Ministry of Finance of the Republic of Estonia

Fiscal consolidation in Estonia

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Structure of the Presentation

I. Fiscal policy

II. Consolidation process

III. Consolidation effort 2008+

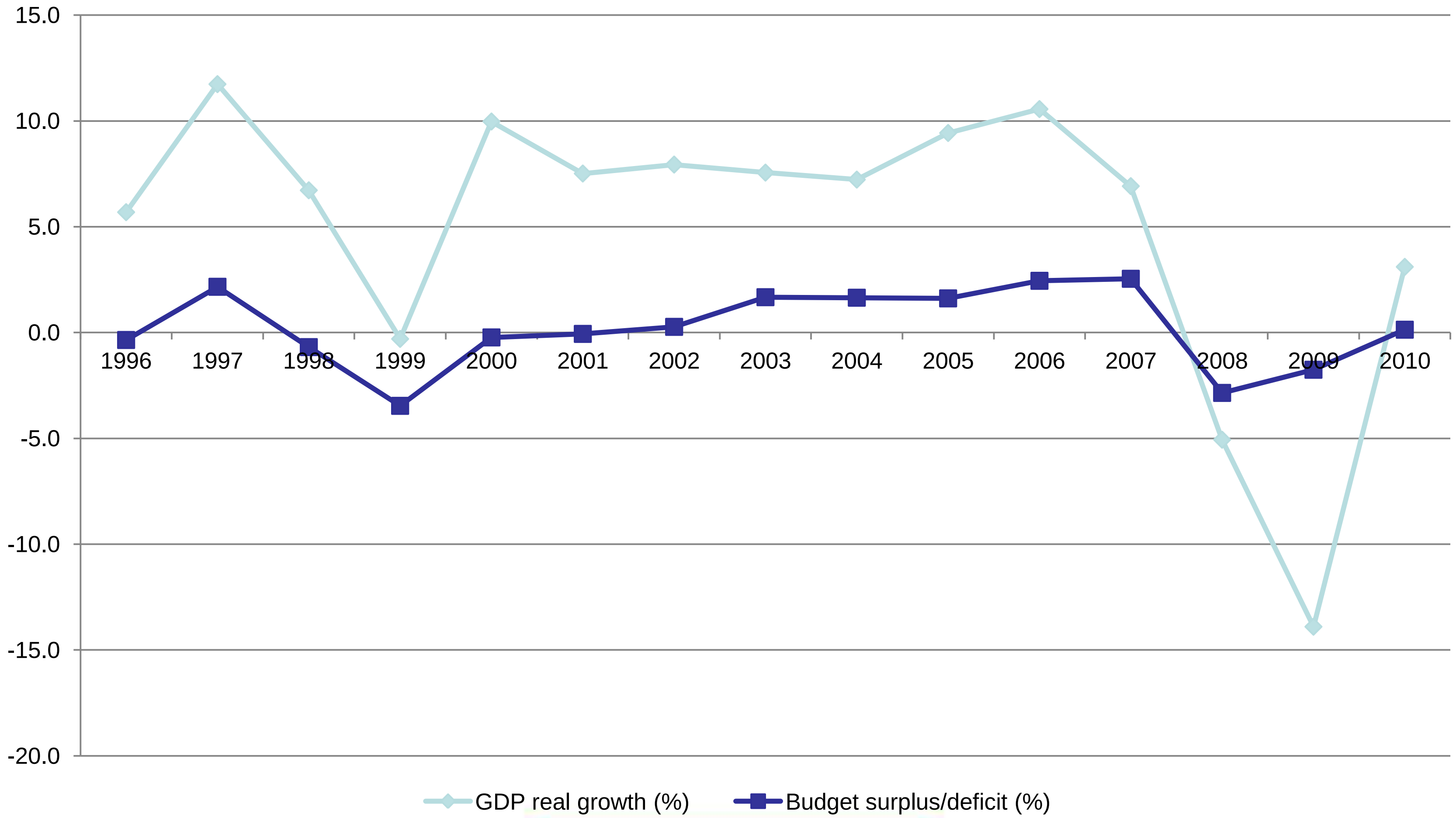
IV. Conclusions

I. Fiscal policy

Culture of prudence – enables to switch on the autopilot

- Sound fiscal management since transition - natural preference of conservative fiscal policy
- Small and efficient government sector
  - Total government expenditures 40% of GDP
  - Central government 75% of general government
- Stakeholder accountability (by state, by tax-payer, as a member of eurozone, NATO)
- Mid-term budgetary objective “balanced or in surplus” well rooted informally for a long time

Estonia`s budget fairly balanced over the last decade



II. Consolidation process

Consolidation need internally driven

- Very strong political commitment
- Fiscal issues were the priority:
  - the cabinet discussed budget 2009 37 times
  - almost the length of an entire working month
- Prerequisite for strong budget cuts:
  - flexibility within the system and the administration
  - no budget line is fixed – almost each and every budget item can be cut
  - laws can be amended, eg: 29 laws were modified, attached to negative supplementary budget 2009
- Good legal discussions: which expenditures can be cut?

