

# 2 Recent trends in the Estonian labour market

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In 2019, Estonia was among the top performers in the European Union in terms of employment and labour market participation. Although the early figures from 2020 show that the COVID-19 crisis had a strong impact on Estonia, the economy also already shows early signs of recovery. Despite comparatively robust labour market fundamentals, some structural challenges persist. Demographic trends are likely to limit the extension capacity of the labour market, skill mismatches are common and the unemployment insurance system leaves many unemployed with a low level of or even without benefits, thereby contributing to a high risk of poverty among the unemployed. Some population groups are particularly vulnerable in terms of labour market outcomes and face a high risk of unemployment.

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## 2.1. Introduction

This chapter takes stock of recent labour market developments in Estonia. The Global Financial Crisis starting in 2007 had severely affected the labour market but the situation remarkably improved after the crisis. In 2019, Estonia was among the top performers in the European Union in terms of employment and labour market participation. While the Estonian labour market was starting to cool in the second half of 2019 and early 2020 (Eesti Pank, 2020<sup>[1]</sup>), it was still in a very good position prior to the outbreak of the COVID-19 pandemic. Early figures from 2020 show that the COVID-19 crisis, which triggered a global economic downturn, had a strong impact on Estonia. Nonetheless, the economy already shows early signs of recovery.

The chapter highlights that despite comparatively robust labour market fundamentals, some structural challenges persist. Demographic trends are likely to limit the extension capacity of the labour market, skill mismatches are common and the unemployment insurance system leaves many unemployed with a low level of or even without benefits, thereby contributing to a high risk of poverty among the unemployed. The chapter also reports aggregate statistics demonstrating that some population groups are particularly vulnerable in terms of labour market outcomes and face a high risk of unemployment. The chapter prepares the ground for a more in-depth analysis of population groups with a potential need for labour market policies (ALMPs) in Chapter 5 of this report.

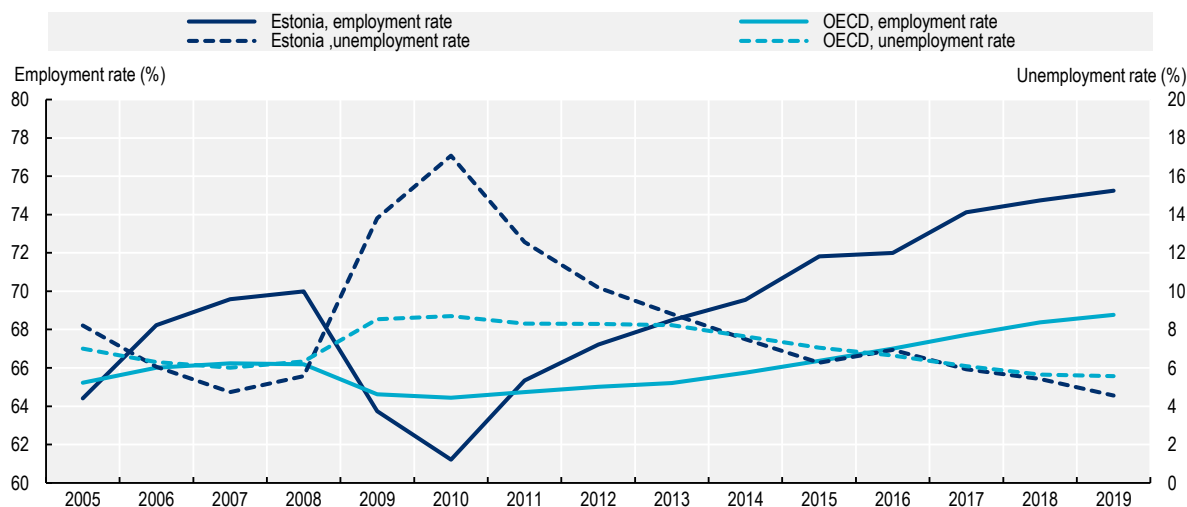
## 2.2. The Estonian labour market made remarkable progress after the Global Financial Crisis

Following a period of sustained economic growth, the Global Financial Crisis severely hit the Estonian economy from 2007 onwards. Unemployment escalated, rising from 4.6% in 2007 to 16.7% in 2010. Young people were particularly hard hit and every third active 15-24 year-old was unemployed when the crisis reached its peak in 2010. Similarly, the employment rate among 15-64 year-olds dropped from 70% just before the Global Financial Crisis to only 61.2% in 2010, thereby falling well below the 2010 OECD-average of 64.4% and the EU average of 63.3%.<sup>1</sup>

