

BACKGROUND INFORMATION

UNEMPLOYMENT IN THE TRANSITION PERIOD

Over the last two years the increasing unemployment in Estonia has reinitiated an active discussion about labour market trends and their analysis. During the 1999 economic recession falling employment and growing unemployment seemed inevitable. Contrary to expectations, the same processes continued during the relatively rapid economic growth in 2000 as well (see Figure 2b). Recent developments show that we should differentiate between:

1. Unemployment and its changes;
2. Employment and its dynamics.

While the employment reflects primarily production potential and business cycle, the level of unemployment reflects also demographic aspects and attractiveness of benefits accompanying the status of the unemployed.

Retrospectively it is not clear whether during the transition period unemployment or employment

dynamics has offered more surprises. According to widespread concepts, the high unemployment rate in transition economies is primarily due to time-consuming transfer of jobs from the public sector (including state-owned enterprises) to the private sector. Such an approach is based on the premise that the pre-transition economic potential has been properly assessed. This is difficult to achieve. Thus, the extent of the so-called transitional recession at the beginning of the transition period was a surprise for most of the experts and temporarily it has been treated as a largest recession in the last 200 years. Definitely, in case it is not a measuring error.

For historic reasons it is not clear how extensive was the hidden unemployment during centralised planning economy. According to the current data, the employment decreased in Estonia in 1989–2000 by 27%, GDP by just above 20%. Contemporaneously the unemployment rate has exceeded 13%¹. Unfortunately

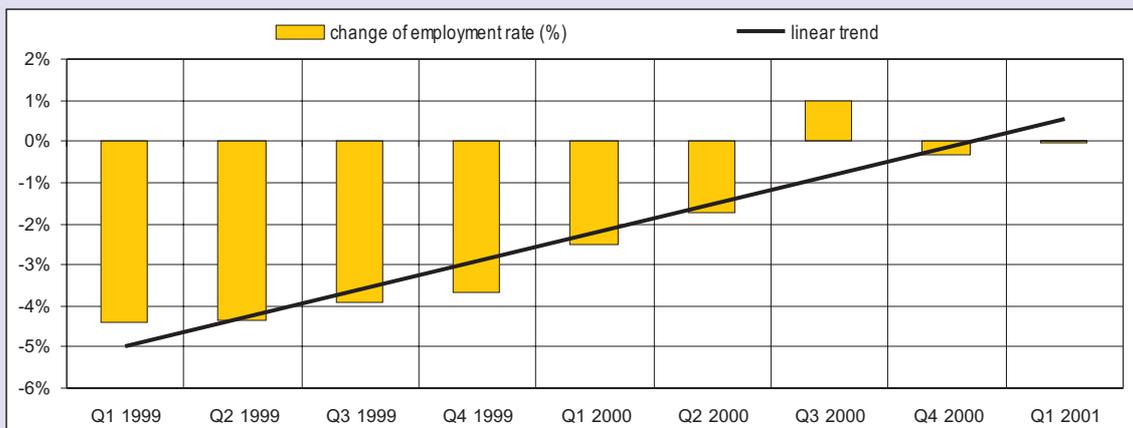


Figure 2b. Employment dynamics (against the respective period of previous year)

¹ While in Central European countries cumulative transitional recession was limited to about 30%, the indicator in Estonia reached almost 40% in 1989–1994. The validity of this data will probably remain controversial in future as well.

this data does not provide an answer to the question which unemployment level could be natural and to what extent it should differ from the average of the European Union (8.5%). Conducting relevant studies is difficult, as the methodology for determining the natural unemployment level based on historic experience and time-series cannot be used in case of transition economies. The main obstacle in determining the natural unemployment rate lies in the lack of the concept what the job-creation process in a transition economy should look like.

Employment vs Investments and Productivity

The development of employment depends largely on investments, their efficiency and distribution between sectors. Labour market developments in transition economies also depend on the level and quality of investments originating from the command economy. The complicity in assessment makes it difficult to measure the fixed capital per worker.

Balassa-Samuelson hypothesis assumes that the development of small open economic systems can be based only on the open, ie exporting sector. The technological-development-based (investment-based) preferential growth of productivity in this sector facilitates decreasing income and price difference between industrial countries and transition economies. However, these differences are still high and difference in the inter-state income level is seen to lie in the too small productivity of the open sector and its growth in transition economies against rich countries and other sectors of economy of the country. Slow growth of productivity in the open sector does not enable to create new jobs in the extent to increase employment. This has been said about Estonia as well.

In a simplified approach the open sector can be identified with manufacturing and all other activities with the sheltered sector (conditionally the services sector). Most of the theoretical research assumes that the productivity of the services sector is quite similar in countries with different levels of development. As most of the investments under planned economy were not profit-oriented, the services sector inherited from the command economy was underdeveloped and inefficient. Thus, after the transition to market economy it was possible to develop the services sector whereas in Estonia the value added per worker increased by more than 40% in 1995–2000. Considering the experience of developed countries, such growth is exceptional.

*Contemporaneously in manufacturing productivity grew by over 80%. **The difference is really significant but simultaneously shrinking employment confirms that the productivity growth in the open sector did not suffice to employ the existing workforce**². The year 1997 was an exception with productivity in the open sector growing five times more than in the sheltered sector. Up to now this has been the only period when the drop in employment was suspended due to rapidly growing construction sector (the employment even amounted to a rise just under 0.5% against 1996). We can conclude that economic policy favourable to economic potential, eg continuously improving investment climate, is contemporaneously the best policy to cut unemployment.*

Structural Aspect of Unemployment

The current high unemployment level is partially also of structural nature, subject to low geographical mobility of the labour and limited skills. On the premise that there is a high number of vacant jobs, the

² The relatively slow growth in productivity (eg compared to the United States) is often outlined as the key reason for high unemployment level in the European Union.

unemployment level could be relatively fast decreased by upgrading training and retraining systems.

The main objective of the labour market policy at the current high unemployment level should be flexible supply-side of the labour market. This is the only way:

- 1. To meet existing labour market demand for skilled labour;*
- 2. To ensure labour for future investments and new jobs.*

The flexible labour market is one of the main prerequisites for the large part of the population to participate in using economic-growth-related benefits.