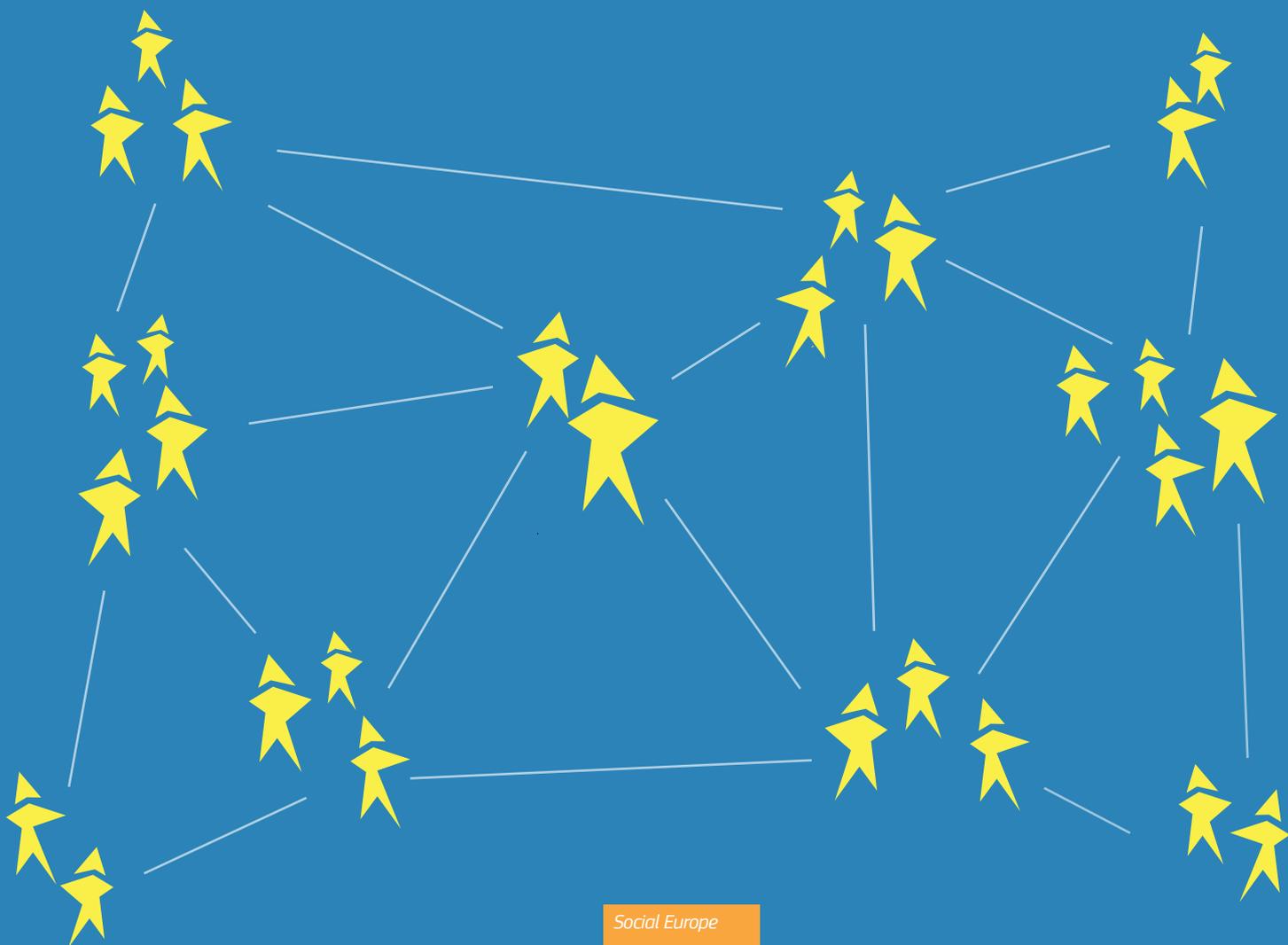




EUROPEAN SOCIAL POLICY NETWORK (ESPN)

In-work poverty in Estonia

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European Social Policy Network (ESPN)

**ESPN Thematic Report on
In-work poverty**

Estonia

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Summary

The in-work at-risk-of-poverty¹ rate was at the same level in Estonia (9.6%) as the average in the EU in 2017. However, during the last decade the rate has been volatile, having fallen to this level from 11.8% in 2014. Also, in some sub-groups, the in-work poverty rate was much higher in Estonia in 2017 than in the EU. In Estonia, the most affected sub-groups of the employed population were persons with lower educational attainment, single persons with dependent children, self-employed people and part-time employees. The root cause of in-work poverty in Estonia is both market income inequality (including lack of permanent income) and the small scale of income redistribution by the tax-benefit system.

