

Sound public finances in Estonia. Why and how?

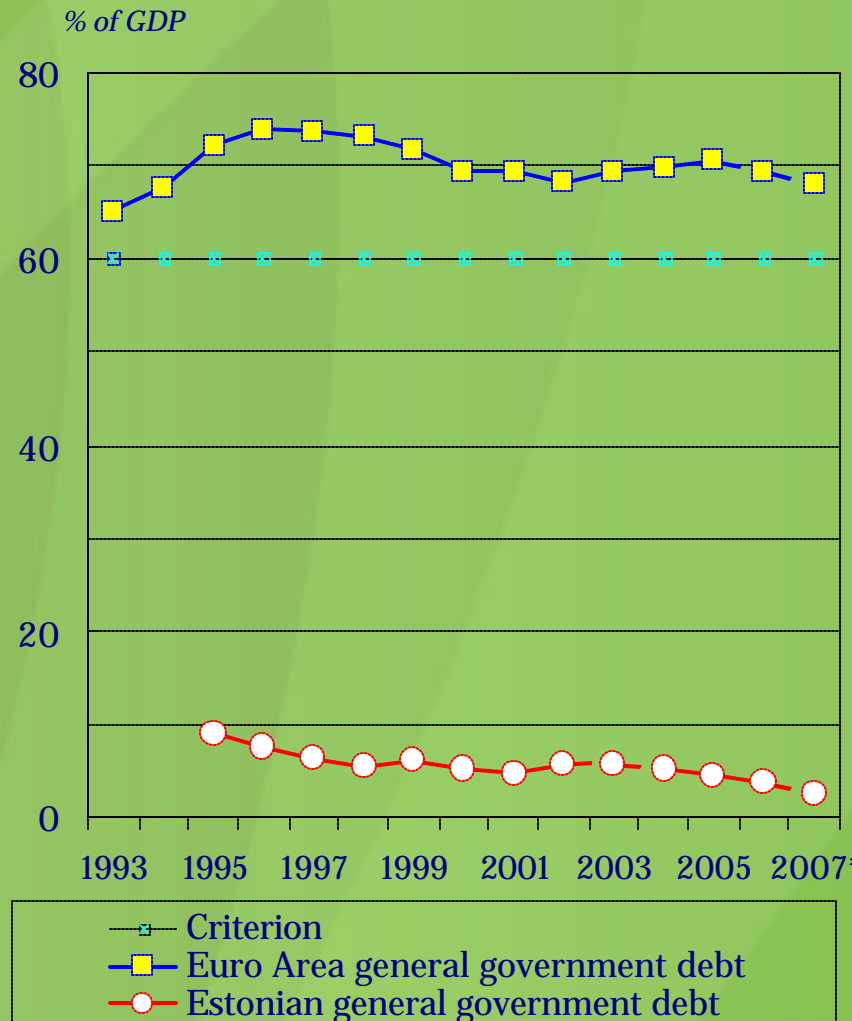
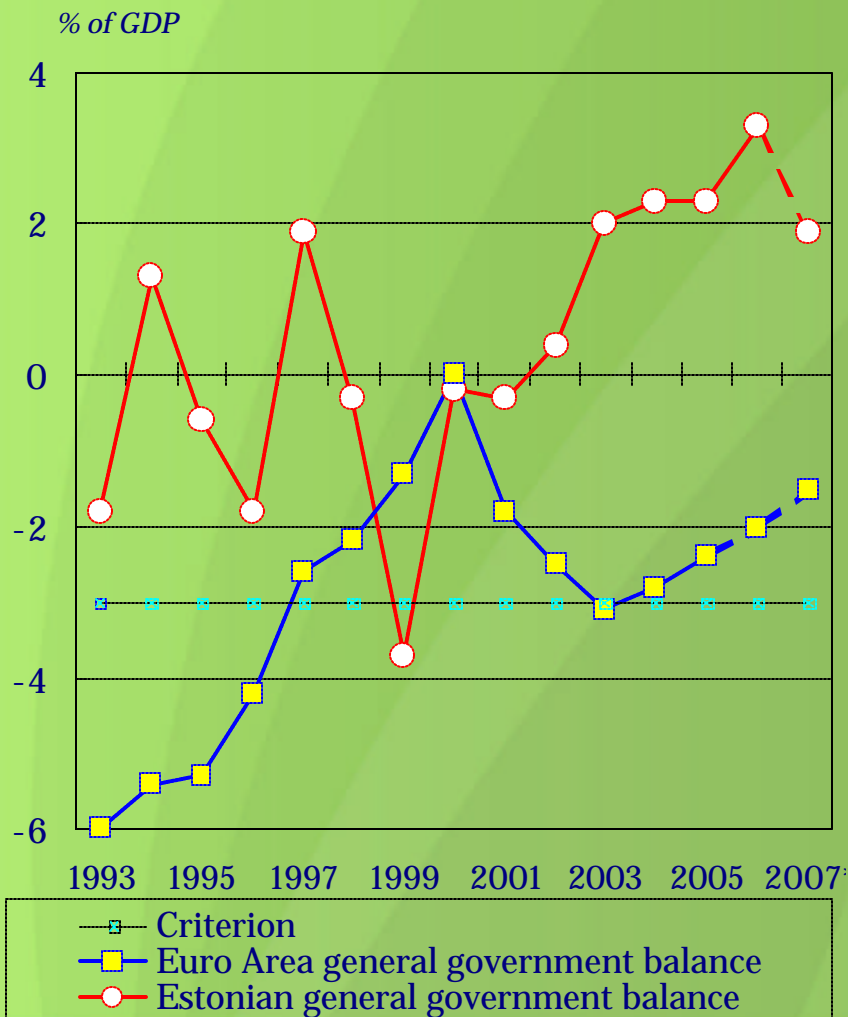
