

ORIGINAL PAPER

Citation: Pernica, M. (2017). Evaluation of the adequacy of government minimum wage valorization policy in the Czech Republic in 2017 in the European context. *Oeconomia Copernicana*, 8(1), 21–36. doi: 10.24136/oc.v8i1.2

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Received: 9 November 2016; Revised: 14 January 2017; Accepted: 28 January 2017

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Evaluation of the adequacy of government minimum wage valorization policy in the Czech Republic in 2017 in the European context

JEL Classification: *E24; J3*

Keywords: *Kaitz index; labour productivity; minimum wage; real GDP per capita; unemployment*

Abstract

Research background: The government of the Czech Republic has agreed to an increase in the minimum monthly wage as of the beginning of 2017 to 11,000 CZK, which represents a year-over-year increase of over 11 %. The government is thus fulfilling its objective set out in February 2014 and stipulated in the Government Statement of Purpose, i.e. to approximate the minimum wage to 40 % of average wages.

Purpose of the article: The purpose of the article is to assess the adequacy of the Government Minimum Wage Valorization Policy, in particular from two points of view. Firstly, in view of selected macro-economic indicators in the Czech Republic — the development of consumer prices, average gross wages, economic growth and workforce productivity. Secondly, in comparison with other EU member states which have introduced the institution of a minimum wage.

Methods: In order to assess the adequacy of government policy to improve the social protection of the rights of the working population, a background research was conducted into the literature of important studies on the effects of minimum wages on unemployment, while the development of average gross wages in the CR, the minimum monthly wages in the CR and the Kaitz index were also analyzed. Furthermore, an evaluation of selected macroeconomic indicators in the Czech Republic was performed by means of time lines and the percentage representation of employees in the individual gross wage bands according to sex

and type of economic activity. Last, but not least, a comparison was made of minimum wages, real gross domestic product per capita and workforce productivity in Euros and in purchasing power standards between the Czech Republic and countries which have enacted the institution of minimum wages.

Findings & Value added: The minimum wage in the Czech Republic is the fifth lowest in the EU. In the long term, it is earned by approximately 3% of employees, which is less than the rate common in other EU countries. Currently, the amount of the minimum wage is below the threshold of income poverty. In comparison with the GDP per capita in PPS and real labour productivity per person employed in other EU countries, the position of the Czech Republic is significantly better, although other EU countries offer higher minimum wages. The decision of the current government to significantly increase the minimum wage as of 2017 is correct.

Introduction

The minimum wage is one of the oldest instruments for protecting the rights of the working population. It was first introduced at the end of the nineteenth century in New Zealand. During the twentieth century, it spread to every continent. So far, the last EU member state to enact a minimum wage was Germany (as of 1. 1. 2015). The German law on the minimum wage stipulates an obligation on all German and foreign employers to pay their employees a minimum wage in the statutory sum per every hour of work performed in the territory of Germany. The German minimum wage applies to all fields of business, with the exception of minors and long-term unemployed persons. (Federal Ministry of Justice and Consumer Protection, 2016). Of all the EU member states, there are only six left which do not have minimum wages enacted by law. These are Denmark, Italy, Cyprus, Austria, Finland and Sweden (Eurostat, 2016).

The purpose of the minimum wage is to protect employees from poverty, to secure the availability of the basic necessities of life, and to ensure basic equal conditions for wages competition. The minimum wage establishes the prerequisites for the income motivation of citizens: it motivates them to work and not just collect social welfare benefits (Uhrová & Skalka, 2016, pp. 183). For employers, the minimum wage represents the lowest level of costs for employees' wages (Kaufman, 2010, pp. 427–453). The Czech Republic has regulated its minimum wage by law. Act no. 262/2006, the Labour Code, stipulates the minimum wage in Section 111 and the guaranteed wage in Section 112. The minimum wage represents the lowest amount of remuneration for work in the basic labour-law relationship. It is independent of the type or work performed. The guaranteed wage is defined generically and its sum depends on how demanding and complex the work performed is (Czech Republic, 2006). The Czech legislation does not

stipulate any conditions based on which the minimum wage should be valorized. The opinions of representatives of employers and the unions on the valorization of minimum wages usually differ considerably. As such, minimum wages are always valorized ad hoc as a political decision of the specific government. Between the years 2008–2012 the sum of the minimum wage did not increase, and remained at the 8,000 CZK level. Between the years 2013 and 2017 there was a significant growth in the minimum wage to the level of 11,000 CZK (Eurofound, 2016).

