CEE and SEE wage convergence stalled: this is not only unfair but economically detrimental!

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Structure

Show different measures for wage development

- Between 1995 and 2008 wage convergence was dynamic without a loss of competitiveness
- Reversal since 2008 without a good reason
- CEE wages in EUR terms as share of EU15
- Real wage growth much behind productivity growth
- Wage shares among the lowest in the EU
- In manufacturing (where competitiveness really matters) there is a great productivity reserve

Not only unfair, also wrong

- Less purchasing power, less growth
- Low wage trap: getting stuck in a subordinated role in the international division of labour

CEE-s are underperforming

Two major causes:

1/ EU crisis management practice was particularly harmful to peripheral middle-income economies

CEEs (exc: HU, HR) had no public debt problem and CEEs have no cost-competitiveness problem

STILL: austerity and a downward pressure on wages was applied (as graphs below will show)

2/ There is also a longer term problem with CEE-SEE growth model:

Externally financed low wage based growth is out of steam

A change towards investment led innovation based growth model with higher value added content is necessary

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UP to the crisis: higher wage dynamics in CEE than in both the core and periphery of EMU

When looking at wage levels in nominal EUR terms (indicative for investment decisions, labour mobility)

The graph below shows that wage convergence between the mid 90-s and the mid 2000s was possible and this did not deter investments and did not ruin competitiveness

CEE countries outside the Eurozone tend to have (real effective) appreciating exchange rates (apart from short term fluctuations, this was the longer term trend)

Only Bulgaria had uninterrupted wage convergence but still hast lowest wages in EU; In Romania: no wage convergence after 2008

In all countries 2008 was a point of reversal in wage convergence – in all measures as illustrated on the graphs below