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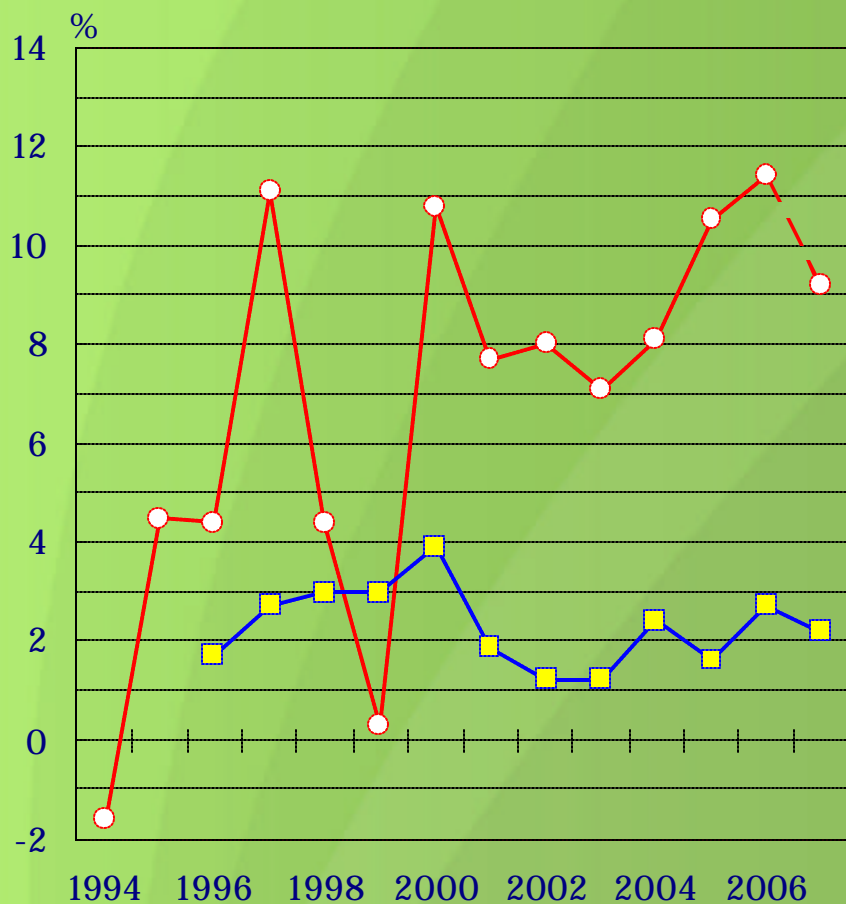
March 16, 2007



