

Delocalisation of EU Industry and the Challenge of Structural Readjustment. A Review of Policy Options

European Parliament, ITRE Committee
Brussels, 13 September 2007

TNO | Knowledge for business



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Delocalisation of EU Industry - overview

- ETEPS-study by TNO, the Netherlands, one of Europe's largest RTOs (Research and Technology Organisations)
- TNO-team consisting of Dr Frans van der Zee (ed.), dr Walter Manshanden, Wouter Jonkhoff and Felix Brandes
- Goal of the study: “to provide an independent view (...) and to review possible policy instruments in relation to delocalisation and assess their impact within the context of industrial restructuring and globalisation”
- Structure and contents of the study:
 - Ch 1. Delocalisation: the debate, definitions, measurement issues
 - Ch 2. Economic analysis of delocalisation: economic theory, underlying factors, how does it affect Europe?
 - Ch 3. Review of policy options: short-, medium- and longer-term answers – ranging from safety nets to flexibility and education

Delocalisation defined

- Delocalisation or relocation, i.e. the migration of production and jobs to other parts of the world – it is firms (!) that move
- Different definitions in use in the public debate, most of which are non-neutral / biased on the effects of delocalisation:
 - Example 1. “Process of relocation of economic activities towards foreign sites, closing down activities at home”
 - Example 2. “Delocalisation occurs when a business activity is ceased, to be reopened by means of direct investment (...)”
- Delocalisation and offshoring debates: two birds of the same feather
- Different forms: firms can relocate by sourcing internally to foreign-based affiliates (‘captive offshoring’) and externally to other firms (‘offshore outsourcing’)

Delocalisation of EU Industry: between myths and facts (1)

- Relocation and job losses - the bogeyman of our time, spreading fear and public anxiety... but based on facts?
- Relocation recently seems to have become more pervasive, within and across sectors, hitting both low-skilled and high-skilled workers
- Relocation part of broader phenomenon of adaptation and structural adjustment to underlying changes in productivity and markets.
- Measurement problems – no sound precise statistics behind
- Overall employment impact relatively small:
 - Predicted job losses due to delocalisation: 1.17 million in total period 2005-2015 (Forrester 2004)
 - Total employment: 175 million EU-15
 - Net job creation *annually*: 1.8 million (period 1995-2005)
- At first glance: delocalisation is a modest phenomenon and part of the 'normal' process of job creation and destruction

Delocalisation of EU Industry: between myths and facts (2)

- Delocalisation caused by essentially three major forces: global economic integration (including the emergence of two giants India and China), international competition and technological development
- Importance of Technology, Talent and Time has increased
- Key in most recent relocation trends is the shifting balance between tradable and non-tradable services – most affected are the ‘impersonal’ services → driven by ICT-related developments / ‘death of distance’
- Delocalisation is part of a dynamic, non-zero sum game, resulting from a search for new value-creating business configurations (e.g. emergence of regional and global value networks)
- In terms of possible effects, delocalisation is largely a ‘prospective’ phenomenon → emphasis should be on preparing for the future – also in policy recipes!

Delocalisation from an economic perspective

- Overall productivity performance is the determining factor for growth and for (retaining or losing) jobs in the medium and longer term
- Wage-productivity profiles are key
- Knowledge, research and innovation are at the heart of the challenge (main drivers of productivity)
- Two major recent developments:
 - Strong increase in tradable services (ICT-driven)
 - Lower transaction costs in trade (ICT- and WTO-driven)
- Where will this lead us? To a future in which part of the services sector takes on a similar development pattern as currently the agricultural and manufacturing sectors, i.e. increasing productivity, decreasing employment and continuous structural adjustment over time?

Delocalisation and economic performance in Europe

- Link between the two not clear!
- Economic performance is important → analysis of 10 year period
 - GDP growth
 - Employment growth
- Some shrinking sectors in terms of employment (agriculture, manufacturing), some booming (financial and business services)
- But shrinking sectors show medium to high productivity increases – clear performers, even though stable or declining



Table 2.1: GDP growth by country and sector (EU-15), period 1995–2005 (annual averages, in %)

