

STANDARD OF LIVING AND LABOUR MARKET TRENDS IN ESTONIA – A COMPARISON WITH OTHER EUROPEAN UNION COUNTRIES DURING THE RECESSION

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The article discusses the trends in the Estonian labour market in comparison with other European Union countries. The main focus is on the years of the recession, but the developments of some indicators are analysed since Estonia's accession to the European Union. The main things considered are economic activity rate, employment, unemployment and long-term unemployment, part-time employment and labour policy measures. Comparisons of wages and the Purchasing Power Standard are used to compare the standard of living.

Introduction

Soon Estonia will have been a full member of the European Union (EU) for ten years, being able to contribute to decisions that affect the development of the Union as a whole. Based on the EU average indicators (derived from the indicators of the Member States), the European Union has not been a driving force of global development in recent years. However, average indicators often suffer from a common problem. In Estonia, a vivid example of this is the announcement that average wages have increased, which always leads to fierce debates due the following fact – an increase in average wages does not mean that all employees receive higher wages: there are some whose wages have increased, but also some whose wages have decreased instead. The same applies to developments in the EU Member States. When the average unemployment rate in the EU goes up, this does not necessarily mean that the rate has increased in all Member States, and some countries may even experience a decrease in the unemployment rate. This train of thought leads to one of the central questions of this article: is Estonia with its trends a Member State that helps to improve the EU's average indicator values, or vice versa? The article does not focus on all areas of life but only on the factors that have the biggest immediate impact on people's subsistence: labour market trends and changes in the standard of living, incl. incomes.

Trends of key labour market indicators in Estonia and other EU countries

Changes in the number and share of labour market participants, employed persons and unemployed persons among the working-age population are the most common indicators used to assess general trends in the labour market.

The economic activity rate, i.e. the share of the labour force (employed and unemployed persons) in the total working-age population (aged 15–74), was 67.8% in Estonia in 2011. The activity rate has gradually increased over the years, growing by more than five percent in the past ten years. In 2011, the EU average was 63.5%, which means that the share of the economically active persons in Estonia exceeded the EU average. At the same time, there are quite large differences between the EU Member States. For example, the activity rate was 54.3% in Malta and 71% in Sweden. On average, the activity rate in EU Member States has increased by a couple of percentage points in the past ten years. The average increase does not mean an increase across the board and does not exclude the possibility of a decrease in some countries. For example, compared to 2002, the share of economically active population decreased in Finland and Denmark, while Spain and Estonia recorded the highest growth. The Netherlands, Denmark and Sweden continue to have the highest activity rates.

The economically active population includes persons who are willing and able to work. Consequently, an increase in the activity rate does not provide immediate information on the state of the labour market or the economy, for example, because the willingness to work may not be realised in practice. The economically active population is divided into employed persons and jobseekers, with employment rate and unemployment rate used as indicators for these groups. The employment rate reflects the share of employed persons in the working-age population, and the unemployment rate reflects the share of the unemployed (persons who are not employed, but are able to work and want to find work) in the labour force. In the 2nd quarter of 2012, Estonia's employment rate was 61.3%, which was above the EU average (57.4%). At the same time, the highest employment rates were recorded in the Netherlands, Sweden, Austria and Denmark, and the lowest in Greece, Italy and Spain (Figure 1, p. 22).

The employment rate data for the 2nd quarter of 2012 indicate that Estonia has a rather good position among EU countries. But before we can draw any in-depth conclusions, it is necessary to consider several aspects. Traditions can play a significant role in employment rate values, especially in Southern European countries. In Greece and Italy, for example, the employment rate of women is significantly lower than in Estonia, which enables Estonia to rank higher than these countries (based on employment rate) even in times of recession. Another important factor is retirement age, which also varies a great deal between countries. Traditions and pension systems are not going to change over a short period of time, which means that any changes in the labour market in the last two years, for example, should mainly be associated with economic factors. Also, the data for a single quarter do not reveal whether Estonia has done well in terms of the employment rate or have Estonia's figures simply been less poor than in other European Union countries.

It is somewhat complicated to pinpoint the exact time when the economic crisis began or when the recession was first manifested in the labour market. This becomes especially complicated when we want to compare countries, as the crisis started to impact labour market indicators at different times in different countries. Based on the majority of EU countries, we could say that economic difficulties became fully manifest in the labour market from the 4th quarter of 2008, which was the starting point of a decrease in employment rate in most EU Member States.

