Chapter 5
Estonian labour legislation and labour market developments during the Great Recession

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1. Introduction

This chapter aims to shed light on the labour market reforms in Estonia during the Great Recession. Estonia has been treated in the labour market literature as a post-communist country with a fairly flexible labour market arrangement. We show that the labour market reform that was implemented in the middle of recession has had little effect on the overall level of flexibilisation of the labour market. Empirical findings let us argue that, in spite of labour market flexibilisation, drastic changes in employment and unemployment had already occurred before the reform, which proves that the labour market in Estonia was sufficiently flexible within the framework of the old legislation.

After Estonia regained its independence at the beginning of the 1990s, its economy went through several changes. Estonia shifted from a centrally-planned economy to a market economy, characterised by decentralisation and privatisation. This resulted in a need to modernise labour relations since the strict regulation of employment relationships from 1972 (Eamets and Masso 2004) did not meet the needs of the new economic situation. Throughout 2004-2007, Estonia had one of the highest growth rates in the world. However, this was not sustainable and, at the beginning of 2008, the first signs of recession appeared. Estonia experienced a sharp drop in its GDP and this resulted in high unemployment. The currency exchange rate was fixed, so most of the adjustment in response to the crisis took place through the labour market. However, it was soon realised by the government that, in order better to adjust to the macroeconomic circumstances, more flexible labour market institutions were needed. Therefore the concept of 'flexicurity' entered into labour law.

Reform was negotiated between social partners over several years. Finally, it was agreed that, together with more flexible arrangements on the employer side, there will also be a package of tools to increase social security for unemployed people. Unfortunately, the government later jettisoned all the promises made during the negotiations on social security, and only the flexibilisation of the Labour Code was achieved.

This chapter is organised as follows. Section two discusses the Great Recession of 2008 and its main impacts on Estonia's labour market. Section three gives an overview of Estonia's previous labour law and proposals for reform. Then it discusses the labour law reform that was carried out in 2009 and, finally, section four concludes with the impact the reform had on Estonia's labour market.

2. The Great Recession and its main impacts on the Estonian labour market

In 2009, GDP declined in Estonia by almost 15 per cent and the unemployment rate rose from 4 per cent to 20 per cent in the second quarter of 2010. Eamets (2011) argued that Estonia's structural economic crisis had begun before the global downturn and that the economy, overinflated with borrowed money, would have experienced a recession sooner or later in any case. The quick inflow of foreign money increased wages and public sector spending.[1] The overall structure of the economy had relied on low value-added production. Estonia has the most open economy among the Baltics (exports and imports consist of 80-90 per cent of GDP) and a relatively small domestic market. The export capability of the country diminished, the public sector grew and the government's pro-cyclical fiscal policy contributed to the acceleration of economic growth. The large inflow of credit financed, through consumption, higher imports and hence current account deficits. Additionally, during the boom years (2004-2007), Estonia was among the countries to experience the highest growth in the EU (8.5 per cent). However, this growth was unsustainable. Wage growth exceeded productivity growth, causing a loss of private sector competitiveness (the ability to sell products in foreign markets) (Estonian Development Fund 2008).[2] The large current account deficit was largely financed by credit inflows and it was no longer possible to maintain external imbalances when the crisis broke out. In 2008 and 2009, bank lending contracted significantly due to fear of loan defaults (Masso and Krillo 2011b). This all led to the economy experiencing a sharp downturn.

Estonia has been characterised by having a strong commitment to balancing the state budget. It has followed a tight fiscal policy to satisfy the Maastricht criteria for joining the Eurozone (Staehr 2010). Three supplementary state budget cuts passed in 2009 accounted for 9.3 per cent of GDP. The government relied largely on non-tax measures like additional dividends from state-owned enterprises. Operational measures like wage cuts constituted 0.73 per cent of GDP. Adjustments to pensions, such as reducing pensions increases and suspending contributions to the second pension pillar[3] constituted 1.2 per cent of GDP. Thus in Estonia about 50 per cent of budget cuts were achieved by the two-year suspension of contributions to the funded pension scheme, which will have to be made up by higher pension contributions later (Masso and Espenberg 2013). Estonia mainly implemented cost-saving austerity measures. Adjustment took place without exchange rate devaluation but instead through 'internal devaluation' due to wage cuts. A devaluation of the exchange rate would have resulted in

1. Public expenditure increased in some years by almost 20% thanks to increasing tax revenues due to fast economic growth. At the same time, sovereign debt remained at a rather low level and the government was even able to build up some reserves that helped to sustain public finances during the Great Recession.
2. Exports from Estonia grew quite rapidly from 2000-2008, while the same applies also to imports which grew at an even faster rate (both around 1.9 times). The real exchange rate increased in that period by 22 per cent due to rising prices in Estonia indicating a loss of competitiveness (Eurostat data).
3. Estonia has a three-pillar pension system. The First Pillar is the renewed state pension scheme; the Second Pillar is a mandatory funded pension scheme; while the Third Pillar is a voluntary supplementary pension scheme that is supported by the government through tax deductions. The Second Pillar offers a retirement savings plan in which a working person saves for his or her own pension, contributing 2 per cent of gross salary to the pension fund. The state contributes to the individual's personal account an additional 4 per cent out of the 20 per cent social tax used to support pensions, retaining the remaining 16% for members of the First Pillar.

the insolvency of many households and firms due to their large euro-denominated debt burden[4] (Masso and Espenberg 2013).

All these austerity measures were, as we have said, targeted towards preparations for Estonia to join the Eurozone. Retrospectively, we can say that all the austerity measures were generally perceived by the public as necessary ones. Reflected also in Eurobarometer, the approval ratings for the government increased from 38 per cent in the summer of 2009 to 53 per cent by the spring of 2010 (OECD 2010); while the ruling coalition who implemented the austerity measures in 2009 won more parliamentary seats in the 2010 election than they had in previous ones.