III. Consolidation Effort 2008+

Consolidation at Glance

- 2008: 4,1% of GDP
- 2009: more than 9% of GDP
- 2010: 2,8% of GDP

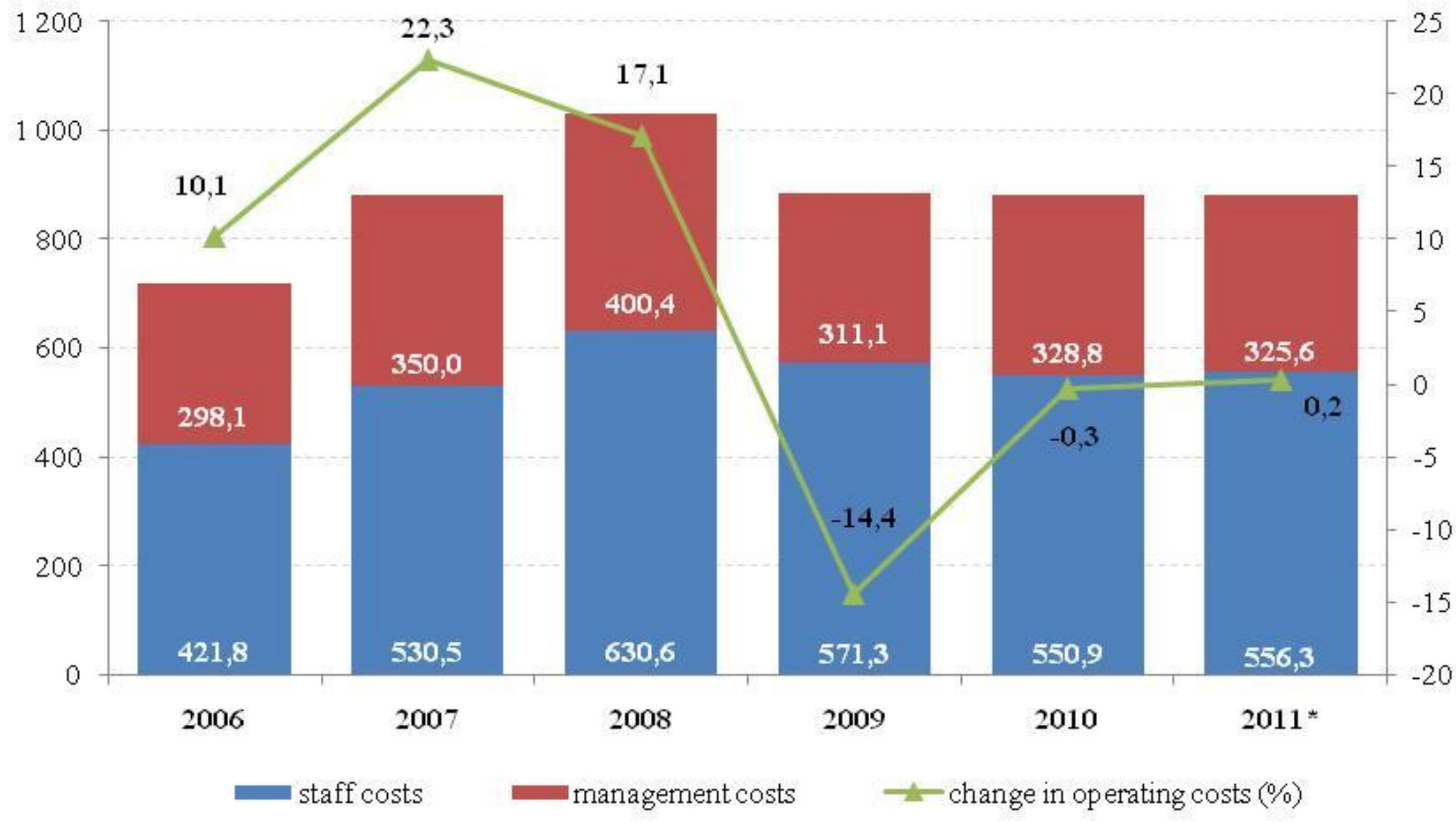
- 2/3 of measures on the expenditures side
- 1/3 of measures on the revenues side

- Ca 70 % long-term measures
- Ca 30 % one-offs (incl. 1+ years)

Cuts covered most of the agents. Some examples:

- Cut of operational expenditures of the public sector (20% compared to pre-crisis level)
- Lower increase of pensions from 2009 onwards (5% increase in 2009 instead of ca 14%, no increase in 2010 and 2011)
- Major cuts of road maintenance, local gov. funding, defence budget
- Reform of the compensation scheme for sick days and reduction of health insurance costs by 8%
- Suspending govt. co-payments to the II pillar pension funds for 2009 and 2010, gradual resumption of payments thereafter
- Borrowing of local government curbed by a law (2009-2010) – same measure for public foundations
- Etc

Positioning of public administration as a frontrunner helped to legitimate budget cuts



* available resources (budget, with funds transferred from the previous year)

The slowdown of the economy counterbalanced the effect of the indirect tax rises on prices

- Rise of unemployment insurance tax
- Rise of alcohol, fuel and tobacco excise
- Rise of VAT from 18% to 20%
- Dividends from the state owned companies
- Sale of land
- Temporary stop of the step-by-step lowering of the income tax rate

IV. Conclusions

What has changed after consolidations?

- More control over other general government players
- Better capability to assess general government budget position
- Stronger tools and techniques for planning and monitoring
- Much better knowledge on budgetary issues – politicians, general public, public administr.
- Different thinking

Lessons learned

- Consolidation pays off even in a relatively short term, at least in a small, open and flexible economy

- Buffers are needed for the future: that gave a breathing space when it was most needed and the market conditions for lending were in the heights

- EU money helped – the level of expenditures did not fall during the crisis

Thank you!