In-work poverty is tackled through both wage policy and tax-benefit policy in Estonia. Firstly, in-work poverty is addressed through wage-setting policy, in which **minimum wages** are the most crucial element. A national-level minimum wage (€500 in 2018) is agreed in Estonia by the social partners and enforced by governmental decree. From 2018 until 2022 the national-level minimum wage increase will be calculated annually on the basis of labour productivity and economic growth. The minimum wage influences other aspects of income too, as it affects the amount of unemployment insurance, parental benefit, and sickness benefit. In Estonia, the minimum wage has contributed to lower wage inequality and thus a lower risk-of-poverty rate. Additionally, the most discussed issue regarding pay inequalities in Estonia is **the gender pay gap**, which is the highest among the EU Member States (25.3%). Efforts have been made to make the employment rights effective that **prohibit unjustified unequal treatment in wage setting**.

Secondly, during recent years low employment income has been addressed through the income tax rules. In 2018, an income tax reform was implemented, under which the **tax-exempt portion of income** for low- and medium-income earners increased to €500 per month (meaning an increase in net salary of up to €64 per month). This helps to reduce poverty among people on lower incomes. There is also an increased basic exemption for people with at least two dependent children (€1,848); this supports families with children, who also have a higher risk of poverty.

The Estonian **social protection system** has a few in-work benefits, including means-tested benefits, that redistribute to low-income earners. The most crucial benefit is the **subsistence benefit** that protects people from suffering direct poverty, and which it is possible to receive while working. From the beginning of 2018, the **subsistence benefits system** has been made more flexible in order to motivate labour market participation. When a person goes to work and starts to earn an employment income, they continue to receive the full benefit for the first two months, and 50% of the benefits for the following four months. The subsistence level was €140 for an adult and €168 for children in 2018.

One of the risk groups for income poverty is disabled people, who often lack employment opportunities and at the same time have addition consumption needs. The recent work ability reform, implemented in 2016, introduced a **work ability allowance** that helps to reduce poverty among people with reduced or no work ability, and is also paid while the person is working (at a lower level in some cases). The introduction of the work ability reform, together with a wider selection of active labour market measures targeted at people with reduced work ability, has already improved people's access to the labour market.

The Estonian **parental leave and benefits system** supports work and family life and allows the simultaneous receipt of employment income and the related benefits. This also helps to reduce in-work poverty among people with children. As a result of the recently adopted reform, flexibility has significantly improved: since March 2018, the benefit has been reduced if the income from employment exceeds 1.5 times the national average wage (€1,544 per month in 2018); as from 2022, the benefit will be receivable for three years,

¹ For ease of reading, in the rest of this report we will refer to the notion 'at risk of in-work poverty', and to the indicator that measures it, using the generic term of 'in-work poverty' (IWP).

i.e. the amount of the benefit will not change, but the duration of the right to claim the benefit will be extended.

The unemployment insurance fund offers many **labour market services**. Since 2017 the focus has shifted to preventing unemployment and therefore to services targeted at people who work, supporting their continued receipt of a market income. The main target group of the measures among employees are those at risk of losing their job due to health conditions, lack of skills or outdated skills, by making training and study options more available.

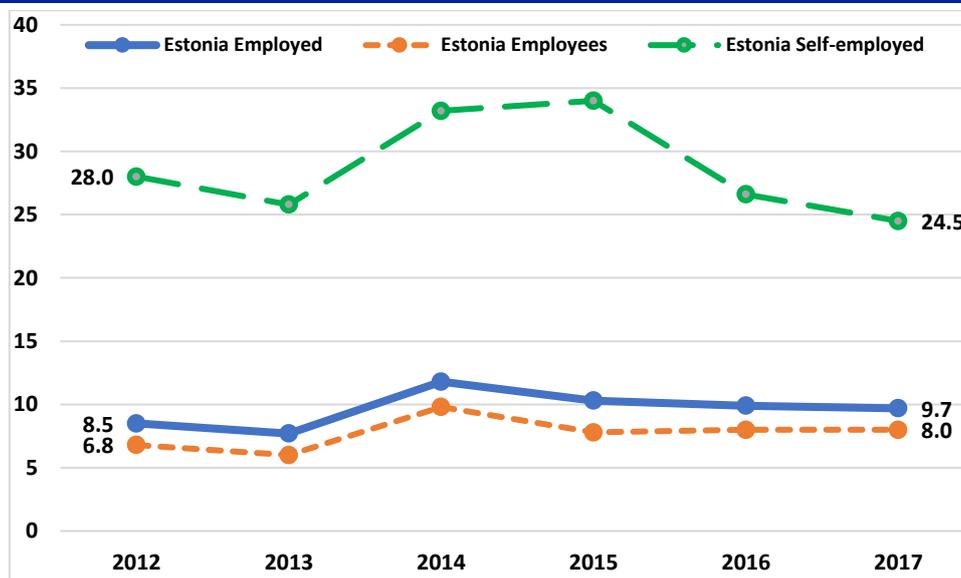
Regarding future policy developments, different plans have been proposed. The Ministry of Social Affairs commissioned an evaluation in 2018 of the adequacy of the current methodology for estimating the subsistence minimum, with a view to proposing a new or amended calculation methodology. This is expected to lead to better support for low-income families. The ministry has also commissioned a study of ways to improve the unemployment insurance system, as the low coverage and adequacy of benefits may lead to suboptimal matching in the labour market and to income poverty.

