Labour Market in Estonia: Responding to the Global Finance Crisis

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Introduction

Estonia had one of the highest GDP growth rates in the world in 2004-2007, with average GDP growth of over eight percent. A high inflow of relatively cheap and unlimited financial resources form Nordic banks caused a boom in many sectors (real estate, construction, whole and retail sales etc). Baltic countries are textbook examples of overheating economies. Global financial crises caused a very sharp GDP drop (-15 percent in 2009), increasing unemployment and the budget deficit.

In Estonia, a liberal market economy, a relatively small public sector, and a relatively low tax burden resulted in scarce resources for policy options. Attempts to achieve an annually balanced state budget have a pro-cyclical nature, which means that they worked well during the economic boom exaggerating growth through growing public expenditure. However, the opposite occurred during recession when government tried to cut expenditure in order to keep the budget deficit under control. As taxes were relatively low, the government also lacked sufficient automatic stabilisers. In general, we can say that the government had limited fiscal tools to smooth cyclical fluctuations.

Additionally, the currency board system sets restrictions for money supply as well as for restraining inflation. Currency board means that the base money (M0) of the Estonian national currency (EEK) was fully (100 percent) guaranteed by the Central Bank's foreign reserves. At the beginning (1992) the Estonian kroon was pegged to the Deutsch mark and from 1999–2010 EEK was pegged to the Euro (1 EUR = 15,6466 EEK) as Germany joined the Eurozone. Central reserves in their turn depend on the inflow of foreign money. The continuously high rate of foreign investment and foreign loans increased the foreign reserves and the resulting rise in money supply put pressure on the price level. The Estonian Central Bank did not have any appropriate means to reduce the money supply which resulted in higher inflation. The only tool for steering the money supply was the reserve requirement rate for commercial banking, but as most banks were subsidiaries of Scandinavian banks, they were not subject to any restrictions on borrowing cheap money from Scandinavia. Hence, their financial possibilities of increasing the money supply did not depend on their reserves.

In such a situation only a flexible labour market can act as an economic "buffer" for macroeconomic adjustment. Until 2009 Estonia's labour market was quite successful in this role. Employment reached 70 percent and unemployment was four percent. Compared to other EU member states, the Estonian labour market is considered very flexible. Although employment protection legislation (EPL) shows that Estonia has relatively rigid labour markets, changes in labour market outcomes reveals the opposite. Empirical data show the high flexibility of the labour market. Within a year unemployment has escalated, average nominal wages have declined and the number of working hours has dropped.

The Estonian government reacted to the crises very differently from the EU15 governments. In older EU member states public sector expenditure was increased, taxes in most cases were reduced and the financial burden was shifted by increasing the public debt of future generations. In Estonia (as in other Baltic countries) the budget deficit was covered by reducing public sector expenditure and raising the tax burden. In other words, Estonia shifted the whole burden of the crises to today's generation through lower wages, less income and less consumption. Today we can say that such behaviour was socially and politically acceptable, as there was no social unrest in Estonia, and the political parties who implemented heavy cuts in the public sector in 2009

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got more votes in the 2010 Parliament elections than in previous ones. All together this means that Estonia will hopefully move to a new growth stage of the economic cycle with a much more competitive economy and a low debt burden.

Employment and unemployment

Estonia, like the other two Baltic countries, is characterized by large fluctuations in the level of employment: the quick fall in the level of employment during the crisis and the fast increase during the boom. During the boom the employment rate reached 73 percent, while at the lowest point of the crises the employment rate plunged to 60.4 percent as can be seen in Figure 1. These changes took place within six quarters, which is also an indication of high labour market flexibility.

