

5. Improving the reallocation of labour

As described in Chapter 1, problems in the functioning of the labour market are becoming increasingly apparent. Though the employment rate is about 65 per cent and still slightly above the OECD average, it has declined substantially from the very high rate characterising the communist regime, and could well decline further as economic restructuring proceeds. Real convergence of the economy could be speeded up through reversing this trend decline and further activation of labour reserves. The unemployment rate is roughly 8 per cent (twice this level in some regions) and half of the unemployed have been out of work for more than a year. In part, the unemployment reflects economic restructuring that is an inevitable part of the growth process. But, the unemployment also reflects problems in policies: the benefit system creates poverty traps for the unemployed; mobility is reduced by problems in the rental market for housing; the tax wedge on labour is high; employment protection legislation makes the labour market inflexible; state payouts encourage sick leave; and wage setting is affected by administrative extensions. Workforce skills are also less than ideal; although the share of the population with secondary-level education is high, the share of those with degree-level tertiary education is still very low in international comparison, and the education system reacts relatively slowly to changing labour market conditions. An even more serious issue at the other end of the skill distribution is the widespread exclusion of the Roma population from acquiring labour market relevant skills.

This chapter first focuses on labour supply issues, with an examination of the role of the welfare system, issues in labour mobility and an overview of active labour market policies. The chapter then examines the tax wedge, employment protection legislation, and wage setting. Finally, the main issues in skills and education levels are reviewed. The policy recommendations are summarised in Box 5.1.

Tackling inactivity traps and increasing mobility

Issues related to the Czech welfare system

Background

Czech welfare has three main systems of state help: social insurance, state social support and social assistance (Box 5.2, Table 5.1 and Annex 5.A1). The social

Box 5.1. Policy assessment and recommendations for the labour market and workforce skills

Addressing inactivity traps

- The plans to **strengthen financial incentives for job-search** and for stricter control are welcome and the authorities should not hesitate in implementing reforms. As a general strategy, the reform should also allow a widening of the gap between the family minimum subsistence amount and the average wage in order to reduce poverty traps. In addition a general strengthening in the application of rules and conditions across all benefits is needed.
- The intended introduction of an option of **joint income taxation** would increase the incentives to take up work in families that do not have any earned income. In designing the tax schedule for joint income taxation, the authorities should ensure that it does not create disincentives for second earners to take up work, in particular through interaction with the transfer system.
- In a welcome move, the amendment to pension-insurance act will **allow pensioners to receive work income** without losing pension income (except in the case of early retirement).
- Attention should be paid to definition and thorough implementation of the **access rules to disability pensions** to limit their use as a route out of the labour market.
- Developments in **youth unemployment** should be closely monitored to examine the impact of the change in eligibility for benefit, with a view to establishing whether this measure is sufficient.
- The government intends to increase the obligation on doctors to **make responsible decisions when granting sick leave** and to cut employers' social security contributions by 1-2 percentage points in exchange for the employer being responsible for payments the first two weeks of sickness benefits.

Reforming the rental market to increase mobility

- Steps need to be taken to gradually **free-up frozen rents** and establish a unified rental market, as this will help mobility in the Czech labour market. In the process of rent liberalisation, the government needs to ensure welfare concerns are addressed through adjustment of the benefit system. Public support to housing should be rebalanced from encouraging ownership towards supporting rental of low-income households.

Active labour market policies

- **ALMP programmes** need to be more systematically evaluated and a broad shift to greater use of activation schemes is desirable.
- The authorities should monitor the cost-effectiveness of the **First Opportunity scheme** and whether labour offices have the capacity to deliver these additional services.
- There is perhaps room for more radical change in ALMP; the authorities could consider the introduction of **private placement systems**, similar to those that have been developed in the Netherlands and Australia.

Box 5.1. Policy assessment and recommendations for the labour market and workforce skills (cont.)

Tax wedge

- Measures to further **level the tax treatment of income from dependent employment and self-employment** are needed in order to reduce the room for tax evasion.
- Tax expenditures that **cut the non-wage cost at the lower end** of the market would be more welcome than the proposal to cap social-security contributions.
- In addition, further measures to **enhance the efficiency of tax collection** (notably through labour controls) should be implemented.

Levelling employment protection legislation

- **Lighter rules on redundancy** for those on permanent contracts would help the labour market work more efficiently. The government's intention to introduce a major reform to the labour code to liberalize the market is therefore welcome.
- Abuse of **alternative work contracts** should be dissuaded by making standard contracts more lightly regulated and by appropriate action on the tax wedge. At the same time direct measures to prevent abuse of alternative work arrangements may be needed.

Wage setting

- Rather than planning to increase administrative extensions in wage setting, the authorities should instead be aiming to cut them back to **leave room for more flexible individual or enterprise-level wage bargaining**.

Improving skills

- In secondary and primary education there is very little by way of **output measurement and benchmarking** and this should be remedied.
- The quality of education should improve with the recent **adoption of standardized secondary-school leaving exam** (*maturita*). It will also help both employers assess qualifications and help the assessment of students applying for post-secondary education courses.
- In reforming the financing system of regions, the government should also ensure that the new system will not affect educational equity by reducing **accessibility and quality of education for disadvantaged groups**, such as Roma children.
- The **introduction of fees in higher education** that at least partially reflect the cost of tertiary courses would promote a more economic approach to higher education by students and universities. To ensure accessibility of tertiary education, the introduction of tuition fees should be accompanied by a system of student loans. In order to reduce the risk borne by individuals investing in their education, the repayment of such loans should be made income-contingent.

Box 5.1. **Policy assessment and recommendations for the labour market and workforce skills** (*cont.*)

Improving Roma integration

- Further **integration of the Roma population** is needed, not only to address social concerns but also to help mobilise labour resources.
- A new draft school act proposes to take a positive step by **eliminating the special schools** to which most Roma children are sent. However, the elimination of the special schools should be complemented by steps to increase access to early childhood education.
- The use of properly trained Roma **teaching assistants** and adaptation of curricula and teaching methods should be extended.
- The programme of **financial support to Roma students** has been reasonably successful in encouraging enrolment in secondary schools. The possibility of providing scholarships for socially disadvantaged students in tertiary education should also be considered.
- In a welcome move, the government is currently working at **designing an agency** that would implement projects to provide housing and jobs to combat social exclusion of the Roma population.
- Finding a solution to the problem of **lack of information about the Roma** would be a considerable help to policymakers. An anonymous mapping of Roma communities similar to that carried out in Slovakia providing information on basic demographic features, infrastructure and housing, socio-economic integration, and projects undertaken may be a good solution.

insurance system includes unemployment, sickness, disability and old-age benefits. The state social support system provides general financial assistance to both the employed and non-employed for housing, raising children and other forms of family support. The benefits are not dependent on labour market status, but some of them are income-tested. The social support and insurance systems are backed up by social assistance schemes that provide a safety net for individuals or households with insufficient income.¹ In general, the socially acceptable minimum income is defined by the *minimum subsistence amount* (MSA). The MSA varies according to household characteristics. Strictly speaking it is only a guide to welfare payout and there is therefore room for discretion in the amount paid.

The MSA (Table 5.2) is central to the state social support and social assistance benefit system, representing the minimum individual or family income that is considered necessary to fulfill basic needs. In addition, multiples of the MSA serve as limits for income tests throughout the welfare system. Households with

Box 5.2. The social protection system

Social insurance covers situations of unemployment, in-work sickness, disability and old age. Contributions are defined as a percentage of gross earnings and are divided between the employee and the employer. Benefits are paid in relation to previous net income, but the formulae for computation of the benefits entail significant redistribution.

State social support addresses the financial needs connected with family life. Most of the benefits are income-tested. Support covers child benefits, parental allowances for parents taking full-time care of their children, social family allowance for low-income families with children, housing allowance for low-income families and some other benefits (Table 5.1).

Social assistance provides safety net income. If the income of the concerned person or family, including all other state support benefits, pensions or sickness insurance benefits, does not reach a state-defined minimum (the MSA), and eligibility conditions are met (Table 5.1), the gap is typically matched by social assistance. However, in reality, the after-benefit income may be both above and below the MSA. The MSA (Table 5.2) is constructed from two components, one setting the amount for the basic personal needs of each member of the household (personal needs) and the other setting the amount for the needs of the household as a whole (household needs).

net income (including other relevant state support benefits) below the MSA can receive the social assistance benefit. Eligibility for social assistance requires prime-age adults to be registered with the public employment office and to be available for work. The means test implies that, in principle, all avenues to increase household income should be exhausted before social assistance is granted. Although the benefit is not automatically awarded and eligibility requirements apply, the size of the benefit, in practice, mostly at least equalizes the family income to the level of the MSA.² The value of the MSA is set by the Ministry of Labour and Social Affairs. It is worth noting that the amounts do not vary regionally as the costs of living are not assumed to differ substantially.

Unemployment insurance is not especially generous in international comparison (Annex 5.A2). While on unemployment insurance, individuals may also be eligible to benefits under the social support system and household incomes may also get topped up through the social assistance. Recent legislation (Box 5.3) focuses on unemployment benefits, making eligibility to benefits more stringent in general but also making targeted increases in generosity. For example, the new legislation weakens the incentives for older workers to look for work as the benefit period was extended.

