

Business

# Wages Are Getting Too High in Europe's Eastern Workshop

Countries need to raise worker skill levels to match higher pay

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The Baumruk & Baumruk factory near Plzen, Czech Republic. *Photographer: Martin Divisek/Bloomberg*

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IBM  
**IBM**  
 120.73 USD  
 ▼ -0.43 -0.35%

DE  
**DEERE & CO**  
 148.31 USD  
 ▲ +0.17 +0.11%

G  
**GENERALI ASSIC**

When the Baumruk brothers started making simple machinery parts in their garage after the Communist regime collapsed in Czechoslovakia, they could rely on one crucial ingredient: cheap labor. Their employees were willing to do manual work for a fraction of the salaries Germans were making across the border.

Almost three decades later, the eponymous company is unrecognizable. The halls of the factory near Plzen are decked out with state-of-the-art machines from Japan that press metal sheets and cut pipes for such equipment

14.41 EUR  
▲ +0.06 +0.42%

VOW  
**VOLKSWAGEN AG**  
147.80 EUR  
▼ -1.50 -1.00%

WHR  
**WHIRLPOOL CORP**  
117.19 USD  
▼ -0.18 -0.15%

makers as Deere & Co. And they're operated by highly skilled engineers—who make more than the nation's average pay.

“It used to be that people were cheap and we couldn't afford to buy the machines,” said Martin Baumruk, one of the founders' sons. He runs the company, whose yearly sales are about 10 million euros (\$12 million). “Now the right person is more valuable to us than expensive equipment.”



Martin Baumruk  
Photographer: Martin Divisek/Bloomberg

Baumruk's business embodies a new reality that's transforming the formerly socialist economies of Eastern Europe. From Warsaw to Riga, governments are starting to bump against the limits of an economic model that lured western foreign investors for almost three decades, based on lower-paid, less-skilled labor. With wages rising and unemployment in major countries around 4 percent, politicians now realize they must invest more in research and education.

“We must concentrate on products that will bring higher added value,” said Radomir Jac, chief economist at the Prague-based asset-management unit of Assicurazioni Generali SpA. “Building more factories and assembly lines won't benefit our economy. If anything it will create more tensions on the already stretched labor market.”

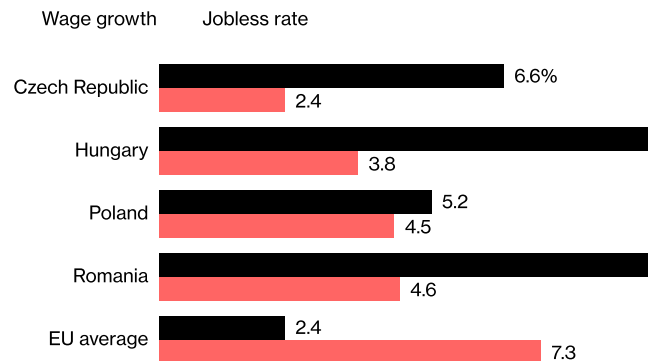
It's a turnaround from the 1990s, when the collapse of communism brought private western European and U.S. companies eager to profit from the low wages and, later, tariff-free access of the European Union. In the Czech Republic, Germany's Volkswagen AG bought Skoda Auto in 1991; Slovakia welcomed appliance maker Whirlpool Corp.

and turned itself into the world's biggest car producer per capita. The region became a vital link in the supply chains that keep German industry running.

Now, rising wages are starting to send factory jobs to cheaper countries. Japan's Yazaki Corp., for instance, is switching production of the vehicle wiring it makes from the Plzen area to Serbia, where industry wages are almost 60 percent lower. In Poland, an influx of workers from Ukraine is plugging holes in the labor force and restraining salaries.

### Workers' Paradise

Labor shortages are driving up salaries in EU's east



Source: Eurostat

Note: Wage data are 3Q 2017 vs 3Q2016; unemployment January 2018

With one of the region's best-educated populations, the Czech government pushed through development programs that lured German carmaker BMW to invest more than 200 million euros into a research facility developing digital technology and autonomous driving. In Romania, tax breaks lured the likes of Oracle Corp. and IBM.

In Poland, such companies as Amazon, JPMorgan and IBM have set up hubs or distribution centers, bringing foreign direct investment to a record \$10 billion in 2016. That's in part because Poland's work force offers a higher level of training relative to wage levels than in other parts of eastern Europe, said Joanna Tyrowicz, professor of economics at the University of Warsaw and the co-founder of GRAPE research center.

Working against Poland: government efforts to increasingly control the judicial system and public broadcasting. In addition, Tyrowicz said, "increased uncertainty about tax rules and other regulations along with declining stability of business conditions definitely reduce the value of investment in Poland, hence discouraging some of the potential investors."

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investing”**

To find a solution to rising wages, Eastern Europe can look to such formerly developing nations as Taiwan and South Korea, which moved from low-level manufacturing to the cutting edge of technological innovation over the course of a few decades. Jeffrey Frieden, a professor at Harvard University, said countries need to make products that match salary levels even as those are changing.

“If you’re successful, wages rise and you have to move into products that include more human capital, that is, more skilled labor,” he said by phone. “The success story of most of the world’s countries that have graduated from poor to middle-income, and from middle-income to rich, is a story of the development of the quality of the labor force and that means education.”

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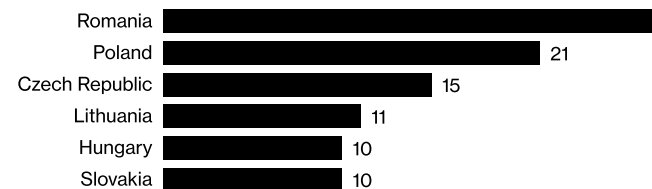
It requires research and innovation to put workers into higher-skilled jobs, though, and eastern Europe isn’t moving fast enough. A study by the European Bank for Reconstruction and Development found that the number of patents granted relative to the population—a proxy for innovation—grew by less than 50 percent between 2002 and 2015 in the region, which also includes such countries as Russia and Turkey. In the same period, patents granted in China grew 3,000 percent and in South Korea, 317 percent.

“Changing your economic model is easier said than done,” said David Marek, the chief economist at Deloitte in Prague. “East Europe’s economies can’t get out of the trap of being the West’s ‘assembly line’ until they start properly investing in research and development.”

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Source: ABSL report  
Note: Growth 2013-2016

Romania, for instance, has a shortage of at least 10,000 computer programmers to fill openings. Bogdan Balan, who works for a multinational finance company, said he learned his programming skills despite, not because of, the university system.

“The curricula in most colleges is very outdated and should be significantly changed,” he said. Still, the 32-year-old software engineer earns about 3,000 euros a month, compared with an average national wage of 536 euros. “I had the possibility of leaving the country. But my family convinced me to give it another try. Rent is paid by my company and taxes for IT workers are much smaller.”

The economic changes are also visible in Lithuania, where Akvile Svolkiene returned to Vilnius to work as a communications manager at Danske Bank Global Services after spending five years at A.P. Moller-Maersk A/S in Copenhagen.

“There’s essentially no difference between job possibilities here and in other nations,” said Svolkiene, 32, adding that more than 100 of her colleagues have previously worked abroad. “It’s not that we have a lack of opportunities in Lithuania, rather a gap of talent.”

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