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# The Labour Market in the CR: Trends, Policies and Attitudes

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## 1. Introduction

The opening of markets which started in 1990 produced new opportunities and incentives for labour adjustment and mobility. In parallel, it necessitated the establishment of standard labour market institutions which framed mobility and flexibility. The labour market became an arena of constant flux in terms of institutional settings and policies, as well as in terms of peoples' adaptation and shifts between different labour market states or jobs. During the process, the labour force differentiated according to education, ownership sector and, in particular, to personal abilities and willingness to move.

The market reforms and stabilisation policies that followed the foreign trade and price liberalisation were expected to produce high unemployment in transition countries. Because of the apparent inevitability of rising unemployment, Boeri (1997, p. 367) argues that in such circumstances the policy issue is not "[...] to prevent the rise in unemployment, but to cushion its social costs and to avoid the spread of long-term unemployment". In the Czech Republic, however, there initially appeared to be more emphasis on keeping unemployment (artificially) low, instead of moderating the consequences of relatively high transitional unemployment, a phenomenon known as the "Czech unemployment miracle".

Now, the country is facing a 10% unemployment rate, and many aspects of labour market functioning and its impact on economic growth and stability remain unclear. This concerns fundamental questions such as the actual degree of labour market flexibility, the appropriate design of labour market institutions and the adequacy of the labour market policies adopted. Moreover, there is no statistical evidence on the informal economy, which allows people to combine various forms of labour market involvement with welfare provisions and to accumulate unregistered income in such a way.

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In this paper we put together various statistical and sociological data on employment and unemployment trends (section 2); wage developments (section 3); and even workers' opinions and their potential labour market strategies, as reflected in various sociological surveys (section 4). Behind this attempt, there is a belief that labour market institutions, applied policies and people's attitudes are all interlinked, eventually affecting aggregate labour market performance. Both the path dependency from the communist society and the new challenges brought by open markets are in play here.

## 2. Changes in Employment, Unemployment and Labour Mobility

In the 1990s, the quantitative shifts in demographic behaviour, including reproductive activity and life expectancy, were so substantial that they allow us to speak of a qualitative change. Two trends characterise the development of family behaviour since 1989: the number of marriages is declining and fewer children are being born. Three conditions help to explain the internal sources of this development: (i) the inheritance of a deformed population structure from the former regime, (ii) an increase in opportunities for self-fulfilment of young people, and (iii) a weak housing market. Similarly, ageing of the population accompanies this demographic transition – see (Možný – Rabušic, 1999) for details.

Regarding unemployment trends, there was no radical increase in unemployment in the Czech Republic as had been expected immediately after 1990. There are both microeconomic (institutional) and macroeconomic arguments explaining the Czech “unemployment miracle”:

Due to the specific character of the Czech privatisation process and the semi-state-owned banks providing generous credit to large enterprises, labour was further hoarded. This is not to say that employment reductions did not take place. But, because of the above-mentioned specificity of financing of (formerly) state-owned enterprises, these pressures were clearly much lower than they would otherwise have been.<sup>1</sup> Moreover, most of those who eventually left the large industrial giants did not enter the pool of unemployed people anyway. Instead, they moved directly to another job or exited the labour market altogether (see below for more discussion). The country thus enjoyed a remarkably low unemployment rate until the mid-1990s.

In the near absence of unemployment, direct job-to-job shifts were the main source of structural changes in employment, to respond to labour

<sup>1</sup> Bank-owned investment privatisation funds established in the course of voucher privatisation became the key owners of Czech privatised enterprises. As a result, commercial banks often tended to treat their “clients” in a specific manner, meaning in many cases artificial enterprise survival for an extended period. Apart from the inter-linked ownership structure, commercial banks were afraid to terminate credit lines to (formerly) state-owned enterprises simply because of the large amount of already accumulated “non-performing” or “bad” loans, some of them inherited from the previous regime. Thus, a more prudent approach by commercial banks would have led not only to immediate bankruptcies of many industrial enterprises, but also to the destruction of any prospects of repaying less recent loans. This strategy of commercial banks, based on wishful thinking, further damaged their own balance sheets, a situation that was resolved only by the full privatisation of banks starting in the second half of the 1990s. See (Čapek, 1995) or (Mervart, 1998) for more discussion.

TABLE 1 Employment, Wages, Productivity and Participation  
(annual changes in per cent)

	90	91	92	93	94	95	96	97	98	99	00	01	02	03 <sup>b</sup>
Employment <sup>a</sup>	-0.9	-5.5	-2.6	-1.6	0.8	2.6	0.7	-1.9	-1.3	-2.5	-0.2	0.3	-0.4	-0.5
GDP per employee	-0.2	-9.2	-0.7	1.9	1.0	4.2	3.2	0.0	0.9	3.3	4.0	2.6	1.2	3.2
Real wage	-5.5	-26.0	10.0	3.7	7.7	8.6	8.8	1.8	-1.2	6.1	2.6	3.8	5.2	6.9
Participation rate	66.9	.	62.6	61.0	62.0	61.5	61.2	61.0	61.0	61.0	60.0	60.0	60.0	59.0

Notes: <sup>a</sup> average number of workers in the civil sector of the national economy

<sup>b</sup> preliminary 1<sup>st</sup>–3<sup>rd</sup> quarters 2003

Source: Statistical Yearbooks of the Czech Republic

demand in the newly expanding sectors. Indeed, active workers profited from the open markets, and huge mobility (job-to-job) flows between the “old” (primary and secondary) and “new” (tertiary and quaternary) sectors occurred (see also Table 5). The biggest absorption capacity was expected among new entrepreneurs. According to the Labour Force Surveys (LFS), in the spring of 1992 the self-employed represented 6 % of the total labour force, and entrepreneurs with employees 2.5 %.<sup>2</sup>

As a result of both lax financial markets and a relatively high labour turnover, the higher unemployment remained strictly localised in regions of heavy manufacturing and iron and steel production, which lost their Eastern markets. Also several micro-regions depending on one factory instead of industrial diversity – a typical product of socialist industrialisation – faced employment problems. (More recently, however, regional unemployment, especially in Northern Bohemia and Moravia, has become one of the most striking features of the Czech labour market, with some local unemployment rates exceeding 20 %.)