Table 5.1. **Low-income assistance and family benefits**

| Scheme | Key eligibility conditions | Maximum length of benefit | Main benefit amount | Funding arrangements |
|-----------------------------|--|---------------------------|---|----------------------|
| State social support | | | | |
| Child allowance | Have a child fulfilling obligatory school attendance or a dependent child under 26 years old, and a family income not exceeding 3 times the family MSA in the last year. | No | A percentage of the child's personal needs depending on last years' family income. – 32 per cent if family income below 1.1 times the family MSA – 28 per cent if between 1.1 and 1.8 times the MSA – 14 per cent if between 1.8 and 3 times the MSA | State budget |
| Parental allowance | Until the child is 4 years old (7 years in the case of child's long-term incapacity); full-time and regular care. The limit imposed on income was abolished in 2004, but the entitlement is lost if the child attends a child-care institution for more than five days in a month. | No | 1.54 times parent's personal MSA (about 50 per cent of the minimum wage) | State budget |
| Housing benefits | Accrues to the owner or tenant of a flat, who is permanent resident, if the family income does not exceed 1.6 times the family MSA. | No | A share of the defined household needs that decreases with the relevant family income including other state social support benefits. | State budget |
| Social family allowance | Taking care of at least one dependent child; family income including other state social support benefits does not exceed 1.6 times family MSA. | No | A share of the defined child's personal needs that decreases with the family income. Level of benefits depends on state of health, number of family members, children etc. | State budget |

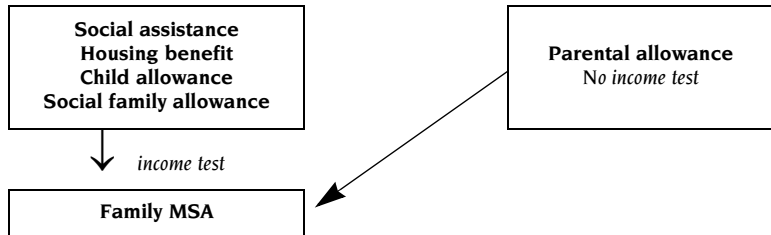
Table 5.1. **Low-income assistance and family benefits** (*cont.*)

| Scheme | Key eligibility conditions | Maximum length of benefit | Main benefit amount | Funding arrangements |
|--|--|---|---|----------------------|
| Unemployment insurance benefit | 12 months of work in the last 3 years; 6 months of contribution; no income from work. | 6 months; persons close to the retirement age are entitled to another 3 to 6 months of benefits | 50 per cent in the first three months of the last earned income net of tax and social security contributions up to a maximum of 2.5 times the MSA. 45 per cent after the third month, 60 per cent of previous earning during retraining (up to a maximum of 2.8 times the MSA). | State budget |
| Social assistance benefits (in accordance with Social Need Act) | Insufficient income and inability to increase it. The prime-age unemployed have to be registered with the public employment service. They are required to take up an available work opportunity, to make use of own property, and to see to school attendance of their children. | No | Level of benefit depends primarily on fulfilling the eligibility conditions and the difference between MSA and family income; further determinants are expenditures on living, health status, own property, etc. | State budget |

Source: Ministry of Labour and Social Affairs.

Table 5.2. **Definition of minimum subsistence amount (MSA) and income tests for low-income assistance**

Monthly, CZK



=

Sum of personal requirements + household requirement

| | | | |
|-------------------------------------|-------|------------------------------------|-------|
| Amounts needed to insure sustenance | | Amounts needed to assure household | |
| For dependent children | | Household with | |
| To the age of 6 years | 1 690 | 1 member | 1 780 |
| From 6 to 10 years | 1 890 | 2 members | 2 320 |
| From 10 to 15 years | 2 230 | 3 or 4 members | 2 880 |
| From 15 to 26 years | 2 450 | 5 and more | 3 230 |
| For other persons | 2 320 | | |

Source: Ministry of Labour and Social Affairs.

When unemployment extends beyond six months, provided eligibility conditions are met, household income will almost always be at least at the MSA through a combination of state social support and social assistance. About 7 per cent of households are estimated to be receiving social assistance (2001 figures).³ For unemployed families, state social support accounts for most income with social assistance playing a smaller role. For example an unemployed family with two children gets a majority of its income from state social support (Figure 5.1).

Poverty traps for families

Successive *Surveys* have emphasized that there are poverty traps in the welfare system, particularly for families. Due to the minimum income *de facto* guaranteed by MSA, taking up work often does not substantially change household income.⁴ For instance, a worker with a non-employed spouse and two children, starting a job at two-thirds of the average-production wage will see family income increase by less than ten per cent (Table 5.3). Further down the earnings ladder, job offers at the minimum wage, and to a certain level above it, do not imply any increase in household income because of the income guaranteed by the MSA (Figure 5.2, lower left panel). In short, the tax-benefit system means there are high

Box 5.3. The new Employment Act

A new employment law has been in force since October 2004. It regulates the implementation of state employment policies, including rules for job placement and entitlement for unemployment benefits, employment of workers with disabilities and employment of foreigners. The new law also defines tools for active policies (Box 5.4) and assigns duties for labour inspection of both Czech and foreign workers.

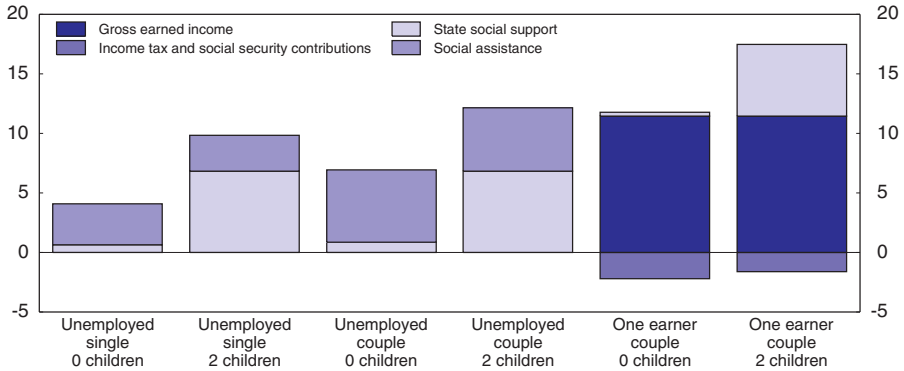
The main changes introduced by this law are:

- Stricter registration and reporting requirements with labour offices and conditions for provision of unemployment benefits.
- The six-month standard duration of unemployment benefits has been prolonged to nine months for those older than 50 years and to twelve months for those above 55 years of age, conditional on 25 years of participation in pension insurance (30 years for the twelve-month extension).
- The amount of unemployment benefit is to remain the same for the first three months of unemployment (at 50 per cent of previous net earnings) but has been increased from 40 to 45 per cent thereafter, with the maximum amount remaining 2.5 times the personal minimum subsistence amount (Table 5.2).
- “Partial unemployment” has been introduced, in which the unemployed can earn up to a half of minimum wage (working maximum of a half of legislated fixed working time) and still get unemployment benefit.
- Principles and conditions of active labour market policies have been re-defined.
- With EU accession, all EU citizens and their families are granted the same legal status on the Czech labour market as Czech citizens. Employment of other foreigners is subject to a labour market test, and its control is assigned to labour offices (Chapter 6).

average effective tax rates facing families with children that often lock them into inactivity. The situation is similar, though the disincentives are somewhat weaker, for single parent families and also childless unemployed couples. Single persons and spouses of employed workers do not face such significant tax-benefit disincentives to take up jobs.

Although social assistance benefits are conditional on availability to work and sanctions can be imposed, checks and enforcement are not very strict. In addition, state social support is not conditional on active job search. As a result many beneficiaries do not look for work and remain for prolonged periods on benefits, often augmenting income by working in the grey economy. Indeed, Renooy *et*

Figure 5.1. **Sources of monthly income of families in long-term unemployment, 2004¹**
 Thousand CZK



1. Unemployed: no income from work, not eligible for unemployment benefits, eligible for social assistance. One-earner couple: employed spouse earns 67 per cent of average production worker wage. It is assumed that household income below MSA is topped up to the level of MSA by a social assistance benefit.

Source: OECD computation.

Table 5.3. **Average effective tax rates (AETR) for transitions from full-time unemployment to full-time employment¹**

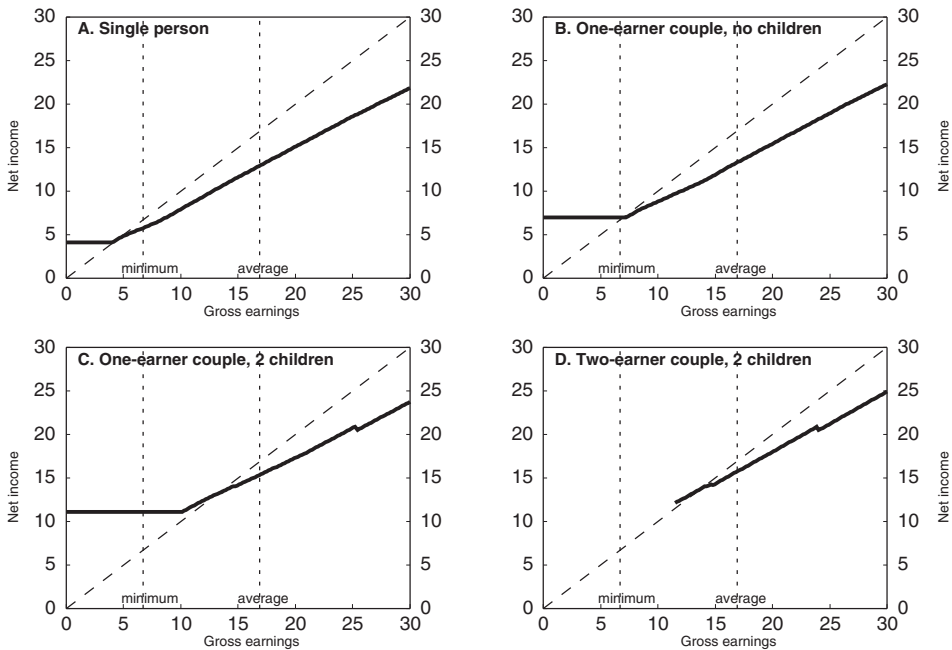
| Household type | Earnings as a share of average production wage in per cent | | | | |
|--|--|-------|------|------|------|
| | 33 | 50 | 67 | 100 | 150 |
| 1 Single | 80.6 | 67.8 | 57.1 | 47.5 | 41.9 |
| 2 Single parent 2 children | 100.0 | 89.6 | 76.9 | 64.7 | 54.9 |
| 3 One earner married couple, no children | | | | | |
| 1st spouse = inactive, 2nd spouse... | 100.0 | 88.3 | 76.3 | 62.1 | 51.4 |
| 4 One earner married couple, 2 children | | | | | |
| 1st spouse = inactive, 2nd spouse... | 100.0 | 100.0 | 91.2 | 74.2 | 62.5 |
| 5 Married couple, no children | | | | | |
| 1st spouse = 67% APW, 2nd spouse... | 28.8 | 27.7 | 27.2 | 27.5 | 28.5 |
| 6 Married couple, 2 children | | | | | |
| 1st spouse = 67% APW, 2nd spouse... | 32.6 | 30.6 | 29.4 | 31.1 | 30.5 |

Note: $AETR = 1 - (\text{change in net income} / \text{change in gross income})$. $AETR_{x\%}$ is that part of additional gross earnings that is "taxed away" when moving from unemployment (full-time with previous earnings of $x\%$ APW) to full-time employment (with current earnings of $x\%$ APW). AETRs are measure at the household level and take into account increasing taxes and contributions as well as reduced benefits. Weekly working hours are 0/40 for the out-of-work/in-work situations. For household types 3 and 4 the first spouse is inactive with 0 earnings. The " $x\%$ " therefore relate to the second spouse only. For household types 5 and 6 the first spouse's earnings are held fixed at 67% of APW. The " $x\%$ " therefore relate to the second spouse only.

1. Czech Republic 2002.

Source: OECD Tax-benefit database.

