

**Republic of Estonia: Reassessment Report on the Observance of Standards
and Codes—Fiscal Transparency Module**

This Reassessment Report on the Observance of Standards and Codes on Fiscal Transparency for the Republic of Estonia, was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on January 30, 2009. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Republic of Estonia or the Executive Board of the IMF.

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REPUBLIC OF ESTONIA

**Reassessment Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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January 30, 2009

EXECUTIVE SUMMARY

This report provides a reassessment of fiscal transparency practices in Estonia in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency*, based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (<http://www.imf.org/external/np/fad/trans/manual/>) should be consulted for further explanation of the terms and concepts discussed in this report.

Since the initial fiscal transparency ROSC was published in 2001, Estonia has made further advances. It now meets nearly all of the requirements of the transparency code, and approaches best international practice in some areas. The roles and responsibilities of general government are well defined and clear. The budget process is governed by a precise legal framework. Regulation of the private sector is transparent and light. Tax administration and taxpayers' rights are rules-based and efficiently delivered. A coherent medium-term framework for the whole of general government provides a clear context for budget decisions. Fiscal targets and medium-term objectives are clearly described and openly discussed. Budget execution is controlled and monitored according to clear regulations and standards. Fiscal reporting is comprehensive, readily accessible and timely, including full balance sheets. Budget documentation includes detailed historical data and medium-term projections. A straightforward plain-language guide accompanies release of the medium-term strategy. Institutional mechanisms to ensure the integrity of fiscal data are, for the most part, well established. Rules for public procurement, employment, and ethical behavior are clear.

Nevertheless, there are a few areas where further reforms could usefully enhance fiscal transparency. In particular, routine recourse to supplementary budgets to revise expenditure plans should be avoided. The appropriations process could also be strengthened by limiting the carry-over of expenditure and ring-fencing the contingency reserve. Proposed legislation to broaden the definition of debt included within the ceilings applied to local governments, and to limit their fiscal deficits, should improve predictability of the general government balance.

Three innovations in documentation would promote better informed debate about the budget. First, inclusion of an analysis of variations of outturn data from the initial budget projections in the budget documentation would promote more thorough monitoring of the budget by parliament. Second, the publication of occasional long-term reports on the economy and public finances would show more fully the context in which medium-term decisions are being taken. Third, inclusion of a statement on fiscal risks in the budget documentation would help ensure that these are systematically analyzed and publicly understood.

While the credibility of official data is high, statutory independence for the Statistics Office of Estonia would ensure maintenance of its integrity. The macroeconomic assumptions used in budget projections should also be externally scrutinized. Finally, to simplify monitoring of fiscal developments and policy, an advance data release calendar should be published.

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ABBREVIATIONS

CoFoG	Classification of functions of government
EU	European Union
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
HIF	Health Insurance Fund
IPSAS	International Public Sector Accounting Standards
IFC	International Finance Corporation
MoF	Ministry of Finance
MTBF	Medium-Term Budget Framework
NAO	National Audit Office
NPIs	Nonmarket nonprofit institutions
NFPEs	Nonfinancial private enterprises
ODP	Organizational Development Plan (of a line ministry)
PPP	Public private partnership
QFAs	Quasi-fiscal activities
ROSC	Reports on the Observance of Standards and Codes
SBS	State Budget Strategy
SDDS	Special Data Dissemination Standards
SGP	Stability and Growth Pact
SoE	Statistics Office of Estonia
SRF	Stabilization Reserve Fund
TIN	Tax identification number
UIF	Unemployment Insurance Fund

I. INTRODUCTION¹

1. **This report provides a reassessment² of fiscal transparency practices in Estonia against the requirements of the revised IMF *Code of Good Practices on Fiscal Transparency (2007)*.** It has two parts. The first part is a description of practices, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Estonia. Appendixes summarize the staff's assessments and comments on observance of good practices, document the public availability of information, and record progress since completion of the 2001 fiscal transparency ROSC.

II. DETAILED DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

Definition of government activities

2. **General government is defined consistently with the principles of Government Finance Statistics (GFS) and is well covered in the budget process.** 1.1.1.

General government consists of central government, social security funds (for health and unemployment), and local government (rural municipalities and city governments) (Box 1). Central government includes budgetary institutions and a number of nonmarket nonprofit institutions (NPIs).³ NPIs have their own budgets, but constitute a very small proportion of expenditure. Local government includes municipalities, and some local foundations and hospitals. Although municipalities are independent of central government, they are heavily reliant for revenue on the assignment of state taxes and grants administered by central government.⁴ General government activities are clearly defined and consistently applied across government. There is limited commercial activity. Fiscal reporting is comprehensive, encompassing all revenues and expenditures.

¹ Discussions on fiscal transparency were held in Tallinn during November 14–28, 2007. The IMF staff team comprised Mr. Shields (Head), Mr. Robinson, and Mr. Hayman (all FAD), and Mr. Sarraf (FAD's panel of experts). The mission met with officials from the Ministry of Finance (MoF), Ministry of Social Affairs, the Prime Minister's Office and State Chancellery, Tallinn City government, representatives of national-level unions of municipalities, the Central Bank Eesti Pank, and the National Audit Office (NAO). The mission also met with members of the Parliamentary Finance Committee and representatives of the Estonian Chamber of Commerce and Industry.

² The original fiscal transparency ROSC was published in June 2001, and was updated in July 2002.

³ Central government is well defined. A breakdown by agency is maintained on the central government website, which includes all foundations and NPIs.

⁴ See paragraph 9.

Box 1. General Government Budget in Estonia, 2006		
	Expenditure in billions of Kroons (EEK)	Expenditure in % of GDP
General government in Estonia comprises the following:	68.4	33.0
Central government	46.0	22.2
Central budgetary institutions: parliament, president's office, Supreme Court, National Audit Office, State Chancellery, Chancellor of Justice, National Archives of Estonia, ministries (11) and their governing areas. 1/ 2/	39.7	19.2
Nonmarket nonprofit institutions: foundations, public institutions, hospitals. 2/	6.3	3.0
Local government	17.2	8.3
Municipalities, municipal institutions (227), local foundations and local hospitals.		
Extrabudgetary funds		
Health Insurance Fund, Unemployment Insurance Fund. 3/	5.2	2.5

Sources: SoE, MoF and staff estimates.

1/ Excludes transfers to EBFs, interest payments, and transfers to subnational government.

2/ Fund staff estimates.

3/ Excludes payments and contributions in respect of the Health Insurance Fund provided within the budget.

Government relations with the central bank and public financial sector

3. The central bank of Estonia—the Eesti Pank—is operationally independent, and has no fiscal role.

1.1.4

The *Eesti Pank Act* establishes the independence of the central bank and prohibits it from financing Estonian (or other European) government institutions or corporations in which the government holds equity. The *Act* provides that the proportion of the bank's profit which may be transferred to the state budget—up to a maximum of 50 percent—is determined by parliament's decisions and the bank's supervisory board. The bank's medium-term policy on profit transfers has been explained publicly. In practice, this has in recent years resulted in the transfer of approximately 25 percent of bank profits. The bank does not provide commercial services, including to the government. There are no other financial public corporations.

Government relations with nonfinancial public corporations and the private sector

4. Relationships between the government and nonfinancial public enterprises are clear. 1.1.4

Each nonfinancial public enterprise (NFPE) is supervised by an individual line ministry, while overall policy on NFPEs is the responsibility of the Ministry of Finance (MoF). NFPEs are managed by independent supervisory boards, appointed by the supervising ministry. Government intervention in NFPEs is very limited. NFPEs must first operate according to commercial principles. Although they must also take into account state strategies and targets in their sphere of activity, this does not appear to significantly affect their operations. In the event that an NFPE becomes unprofitable, it is the responsibility of its council to secure financing and ensure its viability through restructuring or changes in operating policy. The government has made it clear that it will not guarantee any new debt of NFPEs.

5. Quasi-fiscal activities of nonfinancial private enterprises appear to be insignificant, and arrangements regulating profit transfers from NFPEs to the budget are clear. 1.1.4

There is no evidence of NFPEs engaging in significant quasi-fiscal activities. A limited number of services are carried out by NFPEs on behalf of government (such as newspaper delivery to outlying areas and ferry crossings), but these are subsidized directly through the budget. NFPEs' performances are monitored closely. Nearly all NFPEs are profitable, although the postal service has recently sustained losses.⁵ NFPEs are required to submit quarterly, published reports to the MoF, along with an annual performance report.⁶ The distribution of dividends is governed by legislation.⁷ The council of the NFPE, in conjunction with the government, determines the level of dividends, and explanations are provided in its annual report.

6. Government holdings of fully-owned corporations and equity are moderate and are comprehensively reported in the annual government accounts. 1.1.5

⁵ Total losses of all loss-making NFPEs in 2006 were EEK 86.6 million, of which the postal service contributed EEK 20.4 million.

⁶ The link to these reports (in Estonian) can be found at <http://saldo.fin.ee/reporting/institutionSearchListView.do>.

⁷ Dividends are governed by the *Foundation of and Participation in Legal Persons in Private Law by the State Act*.

The government currently has ownership in 38 public companies, valued in total at EEK 29.3 billion or around 14 percent of GDP.⁸ Of these, the major holdings are in the transportation and energy sectors.⁹ The number of NFPEs was substantially reduced in the 1990s, reflecting an aggressive privatization program, but has remained broadly stable since 2000.¹⁰

7. Laws and processes governing government regulation of the nonfinancial private sector are clear and open. 1.1.5

Estonian law allows for the formation of several types of enterprises and prescribes rules for their governance. The principal legislation is contained in the *Commercial Code*, while principles relating to corporate governance are contained in the *General Principles of Civil Law Act* and the *Law of Obligations Act*. The burden of government regulation in Estonia is considered light; regulations affecting business are clear and consistently applied. The International Finance Corporation (IFC) in 2008 placed Estonia 17th out of 178 countries on its index of the ease of doing business, while the 2007-08 Global Competitiveness Report of the World Economic Forum placed Estonia 10th out of 131 countries in relation to government regulation.¹¹

Fiscal management relations among the branches of government

8. The fiscal roles of the executive and legislative branches are clearly defined. 1.1.2

The *Constitution* and *State Budget Act* (organic budget law) clearly define the fiscal roles and responsibilities of the executive and legislative branches of the government in managing public finances. Within the executive branch, the roles of the Council of Ministers, MoF, ministries and agencies are clearly defined in the areas of budget preparation, coordination, submission, execution, accounting, and reporting. The legislature's power to affect the fiscal stance is tightly constrained. Any parliamentary amendment to the draft budget, which would increase expenditures or decrease estimated revenues, must be accompanied by appropriate counterbalancing revenue or expenditure measures, so it would not give rise to a budget deficit, or increase a proposed deficit, or reduce a proposed surplus. Parliament is also not permitted in a draft government budget to eliminate or reduce expenditure that is prescribed by other acts or arises from international agreements ratified by parliament.

⁸ The only minority shareholdings are in telecommunications (Eesti Telekom), airlines (Estonian Air), a sporting hall, and a radioactive waste handling company.

⁹ The largest NFPE is Eesti Energia AS, an energy company with a capitalization of around 8 percent of GDP.

