CHAPTER 2.

FLEXIBILITY WITH LIMITED SECURITY

Estonia's flexible labour market allows companies to rapidly adjust to changing market conditions, but income security for the unemployed and the protection against violations of labour law remain limited. Recent labour market reforms have addressed several institutional problems, but the public employment service still suffers from a number of shortcomings that hinder effective assistance to job seekers. Improved activation measures are needed to ensure that those who become unemployed do not lose contact with the labour market. This chapter reviews Estonia's principal labour market policies against the benchmark of the Reassessed OECD Job Strategy.

1. Introduction

Before the economic downturn, Estonia's flexible labour market had performed very well, with rising productivity and a steady growth of employment notably for youth, women and the elderly since 2000. Unemployment shrank to a historical minimum just before the recession, but the gender-wage gap and the insufficient integration of ethnic non-Estonians remained as structural problems. The current recession has exposed the weaknesses of the country's employment services and the social safety net.

Inspired by the international debate about flexicurity, Estonia drastically reformed its labour market institutions and employment legislation in mid-2009, a decision that followed a decade of discussions between trade unions, employer federations and the government. Chief aims were to encourage the reallocation of labour to more productive jobs and to improve the social protection of the unemployed. However, due to the economic crisis and considerations of fiscal sustainability, the envisaged increase in spending on labour market policy has been largely postponed if not cancelled (*cf.* Box 2.1). The government's commitment to keeping the budget deficit under 3% restrains the provision of income support for the unemployed at a time of rising unemployment. To respond to this, tripartite discussions were held and they led to a number of policy changes, designed to tackle the effects of the crisis while respecting the short-term fiscal constraints.

This chapter reviews Estonia's main labour market policies, focussing on the observed long-term achievements and structural shortcomings. A benchmark is provided by the *Reassessed OECD Jobs Strategy* (see OECD, 2006), which gave detailed recommendations for policies to boost jobs and income while emphasising that there was no single golden road to success. Taking account of Estonia's recent labour market reforms, the country now comes closer to a high-flexibility model (resembling the United States and New Zealand) than to flexicurity (*e.g.* Denmark and the United Kingdom). The following four sections analyse employment regulations, their enforcement, labour taxation and industrial relations. Three subsequent sections consider the unemployment benefit system, employment services and issues about active programmes and lifelong learning. A concluding section summarises the key observations.

Box 2.1. Labour market and social policies to address the crisis

In March 2009, representatives of several ministries, trade unions and employer organisations agreed on a package of policy measures to tackle the recession. The main purpose is to maintain jobs and provide effective help for the registered unemployed, but most of the proposed initiatives are also part of longer-term action plans addressing structural shortcomings in the labour market (Leetma and Nurmela, 2009).

This anti-crisis package, financed mainly from the state budget and the European Social Fund (ESF), has no fixed timetable and the extent of available funding remains unclear. To address budgetary pressures, the government has reversed several potentially expensive labour-market and pension reforms that had just been legislated in a new Employment Contracts Act.

Anti-crisis package

- *Preserving jobs*. Employers can reduce working time in connection with training during a one-year period, but this is not financed by the government.[a] The government has also promised to put pressure on employers to preserve jobs.
- *Job creation*. Local municipalities are encouraged to provide community jobs for the unemployed. The public employment service's subsidy to business start-ups will be extended to unemployed persons who establish non-profit associations.
- *Vocational training*. Unemployed participants in training will be allowed to continue their training even if they find a job before the end of the training programme. The maximum length of the supported training will be extended from one to two years. The Employer Federation will report monthly to the Ministry of Social Affairs about skill needs in enterprises.
- *New financing system for vocational training*. Training vouchers have been proposed as a way to reduce the need for public procurement of courses, considered as too rigid. The unemployed would be offered a voucher with a fixed value that they can use for any training of interest.
- *Job-broking*. More IT assistance is being introduced for registration and monitoring of job seekers and vacancies.

Reversal of previously adopted policy measures in order to address budgetary pressures

- *Suspension until 2013 of the increase in unemployment benefits*. The new Employment Contracts Act included an increase in the unemployment insurance benefit to 70% of the previous wage during the first 100 days and 50% afterwards, and a more than doubling of the unemployment assistance benefit from EEK 1 000 per month to EEK 2 300 per month. Both measures have been suspended by the Parliament until 2013.
- *No widening of the coverage of unemployment benefits*. A decision to extend unemployment insurance benefits to some cases when employees quit jobs or leave them in agreement with employers has been postponed till 2013.

- *Higher unemployment insurance contribution rates.* The new Employment Contract Act increased the contribution rates from 0.6 to 1% for employees and from 0.3 to 0.5% for employers in mid-2009. As a temporary measure, the contribution rates were thereafter increased further to 2.8% for employees and 1.4% for employers, which will apply at least until the end of 2009.
- *No reduced income tax in 2009.* The planned reduction of the flat tax rate from 21 to 20% is delayed for one year, along with a planned rise of the tax-free income allowance from EEK 27 000/year to EEK 30 000 per year. An additional tax-free allowance for the first child is temporarily suspended during 2009.
- *Paternal benefit abolished.* This benefit, giving fathers ten days of paid leave, had been introduced in 2008. (Fathers can still take ten days of extra leave, though without pay. They can also take part of the 18 months of paid parental leave, of which only about 70 days are reserved for the mother. See Chapter 3.)
- An *allowance for children of school age enrolled in education*, at EEK 450 per year, was abolished.
- *Sickness benefits.* The healthcare insurance compensated 80% of the lost wage from the second day of sickness. From July 2009, this benefit is only paid from the 9th day of sickness, while employers are obliged to pay for days 4-8.
- *Reduced indexation of pensions.* The indexation of pensions is reduced from 14 to 5% in 2009.
- *Temporary interruption of contribution towards 2nd-pillar pension saving.* To boost the financing of 1st-pillar pensions, the government will allocate all employer contributions pertaining to the pension system – altogether 20% of wages – to the 1st pillar between June 2009 and the end of 2010. A legislated allocation of 4 percentage points of employer contributions to the funded 2nd pillar is suspended.
- *Suspension of employee contribution to 2nd-pillar pension.* As an exception, workers with up to eight years left to retirement can choose to keep contributing to the 2nd-pillar pension, in which case the government exceptionally pays the 4 percentage points from employer contributions to the 2nd pillar. In 2011-17, employees will have the option to save an additional 2-3% of their wages, and benefit from an additional 6-8 percentage points from employer contributions in 2nd-pillar funds.

a) Under the current system, reduced working time can be implemented for a maximum of three months during a one-year period without requirement for providing training measures.

2. Employment protection

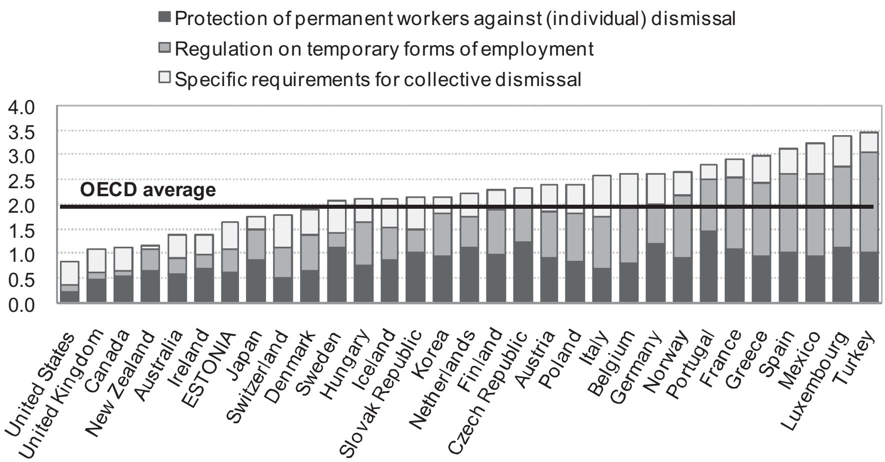
The new Employment Contracts Act introduces more flexibility

With the entering into force of the new Employment Contracts Act in mid-2009, Estonia's employment protection regulations became more flexible than those of any OECD country except the English-speaking ones

(Figure 2.1 and Annex 2.A1). The rules were liberalised on many points, reducing Estonia's overall index of employment protection from 2.4 to 1.65 according to the OECD measure.[10] For example, the previously relatively long notice periods for workers with short tenure were reduced, the possibilities for dismissed workers to obtain re-employment or compensation became more limited, and the use of fixed-term contracts was facilitated (*cf.* Box 2.2).

Figure 2.1. Employment protection in Estonia and OECD, 2008*[1]*

Average scores 0-6 from lowest to highest strictness



1. Scores for Estonia, France and Portugal refer to 2009.

Source: *OECD Employment Protection database* (*www.oecd.org/employment/protection*), updated for Estonia according to the 2008 Employment Contracts Act, which entered into force on 1 July 2009. See Annex 2.A1 for a discussion of the OECD employment protection indicator.

Whereas employment protection reforms in many OECD countries over the past two decades have focused on the liberalisation of temporary contracts, Estonia's new Act makes permanent contracts much more flexible. As discussed in the *Reassessed OECD Jobs Strategy* (OECD, 2006), this approach is preferable because it reduces the risk of labour market segmentation, a problem often observed in countries where temporary contracts are used to get around strict regulations of regular contracts. Only

10. The employment protection index has been revised slightly downwards in comparison with the *OECD Economic Survey of Estonia* (OECD, 2009a) after rectifications by the Estonian Ministry of Social Affairs.

the rules on collective dismissals remain relatively strict in Estonia. These regulations, which start applying already from five dismissals, oblige employers to notify both employee representatives and the Unemployment Insurance Fund, although the latter's approval is no longer necessary.[11]

Box 2.2. The new Employment Contract Law: key changes from 1 July 2009

The *notice period for dismissal* has been shortened from 2-4 months to 0.5-3 months. It is thus 15 calendar days after one year of employment; 30 days after 1-5 years; 60 days after 5-10 years; and 90 days after ten years or more. On the other hand, the employer must give notified employees free time for job search.

Severance pay has also been cut, and the Unemployment Insurance Fund (UIF) will carry an increased part of the costs. The employer now pays only one monthly wage, while the UIF pays one additional monthly wage to employees with 5-10 years of tenure and two monthly wages for those with at least ten years of tenure.[a]

Fixed-term contracts are now allowed if they are justified by "good reasons" arising from the temporary nature of the job, with a maximum duration of five years. But in cases of premature cancellation of such contracts due to economic difficulties, the employer must compensate the employee for the loss of income till the end of the contract term (except in bankruptcies).

The new Act includes a definition of *temporary agency work* and obliges the employer to inform the employee about the specific characteristics of the employment relationship. In addition, the 2006 Labour Market Services and Benefits Act has been amended to mention temporary work agencies as providers of labour market services.

Remuneration for unsocial working hours. Remuneration for night work – *i.e.* between 10 p.m. and 6 a.m. – is increased from 1.2 to 1.25 times the regular wage, unless the worker's salary already includes additional remuneration for working at night. Evening work – *i.e.* work between 6 p.m. and 10 p.m. – will no longer be distinguished from standard working time and will be paid as regular working hours.

