LABOUR MARKET POLICY IN THE CZECH REPUBLIC AFTER EU ACCESSION

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Abstract: The general objective of labor market policy (LMP) is to enhance efficiency of job matching. It consists of policies to activate various groups of unemployment (active LMPs) and policies providing income replacement (passive LMPs). The paper describes development of Czech LMP after 2004 when the Czech Republic joined the EU and main problems it had to face. The main aim of the paper is to evaluate LMPs in the Czech Republic and to find out if they met its general objective. It focuses on crude indicators of labor market efficiency, long-term unemployment, NAIRU rate and model of Beveridge curve. According to these indicators it seems that Czech LMP meets its general objective and enhances labor market efficiency.

Keywords: labor market policy, active measures, passive measures, NAIRU rate, Beveridge curve, long-term unemployment

JEL classification: J48, J58, J68

1. Introduction

In recent two decades, there has been a growing interest in labor market policy as a means of fighting the persistent unemployment in European countries. Traditional stabilization policies have ambiguous effects on employment with the risk of inflation and supply-side structural reforms have been difficult to implement or appear to produce only slow results (Calmfors, 1994). In this context, active labor market policy seem to be the way how to mitigate the unemployment problem. Active labor market programs constitute a central part of the European Employment Strategy, which defines employment as one key objective of a joint economic policy in the European Union. Given the deep and long lasting impact of recent economic crisis, labor market policies play an important role in responding to the recession. The main challenge facing governments are structural problems in the labor market and low level of flexibility employers have in adjusting labor. This is influenced by institutions in the labor market (e.g. wage setting institutions, minimal wages, unionization, employment protection legislation, etc.).

Labor market policy (LMP) comprise regulative policies that influence the interaction between labor supply and labor demand in order to enhance efficiency of job matching. Changes in labor market efficiency should be reflected in the NAIRU rate (Dickens, 2009; Hurník and Navrátil, 2005), so the successful labor market policy should lead to the decline in the NAIRU. This linkage should be interpreted carefully because the NAIRU is influenced by factors that are out of direct government control (e.g. demographic development, structural changes, etc.).

Labor market policy consists of policies aiming to activate various groups of unemployed (usually called active labor market policies (ALMPs)) and policies that provide some income replacement (passive labor market policies (PLMPs)). Generally, there are four main types of ALMPs: training, subsidized employment, public employment services and activation. Training programs essentially comprise all human capital enhancing measures. Subsidized employment concerns measures to promote or provide employment for the unemployed and other vulnerable groups in the labor market. It also contains wage subsidies aimed to encourage employers to hire new workers or to maintain jobs that would otherwise be broken up. Public employment services concern job search courses, vocational guidance, counseling and monitoring and administration of unemployment benefits. Activation measures provide incentives to unemployment to increase job search process through

1 See Franc and Breinek (2014) for details.
benefit sanctions (e.g. reduction of unemployment benefits) or through mandatory participation in training or subsidized employment.

Except this main function, labor market policy plays the complementary role of ‘keeping the unemployed going’ in general during a recession, so that effective aggregate supply of labor is maintained (Layard et al., 1991, Calmfors, 1994). Passive labor market policy providing income replacement in form of unemployment benefits influences search intensity of unemployed and duration of their unemployment spell.

ALMPs may thus reduce mismatch in the labor market because they promote more active search behavior on the part of the unemployed. However, these policies may lead to opposite results; workers can be locked into training and job creation programs, which can reduce their search activity. The important is that there are interrelationships with other government regulations affecting labor market efficiency, minimum wages and employment protection legislation.

2. Policies

According to available indicators, the situation on the Czech labor market at the moment of accession to the EU can be summarized as follows. Employment and unemployment were essentially on the average level in comparison with EU15 countries. Significant differences in the position of various groups in the labor market are what distinguishes the Czech Republic from other EU countries. Although in the late 90s has increased, the rate of unemployment among young people and older workers was slightly below the EU average. Significant differences were in the rate of unemployment of unskilled and high skilled workers. The unemployment rate for workers with basic education was 19 % in the Czech Republic, while the EU average was 12 % (Kulhavý and Horáková, 2005). For high skilled workers the situation was exactly the opposite; lower unemployment rate for this group of workers was only in Hungary. Czech Republic was among the countries that were characterized by rather higher proportion of long-term unemployed (see Figure 3); about 70 % workers had been unemployed for more than six months, 50 % for more than 12 months, which was 10 percentage points higher than the EU average.

