

LABOUR MARKET ASPECTS IN VISEGRAD GROUP COUNTRIES

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Abstract: *The presented article deals with labour market institutions and labour market performance in the European Union, especially within Visegrad group countries. A set of institutional aspects such as employment protection legislation, structure of wage bargaining, taxation of labour and the system of unemployment and social benefits determine the institutional framework of labour market. The paper is composed of the comparative analysis of selected criteria and corresponding economic indicators of the EU Member States. The author has chosen the method of comparative analysis as the basic method for accomplishing the goal of the paper - to analyse the labour market institutions and their contribution to labour market performance in the EU Member States. The evidence shows that the labour market flexibility is higher in the Visegrad group countries than average of “old” EU-15 Member states.*

Keywords: *Labour Market, Flexibility, Institutional Aspects, Employment Protection Legislation, Wage Bargaining, Taxation of Labour, Unemployment Benefits.*

1. Introduction

The presented paper deals with the various problems associated with labour market performance in the Czech Republic and other Visegrád group countries (V-4) in comparison with “old” EU Member States. The main goal of the article is to evaluate an institutional framework of V-4 labour markets within. Labour markets in EU new Member States are blamed for insufficient flexibility which stemmed from persisting but still weakening influence of precedent system of central planned economy. This argumentation is supported by the development of main macroeconomic indicators such as high unemployment rate, respectively low employment rate and high share of long term unemployment on overall unemployment. Moreover, after joining the Eurozone new Member State will lose autonomous monetary policy which is perceived as effective instrument of economic policy in case of an asymmetric shock. Then we can ask if any alternative instrument exists. Economic theory defined fiscal policy as one of the main instruments but because of Maastricht´s fiscal criteria and long-term state-budget deficits in most V-4 countries this instrument will hardly to be used. Then the only possible instrument is labour market flexibility which “*shows how quickly markets adjust to the external shocks and changing macroeconomic conditions.*”¹

2. Institutional aspects of labour market

The labour market is more complicated in general way. In accordance with [3] the labour market is affected by culture, institutional, legislative or political mechanism. Generally, we can find this structure of labour market institutions in theoretical literature:² employment protection legislation, structure of wage bargaining, active labour market policies, taxation of labour and unemployment benefits.

¹ Eamets and Masso [11, pp.4]

² Borghijs and van Poeck [5]; Buscher et al [7]; Jackman, Layard and Nickell [16].

Most studies are focusing on influence of institutional aspects on unemployment or employment, both in positive or negative direction - (i) some institutional aspects may generate higher unemployment rate; (ii) some institutional aspects may influence the nature of unemployment but have an ambiguous effects on unemployment rate and (iii) some institutional aspects do not influence both the nature of unemployment or unemployment rate.

The analysis of an influence of these aspects may be carried out in two directions: first, we can analyse the degree of labour market regulation, secondly, we can try to find an optimal setting of institutional framework.

Freeman [13] discriminates two approaches to labour market regulation. The first one (institutionalist view) considers these aspects desirable as significant instrument of social protection and they can incite growth of productivity. These aspects can also operate as moderate measures in case of aggregate demand decline. The second one (distortionist view) highlights the benefit of market mechanism and takes it, that these institutional aspects impede the adjustment process in case of economic shocks.

Betcherman et al [3], on the basis of *World Development Report, Workers in an Integrating World, the World Bank* (1995), emphasizes four different reasons for public intervention in the labour market:

- *Uneven market power - workers may find themselves in a weak bargaining position.*
- *Discrimination - workers belonging to groups with little voice or power (e.g., due to age, gender, ethnicity, etc.) may experience particular disadvantages in the labour market.*
- *Insufficient information - workers and some employers may not have adequate information to make informed decisions about the conditions of work.*
- *Inadequate insurance against risk - workers are typically unable to formally insure themselves against labour market-related risks associated, for example, with unemployment, disability, or old age.*

