EMPLOYERS' MANIFESTO FOR 2007−2011

THE ESTONIAN EMPLOYERS' CONFEDERATION
2006−2007

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FOREWORD

The Estonian Employers' Confederation is the most representative social partner organisation in Estonia. We shape policies by participating in social dialogue with the state and trade unions, thus, we bear some of the responsibility for the wellbeing of the state.

When reading this document we would like you to bear in mind that the Employers' Confederation feels an obligation to stand primarily for the development of economy. For the development that ensures that social systems are sustainable now, as well as in more difficult times. The economic success, however, does not happen by itself and the market is not able to overcome each and every obstacle.

There are three reasons why we have chosen this moment in time to issue our manifesto. First, the parliamentary elections of 2007 are approaching. Second, Estonia is about to receive the European Union structural fund support for the whole seven-year planning period for the first time. Third, the current stormy economic growth is likely to give way to a slowdown in the coming years. How well we are prepared for this is only down to ourselves.

Enn Veskimägi
President

Tarmo Kriis
Chairman

24th January 2007

1. STATE ADMINISTRATION AND MACRO ECONOMICS

1.1 Savings in government sector

Coalition governments have failed to fulfil their promises to keep the running costs of the Estonian state sector under control. Investments, at the same time, have fallen to less than a tenth of the government sector spending. As fiscal adjustment by way of restricting expenditure has better chances of succeeding than changing tax rates, then instead of stepping up spending in the current favourable phase of the economic cycle the time should be used to decisively improve the efficiency of state administration. As a rule, the public sector is relatively efficient as long as it does not exceed one third of Gross Domestic Product. Empirical studies have shown that when the public sector rises above this limit, very little socio-economic benefit is gained. Once above the level of efficiency, the increased spending in the government sector will have a negative impact on the economic growth, bringing about a fall in investments and causing labour market problems in the long-term.

Objective 1.1.1: The average total expenditure in the government sector may not rise above 33% of Gross Domestic Product during an economic cycle.

Objective 1.1.2: It is critically important to complete the administrative-territorial reform, as well as the practical implementation of the e-state and, as a consequence, reduce the number of employees in the public sector.

1.2 Restriction on tax burden

Direct taxes as a share of budgetary tax revenue in Estonia have decreased in favour of indirect taxes. This trend complies with the modern tax policy. Income tax cuts, however, have not reduced the tax burden of Estonian enterprises, which pay high social tax and other similar taxes. These are at the same level as the average of the EU states, but noticeably higher than in the countries whose example we are to follow (e.g. Ireland) or in our neighbouring states (e.g. Finland, Latvia). Companies' tax burden is high due to social tax and other similar taxes, which form over 80% of the business tax burden in Estonia. According to EUROSTAT, the actual tax rate on the labour force in Estonia is higher than in the neighbouring countries or the EU average, as well as extremely disproportionate in comparison with the taxation of another factor − capital. The big role of non-wage related costs, incl. social tax and other similar taxes, does not promote the development of business in Estonia.

Objective 1.2.1: Taxes collected to government sector budgets in Estonia should remain on average at no higher than 30% of Gross Domestic Product during an economic cycle.

Objective 1.2.2: Tax policy should be used to decisively reduce employers' non-wage labour costs.

1.3 Resources from structural funds to increase productivity

The biggest challenge for the Estonian economy is to increase productivity both in general and per labour unit. Estonia is one of the fastest ageing societies in Europe and the demographic situation is not expected to improve before 2020. It is therefore critically important to invest into Estonia's business competitiveness during the period 2007−2013. As it stands today, business opportunities for rapid sustainable development are nearly exhausted and economic forecasts predict a significant slow down of the economic growth in the coming years. One of the contributing reasons is the current imbalance of the labour market that forces employers to raise wages faster than the growth of productivity would allow. The development of productivity in current conditions is increasingly dependent on applying modern technologies and innovative activity principles. Based on the existing shortfall, it is absolutely necessary to allocate additional resources to overcome the technological backwardness.

Objective 1.3.1: To increase measures allocated to ensuring innovativity and growth of business to 460m euros in the "Operational Programme for Developing Economic Environment".

