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FOREWORD

In the light of the enlargement of the European Union and the euro area, countries are often faced with the issue of migration. Migration concerns social policy, the labour market as well as society in general. As migration affects a country and society in different ways, it should also be examined from various aspects. Thus, the present issue of the Kroon and Economy analyses the experiences of the EU and Estonia in that field, the legal framework for migration policies and other related issues.

The adoption of the euro has been Estonia's economic policy priority for quite a while. Even though Estonia meets the other necessary criteria, the high level of inflation has been the main obstacle to the adoption. Slovenia has been the first Central and Eastern European country to introduce the euro. The euro has been used for a year and a half there by now. In relation to that, we give an overview of Slovenia's experience and economic developments during its first year as a full member of the euro area.

The strong economic expansion in Estonia in recent years has eased, which has also affected people's perceptions and expectations regarding the future outlook. Therefore, we asked the market research company Emor to conduct a survey to identify Estonian residents' opinion of the current economic situation, the labour market and consumption. The current issue brings you the main outcomes of that survey.

LABOUR MIGRATION DEVELOPMENTS AND LESSONS LEARNED

Maarja Kuldjärv, Thor-Sten Vertmann

INTRODUCTION

The recent history and present-day of Estonia is rich with experience of various types of migration. Unfortunately, it is uncertain how much one can learn from it in the contemporary and future international market economy. If today we are discussing the economic need for foreign labour, was migration into Estonia in the second half of the 20th century justified similarly? And is there much sense in looking for analogies and examples from the history of Western Europe and the present migration policy and practices of the European Union? Or should Estonia serve as an example for other countries instead?

MIGRATION TO EUROPE

Europe became the destination for labour immigration relatively recently, in the middle of the last century. Guardia and Pichelmann, researchers of labour migration, have distinguished between three types of immigration dominant in different periods: migrant workers (from the 1950s until the 1970s), the families of migrant workers who stayed put (1970s) and asylum applicants (1990s).

In 1950-1960s there was a great need for workforce in Europe for building up the post-war economy. Several factors hindered finding the necessary workforce: the baby boom diminished the employment rate of women; people started entering the labour market later and leaving it sooner owing to the evolution of the educational and pension system; investment in technological developments instead of obtaining additional workforce was often considered too risky, etc. Thus, several European countries created so-called guest worker programmes in order to find the necessary workers, mainly in manufacturing. It was presumed that guest workers would be temporary – they could be recruited in times of labour shortage and sent back home when unemployment grew.

Indeed, most migrant workers did so, going home after working abroad for a few years. For instance, in 1960–1973, 75 percent of the 18.5 million migrant workers of Germany returned to their homelands.[1] However, even the 25 percent that stayed in Germany formed an unexpectedly large number of foreigners whose permanent immigration had not been taken into consideration. Many of them also had their families following to Germany. One of the reasons why they did not return home was the unrealistic wage expectations. Namely, they discovered only after arrival that living costs consumed a large share of their incomes and it was impossible to earn a fortune to live peacefully upon returning to their homeland. They were also encouraged to stay by some employers for whom the rotation of employees (as originally planned) would have meant constantly recruiting and training new workers, which

[1] Martin, et al (2006, p 87).

the employers were not interested in. The deterioration of the labour market situation in the homeland of migrants was yet another factor forcing them to stay.

The European countries that had implemented the guest worker programme learned several lessons from this experience. Martin et al[2] have pointed out the following:

- the programmes deviate from their goal and develop an addiction; thus, their scope and duration exceed the initial plans;
- the rules that do not comply with the economic motivation factors of employers and employees are severely pressured and will probably be adjusted. Therefore, it is difficult to establish and adhere to the rules related to rotation and returning, while also ensuring the human rights of migrant workers;
- the emigration desire of people from the country of origin cannot be controlled and migration cannot be curbed when no more migrant workers are desired; on the contrary, after the establishment of networks migration may even increase;
- the programmes might strain relations between countries.

ESTONIA'S EXPERIENCE

A similar development occurred also in Estonia, where a vast number of workers migrated from other Soviet Union countries. In the first years following World War II approximately 45,000 people arrived per year. Further on, the amount of migrants decreased gradually but migration continued until the 1980s. With time the educational background of migrants changed: at first the education level of migrants tended to be low, but in the 1970s the share of those with higher education started to rise significantly. This was caused by an increase in general education level among the population as well as a need for workforce (in the 1950s and 1960s, both unskilled and skilled workers were required, whereas later the need for unskilled workers decreased).[3]

Similar to Western Europe, with time the importance of family immigration increased also in Estonia. While in the 1940-1950s immigration was mainly guided by the central government, in the 1960s migration was primarily fostered by manufacturing companies founded in Estonia, which attracted migrant workers with various special offers (e.g. provided housing).[4]

Thus, we also have prior experience in what should be taken into account when establishing immigration rules today. Although the reasons for labour immigration during the Soviet era included economic as well as population policy considerations, the latter dominated. Based on the example of the Tartu Control Equipment Factory[5] in Estonia that operated under the

[2] Ibid (pp 93–94).
[3] Kulu (2003, pp 40–42, 46).
[4] Ibid.
[5] A secret military factory under the Ministry of Defence of the USSR.

governance of the Soviet Union, one can conclude that from the one hand, the production process required specialists that were only trained in Moscow and Leningrad. On the other hand, there were various activities and circumstances that were not directly caused by the company's economic activity, but still facilitated immigration:

- the working language was Russian;
- the senior and middle management almost all spoke Russian;
- military pensioners were employed;
- the families of migrants were encouraged to come live and work in Estonia;
- those who had worked in severe conditions in the far north and received special pensions were granted housing at a special price on the outskirts of the Soviet Union.

Instead of looking for workers to fill vacancies, new positions were created for the continuous inflow of Russian-speaking population.[6]

The hidden aspect of the population policy in the Soviet labour migration was clearly seen and described already before regaining independence. Jaan Rebane described the "immigration pump" model in the magazine Eesti Kommunist already in 1988. According to Rebane, besides importing the workforce necessary for actually expanding production, several companies had boosted immigration like pumps. Being unable to create a stable staff, they constantly recruited people who were primarily interested in finding a new and better place to live. Rebane has also pointed out that companies commanded by the Soviet Union often had great resources for social development and building capacity, which enabled to favour some of the new residents over the original population in receiving residential spaces.[7]

POLICIES IN THE EUROPEAN UNION

While in the past the European guest worker programmes were mainly used by workers with low qualification of whom many decided to stay, more recent immigration schemes also consider the possibility that immigrants might not go back. This is even recommended to a certain extent, as demographic developments are causing problems in the labour market, welfare systems and public finances throughout Europe, and immigration is one way to alleviate the situation.

With time the legal framework protecting the rights of foreigners and migrant workers has gradually become stronger and it is no longer easy to implement schemes including the obligation to return. Besides human and fundamental rights, countries have to take into account their reputation and international relations. Thus, the current schemes used proceed from choosing immigrants not only with regard to the labour market needs at the very moment

[6] Vertmann (1999, pp 3–4).
[7] Rebane (1988, pp 19–20).

but also considering the long term by preferring more highly qualified people. The economic structure has also changed, which points to a need for highly qualified employees.

A clear mandate to develop a single policy concerning migration issues on the European Union level was first granted at the Tampere Summit of the Council of the European Union in 1999.[8]

In 2000, the European Commission published a communication concerning the Community's immigration policy. The communication admitted that immigration has a significant role in the economic development of the European Union and for achieving the goals of the Lisbon Strategy. Thus, a broader approach was adopted compared to the previous one focused on security and it was acknowledged that migration is strongly related to economic, labour market and social policies. The communication also stated that strict immigration rules are no longer justified and migrant workers have to be offered more favourable conditions for their arrival in the European Union[9].

In 2004, the Council of the European Union approved the Hague Programme for the years 2005–2009. One of its ten priorities was to find a balanced approach for managing immigration on the EU level. It was acknowledged that as movement on the EU territory has to be free and the migration policy of one Member State may substantially influence others and their labour markets, countries should proceed from similar principles in the establishment of immigration rules (e.g. immigration criteria, rules of procedure and rights of immigrants). It is also emphasised that every Member State will retain the right to decide on the number of immigrants allowed to the country.

In January 2005, the European Commission drafted a Green Paper on the European Union's approach to economic migration and a respective policy plan until 2009 for the development of a single EU legal migration policy. The plan outlines four action lines:

1) legal framework – elaboration of a framework directive and four individual directives on labour immigration;
2) exchange of information on migration among the Member States;
3) policy measures and financial resources for the integration of economic migrants and their families into the receiving society;
4) measures for a more effective management of migration flows in cooperation with countries of origin.[10]

[8] See the Presidency Conclusions of the Tampere Summit, http://www.europarl.europa.eu/summits/tam_en.htm#union.
[9] Communication from the Commission to the Council and the European Parliament on a Community immigration policy, COM(2000) 757 final", November 22, 2000.
[10] Commission Communication of December 21, 2005 on the policy plan on legal immigration (COM(2005) 669 final).

LEGAL FRAMEWORK

The goal of the framework directive is to ensure common rights to everyone who has arrived to the European Union for employment purposes. This directive also aims to simplify procedures and create a framework for granting residential and working permits with a single procedure and as a single document.

The abovementioned four individual directives concern the following areas: the reception and housing conditions of highly qualified workers; the reception and housing conditions of seasonal workers; the reception, stay and housing of workers sent within companies, and the reception and housing of paid trainees. The two latter groups are not very significant for the Estonian labour market and these drafts are still in preparation. The first two directives, however, undoubtedly have a broader impact on us. The labour markets of many Member States suffer from a lack of qualified workers and several countries (mainly in Southern Europe) have a strong need for seasonal workers.

Until today, the most effort has been put into the directive concerning highly qualified workers. The Commission's draft draws on the need for highly qualified workers all over the EU and thus, the regulation has been devised so as to attract the necessary people. The residential and working permits granted to highly qualified workers are called the blue cards and their owners are entitled to more favourable conditions than those with ordinary residential and work permits with respect to movement within the Member States, but also in other aspects.[11]

While generally the Member States have reached a consensus that the immigration of highly qualified workers should be fostered (Estonia's recent immigration policy also focuses on highly qualified workers), the source of discord is the definition of qualified workerThere is no single international definition yet. For instance, the OECD has recommended to use the definition agreed upon in the Canberra Manual[12] concerning workers in the science and technology sector: these are workers who have a third level education (higher education) in technology or natural sciences and/or who have worked on a position requiring such education, even if they lack the formal education.[13]

The European Union's draft directive on highly qualified workers draws on job requirements. Highly qualified workers are specified according to the jobs they come to perform to the

[11] See Commission Proposal of October 23, 2007 for a Council Directive on conditions of entry and residence of third-country nationals for the purposes of highly qualified employment (COM(2007) 637 final).
[12] A manual published by the OECD in 1995 on the calculation and analysis of human resources in the technology and science sector. The mentioned definition was formulated primarily in the context of collecting statistical data, rather than for policy plans.
[13] OECD (2002, p 2).

Member States. This has to be a position that requires higher education or equal professional experience[14] (thus, it is essentially similar to the abovementioned OECD approach). It is obvious that such a definition raises a number of practical concerns starting from the specification of job requirements (should they be determined only by employers or also by some state authorities?) to the evaluation of a person's education and work experience. While to a certain extent the recognition of higher education is also internationally regulated and thus more easily performed, the grounds for acknowledging work experience as sufficient are more ambiguous and might make the scheme even more complicated, even though its aim is to simplify the procedures. So far, no consensus has been reached in these and several other issues among the Member States.

In addition to the planned directives on migrant workers, attention should be paid to the circular migration schemes currently underway in cooperation with third countries[15].The concept of circular migration is based on the presumption that temporary employment in another country may be beneficial to employees as well as countries of destination and origin. Thus, efforts have been made to make the scheme more flexible and allow some back and forth movement between countries of origin and destination. This would help to preserve human contacts, the likelihood of returning would increase and an excess brain drain from third countries would be prevented. According to the initial plan, the opportunities of circular migration will be tested with contracts between countries (i.e. between an EU Member State and a third country) and not as a general legal framework. As mentioned above, temporary migrant worker schemes have been considered also in the past and the consequences have been considerably more complex than expected. Therefore, earlier experiences should definitely be taken into account in the development of new schemes.

RELATED ISSUES

As migration is a complex phenomenon and its impact on the society may be very diverse, migration policies should not be limited only to the regulation of immigration conditions and the number of immigrants but deal with other related issues too.

In order to avoid the formation of separate groups and tensions between them, attention should be paid to measures of integration. One reason why the migrant workers, who arrived in the middle of the last century and remained in Europe, and their descendants usually have a weaker social economic position than the original population is that insufficient attention is

[14] See Commission Proposal of October 23, 2007 for a Council Directive on conditions of entry and residence of third-country nationals for the purposes of highly qualified employment (COM(2007) 637 final).
[15] See Commission Communication of May 16, 2007 on circular migration and mobility partnership between the European Union and third countries (COM(2007) 248 final).

paid to their inclusion in the society. Moreover, also short-term migrant workers need information and support to cope in a new environment and understand their rights and obligations as well as any other matters. For long-term immigrants such measures are especially important. Naturally, integration measures are equally important for those immigrants who have arrived for other purposes (e.g. as family members or asylum seekers), in order to make use of their capabilities in the labour market, possibly reducing the need to find workers abroad.

Experience has shown that people working away from their homeland are more easily exploited and vulnerable to abuse, which is why international organisations, such as the UN and the International Labour Organisation (ILO), have adopted standards for the protection of migrant workers. The key principle of these standards is that migrant workers should be treated equally with local workers. This entails a need to inspect work conditions.

In parallel with facilitating immigration, illegal immigration (incl. human trafficking) must be combated. The EU is developing a directive on punishment of employers hiring illegal immigrants, in order to avoid illegal employment more efficiently. Discussions concerning potential sanctions have, inter alia, touched upon criminal punishments. In order to prevent human trafficking, effective information exchange among the Member States is necessary.

Cooperation with third countries (countries of origin) and ethical considerations are yet separate issues. Martin et al.[16] have described several types of measures for reducing the persistence and aggravation of inequality resulting from migration. For instance, countries of origin may maintain contact with people who have gone to work abroad; destination countries may compensate for lost human capital to countries of origin (e.g. through a coefficient of the number of migrant workers and their incomes or in the form of general development assistance). Yet another option is to support the educational system of countries of origin. So far, related discussions have primarily remained declarative, but the planned circular migration contracts might enable to realise those ideas in the future.

Finding a balance among all these issues is, undoubtedly, a difficult task and thus, shaping the modern migration policy is a serious challenge.

RECENT DEVELOPMENTS IN ESTONIA

Over the recent years, migrant workers has been a constant issue of public concern. The reason lies in the demographic pressures on the labour market (see Figure 1), which has been boosted by recent strong economic growth as well as the emigration of Estonian workers. It is a fact that Estonia is currently a labour donor in the European Union. Whether or

[16] Martin, et al. (2006, p 123).

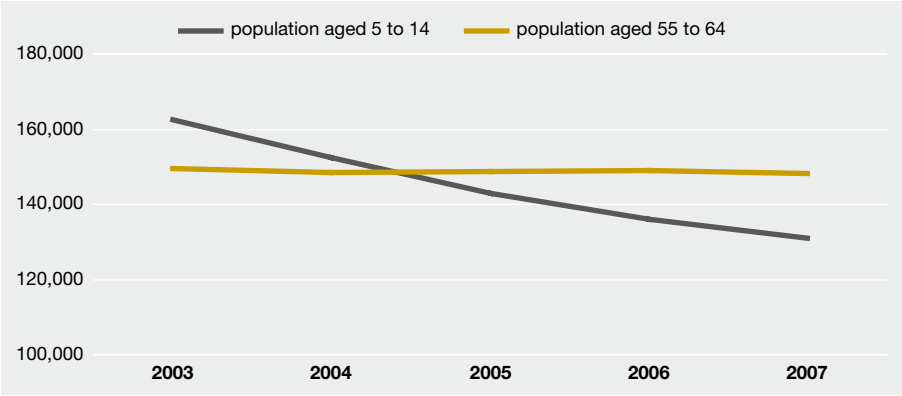

Figure 1. Demographic labour market pressures

when this might change, remains to be seen. Moreover, also the impact of the accession of new countries to the EU is unclear.

Another issue is the qualification of the existing workforce; more precisely, to what extent it meets the needs of the economy. The problem is the most acute for manufacturing companies, because their labour shortage is the greatest. Fuelled by contradictory emotions, the media has compared migrant workers to barbarians and Trojan horses[17]. Heated media discussions and common values, which probably have their roots in the history, tend to favour a cautious migration policy so far.

A discussion concerning foreign labour was started at the end of 2006 by the Ministry of Economic Affairs and Communications. A working group was composed of the representatives of relevant state authorities and social partners. The principles laid down in the amendment to the Aliens Act, approved by the Riigikogu in spring 2008, served as an output of that working group. Owing to this, the politically sensitive topic has not much triggered much animosity in the society, but this probably has also other reasons besides the policy consensus.

