

# THE MINIMUM WAGE IN THE CZECH REPUBLIC – THE INSTRUMENT FOR MOTIVATION TO WORK?

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## Abstract

The minimum wage is an economic policy measure on which there are divergent opinions. This article attempts to find an answer to the question whether the minimum wage in the Czech Republic is set at a level that motivates people to seek work. This paper describes the development of the gross minimum wage in the Czech Republic in the years 1991 - 2012. After taxes on personal income and after considering other deductible items the net minimum wage is derived. The paper also describes the development of the living minimum in the Czech Republic. The living minimum reflects a change in its structure since 2007. A separate contribution for housing was introduced. By comparing the net minimum wage and the living minimum this paper examines whether particularly low-skilled people are motivated to look for work and not to rely on social benefits in the Czech Republic. It shows that there were years during which it was better not to work and to live on social benefits in the Czech Republic. It is necessary to set a relationship between these two variables which motivates people to work.

**Key words:** minimum wage, flexibility, unemployment, inflation

**JEL Code:** J 30, J 60

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## Introduction

The minimum wage was introduced in Czechoslovakia in February 1991. Since then, the minimum wage increased fifteen times. The minimum wage in the Czech Republic is set as a monthly and hourly wage. Besides these basic minimum wage rates the reduced rate for disabled workers and young workers also exist.

The minimum wage is established in certain legislation of the Czech Republic. Already the Constitution of the Czech Republic or more precisely the Charter of Fundamental Rights and Freedoms contains the right to a fair remuneration for work. The key legal standards are: Act no. 262/2006 Coll., the Labour Code and Government Regulation no. 567/2006 Coll. „Minimum wage shall be the minimum permissible amount of remuneration

for work done in a labour relationship...A wage, salary or remuneration to an agreement may not be lower than the minimum wage“ (Section 111, the Labour Code).

Views on the minimum wage vary. The proponents of the minimum wage point out that the minimum wage represents a protection of the poorest workers, enabling them to meet their basic living needs and reduces labour dumping. According to proponents of minimum wage the increase of the minimum wage can even increase employment due to higher motivation of labour force. In other words, the work must pay off. According to opponents of the minimum wage, the minimum wage is an interference with the market mechanism in the labor market. They point out that an increase in the minimum wage leads to a rise in unemployment, especially among vulnerable groups such as younger employees. Determining the remuneration threshold reduces the flexibility of the labor market. The minimum wage also does not present an effective tool in the fight against poverty.

A detailed description of the functions and development of the minimum wage in the Czech Republic was presented by the two studies of Ivo Baštýř (Baštýř 2005 and Baštýř 2007). The minimum wage as a measure that worsens labour market flexibility is mentioned in the joint study of the Czech government and the Czech National Bank (CNB, 2011). Effects of the minimum wages on unemployment in the Czech Republic can be found in an article by Fialová and Myšíková. According to them: „...the increasing minimum wage expressed as a share of the average regional wage has had a significant upward effect on the unemployment rate in regions“ (Fialová, Mysíková, 2009, pp. 271). Unemployment, however, has significant economic and social impacts. How high the costs of unemployment are in the Czech Republic can be found for example in the article by Čadil, Pavelka, Kaňková Vorlíček: “Odhad nákladů nezaměstnanosti z pohledu veřejných rozpočtů“ (Čadil, Pavelka, Kaňková, Vorlíček, 2011). If adjusted improperly, the minimum wage may even lead to long-term unemployment. The book: “Dlouhodobá nezaměstnanost v České republice” by Pavelka, Löster, Makovský and Langhamrová discusses the incidence of long-term unemployment in the Czech Republic in detail (Pavelka, Löster, Makovský, Langhamrová, 2011). Also the article by Löster and Langhamrová titled: Long-Term Unemployment is devoted to the question of seriousness of the issue of long-term unemployment in the Czech Republic (Löster, Langhamrová, 2011). Many statistical methods can be used to analyze the impact of the minimum wages on the economy. One of them is the cluster analysis, see for example Řezanková, Löster, Húsek (2011).