In the preceding quarter (3rd quarter of 2008), Estonia's employment rate was 63.3%, i.e. about two percentage points higher than in the 2nd quarter of 2012. This difference could be reduced to an extent by taking into account seasonal effects (seasonal work in the 3rd quarter), but it would not be sufficient to bring the two employment rates to the same level. At the same time, we cannot say that the employment trends in Estonia have been wholly negative. It would be more accurate to conclude that, after a significant drop, the employment rate has not quite returned to the level in the boom period. If we take the 1st quarter of 2010 as the reference point (when Estonia's employment rate was the lowest), the increase in Estonia's employment rate thereafter has been one of the fastest among EU countries: only four countries are above Estonia (Figure 2, p. 23). However, in 2009, Romania, Lithuania and Estonia all stood out with a fast decrease in employment.

Even though Estonia also had one of the fastest decreases in employment, it has reason to be proud of the turnaround towards growth in the 2nd quarter of 2010, especially considering that the employment rate is still falling in a number of EU countries (such as Greece and Spain). The fact that the economic activity rate did not change significantly when the employment rate dropped indicates that the fast decrease and the subsequent relatively fast increase in the employment rate were also reflected in the unemployment rate. In other words, if the activity rate had decreased significantly simultaneously with the employment rate, this would have meant that many people who lost their jobs had given up further job searching and would have been counted as inactive.

Estonia's unemployment rate in the 2nd quarter of 2012 was 10.2%, which was lower than the EU average for the first time after a long period. Compared to other EU countries, Spain and Greece had significantly higher unemployment rates at 25% and 24%, respectively. The lowest unemployment rates were recorded in Luxembourg (4%) and Austria (4.3%) (Figure 3, p. 24).

One concept used in the context of unemployment is 'natural unemployment', which is caused by technological developments and the movement of the labour force between jobs. In case of natural unemployment, 4–6% of the economically active population are unemployed. Consequently, a certain level of unemployment is inherent even in well-functioning labour markets. In addition to Luxembourg and Austria, the unemployment rate in the 2nd quarter of 2012 was close to the natural level also in Germany and the Netherlands. The last time that Estonia's unemployment rate was within the limits of natural unemployment was in the 3rd quarter of 2008, after which the unemployment rate started to increase rapidly. With the increase in employment rate, the unemployment rate started to fall again in the 2nd quarter of 2010 but – similarly to the employment rate – the unemployment rate has not yet reached the pre-crisis level.

Since the 2nd quarter of 2010, Estonia has had the fastest decrease in the unemployment rate among EU countries – at the same time, Estonia's unemployment rate in the 1st quarter of 2010 was so high that this rapid decrease only meant that the rate fell down to a level comparable to the EU average. Nevertheless, the downward trend of the unemployment rate is quite noteworthy, especially in the EU context where unemployment has not decreased but mostly increased in the past two years. Figure 4 (p. 25) compares the unemployment rate in Estonia, in the nearby Latvia and Finland, and in the Southern European countries that are currently in the most difficult situation. In the 1st quarter of 2010, Latvia, Spain and Estonia were all in a very similar unenviable starting position. At the same time, Greece and Finland had significantly lower unemployment rates. In the 2nd quarter of 2012, Finland's unemployment rate was comparable to its starting position, while the rate had decreased significantly in Latvia and even more in Estonia. However, in Spain and in Greece, the unemployment rate continued to increase, whereas the increase was particularly dramatic in Greece.

Economic cycles have an impact on the unemployment rate and the number of employed persons in the labour market. The unemployment rate generally drops in boom years and rises during difficult periods. However, the unemployment rate increases differently across economic activities and social groups. It has been found that economic cycles have a stronger impact on people with a lower level of education (Dustmann 2009). Dustmann's claim is supported by the data on changes in unemployment rates by education. In most EU countries, the unemployment rate of economically active people with higher education (ISCED 5 and 6) has been close to the natural unemployment rate throughout the crisis. In the 2nd quarter of 2012, the unemployment rate of people with this level of education was 4.9% in Estonia. Greece and Spain were the only countries where higher education did not reduce the risk of unemployment. In the 2nd quarter of 2012, the unemployment rate of the economically active population with higher education reached 17.7% in Greece and 14.6% in Spain.

