

Central Bank Policy Department  
Economic Policy Subdivision



# Labour Market Review

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**Dear reader,**

This is the semi-annual review of the Estonian labour market, which treats the developments in the supply, demand, and price of labour. The labour market has a large impact on price stability in Estonia, which has a fixed exchange rate and open economy. While economic shocks can be absorbed through exchange rate adjustments in economies with floating exchange rate regimes, input prices do the adjusting in the context of a fixed exchange rate regime. However, one of the most important inputs is labour. This is the reason why a central bank has to closely monitor labour market developments.

Unemployment decreased sharply during the first half of 2005, which has raised questions regarding the shortage of labour supply. This review aims to address these concerns. The data used in the analysis is from the Statistical Office of Estonia and the Labour Market Board.

## Main developments in the first three quarters of 2005

The year 2005 was characterised by a fast exports-based economic growth. Employment grew 0.2% in 2004, but already 0.9% in the first quarter of 2005, 2.34% in the second, and 2.49% in the third quarter. In the first half of the year labour force participation somewhat increased, but employment grew mainly on account of decreasing unemployment<sup>1</sup> – the rate of unemployment fell to 9.5% in the first, 8.1% in the second and 7% in the third quarter (see Figure 1 and Table 1). Employment increased most in the service sector.

**Labour shortage has attracted more attention against the background of decreasing unemployment.** Both the vacancy statistics of the Labour Market Board and households' increasing confidence regarding employment indicate that labour shortage is indeed becoming an issue<sup>2</sup>.

**The unit labour cost index<sup>3</sup> of the whole economy remained practically unchanged in the first half of 2005 year-on-year,** which indicates that the high increase in wages was in accordance with productivity growth.

**While in 2004 unemployment fell mainly because of the decrease in the number of short-term unemployed, in the second and third quarter of 2005 the number of long-term unemployed decreased as well.** Unemployment continues to be the highest among ethnic non-Estonians (13.2% in the first three quarters of 2005, while just 5.6% among Estonians) and in Ida-Virumaa (16.2% compared to 8.2% on average in Estonia).

**In January 2006 the new Employment Services and Benefits Act entered into force,** which defines the term „suitable work“ (see also chapter “Institutional Developments of the Labour Market: The Employment Services and Benefits Act”). The goal is to increase the incentive of the unemployment insurance beneficiaries for active job search. Also, the unemployed belonging to risk groups will be individually approached and training opportunities will be increased.

**In January 2006 significant changes in the tax policy concerning the labour market entered into force: the non-taxable income threshold was raised from**

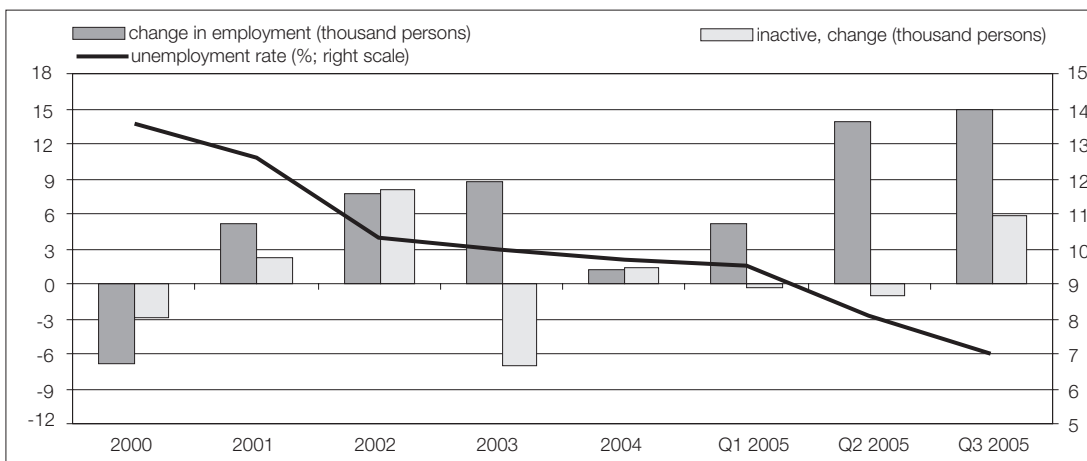


Figure 1. Changes in main labour market indicators

<sup>1</sup> An unemployed is a working-age person, who 1) is not employed, 2) searches actively for work, 3) is ready to start working in a short time; the unemployment rate is the ratio of the of the number of unemployed to economically active population.

<sup>2</sup> Source: the Consumer Confidence Indicator of EKI.

<sup>3</sup> Unit labour costs are the costs of labour per one unit of production.

**EEK 1,700 to EEK 2,000, and the income tax rate reduced from 24% to 23%.** In the case of minimum and average wages, this implies a 3% and 2% increase in net wages, respectively. Different from 2004, when the

average tax rate decrease was accompanied by a slow-down in wage growth, based on the data from the first half of 2005, it seems that this time the workers benefit more from the tax cut.

**Table 1. Main labour market indicators**

Population (as of 1 January)	Change y/y (%)				Change (thousand persons)			
	2004	2005			2004	2005		
Population	-0.4	-0.3			-5.0	-4.1		
Employment status (15–74)	2004	Q1 2005	Q2 2005	Q3 2005	2004	Q1 2005	Q2 2005	Q3 2005
Labour force	-0.2	0.2	0.2	-0.8	-1.4	1.1	1.6	-5.0
Employed	0.2	0.9	2.3	2.5	1.2	5.2	13.9	14.9
Industry	5.1	-1.7	1.3	-3.6	6.8	-2.2	1.9	-5.4
Unemployed	-3.9	-6.2	-18.4	-30.3	-2.6	-4.1	-12.2	-20.0
Less than 6 months	-17.2	-14.2	-17.2	-24.4	-4.4	-3.4	-3.7	-5.4
6–11 months	-9.8	-21.8	-26.0	-67.4	-1.0	-2.4	-2.6	-6.4
12 months or more	9.2	5.4	-17.0	-23.6	2.8	1.7	-5.9	-8.1
24 months or more	7.0	16.9	-13.7	-33.6	1.4	2.9	-3.1	-8.7
Inactive	0.3	-0.3	-0.3	1.5	1.3	-1.2	-1.0	5.8
Total	0.0	0.1	0.1	0.1	0.0	0.8	0.8	0.8
	Level (%)				Change (percentage points)			
Participation rate	62.9	62.6	63.2	62.7	-0.1	0.0	0.1	-0.5
Employment rate	56.8	56.7	58.1	58.3	0.1	0.5	1.3	1.4
Unemployment rate	9.7	9.5	8.1	7.0	-0.3	-0.6	-1.9	-3.0

## Labour Market Supply and Demand

### Participation and Inactivity

Like in 2004, aggregate labour force participation<sup>4</sup> did not change significantly in the first three quarters of 2005. Regionally the number of the inactive<sup>5</sup> decreased vigorously in Tallinn and Harju County (more than 5%), but increased at the same time in Western and Southern Estonia (6.7% and 5.9% respectively). The most remarkable change occurred in Tallinn in the second quarter, when the number of the inactive decreased by 13,700, and the labour

force participation rate grew<sup>6</sup> from 68.3% in the second quarter of 2004 to 72.6%. The reason behind the increase in activity was a big leap (from 49.5% to 58%) in the participation of the young (15–24 years old) in Tallinn. At the same time the youth activity rate remains close to 30% in the rest of the country. Unfortunately this leap proved to be a one-off event – it dropped in Tallinn already in the third quarter below the value of the same quarter of the previous year.

