

Economics Department
Economic Policy Office



Labour Market Review

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April 2006

Main developments in 2005

In 2005, employment grew rapidly due to an extremely favourable environment of economic growth. The growth of employment recovered after a modest year of 2004 in the first quarter of 2005 and accelerated to nearly 2.5% in the following quarters. Employment growth was accompanied by a drop in the number of the unemployed year-on-year, however, the number of inactive people remained about the same. Slightly over 3,000 people entered the labour market from amongst the inactive people in the fourth quarter. Favourable economic climate allows for hopes that the trend will continue in 2006. The number of jobs rose only in the service sector over the year after a remarkable fall in 2004. In the industrial sector there were no changes in employment after two growth years.

Short-term and long-term unemployment decreased along similar lines in 2005. Risk groups again include Ida-Viru County, ethnic non-Estonians and young people, even though youth unemployment shrank significantly in 2005.

Against the backdrop of an upcoming fall in the number of working-age population and rapidly

decreasing unemployment rates, it is important to ensure labour force participation of the population in order to guarantee workforce for the economy. Labour force participation rate in Estonia is lower than in several other EU countries, although it has been increasing among the elderly in recent years.

As of May 2006, there will be no obstacles for Estonian citizens to work in Finland, Spain and Portugal. About 17,000 people have left to work abroad since Estonia's accession to the EU. The impact of labour outflow on local companies and wage formation may strengthen in the future.

The European Commission together with finance ministries of the Member States recently published a report on the impacts of an ageing population via the budgetary effects. Estonia stood out as a Member State with a successful pension reform, where, should policies remain unchanged, pension expenditure from the state budget will be decreasing until 2050.

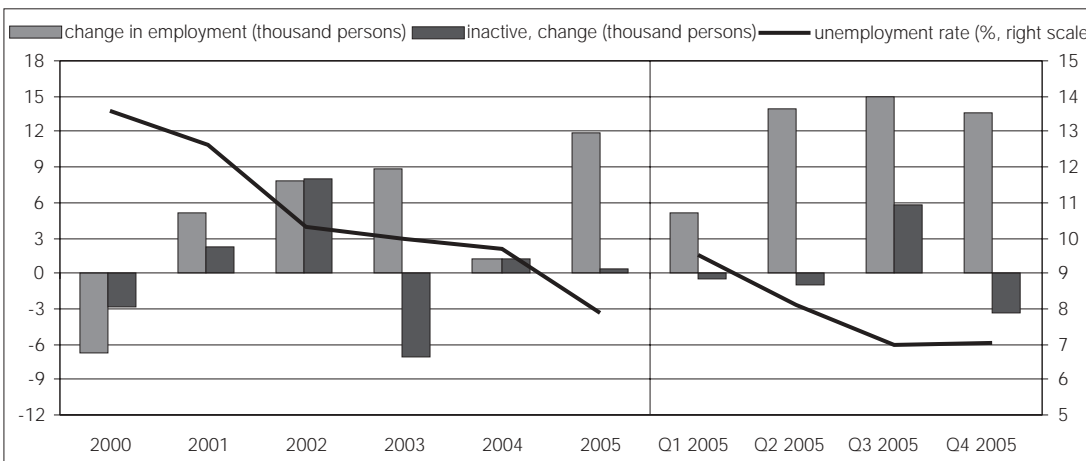


Figure 1. Main labour market indicators

Table 1. Main labour market indicators

	Change y/y (%)						Change y/y (thousand persons)					
	2004	2005					2004	2005				
Population (as at 1 January)												
Population	-0.37	-0.26					-5	-3.6				
Employment status (15-74)	2004	2005	Q1 2005	Q2 2005	Q3 2005	Q4 2005	2004	2005	Q1 2005	Q2 2005	Q3 2005	Q4 2005
Labour force	-0.2	0.1	0.2	0.2	-0.8	0.6	-1.4	0.5	1.1	1.6	-5.0	4.1
employed	0.2	2.0	0.9	2.3	2.50	2.3	1.2	11.9	5.2	13.9	14.9	13.6
manufacturing	5.1	-0.9	-1.7	1.3	-3.6	-0.1	6.8	-1.4	-2.2	1.9	-5.4	-0.2
unemployed	-3.9	-17.9	-6.2	-18.4	-30.3	-16.7	-2.6	-11.4	-4.1	-12.2	-20.0	-9.5
less than 6 months	-17.2	-12.3	-14.2	-17.2	-24.4	12.9	-4.4	-2.6	-3.4	-3.7	-5.4	2.2
6-11 months	-9.8	-38.0	-21.8	-26.0	-67.4	-43.8	-1	-3.5	-2.4	-2.6	-6.4	-2.8
12 months or more	9.2	-16.0	5.4	-17.0	-23.6	-27.4	2.8	-5.3	1.7	-5.9	-8.1	-8.9
24 months or more	7.0	-15.3	16.9	-13.7	-33.6	-20.2	1.4	-3.3	2.9	-3.1	-8.7	-4.1
Inactive	0.3	0.1	-0.3	-0.3	1.5	-0.8	1.3	0.3	-1.2	-1.0	5.8	-3.3
Total	0.0	0.1	0.1	0.1	0.1	0.1	0	0.8	0.8	0.8	0.8	0.8
	Level (%)						Change (percentage points)					
Participation rate	62.9	62.9	62.6	63.2	62.7	63.0	-0.1	0	0	0.1	-0.5	0.3
Employment rate	56.8	57.9	56.7	58.1	58.3	58.6	0.1	1.1	0.5	1.3	1.4	1.2
Unemployment rate	9.7	7.9	9.5	8.1	7.0	7.0	-0.3	-1.8	-0.6	-1.9	-3	-1.5

Labour supply and demand

Labour force participation and economic inactivity

In 2005 the labour participation rate stood at 62.9% similarly to 2004. The annual number of the inactive remained nearly unchanged. In the longer term, the number of the inactive has been fluctuating around 390,000 from 1999 without a notable long-term trend. The number of the inactive in the first half of 2005 was the same as in 2004, it rose in the third quarter by 1.5% year-on-year and dropped by 0.8% in the fourth quarter. However, fluctuations remained negligible in regard to volatility of time series.

By regions we may see some long-term growth trends in the number of inactive people in Western and Central Estonia, while it is decreasing in Northern Estonia. The number of the inactive in Ida-Viru County

has been falling over the last two years, and in 2005 there occurred a rather significant 5.5% change. The fourth quarter made the strongest contribution when the number of the inactive decreased by 12,200 or by 20.6% in Ida-Viru County. It should be noted that the fall in the overall number of inactive people in Estonia in the fourth quarter was caused by developments in Ida-Viru County, the number of the inactive in the rest of the country was growing.

