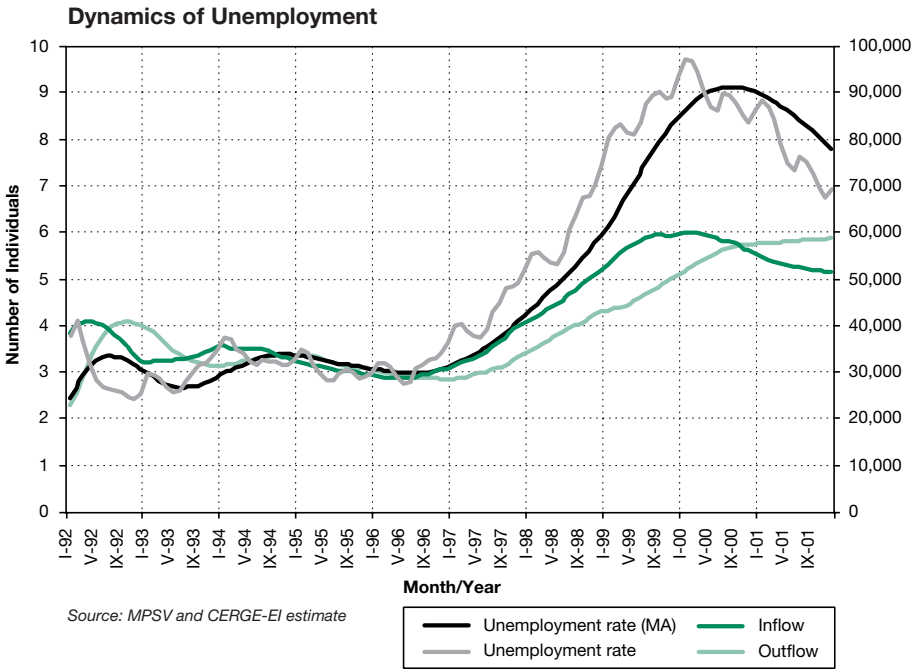
V. WORK AND PAY

V.1 Unemployment



Source: MPSV and CERGE-EI estimate

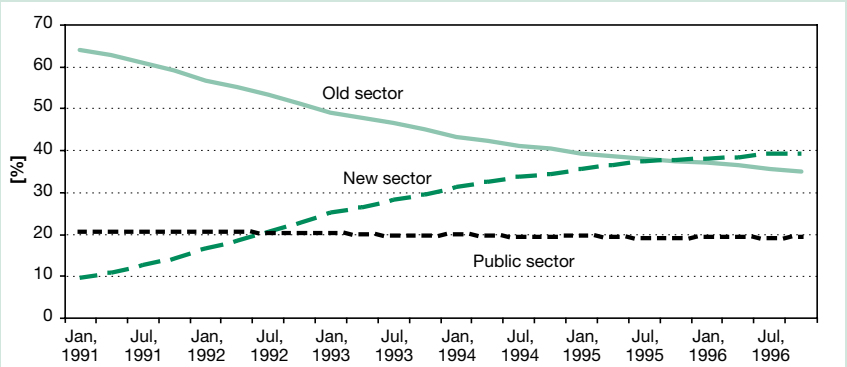
The registered unemployment rate, which has been steeply rising since 1997, reached its peak in mid 2000. This four year rise was caused by the recession of 1997 and has been affected by the credit crunch of recent years, both in terms of drying up soft credit for partially state-owned large firms and in terms of the lack of credit for viable smaller firms. Given current and expected dynamics of inflow into and outflow from unemployment, the unemployment rate is likely to decline during the whole year of 2001. Figure above shows the dynamics of the unemployment rate and inflow and outflow during the last decade. Even though the unemployment rate is expected to decline as a result of recent GDP growth, it is very unlikely, at least in the next few years. There are two major reasons: (i) further need for restructuring of large firms will result in massive job destruction and large inflows into unemployment; and (ii) although economic growth will lead to job creation, part of the unemployed will be trapped in the powerful Czech welfare trap.