<sup>4</sup> Participants in labour force or economically active are considered working-age persons who are employed or unemployed.

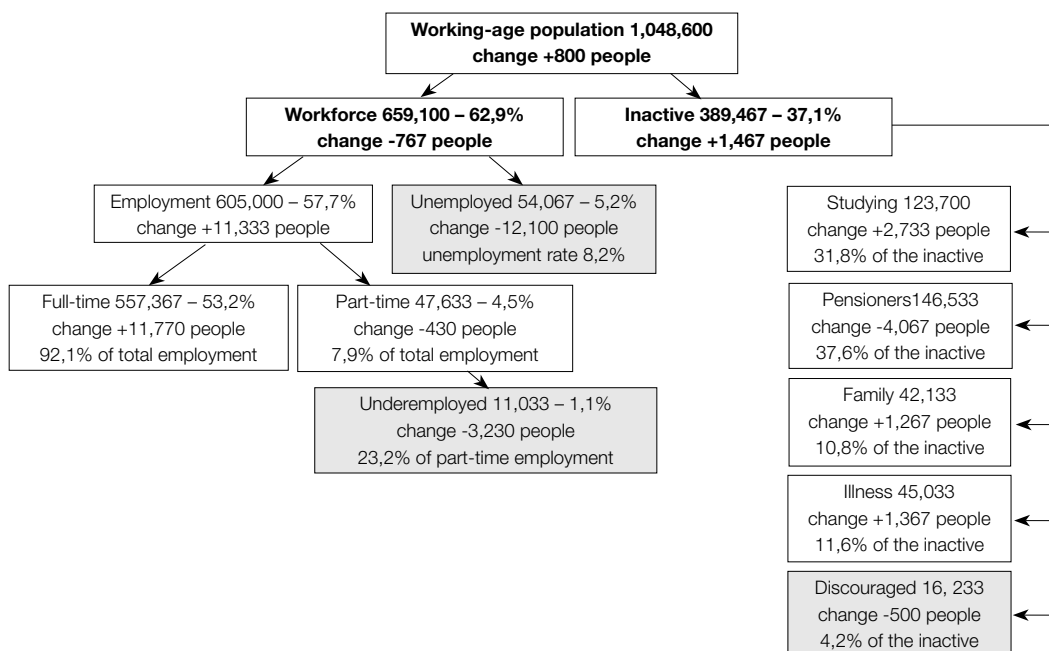
<sup>5</sup> Inactive are working-age persons who neither work nor search for work.

<sup>6</sup> The rate of participation in labour force is the ratio of the amount of the employed and the unemployed to the working age population.

The unemployed, underemployed<sup>7</sup> and the discouraged<sup>8</sup> workers among the inactive may be considered the “reserve” of the labour market. Also people who are currently inactive but who may decide to return to the labour market in case of favourable conditions form a sort of buffer. For example, the labour force participation of the young has been relatively low - while it was 45.2% in 1997, in 2004 it only reached 34.2%, i.e. almost 18,000 less were participating. This may change, however, when employers start offering more jobs with flexible working time. Starting from the second half of the 1990s along with the increasing pension age, the labour force participation rate of the elderly has been growing. The activity of the elderly is higher in Estonia compared to the average of the EU, which is at least partly due to the pension system, which allows to earn labour income without reducing pension

benefits and relatively low substitution rates<sup>9</sup>. Fast-rising pensions and more favourable early retirement conditions may have the opposite effect. Figure 2 illustrates the Estonian labour market of 2005.

When analysing the causes of inactivity, it is useful to look at the four-quarter moving averages, because the quarterly growth estimates are less reliable due to the relatively small sample size. The decrease in the number of the inactive because of the pension age continues due to the gradually rising pension age and favourable economic climate. The average number of the discouraged has been fluctuating between 17,000 and 19,000 persons since 2002; in the third quarter of 2005 the four-quarter moving average constituted 16,200 people.



**Figure 2. Estonian labour market in the first three quarters of 2005 and change compared to the same period in 2004 (% of the working age population (15 to 74 years old))**

<sup>7</sup> Underemployed are part-time workers who would like to work more.

<sup>8</sup> Discouraged are those unemployed, who have lost hope to find a job and do not search actively for work.

<sup>9</sup> Pension substitution rate is the ratio of pension to the previously earned wage.

## Employment

In 2005, employment seems to have increased considerably faster than in 2004. In the first quarter employment grew by 0.9%, in the second quarter by 2.3% and in the third quarter by 2.5% (0.2% in 2004). **On the basis of the three quarters, employment grew mainly in the non-tradable sector, especially in service enterprises (see Figure 3).** Employment remained almost unchanged in the manufacturing.

As mentioned earlier, the fast growth of employment in the first three quarters of 2005 resulted from the growth in the service sector. In the first half of the year employment grew particularly fast in the field of hotels and restaurants (by 50.5% or 7,600 persons), but in the third quarter the growth decelerated, still reaching 13.2%. The real estate, renting and business activity sector also showed a strong employment growth (by 16.2% or 64,000 persons), which could be expected against the background of the current situation in the real estate market.

Looking at employment growth by regions and

sectors, the biggest contribution came from the service sector of Tallinn. While employment in the whole country grew by 11,300 employees (including a fall in some sectors), employment in the service sector grew by 14,300, of which 8,700 jobs were created in Tallinn. The growth was also strong in the service sectors of Central and North-Western Estonia, where 3,200 and 4,700 new jobs were created respectively. The total employment decreased in Western and Southern Estonia, but it also fell in some sectors of other regions. The biggest decrease was registered in the industrial sector of North-Western Estonia: 4,300 jobs were lost, but this was compensated by a strong growth in the service sector in the same region. Employment in mining industry fell by 31%, i.e 2,500 persons.