Blanchard and Wolfers [4] pursued how labour market institutions form the impact of shocks on unemployment in two directions. First, they examined aspects influence on the impact of shocks on unemployment. Secondly, the authors examined their influence on the persistence of unemployment. In context of European labour market the authors conclude: „*There is enough heterogeneity in labor market institutions within Europe to potentially explain differences in unemployment rates today. As to the evolution of institutions over time, it is clear that neither the view that labor market institutions have been stable through time, nor the view that the labor market rigidities are a recent development are right.*“³

If labour market flexibility may be an instrument of adjustment process in case of an asymmetric shock we matter to define labour market flexibility and its aspects. We can find out pregnant definition of labour market flexibility in Eamets and Masso [11]: “*We can say that labour market flexibility shows how quickly markets adjust to the external shocks and changing macroeconomic conditions.*” Klau and Mittelstadt [17] distinguish four broad aspects of labour market flexibility: (i) real labour cost flexibility at the economy-wide level; (ii) adaptability of relative labour costs across occupations and enterprises; (iii) labour mobility and (iv) flexibility of working time and work schedules. The first two are macro- and

³ Blanchard and Wolfers [4, p.16]

microeconomic aspects of labour-cost flexibility, while the latter two relate to the quantitative and qualitative adaptability of the supply and use of labour. Some of these elements interact. Eamets and Masso [11] also subdivide flexibility into microeconomic and macroeconomic level. Macroeconomic level can be further divided into institutional flexibility and wage flexibility. The first one represents to what degree the institutions and labour unions are involved in regulation of labour market. The latter one indicates how the wages are sensitive to market fluctuations. Microeconomic flexibility is associated with the labour market flows analysis. The labour market can be characterized by various flows of workers (transitions between labour market states, occupational mobility and geographical mobility) and by jobs flows (job creation and job destruction).

2.1 Employment protection legislation

First observed institutional aspect is employment protection legislation (EPL). We can understand EPL as rules refer to hiring and firing process (e.g. unfair dismissals, termination of employment for economic reasons, severance payments, minimum notice periods, administrative authorization for dismissals, and prior consultations with trade union and/or labour administration representatives).

Betcherman et al [3] consider EPL along a rigidity/flexibility continuum. At the rigid end these regulations are enforced: temporary employment is restricted, hiring standards for employers are in force, employer's decision on workers dismissal is limited by legislation or by severance, notice, and administrative requirements. At the flexible end liberal concept of EPL is enforced: statutory (or collectively bargained) regulations are minimal and market mechanisms largely determine hiring and firing.

According to Eamets and Masso [11] some of these rules of law were adopted as a “pillow” in case of labour demand decline which can have negative effects on employment while others are designed to protect employees from arbitrary dismissals.

We can find out two parallel view of EPL. The first one supposes that strict EPL can impede effective labour market performance and implicitly the economy. The latter one is based on an opinion that employment will be more stable and individual contracts long-term if strict EPL exists. In other words – strict EPL reduces hiring and firing and stabilize the flows within labour market.

We can determine the level of strictness of labour market legislation through the use of indexes, which were created by World Bank within the frame of Doing Business Program. The structure of following table is: column *a* represents Difficulty of Hiring Index and it means difficulty of hiring a new worker; column *b* represents Rigidity of Hours Index and it means restrictions on expanding or contracting the number of working hours; column *c* represents Difficulty of Redundancy Index and it means difficulty and expense of dismissing a redundant worker; column *d* represents Rigidity of Employment Index and it means an average of the three indices; column *e* Redundancy costs (cost of a redundant worker, expressed in weeks of wages).⁴

⁴ Methodology is available on <http://www.doingbusiness.org/MethodologySurveys/EmployingWorkers.aspx>

Tab. 1: Employing Workers (Doing Business 2009 edition)

	a	b	c	d	e
	Difficulty of hiring index (0-100)	Rigidity of hours index (0-100)	Difficulty of redundancy index (0-100)	Rigidity of employment index (0-100)	Redundancy costs (weeks of salary)
Czech Rep.	33	0	0	11	22
Hungary	0	67	0	22	35
Poland	11	33	30	25	13
Slovakia	17	20	30	22	26
EU-15	31,4	40	32	34,4	30,2

Source: World Bank: Doing Business [online][cit.2009/15/09] Accessible from <http://www.doingbusiness.org/CustomQuery/Default.aspx?excel=false>.