1.4 Transfer to euro

Since Estonia has joined the European Union and the euro zone has assumed a dominant role in our foreign trade, it has become important for employers to keep reducing business costs. Both transaction costs and foreign capital expenditure are linked to the exchange rate. It is therefore in the employers' interest to adopt euro in Estonia as soon as possible. At the time of accession to the European Union in spring 2004, the Estonian government and the central bank adopted a strategic course to ensure the country's technical readiness for euro by 2006, with the adoption taking place on 1st January 2007. Today, however, there is no clarity as to Estonia's readiness or the transfer date because Estonia will probably be unable to control the rising cost of living in a manner that would ensure the Maastricht criteria − prerequisites to joining euro zone − are met in full. It would be possible to meet the requirements by 2010 and join the euro zone in 2011 if we restricted somewhat the rapid growth of domestic demand by applying economic policy measures − stifle the growth of government spending through fiscal policy and curb public sector wage rise to match the nominal growth of the economy along with pooling all possible significant price increases into 2008.

Objective 1.4.1: To apply economic policy measures to ensure complete accession to the euro zone by 2011 latest.

2. LABOUR MARKET

2.1 Raising employment levels

Despite great demand for labour force, the employment in Estonia has yet to reach the level of successful European countries. As unemployment is decreasing fast, the main attention should be turned to bringing non-active population back to the labour market. The problem is aggravated further by the fact that 2005 was the first year when the number of people exiting the labour market exceeded the number of those entering. According to expert opinions, increasing the level of employment is one of the most important measures for keeping the current social system functioning for at least mid- to long-term.

Objective 2.1.1: The share of employed persons in the age group 15−64 will increase to 70%, thus, reaching the EU average according to the Lisbon Strategy.

Objective 2.1.2: General unemployment (according to the ILO definition) will remain at around 5% and the number of the long-term unemployed does not exceed 3% of the Estonian labour force.

2.2 Involvement of foreign labour

Local workers alone are not sufficient to achieve a labour market balance in Estonia. In addition to actual shortage of workers, the unevenness of qualifications and levels of skill also play a big role in it. The Estonian legislation on cross-boarder movement of workers is obsolete and fails to offer satisfactory solutions to employers. Today's process of bringing foreign workers to Estonia can be characterised as follows:

- long proceeding deadlines,
- lack of common grounds for allocating work permissions to foreign workers,
- bureaucratically burdensome both to employers and the authorities.

While industries can alleviate the shortage of workers by introducing new technologies or outsourcing, the service sector needs different solutions. Simplifying and facilitating the involvement of foreign labour will be the prerequisite to our continued competitiveness.

Objective 2.2.1: To simplify third country citizens' labour migration to Estonia by shortening procedure times, reducing bureaucratic burden on employers and the authorities and creating common grounds for registering short-term employment as the basis for visa and for work permission applications.

Objective 2.2.2: To avoid mass import of cheap labour employers should be restricted to pay migrant workers at least the average wage of the relevant sector.

2.3 Flexibility of wage policy

In the context of current labour market problems the flexibility of labour relations, including wage policy, plays an important role. The growth of public sector wages ahead of the local private sector has to be brought to an end. Wage policy instruments at national level are collective agreements: national minimum wage and sector-level agreements. Even though the circle of minimum wage receivers has shrunk, the issue primarily concerns the wage opportunities of people with low competitiveness and those new to the labour market. The current level of minimum wage has given an opportunity to find work to older people, people with special needs and others who belong to labour market risk groups, illustrates a survey carried out among employers. In order to maintain current flexibility, the conservative approach to raising the minimum wage has to be retained.

Objective 2.3.1: The Estonian wage policy has to remain flexible and de-centralised. Public sector wages may not rise faster than these of the private sector and the Employers' Confederation has to be involved in such planned changes in the state budget as early as possible.

Objective 2.3.2: To cease comparing minimum wage with average wage and instead adopt a system based on the comparison of median wage.

2.4 Reform of labour legislation

Economic relations, public perceptions and needs of labour market parties have changed radically compared with the assumptions for reforms carried out in 1992. Estonia is now a member of the European Union, new laws regulating civil right and right of obligations have been adopted. The current Employment Contracts Act does not reflect the changes that have taken place and has become obstructive to developing economic relations. High labour costs prescribed by the Act restrict the ability of small size companies to react to changes in the economy. Restrictions on redundancy tend to make employers more selective. High redundancy costs do not motivate small entrepreneurs to enter into employment contracts, one result of which is a distorted labour market containing an exceptionally high number of sole proprietors.

