ETUI-REHS

Relocation:

Challenges for European trade unions

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Contents

Introduction*

Throughout Europe increasing fears have been raised about employers relocating jobs to low-wage countries. Sluggish economic growth and continued high unemployment in much of the EU15, and low employment and income levels in the new member states (NMS), exacerbate these fears, and this has made relocation a hot topic in the media. Companies seek to take advantage of newly emerged opportunities to exploit large differentials in wages and working conditions. Workers and unions in the EU15 fear that this will lead to a massive exodus of well-paid jobs from high-wage countries, to a weakening of labour's bargaining position and thus to a downward spiral of wages and working conditions. Meanwhile the NMS, which suffered huge job losses when they opened up their markets at the beginning of the transformation, see foreign investment as the key modernisation and job-creation factor (although the employment effects of FDI are sometimes ambiguous). This discussion paper is intended as a contribution to the ongoing debate in this area and a critical evaluation of the extent to which the fears and media attention are justified by the available facts. It is hoped that it will serve as a useful starting point for policy development within the labour movement.

These questions have emerged in a world economy that is dramatically different from 10-15 years ago. With the fall of the Iron Curtain in Europe and the opening up of China, a huge part of the world population has become integrated into the world economy within a very short period. World GDP between 1990-2002 grew by 50% and during the same period world trade increased by 90%. Trade in intermediary products grew even faster – implying a further internationalisation of the production chain –, and foreign direct investment flows also expanded substantially. With the integration of new countries into world trade, new markets have emerged, but also a huge, relatively cheap – and in some cases skilled – labour force has joined the world economy. This has tended to intensify competition between production locations for available investment and to weaken the relative position of labour.

Relocation has both an intra-European dimension and, against the background of the rapid growth of, in particular, China and India, a global dimension. The Central and Eastern European Countries were already integrated into goods trade and investment prior to EU enlargement. On accession they have joined the EU regulatory framework, including its labour, industrial, environmental and investment standards. Enlargement has also decreased the perceptions concerning the risks for multinational companies of investing in the NMS.

The situation with the newcomers in Asia is even more in flux and even more uncertain. The sheer size of countries like China and India – even if, at market prices and exchange rates, they are still 'only' the seventh and tenth largest economies in the world – is a major cause of concern to many in Europe, as are their very low labour costs and the lack of clarity about the regulations of their economies and labour markets.

In response to fears related to relocation, mainstream economists, governments and employer representatives often claim that the overall impact of such processes will be to

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permit specialisation, promote trade, thus increasing productivity and raising living standards, in both low-wage and high-wage regions. However, the model of 'creative destruction' requires the creation of new jobs to re-employ the displaced workforce. There is, however, no guarantee that the pace of new job creation will equal the pace of job destruction and the market price mechanism (the 'cost of labour', in other words wages) that is supposed to bring job creation and job destruction back in line is a drawn-out and unreliable mechanism. Especially in the downturn part of the business cycle, when job creation is already suffering from slack aggregate demand and excess savings from households, restructuring is extremely painful and can, by undermining general confidence, even add to the problems of workers' insecurity and excess savings. In fact, it is striking that public concern on exporting of jobs coincides over time with downturns in the business cycle and, within Europe, varies very much according to the state of the labour market. If on the other hand, the economy is doing reasonably well and workers are able to find new jobs (sometimes in the same enterprise as it is also expanding activity in its home country), then the theme of '*délocalisation*' is much less prominent in public discussion.

Rather than setting out from liberal or other baselines in this paper we wish to take, as our starting point, a set of questions. What we are asking is not whether 'change' should be rejected or accepted, but rather how to ensure that globalisation and technological progress result in more and better jobs instead of functioning as alibis to downgrade wages and working conditions. What kind of policies does this imply and what role can trade unions and social dialogue play here? What is the real extent of production relocation and what is driving it? What are the potential threats to trade unions and workers? Are there also benefits and opportunities? What can we expect for the future? What policies should unions be demanding from governments and what strategies should they themselves adopt to confront the challenges of relocation in an increasingly globalised economy and maximise the benefits for their members? It is clear that only provisional answers can be offered to these questions. Relocation is a focus of ongoing research by the ETUI, and this paper represents a mere point of departure.

In starting to address these difficult questions, let us start by reviewing and assessing the available information.

What is relocation all about? Some terminological issues

To evaluate what has happened in recent years concerning relocation we need to begin by clarifying the terminology used. A key concept is foreign direct investment (FDI). FDI is a broad term referring to a wide range of international capital movements, including mergers, acquisitions, inter-company loans, but also the establishment or extension of foreign production sites. It is important to note here that FDI is not always linked to new capital investment abroad.[1]

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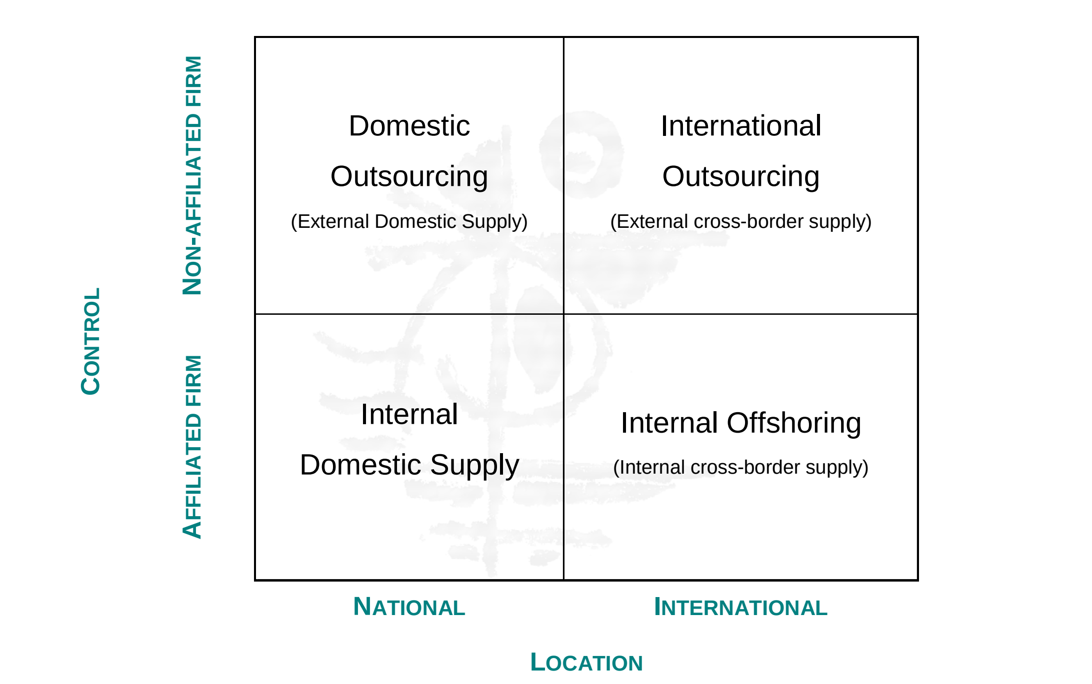
[1] The definition of the OECD used by the IMF and Eurostat is: "Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy ('direct investor') in an entity resident in an economy other than that of the investor ('direct investment enterprise'). It can cover the transfer of ownership, but also equity capital, reinvested earnings, other capital (e.g. loans). In the first instance, FDI may simply cover the transfer of ownership; secondly, it may comprise equity capital + reinvested earnings + other capital (e.g. loans).

Two other key terms are outsourcing and offshoring. Outsourcing refers to a shift in control over production through the contracting out of existing or new activities to non-affiliate firms. Offshoring occurs when a firm moves existing or new economic activities abroad. This can take place within the firm, i.e. towards a subsidiary, or it can concern outsourcing. The relation between outsourcing and offshoring is presented in Figure 1.

Figure 1 Outsourcing and offshoring



Source: Adapted from WTO 2005 and OECD 2005

When activities are outsourced to firms in the same country, we term this domestic outsourcing. When the firms are abroad, we term this international outsourcing (or ‘offshore outsourcing’). Finally, when a firm moves some of its activities abroad but retains ownership over them, this can be called (internal) offshoring. Both types of offshoring lead to increased intra-industrial trade and have contributed to the rapid growth of international trade.

Relocation, the central issue of this paper, is a type of offshoring, i.e. of cross-border investment, when economic activities are shifted towards foreign locations. It does not distinguish between type of control and thus covers both international outsourcing and intra-firm cross-border investment. Rather it focuses on the question of substitution. Relocation implies that the process of offshoring has a substitution effect on domestic operations in the source location, including, most importantly, employment (e.g. through the transfer of jobs).