Job and Worker Reallocation and the Optimal Speed of Transition

(Based on Jurajda Š. and Terrell, K.: Optimal Speed of Transition: Micro Evidence from the Czech Republic, CERGE-EI Working Paper No. 170, forthcoming in 2001)

The Czech Republic has been an important case among the dozens of countries reforming their centrally planned economies after the fall of communism. Some consider it a successful rapid reformer while others question its success, suggesting slow restructuring. The debate hinges partially on the interpretation of the low rate of Czech unemployment in the early years of transition (1990–96). It is argued that the high pace of downsizing in the old state sector can slow down the growth of the new private sector and hence create considerable unemployment. However, one possible explanation for low Czech unemployment is that transition followed what is called in the theoretical literature an optimal speed of reallocation from the old to the new sector (Aghion and Blanchard, 1994; Castanheira and Roland, 2000). This explanation is supported by new evidence:

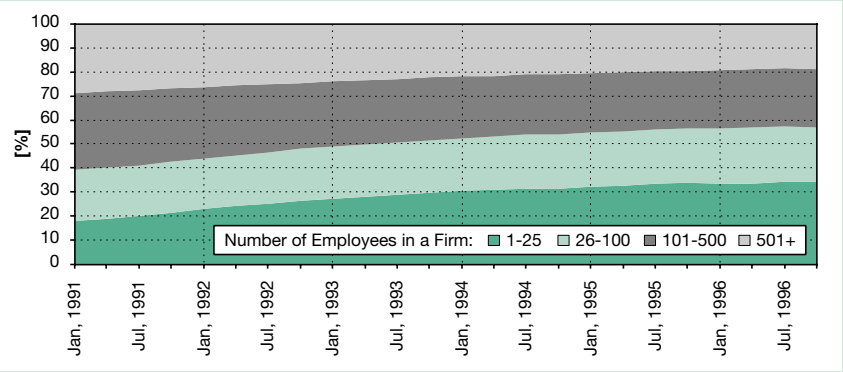
Percentage Share of the Public, "Old," and "New" Sectors in Total Employment



A natural way to learn about the fundamentals of the Czech transition (and its low unemployment) is to analyze its job and worker reallocation. The figure above shows that there has been a steady and balanced transfer of workers from the old (traditional) firms to the newly established enterprises. This flow resulted in substantial reallocation of jobs and workers: by the end of 1995, the new sector became the dominant employer in the Czech Republic. We show that this reallocation was driven by the creation of jobs in the new small-scale sector. Figure below shows the decreasing importance of large firms employing more than 500 workers on total Czech employment and the rise in the share of small firms and self-employed (included in the category of firms with 1–25 employees). The new sector was growing at such a rate that it was able to absorb most workers released from the old sector; hence, the low transitional

unemployment. Further research is needed to answer the question of whether the restructuring (demolition) of the old sector could have been faster without jeopardizing low unemployment.

Employment Structure by Firm Size



V.2 Wages

The real wage in the entrepreneurial sector grew by 3.7 percent in the first three quarters of 2000. However, the real wage in the public sector declined by 1.4 percent, which combines to a total economy-wide real wage growth of 2.4 percent. The overall real wage growth of 2000 will therefore be substantially lower than in 1999 when overly high inflation forecasts affected wage bargaining and resulted in real wage growth of about 6 percent. The decrease in public wages followed a jump in teachers' and public servants' wages in 1999. The nominal average monthly wage in the entrepreneurial sector was around CZK 13,500 in the third quarter of 2000.

In the mining, manufacturing and utilities sector, productivity grew by 9 percent during January to September 2000, surpassing the growth of real wages by about 7 percent. This has been one of the big success stories of the year 2000. (Recall that high real wage growth ungrounded in productivity was one of the triggers of the 1997 recession.)

There were no major changes in the structure of wages except for a further increase in the level of the minimum wage to 4,500 CZK, about 35% of the average wage (is going to increase to 5,000 CZK in 2001). This is still well below the EU levels of minimum wages and can be expected to have a inappreciable negative effect on low-wage employment. On the other hand, the goal of the government to increase the labor supply by raising the level of the minimum wage is also unlikely to be fulfilled as the minimum wage is now comparable to the level of minimum guaranteed social assistance, which is currently set at the subsistence minimum.

Gender Wage Gap and Segregation

(Based on Jurajda, Š.: Gender Wage Gap and Segregation in Late Transition. CERGE-EI Discussion Paper No.36, 2000)

The legislation of most transition economies (TEs) has long included fundamental clauses about the equality of men and women. Until recently, however, western-style anti-discrimination labor market policies were either not introduced or enforced. Since one of the pre-requisites of accession to the European Union is harmonization of legislation, this year, the Czech Republic has enacted policies of comparable worth, equal pay, and equal employment opportunity.