Surprisingly, the number of white-collar workers<sup>11</sup> grew by 18,767 persons or 7.3%, whereas the number of blue-collar workers<sup>12</sup> fell by 7,433 or 2.2% according to the Statistical Office of Estonia. The increase in white-collar workers and decrease in blue-collar workers was especially fast in Central Estonia and Tallinn.

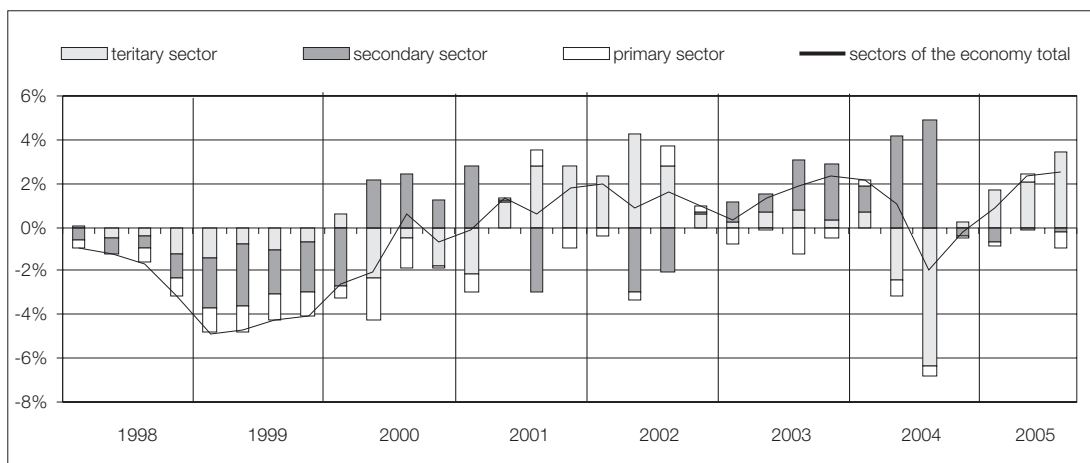


Figure 3. Growth of employment and sectoral contributions<sup>10</sup>

<sup>10</sup> Primary sector – agriculture, forestry, fishery; secondary sector – industry; tertiary sector – services.

<sup>11</sup> White-collar: lawmakers, higher officials and executives; middle level specialists and technicians; officials.

<sup>12</sup> Blue-collar: service and salespersons, skilled workers in agriculture and fishery, skilled workers and artisans; machine operators, ordinary workers, military personnel.

## BACKGROUND INFORMATION

### **Labour Demand Forecast until 2011**

*In September 2005 The Ministry of Economic Affairs and Communications published a forecast for labour demand in Estonia until 2011<sup>13</sup>. The main goal of the forecast was to create a basis for state-commissioned education. The forecast is based on the Estonian Labour Force Study (ELFS) and the Estonian Tax and Customs Board data on persons who declared income tax and/or social tax. Managers' expert opinions played an important role, especially in case of the fields of activity with lower employment.*

*The forecast, which includes a short overview of 8 broader fields of activity (EMTAK<sup>14</sup> first level) and of further 14 fields of activity in the manufacturing sector (EMTAK medium level), describes the present situation in the field, most important developments in the past years, lists the largest enterprises, and gives an outlook for the future. The forecast does not contain an overview of the public and service sector, including education, medical services, financial intermediation and public administration, but the numeric labour demand forecast is annexed to the forecast in the form of a table.*

*The labour demand estimates are based on the employment forecast for 9 sectors by the macroeconomic model HERMIN<sup>15</sup>, which derives from the supply and demand functions for the respective industries' output and the parameters of the production function. In order to estimate the demand for additional labour force, mortality rates, moving into retirement (assuming that all employees retire at the age of 63) and mobility of employees from one field or position to other were taken into account.*

*The main conclusion is that in the years 2004–2011 on average 4,000 jobs will be created in Estonia per year (0.6–0.7% growth) and until 2011 the number of jobs will increase to 623,000. Most of the new jobs will be created in the service and industrial sector; by groups of occupation the largest increase is expected in the number of specialists and the largest decrease in the number of elementary workers. At the same time the number of people employed in agriculture will continue to decline. The analysis of the mobility between fields of occupation revealed, as expected, that it is difficult to find an employee from another field in sectors where specific skills are required, especially in the industrial sector. However, the service sector can successfully employ workers from other fields inside the sector or from the industrial sector.*

<sup>13</sup> See <http://www.mkm.ee/index.php?id=10272>.

<sup>14</sup> EMTAK is the Statistical Classification of Economic Activities in Estonia (see <http://www.stat.ee/klaskifikatorid>).

<sup>15</sup> HERMIN is a macro model of Estonian economy devised by the Ministry of Finance and used in economic forecasting.

### Vacancies

Unfortunately, reliable and sufficiently representative statistics on vacancies in Estonia's economy do not exist. According to the Employment Service Act, which entered into force in 2000, employers are obliged to inform the Labour Market Board about vacancies, except those which "... in the cases prescribed by an Act or a regulation of the Government of the Republic are filled by way of public competition or election, or for which the employer has already found a suitable candidate<sup>16</sup>." Hence, informing the Labour Market Board is voluntary in principle, and the job meditation service of the Labour Market Board is probably used only when it appears to be useful.

Although the statistics of the Labour Market Board are not representative and do not extend to the whole economy of Estonia, they are used in the present analysis as a possible indicator to establish the existence of limitations in the labour supply. Figure 4 depicts vacancy announcements received by the Labour Market Board and the stock of announcements valid at the end of the period. As seen from the Figure, the number of unemployed was ten times higher than the number of vacancies in the second quarter of 2005.

At the end of 2004, the number of announcements submitted to the Labour Market Board and the number of announcements valid at the end of month

increased by 80% and 55% respectively, at the same growth rate in Tallinn as in other regions of Estonia. In the first half of 2005 the growth rates remained at the same level outside of Tallinn, but in Tallinn the growth of new job announcements slowed down to 13.2%.

