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THE PERFORMANCE OF THE CZECH LABOUR MARKET AFTER THE 2004 EU ENLARGEMENT

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ABSTRACT: *This paper examines whether there has been a significant change in the performance of the Czech labour market after the Czech Republic's EU Accession in May 2004. We analyse methodological changes of measuring unemployment caused by inevitable legislative adjustments and follow the development of the Czech labour market and the inflows of foreign workers to the Czech Republic over the past two decades.*

Our results show that the EU Accession resulted in simplifying foreigners' access to the Czech labour market and did not cause a significant change in its performance. Our findings might be of some relevance for the countries seeking EU Membership in the near future (e.g., Serbia or Montenegro).

KEY WORDS: *labour market, economics of migration, EU Enlargement, Czech Republic*

JEL CLASSIFICATION: F02, F22, J61

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1. INTRODUCTION

The Czech Republic was among the ten countries which comprised the EU Enlargement of 1 May 2004. This was one of the most important events in the history of the post-Communist Czech Republic. By joining the EU the Czech Republic became a part of the European integration process which had started more than fifty years earlier. In 2004 the EU had already accomplished the integration stage of being a single market, which is usually defined by free movement of people, goods, services, and capital. There is a legitimate conjecture whether a country becoming part of the single market will impact on the functioning of the whole economy.

Research literature on labour migration and its impact on the labour market is extensive. Todaro (1969) and Harris and Todaro (1970) provided the first theoretical models, which describe the behaviour of people in less developed countries who migrate to urban areas. Katz and Stark (1986) deepened these findings and argued that migration to urban areas is perfectly rational even if it lowers an individual's income, since it provides better opportunities for the future. Zhao (1999) presented the results of a survey conducted in China and concluded that migrants have substantially higher wages than rural farm and non-farm workers, and that the amount of migration depends on the availability of rural non-farm jobs.

With regard to the labour market, Borjas (1989) provided a theoretical framework on the topic of international migration based on neoclassical assumptions. He concluded that this theoretical insight roughly corresponds to the previous empirical studies. Massey et al. (1993) surveyed the main theoretical concepts and concluded that, even though they all have similar assumptions and propositions, the related policy implications are very different. Additional empirical papers supplemented these theoretical concepts. Vogler and Rotte (1998) examined migration flows from developing countries to Germany. They describe and estimate determinants of migration and claim that economic difference and the political situation are substantial incentives to emigrate. Moreover, Salt, Clarke, and Wanner (2004) and Lučkaničová et al. (2012) showed the trends of European labour migration, and they ascertained that unemployment is significantly higher for immigrants. Therefore they suggested that prioritizing integration and anti-discrimination policies in the labour market might be beneficial.

The research literature dealing with outward labour migration and its economic impact on sending countries remains scarce. Apart from some research conducted

in the U.S-Mexico context (see e.g., Aydemir and Borjas, 2006; Mishra, 2006; or Hanson, 2006) which showed a significant relationship between emigration and wage growth rates in sending countries, little research has been undertaken on this issue.

The scope and size of migrations strongly depend on the migration potential of the population of any given country. It is more likely that in the countries with high migration potential a worsening economic situation at home will result in more migrants (see for example, Fidrmuc, 2002; Bernab and Krstić, 2008; or Glazar and Strielkowski, 2010). With regard to this Strielkowski and Turnovec (2011) developed the concept of an “indicator of migration costs” which is country-specific and consists of tangible (e.g., cost of resettling or adjustment in the new country) and intangible (e.g., psychological costs of migration - breaking social ties, leaving family or friends, language barrier) components. It appears that if this indicator is greater than the difference between wages in the source and the target countries of migration, there is no motivation for the labour force to move (in this case the propensity to migrate equals zero). For the countries where the indicator of migration costs surpasses wages, the migration potential remains low and the people might not react promptly to wage and unemployment incentives abroad.