However, not all researchers have treated the austerity measures as positive ones. Kattel and Raudla (2012) argued that the Baltics 'outsourced' their recovery. There were three phenomena behind the recovery: i) the use of European Union (EU) fiscal funds; ii) a flexible labour market; and iii) the integration of export sectors into the key European production networks.

The main developments in social benefits during the crisis were as follows: sickness and healthcare costs were reduced while average pensions payments were increased; collective mandatory pension contributions were reduced in 2009. Women's retirement age was raised in 2012 to 63 years (from 55 in the early 90s). Public expenditure on unemployment benefits per unemployed person receiving benefit dropped significantly (Masso *et al.* 2014).

Next we will have a brief look at changes in major labour market outcomes. We start with employment. As in many other European countries, the construction sector suffered the most during the crisis. During the boom, the number of people employed in construction reached 82 000 while, during the crisis, it dropped to 48 000. Manufacturing also experienced a large decline, losing 37 000 jobs. Primary industry and the mining sector also suffered. During 2007-2010, the employment rate increased in the professional sector, scientific activities, real estate, administrative services and public administration (Masso and Krillo 2011b).

Next we analyse changes in wages. Estonia has high downwards flexibility of nominal wages due to performance-related pay being quite common among workers. Compared with the second quarter of 2008, monthly wages dropped by 20 per cent during the recession. In the trade sector, the decline was 15 per cent and national average wages declined by 10 per cent. While in most sectors wage recovery took place by the end of 2011, in the public sector a final recovery only happened in 2013 (see Figure 1 below).

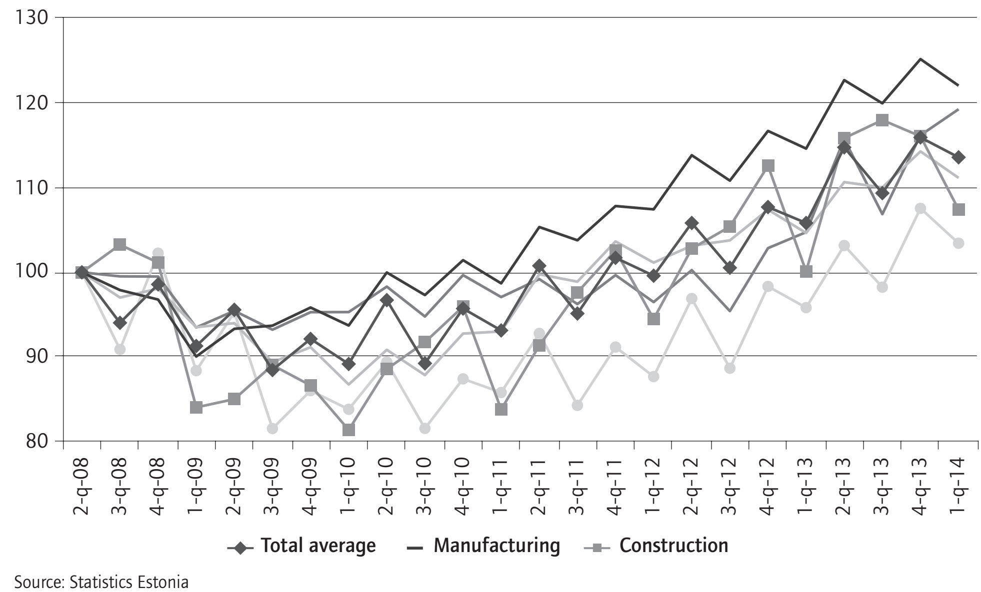
Estonian Labour Force Survey data allows us to analyse wage cuts in a more detailed manner at an individual level. Calculations by Masso and Espenberg (2011b) showed that, by 2009, 42 per cent of all employees had their wages reduced compared to the situation one year earlier (for more detailed dynamics, see also Figure 2 below). In

4. In some other Central and Eastern European Countries, the bulk of the loans were instead denominated in Swiss francs.

many sectors, performance-related pay formed as much as 30 per cent of wages, which enabled firms to keep basic wages lower. During the crisis, performance-related pay was often reduced and, in some cases, the basic wage was also cut back (Masso and Krillo 2011b). Masso and Krillo (2013) calculated that, in 2009, and relative to the previous year, wages were reduced for 61 per cent of employees in the public sector and for 40 per cent of employees in the private sector. Two sectors – public administration and construction – suffered the most from wage cuts. The middle class, defined as individuals that held ISCO 1-digit occupations 1-4,[5] fared better during the crisis as their average wage decreased less: in 2009, -0.6 per cent for the middle class, but -7.9 per cent for the working class, the latter being defined as individuals that held ISCO 1-digit occupations 5-9. Members of middle-class occupations also experienced lower probability of losing their job. The average wages of the middle class had already exceeded their 2008 level by 2011 (Masso and Espenberg 2013). Wage cuts were somewhat more frequent among males compared to females; while, among those with higher education, wage cuts were significantly less common. Wage cuts were also more often found among small firms.

Even so, the calculations by Masso and Espenberg (2011b) indicated that, whereas wage cuts were widespread, most of the adjustment in payroll costs nevertheless still occurred via a reduction in the number of employees: in 2009 relative to 2008, the total payroll decreased by 15.8 per cent in the context of which the reduction due to the number of employees was 9.2 per cent.

