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The dark side of globalisation

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Jobs come, but they soon go again

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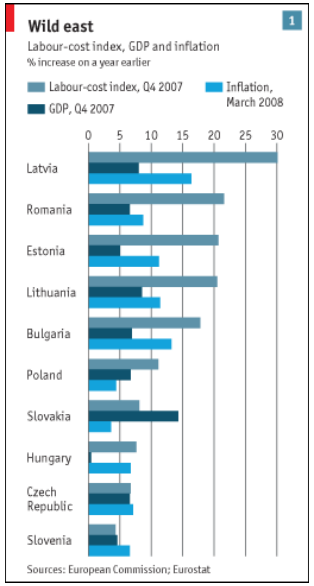
Correction to this article

A DECADE ago, Samorin—a small town in western Slovakia, on the banks of the river Danube—was one of many good places in which to watch the effect of globalisation on central Europe. The town was full of cheap, experienced workers in need of jobs, with unemployment at 20%. Foreign investors duly arrived, notably Samsonite, an American luggage-maker, which set up a factory there in 1997. The town's location helped, near a four-way border where Slovakia, Hungary, Austria and the Czech Republic meet in a cat's cradle of big roads and railway lines. There are scores of similar towns across the region that attracted jobs from higher-cost, more highly regulated labour markets farther west.

Workers, trade unions and politicians in old Europe mourned each factory moving east. But, as a European Commission official explains off the record, such shifts were fully expected: offshoring "was the whole idea of enlargement". The process, though wrenching to some, made the European Union as a whole more competitive and spread the benefits of global trade to every corner of Europe.

So far, so familiar. But things have moved on in Samorin. Even though new investment and jobs are still arriving in Slovakia, and proximity still counts, this river town has already lost a factory to offshoring. Samsonite closed its plant in 2006, shedding all 350 staff and shifting production to China.

Like its neighbours, Slovakia has seen wages rising fast as new jobs arrived and many of its own people headed west. In most of the new member countries, unemployment rates are lower than at any time since early 2000.



Sources: European Commission; Eurostat

But rising labour costs are only part of a more complicated story. Slovakia is still cheaper than the Czech Republic. In Samorin, unskilled workers might earn 12,000-15,000 crowns (€380-480) a month. Labour costs have risen faster in other new EU members too. In overheating Latvia, pay in the fourth quarter of 2007 was 30% up on a year earlier (see chart 1).

Samorin is a witness to the way that globalisation is fragmenting as supply chains break into ever smaller parts, sending jobs in all directions. The European Restructuring Monitor (ERM), an EU outfit that tracks globalisation, has analysed about two dozen cases of offshoring from new members of the EU, often involving complex moves. In one example, a German lighting company shed 400 jobs in Slovenia and sent the manufacturing end jobs back to Germany. In another, a Hong Kong-owned textile-maker shut up shop in Latvia, citing a "lack of workforce" in the region, and shifted production to Macedonia and Vietnam.

Citizens of the world

Slovakia is currently a European cheerleader for open markets and free trade. In a Pew Global Opinion survey last year, Slovaks were more enthusiastic than Americans, Swedes or Britons about multinational companies, with 72% agreeing that big foreign companies were good for their country, a European record (55% of French respondents thought foreign firms were bad for them, setting a record in the opposite direction). But will Slovaks remain so upbeat if the jobs stop coming in?

Vladimir Osvolda, the former boss of Samsonite's Samorin factory, thinks his fellow Slovaks have no choice. Western Europeans over 40 remember a working life that was "very comfortable", he says: the iron curtain shielded them from competition in central and eastern Europe, China did not yet present a threat and strong trade unions guarded their interests. East Europeans never had that comfortable life, he says, and never will.

Mr Osvolda lost his own job when Samsonite left; he now runs a factory for an Italian firm. He suspects that not all his staff understood that they lost their jobs to globalisation. All they knew was that they were made redundant five times before, in the tough years that followed the collapse of state socialism, so they felt resignation rather than shock.

Mr Osvolda managed Samsonite's startup in 1997. He recalls that Samorin felt like a mirror of a Samsonite factory in the Belgian town of Turnhout. "They would lay off 100 staff, we would take on 100." His employers had to deal with three trade unions when shedding staff in western Europe. "Here, there was no trade union."

Not that the Americans were ruthless, he says. They rather overpaid people in Samorin. Labour costs were higher than in Asia, but location trumped cost advantage. The factory's role was to manage peak demand for the highest-priced products. What killed his plant was the effect of higher labour costs on suppliers, who one by one moved to Asia. By the end, the factory was having to fly in materials to fill urgent orders at great expense.