Implementation of labor market policy is the responsibility of each member state in accordance with the subsidiarity principle. At the EU level there are issued directives and given recommendations whose implementation is monitored. Czech government prepared annual National Employment Action Plan, which was designed to comply with the European Employment Strategy. National action plans were submitted to the Council of Europe and the European Commission, which made recommendations to individual member countries.

2.1 Active Labour Market Policy

Active labor market policy is carried out by labor offices on behalf of Ministry of Labour and Social Affairs. It focuses on the most vulnerable groups in the labor market; long-term unemployed, older workers, workers with inadequate skills and workers with health and other disabilities. There has been increased emphasis on active labor market policy since 1998 in the Czech Republic as regards both the amount of resources spent on active measures and the number of participants in these programs. The structure of ALMPs has begun to reflect trends in European labor market – activation and motivation of all participants in the labor market, the emphasis on employability of the labor force and motivation system, the pursuit of personalization and professionalization of employment services and higher emphasis on the business environment.

The extent to which active labor market measures are implemented, is significantly determined by the financial resources available. In this regard the Czech Republic belonged among countries with lowest level of total expenditures on ALMPs even with regard to the level of unemployment. As table 1 shows, these expenditures have not exceeded 0,3 % GDP (except 2010), while in EU15 countries it
was 1 % on average. Approximately half of the ALMP expenditures are allocated on public employment services (PES), the other substantial amount of resources goes to some form of employment support.

**Table 1**: Participation and public expenditures on ALMP (percentage of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Labor force involved (%)</th>
<th>PES</th>
<th>Training</th>
<th>Employment incentives and supported employment</th>
<th>Job creation</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>1.03</td>
<td>0.12</td>
<td>0.02</td>
<td>0.07</td>
<td>0.03</td>
<td>0.24</td>
</tr>
<tr>
<td>2005</td>
<td>1.06</td>
<td>0.12</td>
<td>0.01</td>
<td>0.07</td>
<td>0.03</td>
<td>0.24</td>
</tr>
<tr>
<td>2006</td>
<td>0.99</td>
<td>0.12</td>
<td>0.01</td>
<td>0.08</td>
<td>0.03</td>
<td>0.25</td>
</tr>
<tr>
<td>2007</td>
<td>1.07</td>
<td>0.13</td>
<td>0.01</td>
<td>0.10</td>
<td>0.02</td>
<td>0.25</td>
</tr>
<tr>
<td>2008</td>
<td>0.97</td>
<td>0.12</td>
<td>0.01</td>
<td>0.08</td>
<td>0.02</td>
<td>0.23</td>
</tr>
<tr>
<td>2009</td>
<td>0.91</td>
<td>0.12</td>
<td>0.03</td>
<td>0.09</td>
<td>0.04</td>
<td>0.29</td>
</tr>
<tr>
<td>2010</td>
<td>1.14</td>
<td>0.11</td>
<td>0.04</td>
<td>0.13</td>
<td>0.04</td>
<td>0.33</td>
</tr>
<tr>
<td>2011</td>
<td>1.01</td>
<td>0.10</td>
<td>0.01</td>
<td>0.13</td>
<td>0.03</td>
<td>0.27</td>
</tr>
<tr>
<td>2012</td>
<td>-</td>
<td>0.11</td>
<td>0.01</td>
<td>0.11</td>
<td>0.02</td>
<td>0.26</td>
</tr>
</tbody>
</table>

*Source: OECD.Stat*

Individual ALMP measures have a specific purpose that determines their influence on the individual unemployed. The most convenient overview of measures implemented in the Czech Republic is: (i) financing and other support of job creation, (ii) programs increasing/changing qualifications and skills of the unemployed, and (iii) activation programs (motivation and rehabilitative measures) that do not meet nature any of the previous categories. While retraining programs are market conforming measures, financing of job creation is labor market intervention implemented in economies with small number of vacancies or low employment of vulnerable groups of workers.