To *reduce the administrative burden* for employers, several outdated register procedures have been abolished, *e.g.* work books and personnel files. The requirement to obtain approval from the Labour Inspectorate for certain procedures, such as temporary part-time work or collective dismissal, has been cancelled.

a) For employees with at least 20 years tenure, the previous redundancy benefit rules will apply until 2015. Those concerned will often be entitled to one monthly wage more than the new rules stipulate.

11. Redundancies are collective if they concern at least five employees in a firm with up to 19 employees, ten employees if total employment is 20-99, 10% if the total is 100-299, and 30 employees if it is 300 or more.

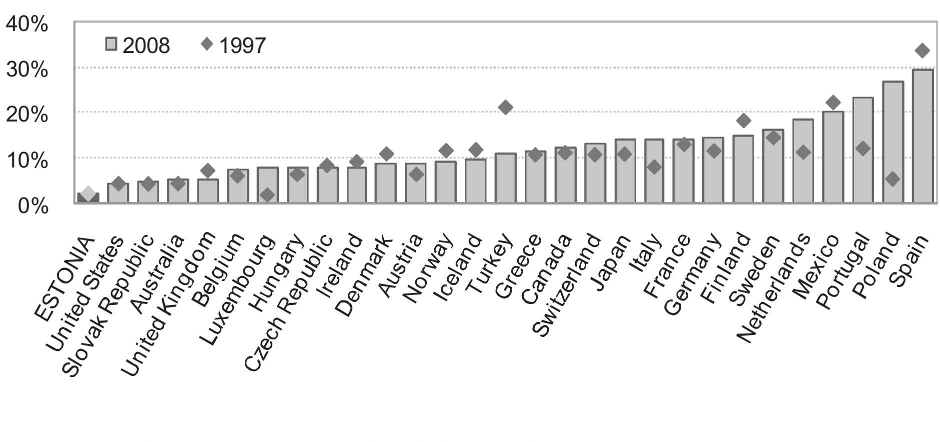
Temporary contracts remain an exception

Almost all employee jobs in Estonia are of indefinite duration, as has traditionally been the case in several other transition countries. But in contrast to some of the latter, Estonia has not seen any significant growth of fixed-term employment since the 1990s (Figure 2.2). Most employers apparently find the open-ended contracts flexible enough, apart from the construction sector (38% of all temporary jobs) and occasional service tasks (35%). While two-thirds of the temporary workers said that they would have preferred open-ended contracts in 2000, this share declined to one-third by 2008 (*cf.* European Labour Force Survey).

Estonia's new labour law makes it easier to conclude fixed-term contracts, but it also obliges employers to pay compensation on premature termination of such contracts (*cf.* Box 2.2). The need for the latter provision is questionable, and it can be expected to further discourage the use of fixed-term contracts, especially for extended contract periods.

Figure 2.2. Temporary employment in Estonia and OECD countries, 1997 and 2008

As a percentage of total dependent employment



Source: OECD Labour Force Surveys and Statistics Estonia.

Temporary work agencies (TWA) are relatively new in Estonia and many potential user companies are not aware of their existence. The first TWA started in 2002 and the sector soon expanded with the entry of international firms. A majority of TWA also provide other labour market services (Klaster and University of Tartu, 2007). No comprehensive statistics exist, but a survey in 2007 found about 50 TWA employing

2 880 workers.[12] Most of these workers used TWA as a channel for local job search, but TWA also sent workers to foreign countries (mainly Finland and Sweden). The main economic sectors of the user companies are manufacturing, construction, and transport (Roosaar and Nurmela, 2007).

As the labour law requires equal treatment of all employees, the same regulations and social security provisions apply to TWA workers and regular employees, including the length of assignments and renewal of contracts. But in practice, the TWA workers may not be eligible for social benefits due to the lack of required length of employment. On the other hand, about a third of the agencies surveyed in 2007 paid higher wages than the user company.

There is no independent quality control, but a group of TWA have introduced a self-regulation mechanism. While until 2005, a license was required and had to be renewed every three years, it is now sufficient for a TWA to be recorded in the business register. In 2005, a couple of TWA formed the Estonian Staffing Agency Association (EPREL) and agreed on a moral code. Nevertheless, the EPREL affiliates only six TWAs and about 500 TWA workers, which is probably around 12% of the TWA and 18% of its employees (Nurmela, 2008).

Working-time rules are flexible, but part-time work is not very common

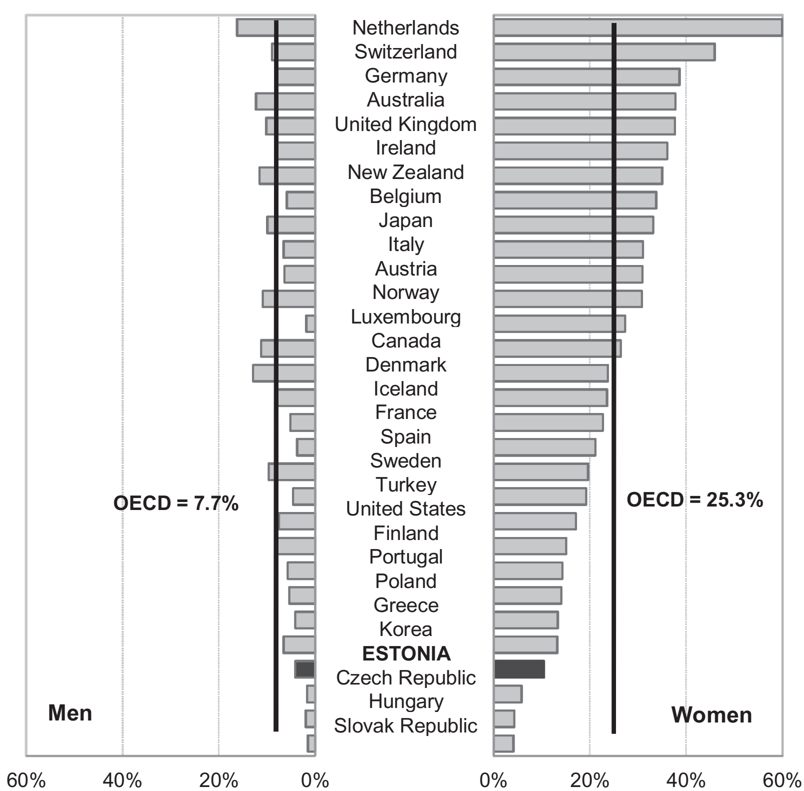
Estonia's rules about allocating weekly working time are flexible by OECD standards. With some exceptions, the standard working time should not exceed eight hours per day and 40 hours per week. Employers can unilaterally adapt the working hours to "reasonable" needs, provided that the total working time does not exceed 48 hours per week on average over four months. For healthcare professionals and workers in agriculture and tourism, working hours can also be averaged over 12 months by means of a collective agreement. Overtime is allowed if the employee agrees, but it must be compensated for by time-off unless the labour contract provides for overtime pay at 1.5 times the regular wage. There are no restrictions on weekend work, but work on national holidays should be remunerated at twice the regular rate. Workers can request a change in working hours for any reason (*e.g.* from full-time to part-time or vice versa) and employers must consider such requests.

12. The standard labour force surveys' samples are too small to measure TWA employment. The cited figures from 2007, drawn from a survey by the Klaster research centre and the University of Tartu, have also been criticised on methodological grounds (Nurmela, 2008). They must therefore be treated with caution.

However, the incidence of part-time work is much lower than in most OECD countries, and it has declined in the past decade. There are no legal limits on part-time work and it gives the same rights and duties as full-time work (in proportion to the working time), but most Estonians seem to reject part-time work for financial reasons. In 2008, only 4% of the employed men and 10% of the women worked less than 30 hours per week, compared with OECD averages of 8% and 25%, respectively (Figure 2.3). Most of them did so for personal reasons including childcare and studies (*cf.* Estonian Labour Force Survey). But when the economic downturn began, enterprises imposed involuntary part-time schedules on about 2% of the labour force. In contrast to some OECD countries and Slovenia, Estonia did not encourage this practice: it emerged as a spontaneous cost-cutting reaction by enterprises.

Figure 2.3. Part-time employment (<30h/week) in Estonia and OECD countries, 2008

Share of part-time employees (men and women) in total employment



Source: *OECD Labour Force Statistics database* and Statistics Estonia.

As noted in the *Reassessed OECD Jobs Strategy*, flexible working arrangements encourage job creation but they can make it more difficult to reconcile work with family life. This holds especially when there is a shortage of childcare, as is sometimes the case in Estonia (*cf.* Chapter 3).[13] Working-time flexibility for employers should therefore be accompanied by some flexibility for employees as well. In general, however, "unsocial" working hours (evenings, nights or weekends) appear less common in Estonia than in most European countries, and the share of employees with long working weeks or overtime has declined in recent years (MSA, 2008).

3. Labour law enforcement

The Labour Inspectorate is intensifying its educative role

Employment protection depends not only on what is written in the law, but also on the extent to which it is respected and enforced. The Labour Inspectorate, which monitors compliance with labour law and occupational safety, was restructured in 2008 to strengthen its preventive and educative role. To raise awareness about the working environment and labour relations, the inspectorate is putting more emphasis on communication with the media and the general public and it has set up an "e-inspectorate". One reason for the restructuring was that the new Employment Contracts Act had removed several administrative reporting requirements and control functions in favour of contractual freedom, for example in matters of working time. While this change was widely welcomed, it has made the Inspectorate's role more demanding as it must now be fulfilled mainly by means of information and practical assistance rather than by use of administrative power. Internal training courses and new guidelines have been developed with the help of the European Social Fund.

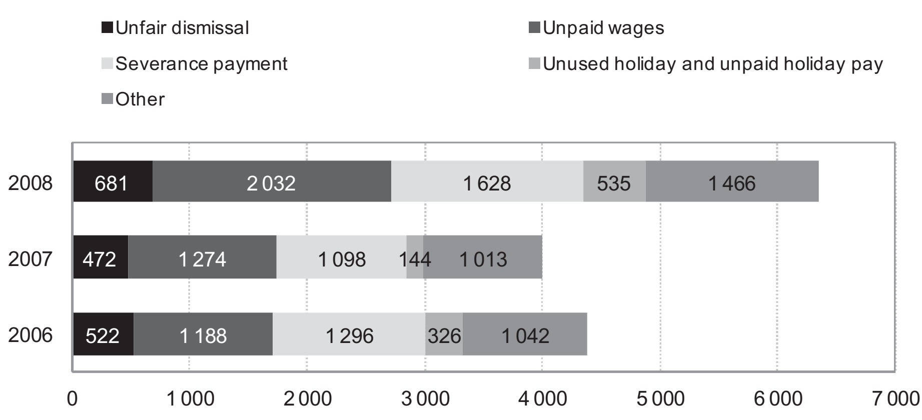
The Inspectorate's previous 14 county offices have been regrouped into four local inspectorates, while the staffing was cut from 153 to 131 positions. The latter figure includes 70 professionals of whom over half are concerned with health and safety, while 20 are lawyers focusing on employment relations. This represents around one inspector per 9 400 employed persons, thus in line with the ILO recommendation of one labour inspector per 10 000 employed persons for advanced countries (OECD, 2008).