¹⁰ The legal framework for privatization is discussed in paragraphs 19 and 52.

¹¹ The IFC's Doing Business report can be found at <http://www.doingbusiness.org>. The World Economic Forum's Global Competitiveness report can be found at <http://www.gcr.weforum.org/>.

Fiscal management relations among different levels of government

9. The responsibilities of different levels of government and the relationships between them are clearly defined. 1.1.3

The *Constitution*, *State Budget Act*, and the *Local Governments Act* and its amendments, establish local governments and the fiscal relationships between central government and the 227 local governments.¹² Local governments receive own revenues, an education grant, a general equalization grant, and occasional conditional grants. Own revenue sources include a share of personal income tax, land tax, local taxes, natural resource fees, and user charges and fees. Because of the low tax base of many local governments, there is a formula-based general equalization grant from central government to local governments, which is calculated annually and allocates grants according to population, indicators of local needs, and the local tax capacity of each local government.¹³ Additionally, certain ministries sometimes provide earmarked and conditional grants to local government to help implement ministry tasks in the localities.¹⁴ The main expenditure tasks of local governments include: pre-schooling, primary and secondary education, social welfare services, housing, water supply, public transport, physical planning, and general municipal services.

10. Local governments are subject to nominal ceilings on the total stock and servicing costs of specified categories of their debt, but there are no specific limits on budget deficits, and no sanctions are currently being applied. 1.1.3

The *Rural Municipalities and City Budgets Act* permits the central government to reduce a local government's share of the equalization grant if its stock of debt exceeds 60 percent, or its debt servicing costs exceed 20 percent of its proposed net annual revenue.¹⁵ In practice, there has been a reluctance to impose sanctions. This is partly a reflection of the historical circumstances in which some of the debt was incurred. Some local governments have also been able to avoid hitting the debt limits by exploiting the fact that not all of their potential liabilities are covered by the ceilings specified in the *Act*—notably by using subsidiary

¹² The number of local governments has declined from 247 in 2001. In 2004, the central government introduced a merger grant, to encourage small local governments to combine, but it has attracted only limited interest. Local governments are diverse, varying from the city government of Tallinn with about 400,000 inhabitants to the small village of Ruhnu with 63 inhabitants. At times, through the municipal associations, local governments within a region share the cost of certain items or services.

¹³ Local needs are proxied by total population, children, school-age children, labor force, elderly, disabled persons, and the projected cost of roads and streets of a local government. Tax capacity is proxied by personal income tax, land tax, and natural resources tax.

¹⁴ There are also 15 county governments responsible for conveying central government policies with local implications, such as education or environment policies. They report to the Ministry of Internal Affairs.

¹⁵ Net revenue is defined as its proposed budget revenue, less allocations from the state budget designed for a specific purpose.

institutions to take loans or using PPPs.¹⁶ However, under new legislative proposals, which have been circulated for comment by the MoF, additional constraints would be applied to local government finances. Debt ceilings would be defined to include both debt belonging to subsidiary bodies and liabilities incurred under PPPs.¹⁷ Also, for the first time, limits would be placed on the budget deficits of individual governments, requiring them to be at least in balance on average over a five-year period.

The legal and administrative framework for fiscal management

11. The legal framework for management of public finances is clear, comprehensive, and very detailed.

1.2.1

The legal framework is up-to-date and draws on a sound constitutional base. The organic budget law, and several other related laws, collectively provide the basis for the management of public finances, including local governments, internal audit, external audit, government asset management, and taxation.¹⁸ The MoF is legally and in practice given a strong central role. Estonia has consistently and speedily updated and revised its laws in response to the structural changes that have taken place since the restoration of independence.

12. The legislative basis for tax and nontax collection is clear and comprehensive.

1.2.2

All required processes and procedures of tax are covered in the *Taxation Act*.¹⁹ The tax and customs board posts extensive administrative and technical literature on its website, such as legal and administrative updates, a tax self-assessment guide, tax forms and press releases. Self-assessment applies to most taxpayers. There is no discretionary power for tax officials over tax liability. Apart from the application of a universal taxable income threshold, other tax deductions, exemptions, and concessions are determined by law.

¹⁶ Based on local governments' balance sheets, the total value of the debt of subsidiary bodies, and liabilities arising from PPP, are estimated, respectively, at around 10 percent and 30 percent of net revenue.

¹⁷ It will be important for any new legislation to specify transitional arrangements for local governments subject for the first time to a binding debt ceiling.

¹⁸ The organic budget law contains detailed provisions on definitions for the public sector and general government, and requirements for pre-budget macro fiscal projections and sectoral analyses. It also covers the budget calendar, budget preparation, budget negotiations, budget documentation, budget implementation, parliamentary budget approval process, central/local governments' fiscal arrangements, governmental reserve fund for unallocated expenditures, supplementary budget, stabilization reserve fund, bridge financing, lending, state guarantees, cash and debt management, fiscal reporting, government accounting system, compilation of final accounts, etc.

¹⁹ The MoF website provides access to the *Taxation Act* and individual tax laws, including those covering *income tax, VAT, social tax, and land tax*, which together provide a comprehensive tax legislation literature.

13. Tax expenditures are not reported, but tax exemptions are not extensive.

1.2.1, 3.1.3 3

Although the MoF has recently initiated a study of the major deductions and exemptions against tax liabilities, a definition of tax expenditures has not yet been determined.²⁰ Consequently, no estimates of the cost of tax expenditures are at present produced by the government, nor contained in any budget or public documents. However, relative to international experience, the extent of deductions and exemptions is small and limited to a few specific instances such as increased basic exemptions for pensioners and families with one or more children, and exemptions for housing loan interest and training-related expenditure.

Tax administration

14. Tax administration is clearly defined and well coordinated with overall fiscal management.

1.2.2

Tax administration is the responsibility of the tax and customs board, which is a semi-independent organization under supervision of the MoF (Box 2).²¹ Tax policy issues are addressed by a department within the MoF in close cooperation with the board. The board has the authority to demand third party information to facilitate collection of tax arrears.²² Both income tax and customs wings of the board use the same taxpayers' registry in their taxpayers' database, which records a registration number received from the business register in the case of legal entities, and ID numbers issued by the citizenship and migration board in the case of individuals. No separate tax identification number (TIN) is used at this time. A taxpayer operating several businesses may have several registration numbers, but the board has mechanisms to ensure that these are connected. There are routine tax audits based on annual audit plans, as well as risk-alerted and ad-hoc audit cases where indicated.

²⁰ A number of items that might be defined as tax expenditures have been considered by MoF. In relation to personal income tax, these include: deductions for mortgage interest; child allowances; student loan interest deductions; and education expenditure deductibility. In relation to VAT, these include a small number of items taxed at the concessional 5 percent rate (books, newspapers, hotel accommodation).

²¹ The board comprises 17 functional departments and 4 regional tax and customs centers. The main functions of the regional tax and customs centers are: supervising compliance, implementing tax and customs arrangements based on the state tax and customs policies, ensuring receipt of state budget revenue from state taxes and customs duties, protecting society and legal economic activities, providing services to persons fulfilling their tax liabilities, and performing customs formalities.

²² Tax arrears are estimated to be, on average, about 2 percent of total tax revenues a year.

15. Taxpayers' legal rights are defined and the appeals of tax or nontax obligations are considered in a timely manner. 1.2.2, 4.2.6

Taxpayers' legal rights both for tax and nontax obligations, including penalties, are stipulated in the *Taxation Act*. Complaints are handled, free of charge, by the tax and customs board, and its administrative court. There are, however, no independent appeals procedures (Box 2).

Box 2. Transparency of Tax Administration in Estonia

Discretion

Tax laws and regulations are clear. Tax officials have no discretionary power and all tax exemptions of any nature are determined by laws. There seems to be no room for negotiations between tax officials and taxpayers.

Integrity and accountability

An internal discipline department of the tax and customs board is responsible for supervising the legality of the activities of tax and customs officials, and overseeing ways of mitigating the risks arising from the specific nature of the profession, and minimizing the potential for corruption. There are also routine internal and external audits. The expenditures of the tax and customs board are covered by the government budget as a semi-independent agency under the MoF. The formal independence of the director of the tax and customs board from the administration is limited by the fact that the appointment is the responsibility of the minister of finance.

Reporting

The tax and customs board reports monthly tax collection data to the MoF, which displays them on its website. After government accounting is closed and finalized, the data also appears on the website of the SoE. There is no direct reporting of data to the legislature or public by the tax and customs board, except in the context of general presentation and briefing notes. New tax measures appear on the tax and customs board's website after they are approved and entered into implementation. The board's website is mostly used for communication with taxpayers, including tax education. Tax expenditures are not published, but they are not extensive.

Taxpayers rights

Taxpayers' complaints need to be submitted in writing to the tax and customs board and supported by documentation. A response is then provided within 30 days. If the issue is not resolved satisfactorily, the taxpayer may file an appeal with the administrative court (part of the tax and customs board), the decision of which is final. Taxpayers have no access to appeal to an independent judiciary or an independent representative.

Public consultation

16. Public opinion is normally sought concerning proposed laws, regulatory changes and broader policy changes. 1.2.3

There is a *code of good practice* which requires ministries to consult the public in the formulation of legislation and other public policy. This code requires that, in general, at least

four weeks should be provided for consultation. Public participation is facilitated by use of web-based consultation, the environment for which has recently been enhanced.

Contractual arrangements

17. Contractual arrangements between the government and public or private entities are clear and publicly accessible. 1.2.4

Contracts between the government and public or private enterprises are registered in the central document registry of the institution and listed on the government website.²³ The contracts can be requested under the *Public Information Act*. Local governments in Estonia are currently undertaking a number of public private partnerships (PPPs) (Box 3). These are listed on their websites and in their annual reports, and the contracts can be obtained by the public. Concerns remain nevertheless about whether there has been excessive use of PPPs because of the incentives for some local governments to avoid other sources of debt (as noted in paragraph 10 above).

Box 3. Public Private Partnerships in Estonia

PPPs are partnerships between the public sector and the private sector for the purposes of designing, planning, financing, constructing and/or operating projects that traditionally fall within the remit of the public sector.

Although the central government does not have any PPPs, they have been increasingly used by local governments in Estonia in recent years. One motivation for this has been that PPPs have not been included in the official definition of local government debt, which has been subject to a nominal ceiling of 60 percent of net revenue.

The total value of liabilities in relation to PPPs in FY2006 was estimated at around EEK 7.3 billion, which was equivalent to about one third of local governments' net revenue. PPPs are reported in detail by local governments in their annual reports and balance sheets and lists of PPP contracts are placed on local governments' websites. The contracts are provided to municipalities' credit rating agencies and are available to the public on request. There are currently no specific legal instruments regulating PPPs in Estonia.

A recent example of a PPP was the development of a contract between the Tallinn city government and Riigi Kinnisvara Aktiaselts (RKAS) in 2005 to renovate two schools. Instead of the city government directly bearing the cost of renovation (and hence needing to increase revenue, decrease other spending, or borrow by conventional means) the PPP specified that:

- RKAS would renovate the schools and bear the construction risks.
- The school buildings would be given to RKAS as collateral, and written off by the municipality in the balance sheet.
- The municipality would pay rent to RKAS until costs had been paid, after which the municipality would take back ownership of the school buildings.