The number of people inactive due to their retirement age has been on the fall over a longer period and kept so in 2005 (2.7% less, or a drop of 4,000 people). One of the major underlying reasons for this development is a gradual rise in women's retirement age until 2016 when both men and women retire at the age of 63. In 2006, 63-year-old men and women of 59.5 years of

age may retire. This is supported by a positive trend in the labour participation rate of women between 50 and 74. The favourable economic climate certainly makes its positive impact on labour participation numbers.

The number of people inactive due to their studies also increased, being 2.4% or 3,000 in 2005. This is mostly caused by an increasing number of young people (15 to 24 years of age) since it involves birth cohorts of the singing revolution. The labour participation rate of 15 to 24-year-olds was 34% in 2005, thus rather close to the 34.2% in 2004, but was considerably lower than in 1997–2000, for example, when it stood at 42.7% as the annual average.

The number of people inactive due to illnesses increased by 3,700 after a two-year fall. The number of people on pregnancy and maternity leave stood

at 27,000 year-on-year, being slightly over 20% higher than the average of the years 2001–2003. A major role is being played by the launch of the parent benefits system in 2004, to a lesser extent also the higher number of live births in 2004 and 2005 (9.8% higher on 2001–2003).

One of the positive developments has certainly been a sharp drop in the number of discouraged people from 17,700 in 2004 to 14,300 in 2005, whereas the number of the non-Estonian discouraged people fell by 2,700 and that of Estonians fell by a mere 300. The overall average number of the discouraged in Estonia was 16,200 within the first three quarters of 2005, and only 10,300 in the fourth quarter. The number of the discouraged evidently underwent a significant decrease in the fourth quarter in Ida-Viru County.

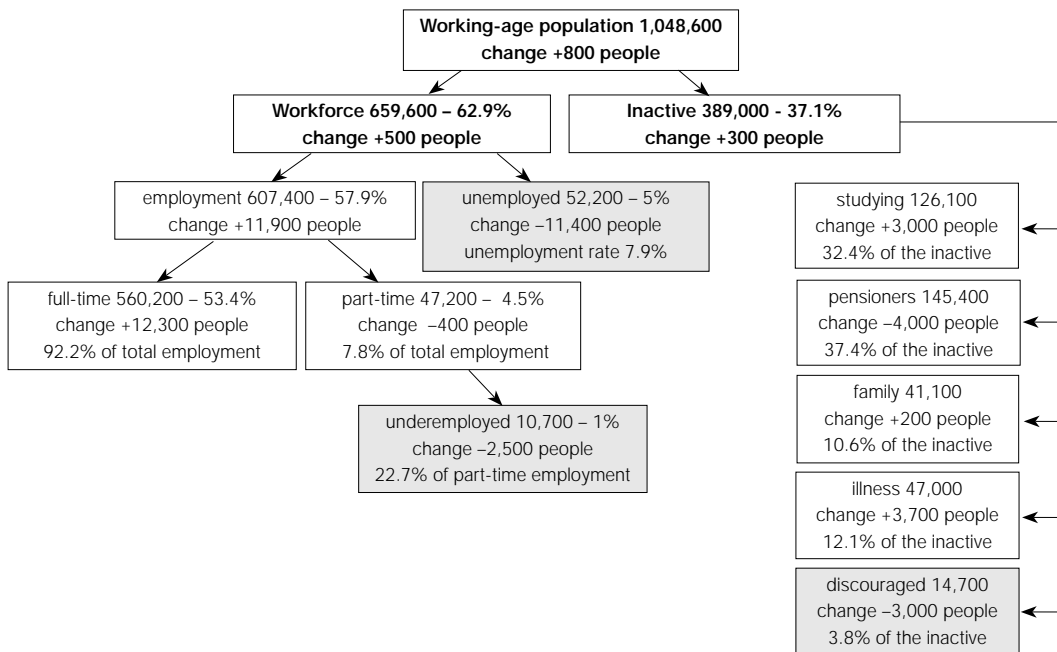


Figure 2. Estonian labour market in 2005 and the change compared to the same period in 2004 (% of the working age population, i.e. 15 to 74-year-old people)

BACKGROUND INFORMATION

Impacts of ageing population on the state budget

The European Commission published a report "The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)" in January 2006. The analysis was completed in three years. All Member States made their contribution.

The Eurostat population forecast served the basis for the projection. Rules of the national pension systems were used to compile a projection for pension expenses presuming that policies remain unchanged. A common model was worked out for the rest of the expenses.

Provided the assumption of unchanging pension policy is correct, the expenses for pensions will drop to 4.8% of GDP by 2030 while the population ages, and to 4.2% in 2050 as opposed to 6.7% in 2004. This only presumes a rise in pensions by a statutory index a year, which is a weighted average of social tax revenues and CPI. The projection does not allow for the ad hoc pension rises, e.g. like the one that occurred in 2005. The share of pension expenses in GDP in Estonia was in line with that in the other Baltic States in 2004, but significantly lower than the averages of the new and old Member States, 10.9% and 10.6% respectively. Only Poland shows a deeper decline in pension expenses in the projection than Estonia. A considerable rise in pension expenses is predicted for the countries which have not yet carried out their pension reforms.

Health care expenditure in the Estonian state budget should rise to 6.2% of GDP by 2030 and to 6.5% in 2050 (from 5.4% at the start of the period in 2004). The projection took into account the age structure of the population (average health expenditure depends significantly on age and gender) as well as a rise in the expenses due to advances in medical technology. A fall in expenditure in the state budget would get support from a drop in education expenses from 5% of GDP in 2004 to 3.9% in 2030 and to 3.7% in 2050.

The projection is even more valuable for it accounts the effect of the ageing population in the economic growth forecast as well. On the one hand, the working age population (15–64 years old in the report) will decrease in almost all countries, including Estonia, by 27%, but on the other hand, it is expected that labour participation rate will continue growing, for Estonia it is 6 percentage points by 2050 on 2004. Unemployment will fall to 7% in 2015 and is expected to remain stable until the end of the forecast period.

The GDP projection is based on the production function where inputs are the amount of labour found using the above method, and additional presumptions are TFP and concentration of capital. It appears that even though the working age population reaches its peak in 2006, the growth of employment may continue due to growing labour participation, a fall in unemployment and changes in the age structure of the population, and do so until 2011. The report calls this period "a window of opportunity", when there is a favourable environment for carrying out structural reforms. As of 2011, a fall in the number of the working age population will dominate

and the labour's contribution to the potential growth will become negative (in 2011–2030, a fall of 0.6 percentage points, and in 2031–2050 a fall of 0.7 percentage points a year).