13. High employment rates in the 25-49-year age group – 90% for men and 79% for women in 2008 – suggest that most parents can reconcile work and family life. Nevertheless, family responsibilities are a chief reason for inactivity in the aforementioned age class in 2008 (*cf.* Estonian Labour Force Survey).

Preventive inspections were suspended in 2009, but this should only be temporary. With more resources devoted to counselling and information about the new Employment Contracts Act, inspectors currently visit firms only in response to specific complaints. The timing of this temporary suspension of most inspections has proved unfortunate as it coincides with the economic downturn, which triggered a 50% increase in claims by employees already in 2008, often concerning unfair dismissals and unpaid wages (Figure 2.4). On the other hand, complaints about severance pay are likely to diminish as the latter has been reduced and is paid out to a greater extent by the Unemployment Insurance Fund since 1 July 2009 (*cf.* Box 2.2). In addition, the administrative workload should lessen as employers no longer need the Inspectorate's permit for certain procedures, especially involuntary part-time work and collective dismissal.

Many workers remain vulnerable to offences against labour law. In 2008, around 5 000 inspections were conducted, covering 6% of all registered businesses; one-fourth of the inspections concerned labour legislation. In Estonia as in most countries, it is impossible to conduct systematic controls in small firms. Hence, inspections generally target firms with over five employees concerning the working environment and over ten employees concerning labour law, while focussing on firms with a higher risk of violation. This limitation is problematic, considering that small firms seldom have trade unions (*cf.* Section 5, p. 68) and that about 55% of all registered firms have up to five employees. Most of the detected violations of labour law occurred in firms with ten to 20 workers.

Figure 2.4. Complaints submitted by employees to the Labour Inspectorate, 2006-08



Source: Estonian Labour Inspectorate.

The Inspectorate can impose sanctions against violations of labour law, but these are very low. For companies, the maximum sanction is EEK 20 000 or 13% of the average annual wage, compared with one to nine times the average annual wages in other eastern European OECD countries (OECD, 2008). For individual entrepreneurs, the maximum fine is only 4% of the average annual wage. Judging from OECD experience, some increase in these penalties might contribute to a better balance between deterrence and the desire to protect business and jobs (OECD, 2008).

Labour dispute committees limit the cost of resolving conflicts

In the absence of specialised labour courts, claims related to labour rights are often brought to civil courts. To limit the cost and time needed to resolve conflicts, individual and collective labour disputes can also be handled by one of 11 individual labour dispute committees, composed in equal numbers by employee and employer representatives and chaired by the labour inspectorate.[14] Any party who is not satisfied can subsequently bring the case to a court.

In 2008, some 4 100 claims were submitted by employees to labour dispute committees, representing an increase of 57% from the year before. Most conflicts concerned unpaid wages (32%) and severance pay (26%), followed by unfair dismissal (10%; *cf.* Figure 2.4). The number of claims is expected to rise further because the new Employment Contracts Act has increased the limit on the financial claims that can be handled to EEK 150 000 (about EUR 9 600). The previous ceiling at EEK 50 000 excluded many potential cases or obliged the claimants to settle for a lower amount (Kallaste and Roosaar, 2007).

Labour dispute committees charge no fees for reconciliation, and the law obliges them to hear any case within one month (with a possible one-month extension), after which the committee has five working days to communicate a decision. In 2007, the average time of handling cases was 1.3 months compared with nine months in civil courts (Venn, 2009).

14. The representatives are appointed by the Estonian Trade Union Confederation and Estonian Employers' Confederation and receive remuneration from the Inspectorate during the period they participate in the work of a labour dispute committee.

4. Labour taxation and undeclared work

Estonia was the first European country to introduce a flat-rate income tax in 1994. Fixed initially at 26% of taxable income, it has been reduced to 21% by 2008 (*cf.* Box 2.3). The goal is to reach 18% by 2011; but a planned reduction to 20% in 2009 was suspended as part of the package of budget-strengthening measures, as was a foreseen increase of the tax-free allowance.

The flat rate simplifies taxation considerably and reduces compliance costs, a fact that has probably contributed to reduced tax evasion. Such tax reforms can also be motivated by the desire to stimulate work efforts and investment (Hall and Rabushka, 2007). But it also limits the tax-benefit system's capacity to redistribute income (*cf.* Chapter 3).

Box 2.3. The taxation of work income

Income tax was charged at a flat rate of 26% from 1994 until 2004, after which it was cut to 24% in 2005 and then reduced in annual steps down to the present 21%, applicable from 2008. A planned reduction to 20% in 2009 has not been implemented.

Each income earner receives a tax-free allowance of EEK 27 000 per year, or about 17% of the average gross wage, plus the same amount for each child other than the first. (The allowance for the first child, introduced in 2008, was suspended from the beginning of 2009.) A pensioner receives a tax-free allowance of EEK 36 000, which is not much less than the average pension. The tax is individual, but a married couple may file a joint tax return and share tax allowances.

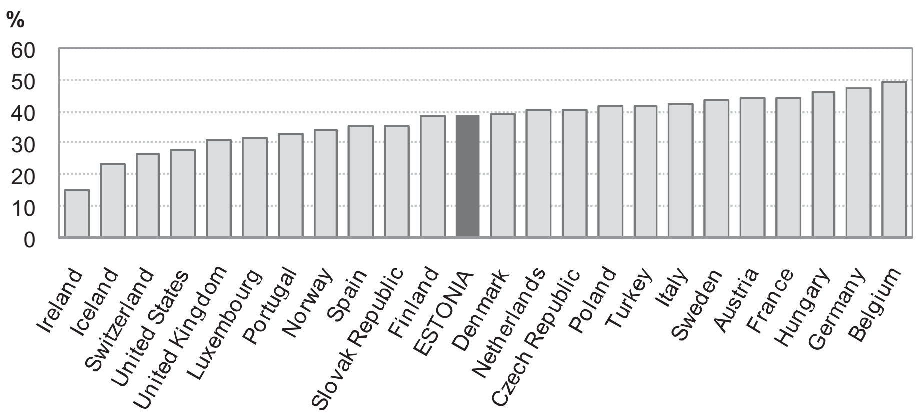
The *social tax,* which finances pension and healthcare insurance, is paid by employers and the self-employed at a rate of 33% of salaries and wages, of which 13 percentage points refer to healthcare insurance and 20 percentage points to the pension system. The social tax is charged only on wages that exceed EEK 1 400 per month (EEK 16 800 per year), but it is not subject to any upper income limit.

Workers participating in the funded 2nd-tier pension must pay a 2% contribution out of their wages, which is allocated to individual accounts along with 4 percentage points of the employer's social tax. The accumulation of 2nd-tier pension funds has been temporarily suspended in 2009 and 2010, except for older workers who opt to continue paying the 2% contribution.

Unemployment insurance is financed by separate contributions. The rates were increased in July 2009, rising from 0.6 to 1% for employers and from 0.9 to 2% for employees, after which a temporary further increase to 1.4% and 2.8%, respectively, was adopted for August-December 2009.

The overall tax wedge on labour costs was estimated at 39% in 2007. This was close to the EU average, but higher than in most non-European OECD countries (Figure 2.5). OECD experience shows that a reduction in the tax wedge is likely to have a positive impact on employment and total hours worked. In the average OECD country, a 10 percentage-points reduction of the tax wedge can be expected to reduce equilibrium unemployment by 2.8 percentage points and increase the employment rate by 3.7 percentage points (OECD, 2006). Surveys also indicate that the tax burden is one of the key factors behind undeclared or under-declared wages in Estonia (Leetmaa and Võrk, 2007). Some further cuts in the income-tax rate would therefore be welcome when the budgetary situation improves.

Figure 2.5. Tax wedge on labour costs in Estonia and selected OECD countries, 2007[1]



1. Income tax plus employees' and employers' social security contributions as a percentage of the total labour costs (including payroll taxes where applicable) for a single person without children earning 67% of the average wage.

Source: *OECD Benefits and Wages database*.

To the extent it can be measured, undeclared work is not very common in Estonia by international standards and has been decreasing. According to one survey, the share of workers without written contract declined from 11% in 1998 to 5% in 2005.[15] In 2001, the size of the informal sector was estimated at 8-9% of GDP (Renooy *et al.*, 2004).[16] While this is slightly

15. The Working Life Barometer surveyed Estonian job conditions in 1998, 2002 and 2005, using a sample of about 1 000 individuals (Philips, 2007b).

16. The size of the informal sector is estimated by the discrepancy between survey-based and administrative employment data.

higher than the EU average of 5%, it is the lowest share of undeclared work among new EU members (ranging from 9-10% of GDP in the Czech Republic to 22-30% of GDP in Bulgaria in 2001).

A common form of tax evasion involves so-called "envelope wages", *i.e.* cash payments to workers on which social security contributions and income tax are not levied. Such payments typically come on top of a declared wage, accounting for 35-50% of the total income (*cf.* Philips, 2007b; and Nurmela and Karu, 2008). According to a survey by the Estonian Institute of Economic Research, the share of employees receiving envelope wages regularly or sometimes declined from 16% in 2003 to 11% in 2006.[17] The practice is most common in the construction and services sectors, where it often seems to concern workers under the age of 30, those with low education and ethnic non-Estonians. The tax loss due to under-declared wages was estimated at about 3% of the tax revenues in 2007 (Leetmaa and Võrk, 2007).

The reasons behind the decline in undeclared work can be found in Estonia's general economic development, European integration and social security reforms (Leetmaa and Võrk, 2007). Joint efforts by the social partners, social security and other public bodies have contributed to the decline by detecting more violations and by increasing awareness in the general public (Kallaste and Nurmela, 2007). Nonetheless, the current economic crisis and the recent increase in the tax burden for employers (with temporarily higher UI contributions, *cf.* Box 2.3 above) are likely to lead to a renewed problem of undeclared and under-declared wages. In 2007, when the Estonian economy started to slow, the incidence of envelope wages already rose by 3 percentage points to 14% (Nurmela and Karu, 2008). But this increase primarily concerned occasional undeclared payments, while the undeclared part accounted for a smaller share of a worker's salary than in previous years. This suggests that the present higher incidence of informality may represent a temporary response strategy by employers to the economic crisis.

17. The survey undertaken by the Estonian Institute of Economic Research is carried out annually since 1999 and covers a representative sample of 1 077 Estonian residents aged 18-74 (Nurmela and Karu, 2008). These figures are confirmed by the Working Life Barometer survey, where 9% of the respondents stated that the received undeclared wages on a regular or occasional basis in 2005 (Philips, 2007b).