Many types of FDI – in particular that which establishes production facilities abroad to serve local markets – do not involve a ‘transfer’ of jobs and are not usually perceived as a threat by source countries. Such investment is not discussed further here. The other extreme is the case in which entire production locations are closed in one country, only to be re-opened in a foreign location where the wages paid will be lower. In this case, domestic markets will be served from the foreign location. In other cases, third markets can be supplied by the foreign location, which appears as a more indirect loss to the domestic firm. But there are a range of intermediate cases where explicit and implicit forms of factor substitution (with direct and indirect impacts) get mixed, and processes of specialisation and structural change also play a role. On the other hand there are relocation processes with a substitution effect that do not appear in the FDI statistics; this is true, in particular, of the international outsourcing of activities to foreign suppliers.

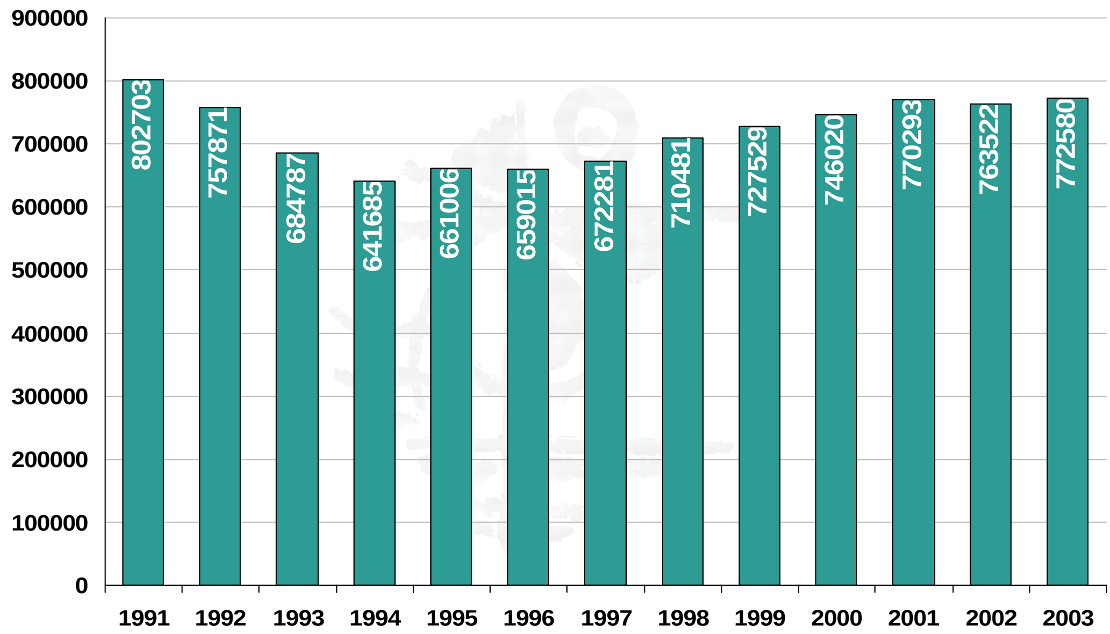
Box 1: The case of the German automobile industry

The German automobile industry illustrates a 'new division of labour', with a high level of intra-industrial trade integration. Germany – being a worldwide champion in exports – has a negative trade balance in the automobile industry vis-à-vis the CEE-4 countries.

On the other hand, employment in the German automobile industry had grown from its trough of 641,000 in 1994 to 772,000 by 2003 – a 20% increase in a period when its investment activity abroad gained momentum. In the period 1997-2001 it created 271,000 workplaces abroad, but also 72,000 at home. (IG Metall, 2004). This trend has of course no implication for future developments.

Studies also refer to the fact that Volkswagen's investment in Slovakia contributed to the stability of the company headquarters in Wolfsburg, while investment by Audi in Hungary helped to revitalise the parent company.

ETUI REHS **Figure 2 Employment in the German automobile industry 1991-2003 (number of employed)**



One important motive for companies to relocate certain types of activity is to optimise their value chains. Specific stages of production (often ancillary business services such as accounting, but also labour-intensive elements of the manufacturing value chain) are relocated (to foreign-based companies or subsidiaries) to increase the competitiveness of the entire production chain. In such complex cases it is very difficult to evaluate the employment impacts, either overall or in specific locations. On the surface it may result in job losses in the source country. However, optimising value chains may strengthen the company as a whole, securing jobs also at the central location. Through intra-firm trade of intermediary products or services, it may allow the mother company to specialise on activities where its competitive advantages are strongest, while relocating other activities. This can contribute to the expansion of the whole firm on the world market. For example, the German automobile industry, which in recent years has invested extensively in low-cost locations, has managed to stabilise its position on world markets and created jobs also at home in the second half of the nineties (see Box 1). However, it can also mean the expansion of production at subsidiaries to the detriment of the mother company, in the short or longer run (some examples are considered below).

We cannot in this short paper review all the different types of corporate strategy to optimise value chains, outsource 'upstream' and 'downstream' production elements, etc. The discussion so far should, however, have made it clear that international trade and investment are of such a complex nature that measuring their aggregate impact, even 'in theory' is rather difficult. It is against this background that we turn to the available evidence.

Relocation – what are the facts?

The available data on relocation are patchy and not always easy to interpret. We can start by looking at overall FDI, which covers all types of direct efforts to establish production abroad (and the limitations of which as an indicator were mentioned above).

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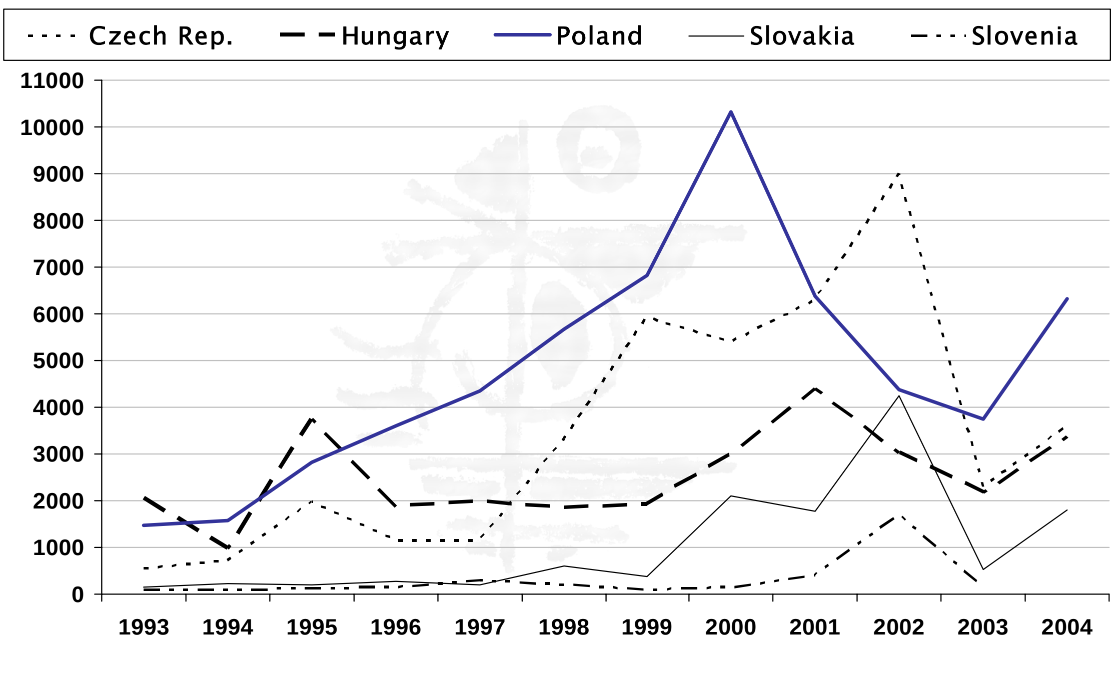
Figure 3 Inflow of FDI into the 5 accession countries between 1993 and 2003 (in € millions)