While the Global Financial Crisis was very disruptive for Estonia's economy and labour market, the country recovered remarkably well in the aftermath of the crisis. Between 2010 and 2019, the labour market situation continuously improved and Estonia outpaced many OECD countries in terms of employment performance. In 2019, the employment rate among 15-64 year-olds rose to 75.2% in the country (Figure 2.1), against 68.8% on average in the OECD and 68.4% in the EU, exceeding its maximum pre-crisis level. The number of employed people reached record levels, even though the size of the working-age population has been shrinking: about 670 000 people worked in Estonia in the first quarter of 2020 (Eesti Pank, 2020<sup>[1]</sup>), against 570 000 in 2010 and 588 000 in 2000. Among 15-74 year-olds, Estonia's 2018 employment rate of 68.3% was, along with Sweden, higher than that of any other member country of the European Union. In 2019, Estonia was among the top performers in the OECD in terms of both employment and activity.


**Figure 2.1. The Estonian labour market was severely hit by the Global Financial Crisis, but recovered quickly**

Employment and unemployment rates among 15-64 year-olds in Estonia and the OECD



Note: OECD is the weighted average of the 37 OECD member countries.

Source: OECD LFS by Sex and Age – Indicators Database, <http://stats.oecd.org/Index.aspx?QueryId=54218>.

StatLink  <https://stat.link/gxbptv>

Favourable macroeconomic conditions were an essential factor permitting the marked labour market improvements after the Global Financial Crisis. In addition, a number of policy reforms took place and are likely to have contributed to the swift recovery of the Estonian labour market.

- In 2009, the system of ALMPs went through an institutional reconstruction, resulting in major changes to the ALMP provision system. The reform strengthened the conditionality of unemployment benefits on jobseekers' participation in ALMPs and aimed at improving the match between ALMPs and individual needs (HoPES, 2013<sub>[2]</sub>). Since the introduction of the reform, ALMP provision has followed a continuous improvement process with the objective of enhancing effectiveness and efficiency and reaching out to more people in need (Chapter 4).
- In 2016, the system of work ability/incapacity benefits was reformed, with the aim of supporting and incentivising people with reduced work ability to return to the labour market. The reform introduced a work ability allowance system requiring people with at least partial work capacity to register with the Estonian Unemployment Insurance Fund (EUIF, the Estonian public employment service) as a prerequisite for work ability allowance, unless they are employed or otherwise actively engaged. Work ability assessments based on functional limitations were introduced instead of diagnosis based assessments to increase the accuracy of work ability assessments and to help identify people in need of assistance. In addition, the benefit structure changed and the use and provision of ALMPs increased, e.g. work-related rehabilitation was introduced as a new measure. While this reform is still ongoing, its first results point to positive effects on labour market outcomes (Masso, 2019<sub>[3]</sub>). Prior to the reform, a strong temporary surge in unemployment was expected, as previously inactive people with disabilities and partial work ability would join the labour force and register with the EUIF in order to receive benefits, but would struggle to find employment quickly. Contrary to these expectations, unemployment did not increase significantly until 2019 whereas employment rates have risen, suggesting that people with partial work ability registering with the EUIF were able to find employment more easily than expected.