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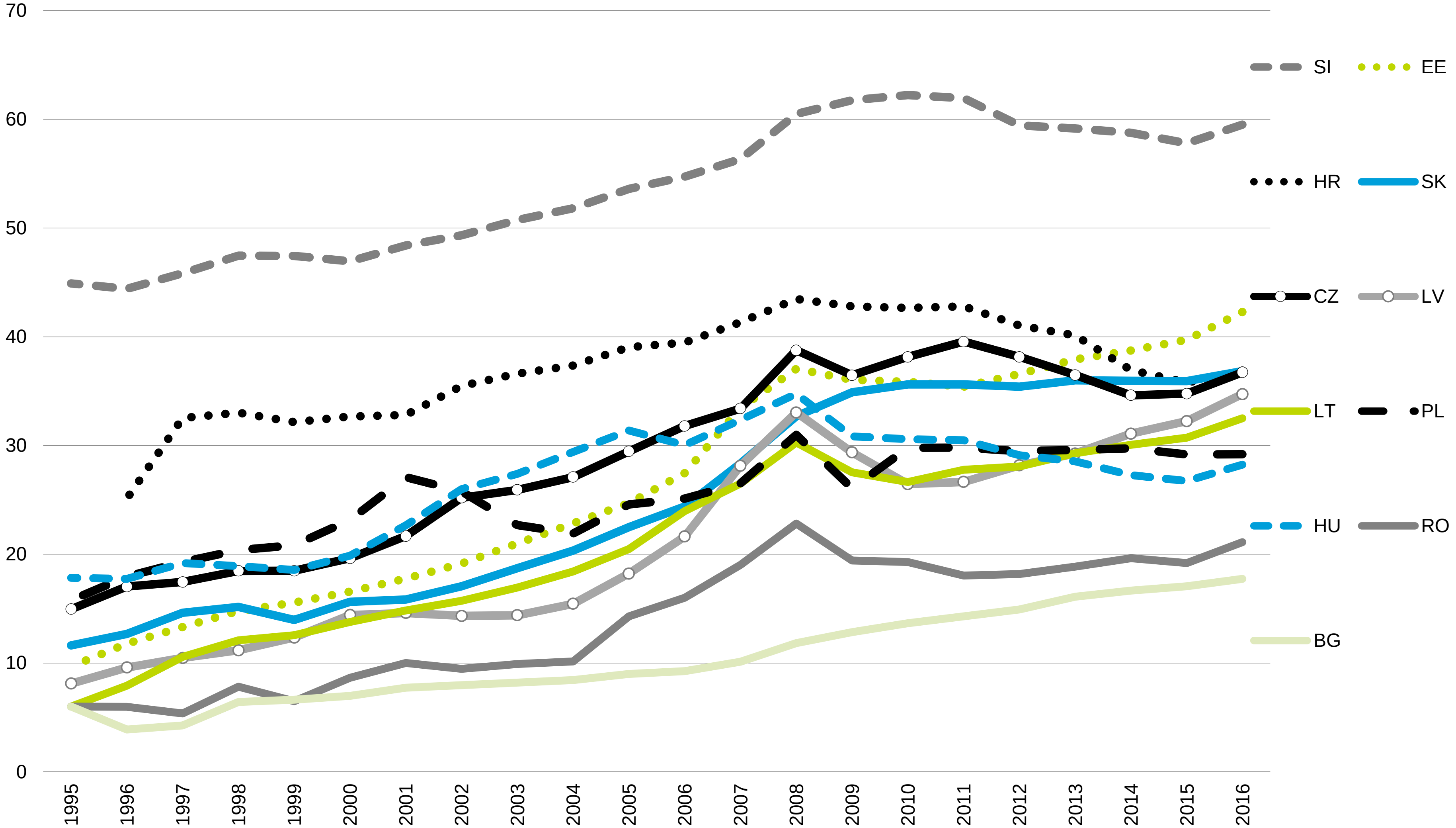
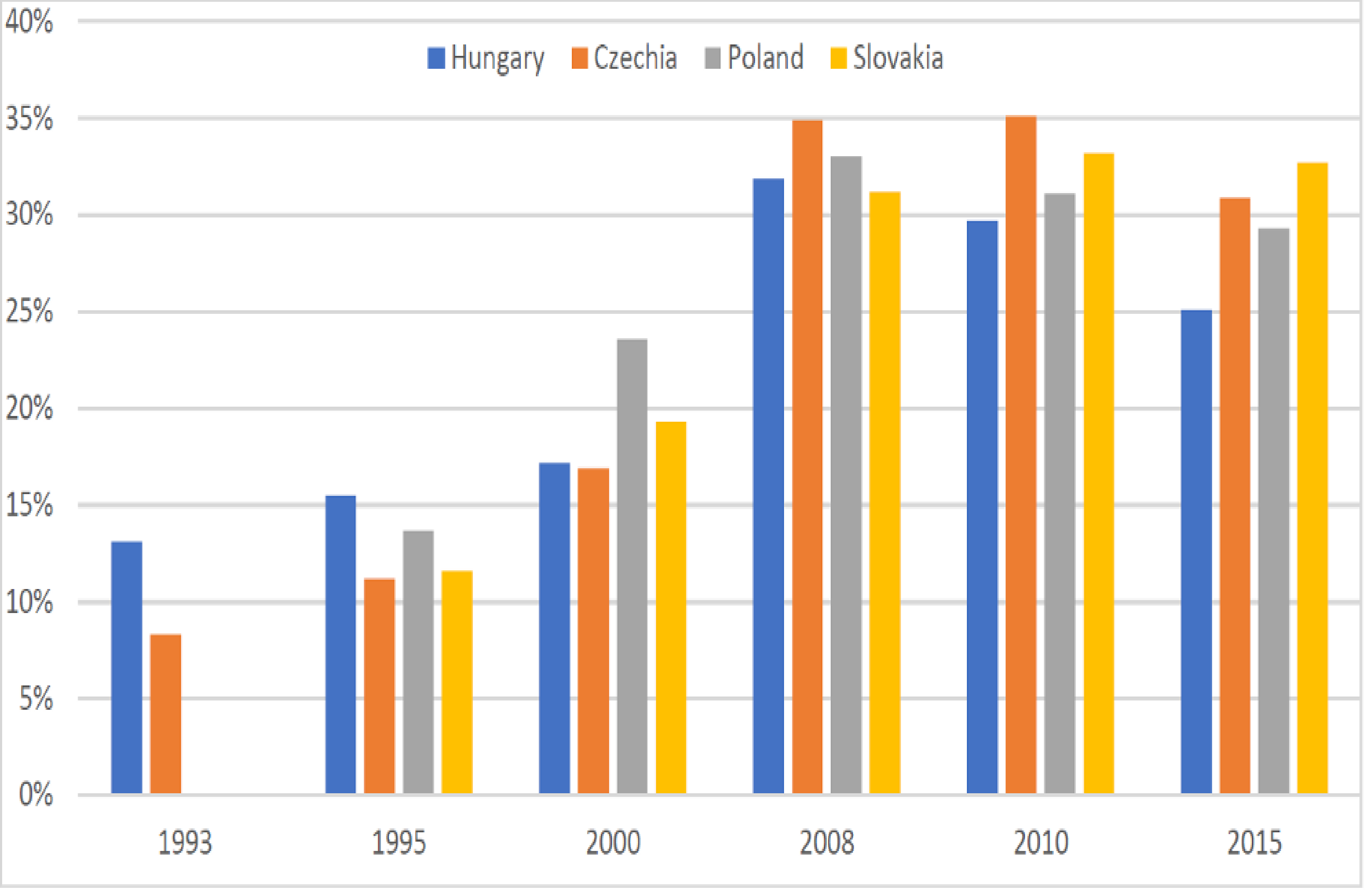
Yearly average gross wages in % of the EU15, 1995-2015 (in nominal EUR terms)