In macroeconomic terms, the initial downward real wage flexibility in the early 1990s additionally reduced the pressures for mass redundancies: real wages declined more than labour productivity, so that labour became, relative to output per employee, even cheaper than before the beginning of the transition period (*Table 1*) – see, for example, (Flek, 1996) for more discussion.

Low real wages, high mobility flows and relatively low pressure for restructuring, however, cannot explain the story in full: given the extent of the transition recession, employment reductions were frequently inevitable – aggregate employment dropped by more than 500,000 persons during 1990–1993, a net change of some –10 %. Fortunately, the contraction in aggregate employment took place simultaneously with declining labour force participation. Flows from employment to unemployment were much lower than they would otherwise have been because of sharply declining labour

<sup>2</sup> Note, however, that even though the launch of *de novo* firms was vigorous (almost no self-employment existed before 1989 in the Czech Republic), it could hardly be called an explosion. In 1998 the corresponding figures were 10 % and 4 %, and by the end of 2000 only the percentage of self-employed had increased, to 12 %, remaining the same in 2002. Self-employment is used much more, however, as a secondary job.

TABLE 2 Unemployment in the Czech Republic <sup>a</sup>  
(registered unemployment)

	90	91	92	93	94	95	96	97	98	99	00	01	02	03
<i>Unemployment</i>														
- rate <sup>b</sup>	0.73	4.13	2.60	3.50	3.20	2.93	3.52	5.23	7.48	9.37	8.78	8.90	9.81	10.30
- rate <sup>b, c</sup>	.	2.80	3.04	2.98	3.28	2.98	3.08	4.36	6.13	8.62	8.99	8.54	9.20	9.92
- stock <sup>d</sup>	39	222	135	185	166	153	186	269	387	488	457	462	514	542
- stock <sup>c, d</sup>	.	149	160	157	171	155	162	223	317	447	469	444	480	523
<i>Unemployment by education</i>														
of which: <sup>e</sup>														
primary	.	33.0	38.0	38.0	39.0	39.0	37.8	32.0	30.0	29.0	31.0	31.0	31.0	30.8
university	.	4.1	2.7	2.2	2.1	2.1	2.2	2.7	2.7	3.0	2.9	3.1	3.1	3.2
(school-leavers)	8.9	21.0	20.0	18.1	17.7	18.0	20.1	23.0	25.0	24.0	22.0	22.0	22.0	21.5
<i>Duration of unemployment</i>														
less than 3 months	.	40.0	47.0	46.0	40.5	39.0	41.6	37.0	35.0	27.0	26.0	26.0	24.0	22.7
3–6 months	.	31.0	21.0	23.0	22.0	22.0	23.0	25.0	26.0	21.0	18.0	19.0	20.0	18.6
6–9 months	.	16.0	8.4	9.5	9.9	9.4	9.7	11.3	11.0	13.0	10.0	10.0	11.0	10.3
9–12 months	.	9.4	6.5	6.4	6.6	6.4	5.6	6.7	6.9	9.6	7.5	7.6	8.1	8.1
more than 12 months	.	3.9	17.0	15.0	21.0	24.0	20.1	20.0	22.0	30.0	38.0	37.0	37.0	40.3
<i>Unemployed per vacancy</i>														
	.	4.6	1.7	3.4	2.2	1.7	2.2	4.3	10.0	14.0	8.8	8.9	13.0	13.5
of which:														
– primary	.	6.0	3.2	7.9	4.5	3.2	3.5	6.2	12.0	16.0	11.0	10.0	14.0	13.6
– university	.	1.8	0.7	1.0	0.7	0.7	1.2	3.0	5.2	7.3	4.6	4.4	5.7	6.2
<i>Unemployment by age groups <sup>e</sup></i>														
of which:														
up to 19	.	19.0	17.0	16.0	14.0	13.0	12.9	12.0	8.4	4.8	3.5	7.8	7.4	6.9
20–24	.	14.0	15.0	15.0	15.0	27.3 <sup>f</sup>	26.8 <sup>f</sup>	29.5 <sup>f</sup>	25.0	25.0	23.0	18.0	18.0	17.0

Notes: <sup>a</sup> Unless stated otherwise, the figures refer to year-end data.<sup>b</sup> per cent of the labour force<sup>c</sup> annual average<sup>d</sup> number of job applicants in thousands<sup>e</sup> per cent of the stock of unemployed<sup>f</sup> for age group 20–29

Sources: Statistical Yearbooks of the Czech Republic; Czech Ministry of Labour and Social Affairs

market participation by women and people of post-active age: During 1990–1993, the number of working pensioners declined by 250,000, about 100,000 more individuals opted for early retirement schemes, and the participation of women dropped by 270,000. As a result, there was only one unemployed person for every five jobs lost.<sup>3</sup>

In 1994 the first rise in aggregate employment was recorded and end-year unemployment declined by comparison with the end of 1993 (see also *Table 2*). In 1995, the developments of both employment and unemployment were

<sup>3</sup> See, among others, (OECD, 1995) or (Rutkowski, 1995) for additional discussion of the Czech “miracle”.

even more favourable. The same situation essentially prevailed on the labour market in 1996 as well. This can be attributed to a demand-driven economic recovery resulting in a macroeconomic overheating. But one equally has to note the prevailing low pressure for restructuring in (privatised) enterprises as a transition-specific, short-term factor keeping the unemployment figures artificially low. The low pressure to restructure manifested itself in an absence of large waves of redundancies and in automatically continuing credit lines to the pre-privatisation clients of commercial banks, as well as increasing inter-enterprise arrears and almost absent bankruptcies of over-leveraged firms.

The combination of increasing employment, low unemployment and real wages growing sharply in excess of labour productivity during 1994–1996 was clearly unsustainable over the long term, not least because of impending wage-push inflation and adverse effects on the country's international (price) competitiveness. This lay at least partly behind the strong policy response to the macroeconomic developments in mid-1997 (involving changes in the exchange rate regime, budgetary cuts and a more restrictive monetary policy). Consequently, a decline in aggregate employment was recorded in 1997 for the first time since 1993.