1 Analysis of the country's population at risk of in-work poverty

A person is at risk of in-work poverty if they are in employment (waged or self-employed people aged 18-64 who worked more than half of the year) and live in a household that is at risk of poverty – that is, its equivalised disposable income is below 60% of the national equivalised disposable household median income².

The in-work at-risk-of-poverty rate of employed persons was 9.7% in Estonia in 2017 (Figure 1), which was at the same level as the EU average (9.6%). However, during the last decade the rate has been volatile and fell to this level from a peak of 11.8% in 2014.

Figure 1 The in-work at-risk-of-poverty rate of employees and self-employed, Estonia 2012-2017 %



Source: Eurostat, *ilc_iw01*.

² Those at risk of poverty or social exclusion (AROPE) correspond to those who are either at risk of poverty, or severely materially deprived or living in a household with a very low work intensity. The material and social deprivation (MSD) rate is the proportion of people who are deprived under at least five out of the following 13 headings – can deal with unexpected expenses; can afford a one-week annual holiday away from home; avoid arrears (in mortgage or rent, utility bills or hire purchase instalments); can afford a meal with meat, chicken or fish every second day; can afford to keep the home adequately warm; have access to a car/van for personal use; can replace worn-out furniture; can replace worn-out clothes; have two pairs of properly fitting shoes; spend a small amount of money each week on themselves; have regular leisure activities; get together with friends/family for a drink/meal at least monthly; have an internet connection.

There have been recent changes in the relative in-work poverty rate as between the sexes in Estonia. In 2012 the in-work poverty rate for females (10.3%) was higher than for males (6.8%); but from 2014 it was almost at the same level or even lower. In 2017, the in-work poverty rate for females was 9.4%, but for males it was 10%. Women's risk of in-work poverty fell somewhat, but for men the risk increased. The high gender pay gap is a frequently discussed topic in Estonia. According to Statistics Estonia, the gender pay gap was 21% in 2017 (women's hourly pay was lower)³. The gender pay gap in 2016 was about 9 percentage points higher in Estonia than the EU average (Estonia 25.3%; EU 16.2%)⁴.

The in-work poverty rate also varies by age group. In Estonia in 2017, in-work poverty was highest for those aged 18-24 (18.4%), followed by those aged 25-54 (9.8%) and 55-64 (6.8%). However, the in-work poverty rate varies from year to year, especially among the group aged 18-24, for whom it was 7.4 % in 2016, but 11 percentage points higher in 2017. On average in the EU, the risk of in-work poverty is also higher among younger people, but according to Eurostat data for 2017 the risk of poverty rate for those aged 18-24 was 6 percentage points lower in the EU (12.5%) than in Estonia (18.4%).

The in-work poverty rate in Estonia is lower for those with a higher educational attainment level, and higher for those with a lower educational attainment level. For persons with lower secondary education or below, it was 15.4% in 2017; for persons with upper secondary and post-secondary non-tertiary education it was 12.1%; and for persons with tertiary education, 5.4%. The EU averages were, respectively, 20.6%, 9.3% and 4.5% (Eurostat data).

The in-work at-risk-of-poverty rate also depends on household structure. According to Eurostat data, those most at risk in 2017 were single persons with dependent children, both in Estonia (21.6%) and on average in the EU (21.4%). In Estonia, the in-work poverty rate was also higher than average for single persons (15.2%) in 2017, having increased between 2012 and 2017 by almost 5 percentage points. In Estonia the in-work poverty rate was lower in 2017 for households with two or more adults without dependent children (5.6%) and with two or more adults with dependent children (9.5%). The EU averages were, respectively, 6.1% and 10.6% in 2017.

Low-wage earners made up 22.8% of all employees in Estonia in 2014, but 17.2% on average in the EU (Eurostat data). Atypical workers, especially the self-employed, are more affected by low pay than typical employees. They also have a higher risk of poverty, whether in or out of work, in both Estonia and the EU as a whole (Jara, Tumino 2018). This is partly because self-employed people are less protected against social risks – for example, they cannot access unemployment insurance benefits. The in-work poverty rate of self-employed people in Estonia was three times higher than that of standard employees in 2017 (24.5% vs 8%). However, the rate of in-work poverty among self-employed people fell significantly (by 10 percentage points) in recent years, as in 2015 it was 34% and in 2017 it was 25% (Eurostat data). An important factor that affects the in-work poverty rate is whether a person works full time or part time and how stable the work is. In Estonia about 90% of the employed population work full time, and about 10% part time⁵. Part-time workers in Estonia have poorer access than full-time workers to different contributory benefits, and as a result they have a higher risk of in-work poverty. In 2017, the in-work poverty rate of full-time workers was 8%, but for part-time workers it was 18.4%. In the EU, the average in-work poverty rate of part-time workers was a bit lower (15.8%), but the rate for full-time workers was at the same level (8%). In addition, in 2017 the in-work at-risk-of-poverty rate was three times higher in Estonia for those working on a temporary contract (21.1%) than for those working on a permanent contract (7.3%). There was a similar differential in the EU as a whole, but the in-work poverty rate for those working on

³ Statistics Estonia 2018. Gender pay gap by economic activity (Table PA5335).

