

# Labour Costs in the European Union

Tomáš Kozelský

EU Office of Česká spořitelna

**EU OFFICE**

Česká spořitelna, a.s.

Olbrachtova 1929/62

140 00 Praha 4

tel.: +420 956 718 012

fax: +420 224 641 301

[EU\\_office@csas.cz](mailto:EU_office@csas.cz)

<http://www.csas.cz/eu>

Jan Jedlička

+420 956 718 014

[jjedlicka@csas.cz](mailto:jjedlicka@csas.cz)

Iva Dlouhá

+420 956 718 015

[idlouha@csas.cz](mailto:idlouha@csas.cz)

Helena Chamerová

+420 956 718 012

[hchamerova@csas.cz](mailto:hchamerova@csas.cz)

Tomáš Kozelský

+420 956 718 013

[tkozelsky@csas.cz](mailto:tkozelsky@csas.cz)

## Introduction

Labour costs are monitored both at the national and international levels, since their level fundamentally influences market and revenue positions as well as decisions of business entities, business activities, the business climate and possibilities for substitution of capital and labour. Labour costs in individual states are a basis for production and total reproduction costs. Their amount and structure are deciding factors regarding positions in the competitive environment on local and world markets and can significantly influence investors' activities. The structure of labour costs, meaning the ratio between wages and social and HR cost items, reflects the basic mechanisms of labour distribution and redistribution processes and affects relationships between employers, employees and the state.

Labour costs represent a link between the economic and social spheres. Their level and dynamics are mutually related to the levels and dynamics of work productivity and the relative level of production costs and consumer prices. Labour costs are also a crucial factor in competition. They include wages and salaries, earnings of the largest social group - employees. Their architecture together with other sources ensures the creation of financial resources for social protection funds, from which retirement, disability and hospital benefits are paid and which cover the costs of healthcare and/or employees' other social needs. They also include HR costs for acquiring and maintaining a labour force, improving their qualifications, etc.

## Definition and structure of complete labour costs

Labour costs (monthly) are defined by the Czech Statistical office as: "an employer's costs for employees. They are the sum of direct costs (wages and compensation), social benefits, social costs/expenditures, HR costs/expenditures and taxes. Received subsidies from labour offices for publicly beneficial work or workplaces with a community purpose are deducted. This is a value on average for 1 employee per month."

The basic source of data about the structure and movement of labour costs in the Czech Republic is the regular yearly examination carried out by the Czech Statistical Office since 1994. The office publishes the results in December of the subsequent year the Complete Labour Costs series of publications.

The definition of complete labour costs and their structure, examined by the Czech Statistical Office, is derived from the Eurostat method, which is defined as: "the employer's expenditures related to employing workers. These include compensation for employees (including wages, pay in monetary form and in kind, employees' contributions to social security); costs for professional education and other expenditures (such as costs for hiring workers, expenses for work clothing and taxes from wages considered labour costs minus any received aid). These labour cost items and their parts are defined in Regulation No. 1737/2005 of 21 October 2005. These data relate to three main indicators:

- average monthly labour costs, defined as total labour costs for the month earned by a corresponding number of employees, expressed as the recalculated number of employees;

### Labour Cost structure in % (2010)

	Direct cost	Indirect cost
France	66.6	33.4
Sweden	67.1	32.9
Belgium	72.0	28.0
Italy **	72.2	27.8
Lithuania	72.2	27.8
<b>ČR</b>	<b>73.1</b>	<b>26.9</b>
Estonia **	73.4	26.6
Spain	73.7	26.3
Austria	73.8	26.2
Hungary	74.4	25.6
Slovakia	74.5	25.5
Romania	76.8	23.2
Netherlands **	76.9	23.1
Poland **	77.3	22.7
Germany	77.7	22.3
Finland	77.9	22.1
Latvia	79.1	20.9
Greece *	79.4	20.6
Portugal	80.9	19.1
Bulgaria	83.9	16.1
United Kingdom	84.3	15.7
Slovenia	85.7	14.3
Cyprus **	85.9	14.1
Luxembourg	86.0	14.0
Denmark	86.5	13.5
Ireland	86.6	13.4
Malta *	91.1	8.9

Source: Eurostat; \* - data for 2009, \*\* - data for 2008

- the average hourly labour costs, defined as the complete labour costs earned by a corresponding number of hours worked;
- structures of labour costs (wages and salaries; employers' contributions to social security; other labour costs), expressed as a percentage of total labour costs."

