

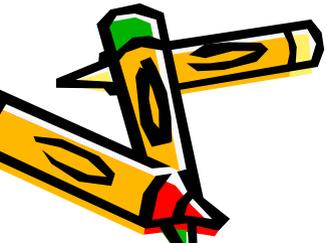
The employment effects of labour costs reduction

(general statements and illustrations)

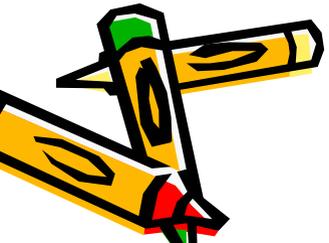


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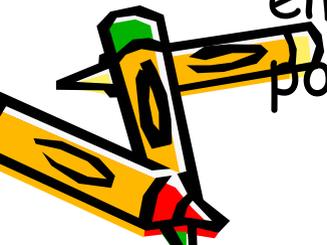
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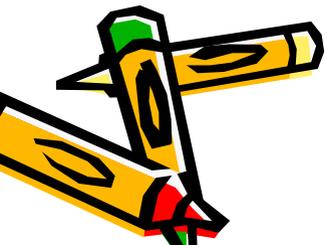
1. General statements



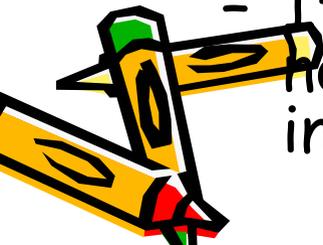
- The effect of labour costs reduction on employment level greatly varies in the different sectors:
 - The lower is the labour intensity of a sector, the less this change affects employment and vice versa.
 - E.g., in power generation fixed capital and energy cannot be replaced with labour, so lower labour costs will not induce the management to hire more labour.
 - While, in industries with high labour intensity the tax shift from labour will result in more employment (if market conditions make possible output increase).



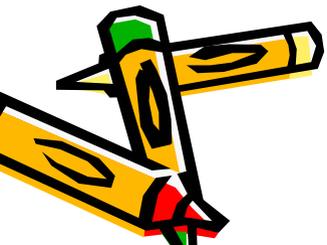
- We have to differentiate clearly, which component of labour costs is to be reduced:
 - The more simple case is when that part of the labour cost is reduced which is born by the employer (typically the social contribution covered by the employer).
 - In such cases the labour becomes cheaper for the employer and, as a result, demand for labour increases and employment also increases.



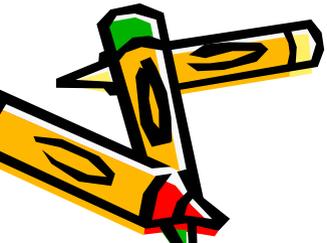
- Cases, when labour costs born by the employee are reduced, are more complicated:
 - The employment effect depends on the social layer, income group, unionization and general welfare gratification.
 - In a family with one earner (typically the husband), wife and children the husband's work propensity is not elastic downwards, lower labour costs (which result more net wage) will not induce him to work less.
 - In contrast, in families belonging to higher income groups and with two earners, the work propensity of the second earner (typically the wife) may be influenced by changing labour costs.
 - If, e.g., labour costs are very high, the wife will not go to work, and a decrease in them may induce further employment.



- In countries with high marginal tax rates and generous social gratification systems the employment effect of tax shift from labour to the environment may be also negative for those unemployed and belonging to the lower social layers:
 - because the income increase, due to employment, could be cancelled by the high marginal income tax and the loss of welfare assistance. (This phenomenon is called "poverty trap" or "unemployment trap".)
 - As a result, prospective employment effects of an ecological tax reform need thorough studying.



