

The impact of the minimum salary on the socioeconomic development of Estonia

The **minimum salary** (also known as the ‘minimum wage’) is the lowest salary an employer in Estonia can pay a full-time employee. **In Estonia, the rate of the minimum salary is agreed on by social partners** – employees are represented by the Estonian Trade Union Confederation (EAKL), while employers are represented by the Estonian Employers’ Confederation (TKL).

The minimum salary has doubled in Estonia in the last decade: from 278 euros in 2011 to 584 euros in 2021. **During this period, the minimum salary has also increased relative to the average salary.** In other words, the minimum salary has increased more rapidly than the average salary: in 2010 the minimum salary was 35% of the average, whereas in 2020 it was 40%.

This study applies **scientific research methods to provide an evidence-based overview of the impact of the minimum salary on the socioeconomic development of Estonia.** The focus of the study is multifaceted. It includes an overview of the profile of minimum salary earners, the impact of the minimum salary on the economic indicators of companies (on employment, productivity, and export competitiveness), employers’ labour costs, the competitiveness of employees and their motivation to work, income distribution and inequality, and an examination of the impacts of the minimum salary being equal to or forming a certain percentage of the relative poverty rate.

The rate of the minimum salary affects a significantly larger number of Estonians than just those who earn it. For example, a number of state benefits (such as the parental benefit and unemployment insurance benefit), payments (such as kindergarten fees in some local governments and child maintenance) and the minimum social tax in Estonia are linked to the minimum salary. Further, there are spillover effects in increasing the minimum wage, such as increases in wages of employees already earning more than the minimum.

MAIN RESULTS

PROFILE OF MINIMUM SALARY EARNERS AND PAYERS (DATA FROM 2015-2020)

- The number of people who earn the minimum salary in Estonia has remained stable at around 21,000 (the exception being 2019, when the same figure was 24,000). From 2015-2019, between 31,000 and 37,000 Estonians earned the minimum salary or a salary close to it (no more than 10% higher).
- There were more men than women among minimum salary earners.
- Minimum salary earners were most numerous in the 25-49 age group.
- The proportion of minimum salary earners was highest among workers with only basic education. Among those earning the minimum salary, there were also relatively more people with vocational secondary education or vocational education based on secondary education.
- A significant proportion of minimum salary earners were unskilled workers (32% in 2015; 22% in 2020), service and sales workers (23% in 2015; 21% in 2020) and skilled workers and artisans (10% in 2015; 18% in 2020).
- In terms of numbers, Harju, Ida-Viru and Tartu counties, which have the largest populations in Estonia, were home to the most minimum salary earners. The percentage of minimum salary earners among all employed people was considerably higher in Ida-Viru County than in other Estonian counties.
- The vast majority (77%) of companies paying the minimum salary were micro- or small businesses with up to 10 employees. The minimum salary tended to be paid by companies that had been operating for a long time: 55.9% had been operating for more than 10 years.
- Among the companies paying the minimum salary, the trade and construction sector was represented more than any other.

THE IMPACT OF THE MINIMUM SALARY ON SOCIOECONOMIC INDICATORS

- From 2012-2019, the impact of the minimum salary on employment was mostly insignificant or positive, depending on the year.
- Although the minimum salary is raised in order to increase the wages of people who earn less than the new minimum salary, employees who earn a higher salary may also see an increase due to a spillover effect. According to an analysis of data from 2006-2018, if we consider only employees earning the minimum salary and above, the average salary increased by 0.83% in the next lowest percentile due to a 1% increase in the minimum salary. In general, analysis of salary distribution indicates that the economic significance of the spillover effect continues to tail off up to the 35th percentile of salary distribution. It has no significant impact in higher percentiles.
- A high proportion of minimum salary earners is associated with lower growth in capital intensity, which may indicate that companies have limited investment capacity as labour costs increase. The higher initial proportion of minimum salary earners (from 2010-2012) is related to somewhat faster growth in labour productivity and the total productivity of factors in the following period (2013-2018), which may counterbalance the potential negative effects of raising the minimum salary.
- Companies which had a relatively high proportion of minimum salary earners from 2010-2012 (and which were therefore relatively strongly affected by the subsequent salary increase) later experienced somewhat slower export growth than companies with a lower proportion of minimum salary earners. There is no evidence that raising the minimum salary has a negative effect on companies' export activities.
- Raising the minimum salary had a significant impact on the growth of companies' labour costs.

THE IMPACT OF THE MINIMUM SALARY ON INCOME DISTRIBUTION

- Raising the minimum salary helps reduce inequality and the relative risk of poverty, including the risk of poverty faced by working people. Increasing the minimum salary to the relative poverty rate or to 50% of the average salary would affect 12% and 18% of employees, respectively. Most of the increase in gross salary (80%) reaches households as disposable income. The rest is taxed away as increasing income tax, employees' social security contributions or a decreasing subsistence benefit (the average effective marginal tax rate thus being 20%).
- Due to the structure of households, raising the minimum salary lowers the relative risk of poverty of both working people and children. Its smallest impact is on the risk of poverty faced by older people.

THE IMPACT OF THE MINIMUM SALARY ON THE COMPETITIVENESS OF WORKERS ON THE LABOUR MARKET

- Moving downwards professionally (i.e. moving from a higher code to a lower code in ISCO one-digit classification) was not associated with any statistically significant explanatory variables when looking at the longer period (2011 vs 2019). In the short term (2018 vs 2019), only employment in certain individual areas of activity was statistically significant. When moving upwards professionally (i.e. moving from a lower code to a higher one), some employee-related factors also had a significant effect.
- There are areas of activities where there are more movements in ISCO codes both upwards and downwards, or only upwards. Compared to the reference sector, there were no areas of activity that had mainly downward movements.
- Thus, the analysis did not indicate that the increase in the minimum salary is related to the competitiveness of workers on the labour market in terms of occupational mobility.