Strielkowski and O'Donoghue (2006) analysed the impact of economic factors on the scale of migration and concluded that they are the main incentives to move abroad, together with the deteriorating state of the home economy. This is why the EU enlargement in 2004 did not lead to a massive inflow of workers to the original member states (perhaps with the exception of Poland). Another paper by Strielkowski (2007) describes the pattern of Czechoslovak migration over the period 1993-2004 after the split of the Czech Republic from Slovakia. He argues that even though the Czech Republic had better economic conditions, this did not greatly influence migration between these countries.

The aim of this paper is to examine whether there has been a significant change in the performance of the Czech labour market after the Czech Republic joined the EU. There are several ways of approaching this issue. This research aims to be an empirical analysis rather than a theoretical study. It focuses on the development of the main indicators of the labour market (unemployment, employment, long-term unemployment, etc.). Furthermore, the paper intends to explore the development of foreign worker inflows and their impact on the Czech labour market. Particular emphasis is put on the question of whether joining the EU changed the fact that the majority of foreign workers participating in the

Czech labour market are from Eastern European countries. Last but not least, the paper examines how entrance to the EU influenced legislation related to the Czech labour market.

2. EU ACCESSION AND NEW REGULATIONS IN THE LABOUR MARKET

In the Czech Republic two distinct methods of measuring unemployment are used (see e.g., Malá and Červená, 2012). Political representatives often deliberately misuse this, choosing the lower rate if they are describing a period when they were in power and the higher rate if they are in opposition. The first methodology, used by the Czech Statistical Office (CSO), is a Labour Force Survey (LFS) which determines the International Labor Organization (ILO) unemployment rate. The second methodology is applied by the Ministry of Labour and Social Affairs (MoLSA) and defines the rate of registered unemployment. In the following paragraphs the differences between these two methodological approaches towards measuring unemployment are discussed, as well as how joining the EU influenced both approaches.

The rest of the paper is organised as follows. The second section deals with methodological changes which were caused by the implementation of necessary legislative adjustments. The third section describes the development of key features of the Czech labour market. This is followed by a section analysing the inflow of foreign workers. A brief summary of the most important findings concludes the paper.

2.1. Labour force surveys

The LFS is a statistical inquiry from which the CSO gets information about the situation in the Czech labour market. The measuring methodology is set by the European Statistical Office (Eurostat), based on recommendations by the ILO: therefore the results are easily comparable. There exist only minor differences in the LFS across EU countries. One of the differences is that in some countries (i.e., Germany) participation in the LFS is compulsory, while in other countries (i.e., the Czech Republic) participation in the LFS is voluntary. It is therefore surprising that there are no significant differences in the response rate between the states with compulsory participation and those with voluntary participation (Eurostat, 2011).

Eurostat, based on the ILO guidelines, defines an unemployed person as aged between 15 and 74, without work during the reference week, and available to start work within the next two weeks. To comply with the definition the person should have actively sought employment at some time during the last four weeks (Eurostat, 2011).

In the Czech Republic the LFS has been conducted since December 1992 as a continuous quarterly survey. The survey covers the whole country, but only private and not collective households are surveyed (Eurostat, 2011). The exclusion of people living in collective accommodation is partly responsible for the constant undervaluation of the number of foreign workers in the Czech Republic by the LFS¹. Other reasons are the language barrier and the unwillingness of foreign workers to participate in any survey.

The sampling plan is a stratified two-stage probability sample. In the first stage census areas (primary sampling units) are sampled with probability proportional to size. In the second stage surveyed dwellings are selected from the initial sample by simple random sampling (Eurostat, 2011). The collected data (25,000 dwellings were surveyed in the fourth quarter of 2011) are sent to the CSO. At the CSO the data are aggregated to the whole population. The results are published quarterly, and year averages of monitored variables are computed (CSO, 2012).

2.2. Methods of measuring employment

The rate of registered unemployment is an indicator which is based on data from Labour Offices (LO) and registers of MoLSA. The main methodological difference between the ILO unemployment rate and the rate of registered unemployment is data collection. As mentioned above, the LFS deals with a sample which is later aggregated to the whole population, while MoLSA collects data from the LO and registers of jobseekers so that it works with the absolute number of jobseekers. As the LFS has been harmonized with Eurostat since December 1992 EU Accession in 2004 hardly affected its use. However MoLSA had to harmonize its methodology with EU countries, and therefore a new statute was introduced shortly after the Czech Republic joined the EU.

