

SUR/14/33

May 5, 2014

**The Acting Chair's Summing Up  
Republic of Estonia—2014 Article IV Consultation  
Executive Board Meeting 14/40  
May 5, 2014**

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended Estonia's continued commitment to sound macroeconomic policies. Directors noted that while the outlook for growth is favorable, risks are tilted to the downside because of the difficult regional environment. They emphasized the need to maintain strong macroeconomic policies to preserve competitiveness, address the high unemployment rate, and enhance long-term growth.

Directors welcomed the 2014 budget, which continues Estonia's tradition of prudent fiscal policy characterized by low deficits or surpluses, and low debt. They considered the budget's underlying stance to be broadly appropriate and consistent with prevailing economic conditions. Directors agreed that the creation of the fiscal council and the structural surplus target embodied in the new Budget Law should help address the previous pro-cyclical patterns of fiscal policy by preventing unsustainable increases in expenditure during good times, and provide scope to allow automatic stabilizers to operate in downturns. More broadly, Directors underscored that fiscal policy should be flexible and growth friendly.

Directors welcomed the authorities' commitment to maintain a strong financial system in the face of the evolving financial architecture, including the planned early implementation of the new capital and liquidity provisions. They advised close collaboration among the Estonian authorities, the ECB, the Nordic-Baltic sector supervisory, and governmental structures to ensure that Estonia's transition to the Banking Union is smooth. In the context of a strengthened macroprudential framework, developments in housing prices should be closely monitored.

Directors emphasized the need to preserve competitiveness in light of recent increases in wages and unit labor costs. While acknowledging that wages are largely market determined, they encouraged the authorities to refrain from additional large public sector wage hikes or agree to minimum wage increases, until it is clear that the wage rates are not undercutting net exports.

Directors agreed that Estonia's high level of structural unemployment needs to be addressed. They noted that some policies to address skills mismatches and maintain labor

participation rates are already in place, and that funding for these programs has been substantially expanded. Directors agreed that further efforts to improve the skills of those already working and increase the number of people with education in technical fields should reduce the shortage of highly-skilled workers and boost productivity. They also recommended reducing the tax wedge on lower-wage workers in a budget-neutral manner, which would contribute to containing unit labor costs and improving competitiveness.

Directors agreed that regionally-coordinated efforts to improve infrastructure links to Estonia's neighbors could help improve competitiveness and better connect with the rest of the European Union.

It is expected that the next Article IV consultation with the Republic of Estonia will be held on the standard 12-month cycle.