

PANORAMA



Labour shortages in Central and Eastern Europe countries: a growing concern for businesses

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set to continue to fall

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TACTICS for alleviating labour shortages

Labour markets in the Central and Eastern Europe (CEE) region are continuing to improve. Unemployment rates have reached the lowest levels ever recorded and most CEE economies are enjoying lower unemployment than the EU average. Rising wages and low inflation, amid improving consumer sentiment, have made household consumption the main driving force behind economic expansion.

Nevertheless, while households and the region's overall economic activity are benefiting from these developments, corporates are suffering. The latter are faced with the strengthened wage bargaining power of their employees and are forced to accept higher compensation costs. Dynamic external and domestic demand, the low birth rate and emigration have all contributed to labour shortages. A rising number of companies are reporting this as a barrier to business expansion. Job vacancies are especially high in the Czech Republic and Hungary.

The increases in wages currently exceed labour productivity gains. Fortunately, regional labour costs remain much lower than in most Western Europe. On average, labour costs in Western Europe are more than 3 times higher than in CEE countries.

This comparative advantage, associated with the region's geographical and cultural proximity, should endure - although it could be eroded if emigration of the youngest and most skilled workers continues to weigh on productivity. Companies will continue to report labour shortages, especially with regards to qualified employees. Recent surveys indicate that skilled professions, drivers and engineers are among the vacancies that are the hardest to fill by employers in the CEE region. Labour shortages could be alleviated by encouraging emigrants to return and by more immigration. This would necessitate improvements in governance and addressing the reluctance in accepting migrants. Developing vocational training and tertiary education, as well as encouraging labour participation among the ethnic minority, female and senior populations, would also help to address the situation.



Labour markets in the CEE region are continuing to improve.





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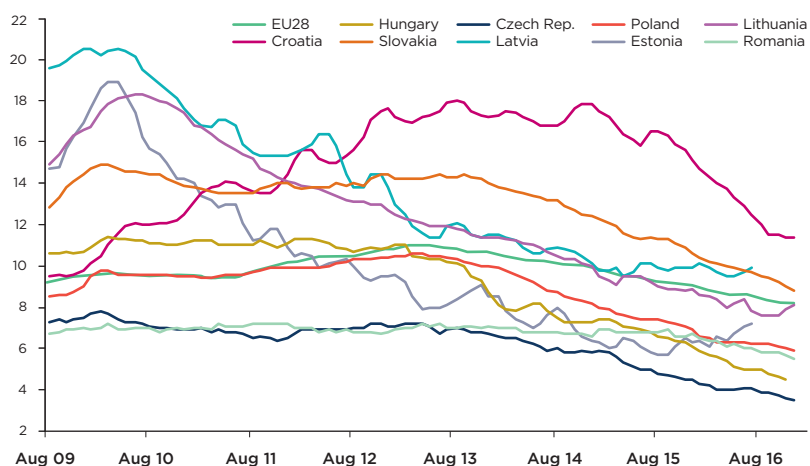
Unemployment set to continue to fall

After soaring in 2013, unemployment has significantly declined (see *chart 1*). Whilst four years ago unemployment rates stood at over 10% in nearly all CEE countries, hardly any of them experienced this situation at the beginning of 2017. The only exception is Croatia, where the unemployment rate was over 11% in December 2016. Nevertheless, it has contracted significantly over recent quarters, as just two years ago it was close to 18%. The improvement in the CEE region's labour market has been stronger than in the entire European Union, with a particularly sharp decrease in unemployment recorded during the last two years. Unemployment rates in CEE are now generally lower than in Western European countries. The Czech Republic enjoys one of the lowest levels of unemployment in the EU - even worldwide - falling to just 3.5% at the end of 2016. Many countries have returned to pre-crisis levels, in terms of unemployment indicators, with Poland reaching its lowest rate in 25 years.

Falling unemployment and rising labour shortages increase employees' bargaining power

CEE households have been enjoying a mix of developments that incite them to spend. In contrast with the past, not only are households less concerned about losing their jobs, but they also have seen their salaries grow. Most CEE countries have been recording positive wage dynamics over recent years (see *chart 2*). Since 2010, gross wages have jumped by more than 30% in Romania and Bulgaria, and by more than 20% in Hungary and Poland. The increasing difficulties in filling job vacancies, deriving from falling unemployment and rising labour shortages, have strengthened the wage bargaining power of employees. Moreover, many CEE economies recorded price deflation over the 2014-2016 period, resulting from the slump in commodity prices - in particular energy. In general, net energy importing CEE economies have been benefitting from this (mainly imported) deflation - which gave corporates more leeway to raise their employees' salaries. Finally, households in some CEE countries have also benefitted from additional fiscal measures. These include, for example, a sizeable decrease in Romania's Value Added Tax and new social allowances in Poland. While the repercussions of these last two factors (fiscal measures and deflation, see *chart 3*) are evaporating, the first, linked to labour shortages, will endure.

Chart 1:
Unemployment rates (%): Plunging in all countries



Source: Eurostat



While contributing to filling the gap with Western European and slowing emigration rising wages can only be sustained in the long run if they are accompanied by productivity gains.



Several factors have contributed to labour shortages

1/ Dynamic external and domestic demand

As the Eurozone recovered from its 2012-2013 double-dip recession, sentiments in the CEE region also began to improve. The growth acceleration in the euro area, where the bulk of CEE exports are destined, has made CEE corporates more confident in expanding their businesses, leading them to increase capacities and strengthen their workforces. Rising employment made households' assessments of their future brighter, especially when compared to the challenging year of 2013. This, along with increasing wages, accelerated consumer spending which, in turn, further fueled companies' expectations on the sustainability of demand for their products and services. As a result, corporates became even more willing to expand their businesses, both in capital and labour terms. Improving external demand, combined with the more recent expansion of domestic demand, has contributed to better prospects for the CEE region.

