Why are wages still lower in eastern and central Europe?

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Summarise the argument

Set the scene, how big is the gap, narrowed by FDI, but only so far, strategy (implicit) of low wages to attract FDI, harder to raise economy to higher level, dependent on technology, innovation from outside, dependent on what MNCs decide to put there,

higher wages would help, but other policies too, look at cz, hu, pl, sk plus ro, similar strategy.
Czech GDP/EU15

- **Nominal**
- **PPP**

[Graph showing the comparison of nominal and PPP GDP for the Czech Republic against the EU15 over the years from 1991 to 2017.]
Catching up?

Narrows to 2008, stagnates, some revival, much lower wages, apparently similarly lower productivity, similar for GDP in nominal terms. PPP, never so big a gap, maybe still narrowing from 2008, not comparable over time, gap between PPP and nominal, key to MNC strategies, much higher productivity in real terms (PPP, if believed) than implied by nominal comparison.
How MNCs came

1990s, privatisation into domestic ownership failed, only MNCs competitive in modern manufacturing (technology, finance, strategy, networks), hence dependence on FDI (least for pl), exceptional in Eu. Especially exports (sk 75%). Absolute dominance in some branches, inflow important for balance of payments, but lower from 2008, danger; passed peak of cycle? net benefits reversed?
## Net FDI as % of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Peak year</th>
<th>value</th>
<th>1995-2008</th>
<th>2009-2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cz</td>
<td>2005</td>
<td>10.1</td>
<td>5.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Hu</td>
<td>1995</td>
<td>10.3</td>
<td>4.6</td>
<td>1.9</td>
</tr>
<tr>
<td>Pl</td>
<td>2000</td>
<td>5.4</td>
<td>3.2</td>
<td>1.7</td>
</tr>
<tr>
<td>Sk</td>
<td>2002</td>
<td>11.7</td>
<td>4.1</td>
<td>0.5</td>
</tr>
<tr>
<td>Ro</td>
<td>2006</td>
<td>8.5</td>
<td>4.2</td>
<td>2.0</td>
</tr>
</tbody>
</table>

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### Foreign share in value added 2014

<table>
<thead>
<tr>
<th>Country</th>
<th>manuf</th>
<th>Computers, etc</th>
<th>Motor vehicles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czechia</td>
<td>59.2</td>
<td>73.8</td>
<td>92.3</td>
</tr>
<tr>
<td>Hungary</td>
<td>69.9</td>
<td>92.7</td>
<td>94.8</td>
</tr>
<tr>
<td>Poland</td>
<td>44.0</td>
<td>45.6</td>
<td>85.4</td>
</tr>
<tr>
<td>Slovakia</td>
<td>68.5</td>
<td>88.5</td>
<td>96.2</td>
</tr>
<tr>
<td>Romania</td>
<td>58.0</td>
<td>74.0</td>
<td>93.0</td>
</tr>
<tr>
<td>Germany</td>
<td>23.1</td>
<td>32.8</td>
<td>13.7</td>
</tr>
</tbody>
</table>
Come for low wages + other conditions (labour force, infrastructure, financial incentives, proximity), but how do they take advantage of cheap labour?

looked at labour’s share (personnel costs in value added) (Eurostat),

looked at what they export. Foreign trade data, volume + value by detailed product (UN comtrade), price per kilogram, measure of relative quality, Cz, 1960s, kg price of exported cars, 60% of EEC, because… will it be better now?
MNC strategies 2, options

1. Outsource simpler parts/processes, less skilled labour: could be higher profit, could be lower price,
2. Cheaper part of range, older/obsolete, profitable thanks to cheaper labour: higher profit & lower price,
3. Supplement home activities, same products /processes: should be same price & higher profit,
4. Transfer whole activity: almost always peripheral, small contribution to total activities,

follow with three examples.
Share of personnel costs

- manuf
- tyres
- auto

- de
- cz

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Car tyres
(broader category)
Came by privatisation and greenfield investment, now exports; de 0.3%, cz 0.8%, ro 1.8%, not much innovation, but specific equipment, most modern used, kg prices catch up quickly for cz, hu, sk,
case of (3), supplement, benefits in profits, confirmed in Continental accounts,
additional capacity, higher profit, stronger bargaining position.
Kg price, tyres, cz/de
Passenger cars

11%+ exports cz, de, almost 20% sk. Means de volume much bigger than all the others, and only marginal catching up. Not (3), not (4), but (2)

Smaller, cheaper cars, lower kg price, not obsolete, innovating and using best technology, but cheaper, also cheaper within same product type, why? (wages 5-10% of production value), so cheaper product goes where wages are lowest, why not move all? committed, investment, employees, R&D base, political costs.
Wiring for transp. equipment
(mostly cars)
Case of shifting towards lower wages, ie (1) simple technology, low skills, increased in cz, then reduced capacity and increased in ro, show export volumes, de becoming importer, also note kg price lower for ro and falls, MNC benefits from lower price (maybe profit?), Note; measured productivity in ro appears lower than de, lower wages lead to lower price (cars too).
Wiring, mn kg, cz, de, ro
Kg price, wiring, cz&ro/de
Conclude – 3 policy options

MNCs brought growth, but never transfer the best,

1. Low wage strategy, keep wages in line with measured productivity (EU advice), but prod lower because wages are low, same products/processes (cars, wiring, many more),

2. Raise wages; scope from profits, from PPP measure: but MNCs have bargaining power and activities may move, eventually,

3. Active policies to create environment for R&D, innovation; need to attract most qualified…