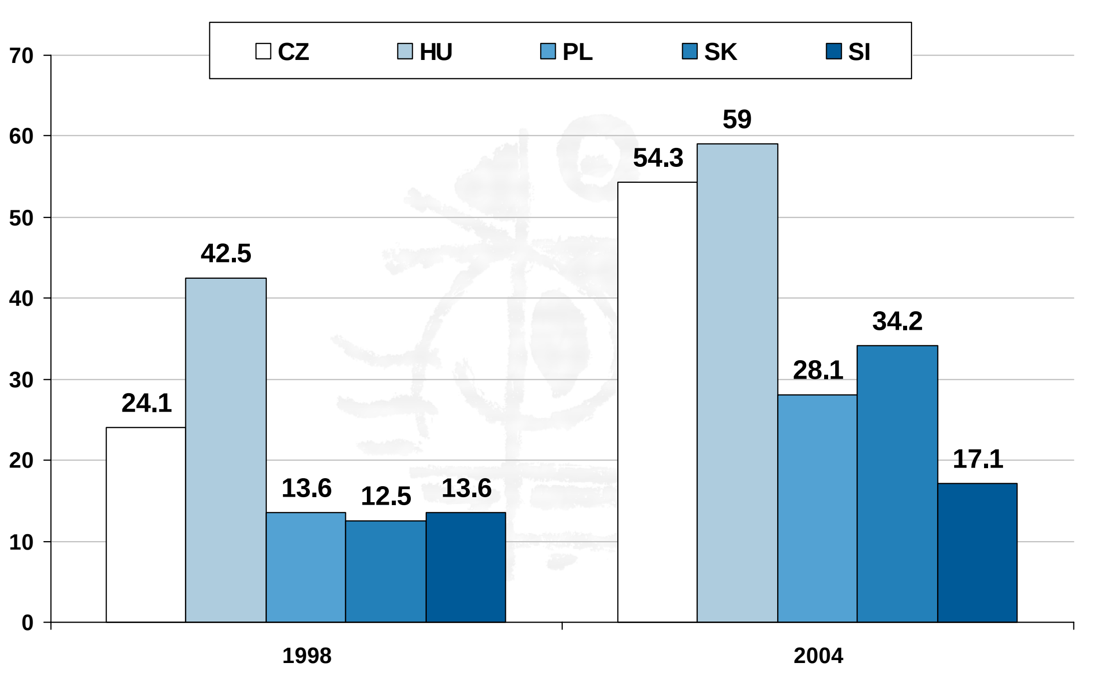


Source: WIIW, (2004)

According to Eurostat, the share of the NMS in the total FDI inflow to Europe, and their share in the FDI flow within the EU25, remain rather marginal. Of the €77.2 bn inward FDI to EU 25 in 2003, €74.9 bn went to EU15 and just €2.3 bn to EU10. And while FDI from the EU15 to EU10 amounted to €6.9 bn in 2003, between the EU15 it was €183.7 bn. Contrary to popular perceptions, investment flows among the 'high-wage' western European countries are far more important than those from the high to the low-wage eastern European countries.

If we look at the yearly FDI flow to the major NMS (Figure 3), a renewed pick-up of investment can be observed in 2004, falling, however, substantially behind the pre-accession peaks that largely reflected western involvement in privatisation programmes. It is not yet apparent whether such FDI is set to level out or to pick up once more. At the same time, the continued flow of FDI means that the share of FDI as a percentage of the GDP of the NMS has also grown substantially since 1998 (Figure 4).

Figure 4 FDI as a % of GDP

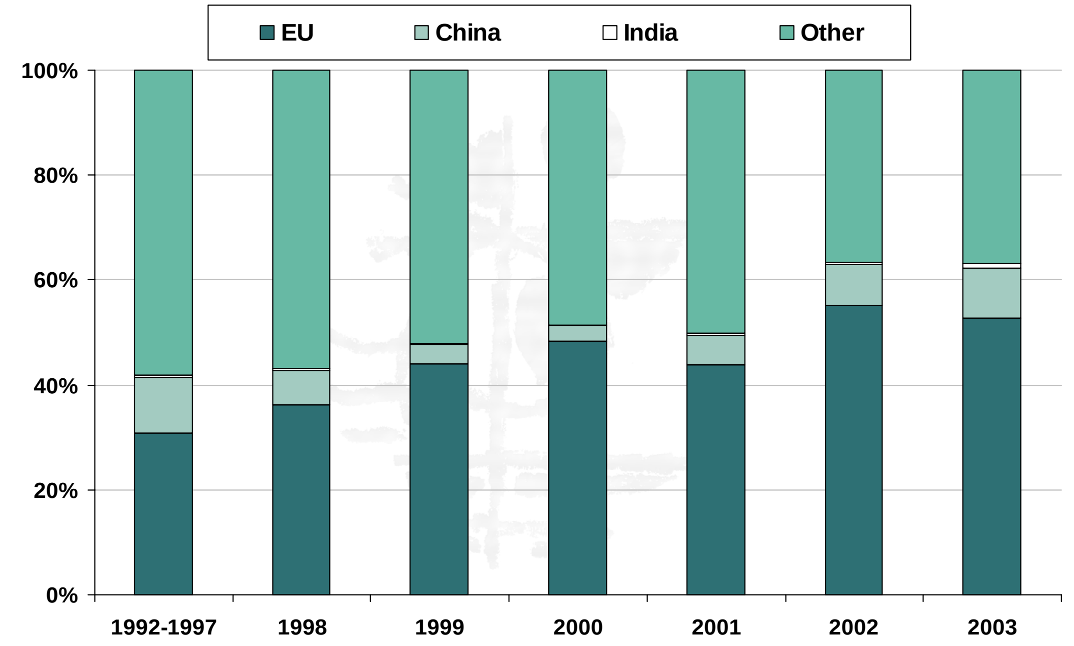


Source: Statistisches Bundesamt (2004)

Similar remarks apply at the global level. In the case of China, for instance, which has attracted much media interest, FDI in recent years has represented a not insignificant 12% of its total investment. Yet China accounts for only around 10% of global FDI: investment flows between the advanced capitalist countries are quantitatively far more important (Figure 5). Moreover, Chinese companies are starting also to invest abroad, with a number of high-profile cases of takeover bids in the US: it is a curious feature of the debate that there seems to be concern amongst politicians and in the media both when US firms invest in China and when Chinese firms invest in the US.

There are some signs of changing patterns of FDI in the NMS. Market exploration was the driving force of EU15 investments in the 1990s. Foreign investors bought retail chains, service providers for the domestic market and production facilities serving domestic or regional markets, or established retail outlets to service local consumption. This type of FDI has declined in importance and activity is now more focused on vertical integration, with growing intra-industry and intra-firm trade in which exploiting competitive advantages (using cheap skilled labour) through a 'new division of labour' is gaining more ground. This implies that the substitutive aspect of such FDI may be increasing. Against this must, however, be offset the fact that the size of sales markets is also growing (relative to those of western Europe), increasing the scope for both market-capturing FDI and exports.

Figure 5 FDI inflows, world = 100%



Source: Statistisches Bundesamt (2004)

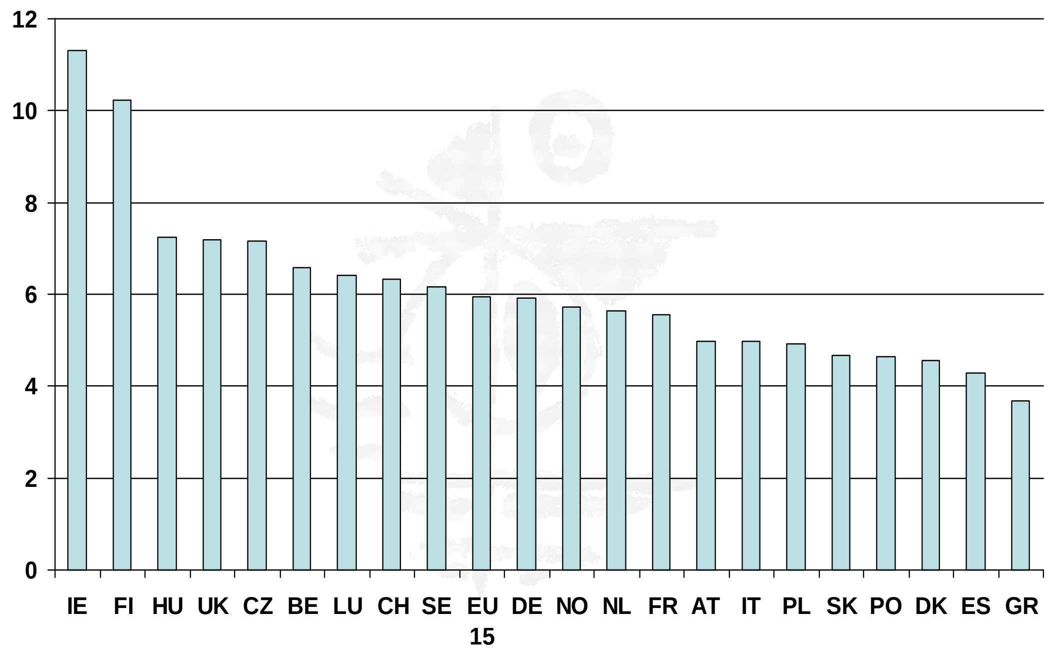
In addition, the division of labour shows a shift to higher value added products in the NMS. Not only labour-intensive, low value-added activities are performed, but also technology and skill-intensive activities with higher value added; this is being reflected in changing trade patterns. Activities that were not thought of as being subject to relocation also become affected (for instance, a wide range of business-related services and research and development). For example, some Central Eastern European countries have become an important location for ICT manufacturing and this development has contributed to the expansion of Europe on the ICT world markets (see Box 2).

