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Relocation to the NMS countries – the case of Hungary

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Introduction

Debates about the process of relocation have come to the forefront in recent years, especially in developed countries. At first glance it seems, that the process has been embracing more and more sectors and activities, it has become more and more pervasive in all economic fields and it has been responsible for an increasing number of job losses in developed economies. The perception of "pervasiveness" of relocation has been enhanced by the fact that its effect is concentrated regionally, sectorally and on certain groups of employees, especially those of un- and semi-skilled people.

The enlargement of the European Union, and together with that highly publicised cases of relocations, carried out by well-known multinationals to the new member states also strengthened the perception, that the frequency of job transfers has become higher recently. Some old member states are particularly sensitive to that issue, given their persistent competitiveness, unemployment and fiscal problems, which turned out to be especially acute in the last 2-3 years.

Relocation – definition and background

Relocation is a process, in which companies shift their production to a foreign location. The transfer of production can be realised through two mechanisms: either through offshoring, when the firm retains the ownership of the whole of the production process, i.e. it relocates parts of or the whole production to a foreign company, which is under the relocating company's control and in its ownership; or through international outsourcing, when parts of or the whole production process is contracted out to independent foreign suppliers. Relocation means a transfer of activity to a foreign location, on one hand, the case when the closing down or reduction of domestic capacities is accompanied by expansion abroad, and on the other hand, the case when instead of expanding capacities at home, it is realised abroad.

Relocation is driven by various factors, the same that are also responsible for deep structural changes in the global economy. Multi- and unilateral steps of trade liberalisation, freer movement of capital, technological advancements and reduction in transportation and communication costs, among others, make markets more integrated, and enable companies to cut production processes up and locate the parts of production to (foreign or domestic) production sites, which are the most efficient in carrying them out. Thus, relocation is a response of companies to the more competitive business environment in a more and more integrated global market and to the faster technological development.

Estimations about the extent of relocation in the global economy are numerous, however, almost all have their methodological shortcomings, and thus they can give only an upper or lower limit of its real size. Foreign direct investments flows, trade in parts and components, imported intermediate inputs, share of imported inputs in exports, intra-firm trade are used as proxies for the extent of offshoring and outsourcing and while the result differ in terms of their coverage (sectors and countries), all agree in the dynamic growth of this type of company cooperation starting already from the second quarter of the last century. Another common result is, that while these mechanisms were one of the main drivers of integrating developing (and transition) economies in the global economy, the overwhelming majority of them is realised between developed countries. Relocation is concentrated in certain manufacturing sectors, such as production of vehicles or electronics, but it is increasingly present in some hitherto non-traded services activities.

The most frequently analysed aspect of relocation is its impact on the number of jobs and wages in the developed countries. A widespread fear has arisen in the developed countries that the recently accelerated relocation implies an increasing number of job losses, a strong downward pressure on wages and deteriorating employment conditions, and these developments would not be confined to low skilled activities. However, on the basis of empirical evidence, provided by studies, these fears are largely unfounded. While the extent of job losses due to relocation may be significant, job creation in other sectors – connected to relocation – may counterbalance this impact. The net outcome depends to a great extent on the flexibility of the labour market and on the impact of government policies.

Relocation between EU-15 and NMS-8

Relocations are estimated to be relatively frequent in EU-15 and NMS-8 relations, especially between geographically closer countries. According to a survey of relocations, every fifth FDI project in the period between July 2003 and September 2005 was a clear-cut relocation in Hungary. It is mainly US and German investors, who are the most active in transferring their activities to the NMS countries from other, more costly locations, however, other Western European investors follow them relatively closely.