²³ This is explained in the *Public Procurement Act 2007*.

Legal framework for liability and asset management

18. **There is clear legislation governing liability and asset management, and the granting of rights to use or exploit public assets.** 1.2.5

The legal basis for debt management, including borrowing, instruments, lending and guarantees is established in the Organic Budget Law (Articles 38 through 40). The central government has almost no internal debt and its stock of external debt is currently less than 3 percent of GDP. Local governments, however, have substantial domestic debt (around EEK 4.8 billion in 2006 or 28 percent of their net revenue). According to Article 32 of the Organic Budget Law, the MoF has the right to determine modalities for managing the state's money, securities, and other financial assets, which include money in the treasury's two main accounts, as well as the pension reserve and Stabilization Reserve Fund (SRF). These are currently managed by the treasury, mainly through depositing in internal and external money market accounts. The management, transfer, and use (with or without charge) of all state movable and immovable assets are regulated by the *State Assets Act*, which is currently under review.

19. **The legal frameworks for the privatization process and the payment of receipts to the budget are clear.** 1.2.5, 4.2.4

The *Privatization Act* governs all legal procedures regarding privatization and transfers of the fund to the budget. Most of the planned privatization activities in Estonia have been completed, and the privatization agency has been closed. The minimal remaining activities are implemented by the MoF.

B. Open Budget Preparation, Execution, and Reporting

The medium-term framework and policy basis for the budget

20. **The budget calendar is clearly specified in the organic budget law and is followed in practice.** 2.1.1

The budget preparation process is outlined in Box 4. The budget process is on a calendar year basis. Budget preparation commences in January, with the MoF issuing a call circular and providing initial multi-year projections to ministries for the preparation of the State Budget Strategy (SBS). After the SBS is adopted (by the end of May), the annual budget circular and budget envelope are issued by the MoF. Budget negotiations take place in the summer and

the budget is approved by the cabinet and presented to the legislature no later than the end of September.²⁴ The SBS is published by the end of May and the *Macroeconomic Forecasts*²⁵ are published in March and August and made available on the MoF's website. All the budget documentation is published when it is presented to the legislature.

Box 4. The Budget Preparation Process in Estonia	
The fiscal year is set on a calendar-year basis by the <i>organic budget law</i> . The main steps in the process are as follows:	
Due dates	Activities
January	Budget circular issued to ministries. Initial multi-year projections provided.
March	Organizational development plans/ preliminary budget bids submitted by ministries. Spring macroeconomic forecast published.
April	<i>SBS</i> produced; macroeconomic analysis and fiscal aggregates developed.
End-May	SBS approved by cabinet and published. Budget decree issued by MoF, including official budget envelopes to ministries. (This is required under the organic budget law.)
June	Budget bids and operational plans submitted by ministries to the MoF.
August	Budget negotiations undertaken between the MoF and ministries. Summer macroeconomic forecast published. Finalization of budget estimates.
End-September	Budget presented to parliament and budget memorandum published. (This is required under the organic budget law.)
December	Budget adopted by parliament.

Source: MoF.

Medium-term planning and analysis of fiscal risks

21. **Budget forecasts and underlying macroeconomic assumptions are clearly presented, but further work is needed to improve their realism.** 2.1.2

The *Spring Macroeconomic Forecast* is used in the preparation of the SBS and presented, together with revenue projections, in the published SBS. An overview of the *Summer Macroeconomic Forecast*, which underlies the annual budget, is presented to parliament, together with a full set of budget forecasts, in the *Explanatory Notes* to the budget. In the course of developing the macroeconomic forecasts (including fiscal projections) the MoF has access to central bank and other macroeconomic forecasts. There is also a quarterly meeting involving the MoF, the central bank, and other relevant government parties, to discuss

²⁴ The Organic Budget Law states that the draft budget must be presented for review and discussion to the legislature at least three months before the beginning of the next fiscal year.

²⁵ The *Macroeconomic Forecasts* provide forecasts for key macroeconomic variables (including revenues and expenditures), and the budget balance.

macroeconomic forecasts and economic policy. Macroeconomic and fiscal forecasting has been difficult and imprecise in recent years, partly because the uncertain impact of structural reform and accession to the EU has inhibited the usefulness of formal macroeconomic models. However, the persistent underprediction of economic growth and employment, and hence of revenue generation, during the upswing suggests that there may be potential to improve the realism of budget forecasts by giving more weight to cyclical factors.

22. New revenue and expenditure initiatives are identified in budget documentation and estimates are provided of their financial impact in the budget year and medium-term. 2.1.3

Tax policy objectives and changes to tax legislation are discussed in the fiscal strategy section of the *SBS* and the medium-term budget framework (*MTBF*). The annual budget reflects any changes made to date, and a review of these is presented in the *Explanatory Notes* to the budget, together with new measures.

Box 5. A Medium-Term Focus to the Estonian Budget

Estonia has over recent years been progressively strengthening the medium-term perspective in its budget process. Since 2001, the cabinet has at an early stage in the budget process considered and approved the *SBS* which is intended to provide a medium-term fiscal policy framework and also to articulate spending priorities. Elements of program and performance budgeting have been present since 2003 and became official requirements in 2006 as part of a strategic planning system in an effort to strengthen the expenditure prioritization mechanism. This required ministries to present their budget bids as “organizational development plans” based on programs (“activities” and “measures” i.e., groupings of activities), with four-year expenditure projections (the budget year plus the three subsequent years) which distinguish existing policy from proposed new initiatives. This serves as the basis for the preparation by the MoF of whole-of-government four-year projections which are presented to Parliament in the annual budget and *SBS*.

Plans to move to performance-based appropriations by 2010 should help to strengthen medium-term budgeting by putting the programmatic basis of expenditure estimates on a firmer footing. Formulating expenditure estimates on a program basis helps to put the spotlight on the demand factors and other cost drivers which impact on specific government services. The move to performance-based appropriations will however require the rethinking and improvement of the program classification currently used by ministries in their organizational development plans particularly with a view to ensuring that all programs are output and outcome based, and that programs can be costed with sufficient accuracy.

The predictability of the medium-term expenditure policy has been greatly reduced by the unexpectedly rapid growth in government revenues, reducing the pressure to set expenditure priorities. The tighter specification of the fiscal policy stance in 2007—and in particular the explicit formulation that the aim would henceforth be to save any revenue overperformance rather than to spend it via supplementary budgets—is a useful step in making expenditure policy more predictable, while also making fiscal policy less pro-cyclical.

23. A statement on medium-term fiscal policy objectives is included in the budget documents. 2.1.2

The Estonian government has in recent years articulated a clear medium-term policy objective concerning the budget balance, and has adhered to that policy. Prior to 2007, the objective was to keep at least a balanced budget for general government in the medium term. In 2007, the government specified an objective of delivering sustained surpluses and, as part of this, of saving any within-year excess in revenue performance (rather than spending it via a supplementary budget, as has been the practice in recent years).²⁶ The medium-term fiscal framework is outlined in the *SBS*, which is considered and approved by the cabinet early in the budget preparation process each year and which provides a rolling four-year framework within which tax and spending decisions are made (Box 5).²⁷ To support the medium-term orientation of fiscal policy, forward projections of expenditure, revenue and the fiscal balance for the whole period are prepared and included in the budget documentation. The medium-term expenditure estimates are prepared initially by line ministries and forwarded to the MoF as part of their budget bids (the bids consist of organizational development plans and financing plans). The MoF reviews and consolidates these into aggregate forward expenditure estimates, but the methodology for constructing forward estimates is not applied consistently. The medium-term revenue estimates are prepared by the MoF.

24. The medium-term objective for the budget balance does not constitute a fiscal rule. 2.1.2

The *SBS* for 2008–11 specifies that: “at the planning stage, the state budget is made for the medium term in such a manner that the budget of the general government is in surplus.”²⁸ The fiscal policy thus described is considered appropriate in the circumstances which are expected to prevail in the medium term, but not necessarily as a principle which will remain appropriate under all future circumstances. For example, the decision to set budget balance objectives in terms of the nominal, rather than cyclically-adjusted budget balance is a reflection of the difficulties currently being experienced in making reliable estimates of the structural deficit while the Estonian economy is undergoing rapid structural changes. Furthermore, the budget balance objective is not specified in Estonian law, but is a matter of government policy and agreement between political coalition partners.²⁹ However, Estonia is bound by the fiscal rules specified in the European Union’s Stability and Growth Pact (SGP).

²⁶ *SBS* 2008-11, Section 2.2.1.

²⁷ However, a proposal currently under consideration would make the formulation of the *SBS* a process which would only take place in the first budget of every newly-elected government.

²⁸ Section 2.2.1.

²⁹ The central government specifies a target for the central government balance, which is designed to ensure that the agreed general government target balance will be met, based on projections for the local government and social security sectors.

The Council of the EU found in its opinion on Estonia's 2006 Convergence Program that Estonia's fiscal policy was clearly consistent with the SGP deficit and debt rules, but was nevertheless not fully in line with the SGP because it remained pro-cyclical.

Fiscal sustainability analysis

25. An assessment of fiscal sustainability is included in the budget documentation.

2.1.4

The *SBS* includes a section on fiscal sustainability, the main analytic content of which concerns pension system sustainability. There is a similar discussion of fiscal sustainability issues in the annual Convergence Program updates prepared for the European Commission.³⁰ Analysis of other fiscal sustainability issues associated with demographic pressures (such as health expenditures) is at this stage very limited. There is no published sensitivity analysis in respect of the impact of variations of macroeconomic or demographic assumptions upon the long-term projections of pension finances. Public debt is very low in Estonia (and is indeed substantially less than the stock of financial assets), so there are no debt sustainability concerns. The 2006 EU report on *The Long-Term Sustainability of Public Finances in the European Union*,³¹ rated Estonia as in the "low risk" category in respect to long-term fiscal sustainability. However, this assessment was qualified by a recognition that the favorable projection for pension expenditure arose in part from unsustainably ungenerous pension indexation arrangements. Since then, the Estonian government has revised the pension indexation formula to make it more generous.

Coordination of budgetary and extrabudgetary activities

26. Mechanisms for the coordination and management of budgetary and extrabudgetary activities are well defined.

2.1.5

There are two significant extra-budgetary funds, separately classified within general government as social security funds. The Health Insurance Fund (HIF) and Unemployment Insurance Fund (UIF) are however fully integrated into budget decision making and are reported in budget documentation. In addition, most of the revenue of the HIF flows directly through the budget and is recorded and reported within the budget.³² The two funds reported a combined surplus of over EEK 1.2 billion in 2006 and their assets were around EEK 5.3 billion in 2007. There is also a series of designated accounts that are administered entirely within the budget. The Stabilization Reserve Fund (SRF), which was established in 1997 mainly to help secure fiscal and economic stability and military preparedness, receives transfers under the state

³⁰ Available publicly at <http://www.fin.ee>.

³¹ http://ec.europa.eu/economy_finance/publications/european_economy/2006/ee0406sustainability_en.htm.

