



Mr Maarten Verwey
European Commission
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Your ref. 08.05.2024 No

Our ref. 17.05.2024 No 11-4.1/2318-2

**Estonia - Proceedings related to
fiscal surveillance: Letter on
relevant factors for 126(3) reports -
2024**

Dear Mr Verwey,

I am writing you in response to the letter on relevant factors in relation to upcoming Commission report under Article 126 (3) of the Treaty.

First, let me emphasise that Estonia continues to take the fiscal rules and commitments seriously. The Government has underlined its commitment to keep the public finances in order in its latest State Budget Strategy in 2023 and confirmed the target of following our European obligations and domestic fiscal rule of 1% GDP deficit in structural terms in the latest Stability Programme 2024.

As you referenced in your letter, general government deficit in Estonia did breach the Treaty reference value in 2023. This is the reflection of wide range of actions taken by Estonian government in response to effects of the Russia's unjust invasion of Ukraine and to the wider security situation. According to the data of the Classification of the Functions of Government (COFOG), spending on the defence increased by nearly 50%, from the level of 2,2% of GDP in 2022 to 3,1% of GDP in 2023. In addition to that, the Kiel institute ranks Estonia as the largest contributor in terms of bilateral support to Ukraine ¹.

I would like also to point to the fact, that the economic situation was exceptionally difficult for Estonia in 2023. Main trading partners of Estonia all experienced different issues, resulting in extremely weak external demand. Coupled with the historically low business and consumer confidence, economy contracted by 3,0% in real terms compared to previous year, which had a major impact on the revenues of the general government. However, taking all this into account, the deficit for 2023 turned still out to be lower than was expected in the Draft Budgetary Plan for 2023 (where it was forecasted to reach 3,8% of the GDP).

Adverse conditions in terms of the economy will also dominate the picture in 2024. Economy will slowly stabilize, and the quarterly growth will return later in the year, but the Spring Forecast of the Ministry of Finance still sees zero real growth for the entire year. At the same time, it is important to emphasise, that the Government continues to implement the budget which the Commission assessed to be in line with the Council Recommendation in its opinion of the Estonia's Draft Budgetary Plan of 2024.

¹ <https://www.ifw-kiel.de/topics/war-against-ukraine/ukraine-support-tracker/>

But as the underlying economic situation has turned out worse than was expected at the time of the compilation of the 2024 budget, the Spring Forecast of the Ministry of Finance points to the breach of 3% of GDP deficit limit and the breach is also confirmed by the Spring 2024 Forecast of the Commission. The Government has therefore started a process of a supplementary budget with a clear target of reducing the deficit below 3% already this year with range of spending cuts considered.

Looking forward, I would once more like to stress the challenge posed by the security situation and the impact of that to the overall budgetary position. The Government has decided that, given the overall adverse security situation in Europe, the minimum required annual defence spending will be at the level of 3% of GDP, at least for the medium term. In 2024, the level of spending on defence is planned to increase to 3,4% of GDP, stabilising in following years. Furthermore, it is also important to note that the actual concept of defence investments (measured in gross fixed capital formation) does not cover the whole need in terms of additional security spending. It could be argued that a cost of needed ammunition could be substantial as well, together with the actual training of the personell to use the additional equipment.

As to your request for data on the increase of government investment in defence, our preliminary indications from government accounts are showing the increase of 0,45% of GDP in 2023 and 0,44% of GDP in 2024.

Finally, I would like to underline again that we do consider the breach of the deficit limit temporary and the conditions exceptional in 2023 and 2024. In addition to that, the Government intends to take corrective actions already in 2024 and decide on further specific measures for 2025 in coming months.

Yours sincerely,



Mårten Ross
Adviser to Ministry