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**INTERNATIONALIZATION OF PRODUCTION:
OPTIONS AND RESPONSES.
EVIDENCE FROM GERMAN ENTERPRISES
IN HUNGARY**
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ABSTRACT

The purpose of this paper is to discuss one of the policy choices being pursued by German enterprises, choices that affect both the current developments in the German economy as well as the future structure of the European economy in general. Using empirical data gathered at some twenty German enterprises that have invested in production facilities in Hungary over the past decade, the paper will evaluate the impact of this strategy on work organization and labor relations in the Hungarian subsidiaries and highlight possible ramifications for the remaining or former German production sites.

The research for this paper analyzed a variety of manufacturing sectors to determine which elements of the German model of production and labor relations have been selected for transfer to Hungary, why this particular selection was made, and whether there are clear indications that certain German foreign direct investments are initiated as either a high-road (high wage, high skill, high technology) or as a low-road strategy (attraction of the low level of regulation and low costs).

After a brief look at the German Production Model, the paper reviews the development of German foreign direct investments (FDI) as they relate to central and eastern Europe and in particular to Hungary. From there, the paper goes on to illuminate the process of production relocation at the companies in the sample, i.e. just what has been relocated, how this transfer is managed, and to what extent it represents a developmental process over time. After this, the focus will turn to the repercussions of the internationalization of production on the enterprises in general and at their sites in Germany in particular. By way of conclusion, the paper will present some arguments tying the micro-level focus to the broader issue of the European Social Model.

**INTERNATIONALIZATION OF PRODUCTION: OPTIONS AND RESPONSES.
EVIDENCE FROM GERMAN ENTERPRISES IN HUNGARY¹**

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INTRODUCTION

The globalization of production and markets along with the political enlargement process of the EU is reshaping the contours of Europe. Far-reaching changes in technology and information communication have been further catalyzed by the end of the Cold War and the ensuing process of transformation in Central and Eastern Europe, buttressed by market liberalization, financial unification and supranational cooperation within the European Union.

In the course of these developments, Germany, in particular with regard to its renowned export economy, has undergone profound and fundamental changes. The most prominent of these of course has been unification, re-establishing a full-fledged German state in the middle of Europe after almost forty-five years of separation and division along the fault line of the Cold War. Following that historic moment in November 1989 when the Berlin Wall ceased to exist, the institutional structures of the West German political system were extended to the new states of what had been the German Democratic Republic. In contrast to this generally successful transformation in the political sphere, the task of building a flourishing market economy—the “blühende Landschaften” envisioned by former Chancellor Helmut Kohl—has been both much more difficult and decidedly less successful. Indeed, unemployment is still exceedingly high (and would be higher save the fact that there is a continuous stream of young people from East to West) and there is a high level of dependency upon continuing and massive public subsidies for the unemployed and for infrastructural measures, without which the economy in the East would suffer a serious blow.

One indication of the problems faced in eastern Germany is the fact that production firms in western Germany have not been keen on investing there. Either they are servicing the domestic market in eastern Germany from their existing locations or they have decided to expand by focusing new investments outside of Germany altogether. This points not only to the development of a new competitive arena in Central and Eastern Europe, offering a wider range of opportunities and conditions for investments from which to choose, but also to the more general impact of the flash-like exposure of the German economy to the forces of globalization and technological change. Of course, as one of the leading exporting countries in the world, West Germany was not insulated from the international economy prior to 1989. But in the Europe of the “mid-century social compromise” (Crouch 1999: 34), West Germany had developed a protective regulatory shield designed to ensure prosperity to a maximum number of citizens (at least as defined by their economic status) in a society of institutionalized negotiated interest representation. The end of the bloc confrontation was not solely responsible for the changes, but it was an important catalyst which both hastened and accelerated the weakening of the consensual regulatory regime, known in its economic context as the German Production Model.

The purpose of this paper is to discuss one of the policy choices being pursued by German enterprises that is affecting both the current developments in the German economy as well as the future structure of the European economy in general. Using Hungary as an example, the paper will analyze the process of foreign direct investment and production relocation as pursued by German manufacturers in Central and Eastern Europe (CEE), evaluating its impact on work organization and labor relations in their Hungarian subsidiaries.

