# Analysis - EU firms look to eastern hinterland for high skills

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LONDON, March I (Reuters) - As breakneck globalisation sees many Western companies search for low-wage but high-skilled workers half way around the world, many European firms are finding solutions in their own back yard.

High-tech and white-collar work, from Germany in particular is moving as much to eastern Europe as to east Asia but, despite the rhetoric flying in the U.S. election campaign, European leaders have move quickly to nix any protectionist reaction.

Cost-cutting and cheaper production is a major motivation for firms, not least because of rigidly high labour costs in the EU and intense competition on the global marketplace.

But new studies show skills shortages in the West have been a major reason behind the job shift and the bloc's eastern hinterland - not just countries about to join the European Union but countries like Russia, the Ukraine anti Bulgaria - is rich in that commodity.

The move east is providing a skills safety valve of sorts, something governments would be wary of questioning.

As German technology giant Siemens shocked the nation in December with plans to move up to a third of its IT research and development, about 10,000 jobs, to low-wage countries, the government cautioned against a kneejerk response.

Politicians in Germany have been at pains to highlight the greater overall benefits from globalisation and free trade, stressing that boosting education and skills and raising research and development were the appropriate responses.

German Chanceller Gerhard Schroeder, speaking during a trip to the United States last week, said protectionism was no answer to a trend rooted in free trade and corporate flexibility. “We have to convince people that the global economy and free trade offer the best chances for development to us all”, he said.

The EU’s “Lisbon agenda” targets, aimed at making the region the world’s most dynamic and competitive economy by 2010, also contains much on this issue.

NEW STUDIES

Analysts say this moderate response is partly naked realism but also reflects the fact many European firms have been tapping the relatively cheap labour pools of eastern Europe for a decade and many need the skills that are increasingly scarce at home.

Although, like U.S. counterparts, they have also been tempted to booming China and hi-tech havens like Bengalore in India, there is also a tradition in countries like Germany and Austria of moving closer home.

The process of the European Union’s eastward enlargement and relative proximity, geographically and culturally, has helped.

A study of German and Austrian firms engaged in outsourcing and offshoring in eastern Europe, to be published in full later this year, shows a key motivation for the latest shift east in software services and back office banking has been a skill search.

Dalia Marin, Professor of Economics at the University of Munich, said her study showed that although total numbers of jobs offshore were small – less than 1.0 percent of German and Austrian workforces – they were increasingly concentrated in the most skills-intensive activities and not manufacturing.

"One reason is that many firms simply cannot find the skills at home and have had very good experiences of extremely well-educated and skilled workers in countries like Russia, Bulgaria and Czech Republic," Marin told Reuters.

She stressed that the supply of high-skilled labour in Germany fell by two-thirds during 1990s, just as the Silicon Valley revolution was taking off in the United States.

"We found that high skilled jobs transferred to Eastern Europe account for 10 percent of Germany's and 48 percent of Austria's supply of university graduates in the 1990s, she said. “Outsourcing of skill intensive activity to eastern Europe has helped to ease the human capital crisis in both countries.

What is more, the savings firms made in the EU accession countries are pretty limited now, she argued, and cannot be the sole driver. Her statistics show that while wages in the Czech Republic, for example, were 23 percent of German wages - productivity was only 23 percent of German counterparts too.

And, despite an EU-wide push to get governments to spend more to boost research and development, Marin's study concluded that R&D subsidies do not work in economies with a skill crisis.

She says allowing greater movement of skilled labour within an enlarged EU was a better solution.

The study tallies with Siemens' defense of its decision last December.

Johannes Feldmayer, the company's head of strategy, said Siemens was motivatednot only by the potential for cost-cutting but also the high level of skills to be found among workers in lower-wage countries.

"We have found fantastic staff with excellent training, particularly software engineers,” he said.

FEARS OF HOLLOWING OUT PERSIST

Yet, it is difficult to assuage fears that inflexible German labour markets and one of the highest hourly wage rates in the world will only accelerate the move east and beyond accession countries to Bulgaria and Russia.

There is also a concern that while transnational corporations have been offshoring for years, smaller firms will be tempted by the relatively short hop east and a long-feared "hollowing out" of German industry will proceed in earnest.

"Just as German big business turned to Asia to avoid high German labour costs, German small and medium-sized firms are turning to eastern Europe," Hans-Werner Sinn, president of Germany's Ifo Institutes said in a recent lecture.

"Germany is gradually evolving into a bazaar economy that supplies world markets with products that have been produced in its eastern European hinterland."