Delocalisation of Industries and the Role of Governing Institutions with Evidences from Estonia

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Abstract

The paper covers public governance tools and opportunities related to delocalisation problems of labour-incentive industries. The internationalization process and, related to that, delocalization of industries makes it necessary to treat governance possibilities on national, local and sector levels. The role of multinational enterprises (MNE) and their relationships with different level governing institutions is one important factor. The critical areas where economic interests of MNEs and policy goals of governing institutions meet are the labour market regulations, the FDI related problems, conditions for foreign trade, innovation, taxation and state aid. Subcontracting, outsourcing, off-shoring and offshore outsourcing, value chain and clusters are the specific concepts that describe forms in which organizational and technological capacities have been matched together. One task of the current approach is to clarify those concepts and to develop a framework for empirical study in the field of electronics, software, garment and footwear industries. The second part of the paper analyses information received through a survey. The main areas of interest are employment conditions, the role and impact of trade unions and business associations, product quality, health and safety standards on firms’ delocalisation decisions. Also tax levels and other important parameters describing the influence of tax system on firms have been covered. The government support to FDI together with outside assistance patterns is another important aspect of our analysis. The particular aspects of education and training are a final topic of this
approach. Information from the survey is accompanied with the description of important regulations and governance tools applied in Estonia.

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1 Introduction

This chapter covers public governance problems and opportunities related to delocalisation of labour-intensive industries. Governance is generally understood as a broad process affecting the collective decision-making roles and procedures, management and authority relationships of social and economic agents, involving multiple jurisdictions and domains.

The internationalisation process and the related delocalisation of industries makes it necessary to treat governance possibilities at global, EU, national, local and sector levels. The role of multinational enterprises (MNE) and their relationships with different level governing institutions is an important factor. Critical areas where economic interests of MNEs and policy goals of governing institutions meet are the labour market regulations, the FDI related problems, conditions for foreign trade, innovation, taxation and state aid. Subcontracting, outsourcing, off-shoring and offshore outsourcing, value chain and clusters are the specific concepts that describe forms in which organisational and technological capacities have been matched together.

Analysis of information received through a survey conducted in the United Kingdom, Greece, Poland, Bulgaria and Estonia in governance related issues is presented in this chapter. Information from the survey is accompanied with a description of important regulations and governance tools applied in Estonia. The results would also create a basis for economic policy suggestions.
2 The Literature

2.1 Definitions of Governance

The main tools of governance are institutions creating rules of the game and enforcement means putting those rules to work. Governance can be implemented at multiple levels and in different policy areas. Terms such as ‘multi-level governance’ that have been introduced in the ‘90s (Marks, Hooghe and Blank 1996), describe the situations (such as the EU) in which authority and policy-making are shared across multiple levels (subnational, national and supranational) of government. Gereffi and Mayer see the role of governance not only in facilitating market growth and stability, but also in the regulation of markets and in creating compensations for undesirable effects of market transactions (Gereffi and Mayer 2004).

In our study the governance aspects related to delocalisation problems of labour-intensive industries are examined. The study concentrates on the impact of different tools of governance, compares attitudes of managers of companies toward the impact of these tools on activities of the companies and their delocalization decisions and also evaluates the effectiveness of the tools in the framework of general goals of different level governance.

2.2 The EU

More recently, and given the major developments in EU integration (EMU and Euro, extension of qualified majority at the Council), the governance debate has focused on the relations of the EU with its constituent member states. The intergovernmental or “state-centric” governance is based on the presumption that European integration does not challenge the autonomy of nation-states and that state sovereignty is preserved through EU membership. It is argued that bargains among member states are the main governance process, and that no country has to integrate more than it wishes because the Council decisions are based on the lowest common denominator. Thus, policy outcomes reflect the interests and relative powers of member states (Marks and et al. 1996). The multi-level governance approach (Marks 1993, Hooghe 1996) argues that as the European integration proceeds, authority and policy-making influence is shared across different levels (subnational, national and supranational) of government. Member states lose some of their authoritative control and their sovereignty is diluted in the EU by collective decision-making among governments and by the independent
role of the European Commission, the European Parliament and the European Court of Justice (Marks et al. 1996).

Given the strong reluctance of certain member states to yield more power to supranational institutions, the Commission adopted a new form of governance at the beginning of the present decade – “the open coordination mechanism”. Starting with the policy area of employment, at the Luxembourg Summit of 1997 (20-21/11/1997) this method was quickly extended to other areas that remained by and large under national sovereignty.

