

**Post Lisbon Reform Programmes Assessment  
(Post LRP)  
Czech Republic 2005**

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## Introduction and Overall Assessment

We provide an assessment of the Czech National Lisbon Programme 2005-2008 (NLP) with reference to the Employment Guidelines. Throughout the assessment we rely extensively on our pre-Lisbon-Reform-Programme evaluation (pre-LRP), in which we surveyed the state and the evolution of the Czech labour market and discussed recently enacted policies. Our assessment of the NLP policy responses in this report is conducted at the level of Employment Guidelines No. 17-24 and focuses on policy-specific targets, implementation dynamics, evaluation, governance, and policy-response consistency with the 2004 Recommendations.

Overall, we find major discrepancies between the analysis we provided in the pre-LRP report and the content of the NLP. Many of the proposed future policy directions consist of the implementation of ESF and other EU funds, but fail to outline what we would view as desirable reforms of Czech labour-market institutions and policies. Much of the discussion in the NLP is about goals, but not about the strategy, direction or specifics of the planned policy response; there are few quantified targets and little reference to underlying analyses. It would almost seem that the NLP pays only lip service to several important issues and many key policy areas are not addressed at all or only inadequately. The **missing policies** can be identified in several ways:

Except for (limited) potential positive changes in the system of state social support and social benefits, the employment part of the NLP fails to reflect what in our view are three key employment-related recommendations of the macroeconomic part of the NLP: **(a)** systematic restructuring of the expenditure side of the state budget, **(b)** introduction of outcome oriented budgeting accompanied by control and assessment mechanisms, and **(c)** lowering barriers to participation of older workers.

Judging the NLP in terms of the 2004 Council Recommendations, the Czech Republic did not need much of a policy response to ensure that wage developments remain in line with productivity and there is a policy proposal currently in the legislative process, which may go some way towards discouraging welfare dependency and ensuring that regular work pays. On the other hand, the NLP does not mention any real policy responses to the **(d)** notorious social exclusion of the Roma minority. There are only some very early plans for **(e)** modernising public employment services, which are hard to assess at the moment and there is little systematic response to **(f)** the quality-oriented human-capital-investment Recommendations as the Ministry of Education will likely continue restraining individual schooling allocation decisions.

Comparing the NLS to our pre-LRP assessment, it is clear that - in addition to points mentioned above - the employment analysis of the NLS fails to pay sufficient attention to **(g)** the much over-due pension reform, **(h)** health insurance reforms, and **(i)** employment of the handicapped (including the issue of disability pensions). There are also no plans to introduce credible evaluations of ALMP (see items (b) and (e)).

## **1 Full employment, quality at work, strengthening cohesion (Guideline No.17)**

The NLP does not frame policy discussion specifically in terms of full employment, quality at work, or cohesion, but pro-employment policies are discussed within the making-work-pay effort (and are the subject of Section 3). The NLP also covers the policy area we view as most important for Czech full employment, namely improving education quality (see Section 7). Cohesion-related policies of the NLP are those supporting territorial mobility (Section 4) and those making the labour market more inclusive (Section 3). (We also note that there is little connection between the well-written macroeconomic part of the NLP and the content of the employment part.)

### *Employment Level*

The NLP correctly notes that Czech employment rates are high but steadily declining. The national employment-rate target for 2008 is then set at the high level of 66.4%. While it is likely that the employment rate of older workers will increase because future older cohorts may be less affected by loss of skills acquired under communism, it is not clear where the bulk of the short-run 2-percentage-point expected employment-rate increase will come from. First, as tertiary education enrolment rates gradually increase, this has a negative immediate effect on employment rates (out weighted by a positive effect later on). Second, employment and employment rates have not improved over the last four years, despite robust economic growth. Given this experience and given that NLP does not propose any truly major changes affecting employment, it is unlikely that potential future economic growth will lead to employment gains. On the other hand, should the Czech Republic experience a recession similar to that of 1997/8, it is likely that its employment would decline given that labour market institutions have not radically changed since then.

Here, it is crucial to mention that an even more important target has to do with employment after 2008. This is so because 2008 marks the beginning of the Czech Republic's rapid ageing (an important topic in the macroeconomics part of the NLP). The employment rate of older workers will therefore become a progressively more important determinant of the overall employment level. The average exit age from the Czech labour force remains below the EU15 level and there is a substantial growth of disabled pensioners since 2001. The majority of these newly-disabled are over 50 and the number of as well as the rise in the disability cases is largest in high-unemployment regions. It is therefore surprising that the NLP does not spend any time discussing the evolution of early retirements and disability pensions and the policies affecting these two key indicators. (The NLP does highlight the unemployment of older workers.)<sup>1</sup>

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<sup>1</sup> When describing the situation on the Czech labour market, the NLP repeatedly and almost solely focuses on (the changes in) the number of unemployed of a given group (i.e. older or young workers) or the share of all unemployed who come from a given demographic group. This is surprising given that the relevant indicator of a group's labour-market success is its specific unemployment *rate*, because changes in the number of unemployed can be to a large extent driven by the evolution of the demographic composition of the population. However, this use of the number of unemployed by group is symptomatic of much of the labour-market and education policy discussion in the Czech Republic.

## **2 Lifecycle approach to work (Guideline No.18)**

### *Ageing and Employment of Older Workers*

The NLP recognizes the problem of older-workers' unemployment and mentions the National Programme of Preparation for Ageing for 2003-2007. However, perhaps symptomatically, the NLP only described this Programme in terms of its general aims; there are no specific measures mentioned other than a national promotional campaign. Yet, there are some proposals (not mentioned in the NLP) lowering the unnecessary regulations that hinder older-workers' unemployment, such as increasing pensions to reflect additional years of work beyond the statutory old-age pension age.<sup>2</sup>

The National Action Plan for Employment 2004-2006 proposes extended counselling and retraining of older workers. Given that the labour-market administration is now not able to effectively implement and evaluate the limited activation measures in place, it is not clear how this proposal can become successful.

Most importantly, the NLP does recognize that pro-work incentives must be an integral part of the future pension reform, but it misleadingly refers to the reform as "upcoming". There is so far no viable reform plan in existence and the current government is obviously not serious about pushing through a pension reform, despite its urgency and the recent solid economic growth and additional privatization income, which both provide a much-needed opportunity for reform.

### *Life-Long Learning*

To increase future employment rates of older workers, it is imperative that their skills, acquired in part under central planning, be upgraded. The available statistics suggest that, in comparison to EU15, only little life-long learning takes place among Czech workers with primary or secondary initial education. The NLP responds by the creation of the (ESF-sponsored) National system of qualifications, which is supposed to support recognition of post-initial education programs. It also proposes that continuing education be promoted within ESF-sponsored projects, without specifying the nature of this promotion. The key question is whether the EU-sponsored programmes will be sufficiently market-wide and systematic to improve the skill flexibility and quality of the ageing Czech labour force.

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Basic facts and their relative importance (i.e. the sheer size of the ageing problem) are regularly neglected or misinterpreted by labour-market administration, state officials and government members.

<sup>2</sup> Such proposals are outlined in the Strategy of Economic Development – a detailed pro-reform document, which still awaits the government's approval and which was prepared under the direction of the vice-prime minister for economics. This Strategy is not mentioned in the NLP.

### **3 Inclusive labour market, make work pay (Guideline No.19)**

#### *Inclusion and Activation*

The NLP proposes to extend activation services available to the rising number of long-term unemployed within the current setup of the Active Labour Market Policy (ALMP), in part relying on financing from the European Social Fund. While this is in general likely to be the right policy response, there is little discussion of how the effectiveness of the additional activation measures will be measured and where will resources be targeted with higher priority.<sup>3</sup> In particular, the NLP proposes to continue the current style of implementation of the Individual Action Plans to deal with the rising youth unemployment. However, it is not clear how effective this current implementation is given the limited staffing of the district Labour Offices. This is an important concern, as the current employment rate of those aged 15-24, at 28% in 2004, is much below the EU15 average of 40%.

The discussion of policies supporting the employment of women again focuses on projects co-financed from the European Social Funds. The NLP does not mention the recent introduction of joint married-couple income-tax filing, which was introduced with the aim of helping family formation and fertility, but which is likely to negatively affect the re-entry of women into the labour market after maternity leaves. It is also not clear how the envisaged (stricter) control of no-discrimination in relationship to motherhood and maternity leave will be carried out.

While the NLP has some vision of increasing spending on activation measures, there is no discussion of those who are lost from the unemployment registry, but remain socially excluded, and there is no focus on specific measures targeted at the most vulnerable: the handicapped and the socially excluded Roma minority. The NLP simply states, on a total of 4 lines, that the share of ALMP expenditure on all disadvantaged groups will rise and barriers to entry will be removed, but fails to specify how. Again, as detailed in the pre-LRP report, the effectiveness of current policy measures supporting the employment of handicapped is not clear (and there are no credible evaluations available). The problem of the Roma minority is admittedly even more complex, but there are apparently no policy responses formulated. Meanwhile, the majority of the Roma youth continues to achieve only compulsory education at best.

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<sup>3</sup> The Ministry of Labour and Social Affairs has little expertise and experience in administering program evaluations that result in cost/benefit comparisons and take into account the likely selection of high-quality unemployed into retraining or supported jobs. For example, a typical desk-top calculation by the administration compares the cost of supporting a job to the cost of unemployment benefits, but fails to realize that if supported jobs are staffed with highest-quality unemployed, these unemployed would be likely to find a job even in absence of government support. There are no micro-data based evaluation studies utilizing randomization or at least generating comparable treatment and control groups. There is even only limited accounting-style evidence on the targeting of the most vulnerable unemployed by the current activation programs.

## *Make Work Pay*

As mentioned in Section 1, the most disturbing overall feature of the recent Czech labour market evolution is that four years of continued economic growth of about 3% per year has so far had only a negligible positive impact on unemployment and the activity rate. This suggests that labour-market institutions may be at fault; in particular, the generosity of welfare benefits and the high tax wedge on low-wage labour is generally perceived as an important factor weakening employment.

The NLP policy response is the proposed lowering of income taxes on the lowest two brackets and the introduction of child-related tax credits reminiscent of the now-standard Western policy of earned income tax credit. This new tax policy will likely go hand in hand with an extensive change in the structure of the Czech social support system that just entered the legislative process and could become effective in 2006.

These changes are supposed to correct some of the labour-supply disincentives faced by larger families and to shift some of the budgetary and ‘activation’ responsibility from the central administration to municipalities.<sup>4</sup> The proposed set of changes is likely to increase pro-work incentives for low-wage larger families and may effectively “punish” long-term unemployment (inactivity). On the other hand, the new system may generate higher disincentive to increasing one’s labour earnings for those currently employed at wage levels in the neighbourhood of the median wage. A key remaining problem is that the system of social support is very complicated and hard to grasp for the unemployed, which is likely to lower pro-work effects of proposed changes, especially for low-educated.

A closely related policy affecting the level of labour-supply is the nature of sickness insurance. Employers in the Czech Republic face notoriously high sickness-driven absenteeism. However, the NLP does not discuss the recent (mainly positive) changes and so it does not face the issue, so far not addressed, of how to deal with the high incidence of long-term sickness (possibly representing hidden welfare dependence).

## **4 Matching of labour market needs (Guideline No.20)**

### *Employment Policy*

The NLP correctly highlights the need for modernisation of Czech employment policy and it implicitly admits the failure of implementing such modernisation. Specifically, the NLP states that “*in future*, the Czech Republic will focus ... on securing sufficient human and financial resources” for implementing employment policy (*italics added*)

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<sup>4</sup> While the general aim of shifting ‘activation’ to municipality level and supporting it with budgetary incentives may be advisable, the proposed implementation of the new laws does not include the necessary increase in the staffing by social workers responsible for dealing with low-income families. It is sometimes estimated that currently each applicant for Czech Social Assistance can get on average only little over an hour of attention a year from the administrator in question. This likely future failure to staff (finance) reforms (new policies) is reminiscent of the introduction of Individual Action Plans to the agenda of Labour Offices and of the way the Publicly-Purposeful-Jobs ALMP program (short-term public employment) is implemented -- to a large degree relying on municipalities to provide the staff and finance to execute this program.

by us). While the idea of relying more on public-private partnerships is good, such plans so far do not appear realistic either.

Again, there is no mention of the need for evaluations as guidance of ALMP spending. There are no plans stated in the NLP with respect to changing the current structure of ALMP spending across its main programs and no vision of unifying social and employment services such that each social worker would spend more time with each unemployed. Instead, there is a plan to introduce a new layer of labour-market administration, the Regional Labour Offices. Most of the stated plans are in an early stage of planning and it is hard to evaluate them. There is also no plan to start using some of the ALMP programs as an effective prevention of misuse of benefits. There are no quantified easily-controlled targets and no time frame of implementation.

### *Foreigners*

The Czech labour market will suffer from ageing (compounded by lowest low fertility rates) and does suffer from a relatively low proportion of workers with tertiary education; hence, it is imperative that immigration policy is employed to remedy these deficiencies. The NLP does correctly recognize that foreigners currently face “significant administrative barriers”. It is worth stressing that these barriers are indeed extraordinarily complicated and hostile and that this is true even for highly educated professionals and academics as well as for foreigners graduating from tuition-free Czech public universities. The natural outcome of this policy is illegal employment of low-skill foreigners and insufficient immigration of high-skill foreigners.

While the NLP plans the introduction of information systems assisting matching of foreign labour supply and Czech labour-market needs, there is a startling lack of serious response to the presence of these administrative, unnecessary employment barriers to foreigners. The NLP only vaguely mentions that sometime in the future, the Czech Republic will simplify its system of granting work permits, which currently requires that foreign workers apply for each specific job from outside the Czech Republic, even if they have already worked in the country. If there were political will, such change could be implemented immediately.<sup>5</sup> Instead, more attention will apparently be paid to eradicating illegal foreign employment – effectively increasing incentives for corruption in non-transparent entry procedures.

### *Territorial Mobility*

An important cohesion problem in the Czech Republic, related to insufficient matching of labour market needs, is the high discrepancy between district (NUTS4) unemployment rates. Areas 80km away can display unemployment rates as different as 3 and 20 percent and the residential mobility of Czech population *in response to unemployment differences* continues to be low.

In this regard, the NLP highlights the proposal of corporate-tax-base deductions for firms co-financing the costs of commuting of their employees to work and for firms

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<sup>5</sup> Recent overt cases of large-scale corruption among Czech Foreign Police only illustrate the lack of attention this issue continues to receive from the government.

providing temporary accommodation for their workers. There is hope that this may alleviate regional difference in unemployment as the recent experience with some of the large foreign direct investments suggests that few workers move to take up a job vacancy outside of their hometown or district, in part thanks to the government's own rent-control policy supporting housing-market rigidities. The NLP also mentions the gradual 6-year plan of finally dismantling rent control, which in the Czech Republic involves significant ownership-right restrictions. This policy will therefore not become fully effective until after the time horizon of the current NLP (for 2005-2008).

## **5 Flexibility combined with employment security (Guideline No.21)**

### *Labour Code*

The NLP touts one positive feature of the new Labour Code, currently in the legislative process, but it fails to give a balanced account of the many other aspects of the Code. Specifically, while the new Code does improve flexibility by introducing working-time accounts, it is also heralded as extending contractual freedom in employment relationships, which is questionable. The new Code certainly does further increase the power of trade unions and protects those currently employed, but it is not clear that it is sufficiently different from the old Code, which is still based on the communist one, albeit after several amendments. There are new restrictions on working under temporal and seasonal arrangements. Most importantly, the current Code severely limits individual layoffs (even in comparison with typical EU15 legislation) and the new one does little to remove this barrier to labour-market flexibility. Both the old and the new code are likely to become an obstacle for reallocation during the next downturn of the business cycle. This new legislation was mainly prepared in the cooperation of the Ministry of Labour and the Confederacy of Trade Unions, which plays an important role thanks to its close ties to the ruling Social Democratic party. Employer Associations were not an integral part of the drafting of the legislation.

## **6 Labour costs (Guideline No.22)**

The most important problem with labour costs in the Czech Republic has to do with the total tax wedge on low-wage labour. Here, the NLP correctly highlights the proposal of lowering income taxes for the lowest two income brackets. However, this is only a minor change and in part it only compensates for the recent increases in nominal wage levels. What is missing is a reform of the non-wage labour costs. The only current policy proposal is to introduce (very high) ceilings on social security contributions, effectively binding from 2009, which will lower labour costs of high-educated workers, who already have the highest employment rates.

The new Labour Code is likely to increase the effective cost of labour as it will not allow for more flexible individual layoffs but instead will further increase severance pay. In a related line of policy agenda, not mentioned in the NLP, the discretionary practice of Ministry of Labour of extending the coverage of industry-level collective agreements to those firms where no firm-level collective agreement is present, has been codified into a law and made "automatic" under general conditions.