The Employment Act (Zákon 435/2004 Sb., O zaměstnanosti in Czech) is a key legal enactment relating to the Czech labour market. It came into force on the

¹ It is known that many manual workers from the USSR and also from Slovakia live in collective households.

13th of May 2004. The Employment Act adjusted methodology used by MoLSA by introducing the condition of jobseekers' availability. In practice it says that only jobseekers registered at a LO who are currently available to start work within 14 days are considered as unemployed. Jobseekers who are registered at a LO but do not fulfil the condition of availability are considered as economically inactive. The condition of availability was introduced mainly due to the possibility of citizens from the European Economic Area (EEA) and Switzerland becoming jobseekers in the Czech Republic. Citizens from the EEA and Switzerland also have to be included in the labour force (MoLSA, 2004). To make this clearer the discussed methodologies are defined below.

The common rate of unemployment published by the CSO can be presented as follows:

$$U_{LFS} = \text{Number of unemployed} / \text{Labour force}$$

where all values in the numerator and the denominator are gained from the LFS (this comprising those actively seeking for jobs and registered at LOs and living in private households).

The rate of registered unemployment measured by MoLSA using the old methodology:

$$U_{MoLSA}^{OLD} = \text{Number of jobseekers} / \text{Number of unemployed} + \text{number of jobseekers}$$

where in the numerator the jobseekers are defined as Czech citizens actively seeking employment and registered at the LOs. The denominator is represented by all active jobseekers registered at LOs plus the number of unemployed persons taken from the LFS (thus excluding people living in collective households).

The rate of registered unemployment measured by MoLSA using new methodology:

$$U_{MoLSA}^{OLD} = \text{Number of jobseekers} / \text{Number of employed} + \text{Number of jobseekers}$$

$$U_{MoLSA}^{NEW} = \text{Number of available jobseekers} / \text{No. of employed} + \text{No. of available jobseekers} + \text{No. of working foreigners}$$

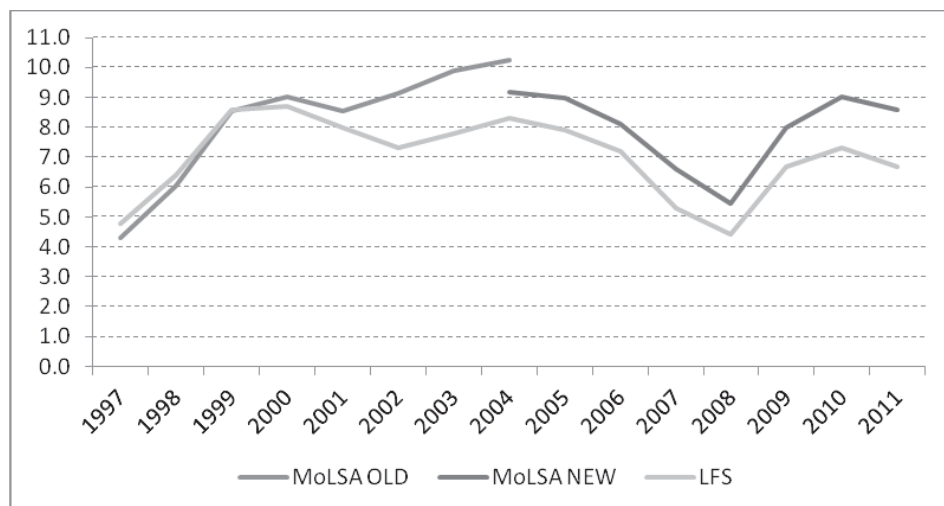
where in the numerator jobseekers are defined as fulfilling the condition of availability (active jobseekers), amended by the citizens of the EEA and

Switzerland. The denominator represents jobseekers fulfilling the condition of availability plus the number of unemployed taken from the LFS (excluding collective households) and the number of working foreigners taken from the registers of MoLSA and the Ministry of Industry and Trade (MoIT) of the Czech Republic.