This method can be described briefly as follows: the Commission provides a detailed analysis of the situation in the areas concerned, and sets specific, quantified targets for the member states to meet them. It is then left to the member states to formulate and implement the policy measures that they deem appropriate in order to achieve these targets, while the Commission ensures proper monitoring and facilitates benchmarking between the various national policies.

The governance of delocalization is very much treated in the framework of open coordination mechanism. This will be the means by which the Commission will guide the EU’s approach to governance and development, identify the type of measures to be supported in different situations, and contribute to the international debate on these issues.

In the case of dealing with problems of delocalisation of labour, the overlapping jurisdiction and regulation issues concern the impact of regulations in the field of social protection and labour market issues on the EU level and division of responsibilities between the EU institutions and national governments.

2.2.1 Industrial policy

The EU does not have an industrial policy as such. There was, however, enterprise policy and policy on research. Industrial policy is horizontal in nature and aims at securing framework conditions favourable to industrial competitiveness. Three key factors of industrial competitiveness deserve particular attention: knowledge, innovation and entrepreneurship.

In December 2002, the Commission published its Communication on “Industrial Policy in an Enlarged Europe” to launch the debate on industrial policy (European Commission 2002). In order to address current fears about de-industrialisation, the European Council in October 2003 asked the Commission to assess the situation and to present solutions to counteract this trend in order to revive Lisbon strategy of making the EU the most competitive economy in the world by 2010.
Industry leaders and politicians have voiced their fears about the EU’s manufacturing base moving out of Europe to benefit from cheaper labour, lower social costs and more flexible regulation in the East. The Commission on 20 April 2004 published a new Communication – “Fostering Structural Change: an Industrial Policy for an Enlarged Europe”, which examines the competitiveness of the European industry, assesses the existence and scale of the risk of de-industrialization and proposes specific solutions (European Commission 2004).

One important question related to delocalisation issues is whether the European countries should implement policy measures to fight de-industrialization, i.e. the decline of production industries both as a share of total output and in terms of employment levels? A possible answer is yes, but also the choice of tools is important. Most of the industrial policies are not carried out at the EU level, but under the competence of the member states.

2.2.2. Lisbon Agenda

With the adoption of the Lisbon Agenda in 2000, the European Union established an ambitious goal of becoming the most dynamic and competitive economy in the world by 2010. The initial observation of the Lisbon Strategy was that the existing EU arrangements were not the globally most competitive ones.¹ The need to de-emphasize traditional redistribution, the urgency to lessen the role of funding for primary branches, the need to roll back welfare reducing protectionism in favour of information and communication technology development, flexibility and innovation has been very real. Specific attention was given to interface between firms and research institutions and dissemination of new knowledge into the business sector.

This ambitious commitment was further broadened in the subsequent European summits where the leaders undertook to achieve additional objectives in the economic, social and environmental spheres. The European Council eventually adopted a set of 14 quantitative targets that summarise different commitments.²

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¹ The Lisbon Agenda contains a self-critical assessment of the global position of the EU and calls for structural reforms and investment into human capital and information and communication technology to revert the present trend. See, European Commission (2000).
² The 14 basic structural indicators are the following: GDP per capita, labour productivity, aggregate employment rate, employment rate of older workers, education achievement, expenditure on research and development, business investment, comparative price levels, at-risk-of-poverty rate, long-term unemployment, dispersion of regional employment rates, greenhouse gas emission, energy intensity of the economy and volume of transportation. See, European Commission (2005c).
Realisation of the targets of Lisbon Agenda depends substantially on the efforts of the EU member states and there are only limited tools to enforce the governments fulfil respective criteria. The fulfilment of those targets, on the other hand, has an important impact on global competitiveness of the European economic space.

2.2.3 Employment

The European Commission adopted a communication setting out measures to be developed or strengthened with the aim to improve management within the EU in 2005. The Commission proposed to refocus the European employment strategy around three priorities: 1) boosting the labour market participation; 2) improving the adaptability of workers and companies; 3) invest more in human capital (European Commission 2005g). In the context of delocalisation, the critical issue is the creation of new activities and jobs, and shifting of resources from declining sectors to sectors where the EU can sustain a comparative advantage. The coordination across the range of already existing EU policies, such as industrial, competition, trade and employment policy, is considered to be necessary. Also harmony with the revised Lisbon strategy for growth and employment with details of structural reforms needed to make the EU the most competitive economy is considered to be important here. However, employment policy has been still very much dealt with by national governments.