## **7 Investment in human capital (Guideline No.23)**

Overall, the NLP correctly focuses on tertiary education and life-long learning as the main two policy areas, but it refuses to consider introducing more individual choice and market-driven allocation mechanisms, which could help in improving the quality of education provided at all levels. Currently, schools that generate a lot of unemployed graduates continue to receive the same government funding as those producing productive graduates, while the total number of students in both types of schools continues to be largely fixed by the Ministry of Education. Further, the NLP does not focus on the major foreign language deficiencies and there is in general little interaction between the labour-market and education sections of the NLP.

### *Less Than Tertiary Education*

The NLP discusses the welcome curriculum reform at the elementary education level, which opens up the possibility of school-specific modernisation of teaching methods. However, the NLP does not mention that it is not clear what fraction of the rapidly ageing pool of teachers will be ready to adopt new methods, given their life-long habits, the low level of teacher salaries and the limited scope for differentiating teacher pay within schools. The NLP also does not spend any time discussing the severe handicap and adverse education outcomes of children from disadvantaged families. (Policies could be directed at families where both parents have only low educational attainment and this would capture the majority of the Roma minority.) The Czech education system is highly selective at all transition stages.

At the secondary education level, the total number of students in the general secondary programs continues to be fixed by the Ministry. This preserves the inefficient inherited structure of education, where a large fraction of the cohort studies in apprenticeship programs generating high unemployment and low flexibility of labour force. During the next five years, however, the secondary education system will have to face rapidly shrinking cohort sizes (from about 140 to below 100 thousand a year), allowing for much needed adjustment in education structure. This issue is not mentioned in the NLP.

### *Tertiary Education*

The NLP correctly stresses that the share of Czechs with tertiary education continues to be very low and it correctly argues that extending lower-level tertiary programs and improving their field-structure and quality is the right policy response. However, the NLP fails to outline a workable strategy that would lead to improving the quality of tertiary education, in terms of both the above mentioned lower-level programs and top-level research.

In today's Czech Republic, only about a third of 19-year olds enters tertiary sector immediately after completing secondary education. The production of university diplomas therefore continues to be dominated by tuition-free over-subscribed public colleges, which are under little effective pressure to improve the quality of their services or generate world-class research. The Ministry simply provides (the so-called

normative) financing per student enrolled, up to given limits on total enrolment, and students who are “protected” from paying tuition by government policy, can hardly exert pressure on over-subscribed schools to change the structure of offered programs, improve the quality of teaching, or produce world-class research. There are no student evaluations of teachers, little threat of closing down inefficient programs, and insufficient motivation to conduct state-of-the-art research. Furthermore, potential students coming from low-educated families face extremely low chances of entering the Czech tertiary education system.

The NLP does not address this issue at all, and the Ministry of Education refuses to consider the introduction of government stipends and college tuition, which could serve as an allocation mechanism providing pro-quality incentives. Instead, the Ministry apparently plans to manage tertiary school finance more closely based on its own measures of school quality (including teaching quality, research quality etc.). The Ministry has recently applied a first (attempt of) research finance allocation mechanisms based on quality comparisons. However, the practice of these first attempts to compare quality of institutional research plans has been poor at best.

## **8 Adapt education and training (Guideline No.24)**

While built-in schooling allocation mechanisms based on individual choice of school type and field are not outlined, the NLP does propose more career counselling and more school-enterprise interaction. While this is desirable, we would view school-specific initiative based on systematic incentives to provide such services as a preferred way of reaching the goals of more adaptive education. The NLP also suggests promoting mobility within the education system, but it is not clear how this will be achieved. In general, much of the discussion in the NLP on adaptable education was not clear to us.

The NLP does mention increasing public spending on education as a way of ensuring higher flexibility of education. We disagree. Under the current institutional setup, additional resources will not be spent effectively and are not likely to improve the quality and flexibility of education. Instead, the Czech Republic features a very low use of private resources in education and allowing the inflow of private funding could be used not only to support the level of human-capital investment, but also as an effective quality-promoting allocation mechanism.

As an illustration, we note that unemployment rates of recent secondary school graduates remain very high for graduates from schools without the so-called *maturita* school-leaving exam, i.e. mainly those with apprenticeship diplomas. This is one of the most alarming current problems since these graduates still constitute almost 40% of all graduates and because they face low chances of continuing on with their education at higher levels; this is a potentially important problem in terms of the social cohesion objective. Yet, the departure from apprenticeship and vocational schools to general curriculum programs has been slow and proceeded mainly thanks to shrinking incoming cohorts.