| GDP | Total | Agriculture | Manu- facturing | Con- struction | Trade, transport& communic | Financial business services | Other services |
|----------------|--------------|--------------------|----------------------------|---------------------------|---|--|---------------------------|
| Austria | 2.2 | -3.0 | 2.1 | 2.0 | 2.3 | 3.9 | 1.3 |
| Belgium | 2.1 | -1.0 | 0.2 | 1.7 | 2.6 | 3.0 | 2.5 |
| Denmark | 2.2 | -6.1 | 1.9 | 4.0 | 2.0 | 2.9 | 2.2 |
| Finland | 3.5 | -0.5 | 2.4 | 6.6 | 4.4 | 4.5 | 3.2 |
| France | 2.2 | -2.2 | -0.6 | 4.6 | 2.6 | 3.4 | 2.7 |
| Germany | 1.4 | -1.2 | 1.4 | -4.1 | 1.4 | 2.4 | 1.5 |
| Greece | 3.9 | -0.5 | -1.8 | 6.2 | 6.3 | 3.7 | 6.4 |
| Ireland | 7.7 | -4.7 | 5.9 | 13.5 | 8.2 | 11.2 | 7.0 |
| Italy | 1.2 | -2.8 | -0.7 | 2.5 | 0.9 | 3.1 | 1.8 |
| Luxembourg | 5.2 | -4.0 | 1.2 | 4.0 | 5.4 | 6.5 | 5.6 |
| Netherlands | 2.3 | -2.3 | 0.7 | 2.5 | 2.3 | 3.6 | 2.9 |
| Portugal | 1.7 | -5.6 | -0.1 | 2.4 | 1.8 | 2.4 | 3.9 |
| Spain | 3.6 | 0.5 | 1.4 | 8.2 | 3.1 | 5.3 | 3.4 |
| Sweden | 2.8 | -5.2 | 1.7 | 3.7 | 2.7 | 3.4 | 3.7 |
| United Kingdom | 2.8 | -4.1 | -1.2 | 4.3 | 2.9 | 5.4 | 3.3 |
| EU 15 | 2.2 | -2.2 | 0.4 | 2.7 | 2.3 | 3.7 | 2.6 |

Source: Eurostat/OECD/TNO

Table 2.2: Employment growth by country and sector (EU-15), period 1995–2005 (annual averages, in %)

| Employment | Total | Agriculture | Manu- facturing | Con- struction | Trade, transport& communic. | Financial business services | Other services |
|----------------|------------|-------------|--------------------|-------------------|-----------------------------------|-----------------------------------|-------------------|
| Austria | 0.7 | -0.9 | -1.1 | -1.0 | 0.8 | 4.7 | 1.2 |
| Belgium | 0.8 | -3.2 | -1.3 | 0.0 | 0.4 | 3.2 | 1.4 |
| Denmark | 0.5 | -2.8 | -1.8 | 1.6 | 0.9 | 3.3 | 0.6 |
| Finland | 1.6 | -3.2 | 0.4 | 3.5 | 1.8 | 3.7 | 2.0 |
| France | 1.0 | -2.1 | -0.9 | 0.4 | 1.4 | 3.0 | 1.1 |
| Germany | 0.3 | -2.3 | -1.3 | -4.0 | 0.5 | 3.7 | 1.1 |
| Greece | 0.5 | -2.4 | -1.0 | 2.5 | 1.1 | 3.7 | 1.3 |
| Ireland | 4.2 | -2.3 | 1.3 | 9.4 | 5.4 | 7.9 | 3.7 |
| Italy | 1.1 | -3.1 | -0.3 | 2.2 | 1.1 | 4.4 | 1.2 |
| Luxembourg | 3.6 | -1.7 | -0.3 | 2.1 | 2.7 | 7.4 | 4.1 |
| Netherlands | 1.3 | -0.6 | -1.2 | 0.5 | 1.2 | 2.8 | 1.9 |
| Portugal | 1.3 | -1.5 | -0.9 | 4.5 | 2.0 | 2.4 | 2.0 |
| Spain | 3.4 | -0.2 | 1.7 | 7.8 | 3.4 | 5.4 | 2.8 |
| Sweden | 0.5 | -2.8 | -0.8 | 1.1 | 0.5 | 3.0 | 0.6 |
| United Kingdom | 1.1 | -1.8 | -2.9 | 2.5 | 1.4 | 2.5 | 1.8 |
| EU 15 | 1.1 | -1.8 | -1.0 | 2.5 | 1.3 | 3.4 | 1.5 |

Source: Eurostat/OECD/TNO

Table 2.5: Labour productivity growth by country and sector (EU-15), period 1995–2005 (annual averages, in %)

| Manufacturing | 1995–2000 | 2000–2005 | 1995–2005 | Difference 95–00/00–05 |
|----------------------|------------------|------------------|------------------|-----------------------------------|
| Austria | 4.2 | 2.1 | 3.2 | 2.2 |
| Belgium | 2.3 | 0.6 | 1.4 | 1.7 |
| Denmark | 5.1 | 2.4 | 3.7 | 2.7 |
| Finland | 2.6 | 1.5 | 2.0 | 1.1 |
| France | 0.7 | -0.1 | 0.3 | 0.8 |
| Germany | 2.8 | 2.6 | 2.7 | 0.3 |
| Greece | -5.9 | 4.6 | -0.8 | -10.5 |
| Ireland | 7.7 | 1.6 | 4.6 | 6.1 |
| Italy | 0.9 | -1.7 | -0.4 | 2.6 |
| Luxembourg | 3.0 | 0.0 | 1.5 | 3.1 |
| Netherlands | 1.1 | 2.7 | 1.9 | -1.7 |
| Portugal | 1.9 | -0.2 | 0.8 | 2.1 |
| Spain | -0.5 | -0.1 | -0.3 | -0.3 |
| Sweden | 2.2 | 2.7 | 2.5 | -0.5 |
| United Kingdom | 1.4 | 2.1 | 1.8 | -0.7 |
| EU-15 | 1.6 | 1.1 | 1.3 | 0.5 |