2.3. Comparison of both methodologies

At the end of this section the pros and cons of both methodologies will be discussed, as well as the question of which method better depicts the performance of the labour market. The main weakness of the LFS is that the information is gathered through a questionnaire. Therefore, as the newly evolving experimental economics suggests, the results are highly dependent on the chosen questions and on the order of questions. Since the beginning of 2002, in the Czech LFS questionnaire the question of whether a respondent has worked at least one hour in a referential week precedes the question concerning the usual economic status of the respondent (employed, unemployed, or economically inactive) (LFS, 2011). This change in the order of questions led to a one percentage point (pp) drop in the common rate of unemployed, whereas the rate of registered unemployed increased by one pp.

Figure 1: Unemployment Rates, Czech Republic (1997-2011)



Source: MoLSA, CSO (2012)

Figure 1 suggests that the rate of registered unemployed, even after the implementation of the availability condition, has always been 1-2 pp higher than the common rate of unemployment. There are a couple of reasons behind this trend. Firstly, some registered jobseekers probably work in the grey market but in an anonymous survey might respond that they have worked at least one hour in a referential week, which makes them employed in the LFS approach. But they are not necessarily working in the grey market, as the above-mentioned Employment Act rules that if a jobseeker works but her/his wage does not exceed half of the minimum wage (4000 CZK in year 2012), s/he still fulfils the conditions of being unemployed according to MoLSA (Zákon č. 435/2004). Therefore some part-time employees are considered as unemployed if they are registered at an LO.

Both of the methodologies used in the Czech Republic are justified. The common rate of unemployment, because of its harmonization with ILO definitions and Eurostat methodology, provides a perfect international comparison. On the other hand, the rate of registered unemployment based on the absolute number of available registered jobseekers is more useful for legislative changes and employment policies. In the context of European integration, joining the EU caused MoLSA to introduce new methodology while the LFS was not affected at all.

3. RECENT DEVELOPMENTS IN THE CZECH LABOUR MARKET

The task of this research is to examine whether there was a significant change in the performance of the Czech labour market after joining the EU. To do so it is essential to understand the development of the Czech labour market since the collapse of the central planned economy (CPE) as a comprehensive story.

At the beginning of the 1990s most economists assumed that transformation from a CPE to a market-oriented economy would necessarily be followed by a significant increase in unemployment. The majority of former Eastern Bloc countries confirmed this assumption, with the exception of the Czech Republic². Hence, terms such as 'success story' and 'Czech unemployment miracle' were used to describe the performance of the Czech labour market (Flek and Večerník, 2004). Nevertheless, behind this success story were hidden problems, which would later become evident.

² Until 1.1.1993, the Czech and Slovak Federal republic.

Devaluation along with price liberalization led to the creation of the ‘wage cushion’, which lowered labour costs significantly³. Also, until the privatization of the Czech banks, big national concerns faced so-called ‘soft budget constraints’⁴. There was no pressure to sufficiently restructure businesses. Nevertheless in the period 1990-1993 employment dropped by 10%. Such a radical fall in employment should in a standard free economy cause a substantial growth of unemployment. How is it possible that the Czech labour market managed to absorb it without an increase in the number of unemployed? The former regime was characterized by the high economic participation of women and pensioners. Many of these decided to leave the labour force voluntarily (became economically inactive); hence there was only one unemployed for five lost jobs (Flek and Večerník, 2004). This caused a schizoid situation where the economy was in recession (should be lots of unemployed) but there was insufficient labour for the newly emerging private sector. This fact, and others, contributed to a general imbalance of the Czech economy, leading to a monetary crisis in May 1997 which revealed the hidden problems of the Czech labour market (Flek et al., 2010).

The monetary crisis in May 1997 began a period which was characterized by a worsening of all labour market indicators. Unemployment began rising sharply: in the 4th quarter of 1996 the common rate of unemployment was just below 4% and only three years later it was 8.7%. At the same time the employment rate of those aged 15-64 decreased from 69.4% to 65.8%. As the number of unemployed did not start to decrease the Czech labour market experienced the inevitable problem of long-term unemployment for the first time. This was mainly due to a shortage of qualified labour force and regional discrepancy between labour demand and supply.