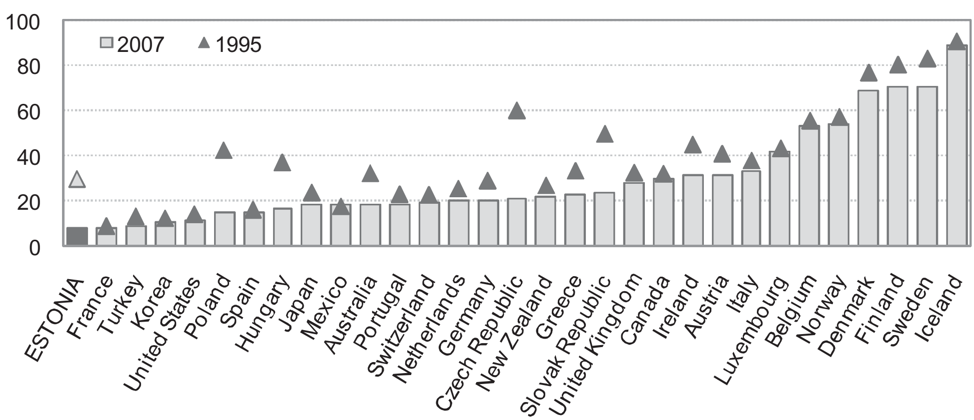
5. Industrial relations

Limited collective bargaining

Estonia's labour market is characterised by the presence of many small firms and low trade union membership (Figure 2.6).[18] Similar to the eastern European OECD countries (the Czech Republic, Hungary, Poland and the Slovak Republic), trade union membership in Estonia has declined steadily over the transition period due to privatisation, the entry of new small enterprises, and a structural shift from manufacturing to private services. There were approximately 45 000 trade union members in 2007 and union density was estimated at 7.6% (MSA, 2008), but recent redundancies in unionised sectors are causing a further decline. There is no reliable estimate of the organisation rate on the employer side, but it is probably similar (Ahlberg and Bruun, 2009). Box 2.4 provides an overview of Estonian labour market associations.

Figure 2.6. Trade union density in Estonia and OECD countries

1995 and 2007 (or latest available year)



Source: *OECD Employment database* and Estonian Ministry of Social Affairs.

18. Almost 90% of the enterprises in Estonia have less than ten employees (*cf.* Statistics Estonia).

Box 2.4. The social partners in Estonia

Trade unions are organised at the industry level and most of them embrace an entire sector or sub-sector. The sector-based organisations are gathered in two trade union confederations, which are both internationally recognised and act as social partners in consultations with the government. The two confederations are separated partly on occupational rather than ideological grounds, being both pluralistic in their general outlook and independent of political parties (Philips, 2006). On the employer side, only one confederation is generally recognised as a social partner.

- The *Confederation of Estonian Trade Unions (EAKL)* is the largest organisation, with 19 affiliated trade union organisations. It covers mostly blue-collar workers in the public sector, transports, industry and some services.
- The *Estonian Employees' Unions' Confederation (TALO),* with 11 branch unions, mainly represents teachers, culture and healthcare professionals and other white-collar groups.
- The *Estonian Employers' Confederation (ETTK)* is the only employers' association recognised by the government and trade unions as a social partner. The Confederation represents 24 branch organisations and 60 single large enterprises, covering more than 1 500 companies with around 35% of the private sector's employees.

Some smaller trade unions that do not belong to any association are acting autonomously in the labour market, but have little political influence. Two other business organisations exist – the Estonian Chamber of Commerce and Industry and the Estonian Association of Small and Medium Enterprises – but they are not primarily regarded as labour market partners.

For the large majority of employees, working and pay conditions are fixed in direct discussions between the employer and the individual worker. When collective bargaining occurs, it takes place mainly at the company level. Apart from an agreement about the minimum wage (*cf.* below), there are currently no national collective agreements and only two sectoral ones (in transports and health care), to which must be added some company-level agreements in sectors or sub-sectors with only one enterprise (energy, post and railways). These collective agreements, renewed every year, mainly cover general working conditions and pay standards, such as sectoral minimum wages.

Only 0.1% of the enterprises and 11.3% of the employees were covered by collective agreements in 2007 (MSA, 2008), but the latter proportion rises to 20-25% if the extension of some collective agreements is taken into account (Philips, 2007a).[19] It is also notable that 90% of the collective agreements are concluded in the public sector. Collective bargaining is most common in the public sector in many countries, but this imbalance appears extreme in Estonia (Parissaki and Vega Vega, 2008).

When there is no trade union, the law allows non-union employee representatives to engage in collective bargaining at the company level, but their role remains minor. Such representatives must be elected by a general assembly and represent all employees, provided that there is no trade union.[20] By contrast, trade unions represent only their members unless the general assembly gives them a mandate to represent all workers. In practice, very few Estonian companies have non-unionised employee representatives, and their role tends to be limited even where they are present (Kallaste *et al.*, 2008).

Various reasons have been mentioned for weak social dialogues in Estonia, including a general unwillingness of branch-level employer associations to sign collective agreements, the lack of such associations in certain sectors and the trade unions' extreme weakness, which effectively prevents them from changing the situation (Philips, 2007a). In many sectors, the trade unions' scarce human and financial resources have prevented the establishment of permanent organisations, while several of the sectoral business organisations have traditionally been more active as political pressure groups (Kerem and Lubenets, 2004).

In road transport and healthcare, the signatory partners have used a possibility – foreseen in law – to extend their collective agreements to all companies in these sectors. In contrast to most other countries where such extension is possible, it requires no decision by public authorities and its legality does not depend on any particular definition of an association's representativeness: the existing sector or higher-level associations are presumed to be representative.[21] Furthermore, Estonia's legislation does not specify any right for the affected non-signatory employers to express

19. Figures on the coverage of collective agreements differ according to the source. In principle, collective agreements should be registered at the Ministry of Social Affairs. But some companies are reluctant to provide the information and there are no sanctions for not reporting.

20. The Employee Trustee Act, which entered into force on 1 February 2009, brought an end to the dual system in which trade unions represented the rights of their members and non-unionised employee representatives represented non-unionised employees.

21. For example, in Germany, Greece and Japan, an agreement can be extended when 50% or more of the employees in the agreement's domain are already covered by it (OECD, 2004, Chapter 3).

their views, nor are the contracting parties obliged to inform outsiders about their negotiations or their plan to extend the agreement. So far, this extension mechanism has not been very controversial in Estonia, and the relevant associations do in fact cover over half of the workers in their sectors. But the mere fact that associations with much lower membership can also seek an extension of their agreements has caused some concern in Estonia. Some clarifications in the law could merit consideration in order to prevent such developments.

The minimum wage

The only national collective agreement in Estonia concerns the minimum wage, which the government has extended by decree to all employees. Introduced in 1992, the minimum wage was first set by tripartite agreements, but the government decided to "step out" of these negotiations in 2002 as a means to stimulate bipartite bargaining. Since then, all collective agreements about the minimum wage have been made applicable to all employees without differentiation by age, sector or region (Carley, 2006).

At the current level, the minimum wage may recently have begun to price-out some low-skilled workers. Its growth was in line with the average wage trend until 2007, after which it has tended to outpace both the average wage and labour productivity (Table 2.1). The ratio of the minimum to the average wage increased from 32% in 2007 to 34% in 2008. It was temporarily at 36% in the first quarter of 2009, when the average wage reached a low point. The social partners agreed not to increase the nominal value of the minimum wage in 2009. However, some low-productive workers might have been priced-out already in 2008 in such sectors such as hotels and restaurants, where the average wage was less than twice the minimum wage.

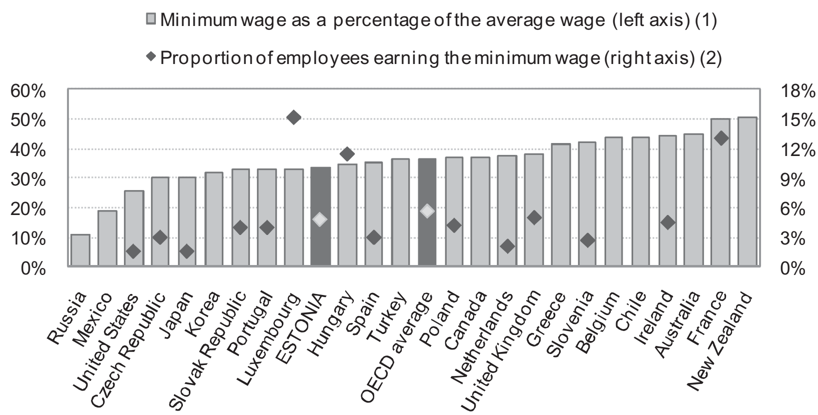
Table 2.1. Evolution of the minimum wage in Estonia, 2002-09

	2002	2003	2004	2005	2006	2007	2008	2009Q1
Monthly minimum wage (EEK)	1 850	2 160	2 480	2 690	3 000	3 600	4 350	4 350
Minimum wage growth		17%	15%	8%	12%	20%	21%	0%
Labour productivity growth	7%	6%	7%	7%	3%	6%	-4%	
Minimum wage / Average wage	30.1%	32.1%	34.0%	33.3%	31.9%	31.8%	33.7%	35.8%
Proportion of full-time employees earning the minimum wage	6.9%	6.3%	3.7%	4.8%	4.7%	4.7%	..	..

Source: Statistics Estonia and Masso and Krillo (2009).

The proportion of employees earning the minimum wage decreased in comparison with 2002 and was under 5% for most of the 2000s (Table 2.1). It still appears higher than in most OECD countries other than France, Luxembourg and Hungary (Figure 2.7, right axis). But the actual share is probably lower, considering the above-mentioned practice of "envelope wages" (*cf.* Section 4, p. 65). On the other hand, the importance of the minimum wage is enhanced by its frequent use as a benchmark for wage scales in both the private and public sector, which makes it likely that any increase of the minimum will "spill over" on other wages (Masso and Krillo, 2009).

Figure 2.7. Minimum wages and coverage in OECD member and accession countries, 2005 and 2008



1. 2008 or latest available year.
2. 2005 or latest available year.

Source: Data on coverage come from Carley (2006); Minimum wages are taken from *OECD Employment database*, Statistics Estonia, Statistical Office of Slovenia, and Russian Federal State Statistics Service.

6. Unemployment compensation

There are two types of unemployment benefit: *1)* earnings-related *unemployment insurance* (UI) benefits available to employees who have contributed to the Unemployment Insurance Fund (UIF) for at least 12 months over the past 36 months, and *2)* a non-contributory flat-rate *unemployment assistance* (UA) benefit covering those who do not qualify for UI or have exhausted their entitlements (Box 2.5). Whereas UI is contribution-financed, UA is funded from the state budget. Finally, unemployed persons who are not eligible or have exhausted their rights to both UI and UA can sometimes receive subsistence benefits from the social assistance system (*cf.* Chapter 3).

Box 2.5. Unemployment benefits

The **unemployment insurance (UI)** was introduced in 2002 by the Unemployment Insurance Act.

Coverage: mandatory for all employees until the retirement age, including public servants.

