

The PRAXIS Center for Policy Studies

**EU Enlargement and its Impact on the Social Policy
and Labour Markets of Accession and Non-
Accession Countries**

**Estonia
Country report**

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Introduction

The current paper gives an overview of the current situation and challenges of the Estonian labour market, social protection system and migration policy in the light of the accession to the EU. The report aims to give a general overview of the three areas in Estonia for people who are not familiar with the Estonian situation. The derived challenges and policy recommendations could be of interest also to Estonian policy makers, but give in addition an interesting background material for policy makers in the countries where the negotiations with the EU are in earlier stages.

The structure of the report is the following: firstly, the labour market situation, institutions and policies are mapped and also an overview of the EU negotiations in the field is given. Secondly, the social protection system is described with the emphasis on the aspects which could be important regarding migration. Next, potential migration push and pull factors are discussed and opinion is given on possible migration flows after joining the EU. Also a brief overview is given of the negotiations with the EU. At the end of the report the policy issues in all three fields are described, which will arise in the context of the EU enlargement.

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1. The macroeconomic picture and the current status of EU accession

In order to give a systematic overview of the current state of the Estonian macroeconomic framework, some kind of supporting structure would be useful. Estonia is firmly committed to joining the EU and the negotiations on the terms of accession have already been concluded. In September 2003 the Estonian people will give their vote on whether to join or not and this will be the final step of the accession process. Estonia will probably become a member of the EU during 2004.

In light of these events, the accession criteria would be an excellent framework for discussing the development of the Estonian macro economy. The overview starts with the outcomes of existing reforms, which can be viewed as approximating “the Copenhagen Criteria¹” (specifically, the second criterion, as this seems to be more clearly connected with the current topic) and continues with the Maastricht Criteria² that must be met in order to apply for the European Monetary Union.

The Copenhagen criteria: The existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union.

The Estonian economy is considered one of the most liberal economies in the world. In the index of Economic Freedom, composed by the Wall Street Journal and The Heritage Foundation, Estonia ranked as the fourth most liberal economy in the world. This means that the Estonian market economy is in some aspects more liberal than in several Member States.

The **privatisation** of the economy has been completed, with only a handful of strategic companies left under the governance of the State. The list includes the Narva Power Stations (Estonia’s largest oil shale based power stations), the Port of Tallinn (the largest port in Estonia) and holdings (between 40-50% of the equity capital) in Estonian Telecom and Estonian Railway. There are some less significant holdings in other companies as well, but the list is relatively short.

Rapid transformation from a planned economy to a market economy is also reflected in the **structure of the Estonian economy**. In 1993 the share of the tertiary sector was 57% of GDP, in 2001 this figure has increased to 66%. The share of the primary sector has declined from 11% to 6% (Statistical Office of Estonia). The structure of economy by firm size indicates also a significant shift towards a market economy – in 2001 nearly 96% of Estonian companies were micro and small size companies with less than 50 workers. The same group of enterprises gave work to 49% of people employed in the entrepreneurial sector (Tax Office of Estonia).

The inflow of **foreign direct investments** (FDI) could be considered as a sign of satisfaction with the Estonian transition process by foreign investors. In 2001 FDI into Estonia reached 597.8 million Euros in total or 438 Euros per capita. If we look at the cumulative FDI inflow during 1989-2000, then, compared with Hungary, Czech Republic, Croatia, Slovenia, Poland and

¹ Excerpt from the Copenhagen Presidency Conclusions: “Membership requires a) that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and, protection of minorities, b) the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. c) Membership presupposes the candidate’s ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.”

² The Maastricht Convergence Criteria were established in 1991 for those countries that planned to join the new European single currency arrangements in 1999. They were (are) designed to achieve a greater degree of economic convergence for countries participating in the Euro project. The criteria included targets for inflation, interest rates, government borrowing and the size of government debt.

Latvia, Estonia ranked as the third with 1,307 USD per capita (Source: Bank of Estonia). Foreign investments come mainly from the EU countries, especially Finland and Sweden.

The Maastricht criteria

The growth of the Estonian **Consumer Price Index** (CPI) has dropped from post soviet hyperinflation to 3.6% in 2002, almost reaching the price stability criteria set in the Maastricht Treaty. In the near future a slight increase of inflation is expected, mainly due to the convergence process with the EU price levels. However, the rise will not be very high.

The Maastricht Treaty states that the **budget deficit** may not be higher than 3% of GDP. In 2001 the Estonian budget was in surplus (0.4% of GDP). In previous years the budget has also been in slight deficit, but not significantly above the criterion.

Government debt, that must not exceed 60% of GDP, is also very low in Estonia – only 1.2% of GDP. Both budget deficit and the debt figures can be explained by the monetary policy framework Estonia has chosen. Estonia runs a currency board system, according to which the exchange rate is fixed with the Euro (in the beginning of our independence the currency was pegged with the German Mark) at the rate 1 Euro = 15.6 EEK. The precondition for the effectiveness of this system is a sound fiscal policy, as recognised by both government officials and politicians, thus no significant pressure to run budget deficit has emerged.

The last criterion (long term interest rate) is not measurable in Estonia, because there is no analogous government bond on the market that could be used as means of reference. In this respect, the Estonian financial market is not fully developed. On the other hand – this could be explained by the Government's cautious attitude towards taking loans.

The interest rate for long-term bank loans at the end of 2002 was 6.5% (Estonian Bank 2003). The Estonian **banking sector** and its services are quite well developed, however, it is mainly controlled by foreign capital. Bank loans are a quite important source of finance. The Estonian **stock market** is not very active and the majority of companies cannot use it as a means of equity finance. Bond finance is also not very popular.

As a conclusion it can be said that with 12 years of independence, Estonia has established quite a strong macroeconomic framework. Most of the state actions have been aimed at designing a healthy environment for businesses and not so much on direct actions (e.g. direct support for businesses, protective tariffs etc). 12 years ago, Estonia did not possess the market economy experience required for a policy of active economic interventions. The resulting liberal and business-focused Estonian economic policy has been productive one. The next decade (post accession) will probably bring about some changes – the state role in the economy is expected to increase, the extent of this, however, is hard to predict.

2. The labour market

2.1. The current state of the labour market

The **Estonian population** in 2002 was 1,336,959 of which the working population (15-64 age group) formed 69% (916,493). The labour force supply is showing a steady decline. While in 1991 the number of the people aged 15-64 was 1.04 million, in 2001 it had already declined to 0.9 million. The reasons for this apparent trend are twofold: firstly, the outward migration of the working population after gaining independence (mainly in years 1991-1994), secondly, the ageing workforce (see Table 2.1). While the first reason has no impact on the current and future labour market, the second one needs to be considered in designing employment policies and social security systems (see also Chapter 4.1.1.).

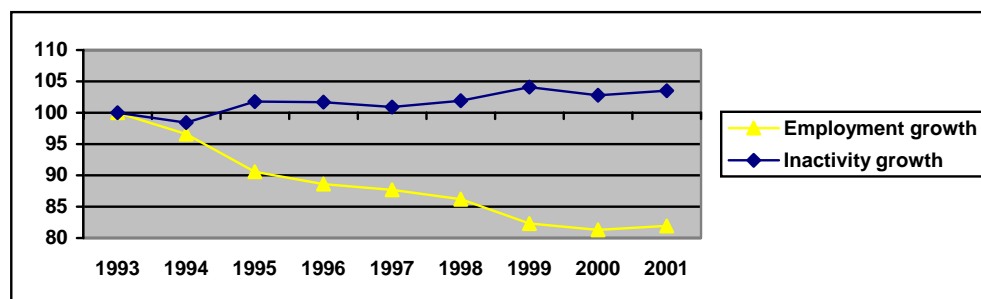
Table 2.1. Demographic projections (medium scenario) up to 2020

Indicator	2005	2010	2015	2020
Population (thousands)	1,316	1,253	1,190	1,127
Percentage of people aged 60 or over	20.6	21.7	23.3	25.0
Median age (years)	38.7	40.0	41.3	42.7
Life expectancy at birth men (years)	65.8	67.3	68.3	69.3
Life expectancy at birth women (years)	76.4	77.2	78.0	78.5

Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, *World Population Prospects: The 2000 Revision*, referred through Leppik et al. 2003.

The **labour force participation** rate has also declined and was 70.1% in 2001 (15-64 age group)³. This decline in labour force participation is caused by the rise in the number of inactive people (see Figure 2.1). The number of inactive people who are ill or disabled has increased, and in addition, the number of people studying has grown. At the same time the number of parents who have stayed home to care for children has declined. The substantial rise in discouraged people is one of the main problems in the Estonian labour market. Lately, the number of discouraged people has declined but at the same time the number of students has increased. This indicates that inactive people, instead of labelling themselves discouraged, prefer to be named as studying, even though the reason for it might be that they do not find a job.

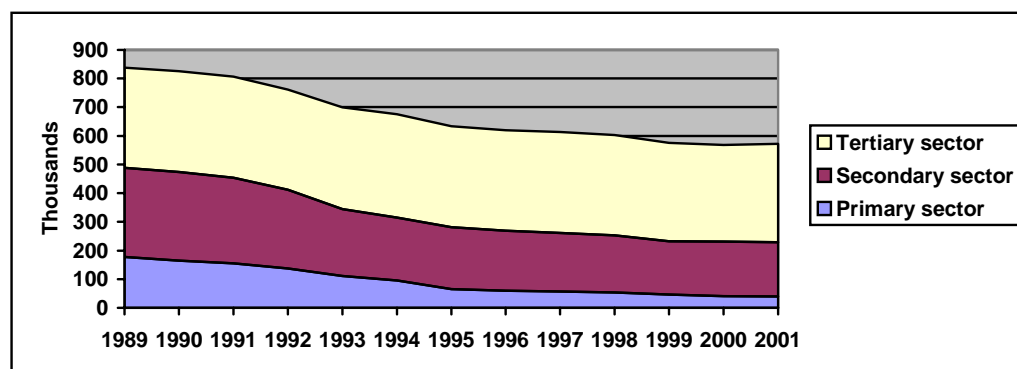
The **employment rate** in 2001 was 61.1% (15-64 age group). This is higher than in 2000 (60.7%), but the overall level is slightly lower than at the end of the 1990s and much worse than the targets set in Lisbon for the EU countries in 2010 (70%) (Diamantopoulou, 2000). The employment rate of women was 57.3% exceeding the EU target for 2005 but lagging behind the 2010 target of 60% by about 3%. The employment rate of men was 65.2% in 2001.



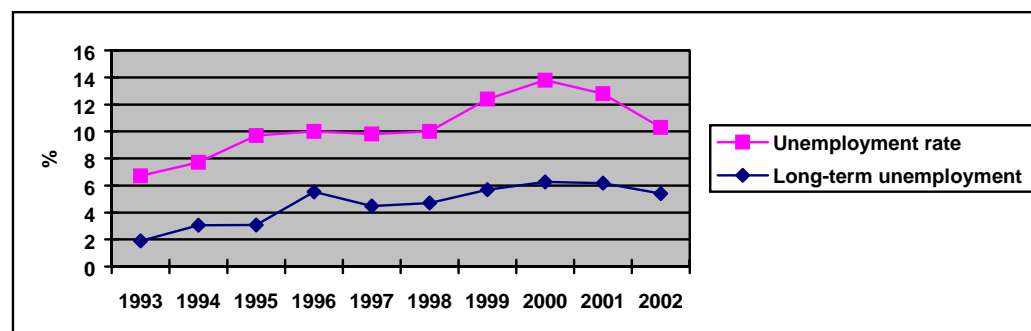
³ All labour market indicators for Estonia are taken from the Estonian Statistical Office Labour Force Surveys. If some indicator is from another source, it is indicated in the text.

Figure 2.1. The dynamics of employment and inactivity in Estonia 1993-2001 (1993 = 100)

The most rapid decline in employment has occurred in the primary sector. In 2001, only 6.9% of the workers were employed in the primary sector compared to 20.4% in 1991 (see figure 2.2). The share of the tertiary sector (i.e. services) is increasing. In 2001, 60.1% of all employees worked in the tertiary sector, while in 1991 the figure fell to 43.2%. The employment in the secondary sector has declined slightly (33% of all employees in 2001 and 43.2% in 1991). Rapid decline in primary sector employment has caused many social and economic problems in rural areas, and regional differences in the labour market can be largely attributed to it as well.

**Figure 2.2.** The share of employment in economic sectors in Estonia 1991-2001 (from 1991-1996 the age group 15-69, from 1997 onward the age group 15-74)

The main problem in the Estonian labour market is the high **unemployment rate**, which in 2002 was 10.3% (see Figure 2.3). The worst year in terms of unemployment was 2000 (when unemployment reached its peak of 13.8%), but this trend has reversed in subsequent years. In the last six quarters the unemployment rate decreased and dropped in the 3rd quarter of 2002 to the lowest level since 1995.

**Figure 2.3.** The unemployment rate and the long-term unemployment rate

The rate of long-term unemployment is almost half that of the total unemployment rate, with the share of long-term unemployment growing (this is partly due to the fact that the overall magnitude of unemployment has decreased). Long-term unemployment is higher among older people and people with less qualifications.

In general, the unemployment level amongst men is higher than that amongst women, contrasting the general trend in the EU countries. At the highest risk of unemployment are young people, especially young women and non-Estonians. Unemployment among the young is 7% higher than the overall unemployment rate. The unemployment rate of women aged 15-24 was 22.5% in 2002. Here again, we can see some improvement compared to 2000 when general youth unemployment was at 23.8%.