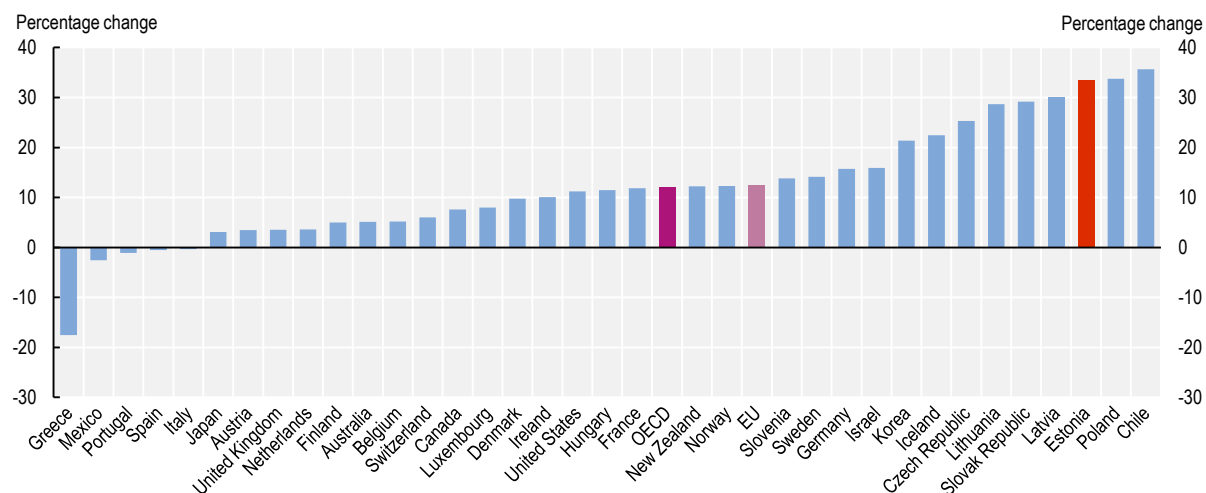
- The pension age increased in Estonia, contributing to rising activity rates among older people. While the pension age was 61 for women and 63 for men in 2010, it went up for women and reached 63 in 2016, thus equalising the male age. In line with these changes, labour market participation of the 60-64 year-olds rose more strongly among women than among men and the female activity rate is higher than the male rate in this age group today, while the opposite is true for younger age groups. Whereas 50.8% of men and 46.0% of women aged 60-64 were active in 2010, there were 65.2% and 68.2% in 2019, respectively. The pension age for both men and women is set to increase further to reach 65 in 2026 and will be linked to life expectancy thereafter.

In addition to good outcomes in terms of employment, unemployment and activity, further employment characteristics point to a labour market characterised by solid labour demand. Involuntary part-time work in Estonia is amongst the lowest in the OECD. In 2019, only 0.8% of all employees worked part-time because they could not find full-time employment, against 3.2% in the OECD. This share is very low, especially compared to countries like France (6.5%), Spain (8%) and Italy (12%). At its peak in 2009, the share of involuntary part-time work in Estonia was four times higher than it is today.

Furthermore, wages have grown substantially over the last years. Between 2008 and 2019, the average real wage increased by 33%, placing Estonia among the countries with the highest wage increase in the OECD (Figure 2.2). Real wage growth is even more pronounced when focusing on shorter periods, as wage levels decreased between 2009 and 2011 in Estonia due to the crisis. The country's average real wage grew by 41% from 2011 to 2019, against 11% on average in the OECD and 12% among OECD countries that are members of the EU. Over this period, the increase in Estonia was stronger than in any other OECD country except for Lithuania (44%) and Latvia (55%). The rapid and sustained wage growth over the past years points to a labour market with substantial labour needs. Although increasing labour supply has alleviated labour shortages over the past years, labour demand still exceeded labour supply in 2018 (Eesti Pank, 2019<sup>[4]</sup>). At the same time, the rate of nominal wage growth slowed from 8.2% in the second half of 2018 gradually to 7.4% in the fourth quarter of 2019. This reflected falling corporate expectations for employment and the general slowing of growth in the economy (Eesti Pank, 2020<sup>[1]</sup>).

**Figure 2.2. Wages grew strongly after the Global Financial Crisis**

Change in average real wage, 2008-19



Note: OECD and EU are unweighted averages. OECD excludes Colombia and Turkey. EU is the unweighted average of the 22 countries shown.

Source: OECD Average Annual Wages Database, <http://stast.oecd.org/Index.aspx?QueryId=25148>.

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### 2.3. Economic impact of the COVID-19 pandemic

Estonia reacted quickly to the first local cases of COVID-19 on 27 February 2020, declaring emergency confinement measures already on 12 March 2020. Overall, however, confinement measures were less severe than elsewhere. Most stores, restaurants and entertainment establishments were able to remain (partially) open during the state of emergency, which ended on 17 May, considerably earlier than in many other countries. In addition, Estonia established a testing system with one of the highest coverage rates relative to its population in the OECD. Over the summer, the number of cases remained comparatively low, with 2 800 confirmed cases and 60 deaths by mid-September, similar to neighbouring Latvia and Lithuania, but much lower (per capita) than in other OECD countries.

