

# LOW EMPLOYMENT INTENSITY OF GROWTH AND SPECIFICS OF SLOVAK LABOUR MARKET

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## Abstract

This paper aims to explain low employment elasticity of growth in the Slovak Republic as a factor behind some atypical trends that occurred in the Slovak labour market in the pre-crisis period. Lower employment intensity of growth is common in some developing economies overcoming the technology and productivity gap – the idea behind the weak relation between output growth and employment increases in Slovakia is the same, however, the “employment growth threshold” in Slovakia has been remarkably high even when compared to other economies in the region. As a result, the shift towards more flexible working arrangements as well as unusually low wage share (in total income) persisted in the economy before the crisis. The very recent development suggests that the crisis could have created the opportunity to change the nature of economic growth and move towards more labour intensive sectors.

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**Keywords:** Employment elasticity, economic growth, wage share

## Introduction

Since the second half of the 90s, economic development in Slovakia came along with relatively high values of “employment growth threshold” – relatively high rates of economic growth were needed to initiate marginal increases in employment. Weak relation between economic growth and growth in employment may be typical for economies that are overcoming the productivity gap, however, in Slovakia, the relation between growth and employment has been unusual, also when compared to other similar economies in the region. The nature of economic growth in Slovakia and its atypically low labour intensity has been reflected in various labour market aspects. Divergence from the European trends in the rate between profit and wage increases in favour of profits during the period of favourable macroeconomic development in Slovakia (especially when compared to EU 15) was remarkable. Low rates of employment (again European comparison)

leading to unusual structure of employment (substitution of contract-type employment by self-employment in order to compensate weak relation between economic growth and employment growth) and other specifics led to a decline of wage share in income structure. Structural problems in the Slovak labour market, in a background of low labour intensity of growth, mean continual struggle for higher employment rates and emerging of more and new policy strategies (active labour market policy programs) aimed at combating the persistent problem of remarkably high long-term unemployment. Labour market development in Slovakia is profoundly marked by the structural unemployment and the post-crisis situation at the Slovak labour market is of concern to many policy makers (unemployment rose notably due to recession in 2009), however, there are some signs that the crisis invoked decent structural changes in the economy towards more labour-intensive sectors with the obvious positive impact on closer relation between future economic growth and job creation (decreasing “employment growth threshold”).

### **Low labour intensity of growth**

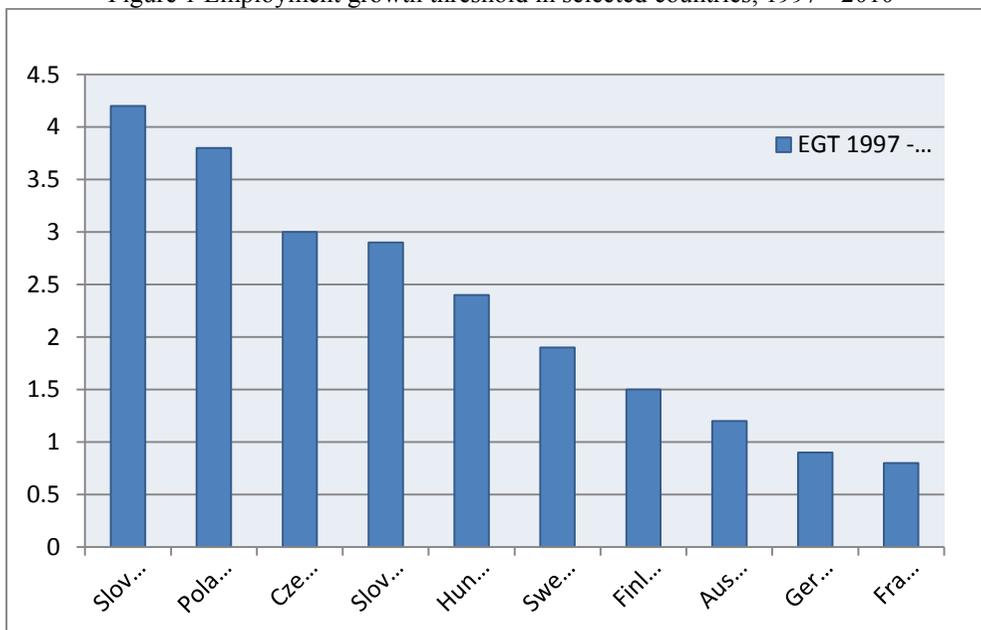
Although the Slovak economy could have been assessed as a quite positive example in terms of the results in its real convergence (during the transformation period), successful convergence to the EU trends was missing something. The convergence in the social sphere lagged behind other macroeconomic parameters – the development in employment and incomes did not succeed to follow trends in other countries. Let’s presume that the reasons consist in the quality and structure of the economic growth, which did not contribute sufficiently to expansion of employment or increase of the wage level. We can confront this hypothesis by exploring employment intensity of growth, in other words, by assessing elasticity of employment with respect to output (how employment varies with economic output).