The Czech Statistical Office determines total labour costs and their detailed structure each year. Eurostat examines the volume and detailed structure of labour costs in EU member states in quarterly intervals in the Labour Cost Survey (LCS). The latest available data are for 2008 and relate to organizations in the industry and service sectors. The data are collected by national statistical services based on a stratified random selection of businesses and local units with more than 10 employees. Data can be compared from the point of view of methodology following conversion to EUR and/or to PPS. Updating of data among individual 4-year surveys occurs with the help of the LCI (Labour Cost Index) method, which is continuous indexing in the structure of direct and peripheral labour costs based on output from the LCS. For indexing, data regarding growth of average earnings for calculated persons are used, which are reflected in the growth of direct costs and mandatory social contributions fixed to wage amounts.

The structure of labour costs influences business activities, motivates employees and affects relationships between the state, employers, employees and other social groups of the population. Direct costs, meaning wages and salaries, represent a decisive labour cost item. According to Czech legal standards, wages and salaries are remuneration for work. Unlike in most European countries, the social situations of employees and their households are not part of labour costs and are handled by the state budget. Labour costs are divided into direct costs, meaning for wages and salaries (tariff wage, remuneration and bonuses, extra payments, etc.), and wage substitutions paid by the employer. In the Czech Republic, direct costs make up more than 70% of total labour costs.

Another item is represented by indirect costs, which include social benefits (company products with a discount, contributions to housing, meals, savings, etc.), social costs/expenditures (payments of legally required insurance premiums, severance pay, other social benefits, etc.), HR costs/expenditures (costs for hiring employees, for training apprentices, costs for training, etc.), taxes and subsidies (taxes and sanctions bound to employing people, subsidies for the labour force). Specific costs per person are basically the costs for which the employer purchases labour on the market. Their level and development oscillates around the balance between supply and demand on the labour market. Unlike the prices of goods and services, their creation is influenced by economic and political conditions and within them the strengths and positions of social partners during negotiation of wage and labour conditions. As a result of minimum yearly arrangements (collective agreements), the movement of labour costs reports approximately yearly rigidity behind the development of economic performance in macro and micro proportions.

Direct labour costs in the Czech Republic are among the lowest in the EU. The difference between the highest and lowest direct labour costs in the EU is approximately 25%. The change in the relationship between direct and indirect costs in EU states is not high in time (the trend of moderate growth of the share of direct costs in labour costs) and has ranged in recent years at around 1%. (An exception is Bulgaria, where direct costs have risen since 2005 by about 9%.)

## Development of labour cost in the EU since 2005

Labour costs have undergone changes since 2005 and up to today, in which the economic crisis has played a major role. The most recent data available are for 2010. Eurostat publishes preliminary data with an international focus and comparable with a two-year delay and in subsequent years further clarifies them. The evaluated period of 2005 to 2010 is not qualitatively monolithic. Between 2005 and 2007, the economy stood at a conjuncture. In the second half of 2008, it was not only the global economic crisis that began in the United States in early 2007 that had an effect on the Czech economy.

Between 2005 and 2007, monthly labour costs in euros in the Czech Republic ranged in the bottom third. Still in 2005, Hungary was above the Czech Republic, but through greater dynamics of growth in labour costs the Czech Republic "caught up" with Hungary. "The most expensive labour force in the EU is in Luxembourg (4,517 euros in 2005). Also above the 4,000 euro limit are labour costs in Denmark and Sweden. Contrastingly the lowest labour costs were in Bulgaria, where they reached approximately 5% of the labour costs in Luxembourg.

During the second half of 2008, the crisis signs of the worldwide economic crisis became visible in the Czech economy and culminated in 2009. Moreover, their impact on labour was intensified by the rigidity of the movement of labour costs via profiled wages.

The process of laying off employees has lasted several weeks and has been associated with financial costs (severance pay, administrative costs, etc.).

During the first wave of the examination of labour costs in 2008, the cost of helping labour was reduced, or helping work positions for unqualified employees with low wages were eliminated, and only afterwards did companies resort to laying off higher paid qualified employees. The end effect was that even despite the decrease in the employment level in the Czech Republic, average wages and average nominal total labour costs grew in 2009 in the nominal (for the entire Czech Republic by 3.3%, for the business sphere by 3.0% and for the non-business sphere by 4.6%) and in real (for the entire Czech Republic by 2.3%, for the business sphere by 2.0% and for the non-business sphere by 3.6%) expressed figures.

During the crisis, Denmark wound up with the highest monthly labour costs, exceeding Luxembourg. The situation on the opposite end remained the same, and Bulgaria, Romania and the Baltic states maintained their position as the states with the lowest monthly labour costs in euros.