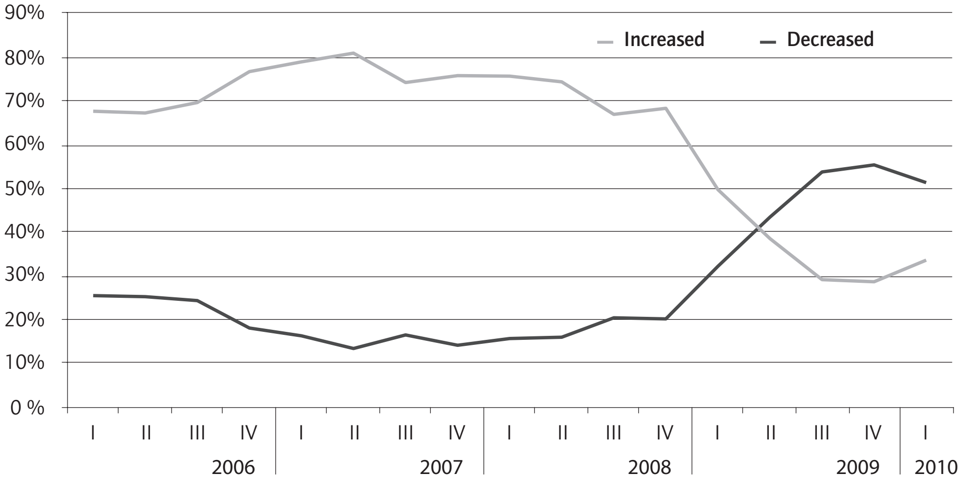
Figure 1 **Changes in monthly wages (quarterly data, Q2 2008=100)**



Source: Statistics Estonia

5. ISCO 1-digit occupations are as follows: 1 – managers; 2 – professionals; 3 – technicians and associate professionals; 4 – clerical support workers; 5 – service and sales workers; 6 – skilled agricultural, forestry and fishery workers; 7 – craft and related trade workers; 8 – plant and machine operators and assemblers; 9 – elementary occupations; 0 – armed forces.

Figure 2 **Proportion of workers whose nominal hourly wages were decreased or increased over the year**



Source: Masso and Espenberg (2011b), based on Estonian Labour Force Survey data

Additionally, union members coped better in terms of employment and wages as their wage premium increased from -3 per cent in 2008 to +4 per cent in 2009 (Masso and Espenberg 2013).

According to the same study during the crisis, union membership remained quite stable (higher in the public sector at about 20 per cent and lower in the private sector at about 4 per cent). The Estonian Trade Union Confederation had expected a decline in membership due to increasing unemployment and collective redundancies in sectors where trade union membership had been higher (Nurmela 2009). Data from the Labour Force Survey indicated that membership as a percentage of salaried workers did indeed decline from 7.6 per cent in 2007 to 6.2 per cent in 2008, but then increased in 2009 back to 7.6 per cent and, in 2010, to 9.5 per cent. Membership even increased in north-east Estonia, where the unionisation rate is highest as a result of the presence of large industrial enterprises (Masso and Krillo 2011b).

However, we should acknowledge that trade union and employer representatives in Estonia are relatively weak. For example, in February 2009, the Estonian Parliament approved a state budget cut of 11 million euros that included cuts to public sector wages and sickness benefits. Even though there was opposition by the social partners, both changes were implemented (Masso and Krillo 2011b).

In addition to changes in employment and wages, we can see labour market flexibility also in terms of working time. On average, the number of actual working hours at an individual's main job declined by 3.8 per cent in 2009. Working time dropped in all sectors except public administration, with the biggest declines taking place in construction and in the hotel sector. Many companies responded to falling demand due to the crisis by shifting to greater use of part-time work. Before the crisis, the incidence of part-time work was rather low: on average, in 2008 only 4.1 per cent of males and 10.4 per cent of females worked part-time. In 2008-2009, however, the share of part-time work increased from 7.2 per cent to 10.5 per cent, with the greatest increase among young people (Masso and Krillo 2011a). During the crisis, the incidence of part-time work increased proportionally for both men and women. In the recovery phase, however, male part-time work decreased while female part-time work continued to increase mainly due to increasing under-employment among women (Eamets 2013).

The percentage of part-time workers being low in Estonia (e.g. the EU average share of part-time workers is 20 per cent; in Scandinavia, it is 25 per cent; and, in the Netherlands, it is up to 50 per cent) is probably due to the average income level not being high enough for people to secure their livelihood through part-time work (Eamets 2012). In Estonia, the level of temporary contracts shows a contra-cyclical trend; it decreased in 2005-2008 from 2.7 per cent to 2.4 per cent, but increased during the crisis to reach 3.6 per cent in the first half of 2010. The new labour law has liberalised the use of fixed-term contracts (Masso and Krillo 2011b).[6]

Another adjustment mechanism for reducing labour costs was the use of involuntary leave arrangements (periods when the employment contract is suspended).[7] According to Labour Force Survey data, the incidence of involuntary leave increased from 1 per cent in 2007 to 7.6 per cent in 2009. Construction workers, those with basic education, those employed in the primary sector, employees of domestically-owned firms and men were most often sent on involuntary leave (Masso and Krillo 2011a).

The most important active labour market policy measure has been training, which absorbed 75 per cent of expenditure on active measures in 2014 (Eurostat data). There has been a shift from passive labour market policies to more active ones. In 2009, the number of people benefiting from labour market policy measures tripled. Spending on labour market policies increased by up to five times during 2008-2009; in 2009, some 76.5 per cent of labour market policy costs were spent on passive measures but, in 2010, the importance of passive measures decreased. Spending on active measures increased substantially during the crisis, mainly thanks to the help of the European Social Fund (ESF). The average annual number of people involved in active measures more than doubled in 2009 and then doubled again in 2010 (Masso *et al.* 2014). Re-training measures for the unemployed targeted especially at-risk groups in the labour market – young people and the long-term unemployed, and the creation of special measures for people with disabilities. Public works programmes were implemented that would enable the poor and vulnerable to earn at least the minimum wage (Masso *et al.* 2014).

6. Earlier, fixed-term contracts were used in the particular cases explicitly mentioned in the Labour Code but, under the new legislation, the particular provisions mention more generally that a labour contract may be concluded for up to five years if that is justified by good reasons originating from the temporary nature of the work (Töölepingu seadus 2009).