Several questions appear in this context. Does the institution of the minimum wage lack meaning? Is the minimum wage set at 11,000 CZK and enacted by the government as of 1.1.2017 too high? Does this sum correspond to the realities of the Czech economy? How high is the minimum wage compared to other EU countries that have enacted this institution? What economic results do these countries achieve with respect to GDP and workforce productivity? The aim of this thesis is to assess the adequacy of the government's minimum wage valorization policy from several points of view. First, with regard to selected macro-economic indicators in the CR — the development of consumer prices, average gross wages, economic growth and workforce productivity. Second, in comparison with other EU member states which have enacted the institution of minimum wages.

Research methodology

In the course of researching and writing this article, the political economy approach has been used. The importance of political economy is its ability to cover important social, political and economic phenomena and their mutual relationships. These relationships influence each other. Political decisions influence economic results, and the allocation of economic resources allows for the acquisition of political power. In the Czech Republic, the amount of the basic minimum wage tariff and other minimum wage tariffs scaled according to the degree of influences limiting the employability of employees, as well as the conditions for the provision of the minimum wage, are stipulated by government directive.

The legislator has empowered the Government in the Labour Code to issue government directives, and it is up to the government how they assess the situation and whether they consider it necessary to adjust the amount of the minimum wage or not. Valorization of the minimum wage is a purely political decision. The decision making process on the amount of the minimum wage reflects both the coalition opinion of the parties on the institution of minimum wages, as well as the economic policy promoted by the

government. One of the most frequent arguments of political parties that have a negative approach towards the institution of minimum wages is that a minimum wage leads to an increased unemployment rate. Political parties that support the institution of minimum wages argue that it yields the necessary protection of the social rights of the working population. In their opinion, a minimum wage limits the undercutting of wages on the part of employers, it stimulates people to work, and prevents payment of illicit wages. However, the arguments of political parties are not substantiated by e.g. data proving the negative impact of minimum wage valorization on the unemployment rate in the Czech Republic. In order to assess the adequacy of the policy of the contemporary government, a research was conducted into important studies on the effects of minimum wages on unemployment and the development of average gross wages in the CR, minimum monthly wages in the CR, and the Kaitz index were also analyzed. Furthermore, an evaluation of the selected macroeconomic indicators in the Czech Republic was performed by the means of time lines and the percentage representation of employees in the individual gross wage bands according to sex and type of economic activity. Last, but not least, a comparison was made of minimum wages, real gross domestic product per capita and workforce productivity in Euros and in purchasing power standards.

Study of the impact of minimum wages on unemployment

A number of studies have been conducted in the past that draw out the positive and negative impacts of the institution of minimum wages. A vast majority of these studies have been aimed at assessing the effects of minimum wage valorization and unemployment.

A positive effects of minimum wage valorization on employment was endorsed by the study “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania”, conducted by American economists David Card and Alana Krueger, who in 1994 published the results of their research on the impact of minimum wage valorization on employment. Their study was conducted in the USA in the form of questions posed over the phone to workers in restaurants and fast food outlets. According to Card and Krueger, minimum wage valorization in New Jersey had no negative impact on employment; on the contrary, the employment rate increased (Card & Krueger, 1994, pp. 772–793).

