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### Detroit east

Auto makers and suppliers are competing for workers in the tiny nation of Slovakia, which is on track to becoming the world's largest producer of cars per capita.

**Bratislava:** Volkswagen's factory employs 9,300 workers. Cars produced include Polo and Audi Q7.

**Trnava:** Peugeot-Citroën SA's factory employs 3,400, and has an annual capacity to make 300,000 units.

**Zilina:** Kia's factory started production in 2006; it has a 300,000-unit capacity.

Source: the companies


**ENGINE TROUBLE?**

# In Eastern Europe, low pay is driving workers away

*Labor squeeze strains industry; Detroit East's fliers*

*By* **Joellen Perry** *in Warsaw and* **Stephen Power** *in Bratislava, Slovakia*

IN RECENT YEARS, global car makers have flocked to Slovakia, attracted by the Eastern European country's plentiful supply of low-cost, skilled labor. But this year, when Kia Motors Corp. needed extra workers at its local car plant, it had to place fliers in local newspapers and mailboxes urging residents to apply.

Near Bratislava, an area with so many car and supplier factories that it is now known as Detroit East, rival Volkswagen AG is so short of help that every day it buses workers from as far away as 100 kilometers.

"I have the most difficult job in the company," says Jaroslav Holecek, director of human resources at VW's Bratislava plant. "Every day people come to me and say, 'I quit. I'm moving to England.' We can't stop them."

Fast growth and high emigration to richer Western European countries are threatening to undermine the strongest asset of the former Soviet bloc nations that joined the European Union three years ago: plentiful, skilled labor at the right price. A dwindling pool of workers is driving up wages in key industries and forcing companies to go to greater lengths to recruit and retain people. It is also eroding one of the EU's key responses to competition from Asia—its low-cost hinterland.

Reform fatigue is compounding the problem. In formerly communist countries, the transition to free-market economies has brought more than a decade of belt-tightening and political turmoil. Across the region, workers are growing frustrated. Populist governments are capitalizing by trying to roll back earlier changes to labor laws and to block new ones.

Tightening labor markets aren't, of course, strictly an Eastern European phenomenon. Global economic growth has been so

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# In Eastern Europe, low wages are driving workers away

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strong for the past three years that unemployment rates have come down almost everywhere. The euro zone's unemployment rate fell to 7% in May, the lowest since Eurostat, the European statistical agency, began calculating the measure in 1993. The U.S. jobless rate in June was at 4.5%, close to a six-year low, though the pace of wage increases for typical workers hasn't accelerated much. The 30-member Organization for Economic Cooperation and Development said recently that in nearly two-thirds of its member countries, unemployment has fallen below sustainable rates.

As the global economy strains against capacity constraints, central bankers are worrying about rising inflation rates—a sharp contrast to the worries about deflation earlier in the decade. Companies in many countries are operating at close to full capacity, facing shortages of everything from land to equipment.

The car, electronics and other companies operating in Eastern Europe aren't about to pull out. With average wages just 16% to 34% of those in countries such as Germany, the countries of Central and Eastern Europe are expected to remain attractive places to make cars and other goods for years. But the labor squeeze is driving up costs, giving new leverage to workers, and speeding Eastern Europe's transition from a low-cost manufacturing haven to a mature market economy.

"Our friends in Eastern Europe should have the same high living standards as people in Western Europe," says Carl-Peter Forster, president of General Motors Corp.'s European division. "The question is how fast you go....We should avoid adjusting the standards too quickly, in order not to lose many opportunities for job growth."

In recent years, waves of foreign investment and booming domestic consumption have spurred growth across Central and Eastern Europe. Last year, tiny Slovakia raked in a record $4.2 billion in foreign investment, and Poland, the East's biggest economy, attracted a record $13.9 billion. Last year, Slovakia's economy grew by more than 8%; Poland's, by 5.8%. The 13 countries that share the euro currency grew, on average, by 2.7%.