Objective 2.4.1: To develop a new employment contracts act that would take into account the needs of today's business and comply with the principle of the law of obligations.

Objective 2.4.2: To shift the responsibility for paying workers' redundancy payments completely to the Estonian Unemployment Insurance Fund and not to increase maximum limits of insurance premiums established in the Unemployment Insurance Act.

2.5 Review of legislation on collective labour relations

The regulation on the right to strike prescribed by the Collective Labour Dispute Resolution Act breaches business freedom as a support strike is not directed at influencing work-related decisions at their own employer's competence and the company involved in a support strike has no legal opportunity to act to avoid the labour dispute. In addition, the three-day notification period for support strikes is too short to enable the employer to reorganise the work in the company.

Objective 2.5.1: Organisation of support strikes will be allowed by law only in support of strikers in the same economic sector; a sensible maximum duration for support strikes will be prescribed, as well as a mandatory notification period that considers employer's interests.

Objective 2.5.2: A possibility must be created for applying a partial strike ban in economic sectors where a basic level of production or services has to be guaranteed during the strike.

3. TAXATION

3.1. Reducing of income tax

According to the Accession Treaty to the European Union, from 1st January 2009 Estonia has to apply in full Directive 90/435/EC on the common system of taxation applicable in the case of parent companies and subsidiaries in different member states. Changing the simple and transparent core of the current income tax system would damage Estonia's competitive edge as compared with other EU countries and impact negatively the economic growth.

At the same time, it should be borne in mind that the 20% income tax rate prescribed for 2009 by the current Income Tax Act will by that time stop short of competitive in comparison with other EU member states. In order to retain our competitive edge, we must continue to significantly lower the income tax rate.

Estonia's shortage of qualified workers could be alleviated by reducing employers' work-related costs − the employer's payment towards employees' formal or information education costs should no longer be considered as fringe benefit. The employer's spending on employees' recreational sport should also be removed from the list of fringe benefits. Worker's participation in creation of value as a factor of production is directly linked to his/her health and preventive spending on maintaining good health cannot be classified as fringe benefit.

Private persons as share investors are today treated differently than businesses − a private person has to pay income tax on profit from the sale of shares immediately, even if he/she buys new shares for the money received, whereas a business is exempt from paying tax on re-invested profit.

Objective 3.1.1: To preserve the current corporation tax system in Estonia by introducing minimal amendments to income tax legislation in order to comply with the European Union directive.

Objective 3.1.2: To continue with the principle of low income tax by lowering the tax rate by at least 2 percentage points a year and reaching 14% mark by 2011.

Objective 3.1.3: Not to treat as fringe benefits employer's investments into employees' adult education and recreational sport.

Objective 3.1.4: To exempt private persons' profit from long-term investment in securities from income tax if the profit is re-invested within 90 days.

3.2 Splitting social tax between employee and employer

Social tax is in essence a special type of individual income tax aimed at financing health and state pension insurance systems. Based on that, social tax (33%) is divided into a contribution to health insurance (13%) and a contribution to pension insurance (20%). The Estonian social tax is different in that it is the employer's tax and it does not reflect directly in the person's gross pay in the way income tax does. If social tax liability was shared between the employer and the employee on a basis of parity, it would also be possible to involve insured persons − employees − in social insurance issues. If social tax and income tax were treated as an individual's tax liability, it would help to make clearer decisions on redistribution of profit and increase public interest in monitoring expedient use of taxes. Estonia would not be an exception in this issue as other countries are also moving towards treating social tax as an individual's income tax.

Objective 3.2.1: To start sharing social tax liability between employers and employees on a parity basis by changing at least 50% of social tax into an employees' tax. Lower income brought about by a changed tax burden would be compensated to employees through a national collective agreement.