Previous studies on this topic mostly used empirical data to estimate employment elasticity, some of them were focused on international comparison (Kapsos, 2005; Padalino and Vivarelli, 1997), some tried to identify structural determinants of country’s employment elasticity (Choi, 2007), some analyzed the effect of structural and macroeconomic policies on the employment intensity of growth (Crivelli, Furceri, and Toujas-Bernaté, 2012). Even though our methodology is different, the results are comparable. We use “employment growth threshold” calculation (not the elasticity coefficients of change in employment; and/or wage), which is defined as a critical level of economic growth rate (real GDP, in %), when employment is no more constant and start to increase.

$$EGT = 100 \times \frac{\delta(VA t) + \delta(VA t - 1)}{2\delta(EMP t)} - 100$$

Presented formula defines “employment growth threshold” (EGT) and reflects (year-on-year) changes in employment in time t related to changes in value added (real gross value added extracted from national accounts) in time t and t-1 (as employment tend to react to output changes with a time delay). The results of comparison with other economies in the region as well as leading economies are shown in Figure 1.

Figure 1 Employment growth threshold in selected countries, 1997 - 2010



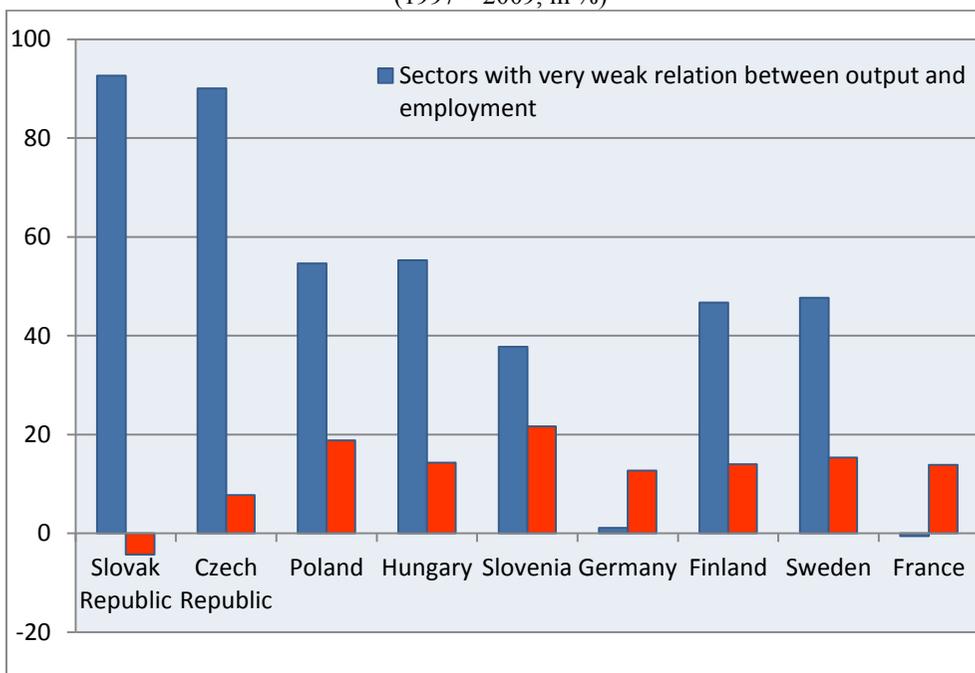
Source: Own calculations based on Eurostat data.

In CEE countries the values for EGT are markedly higher than in selected developed countries – it is an outcome of strong productivity increases. This phenomenon is typical for economies that find themselves in the stage of productivity gap overcoming, when economy with low initial level of capital capacities is able to grow at solid pace without increases in the number of employed (Solow-Swan growth model). In case of Slovakia, the existence of productivity gap can be confirmed by comparing the data for hourly labour productivity (labour productivity in the Slovak economy grew cumulatively by 21 % between 2005 and 2011; Morvay, 2012). As Kapsos (2005) says, in CEE countries we could have observed a rapid decline in labour intensity values after 1999 (in these countries the productivity grew at the expense of employment growth after collapse of the Soviet Union).