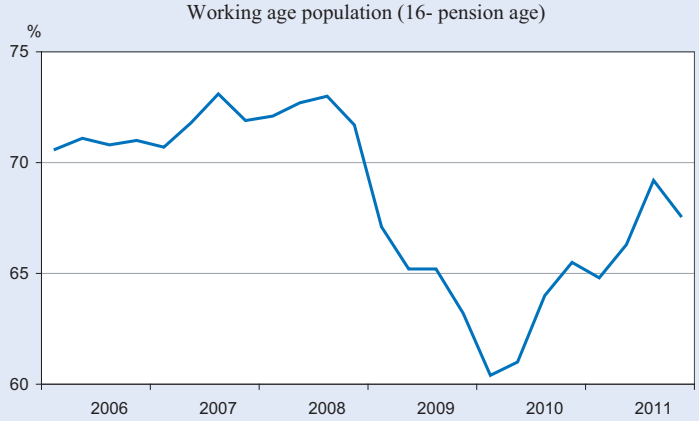
A similar picture emerges for unemployment. Here we can observe a certain time lag between the recession and an increase in unemployment as shown in Figure 2. Although the economic growth turned into a recession during the second quarter of 2008, the unemployment rate did not peak until the first quarter of 2010 (20.7 percent).

Will the unemployment rate drop down to a level equal to the pre-crisis situation and if so, when will this happen? If we compare our situation to the economic crisis in Finland during the early 1990s (Figure 3), we can assume that high unemployment levels may persist in Estonia for a further six to seven years.[1] It is also quite possible that the unemployment rate will not reach the pre-crisis level at all.

A persistently high unemployment rate can be caused by structural changes in the economy. In Estonia, there are several labour intensive sectors with low labour costs, which became unprofitable for entrepreneurs as labour became more expensive. As a result, these businesses have no future in Estonia in their old form. The sectors of the economy that have become unprofitable include the textile industry, clothing, the plastics industry, etc. Other industries that have suffered also include construction, the construction materials industry and the transportation sector (Varblane, Eamets et al. 2008). In certain fields, the increase in exports or the recovery of domestic demand may result in an increase in the number of jobs, but there are also industries where jobs have been reallocated to countries with cheaper labour.

Figure 1

EMPLOYMENT RATE IN ESTONIA, 2006–2011
Working age population (16- pension age)



Source: ELFS.

Figure 2

UNEMPLOYMENT RATE IN ESTONIA, 2006–2011
Working age population (16- pension age)

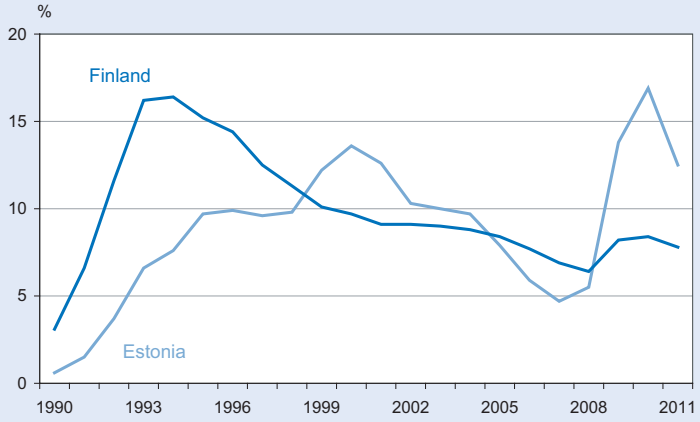
Source: ELFS.

[1] The Finish depression of 1991-1993 had a deep effect on its economy (especially on employment) for the entire 1990s. During the crises the gross national product decreased by 13 percent and the unemployment rose to 18.9 percent from 3.5 percent. Before crises Finland had massive inflow of foreign loans, which caused a real estate bubble. All these elements characterized the Estonian situation during last recession as well.

If we look at the specific industries that suffered most from the recession (Table 1), then traditionally we can see that construction is number one: during the boom the number of employed reached 82,000, while during the recession it drop to 48,000. In manufacturing we also see a decline by 37,000 employees, while other industries suffered less. Some industries even managed to increase their employment rate including the professional sector, scientific activities, real estate activities, administrative service activities and public administration if 2010 figures are compared to those of 2007. It is also true that during severe cuts in public sector expenditures in 2009 employment in this sector declined too.

