RELOCATION

CHALLENGE AND OPPORTUNITY

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Relocation creates benefits for everyone

The phenomenon of relocation which has recently received a great deal of media attention is an emotionally charged issue. The speeding-up of globalisation with the emergence of new players such as China and India has certainly increased the pressure on European companies to develop a global business strategy. Hard facts still underline that, so far, the threat of a massive relocation of economic activities is exaggerated. Nevertheless, relocation is one aspect of the much wider process of globalisation and structural change, with momentous consequences for European society.

It is important to understand both why enterprises relocate and what the impact of relocation on the prosperity outcome is. Following the important reduction in transport and communication costs experienced in recent times, enterprises have adopted internationalisation strategies. European firms go abroad because they cannot stay competitive in the costly European business environment, but also very often because they want to gain access to emerging markets.

Economic benefits of relocation are likely not only for the host but also for the home country. For example, consumers everywhere profit from cheaper products and services. However, an overall win-win outcome is not guaranteed. Relocation will only be a welfare-improving process for everybody if our economies are able to create new jobs, and workers are able to redeploy to these new activities. Low re-employment in some European countries exacerbates the social adjustment costs and undermines the net benefits that could result from an internationalisation of the value chain of European business.

The current danger is that the crucial elements which turn relocation into a win-win situation – flexibility and openness – will be undermined by protectionist pressures. Giving in to protectionism would only increase the social costs of relocation. European businesses urge policy-makers to ensure that new and better jobs can be created in the EU and that workers develop the right skills to fill these new positions. Supporting trade liberalisation policies through an open, rules-based system and implementing the EU Growth and Jobs Strategy are key factors for success. To minimise social costs, re-employment must be eased by improving labour employability through greater flexibility and mobility. The lifelong learning programme and active labour market measures can re-empower laid-off workers particularly vulnerable to long-term unemployment. The cohesion policy aimed at supporting structural changes to increase regional competitiveness will also ease the short-run pain of transition in the regions where most adjustment costs are concentrated.

RELOCATION:

WHAT ARE WE TALKING ABOUT?

> Anxieties versus hard facts

> The real issue is structural change

> Understanding companies' motivations to relocate

Relocation: what are we talking about?

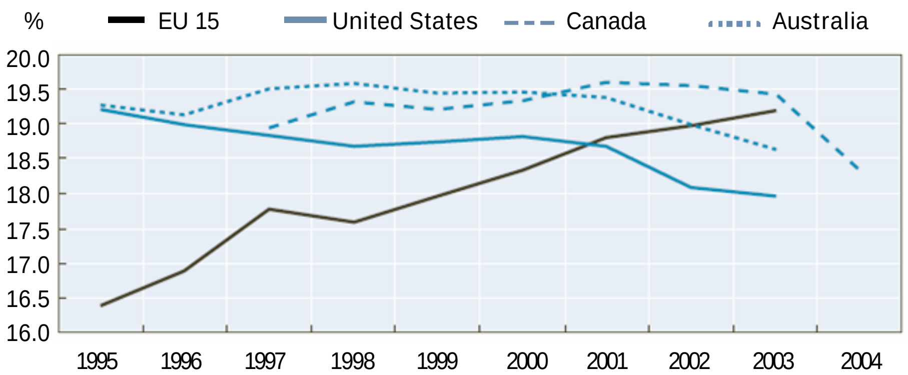
Anxieties versus hard facts

A recent Eurobarometer survey underlines the sensitivity of relocation for European public opinion[1]. Although almost a third of the people interviewed consider globalisation an opportunity, relocation of companies to countries where labour is cheaper is the consequence of globalisation most often mentioned by European citizens (36%). The fear of relocation appears to be particularly strong in France (56%), Belgium (48%), Austria (47%) and Germany (45%). But also in the USA, a fierce debate on relocation has been taking place, in particular ahead of the last presidential elections.