2.2.4 Tax policy

The EU does not have a common policy for taxation as it has a common policy for trade, competition, and agriculture. Its policy is to co-ordinate and harmonise (or approximate) national tax policies as much as necessary for the functioning of the internal market.

Tax harmonisation can be defined as a process of adjusting tax systems of different jurisdictions in order to achieve a common policy objective. Narrowly defined, tax harmonisation implies convergence towards a more uniform effective tax burden across EU member states (Kopits 1992). It can occur as a result of action at the EU level by member states, the Commission or other EU institutions (as the European Court of Justice, hereafter referred to as the ECJ or as the Court).

Harmonisation does not mean unification: differences in national law may persist if they do not violate EU law. Tax co-ordination is a wider term, which includes any policy action or measures undertaken to achieve an objective shared by a group of countries (Tanzi
1989). The aim of tax co-ordination is to influence the tax practices of the member states. Tax co-ordination might take the form of tax treaties between member states, international agreements or legislative acts of the EU (European Commission 1992).

To date, the major steps toward harmonisation have been achieved in the field of indirect taxation, most importantly, the abolition of customs duties, the introduction of the Community Customs Code and common VAT system as well as the harmonisation of the most important excise duties. The harmonisation of indirect taxes has been far more advanced than the harmonisation of direct taxes so that the room for further harmonisation in the former area is much smaller than in the field of direct taxation.

The governance delocalisation of labour-intensive industries through tax policy is possible but can be considered still as a tool applied at national level. The discussion between supporters of tax harmonisation and tax competition approaches is one important factor that will determinate the future development of taxation level and structure.\(^3\)

**2.3 National level**

The state’s role in governing structural industrial problems such as delocalisation has been widely discussed in economic literature. Until the mid-1980s, the role of the state expanded, in advanced countries faster than in developing countries. The immediate roots of the neo-liberal revival lie in the economic crises that followed the rise of oil prices in early 1970s. That was accompanied by a spread of new liberal view with a deeper scepticism about the capacity of state administration to play a developmental role under any circumstances.

That approach was quite important also in transition countries where creation of market economy started at the beginning of 1990s. Partly in response to the experiences of liberalisation during the 1990s, partly due to the impact of the Association Agreements and integration with the EU, the institutional side of the reforms started to be more important. The goals of the reforms were extended from freeing market forces and making economies efficient to addressing problems related to institutions like clear property rights, the rule of law, financial systems, accountability of government, effective and efficient public administration (Batly and Larbi 2004, Kohsaka 2004; Rodrik 2004).

In the general approach to government roles, we can use a division into indirect and direct roles described in economic literature. The indirect roles concern policy and rule

making, enforcing and upholding law, maintaining competitive conditions, providing information. The direct roles are related to managing and provision of service delivery through different government agencies (Batley and Larbi 2004).

2.3.1 Employment

Governments intervene in worker-firm relations on three main fronts: they intervene in the wage-setting process, they regulate working conditions and they control firing and hiring of workers. The government commonly regulates work hours and the cost of overtime; mandates vacations, holidays and sick leave; sets minimum wages; restricts child and forced labour; ensures non-discrimination; provides unemployment, disability and retirement income insurance, and in many countries health insurance; and sets conditions for hiring and firing, unionisation and collective bargaining (European Commission 2005b, OECD 2003, World Bank 2004).

A World Bank study shows that from the investment climate perspective, labour regulations can be a major or severe constraint on firms’ operations in many developing countries. Regulations can reduce incentives to make new investments, adjust the organisation of work to take advantage of new technologies or opportunities, or hire more workers. Some curtailment of those incentives can be justified by social goals beyond those reflected in the core labour standards including, for example, the promotion of workplace safety. But ill-conceived approaches can exacerbate poverty by contributing to unemployment and swelling the size of informal and unprotected economy…. Governments need to confront these difficult and often sensitive tradeoffs (World Bank 2004). In our study, the role of labour market conditions in delocalisation has been studied.

2.3.2 Trade unions

Trade unions have played an important role in labour relationships in Europe. The main play field has been on nation level. Union coverage started to be lower in service economies in comparison with industry dominated economies. Trade unions in the former Soviet bloc countries have changed from institutions of Communist Party control and distributors of fringe benefits to becoming representatives of workers’ economic interests (Svejnar 2004).

There are powerful organisations on the EU level. The European Trade Union Confederation (ETUC) has called for the activities underpinning competition. Without that,
market forces will lead to firms competing on the basis of low quality, low prices and bad and
low-paid jobs, says ETUC, blaming industry for using existing problems as an excuse for
pushing through a deregulation and the liberalisation agenda. ETUC has also called for more
emphasis on social protection and sustainable development (ETUC 2005).