⁴ Eurostat 2018. The unadjusted gender pay gap, 2016 (difference between average gross hourly earning of male and female employees as % of male gross earnings). https://ec.europa.eu/eurostat/statistics-explained/index.php/Gender_pay_gap_statistics

⁵ Statistics Estonia 2018. Employed persons in main job by sex, age group and full/part-time job (Table TT220).

a temporary contract was almost 5 percentage points lower in the EU (16.3%) than in Estonia (Eurostat data). Arguably, the risk of poverty was due both to their lack of a permanent market income and their lack of access to benefits that could smooth income and consumption.

Household work intensity should be considered when describing the in-work poverty rate. Work intensity is the ratio of the number of months worked to the maximum possible number of months worked in one year. For households with very high work intensity (0.85-1), the risk of poverty is lower, about 8% in 2017 in Estonia; but for the households with low work intensity (0.2-0.45) it is higher (about 40%). Nonetheless, the poverty rate for households with low work intensity decreased between 2012 and 2017 by about seven percentage points. For households with high and medium work intensity, the risk of poverty was, respectively, 12% and 20.4% in 2017. In the EU the rates were quite similar, varying by about 2 percentage points. When comparing households without dependent children with households with dependent children, it seems that in the EU the in-work poverty rate is higher for households with dependent children, especially those with medium and low work intensity; but in Estonia the opposite is the case. The in-work poverty rate was 58.4% for households without dependent children and with low work intensity in 2017, but 23% for households with dependent children and low work intensity. With very high and high work intensity there were no big differences between households and the rate was quite similar, about 8% and 12% respectively (Eurostat data).

In Estonia in 2017, the in-work poverty rate among people born in Estonia (9.9%) was similar to that for people born in some other country (8.2%); but on average in the EU there was a big difference – 8.3% for the local-born population compared with 19.8% (Eurostat data).

The complex of challenges for Estonia regarding in-work poverty come from: (a) inequality of income from work, including a lack of permanent income in the case of part-time and temporary employment, allied to wage discrimination; and (b) a deficiency of in-work benefits and in the overall level of social protection.

2 Analysis of the policies in place

The risk of poverty depends on different factors and these factors may also occur in many combinations. In Estonia, the most affected sub-groups of the employed population are persons with lower educational attainment, single persons with dependent children, self-employed people, and part-time employees. Both wage-setting policies and the tax-benefit system (which supports people with lower incomes) have the effect of reducing poverty and inequality (through the minimum wage, tax-free income, subsistence benefit, etc.). The reforms already implemented have had an impact on income distribution. According to the EUROMOD reports, in 2016 they increased the mean household income by 2.2% compared with 2015 (Vörk et al. 2016); and in 2017 they reduced mean household income by about 0.2% compared with 2016 (Masso et al. 2017); but, in 2018 they increased mean household income by about 3.5% compared with 2017 (Masso et al. 2018). Additionally, active labour market policies, including support for training and retraining, should reduce unemployment and therefore also poverty.

2.1 Policies with a direct influence on in-work poverty

2.1.1 Wage setting

One of the main measures to tackle in-work poverty in Estonia is **wage-setting policy**, with the emphasis on minimum wages. It has been suggested that well managed minimum wages or collectively agreed wage floors contribute to the improvement of low-paid workers' wages without negative effects (McKnight et al. 2016). In Estonia, wage setting mostly takes place at company level through bipartite negotiations between the employer and the individual employee. The coverage of collective bargaining is low (3.9% of

companies and 19% of employees were covered in 2015⁶) and there are only two sectors (healthcare and transport), where sectoral minimum wage agreements are in place. Trade unions have emphasised the need to conclude sectoral level agreements to address the inequalities in working conditions in different sectors, which are difficult to solve through general labour law alone, but to no avail so far. Therefore, the main wage-setting policy in Estonia is the statutory national-level minimum wage, which is agreed by the social partners and enforced by government decree (€500 in 2018, €540 in 2019). The ratio of the minimum wage to the national average gross wage has increased year by year, i.e. from 33% in 2012 to 39% in 2018. The most recent empirical analysis covering the period 2001-2014 indicates that in Estonia, where there is large wage inequality, the minimum wage appears to have contributed to lowering wage inequality and thus the risk-of-poverty rate (Ferraro et al. 2016).

Additionally, in Estonia, the minimum wage is linked to different social transfer payments, and therefore the annual increase in it has an effect on other aspects of income and costs as well. For example, the minimum wage is the basis for: the minimum sum of unemployment insurance (50% of the minimum wage in the previous year); the rate of parental benefit when there are no earnings from the previous year (100% of the minimum wage in the previous year); the minimum sum of parental benefit when previous earnings are lower than the national minimum wage (100% of the minimum wage in force); and the minimum sum of sickness or care benefit (calculated on the basis of the minimum wage in force). The link has a positive effect on those earning the minimum wage or less. On the other hand, the minimum wage is also the base for calculating the minimum social tax contributions paid by employers, which has an impact on their ability to provide, for example, part-time job opportunities. There is also a link to the maximum sum of pre-school institutions' fees paid by parents (20% of the minimum wage in force), affecting the situation of families with young children by increasing their monthly costs.