First, the number of immigrants continues to be modest; although having doubled[18], it has still remained only at about 1,300 people per year. Second, employers are now obliged to pay foreigners about 25% higher wages than the Estonian average, which is expected to

[17] See e.g. Eerik-Niiles Kross in Eesti Päevaleht or Kersti Kaljulaid in Postimees (http://www.epl.ee/artikkel/359162 and http://www.hip.ee/290107/esileht/ak/238968.php, respectively; only in Estonian).
[18] Pursuant to the amended Aliens Act stepping into force on June 14 this year, the limit of immigration will be raised from 0.05% to 0.1% of the population per year. The opportunity to immigrate to Estonia with the permission of the Minister of Internal Affairs outside the limit will be abolished.

prevent the possible inflow of cheap workforce. Understandably, Estonian residents are not very happy about higher wages of foreigners, but this is not a very common attitude. Thus, one day we might paradoxically find ourselves in a situation where local workers have to do all the dirty work. In order to avoid social problems, sufficient incomes (and not government support mechanisms) are considered the key factors for foreigners. This approach generally corresponds to the Estonian welfare model: the state primarily puts emphasis on well-paid jobs, whereas social assistance remains secondary.

In the forthcoming years, we will have to fill tens of thousands of vacancies for skilled workers and specialists in the Estonian economy (see Figure 2). According to the wage criterion, it would be proper to invite skilled workers and specialists to Estonia, but due to the set limit foreigners could ease only a small part of the labour shortage.

In addition, some positions will have to be filled by local workers in any case due to language skill requirements, for example in the services sector. While according to the forecast of the Ministry of Economic Affairs and Communications approximately 16,000 vacant positions have to be filled per year, foreign workers may comprise only a tenth of that. Regardless of whether migration is widespread or not, the success of a labour migration policy can only lie in temporary use of foreign labour. In the long term, there are no good alternatives to an increase in births and improvement of skills and knowledge. In this respect, Estonia has to learn from other European countries that have greater experience in importing workforce, so as to avoid their mistakes. The practice of extending work permits is yet to be developed, but this will become a key point concerning migration. Fortunately, the following logic applies to migrants in the case of Estonia: people are willing to come to Estonia from countries with poorer living standards and thus they have every reason to spend the income they earn

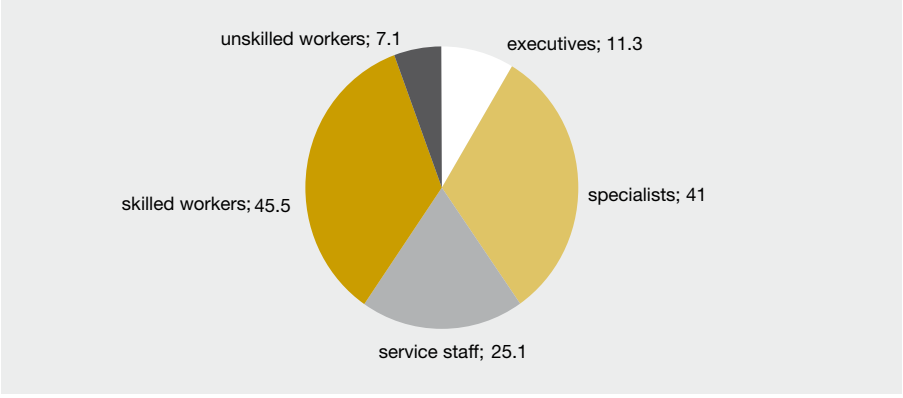

Figure 2. Labour needs until 2014 (thousand)

here in their homeland where its purchase power is higher. The same naturally applies to Estonians working abroad. Ideally, foreign labour would mean, among other things, more tax revenues and less social assistance provided for the taxes paid.

CONCLUSION

There is plenty of international experience regarding the use of foreign labour. Some of it is timeless: for instance, the pragmatic behaviour of workers and employers has to be taken into account which, however, might not be in line with the interests of the state. Today, we can say with certainty that the mistake of importing cheap labour will not be repeated in Estonia. Among other things, the forthcoming years have to show whether the idea of foreign labour as a temporary solution will come true. It is not entirely impossible that the wage restriction scheme applied in Estonia could be applied all over Europe: our laws, although not unique, could become an example to others. The shortage of qualified labour is, in any case, a problem for all the EU Member States and the migration of labour includes a number of issues reaching beyond the labour market.

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THE FIRST YEAR OF THE EURO: A REVIEW OF SLOVENIA'S ECONOMIC PERFORMANCE[1]

Velimir Bole

FOREWORD

By entering the EU and ERM II in 2004, Slovenian economic performance crucial for adopting the euro was well under the control of policy makers. Actually, inflation, debt, interest rates and the deficit were already within the targeted ranges formally necessary to fulfil the Maastricht criteria.[2] Therefore, controlling the variability of the exchange rate within the predetermined bands was the only ability of policy makers (and the economy) which had to also be tested when Slovenia was in the ERM II.

During the process of adopting the euro, the most visible changes had already taken place in the preparatory-ERM II phase.

Entering the ERM II caused three important changes in the financial intermediation sector. Because the exchange rate was no longer used to close the uncovered interest parity, tolar interest rates started to converge (fall) towards foreign interest rates (adjusted for the risk premium) on otherwise equal instruments. That triggered a significant acceleration of credit and a curbing of deposits as households and non-financial corporations started to restructure their portfolios and activities. As a consequence, this considerably increased net portfolio outflows and the current account deficit; the gap was closed (financed) by a huge increase in net bank borrowing abroad.

In the real sector, two changes during the ERM II period are worth mentioning; the acceleration of economic activity and the reformation of the tax system. Economic activity was driven by export demand (growth of the EU and global economies) and domestic investments, with an important contribution made by government investments (particularly road construction). The reformation of the tax system resulted in a significant reduction in revenues from income and payroll taxes, and in a corresponding tax incentive for the household and business sectors. There was no visible deterioration in the trajectory of variables important for the Maastricht criteria during the ERM II period.

After adopting the euro, fiscal policy would also have to become 'responsible' for the stability of the economy. Therefore, its targets and implementation would have to be changed before entering the euro area, especially because of unfavorable initial fiscal conditions.[3] Nevertheless, no special measures were adopted to adjust fiscal policy to the new task. The only change in fiscal policy was the abovementioned tax cutting reform.

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[1] An updated and shortened version of the paper was presented in the January 2008 issue of Gospodarska Gibanja (in Slovene).

[2] For example, see Bole and Mramor (2006).

[3] See Bole (2006).

In January 2007, Slovenia entered the euro area. In the paper, an overview of the economic performance of the most important segments of the Slovenian economy is given for the first year of euro. Special attention is devoted to the possible effects (where visible) of the introduction of the euro.

1. ECONOMIC ACTIVITY AND STRUCTURE OF DEMAND

GDP growth. A strong additional domestic demand impetus increased economic activity further in 2007 from an already high rate of growth in 2006. Figure 1 illustrates the year-over-year rates for Slovenia, the euro area and the EU.

It is evident that growth has accelerated practically unhindered since the middle of 2005. Economic activity also increased relative to the euro area and EU. Given such a relative increase in economic growth as that seen in 2007, per capita GDP in Slovenia (in terms of purchasing power) will catch up with the EU average in less than three years, and with the euro area average in just over six years.

Structure of final demand growth. While economic activity was very high in both 2006 and 2007, the structure of the demand growth driving the growth was very different. In 2006 the structure of demand growth in Slovenia was similar to that in the euro area, but in 2007 it was sharply at variance with it.

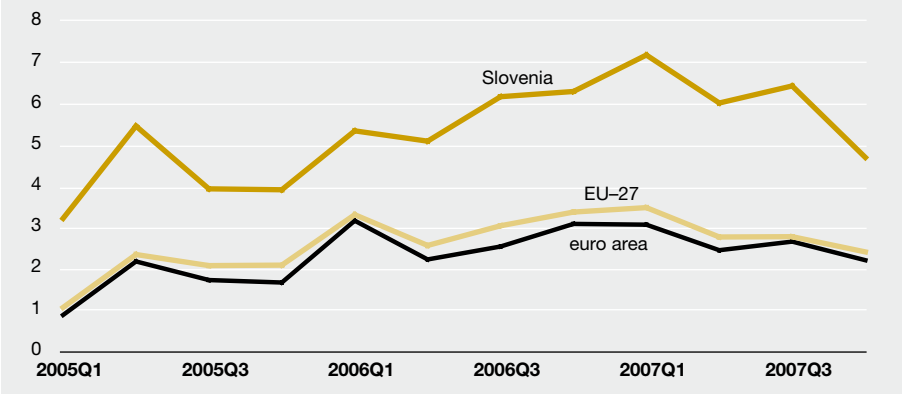


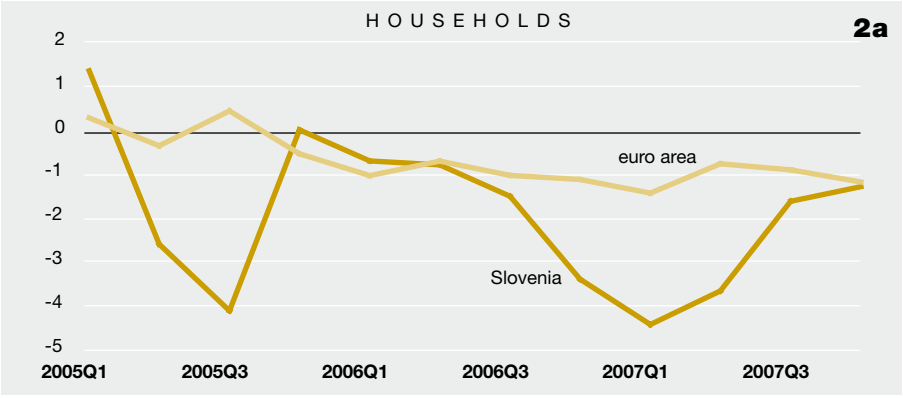
Figure 1. Economic activity (GDP)

Note: yearly rates of growth
Source: Eurostat; own calculations

Figure 2 shows the relative year-over-year real growth in the components of final demand (relative to GDP growth) for Slovenia and the euro area.

Real export demand grew much faster than GDP in both years, but only took the leading role in 2006. Investment spending, which in 2006 grew at the same pace as GDP, accelerated very sharply in 2007, and began systematically outpacing GDP by more than 10 percentage points on an annual basis. Government measures gave an important contribution to the acceleration of investment spending.

Growth in both real household spending and government current spending (on goods and services) trailed GDP growth in 2006, but the gap widened in 2007. Over the year, the gap was 2.8 percentage points on an annual basis for household spending and 4.4 percentage points for current government spending. Growth in current government spending picked up



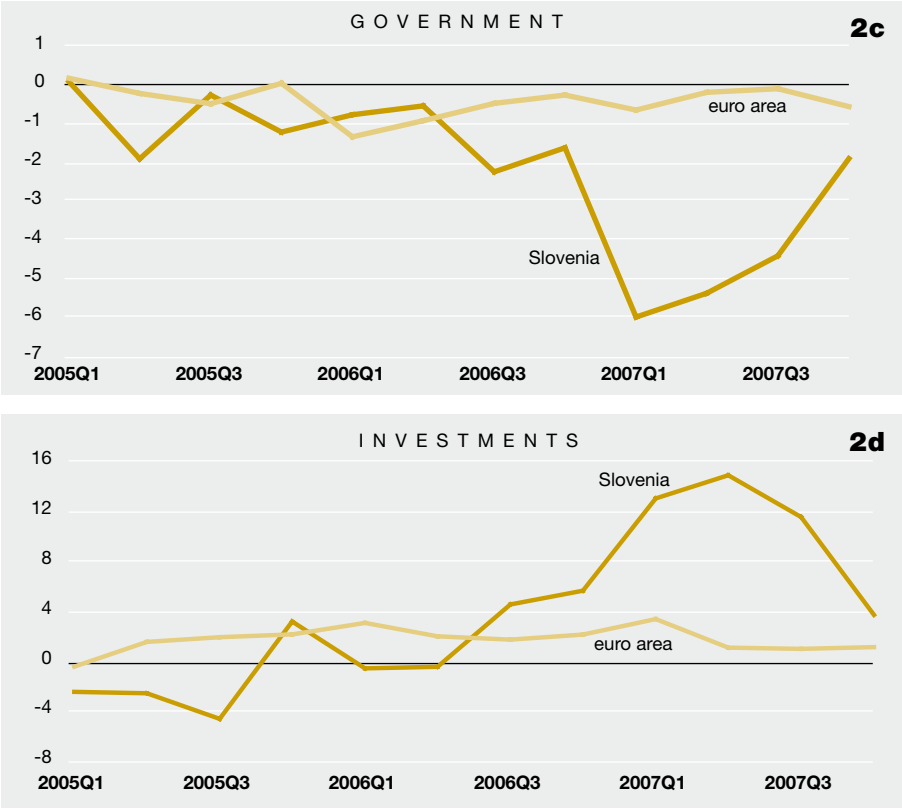


Figure 2. Structure of demand dynamics

Note: rates of growth relative to GDP growth rates
Source: Eurostat; own calculations

notably in the second half of the year, but the gap by which it was outpaced by GDP growth remained large.

As a result of the rapid acceleration in investment in Slovenia, there was a sharp change in the structure of generating economic growth in 2007 in comparison with the euro area. In both the euro area and Slovenia export demand pulled economic activity, but less so than in 2006. The components of domestic demand acted as a brake on GDP growth in the euro area and Slovenia. Therefore, the modest relative growth in investment spending in the euro area (approximately 1.6 percentage points annually) and very large relative growth in

Slovenia (almost 11 percentage points annually) was the key difference between the two in the nature of generating economic growth.

Sectoral growth. The major change in the structure of demand in 2007 naturally brought a significant change in growth in the different sectors of the economy. The changed structure of sectoral growth is illustrated in Table 1, which shows the real growth in value-added in 2005–2007.

It is evident that the rapid (absolute and relative) acceleration in investment spending, which began in the third quarter of 2006, further increased the already very rapid growth in value-added in the construction sector, so that it grew at an annual rate of almost 19% in 2007. The change in the structure of final demand also gave notable impetus to the trade sector and financial intermediation; in both, the rates of growth in 2007 were up almost one-quarter on 2006. In other sectors average growth in 2007 was equal to or less than that in 2006.

Table 1. Value added by activities

	2005	2006	2007
Agriculture, hunting and forestry	-4.4	-3.8	-3.7
Fishing	20.4	1.5	-4.6
Mining and quarrying	0.4	7.5	-0.2
Manufacturing	3.6	8.5	8.3
Electricity, gas and water supply	5.7	5.7	3.5
Construction	4.9	15.2	18.7
Wholesale and retail trade, repair	4.5	6.1	7.6
Hotels and restaurants	1.2	2.9	2.4
Transport, storage and communication	6.1	9.4	6.2
Financial intermediation	10.5	9.8	12.1
Real estate, renting and business activities	3.5	3.7	3.7

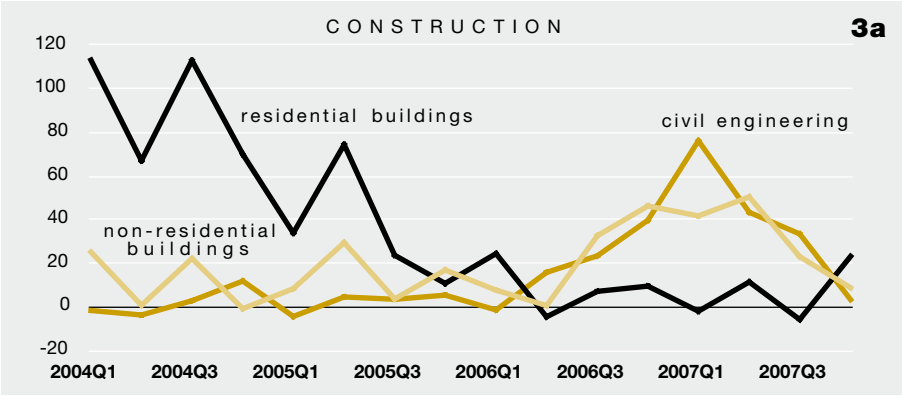
Source: SURS (Statistical Office of the Republic of Slovenia); own calculations
Note: real growth rates

Transmission mechanism of final demand impetus (purchasing power flows). The question is raised about the transmission mechanism via which the changed final demand gave rise to the significant changes in the relative sectoral activities and consequent sectoral differences in price pressures. The most basic changes in purchasing power flows are illustrated in Figure 3, which shows the dynamic of turnover in the construction and trade sectors. Financial intermediation activity (particularly banking intermediation) is illustrated in a separate chapter.

The purchasing power flows (turnover) in construction are shown separately for the following categories: housing, non-residential buildings and civil engineering projects. The turnover in the trade sector is shown for six sub-categories: trade in food, beverages and tobacco; trade in cosmetics and pharmaceutical goods; trade in motor vehicles; the repair and maintenance of motor vehicles; trade in household equipment and building materials; and trade in clothing and footwear.

The dynamic in turnover in the construction sector indicates that demand began to accelerate after the first half of 2006 and peaked in the first quarter of 2007. A leading role was clearly played by the fuelling of the construction of non-residential buildings, and civil engineering projects in particular (a considerable increase in activity in building roads). In the period between the second quarter of 2006 and the third quarter of 2007, year-over-year growth in purchasing power flows into civil engineering projects constantly exceeded 20%, and averaged over 40% annually. Because civil engineering projects represent about half of all construction work, they alone brought about at least 19 percentage points to a 30% average growth in total construction turnover in the period 2006/III-2007/IV.