Contribution rates: the government determines the contribution rates for employers and employees annually, following proposals by the Supervisory Board of the Unemployment Insurance Fund (UIF). The contribution rates (on wages before tax) were 0.6% for employees and 0.3% for employers during 2006-07, but have been increased to 2.8% for employees and 1.4% for employers for the period of 1 August to 31 December 2009.

Conditions for benefit eligibility: involuntary unemployment including cases of unemployment after the end of fixed-term contracts, but not job separations for reasons of discipline or poor performance. A contribution period of at least 12 months over the last 36 months is required (until 2006, over the last 24 months). Claimants must register at the UIF. No supplementary income from work is allowed.

Every new benefit spell requires a new contribution period. Those who take up jobs before the end of an entitlement period can collect the remainder only if they become unemployed again within a year.

The *benefit amount* depends on the average monthly earnings in the last job, with a ceiling of three times the national average wage in the previous year. This income is replaced at a rate of 50% for the first 100 days, thereafter 40%. On 1 July 2009, the minimum UI benefit was increased from EEK 1 000 (equal to UA) to 50% of the previous calendar year's minimum wage (at present EEK 2 175).

Maximum benefit duration:

- 180 days if less than 56 contribution months;
- 270 days between 56 and 110 contribution months;
- 360 days between more than 110 contribution months.

Waiting period: seven days from application.

The **unemployment assistance (UA)** is regulated by the Labour Market Services and Benefits Act.

Coverage: the unemployment assistance benefit is available to registered unemployed persons who are actively looking for work and who do not qualify for UI or have exhausted their UI entitlement.

Conditions for benefit eligibility: unlike UI benefits, UA it is also available in cases of unemployment after voluntary job quits and firings for disciplinary reasons. The UA claimant must have worked as employee, self-employed or on a service contract, or been engaged in daytime or full-time study, for at least 180 days during the 12 months prior to registration as unemployed. UA is also payable in a few other cases, notably to persons who were raising a child or took care of a disabled person. During UA benefit receipt, other incomes are allowed up to the UA amount.

Benefit amount: a flat rate fixed annually in the state budget for each budget. It has been EEK 32.9 per day or around EEK 1 000 (= EUR 64) per month since 2008. It is not means tested.

Benefit duration: up to 270 days; or 210 days after voluntary quits.

Waiting period: usually seven days from application; 60 days after study and after voluntary quits.

Unemployment benefits are modest or low

For those who can claim UI benefits, the initial income replacement rate of 50% appears adequate compared with conventional poverty limits, but it is reduced to 40% after 100 days. The maximum UI benefit period is 6-12 months depending on the individual contribution history.[22] In the first half of 2009, the reported average UI benefit was about EEK 4 400 (= EUR 281) per month or 35% of the average wage. The corresponding average in 2007 (EEK 2 856) represented 39% of the median household income per adult-equivalent (as reported by EU-SILC), *i.e.* it placed a single unemployed person below a poverty line drawn at half of the median income, although it was a little higher than a subsistence minimum defined by Statistics Estonia.

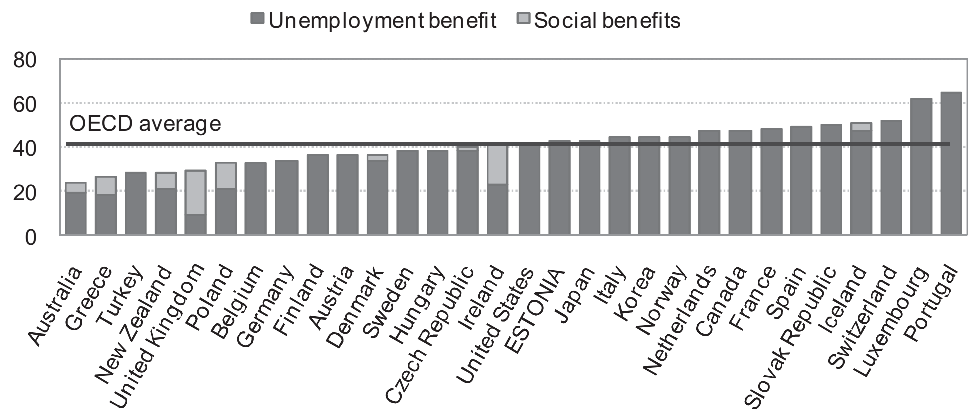
The estimated net income replacement rate at the initial stage of unemployment is close to the OECD average at just over 40%, taking account of taxes and the social benefits that may be available (Figure 2.8, Panel A). But for UA recipients the benefit is barely 23% of the minimum wage, giving an estimated net replacement rate of around 10%, or about 16% if the household receives a social assistance benefit as a complement. This net replacement rate for UA is one of the lowest in the OECD area (Figure 2.8, Panel B).

From mid-2009, UI benefit periods begin only after the one or two months during which the UIF pays severance pay, if applicable. As a result, the payment of the different benefits can now be spread-out over a slightly longer period. This change is expected to improve job-search incentives at the initial stage compared with the previous system (when dismissed persons could receive 150% of their wage during the first few months: 100% as severance pay + 50% as a UI benefit). The total period of severance pay and UI entitlement is still shorter than in many European OECD countries. Given the present moderate rate of income replacement, most beneficiaries are probably eager to take up jobs as soon as possible.

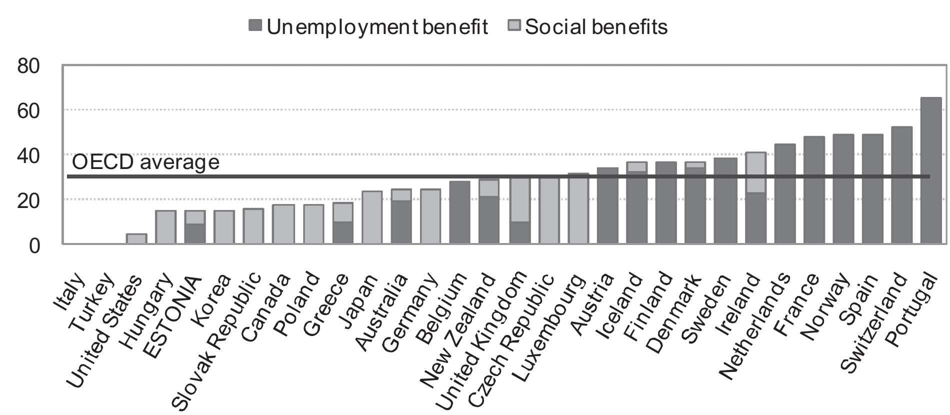
22. Initially, the new Employment Contracts Act included an increase in the UI benefits to 70% of the previous wage during the first 100 days and 50% afterwards, and a more than doubling of the UA benefits from EEK 1 000 (= EUR 64) per month to EEK 2 300 (= EUR 147) per month. However, due to budgetary pressures as a consequence of the current crisis both measures have been suspended until 2013.

Figure 2.8. Net income replacement rates for single persons receiving unemployment benefits, 2008[1]

Panel A. Income replacement rates at the beginning of the employment spell



Panel B. Income replacement rates for long-term unemployed (at the 13th month of unemployment)



1. The replacements rates take into account unemployment benefits as well as other cash benefits (such as social assistance, family benefits, housing benefits, and child-raising allowance), and are calculated for a single unemployed person without children who previously earned the average wage.

Source: *OECD Benefits and Wages database*.

Only a minority receive unemployment benefits

Until 2009, less than half of the registered unemployed received UI or UA benefits, and many were not even eligible for subsistence benefits (SB, *cf.* below). During the present economic crisis, the strong inflow of newly registered unemployed people led to an increase in the number of benefit recipients. Since the introduction of unemployment insurance in 2002, UI and UA together have covered around 40-50% of the registered unemployed in any month, with unemployment assistance being predominant until 2008 (Figure 2.9, Panel A). Even among the newly registered unemployed, who are most likely to receive UI benefits, less than 25% did so before 2008 when the proportion began to rise (Figure 2.9, Panel B). By April 2009, when 65 000 persons were registered as unemployed, some 21 000 or 32% received UI benefits and less than half as many received UA.

A majority of registered unemployed do not receive unemployment insurance because they have not worked as employees, are not considered as involuntarily unemployed, or have exhausted their benefit rights (see Box 2.3). Persons without the required background as employees have recently accounted for almost 40% of the unemployed (Table 2.2). Among the former employees, almost half of the new clients in early 2009 were excluded from UI because their unemployment was considered as voluntary (Figure 2.10). Many of the long-term unemployed have also exhausted their right to unemployment assistance, so they receive no benefit unless they are entitled to subsistence benefits.

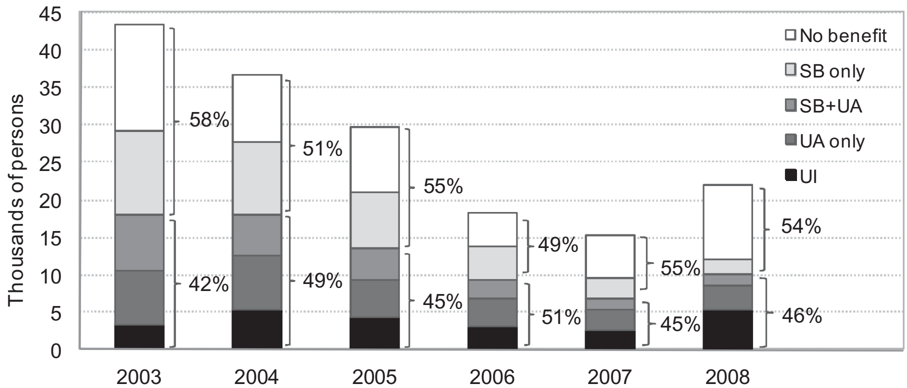
The economic crisis has considerably altered the composition of unemployment. During the first four months of 2009, the share of the newly registered unemployed people who had been dismissed or could not renew fixed-term contracts rose from 37 to 51%, while the share of voluntary quits has been halved (Table 2.2).[23] As a result, the share of UI benefit recipients among the newly registered reached 44% (see Figure 2.9, Panel B). On the other hand, growing numbers of formerly inactive people are appearing at the employment service, a change that may be partly attributable to new rules from 2007 that give unemployed people free healthcare insurance.

---

23. There is some anecdotal evidence that employers force redundancies to be classified as voluntary terminations to avoid paying severance payments (Eamest and Masso, 2005).