Box 2. The case of the ICT and electronics industries

Some Central Eastern European countries have become an important location for ICT manufacturing: within the EU25 only Ireland and Finland have a higher share of ICT in their GDP than Hungary and the Czech Republic (Martinez 2005). As regards the production of electronic parts and components, the share of the CEE8 in the total European (EU15+CEE8) output has grown from 11% in 1993 to 32% by 2003, while in the same period EU15 output grew fivefold (Radosevic 2005).

At the same time the share of European (EU15+CEE8) ICT exports in total world exports has grown markedly, due not least to the rise of CEE8 ICT exports. Clearly production in CEE is being upgraded and at the same time output in this key sector is expanding in both eastern and western Europe.

Figure 6 Share of ICT value added (in % of GDP)



Source: Statistisches Bundesamt (2004)

The above trends can also be seen from the trade statistics between the EU15 and the EU10. The trade surplus of the EU15 with the new member states has been decreasing in the last six years, although a substantial surplus remains. This may suggest that the big wave of market exploration is over, while intra-industry trade through offshoring and outsourcing is increasing. In the longer run, this might threaten the overall positive employment balance for the EU15 from East-West trade, although this still remains substantial.

Box 3 – Relocation in household electronics

French household equipment manufacturers plan to move production to Central Eastern Europe. Against the background of rising costs of raw materials, mostly due to growing Chinese demand, employers have sought to reduce labour costs through relocation. Moreover, sales of household appliances in France and Germany are decreasing, while markets in CEE are expanding. Even so, 12.8 million household machines are sold in a year in France, most of which would be produced in CEE locations in the future. (*Le Monde*, 27 Feb 2005).

Electrolux the Swedish household appliances manufacturer plans to close down half of the production sites in Western European countries and transfer some of the production capacities to Eastern Europe for similar reasons.

ETUI REHS **Table 1 Studies on relocation and employment effects**

Study author	Country/ region	Sector	Time period	No. jobs
Bardhan and Kroll	USA	All sectors	Long term	**14 million** **Note:** maximum potential for offshoring
Deloitte research	US	Financial services	2004-2010	**20% of 'cost base'**
EMCC	EU	all	2000-05	**1.5% of all job losses** Note: Based on newspaper reports - questionable representativeness
Forrester	USA	IT services	15 years	**3.3 million**
Gartner	USA	IT services		**1/10th IT jobs**
ILO World Employment Report 2001	US and EU	Services		**1-5% service jobs**
McKinsey	US, EU, JP	all	One year	**600,000**
McKinsey June 2005	global	services		**160 million (11%)** **Note: Total potential 2.6 million** **Note actual forecast 2003-08**
TUC	UK	Private services	Long term	**150-750 000**
UK Treasury	EU	Services	2015	**5 million**
World Bank	G7	services	Long term	**1-5% of total employment** Note: maximum potential for offshoring services (technically feasible and cost savings of 30-40%)

From our review of FDI and trade statistics we can say that, for the moment, the actual volume of relocation would seem to be limited, with regard to both the NMS and countries such as China. At the same time there are some indications of qualitative changes in trends which suggest that the impact on employment in the source countries may be becoming more serious. This needs to be borne in mind when considering media reports and studies by research institutes and consultancies (summarised in Table 1), most of which suggest that large numbers of jobs have already been relocated, or, more commonly, that there is a huge potential for this to occur in future. Such studies often rely on patchy evidence or bold assumptions about employer behaviour, while consultancies may also have their own agendas and interests (e.g. selling relocation 'packages' to employers keen not to be seen as having missed out on an opportunity). Sector-level studies tend to exclude possibly offsetting cross-sectoral effects. Due to its only recent appearance as a topic of public debate, and the conceptual difficulties mentioned earlier, serious and comprehensive research of the relocation phenomenon over the past few years is still lacking.

Our previous analysis suggests that such figures – which have been given great media attention, causing considerable uncertainty amongst workers – need to be treated with caution. For while it is true that the FDI statistics do not include international outsourcing, there is evidence that this is quantitatively substantially less important than offshoring to subsidiaries. This may reflect the managerial, quality, logistical and other risks and difficulties involved (to which we return below). They also have to be seen against the background of the very substantial number of job losses that occur in any economy every year, even when the overall level of employment (or unemployment) stays the same. Our view that overall relocation seems to have had a limited impact on employment to date, at the macro level, is shared by international institutions (OECD, WTO) that have examined the issue. Of course this does not mean that specific sectors and regions have not faced serious problems. Nor does it belittle the problems posed for workers by the mere 'threat' of an employer to relocate, for instance in pay negotiations. We will return to these issues later. Moreover, the trade and FDI figures are backward looking, whereas the prognoses relate to a future that is, as ever, uncertain: it is impossible to seriously predict how relocation will develop in the coming years. In the face of this uncertainty we turn to some of the major drivers of relocation.

Why do firms relocate – and why don't they?

Many factors can play a role in firms' decisions whether to remain in their current location or to shift some of their economic activities abroad. Some factors act as incentives to consider such a shift, others as disincentives. First of all, certain types of job can simply hardly be relocated. For many services close proximity to the customer is vital. The most obvious examples are personal services where the person performing the job has to be in direct, physical contact with the receiver of the services (e.g. nursing), but also many other types of service fall into this category. Also, in certain types of firm it is complicated to split up production processes or to engage in long-distance management because of technical or size-related reasons. Second, there is the question of whether relocation leads to lower costs. This depends on the levels of wages – judged in terms of labour productivity – but also on, for example, training costs, transport and other logistical costs, the available infrastructure, costs related to regulatory barriers, taxes and state support, etc. Thirdly, firms must consider whether employees with the required education and experience are available elsewhere, or whether there are cultural and language obstacles. Fourthly, there is the wider social and political context, which is of importance. This ranges from the industrial relations climate (is there a tradition of cooperative practices between employees and employers or managers) to issues of political and economic stability.

All these factors may constitute reasons to stay where you are or to consider relocation. Many of these costs and barriers may not be immediately apparent to the investor. Moreover, given the longer-term nature of physical investment, it is not only current levels (of wages, productivity etc.) but also future trends that are important. We will not discuss all these factors in detail (see Box 4 for a discussion of their relevance in the case of services) but limit ourselves to a more detailed look at the issue of wages and productivity, with some references to the debate on corporate taxation and state aid.

Box 4: Factors constraining the outsourcing and offshoring of services:

A recent McKinsey study looked at potential and actual international relocation and provided a useful analysis of the discrepancy between the two in the case of services. Offshoring of service jobs from high to low-wage countries is constrained – at the aggregate level at least – by demand more than supply: i.e. under current conditions western firms do not want to outsource as many jobs as there are people in other countries who would like to take them. A very considerable proportion of service jobs – around 11% – could, in theory, be located anywhere in the world. There is also a substantial supply of qualified labour in low-wage countries, far in excess of current and expected demand for the coming years. But, compared with these numbers, actual relocation is extremely limited.

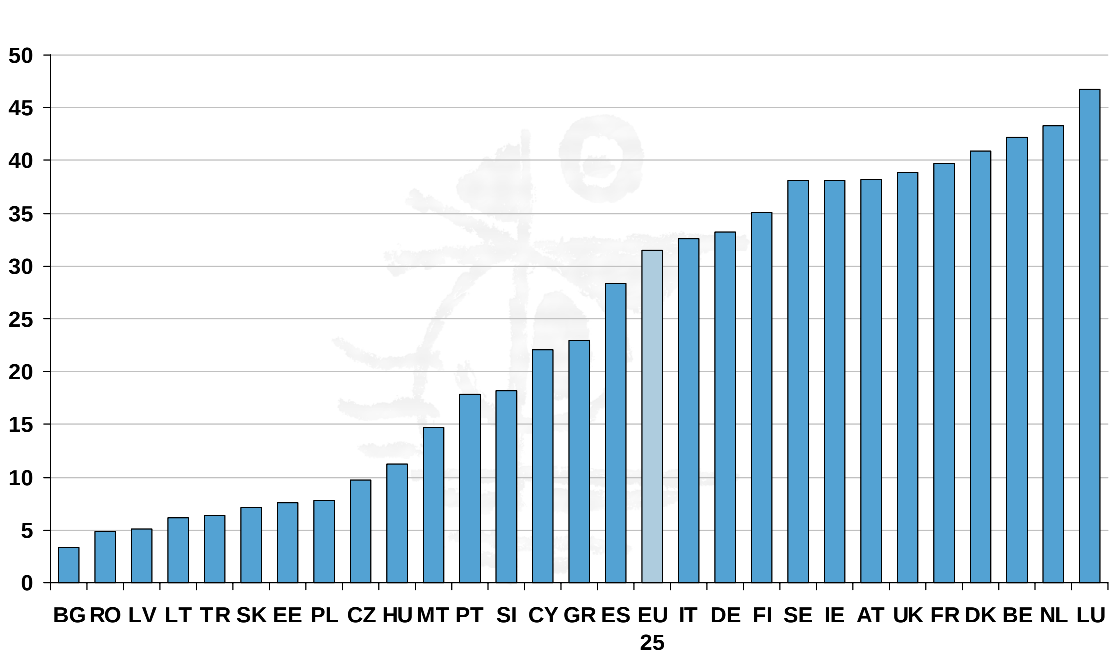
One constraint that is often mentioned is regulatory barriers. Restrictions on dismissals, for instance, are often cited in this regard; critically by employers and some economists and as a useful instrument to restrain excessive offshoring by unions and other commentators. Research based on interviews with employers, however, suggests that company-specific barriers are far more important. Simple issues such as inadequate size, technical and logistical difficulties of 'unbundling' production segments, problems of long-distance management, etc. are powerful deterrents for many firms (especially SMEs).