7. This term is used in cases when, during economic recession, a person has been sent on involuntary leave with lower payment, or no payment at all. This is known in the labour economics literature also as labour hoarding. Formally, an employee can, temporarily, even accept such a situation as the alternative option is dismissal.

In 2010, labour policy measures were overshadowed by employment subsidies.[8] The amount of training allowance was cut in half and the same amount was added to employment subsidies. It was argued that it was no use spending money on training while there were not enough job vacancies; instead, people should be kept in work so that they could pay their everyday bills. Additionally, Tallinn organised and financed a public job creation scheme by creating a few thousand minimum wage jobs (e.g. workers that helped people get on and off a bus) (Eamets 2013). A new plan with a budget of around EUR 45 million was introduced in Estonia in the second half of 2009. Its purpose was to create 5 000 jobs through a range of measures: the development of business start-up support; widening the conditions for wage subsidies; and hiring more consultants to advise the unemployed. Training vouchers, introduced in 2010, were a completely new policy measure. Micro and small firms could buy training from a list of organisations with a maximum subsidy of about 960 euros (Masso and Krillo 2011b).

On 1 August 2009, unemployment insurance contributions increased to 2.8 per cent of wages for employees and to 1.4 per cent for employers. This was explained by the Unemployment Insurance Fund needing the funds to cover the growing costs of the recession and to cope with the rising number of unemployment and other benefit recipients. After the recovery, starting from January 2013, contributions were lowered to 2 per cent for the employee and 1 per cent for the employer (Eamets 2013).

Emigration from Estonia rose annually by 6 per cent during 2007-2009 (Philips and Pavlov 2010). However, this number may be substantially under-estimated since many people do not change their place of residence in registers. Evidence from the Labour Force Survey indicates that the number of people working abroad rose in 2009 from around 15-20 000 to 20-30 000 (Eamets 2011). Trade unions in the health care sector have been concerned that cuts in wages, redundancies, uncertainties, cuts in training benefits and increased workload have led nurses and health care workers to migrate to other countries (Osila and Nurmela 2011).

Concerning the shadow economy, the proportion of employees receiving undeclared wages decreased during the crisis from 12 per cent to 9 per cent in 2009 (the estimate of the Estonian Institute of Economic Research). According to Masso and Krillo (2011b), the indicator 'working under an oral employment contract' also decreased, from 1.5 per cent to 0.9 per cent on the basis of Labour Force Survey data. The authors pointed out that a likely explanation for the decreasing incidence of unreported wages was that employment decreased among construction workers, private sector employees and workers with secondary jobs; these are areas where people are more likely to be paid unreported wages.

The authors thus conclude that the crisis may have improved working conditions such as health and safety, and the reconciliation of work and family life due to the lower number of working hours. However, wage cuts have also led to worker demotivation.

8. Wage subsidies are calculated as 50 per cent of the wage or salary of the new staff member; however, there is a ceiling: the amount of the subsidy (per month) cannot exceed the official minimum monthly wage. The maximum duration of wage subsidy is six months. They are intended for labour market at-risk groups.

Additionally, from the third quarter of 2008 the number of claims submitted by employees to the Estonian Labour Inspectorate started to increase, peaking at about 1 850 in the second quarter of 2009. This was probably due to the new Labour Contracts Act as well as to the recession (Masso and Krillo 2011b).

3. The labour law reform of 2009

Amendments to labour laws and other regulations governing employment relationships had already began in the late 1980s before Estonia regained its independence in 1991. The Labour Code was based on the labour legislation of the Soviet Union and it strictly regulated employment relationships. The parties to an employment contract had basically no flexibility in shaping the contractual conditions by negotiation since the employer had to follow the rules and was not free to make decisions (Orgo 1996).

After Estonia regained its independence, thorough reforms regarding labour relations were conducted. The Employment Contracts Act (ECA) entered into force on 1 July 1992; however, it was immediately apparent that this would be a 'transitional law' (Seletuskiri 2008) on the grounds that most market and institutional reforms started after 1992.

There were several independent Acts regulating labour relations after regaining independence. Some of them are listed here (Orgo 1996):

— Employment Contracts Act (ECA). Passed by the Estonian Supreme Council on 15 April 1992, this was the most important Act concerning labour law;
— Working Hours and Rest Time Act, passed by the Estonian Parliament on 29 December 1993 and entered into force on 1 March 1994;
— The Holidays Act, passed on 7 July 1992 and entered into force on 1 January 1993;
— The Salary Act, passed on 26 January 1994 and entered into force on 1 March 1994.

Most of the above Acts were adopted in a rushed atmosphere; no proper analysis of the prevailing situation nor any prognosis of future needs were carried out. This is why the legislation contained contradictions, overlooked certain aspects, was incognisant of existing social relations, and was declaratory and imprecise in its formulation (Orgo 1996). In the 2000s, the nature of economic relations had changed due to radical reforms and this resulted in the need also to modernise labour legislation (Masso *et al.* 2014). The economic environment, rapid changes and intensive competitive pressure have led countries, including Estonia, to find ways of adjusting labour legislation to the changing situation in the labour market (Malk 2013). During 1995-2005, eight draft acts regulating labour contracts were developed, but only one of them was sent for approval to the Estonian parliament; this was withdrawn for political reasons in 2005 (Muda 2008). It was still increasingly felt that conceptual change was needed (Siigur 2007). One reason behind those understandings was that Estonia had joined the EU. In the mid-2000s, the social partners as well as the government admitted that labour relations regulations needed to be renewed (Tavits 2008).

The idea of a new ECA was to increase 'flexicurity' in employment relations; a combination of 'flexibility' and 'security'. On the one hand, this was meant to increase labour market flexibility and improve labour reallocation, both of which are needed for economic growth (Eamets 2001). On the other hand, 'flexicurity' compensated for the decreased strictness of employment protection legislation (EPL) by increasing the social protection of the unemployed, at least according to the government's initial plan (Malk 2013). The new ECA was adopted on 17 December 2008 and entered into force on 1 July 2009, integrating into one law the earlier ECA, Wages Act, Holidays Act and the Working and Rest Time Act. This reduced the administrative burden and several formal provisions, like the Labour Record Book, were abolished (Eamets 2013).