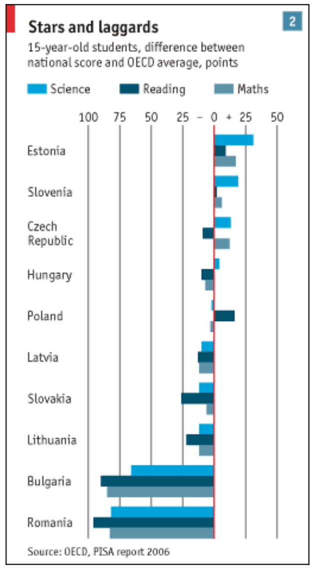
"Samsonite was in Belgium 30 years before they decided the perfect solution was to invest in Slovakia," notes Mr Osvolda. The company's Samorin business model lasted just nine years. "Everything is getting faster and faster."

Not all east Europeans are as philosophical as Mr Osvolda. The big test will come if (or when) growth rates in the ex-communist block slow to match those in old Europe and pay falls in real terms. Companies with strong trade unions—mostly former state concerns—have already seen strikes over pay. Romanian workers recently downed tools at a Renault subsidiary that makes the Logan, a low-cost car (see article).

Nils Muiznieks of the University of Latvia says his country is too small to dream about keeping out foreign threats. For those who are not happy with their prospects, he says, "the policy option here is not protectionism, it's emigration."

Meglena Kuneva, the Bulgarian member of the 27-strong European commission, draws a dividing line, not between old and new Europe but between "lazy and zealous Europe". The new members will thrive as long they do not become lazy, she says.

To date, the newcomers' governments have remained fairly liberal on matters such as flexible labour markets and tax policies (their support for free trade is spottier). Slovakia's prime minister, Robert Fico, won office as a fiery left-wing populist, for example, but was then careful to leave in place business-friendly policies like a flat tax, devised by a previous government.



Source: OECD, PISA report 2006

Günter Verheugen, now EU commissioner for enterprise and industry, has been touring some of the new member countries, urging governments to prepare for rising labour costs. The newcomers' success was based on three things, says Mr Verheugen: cheap labour, skilled and motivated workers, and an existing industrial base. Now costs are rising but productivity is growing painfully slowly, from a low base. The newcomers face the same problem as Spain and Portugal did on entry: relying too heavily on foreign investors to bring technologies and jobs, rather than creating indigenous centres of research and development. In the longer term, if new EU members "cannot compete on costs, they have to compete on quality and innovation", says Mr Verheugen.

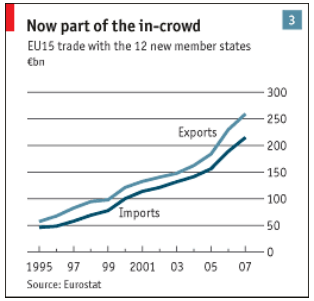
The cliché that eastern Europe is crammed with highly educated boffins and poetry-spouting intellectuals has long been disproved. In the OECD's latest PISA survey of educational standards in science, reading and mathematics, only young Estonians and Slovenians performed above the OECD average in all three. Young Bulgarians and Romanians were way below average (see chart 2).

Body-shopping

Alarmingly, the idea has taken hold across central and eastern Europe that the most pressing crisis is a shortage of people. Every day, newspapers report plans to ship in Vietnamese textile-workers, Ukrainian road-builders or Moldovan waiters to fill vacancies. There may well be some immigration, but it will not be the cure-all some seem to expect.

In sleepy Samorin, the "migrant workers" are from the poorer east of Slovakia, a few hours' drive away, but the locals see even eastern Slovaks as a race apart. They get drunk and sometimes fight, says Irvin Sarmany, a municipal official. Some blame the newcomers for a rash of burglaries.

Miroslav Beblavy, director of the Slovak Governance Institute, a think-tank, argues that the newcomers' governments should start by improving their policies at home. Employment rates in Slovakia, Hungary and Poland hover at or below 60% of the working-age population, compared with Denmark's 77%. "You can't complain about labour shortages when so many people are not working," he says. Across the region, governments have failed to keep people over 55 in the workforce, an urgent problem because ex-communist populations are greying fast. Millions of Roma are widely seen as "unemployable". Large numbers of young people now go to university. Too many are studying fashionable things like social sciences rather than engineering or computing.



Small, mundane changes would help. In some countries workers who have taken early retirement would lose their pensions if they went back to work. Bulgaria has no laws covering temporary work. At his new factory in Samorin, Mr Osvolda has started recruiting toolmakers and other specialist workers from eastern Slovakia. But he notes that once he has persuaded skilled workers to uproot themselves and move 300-400km westward, some of them will keep going to Britain or Ireland to earn two or three times more.

Everything is becoming more mobile, making life more complicated. But many central and eastern European workers remember the days when they were not free to move. They are a tough, flexible bunch and do not think the world will stop for them. The EU is lucky to have them.

Correction: our first chart wrongly put Latvian inflation at 30%. It should have been 16.6%. This was corrected on June 5th 2008.