Since then, gradually increasing restructuring pressure can be observed in privatised firms (including large waves of redundancies leading to productivity improvements), as well as progress in bankruptcy enforcement and enterprise financial discipline. All this has made the aggregate unemployment figures grow more or less steadily (and employment decline at the same time)<sup>4</sup>, almost regardless of business cycle fluctuations and/or government policies.

At the end of 2000, unemployment had dropped to 8.8 %, in comparison with 9.4 % at the end of 1999. This short-term reversal in the rising unemployment trend was for the most part a result of an increase in the numbers of individuals opting for early retirement. The inter-annual growth of employment in 2001 was caused by one-off factors, in particular the introduction of a new Labour Code, which reduced the possibilities for overtime work. The unemployment rate, however, has risen continuously since 2001.

This includes highly undesirable trends such as rising long-term unemployment, job destruction prevailing over job creation, structural unemployment as a consequence of educational and regional labour mismatch,<sup>5</sup> high unemployment among school-leavers and graduates, etc. (Table 2). Growing wage pressure on the part of trade unions has made the situation on the labour market even more complicated.

<sup>4</sup> Sociological surveys show the largest decrease in the number of employed in the pre-retirement cohort (age 45–60 for men and 45–55 for women). Also, prolonged periods of study among the youngest cohort contributed to the overall decrease in employment – see (Matějů, 1999).

<sup>5</sup> Jurajda (2005) documents the consequences of educational mismatch on the Czech relative wage structure. As regards regional mismatch, Fialová (2003) computed a regional “mismatch index” for the Czech Republic using the Jackman and Roper (1987) methodology and showed that the value of the index more than doubled between 1991 and 2002. One also has to note that in 1991, at the peak of “transition recession”, the minimum and maximum district unemployment rates were 0.9 % and 9.1 % respectively. By contrast, in 2002, the corresponding values were 2.8 % and 21.7 %.

TABLE 3 Long-term Unemployment (more than 12 months) in Selected Countries  
(per cent in total unemployment)

	92	93	94	95	96	97	98	99	00	01	02
Czech Republic	n.a.	18.5	22.3	31.2	31.3	30.5	31.2	37.1	48.8	52.7	50.7
Hungary	20.4	33.5	41.3	50.6	54.4	51.3	49.8	49.5	48.9	46.7	44.8
Poland	34.7	39.1	40.4	40.0	39.0	38.0	37.4	34.8	37.9	43.1	48.4
Slovakia	n.a.	n.a.	42.6	54.1	52.6	51.6	51.3	47.7	54.6	48.2	59.8

Note: The different figures for the Czech Republic in Tables 2 and 3 are caused by the use of registered unemployment in Table 2 as opposed to Labour Force Surveys in Table 3.

Source: (OECD, 2002); (OECD, 2003b)

Apart from the regional dimension of unemployment, the rise in long-term unemployment is particularly striking, even by comparison with other Central European countries (*Table 3*) or the EU average.<sup>6</sup> In addition, there is a high measurable extent of social and material deprivation among the long-term unemployed – see (Sirovátka – Mareš, 2005) for more details. This produces labour market marginalisation and excludes a substantial part of the Czech population from competing on the labour market. We also suspect that this phenomenon is behind the wage hikes the country has to face, despite high aggregate unemployment figures. These findings are consistent with the signals that “equilibrium unemployment” (NAIRU) is increasing – see (Hurník – Navrátil, 2005) for more discussion.

Another consequence that appears to be linked with long-term unemployment is a recent weakening of the unemployment elasticity of wages – see (Galušák – München, 2005) for details. All this has happened regardless of the government’s recent efforts to foster an “active” labour market and its industrial policies, including radically increasing budgetary resources for such policy measures.

Substantial shifts have occurred in the structure of employment (*Table 4*). The key changes in the structural composition of employment took place during 1990–1996, when the rate of unemployment was very low.

The employment share of industry declined from approximately 38 % to 32 % during that period, while the employment share of agriculture declined from 12 % to 6 %. Expanding sectors such as trade and banking increased their employment shares mainly in the first half of the 1990s.

The main sources of the changes in employment structure were massive labour force withdrawals in agriculture and industry (exits of working pensioners from the labour market, mass retirements, both regular and early, and also a decrease in women’s participation), coupled with job-to-job movements. Flows to employment from unemployment were rather complementary, with no substantial impact on the structure of employment – cf. (Gottvald, 2005).

<sup>6</sup> According to the (OECD, 2002), the share of long-term unemployment in total unemployment in the Czech Republic exceeded the EU average in both 2000 and 2001. Among EU countries, only Italy (with 63 %) recorded higher long-term unemployment than the Czech Republic in 2001.

TABLE 4 Employment Structure  
(in per cent)

	90	91	92	93	94	95	96	97	98	99	00	01	02	03 <sup>a</sup>
Industry	37.9	38.5	36.5	35.3	33.1	32.5	31.9	32.5	32.4	32.2	31.7	31.9	31.5	30.5
Construction	7.5	8.0	8.3	9.4	9.1	9.0	9.0	8.8	8.8	8.5	8.3	7.8	7.5	6.5
Agriculture	11.8	10.1	8.6	6.8	6.9	6.2	6.0	5.8	5.1	4.9	4.4	4.2	4.1	3.9
Transport, Com- munications	7.0	7.3	7.4	7.9	7.2	7.1	7.2	7.1	7.1	7.4	7.2	7.3	7.3	7.2
Trade and Catering	11.5	11.3	13.1	14.9	17.2	17.7	18.5	17.9	19.0	18.0	18.8	19.0	19.3	19.6
Health and Welfare	5.2	5.3	5.5	5.4	5.3	5.2	5.3	5.4	5.4	5.6	5.6	5.6	5.8	5.7
Education	5.9	6.4	6.6	6.7	6.6	6.5	6.4	6.2	6.3	6.3	6.3	6.2	6.3	6.3
Banking and Insurance	0.5	0.7	1.0	1.3	1.6	1.7	1.8	1.8	2.0	1.8	1.8	1.7	1.7	1.7
Administration, Defence	1.8	2.0	2.5	2.7	3.0	3.2	3.3	3.6	3.7	3.8	3.9	4.1	4.1	6.2
Other services	10.9	10.4	10.5	9.6	10.0	10.9	10.6	10.9	10.2	11.5	12.0	12.2	12.4	12.4
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Note: <sup>a</sup> preliminary 1<sup>st</sup>–3<sup>rd</sup> quarters 2003

Source: Statistical Yearbooks of the Czech Republic

Within public services, state administration and defence have increased their employment shares, while education and health services have stagnated. Despite all the changes, the Czech labour force is still relatively overburdened in industry and short-staffed in services, in particular advisory, information, personnel and other modern services for firms. Nonetheless, the above listed shifts in employment structure were considered, by, for example, OECD (1995), to be a satisfactory indicator of structural changes. Since 1995–1996, however, the process of further change in the structure of employment has nearly stopped. Even the constant rise in unemployment has had no visible consequences in terms of further structural changes in employment.