3.3 Increased tax base for social tax

Companies contribute to health and pension insurances by paying taxes to state budget; they also cover the bill for the difference between social tax paid for people insured by the state and the cost price of health services. In a context where average wage is 10,000 kroons (€639) and minimum wage 3,600 kroons (€230), the social tax for about 150,000 people is, in 2007, calculated on the bases of only 2,000 kroons (€127) per month. The Estonian health insurance system, at the same time, continues to suffer from relatively low funding as a proportion of Gross Domestic Product. As social tax increase is out of question as it is already too high, the funds of social insurance can only be boosted by increasing the base rate of social tax at least to the same level as minimum wage for sole proprietors and persons insured by the state.

Objective 3.3.1: To raise social tax base rate to the same level as minimum wage by 2008 latest.

3.4 Review of excise duty

The current Fiscal Marking of Liquid Fuel Act does not comply with EU directives nor provide for using fiscally marked diesel fuel in vehicles that are not to be used on public roads, but are not used in the fields of forestry, mining or construction either (e.g. port operators performing stevedoring work). Another non-compliant aspect of the Act is that vehicles used in forestry are linked to agriculture on the list of permitted areas of use for this fuel and that the Act does not specifically cover machinery used in forestry. Permitted areas of use for fiscally marked diesel fuel will have to be amended according to EU directives, thereby extending the allowed use of such fuel and enabling companies using this fuel in similar conditions to apply lower excise duty rates. The principle that fiscally marked diesel fuel can only be used by certain target groups should remain in force.

Objective 3.4.1: To extend areas of use for fiscally marked diesel fuel and to enable companies using this fuel in similar conditions apply lower excise duty rates accordingly.

The state budget strategy notes that the price of alcohol has risen less than the price of other consumer goods and that a rapid increase of alcohol excise duty is justified in the light of quickly rising general wage levels. Yet, it is admitted that excise rates should be in correlation with inflation and changes in the population's purchasing power. The government plans to raise alcohol excise duty by 10.5% from 1st January

2008. A sudden increase of alcohol excise rates may not be justified as it will help to speed up inflation and postpone joining the euro zone.

Proposal 3.4.2: In order to avoid rising cost of living to increase alcohol excise duty by no more than 5% (as of 01.01.2008).

4. Education

4.1 Integral planning and governing of education system

Solutions for our labour market problems and the competitiveness of the Estonian labour force all depend on the structure of our education system. The fragmentation of education system and the lack of the big picture have created an unhealthy competition between different types of education and educational institutions. The potential of vocational education establishments as providers of secondary education is weakened as general education system favours continuation of studies in upper secondary schools. The planning for graduates from vocational and higher education institutions, which have a direct output to the labour market, is weakly connected. Different forms of ownership have resulted in an uneven development of funding for general, vocational and higher education areas.

Objective 4.1.1: To plan a uniform state commission for types of education directed at the labour market − vocational and higher education, if possible also adult vocational training.

Objective 4.1.2: To determine a share of funding from the state budget for each type of education (general, vocational, higher) and to adhere to similar principles when allocating resources.

4.2 Continued priority development of vocational education system

A knowledge-based economy can only be built on workers with good vocational skills. Without affecting the importance of higher education system, the vocational education system requires ongoing support. We should immediately start implementing the Vocational Education System Development Plan (for 2005−2008). Vocational schools must be able to attract capable students who would continue their specialised studies on technology and production in higher education. In order to achieve this, more resources need to be pooled into modernising vocational education and into popularising vocational specialities among the youth.

Objective 4.2.1: To fund a student place in vocational education by 1.5 times more than compared to a student place in general education.

Objective 4.2.2: To popularise vocational education through counselling and reputation building and achieve that at least 20% of vocational school leavers would continue their studies in higher education.

4.3 Raising the quality of higher education system

In the coming years, higher education landscape will be hit by a sharp drop in numbers of upper secondary school leavers; this will force higher education establishments either to simplify their entrance requirements or cease work. This would not be in harmony with the needs of the society. Bearing in mind that student numbers will fall, it is inevitable that funding per a student place will have to be increased. Priority, however, should be given to areas that matter from the view point of the labour market. In the context of restricted resources we should prepare for partial tuition fees and provide for funds to support students who are financially worse off.

Objective 4.3.1: To put more effort into developing specialities linked to technology and production, and professional higher education. To reduce the role of higher education that falls outside the state commission and to increase the value of budgetary student places necessary for the labour market.

Objective 4.3.2: To introduce a system of (at least partial) tuition fees by 2011.