Having accumulated a significant fiscal space before the pandemic, the Estonian Government was able to install a significant economic stimulus (4.1% of 2019 GDP, compared to an average of 4.5% on average across G20 countries (IMF, 2020<sup>[5]</sup>)). The stimulus included a temporary wage subsidy scheme, coverage for social contributions, a temporary reduction in fuel excise taxes, and provision of liquidity to firms.

Nonetheless, restrictions on economic activity had an immediate and sizeable impact on consumption and employment. According to data from Swedbank (2020<sup>[6]</sup>), consumer spending fell by 36% year-on-year (YoY) at the peak of confinement in spring 2020 – more than in neighbouring Latvia and Lithuania. In addition, Estonia is a very open economy and vulnerable to falling demand in its main export markets. Exports fell by 2% and 15% in the first and second quarter of 2020, respectively (Statistics Estonia, 2020<sup>[7]</sup>). Overall, GDP fell by 6.9% in the 2<sup>nd</sup> quarter of 2020 and by 1.9% in the 3<sup>rd</sup> quarter of 2020 compared to one year earlier.

The labour market was equally strongly affected. The unemployment rate among 15-69 year-olds rose to 7.2% in the second quarter of 2020 and to 7.8% in the third quarter of 2020, corresponding to increases (YoY) of 2.1 and 3.8 percentage points, respectively. Over the same period, the employment rate dropped by 2.2 (Q2 2020) and 2.5 (Q3 2020) percentage points YoY, falling below 70%. According to Statistics Estonia (2020<sup>[7]</sup>) data, the number of open vacancies was down by 28% in the second quarter of 2020, compared to a year earlier. On the same note, the pandemic stalled sustained nominal wage growth to 1% in the second quarter of 2020 (YoY), ending two years of quarterly wage increases of above 7%. Unemployment increased particularly among women, young people and people with only basic education (Eesti Pank, 2020<sup>[11]</sup>). These groups work more often in the service sectors, which were affected by health measures to curb the pandemic.

At the same time, some indicators point to signs of recovery. In the third quarter of 2020, exports started to rise again and were 1.5% higher than one year earlier. In October and November 2020, the YoY increase in exports even reached 10.2% and 8.9%, respectively. Concerning the labour market, high-frequency weekly data from Statistics Estonia (2020<sup>[8]</sup>) show that the number of new employment relations outpaced the number of terminated relationships in most weeks between May and December 2020. While the unemployment rate stood at significantly higher levels in the third quarter of 2020 than on year earlier, labour market participation had increased. In Q3 2020, the labour market participation rate among 15-69 year-olds reached 75.5%, its highest level since 2018, up from 75% in Q3 2019 (Statistics Estonia, 2020<sup>[9]</sup>).

Starting in late October/early November 2020, the number of newly diagnosed coronavirus infections in Estonia increased rapidly, exceeding the number of diagnosed cases in spring 2020 by far. The implications of this second wave for Estonia's economy and labour market are not clear for now. It remains to be seen to what extent employment will be affected and whether the labour market will be able to recover quickly and permanently.

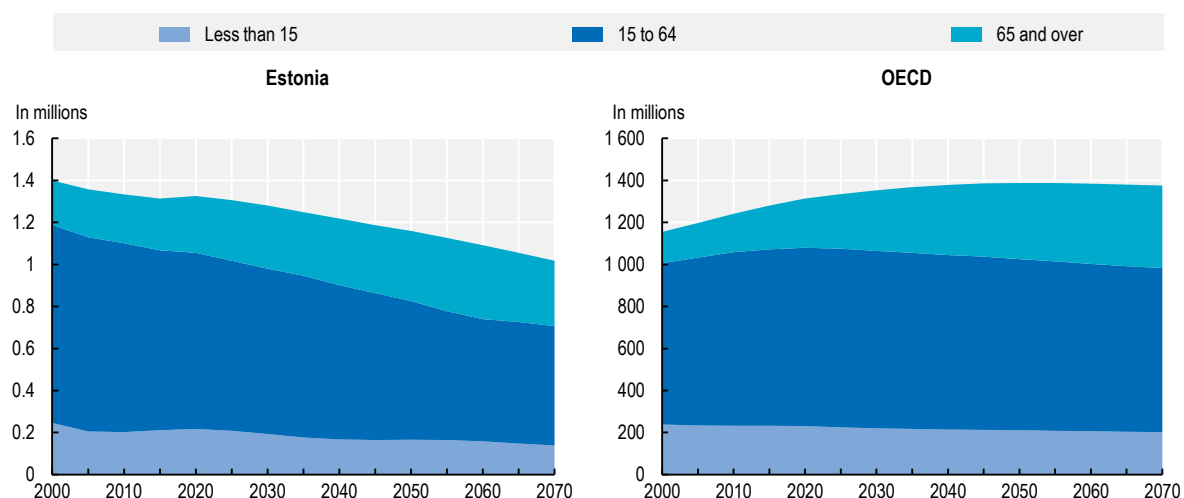
## 2.4. Despite solid labour market fundamentals, structural challenges persist