³² The UIF is financed directly from the unemployment insurance tax.

budget primarily at times of budget surplus.³³ Only one disbursement has been made so far from the fund.³⁴ A specific cash reserve, tentatively called the Pension Reserve, has also recently been created to build up an earmarked reserve in case of future pension funding shortfalls; it has received transfers from the general reserve (Box 6).³⁵ Also, management of externally financed expenditure is fully integrated into budget decision making and reporting

Box 6. Selected Government Activities and Funds in Estonia, 2007

Activity	Assets (in billions of EEKs) <i>most recent data</i>
Extra-budgetary activities	
<ul style="list-style-type: none"> • Unemployment Insurance Fund. The fund is financed by unemployment insurance tax, and is used to pay for unemployment benefits. 1/ • Health Insurance Fund. The fund is financed by social security contributions, and is used to support those who become sick. The bulk of contributions and spending are recorded within the budget. 2/ 	<p>2.5</p> <p>2.8</p>
On-budget activity	
<ul style="list-style-type: none"> • Pension scheme. There is no separate account for the scheme. Pensions under pillar 1 (pay-as-you-go) and transfers by the government under pillar 2 are paid through the budget, which receives revenue from social security contributions. 	<p>0</p>
Reserve funds	
<ul style="list-style-type: none"> • Pension Reserve Fund. This is part of a general cash reserve set aside and handled separately from other general cash reserve assets. It is meant to act as a buffer in the event of shortfalls in future pension funding, financed by transfers from the state budget or other reserve funds. 3/ • Stabilization Reserve Fund. The Stabilization Reserve Fund is financed via transfers from the state budget, reflecting profits from the Bank of Estonia, sales of state assets, and overall budget surpluses, or from other reserve funds. It was established primarily to help maintain fiscal and economic stability. 4/ 	<p>4.8</p> <p>6.3</p>

Sources: MoF, *SBS*.

1/ The Unemployment Insurance Fund is governed by the *Unemployment Insurance Act*.

2/ The Health Insurance Fund is governed by the *Health Insurance Fund Act*.

3/ The MoF plans to introduce legislation for this fund.

4/ The Stabilization Reserve Fund is governed by the *State Budget Act*.

³³ Potential sources to supplement the SRF include designated revenue surpluses, privatization proceeds, central bank profits, and own revenue.

³⁴ Under amendments to the *State Budget Law* in 2002 and 2003, all uses of the funds of the SRF must now be through the state budget.

³⁵ Pensions are fully incorporated into the state budget, and are notionally financed by social security contributions and state transfers.

Accounting and reporting on budget execution

27. Accounting and internal control procedures provide a reliable basis for tracking commitments, payments, arrears, total liabilities, and assets. 2.2.1

Since 2004, an accrual accounting system based on International Public Sector Accounting Standards (IPSAS) has been used by central and local governments. The system provides data on commitments, assets and liabilities (including accounts payable and arrears). This enables timely identification of potential and actual payment arrears in Estonia and any arrears appear to be cleared in a short time. Social security-related liabilities, including those on pension and health care, cannot be extracted from the IPSAS-based accounting system. The accounting standards are well understood and officials in the NAO consider that the modality is satisfactory. The system provides a basis for internal control, but other segments of internal control need strengthening (paragraph 53). Commitments are recorded by the ministries and agencies. Payments are executed and recorded by treasury and in the internal accounting systems of the ministries and agencies. The treasury effectively runs a treasury single account (TSA) system, involving two main accounts in two commercial banks.

28. The accounting system is capable of producing accurate in-year reports of the central government budget outturn. 2.2.1

Monthly reports on budget execution are prepared and published by the treasury a few days after the end of the month. They are based on cash transactions and are classified according to the main categories of expenditure identified in the budget structure. Local governments also publish timely monthly execution reports. There is no regular reconciliation of central and local government monthly reports because this is not required for the managerial functions that they were designed to serve. Until end-2007, accounting reports from ministries and agencies were compiled on a quarterly basis by the accounting department of the MoF. The MoF has requested that ministries and agencies now provide accounting reports on a monthly basis. The expenditure classification system in the accounting reports, which forms the basis of the quarterly consolidated reports on general government published by the SoE, is more detailed than the monthly cash reports and a bridging system is used to meet Eurostat requirements for provisional accruals data. The consolidated general government reports are published with a time lag of about four months. In preparing the government financial statements, both cash and accounting reports are used. The chart of accounts is consistent with the budget classifications in terms of expenditure itemization, but different methodological cash/accrual concepts are applied.

29. There is no regular procedure for a mid-year review to the legislature, but timely reports on the budget outturn are published. 2.2.2

There are no requirements for a formal review of the budget during the year. However, in recent years, towards the end of the year, the government has proposed supplementary

budgets, which have contained updated assessments of the outturn for the current year's budget. In addition, fiscal reporting is regular, open and transparent, including daily data on cash transactions and monthly reports on central government budget execution on the MoF website, and quarterly reports on the general government balance, revenue, and expenditure (reflecting quarterly ministry accounting reports), and the general government balance sheet on the website of the Statistics Office of Estonia (SoE). Within eight months of year-end, the legislature receives the audited annual financial report.

Box 7. The Move to Accrual Budgeting

The MoF has prepared a proposal to move to accrual budgeting by 2010, in parallel with the adoption of performance budgeting. Accrual budgeting will mean that ministries will be given limits for the *expenses* which they incur, rather than (as under cash accounting) for the total payments which they make.

The Estonian government was an early mover by international standards in the adoption of accrual accounting (i.e., the preparation of accounts on an accrual basis) in the public sector, having initiated moves in this direction in the late-1990s culminating with the full adoption of accrual accounting in 2004. The fact that accrual accounting is firmly implanted is an essential factor in preparing the way for the transition of the budget onto an accrual basis.

Current plans suggest that ministries will receive two types of appropriations under the new accrual budgeting regime. The first will be for expenses, excluding certain items which do not require present or future payments (particularly depreciation) or which present difficulties in estimation. The second will be for net acquisition of nonfinancial assets (capital expenditure net of non-budgetary capital funding from asset sales receipts and earmarked grants e.g., EU financing). This would make the Estonian system relatively simple and highly transparent in respect to the relationship between appropriation control totals and aggregate fiscal policy.

The transition to accrual budgeting from the existing cash budgeting system will complement the performance budgeting reforms because it will permit choices about program priorities based on a better measure of program costs. Accrual budgeting will also have aggregate fiscal policy advantages by facilitating in-year monitoring of the quasi-accrual budget balance measure used by the EU for the purposes of the Stability and Growth Pact deficit limit.

30. Supplementary revenue and expenditure proposals during the fiscal year are presented to the legislature in a manner consistent with the original budget presentation.

2.2.3

The Organic Budget Law allows for the presentation of a supplementary budget to parliament no later than two months before the end of the financial year. It follows the same classification as the annual budget. Supplementary budgets have recently been used every year by the government to increase spending in the light of higher-than-expected revenues and shortfalls in capital spending.³⁶ This reliance on supplementary budgets has reduced the transparency of the budget process, because it has impaired the prioritization process built

³⁶ Supplementary budgets have also been used to bring forward spending on priority expenditures that would have been budgeted for the next financial year.

into the annual cycle of medium-term budgeting. In 2007, the supplementary budget increased expenditure by around EEK 2.7 billion or 3.6 percent of the budget. Use of supplementary budgets has also made the profile and total of spending less predictable, because supplementary budgets are adopted late in the financial year and some spending has been carried over into the following year. Although there is a cap (3 percent) on the proportion of recurrent spending which can be carried over to the following year, there is no such limit on capital expenditure. The authorities generally propose only a small contingency reserve in the annual budget and this is reduced further during the parliamentary approval process in favor of specific items of expenditure.

31. The audited final accounts and summary of the audit report are submitted to parliament and published within eight months of the end of the fiscal year. 2.2.4

The final audited accounts of central government, together with the accounts of local government and public corporations, are presented in the consolidated annual report, which includes a summary of the audit report of the National Audit Office (NAO). Although the consolidated report includes a comparison between outturn data and figures for the latest appropriations, the latter figures will incorporate any supplementary budgets approved during the year. There is no mechanism to ensure that the annual report compares or analyzes differences between outturns and initial appropriations.

C. Public Availability of Information

Commitment to timely publication of fiscal data

32. Fiscal information is comprehensive, and readily available to the public in a timely fashion, but there are no specific requirements in legislation for the release of such information (other than annual reports), and there is no advance release calendar. 3.3.1, 3.3.2

A large amount of fiscal information is published in timely fashion, and is made widely accessible through the web and explanatory documentation. However, legislative requirements for the release of fiscal information are confined to commitments to publish annual reports; and there is no advance release calendar for fiscal data. Reports covering budget execution are made available to the public on a monthly and annual basis. The publication of government fiscal data meets the requirements of IMF's Special Data Dissemination Standard (SDDS), to which Estonia has subscribed since 1998.

The coverage and quality of budget documents

33. The budget documents and reports cover central government fiscal activities comprehensively, including a separate identification of all major revenue sources. 3.1.1, 3.1.2, 3.1.4

The central government budget documentation formally consists of the *Annual Budget Bill*, the *Explanatory Note*, and the *SBS*, which are also complemented by the consolidated annual report. The *Annual Budget Bill* provides details on all expenditure and revenue items, and includes budget transfers from privatization receipts. The *Explanatory Note* provides an analysis of the budget (incorporating extra-budgetary funds) and outlines fiscal policy objectives and targets. Detailed information is given on government expenditures, following the budget appropriations structure, classified by ministry and economic type. Information is also provided on the implications of the budget figures in a program-based structure (by objectives and measures). Revenues specify foreign sources, including EU structural funds.

34. **Defense expenditures are comprehensively reported in the budget.** 3.1.1

Coverage of fiscal reporting

35. **The consolidated annual report includes information on the outturn fiscal positions of consolidated general government (and, within that, of local governments), the public corporations sector, and the consolidated public sector; and the State Budget Strategy provides comparative information for the general government for the budget and the following three years; but there are no systematic comparisons or analyses of deviations in outturns from initial budget estimates.** 3.1.2, 3.1.6

The consolidated annual report provides comprehensive data across the public sector. For the general government, it is supplemented by quarterly published reports, which facilitate monitoring of fiscal objectives during the current year and of the debt levels of the central and local government. The *SBS* provides an outturn of fiscal aggregates for two years preceding the budget year and a forecast for three years beyond the budget year, including projections for the balances of subnational governments. However, in the event that there has been a supplementary budget, budget documentation does not include a comparison of outturns or expected outturns against initial budget projections or appropriations. There is also no analysis of the reasons for any deviations in outturn data from the previous budget.

Treatment of fiscal risks

36. **While some analysis of the fiscal risks associated with possible changes in key economic forecasting assumptions is presented in the budget documents, there is no integrated discussion of other fiscal risks, such as contingent liabilities or quasi-fiscal activities (although neither of these currently appear to be significant).** 3.1.2, 3.1.3

The budget documentation does not contain any sections specifically devoted to the analysis of fiscal risks. The *SBS* does include, however, a section on fiscal sustainability and the consolidated annual report identifies all government guarantees, together with other contingent liabilities such as impending court settlements. In addition, alternative economic scenarios are presented in the budget documentation. Nevertheless, no systematic sensitivity

analysis is published of the impact of variations of macroeconomic or demographic assumptions. There is, however, no evidence that either the local government nor the public corporations sector present significant fiscal risks at the present time. Overall, local government has recently moved into overall surplus, albeit with some individual authorities continuing to run deficits. Within the public corporations sector, there have only been one or two enterprises (including the postal service) that have recently sustained losses.