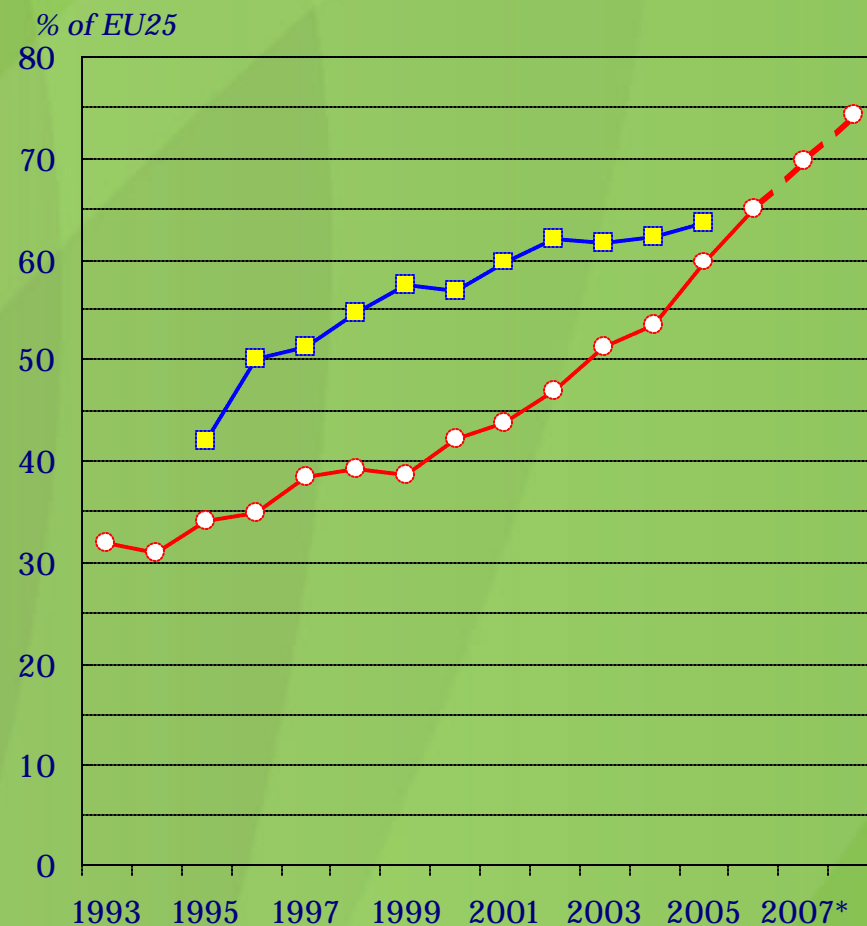
General gov. budget balance and debt



Economic growth



● Estonian GDP growth
 ■ EU GDP growth



● GDP per capita in PPS
 ■ Comparative price level



Factors to support Estonian development

- Economic and fiscal policy principles:
 - Currency Board arrangement.
 - Conservative fiscal policy.
 - Liberal trade and investment policies.
 - Broad tax base with low rates.
- Budgetary framework:
 - Numerical fiscal rules;
 - Budget procedures.
- Outside pressure, joining the EU:
 - Attention on the medium-term planning – JA, PEP, CP, SP (hopefully soon).
 - Stability and Growth Pact (SGP).