High unemployment rates among non-Estonians (around 6% than for Estonians) are attributable to the region in which they predominantly live. Mainly this is the Ida-Viru region, which suffers the highest regional unemployment rate. High unemployment rates amongst non-Estonians are also due to the fact that many of them do not speak Estonian.

In addition to the overall high unemployment rate there are big regional differences in the labour market situation (see Figure 2.4). The difference between the lowest and highest unemployment rate regions is twofold. Also the income difference between regions is high. It is notable that only the capital region has an average wage higher than that of the Estonian national average.

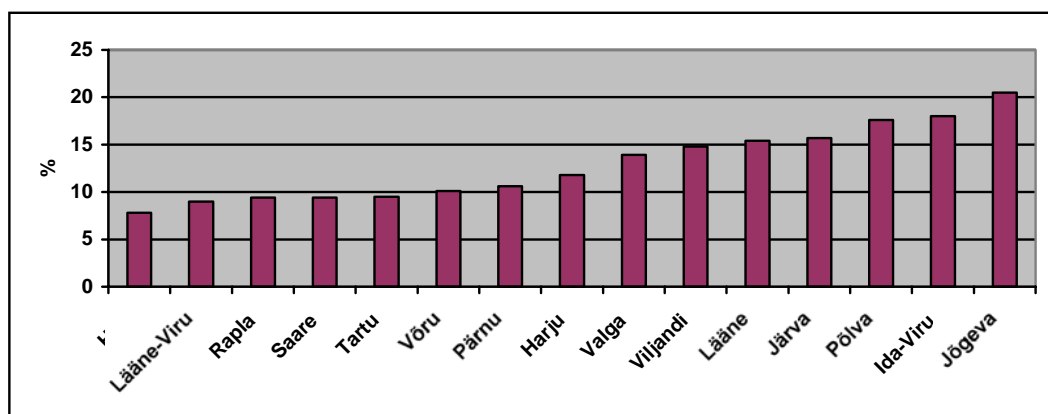


Figure 2.4. The unemployment rate regionally 2001

The main reason for a high unemployment rate is the structural nature. The qualifications and skills of the unemployed do not correspond to the labour market's needs. Many of the unemployed are educated below secondary level, making up 15.2% of unemployed in the age group 25-64 in 2001 (among the employed it was 8.3%). This suggests that Estonia needs an effective training and retraining system, which conforms to labour market needs.

The registered unemployment is half that reflected in labour force surveys unemployment. This is because weak incentives are offered to the unemployed to register. The unemployment allowance has been extremely low and Public Employment Services offer few active labour market measures (see subsection 2.2. for employment policies).

Wage rates in Estonia have constantly increased, both in nominal and real terms (see Figure 2.5). The growth outpaces European average wage growth, thus in longer term there is expected to be convergence (see Boeri *et al.* 2001a) with the EU wage level.

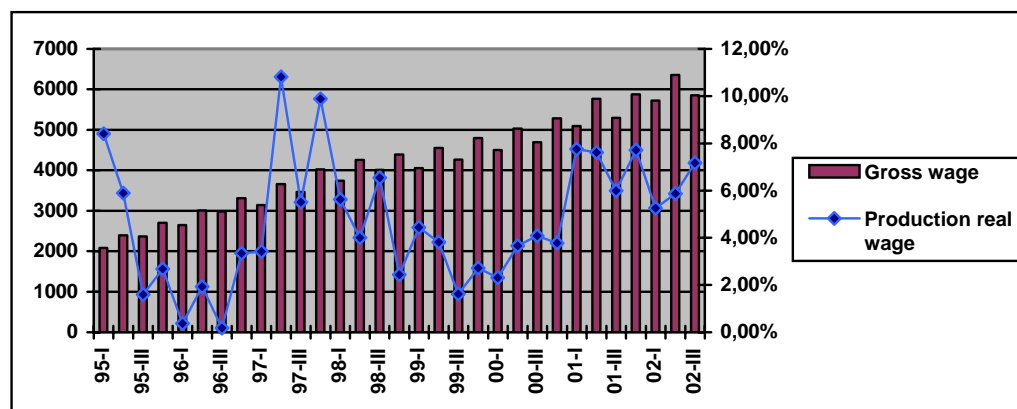


Figure 2.5. Real wage growth and nominal wages (in kroons)

The wage rates in different economic activities differ significantly. The highest wages are in financial intermediation and in public administration. The lowest wages are in agriculture, hunting, and hotels and catering.

To conclude, the Estonian labour market is characterized by:

- Low and declining labour force participation and low employment rates;
- High unemployment rates, a large share of long-term unemployed among the unemployed, high unemployment of young people and non-Estonians;
- High regional disparities in labour market performance;
- Mismatch of labour demand and supply (structural unemployment).

The main reason for labour market problems has been a rapid structural change, resulting in people's qualification and skills becoming redundant. Therefore there has been an emergence of structural unemployment and regional disparities in labour market performance.

2.2. Employment policies

2.2.1. Active policies

The Employment Service Act specifies seven types of active labour market programs in Estonia:

- Information on the situation in the labour market and the possibilities of employment;
- Employment mediation;
- Vocational training;
- Employment subsidy to start a business (business start-up grant);
- Employment subsidy to employers to employ less competitive unemployed persons (wage subsidy);
- Community placements;
- Vocational guidance (public work).

Community placements have been financed through local budgets since 2001, with no transfers made from the state budget. As no additional resources were allocated at a local level, the interest in organizing placement programmes and the number of participants has declined considerably (see Table 2.2).

Table 2.2. Number of participants in active labour market programs (1995-2001)

Programme	1995	1996	1997	1998	1999	2000	2001
Participants in employment training	9,809	9,434	8,241	7,956	7,027	8,150	10,232
Found job after training (%)	52.9	64	75.8	61.9	56.2	57.3	52
Employed with subsidies to employer	121	246	216	136	265	189	356
Received business start-up subsidy	459	456	434	380	433	413	421
Participants in community placement	5,741	4,089	4,661	3,771	3,667	4,177	125
Total number of participants in ALMP-s	16,130	14,228	13,552	12,243	11,366	12,929	11,134

Source: Estonian Labour Market Board

Table 2.3 shows that total public expenditure on labour market policies, measured as a percentage of GDP, has been very low in Estonia, ranging from 0.19% to 0.33% of GDP. The comparable indicator in the EU countries was 2.6% in 2000. The expenditure on active labour market policies in Estonia account for only 0.08% of GDP, which is more than ten times less than the amount spent in the EU countries, which have comparable or even lower unemployment rates. In 2001 only 26.8% total spending was dedicated to active measures in Estonia.

Out of the active measures **labour market training** is the most important, both in terms of expenditure and in terms of participants. Employment training may take the form of 1)

vocational training or 2) more general training aimed at providing information on the labour market situation, and psychological preparation for competing in the labour market. Most of the participants belong to the first group. The local labour offices organize training and the duration of the courses is limited to a maximum of 6 months. In 2001 the average duration of the training course was 25 days. Participants in training receive a retraining allowance equal to 1.5 times unemployment benefit. Actual participation in labour market training decreased steadily between 1995 (9,809 participants) and 1999 (7,000 only). However, since 1999 the number of participants has increased reaching the highest absolute figure since 1995 in 2001 (10,200). Hence, comparing the relative numbers, we see that whereas in 1995 about 28% of registered unemployed participated in training, in 2001 the respective number was only 19%. This can be explained by the increasing costs of training the participants.

At the same time there is no state-financed system to support adult training (except for the unemployed, civil servants and teachers). This can be considered as a major shortcoming within existing Estonian labour market policy. The skills of the workforce are often obsolete and do not respond to the needs of employers, who cannot find employees with required skills. Supporting in-service training of the workers and providing opportunities for re-training are the key factors in fighting structural unemployment.

The **business-start-up grant** is the second largest measure in terms of public expenditure. However, only a small number of unemployed (between 380 and 460 annually since 1995) have participated in the programme. To apply for start-up subsidy the unemployed must be at least 18 years of age and have undergone relevant training or demonstrate “sufficient” experience. The upper ceiling of the subsidy amounts to 10,000 EEK (since the beginning of 1998), which is about 640 Euros only. It must be mentioned that there are also additional business support measures, which are not provided through public employment services but Enterprise Estonia.

Wage subsidy to the employer for recruiting less competitive persons has been the least important active measure both in terms of expenditure and participants (only between 120 and 350 unemployed annually since 1995). The following persons who are registered as unemployed are considered to be less competitive in the labour market: disabled persons, pregnant women and women who are raising children under six years of age, young people aged 16-24, persons who will be retiring within 5 years and persons who have been released from prison. The level of the wage subsidy is 100% of the minimum wage during the first 6 months and 50% of the minimum wage during the next 6 months of his/her employment period.

Table 2.3. Expenditure on labour market policies in Estonia

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Expenditure on labour market policies as a % of GDP									
Total on labour market policies	0.19	0.24	0.17	0.17	0.17	0.16	0.34	0.33	0.30
Passive labour market policies	0.17	0.11	0.07	0.07	0.08	0.08	0.26	0.25	0.22
Active labour market policies	0.02	0.13	0.10	0.09	0.09	0.08	0.08	0.08	0.08
Expenditure on active and passive policies as a % of total expenditures									
Passive labour market policies	88.6	45.8	40.5	44.8	47.3	49.9	75.7	77.0	73.2
Active labour market policies	11.4	54.2	59.5	55.2	52.7	50.1	24.3	23.0	26.8
Breakdown of the expenditure on active labour market policies, %									
Labour market training	84.3	62.5	55.5	57.9	59.6	55.4	59.3	58.1	63.7
Community placement	7.8	5.2	2.7	4.6	4.1	3.3	5.2	4.9	0.0
Start-up grants	7.9	4.7	9.1	7.7	7.1	6.4	6.6	6.6	5.3
Subsidy to employer	0.0	0.5	0.9	1.7	1.7	1.9	2.8	3.2	4.1
PES administration	0.0	27.2	31.9	28.2	27.5	33.0	26.1	27.1	26.9

Source: National Labour Market Board, Statistical Office of Estonia

To conclude, the expenditure on labour market policies is very low in Estonia compared to the EU countries, as well as other transition countries in Central and Eastern Europe. This results in low spending on active measures and low participation in active labour market measures. However there are also employment-supporting measures in Estonia carried out through channels other than public employment services. To gain a comprehensive picture on employment policy, these should be taken into account. There is no evidence to suggest that active measures are effective. In order to develop an appropriate set of active measures the existing policies should be regularly evaluated.

2.2.2. Passive labour market measures

The main passive labour market policy measure until 2003 in Estonia was a flat rate unemployment assistance benefit, which was launched in 1991 and was financed from the state budget. In January 2002 the Unemployment Insurance Act came into force and the payments out of the Unemployment Insurance Fund started in 2003. The unemployment assistance benefit is now paid only to those who are not eligible for unemployment insurance payments (e.g. students).

Unemployment assistance

In order to get unemployment assistance the person must be registered as unemployed in the public employment service and have been employed for 6 months during the previous year. Unemployment assistance is paid up to 270 calendar days. The replacement rate of the assistance benefit has been constantly low in Estonia, comprising only 6% of the average wage in 2002.

Unemployment Insurance

The Estonian Unemployment Insurance Fund pays unemployment insurance benefits and administers the unemployment insurance system. The unemployment insurance operates as a compulsory insurance. The rate of the contribution made by the employee is 0.5-2.0% of the employee's income and the employer's rate is 0.25-1% from the total salary paid out to all employees. The Government establishes the rates for each year. Self-employed persons are not covered by the unemployment insurance scheme.

The right to receive unemployment insurance benefit arises when a person has made contributions for at least 12 months during the previous 24 months. Unemployment insurance benefits are not paid to those who leave their job or service voluntarily or on the initiative of the employer for a breach of duties, loss of confidence or indecent act on the employee's behalf. They are still entitled to unemployment allowance.

The unemployment insurance benefit is paid from 180 days up to 360 days depending on the length of contribution payments. If the period of unemployment insurance benefits is 180 days, a person can apply for unemployment allowance at the end of the period. During the first 100 days of unemployment an insured person is entitled to 50% of his/her previous average daily income, afterwards it is 40%.

Early retirement

There is no early retirement system in the framework of labour market policies in Estonia. Although, the State Pension Insurance Act, which came into force in 2000, provides the option of retiring 3 years before statutory retirement age, effective from 2001. If a person chooses the option of early retirement, the pension payments will be reduced by 0.4% for each month occurring between the actual date of retirement and statutory retirement date. As of the beginning of 2003 there were 2.1% of all old-age pensioners receiving early retirement pensions. Around 80% of people, who retired with early retirement pension, were previously unemployed or inactive.

As with the active measures, there is no research done on the impact of passive measures on work incentives and people income.

2.3. Social dialogue and partnership

Social partnership is poorly developed in Estonia. This also reflects in the development process and the implementation of employment policies. Social dialogue is better developed on a national level compared to lower levels where it is virtually non-existent. The weak development of social partnership is, partially, a result of poorly developed social partners. This is evident from the institutional and financial shortcomings of social partners' institutions, as well as their low representation.

Social partners in Estonia, as in most other CEE transformation countries, are weakly institutionalised. On the employees' side, trade union membership is around 14% of all employees as of the beginning 2002 and membership is declining (almost 100% at the end of the 1980s, 21% in 1996). Some industries in Estonia, such as construction and banking, are almost union-free.