Figure 1 compares the valuables of three groups – EU15 and V-4. The conclusions in this section are as follows:

- V-4 countries had lower legislation regulation than EU-15 average;
- EU-15 average employment protection legislation was the higher but considerable differences existed (countries with low level of regulation e.g. Denmark or United Kingdom on the one hand and countries with significant higher degree of regulation e.g. Greece or Spain).

2.2 Structure of wage bargaining

We understand trade union as: „a continuous association of wage earners for the purpose of improving the conditions of their employment”.⁵

Trade unions are established on the basic of asymmetry in contracting between individual workers and employers. This inconsonance rises from existence of human and labour rights. Aidt and Tzannatos [1] show both costs arising from existence trade unions and potential benefits. Trade unions play key role in wage bargaining within EU and they have impacts on labour costs. Higher negotiating power of trade unions tends to increase wage level above equilibrium level. Buscher et al [7] argue that this effect could be forced if strict EPL and generous unemployment benefits exist.

Borghijs and van Poeck [5] distinguish three levels of wage negotiations: (i) firm or plant level (decentralised bargaining); (ii) industry level (bargaining at the intermediate level) and (iii) national or country wide level (centralised bargaining).

De Grauwe [14] argues: „...countries with either strong centralization or strong decentralization of wage bargaining are better equipped to face supply shocks, such as oil increase, than countries with an intermediate degree of centralization. In these „extreme“ countries there will be a greater wage moderation than in the intermediate countries. As a result, the countries with the extreme centralization or decentralization tend to fare better, in terms of inflation and unemployment, following supply shocks, than the others.”⁶

⁵ In Checchi and Lucifera [8, pp.5]

⁶ De Grauwe [14, pp.16]

This institutional aspect is hard to search because of data's accessibility and their harmonisation from different sources. We made use of [19] and [20]. We add one new partial indicator – coefficient of coverage/density. Following table summarizes main indicators for appraisal of the structure of wage bargaining.

Trade unions' negotiating power is a factor which has impacts on rigidity degree of the labour market. This is a result of a fact that unions control wage bargaining effectively not but that they have few members as we can see in a table. Last but one column represents collective bargaining coverage (as percentage). The significant contrast is the situation in France, where only 10 % of workers were members of trade unions but 90 % of workers were covered by collective agreements. The coverage was high also in Scandinavian countries but this was with one difference – these countries were distinguished by high degree of union density which compensated the high coverage. On the other hand both indicators were low in some countries – Anglo-Saxon countries and V-4 countries, where both density and coverage reached low values. If we attach these indicators in a fraction (numerator is the coverage and denominator is a density) we get new coefficient (in table this is the last column).

We believe that this coefficient is important factor of overall labour market flexibility. If the coefficient reaches value close to one, then the negotiating power of unions conforms to size of union's membership. If we look at previous table we can see that values of United Kingdom, Czech Republic, Slovakia or Scandinavian were close to 1. We tried to demonstrate that low unions' density does not mean their low negotiating power by definition.

Tab. 2: Wage bargaining indicators

	Centralization ¹ 1995 – 2000	Co- ordination ² 1995 - 2000	Trade Union Density 2000	Collective bargaining coverage (as %) - 2000	Coefficient coverage/density 2000
Belgium	3	4,5	56	90	1,6
Denmark	2	4	74	80	1,08
Finland	5	5	76	90	1,18
France	2	2	10	90	9
Ireland	4	4	38	n.a.	-
Italy	2	4	35	80	2,28
Germany	3	4	25	68	2,72
Netherlands	3	4	23	80	3,43
Portugal	4	4	24	80	3,33
Austria	3	4	37	95	2,56
Spain	3	3	15	80	5,33
Sweden	3	3	79	90	1,13
United Kingdom	1	1	31	30	0,96
Czech Republic	1	1	27	25	0,92
Hungary	1	1	20	30	1,5
Poland	1	1	15	40	2,67
Slovakia	2	2	36	50	1,39

Note:

a) Centralisation:

1 = Company and plant level predominant.