On the supply side there are indeed millions of university graduates (more in absolute terms than in the high-wage countries). However, many of these are unsuited for offshoring work for a number of reasons. Firstly, despite the formal qualification, actual skill levels may not be of the requisite standard. On top of that come demands in terms of language and other 'cultural' aspects that make such workers unattractive to western companies; some of these restrictions weigh much more heavily with regard to emerging-market economies, the focus of the McKinsey study, than to those in central and eastern Europe. Particularly in the larger emerging market countries (but also Russia) those with the required skills are often 'inappropriately' distributed geographically, from the point of view of western investors. Specifically, they do not live in a city near an international airport; except in India, it is also reported that their willingness to move to take up work in such a city is limited. Last but not least, foreign companies must compete for labour with domestic firms – a point that is often ignored by western commentators. They will almost certainly have to pay above the prevailing wage level to attract skilled labour. Such restrictions reduce the potential labour supply to around one tenth. It is also true, however, that both the overall potential is increasing (as emerging market economies produce more graduates) as is the proportion of that overall potential that is 'actually' available to foreign companies (e.g. due to improved language skills, infrastructural development).

The interaction between demand and supply side effects means, among other things, that national averages (of 'excess' labour supply, wages, etc) are not a good guide to the potential for relocation, because local and regional differences are very pronounced. Specifically, incoming FDI of different types tends to be highly concentrated in specific cities and regions, which pushes up the cost of skilled labour (and other production factors) there, and can even lead to labour shortages against the background of widespread unemployment at the national level. In the short run this serves to reduce the incentive for relocation. In the longer term, of course, adjustment processes can be expected to occur (e.g. labour migration, infrastructural development in currently less attractive areas), but such effects will take some time to work themselves through.

Most often, in the debate on relocation the huge differences in wages and working conditions are evoked as being prime drivers of relocation. Turning first of all to the intra-European situation, there are indeed very substantial differences. Within Europe, in 2004, average annual employee compensation (in €) ranged from 3,315€ in Bulgaria to 46,750€ in Luxembourg (Figure 7). Clearly, there is something of a divide between old and new member states. For example, in the Netherlands employee compensation is 5.7 times higher than in Estonia and 3.8 higher than in Hungary; in Germany it is 4.3 times higher than in Poland and 3.4 times higher than in the Czech Republic. However, the old member states and the new member states are not two homogeneous groups. For example, compensation in Luxembourg is 2.6 times higher than in Portugal, and in Slovenia it is 3.6 times higher than in Latvia. Indeed, Slovenia, Malta, and Cyprus, together with Portugal, Spain and Greece, form a group with intermediate wage levels within Europe. Such subtleties suggest that we should be cautious with the comparison between 'high-wage' old and 'low-wage' new member states since they are not two completely distinct groups.

Figure 7 Wages in Europe, 2004 (1000 Euro)

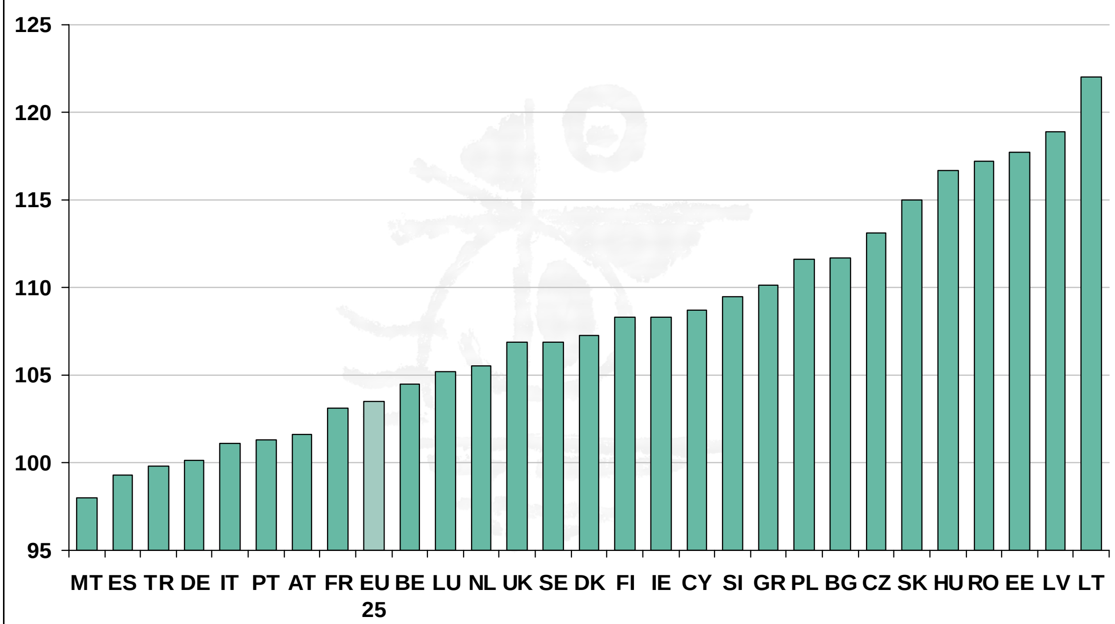


Note: Data refer to average compensation per employee

Source: AMECO database

It is not just wage levels, however, that are important for relocation decisions, but also wage trends. If we consider real wage *growth*, the division between old and new member states is much clearer (Figure 8). Real wage growth has recently been substantially stronger in the NMS and candidate countries (with the exception of Malta and Turkey). For example, in the period 2000-2004, real wages in local currency increased by 22% in Lithuania, 16.7% in Hungary and 11.6% in Poland. In the same period, in the UK the increase was 6.9%, in France 3.1% and in Germany 0.1%. Hence, the wage gap between the old and new member states has been diminishing over the past four years. Expressed in euro, which is of greater relevance for the decisions of international investors, the differences have decreased even more rapidly since the NMS currencies have tended to appreciate against the euro. Still, the gap between the poorer NMS and the candidate countries on the one hand and the OMS on the other hand remains very substantial and many years of strong wage growth differences would be needed to close it.

Figure 8 Real wages in 2004 compared to 2000



Note: Data refer to change in real compensation per employee in local currency in 2004 (2000=100)

Source: Statistisches Bundesamt (2004)

A quite similar picture emerges concerning productivity growth, against the background of which wage differentials, of course, need to be seen. In the past four years, in the EU, the ten countries with the highest productivity growth were the NMS from Central and Eastern Europe, Turkey, and Romania (Figure 9). Productivity growth in the EU15 was very modest over these four years, ranging from 8.5% in Ireland to –0.6% in Italy. Hence, apart from some closing of the wage gap we also observe some closing of the productivity gap.

If we compare the two figures, we can also observe divergence among the NMS. In this four-year period, in a number of NMS and candidate countries (e.g. Hungary, the Czech Republic, Bulgaria) wages increased at a higher rate than productivity. This also means that, for investors, the labour-cost incentive in these countries declined. In others, it was productivity that increased more than wages. The difference is noticeably high in Turkey, Romania and Poland, the larger countries of the group. In these countries, labour costs have decreased (although this effect may have been reduced or even reversed because of exchange rate developments).

On top of the wage differentials come issues such as longer working hours and greater flexibility in labour deployment. Of course these differentials need to be seen in the light of the considerable productivity differences between the countries. However, average productivity levels are not decisive: manufacturing productivity levels are closer and productivity differences in the subsidiaries of multinationals are often negligible. This also has implications for the types of job being re-located. As mentioned earlier there is some evidence that, at least in the case of the NMS, production relocation is no longer limited to labour-intensive manufacturing, but also to more sophisticated products and services, up to and including key areas like R&D. This also means that even the NMS will be unable, in the longer run, to rely on low-wage competitiveness.