The new ECA, still in force in 2015, relaxed the regulations on regular contracts in many ways. First, redundancy notice periods were cut, depending on the length of the previous employment, from 2-4 months to 1 month. Second, severance payments were reduced from 2-4 months to 1-3 months and, additionally, the payment is now shared between the employer and the Estonian Unemployment Insurance Fund. Third, fixed-term contracts were permitted in all cases (Masso and Krillo 2011b). The probation period was also increased in all cases to 1-4 months. Employers now have the right to cut employees' wages in exceptional circumstances and collective redundancy procedures were facilitated (Purfield and Rosenberg 2010, Masso *et al.* 2014). Furthermore, pregnant women, employees with children under the age of three and union representatives no longer systematically enjoy protection against dismissal without the prior authorisation of the labour inspectorate (Clauwaert and Schömann 2012). These changes were intended to make the labour market more flexible.

It was mentioned above that the compensation paid by the employer also changed. The payment of redundancy benefits is now shared by the employer and the Estonian Unemployment Insurance Fund to ease the financial burden for employers. In all redundancy cases, the employer has to pay a proportion of the benefit, amounting to one month's average wage, while the Unemployment Insurance Fund finances the rest of the benefit (Clauwaert and Schömann 2012). If the employment relationship had lasted 5-10 years, then the Unemployment Insurance Fund would pay compensation amounting to one month's wage whereas, if the employment relationship had lasted for over ten years, the Fund would pay compensation of two months' wages. Additionally, the advance notice period in the case of redundancies was shortened from 2-4 months to 15-90 days.

The new law allows the employer to reduce an employee's wages temporarily;[9] this is in the case of the employer not being able to provide the employee with the agreed amount of work due to unforeseen circumstances beyond the employer's control.[10] The wage may be reduced for up to three months over a twelve-month period and to a limited extent; it cannot be lower than the minimum wage set by the government. This would be the case where the contractually-agreed wage was unreasonably burdensome[11] for an

9. A decrease in wages must be accompanied by a proportional reduction in the employee's workload.
10. For example, if the number of customers suddenly declines, or a contractual partner has an insolvency problem.
11. Where unforeseen (economic) circumstances lead to the employer not having sufficient resources to pay wages in their full scale.

employer in difficult economic circumstances (Eamets 2013). This is the exclusive right of the employer and, if the employee rejects the lower pay, he/she can quit the job with a notice period of five days. In case of dispute, it is the court that will decide whether all those circumstances are valid.

As for flexible employment forms, if a fixed-term contract is terminated prematurely due to economic difficulties, the employer must make an additional payment to the employee to compensate for the whole of the income they would have received up to the end of the period of the contract (Clauwaert and Schömann 2012).

Simultaneously with these labour law changes, some administrative changes were also implemented. The Labour Market Board and the Unemployment Insurance Fund were merged in order to increase the administrative capacity of the labour market institutions. This allowed for the better integration and control of labour market services and benefits. The services provided by the Unemployment Insurance Fund as follows (Eamets 2013):

— The provision of information about the labour market situation, and services and benefits;
— Job mediation (free of charge for everyone);
— Career counselling to help people make the right decisions in their career development;
— Labour market training, which can last for up to one year. If the training lasts for more than 40 hours, then the participant receives a grant as well as transport and accommodation allowances;
— Work experience to help people gain practical experience in the workplace (the maximum length is four months);
— On-the-job experience, which involves simple tasks that do not require special knowledge or for which the necessary skills can be learnt while working under the guidance of a supervisor (maximum length three months at any one time);
— Wage subsidy, which is paid to employers who hire an unemployed person. This is designed for high-risk groups (e.g. people released from prison, the long-term unemployed and young unemployed people);
— Public work, which is organised by local government departments, non-profit organisations and foundations who pay the employee at least the minimum wage;
— Business start-up subsidies. Unemployed people at least 18 years of age who have completed business training or have higher or vocational education in economics or business experience are eligible to apply for these. The one-off amount to be received is EUR 4 474;
— Adaptation of work premises and equipment. This service is designed for unemployed people with disabilities;
— Special measures for people with disabilities.

The drafting of the new ECA posed great challenges within the state-level social dialogue. The Estonian Trade Union Confederation opposed the proposed law as it worsened the position of employees in several ways: it decreased severance; shortened notice periods; etc. (Estonian Trade Union Confederation 2008). Intensive consultations were held to find a compromise between the parties. On 23 April 2008, trade unions, employer representatives and the government signed a tripartite agreement approving the text of the new ECA and the reform of labour market institutions (Masso *et al.* 2014). This was a mark of satisfaction and cooperation between all the social partners; labour relations experts also welcomed the new law since it made labour relations more flexible and potentially secure for employees as well as employers (Muda 2008, Tavits 2008).

Three main agreements were proposed in order to provide financial assistance for the unemployed while they were finding a new job. The intention was that, in the first place, unemployment insurance benefit would be raised from 50 per cent to 70 per cent of wages during the initial stage of unemployment; and from 40 per cent to 50 per cent of wages from the 101st up to the 360th day of unemployment. Second, according to the old law, only those whose employment was terminated at the employer's initiative were able to receive unemployment insurance benefits. The new law planned to introduce a 40 per cent unemployment insurance benefit to those quitting a job under a voluntary agreement between the employer and employee, or at the latter's own initiative. However, in order to be eligible for the benefit, the person had to have paid unemployment insurance premiums within the past five years for a minimum of 48 months. Finally, the unemployment insurance was planned to be increased to 50 per cent of the national minimum wage (Masso *et al.* 2014).

