

ABOUT THE ELEMENTS OF ECONOMIC POLICY – ECONOMIC GROWTH, RELATIONSHIP BETWEEN PRODUCTIVITY AND WAGE GROWTH, ABOUT TAXES AND PLAYING WITH THEM IN ESTONIA

(incl. also introductory thoughts about economic terminology in the current situation)

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Introduction

The keywords and the subject of this article are topical in the Estonian economy as developments in economy are very closely related with them.

The purpose is to assess the impact of the respective economic policies both on the development of Estonia and its social situation and the quality of life of the population.

Research tasks/issues are briefly treated under the subheadings of the article.

The undersigned has monitored for decades the treatment of the Estonian socioeconomic situation both in speech and in writing and unfortunately his position is that very often the information and the explanations and the discussions contain wrong terms and have been arbitrarily translated without understanding the essence of the phenomena. This is probably caused by inadequate preparation and qualification of both politicians and many journalists.

Also, international organisations often seem to issue recommendations without sufficient knowledge of the local situation and possibilities. This, however, creates confusion and instability and does not lead to right decisions or ensure the required development of the economy. Sometimes the insufficient orientation in economic issues is unacceptably widespread despite great self-confidence in speech.

The article uses several sources, both official opinions and from the media and by individuals and they have also motivated the undersigned to add comments and express his positions.

1. About terminology, growth, incl. productivity and wage growth

Firstly, we should look at the terms used in Estonian as although we have our own terms, the wrong translations and incorrect terms derived already from Russian during the earlier russification period and translated from English shortly after the regaining of independence are still used.

Economic growth has been talked about for many years already which is no doubt right. In the recent years also the need for wage growth is increasingly talked about. However, the concept of productivity (productiveness, work output) and work productivity and its growth and relationship to wage growth has been almost forgotten next to these issues. Work efficiency would be in Estonian labour productivity or just productivity.

The undersigned has written on the subject of terminology in the journal also earlier, above all about the rather free use of the term “industry”. Probably by translating from English without understanding the true meaning of the word. Also the brainless use of

the term “planeerimine” which is derived from Russian, and also nowadays. In Estonian, “plaan, plaanimine” is correct, as “planeerimine” also means road levelling by road-grader. Wrong use of the term “industry” is startlingly frequent in Estonian. The undersigned has also consulted the Chief Language Planner of the Institute of the Estonian Language Peeter Päll more than 10 years ago in these (and also other) terminological issues.¹ The well-known language planner agreed with the critical positions of the undersigned but stated that it would be extremely difficult to change the wrong use as commands would not change anything. Unfortunately, a large part of Estonian journalists (to speak nothing of other specialists and politicians) use wrong economic terminology and thus set an example also to the Estonian population.

Productivity and its growth are rarely talked about in Estonia. Here in Estonia above all the need for economic growth and wage growth are talked about but very rarely the need for productivity growth. I remember that when I studied very thoroughly the German economic statistics and literature and talked to local colleagues during my first fellowship period of three months in the Western world, so-to-say, in the Federal Republic of Germany, at the University of Kiel and the University of Frankfurt (Main) from the end of October 1989 until January 1990, many problems became much clearer to me, including that productivity has to grow faster than the wages (expanded economic reproduction!). And this relationship was very carefully monitored in the German economy!

There are sometimes problems also with economic growth: it is calculated either at current prices or constant prices. If it is performed at current prices and this is also promoted, it is real self-deception. This seems to be loved here!?

2. Visit of the representatives of the International Monetary Fund (IMF) to Estonia: a few sensible and many impracticable recommendations

In mid-April 2024, a high-level **IMF delegation**² visited Estonia to examine the situation of our economy and give recommendations.³ Including:

- to achieve the balance of payments of the state budget, which we can certainly agree with;
- to impose the motor vehicle tax, being “in the same boat” with our unsuccessful Government;
- to impose property taxes which can be regarded as an early, impracticable and somewhat chaos-causing activity in the conditions of Estonia.

Imposing the motor vehicle tax and the property tax shows that the respected IMF members are not familiar with our economy and the society. They are used to comfortable

¹ **Peeter Päll** is an Estonian linguist and onomastician, Chief Language Planner of the Institute of the Estonian Language. His main expert areas are onomastics, language planning, name planning and lexicography.

² IMF (*International Monetary Fund* (visit on basis the IMF Articles of Agreement; usually once a year).