There are two national trade union confederations, which are internationally and nationally recognized as social partners: the Association of Estonian Trade Unions (EAKL), and the Estonian Professional Employees' Unions Association (TALO). The EAKL is the largest organization for blue-collar workers, comprising 25 branch unions as of April 2003 and approximately 50,000 members. TALO is recognized as the organization of trade unions of white-collar workers. TALO comprises 11 branch unions, 1 co-operative association and approximately 37,000 members.

There is one federal organization of employers - the Estonian Employers Confederation (ETK). The membership comprises 21 branch associations of employers, 4 associated member associations and 23 commercial undertakings as of 2002. This means that the ETK encompasses 1,442 enterprises with around 45,000 employees (25% of all employees). Overall there are 39,794 commercial undertakings (Statistical Office of Estonia).

The regional social dialogue is hindered by the lack of regional organizations. Of the named three organizations only EAKL has regional branches in 5 regions of Estonia. The aim of the regional organizations is the counselling of existing unions and promoting new ones. There is one regional employment pact concluded in the Ida-Viru region, which is aimed at promoting employment and fighting unemployment through measures created in social partnership.

The low level of membership is accompanied by low levels of collective bargaining coverage that is roughly equal to trade union membership. This indicates that there is no higher level binding collective bargaining than enterprise level, thus the agreements cannot be extended further and coverage rate is low. The number of valid collective agreements registered in the collective agreements register as of in April 2003, was 102 (Register of Collective Agreements). The total number of agreements is higher because some agreements are not registered, as the register is created only in the last year. The number of agreements in private enterprises is 60, other agreements cover state and municipal entities, such as schools, hospitals etc.

It must be mentioned that there are no other forms of workers representation, such as works councils, present in Estonia. Thus industrial relations are mainly regulated through minimum standards set at state level, partially through social dialogue on a national level, and through individual contracts.

The only level on which social dialogue is held more or less regularly is on a national level. There are contracts concluded almost in every year regarding minimum wage, and some tripartite agreements have also concerned the development of the social security system (e.g.

unemployment benefits, subsistence level). It must be mentioned that the range of issues discussed is not wide, but the social dialogue is present and accepted by all social partners as a necessary medium in the labour market. In 2002 a wider context agreement was also concluded on labour market policy development. At the same time there is the problem that the voice of social partners is only partially taken account on a national level. The Government is still the final decision maker and social dialogue is sometimes just for meeting European demands. At the end of 2002 social dialogue was halted by the trade unions. This was on the grounds that the Government did not fulfil the tripartite contract. Namely, the Government did not increase previously agreed tax-free minimum income and unemployment allowance. Because of this, the trade unions sued the Government and social dialogue will not resume before the case is resolved.

In addition to state level, regular social dialogue social partnership is implemented through regular tripartite bodies. The tripartite bodies are listed in Appendix 3. In general, the tripartite bodies have a consultative role. Participation in various councils and boards undoubtedly increases the importance of partnership and social dialogue in Estonia. It should be mentioned here that public employment services have recently created regional employment councils, which could have a real impact on the future labour market policies on a regional level. At present there is not much information on their effectiveness.

2.4. The challenges of EU accession

Estonia has completed the accession negotiations with the EU. Estonia is prepared to take over the *acquis* in the field of labour and social policy without exceptions and transition periods. The negotiations concentrated on several issues, which included occupational health and safety, equal opportunities of men and women, public health, promotion of social dialogue, social protection, social security, and labour law. There were several amendments introduced into Estonian legislation and several acts are still in the legislative process (e.g. the law on equal opportunities for men and women). There are also several ongoing projects for introducing and implementing EU principles. For example, there is a project for promoting social dialogue on a sectoral level. The sectoral level social dialogue is the main level in the EU countries and in Estonia it is virtually non-existent.

In general, it is not envisaged that there will be any obstacles to joining the EU in this area. Since 1999, Estonia has annually prepared National Employment Action Plans, which follow the European Employment Guidelines' principles, objectives and structure. This ensures that Estonian priorities are in line with the EU priorities. However, reaching the EU employment objectives (by 2010 employment rate 70%, women employment rate 60% and employment rate of older workers 50%) is a serious challenge for Estonia.

The precondition of joining the EU is the ability to implement EU policies. In the EU, Estonia will classify as a region for the highest support rate. This will provide an essential increase to the finances available for employment policies. One of the priorities of the National Development Plan, which is the main document for obtaining the funding from the EU Structural Funds, is the development of human resources. The additional funding of 1 billion kroons for the period of 2003-2006 is planned for human resources development. This will raise the annual spending on the active labour market policies by more than double. Such a jump in financing poses the problem of how to effectively use the available finances. Therefore the increase of administrative capacity is one of the priorities, which should be carefully considered. Despite the remarkable increase in financing, it is estimated that the share of ALMPs as a percentage of GDP will remain around 0.18%, which is still low compared to the EU average of 1%.

Estonia expects to join the EU in 2004. The effect of joining the EU on the labour market is unpredictable. This issue has not been thoroughly researched. Thus there are several opinions on the future labour market trends, especially concerning the migration flows. On the potential migration movement see Chapter 4. While most of the current EU Member States will not allow free inflow of Estonian workers, they have to allow (with exceptions of Austria and Germany) free movement of services. This might also have an impact on the Estonian labour market by increasing demand for Estonian labour as the wages in Estonia are lower, Estonian companies can offer cheaper services (e.g. construction) and demand for their services will increase.

Another impact of EU accession on the Estonian labour market might come through the inflow of FDI. The essential additional inflow of FDI could increase job creation and labour demand in Estonia. This would reduce unemployment and even induce the inflow of migration. Besides the main source countries of FDI for Estonia (Sweden and Finland), it is expected that the EU enlargement will create awareness of and confidence in an attractive Estonian economic climate among potential investors from other EU Member States.

Fast or rapid changes in labour market situation, due to the accession to the EU, are not predicted. The Government prognosis does not foresee a jump in employment, unemployment or wages due to joining the EU (see Table 2.4). If Estonia manages to use efficiently the financial aid available from the EU, it could be expected that the active policy measures help the unemployed to find jobs more easily and there will be a gradual decline in unemployment.

Table 2.4. The Government Prognosis of Labour Market Indicators

	2002	2003	2004	2005	2006
Growth of employment (%)	1.4	0.2	0.2	0.3	0.3
Unemployment rate (%)	10.3	10.1	10.0	9.8	9.5
Real growth of wages (%)	7.1	6.8	5.3	5.6	5.7
Real growth of GDP (%)	5.6	4.8	5.4	6.0	6.0

Source: Ministry of Financial Affairs 2003

The wage level is expected to converge to the European average wage level, but there is no reason to believe that this should happen faster than the convergence of GDP. According to the research by the European Commission it will take Estonia 19 years to get to the level of 75% GDP per capita of the EU average (Real convergence..., 2001).

No rapid changes are expected due to EU accession. Thus no special policies have been developed. Of course, Estonia adopts the *acquis communautaire* and, therefore some amendments to existing laws and some new legal acts must be adopted. However, the process of adoption of the EU legislation has already begun and is expected to continue smoothly.

2.3. Conclusions

The Estonian labour market has several problems: low labour force participation and low employment rates, high unemployment rate, a large share of long-term unemployed among the unemployed, high unemployment of young people and high regional disparities in labour market performance.

The causes of these problems are rapid changes in economic environment, which has caused the destruction of many jobs in agriculture and industry. Adult education, the vocational education system, and active labour market measures are not developed enough to bring people's skills in line with the labour market needs and get the unemployed back to work. In addition, the regional mobility of labour is not enough to reduce labour market differences and bring down unemployment in high-unemployment regions.

Social dialogue is weakly developed in Estonia. At a national level it occurs invariably, but at all other levels it is virtually non-existent. The main reason for a lack of social dialogue is the weakness of social partners, which is evident from a low representation, which in turn causes scarce financial resources. Although social dialogue has existed, it is the Government who has the final decision on the implementation of agreements.

EU enlargement will bring to Estonia an essential increase of finance for employment policies. Therefore there has to be a qualitative and quantitative improvement in the implementation of employment policies. The current system could not utilise effectively the extra finances from the EU.

In the context of EU accession no significant changes are expected in general labour market conditions. The EU principles in this field are being adopted gradually in accordance with the NEAP, which has been already prepared since 1999.

3. Social policy

3.1. The current situation: policies and problems

In terms of **eligibility**, social security and social assistance rights in Estonia are primarily residence-based (for an overview of social benefits and schemes see Tables A.11. and A.12. in Appendix 2). Nationality is not a criterion, which means that Estonia's sizeable non-citizen population is also covered. Residence is the only criteria for the receipt of national pensions, family benefits, funeral grants, social benefits for disabled persons and social assistance subsistence benefits, when a contingency occurs, making the coverage of these schemes universal. For old age, work incapacity and survivors' pensions, and unemployment benefits, fulfilment of an additional employment-related qualification period is required, and accordingly, these schemes are designated to cover all economically active persons. The only exception relates to the unemployment insurance scheme, where self-employed persons are excluded from the scope.

Regarding health insurance, individuals are insured firstly on the basis of payment of social tax. However, as a number of large population categories (pensioners, children etc.) are equalised with the insured, the coverage is nearly universal, reaching 94% of the population. Emergency social and medical assistance is available to all persons legally staying in Estonia.

The type of benefit

As for cash benefits, flat-rate benefits prevail. National pensions, family benefits, state unemployment allowance, social benefits for disabled persons and funeral grants are all flat rate benefits. Old-age, work-incapacity and survivors' pensions are so far relatively weakly differentiated by former earnings. Sickness and maternity cash benefits and unemployment insurance are currently the only cases of direct earnings-related benefits. However, with recent reforms, the role of earnings-related benefits has increased. From 1999, pension rights are acquired on the bases of social tax paid on earnings. Also, the introduction of the funded pension pillar will emphasise the link between contributions and future pensions. Means-testing is applied only in connection with social assistance subsistence benefits.

The Estonian social protection system includes 3 contributory social security schemes - pension insurance, health insurance and unemployment insurance. The other schemes: family benefits, state unemployment allowances, funeral grants and social benefits for disabled are non-contributory, being financed from general state revenues. The main financing source for social protection is a social tax – 33% of the payroll, which is paid by employers and self-employed persons, and is earmarked to finance pension and health insurance. The direct participation of employees in the financing of social security was introduced only in 2002, and the 1% unemployment insurance contribution is currently their only direct share. This is supplemented with the 2% contribution for funded second pillar pensions. However, the latter contribution is compulsory only for young persons entering the labour market and optional for all current employees.

Financing

Revenues from social tax account for *ca* 70% of the total social protection expenditure. General state revenues make up about 24% and resources of local government the remaining 6% of expenditure.

So far, all social security schemes are financed on pay-as-you-go principle. However, all the contributory schemes have developed (or are currently developing) notable cash reserves and/or reserve capitals. As a result of the ongoing pension reform, a fully funded pension scheme was

introduced in 2002, which in turn creates a necessity for state subsidies to the first pillar to cover for the partial loss of social tax revenues.

Administration

Social security schemes are administrated on the national level, either by specialised state agencies (Social Insurance Board, Labour Market Board) or by autonomous public-legal bodies (Health Insurance Fund, Unemployment Insurance Fund). The governing bodies of the public-legal funds include representatives of social partners, but except this supervising function, the role of employers' organisations and trade unions in the social protection administration is relatively modest. The administration of social assistance and social services rests with local municipalities, who may sub-contract the provision of services from NGOs or private bodies.

In conclusion, the Estonian social protection system is characterised by the following dominating features (Leppik and Kruuda 2003):

- Universal (or nearly universal) coverage;
- Substantial role of flat-rate benefits (but these provide relatively low replacement rates);
- Relatively few earnings-related benefits (but their role is increasing);
- Public administration of schemes with a relatively modest role for social partners;
- Great reliance on contribution-based financing.

Social protection expenditure in Estonia has accounted for 16-17% of GDP. In comparative terms, this places Estonia behind the average level of GDP spending on social protection in the EU, which is about 28%. However, it should be kept in mind that at least in the OECD countries the share of social protection expenditure in GDP correlates with the GDP per capita, meaning that more affluent countries spend relatively more on social protection than lower-income countries (see e.g. Scharpf 1997).

3.2. The challenges of the EU accession

One of the core areas of binding *acquis communautaire* of the European Union in the field of social protection relates to the co-ordination of social security schemes for migrant workers and members of their family⁴.

The EU's co-ordination rules – Regulations 1408/71 and 574/72 – are based on four key principles:

1. *Equal treatment of one's own nationals and nationals of the other Member States*^{5,6}. Intra-Community migrant workers are subject to the same obligations (e.g. with respect to the payment of social contributions) and are entitled to the same benefits as the nationals of that state based on national legislation.

⁴ Social security co-ordination is a mechanism, which links different national social security systems with an aim to secure social protection for persons moving from one country to another.

⁵ The regulations apply also to stateless persons and refugees, but currently do not apply to third-country nationals. However, the European Commission has prepared a draft regulation on extending the personal scope of co-ordination also to third country nationals legally residing in any of the Member States. There is a general political agreement in the EU that the draft will be adopted in 2003.