Figure 2.9. Unemployment benefit recipients in Estonia, 2003-09

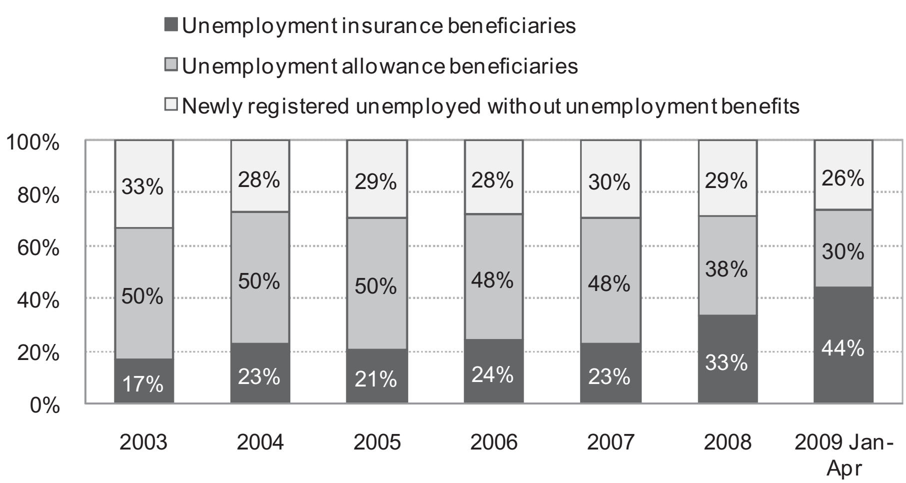
Panel A. Registered unemployed persons by benefit status



Note: The figures for subsistence benefits (SB) refer to the numbers of unemployed persons in SB client households, not the number of applicant households.

Source: OECD calculations based on data provided by the Unemployment Insurance Fund and Statistics Estonia.

Panel B. Share of recipients with different types of benefits among *newly* registered unemployed persons



Source: OECD calculations based on data provided by the Unemployment Insurance Fund and Statistics Estonia.

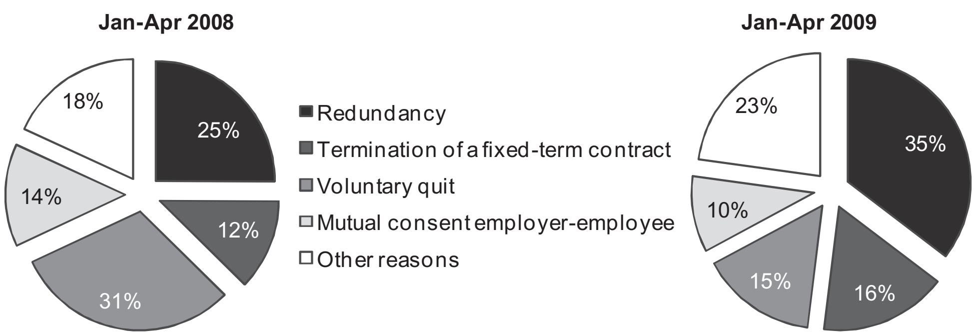
Table 2.2. Main activity of unemployed people prior to their registration, 2008-09

In percentage of the total stock of registered unemployed persons

	End April 2008	End April 2009
Working as an employee or a civil servant	61.5%	72.6%
Self-employment and entrepreneurship	2.3%	2.1%
Studying	3.1%	2.6%
Serving a conscript obligation	0.1%	0.2%
Raising a child	6.7%	4.0%
Taking care of a sick or disabled person	1.8%	1.1%
Serving a sentence in a prison	2.5%	1.2%
Inactive, no specified activity	22.0%	16.1%
TOTAL	100.0%	100.0%

Source: OECD calculations based on data provided by the Unemployment Insurance Fund.

Figure 2.10. Newly registered unemployed persons, by reasons for leaving work, 2008-09



Note: Redundancy also includes employees who lost their job due to insolvency or liquidation of the enterprise. Other reasons include job loss due to unsatisfactory results of a probation period, violation of contractual terms by the employer, loss of trust, breach of duties, and unspecified reasons.

Source: OECD calculations based on data provided by the Unemployment Insurance Fund.

UA recipients often receive subsistence benefits as well

About 65% of the households receiving subsistence benefits (SB) in 2008 had one or more member who was registered as unemployed. This often concerns long-term unemployed persons who have exhausted their rights to both UI and UA, but also others who receive SB as a complement to unemployment assistance (see Figure 2.9, Panel A above). The income limit for SB is usually EEK 1 000 (EUR 64) per month for one person and EEK 800 (EUR 51) for each additional family member, plus approved housing costs and some supplements.

OECD experience suggests that the use of social assistance to compensate large numbers of unemployed job seekers is problematic because it complicates activation programmes, which are necessary in order to prevent clients from losing contact with the labour market (OECD, 2005, Chapter 5). Moreover, it can be difficult to establish an appropriate division of responsibilities when the agency best placed to promote job search does not administer the benefits. In Estonia, the fact that the state finances SB can also be expected to reduce the incentives for municipalities to prioritise the labour-market activation of hard-to-place clients.

It falls on municipalities to motivate job-ready SB recipients to seek employment with the assistance of the UIF, but the extent of such cooperation is limited. Only few municipalities require systematic activation or organise training, public works and activity centres for the long-term unemployed in collaboration with the UIF. The law also allows municipalities to refuse benefits to working-age clients if they repeatedly reject suitable jobs, but such sanctions are seldom applied. On the other hand, the present SB amounts are so low that relatively few households are likely to fall into an "inactivity trap".[24]

7. Labour market services

Merging the public employment service with the unemployment insurance

Estonia's public employment service was a separate agency under the Ministry of Social Affairs until April 2009, when it was merged with the Unemployment Insurance Fund (UIF). The latter is a tripartite public institution fully financed from employer and employee contributions. The

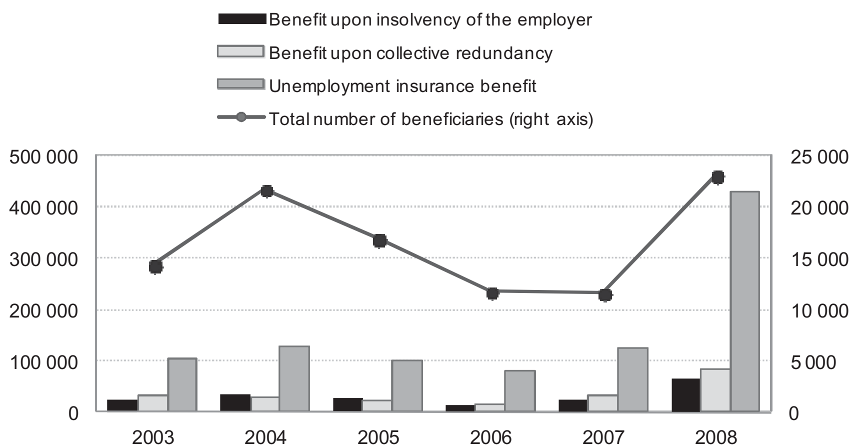
24. Given the generally high work incentives, interviewed policy makers did not regard it as necessary to develop programmes for in-work benefits, as some OECD countries have done.

merged agency, henceforth called the UIF, is governed by a board with equal numbers of representatives of the government, employers and employees, and it is responsible for active and passive labour market measures.

The merger was justified by the need for tighter links between unemployment insurance, unemployment assistance and the employment service in order to put pressure on the latter to reduce the UI caseload. At the same time, it was expected to give UI administrators more insight into the nature of the required employment services and their effects. The employment service and its programmes – including UA – are still financed mainly from the state budget and EU funds, but the UIF accepted in 2009 to contribute money from its own funds to permit a significant increase in the employment-service staff.[25]

Figure 2.11. Expenses of the Unemployment Insurance Fund, 2003-08

In thousands of Estonian kroons; accrual based accounting



Source: OECD calculations based on data provided by the Unemployment Insurance Fund.

The economic crisis has put much pressure on the UIF as it affects contribution revenues as well as expenditures. With rising unemployment, the number of contributors has been declining, while the number of UI beneficiaries doubled already in 2008 (Figure 2.11). In addition, as

25. The advantage of keeping separate budgeting for active and passive labour market programmes is that these budgets are treated as complements rather than substitutes, and increasing benefit payments do not crowd out expenditures on active measures in times of high unemployment rates.

mentioned earlier, the UIF pays severance benefits and benefits to workers affected by employers' insolvency.[26] Despite the temporary increase in contribution rates and the decision to postpone important increases in UI and UA benefits, it remains uncertain to what extent the available funding will prove sufficient in 2009 and 2010.

Employment services under pressure

The merged UIF has retained the 15 regional and 26 local labour offices, as well as 70% of previous staff members – with the plan to increase the number of employees from 345 to 470 posts. However, a shortage of working space in several offices has prevented them from filling all positions. Most UIF staff members are well qualified, with almost half having tertiary education degrees.

Around 80% of the regional and local office staff have front-line functions such as information, job counselling and case management, all in contact with jobseekers and employers. This high proportion is related to the centralisation of important tasks such as benefit administration, procurement of training courses and outsourcing of IT. In addition, the low proportion of administrative staff must be seen in the context of the limited use of active programmes (see below).

Due to the worsening labour market conditions, the employment-service caseload had increased to 263 registered unemployed persons per front-line counsellor by June 2009 – a number that may reach 300 by the end of the year (corresponding to 90 000 registered unemployed persons; *cf.* Table 2.3). In Tallinn, there are already about 800 clients per counsellor, so they can hardly spend more time with each job-seeker than the five minutes it takes to approve a benefit payment.[27] To reduce the workload, clients are currently required to report only once in 60 days instead of 30 days and non-cooperative clients are often removed from the register.

---

26. The UIF previously paid severance benefits only after collective dismissal. But from July 2009, it pays the second and third monthly benefit whenever an entitlement exceeds one month, *i.e.* for over five years of tenure (*cf.* Box 2.2 above). Upon bankruptcy, the UIF compensates for unpaid wages and holiday pay.

27. Offices whose workload exceeds 400 clients per counsellor are allowed to temporarily hire additional staff.

Table 2.3. Workload indicators for public employment centres in Estonia and selected OECD countries

	Estonia		CZE[2]	FIN	IRL	JPN	NOR[3]	POL	SVK	SVN
	Jun 2009	Dec 2009[1]	2007	2007	2007	2007	2009	2006	2006	2008
Placement staff as a share of total staff (including benefit administration)	64%	65%	22%	61%	36%	59%	62%	..	..	28%
Registered unemployed ('000s) per placement staff	263	296	214	..	168	..	13	691	92	253

1. The expected number of registered unemployed people for 31.12.2009 is 90 000 (*Source*: UIF predictions). All approved staff positions are assumed to be filled in by then.
2. Data are only available at the regional level.
3. Data are for November 2009.

Source: Estonia: Unemployment Insurance Fund and Statistics Estonia; Czech Republic: Kalužná (2008b); Finland and Japan: OECD questionnaire on activation policy; Ireland: Grubb *et al.* (2009); Norway: Duell *et al.* (2009); Poland: Kalužná (2009); Slovak Republic: Kalužná (2008a); Slovenia: OECD (2009c).

Major deficiencies in the office infrastructure are currently being addressed.[28] Some offices are moved and it is recognised that outdated IT systems need to be replaced. To save some time, counsellors are often obliged to deal with two to three clients simultaneously, *e.g.* serving one of them while waiting for the computers to process data about one or two others.