More detailed evidence on labour mobility is provided by the Labour Force Surveys (LFS), which started in 1993. They document massive job-to-job movements, representing one half of all mobility flows at the beginning of the 1990s. By contrast, in the late 1990s the role of this mobility flow declined heavily. The LFS data also show that the Czech labour market reached a turning point between 1995 and 1997, when the employment stock peaked and the unemployment stock shrank. Yet in 1995, job-to-job movements amounted to almost half a million workers, while in 1996 the labour market was more rigid, meaning a relatively sharp decline in total flows.

In 1997, the flows started to rise again, but – in contrast to the previous period – this rise was fed by mounting numbers of employees becoming unemployed (*Table 5*). A look at the changing nature of labour flows provides analogous information to the study of structural changes in employment, thus documenting increasing stagnation and rigidity on the Czech labour market – see (Gottvald, 2005) for more details on labour flows.

The LFS statistics also allow us to observe changes systematically in work

TABLE 5 Yearly Flows between Labour Market States (thousand persons)

<i>Kind of flow</i>	1993	1994	1995	1996	1997	1998
Unemployment – employment	119.5	113.5	101.4	104.6	104.7	100.7
Inactivity – employment	248.3	217.1	176.5	147.8	188.9	166.6
Employment – unemployment	82.7	65.5	61.0	74.6	88.1	147.0
Employment – inactivity	257.3	209.9	281.4	197.4	185.6	183.4
Unemployment – inactivity	25.5	35.0	35.4	20.2	23.9	24.9
Inactivity – unemployment	52.7	31.5	29.6	29.0	53.2	72.1
Job – job	723.1	572.2	446.7	353.5	315.0	247.2
Total flows	1 509.1	1 244.7	1 132.0	927.1	959.4	941.9

Source: LFS, computations by Ivo Makalouš, Czech Statistical Office

contracts and other details. Regarding types of work contract, open-ended full-time job contracts strongly prevail in the Czech economy. Only 9 % of employed workers had a non-standard contract at the end of 2002 and this percentage did not show any upward tendency. Nor are fixed-term contracts increasing: their proportion has remained stable since 1994 at about 7 % of all employee work contracts. This type of work contract is popular among small entrepreneurs, who stick to this form to avoid severance pay and the other relatively strict conditions of lay-off. Typically, professionals in public services, such as teachers, physicians, researchers and even journalists, are forced to accept fixed-term contracts.

Part-time jobs decreased from 6 % of total employment in 1994 to 5 % at the end of 2002 (in contrast to the EU average of 16 %). Women work under part-time contracts more frequently than men. Most of the reasons for not working full time are on the side of employees – men frequently declare health reasons and continuing education as grounds for not working full time, while women usually stress child care.

While men declare a constant rate of under-employment,<sup>7</sup> slightly exceeding one-tenth of those engaged in part-time work, women report increasing levels of under-employment, which reached 28 % of those doing part-time work in 1998, but decreased to 15 % in 2002. In short, part-time jobs do not appear to be a tool that substantially enhances labour market mobility in the Czech Republic.

With closing channels of labour mobility, a decreasing percentage of employed people are also searching for second or additional jobs. According to the LFS, their numbers are sharply decreasing (from 250,000 in 1993 to 115,000 in 2002), amounting to a negligible 2.5 % of total employment at the end of 2002. Such numbers appear to be under-reported: while the LFS tells us that the number of self-employed had reached only 774,000 by the end of 2002, 2.2 million business licenses had been issued and there were 1.848 million registered entrepreneurs (excluding foreigners) by the end of 2002.

<sup>7</sup> The rate of under-employment represents the reported share of those who work part-time involuntarily, as opposed to the share of total part-time jobs in total employment.



### 3. Wage Developments and Disparities

To understand the post-1989 wage developments, one has to address wage issues at both an aggregate and more structured level. The aggregate view will show us wages developing within the context of macroeconomic indicators and government policies. By contrast, a closer look at industrial and even individual wages will deliver us necessary insights into the newly emerged relative wage structures.

Aggregate real wage developments at the very beginning of the transition process were characterised by sharp absolute declines, meaning consumer prices increasing more rapidly than nominal wages. One has to discuss at least three factors that appear to explain the causes of these developments, as well as their social acceptance: a) the overall macroeconomic context, b) the role of mandatory incomes policies, and, finally, c) the pre-privatisation motivation of both managers and employees.

- a) Neither excessive aggregate demand, nor unrealistic wage claims occurred in the early 1990s: price liberalisation followed by sound monetary and fiscal policies had dissolved any monetary overhang and caused aggregate demand to decline sharply. A dramatic fall in GDP had diminished the total real income available. Because of this, the previous real wage levels were unsustainable. The threat of a wage push potentially existed, but was effectively removed by a specific “implicit social contract” between the government and the main social actors.
- b) The mandatory incomes policy agreed between the government, the trade union confederation and employers’ associations was introduced in 1991 to prevent a wage push. The 1991 decline in consumer real wages, however, was more than two and a half times higher than that stated by the agreed targets, thus making wage controls rather superfluous.<sup>8</sup> Thus the only argument, if any, that might have justified the introduction of wage controls is that the government could not have perceived the actual development of wages.
- c) The transitional recession had produced an overall fear of mass layoffs, a threat that outweighed the trade unions’ concerns about wages. With personal benefits connected with the ongoing privatisation at stake, enterprise managers were keen to avoid industrial conflicts stemming from layoffs, since those appeared to be a more probable source of labour un-