⁶ Unless the co-ordination rules are extended to third-country nationals, this may have important implications in relation to the Russian-speaking minority in Estonia. In particular, those Russian-speakers, who have opted for Russian Federation (or Ukraine or other CIS country) citizenship and who number around 100,000 people or 7% of the population, will not have the additional rights arising from co-ordination regulations once Estonia has joined. However, this may also prompt some of these Russian-speakers to give up Russian citizenship and apply for Estonian nationality.

2. *Applicability of only one state's legislation for each individual.* This principle protects against both positive and negative conflicts of law, ensuring that persons can't be entitled to the same benefits from 2 countries simultaneously, while guaranteeing that they are always insured somewhere, but do not have to pay social security contributions in more than one state. The main rule here is the principle of *lex loci labouris*, i.e. legislation of the state of employment is applicable.
3. *Retention of acquired rights.* Persons who have acquired rights for social security benefits in one Member State maintain these rights irrespective of any movement of residence to another Member State. This implies intra-community export of benefits (primarily pensions) for the persons concerned.
4. *Aggregation of periods of insurance or residence.* In case the right to benefit is subject to a qualification period or the amount of benefit depends on the period of insurance or residence, periods completed in other Member States are also taken into account. When paying out pensions, a *pro rata* principle is used. Each Member State involved has to pay that share of the total amount, which corresponds to the insurance period completed in that state.

3.2.1. The role of the Association Agreement

In principle, the core legal instrument, which provided for the approximation of legislation and co-operation between the EU and Estonia during the pre-accession period, was the Europe Agreement, which, entering into force in 1995 established an association between the two sides. While the basic objective of the document was 'to provide an appropriate framework for the gradual integration of Estonia into the European Union', it also contained certain provisions on social security. In general, these were presented by the Commission (CEC 1995:72) as a preparatory stage towards implementation of more complex EU social security co-ordination regulations. As a result, the respective provisions of the Europe Agreement were limited to just three questions:

1. The export of pensions linked to old age, death, work accident or occupational disease (with the exception of non-contributory benefits);
2. The equal treatment of persons with respect to family allowances;
3. The aggregation of insurance periods completed in the various Member States for the purpose of pensions and annuities with respect to old age, invalidity and death and for the purpose of medical care for workers and their family members.

These 'partial co-ordination' provisions reflected the EU's general social security co-ordination policy towards third states, which had association or cooperation agreements with the Community⁷ (Pizarro 1995). However, the provisions were not fully reciprocal. The first two (export of pensions and granting of family allowances) were symmetrical, while the third was applied only to Estonian nationals. As the Europe Agreement did not establish free movement of workers, there was also no aggregation of insurance periods across the EU border for establishing rights to social security benefits. Only insurance periods completed by Estonians in different Member States could be added up. Furthermore, the application of these provisions is limited to citizens only.

⁷ For example, the social security clauses in the CEE association agreements and in the earlier Mediterranean Cooperation Agreements were identical. Cremona, M. 'Movement of persons, establishment and services' in Maresceau, M. (ed.) *Enlarging the European Union: Relations Between the EU and Central and Eastern Europe*, London and New York, p. 198.

The primary impact of the Europe Agreements' social security provisions on Estonia would arise from the obligation to export pensions, as currently pensions are paid only to persons residing in Estonia. The agreement came into force in 1997. However, even by 2003 the social security provisions had not yet entered into force because of the absence of implementing provisions due to lack of consensus among the current EU Member States. As the matter currently stands, it is likely that the provisions will never be implemented, since from the date of accession in 2004, these will be overruled by the EU Regulations 1408/71 and 574/72.

3.2.2. The future of bilateral social security agreements

Against the background of failure of the Association Agreement, the main instruments of social security co-ordination in the pre-accession period have been bilateral social security agreements. Estonia has currently 4 bilateral agreements with current Member States or applicant countries of the EU. Agreements with Latvia, Lithuania and Finland (all from 1997) cover all major branches of social security, while an agreement with Sweden (from 1993) covers only medical care for temporary visitors. An agreement with the Netherlands on export of pensions has been recently elaborated and will be signed in 2003.

From the so-called third countries, an agreement with Ukraine is in force from 1997. An agreement with Russia (limited to pensions) was signed in 2002 and an agreement with Canada is currently being negotiated.

While the existing agreements with the EU and candidate countries broadly follow the principles of the EU regulations 1408/71 and 574/72, there are nonetheless certain differences.

The bilateral agreements apply to all persons insured under the national legislation, regardless of nationality. Even when the personal scope of the EU Regulations is extended to third-country nationals, there remain some groups (e.g. recipients of national pensions or work incapacity pensions with no prior employment records) who would fall under bilateral agreements, but not under the EU Regulations. This is because the Regulations (as a general rule) apply only to economically active persons and their family members, while existing bilateral agreements apply to all persons who are subject to national social security legislation, including economically non-active persons. There are some differences also in respect of the material scope (types of benefits to be co-ordinated), but most importantly, in respect of the principles of co-ordination.

From the date of accession, the EU Regulations replace the provisions of any bilateral social security agreements, as regards persons and matters covered by the Regulations. However, the agreements remain in force in respect of persons and matters outside the scope of Regulations. Although there is thus no formal obligation to harmonise the existing bilateral agreements with Regulations 1408/71 and 574/72, the differences in principles of co-ordination would cause substantial administrative problems. This is because persons in similar situations could end up with different benefits or could be subject to different procedures depending whether their rights derive from the EU Regulations or from a bilateral agreement.

3.2.3. Implications of the EU social security co-ordination rules

As the 'migrant worker regulations' deal only with social security co-ordination and not with harmonisation, no formal changes to national legislation were necessarily incumbent on Estonia. Nevertheless, this does not mean that the principle of co-ordination would leave Estonia's social protection system unaffected.

Firstly, the application of co-ordination rules has financial implications. It adds a financial burden to existing social security schemes, since the regulations give persons moving within the

Union new rights. The two largest social protection schemes, i.e. health insurance and pension insurance, will be the most influenced.

The burden arises most notably from the following aspects:

1. Export of pensions;
2. Extending rights to health care abroad.

With accession, the right to a pension will be extended to the whole territory of the enlarged Union. According to the national legislation, the payment of pensions and other benefits is limited to persons residing in Estonia. Export of benefits is currently possible only under a bilateral social security agreement. From the current EU Member States, Estonia has a relevant bilateral agreement only with Finland. (A relevant agreement has been negotiated also with the Netherlands). From the other applicant countries, Estonia has relevant bilateral agreements with Latvia and Lithuania. The increase of costs for the state pension scheme will still be relatively modest. The Ministry of Social Affairs has estimated that the additional expenditure will not exceed 0.5% of the current pension spending, given the relatively small number of Estonian nationals currently residing in the EU Member States and other applicant countries (see Table A.9. in Appendix 2).

With accession, persons covered by health insurance in Estonia will obtain certain new rights to medical care in the territory of the enlarged Europe. This includes:

- 1) Tourists, other temporary visitors and persons working in international transport (e.g. seamen and lorry drivers) will be entitled to emergency medical care in other Member States at the expense of the Estonian Health Insurance Fund;
- 2) Frontier workers and their members of family will be entitled to medical care both in the country of work and country of residence.

Although in principle, the Regulation 1408/71 prevents medical tourism (travelling abroad to obtain medical treatment) via the requirement of prior authorisation from the competent institution, such authorisation may not be refused where the treatment in question is foreseen under the national legislation, but cannot be given within a reasonable waiting period.

Estonian tourists travelling to the EU countries currently have to buy a private travel insurance to cover the risk or potential need for emergency medical care. Under the EU rules this risk will be insured by the public purse, transforming thus from individual to collective responsibility. As higher-income persons tend to travel more often, the obligation to reimburse treatment costs incurred in other EU countries means that higher-income people will absorb in relative terms more resources from the Health Insurance Fund.

In the case of migrant workers from the other Member States whose dependent family members do not transfer their residence, Estonia would have to refund the medical care (not only emergency, but also regular medical care) delivered in another Member State to those family members.

The burden on health insurance is expected to be more significant as compared to that of pension insurance. In the latter case, exported pensions (or parts thereof) are still paid according to Estonian rates. In the former case, treatment costs will have to be refunded by the Estonian health insurance system on the basis of the actual amounts incurred in EU Member States. Given the predictable flows of tourists (see Table A.10 in Appendix 2) and existing differences in the prices of medical services between Estonia and the current EU Member States, the additional burden is estimated to amount to 3% of the current spending of the Health Insurance Fund on medical services.

It is notable that the effects of reimbursement are disproportionately higher for countries with lower prices of medical services. The Regulations provide a possibility for two or more Member States to conclude so-called 'waiver agreements', whereby the states mutually waive reimbursement of costs of medical services provided to nationals of the other contracting state. The Government could use this possibility and make an effort to conclude waiver agreements at least with some EU Member States in order to ease the administrative burden associated with the implementation of the Regulations.

Although, in theory, the social security co-ordination rules should not discriminate against specific types of schemes, the reality is somewhat different. Some types of schemes are more 'fit' for co-ordination than others. From the state's perspective (and not necessarily from the perspective of concerned individuals), the most problematic are residence-based schemes, which offer universal flat-rate benefits with no qualification period (see also Sakslin 1997). As access to these benefits is relatively easy, co-ordination can increase costs significantly. Finland and Sweden, where universal benefits are widespread, modified some characteristics of their universal schemes before entering the Union. As universal flat-rate benefits have also been the predominant type of cash benefit in Estonia, accession may force a tightening of some of the eligibility criteria.

The regulations implicitly favour schemes designed to protect an economically active population by offering earnings-related benefits, or benefits which relate to either previous earnings, previous insurance contributions, previous periods of insurance coverage or any combination of these factors. In other words, the regulations are built around a typical Bismarckian model of social security. Another favourable option for the states would be targeted means-tested benefits, which escape co-ordination as they are considered social assistance, not social security. Also, in-kind benefits (as opposed to in-cash benefits) are largely non-problematic as they are not exportable.

Solutions to these problems have been suggested (e.g. Pieters 1997), but so far rejected. It is important to recall here that the system of social security co-ordination was developed as a measure of 'market-building', and has been locked into this. Changing the current principles of co-ordination to accommodate better residence-based schemes is regarded by some commentators as a 'spill over' into a 'non-market' area, and has therefore drawn both praise and criticism.

Social security co-ordination rules also have a substantial indirect impact upon future policy-making in the area of social security. They limit the policy options otherwise available. (See also Liebfried and Pierson 1996.) For example, a state may not limit social security benefits only to its nationals. Or, in case there is such a limit, the co-ordination rules would extend these benefits automatically to all nationals (and also stateless persons and refugees) of the Member States. Likewise, a state may not limit the payment of social security benefits to its own territory. Or, again, if this were done, the co-ordination rules would extend the payment of such benefits to the whole territory of the Union. Nonetheless, it remains the case that such limitations can still be imposed with respect to nationals and territories of third countries.

3.3. Conclusions

While Estonia's absolute level of social protection expenditure is lower than among the existing EU states, this gap could be linked more to the general differences in wealth, and to a lesser extent to a specific lack of social protection.

The direct effect of accession upon social protection systems and policies will be rather limited, but there will be important indirect implications. Social security co-ordination extends the rights

of Estonian citizens moving across Europe, while also adding a certain degree of financial constraints to its existing schemes of pension and health insurance.

Application of the EU's social security co-ordination rules also requires extending relevant administrative structures both at Ministry level as well as within the implementing bodies. Also, the existing bilateral agreements need revision to avoid extra administrative complications. In this respect, the principles of co-ordination of EU Regulations could be bilaterally extended to all persons who are currently in the personal scope of bilateral agreements. The Government could also make an effort to conclude arrangements on mutual waiving of reimbursement of the costs of medical services with some of the EU Member States, in order to ease administrative burden associated with implementation of the EU Regulations.

4. Migration policy

4.1. Push and pull factors of migration

Todaro (1969) and Harris and Todaro (1970) related migration decisions to expected earnings adjusted for the probability of employment at destination. Nowadays, migration research identifies a series of push and pull factors that influence labour migration. These factors are often difficult to quantify and they interact in complex ways, rendering any precise forecasting very difficult. In this chapter we discuss different factors that could influence the migration potential of Estonia after the joining European Union.

4.1.1. Demographical processes and ageing of the working population

In the past few decades Estonia has witnessed some important demographic changes. The population grew at a relatively high rate in the 1970s and 1980s, due to high fertility rates and increasing life expectancy. In the 1990s, the population decreased steadily due to the co-effect of two factors:

- Migration both to the East and West was larger than immigration, which was influenced by the establishment of immigration quota by the state,
- The negative natural increase.

The most important reason of the population change during 1990s has been the decreasing number of arrivals simultaneously with the large number of departures from Estonia. At the beginning of the 1990s there was a remarkable outflow of the Russian speaking population into Russia, Ukraine and Byelorussia. Emigration to Western European countries has been steadily low. The data characterising migration in the 1990s are presented in Table 4.1, unfortunately the Statistical Office of Estonia does not publish data about migration since 2000. The Immigration Law, which came into force in 1990, and the Law of Foreigners (1993) played an important role in the decrease of immigrants. By these laws, immigration may not exceed 0.05% of the resident population at the beginning of the year.