As illustrated by Figure 3a, the dynamic in purchasing power flows into the construction of non-residential buildings differed little from that of the turnover of civil engineering projects in terms of the timing of the acceleration and its intensity. Therefore, it only further strengthened the extremely high growth in nominal turnover in construction already generated by civil engineering projects in the period after the third quarter of 2006. It is evident that in 2007 investments initiated by the government contributed the lion's share of the rapid acceleration in construction work, as the increase in activity of Dars[4] (by 0.53 percentage points of GDP)



[4] Motorway company of the Republic of Slovenia. It is not included in the general government balance.

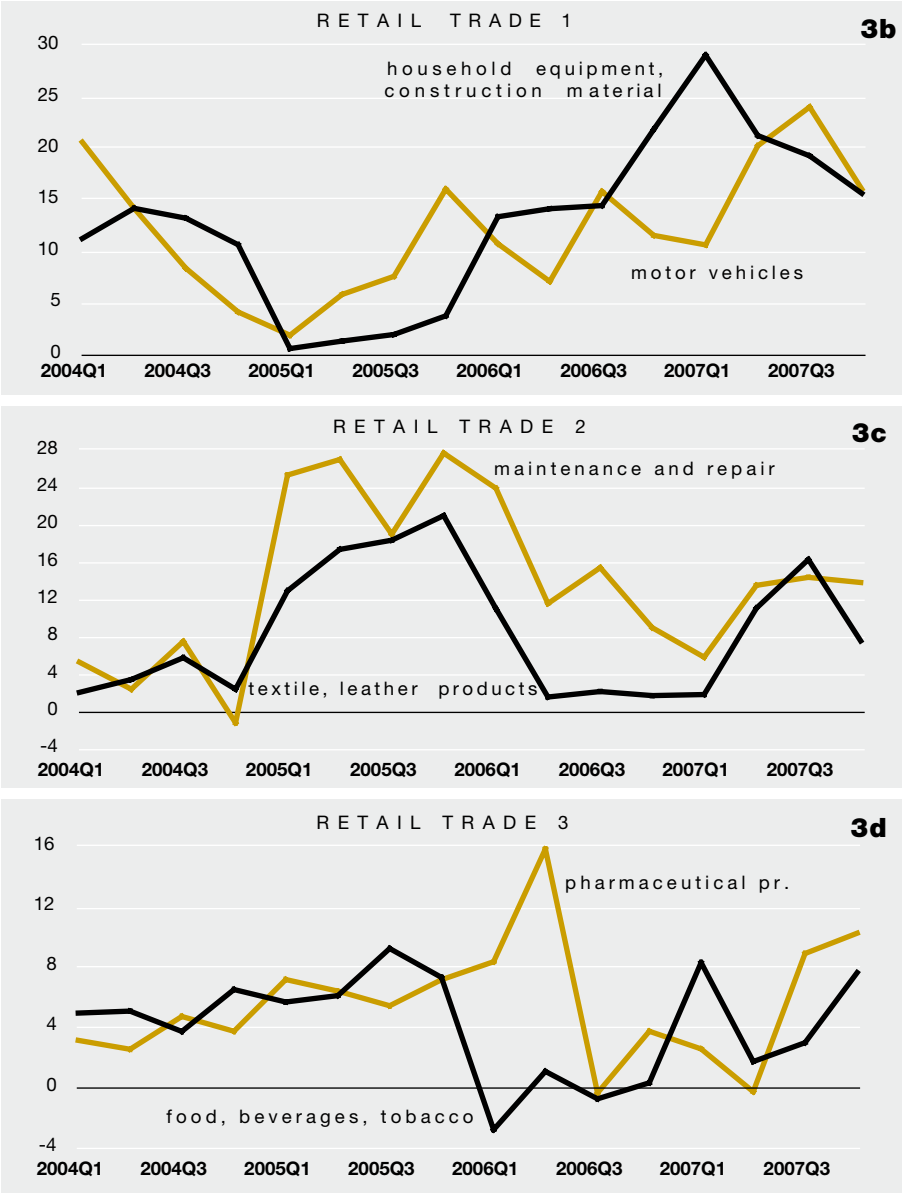


Figure 3. Pruchasing power flows in construction and retail trade

Source: SURS (Statistical Office of the Republic of Slovenia); own calculations
Note: yearly rates of growth

together with the increase in investment expenditure (including investment transfers) by the government (by 0.35 percentage points of GDP) accounted for around 40% of the total increase in construction sector turnover (by 2.3 percentage points of GDP).[5]

Figure 3a does not confirm that the rapid growth in housing loans, which continued after the first quarter of 2006, would significantly contribute to an expansion in construction as year-over-year growth in nominal turnover in residential building has fluctuated significantly below 10%. Further evidence of the slowdown in the residential building construction market comes from the graph of housing prices in Figure 4. It is not entirely clear which transactions and activities the large growth in housing loans actually fuelled during this period.

The other three graphs in Figure 3 show purchasing power flows into the trade sector, which also recorded a large increase in economic activity in 2007. As stated previously, the dynamic in turnover is illustrated for six sub-categories of trade. The dynamic in the demand for trade services varied greatly between the individual sub-categories. The major restructuring in final consumption in 2007 primarily brought impetus to the sale of building materials and household equipment, but also to the trade in motor vehicles. The dynamic in the turnover of the trade in building materials and household equipment peaked in the first quarter of 2007, when the year-over-year rate stood at over 28%. A comparison of the graphs for the construction sectors and the graph for trade in household essentials indicates that the high growth in housing loans in 2007 could fuel completion projects and the equipping of housing.

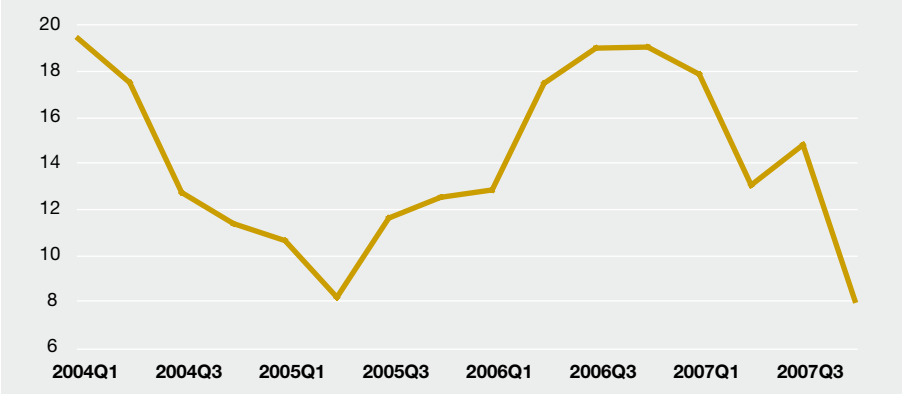


Figure 4. Prices of flats
Source: www.slonep.net; own calculations
Note: yearly growth rates

[5] See DARS, Ministry of Finance Bulletin and SURS (Statistical Office of the Republic of Slovenia).

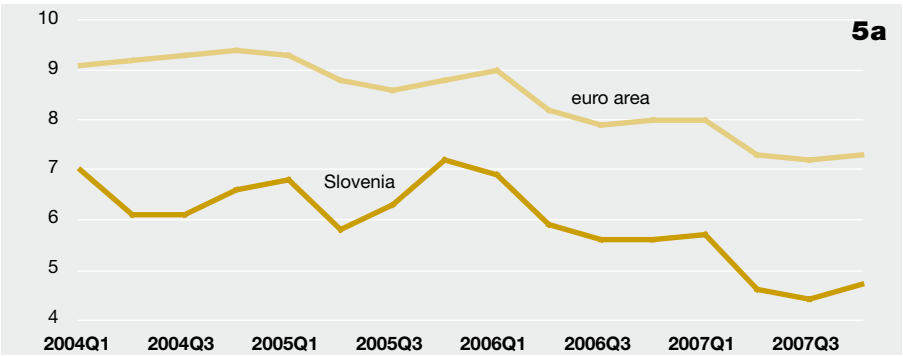
Purchasing power flows into trade in clothing and footwear and into the repair and maintenance of motor vehicles peaked in 2005 (after Slovenia joined the EU), and growth picked up only slightly in 2007 (to approximately 15% on an annual basis) from 2006.

The slowest purchasing power flows in 2007 were recorded in the trade sectors of cosmetics and pharmaceutical goods, as well as food, beverages and tobacco. Given the significant increase in year-over-year growth in prices of food (after the first quarter of 2007), turnover in the trade of food, beverages and tobacco grew very slowly; on average it increased (by 5%) significantly less than prices in the corresponding category of the cost of living; i.e., food and beverages (by 7.5%). These figures do not indicate the significant exercise of market power by companies in the production and/or distribution of food products. Besides, the highest year-over-year growth rate was attained in the first quarter (8%), when the external food price shock could not yet be felt. It was the result of the low basis of comparison; namely, the low turnover in the first quarter of 2006, as shown in Figure 3.

2. Employment and labour costs

Employment. It is important to the question of an overheating economy how the rapid acceleration in economic activity in 2006 and, particularly, in 2007 affected developments in the labour market. Especially important are changes in the labour market caused by the significant restructuring of demand triggered by the government through the large growth in investment expenditure channelled primarily into construction.

Figure 5 shows unemployment in Slovenia and the euro area after 2003. It shows overall unemployment and unemployment among three groups of qualifications: primary and lower secondary (ISCED levels 1 and 2), upper secondary (ISCED levels 3 and 4), and tertiary (ISCED levels 5 and 6).[6]



[6] The ILO definition of employment and unemployment is used.

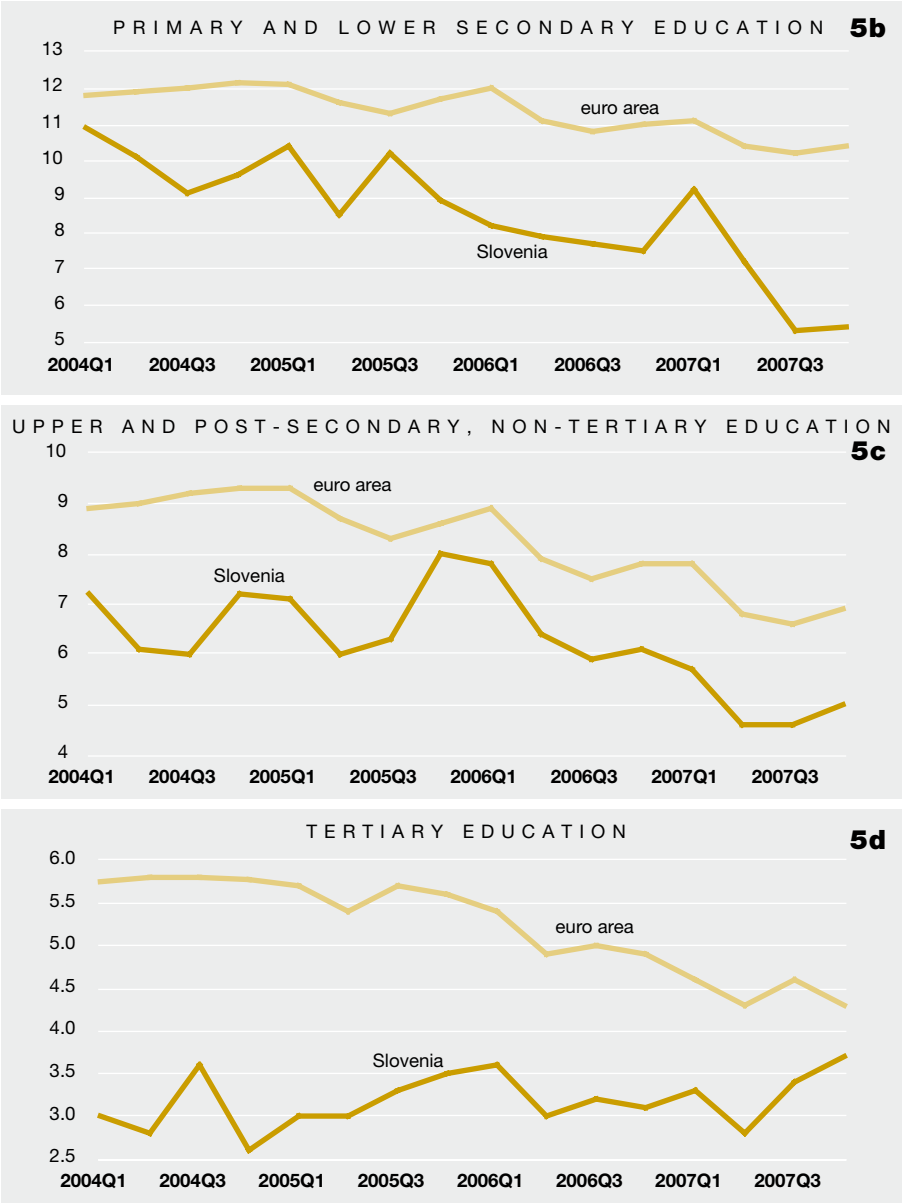


Figure 5. Unemployment

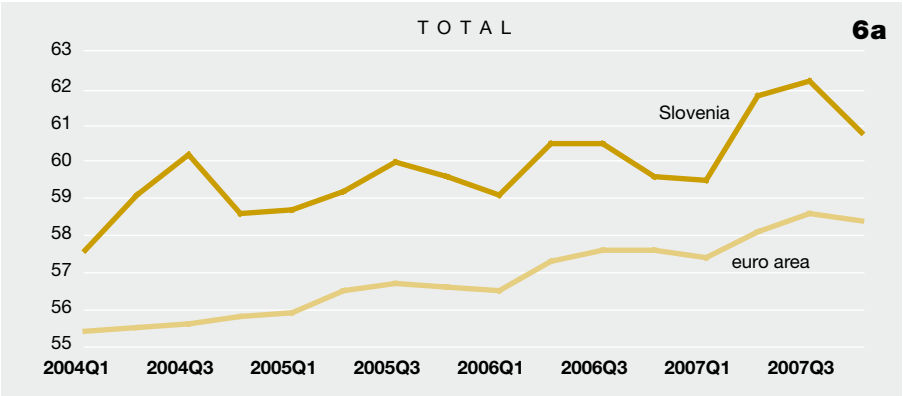
Source: Eurostat
Note: ISCED classification; in percentages of corresponding population segment

The increase in economic activity after the middle of 2006 brought about a significant reduction in unemployment in 2007, more so in Slovenia than in the euro area. In Slovenia unemployment had dropped to 4.7% by the end of 2007.

The decline in unemployment in the euro area was more equal over qualification groups than in Slovenia. In the euro area the largest fall in unemployment was recorded in the second group (upper-secondary qualifications) and the smallest in the third group (tertiary qualifications). In Slovenia only the primary- and secondary-education groups recorded a fall in unemployment in 2007; between the first quarter of 2006 and the last quarter of 2007 unemployment fell by 1 and 1.5 percentage points, respectively. In the highest qualification group, the average unemployment rate in 2007 was roughly the same as in 2005 or 2006.

Because the unemployment rate among those with tertiary qualifications was not only constant, but also very low (it was thus merely frictional), it is one of the indicators of an overheating economy. The dynamic in employment in the same qualification group and the dynamic in costs shown below similarly indicate this.

Because of the high level of economic activity (and the corresponding low unemployment rates) in 2007, the dynamic in the labour market should additionally be illustrated by the employment rate. Namely, if economic activity is high, the employment rate could be a more sensitive indicator of developments in the labour market (especially of entry into and exit from the labour market) than the unemployment rate. Figure 6 illustrates the employment rates overall and among the three qualification groups for Slovenia and the euro area. The employment rates shown are those for the population aged between 15 and 74.