The pre-accession occupied the period after the monetary crisis. As Table 1 depicts, all key labour market indicators remained at relatively unfavourable values. Nor did joining the EU help to reverse the unemployment trend of around 8%, half of which was long-term unemployment⁵. This was made even more disappointing by the fact that the Czech Republic experienced relatively fast growth of GDP. It seems that the period between 2000 and 2005 reflected the true face of the Czech labour market. This period was followed by the Czech economy overheating (2006-2008), which caused unrealistically low unemployment values, long-

³ The wage cushion represented a decrease in real wages of 30%.

⁴ Banks provided big concerns with loans to stop them going bankrupt. Many of these loans eventually became bad loans.

⁵ The long-term unemployed are jobseekers who are unable to find a job for more than 12 months.

term unemployment rate, and number of jobseekers to job vacancies. After the financial crisis the performance of the Czech labour market started converging with the situation before the overheating of the economy began.

Table 1: Key Labour Market Indicators, Czech Republic (2002-2011)

Year	2002	2003	2004	2005	2006	2008	2010	2011
Unemployment	7.3	7.8	8.3	7.9	7.2	4.4	7.3	6.7
Employment	65.6	64.9	64.2	64.8	65.3	66.6	65.0	65.7
Long-term Unemployment rate	3.7	3.8	4.2	4.2	3.9	2.2	3	2.7
GDP Growth	2.1	3.8	4.7	6.8	7	3.1	2.5	1.9

Note: Unemployment, employment, and long-term unemployment rate taken from the LFS. Real GDP growth is computed as a percentage change on a previous year.

Source: Eurostat (2012)

4. FOREIGN WORKERS IN THE CZECH LABOUR MARKET

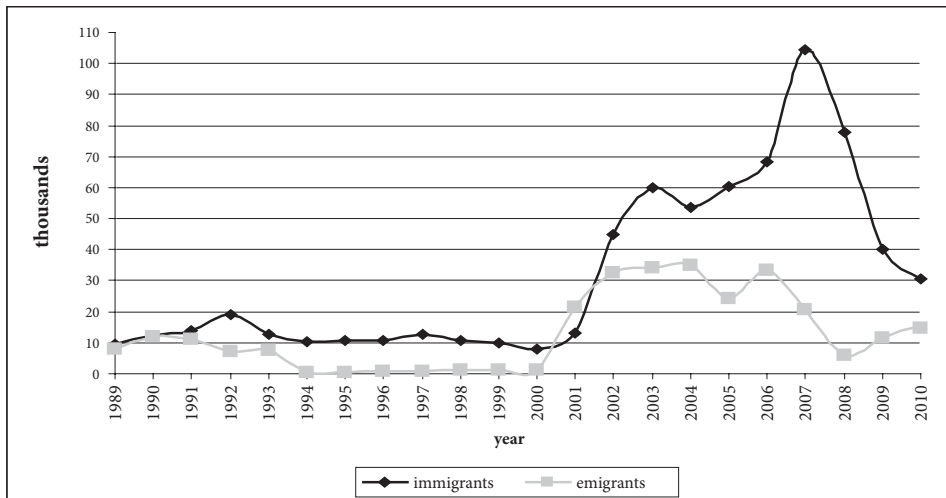
Since the Czech Republic became a part of the EU, citizens from the EEA and Switzerland are no longer considered as foreign workers and therefore have free access to the Czech labour market (Zákon č. 435/2004)⁶, whereas before 1 May 2004 only citizens from Slovakia had free access. Free access to the Czech labour market by citizens from the EU, and, vice versa, Czech citizens' free access to EU labour markets, has undoubtedly had an impact on both worker inflows and outflows of Czechs (Figure 2). However, when analysing gross labour market flows, it becomes apparent that worker inflows were higher than outflows.

Even if a country joins the EU where by law the free movement of workers is granted, it is possible for member states and newly entering countries to impose restrictions on the free movement of workers. These restrictions are called 'transitional arrangements for the free movement of workers'. The aim of these arrangements is to introduce free movement gradually over a seven-year period; hence the transition period is divided into three phases (2+3+2 years) (EC, 2012).