Mean Differences in Hourly Wages by Gender in 1998:
Female wage disadvantage as % of male wage ($1-w_f/w_m$)

		Public Sector	Non-public Sector
Education	Primary	0.123	0.234
	Secondary without GCE	0.179	0.269
	Secondary with GCE	0.137	0.263
	University	0.163	0.327
	Post-graduate	0.209	0.221
Age	–19	-0.026	0.142
	20–29	0.183	0.198
	30–39	0.301	0.301
	40–49	0.286	0.292
	50–59	0.195	0.270
	60–	-0.100	0.120
Ownership	Foreign	–	0.280
Firm ownership	Private	–	0.258
	Co-operative	–	0.211
	State	–	0.293
	Mixed	–	0.213
	Public Sector	0.237	–
Firm size	100–249 Employees	0.223	0.237
	250–499 Employees	0.172	0.250
	500–999 Employees	0.209	0.267
	Over 1000 Employees	0.268	0.285
Number of workers		178,209	548,381
Number of firms		92	571

Each of these anti-discrimination policies affects a different source of the overall wage gap between men and women. The comparable worth policy attempts to equalize wage rates across occupations and job cells of equal worth, where a job cell is defined as a group of workers with the same occupation within a firm and "worth" is defined in terms of the job's skill requirements and other attributes. The equal pay provisions target wage differences within job cells. Finally, the equal employment opportunity clauses address all forms of segregation – the discriminatory hiring, firing, and promotion practices that result in a high concentration of women in low-paying occupations, firms, or job cells. Which of the anti-discrimination policies is the most important in narrowing the gender wage gap therefore depends on the relative size of the gap's elements.

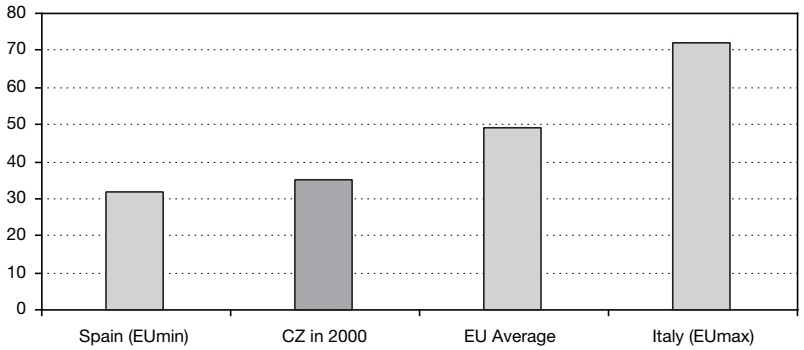
We break down the Czech gender wage gap using matched employer-employee data sets including hourly wage records of almost 1 million Czech and Slovak workers employed in medium and large firms in 1998. The table below shows the mean percentage wage disadvantage of women by various categories. We see that, on average, female wages are almost 30% lower than male wages in the Czech Republic and this difference is somewhat lower in the budgetary public sector. (The unregulated non-public sector includes private and state-owned enterprises while the budgetary public sector sets wages according to wage grids specified by the government.) Even though wages are typically lower in the public sectors, which employ over three times as many women as men, this imbalance is not the primary cause of the overall gender pay gap.

A more detailed analysis suggests that differences in education or other productive characteristics of men and women also do not explain a substantial part of the total wage gap. However, segregation of women into low-paying occupations, firms and job cells appears to be responsible for over one third of the total wage gap. Job-cell segregation appears to be quite intense, in that, about a third of public-sector workers are employed in job cells where almost all employees are women. Furthermore, about 25% of the non-public workers are employed in almost fully male dominated job cells.

In the non-public sector, about two thirds of the gender wage gap appear due to gender differences in wages that remain after accounting for most forms of workplace segregation as well as for other explanatory variables. This compares unfavorably to about one third in the U.S. Within-occupation within-establishment phenomena (such as differences in labor market experience or maternity leaves and/or gender discrimination) therefore remain to be blamed for most of the wage gap.