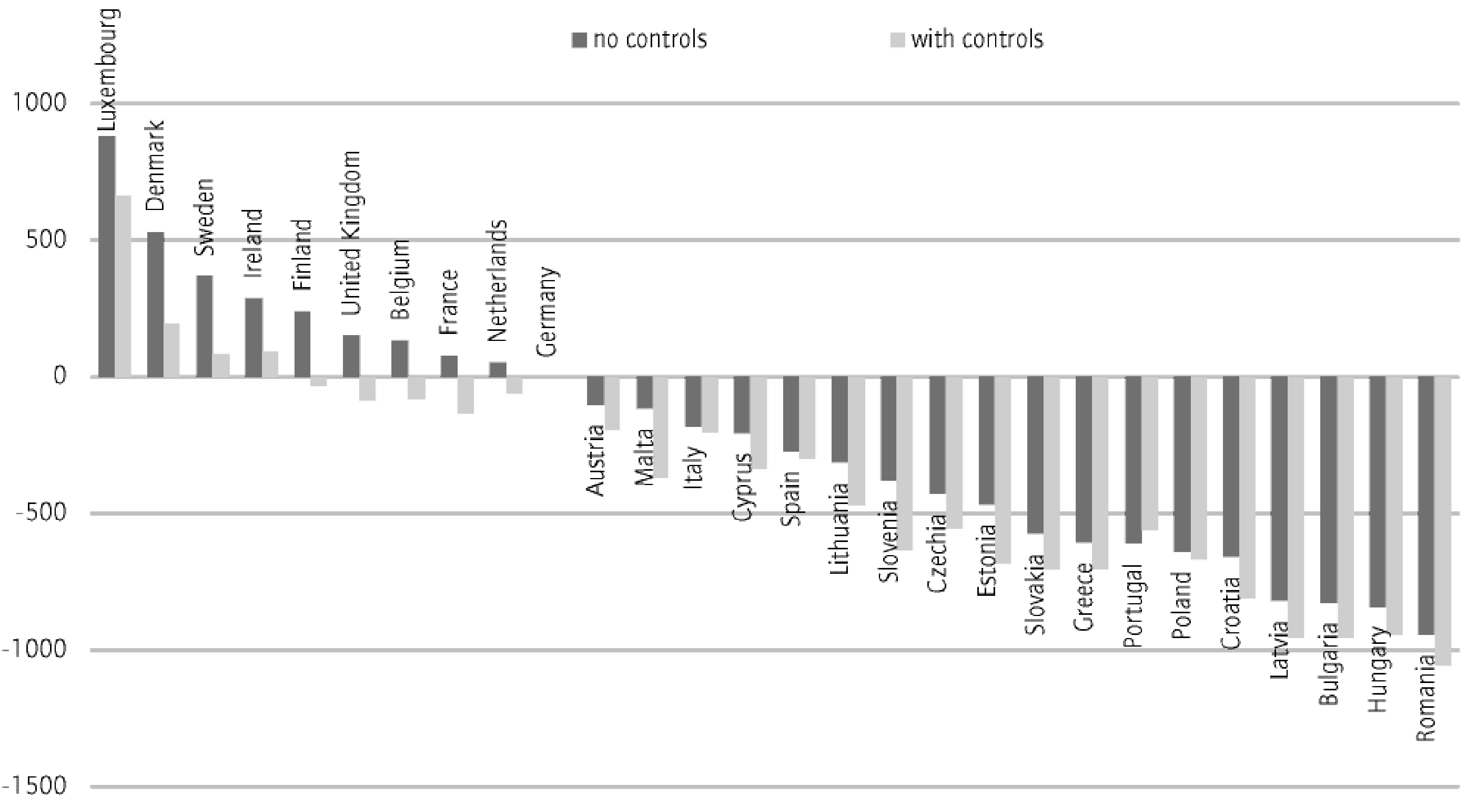
Source: AMECO 2017

Average wage (EUR) in % of Germany



Once we account for structural differences, differences in wages between high wage countries disappear - 2016

However: **The wage gaps between high-wage and low-wage countries become bigger** once differences in worker, work and workplace characteristics are controlled for.