⁶ Henceforth the term 'EU citizens' will be used instead of 'citizens from EEA and Switzerland'. Citizens from Iceland, Liechtenstein, and Norway are covered in the term 'EU citizens'.

All member states had to remove restrictions on the free movement of workers by April 30 2011. Member states decided to abolish restrictions at different times with a number of different exceptions. Therefore only the removal of the main restrictions is discussed. During the first period (May 1 2004 to 30 April 2006) only Sweden, the United Kingdom, and Eire abolished the restrictions. At the beginning of the second period or soon thereafter the other six member states adopted a free movement of workers policy; namely, Finland, Greece, Italy, the Netherlands, Portugal, and Spain. By the end of the third period (April 30 2011) all remaining countries were forced to abolish restrictions. In the case of Belgium, Denmark, France, and Luxemburg the liberalization process started during the second period. By contrast Austria and Germany tried to protect their labour markets for as long as possible. It is worth mentioning that, of the countries that entered the EU in 2004, only Hungary, Poland, and Slovenia restricted access to their labour market for citizens of the EU15. Moreover these restrictions were only reciprocal (EC, 2012).

Figure 2: Gross labour migration flows: Czech Republic (1989-2010)

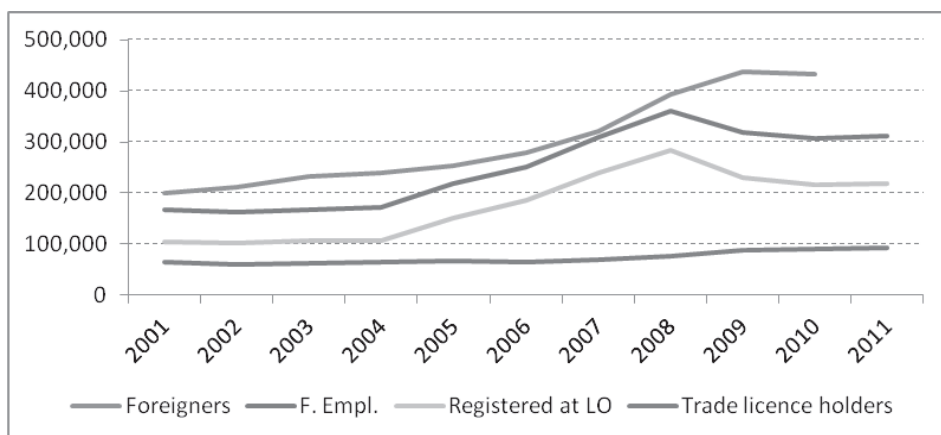


Source: Czech Statistical Office (2012)

The Czech Republic did not restrict access to its labour market, so EU citizens have been free to participate in the Czech labour market since May 1 2004. Figure 3 shows the development of the total number of foreigners and of foreigners participating in the labour force. The number of working foreigners is further divided into employees who are registered at a LO, and trade licence holders (self-employed). Between 2004 and 2005 there is a visible growth of working foreigners

in the Czech Republic (45,000 foreign workers a year). This trend continues until 2008, the biggest growth being in 2007 (59,000). This fact, however, points to the importance of the cyclical character of foreign employment.

Figure 3: Foreigners and foreigners employed in the Czech Republic (2000-2011)



Note: Values for the total number of foreigners for year 2011 are not yet publicly available.

Source: CSO (2012)

Table 2 shows foreigners employed, by citizenship. Only employees registered at a LO are considered. The total number of workers from the EU has been rising since 2002 (almost every year); nevertheless the share of EU workers to all foreign workers oscillates around 50%.