Foreign investments are profoundly shaping the course of the Hungarian economy. Besides such large investors as Audi (4,000 employees) or Siemens (3,200 employees) there are many small and medium sized German companies with investments in Hungary. Enterprises from Germany are key actors in the Hungarian economy not only because they account for about one-half of all foreign direct investments, but also by virtue of their home country production model with a high wage-high skill profile and their commitment to consensual forms of conflict resolution. Thus, looking at German enterprises and the transfer of the German production model to Hungary seems to be an interesting case for explaining changes emanating from a particular home country model. With the focus on German enterprises we seek to explain far-reaching developments at the micro-level (enterprise) that are having a considerable impact on the development of work organization and labor relations. We regard this level as being crucial to economic restructuring throughout central

and eastern Europe. Moreover, in the Hungarian context of a weak state regulatory framework and a fragmented labor movement (Neumann 2000, 2002), the scope of structuring capacity at the enterprise level is especially noticeable. Nevertheless, processes at the micro-level have been largely ignored in the research on transformation and EU enlargement.

In its research design, our project looks at a variety of manufacturing sectors to determine which elements of the German model of production and labor relations have been selected for transfer to Hungary, why this particular selection was made, and whether there are clear indications that certain German foreign direct investments are initiated as either a high-road (high wage, high skill, high technology) or as a low-road strategy (attraction of the low level of regulation and low costs).

In general, research on developments in central and eastern Europe has not adequately dealt with the phenomenon of exogenous influences on the transformation process. Although we do not subscribe to transformation theories that support a “capitalism by design,” we also question the validity of ascribing all political, economic and social developments to path dependency. Rather, we postulate—and are endeavoring to empirically define and verify—a process of hybridization as the exogenous influence of foreign investment interacts with host country transformation processes. By this we mean that both the host country environment with its path dependent influence and a set of powerful impulses from external sources outside of Hungary are pushing the country towards a European style environment which admittedly, as yet, can only be rudimentarily defined.

A key determinant of how that environment may be evolving is the relationship between foreign investment and the host country context. In the Hungarian case, our hypothesis is that foreign investors are moving into what we call a permissive institutional environment. By this we mean that the institutional setting is generally weak, that it is lacking in sufficient capacity for conflict resolution and that it is far from being consolidated. Trade unions, for example, are rather powerless, fueling their propensity to accept whatever cooperative arrangements management offers. In this position they have yet to find a new role commensurate with their independent status as representatives of workers’ interests. The decentralized nature of industrial relations arrangements, we believe, facilitates the introduction of production regimes specifically tailored to management’s goals and practices.

Whether the primary direction is generally tending toward higher standards or whether it signals a low road production model similar to a Central American style *maquiladora* economy is still an open issue. There are cases in which the German investor is clearly striving to rapidly upgrade standards in line with production techniques and employee relations policies at other sites within the enterprise. Such a strategy certainly reflects the characteristics generally associated with the German model of production and labor relations. At the same time, other German investors are taking a different approach. What kind of production regime develops after an initial investment is dependent on a variety of factors, not the least of which is the dimension of market success. Maintaining or expanding the initial investment over time could induce changes in production organization or product lines based on positive learning experiences and the overall increase of know-how and qualifications among employees. In following such an upgrading path, the investor would be departing from the initial “low road” strategy and perceivably have a radiating influence extending beyond the immediate workplace environment to the local political and economic community. Such a development must be reinforced by measures emanating from the host environment and by the creation of a constructively regulative and participatory social framework. The outcome of the exogenous-endogenous interaction at the micro-level will be vastly different in a permissive institutional environment than in a local environment marked by social regulation and thriving trade unions, anchored in a stable and strong institutional framework. Successful production models contribute to increasing productivity and in turn to rising income and wealth. Economic prosperity, it may be argued, helps build public support for the newly democratized political and economic system.