National budgetary rules

- Rules should be simple, clear and transparent.
- Estonian budgetary rules:
 - Balanced general government budget. In the constitution according to a famous myth but actually not written down in the law.
 - Local municipalities debt level shall not exceed 60% of proposed budget revenue for that budgetary year (75% until 2004).
 - Debt servicing shall not exceed, in any coming budgetary year, 20% of the proposed budget revenue for the budgetary year during which the loans are taken.
- Balanced budget rule is deeply rooted in the peoples minds.



Budgetary procedures

- View on the longer term: according to State Budget Act, budget is based on the medium-term budget strategy.
- View on the general government by preparing the state budget.
- Budget includes all the revenues, expenditures and financial transactions of the government (i.e also the EU grants and other foreign aid).
- Ministries and other government institutions are not allowed to take loans. All such decisions have to be made by the Government.
- According to State Budget Act Parliament cannot make worse the position of the budget presented by the Government.

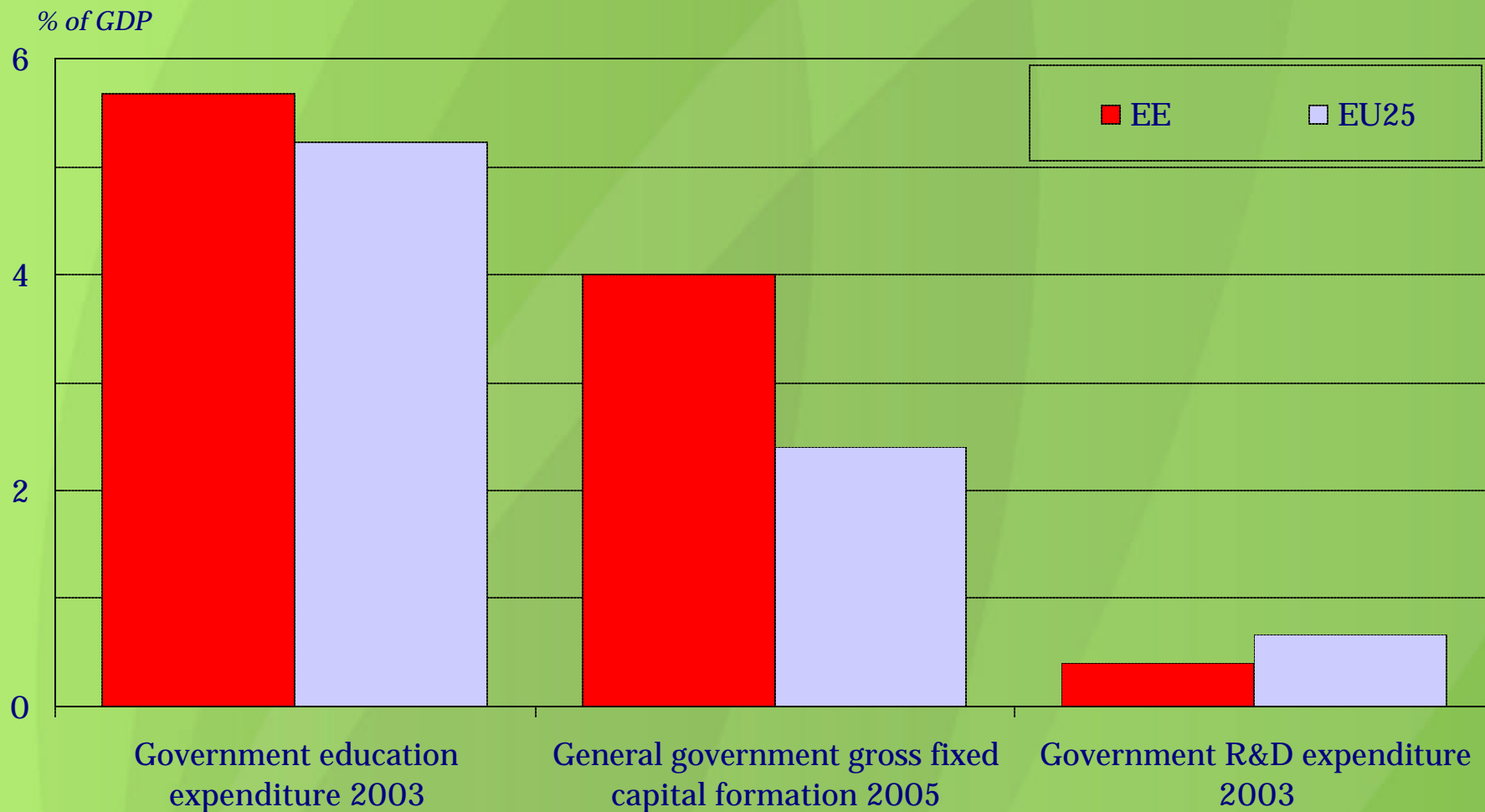


Are the Estonian and SGP rules too restrictive?

- There isn't any trade-off between stability and growth.
 - Several member states have achieved both.
- Investment are possible without big deficit.
 - It's possible to have investments and big R&D expenditure without big deficits.
 - Countries with biggest education expenditure are having budget surpluses.
- The key is quality of public finances and directing expenditure to more growth-enhancing activities.