A few months after the adoption of the new ECA on 17 December 2008, and before coming into force in 2009, the government withdrew from the agreement and decided not to increase unemployment insurance benefit, arguing that this was a necessary step in order to prevent the Estonian Unemployment Insurance Fund from running out of funds. The Estonian parliament also amended the second agreement: the payment of benefit to those quitting their jobs at their own initiative or upon agreement. This was postponed to 2013 due to the economic crisis and since the Estonian Unemployment Insurance Fund did not have sufficient resources in the longer term to cover the benefit (Masso *et al.* 2014). In August 2009, unemployment insurance premiums were increased to the maximum allowed tax rate (Masso and Krillo 2011a). On 8 May 2012, the Estonian parliament repealed the amendment unilaterally without consultation with their social partners. This action resulted in widespread disappointment for trade union representatives as well as labour market experts (Kund 2012). Additionally, in March 2009 the increase in unemployment benefit was postponed in order to avoid the Estonian Unemployment Insurance Fund running out of funds due to the rapid increase in the number of the unemployed. Agreement on the 50% minimum wage rule was also cancelled in the spring of 2009.

Trade union representatives demanded the postponement of the new ECA until a more stable economic environment could be established. However, the demands of the unions were ignored, despite the strike organised in June 2009, as their proposal met much resistance from employers who claimed that it would result in high company insolvency.

It was, however, decided to postpone the increase in unemployment benefit until 2013. In November 2012, the state withdrew from the third agreement on the amount of unemployment benefit. It was decided to increase the benefit from EUR 65 to EUR 101, not to 50% of the minimum wage (EUR 185) (Masso *et al*. 2014). This was explained by the government needing to find extra money to increase wages in the health sector as a result of the promises made after the physicians' strike in October 2012. Additionally, the situation in the labour market had improved and this was expected to motivate the unemployed to find jobs (Koorits 2012).

The development and implementation of the new ECA illustrates the position of the state in the light of the need to balance the state budget during the crisis and to satisfy the promises made to the social partners. Masso *et al*. (2014) argued that Estonia had managed to overcome the deepest point of the crisis rather well; the active labour market policy measures, when used in combination with other austerity measures, worked effectively as poverty did not significantly increase during the crisis. However, during the recovery the state did increase social guarantees in line with increased state revenues.[12] The unilateral style of the state's actions disturbed the social partners as they were not included in decision-making. This is likely to have a dampening effect on the social dialogue in Estonia and it will take time to rebuild social partner confidence. We can conclude that the final balance of these reforms was less security and more flexibility in the labour market.

4. The impact of labour legislation reform on the Estonian labour market

One of the aims of the new labour law was to increase flexibility. According to the Labour Force Survey, the proportion of employees working under a fixed-term contract has increased from 2009. The proportion of such workers was 2.5-3.4 per cent in 2009; this had risen by 2011 to 4.4-5.6 per cent. Thus, the proportion has increased by two percentage points (Masso *et al*. 2013).

The new law was also meant to increase legal awareness; that is, that both parties in an employment relationship are aware of the norms regulating such relationships and of their rights and obligations. However, according to a survey into ECA, 8-14 per cent of firms and offices estimated their knowledge on labour law as 'low' while 73-79 per cent estimated that they needed to know more. Among the employed and unemployed, 28-34 per cent estimated their knowledge on labour law as 'low', while 79-83 per cent of them estimated that they needed to know more (Masso *et al*. 2013).

Malk (2013) analysed labour market flows based on Estonian Labour Force Survey data, using Lithuania as a control group. She found that the lower strictness of EPL has increased the probability of exits from employment. At the same time, the author did not find any significant impact of EPL reform on entering into employment. The new law increases the probability of moving from employment to unemployment by 2.6 percentage points and from employment to non-employment by 3.5 percentage

12. The share of people at risk of poverty or social exclusion in Estonia increased from 21.9 per cent in 2008 to 23.4 per cent in 2009 before decreasing again to 21.8 per cent in 2010 (Eurostat).

points. Additionally, the probability of moving from one job to another (job-to-job flow) decreased by 2.1 percentage points; on the basis of the raw data, job-to-job flows were around 9 per cent in 2007 but 6 per cent in 2011.

Lower EPL strictness should potentially increase labour reallocation and the probability of moving out of employment. The reform has increased Estonian labour market flexibility, making adjustments in the workforce more flexible for employers. However, no significant impact could be identified of EPL reform as regards moving into employment. This, on top of decreased job-to-job mobility, indicates that lower EPL strictness has not been sufficient to achieve the goals and that flexible EPL, by itself, does not improve labour reallocation. A decrease in job-to-job mobility is inherent in any economic crisis period. Labour taxation may have been another reason why EPL reform did not have any effect on the movement of labour into employment; however, the impact of taxation may not be relevant in the longer period as labour supply is rather inelastic (Malk 2013).