Table 4.1. Estonian migration flows in the 1990s

Migration flows	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Immigration	12,498	8,381	5,203	3,548	2,390	1,575	1,616	1,552	1,585	1,414	1,418
Emigration	12,326	12,403	13,237	37,375	16,169	9,206	9,786	7,235	4,081	2,545	2,034
Net migration	172	-4,022	-8,034	-33,827	-13,779	-7,631	-8,170	-5,683	-2,496	-1,131	-616

Source: Statistical Office of Estonia

During the last decade, as economic conditions changed, many young families postponed the birth of the first child. Birth rate decreased considerably in the 1990s, but the falling trend has now slowed and some increase is expected in the near future. Adjustment problems and economic instability have also resulted in unstable family relations, with an increasing number of divorces and a falling birth rate. Also the life expectancy of both men and women declined remarkably at the beginning of the 1990s. Since 1996, the life expectancy of women has exceeded the level reached in 1989, showing that the life expectancy of women has become longer during the stable years of independence. The life expectancy levels of men are still some percentage points lower than they were in 1989. Health care statistics reveal that the number of unnatural deaths (alcohol, poisoning, suicides, homicides, traffic accidents) has increased nearly twofold in the 1990s as compared to the 1980s.

The ageing of the population is a major challenge for the European labour markets. While changes in the age structure have not had a significant effect so far, they will become more relevant in the decades to come (see Figure 4.1). The situation of population ageing is particularly worrying in Estonia. If the current population growth trend continues, ageing of the population will be faster than in any of the other countries of the European Union. The age structure of Estonia already causes the need to expand the tax base to avoid a sudden increase in the proportion of dependent people, which could bring about serious social problems.

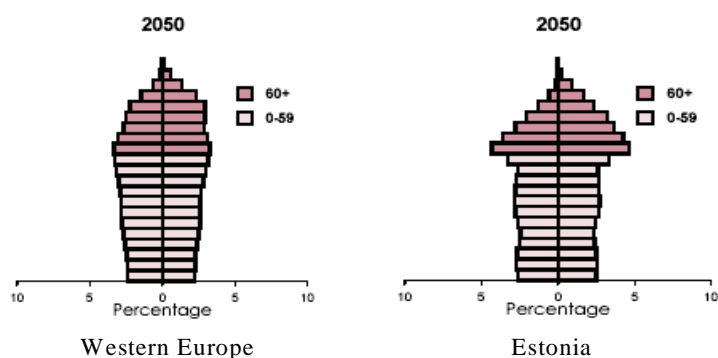


Figure 4.1. Predicted population pyramids in Western-Europe and Estonia in 2050

Source: *World Population Ageing: 1950-2050*

Ageing of the population inevitably causes the fast reduction of the working age population, with the number of people 50 years or older continually increasing. This is taking place at a time, when technological changes require constant re-qualification and training, and the younger generation has to spend more time in the educational system. This has two implications: firstly, it introduces the need for lifetime training, which allows the ageing population more opportunities to participate in the labour market, and secondly, it places special needs on Estonian labour, social and migration policies, all of which will require careful attention to secure the necessary future labour supply.

4.1.2. The labour market situation

The differences in the situations of the labour markets of the source and destination countries of migration are generally considered to be important factors for migration decisions. During the last decade there have been some remarkable changes in the Estonian labour market. As described in Chapter 2, employment has fallen even more rapidly than participation, leading to an increase in unemployment in Estonia. A significant increase in employment in services has been achieved, but it has not yet been sufficient to compensate for the ongoing adjustment and job losses in agriculture and industry. Participation, as well as employment rate in Estonia is below that of the EU and other potential destination countries for Estonian migrants (see Table 4.2).

Table 4.2. Key indicators of the labour market in some EU Member States and Estonia in 2001

Country	Participation rate	Employment rate (age 15-64)	Employment in primary sector	Employment in secondary sector	Employment in tertiary sector	Unemployment rate	Unemployment rate of youth	Long-term unemployment rate
Estonia	69.9	61.1	7.1	34.2	58.7	12.4	24.5	5.8
EU15	62.2	63.9	4.2	26.4	69.4	7.4	14.9	3.3
Denmark	79.9	76.2	3.3	22.6	74.1	4.3	8.5	0.9
Finland	75.0	68.1	5.8	27.7	66.4	9.1	19.7	2.5
Sweden	75.2	71.7	2.6	23.3	74.1	5.1	11.1	1.2
Germany	71.4	65.8	2.4	28.6	68.9	7.9	9.4	3.9

Source: *Employment in Europe 2002*.

The Estonian labour market is characterised by a high degree of unemployment, which even increased during the late 1990s. One explanation for this high unemployment, as described in Chapter 2, is mismatch with respect to qualification and region. Unemployment is especially high among young and less educated persons. At the same time, there is also a surplus demand for highly skilled labour, as well as craftsmen and sales personnel (Modernisation of ..., 2001).

Comparing the average unemployment rates, we can see that the unemployment rate in Estonia is almost two times higher compared with EU average and it is higher than the unemployment rate in the neighbouring EU member countries. Especially big differences are among youth unemployment rates. As migration theory suggests: a high level of unemployment in the country of origin can be a significant push factor of migration. However, as Estonian unemployment is mainly structural (with a large proportion of long term unemployed) and as unemployment is affecting mainly people from different risk groups, this factor is not very influential in determining migration potential, as many will not possess the skills to find a job within other EU countries.

The implementation of structural labour market reforms has paved the way for the recent improvements in the European labour market. Strong employment growth without inflationary pressures suggests that the gains in employment and participation and the decreases in unemployment are sustainable and structural in nature. There is evidence that in the second half of the 1990s, structural unemployment declined overall in the EU and was accompanied by strong employment generation (Employment in Europe 2002). Unfortunately we cannot observe the same tendencies in the Estonian labour market. Due to its smallness and openness, the Estonian economy is influenced by internal and external shocks (for example, financial recession caused by the stock market crash in October 1997 and the crises in the world financial markets; the Russian economic collapse in 1998; etc), also the job destruction process is higher than job creation process and unemployment rate, especially youth unemployment rate, is high. All of these factors increase the migration potential in Estonia.

4.1.3. Income gap

The wage gap and the speed of approximation of wage levels are key factors of labour migration. As argued by Faini and Venturi (1994), the effect of wages in the region of origin, however, need not be linear. In particular, potential migrants in poor regions (countries) may be unable to bear the cost of migration. As wages rise, emigration from such regions will increase as the liquidity constraint ceases to be binding. On the other hand, rising wages at home reduce incentive for migration. As we can see from Table 4.3 there exist remarkable differences in wage

levels comparing Estonia and the EU countries. Over the time, the differences have diminished and as the wage statistics shows, wage growth has been higher in candidate countries than in the EU Member States. However, the process of convergence is time consuming and is expected to last at least 15-20 years.

Table 4.3. Wage level in Estonia and some European Union countries in 1995 and 1998

Country	1995		1998	
	Yearly wage (in USD)	Share from EU15	Hourly wage (in EUR)	Share from EU15
Estonia	2,478	7.1	1.57	14
EU15	34,885	100.0	11.05	100
Denmark	39,079	112.0	17.32	157
Finland	37,992	108.9	11.87	107
Sweden	36,004	103.2	16.00	145
Germany	40,999	117.5	16.71	151

Source: Brücker et al. 2001; Eurostat Yearbook 2002.

While the nominal wages in the EU exceeded that in Estonia many times over, in purchasing power terms, the ratio is more modest (see Table 4.4). Moreover, the accession countries are reporting higher growth rates, as the positive effects of structural reforms bear fruit, but also because of FDI inflows and financial transfers from the EU (Fridmuc 2001). However, according to Boeri and Brücker (2001 a) it will take Estonia around 16-18 years to catch up low income level Member States of the EU.

Table 4.4. Income per person in purchasing power parity in 1997-1998

Country	1997		1998	
	USD	Share EU15	USD	Share EU15
Estonia	5,090	25	5,736	28
EU15	20,710	100	20,176	100
Denmark			23,830	118
Finland			20,270	100
Sweden			19,480	97
Germany			20,810	103

Source: 1997 – Brücker 2001; 1998 – Boeri et al 2001a.

The income difference will remain the main pull factor of migration. According to a survey launched in 2000 by Estonian poll firm SaarPoll, around 90% of respondents saw income increase as the main incentive to go to work abroad (Paas et al. 2003).

4.1.4. Qualification of the labour force and demand for services

The average educational level in Estonia is high and comparable with the average level of the EU countries. If recognition of diplomas of the accession countries is agreed on, some increase of highly skilled labour force movement between East and West (both sides) can be predicted and the wages of highly qualified persons will rather quickly create a new wage equilibrium for some occupations in some areas of economic activity.

The subcontracting of services to other businesses is driven by factors of cost (e.g. in construction) or skill (e.g. business services or the IT sector) rather than, for instance, individuals perceiving a wealth gap (Free Movement of ..., 2001). A recent example in Europe was Germany, who was looking for IT specialists from East European countries. Another example is the Swedish labour market, where there is a severe shortage of health and social care personnel and it appears likely that this shortage will grow more severe in the future. At the same time, there has been overproduction of doctors and other health care staff for several years in Estonia and this may be an important push factor for migration. In the Swedish labour market, there is a

shortage in the teaching field, in childcare, and also among engineers and IT staff (Education and ..., 2002).

These kind of recruiting activities are an important pulling factor of Estonia's "brain drain". It could also affect the movement of low paid blue-collar workers who could be invited by host countries to seasonal agricultural works.

4.1.5. Proximity

Distance is not a crucial factor for the traditional migrant, but it will be an important factor for those workers, who are looking for temporary work or commuting. A survey by the SaarPoll in 2000 revealed that only 4.0% of potential migrants are interested in permanent emigration from Estonia, 7.9% of them would choose to work a few years abroad, 17% would choose to work a few months and 19.9% would prefer commuting, seasonal and casual work. From the destination countries, 33% of Estonians would prefer Finland, 19.3% would choose Germany and 16% Sweden.

As Figure 4.2 shows, the number of Estonian citizens in Finland has grown constantly. Finland is close to Estonia geographically, culturally, and linguistically, with many Estonians speaking Finnish.

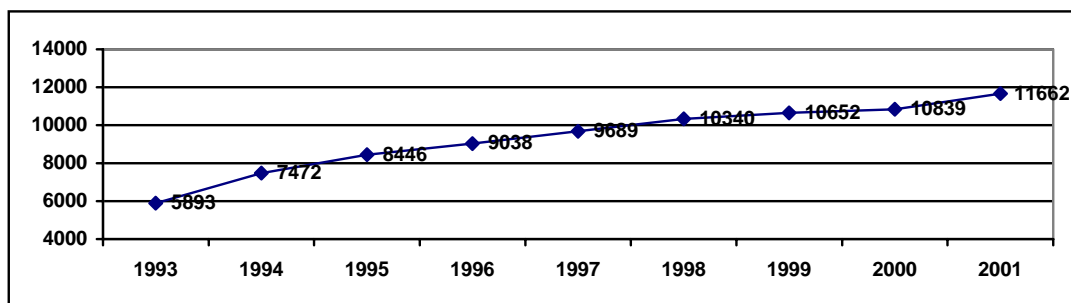


Figure 4.2. Number of Estonian citizens in Finland

Source: Statistics Finland 2001.

According to Eurostat statistics, the highest percentage of Estonians outside of Estonia is in Finland, followed by Germany and Sweden. One reason for that is of course proximity, the second one are the networks and cultural similarities with these countries.

4.1.6. Other push and pull factors

Social rights

Alongside the expected higher earnings, higher earnings-related social security benefits in the current EU Member States may contribute to the pull factors, considering the relatively low replacement rates of Estonian benefits (see Table A.12 in Appendix 2). This is facilitated by the EU social security co-ordination rules, which stipulate coverage of migrant workers with health insurance in the host country and portability of pension rights acquired in the other Member States.

At the same time, social tourism of economically non-active persons is prevented by the relevant EU law. Directive 90/364/EEC on the right of residence has established the existence of an adequate medical insurance and sufficient means of living as pre-conditions for exercising the freedom of movement, in order to avoid becoming a burden on the social assistance system of the host Member State.

Tradition and networks

There is empirical evidence that traditions, family, national or ethnic networks are an important factor for migration. However, concentration of Estonian nationals in the EU Member States is insignificant and it is unlikely that they will attract extra inflow of migrants from Estonia. There are some old Estonian communities in existence in Europe (for example, in Sweden), but they consist of mostly elder persons, with the younger generation quite well assimilated with the local communities.

Ethnic and political problems

The ethnic and political problems have lesser importance in the determining of migration potential in Estonia. Russians in general tend to migrate more than native people in Estonia. The situation of non-Estonians is somewhat more complicated in the labour market, but the reasons for that are mainly structural changes that took place during the last decade in the Estonian economy. Those who are long-term unemployed have lower qualifications, they usually do not have language skills, and their ability and desire to move is limited. According to the above-cited survey of SaarPoll, the probability of migration of Russians is twice as high as that of Estonians.

Cultural and linguistic barriers

It was already explained that the most popular country for Estonians is Finland. If we look at surveys of how many people have done some preliminary investigations about future possibilities to work abroad, then we can see that the number is very small. Only 10% have made some preliminary investigations. 64% said that they speak only two languages, this is mostly English for the younger generation and Russian for middle age (over 30) and older generation. 73% of potential migrants have very poor information about the possibilities of working abroad.

Summarising the pull and push factors of migration, we can say that the main push factors for Estonians are low income levels and a worse situation in the labour market compared to neighbouring EU member countries, especially the high unemployment rate and limited job creation process. The main pull factors are a higher income, a better situation in labour markets and the need for specialist professions (who will easily qualify for work permits). The main factors impairing mobility are the following: language problems, difficulties in assessing foreign qualifications, socio-cultural conditions, availability of accommodation in the destination country, family situation (schooling of children, employment of partner), but also labour and social welfare regulations.