4.4 Increasing the role of adult education

A serious problem for the Estonian economy is the high level of youth drop-outs both from basic and vocational education systems. In addition to growing numbers of unqualified young people, many areas over produce graduates in specialities not required on the labour market. The problems on the labour market can be resolved by significantly increasing the share of people participating in adult education. On the contrary to the Lisbon objective (to increase the rate of adult participation in education to 12,5% among the population aged 25−64), the rate of adult education in Estonia has fluctuated between 5−6% and even dropped slightly. One of the guarantees of continued economic development is considered to be an educated population, which both in Europe and Estonia is ageing. Previously mentioned tax policy and small contributions from state budget to this type of education have kept adult training in an unfavourable state for years. Poor training opportunities are offered to the part of the population between the unemployed and high-earners. There is a general consensus that adult education should take place in existing training facilities, the funding problem, however, requires a solution by state initiative.

Objective 4.4.1: To raise the participation rate of adults in education to 12.5% by increasingly significantly relevant state investments and abolishing fringe benefit tax on adult training.

4.5 Fostering education related to information and communication technology

Work tasks in many traditional sectors of economy require information and communication technology (ICT) skills from workers today. It is therefore necessary to ensure that in addition to general literacy, education system teaches people computer skills related to a specific future profession. In case of many risk groups, low level of ICT skills means low competitiveness.

Objective 4.5.1: Acquisition of computer and information technology skills related to a vocation, speciality or a profession are offered to all age groups and in all educational institutions that have output to the labour market.

5. SOCIAL INSURANCE

5.1 Pension insurance

Despite the development of a multi-pillar pension system, there are several challenges ahead of us. The situation on our labour market will deteriorate in the coming few years as birth rates drop. The ratio of people at pensionable age (aged 60+) to working-age population (aged 15−59) was 35.3% in 2003 but may rise to 65% by 2050. Once the so-called age-dependency ratio has increased, Estonia would either have to sharply raise social tax or bring in masses of foreign labour to avoid the bankruptcy of the national social insurance system. At the same time, in 2004, 42% of retiring people retired before their general pensionable age. Aged workers form a great resource for the labour market. Changes made today would also support the future sustainability of pension and social systems. Consideration should be given to cutting down special merits pensions and superannuated pensions and creating additional motivation factors for keeping aged people working (e.g. the special pension for 1,600 people alone costs the state 130m kroons a year).

Objective 5.1.1: To raise general pensionable age gradually to 67 years and increase the average age of withdrawing from the labour force to 65 by 2010.

Objective 5.1.2: To carry out the reform of special merit pensions and superannuated pensions with an aim to reduce early retirement to 20%.

5.2 Health insurance

Even though the level of funding for the Estonian health insurance system and patient satisfaction levels can be considered sufficient, the mid- to long-term funding of the Health Insurance Fund is no longer sustainable. This opinion is based on a rapidly decreasing number of tax payers during the next 10 years and increased patient expectations about the quality and accessibility of health insurance services. The sustainability could be ensured if we eased the Health Insurance Fund's responsibilities for paying out professional incapacity benefits and increased its funding, that is, without adding to employers' heavy enough duties.

Objective 5.2.1: To involve the resources from the national pension insurance into funding the Estonian Health Insurance Fund, while retaining the current rate of social tax.

Objective 5.2.2: To reduce the share of temporary incapacity benefits in the Estonian Health Insurance Fund.

5.3 Occupational accident and disease insurance

The application of new concepts of occupational accident and disease has to take into account the employers' current tax burden. If a risk-based type of insurance is created, the social tax burden of employers whose working environment is exemplary will have to be reduced. Creation of an occupational accident and disease insurance means that social tax would have to be reduced accordingly.

Objective 5.3.1: If a mandatory insurance system is created for occupational accidents and diseases, social tax will have to be reduced by the extent the new insurance system lowers the costs of the current social insurance system.

LIST OF OBJECTIVES

1. State Administration and Macro Economics

1.1 Savings in government sector

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Objective 1.4.1: To apply economic policy measures to ensure complete accession to the euro zone by 2011 latest.

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Objective 3.1.4: To exempt private persons' profit from long-term investment in securities from income tax if the profit is re-invested within 90 days.

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