2 = Combination of industry and company/plant level, with an important share of employees covered by company bargains.

3 = Industry-level predominant.

4 = Predominantly industrial bargaining, but also recurrent central-level agreements.

5 = Central-level agreements of overriding importance.

b) Co-ordination:

1 = Fragmented company/plant bargaining, little or no co-ordination by upper-level associations.

2 = Fragmented industry and company-level bargaining, with little or no pattern-setting.

3 = Industry-level bargaining with irregular pattern-setting and moderate co-ordination among major bargaining

actors.

4 = a) informal co-ordination of industry and firm-level bargaining by (multiple) peak associations;

b) co-ordinated bargaining by peak confederations, including government-sponsored negotiations (tripartite agreements, social pacts), or government imposition of wage schedules;

c) regular pattern-setting coupled with high union concentration and/or bargaining co-ordination by large firms.

d) government wage arbitration.

5 = a) informal co-ordination of industry-level bargaining by an encompassing union confederation;

b) co-ordinated bargaining by peak confederations or government imposition of a wage schedule/freeze, with a peace obligation.

Source: OECD [19]; [20]; own calculation

2.3 Taxation of labour

Taxis on employment refer to both sides on labour market – labour supply (labour force pay income taxes) on the one hand and labour demand (employers, who pay payroll taxes) on the other side.

Economists created so-called tax wedge which expresses overall taxation of labour (see figure 1).

$\text{Tax wedge} = \frac{\text{Income tax} + \text{social security contributions (total)} + \text{payroll tax}}{\text{Gross wage} + \text{employer's social security contributions} + \text{payroll tax}}$

Fig. 1: Tax wedge (Dolenc and Vodopivec [10])

Buscher et al. [7] argue that labour taxation widen the wedge between employer's costs and employee's income. If taxis are transferred on employers then employment costs rise and eventuality is that labour demand will fall. If firms compensate this additional costs by lower wages than the wage/price of product ration will not change. Indeed, the consumption wage/price of product ratio declines. Then more households can obtain social benefits and their incentive to work is reduced. Hence, rising labour taxes have a negative impact on employment. Daveri and Tabellini [9] controvert this argumentation on the basis of Scandinavian countries – they ask why unemployment is so low while high labour taxation in continental Europe evokes high unemployment. One possibility how to make clear this contrast is connectedness of high degree of centralisation and co-ordination, which can reduce wage claims.

According to [2] tax wedge means that real take-home pay is lower than pre-tax real wage. If that tax wedge increases, than implicitly consumption grows more slowly. Authors make reference to tax wedge changes may affect not only the bargaining stance of unions but also individual labour – supply decisions. This holds if generous unemployment benefits exist.

Table 3 represents total tax wedge and its components. The tax wedge is expressed through the use of percentage rate of overall labour costs. The individual components of tax wedge differed significantly – V-4 countries had the lowest income taxes (except Hungary) and its percentage rate was almost half in comparison with EU-15 average (14,2 %). Scandinavian countries (Denmark, Finland and Sweden) and Germany or Belgium had the highest income taxes. We can see significant differences in the percentage rates of social security contribution too - workers in Poland, Netherlands, Austria or Germany paid the highest amounts while workers in Ireland, Spain, Finland or Sweden paid the lowest amounts. If we look at employer’s social security contribution rates, employees in France, Hungary, Czech Republic, Sweden, Italy, Spain and Germany had the highest rates in EU. The lowest rates existed in Anglo-Saxon countries: USA, United Kingdom and Ireland.