Publication of data on debt, other liabilities and financial assets

37. Detailed information is published regularly on gross public debt. 3.1.5

The consolidated annual report includes data on the stock of debt for all of the public sector. In addition, monthly data on central government debt (which is small) is published on the MoF website, classified by debt instrument, creditor, and maturity.³⁷ Data on local government debt are published on the SoE's website on a quarterly basis.

38. Published information on non-debt liabilities includes arrears, guarantee exposure, and other contractual obligations. 3.1.5

Contractual liabilities and arrears are captured by the accrual accounting system and are published in the consolidated annual report. All government guarantees are also recorded in the consolidated annual report, together with other contingent liabilities such as impending court settlements.

39. Detailed information is published regularly on government financial assets. 3.1.5

Financial assets are captured by the accrual accounting system and are published in the consolidated annual report and, quarterly, on the SoE website, in conformity with EU reporting standards. In addition, monthly reports published on the MoF website show details of all central government financial assets, including the level and composition of the general reserve, SRF, and pension reserve.

Analysis of long-term public finances

40. Some analysis of fiscal sustainability issues is routinely undertaken and published, but no separate report is produced on the long-term outlook for term public finances. 3.1.7

³⁷ These debts are limited to loan agreements arising from the World Bank, European Investment Bank, Nordic Investment Bank, and Council of Europe Development Bank.

Specific issues affecting long-term fiscal sustainability issues are addressed in the *SBS* and the Convergence Program updates. The main concern has been to address future pension commitments. Projections are also provided of public finances to 2050. There is, however, no legal provision for a regular document to be published showing alternative long-term scenarios constructed on the basis of a systematic set of assumptions.

Guide to the budget

41. A clear and simple guide to the state budget strategy is made available to the public. 3.2.1

The *Estonian State Budget Book*, which provides a citizens' guide to the state budget strategy, is published on the MoF website when the strategy is adopted by the cabinet. This provides an explanation of fiscal policy and spending priorities over the medium-term budget in plain language and with clear graphs and tables. In addition, the formal *SBS* is made available via the internet. When the annual budget is presented to parliament, a brief summary (the "citizen's pocket book") is published on the MoF website. This provides a concise guide to the fiscal outlook and expenditure proposals for the budget year, but only limited material on the economic framework or fiscal risks.

Budget classification

42. The annual budget presentation is broadly consistent with the Government Financial Statistics (GFS) 1986. 3.2.2

The classification of revenue, and the input classification of expenditure in the budget, are broadly in line with GFS 1986. Only administrative and economic classifications are provided in the budget, and appropriations are very broad.³⁸ However, the explanatory note that accompanies the budget also presents the principle functional and program classifications of expenditure. In addition, the SoE provides, in the data reporting phase, the main categories of the functional classification based on the Classification of Functions of Government (CoFoG), incorporated in the *Government Financial Statistics Manual (GFSM)* 2001. The chart of accounts follows an accrual classification structure, but the itemization of revenues and expenditures is consistent with the budget.

General government balance

43. The overall balance of general government is the main indicator of the fiscal position in the budget, and the general government balance is monitored during the year. 3.2.3

³⁸ For example, in the case of an agency under a ministry, only the lump sum transfers to the agency from the ministry are detailed.

The government's current primary fiscal objective is formulated in terms of the overall balance of general government. The state budget is designed both to ensure that the budget for the general government is in surplus and to deliver an overall surplus for central government. Because subnational governments have, until recently, tended to be in overall deficit, this has required the central government accounts (including extra-budgetary funds) to show at least an offsetting surplus. The primary focus on the general government balance is reinforced by the fact that EU convergence criteria for the budget balance pertain to general government. The general government balance is monitored on a quarterly basis (and will be monitored on a monthly basis from 2008).

Results-oriented budgeting and reporting

44. The objectives and expected results from government activities are clearly defined, but monitoring and reporting of results is limited. 3.2.4

The *Explanatory Note* to the budget includes a section which presents the budget in a programmatic format, with a clear statement of the objectives of program expenditure, performance measures, and program cost. This is supported by a process in which ministries are required to present their budget bids in the form of "Organizational Development Plans," which are strategic planning documents linking their proposed expenditure to objectives and expected results in a medium-term perspective. Although progress has been made in the development of performance indicators, evaluation (including in respect to the economic and social impact of programs) is at present limited, and no systematic reports of the results of activities are presented to the legislature.

D. Assurances of Integrity

Integrity of budgeting and accounting processes

45. Budget revenues have persistently exceeded forecasts in recent years, partly reflecting unexpectedly rapid growth in economic activity and employment. 4.1.1

Revenues have been buoyed by the strength of the upswing, which has proved hard to forecast because of the impact of structural change and EU accession. By contrast, outturns for expenditures have consistently been lower than budgeted, with capital spending undershooting final budget appropriations by up to 50 percent. Some of this undershoot is explained by delays in disbursing and implementing EU funds (which also depress revenue), coupled with a lack of absorptive capacity in some ministries. Despite the extent of these deviations, the budget documents do not display a direct comparison between the initial budget projections for revenue and expenditure and these outturns; nor do they indicate how these persistent deviations have been taken into account in formulating the new budget projections.

46. **Generally accepted accounting standards are used to compile fiscal data, and a statement on the accounting basis is included in the final accounts, but not in the budget.** 4.1.2

The IPSAS-based accounting standards are recorded in the final accounts, but (although they are well-known) no standards are specifically mentioned in the budget, because it remains in cash. Details of the main categories of expenditures for each ministry are included in budget documentation, but they do not have appropriation significance, allowing scope for some change between certain economic categories in the course of the year.

Reconciliation practices

47. **Cash and accrual reports are reconciled with banking transactions; and deficit and debt data are fully reconciled within the accrual reporting framework.** 4.1.3

Cash reporting is reconciled with banking transactions on a daily basis using the TSA approach operated by the treasury (paragraph 27). Accounting reports are also reconciled separately with banking transactions. Moreover, accrual accounts make a 2001 *GFSM* based balance sheet approach to fiscal data possible, providing a full reconciliation of debt and deficit data. Although treasury reports on cash transactions are useful for cash and liquidity management purposes, they do not provide sufficient detail to monitor budget execution in the required categories (paragraph 28).

48. **Major revisions to historical fiscal data and any changes to data classification are explained.** 4.1.3

The reports in which they appear contain explicit references to any changes made in the classification of data, and their impact is assessed.

Internal oversight

49. **Public servants are subject to a well-defined code of behavior.** 4.2.1

A *Public Sector Code of Ethics* was adopted by parliament in 1999 as an annex to the *Public Service Act*. The provisions of that *Code*, in conjunction with certain provisions of the principal Act, cover all of the principles laid down in the *UN International Code of Conduct for Public Officials*. A key challenge has been to ensure the full implementation of these ethical principles. Amongst a range of anti-corruption initiatives that have been undertaken to this end, the governmental anti-corruption plan “Honest State” launched in 2004 deserves particular mention.

50. Civil service employment procedures are clear and well-understood. 4.2.2

Procedures for recruitment, remuneration, termination and other key areas of human resources management are clearly laid down in the *Public Service Act*. By international standards, the Estonian civil service regime is quite flexible and decentralized, including in its provisions for laying off redundant staff, subject to due process and clearly defined compensation requirements. There is also considerable freedom for ministries to pay substantial incentives over and above base levels of civil service remuneration. Improved civil service remuneration has been important to the retention of qualified staff, which had previously been a major problem.

51. Procurement rules and practices meet international standards, but they are subject to frequent revision. 4.2.3

The 2004 *Procurement Act* and its amendments were replaced in May 2007 by a new act, which the MoF is considering updating further. The *Act* requires tendering mechanisms to be followed for contracts above specified thresholds, which are regularly updated, and does not appear to indicate any excessive discretion for contracting authorities (ministries and agencies). The *Act* stipulates that its implementation is to be supervised by the public procurement office, an independent agency under the ministry of finance. Procurement rules seem to be generally observed, although the capacity of some local authorities to ensure this is very limited. Standard mechanisms exist for review of bidders' complaints. Protests to an appeal commission must be filed before acceptance of the successful tender by the contracting authority.³⁹ The recommendations of OECD-SIGMA's 2003 report have been taken into account by legislation.

52. Purchases and sale of public assets are undertaken in an open manner and major transactions are separately identified in the budget and fiscal reports. 4.2.4

Detailed provisions for the sale and purchase of assets are laid out in the *State Asset Act*, which also covers the transfer of assets to other users with or without charge and the management of both movable and immovable state assets, including the transfer of assets from one manager to another (government ministry or organization). The proceeds of sales are recorded in the government accounts according to the asset manager. The *Act* was amended frequently until 2004 to accommodate reform measures, and a further major review is currently in process. Until that is completed, the *Privatization Act* also remains in force,

³⁹ Appeals must be filed within seven working days from becoming aware of the possible violation of a person's rights or interests. Appeals regarding notices or tender documents must be submitted at least three workdays prior to the date of submission of the tenders or request to participate in the procurement procedure. An appeal can be reviewed in written procedure by a member of the appeal commission alone or the commission of three members depending on the nature of the case. A decision of the appeal commission must be published within 10 workdays from the receipt of the appeal. The decisions of the appeal commission can be appealed to the administrative court.

although its coverage has been reduced and there is no longer a separate privatization agency. The remaining minimal privatization activities are overseen by the MoF.

53. Internal audit is only partly effective, reflecting capacity limitations, and there is no arrangement to publish audit reports. 4.2.5

The internal control and audit system is regulated by the *Government of the Republic Act* and its detailed associated government regulations, particularly the *General Rules for Internal Audit*. In each ministry and agency, internal auditors (in most cases an audit unit, staffed by two to six persons, but sometimes a sole official) report to their ministers or heads of agencies. Responsibility for developing internal audit methodology and internal audit staff training in the ministries, as well as the internal auditing of EU structural funds, lies with the financial control department of the MoF. This department, as the central harmonization unit, also produces an annual review on the development of the internal control and audit system, and provides an evaluation of the system's workability. Based on the 2006 review, only about one half of internal audit systems would appear to be efficient. Internal audit reports are available to the NAO, but are not made public.

Clarity of internal control and independence of tax administration

54. Tax administration has effective internal monitoring and control mechanisms, but does not systematically report to the public on its performance. 4.2.6

There is a mechanism for requesting advance tax liability rulings where indicated. An internal discipline department of the tax and customs board is responsible for monitoring and exercising systematic supervision over the legality of the activities of tax and customs officials, and the mitigation of risks arising from the specific nature of the profession and related persons and opportunities for corruption. The Internal Audit Department of the tax and customs board reports directly to its director general and works independently. Its audit assignments each year include some financial accountability processes. Although the board regularly provides information to the public on its website, no separate reports are presented to the public on the administration of tax laws.