Now, central banks across the region are fretting about wage inflation. If they respond by raising interest rates, economic expansion will likely slow as consumers and firms curtail spending. The Polish National Bank cited rising wages as a reason for its surprise quarter-point interest-rate increase, to 4.5%, in late June. Economists worry that shortages of skilled labor could crimp spending.

"This may become a constraint to further foreign direct investment and economic growth," says Jan Rutkowski, the World Bank's lead economist for Europe and Central Asia.

Already, skills shortages are forcing companies to pay closer attention whether worker turnover is affecting quality.

"It's much more challenging to keep the production lines running," says Nikolaus Pfister, chief executive of SE Bordnetze-Slovakia in Nitra, Slovakia, which supplies wiring harnesses to car makers. In the past year, the company has doubled the number of supervisors on its factory floor. "We have new people pouring in every week," he says. "You have to check their work."

Polish President Lech Kaczynski has complained of being unable to find someone to paint his house because all the painters have moved away. Since Poland joined the EU in 2004, some 800,0000 Poles—many of them young and educated—have emigrated west, by conservative estimates. Most go to the U.K. and Ireland, which lifted labor-market restrictions for eastern EU members. Last year, the exodus helped reduce Polish unemployment to 13.8%, from nearly 20% three years ago.

Poland's unemployment rate is still among Europe's highest. In part, that is because many workers, trained in the communist era, have skills more suited to declining state industries like shipbuilding and mining. For others, housing shortages and higher prices keep them from moving to where the jobs are.

Poland's labor laws also contribute to labor shortages. Teachers and coal miners, for example, can retire after 25 or 30 years of work, regardless of age. As a result, as many as 1.6 million able-bodied Poles—6.5% of the working-age population—aren't part of the labor force. Partly due to pressure from businesses, the Polish government pledged to curtail some early retirement programs next year. But analysts worry lawmakers will bow to political pressure to preserve the perks.

In Slovakia, car makers and other large employers have tangled with Prime Minister Robert Fico over government attempts to restrict their ability to hire temporary employees, and to set limits on the amount of overtime work that companies can demand from employees. Mr. Fico, a left-leaning populist, says it is time for ordinary Slovaks to reap the benefits of a fast-growing economy, starting with "a more social labor code."

"I don't want companies to invest here because we have low wages," Mr. Fico said in an interview during a visit to Volkswagen's Bratislava factory. "I want them to invest here because we have highly qualified workers and good infrastructure."

Shortages of skilled laborers have caused some employers to grant hefty pay raises. In April, Skoda Auto, Volkswagen's Czech unit, agreed to a 12.7% pay increase, phased in over 21 months, for some 25,000 workers after they staged a one-day strike. Last month, some 2,700 workers at a General Motors plant in southeastern Poland got $650 bonuses—more than half an average month's wages. In addition, they got 1% wage increases this year and last.

This year, wages in Poland are expected to grow faster than productivity for the first time, according to Warsaw's Center for Social and Economic Research. Polish doctors earn about $460 a month, prompting many to emigrate west for higher salaries. Many who have stayed behind are now holding strikes, demanding pay increases of as much as 100%.

Employers are also concerned about Eastern Europe's aging work force. One quarter of Skoda's Czech workers are over 50—a percentage that is rising fast. Industry executives are lobbying Prague to speed the approval of work-permit applications from job seekers in former Soviet republics, as well as from countries with young populations, such as Vietnam.

The scarcity of skilled workers is acute in the area many Slovaks refer to as Detroit East, which extends in a roughly 190-kilometer radius around Bratislava. Car production there is set to more than double this year, to more than half a million vehicles. As early as next year, Slovakia, with a population of 5.4 million people, could become the world's largest producer of cars per capita, according to estimates by J.D. Power Automotive Forecasting.

Until a few years ago, most foreign companies shunned the country—Volkswagen was a notable exception—amid concerns about its authoritarian premier, Vladimir Meciar, an ex-boxer who tightly controlled the state media and drove up the deficit with public-works projects. Then a more business-friendly government took over, cutting corporate taxes and putting the country on track to EU membership.