Figure 3

UNEMPLOYMENT RATE IN FINLAND AND ESTONIA, 1990–2011



Source: National statistical offices, Eurostat (for Finland 1990–2000).

The next question is: how has the recession hit labour market minority groups? Ethnical minorities constitute about one third of the population in Estonia. These ethnical groups are Russians, Ukrainians, Belorussians, and people from various nations in Caucasia and Central Asia. Most of them are Russian speakers.

In the labour force survey we distinguish between minorities in two ways: ethnicity and first language. Here we use second option. Non-Estonians are those who do not speak Estonian as their first language. In reality language plays a major role in labour markets, particularly knowledge of the state language; as there are many jobs, especially in public sector where knowledge of the Estonian language is demanded by law. In the majority of cases, the second first language in Estonia is Russian. So the question is whether the Russian speaking minority

Table 1

Employment by industry (NACE 2008), in thousands

	2007	2008	2009	2010	2011
Total	655.3	656.5	595.8	570.9	609.1
Agriculture	30.3	25.3	24.0	24.1	26.9
Manufacturing	131.2	135 .0	113.8	108.4	121.0
Construction	82.1	81.0	58.3	47.9	59.0
Wholesale and retail trade	86.9	92.5	83.2	80.0	81.3
Transportation	52.9	49.9	49.7	43.6	48.3
Accommodation	22.3	23.6	20.1	19.4	19.2
Information and communication	13.6	15.3	14.3	12.4	16.7
Financial and insurance activities	9.5	10.4	11.4	9.4	10.2
Real estate activities	9.7	10.2	9.2	10.1	10.4
Professional, scientific activities	17.6	20.5	20.5	21.2	23.3
Administrative service activities	18.2	17.3	16.8	18.9	17.1
Public administration	39.2	38.4	36.7	40.4	40.3
Education	55,0	59.9	62.5	56.1	57.2
Human health	36.2	31.1	33.0	34.6	35.5
Arts, entertainment	17.7	14.8	14.2	14.7	14.3
Other activities	16.8	14.8	11.5	11.9	10.3

Source: Estonian statistics.

suffered more from the crises than average. If we look at Figure 4 then we can see that their unemployment rate is permanently higher than the average unemployment rate. The ratio of the unemployment rate of Russian speakers to the average unemployment rate has remained relatively stable (between 1.3–1.5) even during recession. There are several reasons for this. Firstly, as already mentioned, knowledge of the Estonian language is a precondition for many jobs. Secondly, the share of blue-collar workers among non-Estonians is about 50 percent, while this figure among Estonians is 33 percent (Malk 2010). Toomet (2011) investigated ethnical wage differences and his explanation for the differences between the wages earned by Estonians and Russians was the glass ceiling effect. He claimed that members of the minority group find it hard to move towards the upper end of the income distribution curve and rely on less well-paid jobs in largely segregated Russian-speaking workplaces. Thirdly, insufficient language knowledge limits the internal geographical mobility of the Russian-speaking population. The concentration of the Russian-speaking population in the work force is highest in North-East Estonia where traditional industries like heavy industry, the textile industry, energy production and mining are dominant. These sectors have been declining over the past 20 years and as mobility is low, this area has one of the highest regional unemployment rates in Estonia. The second generation of migrants can be expected to be in a better position in labour market terms. Here again, however, language skills are key issue. Lindemann and Vöörmann (2009) found that excellent command of the Estonian language is the factor that allows second generation Russian-speakers to compete on a relatively equal basis in the Estonian labour market. Poor language skills, however, significantly limit the opportunities that are available to Russian-speakers.