55. Tax administration is not given explicit protection from political interference. 4.2.6

The director of the tax and customs board is appointed by the minister of finance for a period of four years. The director is protected by the same employment conditions that govern all public servants; there is no specific additional protection from political interference. For government budget purposes, the tax and customs board is classified as an agency under the MoF.

Independent external oversight

56. External audit is independent of the executive branch, and its mandate covers all public sector activities. 4.3.1

The *National Audit Act*, governing external audit functions, is very comprehensive and up-to-date. The auditor-general is appointed for a period of five years on the recommendation of the president and approval of parliament. The auditor-general can be reappointed without limit and can only be removed from office by parliament, on the grounds of sustained incompetence or criminal activity. The NAO is a constitutional institution and by law its budget is protected from downward adjustments. The NAO covers financial and performance audits for all public sector entities, with the exception of performance audits of local governments.⁴⁰ Public corporations commission their own external audit reports from certified accountants, but these reports are subject to review by the NAO. The NAO cannot be assigned mandatory audit duties; it alone makes the determination of which special audits it will pursue, including on issues raised by the parliamentary finance committee. NAO's work is based on international auditing standards and best practices of European and world audit-related institutions, including the International Organization of Supreme Audit Institutions (INTOSAI).

57. External audit capacity appears adequate. 4.3.1

The NAO has 94 staff, 92 percent of whom have higher education and 21 percent have an academic degree. The audit work plan covers almost all risk areas on an annual basis. Salaries appear to be attractive, while non-personnel resources seem to be sufficient, including office space and other facilities. In addition, regular contact with EU audit institutions, and technical assistance from the U.K.-National Audit Office, the U.S.-General Accountability Office, and the OECD-SIGMA program have helped build audit capacity.

58. External audit reports are submitted to the legislature and published, and audit findings are monitored. 4.3.2

The NAO audits the consolidated annual report of public sector entities and the annual reports of the constitutional institutions (parliament, chancellery, office of the president, and the supreme court). A draft report is sent to the MoF by June each year and the final report is submitted to parliament's State Budget Control Select Committee by end-August.⁴¹ The

⁴⁰ Performance audits of local governments remain the responsibility of local governments' councils.

⁴¹ The Committee: reviews the consolidated report and auditor's report for the previous financial year; reviews public sector audit issues; discusses audit reports and overviews by the NAO and important questions raised by the auditor general; informs the NAO about problems communicated to members of the Committee by authorities and private persons; and forms an opinion, based on the information received from the NAO, on cases of obstruction of its activities. Sessions of the Committee where audit results are discussed are public. A representative of the NAO and audited entity and other relevant officials are invited to participate. After

(continued...)

annual report, and all other audit reports, are posted on the NAO's website.⁴² The annual overview on the use and preservation of state assets (a special report presented to parliament and the public) includes a chapter covering both the recommendations of the NAO which were followed up by the government and those that were not. In 2006, the government implemented, fully or partly, around a quarter of the NAO's recommendations. MoF plans to implement other recommendations through amendments to the organic budget law.

59. There is no formal scrutiny by independent experts of the fiscal and macroeconomic forecasts, or the analytical techniques which underlie them, but the forecasts are regularly updated and published. 4.3.3

The MoF does not currently formulate its forecasts with the aid of a formal macroeconomic model. This is justified on the grounds that the rapidity of economic change in the country has made accurate model-based forecasting difficult. Instead, the MoF makes use of different analytical techniques and consults external forecasters and the central bank. The government does not publish regular background information or analysis on its methodology or forecasting record.

60. The Statistics Office of Estonia is not given legislative assurance of independence, but in practice it operates independently. 4.3.4

The operational independence of the SoE, is underpinned by the provisions concerning statistical integrity in the *acquis communautaire*. However, the SoE is an agency of the MoF, and its head reports directly to the minister of finance. There is no special protection for the head of SoE from political interference; conditions of appointment and employment are the same as for other public servants. The SoE has the power to determine methodology under its statutes and cooperates with other public agencies in the production of statistics. Public confidence in the integrity and quality of fiscal data, verified by the SoE, remains high.

deliberation of the audit results, the Committee may submit inquiries to the government, with a response required within one month. The Committee reports to parliament at least once a year.

⁴² The *National Audit Act* requires the NAO to disclose audit reports except where there is information on a state or business secret, information subject to banking secrecy, or if disclosure would be contrary to legislation. In such cases, the NAO is required to disclose the parts of the report that are permitted to be disclosed.

III. IMF STAFF COMMENTARY

61. **Transparency has been a major objective of Estonia’s fiscal reforms since reestablishing independence, and a great deal has been achieved.** By 2001, as was observed in the initial fiscal ROSC, Estonia had “achieved most of the requirements of fiscal transparency and, with planned improvements, should move closer to full observance of the Code.” These improvements have now largely been effected.

62. **Estonia currently meets nearly all the requirements of the transparency code.** In some areas, it approaches best practice standards. Particular strengths are the clarity of the legal framework determining the roles and responsibilities of general government; the well-structured and open processes for preparing and executing the budget; and Estonia’s success in meeting its commitments to keep the public well informed about fiscal developments and policies.

63. **All four pillars of the fiscal transparency code are well addressed:**

- The clear definition of general government and the closely prescribed, all-inclusive nature of the legal framework governing the budget process come close to best international practice. Public corporations (which are all non-financial) conform to commercial principles, and are not required to carry out quasi-fiscal activities, which limits the potential for fiscal risks. Regulation of the private sector is clear and light, and contractual arrangements between government and the private sector are accessible and clear. Tax administration and taxpayers rights are rules-based and efficiently delivered. While the major privatization program has largely been completed, legal provisions and responsibilities for the future disposal of government assets, and use of receipts, are clearly specified.
- Budget preparation is carried out according to a clear, open and systematic schedule, designed to embed budgetary decisions within a coherent medium-term framework for the whole of general government. Fiscal targets and medium-term objectives are clearly described and openly discussed. Proposals for new measures are accompanied by estimates of their costs and expected results. Supplementary budgets are presented in the same way as the original budget. All legal requirements for provision of documentation subject to precise deadlines are scrupulously observed. Budget execution is controlled and monitored according to clear regulations and standards, which minimize the risk of arrears and underpin the provision of regular reports to the legislature, including timely audited final accounts.
- Fiscal reporting is comprehensive, readily accessible (including on government websites), and timely, fortified by Estonia’s subscription to the IMF’s SDDS. The coverage in budget documentation of medium-term projections and past data for the principal fiscal aggregates for the whole of general government, together with

relevant information on the public corporations sector, approaches best international practice. Information on the government balance sheet is extensive. Recent moves towards performance-based budgeting have resulted in a helpful increase in information on the objectives and results of government programs. A very useful innovation is the publication of a thorough but straightforward plain-language guide to accompany release of the SBS.

- Institutional mechanisms to ensure the integrity of fiscal data are, for the most part, well established. The accounts of all public sector entities are subject to comprehensive external audits, and performance audits of the central government increase the effectiveness of the oversight by the legislature and public of current practices and standards. Rules for public procurement, employment, and ethical behavior are clear and appear to be mostly well observed.

Nevertheless, there are a few areas where further reforms could usefully enhance fiscal transparency:

64. **Routine recourse to supplementary budgets to revise expenditure plans should be avoided.** Supplementary budgets can undermine expenditure prioritization and budget credibility. Moreover, the promulgation of a supplementary budget late in the fiscal year weakens expenditure control in the following year by increasing the likelihood of carry-overs in spending. Supplementary budgets should therefore only be used occasionally to revise expenditure plans, to address exceptional circumstances. To moderate pressure for unplanned increases in in-year spending, it would be helpful to increase the emphasis in public pronouncements on medium-term policy objectives of maintaining a stable path for government expenditure. The government's credibility in resisting such spending pressures would also be increased by greater focus in budget documentation on forecasting uncertainty (and, particularly, on any perceived asymmetry in risks such as revenue overrun or spending shortfalls).

65. **Consideration should be given to strengthening the appropriations process by limiting the carry-over of expenditure and ring-fencing the contingency reserve.** While carry-overs help to mitigate inefficient and disruptive end-year spending splurges, they reduce the ability of the authorities to predict and control the following year's annual expenditure levels. In proposing the following year's appropriations, the government should therefore make explicit the possible implications of these carry-overs for generating additional expenditure and any consideration that has been given to ways of directly limiting their impact. The size of the contingency reserve should be sufficient to accommodate unexpected needs within the agreed budget envelope. In the light of the tendency of parliament to reallocate part of the contingency reserve during the appropriations process, it would be useful to introduce a means of protecting at least part of it from such activity, perhaps by formally ring-fencing it.

66. **Inclusion of formal sensitivity analysis and a statement on fiscal risks within the budget documentation would help ensure that exposure to uncertain developments is systematically analyzed and publicly understood.** At present, some alternative scenarios are presented to show the impact of different economic assumptions, and contingent liabilities are detailed in the *Consolidated Annual Report*, but there is no systematic presentation of the effect of changing specific economic assumptions, nor a published analysis of potential fiscal risks, including the uncertain cost of specific expenditure commitments and announced policy proposals.

67. **In evaluating new measures, it will be important to consider both the expected outcomes of the measures and their wider economic impact.** The systematic use of techniques such as poverty and social impact analysis can ensure that policy decisions reflect a consistent approach to evaluating the broader impact of alternative proposals. Presenting to parliament the estimated results of previous measures would also enhance accountability.

68. **A sustained effort will be required to ensure that performance budgeting lives up to its potential for strengthening the capacity of the government to meet expenditure objectives in an efficient and transparent manner.** The MoF target for shifting budget appropriations to a programmatic basis by 2010 is ambitious, and will entail considerable changes in technical implementation and attitudes towards control and information. Some aspects of particular importance to fiscal transparency are:

- The further development of performance indicators;
- Presenting more policy options and supporting information to cabinet to help inform the expenditure prioritization process;
- The introduction by the MoF of explicit processes for the review of program performance to facilitate the redirection of resources to priority areas;
- Clearly linking programs to the outputs/outcomes most relevant to government decision-making about priorities through an appropriate program structure; and.
- Explaining and justifying the merits of the initiative to parliament, taking into account concerns about the changes in control and information that will result.

69. **Proposals to tighten the conditions under which payments are made from the budget equalization fund to individual local governments would reduce the risk of unanticipated general government deficits.** Although, in aggregate, local governments have recently been in surplus, or small deficit, the absence of binding constraints on the borrowing of individual governments has limited the ability of central government to predict or control the overall general government balance. This situation would be improved if agreement is reached on the proposed amendments to introduce a limit on the budget deficits of individual governments, averaged over a period of years, and to extend the definition of

debt covered by the ceilings on the debt stock and servicing costs to include the debt of subsidiaries and PPP liabilities.

70. **A requirement to produce regular long-term reports on the economy, including the fiscal outlook and alternative policy options, would promote better informed discussions about the context in which medium-term decisions are being taken.** It may only be necessary to produce these reports every five years, but they would help to ensure that a systematic approach is taken to addressing potential longer term calls on the budget, including, for example, health care and environmental requirements as well as pensions. The reports should include sensitivity analysis to illustrate the impact of changing specific economic assumptions.