Figure 5.2. **Gross earnings and net income, monthly, 2003¹**
 Thousand CZK



1. Net income is gross earnings plus social benefits less tax. One-earner couple: a couple with one spouse not in the labour market. Two-earner couple: a couple with one spouse earning 67 per cent of the average production wage (CZK 11 500). Children are aged 4 and 6 years.

Source: OECD, Tax-Benefits Database.

al. (2004) list “people without proper employment (registered unemployed, housewives) receiving social benefits, social assistance or pensions” as one of four main groups of undeclared workers.⁵

Czech policymakers recognise that the system of minimum-income guarantee creates key problems for incentives to search and accept work. Indeed, there are plans for reforms. The main measures foresee a new act on “material need” and an amendment to the act on the minimum subsistence amount. While details are yet to be finalised, the measures look set to make a number of positive steps. One proposal is to strengthen job-search and income disclosure require-

ments for eligibility to the social assistance. Also it seems likely that a greater variation in benefits will be introduced. In addition it is intended to no longer have a 100 per cent withdrawal of social assistance for earned income,⁶ thus reducing the high effective tax rates on shifting from unemployment into work. The plans to strengthen financial incentives for job-search and for stricter control are welcome and the authorities should not hesitate in implementing reforms. As a general strategy, the reform should also allow a widening of the gap between the family MSA and the average wage. In addition a general strengthening in the application of rules and conditions across all benefits is needed.

There are also plans, as part of the so-called second-round fiscal reforms (Chapter 2), to improve incentives through changes in family taxation. Three proposals are of note:

- An option of joint income taxation of spouses, conditional on the presence of children. This will increase incentives for the first job-taker in families that do not have any earned income, by reducing average and marginal effective tax rates. Two earner couples who find it more advantageous to remain under separate taxation will be able to do so. However, in designing the tax schedule for joint income taxation, the authorities should ensure that it does not create disincentives for second earners to take up work, in particular through interaction with the transfer system.
- A switch in child benefit from a tax allowance to a flat tax credit. The tax credit would compensate low-income households who cannot make full use of tax allowances. This move should help low-income households and should slightly increase participation incentives *via* decrease in the average effective tax when taking up work.
- A tax bonus for low-wage workers. The tax bonus, being available only for those in work, will reduce the tax burden at the lower end of the wage distribution.

Older workers' disincentives to continue working have been reduced

Older cohorts represent the biggest reserve of potential labour supply and tapping into this could increase the labour force participation rate by perhaps five percentage points (Chapter 1). Labour force participation rates are close to 90 per cent for 50-year-old men and women, but decline steeply towards retirement age. The good news is that employment rates of older-age workers have been increasing in recent years, reflecting earlier reforms. As of 2004, the routes to early retirement have been narrowed further, with the abolition of one scheme and a schedule implemented for phasing out another scheme by 2006. However the recent prolongation of unemployment benefit for those over 50 (Box 5.3) has somewhat diluted the thrust of policy, though the unemployment insurance dura-

tion period remains relatively short in comparison with other OECD countries. Also, the retirement age is set to increase to 63 by 2013, but this will still be rather low in international comparison and low from the point of view of the sustainability of the pension system (Chapter 7).⁷

The analysis in Chapter 7 recommends measures to remove remaining incentives to retire early. This includes further tightening access to the early retirement scheme and adjustment to the rate at which pensions are increased through working beyond the standard retirement age. Until recently, pensioners were not allowed to take up work during their first two years of pension. In a welcome move, the changes in the Pension Insurance Law have allowed pensioners to receive work income without losing pension income (except in the case of early retirement). This broadens the options for working beyond the standard retirement age and for this reason should help improve labour force participation.

Disability schemes are possible pathways for early labour-market withdrawal, if access is insufficiently controlled. Indeed, inactivity in the pre-retirement age because of illness or disability is very high in the Czech Republic compared to other OECD countries (OECD, 2004a), which points to a possible abuse of the schemes.⁸ The incentives for abuse are particularly strong for low-income workers, as the benefits imply rather high replacement rates. While beneficiaries of partial disability benefits have their work income limited, those granted full disability are allowed to work without any limit on earned income (Table 5.4). Therefore, attention should be paid to definition and thorough imple-

Table 5.4. **Disability pension schemes**
Financed from social security contributions

| Scheme | Key eligibility conditions | Main benefit amount |
|---------------------------|---|--|
| Full disability | Permanent reduction in the ability to work by at least 66 per cent and a minimum contribution period (depending on age, maximum 5 years) | Monthly: CZK 1 310 plus a percentage of previous monthly earnings (decreasing with their level) for each year of contribution (years remaining until retirement age are counted as years of contribution) |
| Partial disability | Permanent reduction in the ability to work by at least 33 per cent and, except in case of a work accident, a minimum contribution period (depending on age, maximum 5 years); earned income should not exceed 80 per cent of adjusted average previous earnings | Same calculation as full-disability pension with half of the variable amount if the beneficiary's income is less than 66 per cent of adjusted average previous earnings; a half of this sum if the beneficiary's income is between 66 and 80 per cent of adjusted average previous earnings. |

Source: Ministry of Labour and Social Affairs.

mentation of the access rules to disability pensions to limit their use as a route out of the labour market.⁹

Transition from school to work should be closely monitored

Youth unemployment rates are high (Chapter 1). Though high unemployment rates among the young are typical, reflecting the difficulties of getting a first foot on the jobs ladder, in the Czech case the welfare system has provided additional incentives to register as unemployed. Until recently, school-leavers were exempt from the 12-month work condition for eligibility for unemployment benefits and could automatically get 6-month unemployment benefit immediately after finishing school. Thus, school-leavers were often not motivated to get a job on leaving school. The new Employment Act applies the standard work-history condition for young people to get unemployment benefit, though it will allow temporary jobs and in-job training as part of schooling to count in the assessment of work history. Developments in youth unemployment should be closely monitored to examine the impact of the change in eligibility for benefit, with a view to establishing whether this measure is sufficient.

In-work sickness benefits

Despite improving health of the population (as documented in the previous *Survey*), the productive time lost on sick leave was continually increasing until end 2003 when it accounted for almost 7 per cent of working time, owing mainly to the increasing duration of average sick leave. The Czech sickness insurance system is similar to those in other OECD countries: eligibility requires a medical certificate and the benefit amount varies according to the length of sick leave and previous income (Annex 5.A3). However, the system has problems. First, when a person takes sick leave, the state bears all the payments to the employee, thus giving little incentive for employers to monitor sick leave. Indeed it is thought that employers sometimes encourage sick leave as means of labour hoarding. Second, the employers have few tools to sanction abuse and the control from authorities seems insufficient. The motivation for shirking is highest for low income workers (the benefit being capped at 60 per cent of the average wage) or workers likely to be laid off (employment protection legislation precludes dismissal of workers on sick leave).

In 2004, steps have been taken to try to tackle part of the problems in sickness benefit. As part of fiscal consolidation measures, the government cut the amount of the benefits in the first two weeks of sickness. This measure brought about an overall fall in the sickness rate below 6 per cent by September 2004. This drop has contained a significant decrease in the number of sick leaves but also a further strong increase in their average length. This suggests that these steps have been insufficient. Indeed, the government plans to amend the Sick-

ness Insurance Act and to increase the obligation on doctors to make responsible decisions, and to cut employers' social security contributions by 1-2 percentage points in exchange for the employer being responsible for the first two weeks of sickness benefits.

Labour mobility is low

As Chapter 1 describes, unemployment is strongly regionalised, in part reflecting weak labour mobility. One important factor hindering mobility is persistent friction in housing, particularly in the rental market. Indeed, a study by the Ministry of Finance estimates that friction in the housing market is responsible for at least 2 percentage points of the unemployment rate and represents a loss of about 2.4 per cent of GDP.¹⁰

The key problem in the rental market is that many rents remain *de facto* regulated and well below market rates. The *de facto* regulation applies to housing that was previously state- or municipality-owned and has since been sold off to private landlords, as well housing still owned by the municipalities.¹¹ Rents in these segments of the market were controlled by the government until March 2003, when rent regulation was ruled out by the Constitutional Court. Nevertheless, the rents have effectively stayed frozen because the existing regulation has not been replaced. These frozen rents are estimated to apply to about 95 per cent of rental apartments,¹² which accounts for more than one quarter of households. The incentives for tenants benefiting from these rents to stay put are large: rents on the open market are reckoned to be, on average, 3½ times the frozen rents and regulated rent is secure as long as the tenant maintains the lease.¹³ For example, frozen-rent apartments will often be kept unoccupied with families aiming to keep them for when children want to leave home.¹⁴ Steps need to be taken to gradually free-up the frozen rents and establish a unified rental market, as this will help mobility in the Czech labour market.

Government support for home ownership may also be restricting mobility. The government provides tax allowances on interest payments of mortgages and subsidising interest rates on deposits and credits of housing saving schemes.¹⁵ Although this helps to relieve some of the tension in the rental market and thus ease mobility for some households, home ownership in itself tends to discourage mobility because of high transaction costs connected with the sale of property financed by mortgages.

These problems have been recognised by the authorities but so far nothing has been implemented. In early 2004, members of Parliament failed to push through a proposal that would introduce 10 per-cent annual increases in regulated rents over the next three years. One reason for the unwillingness to reform is because rent deregulation would increase living costs for low-income households. However, many high-income households are also tenants of regulated-rent apart-

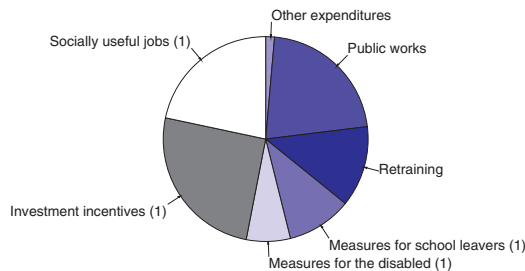
ments and so the situation is an inefficient way of ensuring minimum standards of welfare anyway (Lux and Sunega, 2003). In the process of rent liberalisation the government needs to ensure welfare concerns are addressed through adjustment of the benefit system. Public support to housing should be rebalanced from encouraging ownership towards supporting rental of low-income households.

Active labour market policies should focus more on placement and in-house training

Active labour market policy (ALMP) remains rather too focused on the subsidisation of private-sector job creation and public works and should be more weighted towards activation schemes (Figure 5.3 and Box 5.4). Total spending on active labour market policies is equivalent to about 0.2 per cent of GDP, which is relatively low compared with other OECD countries. Spending on retraining occupies a relatively small share of expenditure, though the number of people going on retraining programmes is quite high. About 17 per cent of the unemployed were in ALMP schemes in 2003, and about half the schemes attended involved retraining. Enrolment is higher among the young where 30 per cent of those unemployed participated in either retraining or in-job training positions.¹⁶

A study commissioned by the Labour and Social Affair Ministry (Sirovátka *et al.*, 2003b) finds that ALMPs aiming at creating jobs have become better

Figure 5.3. **Distribution of expenditure on active labour market policies, 2003**
Total spending 3.2 billion CZK



1. Employer subsidies.

Source: Ministry of Labour and Social Affairs.