As it can be seen in the Figure 1, EGT in the Slovak economy is especially high, even when compared to other economies in the region. In

average (during 1997 – 2010 period), the Slovak economy needed to grow at least at 4.2 % rate to achieve increases in employment. When decomposed by sectors of the economy (the SR), we have found out that extremely high values were recorded in industrial production sectors (10 % in average). We compared the EGT values for individual sectors as well as contribution of sectors to value added increases and the results showed that the industrial sectors with above average values of EGT contributed to the economic growth (value added) the most. The comparison with selected countries is shown in Figure 2.

Figure 2 Share of selected sector groups in cumulative increase of real GDP (1997 – 2009, in %)



Note: Sectors with weak relation between output and employment: those with EGT in interval 2 to 3.5.

Sectors with very weak relation between output and employment: those with EGT above 3.5.

Source: Own calculations based on Eurostat data.

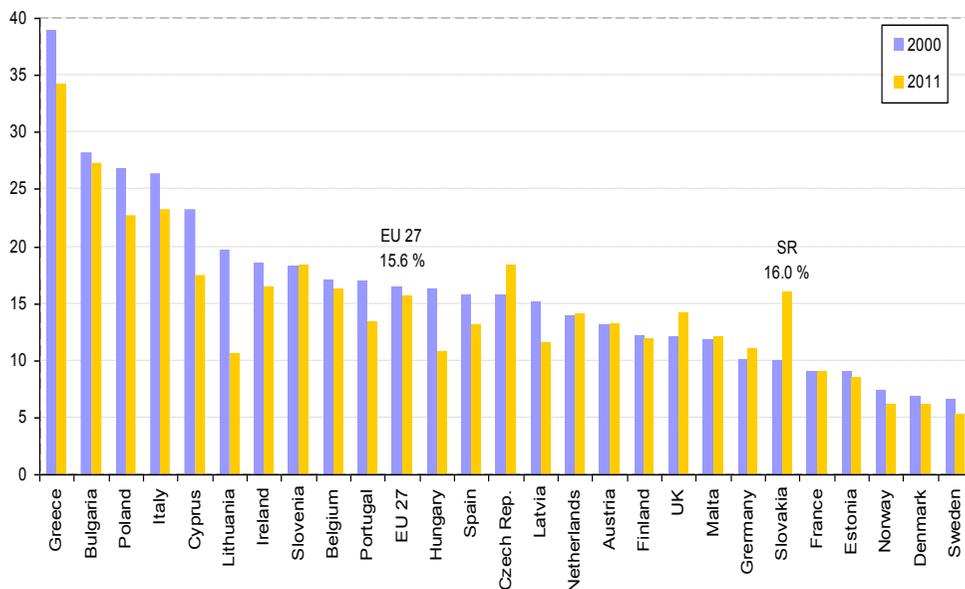
The growth of the Slovak economy in examined period has been pulled predominantly by the sectors with poor arrangement between economy output and employment rather than labour intensive sectors. In the past period, the structural change in economy towards higher capital intensity brought steep growth in productivity (and high economic growth rates), but was not in accordance with the labour market needs. If the next stage of development is related to expansion of “human development services” sectors (education, healthcare, social services, culture, etc.), it

would help the labour market to adjust better. As a result, we have been witness to increasingly more complex segmentation of the labour market, more diverse composition of work arrangements and more diverse structure of incomes. Increasing diversification and segmentation of the labour market represent a serious challenge for policy makers (when designing labour legislation or tax regulation at the background of various groups with diverse interests).

### Consequences of weak relation between output and employment

The nature of economic growth in Slovakia with its extremely low labour intensity contributed not only to (naturally) very low rate of total employment (which lagged behind the EU average almost at a constant extent), but also to an atypical structure of income and atypical relation between standard employment and self-employment. At the background of above mentioned, the position of disadvantaged groups at the labour market is getting worse.

Figure 3 Change in share of self-employment in total employment (2000 and 2011, in %)



Source: Based on Eurostat data.

Over one decade, the share of self-employment in the total employment has doubled in Slovakia, even though this share in the EU average stayed almost constant during the same period. The expansion of self-employment was observed also in the Czech Republic and the Great Britain, but not in such extent. The increase of self-employment share at the

expense of regular employment contracts in Slovakia could be assessed as the substitution of contract work by self-employment. This substitution was typical for recession period (and early post-crisis period) from the obvious reasons, but in case of Slovakia, this trend wasn't invoked by the crisis, it has persisted from the past years (before crisis), the crisis only intensified this substitution. On the one hand, increasing share of self-employment was a consequence of overcoming the initially low level of this kind of employment in the past in Slovakia; on the other hand, it was a result of compensation for low labour elasticity.