Real wage developments

Real wage developments are the most important for domestic purchasing power (important for welfare but also for economic growth).

Wage levels are still a fraction of that of the EU15.

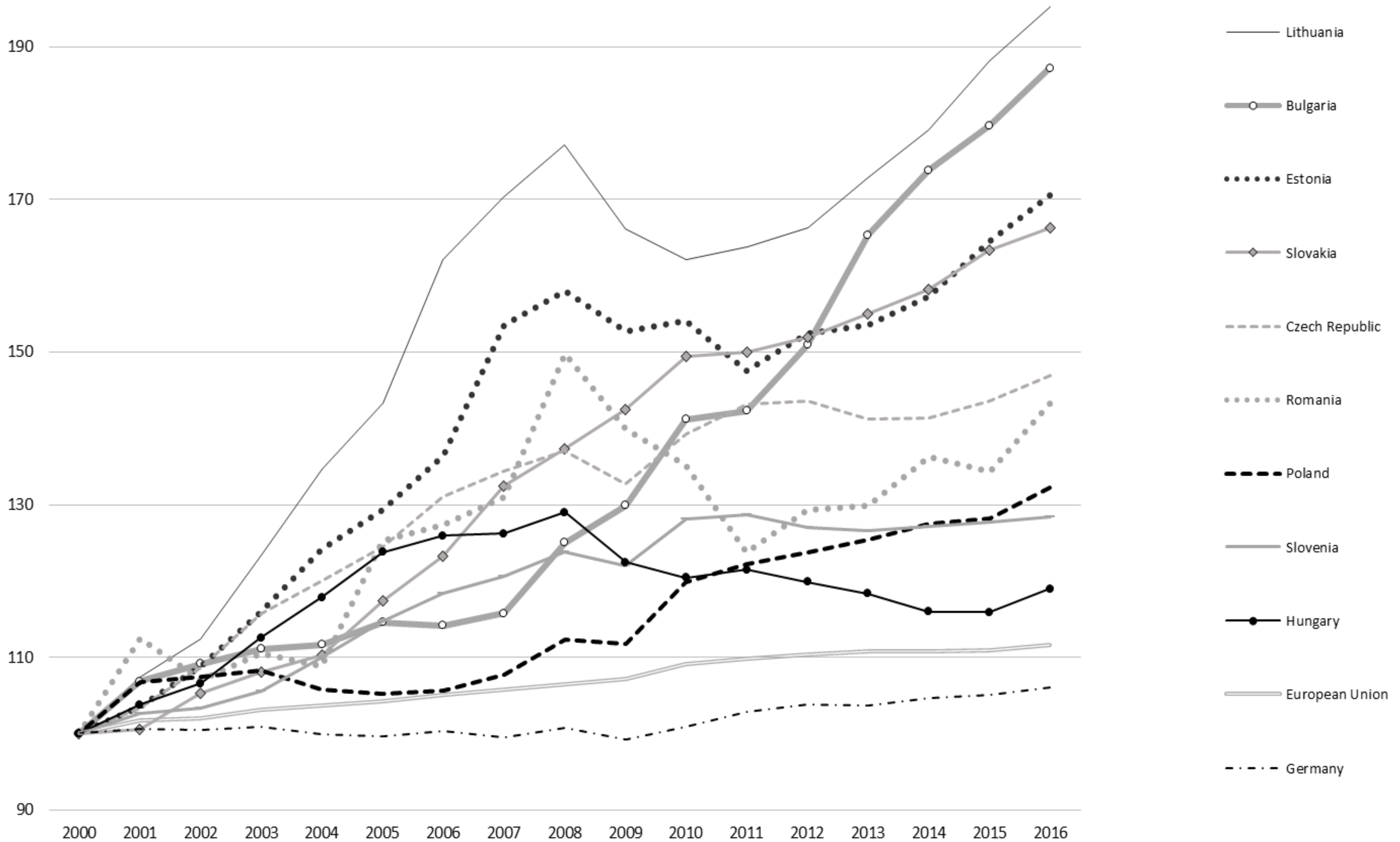
Real wage developments were dynamic up to the crisis, but suffered a serious setback after 2008.