The aim of this article is to analyze whether the level of the minimum wage in the Czech Republic fulfills its motivational function. The question is whether people are willing

to work for the minimum wage or would rather choose to live on social benefits. In the first section, the development of gross and net minimum wage will be described. The second part will include the development of living minimum. The third part will contain a comparison of the net minimum wage and living minimum.

## 1 The development of the minimum wage

Table 1 contains data on gross and net minimum wage in the Czech Republic at the end of particular year. In this context it should be noted that in several years the minimum wage was increased twice. For the calculation of the net minimum wage in the years 1991 - 1994 the Ministry of Labour and Social Affairs used the average rate of taxation. In other years, the net minimum wage is calculated for a single person without children and other dependents.

**Tab. 1: The gross and net minimum wage in CZK**

	<b>Gross minimum wage</b>	<b>Net minimum wage</b>
<b>1991</b>	2000	1600
<b>1992</b>	2200	1802
<b>1993</b>	2200	1902
<b>1994</b>	2200	1878
<b>1995</b>	2200	1905
<b>1996</b>	2500	2187
<b>1997</b>	2500	2187
<b>1998</b>	2650	2318
<b>1999</b>	3600	3105
<b>2000</b>	4500	3772
<b>2001</b>	5000	4180
<b>2002</b>	5700	4702
<b>2003</b>	6200	5080
<b>2004</b>	6700	5457
<b>2005</b>	7185	5818
<b>2006</b>	7955	6721
<b>2007</b>	8000	6760
<b>2008</b>	8000	7000
<b>2009</b>	8000	7120
<b>2010</b>	8000	7120
<b>2011</b>	8000	7120
<b>2012</b>	8000	7120

Source: Ministry of Labour and Social Affairs, online [http://www.ospzv-aso.cz/addons/RHSD92/Dosavadni\\_vyvoj\\_minimalni\\_mzdy\\_v\\_CR.pdf](http://www.ospzv-aso.cz/addons/RHSD92/Dosavadni_vyvoj_minimalni_mzdy_v_CR.pdf)

In 1991, the monthly minimum wage in Czechoslovakia was 2 000 CZK. After taxes and deductible items employees received 1 600 CZK as a net wage. In 2002, the gross minimum wage increased by 10% and net wage by 12.6%. The former right-wing governments were not inclined to further increases in the minimum wage. The gross minimum wage stagnated for the following three years. The net minimum wage changed due to tax adjustments and deductible items. An income tax rate for people with the lowest income, which include persons receiving minimum wage, was set at 15%. As is evident from Table 1, in 2004 net wage fell by 1.3%. It was the only decline in the net minimum wage for the whole period. The gross minimum wage in the years 1996 - 1997 was 2 500 CZK and net minimum wage 2 187 CZK. The period from 1991 - 1998 was characterized by a relatively low growth rate of the minimum wage. Over eight years, the gross minimum wage increased by 32.5% and net minimum wage increased by 44.9%. When we express average annual rate, the gross minimum wage increased annually by 3.6 % and net minimum wage by 4.7 %. This was much less than the inflation rate. The real minimum wages were declining during this period.

In the period from 1999 - 2006 leftist governments dominated in the Czech Republic and this was also reflected in an increase in the minimum wage. The gross minimum wage in this period increased regularly every year. In some years, in 1999, 2000 and 2006, the gross minimum wage increased twice. Since 2006 the lowest tax rate on personal income dropped to 12%, which contributed further to the faster growth of the net minimum wage. Over the period from 1999-2006 the gross minimum wage increased by 200.2% and net minimum wage of 189.9%. After a conversion to the average annual growth rate we find that the gross minimum wage grew annually by an average of 14.7% and the net minimum wage increased annually by an average of 14.2%. Since 2007, the Czech government again has a rather right-wing orientation. And, as is well known, right-wing governments are mostly opponents of increase of the minimum wage. In 2007, the gross minimum wage rose by 45 CZK, i.e. 0.57%. The net minimum wage rose by 39 CZK, i.e. 0.99%. The gross minimum wage has not changed since 2007 and is still 8 000 CZK. Adjustment of income taxes and deductible items led to an increase in the net minimum wage even in the years 2008 and 2009. In the last three years, however, the net minimum wage has not changed.