Labor Market Policies and Institutions in the Czech Republic

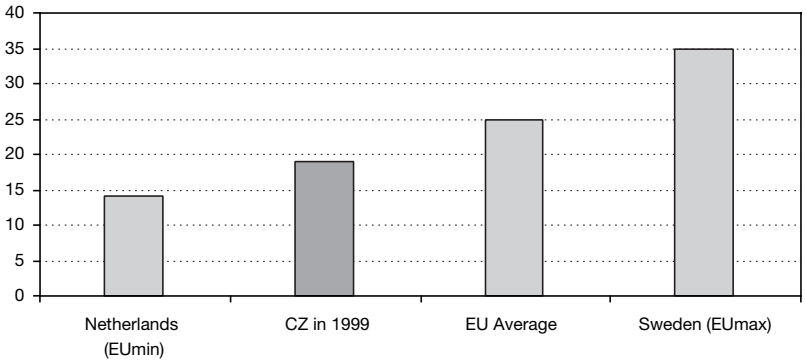
Minimum Wage (% average monthly salary)



Source: EU – Cadiou L., Guichard S., and Maurel M. 1999. "La diversité des marchés du travail en Europe: quelles conséquences pour l'Union Monétaire?" CEPII, Working Document 99-10/11; CZ – CERGE calculations.

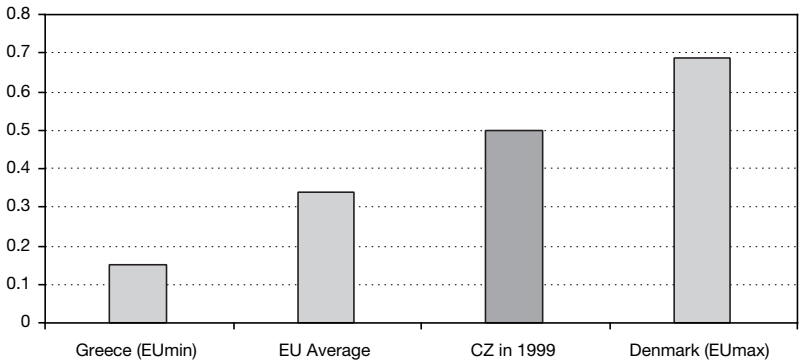
It is commonly recognized that labor market policies and institutions have an important impact on the process of labor market adjustment. In light of future EU enlargement, a comparative analysis of institutional frameworks across accession countries is also of significant interest.

Employment in Public Sector



Source: EU – Cadiou L., Guichard S., and Maurel M. 1999. "La diversité des marchés du travail en Europe: quelles conséquences pour l'Union Monétaire?" CEPII, Working Document 99-10/11; CZ – CERGE calculations.

Unemployment Benefits (Replacement Ratio)

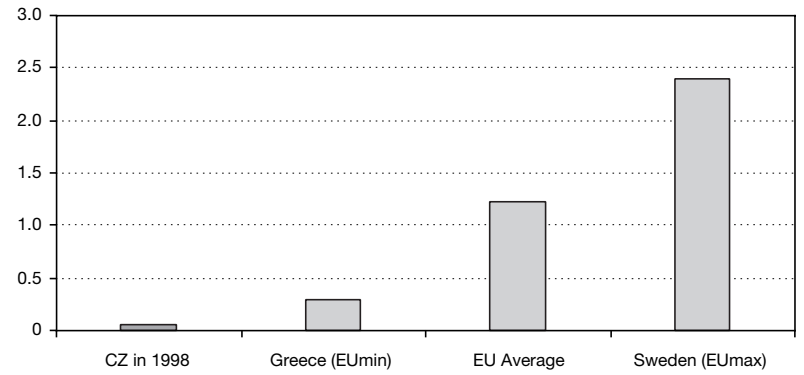


Source: EU – Cadiou L., Guichard S., and Maurel M. 1999. "La diversité des marchés du travail en Europe: quelles conséquences pour l'Union Monétaire?" CEPII, Working Document 99-10/11; CZ – CERGE calculations.

As regulation in Western European countries is heterogeneous rather than homogeneous, the question, thus, is whether the policies and institutions in the Czech Republic are within the current EU norms or they have exceed them.

The accompanying graphs illustrate selected recent indicators for the Czech Republic and the corresponding minimum and maximum values for the EU member countries

Spending on Active Labor Market Policies (% of GDP)