From the figure above it becomes clear that **since 2004 the aggregate number of new job announcements and the number of job announcements valid at the end of month have increased considerably in Estonia, which underpins, all other things being equal, the hypothesis that the situation in the labour market is getting tighter.**

### Unemployment

The rate of unemployment fell to 9.5% in the first quarter of 2005, to 8.1% in the second quarter and to 7% in the third quarter. Year-on-year, the total number of the unemployed declined in the first quarter by 6.2%, in the second quarter by 18.4% and in the third quarter by 30.3%. While the unemployment rate decreased only on account of short-term unemployment in 2004 and in the first quarter of 2005, then in the second and third quarter of 2005 the number of both the long- term and the short-term unemployed decreased (see Figure 5). The number of job seekers, who had been unemployed for more than 12 months declined by 17% and 23.6% (by 5,900 and 8,100), respectively. There also occurred a decline in

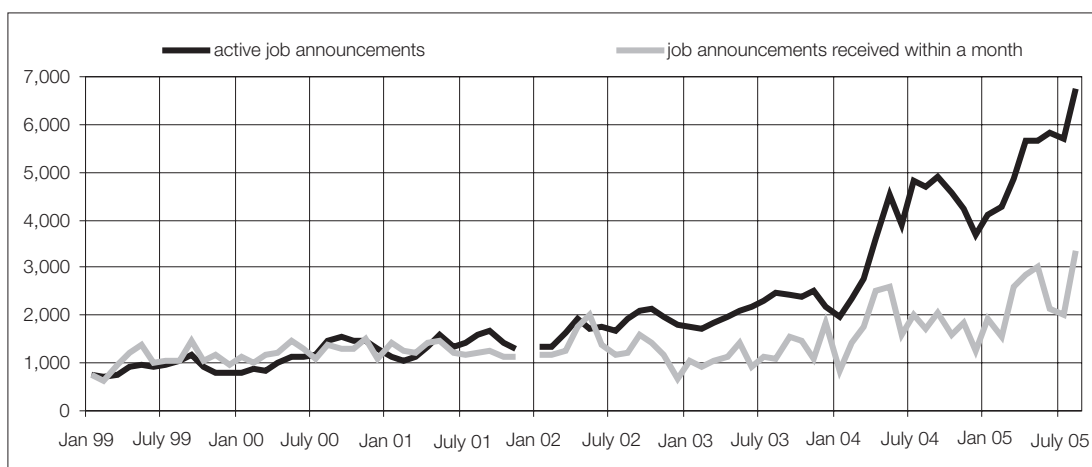


Figure 4. Job announcements received by the Labour Market Board

<sup>16</sup> Employment Service Act § 9 (2).



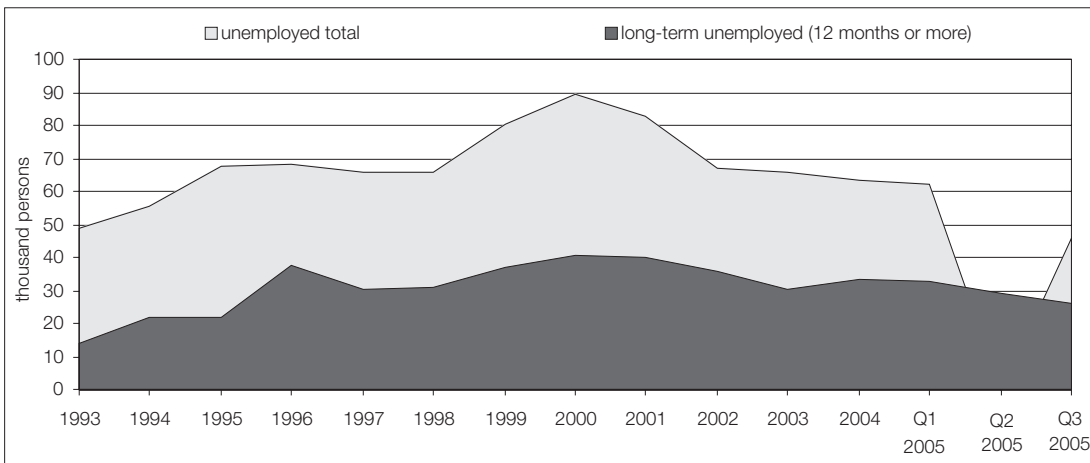
the number of those, who had searched for a job for 24 months or longer.

The number of the registered unemployed declined by 17.2% in the second quarter and by 18.8% in the third quarter year-on-year. Based on the labour force survey, the registered unemployed constituted 48.5% of the total number of the unemployed in the first quarter and 51.2% in the second quarter of 2005: in the second quarter the total number of unemployed people declined faster than the number of the registered unemployed.

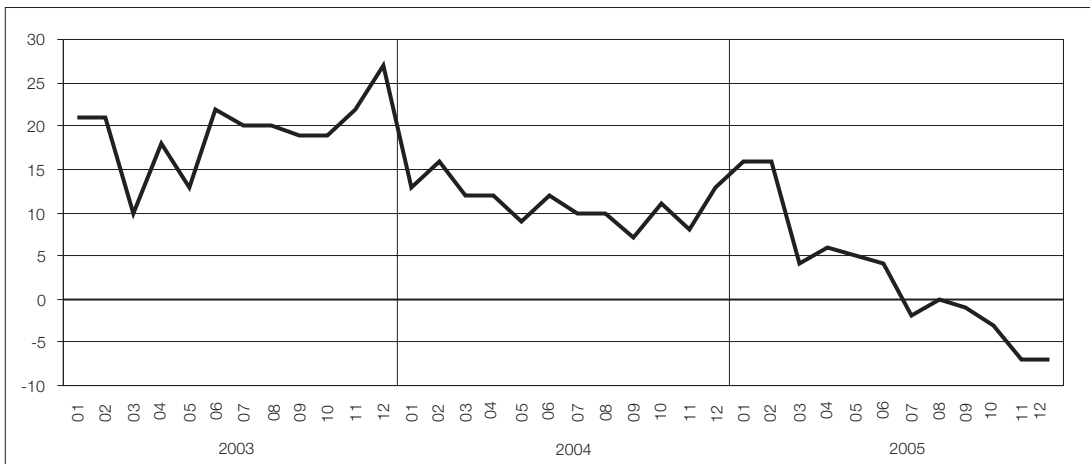
Considering risk groups, the average rate of unemployment of non-Estonians was 13.2% in the first

three quarters of 2005 (among Estonians 5.6%) and 16.2% in Ida-Viru County (compared to 8.2% on average in Estonia).

The consumer confidence barometer index<sup>17</sup> of Estonian Institute of Economic Research (EKI), which shows the respondent's fear of losing their job, has also been declining. This indicates that households perceive the decline in unemployment as well (see Figure 6). In July 2005, there were more respondents considering the risk of unemployment low rather than high for the first time.