Estonian government's willingness to invest in economy and people

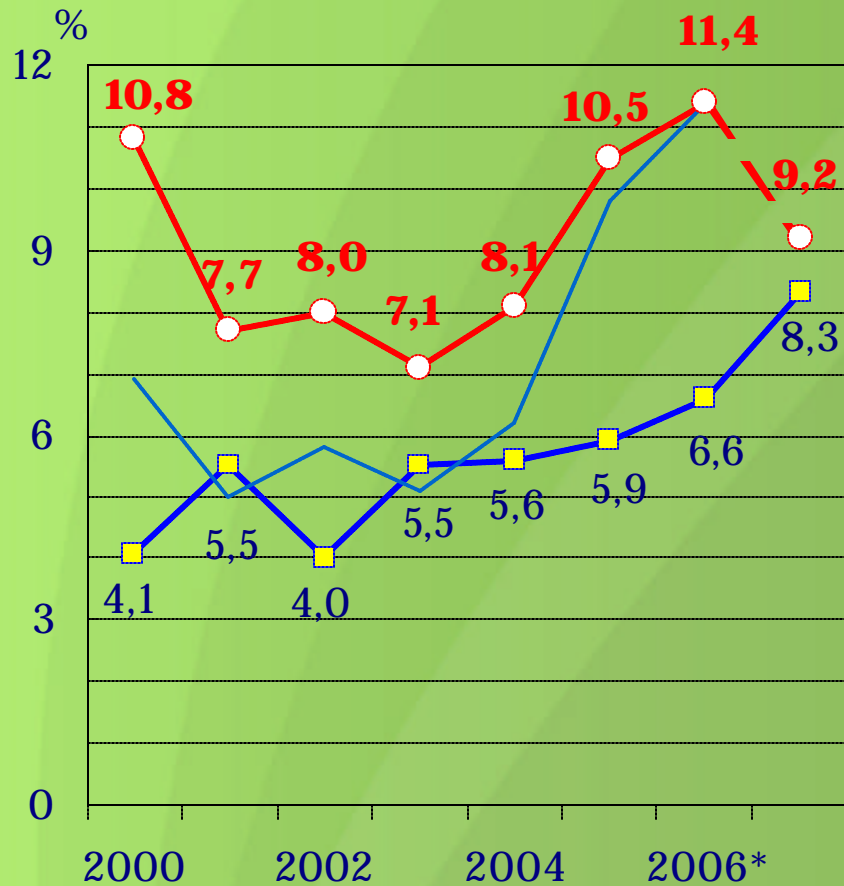


Possible problems

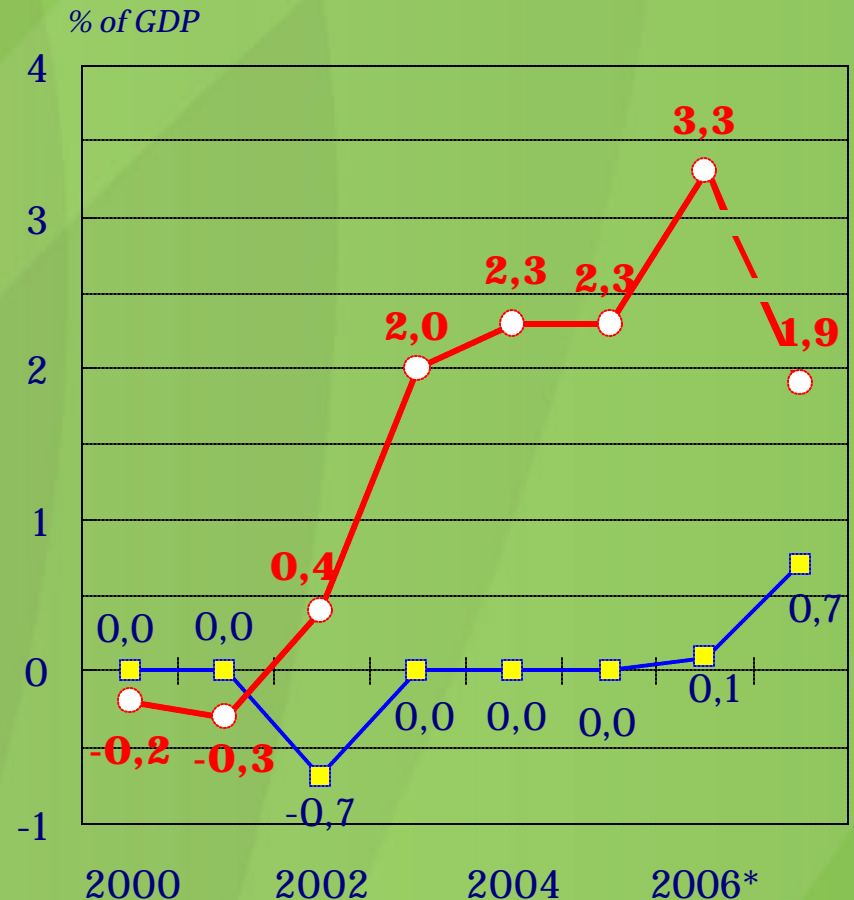
- Balanced budget rule has served us well but there is a risk of fiscal policy turning pro-cyclical.
- Possible solution: to look on the cyclical budgetary position. But:
 - It's complicated to estimate the potential growth and output gap.
 - The estimates are frequently changed.
 - Risk of losing the current balanced budget anchor.
- It's possible to work also with the current rules.
 - Let the automatic stabilisators work.
 - Save the windfall revenues.