Trade Unions in EU-15 countries have been worried about the generally low position
of trade unions in the new EU countries. The active support and involvement of the ETUC in
those countries have been seen as the main task. There are areas like collective contracts,
firing conditions and minimal wages where the trade unions’ role was compared in different
countries. There are interesting questions about linkage of the FDI from countries with strong
trade unions (Germany, Scandinavian) to new EU member states with low trade union
coverage (Bulgaria, Estonia, Poland).

2.3.3 FDI

Over the past decade, the FDI intensity (defined as the sum of outward and inward FDI
positions over GDP) has increased significantly in the European Union. Most of the global
FDI takes the form of ownership changes in existing enterprises (mergers and acquisitions,
privatisation), with so-called “green-field” investments playing only a minor role.

Attracting FDI has become a central component of industrial policy in developed and
developing countries. Investment promotion is therefore an essential component of attracting
investments. There has been a rapid growth in the number of investment promotion agencies
(IPAs) across the world.

2.3.4 Foreign trade

One paradox of the increasing role of foreign trade is that the growing integration of the world
markets has brought with it a disintegration of the production process in which manufacturing
or service activities done abroad are combined with those performed at home. A number of
researchers have referred to the importance of the idea that production occurs internationally.
Bhagwati and Dehejia (1994) called this “kaleidoscope comparative advantage,” as firms shift
location quickly; Krugman (1996) used the phrase “slicing the value chain”, Leamer (1996)
prefers “delocalisation”. The delocalisation of production has a direct impact on foreign trade
volumes, because slicing up the value chain and delocalisation of some parts of it to other
countries create foreign trade flows between those countries.
2.3.5. **Education, training and innovation policy**

The first and most visible policy to promote manufacturing is educating engineers and scientists. Educating of engineers in most of the technology areas requires substantial investments from universities and personal efforts from students. The number and quality of engineers are the concern of governments in highly developed and emerging economies. The particular importance of technical education is related to software and electronics industries covered in our research.

Another area of government interference is support to research and development activities. Electronics and software industry are knowledge-intensive activities and support to research can create a sustainable competitive advantage. Often the main creation centres in this area are located in nearby universities and public laboratories and government grants help to raise the general scientific and technological knowledge in the area.

Education, training and innovation policy is important in the framework of the current study for the reason that it is important in particular industries and also related to the position of companies in the value chain of products.

2.4 **Local (regional) Level**

The traditional location policy addressed three issues: real estate is made available and infrastructure is improved; attraction of external investors is an important issue and facilitation of communication between the business community and public sector is considered valuable for the creation of support to policy decisions.

As competition between potential locations became more intense, local actors started to pursue a more ambitious approach including at least one of the following elements: 1) the creation of round tables, partnerships (including public-private partnerships) or alliances for local economic development in order to formulate and implement a strategy to improve the location advantage or revitalise old locations; 2) the implementation of cluster initiatives; 3) the creation of dedicated local economic development agencies to co-ordinate and organise local level efforts (OECD 2001b, Wallis 1996).

A regional cluster policy can be by definition a policy aimed to sustain existing clusters or to support the growth of start-up clusters. The cluster approach should allow the
regional system to move from more traditional policies based on infrastructure building and technological support to a more comprehensive policy trying to improve the environment in which firms and local actors operate. The keyword for such cluster policies is the improvement of regional competitiveness.

2.5. Hypothesis for Further Study and Methodology

Different public governance level issues have been investigated through evidence from surveys and analysis of respective data on economic regulations in countries included in the sample. That information was supplemented by interviews with key representatives of business and politics of respective countries and industries. On the basis of the literature survey, the following hypotheses were formed:

**H1:** *Flexibility of labour market is a critical issue and perceived also in this way by representatives of firms participating in the survey.*

**H2:** *There is a different sensitivity to increase in labour costs and different adjustment strategy in traditional (foot ware and garment) and new industries (software and electronics);*

**H3:** *The FDI from countries with high coverage of trade unions have an impact on organisation of labour also in target countries of FDI.*

**H4:** *Tax policy matters. There is a correlation between tax burden and delocalisation attempts.*

**H5:** *There is a connection between public support companies’ attitudes toward delocalisation. Larger support creates a positive attitude.*

**H6:** *New industries (electronics and software) receive more public support than traditional industries (clothing and footwear). That is assumed on the basis of political rhetoric of governments).*
3. The Evidence

3.1. Employment Conditions

The general information on labour conditions covers here the employment rates, wage level and regulations, the level and structure of taxation, and costs of social protection (pensions, health care expenditures, unemployment benefits).