71. **In the light of recent high rates of accumulation of financial assets, portfolio management arrangements will need to be of the highest quality.** It will be important to clearly identify the objectives of the different funds that are being created, with fund management strategies that are fully aligned to these objectives, a separation of responsibilities, and clearly defined accountability. There is a risk that a profusion of central government funds (which already include the SRF, pension reserve, and general reserve, and which include assets denominated in both local currency and euros), in addition to the foreign exchange reserves managed by the central bank, will dilute the quality of fund management and lead to inconsistent portfolio allocations. The treatment of currency and liquidity risk should be clearly evaluated and the guidance provided to portfolio managers and their performance should be made public.

72. **Capacity needs to be strengthened in selected areas.** Skills in internal control and auditing would appear to be in short supply. Capacity to implement internal control and procurement requirements is limited, particularly in small local authorities. The arguments for further rationalization at the local level continue to be strong. Also, the propensity for frequent changes in legislation may be a further indication of capacity weakness.

73. **The ability of parliament to monitor the execution of the budget and assess its economic impact would be enhanced by a legal requirement for a mid-year review, analysis in the budget documentation of variances in outturn data from the previous budge, and application of a more complete *GFSM2001* economic classification in the budget.** At present, if there has been a supplementary budget in the previous year, no comparisons with the initial budget are shown in the budget documentation, precluding an assessment of the realism of the full budget process. Monitoring of the budget within the year is also inhibited by the lack of timely data showing estimates of overall spending on wages and salaries or transfers by central or local government. However, with the advent of monthly accrual reports in 2008, the basis will be laid for a comprehensive framework for monitoring progress during the year. This should be supported by a legal requirement for the government to present to parliament a mid-year report on the expected outturn for the budget, ideally complemented by quarterly updates.

74. **A calendar should be published at the beginning of the year showing the release dates of major economic information.** This would improve transparency and, by making clear the government's commitment to release timely data, enhance credibility.

75. **Statutory independence for the Statistical Office of Estonia would ensure maintenance of its integrity and credibility.** In many countries, the appointment of the head of the national statistical office is the responsibility of the legislature or the head of state.

76. **Scrutiny by independent experts of the macroeconomic assumptions used in budget projections, and of the implicit or explicit macroeconomic models that are used, would improve the credibility of the process and encourage innovation in analytical techniques.** Additional procedures might include subjecting the economic projections to formal comparisons with external forecasts, conducted by an independent public agency. An ex-post evaluation of the projections by an independent agency would also help to identify any systematic biases and maintain credibility. Publication of more descriptive and analytical material might also help to promote well informed discussions of forecasting techniques (including use of models).

APPENDIX I. SUMMARY ASSESSMENT OF PRACTICES

	Principles and Practices	Summary Assessments	Comments
Clarity of Roles and Responsibilities			
1.1.	The government sector should be distinguished from the rest of the public sector and from the rest of the economy.	Observed	
1.1.1	The structure and functions of government should be clear.	General government is defined consistently with the principles of Government Finance Statistics (GFS) and is well covered in the budget process.	
1.1.2	The fiscal powers of the executive, legislative, and judicial branches of government should be well defined.	The fiscal roles of the executive and legislative branches are clearly defined.	
1.1.3	The responsibilities of different levels of government, and the relationships between them, should be clearly specified.	The responsibilities of different levels of government and the relationships between them are clearly defined. Local governments are subject to nominal ceilings on the total stock and servicing costs of specified categories of their debt, but there are no specific limits on budget deficits, and no sanctions are currently being applied.	Proposals under consideration to tighten the conditions under which payments are made from the budget equalization fund to individual local governments would reduce the risk of unanticipated general government deficits.
1.1.4	Relationships between the government and public corporations should be based on clear arrangements.	Relationships between the government and public enterprises are clear. Quasi-fiscal activities of nonfinancial private enterprises appear to be insignificant and arrangements regulating profit transfers from NFPEs to the budget are clear. The central bank of Estonia—the Eesti Pank—is operationally independent; and has no fiscal role.	
1.1.5	Government relationships with the private sector should be conducted in an open manner, following clear rules and procedures.	Government holdings of fully-owned corporations and equity are moderate and are comprehensively reported in the annual government accounts. Laws and processes governing government regulation of the nonfinancial private sector are clear and open.	

	Principles and Practices	Summary Assessments	Comments
1.2.	There should be a clear and open legal, regulatory, and administrative framework for fiscal management.	Observed	
1.2.1	The collection, commitment, and use of public funds should be governed by comprehensive budget, tax, and other public finance laws, regulations, and administrative procedures.	The legal framework for management of public finances is clear, comprehensive, and very detailed.	
1.2.2	Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner.	The legislative basis for tax and nontax collection is clear and comprehensive. Tax exemptions are not extensive. Tax administration is clearly defined and well coordinated with overall fiscal management. Taxpayers' legal rights are defined and the appeals of tax or nontax obligations are considered in a timely manner.	
1.2.3	There should be sufficient time for consultation about proposed laws and regulatory changes and, where feasible, broader policy changes.	Public opinion is normally sought concerning proposed laws, regulatory changes and broader policy changes.	
1.2.4	Contractual arrangements between the government and public or private entities, including resource companies and operators of government concessions, should be clear and publicly accessible.	Contractual arrangements between the government and public or private entities are clear and publicly accessible	It will be important to keep under scrutiny the use of PPP arrangements by local governments.
1.2.5	Government liability and asset management, including the granting of rights to use or exploit public assets, should have an explicit legal basis.	There is clear legislation governing liability and asset management, the granting of rights to use or exploit public assets, and the framework for privatization.	
Open Budget Process			
2.1.	Budget preparation should follow an established timetable and be guided by well-defined macroeconomic and fiscal policy objectives.	Largely observed.	
2.1.1	A budget calendar should be specified and adhered to. Adequate time should be allowed for the draft budget to be considered by the legislature.	The budget calendar is clearly specified in the organic budget law and is followed in practice.	

	Principles and Practices	Summary Assessments	Comments
2.1.2	The annual budget should be realistic, and should be prepared and presented within a comprehensive medium-term macroeconomic and fiscal policy framework. Fiscal targets and any fiscal rules should be clearly stated and explained.	The macroeconomic framework is comprehensive, and the budget documents contain a clear statement on medium-term fiscal policy objectives, which does not constitute a fiscal rule. Further work is needed to improve the realism of the budget.	Budget planning and documentation should address specifically any perceived asymmetric risks such as the recent upside risks to revenue and downside risks to expenditure arising from the uncertain pace of structural change and the impact of EU accession.
2.1.3	A description of major expenditure and revenue measures, and their contribution to policy objectives, should be provided. Estimates should also be provided of their current and future budgetary impact and their broader economic implications.	New revenue and expenditure initiatives are identified in budget documentation, and estimates are provided of their financial impact in the budget year and medium term.	Proposals for new fiscal measures should be supported by estimates of their broader economic and social impact, using systematic techniques such as poverty and social impact analysis, to ensure that policy decisions reflect a consistent approach and the public is fully informed about their consequences.
2.1.4	The budget documentation should include an assessment of fiscal sustainability. The main assumptions about economic developments and policies should be realistic and clearly specified, and sensitivity analysis should be presented.	An assessment of fiscal sustainability is included in the budget documentation.	Analysis of fiscal sustainability issues associated with demographic pressures other than pensions (such as health expenditures) is at this stage very limited. Systematic sensitivity analysis should show the impact of variations of macroeconomic or demographic assumptions.
2.1.5	There should be clear mechanisms for the coordination and management of budgetary and extrabudgetary activities within the overall fiscal policy framework.	Mechanisms for the coordination and management of budgetary and extrabudgetary activities are well defined.	
2.2	There should be clear procedures for budget execution, monitoring, and reporting.	Largely observed.	
2.2.1	The accounting system should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities, and assets.	Accounting and internal control procedures provide a reliable basis for tracking commitments, payments, arrears, total liabilities, and assets. The accounting system is capable of producing accurate in-year reports of the central government budget outturn.	
2.2.2	A timely midyear report on budget developments should be presented to the legislature. More frequent updates, which should be at least quarterly, should be published.	There is no regular procedure for a mid-year review to the legislature, but timely reports on the budget outturn are published.	A legal requirement should be introduced for a mid-year report to be presented to parliament, ideally complemented by quarterly updates.

	Principles and Practices	Summary Assessments	Comments
2.2.3	Supplementary revenue and expenditure proposals during the fiscal year should be presented to the legislature in a manner consistent with the original budget presentation.	Supplementary revenue and expenditure proposals during the fiscal year are presented to the legislature in a manner consistent with the original budget presentation.	Routine recourse to supplementary budgets to revise expenditure plans should be avoided, because it can undermine expenditure prioritization and budget credibility. Consideration should be given to strengthening the appropriations process by limiting the carry-over of expenditure and ring-fencing the contingency reserve.
2.2.4	Audited final accounts and audit reports, including reconciliation with the approved budget, should be presented to the legislature and published within a year.	The audited final accounts and summary of the audit report are submitted to parliament and published within eight months of the end of the fiscal year.	
Public Availability of Information			
3.1	The public should be provided with comprehensive information on past, current, and projected fiscal activity and on major fiscal risks.	Largely observed.	
3.1.1	The budget documentation, including the final accounts, and other published fiscal reports should cover all budgetary and extrabudgetary activities of the central government.	The budget documents and reports cover central government fiscal activities comprehensively, including defense expenditure.	
3.1.2	Information comparable to that in the annual budget should be provided for the outturns of at least the two preceding fiscal years, together with forecasts and sensitivity analysis for the main budget aggregates for at least two years following the budget.	The consolidated annual report includes information on the outturn fiscal positions of consolidated general government; and the State Budget Strategy provides comparative information for the general government for the budget and the following three years; but there are no systematic comparisons or analysis of deviations in outturns from initial budget estimates.	The ability of parliament to monitor the execution of the budget and assess its economic impact would be enhanced by analysis in the budget documentation of variances in outturn data from the previous budget and application of a more complete <i>GFSM2001</i> economic classification in the budget. Systematic sensitivity analysis should be published, showing the impact of variations of macroeconomic or demographic assumptions, in addition to the alternative economic scenarios currently presented in the budget documentation.