**Figure 5. Number of short-term and long-term unemployed**



**Figure 6. Fear of unemployment according to the consumer barometer of EKI**

<sup>17</sup> The index equals the share of respondents who consider the risk of losing their job high minus the share who consider it low

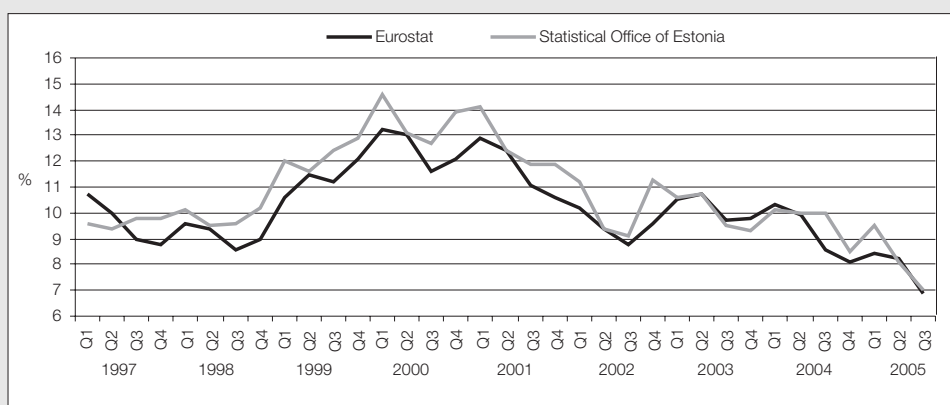
In conclusion, the situation in the labour market got more strained in the first half of 2005. Although the 8% unemployment rate is quite high in international comparison, its fast decline indicates possible price pressures in future – especially taking into account the high estimated structural unemployment<sup>18</sup> in

Estonia. At the same time one must not forget that other labour resources including the discouraged, the underemployed and the young with low participation rates mitigate the strained situation in the labour market.

#### BACKGROUND INFORMATION

##### **Unemployment Rate Estimates by the Eurostat and Statistical Office of Estonia.**

Like in the case of the harmonised consumer price index, the harmonised unemployment rate published by the Eurostat also differs from the unemployment rate estimated by the Estonian Statistical Office. In most of the cases the Eurostat indicator is lower than that of the Statistical Office, as can be seen in Figure 7.



**Figure 7. Harmonised unemployment rate by Eurostat and the national rate by Estonian Statistical Office.**

The definition of “unemployed” matches the definition by the International Labour Organisation in both cases: “The “unemployed” comprise all working age (15-74) persons who during the reference period were:

- (a) without work;
- (b) currently available for work; and
- (c) seeking work.

The difference between the two time series results from Eurostat’s goal to estimate unemployment on a monthly basis, while the national estimate is based on the Estonian Labour Force Survey (LFS), which is quarterly. Eurostat uses the LFS data only in the second quarter (red boxes), when the two estimates coincide. Estimates for the rest of the quarters are averages of monthly estimates. The monthly unemployment estimates by the Eurostat are in turn based on the number of unemployed in the 2nd quarter from the LFS and monthly growth rates of the number of the registered unemployed.

<sup>18</sup> Structural unemployment is a situation where the unemployed do not correspond to the qualification requirements of vacancies or are located in different regions.

## Labour costs and price pressures

### Average wages

The growth of average gross wages accelerated in the first three quarters of 2005. In the first quarter average wages grew by 10.1% (y/y) – to 7,427 kroons, in the second quarter by 11.8% – to 8,291 kroons, and in the third quarter 10.9% – to 7,786 kroons. The growth in average gross hourly wages<sup>19</sup> was even faster (11.3%) than the monthly wages, but it slowed in the second and third quarter to 11.1% and 9.4%, respectively. The faster growth of average gross hourly wages reflects the brisk growth of bonuses and vacation pays compared to the same period in the previous year. The growth of net monthly wages was 12.5% in the first and 14.5% in the second quarter, exceeding the average growth in gross wages by 2.4 and 2.7 percentage points, respectively, due to cuts in income taxes. (see Figure 8).

Average wages grew at the fastest rate in the field of hotels and restaurants (21.4%) and owing to the wage agreement in medicine and social welfare (21.2%). It accelerated noticeably in construction (19.6%) and in the second and third quarter in the primary sector, especially in agriculture (19.2% and

19.9% respectively). Wages in manufacturing grew by 12.3% as a three-quarter average, somewhat faster than the 10.9% of the total economy. The three-quarter average wages declined only in mining.

Considering the non-tradable<sup>20</sup> and tradable sectors, it appears that in the first half of 2005 average wage growth was somewhat faster in the tradable sector (see Table 2). Manufacturing formed almost 80% of the employment in the open sector; wage growth in the non-tradable sector was subdued by the modest wage increases in trade, which represents about 20% of the non-tradable sector.

While in 2004 wage growth was the biggest in the state and local governments administration, in the first half of 2005 wage growth accelerated in private enterprises. Wages in Estonian-owned private enterprises grew by 10.9% in the first quarter of 2005 (7.1% in 2004), 14.8% in the second and 12.9% in the third quarter. Foreign-owned enterprises showed the most modest average wage developments (see Figure 9).