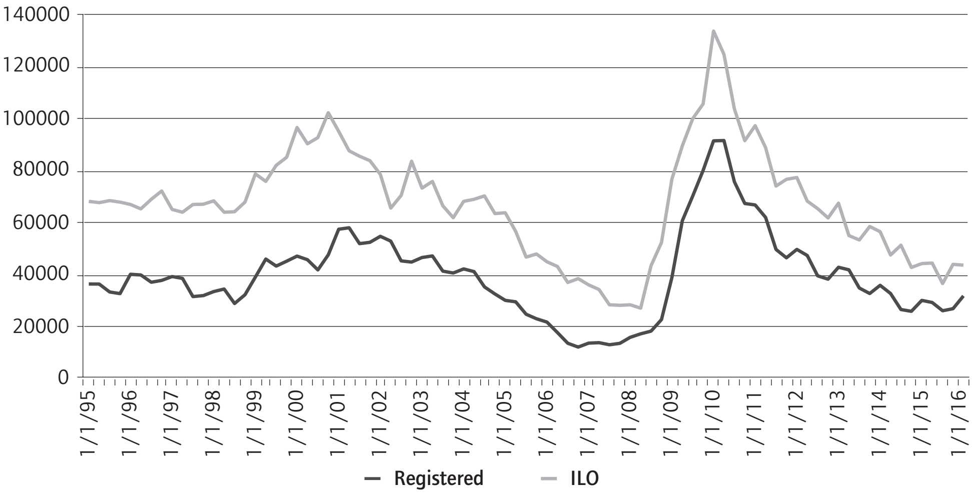
Eamets (2013) concluded that the empirical results do not show clear evidence of the effectiveness of the legislative reforms. According to the Centre for Policy Studies (Masso *et al.* 2013), the reduction in lay-off payments did not seem to have any significant impact on employers' lay-off behaviour. Only a small proportion of employers said that they would have laid off fewer workers had the previous act remained in force. Similar results were found by the Tax and Customs Board, which could not identify that the reform had had a significant impact on lay-off behaviour. Therefore, the reform has left employers with more money for the other costs incurred in lay-off situations, but this has not led to any more lay-offs than in the case of the old act. The new ECA entered into force at a time when most lay-offs had already taken place (Masso *et al.* 2013, Eamets 2013).

If we look at unemployment dynamics in 2009, we can see that the lowest level of unemployment was in the second quarter of 2008, when Estonia had 27 000 unemployed persons according to the Labour Force Survey. Then, unemployment started to increase rapidly and, in the second quarter of 2009, we had 86 900 unemployed. The new legislation came into force in June 2009; this means that most dismissals had already taken place before this point was reached. In the second half of 2009, only 19 000 unemployed persons were added to the total, which reached 105 800. So we cannot see a rapid increase in unemployment immediately after the introduction of the new legislation.

From Figure 4, we can see that changes in unemployment is correlated with changes in employment, particularly during the crisis. During the boom, the increase in employment was higher compared with the decline in unemployment, but this was due to changes in inactivity.

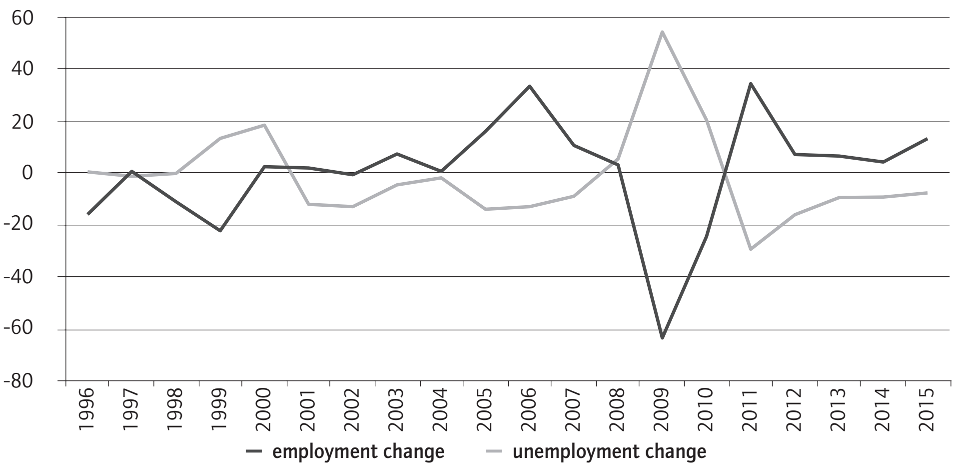
From Labour Force Survey data, we can calculate the flows of people who changed their jobs. Unfortunately, we cannot provide annual statistics as the sample size is too small. If we look at intervals and calculate annual flows, then we can see that, during the 2008-2010 period, flows did increase compared to the previous period. Legislative reform took place in exactly the middle of this period, so we cannot separate the effect of the crisis from the effect of the legislative changes.

Figure 3 **Survey-based ILO unemployment and registered unemployment in Estonia**



Source: Statistics Estonia

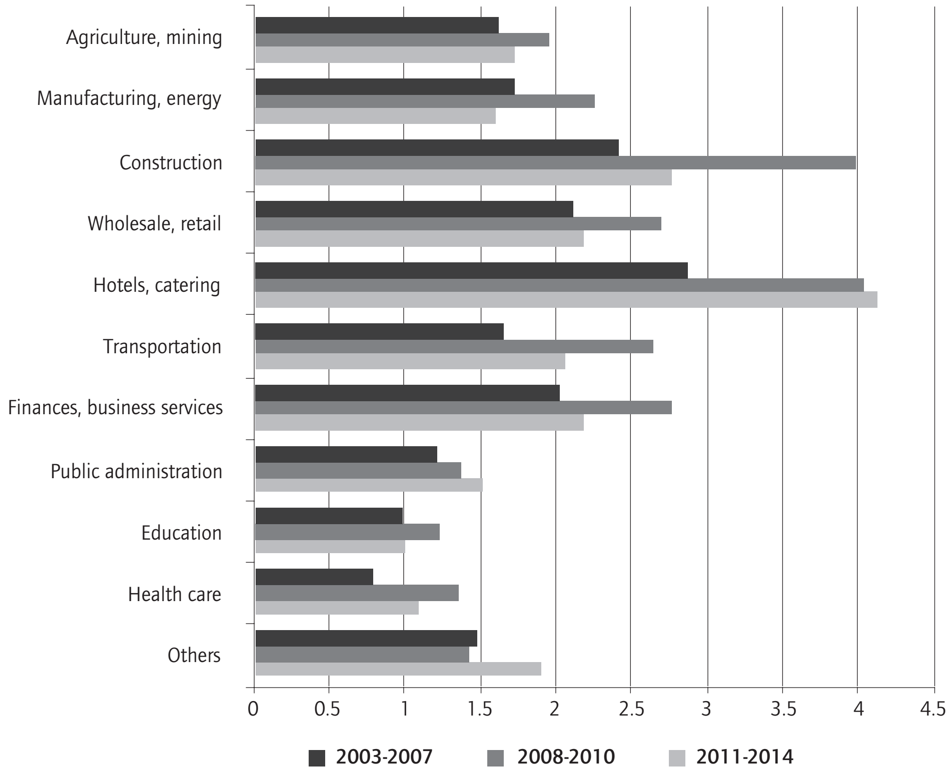
Figure 4 **Changes in employment and unemployment (year-on-year change, thousands)**