When we consider the impact of sex and age on the main labour market indicators in different countries, the trends vary a great deal. In some countries, the crisis clearly had a stronger impact on men. Estonia can also be considered one of those countries, as in the 1st quarter of 2010 the difference in the unemployment rates of men and women was 10% (14.6% for women and 25.2% for men). Young people are another group that tends to be at a greater risk in difficult economic times, as they find it difficult to enter the labour market at a time when the number of jobs is decreasing, and are forced to extend their studies or become unemployed. For example, in the EU as a whole, the average unemployment rate among the population aged 20–24 in the 2nd quarter of 2012 was twice as high as the overall unemployment rate. When the extent of such differences is analysed by social group, we can see that the biggest variation in EU countries occurs in the unemployment rate of young people. For example, in Austria and the Netherlands, the unemployment rate of the population aged 20–24 has remained steadily below 10% throughout the crisis years. On the other hand, in Greece and Spain, half of the young people aged 20–24 in the labour market were unemployed in the 2nd quarter of 2012. The situation was not quite as disastrous in Estonia, but the 22% unemployment rate of this age group in the 2nd quarter of 2012 was far from ideal.

Long-term unemployment and part-time work in Estonia and other EU countries

The long-term unemployed are exposed to the greatest risk of poverty. Long-term unemployment means that a person has been looking for a job for over 12 months. It means the loss of or a decrease in permanent income and smaller likelihood of finding a new job. Long-term unemployment reduces the value of the skills and knowledge acquired through previous work and education, and leads to a loss of the habit of working. Furthermore, employers are often sceptical about the work abilities of the long-term unemployed (Bourdet, Persson 1991). Long-term unemployment can cause a rapid fall in self-esteem and quality of life, forcing the unemployed person into a constant struggle with stress, difficulties in coping and emotional exhaustion (Venesaar 2004). One of the reasons of unemployment (incl. long-term unemployment) is structural unemployment, which means that the qualifications of the labour force or the geographical locations of potential employees and employers do not match the demand in the labour market. Structural unemployment means the simultaneous existence of vacancies and unemployed persons.

In 2009, the share of the long-term unemployed among all unemployed persons was lower than in 2011 in all EU countries. The main reason for this was not the fact that many unemployed people were able to find a new job in less than a year, but rather the addition of many new unemployed persons in 2009. By the year 2011, the share of the long-term unemployed among unemployed persons had increased significantly, being the highest in Estonia, Ireland and Slovakia. In Finland and Sweden, however, the long-term unemployed constituted only about one fifth of all unemployed persons (Figure 5, p. 26).

When employers experience difficulties, they sometimes transfer employees to part-time work as a way to cope, for example, when the number of orders decreases. Both employees and employers can benefit from flexible working hours. What either side thinks about such flexible working time arrangements depends on the position, industry and personal preference.

Employers may want to establish flexible working arrangements in case of seasonal work, for example, or during periods of increased workload when employees have to work overtime (Tijdens 2003). According to De Wolff (2000), employees tend to prefer standard employment contracts with fixed working hours. This allows them to plan the time that they can spend with their families, for example. At the same time, employees expect flexibility in working hours in case of unexpected events, such as family matters, illness etc. (De Wolff 2000). Consequently, flexibility of working hours is, above all, down to compromises between employees and employers. Part-time work is one of the most analysed indicators of time flexibility (Wallace 2003). Part-time work refers to working less than 35 hours a week. As an exception, this definition does not apply to jobs where shorter working hours are stipulated by law.

According to Krillo (2007), part-time work helps enterprises to be flexible and adapt to economic cycles: during the times of growing economy, employers can increase the number of part-time workers to prevent (or alleviate) problems caused by shortage of labour; conversely, during a recession, workers (all or some) can be transferred to part-time work, which helps employers to cut labour costs while keeping the employees who are familiar with the enterprise's business. Furthermore, part-time work enables those who are unwilling or unable to hold full-time positions (particularly mothers of small children, students and older people) to achieve a better work-life balance (Krillo 2007).

The majority of employed persons in the EU work full-time, but the share of part-time workers among all employed persons has increased somewhat, reaching 19% in 2011.