This paper uses Hungary as a model of these developments to find answers to a variety of questions: How have German companies reacted to the impact of the demise of the Soviet bloc and the restructuring of the political, economic, and social framework of Europe since 1990? What has

drawn German investments to Hungary? What has constituted a successful investment policy and how have the more successful investment strategies differed from the less successful ones? What repercussions do production relocation and enterprise restructuring resulting from investments in Hungary have on such firm-specific issues as product development and research, employment policies, work organization, labor relations or internal enterprise communication and cooperation?

After a brief look at the German Production Model, I will review the development of German foreign direct investments (FDI) as they relate to CEE and Hungary. From there, the paper will go on to illuminate the process of production relocation at the companies of our case studies², i.e. just what is relocated, how it is managed, and to what extent it represents a developmental process. After this, the focus will turn to the repercussions of the internationalization of production on the enterprises in general and at their sites in Germany in particular. By way of conclusion, the paper will present some arguments tying the micro-level focus to the broader issue of the European Social Model.

THE GERMAN PRODUCTION MODEL

Without going too deeply into its history (c.f. Lehbruch 2001), it is important to recognize that what came to be called the German Production Model in the 1980's is the result of some thirty years of political and economic development and struggle, which gave it a distinctive institutional structure. Soskice (1999) has referred to Germany as being a "coordinated market economy" and Lehbruch uses the term "socially embedded capitalism" (2001: 47) to describe the model. For his part, Wolfgang Streeck has provided us with an extensive analytical description of the "highly institutionally coordinated, ... politically negotiated and typically legally constitutionalized" German political economy. (Streeck 1997: 36)³ Features of the institutional framework that are common to all of these characterizations are summed up succinctly by Flecker and Schulten:

Accordingly, the model consists of the following main parts: "social market economy" (*soziale Marktwirtschaft*), that is, capitalism tamed by political macro-regulation and redistribution of income by the state; long-term perspectives and a preference for productive investment on the part of capital; highly organized industrial relations combining sectoral multi-employer bargaining and cooperative labour relations within the enterprise; a vocational training system that combines on-the-job training with education in vocational schools; and diversified quality production⁴ based on highly skilled workforces. (1999:83)

This combination of two subsystems (Wood et. al. 1975: 296f.), represented by the coupling of a particular high skill-high wage production system with an industrial relations system that promotes the drive for higher productivity and quality, has been categorized as a *high road strategy*. It contrasts diametrically to less institutionalized systems of labor relations and strategies that are

² Work on the project commenced in June 2000. An initial phase of refining the research design and information input created a project database of ca. 135 enterprises representing over 50 percent of all employment at German manufacturing subsidiaries in Hungary in 1998. From this, we produced a general structural profile of German investments based on a matrix of relevant variables that were used to select enterprises to be approached with a request for interviews. From the responses to this first wave of inquiries, some twenty enterprises from a number of different economic sectors were selected for general interviews with top-level management representatives at enterprise locations in both Germany and Hungary. The intention was to deepen our understanding of the investment in general, of the production transfer process and development strategy as well as of the role of the Hungarian subsidiary in the overall business strategy of the company. On the basis of these interviews a further selection process was initiated. Five enterprises were selected for in-depth case studies. The field work on these has been completed and the final project report is in the process of being drafted.

³ He goes on to explain the role of "politically instituted and socially regulated" markets, of firms as "social institutions" in which labor and capital (universal banks) have institutionalized roles, of the "enabling" role of a state with "vertically and horizontally fragmented sovereignty," of "publicly enabled associations" and an economic culture with a preference for quality. (37-40)

⁴ For more on diversified quality production, see Sorge/Streeck 1988.

geared solely to price competition (*low road strategy*). As Kern and Sabel have noted, the high road is based on “the strategy of a specific German combination of product perfection, flexible process automatisisation, intelligent work organization and consensual regulation.” (quoted in Berndt 2001: 13) Under the high road strategy, the short term cutting of labor costs is both rather difficult and costly, both as a result of investments in human capital and machinery and of the organizational status rights of labor (codetermination). (Jackson 2001)