The other remarkable trend related to such development was unusual combination of economic level development and wage share (the share of compensation of employees in gross value added in current prices). Better economic performance normally comes with higher wage share, in Slovakia, it came with its decline. Lower wage share has obvious implications for households (consumption, domestic demand etc.) and related atypical position of mixed income (the share of gross mixed income in gross value added was increasing b. o. thanks to expansion of self-employment) has implications for the public finance. Technology and structural changes during the period of overcoming the economy's undercapitalization play in favour of higher incomes from entrepreneurial activities at the expense of employees incomes. When looking at the other CEE countries, in Slovakia the wage share was the lowest in "growth" period (2005-2007), but the increase in employees' compensations in the "stagnation" period (2009-2012) was the highest. It might be explained by the fact that the development during stagnation period was mitigated thanks to initially very low wage share during the favourable economic era.

Difficult situation at the Slovak labour market makes disadvantaged groups of persons unemployable. Persons who have never had a job represent in Slovakia 20 to 25 % of total unemployment in a long run, unemployment rate of young people (younger than 25 years) reaches above 30 %, unemployment rate of low-qualified persons (ISCED 0-2) oscillates between 40 – 50 %, which makes Slovakia European leader in this point in a long-run (between 2000 and 2009 average difference between SR and second-ranked country in low-qualified unemployment was incredible 18.3 p. p., difference between the SR and the EU average was 33.6 p. p.). Long-term unemployment counts for two thirds of all unemployment, of which persons unemployed for more than two years represent almost 50 % of total unemployment (Slovakia's leadership in the EU in this context lasted ten years: 2002 – 2012).

## Conclusion

Labour market was the last segment of the Slovak economy where the recession consequences preserved at longest, long after the economic growth has been restored. In the last quarter of 2010, after two years of decline, a slight increase in employment occurred. In the mid-2013, the employment declined again, reflecting worsening of the overall macroeconomic situation in the precedent months (“the second wave” of the crisis). The final stagnation of employment in 2013 was replaced by unexpected size of employment recovery in 2014. The relation between economic growth and employment growth seen for long period before the crisis has been disrupted – the employment growth threshold of app. 3 - 4 % (of output growth) was no more needed to invoke increase in employment.

Returning back to the growth trajectory with the same character of labour intensity could put the break on the potential employment growth – presuming that the economic growth rates will be lower than in the pre-crisis period, with the similar employment elasticity, the growth in employment will be threatened. The policy makers should be aware of supporting employment in past structure; in fact, they cannot increase employment elasticity or wage share directly. However, economic policy can partially influence structural characteristics of growth: by promoting desired sectors of economy (in this case, labour intensive sectors). Some studies suggest that structural policies aimed at labour (and product) market flexibility and reducing government size may have a positive effect on employment elasticity (Crivelli, Furceri, and Toujas-Bernaté; 2012).

In Slovakia, continuous existence of „dual economy“ (highly productive sectors ruled by major foreign companies and slower sectors attended mostly by domestic firms) deepens the problem – high productivity sector observe and adopt behaviour of low productivity sectors (high productivity FDI's exhibit 2.2 times higher productivity, but only 20 % higher wage level). However, weak relation between output and employment growth and related low wage share might have been a temporary effect of mentioned catching-up process; other countries in similar economic development stage have similar experience. The new circumstances of the post-crisis period may create an opportunity to begin a process of structural change – it seems that recent economic growth (since the end of 2013) obtained the new characteristics. While speed-up of GDP growth was in accordance with the expectations, some attendant factors have changed. The compensation of employees raised their share in value added in unexpected extent. The structure of incomes in 2013 – 2014 has changed, and the trend has been confirmed in the first quarter of 2015 as well. As the new tendencies have been occurring for 9 quarters so far, they cannot be assessed as a short-term swing. The Ministry of Finance published a study (Habrman,

2015), according which the reaction of employment in the post-crisis era is not only longer (employers use changes in amount of working hours rather than in number of workers to adjust to the short-term instabilities), but also twice that strong. It means that the growth rate of 1.5 % (instead of previous 3 – 4 %) will be sufficient to invoke increases in employment. It is related to changes in demand, as well as shifts in the pillars of recent growth (towards higher share of the service sectors).

### **Acknowledgement::**

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