Budget forecast and real outcome



- First release of GDP growth
- Actual economic growth
- Budget forecast



- Actual GG budget balance
- Budget forecast



Future challenges

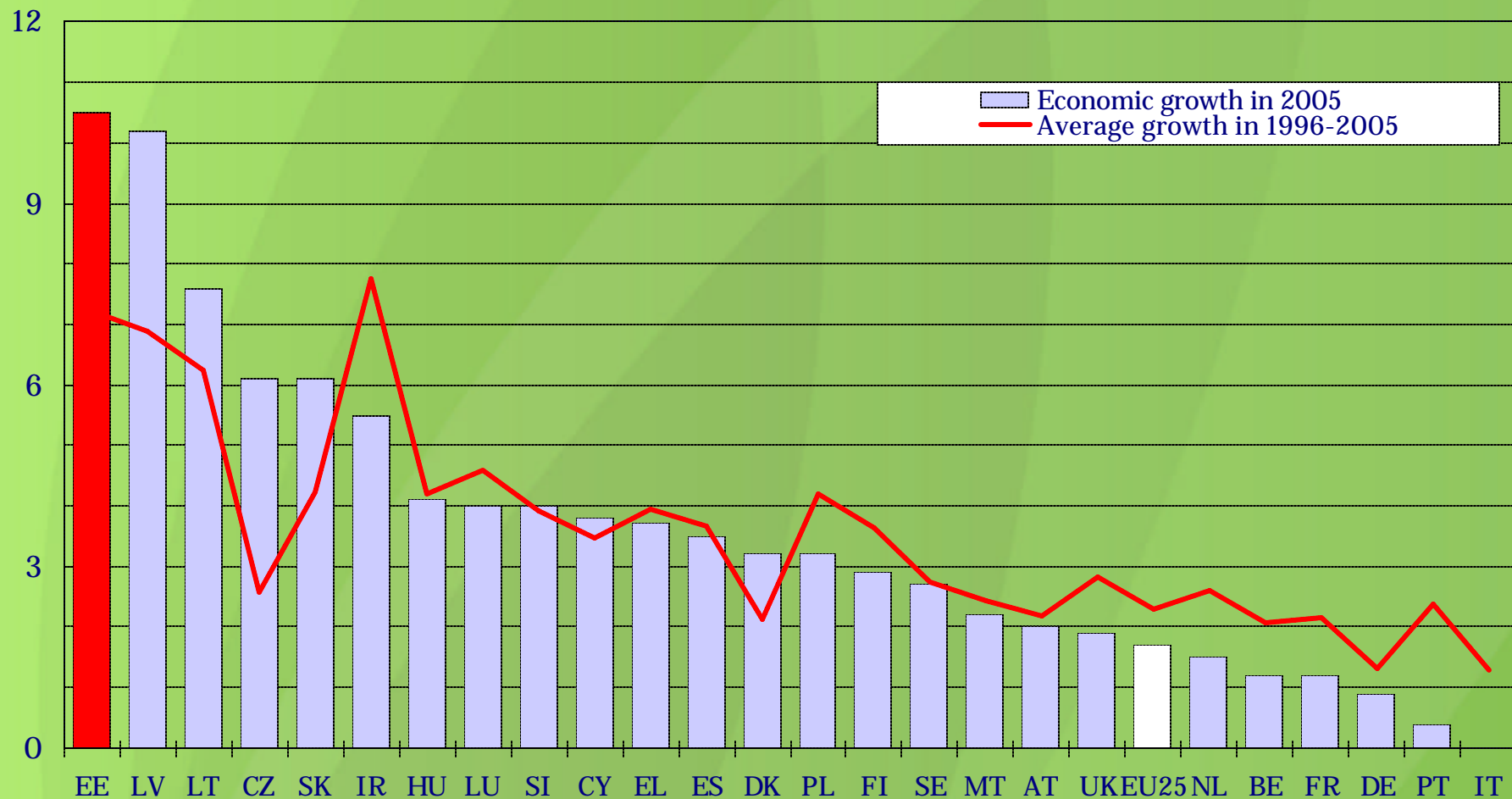
- To continue to pursue strict fiscal policy:
 - Contain the risks of overheating.
 - Hold back inflationary pressures.
 - Meet the Maastricht price stability criterion and join the €.
- Further development of budgetary process:
 - Activity and performance based budgeting.
 - Accrual budgeting.



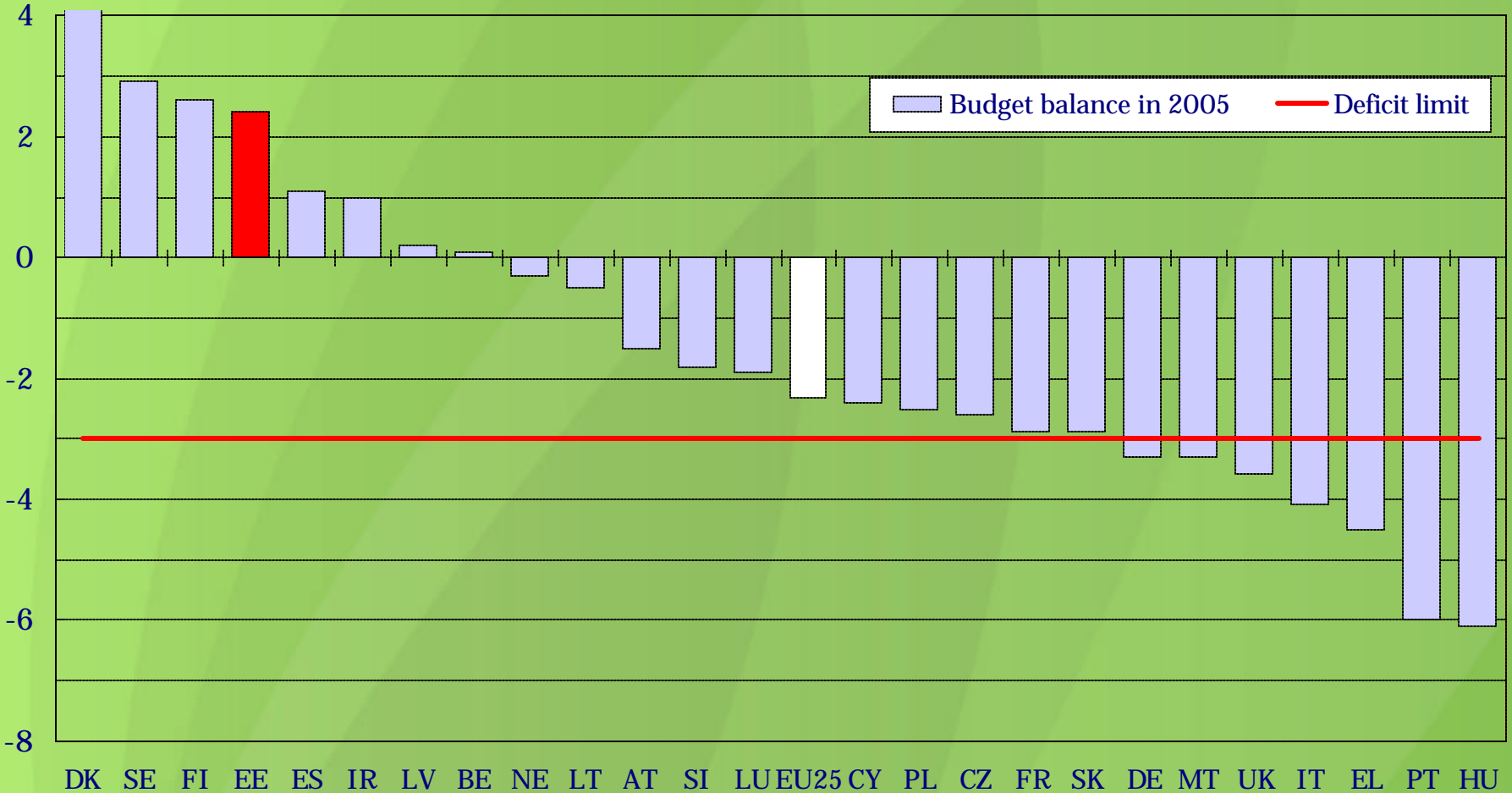
Thank you!