Most of the part-time workers are women, with the main reason being better reconciliation of work and family life. In the EU on average, 8.8% of men and 32% of women held part-time jobs in 2011. In addition to gender differences, there is also major variation between countries. Eastern European countries, incl. Estonia, are notable for the fact that the share of part-time workers is low among both men and women. For example, in 2011, only 15% of employed women in

Estonia had part-time jobs compared to 45% in Germany. The differences between countries are mainly caused by traditions, opportunities to balance work and family life, and the organisation and practices of the labour market. Consequently, the impact of the economic crisis is not reflected by part-time employment per se, but rather when people work part-time because they are unable to find full-time jobs. Economic difficulties have indeed increased the share of those who only hold part-time positions because they have not been able to find full-time jobs. There were only a few countries where the share of such people among employed persons did not increase in 2011 compared to the period before the crisis. The rate of increase has been different in different countries, depending on whether and how the problems in the labour market have been exacerbated. In 2011, inability to find a full-time job was the most important reason for part-time employment in Spain, Bulgaria and Greece. It was the least important as a reason for part-time work in the Netherlands. In Estonia, about 20% of part-time workers were willing but unable to find a full-time position in 2011, which means a 6% increase compared to 2008 (Figure 6, p. 28).

Labour market interventions in Estonia and other EU countries

Active labour market policy is often seen as an effective means of achieving a better rate of employment – by helping people to cope with rapid changes in the labour market, reducing the duration of unemployment periods, and simplifying movement between jobs. Active labour market policy is an essential component of flexicurity. It contributes to a sense of security among labour market participants, making it easier for people to find suitable jobs, providing in-service training or offering start-up assistance (Vörk et al 2010). The labour market policy database of Eurostat defines labour market policy as “public interventions in the labour market aimed at reaching its efficient functioning and correcting disequilibria and which can be distinguished from other general employment policy interventions in that they act selectively to favour particular groups in the labour market” (Vörk et al 2010, according to Eurostat). The subjects and expenditure of labour market interventions are divided into three groups, with the first two groups covering expenditure on active labour market policy and the third covering expenditure on passive labour market policy. These three categories are:

- *Services, which refers to services offered by public employment agencies and other interventions which are not directly related to the unemployed; the main purpose is to provide assistance in job searching, and these services do not necessarily result in a change of labour market status;*
- *Measures, which refers to interventions aimed at the activation of people, including employment training, job rotation and job sharing, wage subsidies and other employment support measures, measures for disabled persons, creation of new jobs, business start-up measures; these activities are not related to job searching and they usually result in a change of labour market status; these interventions are usually limited in time, except for support measures for the disabled which often continue throughout the period of employment;*
- *Supports, which refers to financial assistance granted to compensate individuals for loss of income due to unemployment (this mainly includes various unemployment benefits and early retirement old-age pension due to labour market reasons) (Vörk et al 2010, according to Eurostat).*

Expenditure on labour market policy interventions has traditionally not been a very high priority in Estonia. Considering both passive and active interventions, the level of expenditure on labour market interventions was indeed low in Estonia in 2006 when this expenditure amounted to just 0.15% of the GDP (GDP is the sum of gross value added of all resident producers in the economy). However, the situation was quite different by 2009, i.e. the time when unemployment started to rise rapidly. It is true that expenditure on passive interventions constituted most of the growth but, nevertheless, Estonia's spending was now around the EU average, with 1.62% of the GDP.

The countries where expenditure on labour market policy interventions rose by 2009 were mostly countries with a rapidly growing unemployment rate. In addition to Estonia, such countries included, for example, Spain and Ireland as well as Latvia and Lithuania. Belgium was the biggest spender on labour market policy interventions, with Denmark, Finland and the Netherlands also ranking at the top both in 2006 and in 2009 (Figure 7, p. 29).

Main factors affecting employment and unemployment in Estonia by economic activity

Manufacturing and construction were the economic activities hit hardest by the recession. Compared to the 1st quarter of 2008, the number of persons employed in each of these activities had decreased by about 40,000 by the 1st quarter of 2010. However, these two economic activities were also the main drivers of an increase in employment and a reduction in unemployment. By the 1st quarter of 2012, the number of persons employed had increased to 122,000 in manufacturing and to 53,000 in construction (Figure 8, p. 30). Nevertheless, in both activities, the number of persons employed was still significantly below the level recorded at the start of 2008.