4.2. Migration processes and policies⁸

4.2.1. Emigration

The number of Estonian residents in the EU member countries is insignificant, the main reason for which are work and resident's permits - Estonian residents have to apply to emigrate into the EU member countries. According to Eurostat about 16,764 people from Estonia lived in the EU member countries in 2001 (see Table 4.5). This number is negligible, both in terms of the Estonian population (1% in 2001) and even more in terms of the EU Member States population. The highest percentage of Estonians outside of Estonia is in Finland and the next were Germany and Sweden. According to the statistics from the Estonian Tax Board there were 5,300 people receiving income from abroad in 2001.

⁸ This chapter is based on the documents: 2002 Regular Report on Estonia's Progress Towards Accession; Supplement to the Progress Report; NPAA 2002-2003.

Table 4.5. Number of Estonian citizens in the EU Member States in January 2001

Country	Number of people
Finland	10,839
Germany	3,429
Sweden	1,554
Denmark	458
Italy	179
Netherlands	111
Belgium	72
Spain	52
Greece	39
United Kingdom	32
Portugal	1

Source: Council of Europe. *Recent demographic developments in Europe 2001*, UK Department of Social Security.

In the negotiation process of joining the EU, Estonia has not requested any transitional arrangements and has agreed to a transitional arrangement with respect to the free movement of workers, put forward by the EU. Restrictions on the movement of workers from Estonia to the EU will apply for a minimum two-year period, as of the date of accession, and may remain in force for a maximum of seven years⁹.

Current Member States will continue to apply national measures as regards the right of Estonian nationals to take up work. In this context, any current Member State may introduce, under national law, greater freedom of movement of workers than at present, including full labour market access. Sweden, Denmark, Netherlands, Ireland and the United Kingdom have announced that they will grant labour market access to the new Member States upon their accession. Current bilateral agreements will continue to apply and may be further developed. The access of Estonian nationals to current Member State labour markets cannot be more restricted than that prevailing at the time of the signature of the Accession Treaty. In addition, current Member States will introduce a preference for Estonian national over non-EU labour. The specific case of commuters or frontier workers is also subject to the above arrangements and may be dealt with through national measures during the transitional arrangements.

Any current Member State applying the *acquis* may invoke a safeguard clause until the end of the seventh year following Estonia's accession. As long as safeguard measures can be invoked, Member States may, in urgent and exceptional cases, suspend full application of the *acquis*, followed by a reasoned ex-post notification to the Commission. Member States issuing work permits to Estonian nationals during this period will do so automatically.

Estonian nationals legally residing and employed in a Member State shall enjoy equal treatment to nationals in respect of working conditions, pay, etc, but not regarding access to the labour market of another Member State. In all instances where the *acquis* is suspended during the transitional arrangements, members of the family of a worker already living in a Member State at the time of accession shall have, immediate access to the labour market of that Member State. Estonian migrant workers and their families legally resident and working in another Member

⁹ Before the end of the second year following Estonia's accession, a review of the functioning of the national measures shall be held on the basis of a report from the Commission to the Council. On completion of the review and no later than at the end of the second year following Estonia's accession, current Member States should notify the Commission on whether they intend to continue applying national measures or whether they intend to apply the *acquis* henceforth. In the absence of such notification, the *acquis* will apply. Five years after Estonia's accession a current Member State maintaining national provisions may, in case of serious disturbances of the labour market or threat thereof, prolong these for a maximum of two years, after notifying the Commission accordingly. In the absence of such notification the *acquis* will apply.

State or migrant workers from other Member States and their families legally resident and working in Estonia may not be treated in a more restrictive way than those from a third-country.

4.2.2. Immigration

According to the Estonian law, there exist immigration quotas 0.05% of Estonian population per year. Actual immigration is higher because of different exceptions in quotas. The following table illustrates the decisions made by the Citizenship and Migration Board on the issue of different documents and Table 4.7. describes the distribution of non-permanent habitants by citizenship.

Table 4.6. Decisions made by the Citizenship and Migration Board on the issue of different documents

Document	1997	1998	1999	2000	2001
Temporary residence permit	8,237	27,650	11,626	30,653	39
Permanent residence permit	716	12,485	75,031	162,233	66,156
Work permit	6,172	4,495	1,798	2,409	4,791

Source: Citizenship and Migration Board

Table 4.7. Distribution of persons with valid residence permits by citizenship

Citizenship	Persons with non-determined citizenship	Russian	EU nationals	Other states
Share (%)	64	33	1	2

Source: Citizenship and Migration Board

The citizens from EU member countries are not subject to immigration quotas. After joining the EU, Estonia may apply to nationals from a current Member State, national measures equivalent to the measures applied by that Member State with regard to Estonia in the context of the above arrangement on free movement of workers and provision of services. As long as a current Member State applies national measures to nationals of a new Member State, Estonia may resort to the safeguard provisions outlined above with regard to the new Member States, with the exception of Cyprus and Malta. Nationals of other Member States legally resident and employed in Estonia shall enjoy treatment equal to Estonian nationals in respect of working conditions, pay, etc.

4.2.3. Measures regarding the regulation of labour migration

There are several measures undertaken to facilitate free movement of workers. These include, among others, steps towards mutual recognition of diplomas, ensuring residence rights for the EU citizens residing in Estonia, preparations to participate in European Employment Services System (EURES).

Estonia negotiated on recognition of diplomas and qualifications in respect of free movement of workers who completed education during the time when Estonia was part of the Soviet Union (diplomas issued in the Soviet Union) and of persons who began to study a profession listed in the Sectoral Directives (medical doctors, dental practitioners, pharmacists, nurses of general care, midwives, veterinary surgeons) before the harmonisation of the Estonian curricula and duration of training with EU requirements.

With respect to professional qualifications obtained before harmonisation, Estonia needs to introduce measures to ensure that all its professionals can, as of accession, meet the requirements laid down by the directives. In the case of the general occupations, the third country qualifications recognised by Estonia will be recognised throughout the EU. In the case of health care and architecture relevant Estonian bodies must confirm the equivalence of the qualifications to Estonia's diplomas. In addition, people with those occupations need to have a certificate to demonstrate that they have been working in the profession recently. The mutual recognition of

lawyers' qualification is approached individually for each case, according to the order established in respective Member State.

Estonia is preparing to participate in the EURES system, which will facilitate exchange of information on vacancies in different Member States. The system also enables the procurement of specific information on conditions of social insurance, tax system, working etc.

Concerning the rights of immigrants, Estonia has adopted the laws, which enable the EU citizens residing in Estonia to vote and to stand as candidate in municipal elections. A new Public Service Act enables the citizens of the European Union Member States to be employed in the service as a state or local government official in Estonia¹⁰.

4.3. The challenges of EU accession regarding the free movement of workers

4.3.1. Migration potential

Numerous studies have been made on the prospects of labour migration after EU eastward enlargement, when the current regime will be replaced with the right of free movement of labour (see for example Brücker and Boeri, 2000; Sinn *et al* 2001; Walterkirchen and Dietz, 1998; Bauer and Zimmermann, 1999; Hille and Straubhaar, 2000; Werner 1997, 1998; amongst others). Estimates for the long-term migration potential from the CC, based on various research studies, are roughly 1% of the EU 15 population. Bertola *et al.* (2001) argue, that future trends in migration from CEE crucially depend on how fast the process of convergence in GDP per capita levels will occur, and, even more so, on the expectations of residents of the accession countries about the closing of the income gap with the EU.

The outflow of Estonian citizens is not a problem for Estonia at this stage. Looking at the predicted outflows of Estonians, it might bring about some problems in the context of population ageing. Free movement of labour will have rather serious pressure on the Estonian labour market due to possible movement of a better-qualified and flexible labour force. Movers will be mainly the people with good qualifications, also young people with a secondary level education, who do not find a qualified job at home. They are ready to work as blue-collar workers earning salaries, which are relatively higher than they would expect to get in their home country.

At the same time the flows are predicted to be quite low and their impact on the labour market and economy is predicted also to be low (Philips *et al.*, 2002; Paas *et al.*, 2003). Based on experience of the previous stages of the EU enlargement and the predictions that labour migration will not exceed 0.2% of the Estonian population, it is possible to estimate that in the first years of free movement of labour, migration could be about 2,500-2,800 people per year from Estonia (or about 10,000-14,000 during the first four-five years). Over a long-term period (10 years) the labour migration rate will decline (Paas *et al.*, 2003). As the predicted migration flows will be quite modest, it will not affect the situation in the Estonian labour market and has little effect on wage levels. However, there will be specific sectors and occupations, which will face greater pressure from migration.

4.3.2. Possible problems due to migration

Migration of high-skilled labour force

¹⁰ To certain positions, which are directly related to the defence of the interests of the county or state, only citizens of the Republic of Estonia will be appointed.

Werner (1997) states that partial imbalances and new opportunities for certain groups of workers may arise and additional, economically motivated migration could occur. Such migration might come about because specialists, managers, technicians and other highly qualified manpower will be in demand in all EU countries and are expected to move across borders more frequently. Increasing qualification requirements, an ageing workforce and lower numbers in the younger population will, in principle, intensify competition within the EU for highly qualified personnel, particularly as far as managers and specialist personnel are concerned. As the income gap in these occupations is even larger than average, Estonia may face the “brain drain”, leading to an even larger shortage of qualified workforce in the future than it faces today.

Youth migration

Many younger employees have great interest in the opportunities provided by a larger European labour market. Practice of going abroad at the beginning of their careers, is bringing about a highly qualified, internationally mobile group of people, who are linguistically, technically and culturally flexible and who, with high probability, do not have incentives to return to their home country.

Commuting in border regions

It is highly probable that cross-border movement in border regions of Estonia will significantly increase after free movement of labour is achieved, especially between regions of North-Estonia and South-Finland. Workers in border areas are particularly fast to react to changes in the neighbouring country. In addition, many of the obstacles, which usually play a role in migration across borders, do not apply to these workers or are less important (familiar surroundings, including housing; children can stay in the national school system; the spouse can keep his/her employment; also language problems are relatively minor, because of the proximity of the border). The major incentive to work in the neighbouring country is certainly pay. But also other factors, such as taxation, social security or others will play a role in commuting decisions.

The Commission has invited the National Agencies of all countries involved to present cross-border co-operation plans with a view to develop and implement projects and partnerships which will encourage mobility, initiative, intercultural learning and solidarity between young people and other citizens in border regions.

There are several funds available for EU regions bordering candidate countries, in order to finance specific actions to support these regions. Two regions from South-Finland are going to get financial aid from EU funds to deal with cross-border movement. For example, the Finnish YOUTH National Agency has granted a multilateral youth exchange entitled “COSMO”, which involves young people from cross-border regions in Finland, Estonia and Germany. The project aims at preventing social exclusion and increasing the knowledge of Europe amongst young people. (Progress Report ... 2002)

There are also some funds available for candidate countries to deal with cross-border movement. For example, the Special European Investment Bank Programme has been developed in response to the lack of adequate small-scale infrastructure identified in the border regions of the candidate countries with the EU. Its overall objective is to contribute to the social and economic development of these border regions and to their integration with their neighbouring regions in the current EU Member States. This Programme started in 2002, and the funds for Estonia will be available in the near future. (Progress Report ... 2002)

Summarising the findings about potential migration, Bertola *et al* (2001) conclude, that so far migrants from Eastern countries have been mainly of the high-skill type and they have competed with other foreigners for blue-collar positions in manufacturing or construction and/or low-skilled jobs in the service sector.

4.4. Conclusions

Different push and pull factors influence the migration from Estonia to current EU Member States. The main factors are a still remarkable income gap, a better situation in the EU Member States' labour markets, and also the need for different specialists (IT specialist, doctors, nurses, midwives, etc) in the EU labour markets. Free movement of labour will put rather serious pressure on the Estonian labour markets due to the possible migration of a better-qualified and flexible labour force. It is predicted that the movers will be mainly people with good qualifications, also young people with a secondary school education, who cannot find qualified jobs at home. They are ready to work abroad as blue-collar workers, getting relatively higher salaries than they expected to get in their home countries. Migration will put additional pressure on population ageing and even more on financing social protection.

Estonia has not requested any transitional arrangements regarding free movement of workers and Estonia has agreed to a transitional arrangement in respect of the free movement of workers put forward by the EU. Restrictions on the movement of workers from Estonia to the EU will apply for a minimum two-year period, as of the date of accession, and may remain in force for a maximum of seven years. Estonia is meeting the commitments it has made in the accession negotiations in this field. In order to complete preparations for membership, Estonia's efforts now need to focus on the adoption of outstanding legislation with respect to mutual recognition of diplomas, on bringing curricula and training into line, in particular for nurses and vets, and on further strengthening institutional capacity.

Conclusions and recommendations

Estonia has created a well-structured market economy with an average growth of GDP of around 5% over the last five years. Estonia is characterised by an open and liberal economy. Estonia has signed an accession treaty with the EU and will probably become a member of it in 2004.

Labour market and labour market policies

The Estonian labour market has been characterised since the beginning of the transition period by declining labour force participation and employment rates. The unemployment rate that has declined for two years now remains high at 10%. Compared to the EU average it could be one motivation for labour emigration. Generally, the Estonian labour market problems are the same as those within the EU Member States. Youth unemployment and unemployment of ethnic minorities are higher than average, and there are big regional differences in labour market performance. In addition, Estonia suffers from high levels of long-term unemployment. Also, Estonia unlike the EU countries has unemployment levels for women which are lower than that of men. Against this background the Estonian labour force is ageing and Estonia could face, if current trends continue, a shortage of labour supply.