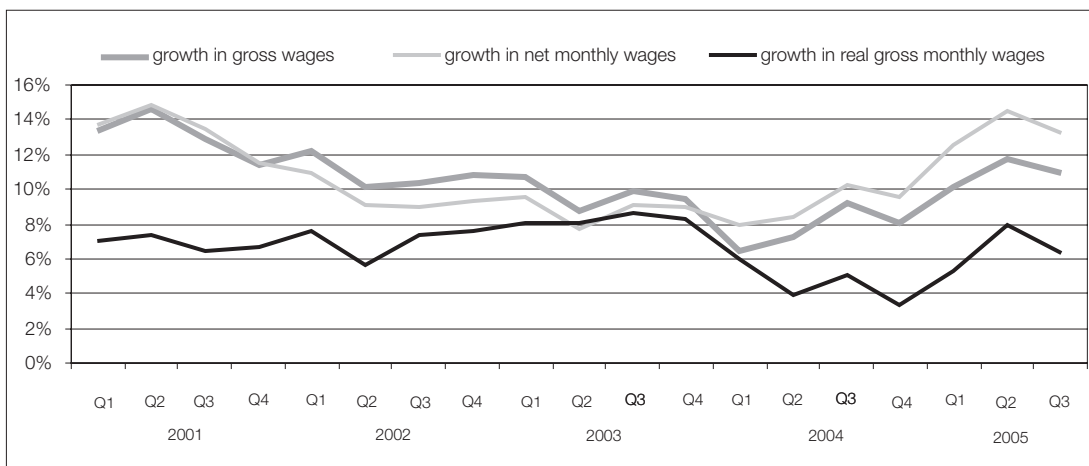


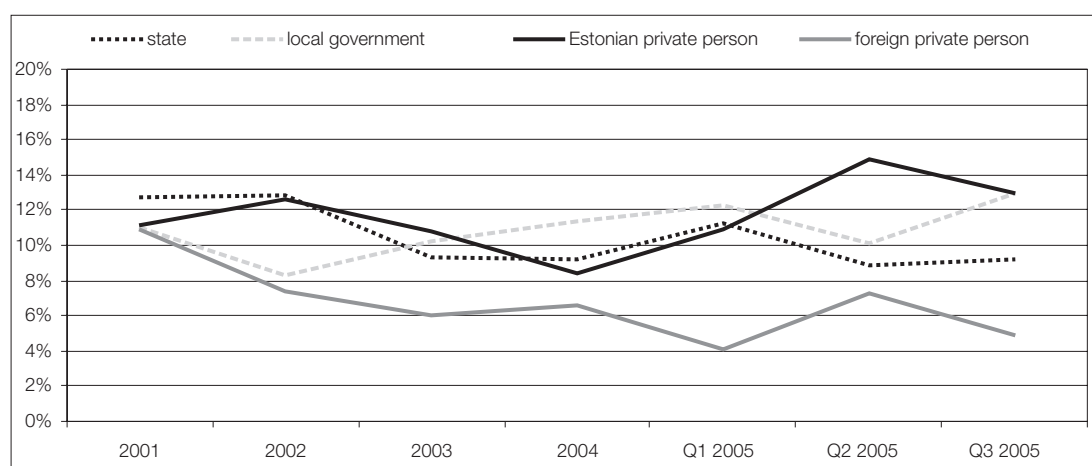
Figure 8. Developments in average wages

<sup>19</sup> While the average gross hourly wage contains only payment for worked time, the average gross monthly wage contains payment for time worked and not worked.

<sup>20</sup> An economic sector is non-tradable, when its enterprises do not compete with foreign enterprises

**Table 2. Growth in average wages by fields of activity (%)**

	2001	2002	2003	2004	Q1 2005	Q2 2005	Q3 2005
<b>Average of fields of activity</b>	<b>12.3</b>	<b>11.5</b>	<b>9.4</b>	<b>8.4</b>	<b>10.1</b>	<b>11.8</b>	<b>10.9</b>
<b>Tradable sector</b>	<b>9.3</b>	<b>9.3</b>	<b>9.2</b>	<b>8.4</b>	<b>11.7</b>	<b>12.5</b>	<b>12.4</b>
Agriculture	16.6	18.3	8.9	13.1	12.2	19.2	19.9
Forestry	15.3	3.4	13.3	22.9	22.1	13.0	14.4
Fishery	10.8	19.4	-4.4	-1.4	-2.5	8.4	25.7
Mining	16.6	9.0	9.3	6.6	-1.9	-1.9	2.1
Manufacturing	7.9	10.0	9.0	8.4	12.0	12.7	12.1
Electricity, gas and water supply	13.7	8.8	9.3	6.0	13.6	13.3	13.0
<b>Non-tradable sector</b>	<b>13.6</b>	<b>12.3</b>	<b>9.6</b>	<b>8.3</b>	<b>9.3</b>	<b>11.1</b>	<b>9.7</b>
Construction	19.5	12.6	13.5	11.7	11.1	19.6	13.6
Retail and wholesale	13.9	9.8	14.5	2.6	2.7	7.5	6.1
Hotels and restaurants	23.5	-5.8	17.7	8.5	28.1	20.9	16.1
Transportation, storage and communication	7.3	9.4	4.1	9.3	10.3	11.4	8.1
Financial intermediation	12.5	8.2	9.8	3.0	11.3	7.7	10.4
Real estate, renting and business activity	26.5	28.9	-0.4	15.4	3.8	8.6	4.9
Public administration and defence	10.7	12.7	8.7	8.2	10.1	7.4	9.6
Education	13.9	12.5	9.4	10.3	12.1	11.3	10.8
Health and social welfare	8.7	4.5	15.0	13.9	23.6	19.3	21.1
Other services	12.1	7.4	8.3	14.3	8.0	14.6	15.7



**Figure 9. Average wage growth by the owner of employer**

Between 2000 and 2004 average wages increased: in state governance by 51.9%, in local governance by 47.5% and in enterprises belonging to Estonian private persons by 50.3%. Average wage growth was considerably slower in foreign-owned private enterprises – 34.6%, which may be due to structural changes in the personnel.

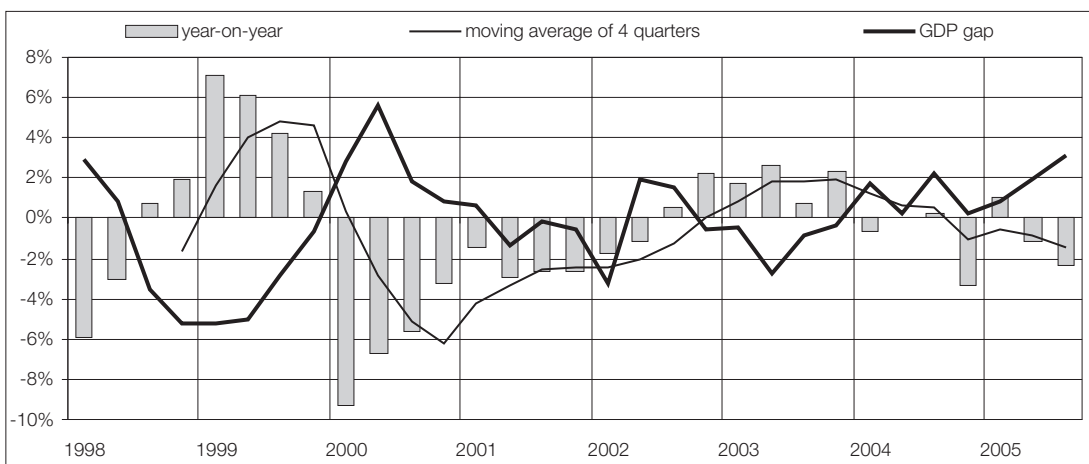
Regionally, average wages grew at the fastest rate in first three quarters of 2005 in Jõgeva (24.8%), Põlva and Võru county. In Tallinn, where the wage level is highest, its growth rate remained under the Estonian average, reaching only 6.6%. It has to be noted that wage growth encompasses also structural changes in employment – there may be regional changes in the shares of fields of economic activity with different average wage levels. E.g. in Tallinn employment grew noticeably in the field of hotels and restaurants, where average wages remain below the overall average. This is in accordance with the forecast of this years wage fund and income tax collection, which implies an increase in wage differences in 2005, in contrast to 2004.