Anxieties about relocation might be fed by the (misleading) perception that everything seems to be "relocatable" and the fear of not finding another job if displaced. Since the mid-1990s, the European Union has seen an increasing proportion of jobs potentially affected by offshoring. According to the OECD, more than 19% of the total number of jobs could be potentially affected[2].

Fig.1. Share of occupations potentially affected by offshoring in total employment

EU -15, United States, Canada, and Australia 1995-2003/4,[1] percentages



1. Includes OECD estimates. Due to differences in classifications, levels are not directly comparable.

Source: *OECD estimates based on EU Labour Force Survey, US Current Population Survey, Statistics Canada and Australian Bureau of Statistics*

The speeding-up of globalisation has certainly made more visible, and sometimes socially more difficult to accept, geographically and/or sectorally concentrated adjustments. In the 1990s, the possibilities to transfer manufacture of components or products (cars, television, computers, etc.) to countries such as Mexico, Brazil, China or Eastern European countries increased. Business anticipated the May 2004 enlargement of the EU to new Member States in the early 1990s. The resulting reallocation of resources constitutes an opportunity to resist transfer of activities to low-wage countries outside the European market and to strengthen the economic prosperity of the whole EU. However, China has been illustrative of a country that has specialised in a broad range of production activities which compete not only with a small proportion of sectors in industrialised countries but with a broad variety of companies in several industrial sectors. Furthermore, relatively easily standardised services such as software engineering, accounting operations, or insurance underwriting, previously difficult to trade, are increasingly tradable on a world scale. India has been a major host territory for such services thanks to low costs, well-educated workforce, proficiency in English and a favourable business environment. Relocation is no longer limited to low added-value activities but also includes highly sophisticated ones.

[1] Special Eurobarometer (2005), Lisbon, fieldwork in November 2004 and publication in February 2005.

[2] The term "potentially affected" only reflects exposure to international competition but does not lead automatically to job variations.

Reported anxieties seem to contrast with a broad academic consensus which underlines the limited magnitude of the phenomenon and its impact on employment. The threat of a massive relocation of economic activities is exaggerated. The overwhelming majority of international trade in goods concerns intra-trade (trade of differentiated goods) that is mainly concentrated in industrialised countries. As for services, despite the recent surge in services offshoring, this process remains limited to relatively standardised forms of services (call centres, back-room processing, accounting operations, etc.). For many high value-added services, distance still matters and face-to-face contacts are necessary to meet the needs of individual customers in Europe.

Most economic studies underline the limited number of jobs that have actually been affected by relocation. The OECD Employment Outlook 2005 stresses that manufacturing activities strongly exposed to import competition only represent on average 4% percent of total employment (from under 2% in Denmark, Norway and Portugal to 5% in Belgium and Finland). Job losses are much more the result of technological change and the internal transition towards a more service-driven economy than of relocation of activities to another country. International trade and investment is estimated to account for between 4% and 17% of all permanent layoffs in Canada, the USA and EU15 (except Sweden).

As shown by the European Monitoring Centre on Change, relocation only represents about 8% of restructuring operations and about 7% of job losses in European enterprises[3].

THE REAL ISSUE IS STRUCTURAL CHANGE

The contrast between hard facts and popular perceptions might have its source in a lack of clarification of what the phenomenon covers. Relocation can be defined as the transfer of production and business services abroad. Not all Foreign Direct Investment (FDI) leads to transfers of activities while relocation is a marginal form of direct investment across national boundaries. For example, greenfield investment should not be confused with relocation. Two forms of relocation can be distinguished. Either domestic firms give up parts of their intermediate production chains and instead buy parts from foreign suppliers ("international outsourcing"[4]). Or domestic firms set up new factories abroad to produce the intermediary goods themselves ("offshoring"). Offshoring differs from outsourcing in the sense that ownership is not transferred.