## 2 The development of the living minimum

Table 2 contains the amount of the living minimum for a single-person household. The living minimum was first introduced in 1991. By 2006, the living minimum also included a contribution for housing. Since 2007 there has been a change. The living minimum does not contain the contribution for housing. The housing contribution is a separate category, the amount of which is influenced by many factors. The amount depends on the size of the city where the person lives, whether a person lives in a rented flat or in a cooperative or their own flat. Table 2 includes a contribution to a person who lives in Prague. The second column contains the level of the living minimum and the contribution for person who lives in rented flat. The third column contains the living minimum and contribution for housing for a person who lives in a cooperative or their own flat. The last column is the average living and housing allowance for a person living in a rented flat and person living in a cooperative or their own flat.

**Tab. 2: The living minimum of single person household in Prague**

	Living minimum + without housing costs (from 2007)	Living minimum + rented flats	Living minimum + cooperative and own flats	Living minimum + flats - average
1991	1 700	1 700	1 700	1 700
1992	1 700	1 700	1 700	1 700
1993	1 960	1 960	1 960	1 960
1994	2 160	2 160	2 160	2 160
1995	2 440	2 440	2 440	2 440
1996	2 890	2 890	2 890	2 890
1997	3 040	3 040	3 040	3 040
1998	3 430	3 430	3 430	3 430
1999	3 430	3 430	3 430	3 430
2000	3 770	3 770	3 770	3 770
2001	4 100	4 100	4 100	4 100
2002	4 100	4 100	4 100	4 100
2003	4 100	4 100	4 100	4 100
2004	4 100	4 100	4 100	4 100
2005	4 300	4 300	4 300	4 300
2006	4 420	4 420	4 420	4 420
2007	3 126	5 371	4 268	4 820
2008	3 126	6 214	4 685	5 450
2009	3 126	7 120	5 141	6 131
2010	3 126	7 909	5 388	6 649
2011	3 126	8 395	5 755	7 075
2012	3 410	9 285	6 270	7 777

Source: Ministry of Labour and Social Affairs, online [http://portal.mpsv.cz/soc/spp/obcane/zivotni\\_min/](http://portal.mpsv.cz/soc/spp/obcane/zivotni_min/), own calculation

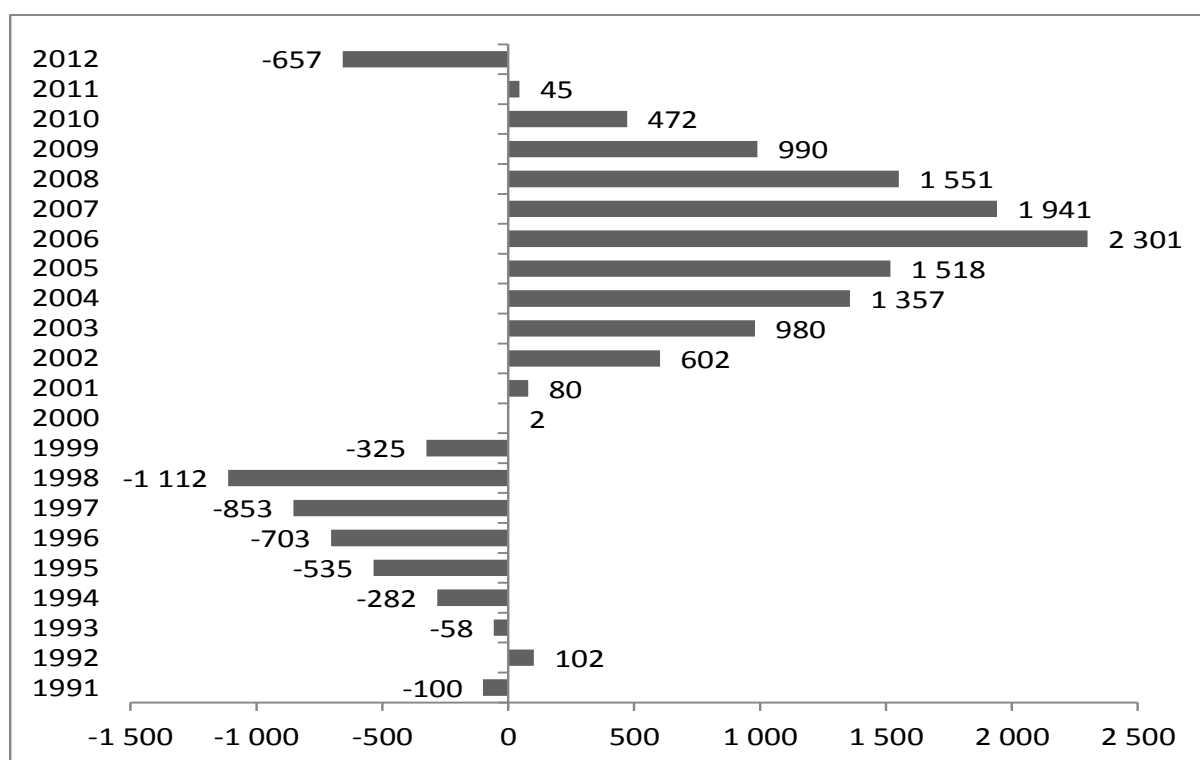
The living minimum was set in 1991 in the amount of 1 700 CZK. By the year 1998, the living minimum increased by 1 730 CZK. In the period from 2001 to 2004 the living