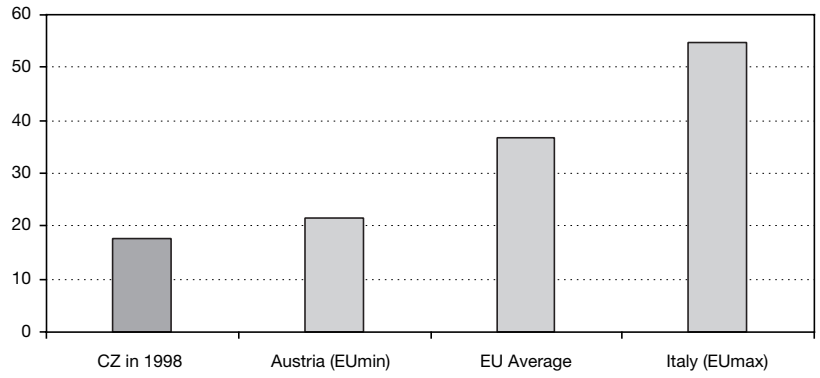


Source: EU – Cadiou L., Guichard S., and Maurel M. 1999. "La diversité des marchés du travail en Europe: quelles conséquences pour l'Union Monétaire?" CEPII, Working Document 99-10/11; CZ – CERGE calculations.

as of 1995. As institutions in Western European countries change much more slowly over time than those in transition economies, the 1995 data can be considered a reasonable benchmark. Since 1998, after a decline related to the beginning of transition, the ratio of the minimum wage to average wage has been growing in the Czech Republic. However, this ratio in 2000 is still on the lower boundary of that for the EU member countries. Similarly, employment in the Czech public sector is lower than average EU values. As for unemployment benefits, the replacement ratio which characterizes a share of salary paid within the first three months of being unemployed exceeds the EU average. While the scope of passive employment measures is comparable, spending on active labor market policies (retraining, jobs for graduates, publicly useful jobs, etc.) is much lower in the Czech Republic than in any of the EU countries. The share of spending on active labor market policy remains slightly lower than the minimal EU values.

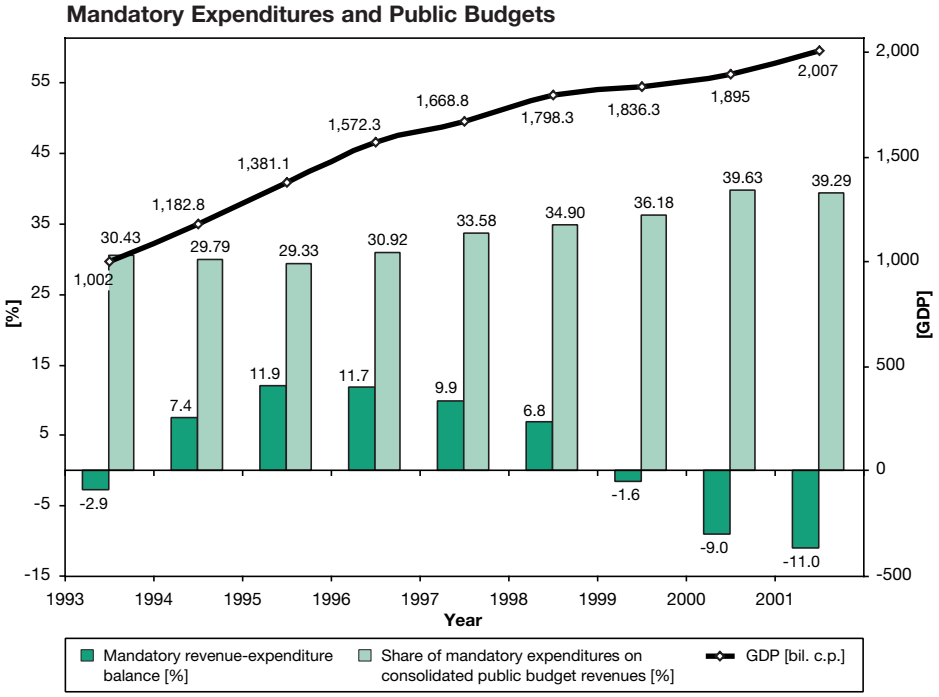
The considered five indicators show that labor market regulations in the Czech Republic do not exceed maximum EU values. However, given the substantial difference in living standards, the burden on the public budget imposed by labor market policies and institutions is much higher in the Czech Republic compared to the EU member countries. The situation in the Czech Republic is also exacerbated by a tendency to increase this spending. This means that in the Czech Republic there is a higher social cost of unemployment. More attention should be paid to improving the efficiency of labor market programs.

Spending on Active Labor Market Policies (% total spending on the employment policy)



Source: EU – Cadiou L., Guichard S., and Maurel M. 1999. "La diversité des marchés du travail en Europe: quelles conséquences pour l'Union Monétaire?" CEPII, Working Document 99-10/11; CZ – CERGE calculations.

