

Delocalisation: a challenge for the EU economy?

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The delocalisation debate

- The phenomenon should not be seen in isolation from other economic developments, but rather in the context of increasing globalisation over the last 50 years.
- The current political debate on the issue is currently fuelled by the perception that delocalisation has become more pervasive both within each sector of the economy (extending progressively to the whole range of activities at the firm level, including research and development (R&D) activities) and across sectors (as no industry, including services seems to be sheltered from international competition).

Introduction

- **Definition and measurement issues**
- **Gains and losses from delocalisation**
- **Conclusions from existing studies**
- **Policy issues**

Definition

- We have used a broad concept of delocalisation defining it as the **process of shifting economic activities towards foreign sites**, including the closing or scaling down activities or not expanding at home for expansion abroad.
- This is reflecting the changes in firms' business strategies while adapting to the more competitive environment and to the faster technological progress.

Definition

In general, firms relocate activities to foreign sites via two mechanisms:

- **Offshoring**, which implies that the firm retains the ownership of the whole of the production process while locating parts of their activities abroad via the setting up of subsidiaries.
 - Intra-firm

- **(International) Outsourcing**, which implies contracting out parts of the production process to external suppliers located in another country
 - Inter-firm

Measurement issues

- In reality **difficult to quantify** the exact extent of the phenomenon as information on how much of the production process of firms is shifting to foreign sites is not readily available.
- **Foreign direct investment (FDI) flows** being a reflection of the activities of multinational enterprises (MNEs) are often used as the main measure of delocalisation.
- **Trade data**, particularly intra-firm trade and trade in intermediate goods as well as trade in computer software design and business services including accounting and other back office operations services may also be used as indicators of delocalisation.
- However, there are **problems** in using these data to measure delocalisation.

Gains from delocalisation

Outsourcing and offshoring activities are creating a new international division of labour, which should be **beneficial for consumers worldwide and both host and home parties involved.**

- By allowing firms to fragment and relocate their activities according to the best conditions, it will ultimately **improve their ability to compete internationally**, increasing their share in world markets and eventually creating jobs.
- For the **home countries** in particular the welfare gains also come from **efficiency upgrades** in the use of resources as these are shifted from lower to higher value added activities as production moves towards high quality segments across sectors.
- Moreover in the long run increased imports from abroad will be matched by increased exports, i.e. as economic growth accelerates overseas and trading partners grow richer, the conditions are created for a **multiplier effect to boost further growth in employment and jobs in the home economy.**

Losses from delocalisation

- There is however a necessary **process of adjustment** of each partner's industrial structure to better match its comparative advantage.
- Hence, inevitably some sectors as well as occupations are likely to expand while others will be reduced, reflecting changing comparative advantages.
- However, the fact that the phenomenon increasingly extends to all parts of the value added chain raises the fear that the EU may not be able to sustain comparative advantage in a sufficiently broad range of activities and thus eventually fail to prevent industries from relocating entirely.

Impact on employment

- The delocalisation debate is fuelled by the concerns that outsourcing/offshoring will permanently destroy jobs.
- In addition, the fact that delocalisation increasingly extends to the employment intensive services sectors will intensify the overall impact on labour markets of developed economies.

However

- So far, there is an overall positive developments of net job creation throughout the EU in recent years (say, 1998-2003), especially for the high skilled.
- So far, the magnitude of delocalisation is not large when considering the overall dynamic adjustment that occurs within economies in a given year.
- The experience of the EU with previous enlargements also reveals that the negative impact of delocalisation on employment and wages that many feared did not materialise and is likely to be limited to certain sectors.

Impact on employment

- Despite not being cause for concern at the macro level the costs of delocalisation, resulting from job losses, may be strongly felt (at least in the short-term) in certain sectors and in the regions where these sectors are concentrated.
- Particularly, those sectors that are more exposed to international competition and where labour represents a large share of the total costs are at risk.
 - sectors of clothing and textiles, leather and footwear, shipbuilding and basic metals as those that have lost the largest number of jobs over the past two decades.

Impact on income distribution

Delocalisation may increase **social inequality** as it is likely to affect workers with distinct skills in different ways.

Despite recent evidence of growing delocalisation of highly skilled occupations, particularly in services, the majority of delocalisation affecting developed economies impacts on the lower skilled workers. This will boost the relative demand for skilled workers in developed economies, which will in turn increase the relative employment level of skilled workers and/or the skilled wage premium.

Conclusion from existing studies

- Despite the recent growth in the involvement of developing economies and of the service sectors, the delocalisation of economic activities through **outsourcing and offshoring is still largely concentrated in the manufacturing sectors and between developed economies.**
- Being rather limited, there is **no evidence yet that the phenomenon poses major problems at the macroeconomic level, particularly in respect to trade imbalances.** Moreover the fears of deindustrialisation also seem to be exaggerated.

Conclusion

- The EU can derive **benefits** from the delocalisation of production overseas, in the form of ensuring the **competitiveness** of European industries in manufacturing and services sectors according to its comparative advantage.
- However these benefits are not guaranteed to occur.
- For benefits to occur it is crucial that the **EU is able to adjust and develop new areas of comparative advantage in the technologically advanced sectors/activities** of the economy to prevent risks of a deindustrialisation process taking place.

Conclusion

- Hence, there are **adjustment costs** to consider (even if temporary), which the current shift towards services is likely to make more pressing particularly in terms of employment.
- As such adjustment costs are also **likely to affect particularly certain sectors, regions and types of workers**

Policy issues

- Overall, the greatest challenge that delocalisation poses for the EU is the need to identify policy recommendations that better prepare the EU economy to grasp the opportunities this phenomenon entails in terms of promoting its competitiveness internationally while being able to safeguard its social institutions.
- The Commission suggests policy making priorities to respond to this challenge, rejecting any protectionist approach and putting the emphasis on the promotion of the factors that sustain its comparative advantage,
- The Lisbon Strategy for growth and employment as proposed by the Commission includes such recommendations as do the existing BEPGs and the Employment Guidelines.
 - in particular by
 - investing to improve the quality of the workforce and the physical and technological infrastructure to foster innovation activities.
 - Improve the flexibility of labour markets, capital markets and product markets

Conclusions and policy issues

However, it is necessary to take into account that the differences in comparative advantage and ability to move towards new areas of specialisation, can affect the degree of exposure of the different Members States to the risks implied by delocalisation.

- Hence, there is often a case for the authorities to intervene in order to provide adjustment assistance and social protection for the workers and regions that are most affected.