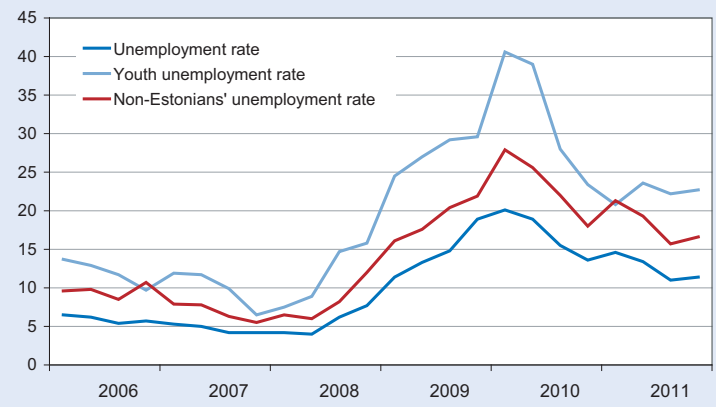
As in many other EU countries, youth unemployment is traditionally high in Estonia. Estonia does not have any special wage regulations for youth employment like youth minimum wages or similar measures. It is also important to bear in mind that inactivity in the youth cohort (15–24 year olds) is 62 percent, as most of these individuals study.

Wages

The peculiarity of Estonia, and apparently of the other Baltic countries, is the role of trade unions. Unions play a relatively marginal role in industrial relations and employees usually agree on wages with their employers individually at a plant level. As a result, employees' salaries consist of relatively low basic wages and relatively high additional fees and bonuses. When the economy is booming, perfor-

Figure 4

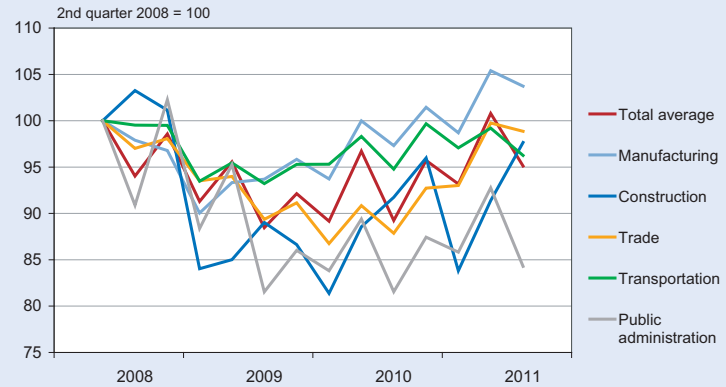
UNEMPLOYMENT RATE OF NON-ESTONIANS AND YOUTH, 2006–2011



Source: ELFS.

Figure 5

AVERAGE NOMINAL MONTHLY PRE-TAX WAGES, 2008–2011



Note: The quarterly data are based on monthly wages (three month average).
Source: Estonia Statistics.

Table 2

Changes in working time in selected industries in 2008 and 2009

	Total			Construction			Manufacturing			Hotels		
	2008	2009	%	2008	2009	%	2008	2009	%	2008	2009	%
EU (27)	37.3	36.9	-1.1%	40.6	40.2	-1.0%	39.2	38.4	-2.0%	40.6	40.2	-1.0%
EE	39.1	37.6	-3.8%	40.3	38.0	-5.7%	39.5	37.6	-4.8%	40.3	38.0	-5.7%
LV	39.4	38.8	-1.5%	41.4	39.1	-5.6%	39.0	38.7	-0.8%	41.4	39.1	-5.6%
LT	39.2	38.6	-1.5%	40.6	39.6	-2.5%	39.9	39.3	-1.5%	40.6	39.6	-2.5%

Source: Eurostat.

mance pay increases rapidly, but during recessions, this may result in a rapid decline of gross wages in certain sectors (Eamets and Leetmaa 2008). This phenomenon caused massive nominal wage cuts in several sectors during the last recession. If we take quarter two of 2008 as a pike of average wages, then we can see that despite a good GDP growth rate in 2011 (7.6 percent), not all sectors returned to the wage level of 2008. Among selected sectors only total average wages and wages in manufacturing reached this level (or above) by the third quarter of 2011.

We can see from Figure 5 that in some sectors (public administration, construction) the wage drop was around 20 percent. We can also see high seasonality of wages: during the summer months there are relatively large increases due to holiday payments while various annual bonuses are also paid to employees at the end of the year. There is also anecdotal evidence that in some sectors (for instance, in construction) hourly wages for some occupations or work tasks remained the same, but the piece-wise job requirements were raised. This means that individuals have to work more in order to obtain their previous payment levels. As unions are weak in Estonia (union density is around seven to eight percent and there are no unions in construction), such manoeuvres allow for a de-facto decrease in hourly wages.