2/ Emigration to Western Europe

Nevertheless, the macroeconomic environment is not the sole reason for declining unemployment and rising salaries. CEE companies have been



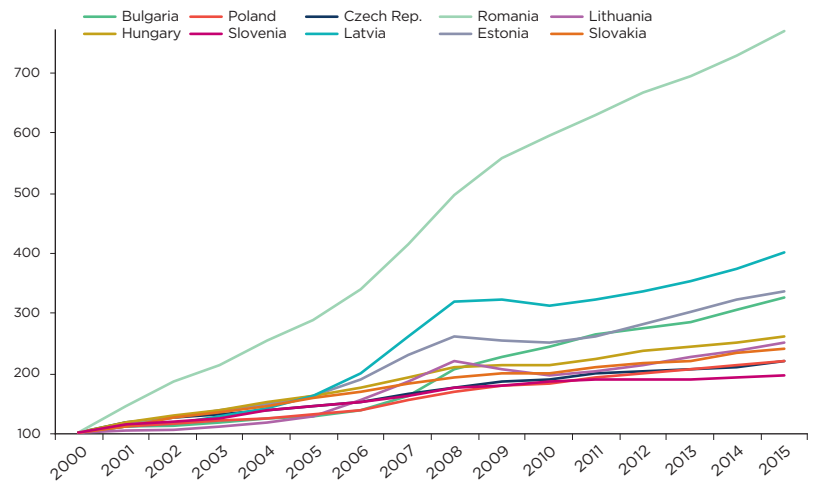
Labour shortages and the consequential rise in labour costs are a concern for businesses.



experiencing more difficulties in access to labour for some time. According to the IMF¹, since the fall of the iron curtain in 1990, approximately 20 million people emigrated - an estimated 5.5% of the entire region's population as at 1990 and 16% for the south-eastern European² population alone (see chart 4). Emigration has, on average, taken away between 0.5 and 1% of the region's working age population growth each year (with 0.6-0.9% peaks in south-eastern Europe and the Baltics). This trend began when wars broke out during the dislocation of Yugoslavia. It accelerated with the successive waves of EU enlargement (in 2004 and 2007) and visa facilitation for non-EU member countries. Although access to the Western European labour market suffered from some restrictions at the beginning, EU Western European countries have attracted a sizable share of the CEE's workforce, thanks to significantly higher wages, brighter employment prospects and the better quality of their governance. The process has been cumulative and generally unidirectional, although a few countries (Czech Republic, Hungary, Slovenia and also Russia) did register positive net cumulative migration during the 1990-2015 period, due to their relatively better living conditions (for example job prospects, salaries and education). This net positive migration reached almost 10% of the 1990 population in Russia (with arrivals from other CIS countries), and a few percentage points in the other three countries (arrivals from neighbouring countries). Despite some expats returning to their home countries, the balance remains extremely negative and this trend is unlikely to reverse. Even if the Brexit results in a lower outflow of the external workforce to the United Kingdom, other Western European countries will remain attractive destinations for relocation. Additionally, although remittances from migrants to their families back home can feed their levels of consumption and, to a lesser extent, investment, these revenues can remove the incentive for their relatives to enter the job market. Remittances account for a large share of GDP in Southeastern Europe (16.7% in Kosovo, 11.1% in Bosnia Herzegovina, 9.6% in Montenegro, 9.2% in Albania, 9.1% in Serbia and 4.3% in Croatia) and in some CIS countries (23.4% in Moldova and 6.5% in Ukraine, according to the World Bank in 2015).

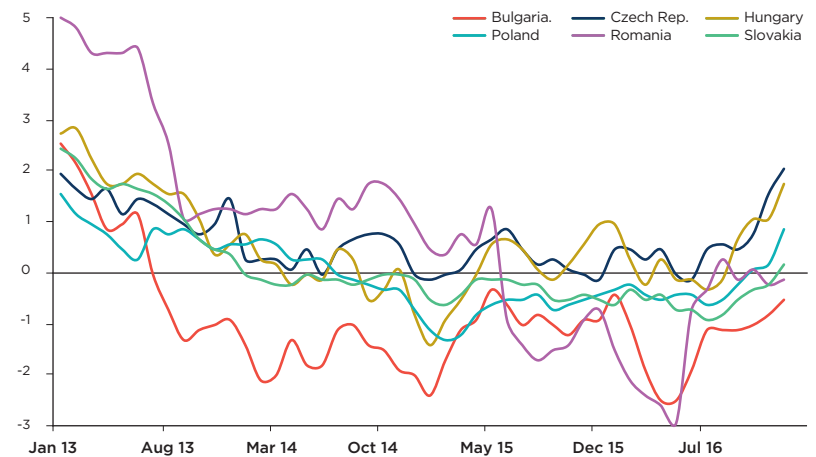


Chart 2:
Labour costs index



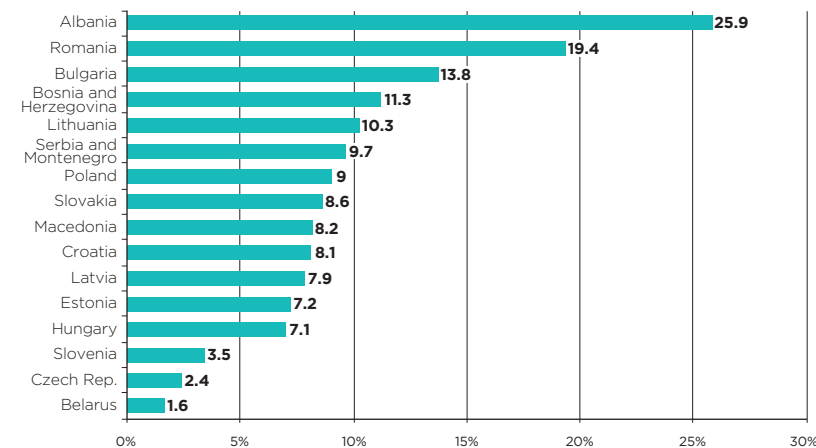
Source: Eurostat

Chart 3:
HICP inflation (%):
Deflation belongs to the past, wages could add to the recent rise in energy prices