### Real Unit Labour Costs

Unit labour costs show the outlay on labour (mostly

wages and taxes on labour) in the economy to produce one unit of output. As proceeds from the definition, the growth in unit labour costs is positive when the labour cost per employee grows faster than the productivity of labour. Long-term positive growth in unit labour costs is a negative development from an economic perspective, because it causes labour demand to decline and results in an increase in unemployment. If labour costs per unit of production grow, employers will face two possibilities for covering these expenses. The first is to raise prices, which lowers competitiveness. The other possibility is to allow a decline in profits. However, profitability is important to attract investment, which in turn affects the future economic growth. In the long term, expenses on labour should rise at the same pace with productivity, but in the short term this may not hold.

In years 2000–2002 real unit labour costs decreased in Estonia, but this trend was broken in 2003, possibly because of the lower than expected growth in GDP and a time lag<sup>21</sup> in wage costs adjustment. During 2004 economic growth was restored, but at the same time the growth rate of real unit labour costs slowed down, which was followed by the long expected decline. The share of wage funds in



**Figure 10. Growth in unit labour cost and GDP gap**

Source: Forecast of Eesti Pank

<sup>21</sup> When GDP growth turns out lower than expected, it cannot be taken into account at the wage negotiations of the same period.

GDP (real unit labour cost) declined in by 0.9% 2004 compared to the previous year. At the same time it is more difficult to draw conclusions on changes in the share of the real unit labour costs and profits in 2004, because in that year revenues from the EU structural funds were added to the income side of GDP, which raised the share of wages as well as profits in GDP. It means that the share of the wage fund in GDP does not necessarily grow on the account of profits of private enterprises.

### Development of Labour Costs by Fields of Activity

A more detailed time series from the Eurostat database makes it possible to estimate the development of real labour costs by five fields of activity. Table 3 shows the share of labour cost in the value added by field of activity. As can be seen, this indicator differs notably across fields of activity and fluctuates in time, being considerably above average

in the non-profit oriented public sector and lower than average in the primary sector.

In the first to third quarter of 2005 the growth in real unit labour costs was the fastest in financial intermediation, which contributed 1.2% and 1.6% to the overall real unit labour cost growth of the economy in the first and second quarter respectively. This was probably partly caused by the one-off additional labour costs that occurred during Swedbank's takeover of Hansapank, which does not affect the Estonian labour market on a larger scale. In manufacturing, which is the most important field of activity in the tradable sector, real unit labour costs declined.

In addition, unit labour costs increased in 2003–2004 in the fields of activity that belong to the fast developing real estate sector – construction, real estate, renting and business – pointing at a possible shortage of labour.

**Table 3. Share of labour cost in the value added**

	2002	2003	2004	Q1-3 2005
Agriculture, forestry, hunting	33.3	33.7	32.0	33.5
Mining, manufacturing, electricity and water supply	61.1	60.6	58.6	56.7
Construction	51.5	53.8	55.7	54.5
Whole and retail sale, hotels and restaurants, transport, storage and communications	45.2	46.1	45.1	45.7
Financial intermediation, real estate, renting and business activity	32.3	33.1	33.6	36.6
Public administration, education, health and social work, other personal services	80.4	81.4	81.1	79.9
Fields of activity total	46.0	46.9	46.4	46.0

**Table 4. Growth in Unit Labour Costs based on GDP Statistics (year-on-year)**

	2002	2003	2004	Q1-3 2005
Agriculture, forestry, hunting	-1.0	1.0	-5.0	4.2
Mining, manufacturing, electricity and water supply	1.2	-0.7	-3.3	-3.3
Construction	-10.6	4.4	3.5	-1.1
Whole and retail sale, hotels and restaurants, transport, storage and communications	-3.6	2.0	-2.1	2.0
Financial intermediation, real estate, renting and business activity	9.4	2.5	1.8	9.9
Public administration, education, health and social work, other personal services	1.1	0.9	0.0	-1.6
Fields of activity total	0.0	1.9	0.9	-1.0

Source: Eurostat

## Institutional Developments of the Labour Market

### The Employment Services and Benefits Act

**On 1 January 2006 the Employment Services and Benefits Act entered into force**, which brings about important changes in the application of active and passive labour market policy measures.

Most disputed are the changes in the definition of „suitable job“. In essence, the unemployed may choose freely to accept or decline a job without losing insurance benefits during the first 20 weeks of unemployment, but starting from the 21st week the definition of suitable job will be broader. A suitable job is considered a job which pays more on a full-time basis than the insurance benefits<sup>22</sup> the unemployed receives during that period, but not lower than the minimum wage set by the decree of the Government of the Republic. The job does not have to correspond to the education, speciality or previous experience of the unemployed and may also be temporary. The unemployed retains the right to decline a job, which offers less than 60% of the wages earned before becoming unemployed, and the minimum wage is set as a lower limit, but theoretically the worker has no ground to decline a part-time job which pays less than the insurance benefit. **Due to this change the eligibility criteria for unemployment benefits will be more restrictive, which provides an incentive for the unemployed to search for a job more actively before the end of benefit payments.**

Another significant change is the exclusion of unemployment benefits (former allowance) and grants from income in calculating subsistence benefits, because this will mitigate the risk of so called „poverty trap“, where a person does not have the means to cover job search expenses and therefore cannot find a job. The new law also prescribes an

individual job search plan for every unemployed, in which suitable labour market services and contact data of the Labour Market Office are scheduled for the future. Nine risk groups of unemployed are defined in the law, including long-term unemployed, youth (16–24 years) and the unemployed, who do not speak Estonian, who are dealt with actively starting from registration as unemployed.

### Minimum Wage

On 18 October 2005 the Confederation of Estonian Trade Unions (CETU) and the Estonian Employers Confederation (EEC) negotiated on the minimum wage rate for 2006. Trade Unions pursued a rise in the minimum wage by 22.7%, i.e. to 3,300 kroons. Employers considered a rise up to 8% or 2,900 kroons feasible. Negotiations yielded an agreement, that the minimum wage will rise by 11.5% in 2006, i.e. to 3,000 kroons, which approximately corresponds to the expected rise in nominal productivity of labour.

The plan for raising the minimum wage signed in 2001 by CETU and EEC foresaw an annual increase in the ratio of minimum and average wages by 1.5%, so that by 2008 the minimum wage would make up not less than 41% of the average gross wages. Based on the fast growth of wages in the first half of 2005 it is probable that the ratio of minimum wages to average wages will not increase in 2005. In 2004 the minimum wage constituted 34.3% of the average wage, in 2005 this indicator will fall to 33.5%<sup>23</sup>. The ratio of minimum wages to average wages will also decrease in net terms – from 38.6% in 2004 to 37.8%.

<sup>22</sup> The amount of the unemployment benefit received after 21st week is 40% of the previous wage, but not more than 40% of the triple average taxed income in previous year (6,962 kroons in 2005).