Relocation often serves as a scapegoat for job losses resulting from the wider phenomenon of structural change. Job losses generated by activities relocated abroad should be considered part of a broader problem of adjustment to structural economic changes. Fears of relocation are rooted in the inability of some European countries to generate new jobs to replace those which are affected by technological changes and, to a lesser extent, by relocation. Anxieties also reflect the fact that the goods and services we will produce in the future, and therefore the jobs that will be created, are not known yet, spreading the misleading feeling that nothing will be left after relocation.

[3] European Monitoring Centre on Change - EMCC, Dublin, quoted in: L. Fontagné et al. (2005), "Désindustrialisation, délocalisations", La Documentation Française, p.68.

[4] We target here a particular form of outsourcing, as the externalisation of services or goods could also take place within national borders. See R. Feenstra and G. Hansen (2001) "Global Production Sharing and Rising Inequality: A Survey of Trade and Wages", NBER WP. 8772, July.

Understanding companies' motivations to relocate

The possibility to move parts of production to a subsidiary or another firm is certainly not new for businesses. But lower transaction costs through easier transport and communication have sped up the phenomenon in recent years. Globalisation has increasingly changed the way people do business on a global scale, by re-organising the value chain as a function of very specific advantages that can be found around the world.

Several factors enter into the decision to move production or provision of services abroad through offshoring or outsourcing. Public debate too often reduces the issue to mere international wage competition.

✓ Access to new markets has become increasingly important for firms that produce highly differentiated goods. A survey by the European Commission on the reasons why SMEs go global shows that the majority are searching for new market opportunities rather than cheaper labour or capital[5]. As stated by L. Fontagné et al. (2004a), particularly industries whose goods cannot be transported tend to be located in countries with big markets or in some countries that have privileged access to them[6]. A better knowledge of consumer preferences and local specificities is particularly important for the retailing sector.

✓ Subcontractors following their principal client (for example in the automotive sector) is a major driving force for relocation among SMEs.

✓ Access to specific resources constitutes an additional factor to relocate. This concerns not only raw materials but also non-tangible resources such as local knowledge spillovers and human capital endowment that is particularly significant for relocation of some R&D centres.

✓ Better cost-efficiency can drive relocation, regarding wages or other factors such as infrastructure facilities available (transport, electricity, telecommunications, etc.) or the regulatory burden (taxation, environmental and social regulations, competition law).

✓ Other factors can play a significant role such as political stability, level of corruption, social climate, cultural and historical ties with the country of origin, etc.

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5 European Commission, 2003 Observatory of European SMEs, 2003/4 Internationalisation of SMEs (survey includes EU, EEA and Switzerland).

6 Lionel Fontagné et Jean-Hervé Lorenzi (2004a) « Désindustrialisation et délocalisations », report presented to the Conseil d'Analyse Economique, January 2005.

ECONOMIC AND SOCIAL IMPACTS OF RELOCATION:

LABOUR MARKET IS KEY

- Economic benefits...
- ... but also social “adjustment” costs

ECONOMIC AND SOCIAL IMPACTS OF RELOCATION: LABOUR MARKET IS KEY

ECONOMIC BENEFITS ...

Economic benefits are evident for the country to which economic activity is relocated, notably through job creation, investment spillovers, and technological transfers. But the relocating country benefits from relocation, too.

✓ Efficiency gains for relocating companies lead to lower prices of products and services for consumers.

