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p-Watch — Europe

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Quo vadis European productivity?

Industrial restructuring, migration, welfare reform, and anxiety are the recurring themes underlying the current productivity debate in Europe. Together they clearly demonstrate the continuous tug between the positive and negative connotations of the concept. Productivity improvement has always been founded on continuously embracing change. Although change is by no means beneficial to everyone, without it few can thrive in a world of competition. And nowhere is competition more acute than in today's expanded EU. From 1 May 2004 some 75 million more people in the 10 new member countries have been looking forward to substantial rises in the standard of living. Their average wage rates were previously not even one-quarter of those of their counterparts in the pre-May EU (Table). Low wage levels have been a major reason for western European companies to set up new plants, or even displace their existing factories, to the new market economies of the Czech Republic, Estonia, Hungary, Poland, and Slovakia. Thus major automobile companies and, in turn, their subcontractors, have introduced best practice productivity approaches in those countries. But wage rates and market economies are only two reasons for investing in eastern European nations, especially when, with their low productivity, their overall unit labor costs are as high as in the EU. In addition, investments based on low wage costs can rapidly shift further eastward, notably to China. More important for the future of the new EU members is their full integration into a common market, their more favorable corporate tax rates (around 20%), and the availability of well-educated workforces with skills that are in short supply in western Europe. Some companies have moved whole R&D departments eastward. So pronounced has this eastward movement become that Germany's chancellor criticized industrialists for being "unpatriotic" by creating new jobs in adjacent countries when unemployment at home is so high. The trend worries many EU governments, spurred on by media headlines such as "Goodbye, jobs."

Hourly labor costs and labor productivity rates in new and previous EU members.

Country	Hourly labor cost*	Labor productivity**
Sweden	28.56	64.4

Denmark	27.10	68.0
Germany	26.34	56.9
Luxembourg	24.61	90.5
France	24.42	65.6
UK	23.85	58.1
Austria	23.60	63.1
Netherlands	22.99	55.6
Finland	22.13	64.3
Italy	18.99	56.5
Ireland	17.31	81.6
Spain	14.22	45.9
Greece	11.62	39.3
Cyprus	10.74	NA
Slovenia	8.98	25.4
Portugal	8.13	NA
Poland	4.48	16.9
Czech Rep.	3.90	17.3
Hungary	3.83	17.0
Slovakia	3.06	13.3
Estonia	3.03	12.0
Lithuania	2.71	12.9
Latvia	2.42	10.7
Old average	22.10	57.6
New average	4.20	16.7
Combined	19.09	51.9

Source: Eurostat; printed in *The Wall Street Journal* 16–18 April 2004.
NA, not available. Countries in bold are new EU members. No data were available for Belgium and **Malta**.
***** In euros for 2000 in industry and services.
****** In gross value added at current prices per person employed, in thousands of euros for 2002 (2001 for France).

More generally, governments have been concerned about "de-industrialization," the decline of traditional industries, and the continuous transfer of jobs to the service sector. They fret under the EU's strict rules on state aid and competition. Yet if they do not respect those rules (which they have already ratif ied), they face serious legal consequences. The European Commission is adamant: competition "makes it necessary to pursue a shift towards sectors with a higher technological content." There is no avoiding the tiresome process of industrial restructuring in the quest for continuously higher added value.

The situation is further compounded by eastern workers (skilled and semiskilled) working, legally and illegally, in western Europe for wages below collectively bargained levels. Clearly they are meeting a need: migration has always prevented labor market arthritis and contributes culturally and economically to the well-being of the adopted country. But as borders disappear will this westward trickle of job-seekers turn into a flood? And will they undermine western wages? So strong is this fear in all "old" EU countries that governments (with the exception of that of the new productivity leader Ireland) have placed short-term restrictions on individuals' free movement. This is despite the fact that the four freedoms of movement of people, goods, services, and capital are enshrined as the legal cornerstones of European prosperity. Again, Europe's future productivity development will depend to some extent on European Court rulings.

To become more competitive, governments realize that they must reform employment markets and welfare systems. These changes are proving very difficult to implement in large economies faced with powerful lobbies. Thus the Germans are struggling to digest mini-reforms in employment regulations; the whiff of even mini-reforms in France has led to a government reshuffle; and in Italy arguments rather than even mini-actions flourish. But all is not gloom: the most productive economies—the Netherlands, Ireland, and Scandinavia—flourish by stressing organizational flexibility, greater individual autonomy, the elimination of repetitive jobs (in particular to avoid stress-related problems and absenteeism), reduced bureaucracy, and close labor-management cooperation; and the UK is developing an entrepreneurially friendly environment, not least for the unemployed. These more positive attitudes toward productivity give rise to far better employment figures.

Fear of change is also visible within the new EU members, with their already high levels of unemployment. The elderly in particular fear that products and systems resulting from western productivity levels will drive many existing eastern companies, or even communities, out of business. Traditional eastern European companies not only lack capital but have access to neither the technology nor the know-how to compete in new open markets; moreover, old "Soviet-style" work practices die hard. This anxiety has already produced a worrying political backlash against the "new Europe" in the new EU members.

An historical perspective shows that such reactions are wholly predictable and unfounded. Back in 1958, Italy's automakers feared being flooded by cheaper German impor ts and then they exported more; in 1973, Ireland feared being turned into Europe's cattle ranch since indigenous companies would be unable to compete and today its economy provides European productivity benchmarks; and in 1995, Austrian retailers saw their future as being swamped by the Germans and they have flourished on cross-border trading. These and other EU members have prospered as companies have sought and embraced the opportunities of change and their governments have developed welfare systems to cushion those individuals, industries, and regions that lose out, although today those systems themselves need reforming.

If Europe is not to drop further behind in its goal of becoming the world's most competitive economy by 2010, there is no way of avoiding the twin strategies of innovation and productivity: producing new, market-driven products and services and continuously improving existing ones and the processes by which they are produced. In other words, EU economies must undertake daily productivity work. Public funds must be directed away from supporting what already exists, e.g., coal mining in Germany, shipbuilding in France, or comforting the comfortable everywhere, to providing some of the wherewithal for the future by stimulating national R&D, improving the quantity and quality of education and training, and making productive use of all resources, particularly the able elderly.

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