There are country differences with the Baltic states gaining in wage dynamism recently, but the Visegrad 4 group and Romania did not recover the losses.

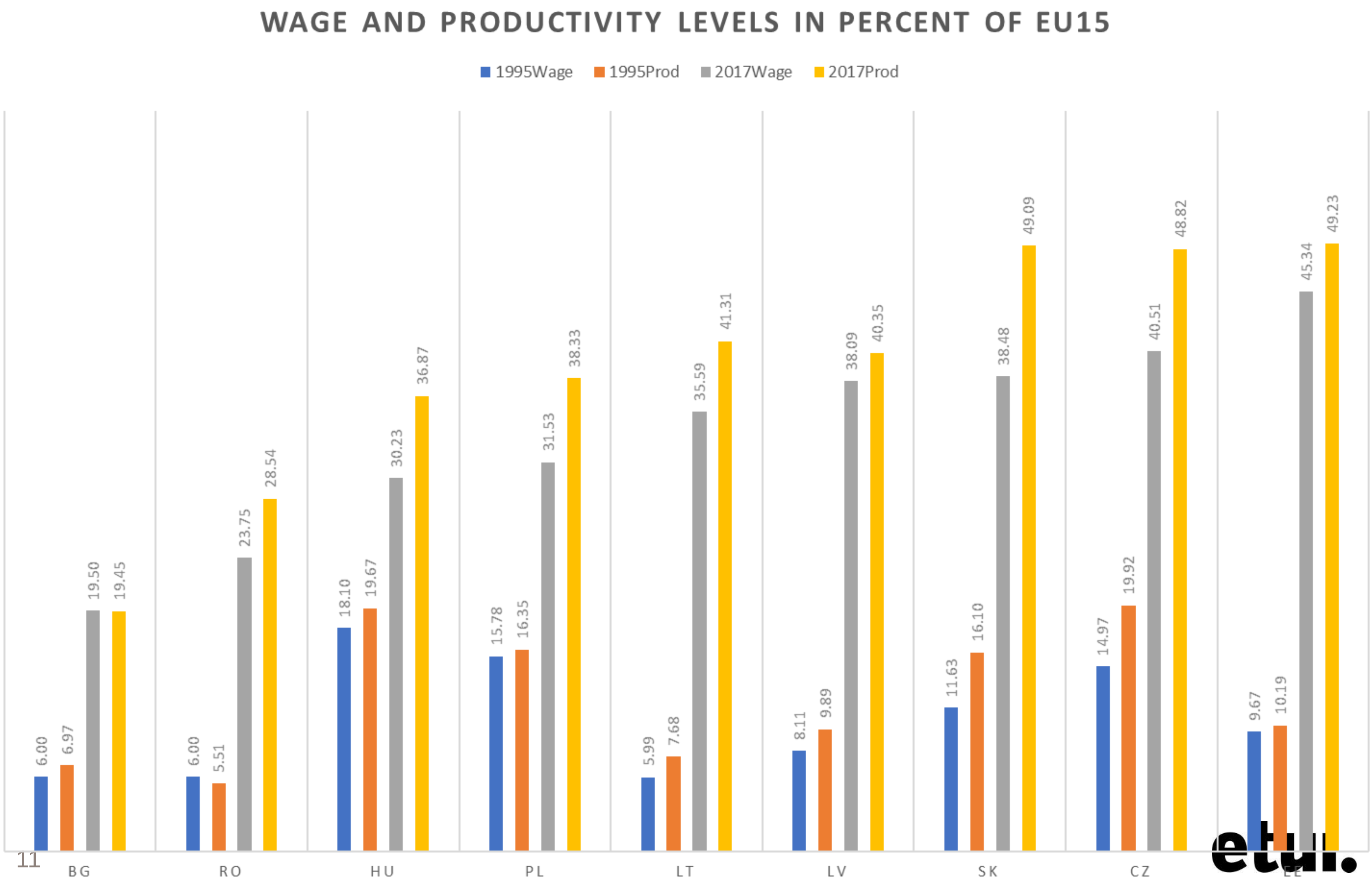
With the sole exception of Bulgaria real wage developments in all countries lag behind productivity (in the entire period since 2008)

Real wages/real productivity 2016/2000, %

Real wage growth in CEE and Germany (2000-2016), %



Wage and productivity levels in % of EU15, 1995 and 2017



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Real wage developments, Western Balkans

- Bulgaria and Turkey had dynamic real wage developments since 2000 and the momentum was also kept after 2010. Slovenia and Croatia had wage catch up until 2010, but after real wages stagnated in Slovenia and fell back in Croatia. FYR Macedonia showed a real wage decrease of over 10 % since 2010.
- It is clear that wage convergence in the Western Balkans region with the exception of Bulgaria was not in place, in certain countries (Croatia, FYR Macedonia) the wage gap with the EU had further widened.