These calculations are based on the assumed unchanging policy but there are other possibilities to alleviate the impacts of ageing. An important factor is certainly raising the retirement age since a longer life also involves better health in advanced years.

Employment

Employment grew by 2% in 2005, i.e. 11,900 people, which is probably the highest figure in the period of independence. The growth was smaller (0.9%) in the first quarter but picked up in the other quarters (2.3-2.5%). Employment increased in the service sector alone and slightly decreased in the primary and industrial sectors on the annual basis.

A longer-term development considered, it appears that the a rapid growth of the service sector was preceded by a major fall in 2004, while employment in the industrial sector was increasing fast in the previous two years (see Figure 3). In the public

sector, employment has decreased by 1.97% and in the private sector increased by 3.36%. The share of the public sector declined to 24.5% (25.5% in 2004).

By fields of activity, the greatest contributor to the employment growth was the field of real estate, renting and business activities where the number of employed grew by 17.8% or 7,000 people, which is not surprising given the fast development of the residential property market. Employment in construction only increased by 4.1% or 1,900 people, but it was 25% higher than, for example, in 2002.

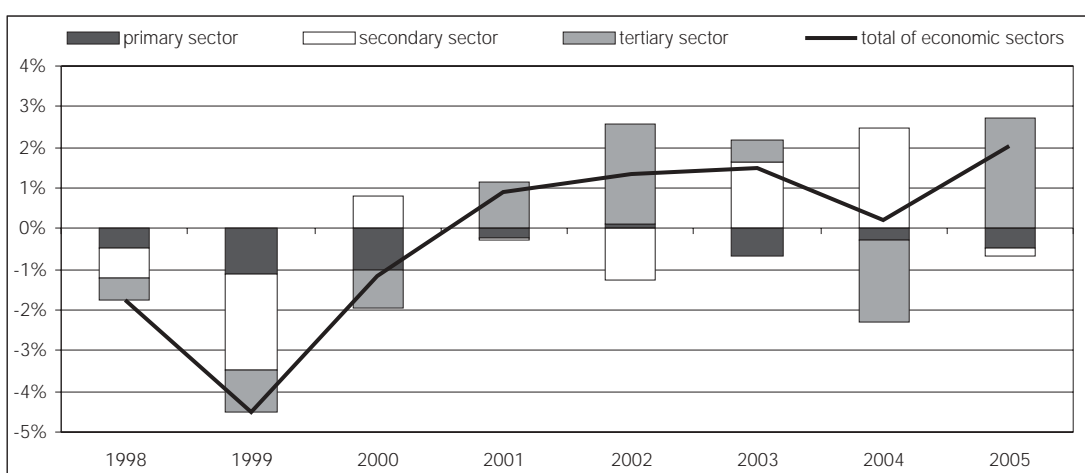


Figure 3. Rise in employment and the weight of sectors in the rise¹

¹ Primary sector – agriculture, forestry, fishing; secondary sector – manufacturing; tertiary sector – services.

Employment saw a rapid growth in hotels and restaurants after several years of stability – the number of employees grew by 36.4% or 5,900 people in 2005. An influential factor may have been the increased number of foreign tourists after the accession to the EU.

Employment in manufacturing grew by 1% (1,400 people), including a rise in paper industry (37% or 2,600 people), and a fall in the textile industry (by 22% or 2,300 people).

By counties the greatest contribution to employment growth was made by Harju County and Tallinn where the number of jobs increased by 10,300 (4%) and 6,700 (3.4%), respectively, whereas employment in the service sector grew but fell in the rest of the sectors. Ida-Viru and Lääne-Viru counties should be exemplified where employment rose by 5.2% and 8.7% (by 3,500 and 2,300 people respectively), in the case of Ida-Viru County, the service sector accounted for all of it (14.5% or 4,900 people). It should be noted, however, that statistics of employment by counties is rather volatile even across years.

The employment rate of 15 to 74-year-olds increased from 56.8% to 57.9%, the respective indicator for men of 61.5% remained at about the last year's level (grew by 0.2 percentage points), while women's indicator rose by 1.9 percentage points to 54.8%. The employment rate growth was broad-based across age groups, it only fell in the case of 50 to 74 year old men.

The share of salaried employees in the total employment has been rather stable over the years – at around 90–92%. In 2005 it rose from 90.3% to 91.9%, or by 1.6 percentage points. It is significant that the share of salaried workers in agriculture and forestry increased by 8.8% and 7.2%, respectively.

It could be assumed that the use of structural funds had its impact on such results. Against the background of heavy demand for labour full-time employment grew by 2.2% whereas the number of people employed part-time decreased by 0.8% and of the underemployed by 18.9%.

The growth in employment in 2005 resulted from the rising number of white-collar workers² by 16.9% while the number of blue-collar workers³ fell by 1.18%. It is in line with a long-term rise in the educational level of the population where a major contribution is made by the young labour force that substitute the elderly people with a considerably lower education on average. The number of working-age people with primary or secondary education decreased by over 21,100 people in 2005, whilst the number of working-age people with tertiary education rose by 21,900 people, including 22,900 people with higher education, Master's degree or doctorate degree. A rise in employment was mainly caused by a higher number of people with tertiary education (by 18,400). The number of the employed with primary or secondary education fell. It should be mentioned that the number of people who acquired general secondary education or vocational education with general secondary education but the rest of subdivisions of the secondary education decreased.

² White-collar workers: lawmakers, senior officials and executives; specialists and technicians; officials.

³ Blue-collar workers: service and sales staff; skilled workers in agriculture and fishing; skilled workers and craftsmen; operators of equipment and machinery; unskilled workers; military personnel.

BACKGROUND INFORMATION

Migration

The labour markets of the United Kingdom, Ireland, and Sweden were fully open to the Estonian people from the accession to the EU. The rest of the Member States maintained restrictions within the transfer period to a bigger or lesser extent. On 1 May 2006, all restrictions were lifted on going to work in Finland, Spain or Portugal. Restrictions of several countries have been alleviated.

Labour outflow may become an essential factor in the formation of wages and other indicators under the circumstances of the falling numbers of population when a large share of the Estonian labour may decide to leave to work abroad. According to the Ministry of Social Affairs, only countries of destination collect data on labour mobility. Estonia as a country of origin has no legal basis to register or to check people going to work abroad. The only exception is medical personnel with more information on their mobility.

Table 2 below presents data collected by the Ministry of Social Affairs on work permits issued to Estonian citizens by the relevant agencies of other Member States. In addition, within the free movement of services employees were sent to work abroad, mostly to Finland (1,882 in 2004 and 6,200 in 2005). Thus, since the accession, 2.6% of the labour force have worked abroad, or 3.8% including those sent on business.