Source: Eurostat/TNO



Performance of the EU economy

- Growth of labour productivity in manufacturing is a good indicator (proxy) of economic change, dynamics and wealth
- Drivers behind labour productivity: more skilled labour, higher capital intensity, economies of scale, liberalised and open markets, outsourcing and offshoring
- Relocation is part of a substitution process involving spatial (re)allocation
- Process of European enlargement and integration is meant to enable, ease and speed up a number of these drivers
- Role of new EU10+2: strong potential for relocation within Europe
- Labour productivity in manufacturing in the EU-15?
 - High-performers: Austria, Denmark, Germany, Ireland and Sweden
 - Low-performers: France, Spain, Italy, Greece and Portugal

Delocalisation of EU Industry: facing the future

- What will the future be like? Not one plausible future, but many!
- Relocation is part of an all-embracing process of structural economic adjustment
- Most attention in the relocation debate focuses on the *negative* (destruction of jobs, capital divestiture), and not on the *positive* (reconfiguration of value chains, orientation towards new markets)
- To deal with relocation and structural adjustment asks for a more encompassing and future-oriented perspective
- Required: 'right' mindset and behaviour to approach the future, i.e. flexibility, pro-activeness, inventiveness and creativity at the level of individuals and households
- Policies are neither a substitute for these, nor 'the' solution

Knowing the Future?

- “Prediction is very difficult, especially of the future” (Niels Bohr)
- “There are no future facts” (Fred Polak)
- “Let’s be honest. No one has the foggiest idea of what the Indian economy will be like in 2040. 2040 is simply too far off.” (Bibek Debroy, 2004, The Indian Economy in 2040. *Futures* 36)
- “There is no agreement on how to interpret recent productivity growth, let alone how to anticipate future patterns” (World Bank, 2007)



Delocalisation of EU Industry: policy options (1)

Distinction between two types of policies:

- A) Growth and employment policies (longer-term, non-specific)
- B) Adjustment assistance policies (short-term, relocation-specific)

Three key messages in formulating policies re relocation:

- I) The three major forces of change: globalisation and opening up, stronger international competition and pervasive technological change
- II) Productivity and competitiveness are key to growth and welfare
- III) There is no a priori or proven set of policies & no quick fix...!
- IV) Don't replace market failure with government failure (cure being worse than disease itself...)

Delocalisation of EU Industry: policy options (2)

A) Growth and employment policies

- Aimed at creating sufficient growth and robust jobs in the longer run
 - Not relocation-specific, but far broader and more inclusive
 - Concerns issues like balanced macroeconomic policies; getting the institutions right; making the regulatory framework more efficient, etc
 - Growth and employment policies typically include measures such as improvement of overall framework conditions, and other Lisbon-agenda type measures (innovation, education, etc).
 - A comparative assessment of possible G&E policy mixes and their chances for success beyond the scope of this paper!
 - Trade and competition are vital to growth and employment
- A big don't in formulating policy is a retreat to protectionism
- Job protection is no answer (means break in fragile connection between wages and productivity)
 - Protection of national/regional produce ditto (damages connection between productivity and competitiveness)

Delocalisation of EU Industry: policy options (3)

B) Adjustment assistance policies (short-term, relocation-specific):

B1) Mitigating or cushioning the direct effects of relocation by providing insurance, reducing inequality and enhancing the functioning of markets

B2) Facilitating transition by increasing the flexibility of Europe's citizens and firms, improving the ability to adapt and adjust to shocks, and enhancing the capacity to respond to yet unknown requirements of the future global economy → key is education

Most measures in one way or another are labour market-oriented →
bottom line: protect workers, not jobs!

Rationale: to smoothen adjustment and minimize societal cost

- Cost of long-term unemployment and persistent under-employment
- Cost of under-utilisation of resources and loss of social cohesion

Delocalisation of EU Industry: policy options (4)

B1. Adjustment assistance policies – different ways of mitigating or cushioning the direct effects of relocation:

I) Direct assistance: *social safety nets* and *active labour market programmes* (ALMPs), i.e. counselling, retraining, mobility allowances, other re-employment services – inherent difficulty is reactivation incentive.

Prominent examples: 1) Flexicurity, 2) Wage insurance

II) Targeted programmes

For all trade-displaced, e.g. EGF (EU), TAA (US)

For specific groups of trade-displaced

III) Regional and sector policy support in response to relocation → no! ('picking losers' vis-à-vis 'picking winners' – also not recommended)

Delocalisation of EU Industry: policy options (5)

B2. Adjustment assistance policies – increasing flexibility of markets and improving the ability to change

I) Tackling structural labour market rigidities (= Europe's weakness)

- Fragmented and compartmentalised nature
- Lack of geographical mobility
- Coping with non-routine tasks and occupational change
- Institutional failures and modernising existing policies (welfare systems, regulatory burdens, tax systems)

II) Improve Europe's ability to adapt and adjust to shocks

- Education is key
- Beyond the traditional classroom education, i.e. on-the-job training and life-long learning
- Not how much, but how and what we educate matters – new forms of communicating and doing business require new skills

Conclusions

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