	Principles and Practices	Summary Assessments	Comments
3.1.3	Statements describing the nature and fiscal significance of central government tax expenditures, contingent liabilities, and quasi-fiscal activities should be part of the budget documentation, together with an assessment of all other major fiscal risks.	While some analysis of the fiscal risks associated with possible changes in key economic forecasting assumptions is presented in the budget documents, there is no integrated discussion of other fiscal risks, such as contingent liabilities or quasi-fiscal activities (although neither of these currently appear to be significant). Tax expenditures are not reported, but they appear to be limited.	Inclusion of a statement on fiscal risks within the budget documentation, including on the uncertain cost of specific expenditure commitments and announced policy proposals, would help ensure that these are systematically analyzed and publicly understood.
3.1.4	Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.	The budget documents identify all major revenue sources.	
3.1.5	The central government should publish information on the level and composition of its debt and financial assets, significant nondebt liabilities (including pension rights, guarantee exposure, and other contractual obligations), and natural resource assets.	Detailed information is published regularly on gross public debt, non-debt liabilities (including arrears, guarantee exposure, and other contractual obligations), and government financial assets.	
3.1.6	The budget documentation should report the fiscal position of subnational governments and the finances of public corporations.	The consolidated annual report includes information on the outturn fiscal positions of local governments and the public corporations sector; and the State Budget Strategy provides comparative information for local governments for the budget and the following three years.	
3.1.7	The government should publish a periodic report on long-term public finances.	Some analysis of fiscal sustainability issues is routinely undertaken and published, but no separate report is produced on the long-term outlook for term public finances.	A requirement to produce regular long-term reports on the economy, including the fiscal outlook and alternative policy options, would promote better informed discussions about the context in which medium-term decisions are being taken. These would address potential longer term calls on the budget such as health care and environmental requirements, as well as pensions.

	Principles and Practices	Summary Assessments	Comments
3.2	Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability.	Largely observed.	
3.2.1	A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.	A clear and simple guide to the state budget strategy is made available to the public.	The “citizen’s pocket book,” published with the budget, would be enhanced by the inclusion of a short summary on the budget’s overall objectives, macroeconomic framework, risks, etc.
3.2.2	Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.	The annual budget presentation is broadly consistent with Government Financial Statistics (GFS) 1986.	
3.2.3	The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.	The overall balance of general government is the main indicator of the fiscal position in the budget, and the general government balance is monitored during the year.	
3.2.4	Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.	The objectives and expected results from government activities are clearly defined, but monitoring and reporting of results is limited.	The monitoring and reporting of results would be facilitated by the introduction by the ministry of finance of explicit processes for the review of program performance.
3.3	A commitment should be made to the timely publication of fiscal information.	Largely not observed.	
3.3.1	The timely publication of fiscal information should be a legal obligation of the government.	Fiscal information is comprehensive, and readily available to the public in a timely fashion, but there are no specific requirements in legislation for the release of such information (other than annual reports), and there is no advance release calendar.	Although adherence to the SDDS ensures release of comprehensive, timely information, it would be useful to incorporate such provisions in legislation.
3.3.2	Advance release calendars for fiscal information should be announced and adhered to.	There is no advance release calendar.	A calendar should be published at the beginning of the year showing the release date of major economic information. This would improve transparency and, by making clear the government’s commitment to release timely data, enhance credibility.

	Principles and Practices	Summary Assessments	Comments
Assurance of Integrity			
4.1	Fiscal data should meet accepted data quality standards.	Observed.	
4.1.1	Budget forecasts and updates should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.	Budget revenues have persistently exceeded forecasts in recent years, partly reflecting unexpectedly rapid growth in economic activity and employment.	
4.1.2	The annual budget and final accounts should indicate the accounting basis used in the compilation and presentation of fiscal data. Generally accepted accounting standards should be followed.	Generally accepted accounting standards are used to compile fiscal data, and a statement on the accounting basis is included in the final accounts, but not in the budget.	
4.1.3	Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions to historical fiscal data and any changes to data classification should be explained.	Cash and accrual reports are reconciled with banking transactions; and deficit and debt data are fully reconciled within the accrual reporting framework. Major revisions to historical fiscal data and any changes to data classification are explained.	
4.2	Fiscal activities should be subject to effective internal oversight and safeguards.	Largely observed	
4.2.1	Ethical standards of behavior for public servants should be clear and well publicized.	Public servants are subject to a well-defined code of behavior.	
4.2.2	Public sector employment procedures and conditions should be documented and accessible to interested parties.	Civil service employment procedures are clear and well-understood.	
4.2.3	Procurement regulations, meeting international standards, should be accessible and observed in practice.	Procurement rules and practices meet international standards, but they are subject to frequent revision.	Capacity to fully implement procurement requirements is limited in certain areas, particularly in small local governments.
4.2.4	Purchases and sales of public assets should be undertaken in an open manner, and major transactions should be separately identified.	Purchases and sale of public assets are undertaken in an open manner, and major transactions are separately identified in the budget and fiscal reports.	
4.2.5	Government activities and finances should be internally audited, and audit procedures should be	Internal audit is only partly effective, reflecting capacity limitations, and there is no arrangement	There is a need to extend the high quality of internal control and auditing to all areas, including small local

	Principles and Practices	Summary Assessments	Comments
	open to review.	to publish audit reports.	governments.
4.2.6	The national revenue administration should be legally protected from political direction, ensure taxpayers' rights, and report regularly to the public on its activities.	Tax administration has effective internal monitoring and control mechanisms, and taxpayers' rights are well defined, but the tax and customs board does not systematically report to the public on its performance, nor have explicit protection from political interference.	Appointment of the director by the legislature rather than the finance ministry would more clearly establish the independence of tax administration from political interference.
4.3	Fiscal information should be externally scrutinized.	Largely observed	
4.3.1	Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.	External audit is independent of the executive branch, and its mandate covers all public sector activities. External audit capacity appears adequate.	
4.3.2	The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.	External audit reports are submitted to the legislature and published, and audit findings are monitored.	
4.3.3	Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions.	There is no formal scrutiny by independent experts of the fiscal and macroeconomic forecasts, or the analytical techniques which underlie them, but the forecasts are regularly updated and published.	A formal process for involving the private sector and/or independent public agencies in the production of macroeconomic forecasts, and of any implicit or explicit macroeconomic models, would enhance their credibility and encourage innovation in analytical techniques.
4.3.4	A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.	The Statistics Office of Estonia is not given legislative assurance of independence, but in practice it operates independently.	Statutory independence for the Statistical Office of Estonia would ensure maintenance of its integrity and credibility.

APPENDIX II. PUBLIC AVAILABILITY OF INFORMATION—A SUMMARY

	Budget and Fiscal Report Element	Included in Budget/ Report Documents	Available to the Public	Paragraph Reference	Code Reference
1.	Central government (CG) budget estimates.	Yes	Yes	20	2.1.1
2.	CG defense expenditures.	Yes	Yes	33	2.1.1
3.	Extra budgetary funds.	Yes. These are included in the <i>Explanatory Note</i> .	Yes	2	2.1.1
4.	CG budget outturns.	Yes. These appear in the aggregate monthly reports	Yes	2. 27	2.1.2
5.	CG budget forecasts	Yes. These are in the SBS at an aggregate level for three years.	Yes	21	2.1.2
6.	CG contingent liabilities.	Estimates included of contingent liabilities.	Yes	35	2.1.3
7.	CG tax expenditures.	No	No		2.1.3
8.	CG QFAs.	No	No		2.1.3
9.	Macroeconomic assumptions.	Yes. These are included in the <i>State Budget Strategy</i> .	Yes	21	3.1.3
10.	Analysis of fiscal risks/sensitivity analysis.	Yes	Yes	24, 35	3.1.5
11.	CG debt.	Yes. These are provided in the <i>Explanatory Note</i> and quarterly reports.	Yes	35	2.1.4
12.	CG financial assets.	Yes. These are provided in the <i>Explanatory Note</i> and final accounts.	Yes	37	2.1.4
13.	Sustainability analysis.	Yes. This is provided in the SBS, covering general government.	Yes	24	3.1.1
14.	General government budget estimates.	Yes. The annual accounts also include an analysis of contingent liabilities.	Yes	28	2.1.5
15.	CG monthly/quarterly reports on	Yes. Reports are available monthly. There is no	Yes	27	3.4.1

	Budget and Fiscal Report Element	Included in Budget/ Report Documents	Available to the Public	Paragraph Reference	Code Reference
	fiscal outturn.	mid-term review document.			
16.	General government monthly/quarterly reports on fiscal outturn.	Yes. Within seven days after month-end. Reconciled. Quarterly accounts on accruals basis are published within a month of end-quarter.	Yes	28	3.4.1
17.	CG final accounts.	Yes. CG final accounts, audited. Eight months after year-end.	Yes	30	3.4.2
18.	Consolidated general government final accounts.	Yes. Consolidated final accounts published eight months after year-end.	Yes	30	3.4.2

APPENDIX III. SUMMARY OF PROGRESS SINCE THE 2001 FISCAL TRANSPARENCY ROSC

Recommendations from 2001 ROSC	Action	Staff Comments
Improvements in State Budget Law		
Clearly define general government.	Done	
Bring Stabilization Reserve Fund (SRF) into budget.	Done	SRF now operates purely as a conduit for part of the budget surpluses.
Incorporate EBFs in budget presentation.	Done	Only two EBFs remain (health and unemployment), and these are fully incorporated into the budget presentation. Most of the Health Fund's transactions are included within the budget itself.
Include clear transparency guidelines for disclosing the objectives of state asset sales and uses of the receipts.	Done	There is now greater clarity in the State Assets Act and Privatization Act; the privatization process is virtually complete.
Include foreign-financed capital expenditure in the budget.	Done	
Budget documentation		
Cover all of general government.	Done	
Include sensitivity analysis.	Done	Although alternative scenarios are now presented, it would be preferable to extend this approach by providing a systematic analysis of the impact of varying economic assumptions.
Explain status of macroeconomic forecasts.	Done	The forecasts are now clearly the responsibility of the government, while also reflecting previous discussions with the central bank, etc.
Show previous two years' outturn.	Done	
Extend analysis of fiscal sustainability.	Done	Reports on fiscal sustainability have addressed population aging, and work is now underway on sickness; but the government does not yet produce a regular, comprehensive long-term report on the economy.
Expand coverage of contingent liabilities.	Done	
Extend estimates and discussion of tax expenditures.	Under consideration	Internal work is under way.
Add statement on QFAs.	Not done	Considered to be insignificant.
Budget calendar		
Implement formal mid-year review of budget.	Not done	There is still no requirement for a mid-year review. There has always been a review of the budget when a supplementary budget has been presented to parliament, but these have occurred late in the fiscal year.
Fiscal reporting		
SoE data to cross-classify functional and economic classification.	Partial	The transition to monthly reporting by ministries and agencies on an accruals basis should further improve cross-classifications.

APPENDIX III. SUMMARY OF PROGRESS SINCE THE 2001 FISCAL TRANSPARENCY ROSC

Recommendations from 2001 ROSC	Action	Staff Comments
Expand balance sheet debt data to include leasing and unfunded pensions.	Partially done	Leasing is included, but not unfunded pension liabilities (not amenable to extraction under IPSAS).
Forward estimates		
Provide more detailed estimates, approved by cabinet, for at least two years beyond budget.	Done	There are still some quality issues stemming from inconsistent application of the methodology for constructing the forward estimates.
Accrual accounting		
Adopt internationally accepted standards, improve valuation methods, and provide training on recording of transactions for the accounting system, while preserving cash appropriations.	Done	
Debt and investment management policies		
Make transparent.	Done	Central government debt is negligible; asset management practice is clear, but further development of strategy and implementation should be subject to external scrutiny.
Subnational governments		
Broaden dialogue on expenditure responsibilities and borrowing.	Done	Information flow is good; legislation is under consideration to increase effectiveness of controls on debt and fiscal balance.