Table 2. Workers left to work abroad

Country of destination	Period	Registered people	Notes
United Kingdom	05/2004–12/2005	4,680	Registered employees (repetition may occur, may have returned to Estonia)
Ireland	05/2004–07/2005	2,861	Eures network
Sweden	05/2004–3/2006	1,357	Received residence permit (783 of them work-related, incl service provider); residence permit not required when living less than 3 months
Finland	2002	7,984	Compared to the pre-accession period, considerably fewer people have applied for work permit; frequently employees are sent on business within the framework of free movement of services
	2003	8,987	
	2004	4,855	
	2005	2,217	
	Total	24,043	
Norway	as at 31/08/2005	678	In addition those sent on business (in 2004 – 412, second place after Finland for the number of people sent on business in 2005)
Spain	as at 31/08/2005	280	
Total	from 05/2004	16,928	Includes data for Finland of 2004; periods do not always overlap

Source: Ministry of Social Affairs

The above data may, however, for various reasons over- or underestimate the outflow of labour. Firstly, the above table does not cover all the countries worldwide, even though

according to data mainly from diplomatic sources, Estonian people have left to work in other EU countries to a significantly lesser extent. Secondly, there is no data on how long people with a working or residence permit actually work abroad, or how many of them have returned. Thirdly, working or residence permits are frequently not required for working over a short period, and some people work unregistered and are thus not included in statistics.

People working abroad are included in the statistics of the Estonian labour force survey. A person included in the sample does not have to fill in the questionnaire in person, a member of the household may do it for the person working abroad at that time. In the case the entire household is abroad when the survey is being carried out, it will evidently be left out of the sample. In 2004, there were 82 cases where working abroad was noted as a primary place for working, which, when extended to the Estonian working age population, it comes to 5,985 employees; in 2003 the respective figure was 4,178, and in 2002 it was 3,585. Consequently, in 2004, the number of employees grew by 1,807, when including those working abroad. Data for 2005 are not available yet.

Vacancies

Although statistics of the Labour Market Board are not representative and do not extend to the entire economy of Estonia, they are used as a possible indicator of demand for labour force in the present analysis. Figure 4 depicts announcements on vacant jobs submitted to the Labour Market Board in a certain period and the stock of announcements valid at the end of that period. The rapid growth in the number of valid vacancy announcements, which had

started in early 2004, continued in 2005. The number of announcements was by 52.4% higher as an annual average, and the monthly number of announcements submitted to the Labour Market Board was 37% higher than in 2004. In December the respective number was nearly 50% less than in previous months, but this was evidently only temporary, since the average growth rate of 2005 kept up in early 2006. An annual average showed 4.45 registered unemployed people per each vacancy announcement.

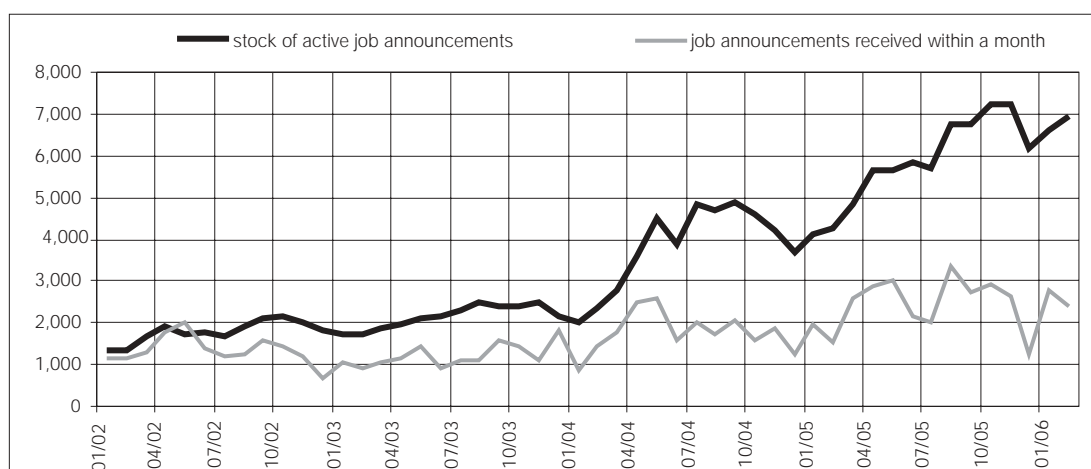


Figure 4. Job announcements submitted to the Labour Market Board

Unemployment

Unemployment fell from 9.7% in 2004 to 7.9% in 2005. By quarters, unemployment began shrinking from the beginning of the year and reached 7% in the second half of the year. The total number of the unemployed decreased by 17.9% year-on-year, in the fourth quarter there was a total of 46,500 unemployed

people. The number of the long-term unemployed shrank by 15.9%, whereas their share in the overall number of the unemployed rose from 52.2% in 2004 to 53.4%. The number of short-term unemployed in the fourth quarter was evidently influenced by inactive people who had returned to the labour market.

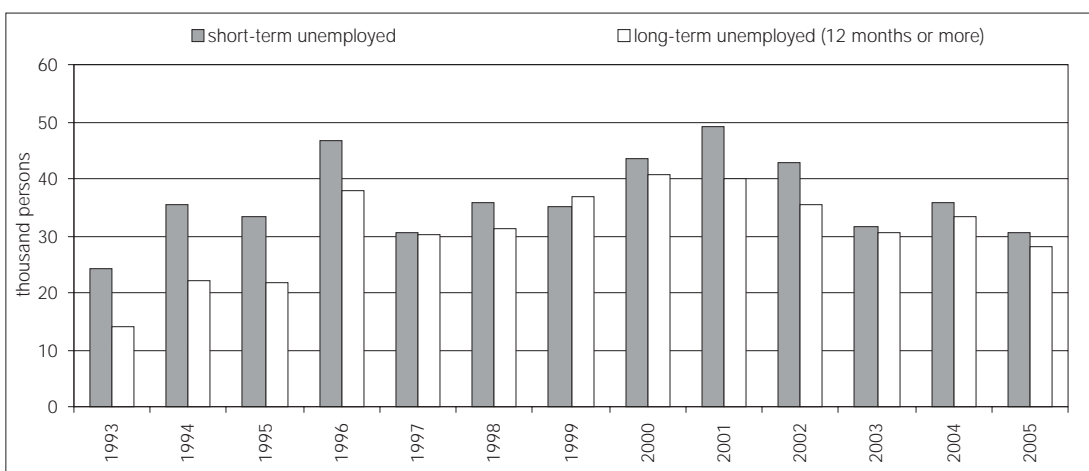


Figure 5. Number of short-term and long-term unemployed

In 2005, registered unemployment decreased even faster than previously – by 30% year-on-year. At the end of December the Labour Market Board had only 22,261 registered unemployed. Registered unemployed accounted for 58.3% in 2004, and 49.9% in 2005 in the estimated number of the unemployed based on the labour force survey. A fall in registered unemployment has continued in the first two months of 2006 at a rate comparable to the previous year.