3.1.1. Employment

The total employment rate describes the participation of working-age people in the labour market. A high employment rate is connected to availability of better jobs but also evidences availability of social services that makes employment possible for the sensitive part of population (women with small children etc.). This is one aspect of greater social cohesion. Proportion of part-time employment, especially for women, is an important indicator of labour market flexibility.

Table 1. Employment rates by age and sex (15-64 years old), 2004

<table>
<thead>
<tr>
<th></th>
<th>Employment rates</th>
<th>Part time employment</th>
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<tbody>
<tr>
<td></td>
<td>By age</td>
<td>By sex</td>
</tr>
<tr>
<td></td>
<td>15-64 15-24 25-54 55-64</td>
<td>Men Women</td>
</tr>
<tr>
<td>EU-25</td>
<td>63.3 36.8 76.8 41.0</td>
<td>70.9 55.7</td>
</tr>
<tr>
<td>EU-15</td>
<td>64.7 40.0 77.6 42.5</td>
<td>72.7 56.8</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>44.7 … … 34.7</td>
<td>49.7 40.0</td>
</tr>
<tr>
<td>Estonia</td>
<td>63.0 27.2 78.8 52.4</td>
<td>66.4 60.0</td>
</tr>
<tr>
<td>Greece</td>
<td>59.4 26.8 73.5 39.4</td>
<td>73.7 45.2</td>
</tr>
<tr>
<td>Poland</td>
<td>51.7 21.7 68.2 26.2</td>
<td>57.2 46.2</td>
</tr>
<tr>
<td>UK</td>
<td>71.6 55.4 80.8 56.2</td>
<td>77.8 65.6</td>
</tr>
</tbody>
</table>


In comparison with the UK, all other countries have much lower employment rates. The largest is the difference in part-time employment of women. This could be considered as a potential source of additional labour force. However, to attract more women to labour market also requires efforts from labour market institutions. Estonia’s employment figure is quite
close to the respective average of EU-25 and EU-15. However, there are some differences in employment by age groups. There is relatively low employment in the group of 15-24 years old people and higher than the EU-15 average in other groups. Especially high is employment in the age group 55-64. Also employment of Estonian women is higher than the EU-15 and EU-25 average figures.

3.1.2. **Wages and Other Labour Costs**

Average monthly labour costs are defined as total labour costs per month divided by the corresponding number of employees expressed in full-time units. Monthly labour costs include net wage, personal income tax and social tax. Minimum wages are those effective in 2006.

In Table 2, the figures have been recalculated from national currencies, and so also the interest rate movements influence the cost levels in different countries. Another important factor here is that the purchasing power of nominal earnings in different currencies may be quite different in countries due to differences in price levels. In the case of Poland, exchange rate changes between the zloty and the euro have influenced the dynamics of labour costs.

**Table 2. Monthly labour costs and minimum wages, 2000-2004.***

<table>
<thead>
<tr>
<th></th>
<th>Labour costs, EUR</th>
<th></th>
<th>Minimal wage, EUR</th>
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<tbody>
<tr>
<td>EU-25</td>
<td>2254.7</td>
<td>2732.3</td>
<td>2768.7</td>
</tr>
<tr>
<td>EU-15</td>
<td>…</td>
<td>3154.4</td>
<td>3149.8</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>…</td>
<td>179.0</td>
<td>189.8</td>
</tr>
<tr>
<td>Estonia</td>
<td>275.9</td>
<td>429.1</td>
<td>496.3</td>
</tr>
<tr>
<td>Greece</td>
<td>1446.3</td>
<td>1658.1</td>
<td>1739.9</td>
</tr>
<tr>
<td>Poland</td>
<td>447.1</td>
<td>672.4</td>
<td>791.8</td>
</tr>
<tr>
<td>UK</td>
<td>2168.8</td>
<td>3676.9</td>
<td>3793.4</td>
</tr>
</tbody>
</table>


The proportion of the minimum wage to average labour costs was the highest in Bulgaria (38.4 per cent); in other states except Estonia between 33 and 34 per cent and in Estonia 29.5
per cent. The relatively high level of minimum wage can be a problem for regions with lower than average wages where a national level minimum wage is applied.

