 1 percentage point of GDP against the background of a more favourable (and more realistic) macroeconomic scenario.

[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website:
http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

(5) The structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is planned to drop by about 1 percentage point to reach ½ % of GDP in 2007, and rebound to above 1 % of GDP in 2008 and above 1 ½ % of GDP in 2009 and 2010. As in the previous update of the convergence programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a balanced position in structural terms which the programme plans to maintain throughout the programme period. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around 2 % of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro-area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is significantly more demanding than implied by the debt ratio and average potential output growth in the long term.

(6) The risks to the budgetary projections in the programme appear broadly balanced. The programme's macroeconomic assumptions can be regarded as cautious over the programme period. The tax revenue projections appear overall plausible. However, the achievement of the envisaged moderation in expenditure growth would benefit from making the medium-term fiscal planning framework more binding.

(7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the MTO by a large margin throughout the programme period, as envisaged in the programme. A fortiori, it provides a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations over the programme period. The fiscal policy stance implied by the programme is not fully in line with the Stability and Growth Pact in the sense that it is pro-cyclical in good times during 2007, when the structural balance is set to decline by around 1 % of GDP.

(8) Government gross debt is estimated to have fallen to 3,7 % of GDP in 2006, far below the 60 % of GDP Treaty reference value. The programme projects the debt ratio to decline by a further 2 percentage points over the programme period.

(9) The long-term budgetary impact of ageing in Estonia is among the lowest in the EU, with age-related expenditure projected to fall as a share of GDP over the coming decades, influenced by the considerable expenditure-reducing impact of the reform of the pension system. The current level of gross debt is very low in Estonia and maintaining sound government finances, in line with the budgetary plans over the programme period, would contribute to containing the risks to the long-term sustainability of public finances. Overall, Estonia appears to be at low risk with regard to the sustainability of public finances.

(10) The convergence programme contains a qualitative assessment of the overall impact of the October 2006 Implementation Report of the National Reform Programme within the medium-term fiscal strategy. In addition, it provides some information on the direct budgetary costs or savings of the main reforms envisaged in the National Reform Programme and its budgetary projections explicitly take into account the public finance implications of the actions outlined in the National Reform Programme. The measures in the area of public finances envisaged in the convergence programme seem consistent with those foreseen in the National Reform Programme. In particular, both programmes emphasise prudent fiscal policies as a crucial element of macroeconomic stabilisation.

(11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data ([1]).

([1]) In particular, some labour market variables and the data on net lending/borrowing of the private sector are missing.

The overall conclusion is that the medium-term budgetary position is sound and the budgetary strategy provides a good example of fiscal policies conducted in compliance with the Stability and Growth Pact. Nevertheless, the planned weakening of the budgetary surplus in 2007 during good economic times implies a pro-cyclical stance of fiscal policy.

In view of the above assessment, Estonia is invited to aim for a higher budgetary surplus in 2007 than planned in the programme so as to foster macroeconomic stability and to continue supporting the correction of the external imbalance.

Comparison of key macroeconomic and budgetary projections

		2005	2006	2007	2008	2009	2010
Real GDP (% change)	**CP Dec 2006**	**10,5**	**11,0**	**8,3**	**7,7**	**7,6**	**7,5**
	COM Nov 2006	10,5	10,9	9,5	8,4	n.a.	n.a.
	CP Nov 2005	*6,5*	*6,6*	*6,3*	*6,3*	*6,3*	*n.a.*
HICP inflation (%)	**CP Dec 2006**	**4,1**	**4,4**	**4,3**	**4,4**	**3,5**	**3,2**
	COM Nov 2006	4,1	4,4	4,2	4,6	n.a.	n.a.
	CP Nov 2005	*3,5*	*2,6*	*2,6*	*2,7*	*2,7*	*n.a.*
Output gap (% of potential GDP)	**CP Dec 2006** (1)	**0,2**	**2,0**	**1,2**	**0,2**	**– 0,3**	**– 0,7**
	COM Nov 2006 (5)	0,0	1,2	0,9	– 0,6	n.a.	n.a.
	CP Nov 2005 (1)	*– 0,4*	*– 0,6*	*– 0,7*	*– 0,5*	*– 0,1*	*n.a.*
General government balance (% of GDP)	**CP Dec 2006**	**2,3**	**2,6**	**1,2**	**1,3**	**1,6**	**1,5**
	COM Nov 2006	2,3	2,5	1,6	1,3	n.a.	n.a.
	CP Nov 2005	*0,3*	*0,1*	*0,0*	*0,0*	*0,0*	*n.a.*
Primary balance (% of GDP)	**CP Dec 2006**	**2,5**	**2,8**	**1,4**	**1,4**	**1,7**	**1,6**
	COM Nov 2006	2,5	2,7	1,8	1,5	n.a.	n.a.
	CP Nov 2005	*0,5*	*0,3*	*0,2*	*0,1*	*0,1*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**CP Dec 2006** (5)	**2,2**	**2,0**	**0,8**	**1,2**	**1,7**	**1,7**
	COM Nov 2006	2,3	2,2	1,4	1,5	n.a.	n.a.
	CP Nov 2005 (1)	*0,4*	*0,3*	*0,2*	*0,1*	*0,0*	*n.a.*
Structural balance (2) (% of GDP)	**CP Dec 2006** (3)	**2,2**	**1,4**	**0,4**	**1,2**	**1,7**	**1,7**
	COM Nov 2006 (4)	2,2	1,5	1,0	1,3	n.a.	n.a.
	CP Nov 2005	*0,4*	*0,3*	*0,2*	*0,1*	*0,0*	*n.a.*

		2005	2006	2007	2008	2009	2010
Government gross debt (% of GDP)	**CP Dec 2006**	**4,5**	**3,7**	**2,6**	**2,3**	**2,1**	**1,9**
	COM Nov 2006	4,5	4,0	2,7	2,1	n.a.	n.a.
	CP Nov 2005	*4,6*	*4,4*	*3,3*	*3,0*	*2,8*	*n.a.*

Notes:

(1) Commission services calculations on the basis of the information in the programme.

(2) Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.

(3) One-off and other temporary measures taken from the programme (0,6 % of GDP in 2006 and 0,4 % in 2007; all deficit-reducing).

(4) One-off and other temporary measures taken from the Commission services' autumn 2006 forecast (0,2 % of GDP in 2005, 0,6 % of GDP in 2006, 0,4 % of GDP in 2007 and 0,2 % in 2008; all deficit-reducing).

(5) Based on estimated potential growth of 9,1 %, 9,6 %, 9,9 % and 9,9 % respectively in the period 2005-2008.

Source:

Convergence programme (CP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations.