The Czech Employment Miracle: Reality, Myth or Luck?

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While the socialist state system guaranteed full employment, most countries experienced a rapid increase in unemployment in the first few years after transition, with the exception being the Czech Republic. Peter O'Brien looks at what the Czech Republic did right, seeing if it was merely a case of fortuitous initial endowments or other factors. He concludes that the effect of Active Labour Market Policies (ALMP's) was positive, although acknowledging that there exists a lack of evaluation of these policies.

Introduction

The Czech Republic (CR) appears to be the only country that has stemmed the flow into unemployment and has managed to keep the rate of unemployment at a relatively modest rate. Other CEE countries, including Slovakia (SK) have not been so fortunate and saw a sharp rise in unemployment in the first few years of transition. The CR and SK are a natural pair to compare as they had identical labour market institutions and regulations prior to the 'Velvet Divorce' of 1993. One of the main reasons attributed to the CR's low rate of unemployment has been its use of Active Labour Market Policies (ALMPs). In this paper, I aim to look at two interrelated areas. Firstly, a brief examination of the rationale behind using ALMPs in transition countries and secondly, the case of the CR and SK and the development of their employment policies following the 'Velvet Revolution' and an exploration of the extent to which ALMPs may have contributed to their different outcomes post-1993.

Why use Active Labour Market Policies?

1 The Uncertain Consensus

Active Labour Market Policies (ALMP's) have become increasingly popular among policy makers in the fight against unemployment. Sweden is the paradigmatic example of a western country with consistently low unemployment for a period of over thirty-five years and where ALMP's have been given much credit for their relative success. Many countries in the west had significant problems with high and persistent unemployment combined with generous welfare systems and draconian tax regimes, which led respectively to a high replacement ration on the one hand and the danger of a poverty (fiscal) trap on the other. An uncertain consensus has been emerging with regards to labour markets with some or all of the following at the top of the agenda:

- An attempt to 'activate' Labour Market interventions (See Box 2.1 for the main types of ALMP intervention). That is a move away from just providing benefits towards intervening with the person to help them find a suitable job or enter retraining.
- An attempt to reduce the impact of poverty traps by making benefit and tax regimes more work 'friendly'.

Box 2.1 - Main Types of Active Labour Market Policies

Calmfors (1994) characterised three main forms of ALMPs:

1. ***Job search assistance*** measures, which primarily involves the work of the Public Employment Services (PES). By providing information to the unemployed, PES may be able to reduce the duration of Unemployment spells and may improve the quality of job match in the economy. This is especially important in Transition countries where there is a high level of job creation and destruction.
2. ***Training Measures*** are usually intended to update an individual's human capital in line with the current skills requirements of the economy. They may also be used as a job 'test' to ascertain an individual's ability to work. This can be the case for those on the margins of the Labour Market.
3. ***Direct Job Creation*** can take two primary forms, namely public jobs or job subsidies to private employers. There may also be an element in some countries that supports entrepreneurs to set up businesses.

2. Active Labour Market Policies in Transition[1]

The restructuring of transition economies inevitably causes unemployment to set in as the process of restructuring gets underway. The emergence of Long Term Unemployment in many CEE countries is a cause for concern. Timely intervention in the form of a broad yet carefully selected portfolio of ALMP measures *may* reduce unemployment spells and the level of insider power.

Blanchard argues (1997: 88-94) that there was a two-sided effect on unemployment. On the one hand there was a distinct decrease in job creation, which led to a fall in the number of quits, while on the other hand there were fewer new jobs being produced, so the net result was a huge decrease in the number of new hirings. This led to what he characterised as a 'stagnant pool' in which the proportion of long-term unemployed gradually increased. It is essential, for reform to be supported, that this does not lead to a growing population of disaffected people who could call for reforms to be reversed or slowed down.

Köning and Walsh (1999) have highlighted micro level sectoral differences and point to the relative success of *de novo* firms in comparison to traditional State-owned enterprises, especially in relation to job creation. The encouragement of an entrepreneurial spirit through the education and training systems and some targeted finance may help some start up companies and foster an entrepreneurial climate, this is especially important as banks are usually restricted (in terms of lending) in the earlier stages of transition.