In our survey a question about the impact of employment conditions on delocalisation was asked. Employment conditions (health standards, labour costs, work hours) had a positive effect on the company’s decision to delocalise in 21.3 per cent of the cases and a negative effect in 10.4 per cent of the cases. The impact of those factors was higher in the UK (46.5 per cent) and Greece (44.7 per cent), followed by Poland (41.0 per cent), Estonia (29.2 per cent) and Bulgaria (19.1 per cent).

Bulgaria, Estonia and Poland have been regarded as the target countries of delocalisation. Traditional industries have been in Estonia more sensitive to employment conditions, but the impact was divided into positive and negative influence. This means that labour costs started to be a reason also for outward delocalisation from these countries, more in Estonia, less in Poland. Labour conditions were less important in software and electronics industry.

3.1.3. Impact of Free Movement of Labour

Increased economic integration and free movement of labour has a strong impact on domestic labour markets, especially in small countries like Estonia or Bulgaria. In the case of Estonia, highly skilled and reasonably priced labour has been one of the cornerstones of rapid economic growth. The relatively flexible labour market contributed positively to changes in the structure of economy.

Over the last couple of years and especially after joining the EU in May 2004, migration became a significant economic and social policy issue in Estonia. One of the main incentives for migration is the existence of an income gap between the home country and destination countries, first of all Scandinavian countries, but also Ireland and United Kingdom. The latter two are the EU countries which did not apply a transition period for the labour market opening for the other EU members. After a two-year transition period, several other EU countries opened their labour market (for Estonia it was important that Finland opened its labour market from 1 May 2006).

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4 The comparison is not fully correct because figures of different years are compared, but it gives some idea about that very important statistical indicator.

5 Flexibility of labour markets is divided into macro and micro level flexibility. On macro level, institutional and wage setting flexibility are the forms. On micro level, flexibility is related to job flows, job creation and destruction. See Blanchard (2004).
Many investors in Estonia are still interested in the maintenance of low technology, cheap labour requiring jobs and even creating new ones. At the same time, many low-paid workers move away from Estonia to earn much higher wages for analogous work in other EU states where also working conditions are better. That has an impact on wage setting in Estonia and creates increasing problems for labour-intensive industries in Estonia. The hardest hit are subcontracting enterprises like garment industry, where the proportion of labour costs in total costs is up to 80%.

Emigration of labour force launches a chain reaction in the labour market. The jobs of those who left for abroad are filled with workers lured over from other enterprises or with unemployed. When skilled people leave it is necessary to train new people to replace them. This leads to a rise in qualification of employees and reduction in unemployment. Age discrimination will decrease and employment of handicapped people will increase.

International competition from low wage countries makes it impossible to substantially increase wages, which creates problems with finding workers. In Estonia it has been possible to find low skilled and badly disciplined labour force from peripheral regions and attract them to industrial towns. Such kind of activities, however, would even more aggravate social and regional problems.

Another option is immigration from the third countries, which would make it possible to keep the present economic structure and prevent overall socio-economic deterioration. That depends to a large extent on the national policy that has been restrictive until now regarding inflow of foreign labour.

The overall labour market policy on the government level is a duty of the Ministry of Social Affairs. The main institutions dealing with conflict resolution are the industrial dispute commissions, the public conciliator as well as local conciliators, and courts. In general, the industrial relations are mainly regulated through minimum standards set at the state level (minimum wage, unemployment benefits, the minimum subsistence level), partially through social dialogue on national level and through individual contracts or enterprise level contracts. The social dialog is realised through tripartite negotiations, where the counterparts are the government, representatives of employers and of employees.

3.1.4. Unemployment Rates and Benefits

Unemployment figures depend on the labour market situation, but also on the size of unemployment benefits, possibilities for part-time work etc. The new EU members had higher
figures for unemployment than EU-15 or UK and Greece in our sample. However, unemployment has decreased substantially in Estonia, and remained on the same level in Poland. Poland was the only country having increased the number of young people entering the labour market. At the same time, Poland, having with Estonia approximately the same income level, had three times higher level of unemployment benefits than Estonia. That made probably people more biased to accept those benefits with less attempts to find work.