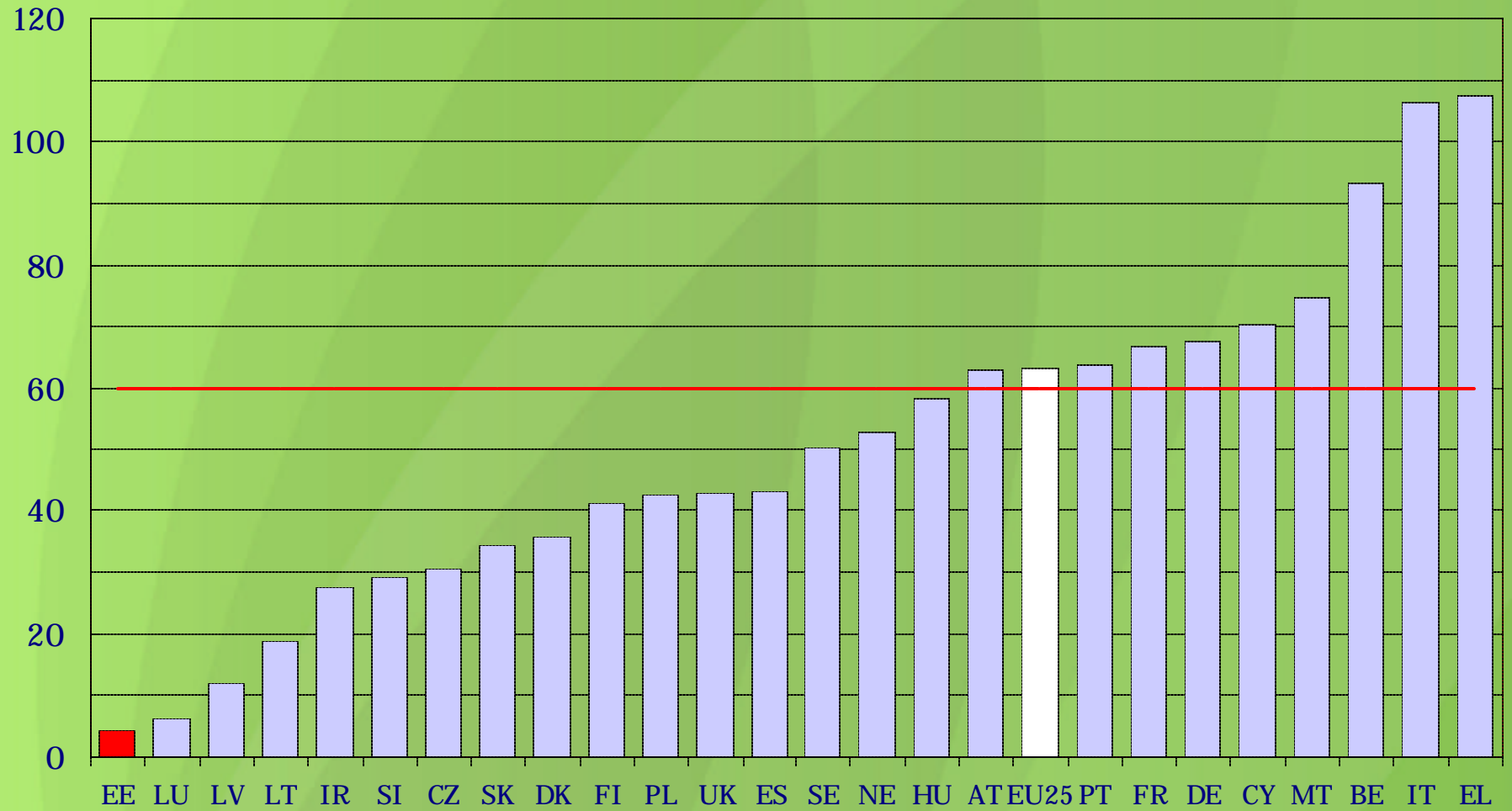
Economic growth in 2005



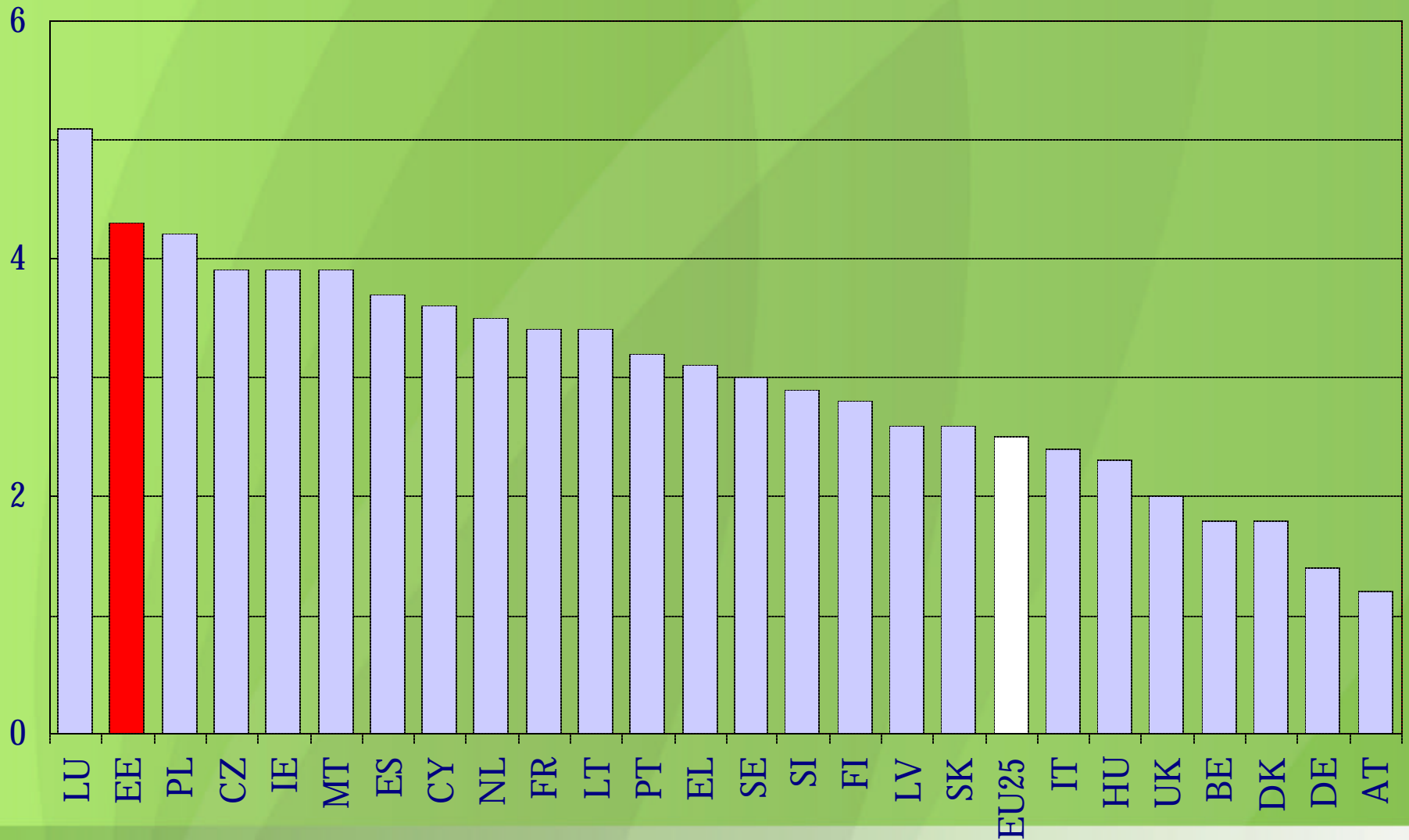
General government budget position in 2005