The reasons of the labour market problems can be largely attributed to fast economic and structural changes. People are not able to keep their skills and qualifications in-line with the labour market needs. Also the public policies (labour market policy and education policy) have not developed enough to bring people who are unemployed efficiently back to the labour market. As there is no state-financed system to support adult training (excl. unemployed, civil servants, teachers) the creation of supported in-service training of the workers and opportunities for re-training are the key factors in further fighting structural unemployment.

The financial allocations for employment policies have been extremely low, lagging behind EU levels by around 8 times. The supply of active policy programs has been small, so that only a small percentage of unemployed can participate. The accession to the EU will bring about big financial support to Estonia, which will include allocation for employment policies. In this context the administrative capacity of public employment services to use these funds should be evaluated carefully. There is no regular monitoring of the effectiveness of either active or passive labour policy measures. Thus there is no possibility to conclude whether the choice of a particular policy set is justified or not.

Social partnership is also relatively weak in Estonia. This is mainly due to their low representation. While there has invariably been social dialogue on a national level, there is no social dialogue on a regional or sectoral level. As the Government is the strongest partner in any social dialogue, the final decision on implementation of negotiated issues rests with them. In order to promote social partnership, which can conform to European Social Models, the general attitude and participation in employees' organisations should be promoted and encouraged.

While there are no rapid changes envisaged in the labour market, due to accession to the EU, there may be an improvement in the unemployment situation if the financial aid is used effectively.

Social policy

The Estonian social protection scheme is characterised by almost universal coverage; with a substantial role of flat-rate benefits, which have relatively low replacement rates; a few earnings-related benefits and reliance on contributory based financing. Social protection expenditures both in absolute terms and as a share of GDP are lower in Estonia than in the EU states, but this gap

could be linked more to the general differences in wealth, and less to a specific lack of social protection.

Currently the social security coordination, in the case of movement of workers, is regulated by bilateral agreements. There are also some provisions in the Europe Agreement, signed in 1995, but these have never been implemented. From the date of joining the EU the EU Regulations will be applied to economically active people (and their family members), replacing the bilateral agreements. For other people the bilateral agreements will still apply. Although there is no obligation to harmonise bilateral agreements with the EU Regulations, the discrepancies may cause substantial administrative problems.

Application of the EU's social security co-ordination rules requires extending relevant administrative structures both at Ministry level as well as within the implementing bodies. Also, the existing bilateral agreements need revision to avoid extra administrative complications. In this respect, the principles of co-ordination of the EU Regulations could be bilaterally extended to all persons who are currently in the personal scope of bilateral agreements. The Government could also make an effort to conclude arrangements on mutual waiving of reimbursement of the costs of medical services, with some of the EU Member States, in order to ease administrative burdens associated with the implementation of the EU Regulations.

The direct effect of accession upon social protection systems and policies will be rather limited, but there will be important indirect implications. Social security co-ordination extends the rights of Estonian citizens moving across Europe. While currently pensions and other benefits are paid on the basis of residence, after accession pensions must be paid also to persons who have obtained insurance periods in Estonia, but reside in any other Member State. The EU co-ordination rules will add a certain degree of financial constraint to existing schemes of pension and health insurance. The additional burden is estimated to be about 0.5 to 3 per cent of respective budgets.

It appears that with accession to the EU from the state's perspective, the most problematic social security schemes are residence-based benefit schemes, which offer universal flat-rate benefits with no qualification period. As access to these benefits is relatively easy, co-ordination can increase costs, depending on the flow of migrants. As universal flat-rate benefits have also been the predominant type of cash benefit in Estonia, accession may force a tightening of some of the eligibility criteria.

Migration and migration policies

The Estonian labour market is currently in a situation where several factors act as push factors for migration. The main features are high unemployment, high unemployment amongst young people, a relatively high educational level of the Estonian labour force and big income differentials.

The outflow of Estonian citizens is not a problem for Estonia at this stage and there is probably no need to restrain the migration after joining the EU. The migration flows are predicted to be quite low and their impact on labour market and economy is predicted to be low as well.

The majority of migration is predicted to be temporary and short-term or seasonal. This kind of migration has some good aspects. During their stay abroad, people can accumulate new knowledge and skills and when they return to Estonia, their human capital value is increased and they are more valuable in the Estonian labour market. Young people, who do not find a job after graduating in the Estonian labour market, are often looking for a job in other countries. If they are able to find a job, they do not have to start their working career with a frustrating unemployment period (keeping in mind that the unemployment of the young is particularly high in Estonia), they can get work experience and the social security system does not have to support

their unemployment or non-activity period. At the same time young people are the ones who have the weakest propensity to come back.

Predicted outflows of Estonians reveal, that it might bring about some problems in the future. In the next ten years, Estonia is facing the problems of an ageing population and the challenge of maintaining a sufficient workforce. Faced with given demographic trends, there is a need to maintain a sufficient labour force, a sustainable dependency ratio and also to diminish the emigration potential from Estonia through reducing the unemployment rate and increasing the participation rate. This is also tightly connected with supporting the job creation process and self-employment initiatives. In order to reduce emigration potential the income differential must decrease. This might be a policy option if there are severe consequences of free movement of workers in some occupations (e.g. medical doctors).

The general system for facilitating free movement of workers is under way. The preparations are ongoing for implementing the European Employment Services System in Estonia. The arrangements for mutual recognition of diplomas and qualifications have been made, and the legislation for coordination of social security systems has been adopted.

Estonia has not requested any transitional arrangements regarding free movement of workers and Estonia has agreed to a transitional arrangement in respect of the free movement of workers put forward by the EU. Only five European countries have announced the freedom of free movement of workers for Estonia: Denmark, Sweden, Netherlands, UK and Ireland. Restrictions on the movement of workers from Estonia to the EU will apply for a minimum two-year period as of the date of accession and may remain in force for a maximum of seven years. At first in two years and then in three years the Member States must justify the maintenance of the transitional period. Estonia should prepare for protecting its interests in these cases by evaluating the migration trends continuously.

Policy Recommendations concerning the challenges of the Estonian accession to the EU

Employment policy

- The accession will double spending on active labour market measures due to support from Structural Funds. In this context the administrative capacity of public employment services (PES) should be evaluated. Currently, there is no clear vision of how much and how efficiently the PES can offer active labour market measures.
- As the generation of new programs must be justified a system must be created for regular evaluation of ALMP. There is no evidence currently on the effectiveness of these programs.
- As there is no state-financed system to support adult training, the creation of public in-service training and re-training services is crucial in fighting structural unemployment.
- Also a system must be developed for evaluating passive labour market measures. More specifically - recently launched systems of early retirement and unemployment insurance should be evaluated regarding work incentives.
- Social partnership is not developed enough for carrying out social partnership and social dialogue, which is an integral part of the European social model. In order to change this, the emphasis should be placed on strengthening the administrative capacity of social partners and prioritising the social partnership approach in society.

Social protection

- The administrative capacity concerning the implementation of social security co-ordination rules must be improved.
- The Government should try to conclude arrangements with other EU Member States on mutual waiving of reimbursement of the costs of medical services.
- The existing bilateral social protection agreements need revision to avoid possible conflicts between the EU Regulations and bilateral agreements. In this respect, the principles of co-ordination of EU Regulations could be bilaterally extended to all persons who are currently in the personal scope of bilateral agreements.
- Accession to the EU may force a tightening of eligibility criteria of some of the current universal flat-rate social security benefits, to prevent increase of expenditure.

Migration policy

- There is no need to restrain migration of workers on behalf of Estonia in the short term as the predicted migration flows are low. Therefore the expected impact of migration on the labour market and wages is also low. At the same time, in some areas of economic activity or occupations, Estonia may face the shortage of qualified workers and therefore the careful monitoring of migration flows and the analysis of their impact on the labour market is needed.
- Long-term measures to cope with the impact of the ageing of population on the labour market and social protection systems, could include migration policies (attracting foreign labour, restraining outflow of domestic labour).
- If many young people migrate in the future, incentives will be required entice them home.
- In some cases (for some occupations) it might be necessary to reduce push factors of migration, e.g. income differential (concerns mainly occupations financed by Government).
- As the transitional agreements in Member States are reviewed and justified after two and then three years, Estonia should prepare for protecting its interests in these cases. Therefore continuous collection, supervision and analysis of migration data should be done.

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Appendices

Appendix 1. General Statistical Indicators

Table A. 1. Main macroeconomic indicators

	1997	1998	1999	2000	2001	2002
GDP at current prices (millions USD) ¹	4,614.0	5,228.6	5,194.2	5,137.3	5,524.8	-
GDP per head in PPS, % of the EU average ³	38	39	38	40	42	-
Consumer price index (change over previous year, %)	11.2	8.2	3.3	4.0	5.8	3.6
Current account balance (% of GDP) ²	-12.1	-9.2	-4.7	-6.0	-6.1	-12.5
Foreign direct investments inflow (% of GDP) ²	25.7	33.2	49.8	51.0	57.9	
EEK/USD average annual exchange rate ²	13.881	14.065	14.695	16.981	17.479	16.6
EEK/USD end of year exchange rate ²	14.336	13.410	15.561	16.820	17.692	14.936
Gross external debt (millions USD) ^{1,2}	2,645.818	2,764.856	2,982.838	2,978.494	3,318.657	4,197.843
Gross external debt (% of GDP) ²	57.3	52.9	57.4	58.0	60.1	-
Domestic government debt (millions USD)	110.27	112.69	121.94	95.36	116.88	-
Domestic government debt (% of GDP)	2.39	2.16	2.35	1.86	2.12	-
Bank of Estonia international reserves at the end of the year (millions USD) ^{1,2}	784.317	774.668	906.356	914.175	832.776	902.566
TALIBOR ^{4,2} 3-month interest rates (December %)	15.77%	15.63%	15.42%	12.33%	10.05%	9.57%

¹ Calculation based on annual exchange rate of the Bank of Estonia

² Source: Bank of Estonia

³ Source: Eurostat, *Statistics in focus, Economy and Finance, Theme 2-59/2002*

⁴ TALIBOR – Tallinn inter-bank offering rates. Here is presented money market rate as there is no base interest rates presented by Central Bank in Estonia.

- data missing

Source: Statistical Office of Estonia

Table A.2. Socio-demographic data

	1997	1998	1999	2000	2001	2002
Population at the beginning of the year	1,405,996	1,393,074	1,379,237	1,372,071	1,366,959	1,361,242
Mean annual population	1,399,535	1,386,156	1,375,654	1,369,515	1,364,101	-
Working-age population (15-64) (annual average thousands)	925.9	919.1	915.6	915.9	916.5	-
Life-expectancy at birth (male and female) (years)	70.44	69.94	70.82	70.69	70.53	-
Life-expectancy at birth (female) (years)	76.0	75.5	76.1	76.0	76.2	-
Life-expectancy at birth (male) (years)	64.7	64.4	65.4	65.1	64.7	-
Disposable income per household member in a year (USD) ¹	1,419	1,630	1,646	1,543	1,571	-
Disposable monetary income per household member in a year (USD) ¹	1,396	1,566	1,576	1,486	1,505	-
Expenditure per household member in a year (USD) ¹	1,437	1,605	1,564	1,579	1,593	-

Expenditure per household member in a year excluding non-monetary consumption (USD) ¹	1,415	1,567	1,520	1,547	1,553	-
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¹Calculation based on annual exchange rate of the Bank of Estonia
- data missing

Table A.3. Structure of household expenditures per household member (% of total expenditure)

	1997	1998	1999	2000	2001
Expenditure total	100	100	100	100	100
Food and non-alcoholic beverages	36.97	33.93	32.98	32.06	31.70
..bought food and non-alcoholic beverages	29.87	27.65	27.53	26.80	26.68
..self-produced or received free of charge food and non-alcoholic beverages	7.10	6.27	5.45	5.26	5.02
Alcoholic beverages	1.92	1.90	1.95	2.14	1.92
Tobacco	1.37	1.36	1.59	1.67	1.57
Clothing and footwear	7.10	7.42	7.14	6.77	6.33
Housing	18.75	18.13	17.68	15.30	14.91
Household equipment and operation	5.32	5.10	5.31	5.36	5.58
Health	1.44	1.57	2.02	2.60	2.50
Transport	6.17	6.47	6.18	8.22	8.49
Communication services	2.06	2.72	3.53	4.38	4.82
Recreation, leisure and entertainment	5.90	7.27	7.32	6.34	6.70
..newspapers, magazines and books	1.06	1.13	1.07	0.97	0.91
Education	1.42	1.15	1.00	1.31	1.62
Hotels, cafés, restaurants	2.85	3.42	3.01	3.80	3.48
..eating out	2.82	3.38	2.95	3.68	3.40
Miscellaneous goods and services	5.15	5.45	5.60	6.07	6.19
Non-monetary consumption	1.54	2.34	2.77	2.02	2.50
Consumption expenditure	97.95	98.22	98.09	98.03	98.32
Other expenditure	2.05	1.78	1.91	1.97	1.68

Source: Statistical Office of Estonia

Table A.4. Key labour market indicators (annual average if not indicated otherwise)