Box 5.4. Active labour market policies

Active labour market policies are specified in the new Employment Law. The schemes include:

Retraining in accredited institutions provided to unemployed with inadequate labour market skills. The cost of retraining is covered by the labour office. In the new law labour offices may also support the training of employees on the basis that this is necessary for the individual to keep their job.

Investment incentives to employers subsidising the creation of new jobs or retraining of new employees in districts where unemployment rate is at, or above the national average. Subsidy amounts are defined by government directives (Chapter 4).

Public works comprise temporary work, mostly in cleaning of public areas or public buildings or work for state institutions, for which a subsidy up to total labour cost can be granted.

Publicly beneficial work positions – subsidised jobs created by an employer after the agreement with a labour office for the unemployed that are classified by the labour office as difficult to place. The total amount of subsidy granted to the employer is limited to 4 to 8 times the monthly average wage per person per year, depending on the unemployment rate in the district and number of jobs created by the employer. This subsidy may also be granted to newly self-employed.

Subsidy for employment of clients in “special care” of the labour office (namely, persons with disabilities, young up to the age of 25, other school-leavers, pregnant women, persons taking care of a child under 15 years of age, persons above 50 years of age, persons unemployed for more than six months and persons with difficult social background). This new subsidy can be provided in the amount up to a half of the minimum wage during three months. Jobs created for in-job training of school leavers and youngsters can be fully or partially subsidised for up to one year.

Support to workers with disabilities. This includes job counselling and training, subsidies for job creation and subsidies to employers where workers with disabilities represent more than 50 per cent of employees. Employers with more than 25 employees are obliged to employ workers with disabilities. Workers with disabilities represent four per cent of employees. Such employers can compensate this duty by buying products or services from other employers who employ mostly workers with disabilities, or by paying to the state budget a 1.5 multiple of average monthly wage per year for each disabled person they do not employ. The subsidy for job creation can amount to 8 to 14 times of the monthly average wage, further recurring support can be provided for wage and operation cost. Funds for employing workers with disabilities are claimable and come under mandatory expenditures of the state budget.

Bridging subsidy for newly self-employed who have been registered as unemployed. This new subsidy can amount to a half of the individual minimum subsistence amount paid during three months.

Transport subsidy. Subsidy for employers who provide daily transport of their employees in the areas not served by public transport. This subsidy can be up to 50 per cent of the cost.

Subsidy for the maintenance of jobs during a change of business activity, when the employer is not able to provide work for employees in the legally stated extent. A subsidy can cover part of the wages (with a cap at half of the minimum wage) for a maximum period of six months.

targeted to the areas most affected by unemployment. In contrast, retraining programmes remain insufficiently targeted, the share of unemployed enrolled in such schemes being similar across labour offices. Retraining schemes also appear unsuited to long-term unemployed, persons over 50 and disabled, who rarely participate in such schemes and, when they do, do not seem to draw clear benefits from them. Reportedly, the scope and quality of ALMP implementation is often limited by insufficient staffing of labour offices; this is even more the case since the introduction of individual action plans (see below). To improve the effectiveness of ALMPs, more systematic evaluation of the various programmes is needed; this is especially relevant in the current context of fiscal consolidation. As yet, existing ALMP programmes are monitored with respect to resources spent, number of participants and number of successfully placed participants. For better evaluation, information on the participants' completion of programmes and subsequent labour market experience should be systematically collected, as already done by many labour offices, and centrally analysed.

New programmes to increase assistance in job search at the individual level are being developed. In 2003, individual action plans for young and old unemployed were tested in some labour offices, and in January 2004, a compulsory programme, *First Opportunity*, began for all those aged under 26 and unemployed for less than 6 months. For the first two months the programme provides information and advisory services, and after that an individual action plan setting out a time schedule and employment objectives is established. The authorities should monitor the cost-effectiveness of the First Opportunity scheme and whether labour offices have the capacity to deliver these additional services.

There is perhaps room for more radical change in ALMP policy; the authorities could consider the introduction of private placement systems, similar to those that have been developed in the Netherlands and Australia. Private placement could, for example, involve contracting out the placement of specified groups of unemployed (*e.g.* by sector and region) to private or community placement companies. One approach is for local government to be given the responsibility for contracting out placement services. For example in the Netherlands, the central government gives earmarked funds for placement to municipalities. Unused funds have to be repaid while savings on benefits can be kept. However it is important for central government to take a regulatory role, in particular in defining robust measures of performance of the private-placement agencies (Grubb, 2003).

The tax wedge is too high

Tax wedges on labour income are among the highest in the OECD and in particular much higher than in other countries with comparable levels of income thus damping both labour demand and supply. Across all types of household and income levels, a very large share of the wedge comprises social security contributions

(Table 5.5). The same social contribution rate applies to all levels of earnings and there is no cap on contributions. In addition, personal income tax is not very progressive, with rates of 15, 20, 25 and 32 per cent. This rate schedule is among the lowest in Europe and has been undercut only recently by the Slovak flat tax of 19 per cent. Taking into account social benefits as well as the social contributions and personal income tax suggests that more than 40 per cent of labour cost associated with employing a single person goes towards government revenues (Chapter 1).

The high tax wedge on labour also encourages tax evasion. Notably, the use of subcontracts with self employed workers has become widespread. Taxes and social contributions are much lower in self-employment than in dependent employment. As a result, in order to save on labour costs, employers, particularly in certain industries (notably in construction), often ask employees to obtain trade licences and then use subcontracting instead of standard employment contracts. In addition, self-employment is more prone to tax evasion than dependent employment, because of the substantial cost for self-employed of accurate accounting, high monitoring cost for tax authorities of individual record-keeping, and the lack of possibility of cross-checking with other sources which can be used for dependent employees (OECD, 2004b). As a part of its revenue-increasing measures, the government has recently increased the tax burden on the self-employed; social security contributions were raised and a minimum tax was introduced. Though these measures will probably raise revenues, they will narrow the gap between the tax rates of the self-employed and employees by only about two percentage points (*i.e.* about one eighth of the difference) at the level of average wage. Measures to further level the tax treatment of income from dependent employment and self-employment are needed in order to reduce the room for tax evasion and induce the move of those formally self-employed but *de facto* working as employees back to dependent employment.

Tax evasion is also a motivation for grey-sector activity. Grey-sector employment takes a number of forms, including under-declaration of earned

Table 5.5. **Social security and health insurance contribution schedule**

Per cent of gross wage

| | Employee | Employer | Total |
|---------------------------|-------------|-------------|-------------|
| Health insurance | 4.5 | 9.0 | 13.5 |
| Sickness | 1.1 | 3.3 | 4.4 |
| Old age pension (PAYG) | 6.5 | 21.5 | 28.0 |
| Unemployment | 0.4 | 1.2 | 1.6 |
| Total contribution | 12.5 | 35.0 | 47.5 |

Source: Ministry of Labour and Social Affairs.

income by formally employed people (dependent or self-employed), undeclared parallel jobs, or undeclared employment of unemployed persons drawing on social benefits. Such strategies to evade taxation increase the burden on non-evaders and contribute to weaken official labour demand and supply.

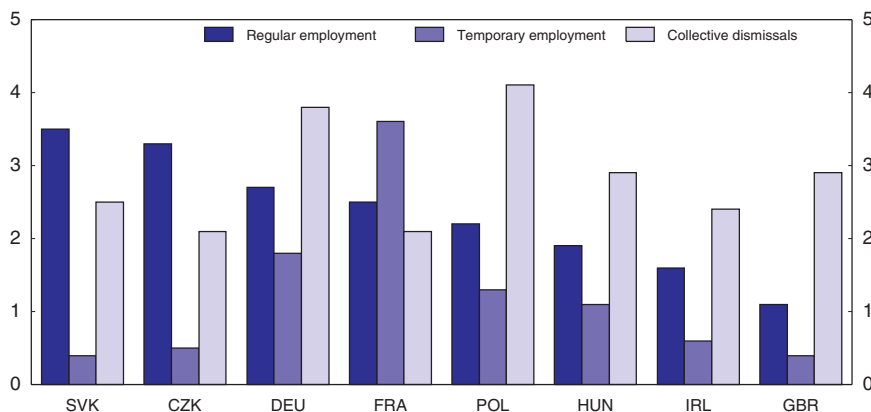
While there is a clear need to reduce the tax burden, the room for manoeuvre is constrained by the need to bring down the budget deficit. As mentioned in Chapter 2, the government intends to introduce a ceiling on social-security contributions at the level of five times the average wage. This move will have positive incentive effects at the very-high-income end of the labour market and establish more parity with the treatment of related benefits that are also capped. However, tax expenditures that cut the non-wage cost at the lower end of the market would be more welcome than those that cut the wedge for high income earners as these also help tackle the problem of unemployment. For example, decreasing social security contribution at the lower end of the market would reduce the cost of employing workers whose reservation wage are influenced by unemployment and welfare benefits. However, in terms of tackling tax evasion and grey-sector activity, further measures to enhance the efficiency of tax collection (notably through labour controls) should be implemented.¹⁷

Employment protection legislation is uneven

Recent OECD work on labour market indicators (OECD, 2004b) finds that the Czech Republic is among those countries that impose stringent employment protection legislation (EPL) on regular contracts (Figure 5.4). While the Czech Republic ranks rather low in regulation on *collective* dismissals, regulation on *individual* dismissals is highly restrictive, both in terms of the stringency of dismissal conditions and procedural difficulties (Annex 5.A4).¹⁸ The law stipulates that employers have to apply one of six reasons for dismissal; four are based on organisational change (including redundancies) and health reasons, and two are based on poor work performance and discipline.