Source: Estonian Labour Force Survey data, Statistics Estonia

Running descriptive statistics on the unemployment data shows that the majority of dismissals took place before June 2009, but it is also true that many job changes took place during the boom, especially in the construction sector, and these were not related to changes in the legislation. If we look at the post-crisis period from 2011 to 2014, then we can see that, in most sectors, job flows slowed down except, perhaps, in the hotel sector and public administration where the number of workers changing their job during the year remained high, higher even than during the crisis period. So we can conclude that, perhaps in the trade sector, the flexibilisation of labour regulations might have had some effect on worker mobility.

Figure 5 **Number of people changing their job during the year (job-to-job flows, thousands)**



Source: Estonian Labour Force Survey, authors' calculations

In order to understand the changes in employment and unemployment, an analysis of flows across employment, unemployment and inactivity might be useful. These have been calculated by Masso and Krillo (2011b). Their analysis showed that, during the crisis in 2009, what increased was the separation rate – from 17 per cent in 2008 to 27 per cent in 2009 – while the hiring rate decreased only slightly; in comparison, in Hungary during the crisis the adjustment occurred rather through reduced hiring. The separation rate increased more for groups affected more heavily by the crisis, such as males and non-Estonians. There was little increase in flows to inactivity, while job-to-job flows decreased, especially for some groups of employees such as females and non-Estonians. When looking at labour market flows from the aspect of job creation and destruction rates, the job destruction rate increased above the average for 2005-2007 (9.2 per cent), in 2009 reaching 19.8%, while the job creation rate decreased from 14.8 per cent to 6.9 per cent. The numbers across various labour market segments show similarly that increased destruction was almost always accompanied by decreased creation.

Labour market adjustment during the crisis was very broad-based, but there were still clear differences across the various labour market segments (Masso and Krillo 2011b). Due to the major decline in construction, but also in manufacturing, the unemployment rate increased especially among males, from 5.9 per cent in 2008 to 17.4 per cent in 2009, while among females the change was from 5.4 per cent to 10.8 per cent (although such a situation was not unique in Europe). Also, national minorities (mostly Russian-speaking) were more heavily affected by the crisis – in Estonia, their unemployment rate increased from 8.2 per cent to 19 per cent (among Estonians from 4.2 per cent to 11 per cent), thereby exacerbating the labour market inequalities that were already there before the crisis. Young people (in the 15-24 age group) were also very heavily affected by the crisis as their unemployment rate increased from 13.4 per cent to 29.2 per cent. All these developments are relatively logical, given that these have been among the more vulnerable groups in the labour market and given the parts of the economy that were more heavily affected by the crisis; thus, the linkages with EPL reform are, if they exist at all, probably relatively weak.

Estonia's new ECA has been severely criticised by the trade unions as well as political parties on the grounds that it emphasises labour market flexibility too strongly but not the security and protection of workers. Additionally, the Act was based on a tripartite agreement, but the government unilaterally postponed and later cancelled several provisions which would have increased the security and protection of workers but which would also have increased the spending of the Unemployment Insurance Fund during the Great Recession (Clauwaert and Schömann 2012).

5. Conclusions

To sum up, it can be said that the labour market reacted to the economic crisis quickly and very flexibly. The measures taken included reductions in working time and wages, and redundancies among employees. This indicates that the traditional institutional factors that protect workers but, to a certain extent, also decrease the volatility of the labour market, such as labour market regulation or trade unions, are not very strong in Estonia and do not have a significant effect on the flexibility of the labour market. The situation may also be affected by regulations being ignored, even when they are in force (Eamets and Masso 2004), or some policy measures being taken but introduced too late as changes in the labour market had already taken place.

Labour market reform was launched in 2009 in Estonia. There were two sides to this reform. First, the new Employment Contracts Act was amended. The new Act enabled greater flexibility in labour relations and severance payments, while notice periods were reduced. In general, it could be said that termination of employment relations became less expensive for employers. Secondly, institutional reform merged the National Labour Market Board and the Unemployment Insurance Fund.

In order to avoid a relatively sharp decline in employment protection, income protection for the unemployed was to be enhanced through raising the unemployment benefit replacement rate and easing the eligibility for unemployment insurance. Those leaving their jobs voluntarily were also to receive unemployment insurance benefits. The adoption and implementation of these measures were, initially, postponed. The major argument was the economic crisis that hit Estonia in 2009. In May 2012, however, Parliament adopted new amendments to the Employment Contracts Law which basically abolished all the above-mentioned agreements to increase social protection for unemployed people. Moreover, this agreement had been achieved at a national level in tripartite negotiations in 2008 between the social partners and the government. Today, we can say that the government is unilaterally refusing to fulfil the agreement. The main argument is the changing economic environment and a shortage of sufficient resources. Social security issues were part of the deal under which unions agreed to the flexibilisation of the labour market in the first place. However, left-wing parties and unions have a small role to play in the Estonian political landscape, so there has been no public unrest at such behaviour of the government.

Few surveys have tried to find empirical evidence for labour market flexibilisation in Estonia. In spite of concerns, the new ECA did not lead to any major changes in labour market trends. Major dismissals had already been made before 1 July 2009 and this by itself actually proves that the Estonian labour market was sufficiently flexible under the old Employment Contracts Act.

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