In addition to national minimum wage, the crucial wage-setting mechanism is **equal pay regulation**. According to studies (e.g. McKnight et al. 2016), pay inequalities are related to low pay and in-work poverty – the greater the level of wage inequality, the greater the incidence of low pay found in different countries. In Estonia, the basis for ensuring equal pay for different groups is the Equal Treatment Act, in force since 2009. It has a broader aim of ensuring the protection of people against discrimination on different grounds. The most discussed issue regarding pay inequalities in Estonia, however, is the gender pay gap, which is the highest (25.3%) among the EU Member States, according to Eurostat. Since 2004, the Gender Equality Act has sought to ensure the equal treatment of men and women by defining and prohibiting discrimination on the basis of gender in all fields and sectors of social life. However, an analysis of the implementation of the Act from 2016 showed that employers were not fully aware of the Act and did not completely understand the overall aims of gender equality (Turk et al. 2015). So far, indirect measures (e.g. general equality rights, work-life balance policy) have been the main tool for the government to deal with the issue. However, these have not proved to be enough. Only recently, the government proposed improved inspection arrangements regarding the pay gap to make the existing employment equality rights effective. The relevant legislative changes will soon be adopted by the parliament (and are expected to enter into force in July 2020). With these changes, all employers will be obliged to collect gender-based data, so that it will be possible to assess gender differences in the remuneration system. In addition, the Labour Inspectorate will be authorised to monitor the remuneration and benefits paid by employers to men and women for equal work. Where potential cases of discrimination are discovered, the inspectorate will be allowed to ask the organisations to conduct an equal pay audit in their organisations, during which the gender pay gap action plan of the organisation should also be developed. Initially, it was planned that the labour Inspectorate's powers of supervision would be used in both the public and the private

⁶ Statistics Estonia. Work Life Survey 2015 (Tables TKU63 and TKU64).

sectors. Employers, however, claimed it would entail excessive administrative burdens, so it was decided that the inspections will be mandatory in the public sector only, while private sector companies can volunteer to be inspected. The measure will require employers to thoroughly analyse the pay policy in their organisation with the help of the relevant authority. Though there have been no evaluations of the current policy yet, it can be expected to help prevent discrimination in wage setting and reduce in-work poverty.

2.1.2 Taxation

The tax policy system affects the income and therefore poverty risk of employed people. The Estonian tax system is characterised by a higher level of employment and indirect taxes and a lower level of property taxes, compared with other countries. Indirect taxes on consumption are especially regressive in Estonia, i.e. they absorb a larger percentage of the income of low-income earners than of high-income earners. Thus, the recent income tax regulation reforms have been targeted at people whose income is lower, and this has increased the mean household income significantly (see next section: income tax reform).

The **tax-exempt portion of income** for low- and medium-income earners was €500 per month (€6,000 per year) in 2018. In that year:

- an annual income up to €14,400 gave rise to the full annual basic exemption of €6,000;
- if annual income was from €14,400 to €25,200, the basic exemption decreased according to the following formula: $6,000 - (6,000 \div 10,800 \times (\text{income amount} - 14,400))$;
- if annual income was above €25,200, the basic exemption was €0.

Therefore, if the monthly gross wage is lower than €1,200 the basic exemption is €500; from gross wage of €1,200 the basic exemption starts to decrease; and from €2,100 it equals €0. If a person works at several places at the same time, the tax-free income can only be counted in one place.

There is also an increased basic exemption for people with at least two dependent children (€1,848 per year). Such an exemption supports families with children, who have a higher risk of poverty. In addition, resident physical person has the right to deduct from a tax period's income the additional basic exemption of €2,160 on behalf of one's spouse if the spouse has not deducted it themselves (the additional deductible sum, however, must not exceed €50,400). Impact evaluation of the recent income tax regulation changes its on income distribution and in-work poverty are expected in 2019.

2.1.3 Social protection system

The social protection system is designed to redistribute income and smooth consumption over households, life cycles and generations. The Estonian **social protection system** has a few in-work benefits, including means-tested benefits, that redistribute to low-income earners. The most crucial here is the **subsistence benefits** that provide a guaranteed income level, designed to protect people from direct poverty, and which it is possible to receive while also working. Subsistence benefits in Estonia are a state aid to people in need paid by local governments and they are paid only in cases where all other measures aimed at alleviating poverty and need have proven to be ineffective. Subsistence benefits are provided to a person living alone or to a family whose monthly net income, after the deduction of housing expenses (up to a certain limit), is below the subsistence level. The subsistence level is based on the minimum expenditure needed on foodstuffs, clothing, footwear and other goods and services that satisfy primary needs. The subsistence level has been increased yearly and it has also increased the mean household income, especially for lower-income groups. In 2014 the subsistence level increased from €76.70 to €90, and studies show that this increased the mean household income, especially the income of lower-income groups (for the first decile group by 3.1%) (Võrk et al. 2015). When in 2016

the subsistence level increased further to €130, it also increased the mean household income of the bottom decile group by 5.8% compared with 2015 (Võrk et al. 2016). In 2018 the subsistence level increased from €130 to €140, and it will also increase in 2019 (to €150). However, according to EUROMOD the mean household income of the first decile group decreased in 2018 compared with 2017 by 2.9% because the needs-based family benefit was replaced with a higher weighting for children in subsistence benefits. While considering all policies implemented in 2018 compared with 2017, household mean income increased in total (Masso et al. 2018).