In January 2003, Slovakia bested Poland in a contest for a new €700 million, or about $1 billion, Peugeot factory employing more than 3,000. A year later, Kia, a unit of South Korea's Hyundai Motor Co., decided to build its first European plant in Zilina, which is 190 kilometers northeast of Bratislava. That created more than 2,000 additional jobs directly and lured more suppliers to the region. Employers from other industries have followed, including Samsung Electronics Co., which in March announced plans to build a new factory in Trnava.

"It's a totally different market," says Mr. Holecek, the VW personnel director. "We used to be alone here. People only wanted to work for VW. Now, it's much harder to find people who want to work for one company."

Similar investment surges have tightened competition for technology and back-office workers in Poland. Tax breaks and a surfeit of inexpensive, educated labor have lured companies to the region around Wroclaw, a city of 670,000 in western Poland where Hewlett-Packard Co., Sweden's Electrolux AB and South Korea's LG Philips Group Co. have set up shop in recent years. By last fall, the pool of skilled labor was so shallow that mayor Rafal Dutkiewicz put up billboards in the U.K. and Ireland proclaiming: "Come back Poles, we have work for you. Wroclaw loves you."

In Slovakia, car makers and suppliers are recruiting from farther away—even from outside the country. Peugeot has built 1,400 dwellings at its factory in Trnava to lure more workers from the country's east. Volkswagen last year recruited about 100 workers from Poland, only to see most quit within a few months to take jobs in Western Europe, company officials say.

"When we advertise, there's often no response," says Norbert Gabriel, director of a Brose AG factory in Bratislava that supplies Volkswagen with door systems and window regulators.

The shortages have benefited workers such as Kamille Lenart, a 26-year-old Hungarian. In 2004, after two years at Edscha SA, a German auto-parts supplier in the western Slovak city of Velky Meder, she moved to Hungary for a job at Audi, increasing her monthly pay to €700 from €500. This April, she jumped to Dirks Logistik GmbH, a Volkswagen contractor in Bratislava. "I was constantly getting offers," she says, "and I didn't have to go far away to earn good money."

More than 170,000 Slovaks now work abroad, according to government estimates, nearly three times the number in 2000. Robert Tancibok, a 22-year-old welder at VW's Bratislava plant, recently told his bosses he plans to move to Frankfurt later this summer. He intends to wash dishes at a restaurant for €8 an hour, about 30% more than his hourly wage at VW. He says he wants to earn enough money to one day return to Slovakia, buy his own house and start a family.

As Eastern Europe's population ages, some economists contend, labor-supply problems may grow. Five of the eight ex-communist countries that joined the EU in 2004 suffered net population drops last year. The cost of caring for rapidly aging populations could drive up tax rates and expand deficits. That, in turn, could make it difficult for countries to embark on public-service projects such as building affordable housing to help lure emigrants back home.

Already, some large employers in Eastern Europe are looking farther afield for solutions. Mr. Pfister, who heads the wiring-harness maker, says his company has cut roughly 700 jobs in Slovakia over the past year—20% of its local work force—and transferred some production to Ukraine, Bulgaria and Morocco.

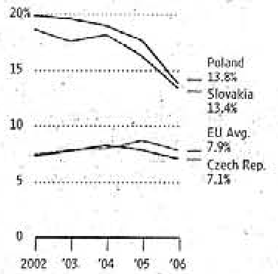
Others are importing labor. Poland's largest residential building firm, J.W. Construction Holding SA, imported some 200 laborers from Uzbekistan and Tajikistan in April to supplement its Polish skilled-labor work force of 1,000. Last fall, to help construction and agriculture firms, the Polish government lifted visa and work-permit restrictions on short-term workers from neighboring countries such as Ukraine and Belarus. Proposals are afoot to extend those privileges to workers world-wide.

*—Malgorzata Halaba in Warsaw contributed to this article.*

## Labor pains

As economic growth accelerates and many workers migrate west, Eastern Europe's unemployment rates are falling, squeezing supplies of skilled labor.

Unemployment rate




Source: Eurostat