V.3 Welfare and the state budget



Source: MF, own calculations

The medium-term instability of public budgets is an issue of primary political concern. Public expenditure on social welfare persistently exceeds payroll revenues labeled as social insurance payments. The deficit is expected to grow over time, even during predicted years of economic expansion. The recent development is shown in the below figure.

This is just the beginning. The fiscal needs are going to rise even further in the medium-term, especially towards the end of the new decade. The major factor is going to be the inevitable aging of the population (see the feature on aging in section I). Most local economists already understand the immense pressure the pay-as-you-go pension scheme places on the budget deficit, while fundamental disagreements regarding its impact persist among leading political parties. The pressures expected due to health care expenditures, however, are not yet fully perceived. Health care expenditures per person are much higher for the population over 60 years of age. Relatively large age cohorts which are going to enter this age group

during the next decade will substantially increase the fiscal requirements of the health system. The share of health care expenditures on GDP is, however, already comparable with developed countries of Western Europe and there is little fiscal room for its further expansion.

Another sector in need of increased expenditure in the medium-term is education. However, the state education budget had been cut substantially during the recession of the late 1990s. The savings were realized at the expense of the depreciation of facilities and by freezing already low wages in education. Further, shrinking cohorts of youth passing through the mostly publicly-funded education system provided some slack for savings. However, the growing demand for expenditure outweighs the potential savings due to demographic declines. In particular, the tertiary education system is in dire need of expansion and this is unlikely to happen under the current funding rules (see the feature Tertiary Education Setbacks).

Given the level of economic development, the level of tax burden and the proportion of public budget in GDP are relatively high, balancing public budgets through tax increases, considered by the incumbent social-democrat government, would therefore hamper the catch-up prospects of the CR by slowing down economic growth.

The structure of legally prescribed expenditures, the so-called mandatory expenditures, is shown in the table. Pensions, health and social support expenditures itself represent more than 80% of mandatory expenditures. Sustainability of public finances inevitably requires elimination of inefficient expenditures and fundamental restructuring of these programs. Attention should be devoted to eliminating existing welfare traps and the adverse effects of well-intended welfare programs. Targeting of programs to truly disadvantaged

Structure of mandatory expenditures

	CZK in c.p.			% of total in given year				% of 1998 level		
	1999[1)]	2000[1)]	2002[2)]	1998	1999[1)]	2000[1)]	2002[2)]	1999	2000[1)]	2002[2)]
Health insurance	29,661	31,979	37,479	9.5	10.9	11.1	11.1	126.8	136.7	160.2
Transfers	243,420	264,439	299,160	90.5	89.1	88.9	88.9	109.6	119.1	134.7
Pensions	174,400	184,428	208,800	66.0	63.9	62.0	62.0	107.7	113.9	128.9
Sickness insurance	20,527	27,800	32,600	7.6	7.5	9.7	9.7	110.8	150.0	175.9
Social support	32,000	34,000	37,400	12.1	11.7	11.1	11.1	108.0	114.7	126.2
Social care	7,420	8,500	9,600	2.7	2.7	2.9	2.9	111.7	127.9	144.5
Other social payments	1,203	1,271	1,350	0.5	0.4	0.4	0.4	107.6	113.7	120.8
Passive employment policies	7,870	8,440	9,410	1.7	2.9	2.8	2.8	187.6	201.2	224.4
TOTAL	273,081	296,418	336,639	100.0	100.0	100.0	100.0	111.3	120.8	137.2

1) Expected
2) Optimistic prediction

Source: Author's own computations based on different sources.

groups and better screening tools should be introduced.