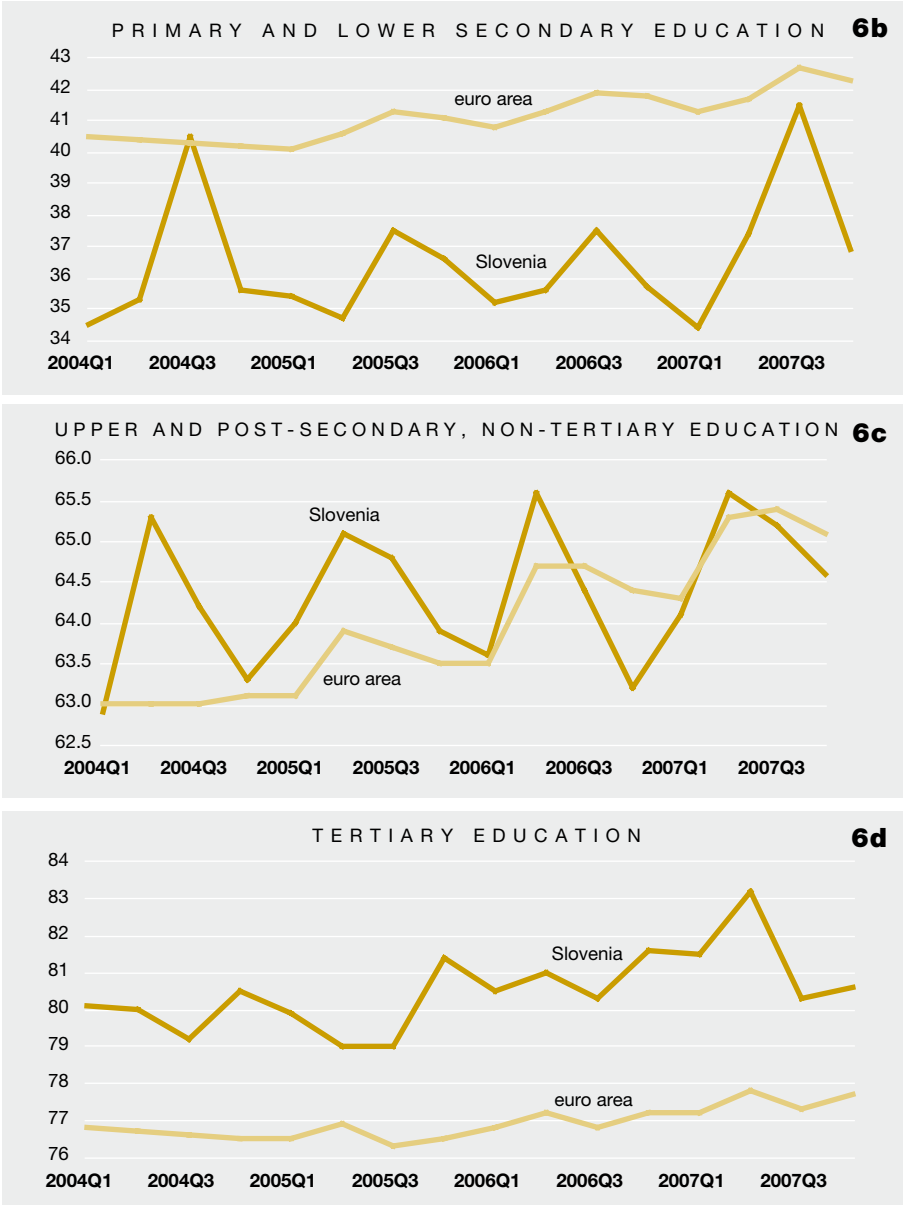


Figure 6. Rate of employment

Source: Eurostat
Note: ISCED classification; in percentages of corresponding population segments

In 2006, the overall employment rate in Slovenia was already higher than in the euro area. It increased further by approximately 1 percentage point (0.3 percentages points more than in the euro area) in 2007. However, the increase in employment was, in absolute terms and relative to the euro area, mainly the result of an increase in employment in the lowest qualification groups of primary and lower secondary (ISCED levels 1 and 2), and, at best, stagnation in employment relative to the euro area in the higher groups (ISCED levels 3 to 6). Such a change in the structure of employment comes as no surprise bearing in mind that the activity of civil engineering projects and non-residential buildings were the main sources of additional economic activity in 2007.

That the overheating of the economy increased in 2007 also indicates the amount of temporary employment in existence, which rose sharply in 2007. The proportion of those in temporary employment is shown in Figure 7.

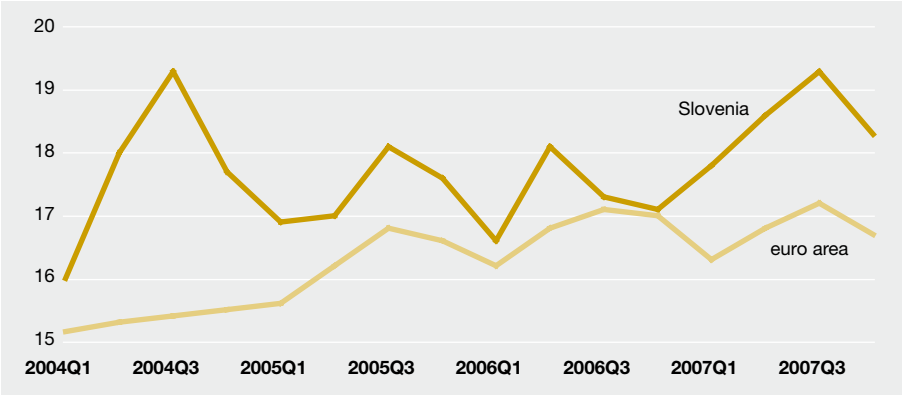


Figure 7. Temporary employed

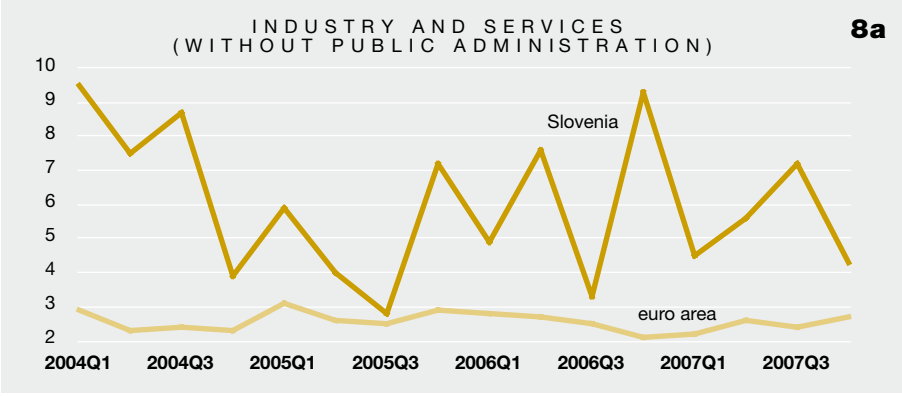
Source: Eurostat
Note: in percentages

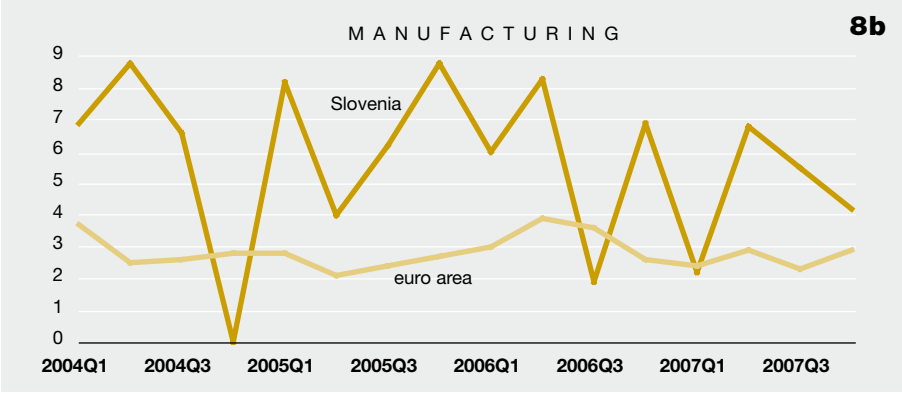
Since joining the EU, temporary employment in Slovenia has generally been higher than in the euro area by 1 to 1.5 percentage points; the average proportion of temporary employment was 17%. In 2007 there was a sharp increase in temporary employment, both in absolute terms and relative to the euro area. It was approximately 1.2 percentage points higher in 2007 than in 2006, and the gap between Slovenia and the euro area increased by the same amount. Practically all the increase in temporary employment came from the groups with primary- and lower-secondary qualifications.

It should be noted that the high proportion of temporary employment (considerably higher than in the euro area) and the speed of the increase in temporary employment probably do not support the idea of significant inflexibility of the labour market in Slovenia, and certainly not in the lower-qualification segment.

Labour costs. For a small economy in the euro area, the gap between the growth of labour costs and the growth of productivity (both relative to the euro area) is a key indicator of the dynamic in competitiveness. In the short run, even only a dynamic of relative labour costs is enough to detect a deterioration in competitiveness, because faster economic growth (a tighter labour market) can cause an acceleration of relative labour costs.

Figure 8 shows the dynamic in overall (hourly) labour costs and, separately, the dynamic in labour costs in manufacturing, construction and market services. The year-over-year growth rates for Slovenia and the euro area are given.





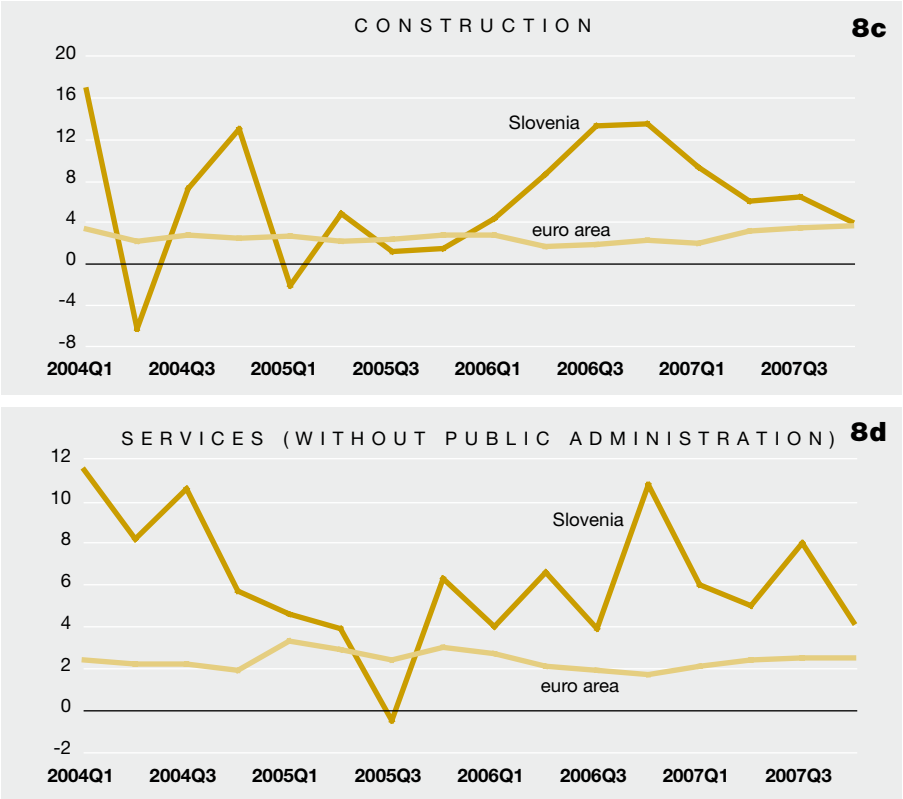


Figure 8. Labour costs

Source: Eurostat; own calculations
Note: yearly rates of growth

The graph of total (hourly) labour costs shows that the dynamic of labour costs in Slovenia slowed in comparison with the euro area in the period before entering the EU. After the second quarter of 2005 it began to speed up again, while in the middle of 2005 the gap between Slovenia and the euro area in the growth in labour costs was just 0.5 percentage points. In 2006 and 2007, labour costs in Slovenia already outpaced those in the euro area by 4 and 3 percentage points annually, respectively.

Since Slovenia joined the EU, the dynamic in labour costs relative to the euro area has also varied greatly between sectors. The comparison of the relative dynamic in labour costs in

the services sectors with that in manufacturing is particularly interesting. After 2005, when economic activity accelerated considerably, the gap relative to the euro area has increased sharply in services and construction, but has declined in tradable sectors, as shown in Figure 8. In 2007, average hourly labour costs in manufacturing grew by just 2 percentage points more than in the euro area, while the gap was 3.5 percentage points in the construction and service sectors.

It should be added that such a sequence in the dynamic of relative labour costs between services and manufacturing is the opposite of that expected if the existence of a Balassa-Samuelson effect is assumed.

Productivity. Because of the large fluctuation in hours worked, employment alone is not suitable for calculating (the change in) productivity; an assessment of hourly productivity is necessary. However, the necessary figures for 2007 are not yet available for the entire euro area and analysed sectors. Therefore, the relative dynamic in productivity in Slovenia is shown relative to Germany for all industrial sectors except construction; i.e., for sectors C, D and E. The first two graphs in Figure 9 show the dynamic in labour costs and the dynamic in hourly productivity in all industrial sectors except construction. Productivity is calculated from an index of output and work hours.

The comparison of the dynamic in labour costs between Slovenia and Germany for the industrial sectors (Figure 9) leads to the same conclusion as the comparison of the dynamic in labour costs between Slovenia and the euro area for manufacturing. After Slovenia joined the EU, there was no deterioration in the relative dynamic in labour costs in the industrial sectors.

Figure 9a shows that productivity in Slovenia has consistently increased faster than in Germany after entering EU. The best relative increase in productivity there was recorded in 2007 by 2.2 percentage points on an annual basis, with the lowest being 0.9 percentage points in 2005.

Competitiveness. Figure 9c shows the sources of changes in competitiveness; it illustrates the difference between growth in labour costs and the difference between growth in productivity (both between Slovenia and Germany). The competitiveness of the industrial sectors in Slovenia obviously deteriorated over the entire period observed (compared with Germany), but the deterioration in the last two years (especially in 2006) was significantly less than in previous years; in 2007 the difference in growth in labour costs outpaced the difference in growth in productivity by less than 1.4 percentage points on an annual basis.

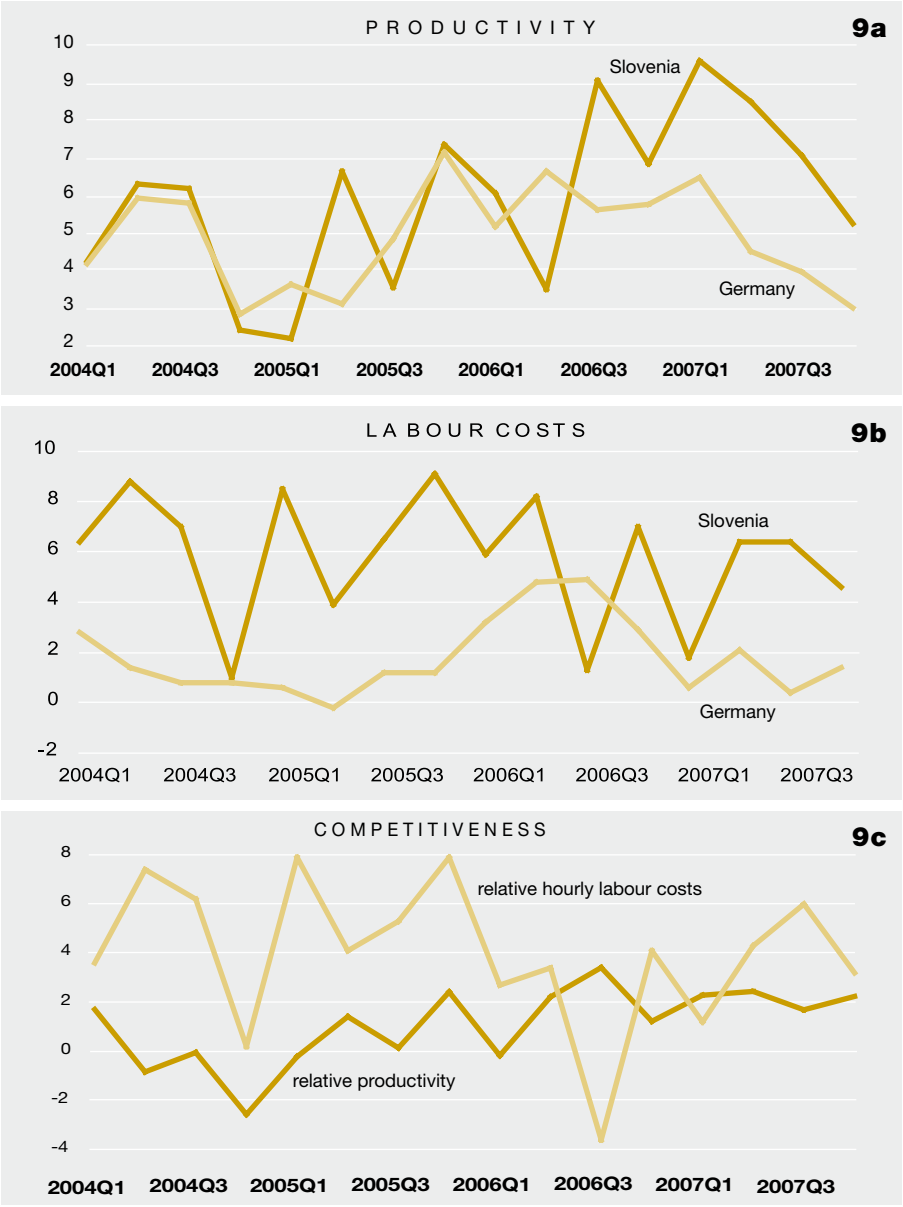


Figure 9. Competitiveness

Source: Eurostat; own calculations
Note: yearly rates of growth

As stated earlier, labour costs in services (in contrast to manufacturing) began to increase faster after the middle of 2005 relative to labour costs in the euro area. In 2006 and 2007, labour costs in service sectors grew by approximately 4 percentage points faster in Slovenia than in the euro area, but only by approximately 2.2 percentage points more in manufacturing. Even assuming the same relative increase in productivity as in the industrial sectors, the significantly faster relative growth in labour costs in the service sectors of Slovenia would have to increase the shortfall in competitiveness behind the euro area significantly more than in manufacturing.