Source: Eurostat

Chart 4:
Emigration: 2010-2014 gross emigration flows represents up to 25% of the population



Source: OCDE International migration database, IMF, Coface calculations

1/ Atoyan, Christiansen, Dizioli, Ebeke, Ilahi, Ilyina, Mehrez, Qu, Raei, Rhee & Zakharova (2016): *Emigration and its impact on Eastern Europe*, IMF

2/ Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Montenegro, Romania and Serbia.

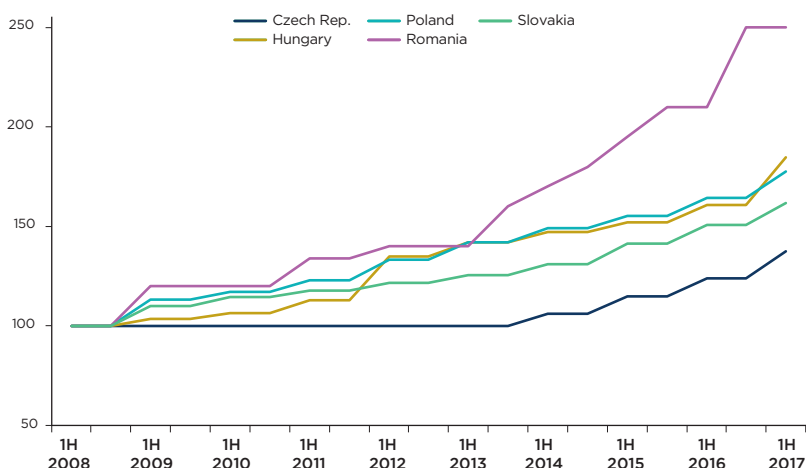


To tackle this trend, governments have been forced to raise minimum wages (see chart 5). Over the last decade, minimum wages have nearly doubled in Hungary and Poland, while in Romania they are 2.5 times higher this year than in 2008. In most cases, the acceleration in minimum levels of compensation began in 2013. Although only a minor share of the employed workforce earns the minimum wage (in Poland this applies to 13% of employees), the elevation of minimum wages triggers pressure on overall wage scales. Salaries in the public sector are indexed to the levels of minimum wages in a number of CEE countries.

3/ Low birth rate:

It is not just the negative impact from emigration that is felt on the workforce but also the influence of the low birth rates that have been experienced by many CEE countries for decades, often since World War II (see chart 6). Even when emigration is not taken into account, the population would still be shrinking in the Baltics, Bulgaria, Ukraine and Belarus, while stagnating or hardly growing in Croatia, Hungary and Romania. Apart from Hungary that registered net positive migration, emigration has added to the underlying diminution of the working age population in the region. Conversely, in Slovakia, Poland, Macedonia, Bosnia Herzegovina and Albania, dynamic natural population growth has either compensated for, or dampened, the negative effect of emigration. Slovenia and the Czech Republic have simultaneously registered natural population growth and cumulative positive migration.

Chart 5: Minimum wages (2008=100): Romania minimum wage progression beats all others