Inefficient job-broking system

About one-third of all vacant jobs in Estonia were reported to the public employment service in 2008, but only 3% of the hires were attributable to its clients.[29] Such measures are influenced by the dearth of information about the outcomes of job referrals, but it nevertheless suggests that the placement function is less effective than in OECD countries. More than 70% of the registered unemployed persons who found jobs in 2008 did so without the employment service's assistance, a share that appears to have risen to 85% in the first four months of 2009.

28. In one office visited by the OECD team, four job counsellors were delivering interviews in a room of $10m^2$. The same office had no wheel-chair access and disabled clients were interviewed in a nearby park; during winter, they were not invited for interviews at all.

29. This percentage relates the average monthly stock of vacancies registered at the employment service to the average monthly stock of vacancies in the economy as reported by Statistics Estonia.

Similarly, only a minority of the unemployed people care to register at the public employment service. Since the 1990s, when around 60% of the unemployed were registered, the share dropped to 47% in the early 2000s and 32% in 2008 (*Source*: Statistics Estonia). The proportion is particularly low for youths (11% in 2007). The majority of those not registering in 2008 claimed that they would manage without help (44%) or that the employment service did not offer suitable jobs (23%; *Source*: Statistics Estonia).

The UIF is aware that its low "market share" must largely be attributed to poor job information and inefficient matching of vacancies to jobs. The relevant procedures will require a substantial development effort.[30] For example, many regional offices lack self-service facilities. Current plans for the near future envisage to make an on-line vacancy database much more user-friendly and to create a similar jobseeker database where employers can look for suitable candidates.

Until now, the UIF has made little or no use of private employment agencies. According to OECD experience, a partial outsourcing can be cost-effective if the public agency monitors the outcomes compared with similar cases treated in-house (OECD, 2005, Chapter 5). Private employment agencies need no authorisation – having only to be listed in the business register – and they can provide labour market information, career counselling and job-broking services, which must be free of charge for the job-seekers. But the UIF does not cooperate with the private employment agencies, partly because their reputation has been tainted by recent cases of violations of the law.[31] As an exception, very hard-to-place clients are sometimes referred to rehabilitation centres run by non-governmental organisations.

Activation measures should focus on clients who cannot or would not help themselves

International experience suggests that activation strategies can be valuable, but they involve significant costs in terms of staff time that may not be necessary for motivated jobseekers, especially not in the first few months

30. In contrast to its counterparts in most OECD countries, Estonia's public employment service has not yet been equipped for automatic matching of vacancies to jobseekers. Employers can notify vacancies through all common means – on-line, phone, e-mail or in person – but office staff must type them manually into the database, where they are listed in an Excel file not suitable for advanced search. Until recently, the online database showed only local vacancies but it should now be nationwide.

31. The Unemployment Insurance Fund provided anecdotal evidence of private agencies asking jobseekers to pay for their services – which is illegal – or asking them to pay for services they never received.

of unemployment. In most OECD countries, the employment service therefore tends to postpone intensive interviews and the development of individual action plans until after three months or more (OECD, 2007, Chapter 5). But in Estonia, UIF officers are expected to develop an individual action plan with each new client upon registration as unemployed. This takes about 40 minutes, after which a second session should follow within 30 days. Such a "front-loaded" allocation of limited staff time at the beginning of unemployment spells appears inefficient because many can find jobs for themselves, for example via self-service systems, newspapers and the Internet. In any case, it is not realistic to require such time-consuming early interventions in a period of high unemployment.

Within the first five months, the unemployed can refuse jobs that do not correspond to their education, previous work experience or salary. After six months, they must accept any job that pays more than the unemployment benefit or the minimum wage, whichever is higher. However, such regulations are difficult to enforce without a targeted use of direct job referrals to low-motivated clients, which should be accompanied by a credible threat of benefit sanctions if suitable jobs are refused.

Estonia's employment service made over 24 000 direct job referrals in January-April 2009 – corresponding to 26 referrals per client and year. This figure is very high compared with OECD countries, where the corresponding number is often between one and eight per year (OECD, 2007, Chapter 5). Yet, with only 4 000 reported vacancies in the mentioned period, this large number of referrals is likely to overwhelm employers. Moreover, employers need not report outcomes of referrals and counsellors rarely contact them for a follow-up. Sanctions appear to be exceptional (*e.g.* two cases in 2007).

The individual action plans are often too formalistic, *e.g.* repeating a standard set of obligations every month without requiring proof of their fulfilment.[32] Much is left to the counsellor's discretion. By contrast, many OECD countries have fixed rules requiring benefit claimants to provide employers' confirmation that job applications were received, and sanctions can be imposed if jobs are refused (OECD, 2007, Chapter 5). These shortcomings in Estonia must also be seen in the context of the jobseeker and vacancy registers, which currently do not permit very careful job-matching.

In sum, the development of employment services and activation measures for the unemployed has not been a high priority until now in

32. The required standard job search obligations are: reporting to the UIF in person on an agreed day; following weekly job offers in the print media, on the Internet and on the UIF's board; contacting employers by phone or sending CVs; contacting friends, relatives and former colleagues.

Estonia. Existing provisions are therefore barely adequate for the most basic functions. Judging from the experience summarised in the *Reassessed OECD Jobs Strategy*, the economic and social risks associated with this situation are possibly moderate as long as the available social benefits are not generous enough to place the unemployed people in an “inactivity trap”. But if and when these benefits are increased in the future, the risk of negative effects on work incentives must be expected to grow. To prevent this, a substantial further development of the public employment service would then be required, over and above the significant but modest changes that were initiated by the UIF in 2009.

Active programmes are insignificant

The UIF offers a range of active labour market programmes (ALMPs), similar to those in OECD countries but on a smaller scale. At 0.11% of GDP in 2008, the relevant expenditure is much lower than the OECD average of 0.56% of GDP (Table 2.4); only Mexico spends less (OECD, 2008). Almost half of this total comes from the European Social Fund (ESF), which has a budget for 2007-13 that mainly targets career counselling, training and measures for special groups.[33] Apart from counselling and job-search assistance, less than 1% of the labour force participated in ALMPs – mainly in training – compared with more than 4% on average in the OECD area (OECD, 2009).

The ministry plans ALMPs annually in accordance with formal eligibility criteria, defined in legislation. Two-thirds of registered the unemployed belong to the selected target groups, suggesting that counsellors have room for further targeting based on local or individual criteria (Table 2.5).[34] The social partners can comment on draft budgets and strategies, and the UIF board can henceforth decide how to distribute the budget between pre-defined programmes – but not on its volume. In practice, the regional offices generally receive as much funding for ALMPs as they request and they seldom ask for more: their human resources permit them to do little more than to provide information and job-broking services.

33. Since 2007, Estonia uses funding from the European Social Fund (Measure 1.3 Increasing the Supply of Qualified Labour Force) to provide additional services to registered unemployed people and to pilot new activation measures. A small proportion of the EU funding comes from the Equal programme – for equal opportunities – and EURES (European Employment Services), a cooperation network to facilitate labour mobility in the European Economic Area.

34. The at-risk groups targeted by the Estonian employment services are: young unemployed (age 16-24), older unemployed (aged 55 and above), disabled unemployed, unemployed without sufficient knowledge of the Estonian language, unemployed released from prison, long-term unemployed, and unemployed individuals who have been taking care of children and family members (MSA, 2008).

Table 2.4. Public expenditure on active labour market policies, 2008

As a percentage of GDP

	OECD[1]	Estonia	EU funds as % of total expenditure in Estonia
1. Employment services and administration	**0.15**	**0.06**	**38%**
1.1 Placement and related services	0.06	0.06	43%
1.2 UI benefit administration	0.05	0.01	0%
2. Training	**0.14**	**0.03**	**42%**
3. Employment incentives	**0.10**	**0.00**	**25%**
4. Supported employment and rehabilitation	**0.09**	**0.01**	**77%**
5. Direct job creation[2]	**0.05**	**..**	**..**
6. Start-up incentives	**0.01**	**0.01**	**60%**
7. Out-of-work income maintenance and support	**0.64**	**0.23**	**0%**
7.1 Unemployment insurance	0.43	0.18	
Unemployment insurance benefit	0.42	0.10	
Collective redundancy benefit	0.00	0.04	
Employer insolvency benefit	0.01	0.04	
7.2 Unemployment assistance	0.20	0.05	
Total	**1.32**	**0.33**	**14%**
Active measures (1-6)	**0.56**	**0.11**	**43%**
Active measures (categories 2-6 only)	**0.40**	**0.04**	**49%**

1. The data for the OECD area are unweighted averages for 2007.

2. Public works in Estonia are entirely financed by the providers (mainly local governments and NGOs).

Source: OECD (2009b) and OECD calculations based on data provided by the Unemployment Insurance Fund.

Table 2.5. Share of at-risk groups among registered unemployed people, 2007-09

As a percentage of the stock of registered unemployed persons, average over the reported period[1]

	2007	2008	2009 Q1
55+ years	16.0	16.4	12.8
16-24 years	11.6	12.2	17.3
Non-Estonians	26.4	24.6	23.2
Caregivers	1.8	1.3	0.8
Young long-term unemployed	6.4	6.9	8.8
Long-term unemployed	44.7	35.1	28.0
Disabled	8.9	8.0	5.2
Released from prison	3.6	2.4	1.5
Unemployed in at least one at-risk group	**71.9**	**67.1**	**63.4**

1. The UIF defines seven groups of unemployed people who may have stronger difficulties in finding a new job.

Source: OECD calculations based on data provided by the Unemployment Insurance Fund.

The implementation of training programmes has been complicated by lengthy procedures associated with public tenders. With rapidly changing labour market conditions, available courses often fail to match the actual needs of clients. To speed up the process and increase flexibility, the authorities plan to introduce a new voucher system for cases when individual action plans identify training needs. The job counsellor would then propose a list of suitable schools, from which the job seeker can choose training for up to EEK 15 000. This system is implemented as a limited pilot scheme from October 2009, focusing initially on short further education courses in certain occupations.

ALMPs have not been systematically evaluated, partly due to the dearth of suitable data.[35] Transitions to jobs are not consistently tracked and the Ministry of Social Affairs has no access to tax registers. However, the merged UIF will now be able to use UI data – covering all employees – to monitor the labour market performance of its formerly unemployed clients. For this and other reasons, the UIF appears well placed to develop better activation strategies based on documented experience, on the condition that the IT system is restructured to facilitate monitoring and evaluation.

In the present short-term situation, it appears neither possible nor necessary to envisage any large expansion of the more expensive types of ALMPs in Estonia. Judging from OECD experience, it is appropriate to keep such spending at a modest level when the employment service itself is facing tight budgetary and administrative limitations. However, assuming that Estonia will eventually make its benefit programmes more generous as part of the flexicurity bargain, it will also have more reason to enhance its ALMPs, not least as instruments for the UIF to contain the risk of moral hazards and benefit dependency.