Table 2. Productivity

	2006	2007
Total industry (excluding construction)		
Euro area	3.0	3.0
Slovenia	11.3	7.4
Construction		
Euro area	1.2	-0.8
Slovenia	17.6	14.1
Trade, repair of motor vehicles, motorcycles and household goods; hotels and restaurants; transport, storage and communication		
Euro area	0.4	0.5
Slovenia	5.3	3.6
Financial intermediation; real estate, renting and other business activities		
Euro area	-1.1	-0.5
Slovenia	1.7	0.1

Note: productivity is defined as a ratio of real value added and employment; rates of growth
Source: Eurostat; own estimates

To corroborate the conclusion about the larger decline in competitiveness in the service sectors compared with the euro area or more precisely, to corroborate the assumption that the relative growth in productivity in the service sectors was at most equal to that in the industrial sectors (except construction), in Table 2 the growth rates of approximate productivity figures are given for services, construction and industry (except construction). Because of a lack of data, approximate productivity is calculated as a ratio of real value-added and the number of people employed. Using the values in the table, it can be verified that the relative growth in productivity in Slovenia in 2006 and 2007 compared with the euro area was significantly larger in the industrial sectors than in the service sectors. Given the presented differences in the relative growth of productivity and labour costs, it can also be expected that the pressure on prices in the market services sectors has increased significantly more than in the industrial sectors since 2004.

3. Prices

Price growth. It was not only the extremely rapid economic growth that was a feature of 2007, but also a significant acceleration in inflation. Because of skyrocketing world commodity prices in the last two years, and the simultaneous high economic growth of the Slovenian economy, the question is raised of the factors of the acceleration in the cost of living, and not merely the size of the growth in prices.

Figure 10 shows year-over-year growth in the overall cost of living (headline inflation) and the dynamic in core inflation. As is customary, the basket for measuring core inflation does not include energy or seasonal food.

Figure 10. Cost of living

Source: Eurostat; own calculations
Note: yearly growth rates

Headline inflation fluctuated close to 2.5% on an annual basis between the end of 2004 and the third quarter of 2006. The gap between the inflation rates in Slovenia and the euro area did not change during this time either. Growth in the cost of living began to pick up relative to the euro area in the final quarter of 2006; the sharp increase lasted until the end of 2007. The acceleration of core inflation relative to the euro area was similar. In the final quarter of 2007, year-over-year growth in core inflation was approximately 2.5 percentage points higher than in the euro area.

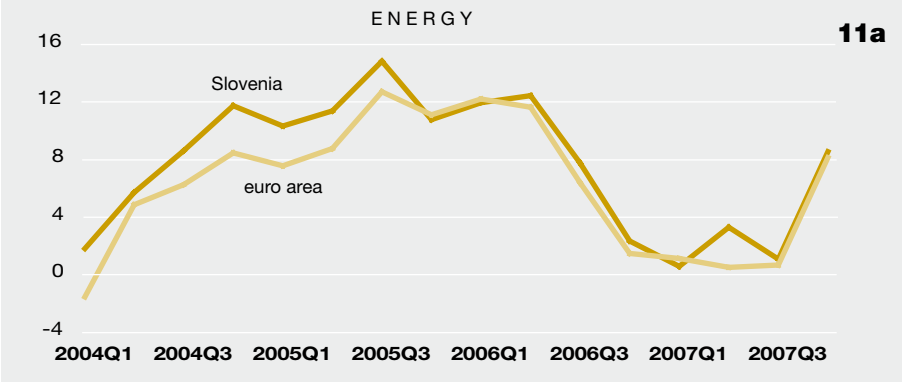
The graph also reveals that the acceleration of core inflation in Slovenia relative to the euro area has been present since the middle of 2005, when the year-over-year dynamic in core

inflation reached its lowest value (of below 1% per year). The increase in core inflation over the last two and a half years was almost uniform. Core inflation rose by 0.4 percentage points on an annual basis every quarter. Therefore, the deterioration in the (endogenous) inflation dynamic, which became evident in 2007, was nothing new. However, as a result of the opposite movements in certain other items, it was not evident in headline inflation until the beginning of 2007.

Structure of price growth. To reveal possible reasons for the longer-term increase in core inflation seen since the middle of 2005, and to identify the factors that led to a sharp increase in inflation (headline inflation in particular) after the first quarter of 2007, in Figure 11 year-over-year price growth rates for certain key subgroups of the cost of living are presented. Because some groups of products were exposed to external shocks during the observed period both in Slovenia and in the euro area, the product categories have been designed to reveal the effects of the most important external shocks (food and energy). Therefore, a deviation from the dynamic in the euro area, heuristically speaking, indicates the possible presence of endogenous causes of increased (decreased) inflation in prices in the corresponding category (neglecting, of course, all indirect effects). The dynamic in the prices of services, food, energy and goods other than food and energy is shown. All the graphs show the yearly growth rates of prices for Slovenia and the euro area.

The dynamic in energy prices in Slovenia has been very similar to that in the euro area since the middle of 2005. Only in the middle of 2007 did the corresponding dynamic in Slovenia increase briefly, probably as a result of the regulated rises in electricity prices. Year-over-year growth at the end of 2007 was again practically the same as that in the euro area.

The prices of goods other than energy and food generally grew more slowly in Slovenia than in the euro area after 2004. In the second half of 2006, the gap began to narrow, and after



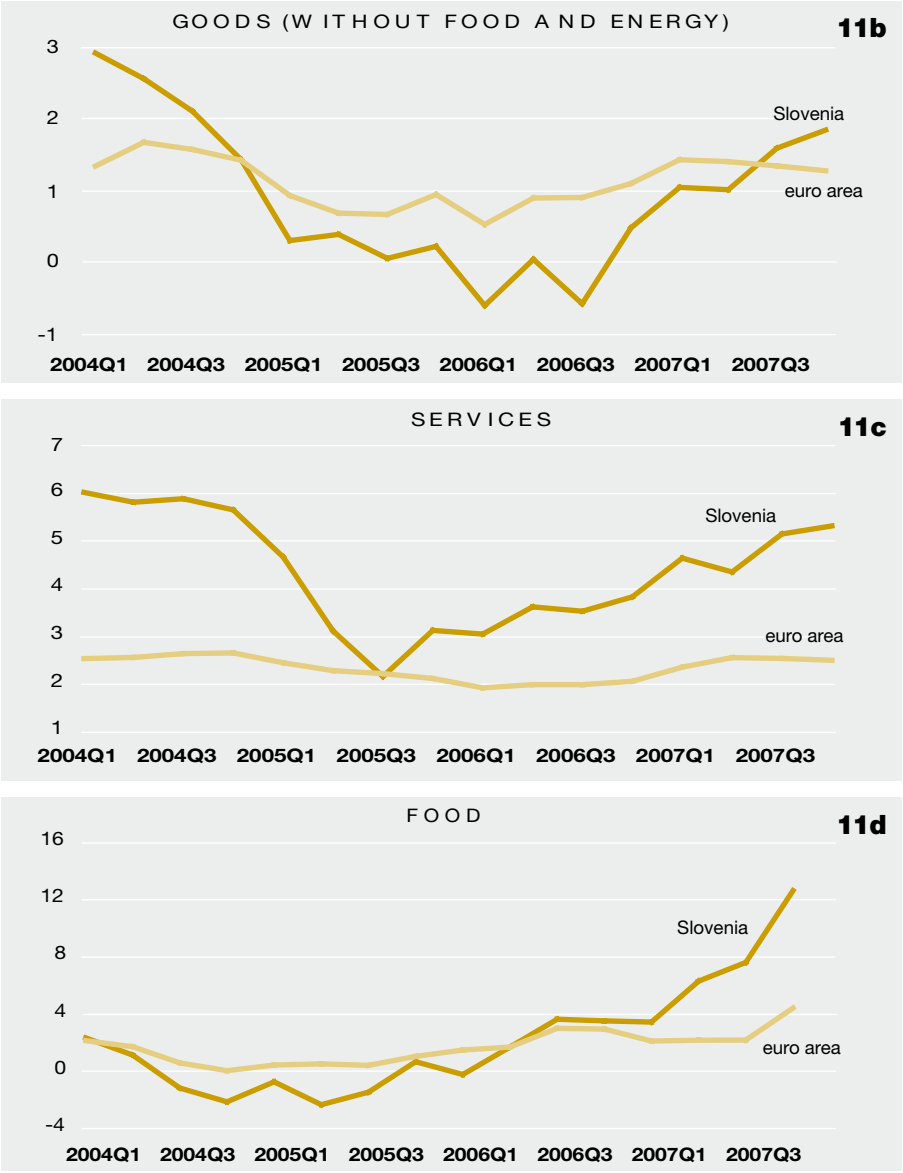


Figure 11. Structure of cost of living dynamics

Source: Eurostat; own calculations
Note: yearly growth rates

the first quarter of 2007, the growth in prices of goods other than energy and food in Slovenia began to outpace the growth in the corresponding prices in the euro area; in the final quarter the gap was approximately 0.5 percentage points higher on an annual basis.

Figure 11c shows year-over-year growth in the price of services. Since 2005 the growth in the price of services in Slovenia has systematically outpaced that in the euro area. The gap between yearly growth rates had reached approximately 2.8 percentage points on an annual basis by the end of 2007. The timing of the acceleration in the price of services matches the timing of the acceleration in core inflation, the timing of the acceleration in labour costs in the service sectors, and the timing of the acceleration in economic activity (all relative to the euro area). It is worth comparing the graphs of core inflation in Figure 10, the graph of services prices in Figure 11c and the graph of labour costs in the service sectors in Figure 8d.

The graph of growth in food prices shows that for a while food prices grew nearly at the same rate as in the euro area until the beginning of 2007, but afterwards began to pick up pace, recording a particularly sharp growth spurt in the last two quarters of 2007. Food prices in the euro area only began to pick up at the beginning of the final quarter of last year.

Structure of price acceleration (comparison with the euro area). The product categories shown have different weights in the cost of living basket, and it is therefore necessary to take the structure of the basket into account to properly assess their contribution to the gap between headline inflation in Slovenia and in the euro area. Figure 12 shows the size of the contributions made to the year-over-year dynamic in the cost of living relative to the euro area by individual product categories. In other words, Figure 12 shows how much each product category contributes to the gap between growth rates in the cost of living in Slovenia and that in the euro area.

The first graph in Figure 12 shows that the entire deterioration in the relative dynamic in prices in Slovenia relative to the euro area was caused by two product categories: food and services. While the contribution made by services rose from approximately 0.5 percentage points (on average in 2006) to approximately 0.8 percentage points (on average in 2007), the contribution made by food prices rose from practically zero in 2006 to 0.6 percentage points on average in 2007. In the final quarter the contribution made by food and services to the relative deterioration in the cost of living in Slovenia compared with the euro area was the same, at approximately 1 percentage point each.

The prices of energy and goods other than energy and food had a negligible effect on the increase in inflation in Slovenia on average in 2007, relative to the euro area.

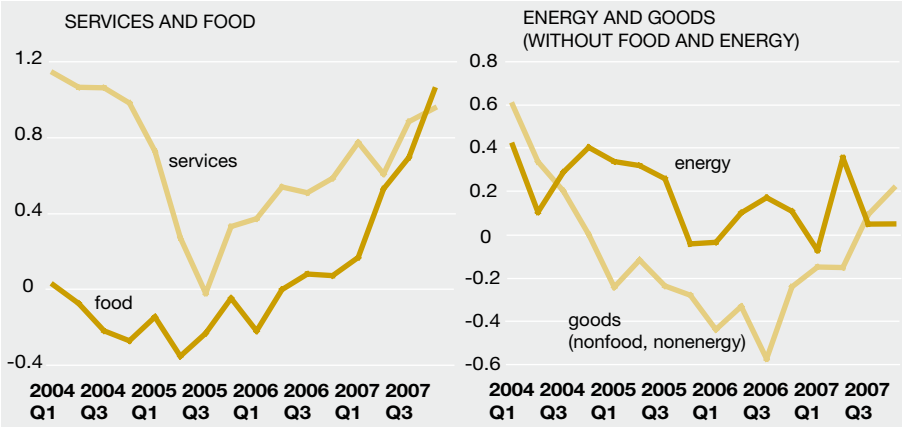


Figure 12. Price dynamics in Slovenia relative to euro area

Source: Eurostat; own calculations
Note: yearly growth rates

The empirical evidence presented documents that the increase in relative growth in the price of services, particularly in 2007, was most probably caused primarily by the faster growth in labour costs as very rapid economic growth in 2006 and even more so in 2007 increased the tightness of the labour market, and this was facilitated by the relatively less-competitive market structure in the service sectors.[7]

The increase in relative food prices is examined in more detail below.

Mechanism of the relative increase in food prices. There was a significant increase in the global prices of food commodities in late 2006 and in 2007. The scale and timing of the shock is illustrated in Figure 13, which gives the year-over-year rates of growth in global commodities prices (in the euro index).

While metals had entirely slowed by 2007 after growing rapidly in 2005 and 2006, and oil again rose sharply in the second half of the year, food commodities prices only began to accelerate in late 2006, recording yearly growth rates of more than 20% in 2007.

Given that the increases in global commodities prices for food producers and distributors were the same in Slovenia and the euro area, the question is raised of what caused the dif-

[7] For example, a comparison of the competitive market structure in the service and non-tradable sectors with that in the tradable sector, and the corresponding impact on the mechanism of price growth in Slovenia, is given in Bole and Mramor (2006).

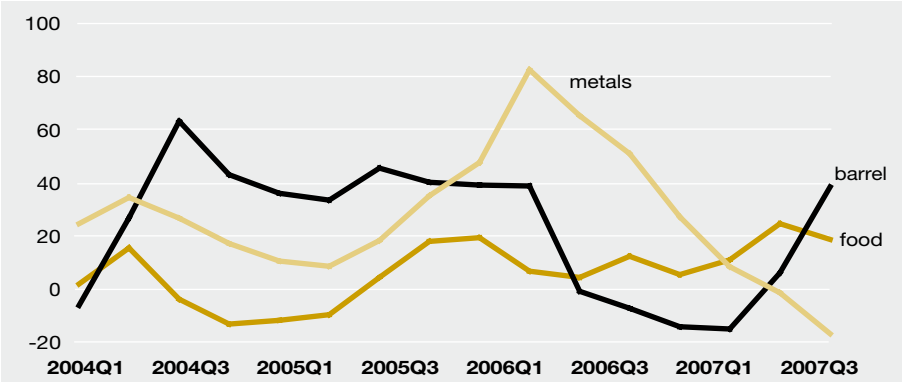


Figure 13. Commodities

Source: Economist; own calculations
Note: euro index; yearly growth rates

ferences in the year-over-year rates of growth in retail food prices between the two, which reached approximately 8 percentage points in the last quarter of 2007.

Let us examine the possible phases in the process of increasing food prices in 2007.

The rise in commodities prices made food producers' import prices more expensive. The size of the increases in import prices of food is shown in Figure 14. The figure shows the level of import prices of food producers, relative to the initial period of the first quarter of 2006, for Slovenia and the euro area.

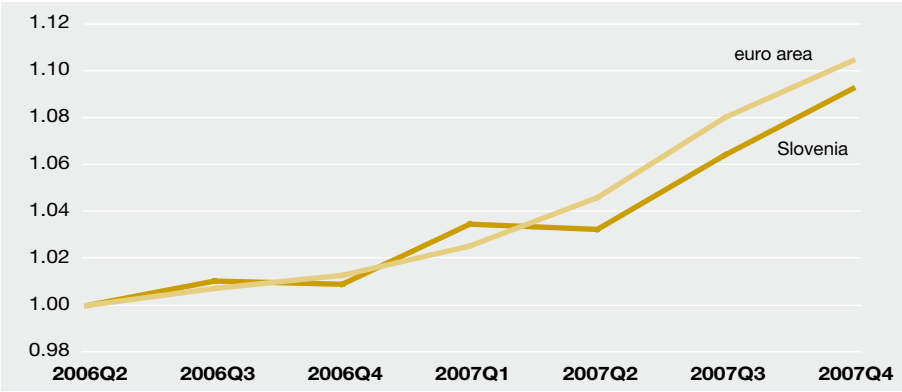


Figure 14. Import prices of food

Source: Eurostat; own calculations
Note: level 2006q1=1

Import prices in the food production sector in Slovenia increased at the same pace as those in the euro area, albeit shifted by one quarter (the coincidence of growth is so systematic that the shift could only be the result of different timing in price-taking). In the last quarter of 2007 import food prices were already 8.3% (9% in the euro area) higher than in the same quarter of 2006. Some components recorded significantly larger and earlier growth.[8]

Producers in both Slovenia and the euro area passed off the increase in the import prices of food commodities through to the prices of their products, as revealed by the dynamic of producer prices of food in the domestic market shown in Figure 15. On average in 2007 food producers increased their prices in the domestic market by 5.6% compared with the same period in 2006, the same as food producers in the euro area (5.5%), and slightly less than the rise in import prices of food commodities and final food products (6.4%), as evidenced by the graph in Figure 14. In the second half of 2007, the difference in the acceleration of producer prices of food in Slovenia relative to the euro area was again similar to the difference in the acceleration of import prices. The yearly growth rates of producer prices of food in the fourth quarter of 2007 was 9.4%, while it was 8.1% in the euro area.