Wages and working conditions in newly industrialising competitors such as China and India are, of course, still at much lower levels (as is productivity), although the basic pattern of rising wages also applies here. A crucial difference is that these countries are not subject to the common rules and regulations of the European Union, while cultural differences are also much more pronounced. This constellation means that relocation to such countries may be more profitable, but is also subject to greater uncertainty and risk. Indeed there has recently been anecdotal evidence of companies having had bad experiences with offshoring and outsourcing and even of them re-locating back from such countries to production locations closer to home ('near-shoring'), as a result of the legal-administrative, logistical, quality and other problems encountered.

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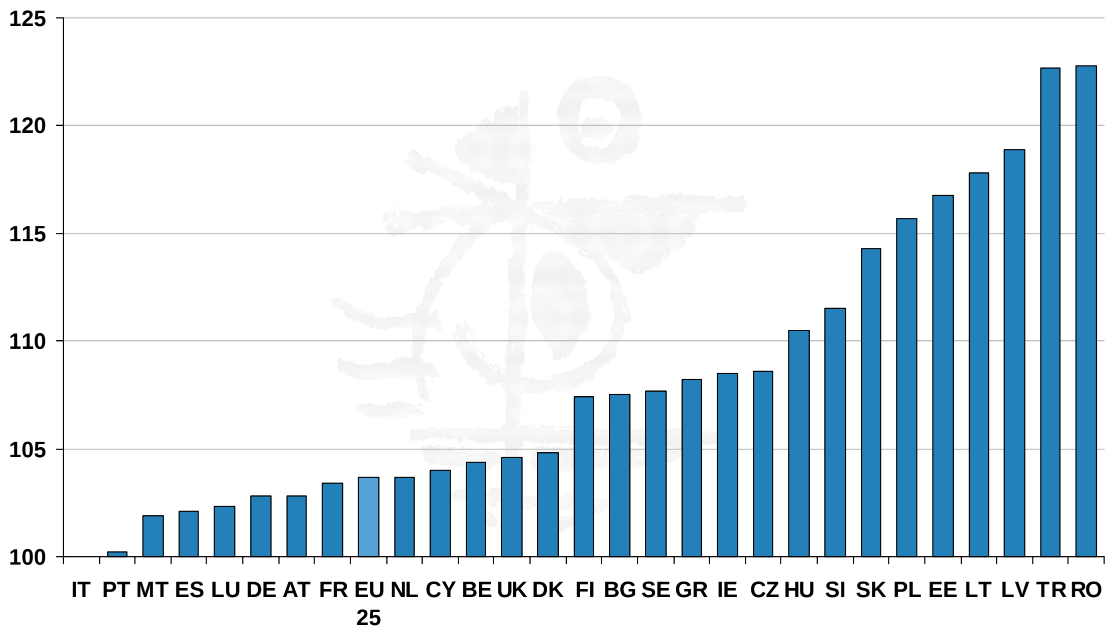
Figure 9 Real GDP per employee in 2004 compared to 2000



Source: Statistisches Bundesamt (2004)

Another issue central to the relocation debate is that of corporate taxation and specific government incentives to attract foreign investment (in EU jargon 'state aid'). There is some evidence that competition for investment is leading to a decline in corporate tax rates across Europe. This raises concerns about a downward spiral and the ability of governments to finance public spending or about a shift in the tax burden to relatively 'immobile' production factors (i.e. labour). While there are exceptions, corporate tax rates tend to be considerably lower in the NMS. Care must be taken in evaluating these figures, however, because they ignore the large differences in the definition of 'profits' to which the tax is applied. For this reason effective tax rates are actually much lower than these figures suggest, particularly in countries like Germany, where there are many deductions and special allowances. More generally still, corporate and other taxes need to be seen against the background of the infrastructure, education and other services provided by government. Certainly the example of the highly competitive and high-tax Nordic model shows that there is no simple relationship between competitiveness and taxation levels.

Apart from general tax rates, governments also try to attract FDI by providing tax holidays, subsidies and other specific types of support. For the members of the EU, such activities are limited by EU competition law, although certain forms of support remain possible, if justified by, amongst other things, regional policy concerns. In particular, this has led to major changes in practices in central and eastern Europe following the accession of the NMS to the EU.

At present there is little concrete evidence regarding the importance of corporate taxation or specific types of support for investment and relocation decisions by companies. However, there is anecdotal evidence of cases in which such 'incentives' did play an important role in deciding between production locations that were otherwise evenly balanced in terms of their attractiveness.

We can conclude from the evidence reviewed here that relocation decisions are based on a whole range of factors and their subjective evaluation by companies. In particular, they cannot be reduced to one-dimensional comparisons of, for example, current wage levels. This means that policy responses also have to be complex and focus on a wide range of inter-related issues.

Potential labour market impacts in source countries

It is not clear that relocation is fundamentally a distinct phenomenon that follows a different logic and has different impacts from the more general mechanisms linked to trade in goods and, increasingly, services (Bhagwati *et al.* 2004). On the contrary it seems likely that the factors leading to a company relocating abroad will often be similar to those that result in company closures in the face of import competition (notably lower labour costs – at prevailing exchange rates – for workers of the same or similar skill levels). Equally the impacts can be expected, by and large, to be the same: company restructuring, plant closures, and structural change, leading to shifts in demand for different types of labour, the latter leading to shifts in employment shares and opportunities of different groups of the workforce, and changes in relative pay. The beneficiaries of such structural changes are usually expected to be the highly skilled, while those with lower skills, the supply of which has increased due to the opening of world markets, will lose out. This raises thorny issues of equity and social cohesion. It should be noted, however, that the susceptibility to trade competition and international outsourcing and offshoring does not divide up simply along skill lines. Predominantly low-skill sectors like retail trade, for instance, seem likely not to be as affected as higher-skill IT services. Indeed, it may be that the media attention given to outsourcing and offshoring partly reflects the fact that it is increasing by affecting higher-skilled workers with closer social and professional bonds to the media.

As is well known, mainstream economic theory, in a tradition going back to David Ricardo in the early 19th century, emphasises the overall welfare gains from free trade. Trading countries specialise in areas where they have a comparative advantage, selling the surplus abroad in exchange for cheaper imports. This increase in efficiency raises the amount of goods that each economy can produce, raising overall welfare. While it is acknowledged that there can be adjustment frictions, these will, according to liberal economists, be temporary. Some groups of the population may also suffer longer-term losses; but these will be more than offset by gains elsewhere in the economy (opening up the possibility of compensating the losers). Thus the mainstream policy recommendation is to allow companies full freedom to relocate production; there is widely considered to be a role for government in smoothing adjustment while, to varying degrees, mainstream economists are prepared to countenance some limited forms of compensation (OECD 2005).

Critics of this view – including many critical economists and trade unionists – have pointed put that the assumptions on which these conclusions, in terms of the role of policy, are based are unlikely to apply in the real world, and thus that policy intervention will be necessary to ensure efficient and socially just outcomes. While it is not possible to review all the relevant arguments here, real-world factors that need to be taken into account include, for example, the possibility of unemployment persistence (and thus longer-run output losses), the increased vulnerability of highly specialised economies to shocks, and dynamic-strategic considerations that are based on the idea that comparative advantage is not ‘natural’, as those in the Ricardian tradition suppose, but has to be actively ‘built’. The common effect of all these factors is that the ‘resources’ (not least labour, but also physical capital and accumulated knowledge and networks) that are ‘liberated’ in the home country by import competition and relocation will not necessarily be redirected to more highly productive use elsewhere in the economy, nor are they likely to be re-employed in their original position even if the conditions that led to a relocation are reversed. In the US a quarter of displaced workers frequently have to accept, in their new jobs, wage cuts as high as 30% (OECD 2005). This suggests that, in a liberal framework, ‘globalisation’ will fail to provide increased welfare for an important part of the population. Apart from the ‘social’ costs to those experiencing such dislocation, even in ‘pure’ economic terms, displacing workers who were previously doing rather productive jobs into jobs that are paying 30% less wages and are less productive represents a waste of productive potential.

Taking ‘restructuring, globalisation, technological progress’ as some sort of ‘magical triangle’ that automatically results in higher welfare for everyone is clearly not a valid strategy for the European labour movement. The ‘invisible hand’ of the market must be complemented by the ‘visible hand’ of public intervention, be it by governments (and their agents, such as the public employment services) or trade unions and employers.

The above considerations can be used to structure an assessment of likely impacts, and possible policy responses.