At present, participation in ALMPs is not compulsory unless this is agreed in individual action plans, and clients frequently refuse job-search training as there is no risk of sanction.[36] OECD experience suggests that compulsory participation, especially in training, can improve individual job

35. The only micro-level evaluation study has been carried out by Leetmaa and Võrk (2003). They focus on the net impact of active labour market programmes on employment and wages of participants and conclude that programmes carried out in 2000 had a positive impact on future employment probability. The data sample is, however, quite small and there is evidence of cream skimming in the sense that job counsellors tend to select the more promising candidates for labour market training.

36. In 2008, only four persons were de-registered as a result of refusing to participate in ALMPs or other activities specified in their individual action plan.

prospects and limit the moral hazard of staying on benefit, especially after long periods of unsuccessful job search (OECD, 2007, Chapter 5). This would also permit the use of referrals to ALMPs as a test of availability for work (Toomet, 2008).

8. Improved lifelong learning system

In order to keep up with the rapidly evolving economy and to address structural skill shortages, Estonia adopted in 2005 a Lifelong Learning Strategy for 2005-08, which aimed to widen the adult population's opportunities to engage in training activities. Chief objectives were to increase the number of adult education providers, to develop the financing of adult education and to define a set of vocational qualifications (MER, 2005). The new Employment Contracts Act simplifies the rules about study leave and grants employees up to 30 days of such leave per year. Thanks to the European Social Fund, many vocational training courses have also become cheaper or free of charge.

Participation in lifelong learning increased by more than half over three years, reaching the EU-25 average of about 10% of the adult workforce in 2008 (Table 2.6). Almost 70% of the Estonian enterprises provided training to their employees in 2005. But as in many countries, access to training continues to vary greatly depending on individual job positions and the size of the companies (EHDR, 2009). Participation in lifelong learning therefore remains strongly segmented and most participants are well-educated, relatively young, financially secure and living in the biggest cities.

Table 2.6. Participation in lifelong learning in Estonia and the European Union, 2002-08

	2002	2003	2004	2005	2006	2007	2008
Below upper secondary education	0.6	1.2	1.1	1.3	1.5	1.6	2.1
Upper secondary education, post-secondary non-tertiary education	4.6	4.8	4.8	4.7	4.9	5.5	7.5
Tertiary education	8.7	12.3	11.4	9.6	11.0	11.3	15.9
Educational levels total	5.4	6.7	6.5	5.9	6.5	7.0	9.8
EU-25 average	7.8	8.9	10.0	9.8	9.6	9.7	9.8

Source: Statistics Estonia and Eurostat.

Several challenges in the area of lifelong learning require further attention. Above all, the high cost of non-public vocational training makes it hard to afford for the many small businesses (European Employment Observatory, 2008). It is generally difficult for public authorities to assess the potential growth of small firms' demand for qualified labour. This uncertainty makes it appropriate to rely as much as possible on initiatives by individual workers and employers, supported, as far as possible, by a high-quality general education system and a favourable climate for lifelong learning in terms of regulations and taxation.

9. Conclusion

By further liberalising its employment regulations, Estonia has achieved what appears as one of the most flexible labour markets in industrialised countries. Already before this reform, most employers did not regard the regulations as unacceptably rigid, as shown by the limited use of non-standard types of labour contract. The new rules promise to provide an even better climate for creation of new and better jobs. Nevertheless, they have not prevented a steep rise in unemployment during the economic downturn.

The "security" part of the flexibility concept has been given less priority until now. In the present situation, it is crucial to encourage those out of work to stay in contact with the labour market and to enhance their skills so that they can take up new jobs when the job market improves. Moreover, the high unemployment rate involves a risk that relative poverty will spread to an extent that might threaten social cohesion. This risk may turn out to be manageable if the economic growth rate soon returns to its previous level above the OECD average; but under less optimistic assumptions, social disruptions could worsen. OECD experience shows that public support for labour market flexibility cannot be taken for granted if the social risks are too high.

If and when it becomes affordable to improve the unemployment compensation programmes, OECD experience suggests that such reforms should be accompanied by a substantial enhancement of the public employment service and its activation measures. The achieved merger between the employment service and the UIF represents an important step that should allow Estonia to develop a comprehensive, cost effective and more balanced flexicurity approach.

References

Ahlberg, K. and N. Bruun (2009), "The Future of Extension of Collective Agreements in Estonia", Ministry of Social Affairs of the Republic of Estonia, Tallinn.

Carley, M. (2006), "Key Themes in Global Industrial Relations: Minimum Wages and Relocation of Production", European Foundation for the Improvement of Living and Working Conditions, Dublin.

Duell, N., S. Singh and P. Tergeist (2009), "Activation Policies in Norway", OECD Social, Employment and Migration Working Paper No. 78, OECD Publishing, Paris.

Eamest, R. and J. Masso (2005), "The Paradox of the Baltic States: Labour Market Flexibility but Protected Workers?", *European Journal of Industrial Relations*, Vol. 11, No. 1, pp. 71-90.

EHDR (2009), *Estonian Human Development Report 2008*, Estonian Human Development Report, Tallinn.

European Employment Observatory (2008), "Lifelong Learning and Skills Development: A Review of Trends and Policies with a Particular Focus on Gender and Age", *EEO Review*, Autumn 2007, GHK Consulting Limited, United Kingdom.

Grubb, D., S. Singh and P. Tergeist (2009), "Activation Policies in Ireland", OECD Social, Employment and Migration Working Paper No. 75, OECD Publishing, Paris.

Hall, R. and A. Rabushka (2007), *The Flat Tax,* Hoover Institution Press, Stanford.

Kallaste, E. and K. Nurmela (2007), "Actions Taken to Curb Undeclared Wages", European Industrial Relations Observatory On-Line, 03/05/2007, Eurofound.

Kallaste, E. and L. Roosaar (2007), "Reduction in Labour Dispute Claims Due to Financial Cap", European Industrial Relations Observatory On-Line, 07/05/2007, Eurofound.

Kallaste, E., K. Jaakson and R. Eamest (2008), "Two Representatives but No Representation – An Analysis of Two Cases from Estonia", *Employee Relations*, Vol. 30, No. 1, pp. 86-97.

Kalužná, D. (2008a), "Main Features of the Public Employment Service in the Slovak Republic", OECD Social, Employment and Migration Working Paper No. 72, OECD Publishing, Paris.

Kalužná, D. (2008b), "Main Features of the Public Employment Service in the Czech Republic", OECD Social, Employment and Migration Working Paper No. 74, OECD Publishing, Paris.

Kalužná, D. (2009), "Main Features of the Public Employment Service in Poland", OECD Social, Employment and Migration Working Paper No. 80, OECD Publishing, Paris.

Kerem, K. and N. Lubenets (2004), "Wage Determination in Estonia: A Case without Trade Unions, in S. Rudolf (ed.), *Emerging Markets: Social, Political, and Economic Challenges*, Lodz University Press, Poland.

Klaster and University of Tartu (2007), "Temporary Agency Work Survey" (in Estonian), Estonian Ministry of Social Affairs, Tartu.

Leetmaa, R. and K. Nurmela (2009), "Addressing the Impacts of Economic Crises in Estonia", *Innovative Policies and Practices*, Spring Review, PRAXIS Center for Policy Studies, Tallinn.

Leetmaa, R. and A. Võrk (2003), "Evaluation of Active Labour Market Programmes in Estonia", mimeo, University of Tartu.

Leetmaa, R. and A. Võrk (2007), "Article on Undeclared Work from SYSDEM Correspondent: Estonia", European Employment Observatory, May, Brussels.

Masso, J. and K. Krillo (2009), "Estonia, Latvia and Lithuania: Minimum Wages in a Context of Migration and Labour Shortages" in D. Vaughan-Whitehead (ed.), *The Minimum Wage Revisited in the Enlarged EU*, Palgrave Macmillan.

MER (2005), *Lifelong Learning Strategy 2005-2008*, Estonian Ministry of Education and Research, Tallinn.

MSA (2008), "Employment and Working Life in Estonia 2007", Trends No. 5/2008 Eng, Estonian Ministry of Social Affairs, Tallinn.

Nurmela, K. (2008), "Estonia: Temporary Agency Work and Collective Bargaining in the EU", European Industrial Relations Observatory On-Line, 19/12/2008, Eurofound.

Nurmela, K. and M. Karu (2008), "Problem of Undeclared Wages on the Rise", European Working Conditions Observatory, 08/08/2008, Eurofound.

OECD (2004), *OECD Employment Outlook*, OECD Publishing, Paris.

OECD (2005), *OECD Employment Outlook*, OECD Publishing, Paris.

OECD (2006), *OECD Employment Outlook*, OECD Publishing, Paris.

OECD (2007), *OECD Employment Outlook*, OECD Publishing, Paris.

OECD (2008), *OECD Employment Outlook*, OECD Publishing, Paris.

OECD (2009a), *OECD Economic Surveys: Estonia*, OECD Publishing, Paris.

OECD (2009b), *OECD Employment Outlook*, OECD Publishing, Paris.

OECD (2009c), *OECD Reviews of Labour Market and Social Policies: Slovenia*, OECD Publishing, Paris.

Parissaki, M. and S. Vega Vega (2008), "Capacity Building for Social Dialogue at Sectoral and Company Level in the New Member States, Croatia and Turkey", European Foundation for the Improvement of Living and Working Conditions, Dublin.

Philips, K. (2006), "Capacity Building for Social Dialogue in Estonia", European Foundation for the Improvement of Living and Working Conditions, Dublin.

Philips, K. (2007a), "Capacity Building for Social Dialogue in Estonia", European Foundation for the Improvement of Living and Working Conditions, Dublin.

Philips, K. (2007b), "Working Conditions in Estonia", European Foundation for the Improvement of Living and Working Conditions, Dublin.

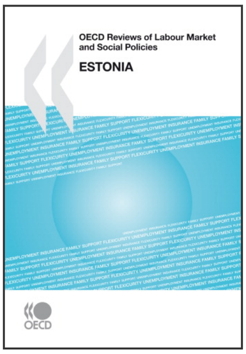
Renooy, P., S. Ivarsson, O. van der Wusten-Gritsai and R. Meijer (2004), "Undeclared Work in an Enlarged Union", European Commission, Brussels.

Roosaar, L. and K. Nurmela (2007), "Temporary Agency Work in Estonia", European Working Conditions Observatory, 18/12/2007, Eurofound.

Tan, H., Y. Savchenko, V. Gimpelson, R. Kapelyushnikov, and A. Lukyanova (2007), "Skill Shortages and Training in Russian Enterprises", IZA Discussion Paper, No. 2751, Institute for the Study of Labor, Bonn.

Toomet, O. (2008), *Threat Effect of the Labour Market Programs in Denmark: Evidence from a Quasi-experiment,* University of Tartu.

Venn, D. (2009), "Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators", OECD Social, Employment and Migration Working Paper No. 89, OECD Publishing, Paris.



From:
OECD Reviews of Labour Market and Social Policies: Estonia 2010

Access the complete publication at:
https://doi.org/10.1787/9789264082120-en

Please cite this chapter as:

OECD (2010), “Flexibility with Limited Security”, in *OECD Reviews of Labour Market and Social Policies: Estonia 2010*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264082120-4-en