



# Weekly Briefing

## **Estonia economy briefing:**

**“The economy must be economical” in a new era**

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## “The economy must be economical” in a new era

The legendary phrase in the title belongs to a different historic era. When Leonid Brezhnev coined it for the first time in 1981<sup>1</sup>, during the 26<sup>th</sup> Congress of the CPSU, it quickly became one of the Soviet era’s major memes of political economy. From that point, the Soviet Union had a bit more than 10 years to exist, but the phrase that ‘advises’ an economy to be economical still lives on, assisting an analyst in bringing some healthy sarcasm into any discussion on ‘spending less’. Closer to the end of April, the Government of Estonia managed to reach a compromise on the state budget strategy – where and what to cut off, how to get the two sides of the ledger balanced up by the end of the year, and what expenditures to leave as untouched.

Talking on the matter, Jaak Aab (*Centre*), the country’s Minister of Public Administration, was extremely generic: “There are problems and we have had to fill the deficit. At the same time, we have agreed on fundamental things that are important to us”<sup>2</sup>. Estonia had to wait for a bit until Minister of Finance, Keit Pentus-Rosimannus, gave away a set of more specific details in her interview to *Postimees* next day. Answering the question on whether or not her Ministry submitted a proposal to the cabinet to cut the budget for all ministries in 2022-2023 by **5.2 per cent** (meaning the actual operating expenses), Minister Pentus-Rosimannus confirmed that “[t]he figure is not precise but the size is correct”<sup>3</sup>. Some of the exact details of the plan are as follows:

- the result of the spending cuts should be about EUR 60 million in 2022;
- allocating 2 per cent of GDP for national defence is the Government’s commitment that should not get changed;
- the Government’s support to municipalities for children’s recreational activities is to be halved (from the previous EUR 14.25 million to EUR 7.25 million);
- the internal security servicemen, school teachers, culture-associated professional staff will see their wages to be increased by 3 per cent, by at least;

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<sup>1</sup> Leonid Brezhnev in *Материалы XXVI съезда КПСС* (Moscow, 1981), 60.

<sup>2</sup> Jaak Aab as cited in ‘Minister: Government has reached agreement on budget strategy’, *ERR*, 28 April 2021. Available from [<https://news.err.ee/1608193318/minister-government-has-reached-agreement-on-budget-strategy>].

<sup>3</sup> Keit Pentus-Rosimannus as cited in Anna Põld, ‘Minister: some 60 million must be cut’, *Postimees*, 29 April 2021. Available from [<https://news.postimees.ee/7236605/minister-some-60-million-must-be-cut>].

- The so-called “digital turn and the green turn” are visualised to be the main priorities for the Government in these coming years.<sup>4</sup>

The economic background for making the aforementioned set of strategic calls is very patchy in Estonia. **From the one side**, as reported, in March 2021, the turnover of retail trade enterprises increased by 4 per cent at constant prices, if compared with the last year’s digits<sup>5</sup>. Moreso, those stores that sell manufactured goods made the 6 per cent increase, while, naturally for the moment, the biggest growth (of 70 per cent) was detected in businesses, which sell via mail order or the Internet<sup>6</sup>. In a significant addition, the general volatility as well as complexity of the situation have not made a noticeably negative impact on the country’s consumer price index – it is exhibiting a routine ‘movement’, rising by 1.1 per cent in March 2021 compared to March 2020<sup>7</sup>.

**From the other side**, if we are to continue on the retail theme, one of the country’s biggest shopping malls, the *T1 Mall of Tallinn* is to go through the bankruptcy process, after Estonia’s Supreme Court decided to rule out an appeal that was contesting the termination of the business’ restructuring and reorganisation<sup>8</sup>. On a different segment of the economy, in February, the records showed that Estonian accommodation establishments served about 100,000 clients who were to spend 187,000 nights in total – it is a drop of 57 per cent if compared to the data from February 2020<sup>9</sup> (see *Picture 1* for more details). Characteristically for this particular indicator, which has a tremendous importance for the country’s economy, Helga Laurmaa, analyst at Statistics Estonia, noted that “[y]ear on year, the number of foreign tourists fell by 90 per cent and the number of domestic tourists by 22 per cent”<sup>10</sup>. Considering the *status quo* on the market, there was no surprise when *Tallink*, the Baltic Sea region’s largest passenger and cargo shipping company, reported EUR a 34 million quarterly loss in April

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<sup>4</sup> Pentus-Rosimannus in Põld, and Põld.