We can find some comparative advantage in the last column. This column represents labour costs in US dollars with equal purchasing power. The tendency is that labour costs in new Member States convergence to EU average. It is evident that this comparative advantage will not last forever. We have to look at other indicators to determine long-term criteria of competitive strength on the basis of the future outlook. This alternative indicator could be the total tax wedge. If we look at this indicator we can see that comparative advantage will disappear. Only two V-4 countries (Poland and Slovakia) had lower total tax wedge in comparison with EU average (41 %). Hungary had significantly higher total tax wedge (54,1 %). We argue that foreigner investors can make decision on the basis of the total tax wedge (because total labour costs converge in long-term period in EU) which it may subsequently end in that they can prefer countries with lower rate of the total tax wedge.

If we look at V-4 countries we can see, except Hungary, minimal differences between two observed groups. If we look more precisely we find out some differences between countries – e.g. Czech Republic applied notably higher level of employer ´s social contribution rates, but in Poland employees paid higher contributions than employer.

Tab. 3: Income tax plus employee and employer social security contributions (as % of labour costs, 2008)

Country	Tax wedge	Income tax	Social security contribution rates		Labour costs ²
			employee	employer	
Germany	52,0	18,6	17,2	16,2	61 635
Belgium	56,0	21,8	10,7	23,4	59 758
United Kingdom	32,8	14,8	8,3	9,7	56 764
Austria	48,8	12,3	14,0	22,5	56 610
Luxembourg	35,9	13,3	10,6	11,9	56 173
Netherlands	45,0	13,7	17,4	13,8	55 943
France	49,3	9,9	9,6	29,7	51 279
Korea	20,3	4,4	6,9	8,9	50 079
Sweden	44,6	14,8	5,3	24,5	49 798
Greece	42,4	8,0	12,5	21,9	46 044

Finland	43,5	19,2	5,0	19,4	45 887
Denmark	41,2	30,1	10,5	0,5	41 710
Ireland	22,9	8,5	4,7	9,7	40 661
Italy	46,5	15,0	7,2	24,3	39 947
Spain	37,8	9,7	4,9	23,2	39 595
Portugal	37,6	9,6	8,9	19,2	30 708
Czech Republic	43,4	8,2	9,3	25,9	25 690
Hungary	54,1	15,8	12,6	25,7	22 507
Poland	39,7	6,0	18,1	15,6	21 587
Slovak Republic	38,9	7,5	10,6	20,8	19 160

Note: ¹ Single individual without children at the income level of average worker.

² US dollars with equal purchasing power.

Source: OECD: Taxing Wages 2007/2008. [online][cit.2009/10/13]Accessible from <
http://www.oecd.org/document/6/0,3343,en_2649_34533_42714758_1_1_1_1,00.html>.

2.4 Unemployment benefits

System of unemployment benefits and employment protection legislation are two way how to protect workers in case of loss of employment. While EPL protects labour force which is employed and do not invoke any tax burden explicitly, unemployment benefits provide insurance to better part of labour force and UB are financed by social security contributions.

Grubb [15] made reference to most national labour legislations on providing these benefits are strict in one aspect – after certain duration of providing unemployment benefits the unemployed workers are obliged to accept whatsoever job regardless of qualification.

Some authors argue that „the longer unemployment benefits are available the longer unemployment lasts“. ⁷ Higher level of unemployment benefits and longer period of providing reduce the gap between income from working activity and transfers which means that the initiative to work is lower. According to Jackman, Layard and Nickell [16] unemployment benefits operate through dual mechanism: i) they reduce fear of being unemployed and ii) they restrain the effectiveness of filling new jobs by unemployed and subsequently employers are hustled to wage increase.

Negative effects of generous system of unemployment benefits can be offset by active labour market policies (if their providing is time-limited and the rules for qualifying exist – e.g. mandatory re-skilling).

International comparison of this institutional aspect is also complicated because only one level of replacement rate does not exist in any state. Individual unemployment benefits systems in member states of EU take into account number of specific personal and family circumstances of unemployed, previous job history. Hence EU member states apply different system of unemployment and social insurance. In some countries unemployment benefit are taxable.