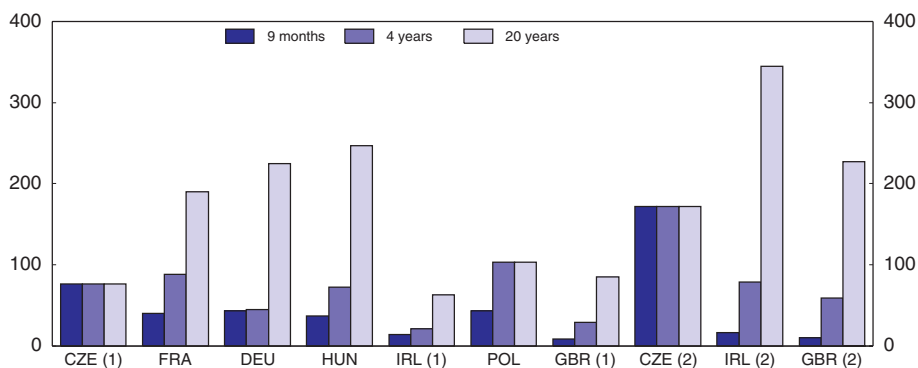
Dismissal due to poor performance is cumbersome for employers and not commonly used, even though it has the attraction of not requiring redundancy payments. Dismissal in this case requires a process of formal notification in which the worker has to be given time to improve performance after which management must be able to then show that performance has not improved. Instead, dismissal is often engineered by re-organisation, even in cases where the employer's real concern is poor performance. In this instance, severance pay must be paid (Figure 5.5). Workers with permanent contracts are entitled to a 3-month notice period and 2-month payout in cases of redundancy, independent of the length of service, otherwise to 2-month notice.¹⁹ There is no variation of the period with the tenure of the job. This is unusual compared to other countries and implies relatively high employment costs for short and medium-length employment periods.

Figure 5.4. **Strictness of employment protection legislation, 2003¹**



1. The summary indicators are normalised to range from 0 to 6 with the higher score representing stricter regulation. Data is ranked by the indicator for regular employment. Source: *OECD Employment Outlook 2004*.

Figure 5.5. **Dismissal cost by job tenure, 2003**
Number of days wages paid by employer



1. Dismissal with no severance payment.
2. Redundancy dismissal with severance payment.
Source: OECD calculations based on the background material for *OECD Employment Outlook 2004*, Chapter 2.

Lighter rules on redundancy for those on permanent contracts would help the labour market work more efficiently. The government's intention to introduce a major reform to the labour code to liberalise the market is therefore welcome (Box 5.5).

Unlike some other labour markets, strict regulation on regular contracts has not resulted in widespread use of temporary contracts. Indeed, only about 10 per cent of workers are on temporary contracts, although the rules in this regard are not particularly restrictive. There have nevertheless been concerns that employers abuse temporary contracts, and steps have been taken in the new amendment to the Labour Code. The maximum duration of successive temporary contracts has been limited to 24 months. At the same time the restrictions on temporary contracts have been lifted for previously protected groups such as school-leavers and other young workers, leaving the protection to collective agreements.²⁰ In addition, rules governing temporary work agencies have also been introduced, offering better opportunities for employers to hire temporary workers.

Temporary contracts are not widely used because other alternatives to standard contracts are also attractive. As discussed above, subcontracting with workers with self-employment status is common. Other alternatives include one-off project contracts and various forms of business contracts. While alternative contracts are preferable to inactivity there should be careful monitoring whether

Box 5.5. **Employment protection: legislative changes**

Amendments to the Labour Code in 2003 and 2004 established:

- explicit principles of equal opportunities and treatment,
- a limit of two years on the maximum total duration of temporary contracts (exceptions will apply to working pensioners, substitutes for long term absent employees and operational or technological reasons on the side of the employer); the maximum cumulative duration of temporary contracts via temporary work agencies will remain unrestricted,
- the competitive clause with a maximum of one year restriction on post contract competitive activities of employees in exchange for pecuniary compensation,
- a collective dismissal clause that fully reflects EU directives.

The government plans a more thorough liberalisation of the EPL via a new Labour Code that would abandon the principle “what is not allowed is forbidden” and lessen the role of the Labour Code itself. This would strengthen the importance of contracts, collective agreements and firm specific rules. The draft law should be prepared in the beginning of 2005.

this partly signals some inappropriate specific restrictions of standard contracts. More generally, lighter rules on redundancy in permanent contracts as well as appropriate action on the tax wedge (see above) would also help cut back abuse of alternative contracts. At the same time direct measures to prevent abuse of alternative work arrangements may be needed.

Wage setting

Wage increases are determined through a mix of individual wage negotiation, company collective agreements and higher-level collective agreements.²¹ Around 30 per cent of workers are directly covered by collective bargaining. In addition, since 2000 government decrees have introduced indirect coverage through administrative extensions of wage agreements.²² In 2003, for example, there were 19 extensions, affecting more than 900 000 workers (about 20 per cent of total employment) mainly in steel, engineering, construction and textiles. In June 2003, the Constitutional Court declared void the Act on Collective Bargaining which included provision for the Minister of Labour to unilaterally decree administrative extensions – the court ruling was made effective in March 2004. In response to the ruling, the government is preparing an amendment to the Act, but there is no intention to significantly alter the sections on administrative extension. Increasing the scope of administrative extensions would not be a good move given the rather sluggish labour market and also the need to maintain international competitiveness in labour costs. Rather than planning to increase administrative extensions in wage setting, the authorities should instead be aiming to cut them back to leave room for more flexible individual or enterprise-level wage bargaining.

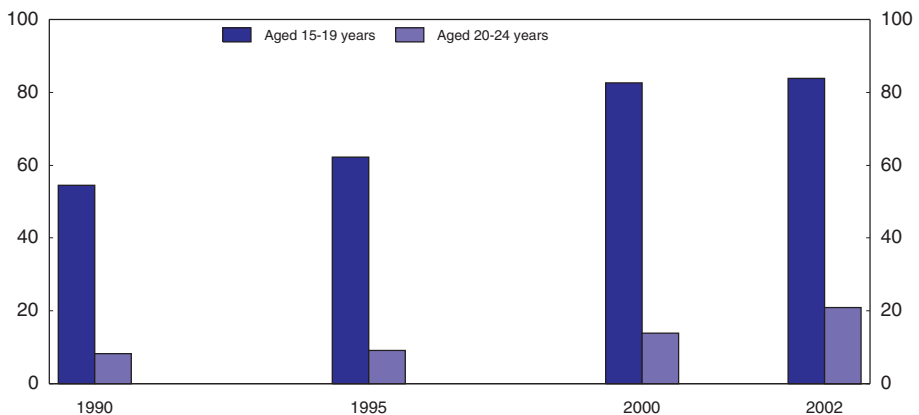
The minimum wage is set by the government after negotiation with trade unions and employers. It is currently CZK 6 700 per month (approximately EUR 212), equivalent to about one third of the average production wage. Although the minimum wage has been increased by about 120 per cent in real terms since 1998, it does not appear to create important distortions in the labour market. Less than 1 per cent of employees earn the minimum wage, suggesting that it is not strongly influencing the labour market in general. Nevertheless, minimum wages are more influential in certain sectors of the labour market, particularly the young, and can stimulate increases higher up the wage scale.

Skills formation and education are not sufficiently responsive to changing labour market demand

The most obvious weakness in educational attainment is the very low share of the working-age population with tertiary education, although increasing enrolment rates mean the situation is improving gradually. While almost 90 per cent of population have at least secondary education, which is high in interna-

tional comparison,²³ the country ranks at the very low end of the OECD distribution in tertiary education, with less than 15 per cent of the population with tertiary education.²⁴ The main reason for the low tertiary attainment is historic. At the beginning of transition to a market economy, post-secondary education was concentrated in vocational education provided by institutions without tertiary status. Economic transition has seen capacity problems in the tertiary sector, with the number of applicants far exceeding the number of available places. In response additional places have become available at state universities and in private tertiary schools. Although demand still exceeds supply,²⁵ the problem is now much reduced, and demographic developments are helping as the population in the 18-25 age group has been declining. The rapidly increasing number of Czech students in tertiary programmes abroad should also help. The strong demand for higher education has brought a sharp increase in student numbers and enrolment rates (Figure 5.6).²⁶ Nevertheless, because the ageing population means young cohorts are relatively small, the pace of change of educational attainment in the workforce as whole will be slow even with high enrolment rates.²⁷ Indeed, the increasing wage gap between workers with tertiary and complete secondary education (*i.e.* with *maturita*) points to the direction that there is still insufficient supply of workers with tertiary education.²⁸

Figure 5.6. **Share of population in full-time study programmes**
Per cent of age-group



Source: Karpisek (2003).

Cross-country comparison of literacy and skills suggests that primary and secondary schooling is delivering reasonable levels of education. The 2001 PIRLS study on reading literacy of the 9-year-olds shows above-average results for the Czech Republic. And the overall literacy performance of pupils in the PISA study of 15-year-olds is close to the OECD average (OECD, 2003a). Nevertheless there are recognised general weaknesses in primary and secondary education. A 2001 strategic document on education (the National Programme for the Development of Education) outlined the need to abandon excessive emphasis on “passive” knowledge, and emphasise communication, active search and processing of information, opinion building, argumentation and teamwork. Some improvement is evident, but progress has been hindered by delayed changes in legislation.²⁹ Furthermore there are major problems regarding the education of the Roma (see below).

One important change in primary and secondary education systems brought about by the reform of public administration is the transfer of a significant part of decision making to the level of regions and municipalities. This will necessitate reassessment of the efficiency of the use of schooling facilities and, possibly, cuts in the number of facilities. It remains to be seen how decentralisation will affect the quality and effectiveness of education. At the moment, in secondary and primary education there is very little by way of output measurement and benchmarking and this should be remedied. There are some plans to introduce an assessment system, though there is reluctance to make the results of this exercise public as is done, for example, in the United Kingdom.³⁰ In addition, the introduction of a standardised secondary-school leaving exam (*maturita*) will in principle also present opportunities for outcome comparisons as well as helping both employers and tertiary education institutions assess school leavers' skills. In reforming the financing system for regions (Chapter 2), the government should also ensure that the new system will not affect educational equity by reducing accessibility and quality of education for disadvantaged groups, such as Roma (see below).

Language and computing skills are highly relevant for the Czech labour market and are recognised in education priorities. Indicators suggest progress,³¹ but there is still room for improvement, particularly at primary and secondary level, and school graduates perceive these skills to be inadequately provided by the education system.³² There was an attempt to improve computer literacy by increasing the use of computers in primary schools. Unfortunately, it appeared that a considerable amount of money has effectively been wasted in this project as the private company invited to make the installations exploited loopholes in the contract to delay delivery and to make cut backs in quality. In addition, the schools reportedly do not always make full use of available computing facilities.