The research of Card and Krueger was subsequently criticized by David Neumark and William Wascher. Neumark and Wascher pointed out, in particular, the limited credibility of Card and Krueger’s results acquired by

telephone questioning. Neumark and Wascher conducted different research on a similar sample of fast food restaurants in New Jersey and Pennsylvania. In order to assess the impact of minimum wage valorization on employment, they used real payroll data. Based on the collected data, they published a study called “Minimum wages and employment: A case study of the fast-food industry in New Jersey and Pennsylvania: Comment.” The conclusion of this study implied that valorization of minimum wages in New Jersey in 1992 had a negative impact on employment (Neumark & Wascher, 2000, pp. 1362–1396).

In response to the data published by Neumark and Wascher, Card and Krueger conducted another research, within which they compared the payrolls of the same sample of fast food restaurants as in the case of the first study. The results of this new study called “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply” confirmed their original conclusions (Card & Krueger, 2000, pp. 1397–1420).

The data in all the above cases was collected from restaurants. According to the classification of economic activities CZ — NACE (NACE — Nomenclature générale des Activités économiques dans les Communautés Européennes), Czech employers in the sector “I — accommodation, food services and hospitality” similarly rank among those whose workers are remunerated at the level of the minimum wage. One of the arguments for the valorization of the minimum wage presented in 2014 by the then Minister of Labour and Social Affairs, Ms. Michaela Marksová-Tominová, was precisely to help workers in this industry.

Members of the classical, and later the neoclassical school of Economics, have shared the opinion that minimum wages have a negative impact on employment, in particular in the case of low-qualified workers and recent school-leavers and graduates. Such individuals are most often found among the staff of restaurants. These workers are usually remunerated according to the minimum wage, or they earn wages not much higher than the sum of the minimum wage. Another example of the study on the detrimental effects of minimum wages is the study published by the American economist Neumark on the impact of the growth of minimum wages on the increase of unemployment among young African-Americans (Neumark, 2009).

In the Czech Republic, there is a lack of reputable studies that would quantify the negative impacts of minimum wage valorization on employment in previous years. The authors of the expert article “Selected Issues of the Minimum Wage in the Czech Republic” have published the results of an evaluation of the impacts of minimum wages on employment and they

found that increases in the minimum wage had no effect on any rise in the unemployment rate in the Czech Republic. For their research they used data from the years 1998–2011 (Pavelka *et al.*, 2014, pp. 39). The Ministry of Labour and Social Affairs has conducted similar research using data from the years 2000–2012 and they reached the same conclusion. These conclusions need not necessarily still hold true for the present day.

Optimal amount for a minimum wage

In the majority of European countries, the ratio of the minimum wage to average wages ranges from approximately 30–50 % (Funk & Lesch, 2006, pp.78–92). The absolute majority of employees do not achieve the average wage in the Czech Republic (Bílková, 2015, pp. 313).

In the period of 2007–2012, when the Czech Republic was governed by right-wing governments, the amount of the minimum wage was not increased. Governments at that time justified their position by citing the possible negative impact of minimum wages on the employment rate. Furthermore, some political parties in previous government coalitions have publicly set out their intention to repeal the institution of the minimum wage. In this period, we witnessed a relatively dynamic growth of prices. The reason for such growth was in particular the dynamic increase of certain tax rates — in particular value added tax, consumer taxes, the de-regulation of rents and the increase of prices of energy and fuel.

In 2013 the minimum wage was calculated as the weighted average of the minimum wage for that year. The average wage for 2016 is based on the estimate of the Ministry of Labour and Social Affairs of the Czech Republic. Estimates of the minimum wage in the accommodation, food services and hospitality industry are not yet available. Figure 1 clearly shows that the minimum wage to average gross wage ratio began to gradually decrease in 2007. A turnaround occurred only in 2013, when the new government approved another valorization of the minimum wage.

No significant growth in unemployment has been registered in relation to minimum wage valorization in the CR. The unemployment rate in the Czech Republic copies (albeit with a certain delay) economic development more generally (see figure 2).

The inflation rate for 2016 was determined on the basis of an estimate of the Ministry of Finance of the Czech Republic. The average unemployment rate for 2016 was determined on the basis of an estimate of the Ministry of Finance of the Czech Republic. The real GDP growth rate for 2016 was

determined on the basis of an estimate of the Ministry of Finance of the Czech Republic.