Job creation. The jobs created due to the financial support should represent the last chance in case of inability to find a job. This measure has form of sheltered workshops, socially purposeful jobs and community works. As can be seen from table 2, these programs carry high financial costs as compared with training programs which are four to five times cheaper. With the decline of investment incentives program related expenditures was reduced.

Retraining programs. The aim of these programs is to change qualification of the unemployed who would not be able to find a job in their field. Retraining courses mostly do not change level of education of participants and therefore are not suitable for low-skilled and long-term unemployed. Even so, it is the most important tool of AMPL.

Activation programs. The goal of these programs is to motivate the unemployed to greater search activity. These programs are relatively cheap and not difficult for preparation. A disadvantage is that participants must continue with another program that provides qualification or work experience.
Table 2: Expenditures on main ALMP measures (in thousands CZK)

<table>
<thead>
<tr>
<th>Year</th>
<th>Socially purposeful jobs</th>
<th>Training</th>
<th>Community works</th>
<th>Sheltered workshops</th>
<th>Subsidized employment</th>
<th>Investment incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>1,030,597</td>
<td>480,635</td>
<td>833,189</td>
<td>88,848</td>
<td>649,012</td>
<td>858,853</td>
</tr>
<tr>
<td>2005</td>
<td>1,184,356</td>
<td>408,250</td>
<td>838,951</td>
<td>101,188</td>
<td>736,913</td>
<td>793,212</td>
</tr>
<tr>
<td>2006</td>
<td>1,071,803</td>
<td>357,299</td>
<td>899,298</td>
<td>97,447</td>
<td>1,410,552</td>
<td>931,617</td>
</tr>
<tr>
<td>2007</td>
<td>867,971</td>
<td>269,288</td>
<td>684,989</td>
<td>47,850</td>
<td>2,187,432</td>
<td>928,653</td>
</tr>
<tr>
<td>2008</td>
<td>596,654</td>
<td>271,130</td>
<td>949,087</td>
<td>44,555</td>
<td>2,283,655</td>
<td>1,434,249</td>
</tr>
<tr>
<td>2009</td>
<td>985,295</td>
<td>388,131</td>
<td>1,371,223</td>
<td>88,016</td>
<td>2,257,461</td>
<td>962,965</td>
</tr>
<tr>
<td>2010</td>
<td>1,454,155</td>
<td>582,261</td>
<td>1,623,832</td>
<td>88,400</td>
<td>2,712,304</td>
<td>481,442</td>
</tr>
<tr>
<td>2011</td>
<td>795,054</td>
<td>316,933</td>
<td>1,025,477</td>
<td>47,244</td>
<td>3,382,404</td>
<td>226,899</td>
</tr>
</tbody>
</table>

Source: Ministry of Labor and Social Affairs

In 2000, the EU launched the Lisbon Strategy aimed at making the EU the most competitive and dynamic knowledge-based economy. It was originally conceived for the period 2000-2010, but due to difficulties in meeting the original objectives in 2005 it was reformulated into Strategy for growth and employment. In 2005 the Czech government declared the National Reform Programme for period 2005-2008, which followed the previous National Action Plans for Employment. The National Reform Programme formulates the main economic policy guidelines. It follows the objectives of Strategy for growth and employment. In the field of employment the programme recommends to enhance labor market flexibility, to focus on labor market integration and education. Greater labor market flexibility should be achieved by expanding freedom of contract in labor relations, reducing the statutory non-wage labor costs and increasing labor mobility. Labor market integration should focus attention on those at the beginning and at the end of their professional career.