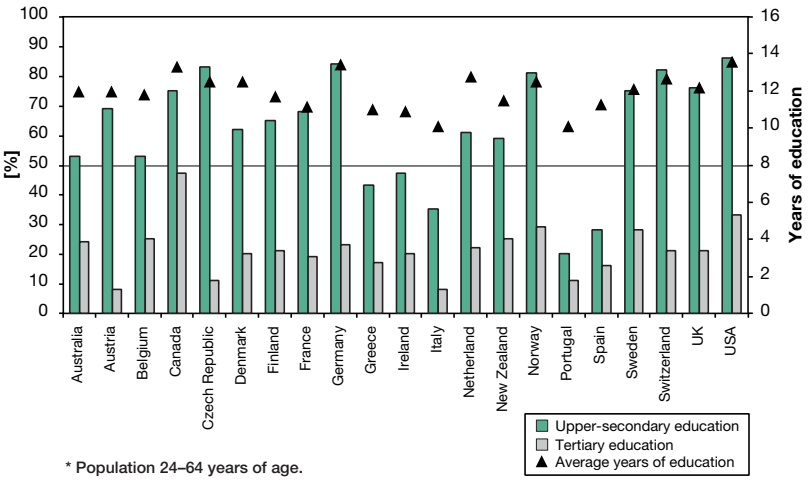
Specifically, the pension system has to be restructured to increase its role as a fully funded pillar. However, pension reform will require additional transition costs since the current system is in huge implicit debt. The health care system has to incorporate minimum co-financing by patients, create incentives for prevention, and increase the role of post-treatment therapies. A substantial amount of savings can also be gained by a more effective allocation of capital resources and utilities. Unemployment benefits should be strictly conditioned on participation of the unemployed in a public works program or participation in effective retraining programs. The efficiency of active employment programs should be subjected to rigorous analytical scrutiny. Willingness to work and involvement in the shadow economy of the long-term unemployed should be subject to better screening. Eligibility for sick day benefits should not be provided from the first day of illness, but after several days. Employers should be obliged to cover part of the benefits, but their contribution to the social insurance payroll tax should be cut correspondingly. Doctors screening the health conditions of sick workers should face incentives to provide unbiased health evaluations. The ceiling for sick day benefits should be lowered to pre-1999 levels. Social support being now provided almost to all households should be limited to families in real need. In particular, richer families with children should not receive child benefits. Guaranteed minimum household income should not increase so rapidly with the household size, because the current setup creates a welfare trap (see the booklet "Czech Republic 1998: Facing Reality").

Although there is dire need for expenditure cuts, some areas of social assistance have been persistently neglected and require greater spending. Among those deserving more focus and greater spending are severely disadvantaged individuals and families in terms of both mental and physical health. The integration of these citizens into work and social life should be supported by further investment in developing easy access to public facilities etc.

However, there is not only a lack of political will to carry out these necessary steps, there is also an institutional obstacle to optimizing the public budget. Currently, there is no governmental body in charge of overall budgetary planning. The ministry of Finance is primarily responsible for the annual budget proposal and disbursement of money during the year, but it has a very small role in the individual ministries' budgeting. Individual ministries submit their proposals independently and, therefore, the need for individual expenditures is very difficult to evaluate. As a result, growing deficits in the public budget have been fought by across-the-board cuts in other than mandatory expenditures in recent years. While the government has already asked the ministries to consider joint optimization of expenditure allocation, this process has not begun de facto yet.

Tertiary Education Setbacks

Proportions of Adult Population by the Level of Education and Educational Attainment*



* Population 24–64 years of age.

Source: Human Capital Investment – An International Comparison, OECD 1998

In the past decades, the tertiary education sector has expanded in the majority of developed countries. The expansion was to a great extent driven by a growing demand caused by a change in demand for skilled labor. Since the role of the state sector in education is dominant in most countries, the expansion is conditional on the political understanding of the role and relative importance of education among other public policies. The Czech communist regime neglected tertiary education, thus the country will face a low proportion of its adult population with tertiary education in the coming decades (see Figure above). This fact further reinforces an increase in the demand for college educated graduates that resulted from the economic transition and restructuring.

However, political neglect in this area during the 1990s delayed desirable expansion and diversification of education opportunities at tertiary educational institutions. Although the number of enrolled students at the tertiary level increased by more than two thirds during the 1990s, the number of applicants increased more than twice. The proportion of twenty year olds still studying is 24% while the OECD average is 44%. The share of rejected applicants remained the same, although the size of 18-years-of-age cohorts has been declining over years. The growing demand is due

to the steady growth of wage returns to education and partly stems from the large backlog of those who were not admitted to colleges in the past.

Those who will truly do well in adapting to the dynamic labor market of the 21st century will be those with broad-based tertiary education. Further increasing the share of the work force with tertiary education should be a goal of public policy, but this raises budgetary issues. The major obstacle to expanding the supply of tertiary education is the funding laws that make colleges and universities almost fully dependent on limited public funds provided by the central government (see Budget section). Unlike secondary schools, public universities are not allowed to charge tuition or engage in profit making activities. Private tertiary institutions were banned until 1999 and those few that emerged recently are very small in size and face huge start-up costs. Therefore, the tertiary schooling is underfunded, as can be seen by a rough international comparison in the table.