<sup>8</sup> In 1991 the government introduced a legally binding incomes policy with the aim of securing a 10% annual decline in consumer real wages. Enterprises as well as public sector institutions first had to wait until the past (quarterly) developments of the CPI were known and then adjust wages in line with the real wage target. Such a backward-looking mechanism thus permitted proportionally lower increases in individuals’ wages compared with those in the CPI. A “tax-based” punitive penalty was introduced for exceeding the regulatory limits. Only small private firms with less than 25 employees were free from these wage controls. The incomes policy continued to be legally binding between 1992 and the first half of 1995 (with a break in the first half of 1993). The government declared zero growth in consumer real wages as a target for 1992 and 5% growth for 1993–1995. In order to compensate for the 1991 real wage deterioration and to preserve social accord, the policy norms became increasingly selective and decreasingly transparent over time and allowed an increasing number of exemptions. That is why real wage growth rates under the 1992–1995 incomes policy exceeded the norm (with the exception of 1993) and were not balanced by appropriate labour productivity improvements, either at the macro-level or at the industry level.

TABLE 6 Wage Developments in the Czech Republic  
(annual growth in per cent)

	91	92	93	94	95	96	97	98	99	00	01	02	03 <sup>d</sup>
Average nominal wage <sup>a</sup>	15.4	22.5	25.3	18.5	18.5	18.4	10.5	9.4	8.3	6.6	8.7	7.1	6.8
Average real wage <sup>b</sup>	-26.3	10.3	3.7	7.7	8.6	8.8	1.8	-1.2	6.1	2.6	3.8	5.2	6.9
Unit labour costs <sup>c</sup>	27.1	23.4	23.0	13.1	15.5	10.4	7.6	7.4	3.7	1.1	3.8	3.0	3.5
CPI	56.6	11.1	20.8	10.0	9.1	8.8	8.5	10.7	2.1	3.9	4.7	1.8	-0.1

Notes: <sup>a</sup> average nominal wage per employee in the civil sector of the national economy

<sup>b</sup> average nominal wage growth deflated by the CPI

<sup>c</sup> ratio of the index of nominal compensation of employees and mixed income of households per worker to the index of total labour productivity at constant prices

<sup>d</sup> preliminary 1<sup>st</sup>-3<sup>rd</sup> quarters 2003

Source: Statistical Yearbooks of the Czech Republic

rest than declining real wages. This, and not the wage controls agreed at the central tripartite level, appears to have been the true essence of the “implicit social contract”.<sup>9</sup>

Conventional measures of wage inflation, such as nominal unit labour costs, would indicate the prevailing presence of inflation pressures stemming from wage developments over the investigated period (Table 6). Alternatively, in terms of real wages, the “wage cushion” (caused by a steeper decline in real wages than in labour productivity) was removed by the mid-1990s. Nonetheless, real wages generally continued to grow faster than labour productivity even after 1995 and the labour share (i.e. wages plus social insurance payments in GDP) increased from 42 % in 1995 to 67 % in 2002. The dominant effect of wage inflation is therefore to be seen in massive income redistribution in favour of wage earners, rather than in price inflation itself.

The role of the central tripartite body has totally eroded over time, with the enterprise level being the true arena for the wage settlement process. The bargaining outcome usually meant that producers accepted declining real profit margins when allowing real wages to grow steadily in excess of labour productivity. Accepting such a wage strategy in fact impeded the privatised firms’ chances of financing restructuring from their internal resources for an extended period. Industrial financial indicators, such as return on equity, remained below the returns on risk-free assets until the end of the 1990s, and the dependency of firms on external financing continued, with an evident adverse effect on employment – see (Flek, 2000) for more details. Therefore, the microeconomic pattern of wage determination appears to express not only efficiency considerations on the part of employers in a Shapiro and Stiglitz (1984) fashion, but also the continuing insiders’ power.

The pre-1989 Czechoslovakia was characterised by extreme wage equalisation and, within the remaining disparities, by a predominance of individuals’ demographic features (gender and age) over their personnel cha-

<sup>9</sup> See (Flek, 1996) for a more detailed explanation of the socio-economic context that had made the real wage declines acceptable for the short term.

TABLE 7 Relative Distribution of Wages by Deciles  
(per cent and coefficients)

Decile	1989	1993	1997	1999	2001	2002
1	4.7	4.4	4.6	4.4	4.3	4.3
2	6.5	5.6	5.9	5.8	5.7	5.6
3	7.3	6.6	6.9	6.7	6.7	6.6
4	8.2	7.4	7.7	7.5	7.5	7.4
5	9.1	8.4	8.5	8.3	8.2	8.2
6	10.1	9.4	9.3	9.1	8.9	9.0
7	11.0	10.7	10.2	10.1	9.9	10.0
8	12.2	12.2	11.0	11.4	11.4	11.4
9	13.7	14.6	13.1	13.8	13.7	13.7
10	17.2	20.7	22.8	22.9	23.7	23.8
Total	100.0	100.0	100.0	100.0	100.0	100.0
Ratio 10:1	3.7	4.7	5.0	5.2	5.5	5.5
Robin Hood Index	14.1	18.2	17.1	18.2	18.8	18.9

Notes: Robin Hood Index measures the share of total income (in per cent) that needs to be redistributed in order to obtain an equal distribution. Algebraically, it is half the mean deviation divided by the mean. (The Gini coefficient was not calculated here due to the small number of incomes bounds in published tables of wage surveys.)

Sources: own calculations based on the Wage Surveys of the Czech Statistical Office

racteristics (skills and occupation). Alongside this, some industries (mining, iron and steel, heavy machinery) were favoured, and selected categories of workers (top state and party bureaucracy, army and police officers) privileged. Behind the facade of an almost stable range of wage inequality and small overall disparities, demographic factors actually strengthened and so-called productive industries were promoted, while the highly educated and the younger generations were disadvantaged (Večerník, 1991). After 1989, the transformation process broke many of those tendencies and started to change the established earnings structure.

