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#### COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2017 National Reform Programme of Estonia and delivering a Council opinion on the 2017 Stability Programme of Estonia

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Recommendation for a

**COUNCIL RECOMMENDATION**

**on the 2017 National Reform Programme of Estonia**

**and delivering a Council opinion on the 2017 Stability Programme of Estonia**

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**COUNCIL RECOMMENDATION**

**on the 2017 National Reform Programme of Estonia**

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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,<sup>1</sup> and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,<sup>2</sup>

Having regard to the resolutions of the European Parliament,<sup>3</sup>

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 16 November 2016, the Commission adopted the Annual Growth Survey,<sup>4</sup> marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,<sup>5</sup> in which it

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> COM(2017) 506 final.

<sup>3</sup> P8\_TA(2017)0038, P8\_TA(2017)0039, and P8\_TA(2017)0040.

<sup>4</sup> COM(2016) 725 final.

<sup>5</sup> COM(2016) 728 final.

did not identify Estonia as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March 2017.<sup>6</sup>

- (2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Estonia should ensure the full and timely implementation of the Recommendation for the euro area that is reflected in recommendation 1 below.
- (3) The 2017 country report for Estonia<sup>7</sup> was published on 22 February 2017. It assessed Estonia's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Estonia's progress towards its national Europe 2020 targets.
- (4) On 28 April 2017, Estonia submitted its 2017 Stability Programme and on 4 May 2017 Estonia submitted its 2017 National Reform Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,<sup>8</sup> where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.<sup>9</sup>
- (6) Estonia is currently in the preventive arm of the Stability and Growth Pact. In its 2017 Stability Programme, the government lowered its medium-term budgetary objective from a structural balance to a deficit of 0.5% of GDP. The government plans to move from a general government surplus of 0.3% of GDP in 2016 to a deficit of 0.5% of GDP in 2017 and 0.8% of GDP in 2018. According to the estimates of the Stability Programme, this corresponds to a structural surplus of 0.2% of GDP in 2017 and a deficit of 0.5% of GDP in 2018, respecting the medium-term budgetary objective. However, based on the recalculated<sup>10</sup> structural balance, the deficit is projected to amount to 0.1% of GDP in 2017 and 0.9% of GDP in 2018, below the new medium-term budgetary objective. According to the Stability Programme, gross government debt is projected to remain below 10% of GDP in 2017 and 2018. The macroeconomic scenario underpinning these budgetary

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<sup>6</sup> OJ C92/01, 24.3.2017, p. 1.

<sup>7</sup> SWD(2017) 72 final.

<sup>8</sup> Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347, 20.12.2013, p. 320.

<sup>9</sup> COM(2014) 494 final.

<sup>10</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

projections is plausible for 2017 and 2018, but it is favourable for the later years of the programme. At the same time, there are risks linked to the revenue yield assumptions related to the various new tax measures taking effect in 2018.

- (7) Based on the Commission 2017 spring forecast, the structural balance is projected to register a deficit of 0.3% of GDP in 2017, remaining above the medium-term budgetary objective. In 2018, Estonia is recommended to remain at the medium-term budgetary objective. Under unchanged policies, there is a risk of some deviation from that requirement. Overall, the Council is of the opinion that Estonia needs to stand ready to take further measures to ensure compliance in 2018.
- (8) Estonia has taken action to ensure the provision and accessibility of high-quality services, including social services at local level as part of its local government reform. In particular, Estonia has adopted the Administrative Reform Act with a view to making it easier to create viable local municipalities that can finance their own activities, to plan development and growth, and to offer quality services. It successfully completed the voluntary phase of the merger of local municipalities and it is implementing the Social Welfare Act. Some key steps to complete the local government reform have not yet been taken. The revision of the financing scheme for municipalities is still pending. Further legislative acts on the responsibilities and division of tasks between municipalities and central government are still in preparation. Adopting these proposals is critical to ensuring the provision of quality public services in areas such as education, youth work, health promotion and transport.
- (9) The gender pay gap in Estonia fell from 28.3 % in 2014 to 26.9 % in 2015 but is still the highest in the Union. The government is taking steps to further narrow the gender pay gap. In particular, the 2016-2023 Welfare Plan has been adopted and is being implemented to tackle gender segregation in the labour market and to fight stereotypes. The modification of the Gender Equality Act to give the labour inspectorates the task of more closely monitoring gender equality in the private sector has still to be adopted. The revision of the parental leave system to allow a more flexible take-up of parental leave is also being considered. The legislative change has not yet been adopted.
- (10) Income inequality in Estonia is high. The ratio of incomes of the richest 20 % of households to that of the poorest 20 % rose from 5.4 in 2012 to 6.2 in 2015, and is now the seventh highest in the EU. The key driver appears to be the high wage dispersion as a result of strong income growth among the higher skilled. In absolute terms, the incomes of the poorest 10 % of households have lagged behind growth in median incomes, leading to problems with the adequacy of the social safety net. A contributing factor is that benefits (particularly pensions, social assistance and unemployment benefits) are not keeping pace with the growth in market incomes. This has also resulted in a gradual increase in the at-risk-of-poverty rate from 15.8 % in 2010 to 21.6 % in 2015. Substantial efforts have been undertaken to make the tax system more progressive as of 2018, in particular for low-income earners, by raising the basic allowance of the personal income tax system.
- (11) Business enterprise expenditure in research, technology and innovation increased in 2015 to 0.69 %, but its overall level remains below EU average of 1.3 %. The share of high-technology and knowledge-intensive companies remains limited and the

number of new doctoral graduates is low. Wage growth has consistently exceeded productivity growth in recent years, affecting profits and thereby pulling investment growth downwards. Subdued investment in technological development may cause the value-added of exports, especially goods, to increase less than expected, and poses a risk to output growth. The volume of contract research between academia and businesses increased in 2015. However, cooperation between the two sectors remained limited despite the measures taken by the government. Estonia has further improved its business environment, but the lengthy insolvency proceedings and recovery rate for secured creditors remain barriers to investment. A project to improve the insolvency framework was launched in 2016 to make the process faster and more efficient and to improve the rate of successful demands. However, amendments to the legislative framework have not yet been adopted.

- (12) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Estonia's economic policy and published it in the 2017 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Estonia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Estonia, but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions.
- (13) In the light of this assessment, the Council has examined the Stability Programme and its opinion<sup>11</sup> is reflected in particular in recommendation 1 below,

HEREBY RECOMMENDS that Estonia take action in 2017 and 2018 to:

1. Pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which implies to remain at its medium-term budgetary objective in 2018. Ensure better adequacy of the social safety net. Take measures to reduce the gender pay gap, in particular by improving wage transparency and reviewing the parental leave system.
2. Promote private investment in research, technology and innovation, including by implementing measures for strengthening the cooperation between academia and businesses.

Done at Brussels,

*For the Council*  
*The President*

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<sup>11</sup> Under Article 5(2) of Council Regulation (EC) No 1466/97.