GOVERNMENT DEBT

With a few exceptions, the Estonian government's fiscal policy has aimed to keep the annual budget in balance and the target has often been outperformed. Thus, for the past five years the general government budget has remained in surplus and the public debt is the lowest among the Member States of the Euopean Union.

The Estonian public debt is divided almost equally between the central government and local governments (see Table a).

About 70% of the central government debt is borrowed from abroad for investments and major acquisitions. According to loan contracts, the majority of loans have been granted in the past decade by international financial organisations (e.g. the World Bank, Nordic Investment Bank, European Investment Bank, Council of Europe Development Bank). The stock of respective loans is constantly decreasing due to repayments and the share of euro-denominated bonds, issued in 2002 for financing dollar loans, has increased to 60%.

The fiscal policy of local governments has been looser and therefore the Rural Municipality and City Budgets Act has set limits on their borrowing. These limits link the loan stock as well as the upper limit of loan servicing costs to the revenue of local governments. The total amount of loans taken must not exceed 60% and the sum of loan servicing costs 20% of the revenue of the current fiscal year. According to the current revenue levels, the debt of local governments should not exceed 5.5% of GDP. Though many local governments have exhausted their possibilities to borrow, in larger cities the situation is different. Thus, presumably the debt of local governments will increase further. As the average Estonian local government is small, it is difficult to get direct access to external funders and 90% of local governments' debt is loans from Estonian banks.

Though the general government budget has been in surplus for the past few years, the total sum of government debt has not decreased (see Table a and Figure a). One reason for this is that only the central government budget has been in surplus, while the revenues of local governments have remained lower than their expenditure. Secondly, the central government debt has decreased but the respective repayment decisions are not determined by the budget surplus of the current year but by the repayment terms of loans in the loan contract. As a rule, the central government has used the revenue surplus to increase reserves and make financial investments. In principle, the deficit-debt adjustment may also be caused by the methodical differences of accounting, changes in debt's market value or simply by statistical errors.[1]

Thanks to the forthcoming central government loan repayments, the government debt-to-GDP ratio will decrease to about 3% by 2008.

Table a. Government debt as at the end of 2001 and 2005

	2001		2005	
	EEK m	**% of GDP**	**EEK m**	**% of GDP**
Government debt	4,845	4.6	7,895	4.8
central government debt	2,915	2.8	3,552	2.2
local governments' debt	1,930	1.8	4,343	2.6

[1] For information on deficit-debt adjustment see also the "Updated Convergence Programme 2005" on the web site of the Ministry of Financial Affairs (http://www.fin.ee/doc.php?14532).

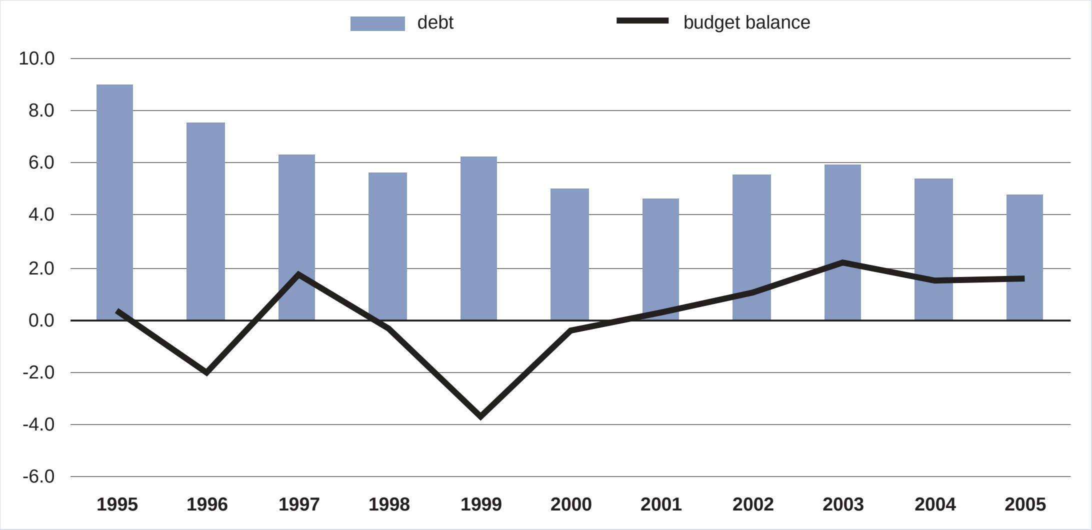

Figure a. Government debt and budget balance in 1995–2005 (% of GDP)