<sup>5</sup> ‘Despite restrictions, turnover grew in retail trade enterprises’ in *Statistics Estonia*, 30 April 2021. Available from [<https://www.stat.ee/en/node/183298>].

<sup>6</sup> ‘Despite restrictions, turnover grew in retail trade enterprises’.

<sup>7</sup> ‘Consumer price index, March 2021’ in *Statistics Estonia*, 8 April 2021. Available from [<https://www.stat.ee/en/node/183266>].

<sup>8</sup> ‘T1 Mall of Tallinn to go bankrupt’ in *ERR*, 27 April (updated 28 April) 2021. Available from [<https://news.err.ee/1608192187/t1-mall-of-tallinn-to-go-bankrupt>].

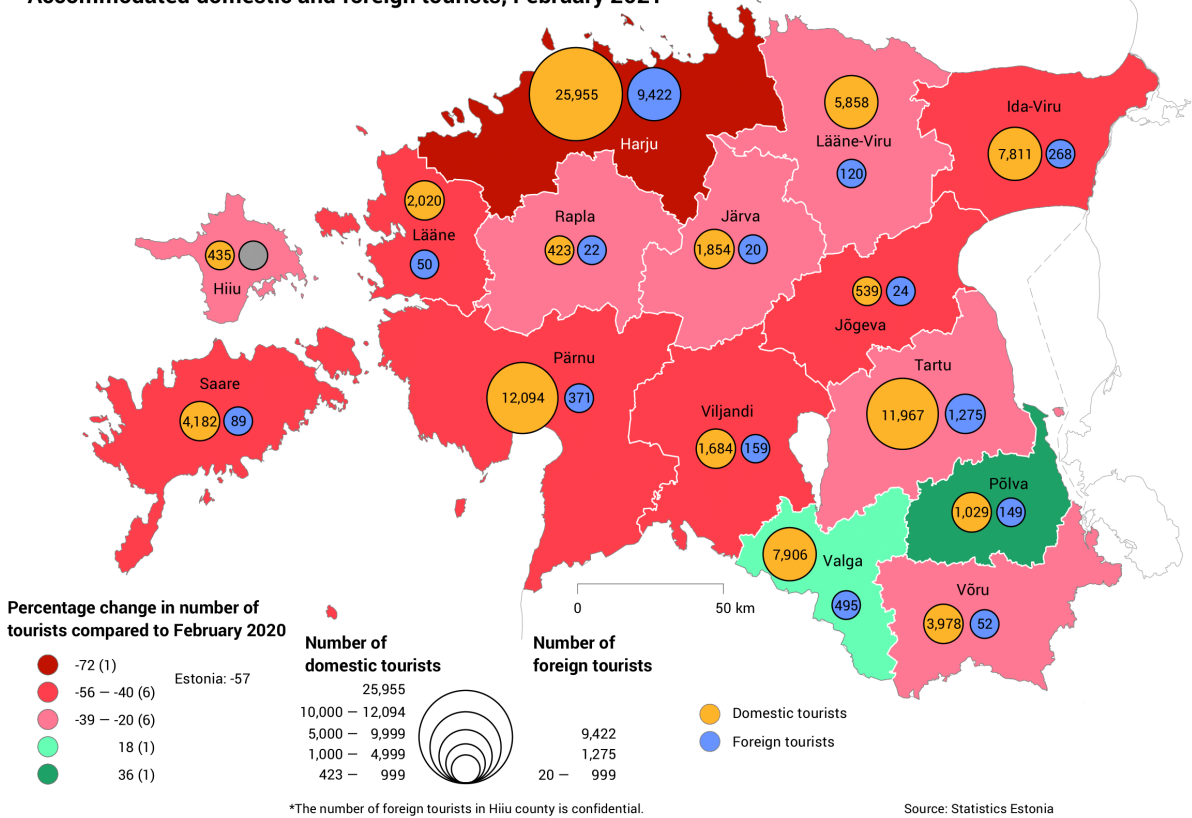
<sup>9</sup> ‘Accommodation establishments kept in business by domestic tourists and a few foreign visitors’ in *Statistics Estonia*, 7 February 2021. Available from [<https://www.stat.ee/en/node/183323>].