Labor market flexibility depend on the set of norms and procedures that must be followed in case of dismissals of redundant workers - employment protection legislation (EPL). The OECD uses various EPL indicators that enable to carry out international comparisons of employment protection regimes. Figure 1 shows how the EPL index changed between 2004 and 2013. The strictness of regular contracts was eased in most EU countries. The same happened in the Czech Republic, but legislative protection of workers in regular contract remains rather strict in comparison with other countries. Stricter regulations in the area of temporary contracts were result of EU legislative incorporation and government effort to move legislative protection of temporary workers closer to workers in regular contracts.
The other government regulation which influences labor market flexibility is minimal wage. In the Czech Republic the minimum wage institute is government legislated and in principal applies to all workers who have a legal contract. Czech government annually raised minimal wage from 6700 CZK in 2004 to 8000 CZK in 2007. The last increase of minimal wage took place in August 2013 (8500 CZK). The ratio of minimum wage to the median wage often used in international comparisons fluctuates around 36 and 38% and is more than 10 percentage points lower than average ratio of 9 EU countries that have national minimum wage.

Meeting goals in the field of active labor market policy means among other things greater emphasis on activation of the unemployed. As Hanesch and Balzter, 2001 (In Hora, et al., 2009) point out, there is no single definition of activation, but it can be understood as a set of tools for the integration of the unemployed (unemployed welfare recipients) to the labor market and thus to
improve their economic and social inclusion. Thus, activation of the unemployed requires both ALMP measures and passive measures (income compensation) as well. The development of activation policies can be characterized by a shift from rather passive to active approaches, but also a shift in the balance between the rights and obligations of unemployed recipients of the welfare state (individualization). These shifts in public discourse have become an important initiator of the ongoing reforms in the labor market and related policies (Hora et al., 2009).

2.2 Passive Labor Market Policy

Although spending on ALPM in the Czech Republic is rather low, the positive thing is the effort to ‘activize’ its labor market policy. Seen as a share of expenditures on active measures on total LMP spending, the Czech Republic belongs to countries that allocates on ALMP roughly the same resources as on passive measures. The exception is period 2009-2011 when the country was hit by economic crisis and growth of unemployment (see Figure 2).

![Figure 2: Expenditures on ALMP and PLMP (in mil. CZK)](source: OECD.Stat, own calculations)

Beside the ALMP it is also important to take account of the development of passive measures because the so called activation discourse covers both of them. Passive labour market policy in the Czech Republic can be characterized as relatively strict with increasing emphasis to strengthen incentives to work. NRR summary measure of benefit entitlements is below the average of EU15 countries, as has long been around 20%, while the average value of this indicator in EU countries is twice as high. Unemployment benefits are provided only for the first six months since 2004 with replacement rate 50% in the first three months and 45% during the following three months. In 2008 duration of unemployment benefits was reduced to 5 months for unemployed people younger than 50 years, to 8 months for unemployed workers between the ages 50 and 55 and 11 months for people older than 55 years. Replacement rate was modified to 60% for the first two months, 50% for the next two months and 45% for the last two months.

The NRR summary measure is defined as the average of the net unemployment benefit (excluding social assistance) replacement rates for two earnings levels, three family situations and 60 months of unemployment.
In addition to changes in the benefit system government increased pressure on searching (and finding) work. This was made possible by changes in the Employment Act in 2004 and implementation of National Reform Plan 2005-2008. Important measures to enhance discipline of the unemployed to find jobs were adopted. The definition of ‘suitable work’ was tightened and penalties with little or no interaction with the public services of employment were increased, including possibility of exclusion from the register of unemployed for a period of six months (this means not only loss of entitlement to welfare benefits but also social and health insurance). To activate the long-term unemployed and unemployed people younger than 25 years individual action plans have been introduced. Non-compliance can lead to removal from the register of unemployed and loss of eligibility for welfare benefits.

Tools for influencing behavior of the unemployed are rather penalties in nature. As Kulhavý and Sirovátka (2009) indicate, EU accession created more opportunities to implement measures designed to promote the abilities, skills and human capital of unemployed (capability/human resource development approach) but negative incentives approach prevailed (benefit cuts, tightening in the eligibility requirements, stricter supervision of job search).

3. **Evaluation of labor market policies**

Some authors (e.g. De Koning, 2001) refer about low net effects of ALMP measures. Recently, there is literature about effects of activation measures and active labor market programs that present more favorable results than previous studies (e.g. OECD, 2005). It has to do with the overall shift in labor markets and labor market policies towards activation measures.