Changes in trade patterns generally, and the relocation of enterprises in particular, will create adjustment needs in specific firms, sectors and regions. If these are to be well managed, and cumulative negative effects (e.g. on local suppliers) avoided, there is clearly a need for various forms of policy intervention to facilitate adjustment processes. This can be justified on both efficiency grounds (the overall impact will be improved by intervention) and in terms of equity: if there is an overall pay-off, those bearing the adjustment burden are entitled to social solidarity. There is also a ‘political’ rationale, combining efficiency and equity arguments, that adjustment support mitigates opposition to changes that are beneficial overall.

If there are longer-run impacts on certain (skill or income) groups in society there may well be a justification for offsetting them with generalised support measures (e.g. to raise their skills) or to offset growing income differentials (more progressive taxation, in-work benefits). This is usually seen, in high-wage countries, as referring to the low-skilled. However, as we have seen, one of the features of the relocation debate has been to raise concerns also about the impact on higher-skill and service-sector occupations.

Box 5: Employee representation, participation rights and restructuring

There is increasing awareness in Europe of the need to reinforce and integrate locally-based employee representatives' rights of participation and involvement in cases of company restructuring. This is considered a crucial factor to build a social Europe based on flexibility, innovation, utilisation of information technologies, job security, lifelong learning, enhanced education and training. This implies, amongst other things, involving the employees at different levels (European, national, regional, local) and linking workers' participation to notions of change in industry (sector) and at the workplace. This reflects both a social as well as an economic and organisational rationale.

Legislation and widespread collective agreements constitute the main two 'pillars' that support the rights of employees' participation related to company restructuring in Europe and the influence that employees can exercise over change. Comparative studies drawn from EIRO (European Industrial Relations Observatory) report that the main weaknesses of participation processes are usually linked to the problem in implementing 'effective' and 'real' employees' involvement in terms of time needed for decision-making and the legitimacy and competence of the decision-makers involved. This is reflected in the cross-national differences with regard to the systems of representation and employees' participation in Europe. In almost all EU countries legislation guarantees workers' rights. However, these rights are articulated across a variety of diverse labour codes and laws which affect differently the effectiveness of employee involvement in cases of restructuring. Employee rights of participation are solidly based upon 'co-determination' and 'veto' power (e.g. Austria, Finland, Germany, the Netherlands and Sweden), or 'co-decision' (Greece) or simply rights of information and consultation in case of industrial adjustment (such as in Belgium, Denmark, France, Italy, Spain, Portugal, Norway and most of the Eastern and Central European countries). Accordingly, in certain countries employees are granted the right to be informed well in advance of any restructuring that will have a significant impact on employment, and in some cases employees' representatives are allowed to negotiate a 'social plan' to deal with the consequences. (See the annex table for an overview of the situation in the EU countries.)

Increasingly there is also a European dimension to employee participation. The EWCs Directive (94/95/EC) requires the establishment, on request or by management initiative, of an information and consultation procedure in every multinational company that has at least 1000 workers in the countries covered by the directive, with at least 150 in a second country. The adoption of the EWC directive highlighted an anomaly in the practice of employee participation in a minority of EU member states, notably Ireland and the UK. The EU Directive (2002/14/EC) on national information and consultation provided for the rights of the worker representatives to information and consultation at national level. Finally, the EU statute regulating company law or European Company Statute Directive (SE) provides that SE works councils based on formal agreements can represent the interests of all workers in a European Company. It also grants workers' representatives seats and voting rights at board level in a European Company, entitling them to exercise co-determination rights with regards to the appointment or dismissal of board members

Going beyond such conclusions, which would be accepted by many mainstream economists, there is certainly a need to insist clearly on the fact that aggregate benefits from trade and outsourcing depend on the maintenance of ‘full employment’ in all the participating countries. This implies labour market interventions, as mentioned, but also a macroeconomic policy responsive to declining demand in a country or region affected by relocation. In terms of the need to ‘build’ comparative advantage and avoid permanent losses in physical and human capital and knowledge, the appropriate response by policymakers should be a coherent industrial policy. While the tools of such a policy will vary according to circumstance, the aims must be to channel investment in human and real capital in areas that are considered to have the most future potential, and also to manage the transformation of old industrial areas.

In this and other policy areas the role of workers’ representatives is key. The know-how of workers and their representatives needs to be mobilised to ensure efficient outcomes. Moreover, the participation of workers’ representatives is key to ensuring transparency and commitment by workers to support change processes. In this context it is worth noting that the legal basis for such involvement differs greatly across Europe (see Box 5). Yet employee involvement is a cornerstone of the European approach to social and economic policy, whatever the differences in national institutional arrangements.

Having examined the facts, as they currently present themselves, and looked at some of the main areas of concern and scope for policy intervention in a general way, it is time to look more specifically at the implications for, and challenges facing trade unions in Europe.

What can trade unions do? – challenges and policy options

Trade unions have, since their inception, been confronted with processes of restructuring, foreign competition and industrial change. This section aims to combine the above analysis of recent trends towards international relocation with that tradition of policy responses and action. Given both the preliminary nature of the research, and the major divergences within Europe, no ‘recipe book’ of policies is offered, but rather an overview of the sorts of policy initiative that have to be taken at different levels by different actors. Further work and discussions are needed within both the trade union and academic communities to flesh out such proposals.

The challenges to the trade unions posed by the question of relocation can usefully be considered under three analytically separate aspects. Firstly, <u>reducing incentives for relocation</u> by developing proactive and forward-looking strategies at both the micro and macro levels and with the involvement of social partners. Rather than the ‘low road’ of adaptation through cost-cutting, the aim would be to manage adaptation through a ‘high-road’ strategy by upgrading activities through innovation, qualification and further investment, supported by active labour market policy. This needs a managing of structural change in a forward-looking way with the involvement of stakeholders. Securing the long-term future of a given production site (in the East or in the West) needs anticipation of change and coordinated interventions from various policy areas, and also by the social partners, in order to manage that change.

Secondly, the <u>actual relocation</u> of companies, whenever it occurs, raises a whole set of adjustment problems for the workers affected, their families and local communities.

Workers facing job losses are in need of, and must be entitled to, support and assistance in finding new employment. If there are indeed overall benefits from globalisation they must be shared also with those who bear the adjustment burden. Likewise, ways need to be found to share the wider social costs of relocation – currently borne primarily by the workers affected and the state – more equitably, with employers taking a share of the burden. This is also vital to sustain confidence, and thus demand and growth, and a willingness to engage constructively in change.

Thirdly, there are crucial issues arising from the threat of relocation – employers' 'exit option' – in the context of collective bargaining and also government policies. The delocalisation debate was intensified by a number of high-profile cases of concession bargaining (Siemens, DaimlerChrysler, Bosch, and others) in which employers threatened to move to low-wage countries if unions and employees refused concessions in terms of wages or working time. Such examples – which have received great prominence in the media and have served to change public perceptions – have been used by employers around the EU to pose similar demands, arguing that enlargement and globalisation require higher competitiveness based on lower labour costs. The risk here is that throughout Europe workers will systematically lose out to capital-owners, being played-off against each other: attempts to sustain national competitiveness by lowering wages and working conditions or by cutting corporate tax rates are fruitless, leading merely to a downward spiral.

How to deal with these challenges? What can governments, unions and other actors do to cope with actual cases of adjustment, once they occur? How can governments, unions and employers, by acting proactively, reduce the incentives for relocation? How can workers at different locations avoid being played off against each other? How can employers' interests in greater flexibility be reconciled with workers' interests? How to strengthen the employment orientation of broader economic policy? These are some of the question to be discussed in view of reducing the (future) impact of and fear of relocation. There are a whole range of policy areas that are of relevance to these questions. Not all of them will be addressed here. We focus on a set of policy issues that we see as the most relevant, that are closest to the key concerns and competences of trade unions, and/or that have played a major role within the public debate on relocation. The policy options discussed address different policy levels, i.e. the European, national and company level. Obviously, at the national and company level the specific context will determine how relevant the policy proposals are in each case.

Anticipating change

To reduce incentives for relocation and anticipate change, governments, unions and employers at national and company level need to be active on two fronts. One is to strengthen, at the company level, efforts to assure continued productivity improvements through upgrading of skills and work organisation and through innovation and R&D, and so reduce the incentive for delocalisation and thereby preserve workplaces. Where possible, win-win solutions that meet the needs of both employers and workers should be negotiated.

At the same time, also at the sectoral and national levels, efforts to upgrade the economy and labour force must be strengthened. This requires a *genuine industrial policy strategy* involving both generalised support for research and innovation (horizontal dimension) and also specific sectoral policies, such as developing and supporting sectors like clean and renewable sources of energy, clean technologies, environment-friendly transport. Support should aim to help the European economy to move up the ladder of international specialisation and focus on those sectors and activities where world demand is dynamic and where Europe can develop its comparative advantages, building on its profile of high wages but also a skilled labour force and advanced capital stock.