Previous studies show that people with reduced work ability who move from unemployment to employment receive about €160 per month less in salary than other unemployed people who move to employment. In addition, 26% of people with reduced work ability received a salary that was lower than the minimum wage in 2015 (Unemployment Insurance Fund 2017). It can be assumed that their poverty risk is also higher. A reform was implemented in Estonia in 2016 aimed at helping people with partial or no work ability to improve their access to the labour market, through increased integration between the work ability allowance and active labour market measures. A **work ability allowance** of €337 per month was paid in 2018 to those with no work ability, and of €192 (57% of the no-ability rate) to those with partial work ability. It is also paid while the person is working, but is gradually decreased when the employee's monthly wage reaches 90 times the daily rate (€1,012 in 2018). Due to the reform, the activity of people with reduced work ability has grown – in terms of participation in active measures, searching for a job, registration with the unemployment insurance fund, and participation in the labour force. For example, the proportion of people with reduced work ability who were registered with the unemployment insurance fund increased from 3.6% in 2014 to 13.1% in 2017 (Melesk et al. 2018).

One in-work benefit measure that reduces unemployment and increases work incomes is the **wage subsidy**. This is a subsidy paid to employers who employ an unemployed person or a person with reduced work ability. Employers who hire a long-term *unemployed* person (registered as unemployed for at least 12 consecutive months; in the case of someone aged 16-24, six months) or a person who was released from prison within 12 months before registering as unemployed, can apply for a wage subsidy paid by the Estonian unemployment insurance fund. It is paid for a maximum of six months in the amount of 50% of the wage; the maximum amount of the subsidy is the national minimum monthly wage. Employers who hire a person with *reduced work ability* who has been registered as unemployed for at least six months or was released from prison within 12 months before registering as unemployed, can apply for wage subsidy that is paid for a maximum of 12 months. However, the duration of the payment depends on the type of the contract. In the case of a fixed-term contract, the payment duration is equal to half of the duration of the employment in the contract, up to the maximum duration (six or 12 months). Previous evaluations have indicated that six months after exit from the programme, the probability of being employed is about 56 percentage points higher for participants than for the control group (Anspal et al. 2012). The wage subsidy therefore appears to be a well targeted in-work benefit that helps to improve labour market participation and income.

2.2 Policies with a (more) indirect influence on in work poverty

2.2.1 Unemployment services

In addition to different benefits, complementary active labour market policies tackle in-work poverty. Recently, the focus has been on **preventing unemployment**, and thus since 2017 **preventive measures** – 'work and study' – have been implemented. The measures tackle the issue of skills mismatch in the labour market and respond to the need to help people adjust to the changing labour market, by making training and study options more available for employees, and supporting employers to upskill their employees (grants for employers cover up to 50% of training costs). The main target group of the measures is those at risk of losing their job due to health conditions, lack of skills or outdated skills. The measures also include a degree study allowance, which is paid upon commencing

vocational or professional higher education or bachelor's studies (€130-€260 per month) and support for obtaining qualifications (up to €500). There are language courses for those who lack Estonian language skills, and training programmes related to ICT or in the areas determined by the OSKA survey (a survey indicating future labour force needs). Those who need to change job due to a health condition are eligible for any training suitable for their health condition. The effect of these newly introduced preventive measures has not been evaluated yet.

Regarding young people, the 'My first job' service is targeted at those aged 17-29 who have been registered as unemployed for at least four months; have little or no work experience (less than two years altogether or less than one year during last three); and have no specialised training (have basic, secondary or upper secondary education). The service includes a wage subsidy paid to the employer of up to 50% of the wage during the first 12 months of employment, subject to a maximum of two times the national minimum wage. The employment contract must be concluded for an permanent term or for a term of at least two years.

2.2.2 Childcare services

One of the groups at risk of in-work poverty and low labour market participation is families with children and caring responsibilities. Whereas the benefit system may raise family incomes and thus to some extent reduce in-work poverty, it must be supported by a system of available and affordable **childcare**. The shortage of childcare facilities has been one of the issues of major public interest since 2005. By January 2012, 33% of local municipalities had a waiting list for pre-school childcare facilities (Ainsaar and Soo, 2012), and in 2015 there were 45 local governments (21%) who failed to offer a place in a municipal pre-school facility to all children whose parents had requested it, affecting mostly children aged 1½-3 (National Audit Office of Estonia, 2015). One measure to tackle the issue was adopted in 2014, allowing municipalities to provide daycare services for parents of children under 3 instead of a place in kindergartens. This lowered the burden on municipalities since daycare services are cheaper than pre-school education, providing only childcare as opposed to education. Another measure was adopted in 2015, allowing municipalities to apply for an ESF grant to finance the creation of additional childcare places (including childcare in non-traditional hours and for children with special needs) during 2015-2018. With the €6,500,000 allocated for the measure, 1,200 new childcare places were planned, of which 568 were created in 2015. No information about the effectiveness of these measures is available. The issue of affordability has also been on the agenda. The upper limit on fees paid by parents was €94 per child per month in 2017 and €100 in 2018 (excluding the cost of meals). The fees differ between municipalities. According to Themás et al. (2015), in 2014 the fees were between €19 and €85; nearly half of the parents found the fee to be too high.