³ Eesti Pank. IMFi delegatsiooni artikkel IV alusel 2024. aastal tehtud visiidi kokkuvõttev avaldus. [<https://www.eestipank.ee/press/eesti-vabariik-imfi-delegatsiooni-artikkel-iv-alusel-2024-aastal-tehtud-visiidi-kokkuvottev-avaldus-15042024>] 26.04.2024.

life in a wealthy society where most people (incl. they personally) have considerably higher income levels compared to Estonia. Besides, Estonia has a scattered settlement structure which requires different solutions than in countries with non-scattered structure in many situations. In the situation of scattered settlement structure, families often need two cars, and rural population does not earn high income. For instance, in the Warder Village in Germany⁴ and in other villages public transport is used, including for taking children to school, but this is not possible between our villages and households.

Property tax – on apartments, one-family houses, etc. would cause many families here, above all young families, to get into high debts or give up their dwellings. They have acquired their dwellings with a loan anyway and now we would add also the property tax. Our society has to become considerably richer to be able for us to pay both property and motor vehicle taxes.

3. Green transition and climate neutrality

Climate change and environmental deterioration endanger the survival of Europe and the whole world. **European Green Deal was designed to solve these problems. It is the new European economic growth strategy to transform the EU into a modern, resource-efficient and competitive economy.** The aim of the European Green Deal is to make Europe climate neutral by 2050, give an impetus to the economy with green technology, to create sustainable industry and transport and to reduce pollution. Problems related to the climate and the environment have to be transformed into opportunities and the green transition has to be made fair and inclusive for everybody.

The Estonian natural environment is unique with its forest and bog communities rich in species, historic wooden meadows, flora and fauna and other values. Estonia has agreed to EU binding climate targets. By 2030, Estonia has set an even more ambitious national target compared to the EU – to reduce greenhouse gases by 70% (compared to 1990). According to the statistics of 2020, the Estonian emissions have already decreased by 65%, above all due to the large structural changes made at the beginning of 1990s. In addition, Estonia has set itself the target to cover its annual electrical energy generation with renewable electricity already by 2030.⁵

Last winter the farmers of France, Germany and Belgium held severe protests. Also Estonian farmers expressed some concern.⁶ They were mainly dissatisfied with the requirements for the achievement of climate targets. Fulfilment of these requirements would have meant for the farmers either reduction of production or higher investments in technology, acquisition of more expensive equipment, etc. Nature conservation and

⁴ The Warder Village in the Warder Rural Municipality (a typical German settlement with about 700 inhabitants, with dense settlement structure) is located in Northern Germany in the Schleswig-Holstein State, about 30 km to the east of the Kiel City (local government: Nortorf Town, about 10 km from Warder) where the former member of the board and editor of our journal and a friend and colleague of the undersigned, Manfred O. E. Hennies (10.09.1938 Berlin – 18.10.2019 Warder) lived.

⁵ Rohepööre Eestis – Euroopa Komisjon. [<https://estonia.representation.ec.europa.eu/strateegia-japrioriteetid/eli-peamised-poliitikavaldkonnad-seoses-estiga/rohepoore-eestiset>] 1.05.2024.

⁶ Rohepööre võtab tuure maha. Põllu- ja metsatehnika. 11. aprill 2024, lk. 3.

reasonable use of resources is a natural activity for both farmers and foresters but it is unfair to set unrealistic requirements.

Climate neutrality is a situation where an area does not emit more greenhouse gases than its ecosystem can currently bind. Thus, the net amount of greenhouse gases is zero. A simplified parallel example of climate neutrality is heating of a sauna – when we heat a sauna, we add firewood to the oven. But once the temperature of the steam room is already sufficiently high and higher temperature is not required, the heating has to be stopped, even the charcoal should be taken out of the oven, if necessary. The same is with the Earth – if we no longer want to increase the global temperature, the “heating” with greenhouse gases has to be stopped.

4. Positions of the representatives of the Organisation for Economic Cooperation and Development (OECD) in Estonia

OECD pointed out in its overview the **challenges of high inflation for pensions** and gave an overview of OECD countries for the period from September 2021 to September 2023. The life expectancy of the elderly was restored starting from 2021 after being on an average about half a year less in 2020. But starting from about 2012 the increasing trend of life expectancy of 65-year-olds has slowed down.

The current Estonian employees are expected to have one of the greatest decreases in income in the whole European Union during their retirement age according to the latest study of the Organisation of Economic Cooperation and Development (OECD).⁷

According to the results of the OECD study, **an employee living in the European Union and earning an average salary will get a pension after reaching the retirement age which accounts for 68.1% of his salary.**

But the **future pension of an average employee living in an OECD Member State earning average salary will account for only 61.4% of his average salary.** This indicator is called **pension replacement rate.**

The study proceeded from the assumption that the employee has entered the labour market in 2022 at the age of 22 and continues working until the official retirement age established in his country. The amount of the future pension was calculated, using all mandatory pension schemes, voluntary pension insurance was not taken into account.