<sup>23</sup> Based on the average wage in the autumn forecast of Eesti Pank of 8,025 kroons for 2005.

## BACKGROUND INFORMATION

### **Minimum Wage According to the 2004 Estonian Labour Force Survey**

*In spite of the great attention paid to the minimum wage negotiations every year, there is no accurate statistics on the share of Estonian workers who are directly affected by the minimum wage.*

*It is theoretically possible to estimate it using the database of the Tax and Customs Board, but it is not available for Eesti Pank. The other possibility is to use the data of the Estonian Labour Force Survey (ELFS). Unfortunately the accuracy of the estimate derived on the basis of the ELFS is diminished by the fact that it is a sample survey. Moreover, the ELFS only includes the net wage received in the previous month, which may differ greatly from the wage rate – because of bonuses, vacation or illness periods. In many cases the net salary in previous month was considerably lower than the minimum wage, even after correcting for part-time employment. On the other hand, it cannot be excluded that the minimum wage is not observed.*

*On the basis of the ELFS data, 10.5% of those who earned labour income in 2004 received less than the same years' minimum wage, 12.4% received less than the minimum wage in 2005 and 22% received less than 3,300 kroons – the labour unions initial minimum wage goal for 2006. In the years 2002–2003 this indicator was at a similar level. In 2004, 29% of those who earned minimum wages or less were aged 55–74 years, 40% were elementary workers and 20% service and salespersons. Among non-Estonians 13.3% and among Estonians 9% earned up to the minimum wage. By fields of activity the share of persons who received minimum wages or less was the greatest in agriculture, hunting and forestry (24%), hotels and restaurants (18%) and real estate, renting and business activity (16%). This indicator was 9% in manufacturing.*

*How many of the employees earning less than the minimum wage will lose their jobs after an increase in the minimum wage? Marit Hinnosaar and Tairi Rõõm found in their analysis<sup>24</sup> that a 10% rise in the minimum wage in 1997–2002 caused the job loss for 0.43%–0.66% of those workers who earned less than the new minimum. One can speculate that this indicator greatly depends on the growth of minimum relative to the average wage and on economic cycle. In the circumstances of fast economic growth job loss is hardly significant. The negative impact may also be reduced by the existence of undeclared wage payment.*

<sup>23</sup> "The Impact of Minimum Wage on the Labour Market in Estonia: An Empirical Analysis", Working Papers of Eesti Pank no 8/2003.



**Table 4. Estonian labour force**

	Unit	2003	2004	2005	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005
Population (as of January 1st)	ths	1356	1351.1	1347					
<b>Employment situation of persons at the age of 15-74</b>									
Labour force	ths	652.7	660.5	659.1	662.5	657	656.7	663.1	657.5
employed	ths	585.5	594.3	595.5	596.5	601	594.5	609.1	611.4
unemployed	ths	67.2	66.2	63.6	66	56	62.2	54	46
Inactive	ths	394.4	387.4	388.7	385.3	390.8	391.1	385.4	391.1
Total	ths	1,047.20	1,047.80	1,047.80	1,047.80	1,047.80	1048.6	1048.6	1048.6
Participation rate	%	62.3	63	62.9	63.2	62.7	62.6	63.2	62.7
Rate of employment	%	55.9	56.7	56.8	56.9	57.4	56.7	58.1	58.3
Rate of unemployment	%	10.3	10	9.7	10	8.5	9.5	8.1	7
<b>Employees by activity</b>									
Agriculture, hunting and forestry, fishing	ths	40.7	36.7	35	36	35.9	34.5	35.1	31.7
Mining and quarrying	ths	5.7	5.7	8	7.2	8	5.7	4.4	6.3
Manufacturing	ths	128.2	134.1	140.9	148.9	137.5	131	146	143.5
Electricity, gas and water supply	ths	10.5	10.2	12	11.3	12.1	14.6	12.6	12.6
Construction	ths	38.9	42.9	46.8	49.9	48.1	43.7	45.1	53.4
Wholesale and retail trade	ths	86.3	80.8	80	78.8	81	77.1	82.9	81.3
Hotels and restaurants	ths	17.9	17.4	16.2	17.4	17.5	22.6	22.4	19.7
Transport, storage and communication	ths	54.5	56.2	51.5	47.6	51.8	59	54.2	49.8
Financial intermediation	ths	7.9	7.6	7.9	6.3	8.6	7.2	6.5	7.6
Real estate, renting and business activity	ths	44.3	44.4	39.4	38.4	39.9	44.7	45.9	46.3
Public administration and defence	ths	33.2	34.5	36.9	31.8	30.7	36	33	40.3
Education	ths	55.6	56.9	54.5	55.2	61.5	54.4	58.1	53.2
Health and social work	ths	31.6	36.4	37.5	38.1	43.1	39	33.3	32.5
Other economic activities	ths	30.1	30.4	28.8	29.8	25.3	24.9	29.7	33.3
<b>Unemployed by period of unemployment</b>									
Less than 6 months	ths	21.3	25.6	21.2	22.1	17.1	20.6	17.8	16.7
6-11 months	ths	10.4	10.2	9.2	9.5	6.4	8.6	7.4	3.1
12 months or more	ths	35.5	30.4	33.2	34.3	32.5	33	28.8	26.2
24 months or more	ths	23	20.1	21.5	25.9	20.3	20.1	19.5	17.2
<b>Inactive by reason of inactivity</b>									
Education	ths	125.6	119.5	123.1	117.8	129.4	130.5	116.3	124.3
Illness or disability	ths	47.2	44.9	43.3	39.6	42.2	44.7	48.5	41.9
Pregnancy, maternity or parental leave	ths	22.8	22.7	27.2	29.2	29.1	27.3	25	30.7
Need to take care of children or other members of family	ths	21	14.8	13.7	15.4	12	13.1	13.7	16.6
Retirement age	ths	148.8	152.8	149.4	151.7	145.6	144.9	149.5	145.2
Lost hope to find work (discouraged workers)	ths	17.7	18.1	17.7	16.1	20.7	16.1	16.6	16
Other reason	ths	11.4	14.5	14.4	15.5	12	15.4	15.8	16.4
<b>Labour force according to educational level</b>									
First level and less	ths	68	71.6	73.2	82.6	71.5	59.7	65.5	70.5
Second level	ths	379.4	383.7	375.6	372	372.9	375.7	372.7	356.7
Third level	ths	205.4	205.1	210.3	207.9	212.6	221.4	224.9	230.3
Vocational education with secondary education	ths	71.9	71	70	63.5	70.3	71.1	67.7	66.1
Higher education	ths	133.5	134.1	140.4	144.5	142.3	150.3	157.2	164.1