Very crude indicator used to assess the effects of ALMPs is long-term unemployment. Avoiding that unemployment turns to be of long-term duration as well as reducing long-term unemployment spells are objectives of ALMPs. As can be seen in Figure 3, declining tendency of long-term unemployment after EU accession was followed by slight increase. Despite this, its level remained below the average level in EU15 countries.³

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³ The upward sloping trend was caused by sharp increase of long-term unemployed in so called PIIGS countries.
Another indicator of efficiency of ALMPs is the extent to which job openings (vacancies) and job seeking (unemployed workers) coexist at the same time in a labor market. The extent of this mismatch can be described by the Beveridge curve, which depicts the empirical relationship between unemployment rates and vacancy rates.

Figure 4: The Beveridge curve for the Czech Republic (2004-2013)

The relation between unemployment and vacancies seem to have a hyperbolic curvature. Figure 4 shows that there are fluctuation and shifts of the curve. Movements along the Beveridge curve reflect the usual ups and downs of the economy; so one can see decrease in cyclical unemployment during the boom and its rise during recession. For assessment of LMP effectiveness it is important to note inward shift of the Beveridge curve. According the theory this can be interpreted as improved efficiency of the labor market caused by ALMPs. This conclusion is rather simplified, because as Boeri and van Ours (2013) point out, the Beveridge curve is an equilibrium condition, potentially capturing both changes in vacancy formation and job search, labor demand and labor supply.

If the inward shift of the Beveridge curve do reflect changes in the efficiency of the functioning of the labor market, then these should correspond to changes in the NAIRU (non-accelerating inflation rate of unemployment). Improved efficiency of the labor market is reflected not just in relationship between unemployment and vacancies, but also in relationship between unemployment and inflation. As can be seen in Figure 5, the NAIRU rate\(^4\) (which is in OECD database identified as structural unemployment) had been steadily decreasing in the Czech Republic in spite of economic crisis. This can be regarded as a result of successful labor market policy on the contrary of EU15 countries where

\(^4\) The NAIRU rates in figure 5 were taken from OECD.Stat.
the exact opposite trend is occurring. LMP thus meets its general objective but this does not mean that labor market position of all groups of workers have improved. Position of some vulnerable groups of workers has worsened as youth (less than 25 years) unemployment rate for example had risen from 10% in to 19.5% in 2012 (slightly below EU15 average). Active measures should therefore targeted to vulnerable groups in labor market.

Figure 5: NAIRU rate (in %)

![Graph showing NAIRU rate](image)

Source: OECD.Stat, own calculations

Sirovátka and Šimíková (2013) conducted interviews and questionnaires aimed at directors of labor offices and employees in position of advisers. Their research shows that ALMP measures are generally considered as significant. Priority is given on creating jobs in the private sector as well as retraining. Their importance is substantially higher in regions with the highest unemployment rates. Respondents placed much higher emphasis on job creation in public and private sector compared to similar survey in 2003, which is probably caused by economic downturn. However, with regard to position of the respondents, it is possible to assume that they may tend to overstate the importance of ALMP measures in comparison with other areas of economic and social policy. Activation of the unemployed is conditioned not only by effective ALMP but also by system of passive measures maintaining work incentives. Directors of labor offices did not tend to aim for cuts in unemployment benefits but rather expressed a preference of more differentiated benefits according to previous length of employment.

4. Conclusion

According to crude indicators of efficiency of LMPs used in this paper it seems that Czech LMP meets its general objective and improves labor market efficiency. Rate of long-term unemployment slightly increased after economic crisis in 2009 and stabilized near 3%, which is more than one percentage point less than in the beginning of period of interest. Decreasing NAIRU rate and inward shift of the Beveridge curve depicted in the previous chapter can also indicate enhanced labor market efficiency. On the other hand we must be careful when drawing conclusions on the basis of these

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5 This is true especially for countries that were deeply hit by economic recession.
crude indicators and the Beveridge curve. NAIRU rate can be influenced by external factors (e.g. structural changes, demographic development) and the Beveridge curve is primarily an equilibrium condition, describing changes in labor demand and labor supply.

References