<sup>10</sup> Helga Laurmaa as cited in ‘Accommodation establishments kept in business by domestic tourists and a few foreign visitors’.

2021<sup>11</sup>. Less passengers for Tallink – less visitors to Estonia. The other way around works with the same preciseness and economic logic.

**Picture 1**

**Accommodated domestic and foreign tourists, February 2021**



All these and many other factors – together and separately – make it very logical for the Government to pay more attention to the process of monitoring the previous forecasts on the economy’s prospective performance. Even though the same Estonian Minister of Finance demonstrated plenty of enthusiasm about her Ministry’s spring economic forecast, the following notes from her press-conference talk about a very mixed situation:

- the country’s economy was expected to grow by 4.5 per cent in autumn, but such a prognosis was based on a 5.5 per cent recession forecast for the last year (this is already known that the economy only shrank by 2.9 per cent then);

<sup>11</sup> Erkki Eri laid, ‘Loss-making Tallink hopeful that travelling will restart in summer’ in *Postimees*, 30 April 2021. Available from [https://news.postimees.ee/7237592/loss-making-tallink-hopeful-that-travelling-will-restart-in-summer].

- the process of recovery is unlikely to be evenly ‘spread’ across the economy, because many indicators, indeed, heavily rely on what Estonia manages to export as well as IT-associated services;
- foreign tourism as a factor is singled out to be “of critical socioeconomic significance”, and there is expectation that it will grow in 2022;
- there is a likelihood that Estonia’s fiscal deficit will be around 6 per cent of GDP in 2021;
- the national debt-related figure is forecasted to grow to 21.4 per cent in 2021, and it will be at nearly 30 per cent of GDP by 2025;
- the country’s treasury’s negative cash flow is in prognosis to be at EUR 2.4 billion (covering “both deficit and refinancing of bonds issued”);
- as a direct outcome of the country’s latest pension reform (discussed in a number of previous briefings), the population will get about EUR 1.2 billion withdrawn from pension funds in 2021, out of which EUR 300 million will be spent “in the short term” whilst another EUR 300 million will be “going into real estate”<sup>12</sup>.

Amusingly for the context of ‘losing’, ‘borrowing’, and ‘recovering’, a report from the National Audit Office notified that about one-third of the Estonian Government’s pandemic-bound reserves still remained untouched/unrequested at the end of 2020<sup>13</sup>. In details, as reported, “more than EUR 58 million of the [G]overnment’s emergency COVID-19 reserve had been spent by the end of last year [...] [while] EUR 26 million remained unspent”<sup>14</sup> (*Figure 1* indicates the actual sources for covering expenditure from the aforementioned reserve). In itself, this fact suggests that the Government may need to do a better ‘homework’ on effectively allocating the available funds to allow for a quicker recovering of the economy. Alternatively, there could be a situation that the economy is already developing a higher degree of resistance to the pandemic, and the stimulating packages are no longer always needed by businesses. This is something that the Estonian Government will need to start comprehending as soon as possible.