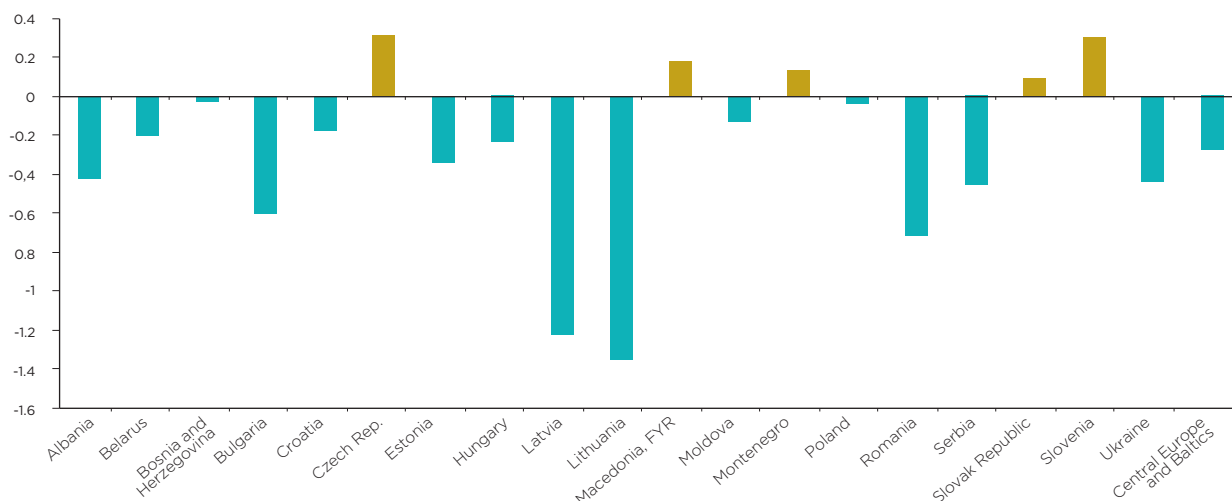


Source: Eurostat

Households are benefitting from labour shortages, while corporates are suffering

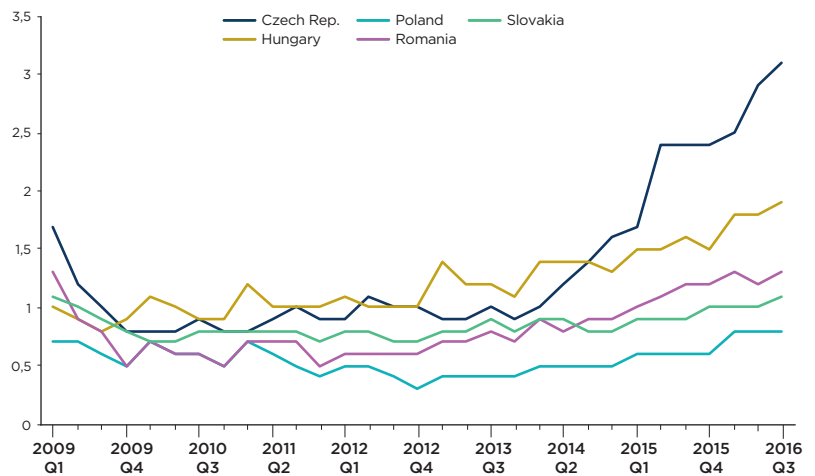
Developments on the labour market have undoubtedly been beneficial for households. They have become more confident, as confirmed by rising sentiment indicators and increasing private consumption - which has become the CEE region's main economic growth driver. A further contraction in unemployment, accompanied by rising wages, is anticipated. These factors will undoubtedly retain household spending as the main propulsor for regional growth.

Chart 6: Natural population growth: Countries registering population growth are rare



Source: World Bank

Chart 7:
Job vacancy rates (%): Dramatic increase in the Czech Republic



Source: Eurostat

Nevertheless, companies are facing increasing difficulties in hiring new employees, particularly qualified ones. This problem is made even more acute by the fact that the proportion of young, skilled workers among emigrants is generally higher than the population average. This situation has been particularly felt in southeastern European countries, where working age people represent 80-90% of emigrants, compared to under 70% in their originating population (according to the 2010 OECD Database on Immigrants). In Central Europe and the Baltics, the skills difference is pronounced. In these countries emigration has mainly concerned those with higher education, with the difference in respective shares ranging from 10 to 25 percentage points (according to World Bank Development Indicators). Paradoxically, while the resulting brain drain can be absorbed to a larger extent in Central Europe and the Baltics, due to the high contingents of those educated to a tertiary level, this is not the case in southeastern Europe, where education levels are, on average, lower. Unsurprisingly, filling vacancies has become particularly difficult in larger towns and manufacturing regions (for example in Bratislava and its surrounding region in Slovakia, Western Hungary and Prague and its surrounding area), where unemployment rates are even lower than in the countries as a whole, and the needs for highly skilled workers is greater, leading to salary inflation. This problem is often compounded by a lack of internal geographical mobility. Job vacancy rates³ have risen to levels not previously experienced, despite companies being more willing to increase salaries in order to retain employees or hire new ones.

Even companies that accept paying higher wages are still confronted with difficulties in hiring employees. As can be seen in chart 7, job vacancy rates are particularly high in the Czech Republic and Hungary. According to surveys carried out among businesses, an increasing number of CEE companies are highlighting labour shortages as a constraint for them. Taking Poland as an example, this difficulty has been experienced by more and more businesses since 2013 – particularly with regards to the needs for skilled labour, which represents a problem for nearly 27% of manufacturing companies (with even higher ratios in sectors such as metals, electrical equipment, machinery, automobiles and furniture). Several other sectors, including construction, are also citing labour shortages as a factor limiting their business activity⁴.

In another survey (ManpowerGroup’s Talent Shortage Survey 2016/2017), more companies reported difficulties filling jobs in some CEE countries than in the region as a whole. While the proportion reached 40% in the whole region, 44% of companies in Slovakia reported labour shortages, 45% in Poland, 57% in Hungary, 62% in Bulgaria and 72% in Romania. According to the same survey, Romania is ranked in 3rd place, globally, in terms of the highest labour shortages⁵. In CEE countries, the occupations reported by employers as being the most difficult to fill are skilled trades, drivers, engineers, labourers and medical professionals. At the same time, corporates are also finding it difficult to fill IT vacancies. This is somewhat in line with personnel shortages being reported globally.



Chart 8:
Top 5 jobs where employers are experiencing difficulties in recruiting

	GLOBAL	EUROPE	CEE
1	Skilled Trades	Skilled Trades	Skilled Trades
2	IT Personnel	Drivers	Drivers
3	Sales Representatives	Engineers	Engineers
4	Engineers	Sales Representatives	Laborers
5	Technicians	Technicians	Medical professionals

3/ Job vacancy rate is defined as the ratio of job vacancies to the sum of occupied posts and job vacancies.

4/ Business tendency surveys, Central Statistical Office, <http://stat.gov.pl/en/topics/business-tendency/business-tendency/business-tendency-survey-in-industry-construction-trade-and-services-2000-2017,1,2.html>.

5/ Japan and Taiwan rank 1st and 2nd places, respectively (reporting labour shortages of 86% and 73%, respectively).