Table 2: Foreigners Employed, by Citizenship (in thousands)

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total	164.2	169.6	215	246.4	309	361.7	318.4	306.3	310.9
Total EU	82.5	85.9	107.3	129.7	159.5	157	156.3	162.5	174.6
% EU	50.2	50.7	49.9	52.7	51.6	43.4	49.1	53.1	56.1
% SK/EU	80.2	79.7	78.3	76.8	68.9	69.7	69.1	68.5	67.5
BG	2.8	2.7	2.8	2.8	6.3	6	5.5	6.7	8.1
DE	2.4	2.4	2.9	3.5	4.1	4.1	4.4	4.5	4.8
PL	8.5	10.1	13.9	18.3	24.9	22	21.7	20	21.4
RO	0.8	0.7	1.1	1.4	4.5	3.8	4	5.1	6.8

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SK	66.1	68.5	84	99.6	109.9	109.4	108	111.4	117.8
UK	2.5	2.6	3.9	3.6	3.7	4.5	4.9	5	5.6
Non EU	81.7	83.6	107.7	116.6	149.4	204.6	162	143.7	136.5
RU	2.5	2.6	3.9	3.6	3.7	4.5	4.9	5	5.6
UA	41.2	41.8	61.1	67.4	83.5	102.2	83.7	71.8	68.9
VN	21.2	22.2	22.8	23.6	29.8	48.3	39.2	36.2	32.1

Source: CSO (2012)

In 2005, the first complete year when the Czech labour market was open to EU workers, there is an increase of 22,000 EU workers: however 16,000 of these were Slovaks. The row indicating the share of Slovaks in the total of EU workers is very important. It shows that until the end of 2006 almost 80% of all EU workers were Slovaks. The drop of this indicator in 2007 by 8 pp was mainly caused by Bulgarian and Romanian workers entering the EU.

Table 3: Trade Licence Holders (in thousands)

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total	62.2	65.2	67.2	65.7	68.7	77.1	87.7	90.8	93
Total EU	13.3	14.4	14.7	14	14.7	15.8	17	18.4	19.9
% EU	21.4	22.1	21.9	21.3	21.5	20.6	19.4	20.3	21.4
SK	8.1	8.7	8.7	8.2	8.6	9.2	9.8	10.6	11.4
PL	1.1	1.2	1.2	1.2	1.2	1.3	1.4	1.6	1.7
DE	1	1.1	1.1	1.2	1.2	1.3	1.4	1.5	1.6
Non EU	48.9	50.7	52.5	51.7	53.9	61.2	70.7	72.5	73.1
VN	20.9	22	22.6	22.9	24.4	32.1	35.5	33.1	29.3
UK	18.7	19.4	21.1	21.3	21.9	21.2	26.2	29.7	33.7
RU	1.6	1.6	1.4	1.2	1.2	1.2	1.3	1.4	1.7

Source: CSO (2012)

Since then the value has oscillated below 70%. Most non-EU workers are from Ukraine and Vietnam. It is clear that the number of workers from these two countries strongly correlates with the economic situation of the Czech Republic.

Table 3 depicts the number of trade license holders by citizenship. The share of EU self-employed is much lower than employees, and has been constantly oscillating around 20% of total trade license holders. This is because Slovaks are

not as dominant here as they are among employees. In fact there are three times more trade license holders from Ukraine and Vietnam than there are Slovaks.

5. CONCLUSIONS

The Czech EU accession in 2004 was followed by inevitable legislative steps that had a direct impact on the development of the Czech labour market. Czech representatives passed a new Employment Act in which a new methodology of measuring unemployment was introduced. The Employment Act also secured free access to the Czech labour market for all EU citizens. In the following years there was a significant growth in the number of workers from the EU. However, above all this research stresses the role of the economic boom, which enabled foreign workers to find an appropriate job more easily. This finding is in accordance with other similar studies (see e.g., Drbohlav, 2003; Pavel and Turková, 2006).

If the discussion is put into the context of the main labour market indicators, EU accession did not cause a significant change in the performance of the Czech labour market. Until the third quarter of 2006 the unemployment rate remained relatively high. Then overheating of the economy resulted in the creation of many new jobs, which subsequently led to lower unemployment. Foreign workers appeared to take advantage of the low mobility and adaptability of the domestic labour force in filling the vacant jobs. To conclude, the initial incentive to participate in the Czech labour market was that it was healthy and offered job vacancies, rather than the change in legislation and the possibility of accessing the domestic labour market without permission. Nevertheless, the fact that the Czech Republic joined the EU made it much easier for citizens of EU Member States.

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