In tertiary education, some measures have been taken to better respond to labour-market demands. For example, most long master-study programmes

have been reorganised into two stages with bachelor and master degrees. Emerging cooperation between universities and enterprises (*e.g.* in the development of curricula) also needs to be strengthened. However, signals from the labour market on which skills are in demand are not all that strong in programme development, even though universities have the freedom to choose which courses to offer. In part, the lack of fees probably weakens the attention of students to the investments and returns in higher education when choosing courses, resulting in less economic decision making. Therefore, public universities get distorted signals from student demand on where programmes should be developing. The introduction of fees in higher education that at least partially reflect the cost of tertiary courses would promote a more economic approach to higher education by students and universities. To ensure accessibility of tertiary education, the introduction of tuition fees should be accompanied by a system of students' loans. Experience of some OECD countries (*e.g.* Australia, New Zealand and United Kingdom) suggests that the introduction (or increase) of fees does not have to lead to decreased access to tertiary education, if it is accompanied by expansion of students' access to loans to finance their education (Blöndal *et al.* 2002). In order to reduce the risk borne by individuals investing in their education, the repayment of such loans may be made income-contingent as is the case in the United Kingdom (OECD 2004b) where the speed of repayment depends on graduate income. Unfortunately, the prospects of introducing fees in the near future look weak. The new government has no consensus on tertiary fees and concrete policy proposals are very unlikely before the next general election.

Integrating the Roma should get higher priority

Policies to deal with Roma issues are under the responsibility of various ministries – notably the Ministries for Labour and Social Affairs, Education and Health – as well as regions and municipalities, the latter being responsible for social welfare. In 1998 the Government Council for Roma Affairs was set up and charged with acting as a consultative and co-ordinating body. The council includes government officials and representatives of the Roma community, and has powers to propose legislation to the government. In 2000, the government issued a document setting the main priorities for the integration of the Roma population. Overall, although a few important measures have been taken and a framework for integrated policy exists, full co-ordination of policy is still lacking in practice.

Further integration of the Roma population is needed, not only to address social concerns but also to help mobilise labour resources. Obviously, the Roma community would benefit from general measures aimed at increasing employment, such as efforts to reduce the tax wedge on low-skilled labour and making the tax-benefit system more employment friendly. However, this will almost certainly not be enough to overcome the very strong gaps between the Roma and

mainstream Czech society. In this regard, more work is needed to develop an integrated set of targeted policies to tackle the various problems leading to poverty and social exclusion of Roma.

Access to proper education is insufficient

Poor access and quality in education are probably the most important factors holding back integration of the Roma population. Some evidence suggests that access has been weakening since 1990 in Central and Eastern Europe, and Roma children are increasingly not starting or finishing school (Ringold *et al.*, 2003). In the Czech Republic, as in other central and eastern European countries, Roma children are very often channelled into special schools. In the Czech case this either means a school for children suffering from health or behaviour problems or special schools for mentally or physically handicapped children. The share of Roma in special schools is indeed very high; an estimate from the late 1990s suggests nearly 65 per cent of Roma children were in special schools, compared with 4 per cent for the total population. These schools provide a relatively low level of education. Children receive fewer Czech language lessons, and are not expected to read for comprehension until the third grade (against the first grade for students in mainstream schools). In addition, the choices following completion of special-school education are limited, as pupils of the special schools most often enter technical secondary schools or even training centres, which offer limited training in narrowly defined fields and are not very highly valued by employers (Ringold *et al.*, 2003).

Some steps to counter these problems have been taken by successive Czech governments over the 1990s. About 300 Roma assistants to teacher's positions have been created in pre-school, primary and secondary schooling and preparatory schools. A new draft school act proposes to take a positive step by eliminating the special schools, however this should be complemented by steps to increase access to early childhood education.³³ Roma children should be better prepared entering primary school, notably in language skills. Preschool education, for children aged 3 to 6, is not compulsory and few Roma children attend while attendance is 89 per cent among all children. Making attendance compulsory for all at least in the year preceding entry to primary school, as currently envisaged by the government, would be a positive step. Roma children would also benefit from better access to kindergarten for younger children. Access to kindergarten is fairly limited in general, and particularly so for the Roma. In part this may be because Roma feel that the environment is hostile to their children, and prefer to keep them in the community. The loss of parental allowance (which amounted in 2004 to about 50 per cent of the minimum wage) when a child is put in kindergarten is likely a significant disincentive.³⁴ In addition, early childhood education needs to be more inclusive for Roma children and the use of properly trained

Roma teaching assistants and adaptation of curricula and teaching methods should be extended. Experience in a number of schools shows that using properly trained Roma teaching assistants and adapting the teaching contents and methods to the Roma population can pay off (McDonalds, 2004).³⁵

Economic constraints are an important factor dissuading school participation of the Roma in secondary and tertiary education. In an effort to tackle the problem in secondary schools, a financial support scheme has been running since 2000 (in 2003 the scheme provided about 1 400 Roma students with support averaging about CZK 7 000 per student) and is judged as having been reasonably successful in encouraging enrolment. No equivalent scheme is as yet run in tertiary education and scholarship schemes for socially disadvantaged students are rare and the possibility of providing scholarships for socially disadvantaged students in tertiary education should be considered. There have been welcome signs of action on this issue with a governmental decree to the Ministry of Education to plan a tertiary scholarship system. In finalising the financing system for regions, it is important that the central government has sufficient leverage in policy to promote better education for the Roma, through for example the earmarking of funds. Otherwise, strong pressure for spending cuts may excessively squeeze expenditures on Roma education.

Efforts to improve labour force participation and housing access are welcome

Unemployment rates among Roma are estimated to be above 50 per cent, and significantly higher in some localities. Because Roma were among the first laid-off in the early 1990s, very long-term unemployment is common. However, this is only part of the picture as informal sector activity (from profitable to more marginal subsistence activities) is also a source of income. Roma have, in principle, access to general ALMPs, and a number of targeted projects have also been conducted, although often without much follow up. Generally organised by labour offices in collaboration with Roma NGOs and the municipalities, the targeted schemes mainly create jobs for community services, for example in the cleaning and maintenance of housing in Roma communities, or in teaching assistance. The government is also developing programmes to prepare Roma to work in the police, and is planning to do the same for work in prisons. Enterprises owned by Roma have also sometimes been given favourable treatment in public procurement procedures; the efficiency of such measures in terms of employment has been questioned however, since support was not conditioned on employing Roma. At another level, anti-discrimination legislation relating to the workplace has been adopted as part of the *acquis communautaire*, which may in the long run help to reduce apparently common discriminatory practices by employers.

Policies are needed to help improve housing conditions for Roma. The Roma are less concentrated in specific location or neighbourhoods in the Czech

Republic than in other Central and Eastern European countries. In part this is because the Roma population is mainly urban and not rural, as for example in the Slovak Republic. However, concentration in peripheral, poorly equipped and decaying areas has been increasing in recent years. The privatisation of housing has increased the incentives to push socially disadvantaged groups, and in particular Roma families, out from the scattered poor quarters in city centres. And new neighbourhoods have grown up in suburban areas that are arguably more problematic in terms of social exclusion.³⁶ Deregulation of the rental market, though broadly desirable, is likely to result in even more Roma being pushed into the suburban areas. This underscores the need, as mentioned above, for the government to ensure that welfare concerns from rent deregulation are addressed.

Well designed community oriented jobs can also help the Roma integrate. Indeed there has been a programme to create such jobs for several years. In a welcome move, the government is currently designing a new agency that would implement projects to provide housing and jobs to combat social exclusion. The status and scope of the agency is not yet decided. It might be modelled after a Spanish institution, which assists municipalities in designing the projects and accessing the EU social cohesion funds. The idea would be to allow Roma to live in the centre of the cities, and not only the outskirts, in a way that avoids the creation of ghettos, and to provide them with some community service jobs at the same time. Following the reform of the public administration which has significantly reduced the possibility for the central government to initiate such measures, the agency could promote some strategic actions in this area.³⁷ The structure of the agency project provides a useful blueprint for co-ordinated policy between national strategy and regional and local implementation. Initiatives like this are important as leaving most of the responsibility for Roma support to local and regional governments, as is currently the case in housing for example, is likely to result in insufficient investment in Roma integration, because generally at the local level the Roma have weak influence on policy, and local government has incentives to pass on social problems elsewhere.

Better data is needed to improve policy towards Roma integration

An important problem for policymakers in looking at the various problems of integration of the Roma community and in designing and evaluating policies is the absence of data. In the population census, the declaration of ethnic origin is voluntary and, as mentioned above, for a number of reasons including fear of discrimination and stigmatization most Roma do not declare their origin and the Roma community is strongly opposed to any compulsory declaration of ethnic origin. Implementing compulsory declaration would thus hardly be consistent with positive integration objectives.³⁸ Other ways could be sought however. One possibility would be to conduct anonymous surveys at the community level. In Slovakia

a survey of Roma communities using this approach has recently been conducted with the help of Roma NGOs. The survey focuses on monitoring: *i*) basic demographic information (number of men, women, children, and children born last year); *ii*) infrastructure (accessibility of water resources, electricity, type of housing etc.); *iii*) the degree of integration or segregation of the community; *iv*) the socio-economic situation and potential of the community (age structure, unemployment, school attendance, accessibility of services etc.); and *v*) projects to help the Roma (Haviarová, 2004). Some of the data will be made publicly available while some will remain confidential to government institutions.

Finding a solution to the problem of lack of information about the Roma would be a considerable help to policymakers. A mapping of Roma communities similar to that carried out in Slovakia may be a good solution, providing sufficient information for policy planning while at the same time respecting the reluctance of the Roma community to provide individual information on their ethnic origin to the authorities.

Notes

1. Social assistance benefits include the social assistance benefits provided due to low income, as stipulated by the Social Need Act, and other benefits, *e.g.* allowance when taking care of close relatives, benefits provided to senior or severely handicapped citizens, and benefits for citizens in extremely difficult circumstances.
2. In theory, the after-benefit income can be both below and above the MSA. However, according to the Ministry of Labour and Social Affairs, citizens whose after-benefit income is still below MSA include mainly those who do not take up the benefit at all (mostly homeless people) and a very small percentage of households who claim the social assistance benefit. It is more often that after-benefit income of households receiving social assistance benefits is higher than MSA.
3. The definition of MSA is narrower than comparative international definitions of poverty. In 2001, 7.1 per cent of Czech households had income below 60 per cent of the median net income generally used as the poverty measure in international studies (Sirovátka *et al.*, 2003a).
4. For the following analysis, it is assumed that households whose income from work and including benefits from the state social support scheme does not reach MSA receive a social assistance benefit that brings their income to the level of MSA.
5. According to Hanousek and Palda (2003) the share of people engaged in undeclared work has probably been growing. The study reports that workers who admitted engagement in the grey economy declared that they spent on average about 3 hours per week in undeclared activities, but this is likely to be an understatement.
6. The system will work through means-testing that allows exemption of part of earned income.
7. The retirement age for women is currently lower than for men and depends on the number of children they have had. In 2013, the retirement age of 63 will apply to men and women without children, women with children will still be able to retire earlier.
8. Probable exploitation of the system is indicated by the fact that almost 11 per cent of labour force was receiving full- or partial-disability benefits in 2003. This is above the average reciprocity rate in 16 OECD countries found in OECD (2003b).
9. While the system of medical screening for disability seems to be rather tight, the definitions of some types of disability may be out of date as they were written 10 years ago.
10. Additional cost for the public budgets stem from higher expenditures on subsidies for housing acquisition and foregone rent on municipal flats.
11. Exempted from rent regulation are apartments that have been freed by the occupant (except for the cases of exchange, inheritance and similar), newly-built privately-

financed apartments, and apartments occupied by foreign corporations or foreigners without a permanent residence permit.