In transition economies there may not exist the informational infrastructure to alert job seekers of available vacancies or training opportunities. It is therefore essential that there exists an effective Public Employment Service, which can provide timely and case-sensitive information. This is not to say that there are no risks attached to the use of ALMPs. Without going into detail[2],it is suffice to say that ALMPs as with any other policy are prone to abuse, misuse, poor targeting, inefficiency etc. The main types of negative effects are:

1. **Dead-weight Loss:** The jobs may have been created without subsidy.

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[1] There exists a substantial literature on the rationale behind using ALMPs in Transition economies (See for example Burda & Lubyova, 1996). I aim here only to briefly introduce some of the potential motivations for 'activating' labour market interventions. See also Appendix 1 for the main characteristics of ALMPs.

[2] See Fay (1996) for a comprehensive exploration of the potential negatives of ALMPs. & Appendix 1.)

2. **Substitution:** The subsidised worker may just be replacing an unsubsidised worker.
3. **Displacement:** Subsidised firms may have an advantage over non-subsidised firms.

Let us now turn to our two case countries and look initially at their labour history since 1991.

The Development of ALMPs in the Czech Republic and Slovakia

Czechoslovakia, The Early Years[3]: In 1989, after the Velvet Revolution, Czechoslovakia set out on an ambitious programme of privatisation and market liberalisation and reform. In terms of Labour Markets, what they had inherited was a system where everyone worked as a form of social obligation and there was a job for everyone. In an environment of centralised targets and soft budget constraints large companies could afford to hoard staff. As a result there was a lot of underemployment in the economy. The closure of inefficient firms led unemployment being seen for the first time in 1990 with rates of 0.7% and 1.5% in the CR and SK respectively, however, the most marked change may be seen in the second year, when there was a rise to 4.13% in the CR and a very large 11.8% in SK. This regional disparity did not go unnoticed and may have been one of the key factors leading up to the Velvet Divorce in 1993.

There was a lot of work to be done before this happened and we will examine briefly some of the key changes in the period 1989 - 1992 with regards to ALMPs. By 6th June 1991, unemployment was a distinct reality in Czechoslovakia and the government introduced ALMP legislation based on the Swedish model. A Federal Ministry for Labour,[4] with two republican offices, was established and charged with the implementation of a series of Active Labour Market Policies. Their core aims can be summarised as follows:

- To provide information, advice and assistance in finding employment
- To create jobs through subsidies to employment generating enterprises

There were four specific programmes involved in the ALMP package:[5]

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[3] For a full discussion, see Ham *et al* (1995) or Burda & Lubyova (1995). For a brief overview of the Law on Employment, see Appendix 2

[4] Abolished in 1993

[5] Ham *et al* (1995) also report that District Labour Offices give subsidies to firms that

1) **Socially Purposeful Jobs (SPJs):** These cover two types of subsidies. The first is to help unemployed set up new companies and the other subsidises positions in existing enterprises.
2) **Publicly Useful Jobs (PUJs):** Primarily, but not exclusively, intended to be provided by Local Authorities, these jobs are intended to test a candidate's work readiness and keep those on the margin attached to the Labour Force. There may be an inherent problem/stigma attached to these positions as they tend to be offered only to those with the least chance of getting a job. Employers know this and this may act against those participants, especially in an employer's labour market.
3) **Job Subsidies for new Graduates:** Also known as YSL (Youth and School-leaver jobs), these jobs are essentially the same as SPJs except that they target younger people.
4) **(Re-)Training for the unemployed:** Primarily intended to equip or update individuals with skills relevant to the modern economy. Training is actually a legal entitlement for the unemployed[6].