OECD in order to compare unemployment benefits systems creates an indicator called **replacement rate**. This indicator gives the relation between income during employment and income during period of unemployment. We can count this indicator as a ratio which means that the closer the values are the less difference between wage and unemployment benefit is. We distinction between i) *gross replacement rate*, which is pre-tax ratio of wage and unemployment benefits and ii) *net replacement rate*, which is after-tax ratio of wage and unemployment benefits.

⁷ Jackman, Layard and Nickell [16, pp.1]

If the net replacement rate does not much differ from income from employment than we talk about *unemployment trap*.

Tab. 4: Net replacement rates (data 2007)

	Initial net replacement rate (as % of net earnings in work)-two-earner married couple	Net replacement rate for long-term unemployed-two-earner married couple	Net replacement rate over a 5-year period following unemployment (overall average)
Austria	81	59	59
Belgium	71	67	63
Czech Republic	80	52	32
Denmark	77	58	66
Finland	77	57	62
France	81	45	57
Germany	89	54	32
Greece	60	44	20
Hungary	82	53	21
Ireland ²	66	56	60
Italy	82	56	7
Luxembourg	93	49	24
Netherlands	83	50	38
Poland	64	50	40
Portugal	93	46	48
Slovak Republic	83	48	9
Spain	87	45	37
Sweden	74	46	43
United Kingdom	53	52	59

Source: OECD Benefits and Wages Statistics [online][cit.2009/10/13] Accessible from <http://www.oecd.org/document/29/0,3343,en_2649_34637_39618653_1_1_1_1,00.html>.

From the Table 4 we can see that individual initial replacement rates (IRR) among the EU countries differ considerably. Lowest setting of IRR was monitored in Great Britain (53%), while Portugal has reached 93% IRR. Differences were recorded also in the V-4 countries, where the lowest setting of IRR was in Poland (64%) to the highest Slovak Republic (83%). Differences in net replacement rates for long-term unemployed (two-earner married couple) were not so notable as the previous rates and they varied between 44% (Greece) and 67% (Belgium). In addition in the case of net replacement rates over a 5-year period following unemployment (overall average) were noted considerable differences. Strict setting of this rate existed in Italy (7%) and Slovakia (9%). On the opposite side stood Finland with 62 %, Belgium with 63 % and Denmark with 66 %. We can find rates of remaining V-4 countries in the group of countries with a lower rate.

3. Conclusions

This paper deals with labour market performance in V-4 countries. If the autonomous monetary policy is no more available, economic theory defined the labour market flexibility as

an instrument for adjustment process in case of asymmetric shock. Another need of the labour market flexibility is resulting from maintenance or increase of competitive strength.

On the assumption that Eurozone states, which had mostly lower overall labour market flexibility than V-4 countries, then we suppose that accession of Czech Republic or other new member states will not mean increased costs for present Eurozone states. It is true, that Eurozone has not been hit by significant asymmetric shocks which would prove theoretical literature conclusions yet. Though we are in essential agreement with argumentation that labour market reforms are unavoidable. This holds for countries of continental Europe and south Europe. If we look at situation in V-4 countries we assume that the need for labour market reform arise not either from future adopting single currency but from demographic situation and structure of social and pension system. In these boundaries future accession into Eurozone may subserve as an exogenous anchor (we can see similarity in accession of the Czech Republic into EU, which also subserved as an exogenous anchor during complicated transition process).

The comparative analysis provides these conclusions:

- Most V-4 countries had similar higher tax wedge compared to EU-15 (except Hungary).
- Strictness of employment protection legislation among V-4 countries is lower in comparison with EU-15.
- Coefficients of union density and union coverage of V-4 countries were close to valuable of 1 (except Poland) which means that bargaining power is corresponding to union membership.
- Wage bargaining coordination is among V-4 countries significant lower. This is given in that wage bargaining takes place on firm level.
- V-4 countries are among the EU Member States with stricter setting of net replacement rates.

Acknowledgement

The research behind this paper was supported by the Czech Science Foundation within the project GAČR 402/09/P142 “*Institutional labour market framework in the context of economic convergence and adopting single currency (application on Visegrád group)*”.

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