Unemployment decreased in all age groups, unemployment of the young fell from 21.7% in 2004 to 15.9%, but only among the Estonians (from 17% to 9.5%), while the unemployment rate of the non-Estonian young still kept high (30.9% in 2004 and 29.4% in 2005). It is largely due to a growth in labour participation among the non-Estonian young people, whereas the respective rate of the Estonians declined.

Unemployment remains significantly higher among the non-Estonian population, however, in this group

a fall in unemployment was sharper – from 15.6% to 12.9% (for Estonians from 6.4% to 5.3%), irrespective of the rise in activity among the non-Estonians by one percentage point to 64.7%.

By regions, Ida-Viru County showed the highest unemployment at 16.2% (17.9% in 2004). The unemployment rate in Southern Estonia declined to 6.3% from 8.2% in 2004, the largest contributor to falling unemployment was Harju County by a fall from 9.6% to 7.5%.

The index of the consumer barometer of the Estonian Institute of Economic Research (EKI) kept rising throughout the year 2005 (except for September) and also in the first quarter of 2006, thus showing that households' confidence is strengthening. The barometer's subcomponent – households' estimates of risk of becoming unemployed – kept declining throughout 2005 (see Figure 6).

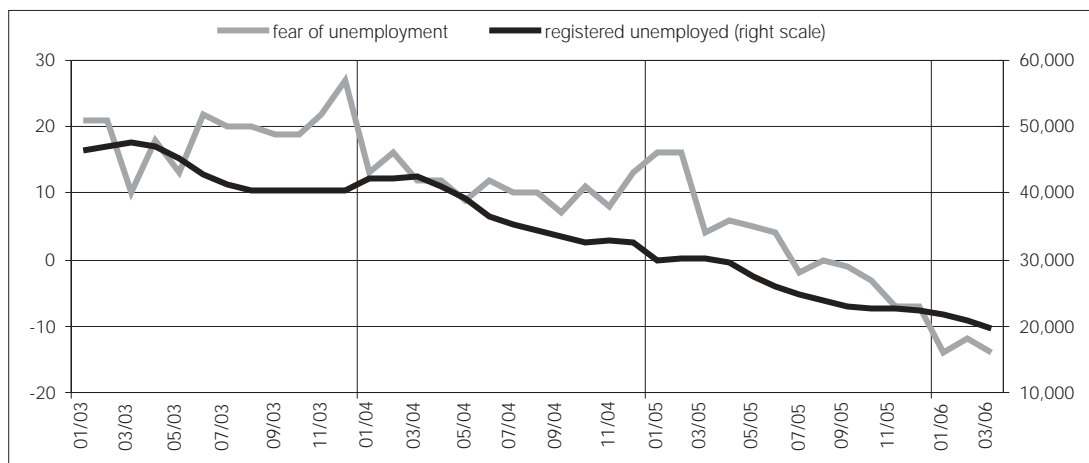


Figure 6. Fear of unemployment according to the consumer barometer of the Estonian Institute of Economic Research (EKI) and registered unemployment

In conclusion, the situation in the labour market became tighter in 2005, and the current indicators allow presumptions that the trends of 2005 continued at the beginning of 2006 as well. A rapid fall in unemployment and expanding opportunities to work abroad imply potentially growing price pressures in the future – especially so when considering structural unemployment⁴ in Estonia which is estimated as high. Developments in labour force participation will become extremely important in the near future – will people who have been away from the labour market decide to start looking for jobs under the conditions of a rapid economic growth and will companies be able to integrate such people.

⁴ Structural unemployment refers to the situation where the unemployed do not meet the qualification requirements of vacancies, or are located in different regions.

Labour costs and price pressures

Average wages

The growth of the average gross monthly wages accelerated from 8.4% in 2004 to 11.4% in 2005, based on quarterly figures. Data of tax collection in the beginning of 2006 imply a continued increase in wage growth in the first quarter of 2006. Average gross hourly wages grew to an annual total of 12%, and even by 15.9% in the fourth quarter, and gross monthly wages by 12.8%. The faster growth

of average gross hourly wages compared to gross monthly wages indicates a year-on-year decrease in payments for the time not worked since the hourly wages only contain pay for the time worked. However, bonuses grew by 25%, or considerably faster than in the fourth quarter of 2004. Growth in net monthly wages was an average of 2.5 percentage points higher than the growth in gross wages due to changes in taxation (see Figure 7).

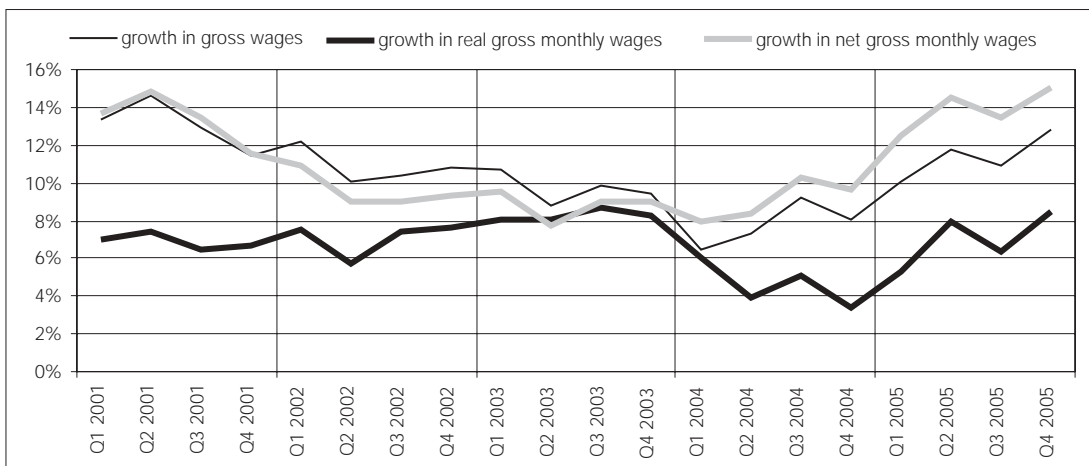


Figure 7. Developments in average wages

Source: Eesti Pank

By fields of activity, the growth in wages was the highest in hotels and restaurants (22.1%) and in medicine and social welfare (21%). In the second quarter the growth in wages accelerated considerably in construction (19.6%) while remaining a temporary feature, and the annual total of the rise in construction came to 14.6% (3.2 percentage points faster than the overall average).