Working hours

One potential way to adjust the labour market to changing market conditions is to reduce the working time. Svejnar and Semerak (2009) argue that the observed adjustment in the form of a shorter working week in new member states may be temporary, and could later translate into unemployment. In Estonia's case this was probably true as unemployment did not peak until 2010. Shortened working hours may appear due to the higher frequency of part-time employment, extra vacations etc. According to the Estonian LFS, among the various reasons for working less than the usual number of hours during the previous week, the importance of the reason "Shortage of work or hours" increased from six percent in 2008 to 14 percent in 2009 (Masso and Krillo 2011).

In total, working time declined in Estonia by 3.8 percent, in 2009. The biggest decline took place in construction and in the hotel sector. Similar tendencies also appeared in another two Baltic countries, as we can see from Table 2. Another form of working time flexibility is part-time work. As economic activity declined during the crises, the working time of employed persons was reduced and full-time workers were given part-time work. The new Employment Contracts Act that came into force on 1 July 2009 changed the legislation for implementing part-time work, making the use of part-time work during the recession somewhat simpler (Masso 2010).

Table 3

Part time-work and underemployment of different social groups (proportion of all employees, %), 2007–2011

		2007	2008	2009	2010	2011
Total	Part-time job	7.6	6.6	9.9	10.2	9.8
	.. underemployed	0.9	0.5	1.8	2	1.9
Males	Part-time job	3.6	3.3	6.1	6.2	4.3
	.. underemployed	0.4	0.4	1.6	1.1	0.7
Female	Part-time job	11.3	9.7	13.1	13.8	14.8
	.. underemployed	1.4	0.7	2.1	2.7	2.9
Age groups						
15-24	Part-time job	13.8	12.4	17	21	16.2
25-49	Part-time job	4.8	4.1	7.1	6.5	6.3
50-74	Part-time job	10.8	9.4	12.9	14.5	14.6

Source: Estonian Statistics.

The Estonian Labour Force survey enables us to distinguish between "ordinary" part time work and so called "forced" part-time work. Respondents in Labour Force Survey can reply that they are working part-time for economic reasons (e.g. their firm was not able to provide a full-time job because of a decline in demand or for other crisis-related reasons). In such cases a worker is underemployed, in other words s/he would like to work more, but there are no job opportunities in his/her firm. We can see from Table 3 that the share of part-time work is very low in Estonia compared with other EU countries. The EU 25 average share of part-time workers is around 20 percent, while in Scandinavia this figure is over 25 percent and in the Netherlands it is close to 50 percent. The fact that the percentage of part-time employees in Estonia is comparatively low is not surprising, since the general income level is not high enough for people to be able to secure their livelihood through part-time work. In relative terms, there was a greater increase in the share of part-time jobs for males.

Conclusion

Macroeconomic adjustment in Estonia during the recent crises was achieved by fierce fiscal consolidation in the form of expenditure cuts and tax increases, whereas the wage cuts both in the public and private sectors have helped to restore credibility and competitiveness, and contributed to the subsequent recovery driven by exports. As mentioned, fiscal policy as a policy tool itself has been rather limited historically. The currency board system has set restrictions for money supply and restraining inflation. Therefore, labour market flexibility has been a particularly important channel of macroeconomic adjustment.

If we look at three aspects of labour market flexibility: numerical flexibility, wage flexibility and working time flexibility, then we can see that in all three cases Estonia has seen drastic changes. Employment dropped from 73 to 60 percent, unemployment increased from four to 20 percent, nominal wages dropped in some sectors by 20 percent and the number of work hours diminished.

Perhaps such drastic changes are only possible in small open economies, where the unions have very limited power, where the government pursues a very liberal market-oriented policy and where there is no social unrest caused by the ruling policy.

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