Source: ManpowerGroup Talent Shortage survey 2016/2017, own compilation of CEE region using ManpowerGroup’s survey’s results in: Bulgaria, Czech Rep., Hungary, Poland, Romania, Slovakia and Slovenia.



The increase in wages exceeds productivity gains, but labour costs remain much lower than in Western Europe

The rise in salaries (see chart 2) has been stronger and sharper than labour productivity gains (see chart 9).

Significant productivity gains have been registered in the region over recent decades, particularly before the 2008 financial crisis. These gains are not just the result of domestic investments but also from the inflow of technologies and expertise from foreign companies that have heavily invested in the region. After a parenthesis of contraction, due the transition between two EU funding programs in 2016, growth in investments is returning.

Clearly, however, this does not compensate for the lasting catch-up effect with Western Europe, which is characterizing the evolution of regional wages. As a result, unit labour costs, which link productivity to labour costs, have been growing (see chart 10) at a faster pace than wages. Fortunately, labour costs are still much lower than in most Western European countries (see chart 11) and, despite further increases, should remain so - at least in the foreseeable future.

Over the longer term, this comparative advantage could evaporate. Productivity gains are being affected by the cumulative effects of the lasting emigration of young and skilled workers on the productivity of those that stay behind and, more generally, on total factor productivity⁶. Moreover, foreign investment in technology requires an adequate workforce to use it, as a skilled labour shortage can deter foreign technology investment, weighing even more on productivity. The OECD recently reported that labour productivity gains slowed down after the financial crises in the Baltics and Central European countries. A recent IMF paper⁷ confirms the link between a slowdown in productivity gains, demographics and a slowdown in (foreign) investment. If a decline in global trade, a stalled expansion of the global (European) value chain and debt overhangs linked to pre-crisis excesses are cited as causes of the slowdown in investment, skilled labour shortages are also part of the equation.

A return of some of the most skillful emigrants to their home countries could solve some of the problems, but this trend is rarely observed. CEE countries could, thus, lose their leading position in international (mainly Western European) supply chains. Luckily, the geographical and cultural proximities between Western and Eastern Europe, along with the advantageous gap between their respective unit labour costs, make the possibility of this risk low - but not impossible in the remote future.

Tactics for alleviating labour shortages

1/ Encouraging immigration and the return of emigrants by improving living conditions

CEE companies which previously mainly hired their own nationals, have now become more open to employing foreigners (chiefly from Ukraine). This inflow has been particularly increasing since 2014, due to the contraction of the Ukrainian economy and armed conflicts in the eastern part of the country.

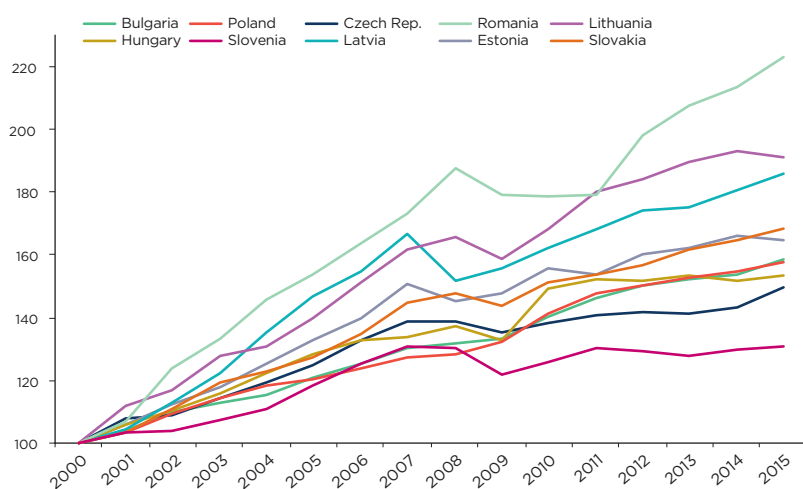
6/ Haque and Kim (1994) in *Human capital flight: Impact of migration on income and growth*. (IMF Working Paper No 94/155); Burns and Mohapatra (2008) in *International Migration and Technological Progress* (Migration and Development Brief 4); Docquier, Ozden & Peri (2011) in *The Labour Market Effects of Immigration and Emigration in OECD Countries* (IZA Discussion Paper No 6258).

7/ Stepanyan, Raei and Podpiera (2017): A fresh look at potential output in Central, Eastern and Southeastern European countries. IMF Working Paper (No 17/37).

Charts 9 & 10:

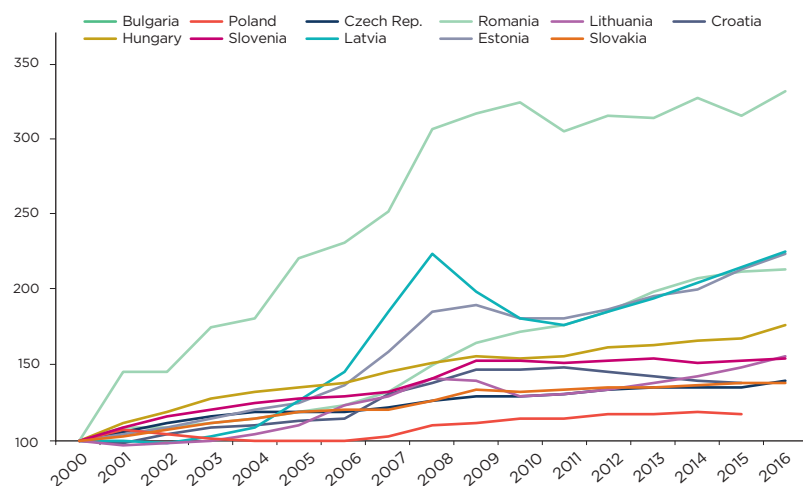
Labour productivity generally growing at slower pace than wages