The net pension replacement rate of Estonian employees, i.e. after taxes, will only be 34.4% according to the OECD study. This is the second lowest result in the EU,⁸ only Lithuania has a lower replacement rate, which is 28.9%.

⁷ OECD: Eesti töötajaid ootab üks madalamaid pensioni asendusmäärasid EL-is. ERR, Uudised, 17.01.2024, kell 16:46 [<https://www.err.ee/1609224915/oecd-estni-tootajaid-ootab-uks-madalamaid-pension-i-asendusmaarasid-el-is>] 28.04.2024.

⁸ MR: In March-April 2024, the Estonian Government who was looking in panic for places and sources from where funds could be taken to cover the budget shortages, started to consider another idea – imposing an income tax on the part of the pensions exceeding a certain level. Thus, our net pension may decrease even more. Our pensions are already low and therefore imposing such an additional income tax shows the “level” of our Government and makes it seem ridiculous in the eyes of the people and probably also other EU Member States.

Relationship between pensions and the salaries is changing from year to year. In 2021, when the average pension was exempted from tax, average pension accounted for about 43% of the average salary. In 2024, this ratio is about 49%. Average pension has considerably increased as a result of indexation and extraordinary pension increases. In 2023, the highest pension increase of the last 15 years took place, which was 17.6% together with the extraordinary pension increase.

The statistics presented in the paragraph above about the ratios of our pensions and salaries are official data of the Ministry of Social Affairs. The same indicators based on the OECD study have been presented in the pages above where the ratio of the indicators for Estonia is considerably lower (approximately by a half!). The undersigned asks – which statistics are correct, who is bluffing or has failed to take something into account or who has considered something in addition?

5. Activities of the representation of the Organisation for Economic Cooperation and Development (OECD) in Latvia

In April 2024, **OECD representatives visited Latvia** and gave many recommendations. The Minister of Economics of Latvia Viktors Valainis said on Friday (MR: 19.04.2024) in connection with their recommendations to the Latvian television that the Latvian economy lacks two or three billion euros of investments, therefore the capital market has to be developed first. “The amount of investments lacking in our economy is not five, ten or a hundred million euros, it is two or three billion euros,” he said and added that such an inflow of funds can only be achieved with a serious review of the financing of Latvian economy, and one of the necessary preconditions is the development of the capital market.

Also the OECD Report considers the tax burden of the Latvian employees with the lowest salaries too high. According to Minister Valainis, the Government intends to find a solution for reducing the tax burden of these employees: “People cannot bear this tax burden, which leads to informal economy,” he said and added that Latvia was not competitive with other Baltic States in terms of its employment taxes, particularly in the salary segment which remains below 2000 euros.⁹

The OECD Report recommends Latvia to raise taxes. Increase in defence and health care costs assumes an increase in tax revenues. Instead of taxing labour, immovable property and other assets should be taxed, also environmental taxes should be increased. People with lower salaries have a disproportionately high tax burden which in its turn induces many people to accept undeclared wages. Despite a lot of official rhetoric, informal economy has not decreased in Latvia since 2012.¹⁰

⁹ Minister: Lātis jāb puudu 2–3 miljardi euro ulatuses investeeringuid. ERR, Vālismaa, Uudised, Allikas: BNS. 26.04.2024, kell 10.20 [<https://www.err.ee/1609325238/minister-latis-jaab-puudu-2-3-miljardi-euro-ulatuses-investeeringuid>] 26.04.2024.

¹⁰ ERR, Vikerraadio, 26.04.2024, Uudised: kell 9.00.

For conclusion

In the opinion of the undersigned, the representatives of the IMF and OECD (considering the case of Latvia here) are not familiar with the local situation if they recommend taxation of immovable property and other assets. As we have written above, the Latvian population is not wealthy enough either for imposing the property tax (MR: in the meaning of the immovable property and other assets tax here). Imposing such a tax would make many people even poorer than they are now and may increase the percentage of people who need social welfare benefits.

Considering also the positions about pensions based on OECD studies, the recommendations of the IMF and OECD both concerning increasing taxes and taxation of immovable property and other assets will have an unfavourable impact on the pensions of our population in the long run. Then the monthly net pension, i.e. the pension replacement rate after taxes will not be much higher than 1/3 of the monthly salary earned at the working age, which means that we would keep the second lowest result among the EU Member States. Is also our current Government steering the state in that direction?

But the members of the representations of both IMF and OECD are clearly used to living in an affluent society for a very long time and have also high income and do not (or do not want to) perceive the situation of other countries and many people living in these countries. These representations should become more familiar with actual life and issue less incompetent recommendations. They should stay at home and enjoy their prosperity and quality of life and do not need to travel around, spend the taxpayers' money, have feasts and teach others in an incompetent manner.