The wage increase in health care primarily occurred due to a wage agreement concerning minimum hourly wages of doctors, nurses and nursing staff concluded at the end of 2004. A precondition for the agreement to take effect was that the health insurance fund increases prices in order to cover the wage increase, i.e. funds were allocated from the health insurance fund's budget. In 2005, the minimum hourly pay for doctors grew by 32%, for

nurses by 36% and for nursing staff by 25%. A rise of 13.6%, 2.9% and 15% respectively was agreed on for 2006. A wage increase arising from the wage agreement apparently will decrease this year since growth rates in 2006 are by far smaller than in 2005.

A considerable wage hike occurred in agriculture and forestry (18% and 16.6%, respectively). A rapid wage rise in agriculture may partly be explained by a change in the employment structure – by a rise in the share of salaried employees, and secondly, by transfers from the EU structural funds.

In manufacturing wages grew slightly faster than the average of fields of activity – 12.8% on overall average of 11.4% of total economy. The wage rise in the mining industry remained the lowest.

The wage rise in the non-tradable and tradable sectors shows⁵ that in 2005 the respective rise in the tradable sector was faster than in the non-tradable sector (see Table 3).

Table 3. Growth in average gross wages by fields of activity (%)

	2002	2003	2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005	2005
Average of fields of activity	11.5	9.4	8.4	10.1	11.8	10.9	12.8	11.4
Tradable sector	9.6	9.5	8.7	11.5	12.7	12.5	14.3	12.7
Agriculture	18.3	8.9	13.1	12.2	19.2	19.9	19.8	18.0
Forestry	3.4	13.3	22.9	22.1	13.0	14.4	17.3	16.6
Fishery	19.4	-4.4	-1.4	-2.5	8.4	25.7	-7.4	4.5
Mining industry	9.0	9.3	6.6	-1.9	-1.9	2.1	3.4	0.6
Manufacturing	10.0	9.0	8.4	12.0	12.7	12.1	14.4	12.8
Non-tradable sector	12.1	9.6	8.2	9.4	11.4	10.2	12.4	10.8
Electricity, gas and water supply	8.8	9.3	6.0	13.6	13.3	13.0	14.5	13.6
Construction	12.6	13.5	11.7	11.1	19.6	13.6	14.1	14.6
Retail and wholesale	9.8	14.5	2.6	2.7	7.5	6.1	12.0	7.1
Hotels and restaurants	-5.8	17.7	8.5	28.1	20.9	16.1	24.3	22.1
Transport, storage and communications	9.4	4.1	9.3	10.3	11.4	8.1	13.0	10.7
Financial intermediation	8.2	9.8	3.0	11.3	7.7	10.4	9.6	9.8
Real estate, renting and business activity	28.9	-0.4	15.4	3.8	8.6	4.9	6.9	6.1
Public administration and defence	12.7	8.7	8.2	10.1	7.4	9.6	11.2	9.6
Education	12.5	9.4	10.3	12.1	11.3	10.8	11.2	11.4
Health and social welfare	4.5	15.0	13.9	23.6	19.3	21.1	20.4	21.0
Other services	7.4	8.3	14.3	8.0	14.6	15.7	10.9	12.2

Manufacturing accounts for nearly 80% of the tradable sector; the wage rise in the non-tradable sector is kept down by trade with its modest wage growth, which accounts for about 20% of the non-tradable sector.

As opposed to 2004 when the public sector led the wage rise, in 2005 the fastest wage rise occurred in private enterprises owned by Estonian residents. In 2005 wages in Estonian-owned enterprises grew by 13.3% (7.1% in 2004 on average) in the public administration by 10.3% and in local governments

administration by 11.8%. The average wage rise was the lowest in foreign-owned enterprises (see Figure 8).

By counties, the wage rise was the largest in Jõgeva County for the second successive year, 14.3% in 2004 and 24.6% in 2005. The wage rise exceeded 15% in several small counties, especially in Southern Estonia. In Tallinn with its highest wages, the wage rise only reached 7.3%, being a modest acceleration from 6.9% in 2004. In Ida-Viru County it was close to the average – 11.6%.

⁵ An economic sector is non-tradable when its enterprises do not compete with foreign enterprises.

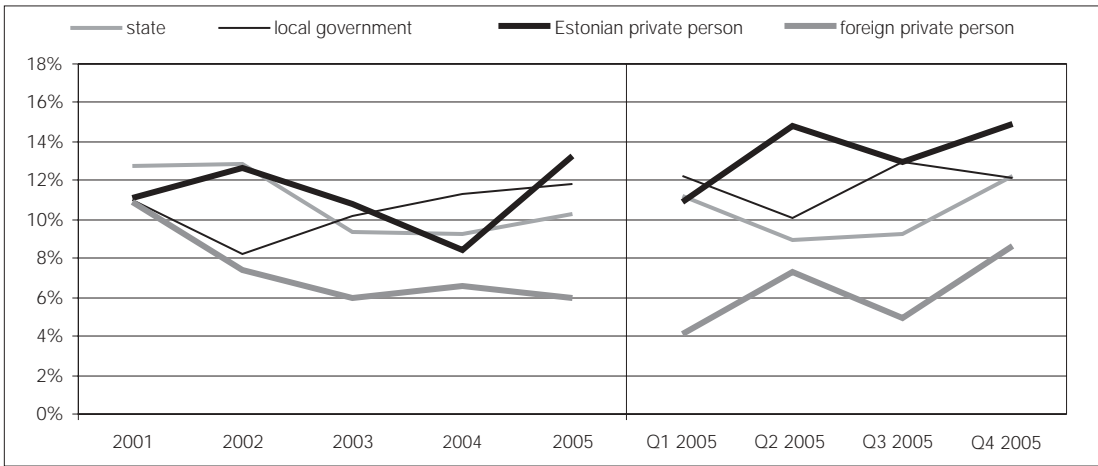


Figure 8. Average wage growth by the owner of employers

Reservation wage of the unemployed
 According to the labour force survey the share of the unemployed who wanted at least 5,000 kroons in wages in order to accept a job rose from 34% to 47.4% in 2005. The share of such unemployed people increased among men in particular. The minimum wages were 2,690 kroons in 2005. Thus, a total of 68.7% of the unemployed would not have worked for the minimum wages, i.e. 80.4% of men and 54.2% of women, respectively.

When we look at the educational level of the unemployed, the impression is that only men with primary education are ready to work for the minimum wages; as for women, it is those with primary education and part of those with secondary education.

