The medium-term budgetary framework in Estonia

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Vilnius, June 3

Evolution of the fiscal framework

From the early 1990s – political commitment to keep annual budgets close to balance (currency board arrangement)

2000 – the first document resembling a medium-term budget strategy was produced

2002 – the annual duty to draft the strategy was put in the State Budget Act

2003 – the first state budget strategy (SBS) was produced

2006 – forecasts for the structural balance were given in the document for the first time, in the SBS 2007−2010

2010 – forecasts for the structural balance were presented as 'targets' for the first time, in the SBS 2011−2014

since 2011 – the four main strategy documents of the government are annually updated at the same time and in coordination

2014 – the new State Budget Act entered into force

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State Budget Act of 2014

There was previously a long-term commitment to the 'soft' budget balance rule that applied to the general government balance and was adhered to by all governments but was not formalised in law.

In 2014, the fiscal framework was strengthened to comply with the TSCG:

- a balanced-budget rule in structural terms was now introduced into national legislation
- correction and compensation mechanisms were added as well
- an independent fiscal institution, the Fiscal Council of Estonia, was set up to monitor compliance with it

MTBF in Estonia takes the form of the state budget strategy

- The state budget strategy (SBS) is a country-specific document produced by the Ministry of Finance each spring alongside the Stability Programme
- It is approved by the government and then presented to the parliament
- It presents projections and targets for the main aggregates of government finances for the current and the next four years based on the MoF's macroeconomic scenario
- It uses a rolling and flexible framework: a new year is added to the framework each year, and at the same time the planned targets for the intermediate years are revised
- It provides a constant four-year perspective in strategic planning and plays a guiding role in the annual budgeting process

The structural balance rule is the main cornerstone of the framework

- The law requires the state budget for each year to be planned so that the budget for the general government is at least in structural balance
- The law also provides for a correction mechanism and a compensation mechanism should a structural deficit greater than 0.5% of GDP occur
- The balanced-or-better rule introduced in national legislation is stricter than EU requirements would allow

- The state budget strategy presents targets for the general government structural budget position for the next four years
- These targets must respect the structural balance requirement
- However, the specific values of the surpluses can be revised each spring, and usually are in practice

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An example from the SBS 2014–2017

Table 1 Budgetary position objective of the general government for 2013–2017

	2013	2014	2015	2016	2017
Structurally adjusted budgetary position of general government (% of GDP)	**0.3**	**0.7**	**0.7**	**1.0**	**1.0**
Budgetary position of general government (% of GDP)	**-0.5**	**0.0**	**0.2**	**0.7**	**0.8**
State budget	-0.6	0.0	0.0	0.5	0.7
incl. state pension insurance	-1.8	-2.0	-2.1	-2.1	-2.0
Other central government	0.0	-0.2	-0.1	0.0	-0.1
Social security funds	0.3	0.3	0.4	0.4	0.4
Local governments	-0.2	-0.2	-0.2	-0.2	-0.2
Budgetary position of general government (mln euros)	**-95**	**-9**	**32**	**155**	**187**
State budget	-110	-7	5	104	165
incl. state pension insurance	-325	-388	-439	-457	-474
Other central government	-7	-34	-16	5	-30
Social security funds	54	64	76	81	90
Local governments	-31	-32	-32	-35	-39

Source: Ministry of Finance.

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Link between the targets set in the SBS and the annual budget (compared to the eventual outcome)

- The targets for the structural budget position set in the SBS are revised each spring
- The annual budget may deviate from the SBS as long as structural balance is respected
- The targets have been less ambitious in recent SBSs, especially for the later years

Targets for the structural balance (% of GDP)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
SBS 2011−2014	0.7	0.1	0.5	1.0						
SBS 2012−2015		0.1	0.6	0.8	1.1					
SBS 2013−2016			0.1	0.5	0.7	1.0				
SBS 2014−2017				0.7	0.7	1.0	1.0			
SBS 2015−2018					0.2	0.0	0.2	0.2		
SBS 2016−2019						0.6	0.2	0.2	0.6	
SBS 2017−2020							0.2	0.0	0.0	0.0
Annual budget plan	−0.1	0.3	0.1	0.8	0.8	0.6				
MoF’s latest estimates	0.1	−0.4	−0.7	0.2	1.0	0.3				

Other budgetary rules also contribute to maintaining the budget balance

- The annual state budget is the main tool for ensuring compliance with the structural balanced budget rule
- Specific regulations for general government sub-sectors also contribute to maintaining the budget balance:
  - restrictions for central government and local government borrowing
  - a balanced-or-better requirement for the operating results of central government entities such as theatres, universities and hospitals

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Role of the Fiscal Council in the current framework

- The Council assesses the soundness of the economic forecasts underlying the state budgets and the state budget strategies
- The Council monitors compliance with the structural balance rule (*ex ante* and *ex post*), but not necessarily compliance with the other budgetary rules
- The Council gives its opinion on the targets for the structural budget position before the SBS and the Stability Programme are approved, looking at the budgetary rules and the need to adjust the structural budget position
- In this way it also contributes to increased transparency in the medium-term budgetary objectives
- There is however no formal obligation for the government to implement the recommendations made by the Council ('comply-or-explain' principle)

Recommendations from the European Commission and the IMF

Country-specific recommendations (*European Commission 2015, 2016*):

- the binding nature of the expenditure ceilings in the MTBF has not been strengthened and no expenditure rules have been introduced
- some uncertainties remain in medium-term fiscal planning, in particular due to the focus on the structural balance target and the problem of measuring the cyclical position of a small open economy
- there is a lack of mechanisms or a numerical rule for sustainable expenditure planning linked to longer-term targets
- the lack of more binding multi-year expenditure rules limits the counter-cyclicality of the framework

Article IV consultation (*IMF 2015*):

- in the longer run, the rule itself could be made more flexible and allow modest structural deficits in line with European requirements while preserving overall prudent fiscal policy

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