BACK
HOME



## p-Watch — Europe

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### Eastern Europe's productivity challenges

In October 2002, the European Union (EU) gave its formal assent to its most momentous expansion: to admit as new members eight Eastern European countries (plus two island republics, Cyprus and Malta). A key feature of these formerly centrally planned economies is their continuing poverty resulting from poor productivity performance. Overall they have not even reached one-third of Western Europe's average performance. Moreover — and still more worryingly — this is a very long-term trend, as shown in the Table.

**Table: GDP per person relative to the USA (=100)**

| | Western Europe | Eastern Europe | Czechoslovakia | Hungary | Poland | Soviet Union |
|---|---|---|---|---|---|---|
| **1870** | 81 | 36 | 48 | 52 | — | 39 |
| **1913** | 66 | 29 | 40 | 40 | — | 28 |
| **1950** | 48 | 22 | 37 | 26 | 26 | 30 |
| **1973** | 69 | 30 | 42 | 34 | 32 | 36 |
| **1998** | 66 | 20 | ~30 | 24 | 25 | 14 |

**Source:** Angus Maddison, *The World Economy*, OECD, 2001.

Thus the EU is about to spread its own wealth eastward. This process is not without resistance. Europe's pampered farmers are just one group to contest this change, since they will have to give up some of their subsidies to benefit the newcomers. The decision to expand EU membership is not primarily economic but political: a reward for past hardships in relinquishing central planning and meeting the political, economic, and social Copenhagen criteria of free-market economies. However, there is an economic light at the end of the political tunnel. After the past dozen years of increasingly open economies in the East, there are signs that expansion will strengthen the EU economically. This was demonstrated at two 2002 national productivity forums in Hungary and Slovakia.

Inevitably, the forums focused on best practices, since adopting and adapting what others have already launched is almost always more efficient than developing new models. Virtually all cases were drawn from manufacturing firms in the automobile industry, demonstrating mainly Japanese but also European and, to a lesser extent, US productivity approaches. Clearly, the future of enterprise in Eastern Europe depends to a significant degree on foreign direct investment (FDI) for both money and know-how, with the latter being predominantly Japanese, from 5S and kaizen through to *muda*.

The foremost company example is, however, German: Volkswagen. Not only has it developed state-of-the-art greenfield sites but also productively turned around brownfield factories, notably skoda. Its Slovakian productivity and unit labor costs have become benchmarks for the whole enterprise, somewhat to the concern of its Spanish subsidiaries. Some of those plants are now manufacturing high value-added components that are exported to Germany to boost the parent company's competitiveness.

The importance of FDI in stimulating enhanced productivity has also been one of the characteristics of Europe's best practice labor productivity performer, Ireland. Ireland tops the OECD's world league of foreign companies' share of manufacturing production (just over 70%, pipping Hungary, with Germany and Japan at 11% and 2%, respectively). Without having any illusions that they can break into Ireland's productivity league, all Eastern European economies are striving to attract ever more foreign investment, not only to their western borders near current EU states, but also to the brownfield sites of former heavy industrial areas to the east bordering Russia and Ukraine.

However, salvation shall not be by FDI alone. Modernization processes need to be espoused by the population as a whole. Old habits remain heavily entrenched: "The bosses pretend to pay us and we pretend to work." This is particularly true of "service" (often understood as "no service") industries. One very powerful way to speed up modernization processes is to embrace competition by joining a common market. With a relatively high overall level of education, the Eastern Europeans are clearly capable of being as innovative as their Western counterparts, but with low incomes and little venture capital available, they need some state stimulation and support.

Some of this support comes from the EU and other international bodies. In 2000 the United Nations Industrial Development Organisation launched a new program for the region called E4PQ — "E" represents the electronic underpinning for boosting productivity and quality in Eastern Europe. Moreover, four central European countries have set up their own (small) Visegrad Fund to support transnational cooperation, such as (but by no means mainly for) productivity forums. Such programs can and must only provide shorter-term seed-money. Dependency on EU subsidies breeds a change-repellent culture in several poor regions and rustbelt industries in Western Europe. The Slovakian minister of labor used the opportunity of the national forum to promulgate a new act on "productivity and competitiveness," which had been three years in the making. This program provides seed-money for "six pillars," from fostering a competitive environment and raising awareness of quality and innovation to developing human resources, from enhanced labor and environmental protection and boosting partnerships to influencing basic education and broad awareness. In the end, the crunch factor is that although new skills and knowledge can be taught, new attitudes can only be learned.

Such attitude change happens, according to Volkswagen, most effectively when the workforce can see just why productivity and quality are important: if a minor defect is not eliminated at source, the cost consequences escalate exponentially when it is only detected and eradicated farther down the line. Understanding this, each member of the workforce is more likely to play his or her role because otherwise it will not be just their colleagues who lose their livelihood but also themselves.

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Elsewhere in Eastern Europe best practices are nearly nonexistent. But in Ukraine, one of the proven tools for fostering such change is emphasized: the joint labor-management study tour abroad to examine standard practices in advanced countries. A recent US$1 million USAID program for Ukrainian enterprises is calculated to have yielded US$18 million in profit and cost benefits in just one year. So effective have study tours been that the Bush administration is toying with the idea of launching a new US$5 billion program for other countries that meet the Copenhagen criteria. Perhaps productivity is again back on the USA's support agenda for poor countries.

Back to list

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To top of page