Total Expenditure from both Public and Private Sources for Educational Institutions as a Share of GDP in 1997

	Non-tertiary	Tertiary
Australia	3.9	1.70
Austria	4.3	1.50
Belgium	3.6	0.90
Canada	4.3	2.00
Czech Republic	3.6	0.80
Denmark	4.4	1.20
Finland	3.8	1.70
France	4.4	1.20
Germany	3.8	1.10
Greece	3.7	1.20
Hungary	3.2	1.00
Iceland	4.1	0.70
Ireland	3.5	1.40
Italy	3.4	0.80
Japan	3.1	1.10
Korea	4.3	2.50
Mexico	3.9	1.10
Netherlands	3.1	1.20
Portugal	4.4	1.00
Spain	3.9	1.20
Sweden	4.7	1.70
Switzerland	4.5	1.10
United Kingdom	n.a.	1.00
United States	3.8	2.70
OECD avreage	3.9	1.30
OECD weighted average	3.7	1.70

Source: Education at a Glance 2000, OECD.

Since education is an investment in students' future labor market success, it is entirely appropriate that they partly pay the costs involved. Tuition payments covering the bulk of tertiary education costs even in public schools and combined with appropriate loans, should be introduced as rapidly as possible. The introduction of tuition payment would likely put an end to the under-provision of tertiary education and lead to the establishment of quality-enhancing incentives at universities. However, the leading political parties have been consistent in opposing college tuition throughout the 1990s.

Private Schooling

(Based on Filer, R.K., and Münich. D.: Responses of Private and Public Schools to Voucher Funding: The Czech and Hungarian Experience. CERGE-EI Working Paper No.160, 2000)

Enrollment in Secondary Schools by Type, 1989-98 (thousands)

		89/90	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99
Academic	State	100.7	101.8	95.9	89.9	80.5	76.6	77.1	66.8	66.3	68.4
	Non-state	0	0.1	0.9	3.5	5.8	8.4	9.2	8.3	7.9	7.4
Technical	State	158.7	166.6	170.4	171.7	176.5	188.8	195.3	151.4	152.7	149.7
	Non-state	0	0.2	4.6	15.5	30.4	44.7	50.5	37.7	31.8	25.5
Vocational	State	310.2	301.8	278.6	250.8	241.2	242.6	234.7	178.6	156.8	132.9
	Non-state	0	0	0	17.4	27.5	26.0	27.3	21.5	19.3	17.5
Total	State	569.8	570.2	544.9	510.4	498.2	508	507.1	396.8	375.8	350.9
	Non-state	0	0.3	5.5	36.4	63.7	79.1	87.0	67.5	59.0	50.4
%	Non-state	0	0.0	1.0	6.7	11.3	13.5	14.6	14.5	13.6	12.6

Source: ÚIV

A state monopoly in education followed on from the collapse of communism in Central Europe. The centrally planned system was abandoned and systems comparable to the educational voucher scheme, also known as the school choice system, were introduced in the Czech Republic. The newly established system of school financing allocates public funds according to the number of students enrolled in a school. Accredited non-state schools, private and religious, are also eligible for public subsidies.

Although public schools were initially relatively good by objective West European standards, there was an initial surge in the demand for private alternatives that eventually reached between 10 to 15 percent of the secondary school population. In our study we find private schools appear to have arisen in response to distinct market incentives. They are more common in fields where public school inertia has resulted in an under-supply of available openings. They are also more common where the public schools appear to be doing a worse job in their primary educational mission, as seen by the success rate of academic high schools in obtaining admission to the top universities for their graduates. As concerns the technical schools, we find that non-state schools rather than state schools seem to react to regional labor market conditions in terms of technical branch premium and unemployment rate. We do not find such reactions to market signals by state schools.

There is also preliminary evidence that public schools facing private competition do improve their performance. While the evidence is modest with respect to inputs, in the Czech Republic public academic high schools facing significant private com-

petition in 1995 improved their relative success in obtaining university admissions for their graduates between 1996 and 1998.

Our analysis of the perception of private schooling by the public suggest that those who are best informed about educational alternatives or who value education more highly are more likely to enroll their children in non-state schools. ***Given that the primary role of non-state schools is to provide an opportunity to those students excluded from top-level academic and technical education due to lack of capacity in the public school system and consequent attempts to divert some students into low quality vocational schools.*** *The finding suggests that more educated and involved parents are more likely to resist such pressure on personal preferences for their children's futures.*