Despite the initial economic shock following the COVID-19 outbreak, unemployment is still comparatively low in Estonia and the labour market proved to have strong fundamentals. Nonetheless, Estonia faces several structural employment-related challenges. In particular, the effects of an ageing and shrinking population, skill mismatches in the labour market and a high risk of poverty among the unemployed are difficulties confronting Estonia's economy and society.

The working-age population is projected to decline over the next decades while the share of retired people in the population is set to rise strongly (Figure 2.3). According to United Nations projections, the number of 20-64 year-olds will decrease by 22% between 2020 and 2050 whereas the number of people aged 65 and over is expected to increase by 23% over the same time span. Similarly, national forecasts point to a pronounced decrease in the working-age population by 2035.<sup>2</sup> These stark population dynamics bear long-term economic risks, most importantly falling labour supply and increasing spending on pensions and health services. Labour supply being scarce already today, the implications for Estonia's growth prospects could be significant.

**Figure 2.3. The Estonian population is projected to shrink and age quickly**

Number of inhabitants, by age group



Note: OECD excludes Colombia.

Source: United Nations World Population Prospects 2019, <https://population.un.org/wpp/>.

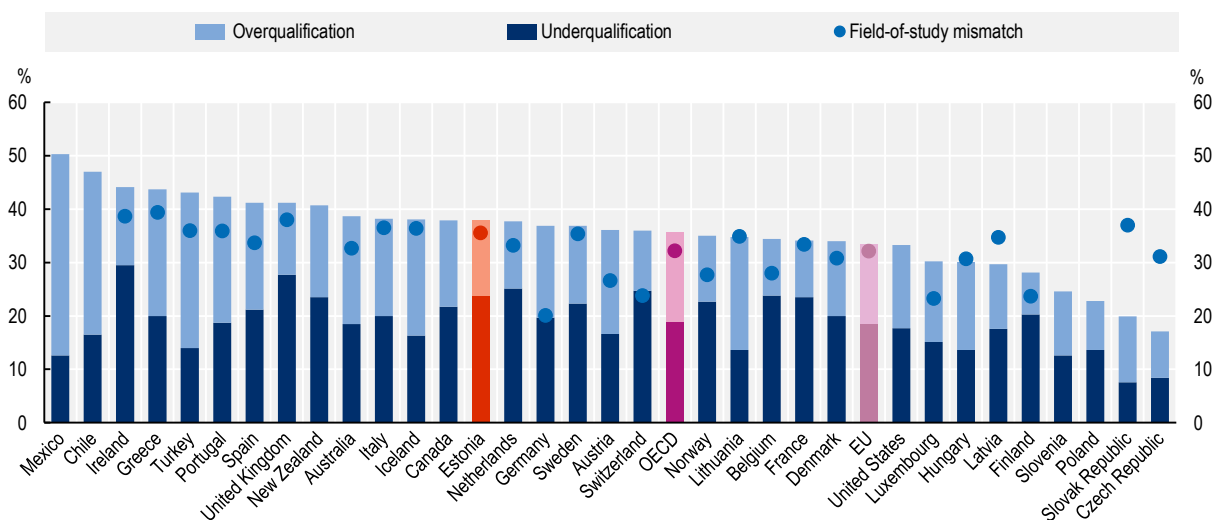
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In addition, there is a high level of mismatch in the labour market, in terms of both mismatch between workers and their jobs and between the unemployed and vacancies, i.e. structural unemployment. Under-qualification and field-of-study mismatches among employees are more common in Estonia than in many other OECD countries (Figure 2.4). In 2016, 24% of Estonian workers were underqualified for the requirements of their job while 14% were overqualified, against 19% and 17% in the OECD, respectively. Furthermore, 36% of workers had a field-of-study mismatch in Estonia, i.e. they were employed in a job that did not match their field of study, compared to 32% on average across countries. A large share of unemployed registered with the EUIF has a low level of qualification, with 40% of the registered unemployed having only general education and lacking higher education, vocational education or studies. Therefore, economic growth is not only limited by a decreasing working age population, i.e. labour shortage in general, but also by low labour productivity due to skill shortages and

a high share of low value-added sectors in the economy. Especially in light of the tense labour supply situation, reinforcing the skills of workers and, more generally, improving the skill match between workers and jobs can be essential factors increasing the economic capacities of the Estonian labour market.