Since 2014, the Czech economy has been experiencing relatively significant economic growth. However, an unexpected drop in unemployment occurred until 2015, and more particularly 2016. The minimum wage in this period increased from 8,500 CZK to 9,900 CZK. The number of job vacancies in the register of the Employment Office amounted to nearly 60,000 in 2014, while in 2015 it was almost twice this number — over 100,000 job vacancies (Czech Statistical Office, 2015). This implies that to date the minimum wage in the Czech Republic has been valorized in a manner corresponding with economic development and proportionally to the financial possibilities of private and public corporations.

In the Czech Republic, the minimum wage is earned by approximately 3% of employees, which in absolute numbers amounts to 110,000 — 120,000 people (Average Earnings Information System, 2016). Current data for a comparison of the ratio of employees remunerated by minimum wages in individual European states is unfortunately not available. However, according to 2010 data we can establish that in the majority of EU countries the ratio of employees remunerated by less than 105 % of the national minimum wage is higher in comparison to the Czech Republic, e.g. in Slovenia (19.2%), Lithuania (13.7%), Latvia (11.8%) Luxembourg (10.2%), Poland (9.9%), France, Ireland and Croatia (all 9.2%) (Eurostat, 2010). The minimum wage in all the above states is significantly higher in euro, and in purchasing power in comparison to the Czech Republic (see the graph “Comparison of the minimum wage in EU countries — 1.1.2016”). The above implies that the minimum wage is set at such a level that almost no one works for it in the Czech Republic. As such, it can hardly have any negative impact on the employment rate.

Minimum wage in the accommodation, food services and hospitality industry

The objective of the current government is to achieve approximately a forty percent ratio between the minimum wage and the average gross wage (Sobotka, 2016).

The prognosis for selected macro-economic indicators of the Ministry of Labour and Social Affairs of the Czech Republic envisages a 3.3–5.7% increase in the average nominal wage in the national economy in 2017. The increase in the monthly minimum wage approved by the government, from 9,900 CZK, as of 1. 1. 2016 to 11,000 CZK as of 1. 1. 2017, i.e. by 1100

CZK, represents an increase of more than 11%. As such, this growth in the minimum wage is approximately double that of the predicted growth in the average nominal wage in the national economy in 2017. We can therefore expect the ratio of the minimum wage to the average gross nominal monthly wage in 2017 (the Kaitz index) to increase to approximately 38%. This outcome roughly corresponds to the ratio in 2007.

As implied by recent data on the structure of employee wages for 2015, there is a high proportion of employees who earn wages at a level not very different from the minimum (figure 3).

According to data from 2015, 2.91 % of employees earned monthly gross nominal wages of less than 10,000 CZK. Another 6.20 % of employees earned monthly gross nominal wages between 10,001–12,000 CZK. The monthly minimum wage set for 2015 amounted to 9,200 CZK. The income poverty line in 2015 amounted to 10,220 CZK for an individual (Goeffery, 2016). The scheduled minimum monthly wage valorization as of 2007 will have the greatest impact on low-income employees. There are 10–15% of such employees.

The industries with the highest ratio of low-income employees in 2015 included accommodation, food services and hospitality. The situation is illustrated in figure 4.

As figure 4 illustrates, if we take into account all employees remunerated by a gross monthly wage of less than 14,000 CZK, this would account for 60% of employees in the accommodation, food services and hospitality industry. In the case of administrative and support activities this ratio would be approximately 43%. The lowest average gross monthly wage in 2015, in the amount of 15,686 CZK, once again is earned in the accommodation, food services and hospitality industry. In the second place follows administrative and support activities, where the average gross wage in 2015 amounted to 18,898 CZK. The scheduled valorization of the minimum wage as of 2017 will have the greatest impact on workers and employers in these industries

Minimum wage in the Czech Republic compared internationally

The highest long-term minimum wage is provided in Luxembourg. In conversion to Czech Crowns, the minimum gross monthly wage amounts to approximately 52,000 CZK. In comparison, the minimum wage in the Czech Republic is more than five times lower. The lowest long-term minimum wages are in Bulgaria and Romania. The minimum wage in the Czech Republic for 2016 is the fifth lowest in the EU (see figure 5).