12. Lux and Sunega (2003); the estimate is for year 1999, but experts do not estimate a significant decrease since.
13. According to the Ministry of Finance, the average regulated rent (defined as the maximum price) was EUR 0.5 per square metre while the average market rent reached EUR 1.8 per square metre. The ratio between average market rent and regulated rent is close to 5 in Prague.
14. 450 000 apartments were unused according to the 2001 Census. However, such apartments are often sub-rented on the black market for market rent. The size of the black rental market is estimated to be close to the size of the official free market (Lux and Sunega, 2003).
15. Construction activity was also recently encouraged by the postponing the shift of residential construction from the lower VAT bracket (5 per cent) to the upper one (19 per cent) until 2008.
16. European Employment Observatory, Quarterly Update: April 2004.
17. In its 2003 report on the adoption of the Community *acquis* in the area of taxation, the European Commission notes that the Czech Republic has already taken effective steps to strengthen the administrative capacity of tax authorities (European Commission, 2003).
18. By law it is possible to strengthen EPL by collective agreement but this is rarely done.
19. The notice period always starts on the first day of the month following the notice being given.
20. Only two such collective agreements were in force, according to the Ministry of Labour, protecting workers in pre-pension age.
21. The Law on Collective Negotiation defines a higher-level collective agreement as an agreement between a higher-level trade union body and organisation(s) of employers. The notion of branch- or industry-level agreements does not exist in the law.
22. The annex to such a decree would contain the list of employers to which the agreement is extended.
23. Secondary education comprises of secondary general, technical and vocational schools; some technical and vocational secondary schools are not ended by the *maturita* exam.
24. The Czech Republic is also one of the countries where the education attainment is biased in favour of men, with the share of women with secondary and tertiary education in the population by 5 and 2 percentage points lower than that of men.
25. According to Ministry of Education, 30 per cent of applicants who took part in entrance tests were not admitted.
26. Also changes in the specialisation of secondary students have gradually taken place with the share of vocational programmes prevailing before 1990 reducing to one third of all secondary students, and the shares of general (academic) and technical secondary education increasing.
27. It is estimated that in a given year 3 per cent of the working-age population is renewed.
28. Jurajda (2004) evaluates the wage gap between workers with tertiary and complete secondary education in 2002 to 43-53 per cent according to gender and age; this study finds also some evidence that the gap has increased between 1998-2002.

29. The previous *Survey* has already described plans to reform the School Act. It was only in June 2004 when new reformed School Act was voted.
30. See the latest *Survey* for the United Kingdom (OECD, 2004b) for a review of UK health and education provision.
31. The intended instruction time devoted to modern languages was in 2001 above the OECD average for children 9-11 years, but just at the average for children of 12-14 years (OECD 2001).
32. Vojtech *et al.*, 2003.
33. Otherwise, it may result in the creation of special classes in the school concentrating the Roma children, as is already sometimes the case.
34. Some countries, such as Hungary have found that offering free meals in kindergartens can help attendance (as well as improve the health conditions of Roma children). A scheme has been tried in the Czech Republic but reportedly was ineffective.
35. Roma teaching assistants can play an important role in liaising with the parents, helping teachers to incorporate Roma culture and language in the classroom, serving as a language bridge for younger children who still not have mastered the Czech language, and mentoring children.
36. For an overview of housing problems faced by the Roma, see Socioklub and UNHCR (2003).
37. One example of negative consequence of decentralisation is the dismantling of the network of Roma advisors. Roma advisors were working at linking the state administration (notably social services) with Roma communities. They existed in 80 districts, and 50 per cent of them were Roma; very few remain.
38. This would actually also violate the EU human rights principles.

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Annex 5.A1
Welfare benefit expenditures

Table 5.A1.1. **Welfare-benefit expenditures, 2003**

| | CZK bn |
|--------------------------------------|-------------|
| State social support – total | 32.2 |
| Child benefits | 12.5 |
| Parental allowance | 8.0 |
| Social allowance | 5.8 |
| Housing allowance | 2.8 |
| Transport allowance ¹ | 1.3 |
| Other benefits | 1.8 |
| Social assistance – total | 14.1 |
| Social need | 10.2 |
| Out of which: Families with children | 4.3 |
| Individuals | 5.9 |
| Old and disabled | 3.9 |
| Passive LMP expenditures | 6.2 |

1. Phased out in 2003.

Source: Czech Statistical Office, Ministry of Labour and Social Affairs, OECD.

Annex 5.A2
Replacement rates in unemployment

**Table 5.A2.1. Net replacement rates for a single person
in the initial period of unemployment¹**

| | Previous earnings as a share of average production wage | |
|-----------------|---|------|
| | 67% | 100% |
| Australia | 46 | 32 |
| Austria | 55 | 55 |
| Belgium | 87 | 66 |
| Canada | 63 | 64 |
| Czech Republic | 50 | 50 |
| Denmark | 84 | 59 |
| Finland | 78 | 64 |
| France | 80 | 71 |
| Germany | 63 | 61 |
| Greece | 64 | 46 |
| Hungary | 61 | 44 |
| Iceland | 66 | 49 |
| Ireland | 40 | 29 |
| Italy | 50 | 52 |
| Japan | 73 | 63 |
| Korea | 53 | 54 |
| Luxembourg | 84 | 85 |
| Netherlands | 79 | 71 |
| New Zealand | 54 | 37 |
| Norway | 66 | 66 |
| Poland | 65 | 44 |
| Portugal | 85 | 78 |
| Slovak Republic | 69 | 62 |
| Spain | 76 | 70 |
| Sweden | 82 | 81 |
| Switzerland | 79 | 72 |
| United Kingdom | 63 | 45 |
| United States | 62 | 56 |

1. Initial phase of unemployment but following any waiting period. No social assistance “top-ups” are assumed to be available in either the in-work or out-of-work situation. Any income taxes payable on unemployment benefits are determined in relation to annualized benefit values (*i.e.* monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months.

Source: OECD *Benefits and Wages* (2004).

Table 5.A2.2. **Net replacement rates for lower income recipients¹**
 After tax and including family and housing benefits for long-term benefit recipients

| | Single person | Married couple | Couple 2 children | Lone parent 2 children |
|-----------------|---------------|----------------|----------------------|---------------------------|
| Australia | 46 | 40 | 79 | 61 |
| Austria | 64 | 84 | 100 | 82 |
| Belgium | 72 | 77 | 77 | 82 |
| Canada | 31 | 50 | 68 | 63 |
| Czech Republic | 45 | 72 | 91 | 77 |
| Denmark | 71 | 88 | 82 | 85 |
| Finland | 69 | 88 | 94 | 77 |
| France | 56 | 77 | 83 | 81 |
| Germany | 82 | 86 | 84 | 92 |
| Greece | 0 | 0 | 4 | 4 |
| Hungary | 33 | 33 | 39 | 41 |
| Iceland | 66 | 86 | 90 | 80 |
| Ireland | 71 | 90 | 90 | 66 |
| Italy | 0 | 0 | 0 | 0 |
| Japan | 50 | 71 | 87 | 92 |
| Korea | 25 | 42 | 72 | 58 |
| Luxembourg | 70 | 99 | 107 | 84 |
| Netherlands | 79 | 89 | 87 | 78 |
| New Zealand | 54 | 79 | 82 | 77 |
| Norway | 60 | 70 | 86 | 79 |
| Poland | 45 | 66 | 85 | 75 |
| Portugal | 34 | 57 | 69 | 61 |
| Slovak Republic | 62 | 100 | 100 | 91 |
| Spain | 37 | 44 | 59 | 54 |
| Sweden | 74 | 97 | 100 | 66 |
| Switzerland | 73 | 90 | 99 | 91 |
| United Kingdom | 63 | 78 | 78 | 66 |
| United States | 10 | 16 | 50 | 44 |

1. After tax and including unemployment benefits, social assistance, family and housing benefits in the 60th month of benefit receipt. For married couples the per cent of APW relates to one spouse only; the second spouse is assumed to be "inactive" with no earnings. Children are aged 4 and 6 and neither childcare benefits nor childcare costs are considered.

Source: OECD *Benefits and Wages* (2004).

Annex 5.A3
The calculation of sickness benefits

Table 5.A3.1. The calculation of sickness benefits

| Days of entitlement | Reduction limits of the daily assessment base and reduction rates (share of average daily income used for computation sickness benefits) Per cent | | | Sickness pay paid from the daily assessment base Per cent | Total maximum CZK per day |
|---------------------|--|---------------------------------|---------------|--|---------------------------|
| | Up to CZK 480 | Above CZK 480 and up to CZK 690 | Above CZK 690 | | |
| 1-3 | 90 | 60 | 0 | 25 | 139.5 |
| 4-14 | 90 | 60 | 0 | 69 | 385.02 |
| 14+ | 100 | 60 | 0 | 69 | 418.14 |

Source: Ministry of Labour and Social Affairs.