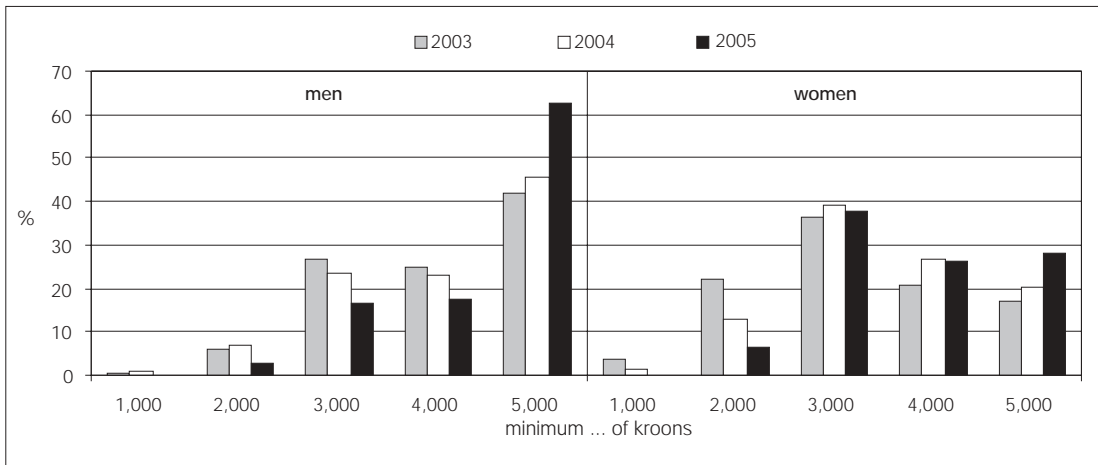


Figure 9. Reservation wage of the unemployed

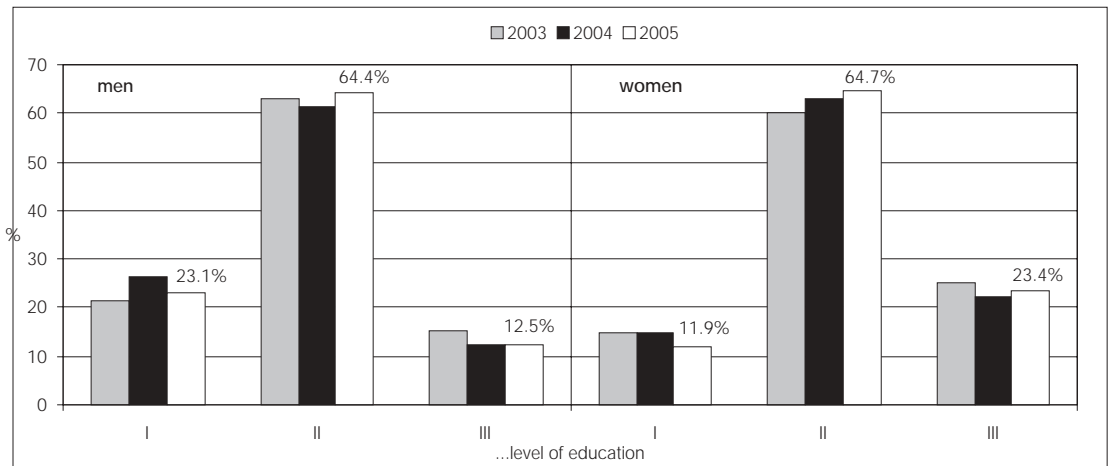


Figure 10. Educational level of the unemployed

Real unit labour costs

Real unit labour costs is an indicator which compares the amount of outlays per employee (mostly wages and taxes on labour) and labour productivity in current prices. It actually considers how much of the value added is spent on labour compensation. Following the definition the growth rate of unit labour costs is positive when labour costs per employee grow faster than labour productivity in nominal terms. When real unit labour costs increase, it normally indicates a decrease in the share of employer's profit in the value added.

Several foreign institutions follow the development of nominal labour unit costs, by comparing labour costs per employee with real productivity, not productivity calculated in current prices. The aim is to analyse inflationary pressures caused by the wage rise whereas enterprises have to increase prices of their products in order to retain their profitability when wage rise exceeds productivity.

The figure below shows that real unit labour costs have been fluctuating around zero for years. In 2003

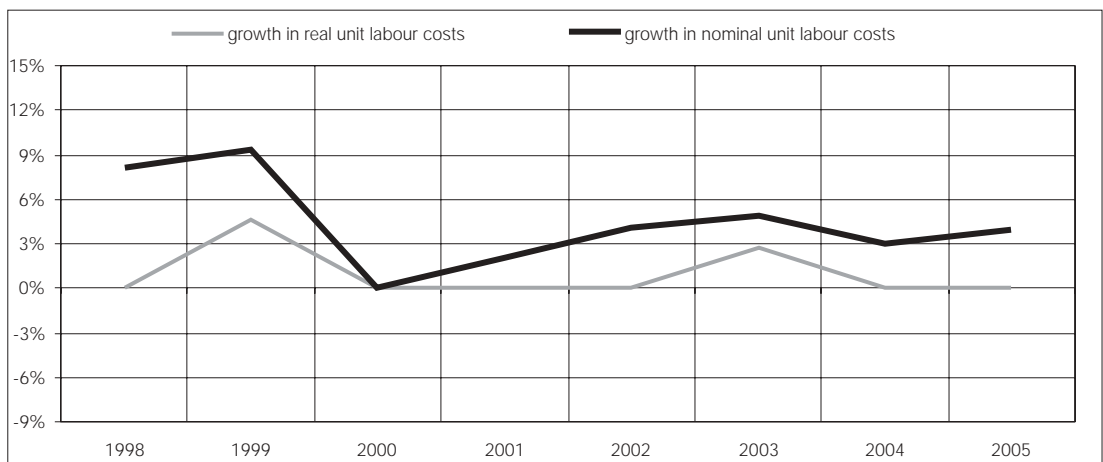


Figure 11. Growth in real and nominal labour unit costs

the share of labour costs in GDP grew, evidently due to inflation, which was lower than predicted, but the next year the growth was again near zero and negative in 2005 (-2.2%). The growth of nominal labour unit costs accelerated from 3% in 2004 to 3.9% in 2005. An analysis of the components of inflation in 2005 shows that acceleration in inflation was largely caused by a rise in fuel and regulated prices. The contribution of core inflation, where the impact of the wage increases should show, was negligible.

Development of labour costs by sectors

A rise in labour unit costs has been the lowest in the secondary sector, including manufacturing. Since manufacturing is a field open to foreign competition and the output of which is exported to a great extent, manufacturing enterprises have fewer opportunities to influence the price of their production than the non-tradable sector. In the interests of maintaining competitiveness of this

sector it is especially important that a rise in labour costs does not exceed that in productivity and the rise in competitors' prices. In 2005 the rise in labour costs in manufacturing equalled the rise in productivity. The indicators of the secondary sector in Table 4 shows a slightly faster rise in labour costs because they include the construction sector.