The range of wage inequality has increased remarkably (*Table 7*), but the main changes appear to have occurred in the first half of the 1990s. Since then, the continuing rapid overall wage increases co-exist with an increasingly stagnant wage distribution. This corresponds to the analogous stagnation of labour flows and employment structure observed in previous sections of this chapter. A similar tendency towards a gradual stagnation in wage structures for the second half of the 1990s can also be observed in *Table 8*.

According to the data in *Table 8*, the relative wage position of agriculture, industry and construction has attenuated while the position of trade, public administration and, in particular, banking and insurance has improved. Against expectations, however, earnings in modern services for human capital – health care and education – stagnated. In general, however, the wage growth rates of particular industries gradually tended to equalise during the second half of the 1990s, in spite of overall real wage increases.<sup>10</sup> From

<sup>10</sup> Flek and Večerník (1998) find an analogous trend in wage distribution within the manufacturing industry.

TABLE 8 The Relative Wage Structure in the Czech Republic  
(in per cent, average = 100)

	90	91	92	93	94	95	96	97	98	99	00	01	02	03 <sup>a</sup>
Industry	103.8	104.7	103.5	101.3	99.9	99.7	99.1	100.3	101.5	100.0	100.7	99.1	97.7	96.6
Construction	109.9	106.6	108.2	112.2	110.6	108.1	105.1	105.1	103.7	100.9	100.2	100.0	99.9	98.3
Agriculture	109.6	97.7	91.8	87.7	85.1	84.2	80.7	79.6	78.9	75.7	76.2	76.7	74.1	71.6
Transport, communications	104.6	103.2	99.1	97.5	98.7	100.8	101.8	105.8	107.9	107.7	109.9	109.0	110.0	110.0
Trade and Catering	85.8	85.9	89.7	88.2	91.6	88.1	87.8	98.1	101.7	101.4	105.0	104.7	104.0	102.0
Health and Welfare	92.6	96.6	94.5	95.0	93.9	92.1	93.7	90.0	85.1	89.3	87.0	91.0	95.8	96.9
Education	88.1	90.3	90.6	90.2	91.7	90.9	93.0	88.1	84.2	87.5	83.6	84.9	86.6	88.4
Banking and Insurance	102.0	136.9	169.6	177.7	175.2	171.5	169.6	174.6	181.1	183.0	189.9	199.0	201.0	201.0
Administration and Defence	100.4	105.3	114.6	118.9	120.7	117.6	118.4	110.1	103.0	107.7	103.2	105.0	108.0	114.0
Coeff. of var.	0.09	0.14	0.23	0.26	0.26	0.25	0.25	0.26	0.29	0.29	0.31	0.33	0.34	0.34

Notes: <sup>a</sup> preliminary 1<sup>st</sup>–3<sup>rd</sup> quarters 2003

Source: Statistical Yearbooks of the Czech Republic

the beginning of the 2000s onwards, only a slight acceleration in inter-industry wage differentiation can again be observed.

At the beginning of the transition period, wage structures were characterised by a wage advantage of new private firms as compared with state-owned enterprises. According to Flanagan (1995), a worker's wage in the new private sector exceeded by more than one-and-a-half times that which a worker of the same education and age range earned in the state-owned enterprise. This finding is, somewhat unusually, linked with the presence of a negative union wage differential because of the almost exclusive presence of trade unions in state-owned firms. Večerník (1996) notes, however, that the ownership-based wage differential tends to diminish over time.

According to (Večerník, 2001), the relative importance of age or sex for explaining wage variation among individuals has declined remarkably since 1988. By contrast, an increasing part of the total variance in wages can be explained by differences between non-manual and manual labour or by regions. The relative importance of education for explaining wage inequality has also increased. On the other hand, despite all the changes, sex still remains the most robust explanatory variable. It is also worth noting that the industry affiliation of a worker explains a greater part of the total wage variance than regions or manual/non-manual labour. This corresponds to the fact that sales-per-worker-based wage differentials between industrial enterprises were also found, as well as those based on profit per worker and enterprise market share, or, in other words, on rent-sharing patterns of wage determination among industrial enterprises (industries).<sup>11</sup>

The strengthening wage disparities caused by education can be considered the most important factor of wage determination – see also (Jurajda, 2005) for the most recent findings and a broader literature overview.<sup>12</sup> At the end of the communist era, one year of schooling increased men's ear-

nings by 4 % and women's earnings by 5 %, according to (Večerník, 2001). In 1992, this figure increased to 6.1 % for men and 8 % for women; by 1996, the return amounted to 8.3 % for men and 9.4 % for women. Simultaneously, the effect of experience (years on the job) on earnings stagnated. Whereas in 1988, the effect of experience among men was nearly as strong as that of education, education clearly dominated over experience in 1996 and also more recently. In 2002, the return amounted to 9.1 % for men and 10.2 % for women. Despite some increase, the recent evolution of returns to education signals a certain stabilisation in the distribution of earnings.

Returns to education, however, tell us little about the actual degree of labour market efficiency. Jurajda (2005) documents in more detail that the exceptionally high returns to education in the Czech Republic appear to be just a result of a short supply of higher education. One can see that although returns to education have risen considerably, labour productivity has improved predominantly due to reductions in the labour force. In any case, employment reductions appear to be much more important for productivity developments than rising earnings disparities themselves.

#### 4. Work Incentives and Workers' Attitudes

Various evidence and documents witness that there is a significant lack of flexibility and variability in employment patterns in the Czech Republic.<sup>13</sup> Emphasis should therefore be placed upon negotiating and implementing agreements to modernise the organisation of work, including flexible working arrangements, achieving the required balance between flexibility and security, and increasing the quality of jobs. At the same time, there are strong disincentives shaped by the relatively generous welfare scheme. *Table 9* documents some of the most striking features of the Czech welfare system. First of all, there is a generously set minimum subsistence level for families with two (or more) children, ranging from 148 % of the gross average wage in 1991 to a still relatively high ratio of 76 % in 2002.<sup>14</sup>

This explains the benefit dependency and poverty trap that have both emerged in the Czech Republic – see (Mareš – Sirovátka, 2005) for more details and a broader outline of necessary changes in the current policy

<sup>11</sup> In imperfectly competitive markets, supernormal rents (sales) are the result of monopoly power, while the participation of workers in sharing these rents depends on their bargaining power. This usually leads to a wage advantage for monopolised industries with high capital/labour ratios: favourable wages are relatively easily affordable because of exceptional profitability and the still low share of wages in value added. As far as empirical research is concerned, Basu, Estrin and Svejnar (1997, p. 285) note the presence of a sales-per-worker-based wage differential in Czech industry, which “is found to be positive and increasing over time” – see also (Buchtíková – Flek, 1995), (Flek – Večerník, 1998), (Flek, 1996) or (Gottvald *et al.*, 2002) for additional evidence on wage differentials based on sales-per-worker, labour productivity and profitability.