These states have adopted a minimum wage. The amount of the minimum wage can also be assessed in view of its purchasing power. If we quantify the minimum wages by purchasing power standard, then according to Eurostat the differences between the individual countries become smaller. However, this does not change the position of the Czech Republic in any significant manner.

This, however, does not correspond to real GDP per capita and even less so when quantified by purchasing power standard, which eliminates the differences in price levels between countries (see figure 6).

The volume index of GDP per capita in purchasing power standards (PPS) is expressed in relation to the European Union (EU28) average set to equal 100. If the index of a country is higher than 100, this country's level of GDP per capita is higher than the EU average and vice versa. The Czech Republic may be below the average of the European twenty-eight, but when taking into account the price differences between the individual countries (PPS), it does much better than Slovenia, Slovakia, Portugal and other states which have significantly higher minimum wages. The above implies that there is room for growth in wages in the Czech Republic, and also for valorization of the minimum wage.

When comparing real labour productivity per person employed in 2016 in the purchasing power standard of major European countries, the Czech Republic is in the first third (see figure 7).

If the index of a country is higher than 100, this country's level of GDP per person employed is higher than the EU average. Data are expressed as a percentage change comparing year Y with year Y-1 and as Index 2010.

States that have statutory minimum wages and which are placed below the Czech Republic in the evaluation of real labour productivity per person employed (international comparison in 2015) have, with the exception of Hungary, significantly higher minimum wages in Euros and in purchasing power standards than in the Czech Republic. This implies that the level of wages does not correspond to workforce productivity.

Conclusions

The institution of minimum wages is needed for employees, employers and for the state. It should protect employees from poverty, allow them to fulfill their basic necessities of life and stimulate them to work. In the case of employers, it should secure equal conditions of wage competition and introduce stability into the labour-law relationships. The state should benefit from the positive effect of tax revenues and social and health care insurance

contributions arising from transparent employment and remuneration of people, and so in turn from the associated savings of money paid on social welfare benefits.

The success rate for meeting these prerequisites depends in particular on the amount of the minimum wage. A too low or too high minimum wages lead to its poor functioning. A too low minimum wage creates a value which in reality almost no one works for, and thus opens up space for the payment of illicit wages. A too high minimum wage creates a disproportionate cost burden for companies and induces employee layoffs.

The scheduled increase in the minimum wage from 9,900 CZK for 2016 to 11,000 CZK with effect as of 1.1.2017 represents year-over-year increase of over 11 %. However high this number may first appear, in reality it moves the Czech Republic (under otherwise identical conditions) up the rankings of the 22 states that have enacted minimum wages from eighteenth to sixteenth position — in between Croatia and Slovakia. We can expect that the minimum wage to average gross wage ratio will increase in 2017 to approximately 38 %, which corresponds to the ration in 2007. In that year the rightward leaning parties assumed control of the Czech government, which then left the minimum wage unchanged for nearly six years. During this period, we witnessed a dramatic growth of prices. Even though the minimum wage remained the same until mid-2013, the unemployment rate continually increased in the period between 2009 and 2012. In 2012 and 2013, the Czech Republic was the only country in Central Europe to show negative economic growth.

In the long term, the minimum wage is earned by approximately 3% of employees. Such a low number fully corresponds to its very low sum. The amount of the minimum wage is currently (2016) still below the threshold of income poverty. In particular, workers in the accommodation, food services and hospitality industry and also in the field of administrative and support services are exposed to the risk of poverty. These two industries have the highest concentration of employees remunerated at the level of the minimum wage. The ratio of employees remunerated with the minimum wage is usually significantly higher in other EU countries.

The amount of average wages, or as the case may be the amount of the minimum wage, does not correspond to the position of the Czech Republic implied by the comparison of GDP per capita in purchasing power standards (PPS) and real labour productivity per person employed of other EU countries.