Annex 5.A4

Administrative procedures for individual notice and dismissalTable 5.A4.1. **Administrative procedures for individual notice and dismissal**

| | Legal provisions | Delay before notice can start (days) |
|----------------|---|--------------------------------------|
| Czech Republic | Personal reasons: Notification of employee, after previous warning. Letter sent by mail or handed out directly. The notice period starts to run from the first day of the calendar month following receipt of the letter. | 16 |
| | Redundancy: Notification of employee. Advance consultation, with offer of another job or re-training if feasible; then letter sent by mail or handed directly to employee. The notice period starts to run from the first day of the calendar month following receipt of the letter. | 22 |
| France | Personal reasons: Letter; interview: statement of reasons to employee; a second letter: notification by registered letter with recorded delivery. Minimum delay required between the first letter and the interview: 5 working days; 1 additional day is then required after the interview for the second letter to be sent. | 10 |
| | Economic reasons: Letter; interview (statement of reasons to employee); a second letter: notification by registered letter with recorded delivery. Notification to Labour Inspectorate. Minimum delay required between the first letter and the interview: 5 working days; 5 to 15 additional days are required after the interview for the second letter to be sent. | 17 |
| Germany | Notification to employee must be in writing (required in many collective agreements), after oral or written warnings to employee in case of dismissal for lack of performance. Previous notification of planned dismissal, including reasons for termination, to works council (if one exists). In case of notice given despite works council objection and subsequent law suit, dismissal has to wait for decision by Labour Court. After notification, maximum 7 days for Works Council to object to dismissal. Notice can then be served, specifying the 1st or 15th of the month. | 15 |

Table 5.A4.1. **Administrative procedures for individual notice and dismissal** (cont.)

| | Legal provisions | Delay before notice can start (days) |
|----------------|---|--------------------------------------|
| Hungary | Written notice to employee, including reasons for termination. The employer must justify his notice. Employee must be given an opportunity for defence against the objections raised against him. Letter sent by mail or handed directly to employee. | 7 |
| Ireland | Individual termination: No prescribed procedure. Notice may be oral or in writing but must be certain. There is no specific procedure outlined in the Minimum Notice and Terms of Employment Act 1973, but there is a Code of Practice on Grievance and Disciplinary Procedure, which sets out best practice in terms of procedures to be followed. Advisable to serve notice in writing after warnings specifying what aspect of behaviour is substandard. Redundancy: Copy of official redundancy form to be sent to Department of Employment. Notice may be oral or written as long as it is certain. | 7 |
| Poland | Notification to representative trade union of intention to terminate, including reasons for dismissal. In case the employee takes the case to the labour court, the court may require evidence of a warning procedure and of a fair account of trade union opinions. After previous warning to the employee, 5 days for consultation with local trade union on justification for dismissal. Notice can then be served, usually by mail. | 13 |
| United Kingdom | Individual termination: Written or oral notification. Employees with 1 years' continuous service have the right to receive from their employers, on request, a written statement of the reasons for their dismissal. Redundancy: Consultation with recognised trade union recommended, but not legally required when few workers are affected. "Reasonable notice" that redundancy is being considered. | 1 3 |
| United States | No prescribed procedures. Written or oral notification. Only a few States prescribe a "service letter" a certain period after dismissal, noting the reasons for termination. | 1 |

Source: Background material for OECD *Employment Outlook* 2004, Chapter 2.

Glossary of acronyms

| | |
|----------------------|--|
| AETR | Average Effective Tax Rates |
| ALMP | Active labour market policy |
| ARP | Agency for Business Development |
| a.s | Joint stock company |
| CEEC | Central and eastern European countries |
| CEZ | Czech Power Company |
| CKA | Czech Consolidation Agency |
| CLRTAP | Convention on Long-Range Transboundary Air Pollution |
| CNB | Czech National Bank |
| CPI | Consumer Price Index |
| CSSD | Czech Social Democratic Party |
| CzechIndustry | Agency for Development of Industry |
| CzechInvest | Agency for Foreign Investment |
| CZSO | Czech Statistical Office |
| ECB | European Central Bank |
| EIA | Environmental impact assessments |
| EMS | European Monetary System |
| EPL | Employment Protection Legislation |
| ERM II | Exchange Rate Mechanism II |
| ESA95 | European Standard Accounting |
| EURES | European Employment Services |
| FDI | Foreign Direct Investment |
| FNM | National Property Fund |
| GFS | Government Finance Statistics |
| GHG | Greenhouse gas |
| ICT | Information and communication technology |
| IT | Information technology |
| KDU-CSL | Christian Democratic Party |
| KOB | Consolidation Bank |
| MLA | Adult minimum subsistence allowance |
| MLS | Minimum Living Standard |
| MTEF | Medium-term expenditure framework |
| NDC | National Defined Contribution pension scheme |
| NGO | Non-governmental Organisation |
| PIRLS | Progress in Reading Literacy Study |
| PISA | Programme for International Student Assessment |
| PPP | Purchasing power parities |
| R&D | Research and Development |
| RILSA | Research Institute for Labour and Social Affairs |

| | |
|------------------|--|
| Roma NGOs | Roma non-governmental organisations |
| SDVR | The proposed new medium-term budgeting framework |
| SEA | Strategic environmental assessments |
| SMEs | Small and medium enterprises |
| SNA | System of National Accounts |
| SZDC | Railway Infrastructure Administration |
| VAT | Value-added tax |
| VOCs | Volatile organic compounds |

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BASIC STATISTICS OF THE CZECH REPUBLIC, 2003

LAND

| | | | |
|-------------------------------|----|--|-------|
| Area (1 000 km ²) | 79 | Major cities, 31.12.2002 (1 000 inhabitants) | |
| Agriculture, 2002 (%) | 54 | Prague | 1 187 |
| Forest, 2002 (%) | 34 | Brno | 387 |
| | | Ostrava | 315 |

PEOPLE

| | | | |
|--|--------|--------------------|-------|
| Population (1 000) | 10 211 | Employment (1 000) | 4 698 |
| Inhabitants per km ² | 129 | Agriculture (%) | 5 |
| Natural increase in population (1 000) | -18 | Industry (%) | 40 |
| Net immigration (1 000) | 26 | Services (%) | 56 |

GOVERNMENT

| | | | |
|--|----|--|-------|
| Public consumption (% of GDP) | 24 | Chamber of Deputies, as at March 2003 | Seats |
| General government total revenue (% of GDP) | 42 | Social Democratic Party | 70 |
| Public debt, national accounts definition (% of GDP) | 37 | Civic Democratic Party | 58 |
| | | Communist Party | 41 |
| | | Freedom Union/Christian Democratic Union | 31 |
| | | – People's Party Coalition | |
| | | Total | 200 |

PRODUCTION

| | | | |
|--------------------------------------|-------|---------------------------|----|
| GDP, current prices (billion CZK) | 2 551 | Origin of value added (%) | |
| GDP per capita (USD, current prices) | 8 864 | Agriculture | 3 |
| Gross fixed investment (% GDP) | 27 | Industry | 38 |
| | | Services | 59 |

FOREIGN TRADE

| | | | |
|---------------------------------------|----|---------------------------------------|----|
| Exports of goods and services (% GDP) | 62 | Imports of goods and services (% GDP) | 65 |
| Main exports (% of total merchandise) | | Main imports (% of total merchandise) | |
| Machinery and transport equipment | 50 | Machinery and transport equipment | 43 |
| Manufactures | 35 | Manufactures | 31 |
| Chemicals | 12 | Chemicals | 11 |

CURRENCY

| | | | |
|-----------------------------|-------|-------------------------|-------|
| Monetary unit: Czech koruna | | Currency units per euro | |
| Currency units per \$, 2003 | 28.13 | Year 2003 | 31.84 |
| | | Aug 2004 | 31.63 |

Note: An international comparison of certain basic statistics is given in an annex table.

Executive summary

Following accession to the European Union the big issue for the Czech Republic is to strengthen growth prospects. Growth potential at present is somewhat above 3 per cent, implying a moderate pace of catch-up to living standards in the EU and elsewhere. There is room for greater ambition in growth performance, and it is welcome to see this reflected in the programme of the new Czech government. This *Survey* underscores four main challenges.

Fiscal consolidation

Fiscal consolidation is the dominant challenge for macroeconomic policy, and is not only necessary to cope with ageing and to bring down the tax burden but is also needed to fulfil euro-area entry conditions. A welcome programme of fiscal reform has begun, including proposals for a system of multi-year aggregate spending ceilings and significant expenditure cuts. However, to date, mainly revenue-raising measures have been implemented while the full impact of expenditure measures is yet to be realised. The attempt to secure broad political consensus on pension reform is commendable, but it must be underscored that whatever reform is finally implemented, it will have to bring considerable fiscal savings. Health-care reform also has to deliver savings, but concrete proposals have yet to be made. To facilitate assessment of the true fiscal position, extra-budgetary funds need to be more fully integrated in mainstream government budgeting procedures. Also, with the further decentralisation of public services, the need for good budgeting practices and accountability in regional and municipal governments is all the more important.

A successful entry into the euro area

The Central Bank and the Ministry of Finance have formulated a transparent strategy for entering the euro area, that foresees minimising the time spent in the Exchange Rate Mechanism (ERM II). Annual reports will assess the economic conditions in relation to the Maastricht Criteria and a request to enter ERM II will only be made if the probability of a positive first assessment by the EU authorities is high. The choice of a 3 per cent inflation target for the run-up to euro entry is justi-

fiable on medium-term grounds. However there may be some difficulty communicating the consistency of this target with the Maastricht criterion for price stability. The Czech authorities should therefore pay *close attention to how the Maastricht criteria are interpreted and applied by the European Commission and the ECB and adjust their communication strategy accordingly.*

Making the environment for business more growth-friendly

Most of the catch-up in living standards will have to come from boosting productivity growth. This means swifter re-allocation of resources across firms as well as stronger in-firm productivity growth. While the Czech Republic is a strong competitor for attracting foreign direct investment, policy towards poorly performing firms and business start-ups has problems, slowing down the exit and entry of firms. Bankruptcy procedures are cumbersome, often long and usually end up in liquidation, with asset stripping not uncommon. Reforms have long-since been planned, and it is welcome that new legislation looks finally set to go ahead. The legislation aims at strengthening the role of creditors, speeding up proceedings and allowing composition to play a bigger role. Likewise, efforts to streamline business registration are welcome and should be implemented as soon as possible. The general business climate is also damaged by issues in network-industry competition, as some services, notably Internet, are expensive in international comparison.

Improving the functioning of the labour market

Mobility between jobs and regions is weak. Administrative extensions of collective wage agreements, strict employment protection legislation (EPL) on individual dismissals, rent control, severe poverty traps (particularly for families) and a high tax wedge have contributed to considerable long-term unemployment. The Roma population is hit especially hard in this respect. Migration is to some extent mitigating the labour-market rigidities with Slovaks filling skilled vacancies and other eastern Europeans (mainly Ukrainians) taking up unskilled jobs that are unattractive for locals. Tackling the unemployment problem requires measures across a wide front, but most notably social benefit reform is needed along with reduction in the tax wedge as well as easing of EPL. The widespread social and economic exclusion of the Roma needs more attention, particularly in the education system. A more open immigration policy is needed to address immediate issues such as the inconsistency between granting work permits as well as for better alignment of immigrants' skills with those needed on the Czech labour market.

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

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The economic situation and policies of the Czech Republic were reviewed by the Committee on 11 October 2004. The draft report was then revised in the light of the discussions and given final approval as the agreed report by the whole Committee on 28 October 2004.

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The Secretariat's draft report was prepared for the Committee by Philip Hemmings, Ann Vourc'h, Dana Hajkova and Boris Cournede under the supervision of Andreas Wörgötter.

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The previous Survey of the Czech Republic was issued in April 2003.



From:
OECD Economic Surveys: Czech Republic 2004

Access the complete publication at:
https://doi.org/10.1787/eco_surveys-cze-2004-en

Please cite this chapter as:

OECD (2004), "Improving the Reallocation of Labour", in *OECD Economic Surveys: Czech Republic 2004*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/eco_surveys-cze-2004-7-en

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