minimum remained unchanged. Since 2007 the separate contribution for housing was added to the living minimum. It is worth noting that at that time housing deregulation took place in the Czech Republic.

### 3 The comparison of the net minimum wage and living minimum.

In this section the amount of the net minimum wage and the living minimum (including housing contribution) will be compared. It is obvious that if the net wage is higher than the living minimum, people are more willing to seek employment and not to live on social benefits. Conversely, if the living minimum is higher, people are not motivated to work. This is especially true for those with low skills. In other words, it is important to provide a combination of these two variables, in order to insure that „work pays off“.

**Fig. 1: The difference between the net minimum wage and the living minimum (in CZK)**



Source: own calculation

Figure 1 contains the difference between the net minimum wage and the living minimum in the Czech Republic in the period from 1991 - 2012. It is clear that in 1991 the net minimum wage was lower than the living minimum. An increase of the gross minimum wage, tax adjustments and unchanged living minimum contributed to the fact that it was slightly better to work in 1992. Slow growth of the gross minimum wage in the following years, in

combination with growing living minimum led to the fact that it was better for people to prefer not to work and rather to receive social benefits. The biggest difference in this context was achieved in 1998. A rapid increase of the minimum wage in the following years changed this trend. The net minimum wage was higher than the living minimum. People were motivated to work. No increase in the gross minimum wage, combined with rising living minimum, caused a gradual reduction of this difference since 2006. This year the living minimum is already greater than the net minimum wage. It is not worthwhile for people to work.

## **Conclusion**

The minimum wage is an instrument of economic policies, whose existence produces different opinions. Some reject the minimum wage because they believe that the minimum wage undermines market mechanism and causes unemployment. Some say that the minimum wage has a social protection function and its correct setting motivates people to work.

The minimum wage was first set in Czechoslovakia in 1991. The first eight years, the gross minimum wage increased only slightly. In the period from 1999 - 2006 the gross minimum wage increased significantly. The last increase of the gross minimum wage was in 2007. Wages which employees receive for their work are also affected by tax rates and other deductible items. The net minimum wage rose (at a different pace) until 2009. The only exception was in 1992.

The living minimum was also introduced in 1991. The living minimum also increased during the period. However, there are noticeable periods of time during which the living minimum was unchanged. Since 2007, there is a separate contribution for housing in addition to the living minimum.

From comparison of the net minimum wage and the living minimum it is clear that up to 1999 people were not motivated to look for work. In the period from 2000 - 2011 the net minimum wage exceeded the living minimum in varying degrees. It was better for people to work than to live on social benefits. This year, however, the situation has changed. It is necessary to set such a relationship between the net minimum wage and the living minimum that motivates people to work.

## Acknowledgment

The article is one of the outputs from the research project “Flexibilita trhu práce České republiky“ registered with Internal grant agency of the University of Economics, Prague under the number 19/2012 .

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