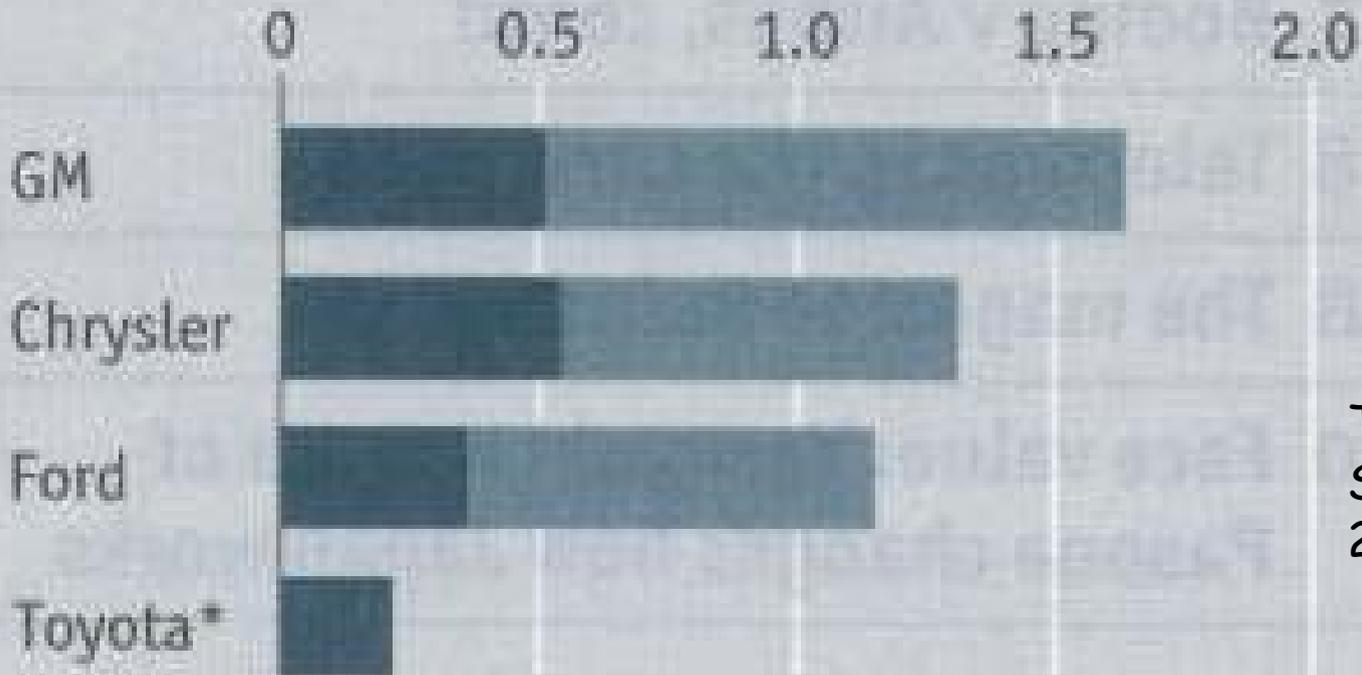
2. Health rate costs in US car industry



Standard on every model

Health-care costs per vehicle produced in the US
2005, \$'000

Active employees Retired employees

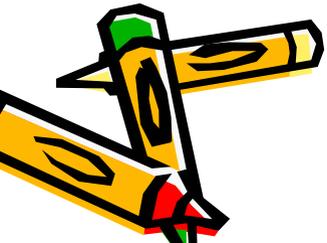


The Economist,
September
29th 2007

Source: Harbour-Felax Group

*Based on estimate of
\$12,600 per employee

- In principle: the \$1000-1500 health contribution per vehicle could be replaced by environmental taxes (e.g. charged on cars).
- But in that case:
 - an institutional change was needed (the environmental authority should pay health contributions to workers in car manufacturing)
- Would employment increase?
 - labour would become cheaper for car manufacturers
 - but technology should not be changed to be more labour intensive
 - employment could be raised only if demand for cars increased
 - but car prices would not be cheaper because health costs were replaced by environmental charges on cars (budget neutrality)
- Conclusions:
 - the employment effect depends on random and external conditions
 - if demand in car market increases, employment will increase even without tax shift



3. Possible employment effects of labour costs reduction in Hungary

- The „historical“ experience of OECD countries:
 - labour costs reduction may reduce unemployment by $1/5$, $1/3$, $1/2$ but even $2/3$ parts
- For Hungary, with 360 thousand of unemployed, this may result in a 100-150-200 thousand reduction