### Monthly Labour Cost (EUR, 2005-2007)

	2005	2006	2007
Bulgaria	235	249	287
Romania	365	434	549
Latvia	449	552	719
Lithuania	545	637	760
Slovakia	620	711	842
Estonia	712	827	995
Poland	808	878	983
<b>CR</b>	<b>949</b>	<b>1 031</b>	<b>1 126</b>
Hungary	969	995	1 104
Malta	1 298	1 341	1 371
Portugal	1 669	1 735	1 788
Slovenia	1 699	1 773	1 871
Spain	2 125	2 197	2 284
Cyprus	2 190	2 277	2 368
United Kingdom	3 368	3 499	3 585
Finland	3 531	3 598	3 687
Belgium	3 706	3 814	3 966
Austria	3 717	3 782	3 847
Germany	3 768	3 819	3 853
Denmark	4 060	4 222	4 381
Sweden	4 134	4 242	4 338
Luxembourg	4 517	4 658	4 817

Source: Eurostat; NACE C - O (industry and services, without agriculture and fishery); data are not available for Italy, Ireland, Greece, France, Netherlands

The crisis years of 2008 and 2009 brought with them substantial disruption of the exchange rates of

the national currencies of EU states outside of the Eurozone. Therefore, any evaluation of labour costs within the EU needs to take into consideration short-term currency exchange rate fluctuations.

During the crisis period of 2008-2009, the national currencies of EU states (outside of the ERM II regime) weakened against the euro. (In Bulgaria, the exchange rate of the national currency (the Bulgarian lev) is firmly fixed to the euro and converted by a coefficient of 1.956.

Another three EU member states (Denmark, Lithuania, and Latvia) tied to the European Exchange Rate Mechanism II (ERM II) at present have their currencies tied to the euro, and they can hover in a range of 15% (even though they do not use this and have set different fluctuation ranges) from the set medium exchange rate to the euro. Denmark has set a fluctuation range of  $\pm 2.25\%$ . Lithuania voluntarily maintains a fixed exchange rate of its currency to the euro, and in Latvia the fluctuation range is maintained at a level of  $\pm 1\%$ .) Later reactions, but not until 2009, have been observable in the Czech Republic and Poland.

The development on the financial markets has in the short term helped the "new states" of the EU to maintain and strengthen the advantages of inexpensive labour at a time of reduced work productivity.

States whose currencies weakened in value against the euro in 2009 reported the sharpest decline in labour costs compared to the Eurozone states.

However, the situation changed in 2010, and the monetary development returned to the trend of more realistic exchange rates of currencies in post-Communist states.

The high tempo of growth in Czech labour costs on the euro market was caused by the rapid appreciation of the Czech crown against the euro. After the Czech Republic's accession to the EU, which occurred prior to the crisis, year-to-year growth reached approximately 2x greater growth of labour costs following conversion to euros than in Czech crowns, but the same proportions also applied for work productivity. The weakening of national currencies in European countries outside of the Eurozone during the crisis year of 2009, including the Czech crown, enabled businesses to compete on the euro market with lower labour costs. The return of the crown to appreciation against the euro in 2010 eliminated that advantage.

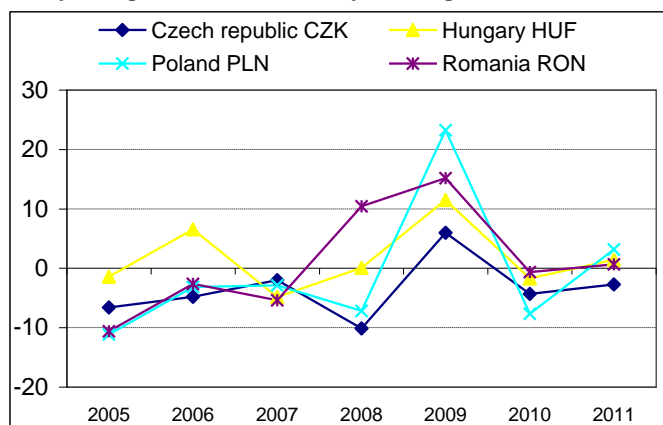
If we examine monthly labour costs in individual EU states more closely, we can also find differences even between individual sectors. Since Eurostat does not monitor data for "Agriculture, forestry and fisheries", the amount of monthly costs in sectors can only be compared for "Industry and services". There have traditionally long been lower labour costs in the sector of "Accommodation, dining and hospitality", with costs reaching approximately 50% to 75% of the labour costs for "Industry and services".