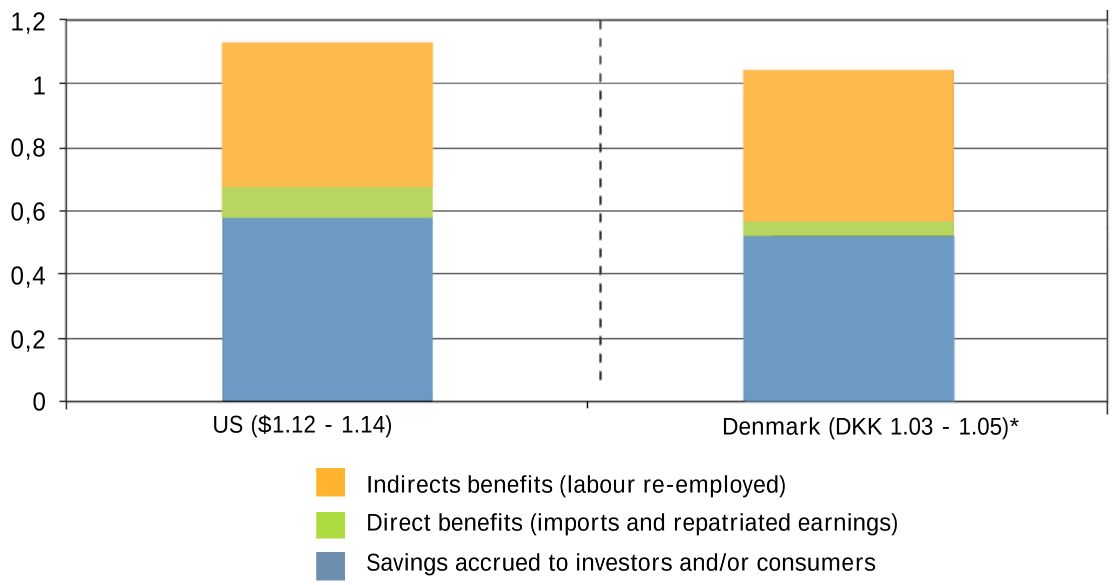
✓ Economic benefits in the host country translate into export demand for the home country. The spectacular economic development of China, India, etc., has already provided a strong stimulus to external demand for European products and services.

✓ Repatriated earnings of the relocating company eventually boost investment and growth in the home market.

✓ Displaced workers previously engaged in the relocated activities are available to move into higher value-added jobs. Labour shortages in some sectors, even likely to increase in the future with an ageing population, underscore the scope for labour redeployment in our economies.

Empirically, the McKinsey Global Institute found offshoring creates net additional value for the US economy that did not exist before, a full 12-14 cents on every dollar offshored. Relocation generates induced effects on profits, innovation, productivity and employment, through an efficient allocation of resources in the home economy. Similarly, DI (2004) found that offshoring from Denmark to India also generates net gains with particularly high benefits resulting from labour re-employment. By contrast, outsourcing is not up to full potential in terms of economic gains in countries with more rigid labour markets and consequently, with difficulties to re-place workers whose activities have been relocated[7].

Fig. 2. Net return to 1$/1DKK outsourced to India



Source: *McKinsey Global Institute (2003) "Offshoring: Is it a win-win game" * Dansk Industri (2005) "The Global Challenge, the case of Denmark"*

[7] Such an analysis is also confirmed by EEAG (2005) which underlines the lack of adjustment due to wage and social rigidities as reducing the benefits from relocation and trade. European Economic Advisory Group (2005) "Outsourcing", chapter 2 in *Report on the European Economy 2005*, March.

The beneficial outcome predicted by economic theory depends on two crucial elements: first, new jobs need to be created, and second, the workers who lost their previous jobs need to have the right skills and mobility to be hired to do these new jobs. A win-win outcome from relocation is not given. The costs and benefits of relocation cannot be investigated without considering the ability and the speed of our economies to create new jobs and to redeploy workers in these new activities. As reflected in the incidence of long-term unemployment, countries' capacities to re-employ displaced workers widely differ across countries. In 2004, about 13% of US unemployed workers did not find a job for more than one year while the figure is 43% for the EU[8]. Across EU Member States, re-employment also differs considerably with long-term unemployment rates from about 20-25% in Austria, Denmark, Sweden, Luxembourg and the UK to above 50 in Czech Republic (51.8%), Germany (51.8%), Greece (54.7%) and Slovakia (60.6%).