Overview of wage levels in SEE region (2017 or latest available)

Country	National minimum wage	Minimum wage set by	Trade union Demand for MW	Average wage	Poverty threshold
Albania	22,000 LEK – 157 EUR	National Labour Council	28,000 LEK	394 EUR (public sector) 340 EUR (private sect.)	
Serbia	22,620.00 RSD 190 EUR	Social Economic Council	35.517,60 RSD 298 EUR	46,990.00 RSD 394 EUR	14,920.00 RSD (single) 125 EUR
Montenegro	193 EUR	Tripartite national council	254 EUR	767 EUR	186 EUR
FYR Macedonia	10,080 DEN, 164 EUR	Social Economic Council	MW to be raised to subsistence level	22,750 DEN, 370 EUR	Not specified

Still EU policies push for wage moderation for most CEE-s…

The main adjustment tool in the EU crisis management strategy has been wage reduction (not addressing the real cause, but creating harmful side-effects and also not fair) and time horizon is also flawed, result: double-dip recession

Policy of internal devaluation:

- Direct intervention into wage developments by cutting and freezing public sector and minimum wages (HU, LV, RO)
- Structural reforms of wage setting institutions to increase downward flexibility of wages

New European Economic Governance:

- European Semester/European Imbalances procedure: half of the EU Member states received recommendations
- Troika /Memorandum of Understanding

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So, are CEE wages too low or too high?

The picture is not black and white, substantial differences in wage trends among individual CEE-s:

Wage shares in GDP tend to be lower in CEE (cca 55%) than in EU15 (65%) and the main trend is also downward.

Biggest drops in Poland (12p.p.) and Hungary (12p.p.).

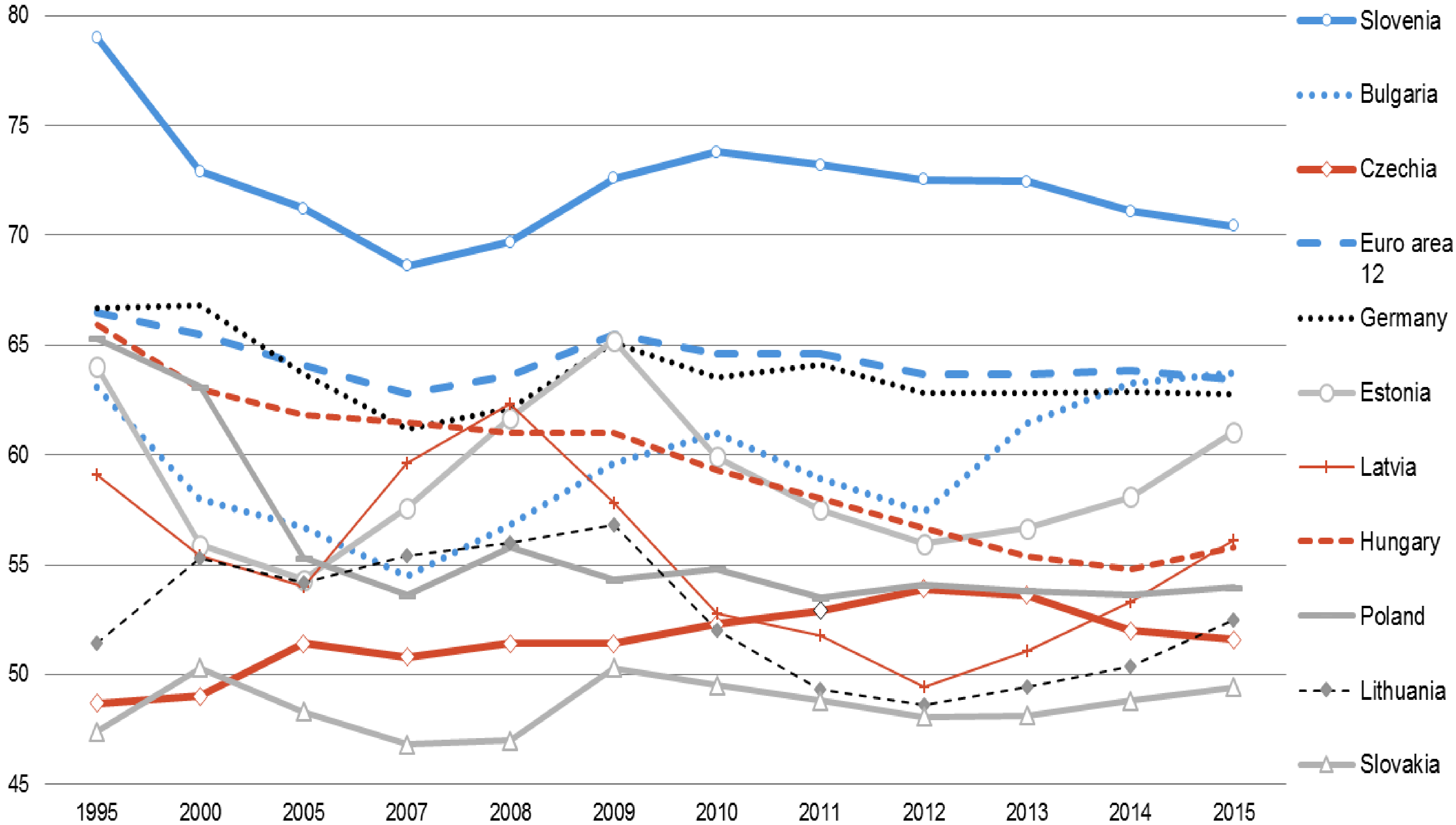
Exception: wage share in Slovenia is even higher than EU15 and wage share in Bulgaria increased a lot against the main trend.