**Figure 2.4. There is a high degree of skill mismatch in Estonia**

Share of employed persons experiencing qualification or field-of-study mismatch in 2016, age 15-64



Note: Qualification mismatch arises when workers have an educational attainment that is higher or lower than that required by their job. If their education level is higher than that required by their job, workers are classified as over-qualified; if the opposite is true, they are classified as under-qualified. Field-of-study mismatch arises when workers are employed in a different field from what they have specialised in. Countries are ranked in decreasing order of the sum of workers over-qualified plus those under-qualified. OECD and EU are unweighted averages. OECD excludes Colombia, Israel, Japan and Korea for which no data are available. EU is the unweighted average of the 22 countries shown.

Source: OECD Skills for Jobs Indicators Database, Mismatch Dataset, <http://stats.oecd.org/Index.aspx?QueryId=77595>.

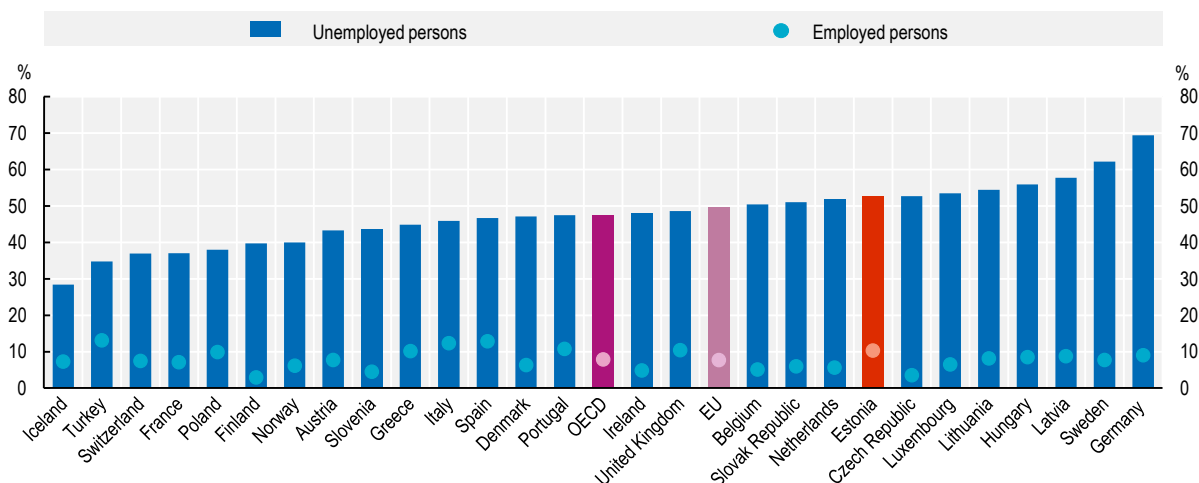
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The risk of poverty is high among the unemployed in Estonia. In 2018, 52% of unemployed people were estimated to be at risk of poverty, against an average of 48% in 27 European OECD countries (Figure 2.5). One factor contributing to this relatively high level is the limited unemployment benefit coverage, with less than half of registered unemployed people receiving unemployment benefits, due to strict entitlement conditions.<sup>3</sup> While strict entitlement conditions increase the financial incentives to find employment quickly, they also bear the risk of strongly penalising vulnerable population groups who struggle to find employment despite job search efforts. In Estonia, unemployed people who do not qualify for unemployment insurance benefits (Töötuskindlustushüvitis) are entitled to the means tested unemployment allowance (Töötutoetus) under certain conditions, most notably a history of labour market participation or studying. The unemployment allowance is low, however, with a maximum benefit of EUR 189/month in 2020 (that is 35% of the minimum wage in 2019), leaving recipients who rely entirely on this allowance below the poverty line. In 2021, the unemployment allowance will be set to 50% of the minimum wage in 2020, thus rising to EUR 292.