<sup>12</sup> Gottvald *et al.* (2002) note that it is not education itself, but rather the type of occupation that is the major wage determinant. The two characteristics are, however, strongly correlated.

<sup>13</sup> See, for example, (*Joint Assessment...*, 2000).

<sup>14</sup> These figures speak for themselves even without involving the net average wage or figures based on dollar wages.

TABLE 9 Average Wage and Subsistence Levels  
(CZK monthly, % of gross average wage)

Indicator	91	92	93	94	95	96	97	98	99	00	01	02
Gross average wage	3,792	4,644	5,817	6,894	8,172	9,676	10,696	11,688	12,658	13,494	14,668	15,709
Gross minimum wage	2,000	2,200	2,200	2,200	2,200	2,500	2,500	2,650	3,250 3,600*	4,000 4,500*	5,000	5,700
Average unemployment benefit	...	1,404	1,654	1,839	2,056	2,306	2,567	2,335	2,529	...	2,961	3,164
Living minimum												
– of single adult	1,700	1,700	1,960	2,160	2,440	2,660	2,890 3,040*	3,430	3,430	3,770	4,100	4,100
– of couples with two children aged 10–15	5,600	5,600	6,400	7,060	7,840	9,110	9,570	10,470	10,470	11,160	11,980	11,980
<i>In % of average gross wage:</i>												
Gross minimum wage	52	47	38	32	27	26	23	23	26 29	30 33	36	36
Average unemployment benefit	...	30	28	27	25	24	24	20	20	...	22	20
Living minimum												
– of single adult	45	37	34	31	30	30	28	29	27	...	28	26
– of couples with two children aged 10–15	148	121	110	102	96	94	89	90	83	...	82	76

Notes: \* Changes made twice a year. For 2003, the minimum wage was set at CZK 6,200.

Sources: Statistical Yearbooks of the Czech Republic, Ministry of Labour and Social Affairs

agenda. The point is that the bulk of the long-term unemployed suffer from low qualifications and employability. Because of the generous social protection scheme, however, their reservation wage remains close to the economy average wage, a fact that further diminishes the employment prospects of the unemployed and increases their benefit dependency. No wonder that, in such circumstances, the rapidly increasing budgetary resources allocated to support active labour market policies (ALMPs) appear to have been wasted.

However, not only work incentives and disincentives, labour market policies and the institutional framework, but also the deep-rooted values and attitudes of workers matter in explaining unemployment rates and the economy's performance. One has to note, however, that those are not easy to inspect and attitudes declared in surveys do not necessarily correspond to reality. Some caution is therefore necessary in judging the surveys' results. Nevertheless, findings of this sort can help us to explain the exaggerated evaluations which characterise people's opinions and expectations in the Czech Republic *vis-à-vis* the rapidly deteriorating functioning of the labour market.

We face a paradox here. On the one hand, the Czech Republic is still considered by many foreign investors to be a "cheap workshop of Europe", well suited for manufacturing goods designed elsewhere, with minimum value added. On the other hand, the Czech labour force has become increasingly demanding, if not somewhat choosy. Heavy work in construction and routine jobs in light manufacturing are left to new "Gastarbeiters" (*guest*

TABLE 10 Job Investment Strategies in International Comparison

Activity (you would be willing to...)	A. You had no job and could get a new one				B. You were offered a new job with twice the salary			
	Czech Republic	Hungary	Nether- lands	United Kingdom	Czech Republic	Hungary	Nether- lands	United Kingdom
1. Work more	39.5		27.4	53.6	63.9		31.6	63.8
2. Migrate	15.9	19.1	25.4	38.6	26.4	26.8	28.9	50.3
3. Worse job	16.6	25.0	20.3	27.2	31.8	29.1	19.1	39.8
4. Retrain	57.5	58.0	50.2	64.3	67.6	60.9	46.4	70.2
5. Language	39.7	44.6	63.2	57.4	49.1	47.5	60.5	63.8
<i>Cumulative response (number of activities enumerated) in %:</i>								
0	48.9		28.7	46.9	42.2		34.7	46.2
1–2	32.5		40.8	22.4	25.3		33.2	14.2
3–5	18.6		30.5	30.7	32.5		32.1	39.6
Total	100.0		100.0	100.0	100.0		100.0	100.0

Notes: 1. work more than 40 hours per week  
 2. move (migrate) to another place  
 3. accept less attractive work conditions  
 4. retrain for another profession  
 5. learn a new foreign language

Only "yes" answers were taken into account. The other two answers were "maybe" and "no".

Source: HWF Survey, 2001

workers) from countries of the former USSR. Even in many localities and regions with high unemployment, job vacancies would remain unfilled if they were not taken by foreign workers. About 100,000 foreigners currently work in the country legally, but a much higher number are estimated to work here illegally.

The explanation lies, at least partly, in changing values related to work and jobs. Večerník (2004) compares work values in advanced Western countries with the transition countries of Central and Eastern Europe and finds that there is much more job commitment in the West. By contrast, less willingness to invest in one's own human capital was found for the transition countries. These findings are based on results received from answers to questions regarding readiness to adjust to harder work conditions or requirements, posed in an international survey "Households, Work and Flexibility" (HWF). The respondents were asked two questions, the first of which evokes the situation of joblessness and asks about the respondent's willingness to accept a new job under certain conditions, while the second evokes the situation of an attractive job offer with twice the salary in comparison with current earnings.