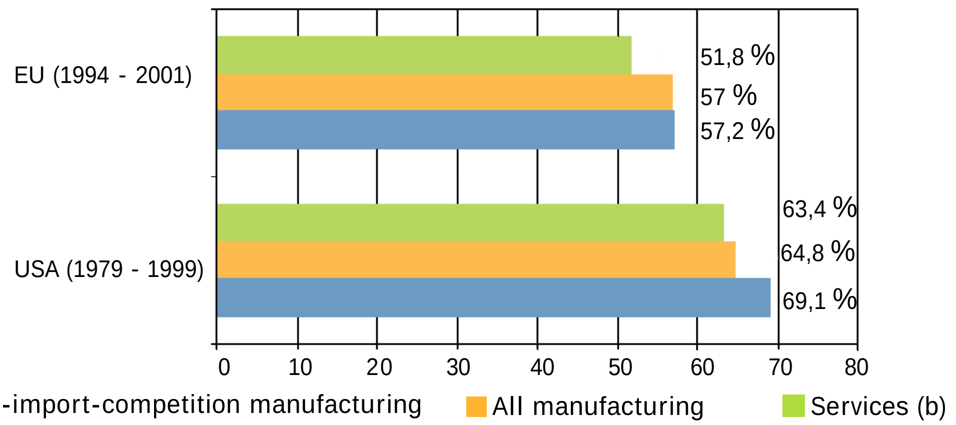
… BUT ALSO SOCIAL "ADJUSTMENT" COSTS

Relocation generates significant adjustment costs:

✓ New jobs may not be created directly when old jobs are lost. This "adjustment time" is crucial as the probability of finding a new job decreases with time out of employment. Creating new jobs with the new resources and redeploying workers in these new jobs takes time. How much time is a question of how flexible the economy is. Flexibility is a well-known shortcoming in Europe. According to the OECD, 63% of US workers displaced from jobs in manufacturing industries where there is fierce international competition find a new job within two years. Re-employment rates for such trade-displaced workers are somewhat lower in Europe, averaging 57% overall and just 52% in manufacturing industries exposed to fierce international competition.

Poor labour re-employment rates exacerbate the adjustment costs of relocation in Europe.

Fig. 3. Re-employment rate (a)



Source: *OECD Employment Outlook 2005*

(a) workers displaced from high-import-competition manufacturing (and, to a lesser extent, all manufacturing) serve as a proxy for trade-displaced workers
(b) Services and utilities for the USA

✓ People having lost their jobs in non-competitive industries may not have the qualifications to be employed in competitive, high-tech sectors. The most exposed workers are generally those who are older, less skilled and less educated than average and thus more likely to enter into the vicious circle of long-term unemployment. Moreover, these groups might be highly concentrated in particular regions or local areas.

✓ Companies whose major clients were other companies which have relocated, suffer from a slump in orders, and thus encounter economic difficulties from relocation. This is particularly true for SMEs.

[8] See OECD Employment Outlook 2005. Data are not available for Cyprus, Estonia, Latvia, Lithuania, Malta and Slovenia.

POLICY REACTIONS

MAKE EUROPE GLOBALLY COMPETITIVE

- Enforce an offensive trade policy
- Implement the Growth and Jobs Strategy
- Minimise social costs, without hindering adjustments

Policy reactions: make Europe globally competitive

For companies, adapting to global competition is not a choice but a matter of necessity. The issue of ensuring the conditions for making relocation a win-win game for everybody is not restricted to business adaptation but also requires awareness on the part of European citizens and a competitive regulatory environment from European governments at all levels (EU, national, regional and local). The worst policy reaction would be to protect the European economy from international competition and not to implement the Lisbon Strategy.

Enforce an offensive trade policy

The fact that relocation could affect activities that used to be relatively untouched by it could dampen support for trade liberalisation policies, even among white-collar workers[9]. Protection would not be feasible and above all not desirable. On the one hand, this would give European firms the incentive to go abroad. On the other hand, trade and investment liberalisation remains an essential driver to raise living standards in Europe and to ensure balanced economic development in the world.

European companies need an open, rules-based multilateral trading system to foster international trade and investment as “engines” for growth and competitiveness. Special attention should be paid to achieving substantially improved market access for EU companies and improved legal security in the large emerging countries and main trading partners. This would allow European firms to gain access to specific resources (e.g. buying and selling commodities), goods and services and to improve the value chain of their production.