Labour productivity index



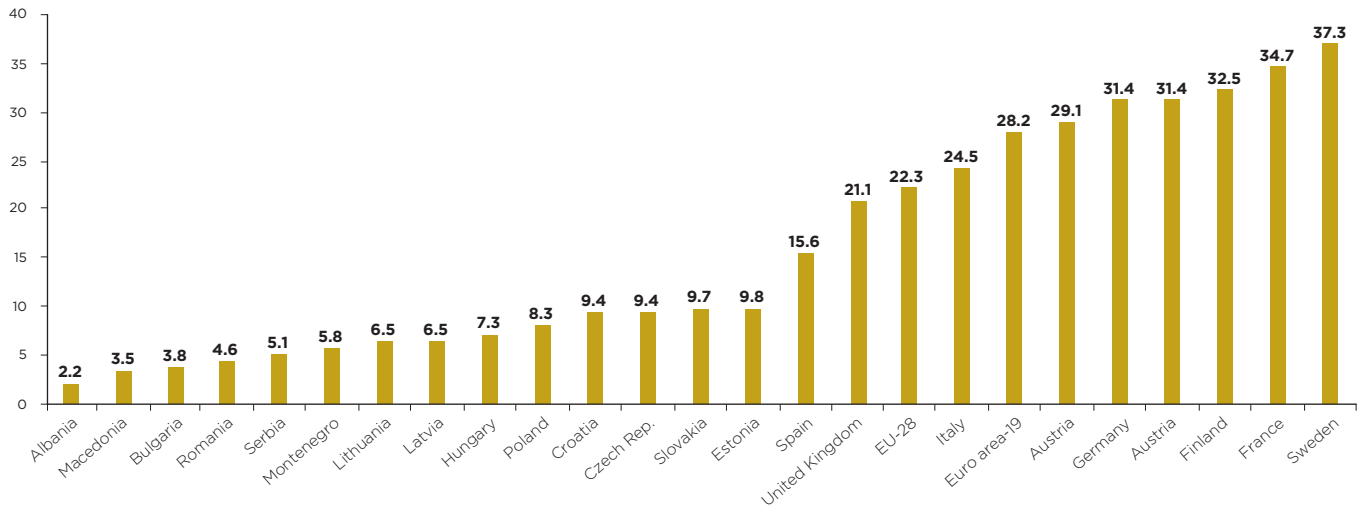
Source: Eurostat

Nominal unit labour cost index



Source: Eurostat

Chart 11:
Labour costs remain much lower than in Western Europe



Source: Eurostat

Poland appears to be the most attractive destination for Ukrainians, thanks to its geographical and linguistic proximity. In 2015 it was estimated that there were up to 1 million Ukrainians living in Poland. They mainly worked in unqualified manual jobs in construction and agriculture, but also in services (see *chart 12*). Other CEE countries, including Hungary and the Czech Republic, have also become more open to employing the Ukrainian workforce.

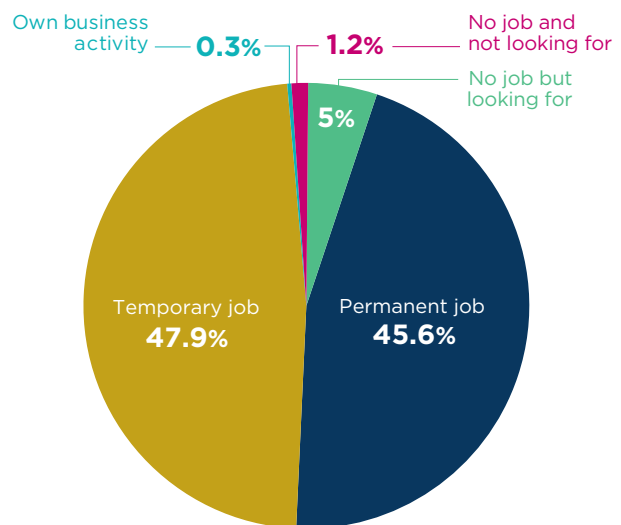
Immigrants are also arriving from overseas, but the numbers are anecdotal. Moreover, immigration remains constrained by the reluctance of governments and populations (in most regions) to accept migrants from any origin. Poor governance (see *chart 14*) is a deterrent to the immigration of skilled labour, and the return of skilled migrants, in most of southeastern Europe and CIS – the countries where they are most needed⁸. Progress from the government side would therefore be a way of loosening the stranglehold of shortages in skilled labour.

The return of emigrants to their native countries is very limited. According to surveys and media information, Ukrainians tend to remain in Poland – as confirmed by their higher presence among buyers in the real estate market. Some of them do go back home for a short period of time, but then return to Poland. The Ukrainian economy is not really improving.

In terms of Polish people emigrating to the UK, some do return but they are mainly senior level financiers taking top management positions in large Polish companies. In general, emigrants do not tend to return to Poland. Even if they are hurt by

Definition: Total labour costs are divided by the corresponding number of hours worked by the early average number of employees, expressed in full-time unit. Labour Costs cover Wages and Salaries and non-wage costs (Employers social contributions plus taxes less subsidies).