The number of persons employed in construction has grown compared to the deepest point of the crisis. This has been facilitated by growing building volumes in Estonia (although these are far behind the level of the boom period). Building volumes have been significantly influenced by public investments in structures (e.g. road construction) and buildings (which increases construction volume and number of persons employed). Another important factor is the fact that many builders have gone to work abroad (mainly in Finland).

The main reason for increased employment in manufacturing is the fast increase in the volume of industrial production, which has returned to a level comparable to 2008. Retail sales have also improved, compared to the lowest point of the crisis, but are still significantly behind the 2008 level (Figure 9, p. 31).

It would be logical to assume that when domestic consumption cannot keep up with increasing production, other ways have to be found to market the production. This is exactly what Estonian enterprises have done and as a result Estonia's exports, which amounted to 8.5 billion euros in 2008, grew to 12 billion euros in 2011. Estonia's closest neighbours – Sweden, Finland, Russia and Latvia – were the main export partners both in 2008 and 2011. Exports to all these countries increased, but the growth was the fastest in exports to Sweden and Russia. Exports to neighbouring countries constituted half of Estonia's total exports. Estonia's main export partners are countries who suffered less in the crisis or who have recovered better. It should also be noted that the support packages aimed at reactivating domestic markets in other countries have, importantly, also raised Estonia's export volumes. In conclusion, the significant increase in exports has been a crucial factor behind the increased level of employment in Estonia's manufacturing, and has indirectly boosted employment in other economic activities as well. In other words, the increase in orders from foreign countries has enabled Estonian enterprises to increase production and hire more employees.

Standard of living in Estonia and changes compared to other EU countries

Standard of living is often discussed in connection with well-being and quality of life. Depending on the specific approach, it is seen as a part or a separate dimension of welfare and quality of life. Erik Allardt, one of the leading scholars in welfare measurement, approaches the concept of welfare through two dimensions – standard of living and quality of life. According to Allardt, the standard of living consists of everything we have, i.e. income, dwelling, work, education and health (Allardt 1976, as cited in Grossmann 2008). A common approach in EU statistics and in Estonia is to use a narrower definition of the standard of living as GDP per capita expressed in Purchasing Power Standards (PPS) (describes the purchasing power of residents of different

countries at comparable prices). Even though people tend to talk about gross and net wages, the increase or decrease in the standard of living is best reflected by real wages, which take into account changes in the consumer price index. While real wages decreased in 2009 and 2010, the decrease stopped in 2011 and there was even a small increase (0.9%) compared to 2010. Real wages increased in the last two quarters of 2011 as well as in the 1st quarter of 2012. Compared to the 1st quarter of 2011, real wages were up 2.4% in the same period in 2012. This is a sign of improvement in the labour market. However, the increase has now remained quite moderate for three quarters and it would be too early to predict that it will continue throughout 2012 and in 2013.

When we assess the level of wages in Estonia in the wider EU context, we cannot say that Estonia's wage level is several times below others. Estonia's average wages are three or four times lower than the wages in Finland, Sweden, the Netherlands and the United Kingdom. The average level of wages in Estonia is about half of the level in Southern European countries, such as Spain or Italy. Estonia's wages are quite comparable to the level of wages in Slovakia, Hungary and Poland, and exceed the wages paid in Latvia and Lithuania and, particularly, in Romania and Bulgaria. As different countries have quite different tax systems, we also need to assess the tax rates applicable to wages, before we can draw any conclusions about the differences in wages. In Estonia, higher income is not subject to higher tax rates, whereas the situation is the opposite in the Nordic countries, for example.

Another important indicator, in addition to average wages, is the minimum wage established in a country as the lowest wage that employers are allowed to pay. Minimum wage is established by law and is applicable to the majority of full-time employees in a country. Minimum wage is calculated as gross monthly wages before the deduction of income tax and social contributions. These deductions can vary across countries. Most EU countries have established a certain level of monthly wages as the minimum wage, but Finland, for example, has not stipulated a general level of minimum wage. Instead, minimum wage has been established separately for different economic activities through collective agreements. During the period 2002–2012, minimum wage has increased in all EU countries, being the highest in Luxembourg and the lowest in Bulgaria (Figure 10, p. 32). A comparison of countries reveals the same pattern as seen in case of average wages. It means that we can distinguish different groups of countries based on the level of minimum wage, and higher average wages generally also mean a higher minimum wage in that country.