Slovak wage share is lowest (49% of GDP).

A polarised picture in recent real wage trends,

BUT all CEEs (exc: BG) had lower real wage growth than productivity /2008-2015/.

Adjusted wage shares in GDP, % (1995-2015)



Source:AMECO

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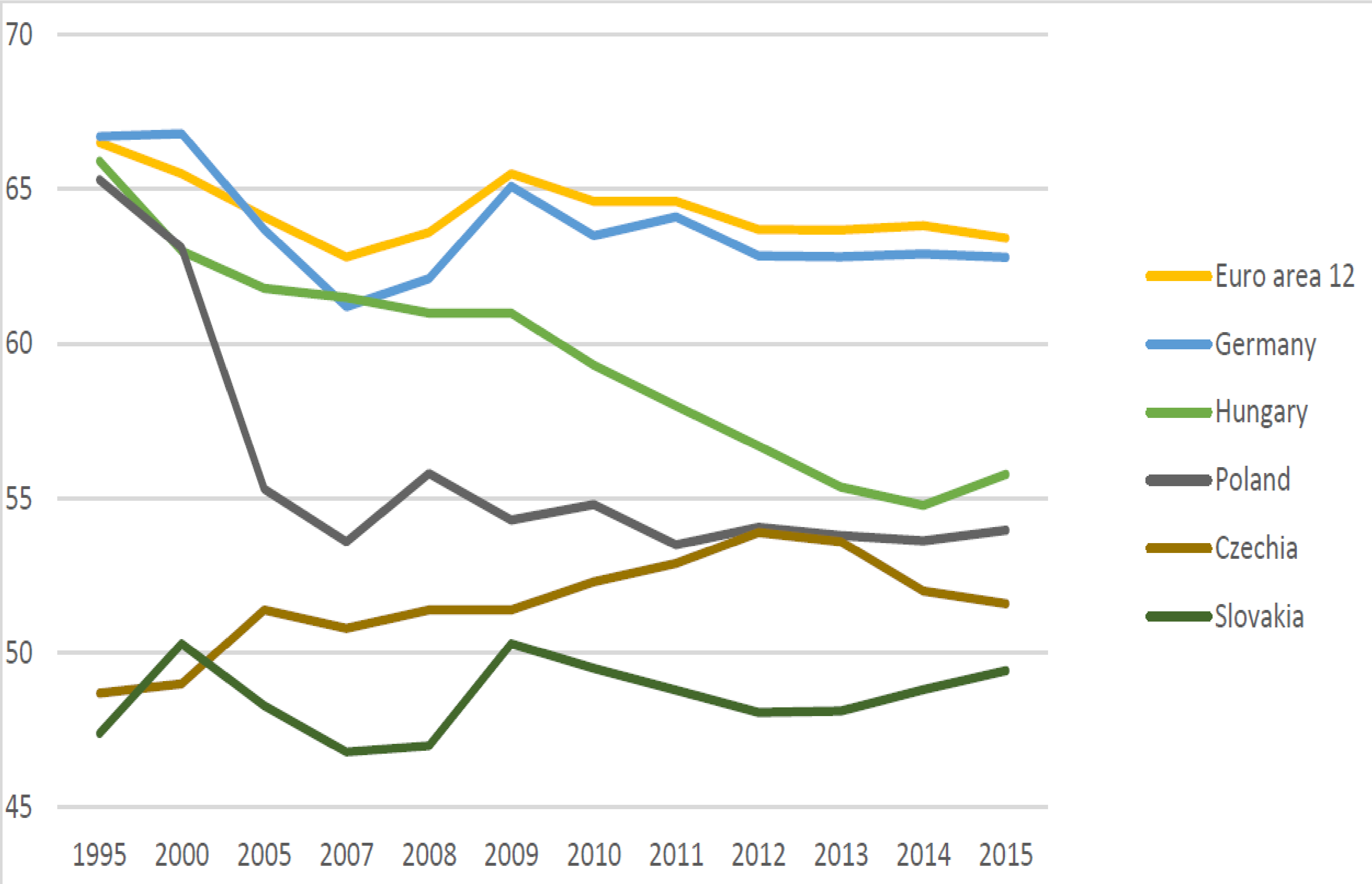
Focus: wage shares in V4 at the bottom of the EU