Monthly Labour Cost (EUR, 2008-2010)

	2008	2009	2010
Bulgaria	375	416	441
Romania	n/a	618	633
Latvia	885	861	816
Lithuania	848	847	818
Hungary	1 164	1 040	1 028
Poland	1 116	965	1 083
Slovakia	n/a	1 096	1 135
<b>CR</b>	<b>1 323</b>	<b>1 297</b>	<b>1 387</b>
Malta	1 452	1 429	n/a
Portugal	n/a	1 790	1 832
Slovenia	1 962	2 000	2 087
Greece	n/a	2 516	n/a
United Kingdom	n/a	2 870	2 917
Spain	2 808	2 932	2 974
Finland	3 716	3 869	3 934
Germany	3 838	3 938	3 954
Austria	3 847	3 951	4 008
Ireland	n/a	4 097	4 021
France	n/a	4 149	4 256
Belgium	4 195	4 305	4 426
Netherlands	4 203	n/a	n/a
Sweden	4 428	4 136	4 688
Luxembourg	4 563	4 650	4 763
Denmark	4 564	4 637	4 908

Source: Eurostat; Nace Rev. 2 B-S\_X\_O; data are not available for Itály, Estonia, Cyprus

Yearly change of national currency exchange rates



Source: Eurostat



The costs are nominally the highest in Denmark (3,683 euros) and the lowest in Bulgaria (265 euros) for 2010. Under the average for "Industry and services" there are still monthly labour costs in "Construction". The most expensive labour force is in the sector of "Financial services and insurance (only "IT and communication" is more expensive in certain states). Labour costs there reached between 844 euros in Bulgaria and 8,163 euros in Sweden, which represents triple to quadruple the costs in the sector "Accommodation, dining and hospitality".

## Conclusion

Companies doing business in the Czech Republic still enjoy the opportunity as a result of lower earnings to take advantage of lower total labour costs compared to other developed EU member states. The difference in labour costs between the Czech Republic and other developed EU states is so sharp that competitive advantages from their low level in the Czech Republic will continue to exist for some time. The process of shifting price (currently over 70%) and earnings ceilings to the standard proportions of the single European market and appreciation of the Czech crown against the euro, which is reflected by quicker growth in labour costs, will be long-term, and business entities have enough room for elimination of the unfavourable impacts of increased work productivity.

After joining the EU, the Czech Republic has managed to maintain the concept of a cheaper labour force compared to other EU states. On the other hand, the income gap between the Czech Republic and other post-Communist countries has been increasing. This development represents for Czech companies and foreign investors a problem amounting to a shift away from using cheap but easy labour and/or moving of jobs to cheaper countries and its replacement with more expensive labour performed by qualified workers, i.e. a shift to sophisticated work activities with higher added value. In view of the so far lower Czech wage appreciation of labour in Europe, this is not an instant or quick process. Businesses in the Czech Republic will still have a cheap labour force for a long time to come.

The significantly lower labour cost ceiling compared to the most developed EU states will enable Czech exporters to make use of price competition or achieve higher profit levels. Low labour costs continue to motivate the influx of foreign capital. However, the concept of low labour costs in the Czech Republic, meaning maintaining of low labour costs, does not stimulate substitution of work with capital and could lead to gradual de-qualification of the labour force, and as a result we could become "Europe's workshop".

### Monthly labour cost in selected sectors (EUR, 2010)

	C	F	H	I	J	K
Belgium	5 077	3 711	4 433	n/a	n/a	7 304
Bulgaria	359	381	509	265	895	844
<b>CR</b>	<b>1 303</b>	<b>1 350</b>	<b>1 346</b>	<b>835</b>	<b>2 616</b>	<b>2 605</b>
Denmark	5 215	4 675	4 996	3 683	6 430	7 250
Germany	4 427	3 341	3 413	2 047	5 459	5 849
Ireland	4 326	4 158	4 091	2 161	5 425	5 984
Spain	3 093	2 880	3 061	2 053	3 920	5 217
France	4 485	3 911	4 027	3 049	6 178	6 772
Latvia	741	773	942	538	1 521	1 730
Lithuania	794	775	940	472	1 302	1 562
Luxemb.	4 296	3 246	4 396	2 520	6 014	8 068
Hungary	1 035	868	1 075	625	1 953	2 240
Austria	4 369	3 924	4 087	2 172	5 939	6 328
Poland	962	1 023	1 057	699	2 001	1 735
Portugal	1 487	1 487	2 312	1 276	3 152	4 309
Romania	538	516	699	359	1 193	1 443
Slovenia	1 872	1 715	2 076	1 563	3 193	3 130
Slovakia	1 107	1 098	1 048	662	2 125	2 087
Finland	4 477	4 356	3 647	3 061	5 246	5 416
Sweden	5 138	4 549	4 405	3 207	6 479	8 163
UK	3 341	3 276	3 280	1 366	4 247	5 177

Source: Eurostat; C – Manufacturing, F – Construction, H – Transport and storage, I – Accommodation, food services and activities, J – Informations and communication, K – Finance and insurance; data is not available for Estonia, Greece, Italy, Cyprus, Malta and Netherlands