Assuming that the difference in price levels between countries is not manifold, higher wages generally mean greater purchasing power and, therefore, it is not surprising that the countries with higher wage levels are also at the top based on Purchasing Power Standard – which describes the purchasing power of the residents of different countries at comparable prices, and is one of the main indicators of the standard of living. In 2011, countries such as Luxembourg and the Netherlands were at the top of the table, while Romania and Bulgaria came last. The purchasing power of Estonian residents was 67% of the EU average in 2011, being significantly higher than in 2001 (46%). Consequently, in ten years, the standard of living in Estonia has increased significantly in comparison with the EU, if we consider this indicator alone. Estonia is currently in the same group with countries like Hungary and Poland, with the Czech Republic not too far ahead. There has also been a considerable increase in purchasing power in Latvia and Lithuania in the past ten years, but they are slightly behind Estonia (Figure 11, p. 33).

Conclusion

Until the recession, real wages were growing strongly in Estonia and the low level of unemployment was almost reminiscent of the virtually non-existent unemployment in the Soviet era. Prices grew at a very fast rate at the peak of the boom, especially in the real estate sector, but this did not reduce the demand for construction workers or for new housing developments. The growth of GDP, the main indicator of economic success, was also impressive. Unfortunately, these figures, including the seemingly excellent labour market indicators and the rising standard of living, were somewhat deceptive. Labour productivity in Estonia was and remains significantly

lower than in the strong EU economies. And although the concept of labour productivity can be interpreted differently, it is still an indication that there is a long way to go before Estonia reaches the standard of living of Nordic countries. The good indicator values were largely achieved through borrowed funds, which were mostly used for consumption instead of their investment in innovations that would have helped to increase the competitiveness of the Estonian economy, create more value added and raise labour productivity. In reality, the pattern was more like this: many home loans were granted and as a result the employment of builders increased (more houses had to be built), more employees were hired in retail (new home-owners needed to buy things for their new home) and this in turn created a need for new loans to build new commercial premises. When banks stopped granting easy loans in Estonia and elsewhere, the result was a rapid rise in unemployment. The decrease in lending in Estonia had the biggest impact on the construction sector, while similar developments in other EU countries affected Estonia's manufacturing, through the sudden drop in demand for Estonian products. Varblane (2011) has described the causal framework of the current crisis, which includes elements such as the credit crisis, competitiveness crisis (which has had varying impact on EU countries), inability to achieve current account balance (meaning that a country's imports exceed the exports of goods and services), and banking crisis. The crisis has also revealed stark contrasts between countries in terms of the existence or severity of the problems. Fortunately, Estonia's economy is mostly connected to countries where these problems are significantly less serious than in Southern Europe – this has had a positive impact on Estonia's indicators. In 2011, the standard of living in Estonia remained lower than in Spain and Greece, the two countries that are now struggling the most. If the current trends continue, we can expect the gap between Estonia and these countries to decrease further in 2012, but it will not be eliminated completely. Compared to the EU average, Estonia's standard of living in 2011 was virtually at the same level as in 2007, which can mean that, overall, we have managed to retain our standard of living despite the crisis. But it also shows that the standard of living has not increased in Estonia, when viewed separately or in comparison with other EU countries. Many ideas and solutions have been proposed for raising the standard of living (incl. income levels) – the main keywords of these proposals are increased productivity, greater value added, reduced structural unemployment, increased efficiency of the educational system, entrepreneurship and management culture, better qualifications, return of talented Estonians from abroad (the "Bring Talent Home" initiative), and so on. Clearly, when it comes to raising the standard of living, we should not focus on a single keyword. Instead, a comprehensive approach is required, and then we can expect a significant change after the next ten years. A good example is the issue of young people who go to study abroad and do not return. The main reason for their staying abroad is the lower income level in Estonia and sometimes also the fact that there are no suitable jobs in Estonia. A comprehensive solution in this case would be to make sure that the education system supports people's attempts to become an entrepreneur and an employer themselves (combined with entrepreneurship support measures in a wider sense), and that more businesses cooperate with the educational institutions that train future specialists and try to establish contacts with Estonians studying abroad.