There remains the question of what happened to the prices of food in the final phase (on the way to retail trade). The retail prices of food, beverages and tobacco in the final quarter of

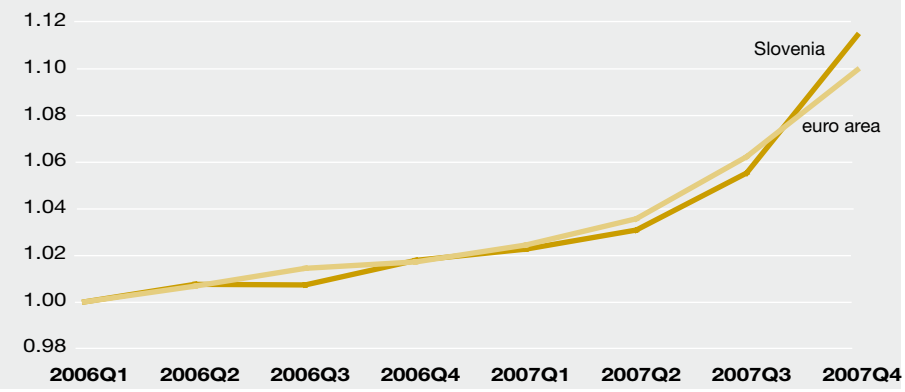


Figure 15. Producer prices of food (for domestic market)

Source: Eurostat; own caluclations
Note: level, 2006q1=1

[8] For example, in Slovenia the import prices of cereals and cereal products were already 10% higher in the third quarter of 2006 than a year earlier, while by the third quarter of 2007 the yearly growth rates of the import prices of cereals and cereal products was over 24%.

2007 were 12.6% (4.5% in the euro area) higher than those in the final quarter of 2006 (see Figure 11). Therefore, the increase in retail prices was around 3.5 percentage points higher than the increase in producer and import prices of food. It could have occurred as a result of an unchanged (percentage) margin used for food (food producer prices) as it passed on to the distribution phase (trade sector); i.e., without any collusion on the part of retailers. Given that, as stated previously, turnover in food retail recorded an average yearly growth of 5.1% in nominal terms in 2007 (sales were down in real terms), the hypothetical unreduced (i.e., nominally higher) margins used by retailers would probably have proven unsustainable in the longer term in the context of tight nominal consumption.

Further evidence of the relatively low possibility of exercising market power in retail trade comes from the values of price cost margin. In the trade sector, price cost margins are significantly larger than in the manufacturing and overall tradable sectors, but at the same time are also significantly lower than price cost margins in other service sectors.[9] In Slovenia, price cost margins no longer deviate significantly from the values seen in the most developed European countries (see Table 3).

Tabel 3. Price cost margin

	Manufacturing of food, beverages and tobacco (DA15)	Sale, maintanance and repair of motor vehicles (G50)	Wholesale and commission trade, except motor vehicles (G51)	Retail trade, except motor vehicles; repair of household goods (G52)
Germany	0.084	0.22	0.24	0.18
Holland	0.11	0.23	0.26	0.23
Finland	0.04	0.27	0.23	0.23
Norway	0.08	0.18	0.21	0.08
France	0.12	0.26	0.18	0.27
Slovenia	0.11	0.25	0.23	0.23

Source: Eurostat; own calculations

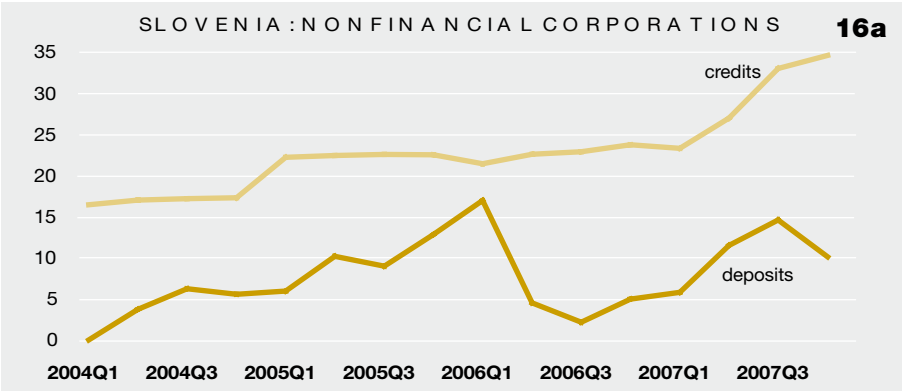
An alternative factor of the large difference between producer (and import) prices and retail prices of food in Slovenia relative to the euro area in 2007 could also be the stronger position of considerably larger retail trade chains in the euro area (also relative to Slovenia) in the buyers' market. Such a stronger position could reduce the increase in food commodities prices and food producer prices on the way into retail prices in the euro area relative to Slovenia, because contracts are agreed upon for longer terms in the euro area. This hypothesis could be supported by the figures on food inflation in 2008. Should it prove accurate, the relative dynamic in food prices in Slovenia compared with the euro area will decline.

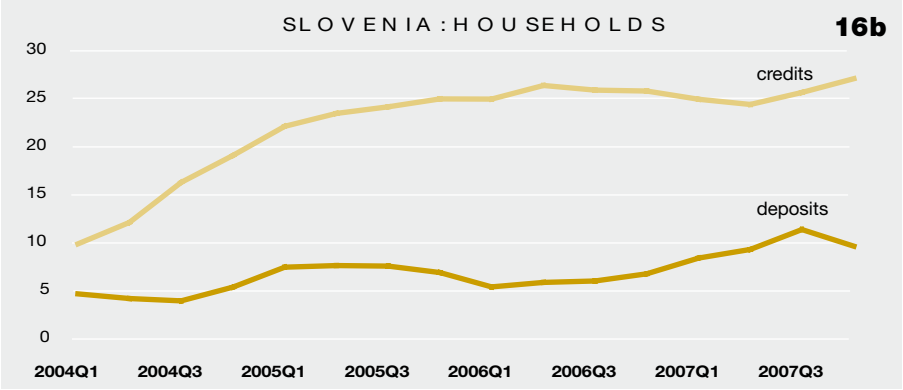
[9] For example, see Bole and Mramor (2006).

4. Money

Credits and deposits. In 2007, developments in the banking sector differed significantly from those in the previous year. The basic features of the change are illustrated in Figure 16, which shows the yearly dynamic in deposits and credits for non-financial corporations and households in Slovenia (only residents are included). The year-over-year dynamic in deposits and credits for the non-financial sector in the euro area are shown on a separate graph.

The already very rapid growth in total credit in 2006 accelerated considerably in 2007; the yearly growth rates exceeding 30% in the second half of the year. Although economic growth in Slovenia was approximately double that in the euro area, credit growth after the second quarter of 2007 was more than three times higher. Irrespective of the uncertainty in foreign financial markets caused by the sub-prime credit market crisis in the USA, credit growth in Slovenia and the euro area picked up further towards the end of 2007.





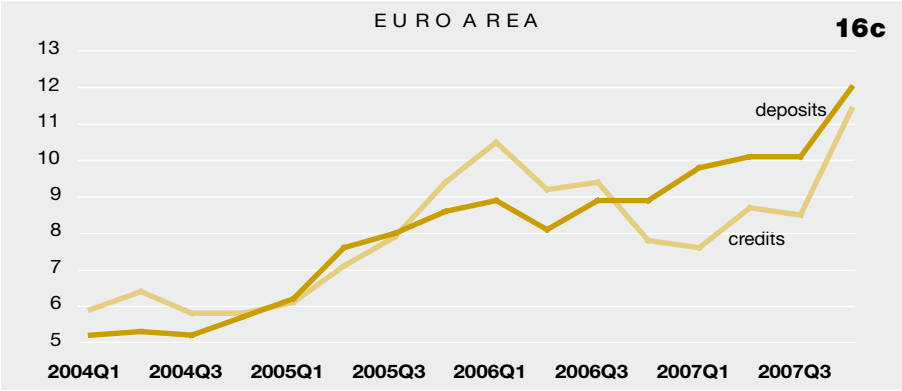


Figure 16. Credits and deposits of residents

Source: Bank of Slovenia Bulletin; Eurostat; own calculations
Note: consolidated items for euro area; yearly growth rates

A surge of activity in banking (financial) intermediation in 2007 also documents the increase of the real value-added growth rate by one quarter in the financial intermediation sector (see Table 1).

While household credit grew at practically the same rates as in previous years, corporate lending accelerated very sharply after the first quarter of 2007. As will be documented below, the acceleration probably resulted from the huge inflow of loanable funds into the banking system when the government repaid domestic debt by issuing new Eurobonds.

The growth in deposits began to increase after the end of 2006, for both household and corporate deposits. However, the rates of growth were significantly lower (less than half) than credit growth. Deposits grew at about the same annual rate of 9% to 10% in Slovenia and the euro area. Developments in foreign financial markets triggered by the subprime credit market crisis and the corresponding increase in uncertainty brought about a decline in the growth of deposits in Slovenia, both household and corporate. No such slowdown in deposit growth was seen in the euro area.

Net financial position. Because the gap between the growth rates of credit and deposits increased considerably in 2007, it is no surprise that the banking system's net financial position against residents in the household and non-financial corporate sectors deteriorated further; the net financial position (difference between deposits and credits) is shown in Figure 17, separately for the household and corporate sectors, as a proportion of annual GDP.

Figure 17. Net resident financial position

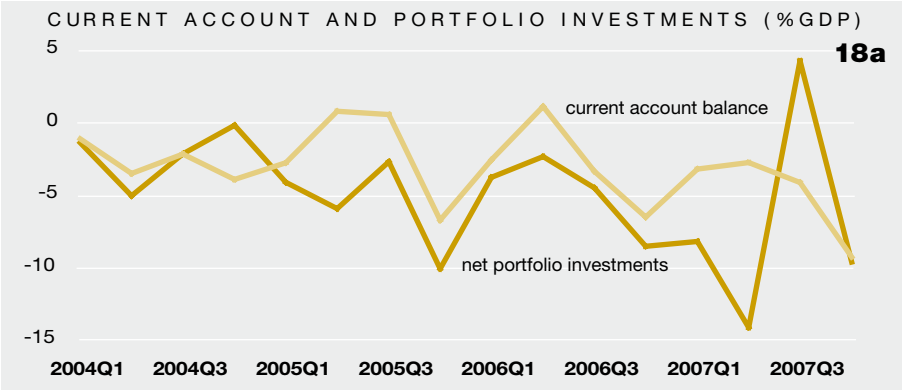
Source: Bank of Slovenia Bulletin; own calculations
Note: in percentages of four quarters moving average GDP

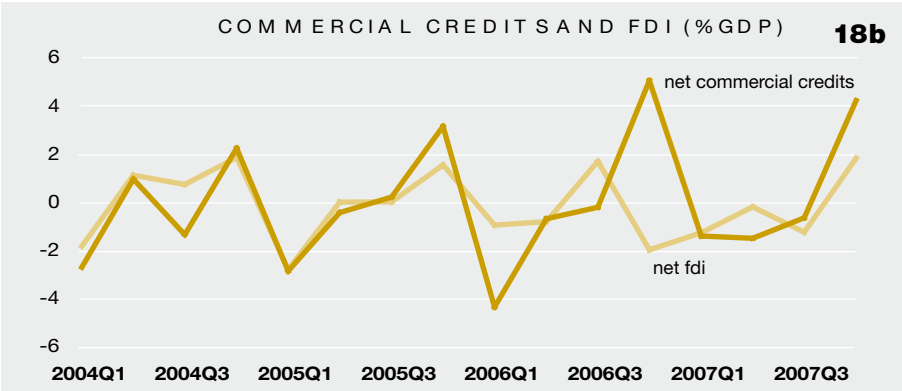
The decline in the banking system's net financial position in the last two years has been huge. Since the first quarter of 2006, its net financial position has declined by approximately 6.5% of GDP against households, and by 8% of GDP against the corporate sector, making a total decline of 14.5% of GDP. The overall (negative) financial position against households and non-financial corporations was more than 18% of GDP (in absolute value) at the end of 2007. Therefore, in the last two years (and especially in 2007), residents have considerably increased the net demand of banks for foreign lending.

Such a rapid decline in banks' net financial position against residents in the household and corporate sectors was driven (as in 2005 and 2006) by large net outflows of capital to the rest of the world, primarily via net portfolio outflows, and notably in 2007, via a significant widening of the current account deficit.

5. Balance of payments

Current account and net financial outflows. The balance of payments trends in 2007 differed significantly from those in 2006 in terms of dynamic and structure. Figure 18 shows the net flows with the rest of the world through the key types of transactions: portfolio investments, FDI, trade credits, current account transactions and loans. The flows are shown as percentages of (quarterly) GDP.





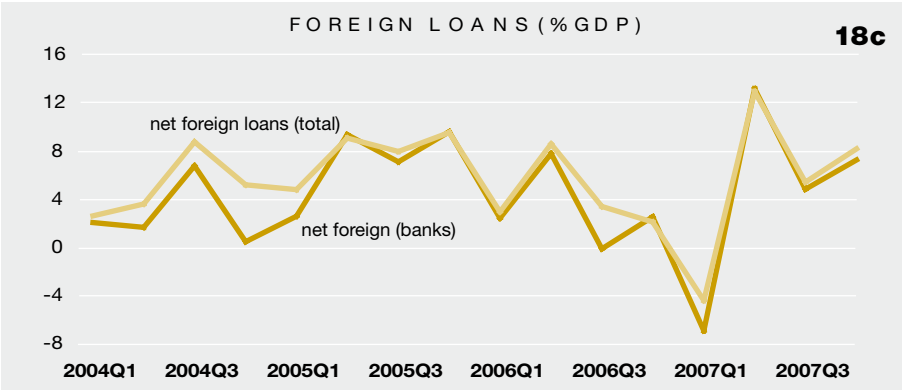


Figure 18. Balance of payments components

Source: Bank of Slovenia Bulletin; own calculations
Note: in percentages of quarterly GDP

Net portfolio investments and the current account deficit brought about the lion's share of net financial outflows. The further increase in economic activity, which was driven by explosive growth in investment demand, caused a sharp widening of the current account deficit in 2007 (-4.9% of GDP). It is worth mentioning that such an increase in the current account deficit (from -2.8% GDP to -4.9% GDP) is further evidence of the overheating of the economy in 2007. The net financial outflows through net portfolio investments also increased further in 2007; they reached 6.9% of GDP for the entire year.

Net financial flows through commercial credit and FDI fluctuated close to a balanced position in 2007 (as in 2006).

Financing financial outflows and current account. Figure 18c shows the key component of the financing of the described net financial outflows via portfolio investments, commercial credits, FDI and the current account. The net inflows through foreign loans of all entities in the economy and the net inflows through foreign loans of the banking system alone are shown. The remaining balance of payments items (e.g., the change in foreign exchange reserves, errors and omissions, etc.), which balance the net financial flows shown, are not given in Figure 18.

Net financial inflows through foreign loans also strengthened in 2007, with the exception of the first quarter, which differed primarily because of the unfinished restructuring of bank portfolios during the changeover to the euro. As shown by Figure 18, again in 2007 the increase in net total foreign borrowing came practically as a result of the increase in net borrowing of the banking sector alone. By increasing net foreign borrowing, the banking system closed the swelling gap in their balance sheets (open financial position) which was driven by a much larger increase in credits than in deposits.

The contamination of the bank lending portfolio with capital market risks generated by the aforementioned process has been unfolding in substantively the same manner since 2005. However, it should be noted that because of investments in equity instruments (which are also often used as collateral in banks), the risk transparency of such bank credit instruments is no larger than the risk transparency of the structured instruments that increased the problems and uncertainty in foreign financial markets after August 2007.

6. Government sector

What should be taken into account in assessing fiscal sector performance in 2007? Acting within the euro area required fiscal policy to make major changes in both its targets

and its implementation compared to previous years. After entering the euro area, "domestic" responsibility for price stability was, in principle, entirely transferred to fiscal policy. Therefore, the criteria of a healthy fiscal policy would have had to be notably different (and significantly stricter) from those when the Bank of Slovenia had been still acting in the tolar currency area.

Three important groups of factors did not permit policy makers in Slovenia to enjoy a comfortable position even in the short run. By 2007, after entering the euro area, external formal constraints on fiscal policy makers increased significantly. For example, the requirements for the cyclical adjusted fiscal stance are not merely matters of principle, but are formally defined in the Excessive Deficit Procedure. Necessary (pending) institutional changes caused by the integration of the Slovene economy into the EU (e.g., entrance into the Schengen zone, acceleration of the building of the transportation network, etc.) exerted additional pressure on fiscal policy, and so did the effects of a standstill in the process of improving the fiscal stance caused by the policy measures (tax reform) in the 2006. Therefore, the improvement of the general government's fiscal stance in 2007 would have had to be much larger than on average in the euro area, even without the necessary fiscal curbing of inflation deterioration.[10]

Dynamics of basic aggregates. The high economic growth in 2007 could lead to a sharp increase in certain general government revenues, but the government considerably mitigated the potential growth of these revenues through the decisions it had already taken in 2004 and 2006. In 2004 there were changes (cuts) in investment incentives in corporate income tax, while in 2006 there were significant cuts in the burden imposed by two types of taxes: payroll and personal income taxes.

The effects of high economic growth on government expenditure are generally smaller and primarily constitute a reduction in transfers to households. However, in Slovenia, in 2007, there was a significant reduction on the expenditure side (in terms of GDP) as a combined result of ex ante nominally fixed expenditures of the government and unexpectedly high inflation and economic activity.

To reveal the scale of the adjustment in fiscal stance to cyclical fluctuations, a comparison of the fiscal stance in Slovenia, the euro area and the EU are given in Table 4. The Table shows the general government revenue and expenditure, as well as the general government's overall and primary deficit as a percentage of GDP.