Up until 1992, there was a strict federal division of the amount allocated to ALMPs. So, even tough SK had far higher unemployment (11.8%) in 1991 then the CR (4.1%), there was more spent in the CR on ALMPs in that year. This was changed in 1992 in favour of SK[7]. One final issue to mention is that of inflows and outflows into unemployment. While inflow rates in the CR and SK were low in 1990 and 1996 by OECD levels (Martin, 1998), the interesting feature has to be the outflow rates achieved in the CR (Boeri, 1994), with rates on average three times higher than the other CEE countries. Let us now look at the two countries separately and analyse the empirical investigations into the effects of ALMPs in the two countries.

After the Velvet Divorce, Disparate Results - the Impact of ALMPs

introduce technological change that reduce worker hours. This reduces any lay-offs that may have resulted.

[6] However, only 5.5% of all unemployed people in the CR in 1992 availed of training (Ham *et al*, 1995: p.137)

[7] 1992 saw an increase in ALMP expenditure in both Republics, the amount in the CR more than doubled, whereas the amount in SK rose more than seven-fold. Although even this reallocation could not stop the calls for independence that were reaching a peak in 1991-2 and led to the Velvet Divorce of 1993.

As we can see from Table 3.2.1, spending on active and passive employment measures in 1993 was not that extraordinary by OECD standards, although spending per person unemployed in the CR was in line with the upper levels and spending in SK was more similar to the other CEE countries. We now turn our attention to some of the literature that investigated ALMPs in the CR and SK and look at how much ALMPs mattered.

2.1 The Czech Republic: The CR managed to keep unemployment at 2-4% right up until the middle of 1997. One of the key reasons for this was the CR's exceptionally high outflow rate from unemployment. This is often attributed to the role of ALMPs and we will examine some of the empirical evidence later on. Most authors agree that ALMPs only represent one of many factors in the success of the CR and point clearly to a variety of initial conditions and endowments as the main factor, however ALMPs are something over which governments have relative control, hence the justification for focussing on ALMPs. Looking at the data for 1991-93, it is clear that the CR had a very different distribution of ALMP expenditure with a larger focus on self-employment (SE) and YSL (see Table 3.1.2). The emphasis on entrepreneurial factors is important, as it is the new companies that seem to have the largest job creation.

One of the key features according to Ham *et al* (1998: 1120) is the ability of the CR to absorb low-skilled unemployed into employment at a rate similar to skilled unemployed. In other CEE countries, this group of people have been far more likely to become unemployed and stay unemployed for longer. It may be that the CR had a more favourable endowment of a better skilled labour force. Janacek (1995: 67) attributes the success of ALMPs on their ability to update or reequip people with the skills necessary for the market economy. This resonates with the shift in employment evident in both republics, where we see a large rise in the numbers employed in the service sector.

The unemployed in the CR were far more likely to get a job than their counterparts in SK. In 1993, 16.5% of the registered unemployed signed off to take up work in the CR, while the corresponding figure for SK was 4.7%. A number of authors point to staffing levels at the national PES as a potential justification for these discrepancies. Data from the OECD suggest that those countries with higher unemployment also have the lowest PES staff to unemployed ratio although causality may be the other way around (Burda and Lubyova, 1995: 192). There is an emerging consensus in the literature that PES services are the least expensive and

most effective labour market intervention. Direct contact with the unemployed can have a 'prodding' effect, especially for the long term unemployed.

Boeri *et al*, (1998: 83) report a statistically significant association of PES staff on outflows from unemployment in a cross-section of Czech Labour Market offices. They found that a 1% increase in counselling staff is associated with 0.2% more outflows of unemployed into regular employment. There may be a case therefore for a proportionate rise in the number of counselling staff for a rise in the number of unemployed. Burda and Lubyova (1995: 198) looked at the sharp decrease in ALMP expenditure in the two republics in 1993 and found that half of the subsequent increase in unemployment could be accounted for by the decrease in ALMP expenditure.

2.2 Slovakia: Independence led to a sharp decrease in ALMP expenditure in Slovakia (see Table 3.1.2). The duration of unemployment is up to four times higher in Slovakia than it is in the Czech Republic and with the number of unemployed per vacancy reaching a high of 89.65 in 1999. Although the figure is estimated to have fallen in 2000 and again in early 2001, these figures still pose an enormous challenge for the authorities.