Chart 12:
Structure of employment of Ukrainian workforce in Poland



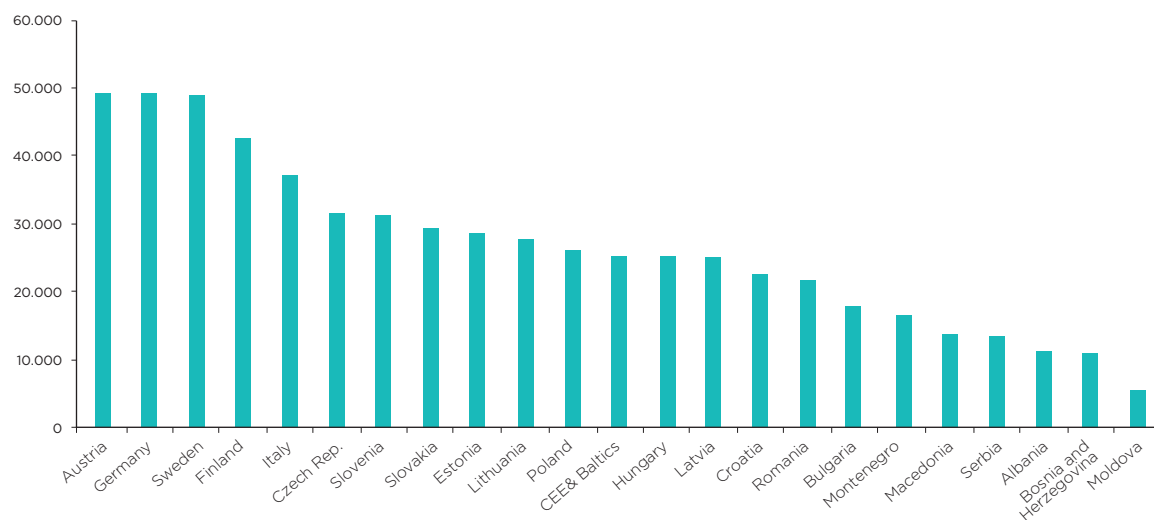
Source: National Bank of Poland's survey



8/ Cooray and Schneider (2016): *Does corruption promote emigration? An empirical examination*, Journal of Population Economics; Ariu, Docquier & Squicciarini (2016): *Governance quality and migration flows*, Elsevier Regional Science & Urban Economics.



Chart 13:
Much lower income than in Western : GNI per Capita (in current USD), 2015



Source: World Bank



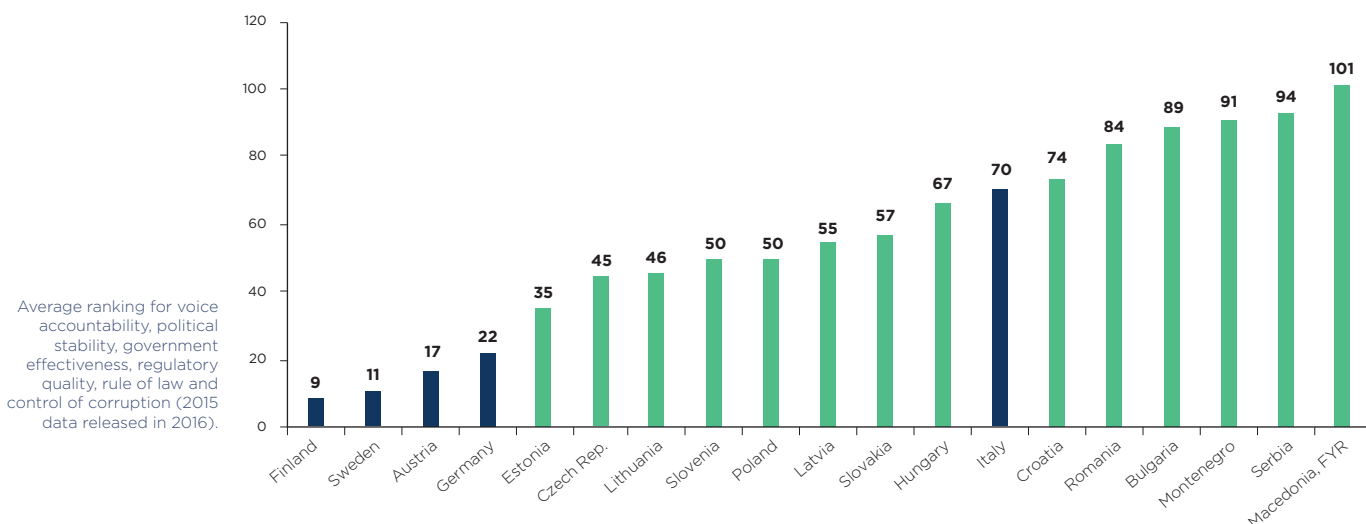
Brexit in the future, they will be more motivated to find work in other Western European countries than in Poland, due to the significant (although decreasing) differences in the level of income (see chart 13).

2/ Promoting vocational training and tertiary education

Despite the decline in unemployment rates, which is expected to continue, the labour market is still suffering from mismatches. This is illustrated by the persistently high levels of unemployment among young people and underemployment in rural areas. This is an indication of structural unemployment. Some of the unemployed are unable to find work due to their lack of sufficient education levels, or differences between their skills and those required. Although there are dedicated programmes in place