[10] See Bole (2006).

Table 4. General government fiscal stance

	2004	2005	2006	2007
General government revenue				
European Union	43.9	44.4	44.9	44.9
Euro area	44.6	44.9	45.5	45.7
Slovenia	44.2	44.5	44.1	43.2
General government expenditure				
European Union	46.8	46.9	46.3	45.8
Euro area	47.6	47.4	46.8	46.3
Slovenia	46.5	46.0	45.3	43.3
General government balance				
European Union	-2.8	-2.5	-1.4	-0.9
Euro area	-2.9	-2.5	-1.3	-0.6
Slovenia	-2.3	-1.5	-1.2	-0.1
Primary balance				
European Union	0.0	0.3	1.2	1.8
Euro area	0.2	0.4	1.6	2.3
Slovenia	-0.5	0.1	0.2	1.2

Source: Eurostat
Note: in % GDP

The Table shows a slow but steady decline in general government expenditure in Slovenia after 2003 and a slow increase in general government revenue until 2005, followed by a significantly sharper decline in revenue until the end of the observed period.

General government expenditure in the euro area fell more slowly than in Slovenia, but revenues were up over the same period. It is thus evident that the fiscal stance in the euro area displayed a trend of gradual improvement over the period observed, as clearly shown by the deficit figures in Table 4. The dynamic in the general government sector in Slovenia in the period analysed also improved, but notably more slowly than in the euro area. Despite the significant increase in economic growth in Slovenia in 2006 and 2007 relative to the euro area, the improvement of the public finance position in the euro area in the same period was significantly larger than in Slovenia. Overall deficit and primary deficit improved, by 0.5 and 1 percentages of GDP less than in euro area, respectively.[11]

The key reason for the deterioration in the fiscal stance in Slovenia relative to the euro area was the dynamic in general government revenues, as the dynamic in general government

[11] Besides, in fiscal stance improvement in 2007 there were some significant but one time gains (for example, the introduction of IFRS increased revenues in 2007 by approximately 0.2% of GDP) and deferred payments (for example, blocking government obligation from the so-called »petrol tolar« program decreased government spending by 0.5% GDP). See Bole (2008).

expenditure was satisfactory,[12] differing little from that of the euro area. The changes in tax legislation in the last two years, which did not track the predetermined reduction in government spending (the legislative changes were not adjusted to the effective cut in spending) or the autonomous changes in tax effectiveness, were the main reason for the relative deterioration in the fiscal stance in Slovenia. At least the timing of the tax reform would have had to have been adjusted to the phase of the economic activity cycle. The wrong timing of the tax reform actually resulted in a tax incentive of over 1.5% of GDP at the time when the economy was already overheated and growing at the highest rate in its (short) history!

Changes in the structure of general government revenue. For an insight into the reasons for the slow improvement in fiscal stance in 2007 (and 2006), the dynamic in individual components of general government revenue is of great relevance. The basic revenue components are given in Table 5.

Table 5. Tax revenues

	2005	2006	2007
Individual taxes on income and profit	5.8	5.9	5.4
Corporate taxes on income and profit	2.1	3.1	3.3
Social security contributions	14.1	13.9	13.7
Payroll tax	1.8	1.5	1.2
Value added tax	9.0	8.9	8.6
Excises	3.4	3.1	3.5

Source: Ministry of Finance Bulletin; own calculations
Note: in % GDP

The effects of the tax reform in 2004 and especially 2006 are clearly visible in Table 5, but the table also reveals some notable surprises of key importance to the public finance results in 2006 and 2007.

As previously stated, the significant leap in corporate income tax in 2006 was probably the result of the reduction in tax investment incentives in 2004 and the increase in GDP growth, but also partly (on a one-off basis) of the release of bank provisions as a result of the changeover to the IFRS.

The phased reduction in payroll tax (to be completed next year), which was launched in 2006, was probably a factor in the decline in the corresponding items in 2006 and 2007.

[12] However, it has to be taken into account that the main government push towards investments actually went through an increase in spending on Dars (Motorway company of the Republic of Slovenia) by 38% (0.4%GDP), which is formally not part of the general government. See www.dars.si.

Similarly, the decline in personal income tax was probably the result of the tax changes made in autumn 2006.

The decline in the tax yield from VAT after entering the EU was expected, but in 2007 it was surprisingly large. It is likely that the significant change in the composition of final demand in 2007 contributed to the larger than expected decline, as did differences in the deflators of individual components of final demand, as a result of the significant increase in inflation limited to only some groups of product. The same is true of social security contributions.

Effects of other fiscal policy measures. Fiscal policy can also have a significant impact on fiscal stance using measures and instruments that do not directly influence general government revenue and expenditure. Through such unorthodox measures fiscal policy can "shift" obligations and funds over time or between sectors (between the public and private sectors).[13] It can also influence fiscal stance through the management of public debt and volume of guaranties or restructuring its assets.

Let us examine the public debt management measures by which the government exerted a significant impact on the growth of financial (particularly banking) intermediation in 2007.

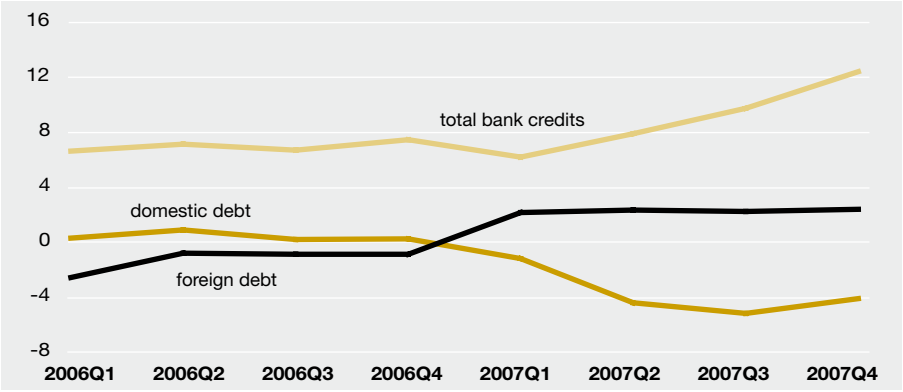


Figure 19. General government debt and bank credits

Source: Ministry of Finance Bulletin; Bank of Slovenia Bulletin; own calculations
Note: yearly increments in % GDP

[13] In 2007, examples of such unorthodox measures were deferred payments to Dars (according to the »petrol tolar« program), and one-time goverment revenue generated by the introduction of IFRS in the banking sector. Both measures brought about a significant but temporary improvement in fiscal stance in 2006 and 2007. See Bole (2008).

Figure 19 shows the effects of restructuring the public debt in 2007. The yearly (quarter to quarter) increments of government domestic and foreign debt and total bank credits to non-financial corporations and households are given in percentages of GDP.

At the beginning of 2007 there were large shifts in the structure of government debt and assets. The following large transactions were of key importance. The government issued Eurobonds and so increased its foreign debt by 2.8% of GDP in the first quarter, while in the second quarter it redeemed domestic debt by 3% of GDP and sold its assets (equity holdings) in the amount of 0.4% of GDP. At a time of very high economic growth, extremely high growth in investments and a correspondingly high growth in banking credits (by 25% yearly), these government transactions increased available loanable funds in banks by at least 2.6% of GDP.

Figure 19 illustrates the substitution of foreign debt for domestic debt (the issuance of Eurobonds and redemption of domestic debt), and the effects of the significant increase in available loanable funds on the growth in bank lending. The graph in Figure 19 shows that after the first quarter of 2007, when the repayment of government debt increased available loanable funds in banks, bank credits swelled by approximately 3.3% of GDP. The government's "contribution" could have accounted for approximately 22% (12 percentage points on an annual basis) of the increase in bank lending since December 2006.[14] It should be noted that the stock exchange also rose sharply after the second quarter of 2007 (traded volume increased by half).

By giving guarantees to public sector enterprises, the government also facilitated additional demand for lending and increased investments not included in the general government expenditures. The government provided a guarantee for the credit of 2.5% of GDP to Dars (Motorway Company of the Republic of Slovenia) in 2007, by which it financed an increase in investments by 38% (0.4% of GDP).

7. Main findings

Economic activity in 2006 and 2007 was very high. The structure of the demand driving growth in 2007 was significantly different compared to 2006 and the euro area. The modest relative growth in investment in the euro area and enormous growth in Slovenia in 2007 was the key difference between the former and the latter.

[14] Bank of Slovenia Bulletin.

The increased economic activity brought a notable decline in unemployment in 2007, more so in Slovenia than in the euro area. The increase in employment in Slovenia, both absolute and relative, was solely the result of an increase in employment among those with the lowest qualifications (primary and lower secondary) and in temporary employment.

The growth in labour costs in Slovenia outpaced corresponding growth in the euro area by 3 percentage points in 2007. The labour costs growth gap in the services sectors relative to the euro area widened sharply, but narrowed in the tradable sectors.

The competitiveness of tradable sectors in Slovenia deteriorated compared with Germany in 2007, albeit notably more slowly than in previous years. The relative dynamic in competitiveness in the market services sectors deteriorated much faster.

Headline inflation accelerated considerably in 2007. There was an increase in inflation relative to the euro area in 2007 in two product categories: services and food. The cost of services has been outpacing that in the euro area for two-and-a-half years, while food prices began to do so only after the first quarter of 2007. In the final quarter of 2007, the contribution to inflation deterioration in Slovenia compared to the euro area of both categories was equal. Empirical evidence does not show any significant contribution of the euro's introduction to the acceleration of inflation.

Since the second quarter of 2005, the acceleration in the cost of services has been driven by the strong relative growth in labour costs, caused by the high economic growth (tight labour market), and facilitated by the less competitive market structure in the services sectors. The acceleration in food prices has probably been driven mainly by rigid (percentage) margins in the retail trade. At weak nominal spending, such unreduced margins will probably not be sustainable in the longer run.

Real value added in the financial intermediation sector accelerated considerably in 2007. The rapid credit growth picked up pace even more; the year-over-year rates exceeded 30% after the second quarter. Growth in deposits began to increase after the end of 2006. However, the rates of growth were significantly lower than those of credit growth. Such difference in the dynamics of credits and deposits caused a further decline in the banking system's net financial position against residents in the household and corporate sectors. It declined by 12% of GDP after the last quarter of 2006.

The further increase in economic growth, which was driven by explosive growth in investment demand, brought a sharp widening of the current account deficit in 2007 (to 4.9% of GDP). The net financial outflows through portfolio investments strengthened further, while

the net flows through trade credits and FDI continued to be close to zero. The large financial net inflows through bank borrowing were the only items that remained to close the balance.

Except for a one-time change in the financial flows through foreign loans because of the unfinished restructuring of the bank portfolios, entering the euro area did not have visible effects on the foreign financial flows.

Entering the euro area should have been a much more important change for fiscal policy than for enterprises and households. The new goals of the government's fiscal policy (stabilisation and growth) and unfavourable initial conditions needed drastic changes in their stances from the very beginning, but the fiscal policy hasn't even achieved an increase in restrictiveness similar to the euro area average.

The key reason for the deterioration of the fiscal stance in Slovenia relative to the euro area was the dynamic in general government revenues (caused by tax reform). Fiscal policy also significantly influenced economic performance by restructuring public debt, increasing guaranties and using unorthodox measures.

In a period of already high economic activity and galloping credit growth, the government gave a large but untimely tax incentive to the economy, stimulated the acceleration of investments (particularly in civil engineering) and significantly increased available loanable funds in the banking system.

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ESTONIAN RESIDENTS' OPINION OF THE ECONOMIC SITUATION, LABOUR MARKET AND CONSUMPTION

Survey by TNS Emor

Eesti Pank commissioned a survey from TNS Emor, a market research company, to identify how Estonians assess the current economic and labour market situation and consumption. The survey was carried out in April 2008 among 15 to 74-year-old people. The following is a summary of major findings.

In general, it can be concluded that the **current economic situation makes people cautious and forces them to review their spending**.

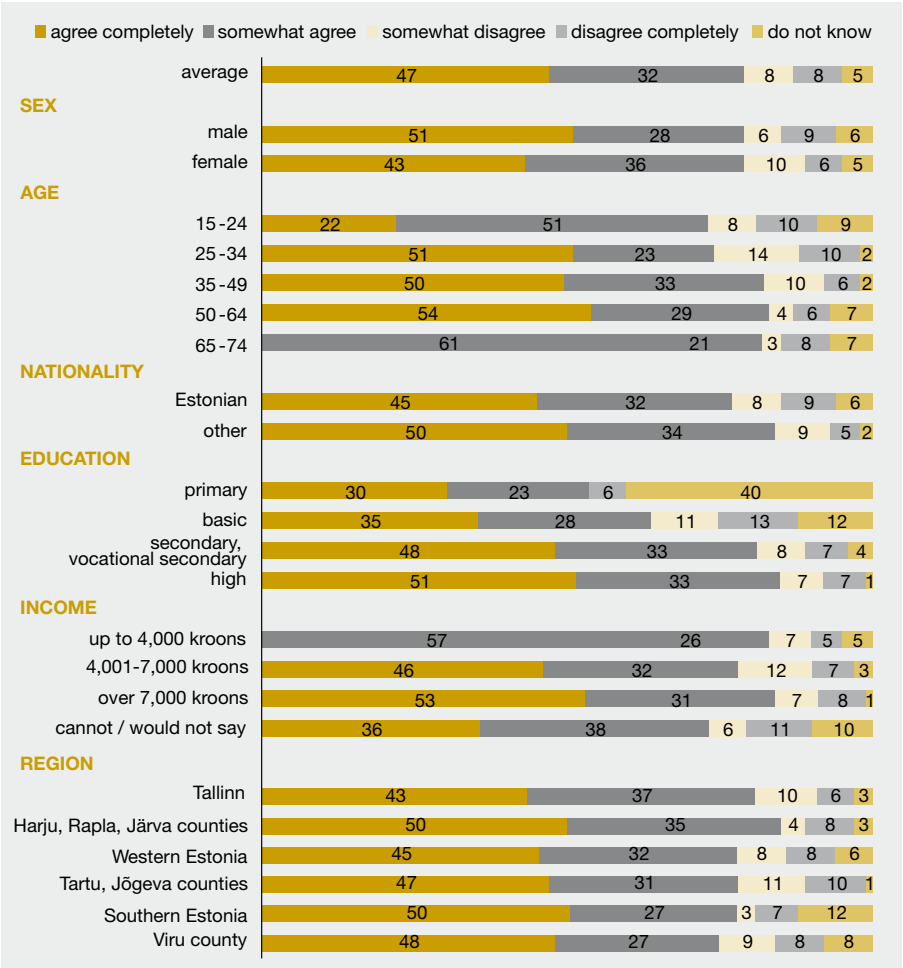

Figure 1. Please indicate the extent to which you agree with the statement: I am more cautious in my current economic decisions than one or two years ago?

It was not possible to identify one single field where residents would want to save most. People rather tend to decrease spending across a range of areas. A quarter of respondents reviews their eating habits and tries to save on account of food. Food expenditure is decreased by non-Estonians, people over 50, pensioners and people with higher education. Equally 21% of respondents makes efforts to limit spending on alcohol/tobacco, clothes and footwear as well as larger industrial goods. 9% of the population tries to curb housing loan related expenditure. Education and health care spending are the least affected by cutting down on expenditure.

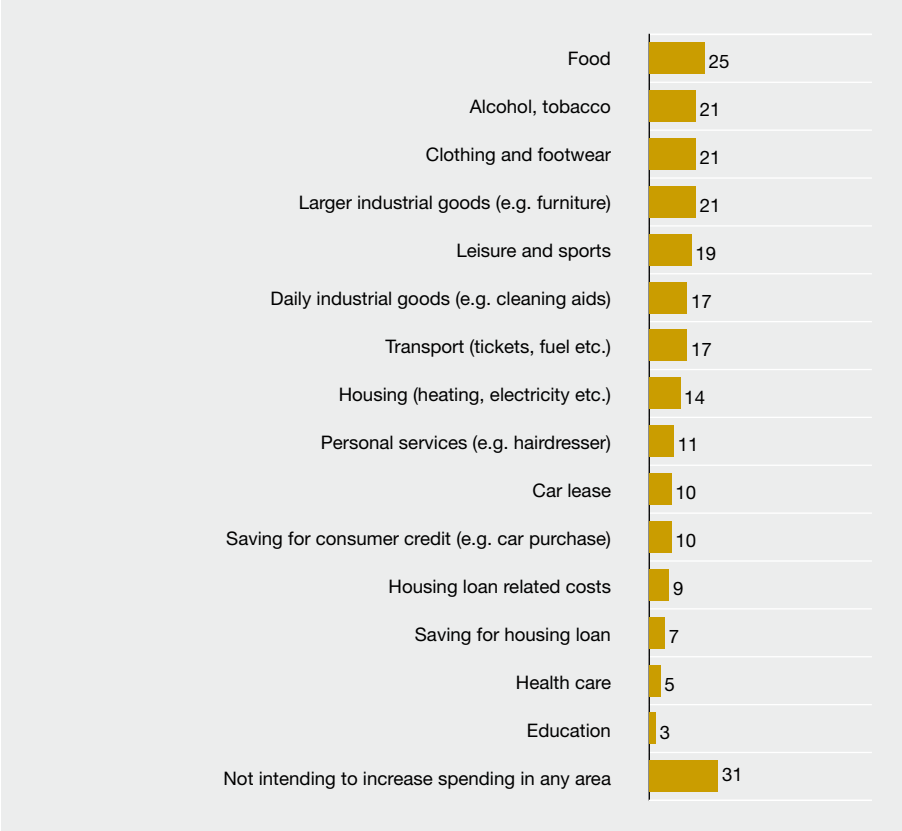

Figure 2. In which areas do you intend to decrease your spending over the next six months?