Based on the facts set out above, we can state that the decision of the current government to significantly increase the minimum wage as of 2017 is correct.

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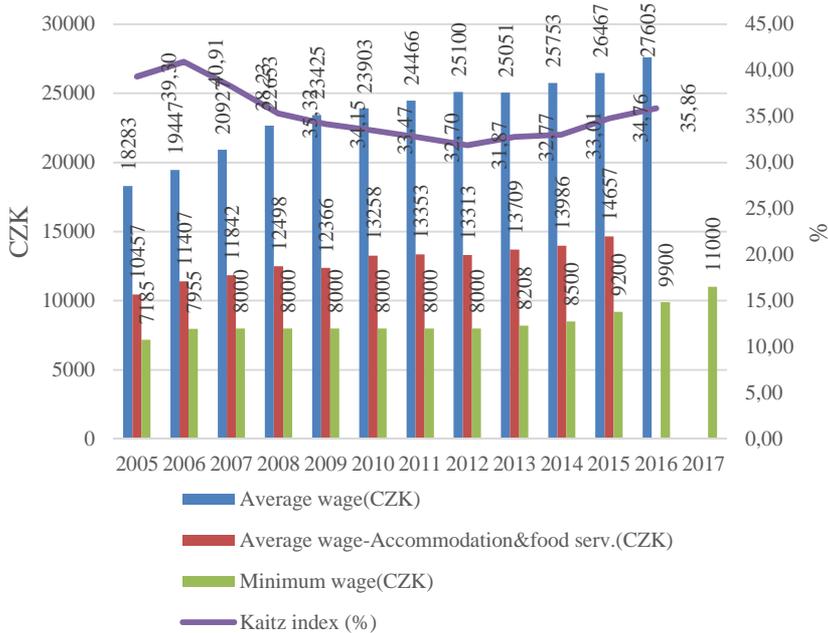
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Acknowledgements

The paper represents an output of the specific research project “Entrepreneurship in the area of industry 4.0” of the Internal Grant Agency of the Technical University of Brno, registration number FP-S-17-4634.

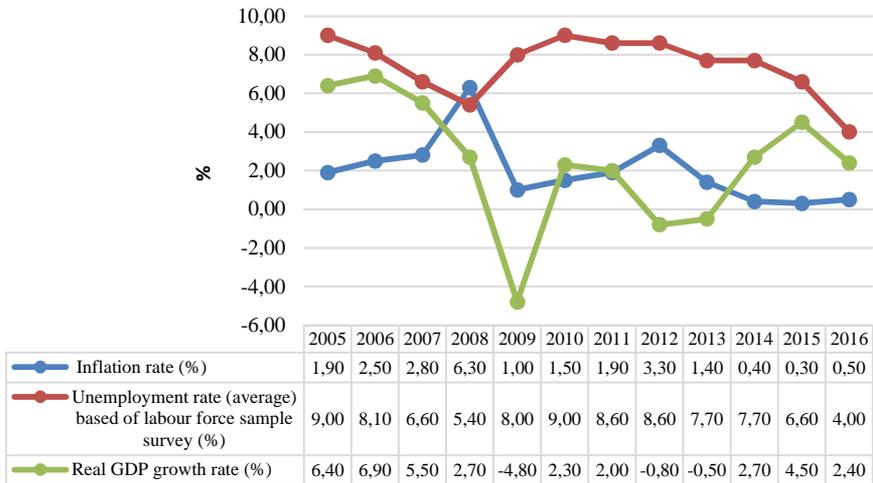
Annex

Figure 1. Depicts the dynamics of the development of the average gross monthly wage in the CR and separately for the accommodation, food services and hospitality industry, the minimum monthly wage in the CR and the development of the ratio between the minimum monthly wage in the CR and the average gross monthly wage in the CR — Kaitz index