Table 3. Unemployment rates and benefits

<table>
<thead>
<tr>
<th></th>
<th>Unemployment rates, %</th>
<th>Monthly unemployment benefits, EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU-25</td>
<td>8.6 8.7</td>
<td>7.4 7.8</td>
</tr>
<tr>
<td>EU-15</td>
<td>7.7 7.8</td>
<td>6.4 7.0</td>
</tr>
<tr>
<td>Estonia</td>
<td>12.5 7.5</td>
<td>13.4 8.9</td>
</tr>
<tr>
<td>Greece</td>
<td>11.3 10.0</td>
<td>7.5 6.2</td>
</tr>
<tr>
<td>Poland</td>
<td>16.4 17.9</td>
<td>14.6 16.8</td>
</tr>
<tr>
<td>UK</td>
<td>5.4 4.6</td>
<td>5.8 5.0</td>
</tr>
</tbody>
</table>


3.1.5. Trade Unions and Business Associations

According to our study, the impact of trade unions and business associations on company’s decision to delocalise was practically missing in Poland, Bulgaria and UK. In Estonia and Greece, the influence of trade unions was also modest, but a little higher still. The influence of trade unions is common in traditional industries like footwear and clothing and business associations had some role in new industries like software and electronics.

It is possible to see from those examples that there are factors supporting and weakening effects of trade union activities. Nevertheless, it is possible to see several additional tasks of trade unions playing a bigger role in negotiations, consultation and representation of members in legal issues, also on international level.

We can say that Hypothesis 1 is proved on the basis of evidence from the survey and labour market statistics. Free movement of labour, low entry and exit barriers and low level of minimum wages and unemployment benefits made labour markets relatively flexible in those
countries. The highest unemployment rate was in Poland with the highest level of unemployment benefits and minimum wages. It should be said that in Poland there have been very important demographic reasons for high unemployment.

The expected increase in the importance of trade unions due to FDI from countries with high coverage of trade unions according to our Hypothesis 3 was not proved.

3.2. Taxes

The tax burden is an important determinant in the costs related strategies of the firms. It is interesting to see that all countries in our sample have lower than the EU-25 or Euro area average tax burden. There was a falling tendency of tax revenues in GDP in new EU members, but in Greece and UK taxes as a share of GDP increased. Estonia is a very clear example of a country with emphasis on taxation of consumption (and labour). Tax burden of labour is largely due to the high social tax. The level of corporate income tax and labour taxes has been considered an important factor supporting FDI and delocalisation into Estonia. The survey supported Hypothesis 4 about positive influence of a competitive tax structure and level on delocalisation. Another side of this phenomenon is that the position of companies of those countries in the value chain of a particular product depends also on the educational level and R&D expenditure of that country, which is mostly financed from the state budget with tax revenue being the source of those expenditures. In the long run, increase of costs (first of all labour costs in labour-intensive industries) makes it necessary to decrease cheap mass production. That production should be substituted by more valuable products with larger value added components, but that assumes larger R&D expenditures, product development, better higher education, which are financed greatly from taxes.

Table 4. Tax revenue and implicit tax rates by type of economic activity

<table>
<thead>
<tr>
<th></th>
<th>Tax revenue, % of GDP</th>
<th>Implicit tax rate on:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EU-25*</td>
<td>39.7</td>
<td>39.3</td>
<td>21.1</td>
<td>21.9</td>
</tr>
<tr>
<td>Euro area*</td>
<td>39.9</td>
<td>39.7</td>
<td>20.3</td>
<td>21.5</td>
</tr>
<tr>
<td>Estonia</td>
<td>37.9</td>
<td>32.6</td>
<td>20.3</td>
<td>20.8</td>
</tr>
<tr>
<td>Greece</td>
<td>32.6</td>
<td>35.1</td>
<td>17.3</td>
<td>17.5</td>
</tr>
<tr>
<td>Poland</td>
<td>38.5</td>
<td>32.9</td>
<td>21.8</td>
<td>19.3</td>
</tr>
<tr>
<td>--------</td>
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<td>------</td>
<td>------</td>
</tr>
<tr>
<td>UK</td>
<td>35.4</td>
<td>36.0</td>
<td>19.6</td>
<td>18.7</td>
</tr>
</tbody>
</table>


### 3.3 Product Quality, Health and Safety Standards

An important role in public policy is played by various standards, including those regulating product quality, but also health and safety conditions at work.

In our study we found evidence that regulations related to product quality, health and safety influenced the company’s decision to delocalise in 23.5 per cent of the cases, in favour in 17.6 per cent and against in 5.7 per cent of the cases. The highest proportion of companies answering positively to this question was located in Bulgaria and Estonia. In Bulgaria, 26.7 per cent of the companies answered that regulations favoured their decision. That answer could be interpreted in the way that the binding regulations guaranteed health and safety standards and were supporting the delocalisation decision of foreign companies to Bulgaria. In Estonia the total impact of regulations was even higher than in Bulgaria. In 21.1 per cent of the cases regulations favoured delocalisation, but in 17.6 per cent had a negative impact on activities. The latter answer could be interpreted in the way that companies saw regulations too costly to follow (very detailed sanitary requirements, for example). They did not see benefits from those regulations.