As Table 10 shows, the Czech working age population appears to be relatively less ready to migrate in order to be employed, to accept a worse job instead of unemployment, or even to learn foreign languages. Czechs score quite well in retraining and also in work intensity (although this is still much lower than in the EU countries), but are laggards in the other hypothetically offered ways of resolving unemployment problems. In general, the incentive (pull) effect of a double salary is much stronger than the enforcement (push) effect of mere unemployment. It is in the Czech Republic,

however, where the gap between both “potentials” is the largest. In any case, there still remain 42 % of Czechs not interested in any strategy leading to a double salary, and about 50 % not interested in any strategy leading to employment.

Taking all the available evidence together, we can say that in the majority of the labour force, a long-term commitment to one job and place is preferred above any change, commuting is preferred over migration, and welfare dependency or early retirement is preferred over retraining and seeking a new job. There is still only a weak minority of the working population that is really active and ready to invest in its human capital and be mobile and flexible. Labour market rigidities endure in the minds and behaviour of people in the Czech Republic.

## 5. Conclusion

The Czech Republic has definitely lost its exceptional position, often labelled as an “unemployment miracle”. What are the reasons for this?

Let us stress that the labour market alone is not fully responsible for its seemingly poor performance. There are the following main obstacles to better macroeconomic performance and job creation which are linked with a still relatively weak supply-side flexibility of the Czech economy as a whole: (i) a long-term stagnation in total factor productivity (i.e. an enormously low rate of growth thereof), (ii) output growth dependency on real imports, and (iii) a low efficiency of investment in spite of a high investment rate. Massive FDI inflows or solid export performance are not yet able to reverse the tendency of diminishing aggregate employment and increasing unemployment – see (Flek *et al.*, 2001) for more details.

As a result, employment and unemployment display, respectively, a strong downward and upward long-term trend, developments that complicate linking labour market performance with business cycle fluctuations alone. (Although there are some signs of pro-cyclical behaviour of employment and unemployment, such as during the transition recession in 1991 or in 1997–1999, when the economy experienced a currency crisis and a recession resulting from macroeconomic overheating.) Instead of stressing the cyclical factors, it is more evident that the increasing unemployment trend can to a large extent be attributed to the fact that the process of reducing excess employment in privatised Czech enterprises accelerated in the second half of the 1990s.

At the same time, the apparent deterioration in labour market performance over time leads us to the conclusion that there are serious “internal” problems inherent to the Czech labour market. Among other factors, it is the changing pattern of labour flows that helps us to understand why the current unemployment rate is approaching two-digit figures. Increasing redundancies cannot be proportionally offset by declining labour force participation. Such a method of reducing labour supply has gradually been exhausted during the 1990s. Since 2001, moreover, early exits have become subject to punitive practices.

As a result, the working-age population is becoming increasingly affected



by involuntary redundancies and, after being dismissed, remains dependent on a labour market exhibiting growing signs of rigidity and insufficient job creation – see (Gottvald, 2005) for more details. Most striking is the growth in long-term unemployment, affecting low-qualified labour above all. High regional unemployment appears to be linked with the former, thus creating “pockets of unemployment”. As will be shown in more detail by Mareš and Sirovátka (2005), the long-term unemployed suffer considerably from mental, social and material deprivation. From this one could derive an argument for deteriorated conditions for proper labour force reproduction and even a considerable amount of involuntary unemployment.

At the same time, however, the reservation wage (as well as other requirements concerning the quality of a job to be accepted), as perceived by the unemployed, appears to be above the subsistence minimum guarantee, a wage that is, however, often difficult to achieve, especially because of the existence of competition for less qualified jobs from the countries of the former Soviet Union. Another reason is that the still ongoing company restructuring often requires further layoffs, which makes it extremely difficult for firms to pay more for non-qualified labour, not to mention the declining demand for it in general. That is why it is hard to deal with the unemployment problem without altering the social benefit scheme.

The high unemployment in the Czech Republic thus resembles a vicious circle, resulting in the emergence of the “unemployment trap” and benefit dependency, accompanied by a measurable extent of labour force deprivation. Active labour market policy measures appear to be insufficient to deal with this problem. The government, faced by pressures to cope with rising long-term unemployment, has repeatedly increased the minimum wage since 1998 with the intention of strengthening work incentives for the unemployed with low incomes. However, this strategy addresses labour supply only, while the incentives to hire domestic non-qualified labour remain largely low, if not further diminished by such measures.

As far as aggregate wage developments are concerned, the previous rapid real wage increases appear less feasible in the future. At the same time, the Czech Republic increasingly displays the patterns of wage differentials that are typical for market economies. The stagnation in both employment and wage structures which started in the mid-1990s, however, signals the growing rigidity of the Czech labour market, in spite of high aggregate unemployment.

The labour market policies are still developing and adjusting closer to EU standards and goals. Aware of inconsistencies between employment and social policies, the Ministry of Labour and Social Affairs has eventually started preparing measures aimed at interrelating them more closely. The new policies should include an emphasis on the enhancement of work flexibility through broad skills and multitask occupations, flexible contracts and hours, and also adaptability to the workplace and related commuting or migration. Simultaneously, some activation measures are envisaged, such as non-entitlement of school-leavers and graduates to unemployment benefits, increased pressure on the unemployed living on social benefits to take a job, etc.

However, this process should also involve substantial changes in labour taxation, labour legislation (where, for example, a reduction in employment

protection is important), welfare institutions (where, for example, the elimination of a strict demarcation between the work life and benefits is needed) and, in particular, peoples' attitudes (greater assertion of work values in general).

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## SUMMARY

JEL Classification: J21, J24, J26, J31, J38, J60, J65

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# **The Labour Market in the Czech Republic: Trends, Policies, and Attitudes**

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The Czech Republic is no longer an employment haven, the site of what had been declared as an “unemployment miracle.” What happened? In this paper, we gather various statistical and sociological data on employment and unemployment trends, wage development, and workers’ opinions and their labor market strategies, taken from various surveys. In such manner, not only is the history of the Czech labour market over the past decade written, but also the reasons for the deteriorating labour market performance are addressed, and an appropriate policy agenda is outlined. In particular, we identify existing labour market rigidities and show that high unemployment here proceeds in an ever-widening gyre, resulting in the emergence of the unemployment trap and benefit dependency. Active labour market policy measures alone appear to be insufficient to deal with this problem.