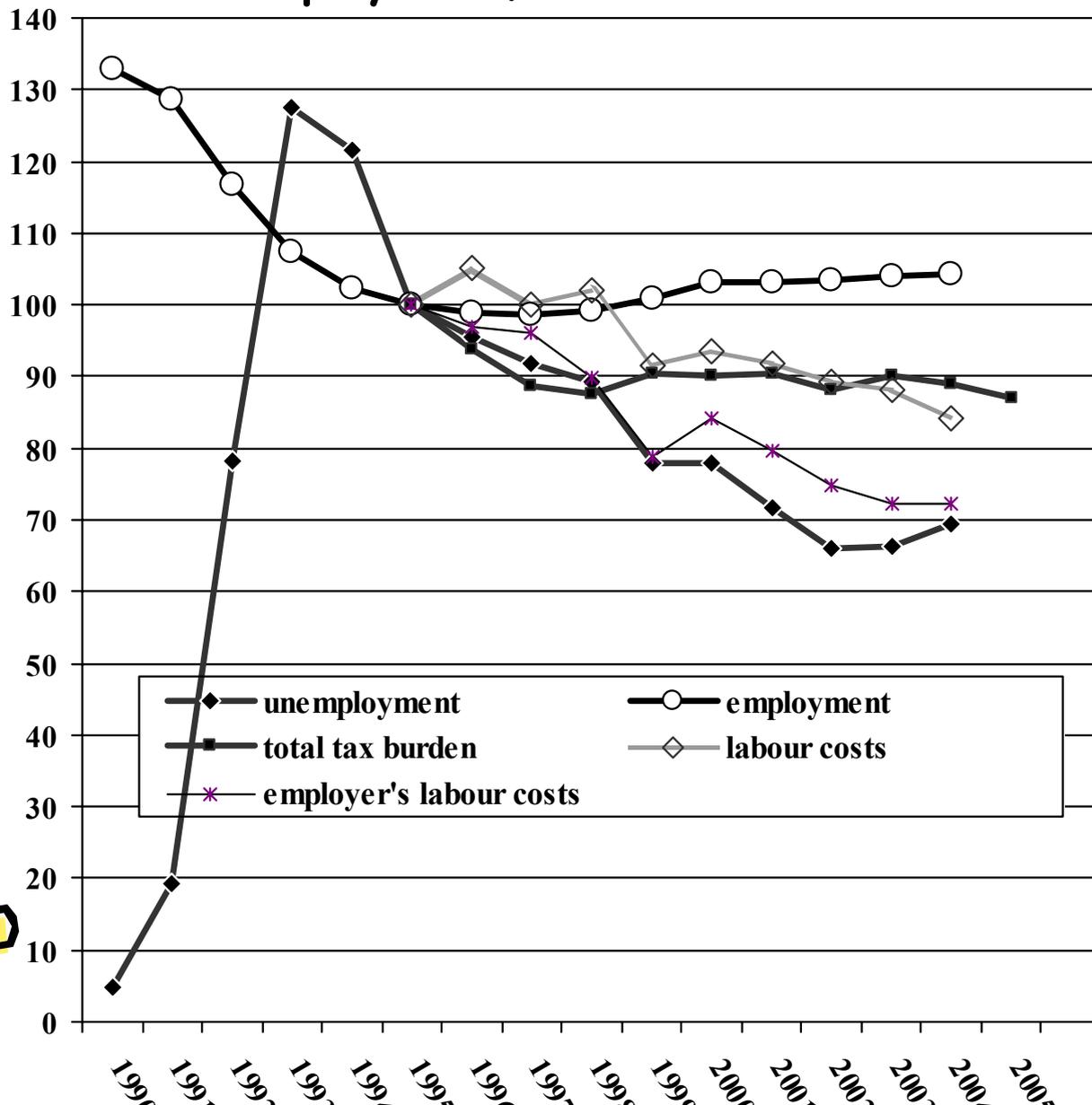


Long term trends of employment, unemployment, labour costs and taxes in Hungary (1995=100)

year	Employment	Unemployment	Employer's labour cost	Total labour cost	Total tax burden
1990	132,9	4,7		...	
1991	128,6	19,3		...	
1992	116,8	78,2		...	
1993	107,4	127,6		...	
1994	102,2	121,7		...	
1995	100,0	100,0	100,0	100,0	100,0
1996	98,9	95,4	96,9	105,1	93,9
1997	98,6	91,9	96,2	99,9	88,6
1998	99,3	89,3	89,7	102,-	87,5
1999	100,8	77,8	78,9	91,5	90,3
2000	103,1	77,8	84,3	93,4	90,1
2001	103,1	71,7	79,7	91,9	90,3
2002	103,3	66,-	74,8	89,3	88,1
2003	103,9	66,4	72,4	88,-	90,1
2004	104,3	69,3	72,2	84,3	89,-
2005					87,1

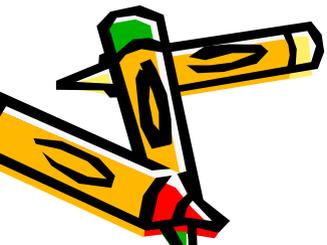
Source: Foglalkoztatottság és kereseti arányok 1998-2003, KSH, 2005; Magyarország nemzeti számlái 2002-2003, KSH, 2005; www.PM.gov.hu

Long term trends of employment, unemployment, labour costs and taxes in Hungary

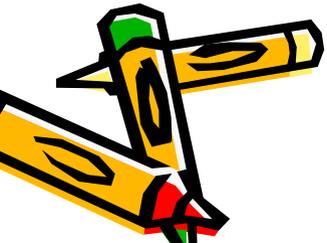


Conclusions:

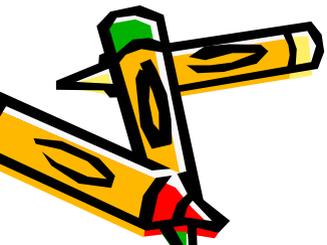
- In the long run, in Hungary 1 point of labour cost reduction induces the reduction of unemployment rate by 1/3, 1/4 point.
- Correlation with employer's labour cost is even more strict.
- Correlation coefficients with unemployment for 1995-2004 are:
 - total tax burden: 0,593
 - labour costs: 0,913
 - employer's labour costs: 0,977
- 1 per cent reduction in employer's labour cost increases employment by 1,185 per cent.



4. Difficulties in realizing an ecological tax shift in Hungary



- In Hungary no environmental tax reform (shift of tax burden from labour to environment) has taken place.
- Present analysis points at the *possible* employment effects of a labour cost reduction, *irrespective* of where the funding for that reduction comes from.
- In Hungary energy and fuel prices are on the European level, so it is rather a problem, where the taxes to cover the shift, should be raised from.
- The income from many of the environmental charges are used in a form of „recycling“, namely used in those fields where they are raised. These „constructions“ are viable, they should not be changed.
- The potential of other environmental tax sources is marginal.
- The biggest potential in raising environmental taxes lays in energy and fuels, but a further increase could only be realized in the all-European context.



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