A rise in nominal labour costs has been rather high in the public sector, but interpretation of this indicator should be careful. Since many services provided by the public sector do not have a market price, distinction between the rise in prices and real productivity might be inaccurate. On the other hand, a faster rise in the labour costs in the public sector is rather natural arising from higher qualifications of the employees in the sector and relatively low wages in comparison to the developed countries. Also, a rise in labour costs in the public sector does not have a direct impact on the rise in consumer prices since most services of the public sector are funded from the national budget.

Table 4. Growth in unit labour costs based on GDP statistics

	2000	2001	2002	2003	2004	2005
Growth in real unit labour costs						
Total economy	-5.7	-3.3	-0.2	2.8	-0.1	-2.2
Primary sector	-9.5	6.9	1.2	-3.7	1.10	-3.0
Secondary sector	-5.5	-2.1	-1.0	1.6	-1.1	-2.9
Private sector service providers	-5.4	-4.8	-1.2	4.8	-0.5	2.5
Public sector	-1.3	-2.7	0.9	1.0	1.2	-2.0
Growth in nominal unit labour costs						
Total economy	-0.6	2.1	4.1	4.0	3.0	3.9
Primary sector	-5.2	17.1	5.6	-2.7	13.6	4.5
Secondary sector	-0.9	2.8	-0.2	3.9	2.8	2.1
Private sector service providers	-0.6	0.3	3.8	4.6	1.3	5.0
Public sector	0.5	3.5	8.5	11.8	8.2	6.6

Sources: Eurostat, author's calculations

Institutional developments of the labour market

On 8 February 2006 the Riigikogu adopted an amendment to the Employment Contracts Act which repealed the employers' right to terminate an employment contract on the grounds of employee's age. On the one hand, the repealed provision to a certain extent contradicted a prohibition in the said act on discrimination on the grounds of age, on the other hand, for employers a repeal of this provision means a potential rise in redundancy payment costs. Previously, expected redundancy cost regarding hiring an employee close to retirement age was zero, but it is equal to all other employees now. It is unknown to which extent such a consideration has influenced employment decisions but probably it has not had any significant importance.

On 1 January 2006 the non-taxable income threshold rose from 1,700 kroons to 2,000 kroons and the income tax rate decreased from 24% to 23%; the employee's unemployment insurance contribution decreased from 1% to 0.6%. In the case of 3,000-kroon wages (minimum wage in 2006) such changes refer to a 4.3% and in the case of 8,986-kroon wages (forecast of Eesti Pank for average wages in 2006) a 3.4% rise in net wages. In 2007 the non-taxable income threshold remains unchanged but the income tax rate will further decrease by a percentage point.

Table 5. Estonian labour market

		2004		2005					
Population (as at 1 January)	thousand	1,351.1	1,347						
Labour market status of 15 to 74-year-olds		2003	2004	2005	Q1 2005	Q2 2005	Q3 2005	Q4 2005	
Labour force	thousand	660.5	659.1	659.6	656.7	663.1	657.5	661.1	
employed	thousand	594.3	595.5	607.4	594.5	609.1	611.4	614.6	
unemployed	thousand	66.2	63.6	52.2	62.2	54	46	46.5	
Inactive	thousand	387.4	388.7	389	391.1	385.4	391.1	387.5	
Total	thousand	1,047.8	1,047.8	1,048.6	1,048.6	1,048.6	1,048.6	1,048.6	
Labour participation rate	%	63	62.9	62.9	62.6	63.2	62.7	63	
Employment rate	%	56.7	56.8	57.9	56.7	58.1	58.3	58.6	
Unemployment rate	%	10	9.7	7.9	9.5	8.1	7	7	
Employed by fields of activity									
Agriculture and forestry, fishing	thousand	36.7	35	32.2	34.5	35.1	31.7	27.4	
Mining and quarrying	thousand	5.7	8	5.9	5.7	4.4	6.3	7.3	
Manufacturing	thousand	134.1	140.9	139.5	131	146	143.5	137.3	
Electricity, gas and water supply	thousand	10.2	12	12.5	14.6	12.6	12.6	10.2	
Construction	thousand	42.9	46.8	48.7	43.7	45.1	53.4	52.5	
Wholesale and retail trade	thousand	80.8	80	80.6	77.1	82.9	81.3	81.1	
Hotels and restaurants	thousand	17.4	16.2	22.1	22.6	22.4	19.7	23.5	
Transport, storage and communications	thousand	56.2	51.5	54.6	59	54.2	49.8	55.3	
Financial intermediation	thousand	7.6	7.9	6.9	7.2	6.5	7.6	6.2	
Real estate and business activities	thousand	44.4	39.4	46.4	44.7	45.9	46.3	48.8	
Public administration and defence	thousand	34.5	36.9	37.2	36	33	40.3	39.4	
Education	thousand	56.9	54.5	54.9	54.4	58.1	53.2	54	
Health care	thousand	36.4	37.5	35	39	33.3	32.5	35.3	
Other sectors	thousand	30.4	28.8	31.1	24.9	29.7	33.3	36.3	
Unemployed by duration of unemployment									
less than 6 months	thousand	25.6	21.2	18.6	20.6	17.8	16.7	19.3	
6–11 months	thousand	10.2	9.2	5.7	8.6	7.4	3.1	3.6	
12 months or more	thousand	30.4	33.2	27.9	33	28.8	26.2	23.6	
24 months or more	thousand	20.1	21.5	18.2	20.1	19.5	17.2	16.2	
Inactive by reason of inactivity									
Education	thousand	119.5	123.1	126.1	130.5	116.3	124.3	133.2	
Illness or disability	thousand	44.9	43.3	47	44.7	48.5	41.9	53.1	
Pregnancy, maternity or parental leave	thousand	22.7	27.2	27.1	27.3	25	30.7	25.5	
Need to take care of children or other members of family	thousand	14.8	13.7	14	13.1	13.7	16.6	12.6	
Retirement age	thousand	152.8	149.4	145.4	144.9	149.5	145.2	142	
Discouraged people (lost hope to find work)	thousand	18.1	17.7	14.7	16.1	16.6	16	10.3	
Other reason	thousand	14.5	14.4	14.6	15.4	15.8	16.4	10.7	
Labour force according to educational level									
First level and less	thousand	71.6	73.2	65.1	59.7	65.5	70.5	64.8	
Second level	thousand	383.7	375.6	367.4	375.7	372.7	356.7	364.6	
Third level	thousand	205.1	210.3	227	221.4	224.9	230.3	231.7	
vocational education with secondary education	thousand	71	70	67.6	71.1	67.7	66.1	65.5	
higher education	thousand	134.1	140.4	159.5	150.3	157.2	164.1	166.2	