### Figure 2.5. The poverty risk is high among the unemployed in Estonia

Share of people (ages 18-64) at risk of poverty, by employment status, 2018



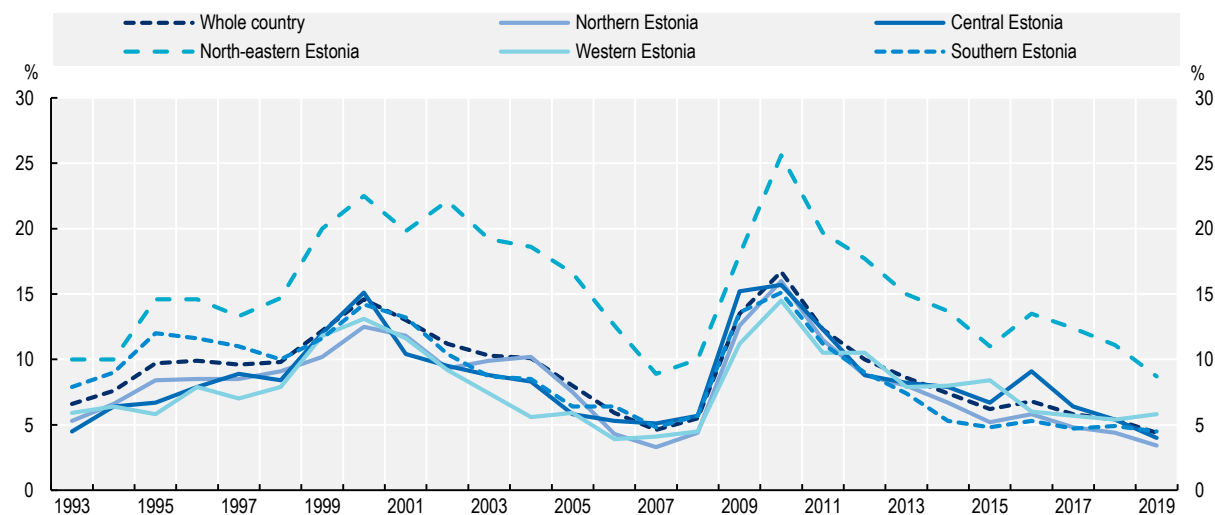
Note: The risk-of-poverty threshold is 60% of the national median equivalised disposable income after social transfers. OECD is an unweighted average of the 27 countries shown. EU is an unweighted average of the 22 countries shown. Data refer to 2017 for Iceland.

Source: Eurostat, *In-work at-risk-of-poverty rate dataset*, <https://ec.europa.eu/eurostat/databrowser/view/TESEM210/default/table>.

StatLink <https://stat.link/6y2eh8>

Finally, significant differences persist in the labour market across regions. Historically, the unemployment rate was particularly high in north-eastern Estonia. In Estonia, as well as in other former Soviet Republics, the drop of employment following the economic reforms in the 1990s was the sharpest in large industrial enterprises. These were mainly concentrated in north-eastern Estonia. Despite overall improvement in the labour market since 2010, these differences persist until today and have even widened recently (Figure 2.6). While the unemployment rate was roughly 63% higher in north-eastern Estonia than in the rest of the country in 2000, the difference was at 96% in 2019.<sup>4</sup>

### Figure 2.6. Unemployment rate by regions, 15-74 year-olds



Source: Statistics Estonia Database, <https://www.stat.ee/en>.

StatLink <https://stat.link/cdbx5r>



## 2.5. Vulnerable groups require specific policy attention

Despite the economic toll of the COVID-19 economic crisis, labour market conditions are generally favourable for workers in Estonia. At the same time, some population groups lag often behind due to the labour market challenges discussed in 2.4 and face significant labour market difficulties:

- According to OECD data, 20% of the unemployed in 2019 were unemployed for at least one year. Although the share of long-term unemployment among total unemployment was higher in the aftermath of the crisis, these numbers point to the existence of a pool of vulnerable people with significant employment difficulties. Since the chances to find high-quality jobs dwindle as people stay out of employment for longer, reconnecting the long-term unemployed with jobs remains a major challenge and requires specific policy efforts.
- The educational divide in Estonia's labour market is strong. The unemployment rate stood at under 3% among highly educated 15-64 year-olds (with tertiary education) in 2019, whereas it was 4.9% among people with upper-secondary education and 10.3% among people with low (below upper-secondary) levels of education (Eurostat, 2020<sup>[10]</sup>).
- Furthermore, there are differences between age groups. Most importantly, young people without previous work experience face bigger difficulties finding employment than other population groups. The unemployment rate of 15-24 year-olds exceeds the rates of other age groups by far: in 2019, the unemployment rate stood at 11.1% among 15-24 year-olds, against 4.0% both among 25-54 year-olds and 55-64 year-olds.
- Regional labour market differences are stark. In 2019, the unemployment rate was 4.4% in Estonia on average, but it was 3.3% in the city of Tartu against almost 9% in the Ida-Viru county in Estonia's northeast. Similarly, labour market participation is much higher in Tallinn, Tartu and north-western Estonia than in other parts of the country, most notably southern and north-eastern Estonia. In Tallinn, for instance, labour market participation among 15-74 year-olds was 78.9% in 2019 whereas it was only about 60% in Ida-Viru, Põlva, Võru and Jõgeva. In addition, in some of the regions with more pronounced labour market difficulties, a large share of the workforce is concentrated in a few economic sectors only, reflecting a low degree of employment diversification in the labour market. In Ida-Viru, 50% of all workers were employed in manufacturing, mining and quarrying or construction in 2017, making the local labour market situation vulnerable to shocks to these sectors.
- One common obstacle to employment in Estonia is bad health. Although good macroeconomic conditions and the Work Ability Reform have contributed to a strong increase in the employment rate among people with reduced work ability in age group 15-64, from 32.5% in 2010 to 52.1% in 2019, bad health remains a frequent employment barrier. More than one out of five inactive people aged 15-74 was inactive due to illness or disability in 2019, placing health problems as the most widespread reason for inactivity in Estonia, apart from retirement and studying.

According to Browne et al. (2018<sup>[11]</sup>), which relies on data from the European Union Statistics on Income and Living Conditions (EU-SILC) from 2013, the most common employment barriers in Estonia were a lack of recent and adequate work experience, a lack of relevant skills and health limitations. Further barriers included care responsibilities and scarce job opportunities, but the latter were less widespread. People who were entirely out of employment or who were only weakly attached to the labour market (e.g. working less than six months per year) tended to face employment barriers significantly more frequently than population groups in regular employment, suggesting that the link between employment barriers and labour market outcomes could be strong. In addition, vulnerable groups often faced several employment barriers simultaneously, thus reinforcing their difficulties in accessing the labour market. According to the study, the five biggest groups with employment barriers were the following: experienced early retirees with health limitations; older labour market inactive adults with health

limitations, low skills and limited work experience; working poor; well-off mothers with care responsibilities; and prime-age long-term unemployed with low skills.

These labour market differences between educational groups, age groups and regions point to a heterogeneous labour market with favourable outcomes for some population groups in some regions, but less favourable conditions for others, and call for labour market policies that are flexible enough to adapt to this high degree of heterogeneity. A number of specific employment barriers exist and prevent some population groups from working despite historically low unemployment and sustained labour demand.

With these results and the recent trends in the Estonian labour market in mind, Chapter 3 provides an assessment of the institutional and regulatory set-up of labour market policies, focussing on both policy design and strategy development, and the legal framework and financing models. Chapter 4 focuses on the outreach to people in need of ALMPs, the strategy of ALMP provision and the networking and co-operation practices between the providers of employment, health and social services. Chapter 5 identifies groups of people with possible ALMP needs and discusses the obstacles they face in integrating in the labour market. Chapter 6 assesses the match between ALMP needs and access to ALMPs.

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## Notes

<sup>1</sup> Average values for the European Union are based on data published by Eurostat.

<sup>2</sup> [https://sisu.ut.ee/sites/default/files/ranne/files/rita\\_hoive\\_ja\\_rahvastik.pdf](https://sisu.ut.ee/sites/default/files/ranne/files/rita_hoive_ja_rahvastik.pdf).

<sup>3</sup> Throughout this report the term “entitlement condition” is used to refer to a prerequisite for benefit payments (e.g. having fulfilled a minimum contribution period) whereas “eligibility criterion” refers to an additional, often behavioural, requirement (e.g. actively search for work). See Immervoll and Knotz (2018<sup>[12]</sup>) and Langenbucher (2015<sup>[13]</sup>).

<sup>4</sup> Calculations based on an unweighted average of regional unemployment rates.



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