With this in view, it is essential to ensure successful and timely conclusion of the Doha development round on the basis of new liberalisation commitments and improved rules. It is also important to pursue in parallel bilateral negotiations on issues not covered in WTO of for which results are likely not to be very ambitious because of different interests.

Implement the Growth and Jobs Strategy

The Lisbon Growth and Jobs Strategy has the ability to improve investment conditions in Europe as a basis for stronger growth and employment. Otherwise, European enterprises will have no choice but to relocate or to be driven out of business. Implementing the Lisbon reforms is the best way to seize the benefits of relocation by improving our own competitive advantages. At the same time, it should make the EU an attractive location for foreign investment. Structural reforms can “onshore” activities by:

✓ Improving labour flexibility and mobility which are necessary conditions for faster job creation. The existence of worker anxieties in countries with high levels of unemployment is no coincidence.

✓ Strengthening economies of scale and promoting market-oriented innovation at all levels of the value chain. Completing the internal market, including for the services sector, will enhance the playing field for business in Europe. A renewed industrial policy, combining and adjusting all the Community instruments available, should help European business to move up the technological ladder in all sectors of activity.

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[9] As reported by M. Amiti and S.-J. Wei (2004, “Demystifying Outsourcing, the numbers do not support the hype over job losses”, in Finance & Development, IMF), a study conducted by the University of Maryland found that, among individuals in the USA with incomes over $100,000, those actively supporting free trade slid from 57% in 1999 to 28% in January 2004.

✓ Releasing knowledge and innovation spillovers e.g. through increased cooperation between public and private sectors or between universities and enterprises. Research is not only about the public funds allocated for that purpose; the research agenda should also fit in with the needs of industry. The same is true for education and training systems. Access to competitive financing is also crucial to economic development in both existing and new companies.

✓ Reducing operational rigidities and bureaucratic burden on businesses.

Minimise social costs, without hindering adjustments

Erecting barriers to the adjustment processes resulting from relocation would tend to encourage firms to relocate rather than the reverse. We should not hinder changes but foster them. To be efficient, all public measures should be included in long-term strategies, aimed at supporting competitiveness of enterprises and the employability of workers. The low re-employment rate in some European countries is a major shortcoming exacerbating the social costs of relocation.

✓ Lifelong learning represents the best channel to minimise the social adjustment cost of relocation by enhancing re-employment opportunities and re-empowering people affected by relocation.

✓ Active labour market measures such as job-search assistance, personal counselling, early retraining, relocation assistance (easing the move to geographic areas where labour markets are more buoyant) and assistance for small business start-up could support laid-off workers in their efforts to find a new job, particularly those vulnerable to long-term unemployment such as older workers, low-skilled workers, etc[10].

✓ The cohesion policy re-oriented towards the Lisbon goals is an efficient way to support changes in the regions where most adjustment costs are concentrated. Therefore, cohesion and structural programmes should primarily focus on supporting structural changes to increase competitiveness, improving human and physical capital and strengthening innovative capabilities.

✓ Needless to say, fostering entrepreneurship and an attractive business environment should help to create new jobs.

The current danger is that the conditions which make relocation a beneficial outcome for all – flexibility and openness – could be undermined by protectionist pressures exerted by endangered sectors or groups of workers. If this pressure prevails, the social cost will eventually be higher.

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10 See OECD Employment Outlook 2005 for further experiences of active labour market measures.

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FOR FURTHER INFORMATION, PLEASE CONTACT:

ECONOMIC AND FINANCIAL AFFAIRS DEPARTMENT

Folker Franz

Tel: +32 (2) 237 65 21

Mail: f.franz@unice.be

December 2005

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168 AVENUE DE CORTENBERGH   1000 BRUSSELS   BELGIUM

T +32 (0)2 237 65 11   F +32 (0)2 231 14 45   MAIN@UNICE.BE

WWW.UNICE.ORG