In addition, caring responsibilities are one of the main factors constraining labour supply. Parents of young children are especially affected. Estonia has a rather generous parental leave and benefits system, which allows the parent to stay on leave for three years and receive the benefit for 1.5 years. In order to support work and family life, the system has always allowed people to receive employment income at the same time as the benefit, it being argued that as working requires additional costs (e.g. childcare), parents could otherwise end up in forced inactivity if the income from employment minus the additional costs were lower than the parental benefit (Explanatory note to the draft Act, 2003). However, the parental benefit was reduced if income from employment exceeded the minimum wage; and due to the formula for calculating the reduction, on some occasions the total income was smaller than it would have been without employment income. Thus, in 2014 the law was changed so that parents were guaranteed to receive at least 50% of the parental benefit for the month regardless of the amount of income received, while being reduced by €1 for every €2 received over the minimum wage. Currently, the system is going through a thorough reform (adopted in 2017 and 2018, with gradual entry into

force by 2022). With the reform, the possibilities for working while being on leave will be drastically improved. Firstly, since March 2018 the benefit has been reduced if the income from employment exceeds 1.5 times the national monthly average wage (€1,544 in 2018). Secondly, as from 2022 it will be possible to receive the benefit for three years: i.e. the amount of the benefit will not change, but the duration of the right to claim the benefit will be extended. The latter was also suggested by relevant research (Biin et al.) in 2013 in order to provide the flexibility needed by different families.

3 Policy debates, proposals and reforms on in-work poverty and recommendations

In-work poverty has been a part of the policy debate in Estonia. There were several reforms and debates between 2012 and 2018 – minimum wage debates, an annual refund for low-paid employees, income tax reform, work ability reform, and changes in the subsistence benefit system.

The **national strategies** address in-work poverty to varying degrees. In the national reform programme 'Estonia 2020', in-work poverty is not directly mentioned. It only arises implicitly in the context of social policy measures (e.g. income tax reform) to help low-wage employees, and in measures to increase the competitiveness of the workforce. It also arises in the context of measures to improve opportunities in the labour market through better education and training possibilities, work capacity reform and the reconciliation of work and family life. On the other hand, the welfare development plan 2016-2023 highlights in-work poverty as a challenge. The main measure suggested to tackle it is improving the qualifications of the workforce (especially through life-long learning and retraining opportunities). It also suggests the need to analyse the use of flexible and non-permanent working time arrangements, as well as to mitigate the consequences of in-work poverty by ensuring grants and services based on people's needs. Coalition agreements have sought to address the situation of low-wage employees through income tax reform, improved life-long learning opportunities, and reform of the subsistence allowance system. The social partners acknowledge in-work-poverty as a social issue. The Estonian Employers Confederation (ETKL) has reported that reducing poverty is just as important for society as increasing wealth, and that a 'smart' working Estonia supports moving upward in the value chain (ETKL 2014). They have pointed out that in-work poverty is the biggest challenge in our society, suggesting that: firstly, the qualifications and education levels of low-wage employees should be improved; and secondly, that creating jobs should be cheaper for employers than it currently is (e.g. by lowering the rate of social tax) (ETKL 2015). In their latest manifesto, they do not directly mention low-paid employees or in-work poverty, but they continue promoting the issues of life-long learning, reducing the social tax minimum, and increasing productivity (ETKL 2018). The Estonian Trade Union Confederation (EAKL) has also argued that in-work poverty is among their priorities (ERR 2016). They also mainly emphasise the importance of life-long learning and improved qualifications in order to keep up with the changing economy and society, but also to reduce poverty. They also suggest concluding sectoral-level collective agreements and reducing the tax burden of low-wage employees (EAKL 2018).

The **minimum wage**, as one of the main wage-setting policies in Estonia, has been a hot topic annually, revolving mainly around its amount. In 2001, the social dialogue parties agreed to raise the minimum wage to 41% of the average wage by 2008 (ETKL 2001). However, this goal has not yet been reached. During the latest debates, trade unions have proposed increasing it to 50% of the national wage, while employers have argued against any increase. The government representatives have promoted the minimum wage, arguing that the continuous increase in it has reduced undeclared work, social inequality and emigration. As a result of such debates, in 2017, it was agreed that between 2018 and 2022 the national-level minimum wage increase would be calculated annually on the basis of labour productivity and economic growth, which gives a better and more accurate basis for the negotiations (EAKL 2017). Also, the optimal distribution of market income and the

prevention of discrimination could be improved by greater transparency in the disclosure of wages.