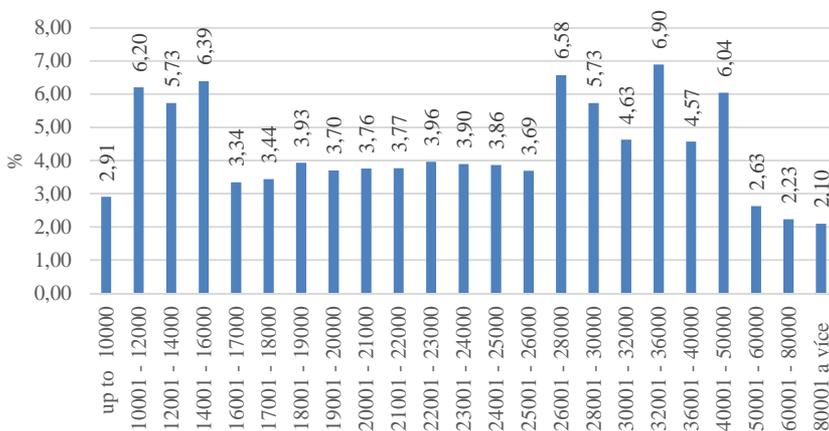
Source: author's interpretation based on the data of Czech Statistical Office and Ministry of Finance of the Czech Republic, 2016.

Figure 2. Development of the inflation rate, average unemployment rate and real GDP growth rate in percentages in the period 2005-2016



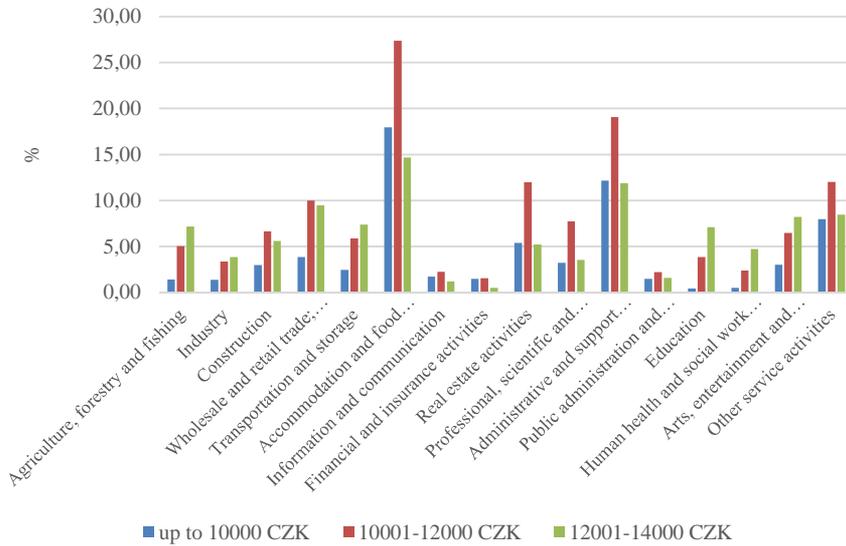
Source: author's interpretation based on the data of Czech Statistical Office, Ministry of Finance of the Czech Republic and Research Institute for Labour and Social Affairs – RILSA, 2016.

Figure 3. Percentage of employees by gross monthly earnings band in the Czech Republic in 2015



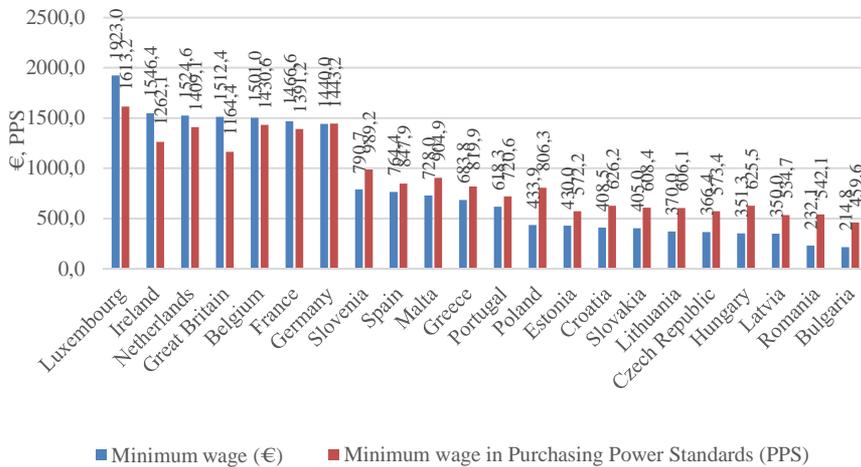
Source: author's interpretation based on the data of Czech Statistical Office, 2016.

