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Policy Responses to Economic Crises

Estonia, 2008-

Note: Policy background memos contain information from various sources on the political economy of a particular country and economic and social policy choices before, during, and after an economic crisis. The memos do NOT contain any original information or analyses, but rather summarize material from various sources. The material is at times quite raw – the text is often presented in bullet points and sources are often quoted verbatim. Thus, the background memos should primarily serve as an overview of 1) policy developments in a particular country, and 2) academic research on the subject.

1 Background

Economy

In the years prior to the crisis, the Estonian economy enjoyed one of the highest growth rates among OECD member countries but growth became unbalanced. Following a period of construction-led economic bubble and the collapse of foreign trade, domestic demand slumped in the lead up to the crisis (OECD 2011, 98).

Politics

Elections were held in early 2007, with the market-liberal Reform Party (RE) emerging as the winner. Prior to the elections, RE had lead a coalition government including the left-leaning Centre Party (KeE) and the agrarian People's Union (RL), but after the electoral victory, RE formed a traditional right-of-center coalition with the conservative Pro Patria and Res Publica Union (IRL) and the Social Democratic Party (SDE) (Pettai 2008, 962). The newly formed government was already pursing some sort of welfare retrenchment early in 2008, in particular in the area of labor law flexibility. The essence the initial proposal was to reduce the layoff time of employees with less than one year at a job to ten working days. In exchange, the government sought to increase the level of unemployment compensation for the first 100 days of joblessness from 50 to 60 per cent of previous income. Labor unions and the Social Democratic party secured an increase to 70 percent of previous income, but gave in to the reduced time frame for layoffs (Pettai 2009, 951–52).

2 Crisis

The crisis started earlier in Estonia than in most cases, since it coincided with the bursting of a domestic credit-driven property bubble at the end of 2007. The global crisis further exacerbated the dire economic situation, with the economy sharply plunging into a recession in 2008 and remaining in recession in 2009 (Raudla and Kattel 2011, 163). Since over 90% of the banking system was foreign-owned, authorities essentially 'outsourced' bailing out the banks, which gave them more fiscal space to deal with government finances (Kattel and Raudla 2013, 437).

3 Policy Response and Politics

Estonia started fiscal tightening in 2008, considerably earlier than most other countries. The most prominent explanation for this stance is the desire to join (as planned) the Eurozone in 2011, which meant that the government had to contain the public deficit at below 3% of GDP (OECD 2011, 99). The consolidation contained both measures to reduce expenditures, but also revenue increasing measures. This stands in sharp contrast with measures taken in other Central and Eastern European countries – in particular, Latvia and Lithuania – where significant deficits were recorded (Raudla and Kattel 2011, 164). Interestingly, the government did not take the option of external devaluation of the currency seriously – this is probably partly due to the desire to join the Eurozone, but Raudla and Kattel (2011, 180) also point out that nearly 80% of household debt was denominated in Euros, meaning that devaluation was politically difficult.

Autumn 2008

Fiscal → No major austerity measures reported by Raudla and Kattel (2011, 171), even though GDP was expected to drop by 3.5% in 2009.

December 2008

Employment → New law on labor contracts passed, which aims to increase "flexibility". In general, this led to a reduction in the employment protection of individuals, especially new employees (Schömann and Clauwaert 2012, 9).

February 2009

Fiscal → First austerity package introduced, with several measures focused on reducing operational expenses and social transfers, for example by reducing sick leave benefits, capping automatic indexation increases of pensions and reducing public investment in construction (Raudla and Kattel 2011, 170). The operational expenses of the central government were cut by 7 percent, with ministers themselves allowed to determine how to implement the cuts (e.g. by layoffs, wage reductions etc.) (Raudla 2013, 38).

March 2009

Unemployment → The government, along with representatives of trade unions and employer organizations agreed on an anti-crisis package, involving several measures of social protection, including: Giving employers the possibility of reducing working time in connection with training of employees, encouraging municipalities to provide community jobs for the unemployed, and an increased focus on vocational training for unemployed individuals. To fund these policies, several measures were postponed or changed: The previously planned increase in unemployment benefits was suspended until 2013, the unemployment insurance tax was increased, paternal benefits were abolished, government contributions to sickness benefits shifted from 2nd day of sickness to 9th day and reduced indexation of pensions (OECD 2010, 56)

Taxation → Employer contributions to 2nd pillar of pension system diverted into 1st pillar in full in 2009 and 2010, then gradually returning back to the full 4% going to the 2nd pillar (ILO).

May 2009

Politics → The Social Democratic Party (SDE) was kicked out of the coalition government, with the Reform Party and Pro Patria forming a minority government, with the implicit support of Greens (ER) and independent MPs. The coalition change was due to differences in opinion over budget cuts and changes in labor laws (Pettai 2010, 957–58).

June 2009

Fiscal → A new supplementary budget passed, over which SDE had left the coalition. The new package included measures both to cut expenses and increase revenues, including those agreed on with the social partners in March. Additionally, operating expenses were cut a further 8% (in addition to a 7% cut in February) and the VAT was raised by 2pp to 20% (Raudla and Kattel 2011, 171).

Autumn 2009

Fiscal → A number of one of measures introduced. Government took out dividends from state owned companies and sold shares of the Estonian Telecom (Raudla and Kattel 2011, 172).

Autumn 2009 (?)

Old age → Pension age to increase gradually to 65 for men (from 63) and women (from 60.5). (OECD 2013, 29)

Unemployment → Wage subsidies offered for job seekers after 9 months out of a job (was 12 months) and for unemployed youth after 6 months without a job. (ILO).

January 2011

Monetary → Estonia become a member of the Eurozone.

March 2011

Politics → Parliamentary elections were held, where the incumbent minority government gained seats, giving it a majority of seats in the legislatures. The government remained in office (Sikk 2012, 92).

Autumn 2012(?)

Pensions → A new pension supplement established for pensioners having cared for a child up to the age of 3 (OECD 2013, 29).

Taxation → From Jan 2013 onward, the unemployment insurance tax lowered from 4.2% to 3%.

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