Here, too, there is a European and a national dimension – and a role for trade unions. Europe needs to rethink both its industrial and its competition policy – and the link between the two. A substantial increase in European-level funding for both horizontal and sectoral measures is called for, in line with the Lisbon strategy. Public investment by national governments should be encouraged, rather than discouraged by European fiscal rules and competition policy. However, such polices must be genuine industrial policies that seek to raise productivity: beggar-thy-neighbour policies (like financial concessions to firms in order to attract foreign investment) should be avoided, for these foster tax competition and regime shopping. They also run the risk of starting a race to the bottom in terms of corporate taxation and social and environmental standards. Policymakers should provide a framework that permits productivity-raising investment, while limiting subsidies and other 'sweeteners' to companies to cases where they are justified by regional development and social cohesion objectives within an overall European context.

Both productivity and longer-term labour market prospects for workers can be strengthened through improved *access of all workers to further training*. This can, in particular, decrease the vulnerability of low-skilled workers to restructuring. In many member states, collective agreements address this market failure by organising (sectoral) training funds that provide all workers with the right of access to training. Where this is not yet the case social partners could adopt such practices. These sectoral training funds also need to be supported by the European Structural Funds. Providing continuous training should also be considered part of the responsibilities of employers towards the future of their workers.

Trade unions have a role to play both in consultations with policymakers on industrial strategy and, more generally, in raising productivity levels at the workplace and through sectoral initiatives (e.g. training funds). In this context *productivity-oriented wage bargaining* gives both sides of industry an incentive to reach agreement on productivity-enhancing forms of production. For workers' representatives to be able to contribute effectively to the management of change by early and timely identification of future challenges, they require stronger *information and consultation rights*. However, present European legislation is vague concerning companies' reporting obligations on the future of the company and on business prospects.

All of this means that European directives on information and consultation and on European works councils, as well as national legislation on workers' rights for participation, need to be improved. For example, one could think of a directive providing an obligation for companies to publish an annual report on changes and future challenges affecting employment and working conditions, to be distributed to and discussed by works councils. Also, in the case of merger proposals, the European Commission should make sure workers' representatives are heard in advance. At present, workers are most of the time confronted with a '*fait accompli*' and are heard by the Commission only after a merger proposal has been accepted by the Commission. This means that the right of workers' representatives to be heard by the Commission in the framework of a merger control procedure cannot be exercised in practice. A particular point of attention is to link up the process of structural change with trade union representatives. This is particularly important at the level of EWCs which are becoming increasingly involved in transnational negotiations on restructuring issues. To strengthen the positions of EWCs in such processes, they should forge stronger links with European Industry Federations and national unions.

Getting the economic policy framework right

A further issue which is of importance to soften the impact and fear of relocation is to ensure that retrenched workers are able to find jobs elsewhere in the economy. Here, *pro-active use of macro-economic demand policies* is necessary. To bring effective output back in line with potential output and so re-deploy the workers that were retrenched in restructuring operations, economic policy needs to support aggregate demand. To this end, Europe needs a fundamental shift in approach from monetary and fiscal policies being exclusively focussed on stability towards a focus on stability and growth. This implies changes to central bank policies, towards monetary policy decisions that are symmetrical, forward-looking and adapted to a low-inflation environment in which the traditional trade-off between inflation and unemployment may not always send the right signals. It also implies using the new version of the Stability Pact in a creative way so as to be able to support aggregate demand through fiscal policy when necessary, and focussing the demand boost on those countries or regions hit by restructuring processes and the risk of downward demand spirals.

Together with employers, unions have an important role to play in macroeconomic policymaking at both European and national level. By orienting wage settlements to productivity and stable and low inflation, the social partners help contain inflationary expectations and cushion price shocks, enabling the central bank to focus on the task of ensuring steady demand. This process can be coordinated in institutions such as the Macroeconomic Dialogue. The ETUC has called for this and other coordination instruments to be strengthened.

Adjustment challenge

A number of policy alternatives are available to reduce the negative impacts of actual cases of relocation. They imply that both the company and society take some responsibility for the fate of the workers affected and that employee rights enabling workers to prepare for job losses are strengthened.

A first issue here is to improve *advance notification*. Advance notification provides workers with a head start in searching for a new job and provides a timeframe for support measures for workers. A certain notification period allows the (public) employment office and sectoral re-adjustment schemes to liase with the company and organize intensive programmes for accompanying the workers who have received such notification. In this way, it can facilitate adjustment and avoid protracted periods of unemployment. Contrary to widespread opinion, dismissal is not completely flexible in Denmark, a country generally highly praised for its adjustment capacity. Here, employers do need to respect a notification period of three months for workers with four years of tenure. In many other European countries (Austria, the Netherlands, Finland, France, Germany, Italy) the notification period is limited to only one month or so.

Secondly, every retrenched worker should have a right to *re-adjustment support* and European politics and European Social Dialogue should translate this principle into 'hard guarantees'. In Sweden and Finland, for example, social partner funds finance job counselling, re-training and job schemes in other firms from the moment a worker receives notice of retrenchment. Public support differs greatly in the European countries: active measures in the Nordic countries appear to have been rather successful in managing change, and need to be examined for their applicability elsewhere. Again, this is done in active cooperation with the public employment services, management and workers' representatives. Such schemes must be financed in such a way that employers bear a share of the costs, while European structural funds could also be used to support social partner schemes that ensure a right to re-insertion in the labour market.

Thirdly, to soften the impact of dismissal and facilitate re-employment, *adequate unemployment benefits* are essential to allow for job search and re-training and other adjustment processes. In many member states unemployment benefit systems are highly inadequate and prevent unemployed workers from taking up retraining. In addition to this, inadequate unemployment benefit systems create general resistance to change and also have the effect of reducing voluntary mobility and keeping workers in existing jobs. Here, too, the Scandinavian countries are a case in point.

Fourthly, since relocation involves employee mobility, adequate *employment protection legislation* is needed to make mobility acceptable to employees and reduce their levels of insecurity. Switching jobs often implies making new investments in new skills, a new place to live, reorganising transportation from home to work, etc. Workers will not be prepared to take such risks and make these efforts if they cannot count on a certain level of job security in their new job but can be immediately fired.

Coordinating collective bargaining

As mentioned above, a number of employers are abusing the threat of relocation as a strategy to downscale wages and working conditions (a practice that contravenes the OECD Multinational Guidelines). This is obviously most common in the high-wage countries but may also increasingly affect the medium-wage countries. Through concession bargaining workers at different locations are played out against each other. In the end all workers will lose from such developments, with workers in higher-wage countries seeing their income decrease while workers in lower-wage countries may see the prospects to improve their wages vanish.

One factor important in countering such tendencies is the strengthening of information and consultation rights – discussed earlier – which can give workers a better view of how real a relocation threat is. In addition, trade unions should accept the fact that their bargaining outcomes are becoming increasingly interrelated and should step up their *coordination of collective bargaining* activities. Through the exchange of information, as well as cross-border agenda-setting, unions can step up their European cooperation. Such coordination can avoid the drifting apart – in either direction – of wage and productivity trends within Europe, preventing a race to the bottom on wages and working conditions and permitting a gradual upward convergence of income levels in the newly unified Europe. To this end European trade unions must seek to strengthen the information and reporting systems that are currently being developed at the ETUC and within the European Industry Federations. Accordingly, trade unions in Europe should meet their responsibility to support the ETUC through the provision of a regular stream of information, while the ETUC should search for better ways to distribute such information in a timely fashion.

Where to draw the line?

As mentioned earlier, movement of capital and jobs is, to an important extent, a 'normal' feature of today's economic system. However, does this mean that any relocation attempt is simply acceptable? There seems to be a need for a debate on this question as more and more questions are asked concerning the situations in which 'protectionist' measures or restrictions on relocation would be permissible? For example, which minimum standards must be entirely taken out of competition? What are the corporate social responsibilities of companies in relocation decisions? Is it acceptable for a company that is already earning a reasonable return to relocate for the sole purpose of increasing its profits? How can companies be given incentives to fully develop the productivity potential of the original location instead of simply relocating to a low-cost environment? Should the regulations governing the reimbursement by relocating companies of subsidies and other incentives from local, national and European sources be tightened? These and other basic questions should become part and parcel of the relocation debate within the European labour movement and beyond.

Conclusion

This paper has attempted to provide a starting point for further reflection on the relocation debate within the European labour movement. We have tried to provide some conceptual clarification, to review some of the (limited) empirical evidence available, reflect on the drivers of relocation as well as its likely impacts, and to point out possible avenues for policy responses.

Clearly, more research and debate are necessary to get a clearer picture of the processes of relocation, their impacts and appropriate responses. The ETUI is undertaking ongoing research in this area. We also hope to further engage with trade unions and policymakers on these important issues.

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