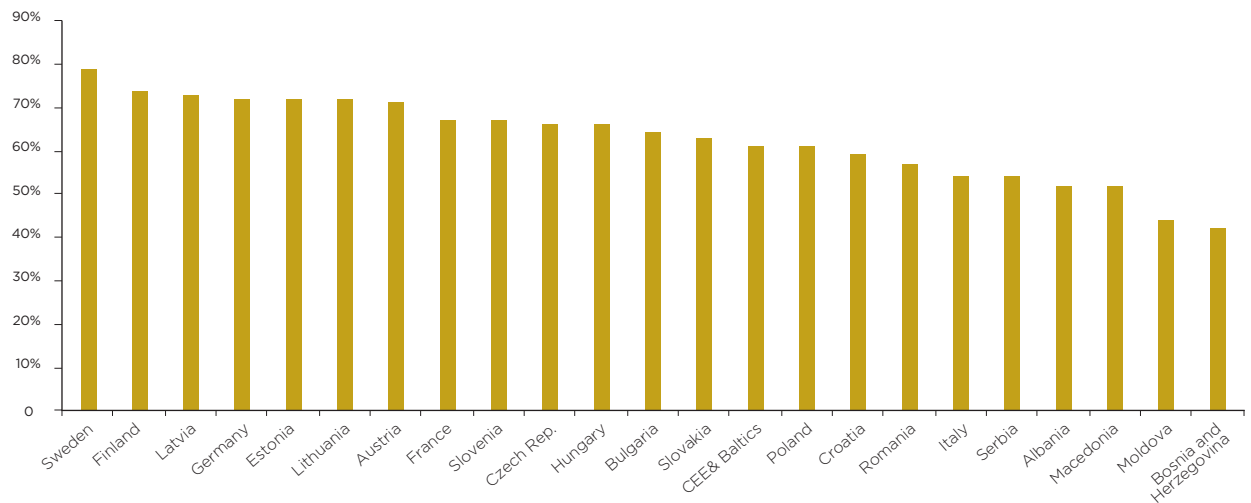
to retrain and requalify these profiles, they are not sufficient to address all of these individuals. Hungarian public works programmes employ a considerable numbers of people in low skilled and low paid jobs, without enhancing their competencies. Considering the latest developments on the labour market, the problem of mismatches seems to be particularly prevalent in Estonia and Lithuania where, as well as a rising number of job vacancies, there are also some increases in unemployment. Enhancing agricultural productivity in CEE countries (such as Romania and Bulgaria), where this sector is a high employer, could free up more of the workforce for other segments and help to relax the pressure on labour costs. Finally, training the working age population could partially compensate for the emigration of skilled labour.

Chart 14:
Governance still leaves a lot to be desired, especially in SEE countries



Source: World Bank, Coface calculation

Chart 15:
Female participation in the labour market remains low in southeastern Europe (2014)



Source: World Bank

3/ Integrating minority, female and senior populations

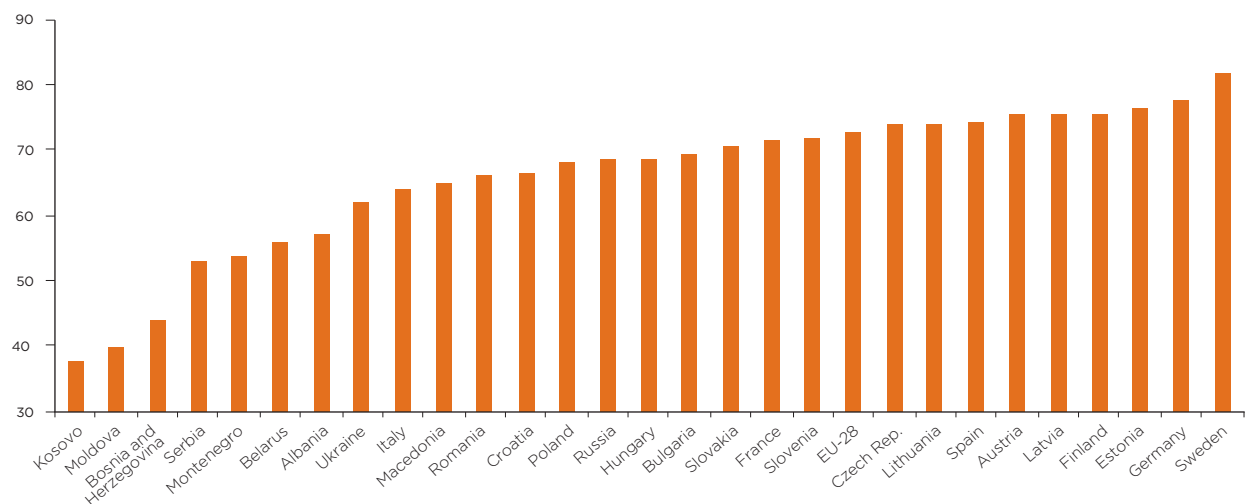
In several CEE countries, a significant number of minorities fall by the wayside of the mainstream economies. This is particularly the case with the Roma in Hungary (7% of the population), Bulgaria (5%) and Romania (3%). The Hungarians (6%) in Romania, Russian speaking people in Estonia (25%) and Latvia (27%), the Turks (9%) in Bulgaria and the Albanese (25%) in Macedonia are also concerned. Despite progress made thanks to financial motivations from the EU, the integration of these minorities is still insufficient.

Compared to Sweden (79%), Finland (74%), Germany (72%) and Austria (71%), the rate of female participation in the working population remains low in Poland

(61%), Hungary (59%), Croatia (59%), Romania (57%) and Serbia (54%). This is mainly due to the lack of child and senior care facilities in many countries.

A low senior (over 55 years) participation rate is also observed in the same countries. Most governments in CEE countries are willing to increase the retirement age, in order to mirror aging populations and longer lifespans. In this regard, Poland's latest decision to reverse retirement reforms and bring the retirement age back down from 67 years to 65 for men and to 60 for women will have adverse effects on the labour market, the state budget deficit and Poland's economy – even if it fulfills election promises.

Chart 16:
Participation rates: South-Eastern European countries show low participation rates (% 15-64 olds, 2015)



Source: Eurostat (National statistics for non-EU countries)

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