Table 1.: NATIONALITY OF INVESTORS IN RELOCATING TO AND FROM HUNGARY

To Hungary	Number of cases	From Hungary	Number of cases
USA	15	USA	3
Germany	14	Germany	2
Austria	6	Austria	1
Japan	6	Italy	1
Great Britain	4	Altogether	7
Switzerland	4		
France	3		
Other	8		
Altogether	60		

Source: Hunya, Sass (2005)

Relocations affect first of all the electronics and automotive sectors, which are interlinked to a great extent (there are many car parts and components, which are in essence an electronic product). Business services are an emerging area of relocation in the NMS countries, which is backed by the fact that according to a survey by McKinsey, suitable candidates for offshoring services jobs are more readily available in Central European NMS, than in other parts of the world, including China, Brazil, Russia or India, in view of language skills, practical skills or living relatively concentrated in major cities. Interestingly, traditional labour intensive sectors still figure highly on the list of relocation cases, however, these are the sectors (clothing, textile and footwear), where relocations from the NMS-countries to their neighbours (in the case of Hungary to Romania) with even cheaper labour are also relatively frequent. Chemical products and the production of household appliances witness relatively high numbers of relocations as well.

TABLE 2.: SECTORS OF RELOCATIONS TO AND FROM HUNGARY

To Hungary	Number of cases	From Hungary	Number of cases
Electronics	12	Footwear+textile+clothing	2
Automotive	12	Automotive	1
Business and related services	9	Electronics	1
Footwear+textile+clothing	8	Chemical products (incl. pharmaceuticals and plastics)	1
Chemical products (incl. pharmaceuticals and plastics)	6	Food	1
Household appliances	4	Machinery (n.e.c)	1
Other	10	*Altogether*	*7*
Altogether	*62*		

Source: Hunya, Sass (2005)

As survey results show, relocations are realised first of all from other Western European sites to Hungary, even outside-European investors (especially US, Japanese, South-Korean) seem to restructure first of all their European activities by transferring production capacities from the Western part of the continent to its less costly (especially in terms of wages) Eastern part. The number of jobs relocated from outside Europe to NMS is insignificant. Inside Europe, Germany and Austria are the two most affected countries, followed by other old EU-members. Contrary to expectations, relocations from the old "EU-periphery" (Greece, Ireland, Portugal and Spain) are realised only rarely.

TABLE 3.: RELOCATIONS TO AND FROM HUNGARY: COUNTRY OF ORIGIN AND DESTINATION

Where from?	Number of cases	Where to?	Number of cases
Germany	15	Romania	3
Austria	8	Austria	1
Other Western Europe (incl. n.e.s.)	28	Latvia	1
"EU-15 periphery" (Ireland, Portugal, Spain)	5	Poland	1
Other NMS	2	Slovakia	1
China	1	Ukraine	1
Other	2	*Altogether*	*8*
Altogether	*61*		

Source: Hunya, Sass (2005)

As far as the labour market impact in the host country is concerned, it is relatively limited: in the analysed period between July 2003 and September 2005, the net job creation connected to relocation was around 7000 jobs (8200 jobs created against 1200 jobs lost). The majority of jobs were created in electronics and in business and related services.

While relocations resulted in relatively large market shares in the EU-15 (and EU-25) markets for some of the NMS countries (especially the Czech Republic and Hungary) in certain affected products, the transferred capacities are still relatively small compared to what has remained in the affected products in the EU-15 countries. For example in TV sets, the Hungarian market share increased to above 10 per cent in EU-15 (including intra-EU trade), notwithstanding, the Hungarian output of the sector does not reach 4 per cent of that of the EU-15.

As far as the host country's experience is concerned, both benefits and costs can be attached to relocation. It results in additional, usually export-oriented capacities, may result in spillovers to the local economy, thus accelerating growth; provides additional employment, wages and taxes. However, exports may become too concentrated both in terms of products and exporters, thus vulnerable to business cycles and changes in (foreign) demand. Large footloose, very cost-sensitive relocations may make foreign trade earnings highly volatile, and may cause quick changes in employment, especially in that of unskilled labour. Moreover, local value added may remain low if local embeddedness of the relocated companies stays low – either due to company strategies and/or to problems of local supplies and absorption of spillovers.

References:

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