As discussed above, one area of focus has been reforming income tax policy rules in order to support low-income earners; however, the approach adopted has recently been subject to reconsideration. In 2015 parliament adopted a new benefit scheme, under which an **annual lump-sum benefit for low-paid employees** in 2016 was paid according to their income tax payments during previous calendar year, in a complicated non-linear way. The first submission of applications and payment of benefits was made in spring 2017. The idea behind the reform was that the state should not collect income tax from people whose income was already low. However, as a substantial general increase in the basic income tax allowance would have been too expensive for the state budget, a special scheme was designed to affect only low-wage earners. As the benefit scheme was the first non-linear in-work benefit scheme to be introduced in Estonia, it was quite controversial. The government argued that the scheme increased low-paid workers' income, reduced poverty and inequality in a cost-effective way, favoured entering and staying in the labour market for a full year, and increased the motivation to seek opportunities to earn a higher income. On the other hand, critics emphasised high marginal effective tax rates, which might reduce work incentives. It was argued that the new scheme might also encourage the non-declaration of earnings; and that annual lump-sum benefits might not help the poorest people, who were often credit-constrained, to smooth their consumption. In 2018, in connection with income tax reform, this benefit scheme was replaced with a new system. It has been found that the income gain in 2016 (especially for lower-income groups) came partly from the annual tax refund for low-paid employees and a higher income tax basic allowance (household mean income increased by 1.5%) (Võrk et al. 2016). But income losses in 2017 compared with 2016 were mainly related to changes in income tax policy as the refund for low-paid employees was abolished (the mean household income of the bottom decile group decreased by 1.14%) (Masso et al. 2017).

In 2018, an **income tax reform** was implemented, which was aimed at stimulating the economy and reducing inequality. In 2017 the tax-exempt portion of monthly income was €180 and was supposed to increase to €205 by 2019, but in 2018 in connection with the reform it was instead increased to €500. This means that people who earn gross wages of up to €1,200 per month will see an increase in their net salary of up to €64 per month compared with 2017, with lower-paid employees' net wages increasing by up to 15%. However, the increased basic tax exemption on pension and compensation for accident at work will not be applied any more. This change in income tax policy increased significantly the mean household income in 2018 compared with 2017, and especially for lower-income groups. The mean household income increased because of the changes in income tax policy by 1.9% in total for all income deciles and by 2.4% for the first decile income group (Masso et al. 2018). Nonetheless, in the years to come, the overall tax burden of low-income families will need policy debate, as the share of indirect consumption taxes is relatively high in Estonia.

In addition to the work ability reform introduced in 2016 (continuing until 2021), it would be possible to work out **partial sickness benefit** (Masso et al. 2015).. Currently in Estonia, it is not possible to receive sickness benefit and work at the same time. However, experience in other countries shows that if someone's health allows them to work part-time under suitable conditions this encourages the return to full-time work. Therefore, subject to a doctor certifying that part-time work would not harm the employee's health, the employee could work part time and receive partial sickness benefit at the same time. This would also increase the income of people on sick leave (Ibid.).

Different **plans for the future** have also been proposed. To tackle the issues of childcare affordability, the Ministry of Education and Research has proposed free pre-school education for 20 hours per week for every child; this will also provide more equal conditions to all children to participate in the education system and thus prevent future disparities, as well as helping parents to participate in the labour market. The related changes are being prepared.

The Ministry of Social Affairs is seeking ways of improving the different benefit schemes. They commissioned an evaluation in 2018 of the suitability of the current methodology for estimating the subsistence minimum, with a view to finding a new or amended methodology. The methodology was established in 2004 and takes into account only basic needs. The evaluation report (Koppel et al. 2018) proposed three new minimum subsistence levels. Using the methodology from a similar analysis in 2005 with a base method approach would mean a minimum subsistence level of €205. Increasing coefficients of non-food expenses to reflect the population median instead of first deciles would then increase the minimum level to €250. Adding imputed rent would raise the subsistence minimum further to €294.

The Ministry have also commissioned a study on improvements to the unemployment insurance system. The main problem with the Estonian system is an insufficient level of social protection – the rates of the benefits are low and a rather small share of unemployed people receive these benefits. The low coverage rate and short payment period of the benefits may lead to early exits from the labour market (i.e. early retirement) or deter people from registering as unemployed (and thus miss opportunities to take up services such as training). In addition, self-employed people, due to their employment status, are not sufficiently covered by unemployment protect system. Arguably, at least the floor of benefits should be increased and more inclusive eligibility rules introduced.

4 Assessing data and indicators

Indicators of the risk of in-work poverty are mainly based on households' total income distribution: thus they do not specifically capture differences in the market incomes of employed persons. Though this approach has strengths, it also has the shortcoming that it conceals issues related to market income differences. In Estonia, for example, there is a considerable gender pay gap; however, there are no major differences in in-work poverty across gender/sex. This points to the need to design and introduce another indicator that focuses more on employed persons' market income and the associated tax-benefit policy rules.

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