Higher wage dynamics in CEE not necessarily a loss of competitiveness

In CEE, no comparable loss of competitiveness occurred, as trade balances, export performance and market share gains show (see European Commission documents, as Annual Growth Survey)

Wage levels are still a fraction of that of the EU15. BUT higher productivity levels and increases in the exporting manufacturing branches. Wage adjusted productivity in manufacturing for CEEs is substantially higher than EU15 or Germany's.

This means: how much value added is produced by a unit measure of labour costs: in German manufacturing 100€ labour cost makes 132€ value added, in Hungary 212€

This `productivity reserve` gives room for upward wage convergence.

Wage-adjusted productivity in manufacturing, 2013

	Apparent labour productivity	Average personnel costs	Wage-adjusted labour productivity
	(thousand EUR per head)		(%)
EU-28	55	38.3	143
Germany	67,9	51.5	132
Czech Republic	25.9	15.9	163.3
Estonia	23.7	14.6	162
Hungary	28	13.2	211.7
Latvia	15.6	8.5	184.3
Lithuania	14.5	9.2	158.4
Poland	23.2	12	193
Romania	12	6.7	179.7
Slovakia	22.8	15.4	147.5
Slovenia	33.3	22.7	146.8

Source: Eurostat 2017 (online data code: sbs_na_ind_r2)

*apparent labour productivity is defined as value added at factor costs divided by the number of persons employed.

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Low wage trap: destined to be left behind; specialisation in low value added labour intensive activities > no future

Low wages also mean, low R&D and innovation activity

CEE are among the laggards in R&D spending and innovation

FDI in CEE is also not R&D intensive

Low innovation capacity in CEE is a blocking factor of further development and low wage profile contributes to conserve this

The role of CEE in international value chains is still dominantly based on cheap labour – a vulnerable position without future perspective

Even the automobile industry – a flagship industry of the region – that is otherwise R&D intensive, has low R&D engagement in CEE

Concluding remarks and outlook

GDP growth below potential, convergence is out of steam

Instead abandoning ‚low wage competitiveness‘ model, this is being reinforced

It is not too high wages or high wage increases that explain economic weakness and lower than potential growth

Austerity and risk avoidance by banks result in low investment activity

Foreign direct investments (FDI): at lower level – this a longer term trend

EU transfers provide a large part of public investments

ALL THIS is NOT SUSTAINABLE!!

A new growth model, investment and wage led growth, upgrading of the economy is needed

Concluding remarks and outlook

Stalled wage convergence between the CEE new member states and the EU core undermines social cohesion in the entire EU. With free flow of capital, services and people the persistently high wage gap creates adverse effects both in the East and the West. The resulting disappointment leads to the emergence of political forces that question core EU values. The lack of wage convergence is thus not only a matter of social injustice for the workers in the East, it is detrimental for sustainable growth and it threats the future of Europe.