Substantial reforms were made in 1997, with increased targeting of expenditure on ALMPs. A study by Lubyova and Van Ours (1999), reported by the IMF (2000) found empirical evidence for a positive effect on specific Labour Market Policies notably retraining and PUJs. They found a negative effect for SPJs. In general, the IMF argue (2000: 42) that ALMPs tend to be more effective when they are addressed at increasing the capacity of specific group of workers. This is especially damning if you take into account that SPJs have traditionally been by far the largest component of ALMP expenditure in SK. That being said, with the nominal amount of expenditure such a small amount in 2000, it may be not as important a finding now as in 1996 (reforms were made in 1997).

Since independence, Slovakia has decreased the proportion of Labour Market Policies that are active. ALMPs in Slovakia rely on funding from a contributory employment fund, from which both Passive and Active Labour Market Policies are financed. This obviously has serious implications in a climate of increasing unemployment. The evidence reported above with regard to PES staff applies also to SK.

Conclusions

In line with the general conclusions for OECD countries, it is reasonable to suspect that ALMPs can have a positive effect on reducing unemployment and up-skilling an economy and indeed the evidence points to a small positive effect of ALMPs on unemployment. PES administration, job counselling and some PUJ schemes were shown to be successful. Boeri (1998: 84) and others have criticised the lack of evaluation that exists on active labour market programmes. I would agree with him when he argues that certain programmes can be wasteful and would argue that programmes need to well *targeted* and efficiently managed. This has been one criticism of the Slovak system that it has an inefficient administration, but with spending in 1999 so low, I am not sure that this is a key issue (Hiadlovská, 1998: 262). There would appear to be a great need for a new way of funding ALMPs in SK and for an acknowledgement of the potential benefits of ALMPs.

In transition countries, it may be the case that there is a theoretical justification for an emphasis to be given to retraining or entrepreneurial programmes[8] and there may also be a case for some government subsidy as a short-term measure to alleviate unacceptably high levels of unemployment as firms restructure. Finally, there is a need to conceive of transition labour markets outside of the traditional western paradigm and while there is a role for ALMPs in transition, we need to establish what works and why, before we can come up with a framework that is truly relevant to transition economies.

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[8] There appears to be no evaluations done on these programmes to date.

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Appendix

Table 3.1.1 Key Figures for 1990 - 2001[1]

The Czech Republic

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP (% Change)	-1.2	-11.5	-3.3	0.1	2.2	5.9	4.8	-1	-2.2	-0.2		
Unemployment (%)	0.73[2]	4.13[2]	2.57[2]	3.52[2]	3.19[2]	2.93[2]	3.52[2]	5.23[2]	7.48[2]	9.37[2]	8.66[3]	8.56[4]
Inflation (%)	9.7	56.6	11.1	20.8	10	9.1	8.8	8.5	10.7	2.1	3.9	4.0[5]

Slovakia

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP (% Change)	2.5	-14.6	-6.5	-3.7	4.9	6.7	6.2	6.2	4.4	1.9	2.1	
Unemployment (%)	1.5	11.8	10.3	13.7[6]	14.1[6]	12.4[6]	10.9[6]	11.8[6]	12.5[6]	17.1[6]		
Inflation (%)	10.4	60.6[6]	10.2[6]	23.0[6]	13.7[6]	10.0[6]	5.8[6]	6.1[6]	6.7[6]	10.6		

1. All figures derived from <http://www.bcemag.com>, unless otherwise stated
2. **Source:** Czech Statistical Yearbook 2000: <http://www.czso.cz/eng/figures/1/10/2000/data/excel/10/1010.xls>
3. **Source:** Labour Force Survey June 2000: <http://www.czso.cz/eng/figures/1/15/mmf2000/chap5.htm>
4. Seasonally Adjusted LFS for end January 2001: <http://www.czso.cz/eng/topical/bsi/avyb0215.htm>
5. Jan 2001 - Czech Statistics agency website: <http://www.czso.cz/eng/topical/inflat/inflation.htm>
6. **Source:** Slovak Republic: Selected Issues and Statistical Appendix Series: Staff Country Report No. 00/115: http://www.imf.org/external/pubs/ft/scr/2000/cr00115.pdf