Figure 4. Percentage of employees by gross monthly earnings band and by CZ-NACE sector in 2015



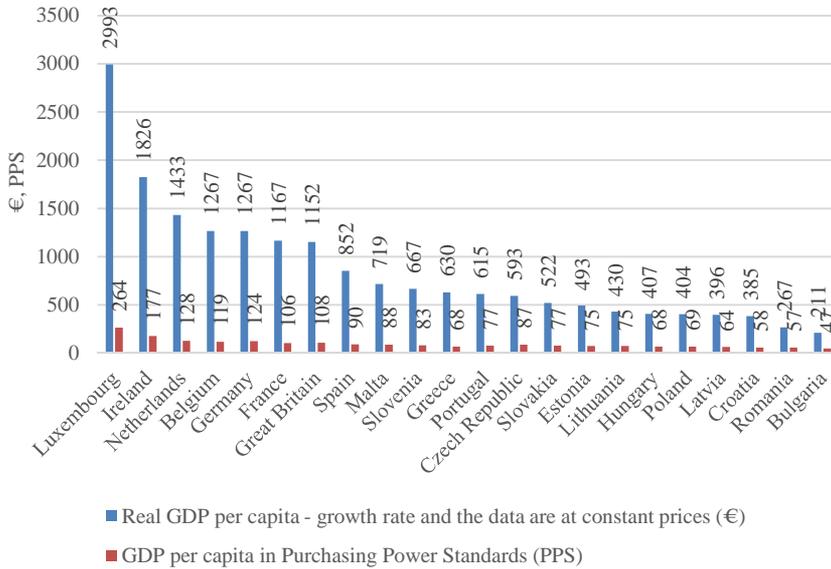
Source: author's interpretation based on the data of Czech Statistical Office, 2016.

Figure 5. Comparison of minimum wage in EU countries - 1.1.2016



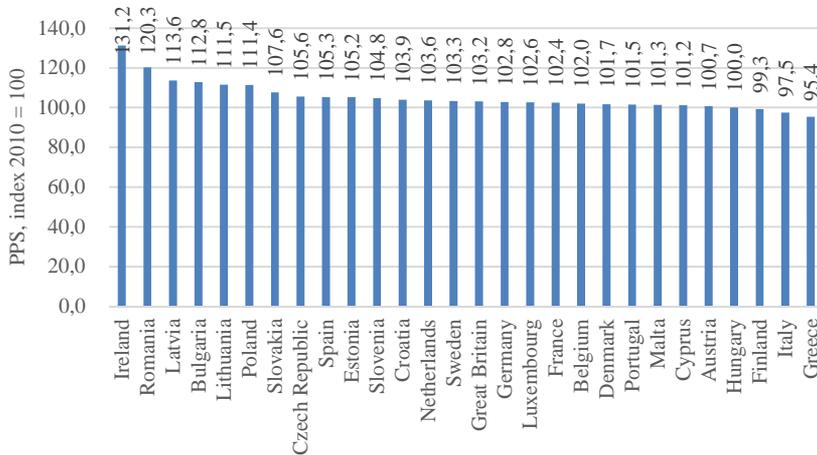
Source: author's interpretation based on the data of Eurostat, 2016.

Figure 6. Comparison of gross domestic product in EU countries in 2015



Source: author's interpretation based on the data of Eurostat, 2016.

Figure 7. Comparison of real labour productivity per person employed in selected European countries in 2015



Source: author's interpretation based on the data of Eurostat, 2016.