	1997	1998	1999	2000	2001	2002
Economic activity rate (age group 15-64)	72.3	71.7	70.3	70.4	70.1	69
Employment						
Employment rate (age group 15-64)	65.2	64.5	61.6	60.7	61.1	61.7
Employment in primary sector (% of total employment)	9	9	8	7	7	7
Employment in secondary sector (% of total employment)	33	33	32	33	33	31
Employment in tertiary sector (% of total employment)	58	58	60	59	60	62
Employment in public sector (% of total employment)	31.9	31.1	31.1	28.8	28.7	26.7
Employment in private sector (% of total employment)	68.1	68.9	68.9	71.2	71.3	73.3
Self employed (% of total employment)	0.047	0.047	0.045	0.052	0.048	0.048
Unpaid family workers (% of total employment)	0.008	0.008	0.008	0.007	0.008	0.005
Informal employment ¹ (the % of workers in informal employment (in parenthesis average % of wage received informally))	-	-	-	19 (38)	16 (42)	13 (40)
Unemployment						

Unemployment rate	9.6	9.8	12.2	13.6	12.6	10.3
Registered unemployment rate	5.02	4.78	6.71	7.03	8.26	7.46
Youth unemployment rate	14.5	15.8	19.7	23.8	22.2	17.6
Long term unemployment (% of total unemployment)	45.7	47.0	45.8	45.4	48.3	52.8
Employed by educational level						
Below upper secondary education (ISCED 0,1,2)					10.4	-
Upper secondary education (ISCED 3,4)					57.1	-
Tertiary education (ISCED 5,6)					32.5	-
... Postsecondary technical after secondary education (ISCED 5B)					11.8	-
... Higher education, master's and doctor's degree (5A, 6)					20.7	-
Unemployed by educational level						
Below upper secondary education (ISCED 0,1,2)					19.3	-
Upper secondary education (ISCED 3,4)					62.7	-
Tertiary education (ISCED 5,6)					18.0	-
... Postsecondary technical after secondary education (ISCED 5B)					9.5	-
Higher education, master's and doctor's degree (5A, 6)					8.6	-
Labour costs and productivity						
GDP/employed (current prices thousands of USD)	7.48	8.62	8.97	8.97	9.56	-
Average unit labour costs (compensation of employees/GDP)	52.154	50.964	53.781	49.992	49.116	-
Average monthly wage (USD)	257.40	293.28	273.63 ²	261.47 ³	280.74	-
Change in average monthly gross wages (previous year =100)	119.7	115.4	-	110.4 ³	110.5	-

¹Source: Estonian Institute of Economic Research

³Change in average gross wages (salaries) of 1999 has been presented in comparison with the recalculated data of 1998, which do not include health insurance benefits.

Source: Statistical Office of Estonia

Table A.5. Average monthly gross wages in USD

	2000	2001
Average of economic activities	290.4	316.7
Agriculture and hunting	167.0	189.3
Forestry	259.1	290.1
Fishing	210.2	226.2
Mining and quarrying	347.3	393.3
Manufacturing	282.4	295.9
Electricity, gas and water supply	350.1	386.6
Construction	259.1	300.7
Wholesale and retail trade ...*	278.5	308.0
Hotels and restaurants	180.7	216.7
Transport, storage and communication	356.6	371.7
Financial intermediation	644.3	704.0
Real estate, renting and business activities	294.7	362.0
Public administration and defence; compulsory social security	372.0	399.9
Education	247.8	274.1
Health and social work	259.6	274.0
Other community, social and personal service activities	247.9	269.9

Source: Statistical Office of Estonia

Table A.6. Expenditures on labour market policies (% of GDP)

	1993	1994	1995	1996	1997	1998	1999	2001	2002
Passive labour market policies	0.17	0.11	0.07	0.07	0.08	0.08	0.26	0.25	0.22
Active labour market policies	0.02	0.13	0.10	0.09	0.09	0.08	0.08	0.08	0.08

Source: National Labour Market Board, Statistical Office of Estonia

Table A.7. Replacement rates to average gross wage

	1997	1998	1999	2001	2002
Unemployment allowance	0.07	0.07	0.09	0.08	0.07*
Old-age pension	0.31	0.30	0.35	0.31	-

* the wage is from 3rd quarter of 2002

Source: Statistical Office of Estonia; Ministry of Social Affairs

Table A.8. Migration flows and target countries

	1997	1998	1999	2001 ¹	2002
Emigration	1585	1414	1418	n.a	n.a
Destination countries	Russia	Russia	Russia		
	Finland	Finland	Finland		
	Germany	Germany	Germany		
	USA	USA	USA		
	Ukraine	Ukraine	Ukraine		
Immigration	4081	2545	2034	n.a	n.a
Countries of origin	Russia	Russia	Russia		
	Ukraine	Finland	Ukraine		
	Finland	Ukraine	Finland		
	Latvia	Latvia	Latvia		
	USA	Germany	Sweden		

¹ Since 2000 Statistical Office of Estonia does not publish migration data.

Source: Statistical Office of Estonia

Appendix 2. Statistical Tables of Chapter 3

Table A.9. Estonian nationals residing in the countries, which are going to apply the EC Council Regulation 1408/71¹ as of 1 January 2001

Country	Number	Country	Number
Austria	n.a.	Liechtenstein	1
Belgium	72	<i>Lithuania</i>	<i>n.a.</i>
Cyprus	n.a.	Luxembourg	n.a.
Czech Republic	n.a.	Malta	n.a.
Denmark	458	Netherlands	111
<i>Finland</i>	<i>10,839</i>	Norway	301
France	n.a.	Poland	n.a.
Germany	3,429	Portugal	1
Greece	39	Slovak Republic	n.a.
Hungary	33	Slovenia	3
Iceland	25	Spain	52
Ireland	n.a.	Sweden	1,554
Italy	179	Switzerland	90
<i>Latvia</i>	<i>487</i>	United Kingdom	32 ²
Total			17,706
<i>of those in countries currently covered by agreements</i>			<i>64%</i>
<i>in countries not yet covered by agreements</i>			<i>36%</i>

Sources: Council of Europe. *Recent demographic developments in Europe 2001. Strasbourg 2001.*

¹ EU Member States, EEA states, Switzerland and EU candidate countries

² UK Department of Social Security 1998

Table A.10. Outgoing visitors to European countries, served by Estonian travel agencies and tour operators in 2001

Austria	4,700	Italy	6,439
Belgium, Netherlands, Luxembourg	5,255	<i>Latvia</i>	<i>14,730</i>
Czech Republic	5,128	<i>Lithuania</i>	<i>6,560</i>
Denmark	4,072	Norway	4,105
<i>Finland</i>	<i>66,462</i>	Poland	1,695
France	8,278	Portugal	1,282
Germany	13,783	Spain	11,654
Greece	4,554	<i>Sweden</i>	<i>23,186</i>
Hungary	2,856	Switzerland	2,506
Ireland	1,402	United Kingdom	21,574
Total			21,0221
<i>Of those to countries currently covered by agreements</i>			<i>53%</i>
<i>to countries not yet covered by agreements</i>			<i>47%</i>

Source: Statistical Office of Estonia

Table A.11. Social security and social assistance benefits in Estonia

Scheme and benefits	Persons protected	Type of benefit	Financing
State pension insurance			
old age pension	economically active	partly earnings-related	social tax
invalidity pension	economically active	partly earnings-related with flat-rate floor	social tax
survivors pension	economically active	partly earnings-related with flat-rate floor	social tax
national pension	residents	flat-rate	general budget
Health insurance			
medical care	economically active + certain groups of residents	services	social tax
sickness cash benefits	economically active	earnings-related	social tax
maternity cash benefits	economically active	earnings-related	social tax
drug compensations			social tax
Family benefits			
child benefit	residents	flat-rate	general budget
child care fee	residents	flat-rate	general budget
single parents allowance	residents	flat-rate	general budget
foster care allowance	residents	flat-rate	general budget
conscripts child benefit	residents	flat-rate	general budget
birth grant	residents	flat-rate	general budget
school grant	residents	flat-rate	general budget
supplementary benefit for large families (4+)	residents	flat-rate	general budget
Unemployment insurance			
unemployment insurance benefit	economically active	earnings-related	insurance contributions
insolvency benefit	economically active	earnings-related	insurance contributions
collective redundancy benefit	economically active	earnings-related	insurance contributions
Unemployment allowances			
state unemployment allowance	economically active + certain groups of residents	flat-rate	general budget
retraining grant	economically active + certain groups of residents	flat-rate	general budget
Social benefits for disabled			
disabled child benefit	residents	flat-rate	general budget
disabled adult benefit	residents	flat-rate	general budget
carers allowance	residents	flat-rate	general budget
disabled parent allowance	residents	flat-rate	general budget
study allowance	residents	flat-rate	general budget
rehabilitation allowance	residents	flat-rate	general budget
further education allowance	residents	flat-rate	general budget
Social assistance			
subsistence benefit	residents	means-tested	general budget
emergency social assistance	persons legally present	services	local budgets
Medical assistance			
emergency medical care	persons legally present	services	general budget

Table A.12. Levels of social security benefits (as of 01.04.2003)

The type of benefit	EEK	Euro (¹¹)	Net replacement rate
National pension	931	60	18.3 %
Old age pension (average)	1,975	126	38.8 %
Invalidity pension (minimum in case of total invalidity)	1,499	96	29.5 %
Survivors' pension (minimum in case of 3 or more family members)	1,499	96	29.5 %
Sickness cash benefit (⌘)	-	-	80 %
Maternity benefit (⌘)	-	-	100 %
Child benefit (single child)	150	10	3.0 %
Child benefit (second and each following child)	300	19	5.9 %
Birth grant (first child) (*)	3,750	240	73.8 %
Birth grant (second and following child) (*)	3,000	192	59.1 %
Child maintenance fee (up to 1 years)	700	45	13.8 %
Child maintenance fee (2 - 3 years)	600	38	11.8 %
Child maintenance fee (from 3 to 8 years)	300	19	5.9 %
Adoption grant (*)	3,000	192	59.1 %
School grant (*)	450	29	8.9 %
Start-in-life allowance (*)	6,000	383	118.1 %
State unemployment allowance	400	26	7.9 %
Unemployment insurance benefit (during the first 100 days) (⌘)	-	-	50 %
Retraining grant	600	38	11.8 %
Labour market business start-up grant (*)	20,000	1293	393.8 %
Labour market grant to employers	2,160	138	42.5 %
Disabled child benefit (severe or profound disability)	1,020	65	20.1 %
Disable child benefit (moderate disability)	860	55	16.9 %
Disabled adult benefit (profound disability)	640	41	12.6 %
Disabled adult benefit (severe disability)	420	27	8.3 %
Disabled adult benefit (moderate disability)	200	13	3.9 %
Funeral grant (*)	1,800	115	35.4 %
Minimum guaranteed income benefit (after deduction of normative housing expenses)	500	32	9.8 %
Minimum wage	2,160	138	-
Average gross wage (4th quarter 2002)	6,512	416	-
Average net wage (4th quarter 2002)	5,079	325	-

(*) Lump sum benefits

(⌘) Benefits calculated as a percentage of the former wage

(¹¹) The exchange rate of the Estonian kroon is pegged to the Euro at the rate of 1 Euro = 15,6466 EEK.

Appendix 3. Tripartite Bodies in Estonia in 2002

Table A.13. Tripartite bodies in Estonia in 2002

The type of social partnership/ tripartite body	Membership	Explanation
National level		
Tripartite negotiations	Delegations based on parity	Minimum wage Basic exemptions Unemployment benefit Legal acts and their conditions Promotion of social dialogue and partnership
The coordination of employment and social field draft legal acts		Government asks the opinion of employees and employers.
Socio-economic Council Advisory body for Government	3x6 members	Advises Government; has right to include issues into tripartite negotiations. Analysis of socio-economic situation and legal acts, promotion of implementation of European social model.
The Board of Estonian Health Insurance Fund Highest governing body of Health Insurance Fund	5 Government's representatives, 5 employers' representatives, 5 representatives of insured people (incl. 2 trade unions' rep)	Approves the budget; approves the action plans and objectives; reports to Government etc.
The Board of Unemployment Insurance Fund (the highest governing body of Unemployment Insurance Fund)	3 trade unions', 3 employers' and 3 Government's representatives	Approves the budget; approves the action plans and objectives; reports to Government etc. Makes suggestions on the rate of unemployment insurance payments for next year.
Estonian ILO Council	3 trade unions', 3 employers' and 6 Government's representatives	
The Board of the Foundation of Qualification	2 trade unions' representatives	Carries through qualifications reform.
Professional Councils	1-2 trade unions' representatives in each council	Determines qualification standards.
The Board of Foundation of Vocational Education and Training Reform in Estonia	4 Government's representatives, 4 employers' representatives, 2 trade unions' representatives, 3 training institutions	Implementing European projects in VET and employment in Estonia.
Working Environment Council	3x5 members	Advisory body to Government on work health and safety issues.
Various working groups		
PHARE projects' managing committee		South-Estonia employment North-East Estonia employment Promotion of Social Dialogue on sectoral level Support for labour market services balanced development
Labour Legislation working group		
The Commission for Evaluating Employment Projects		

SME Council		
Regional level		
The Boards of vocational education institutions		
Labour Dispute Committees	In every county parity membership	
Regional Employment Councils	5 counties 3 employers' and 3 employees' representatives	Counselling regional public employment services.

Source: Taliga, Kolmepoolsus – institutsioonid ja vormid, 2002