Table 3.1.2 Budget allocation Within Active Employment Programmes, 1991-3 (in thousands of crowns)								
	Czech Republic							
	Total	SPJ	SE	PUJ	RET	Y&SL	Hours	Other
1991								
Cost	772,995	330,363	166,783	78,390	39,980	47,735	78,788	29,956
Distribution (%)	100	42.7	21.6	10.1	5.2	6.2	10.3	3.9
1992								
Cost	1,718,096	736,596	232,024	223,027	94,023	325,528	36,400	70,500
Distribution (%)	100	42.9	13.5	13	5.5	18.9	2.1	4.1
1993								
Cost	749,409	170,567	159,605	159,605	73,359	245,190	4,368	49,022
Distribution (%)	100	22.8	6.3	21.3	9.8	32.7	0.6	6.5
	Slovakia							
1991								
Cost	515,259	352,375	d	108,210	54,675	-	-	-
Distribution (%)	100	68.4	d	21	10.6	-	-	-
1992								
Cost	3,812,793	2,857,235	14,307	402,903	292,051	97,767	122,778	25,752
Distribution (%)	100	74.9	0.4	10.6	7.7	2.6	3.2	0.7
1993								
Cost	1,107,216	748,047	2,445	163,932	118,280	54,232	8,029	12,250
Distribution (%)	100	67.6	0.2	14.8	10.7	0.7	0.7	1.1

Source: Ham *et al* (1995)

Table 3.2.1 Active and Passive Labour Market Expenditure in Selected Countries

Country	Active Measures			Passive Measures		
	Total Active Spending (% of GDP)	Total Inflows into Programmes (% of Labour Force)	ALMP expd. Per %point L.F. inflow (% of GDP)	Total Passive Spending (%of GDP)	UE rate, % (LFS)	GDP cost per %point unemployment
Bulgaria (1993)	0.09	0.6	0.15	0.67	21.4	0.03
Czech Republic (1993)	**0.2**	**0.8**	**0.25**	**0.16**	**3.8**	**0.04**
Hungary (1993)	0.67	3.4	0.12	2.27	12	0.19
Poland (1993)	0.36	5.7	0.06	1.82	13.1	0.14
Slovakia (1993)	**0.44**	**4**	**0.11**	**0.77**	**12.7**	**0.06**
Slovenia (1995)	0.68	11	0.06	0.75	7.4	0.1
Sweden (1993-4)	*2.98*	*15.2*	*0.2*	*2.77*	*9.7*	*0.07*
Spain (1994)	0.6	2.2	0.27	3.26	23.8	0.14
UK (1993-4)	0.57	2.4	0.24	1.6	10	0.16

Source: Boeri et al (1998: 80, table 4.4) and OECD (1996a) Employment Outlook

Table 3.2.1 Labour Market Data for the Czech Republic

	Total No. of Vacancies ('000s)[1]	*Total No. of Unemployed ('000s)*[1]	*No. of vacancies per Unemployed*[2]	*No. of Unemployed Per Vacancy*[2]	*Inflow rate*[3]	*Outflow Rate*[3]
1990	57.6	39.4	1.46	0.68	-	-
1991	48.4	221.7	0.22	4.58	0.9	17.1
1992	79.4	134.8	0.59	1.70	0.9	26.6
1993	53.9	185.2	0.29	3.43	0.7	22
1994	76.6	166.5	0.46	2.17	0.6	21.3
1995	88.0	153.0	0.58	1.74	0.6	21.3
1996	84.0	186.3	0.45	2.22	0.6	19.3
1997	62.3	268.9	0.23	4.32	-	-
1998	37.6	386.9	0.10	10.28	-	-
1999	35.1	487.6	0.07	13.89	-	-

[1]**Source:** 19/02/01 Czech Statistical Yearbook 2000

[2] Author's Calculations

[3]**Source:** Ham et al (1998)

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