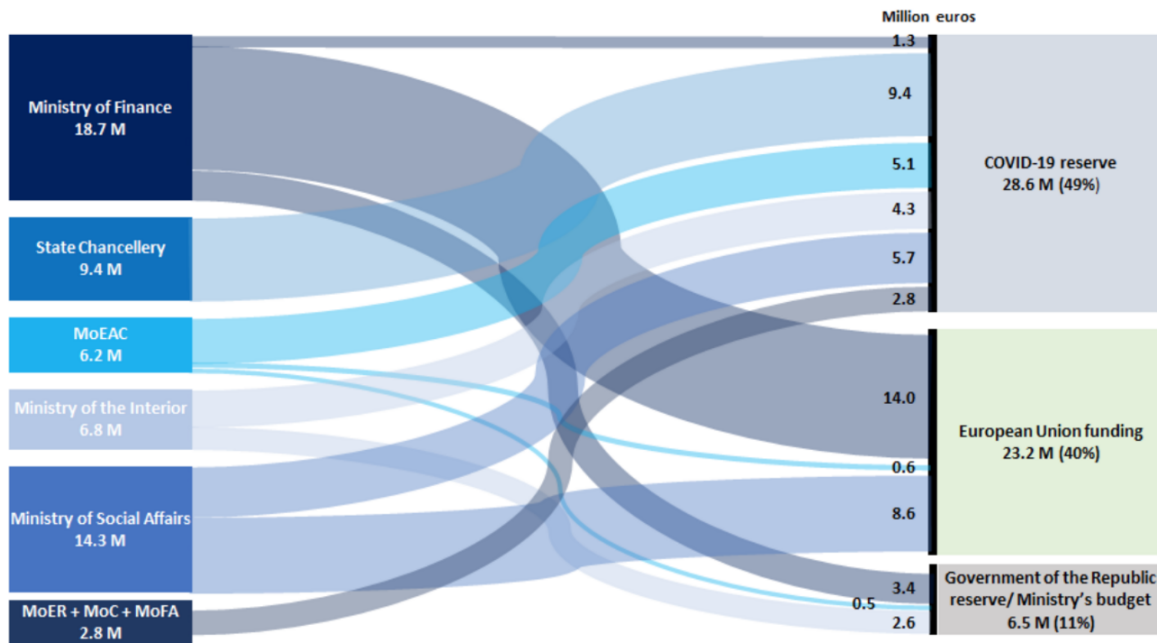
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<sup>12</sup> Keit Pentus-Rosimannus as cited in Erkki Erilaid, ‘Finance minister: Situation complicated but growth incoming’, *Postimees*, 6 April 2021. Available from [<https://news.postimees.ee/7218146/finance-minister-situation-complicated-but-growth-incoming>].

<sup>13</sup> ‘Audit report: Third of COVID-19 reserve unspent at end of year’ in *ERR*, 28 April 2021. Available from [<https://news.err.ee/1608193381/audit-report-third-of-covid-19-reserve-unspent-at-end-of-year>].

<sup>14</sup> ‘Audit report: Third of COVID-19 reserve unspent at end of year’.

**Figure 1: Actual sources for covering expenditure from the COVID-19 reserve as at 31 December 2020 (in million euros)**



**Source:** National Audit Office.

There has been a certain background of the story, after the *Riigikogu* issued its approval of the state budget for 2020 (approximately EUR 12 billion). The ledger included the governmental reserve of EUR 86.4 million, which the Cabinet could, in principle, use for operational needs and at its own discretion. After the pandemic started making a negative difference, the Estonian legislators decided to increase the country's reserve fund by approving a substantial supplementary budget and amending the budgetary digits to EUR 360.8 million<sup>15</sup>. Since the Riigikogu allocated the aforementioned amount to the Government of Estonia, the Cabinet allocated EUR 84.6 million to its Ministries as a high-level assistance to counter the COVID-19 crisis. The pandemic is far from being over, meaning that this is not going to be the final revision of the forecast. It is going to be a long year.

<sup>15</sup> 'Audit report: Third of COVID-19 reserve unspent at end of year'.