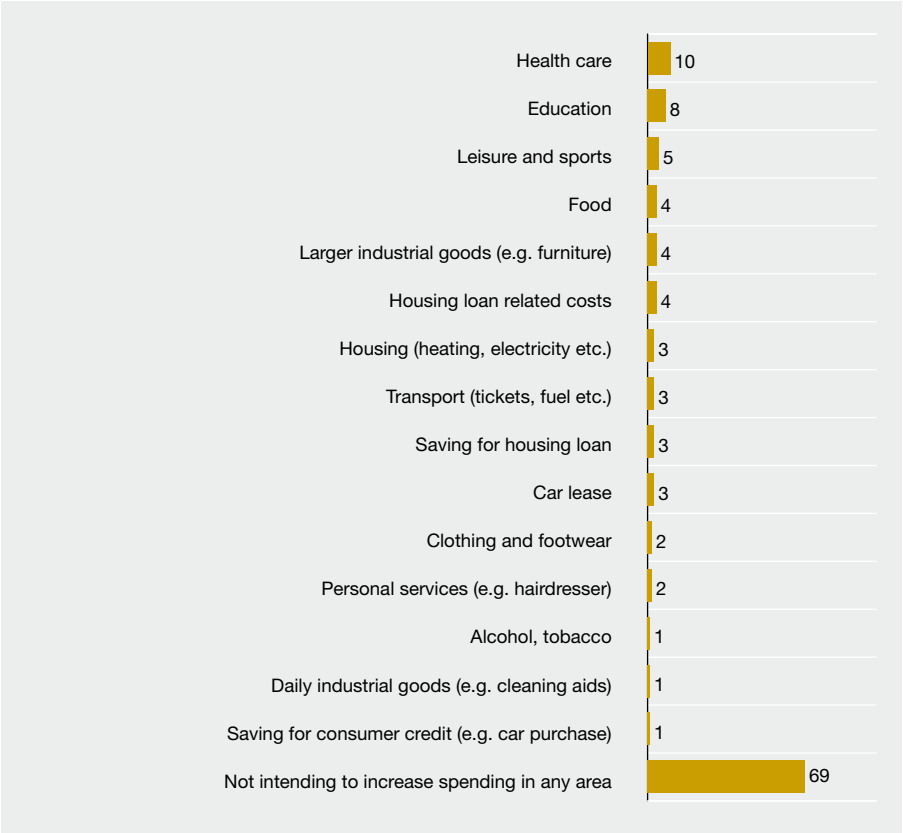

Figure 3. In which fields do you intend to increase your spending over the next six months?

Over two thirds of the residents do not want to increase their spending in any of the areas. If someone was planning an increase at all, this would occur in the areas where people did not wish to decrease spending; that is, in health care and education. Younger people are more willing to increase costs in education but 35 to 49-year-olds and those over 50 intend to increase health related spending.

Every third respondent aged 15 to 74 years (31%) have no intention to decrease their consumption in any of the areas.

The economic situation should also be reflected in the fiscal priorities of the country. Thus the respondents were asked express their views on whether the government should put some of the national reserve into use in the current hard times.

Over a half of the respondents (54%) said the government should not use the reserve yet. They think it is **important that the Estonian government does not spend the entire budget revenue but maintains a reserve for more difficult times**. This statement was favoured by the elderly, Estonians, people with primary or higher education, residents of rural settlements, and population in Western Estonia as well as Tartu and Jõgeva counties.

According to 18% of the respondents, recent price rises are rapidly reducing the value of the national reserve and therefore there is no point in saving. This statement found more support from non-Estonians and people with primary education. 13% said that they were going through some hard times, which is why the government should start using the reserve. People with basic education supported this statement most frequently.

- It is important that the Estonian government does not spend the entire budget revenue but maintains a reserve for more difficult times.
- Recent price rises are rapidly reducing the value of the national reserve and therefore there is no point in saving.
- We are going through a hard time now; the reserve should be put into use.
- I do not agree with any of the statements.

The respondents also had to assess two different arrangements of the labour market. **There are not any clear priorities yet regarding solutions of the labour market arrangements.**

14% of the respondents preferred the arrangement that would make it easier to dismiss employees or make them redundant, while the likelihood for them to find a new job would be relatively high. This approach was mostly favoured by people with the lowest (primary) or highest level of education.

32% preferred the arrangement that would make it difficult to dismiss employees or make them redundant, while it would be relatively difficult for dismissed or redundant employees to find a new job. This group included an above-average proportion of non-Estonians, people with primary and basic education and residents of Tallinn and Virumaa region.

54% of the respondents thought that neither of the options was good.

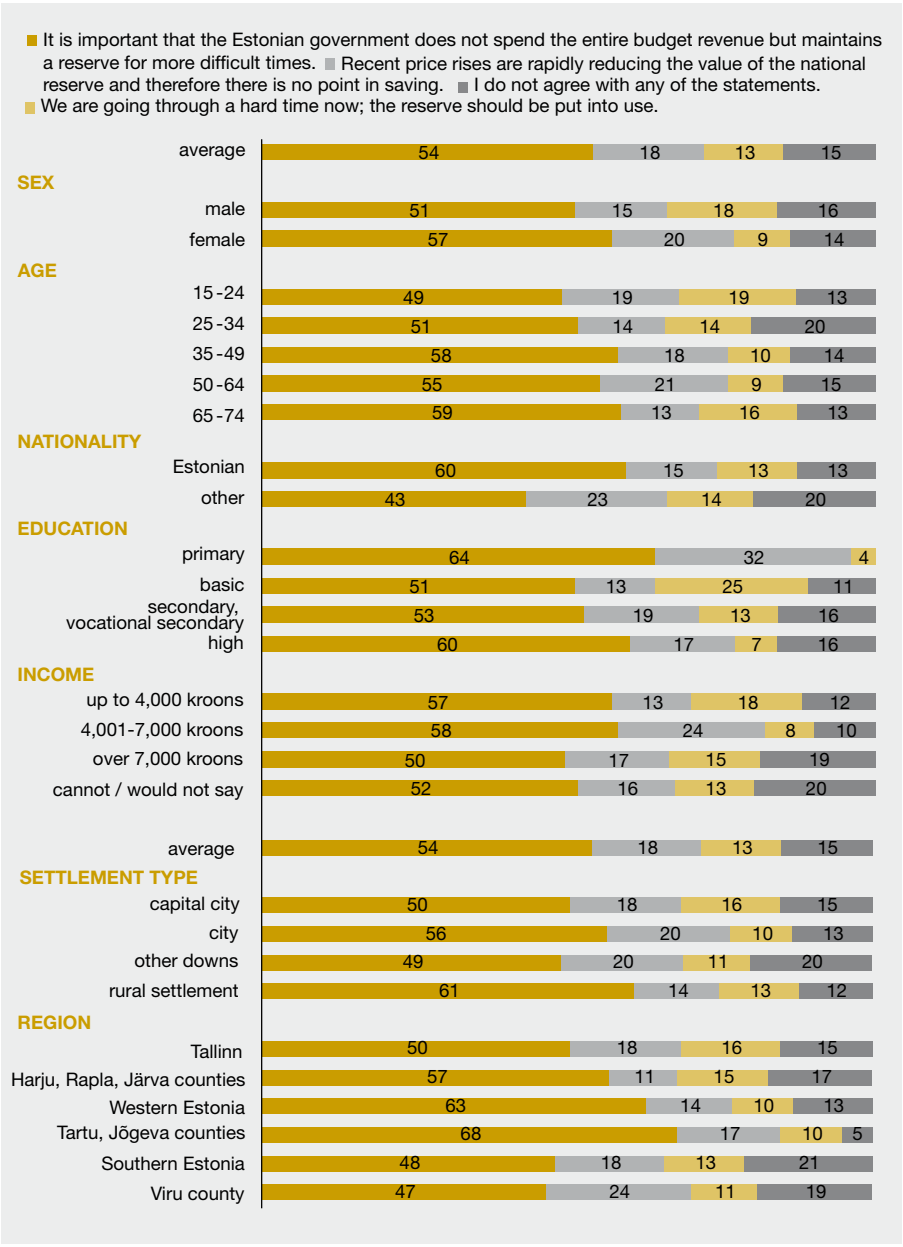

Figure 4. Please state which of the statements you agree with the most:

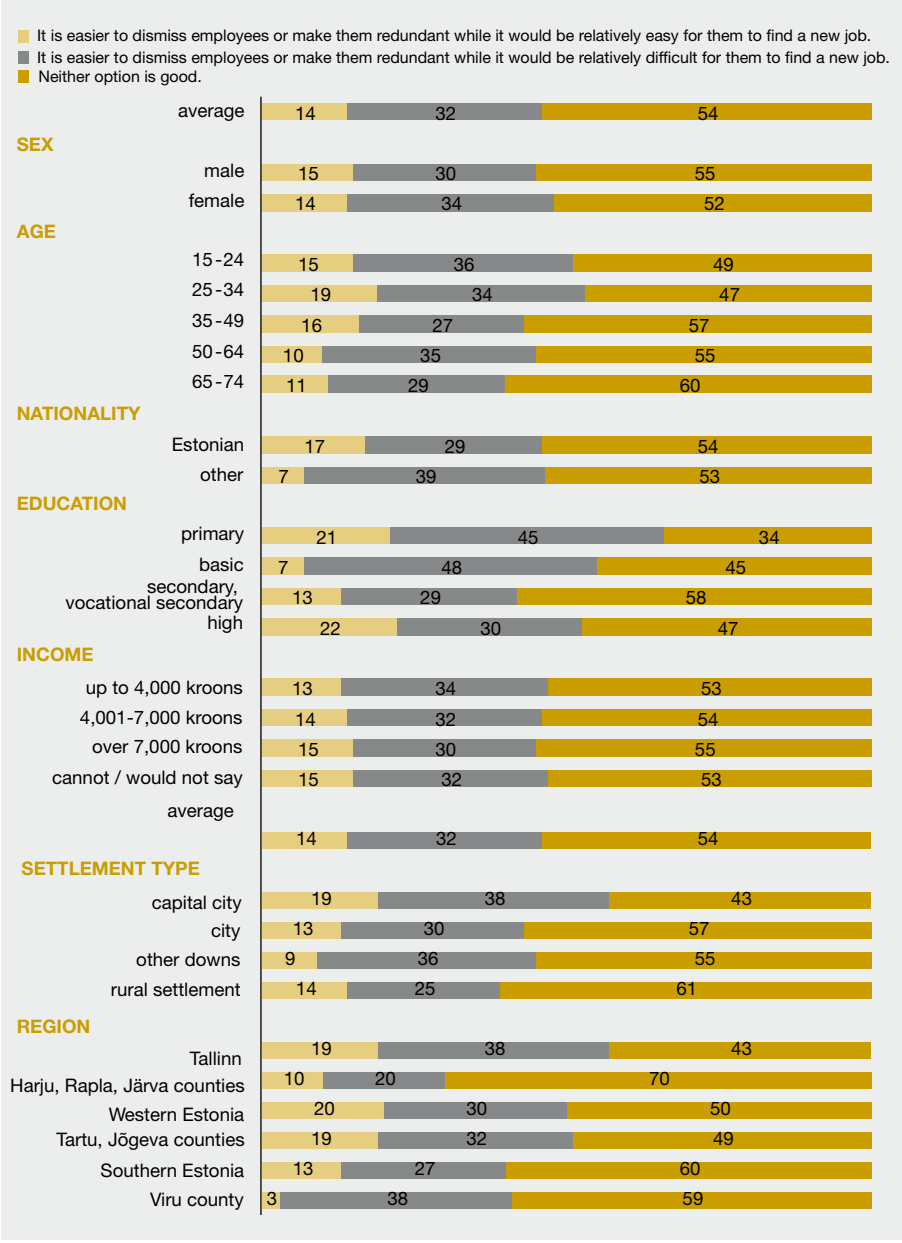

Figure 5. Which arrangement of the labour market would you prefer?

APPENDIX

MAIN QUARTELY INDICATORS OF THE ESTONIAN ECONOMY as at 1 July 2008

	Unit	Period	Indicator	Change compared to the previous period (%)	Change compared to the same period last year (%)	Source
Gross domestic product						
Current prices	EEK m	Q1 08	59,476.0			ESA
Constant prices	%	Q1 08	39,804.4	-8.5	0.1	ESA
Production						
Volume index of industrial production (at constant prices (2000 = 100)	%	Q1 08		-7.9	-0.9	ESA
Investments in fixed assets (at current prices)	EEK m	Q1 08	9,532	-22.0	8.6	ESA
Construction						
Construction activities of construction enterprises (at current prices)	EEK m	Q1 08	11,256	-28.9	6.2	ESA
Usable floor area of completed dwellings	thousand m^2	Q1 08	150.9	-15.7	28.0	ESA
Usable floor area of non-residential buildings	thousand m^2	Q1 08	227.3	-24.9	-0.7	ESA
Consumption						
Retail sales volume index (at constant prices, 2000 = 100)	%	Q1 08		-12	1	ESA
New registration of passenger cars	pieces	Q4 07	14,325	-5.4	-24.6	ARK
Prices						
Consumer price index	%	Q1 08		3.6	11.1	ESA
Producer price index	%	Q1 08		2.4	8.4	ESA
Export price index	%	Q1 08		1.4	6.5	ESA
Import price index	%	Q1 08		1.2	5.1	ESA
Construction price index	%	Q1 08		1.1	6.0	ESA
Real effective exchange rate (REER) of the Estonian kroon	%	Q1 08		1.9	5.7	EP
Labour market and wages						
Employment rate (based on the Labour Force Survey)*	%	Q1 08	62.2	62.5	61.8	ESA
Unemployment rate (based on the Labour Force Survey)*	%	Q1 08	5.2	4.1	5.3	ESA
Registered unemployed (according to the Labour Market Board)	persons per month	Q1 08	16,560	20.0	15.8	TTA
% of population between 16 years old and pension age*	%	Q1 08	2.6	2.2	2.0	TTA
Average monthly gross wages and salaries (health insurance benefits excluded)	EEK	Q1 08	12,337	0.5	19.5	ESA

* Indicators of the period, not changes

	Unit	Period	Indicator	Change compared to the previous period (%	Change compared to the same period last year (%)	Source
General government budget (net borrowing not included here)						
Revenue	EEK m	Q4 07	25,768.0	1.3	21.6	RM
Expenditure	EEK m	Q4 07	26,887.0	30.0	17.0	RM
Balance (+/-)*	EEK m	Q4 07	-1,119.0	4 759.2	-1 804.7	RM
Period's revenue to the planned annual revenue*	%	Q4 07	29.1	28.8	29.5	RM
Transport						
Carriage of passengers	thousand	Q1 08	49,494	-11.4	-7.8	ESA
Carriage of goods	thousand tons	Q1 08	23,992	-6.6	-19.0	ESA
Tourism, accommodation						
Visitors from foreign countries received by Estonian travel agencies	thousand	Q1 08	150.2	-47.3	-64.5	ESA
Visitors sent to foreign tours by Estonian travel agencies	thousand	Q1 08	131.7	12.2	5.4	ESA
Accommodated visitors	thousand	Q1 08	416.5	-15.0	5.4	ESA
o/w foreign visitors	thousand	Q1 08	211.3	-22.8	5.9	ESA
Foreign trade (special trade system)						
Exsports	EEK m	Q1 08	31,273.5	-4.8	4.6	ESA, EP
Imports	EEK m	Q1 08	41,161.3	-8.9	-3.1	ESA, EP
Balance*	EEK m	Q1 08	-9,887.8	-12 319.3	-12 588.3	ESA, EP
Foreign trade balance/exports*	%	Q1 08	-31.6	-37.5	-42.1	ESA, EP
Balance of payments*						
Current account balance	EEK m	Q1 08	-7,888.6	-10 468.0	-13 023.3	EP
Current account balance to GDP	%	Q1 08	-13.3	-15.9	-23.7	EP
Foreign direct investment inflow	EEK m	Q1 08	8,707.3	8 338.2	8 996.6	EP
Foreign direct investment outflow	EEK m	Q1 08	-4,392.4	-2 970.0	-3 619.8	EP
International investment position						
Net international investment position	EEK m	Q1 08	-184,526.3	2.8	14.2	EP
Direct investment in Estonia	EEK m	Q1 08	183,770.1	3.6	17.3	EP
Net external debt	EEK m	Q1 08	277,269.8	3.2	29.0	EP
o/w government	EEK m	Q1 08	3,484.2	0.9	-27.0	EP
EEK/USD average quarterly exchange rate	**EEK**	**Q2 08**	**10,010**	**-4.2**	**-13.8**	**EP**

ESA – Statistical Office of Estonia
ARK – Motor Vehicle Registration Centre
EP – Eesti Pank /Bank of Estonia
TTA – Labour Market Board
RM – Ministry of Finance