### 3.4 Incentives and FDI

Incentives can affect investment location decisions. However, the emphasis on incentives varies considerably. The options include national, regional, or local grants, tax credits, research and development and other special purpose incentives, employment incentives, recruitment and training assistance and site or infrastructure improvements. Incentives can be up-front, or dependent on continuous upgrading of the investment project. Many IPAs use their governmental network of overseas foreign offices for overseas promotion. There is also increasing cooperation between agencies.⁶

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Our study showed that governments were modest in undertaking activities to attract FDI or subcontracting into countries. From total answers only 18.7 per cent of the respondents mentioned initiatives, 83.7 per cent said no initiatives were taken. The highest positive answer was for Estonia with 37.4 per cent, followed by Greece with 33.4 per cent, UK 14.8 per cent, Poland 12.2 per cent and Bulgaria 2.0 per cent.

In terms of industries, the proportion of respondents receiving support for FDI was for clothing industry 24.3 per cent, electronics 22.4 per cent, software 14.5 per cent and footwear 8.8 per cent. The evidence showed that there is no difference in this sense between new and old industries, which was assumed according to Hypothesis 6. Clothing had more support than other industries. However, as the size of support was not exactly determined, our results are based only on frequency of support. Other evidence demonstrated that large FDI into electronics industry were attracted by big government support in several countries. So, the real situation is more ambivalent than our results of the survey demonstrated.

3.5 Outside Assistance

In Estonia, new industries were more supported than the traditional ones. This is in accordance with the economic policy related arguments and policy targets of governments in these countries.

In Estonia, support of the EU was accompanied by support of the central government. A quasi-government organisation, Enterprise Estonia, matching together pre-accession financial resources before 2004 and afterward, was organising the use of EU structural funds with a self-financed part in Estonia, which played an important role in assistance. The dominant form of assistance was the public sector grant in Estonia.

4. Conclusions and Policy Suggestions

The hypothesis of the critical role of flexibility of labour market has been partly supported by the evidence. Employment conditions are regulated first of all by the minimum standards set at the state level (minimum wages, unemployment benefits, minimum subsistence level). Traditional industries had a quite strong negative impact of employment conditions on the delocalisation decision. However, in the new EU member countries there is still a need for
institutional arrangements that would enable higher employment. Particularly important is the creation of relevant conditions for part-time work of women.

The second hypothesis about different sensitivity to increasing labour costs and different adjustment strategies in traditional (footwear and garments) and new industries (software and electronics) is partly confirmed. In electronics industry, the sensitivity to labour costs depends very much on where in the value chain of production a particular company is positioned. Producers in the lower part of the value chain behaved similarly to companies in traditional sectors. The public governance tools targeted at lower costs are critical for these companies. In this sense, software industry is substantially different relying more on the active role of different level governments in providing public services, (technical) higher education and research funding.

Different aspects are important for countries of outward and inward delocalisation. For outward delocalising countries, support for product development and marketing was important. In countries of inward delocalisation, support to creating new jobs, infrastructure development and training were more important.

Trade unions’ and business associations’ influence on company’s decision to delocalise are quite limited in Estonia; there was no big difference between new and traditional industries.

Product quality, health and safety standards influenced company’s decisions modestly. The negative impacts underlined were: some regulations, especially in the context of the EU membership and harmonisation context, costly to follow, no visible benefits.

Analyses of financial assistance patterns suggested that the EU support was significant for Estonia. Semi-governmental organisations had an important role in absorbing EU funds and combining them with local resources. Strong points of those institutions are related to rules and expertise created to deal with projects and competitive bases for treatment of different applications for grants.

Regarding the fifth and sixth hypothesis on the impact of support on delocalisation decisions and position of different industries in this respect, it is possible to conclude that the major market economies rely less on EU funding and tools, but get a dominating part of support from domestic sources. In Estonia, domestic resources, first of all from the central government, were combined with support from the EU. Regarding industries, the electronics industry was more supported, but the difference from other industries was not big.

The dominating form of assistance was the public sector grant. Other forms of assistance were as follows: help and support to purchase or rent of land. Support of vocational
schools by enterprises has been important. Companies mentioned positively also training, visits to fairs and exhibitions financed from the state budget, introduction of industrial zones, export zones with special tax arrangements. There are arguments for the introduction of a wider variety of different support types.

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