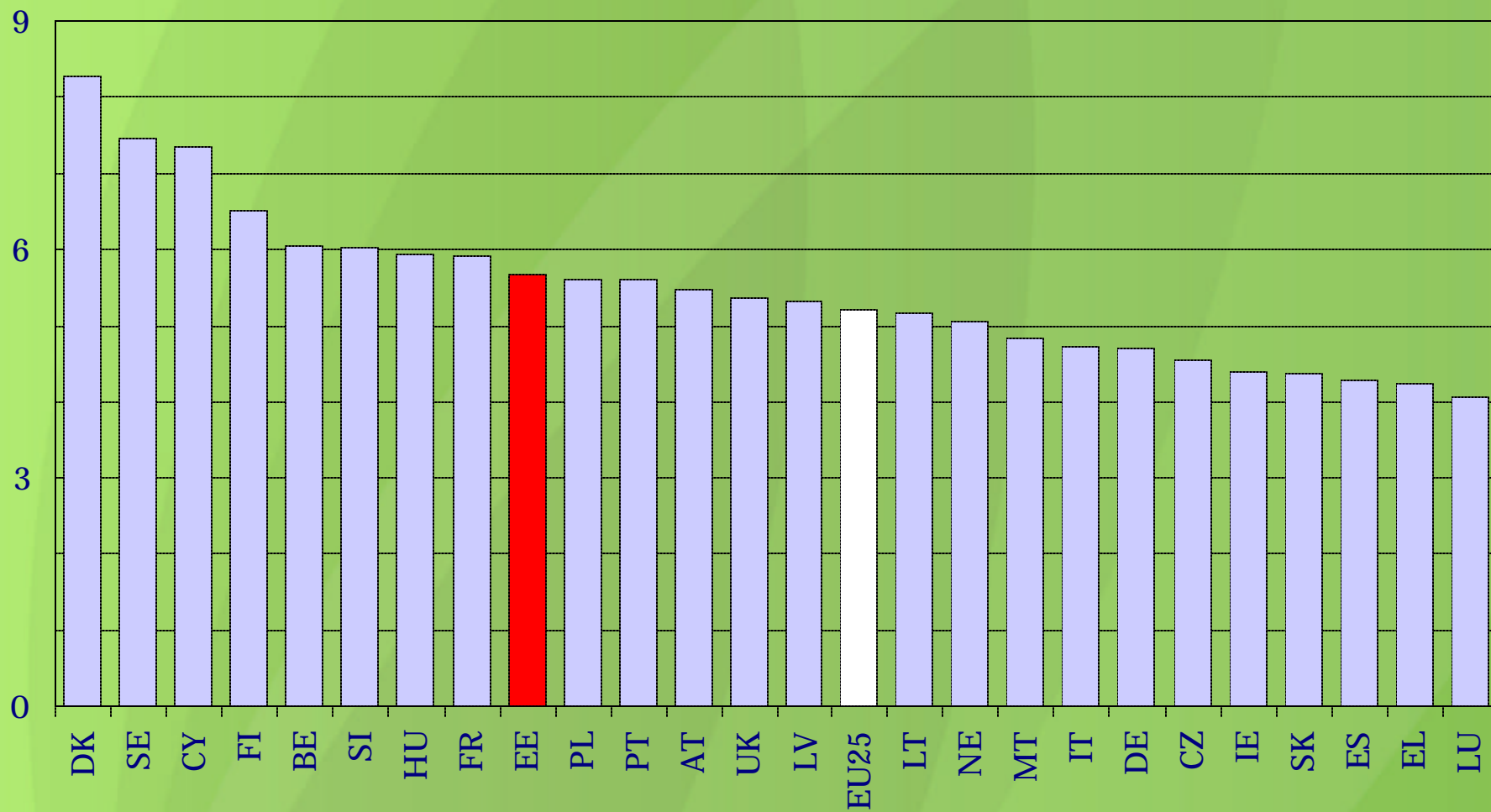
General government debt in 2005



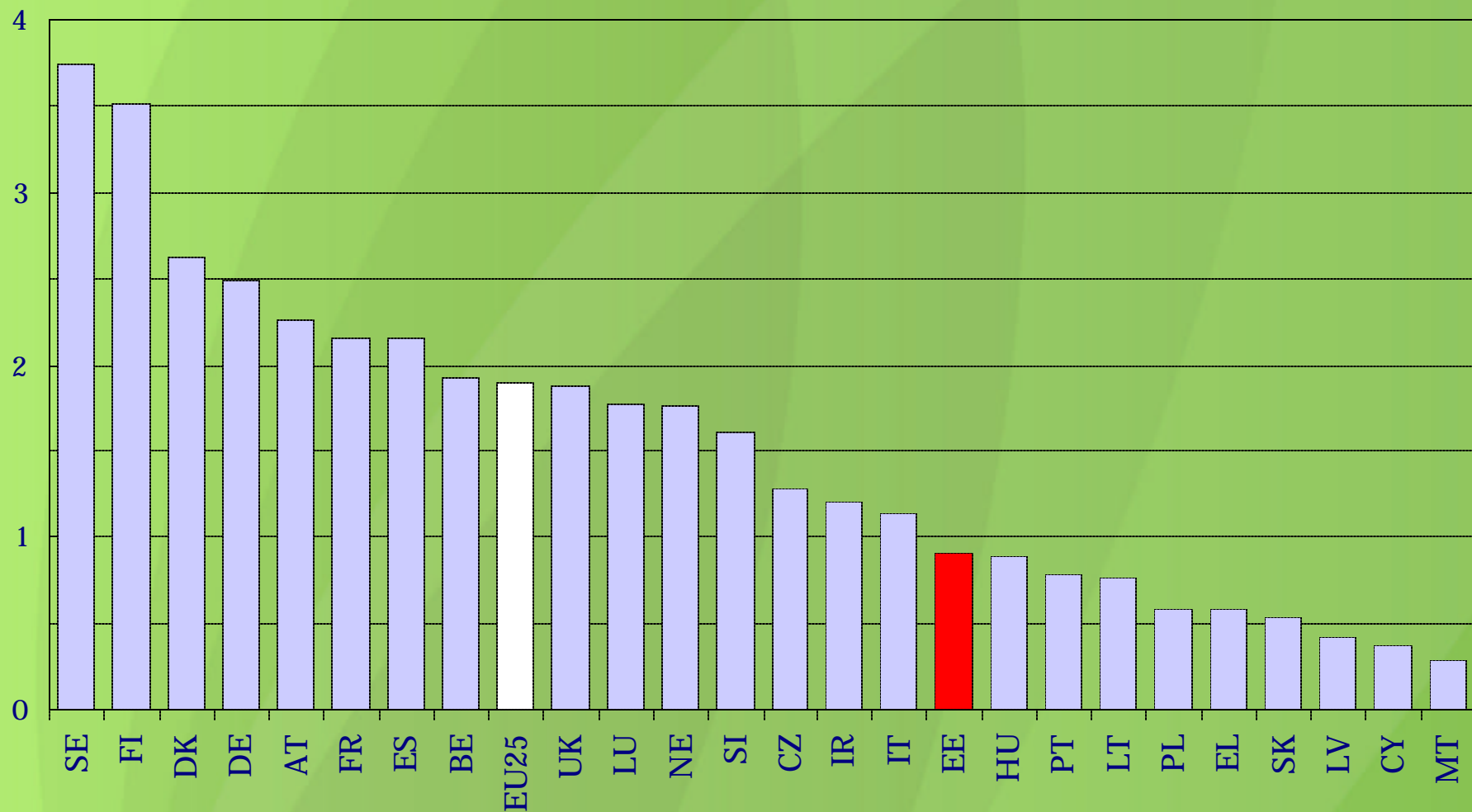
Government investments in 2005



Education expenditure in 2003



Spending on R&D in 2004



State aid in 2004