While the model is certainly useful in providing a structuring instrument for general, macro-level analysis, its validity at the enterprise level has certain limits. For one, the applicability of the model may vary in detail across the various sectors of the economy, depending on such factors as the numbers and sizes of enterprises, the extent to which they are export-oriented, and the organizational density of trade unions and employers’ associations. Secondly, the question has been raised as to the actual practice of the model beyond the realm of the large stock corporations, for example, whether all of the elements of the model are “in place” and functioning in small and medium-sized enterprises (SME), which make up the bulk of the enterprises in Germany. As we have ascertained in our project, in which our case studies comprise a number of SME’s that are generally (still) privately owned and operated, there are some important modifications to the model. SME’s have a more personalized style of human resource management and labor relations and the works councils usually have a weaker role (see also Wassermann 1992). SME’s also generally depend heavily on large customers, not only for volume output but as regards their pricing, their technological standards and their product development as well. This kind of dependency is not generally recognized as an element of the model, and yet it has a profound impact on the business strategies of such enterprises.

NEW CHALLENGES SINCE 1989/90

The current pressure on the model also provides the backdrop for a further issue relating to its future. It has always been postulated that the model has a particularly effective regulatory impact on the system of labor relations and that the system of labor relations is an integral part of the model. For one, the German brand of bank involvement in corporate governance and the adherence to strict monetary policies sets definitive limits for collective bargaining. (Vitols 2001) Through the dual structure of sectoral wage bargaining by employers’ associations and trade unions on the one hand and legally anchored and independent works councils at the workplace on the other, the system keeps conflicts over wages more or less out of the bargaining arena of the workplace while at the same time allowing works councils to exert some influence on employment conditions via information, consultation, and codetermination rights.

The political, economic and social changes that have been impacting the German economy over the past decade or more have made inroads on the functionality of these institutional structures. Whether the system of labor relations has been undergoing a process of “erosion” or whether the noticeable changes are better understood as a restructuring is a subject of intense academic debate. In either case, it is generally agreed that there has been accelerated change and that the major actors—employers’ associations and trade unions—are under growing pressure to find ways to re-establish the effectiveness of the model. (Dörre 2001; Hassel 1999; Hoffmann/Jacobi/ Weiss 1998; Kern/Schumann 1998)

Under globalization pressures, enterprises have devised new business strategies of innovation, product and market diversification, cost reduction and increased productivity using the established institutional mechanisms. At the same time, globalization has also opened the way for expanding, transferring, and relocating beyond the home country borders. While Abraham and Konings (1999: 591) concluded from their study that only a small minority of firms (12 percent) opted for “delocalisation” as “one possible strategic response to increased competition,” the socio-economic ramifications of such a response extend beyond the immediate operating range of the single enterprise. In this case, the question is what happens to the institutional embeddedness of enterprises when they invest in production sites abroad? This is an issue that has been written about

in connection with investments throughout the EU (Muller-Camen/Tempel 2001; Bélanger 1999) as well as in regard to German investments in other EU countries (for example, Ferner/Varul 2000), but there is still little research available in regard to CEE (see Dörr/Kessel 1999; Dörrenbächer 2002; Kluge/Voss 2003; Tóth 1999). As such, it is highly interesting that with the exception of the one “global player” in our sample, a transfer of the German system of labor relations as an integral part of the production model has not taken place at our case studies.

The reasons for this are many and varied and will be discussed in full in the course of the paper. What is important to note at this point, however, is that the internationalization process and the cross-border transfer of the German production model is not restricted to only the recognizable multinationals. In today’s world, it encompasses enterprises of all sizes. Among the strategies pursued to enhance competitiveness, going international with production appears to be widely regarded as a matter of necessity, a “natural” reaction to factors pushing enterprises to make a selective departure from the embeddedness of their institutionalized home country environment in the hopes of staying competitive with lower production costs while maintaining productivity and quality levels. This is a development which has been enhanced by the opening of CEE to foreign investments and by the advantages which new technologies offer in managing decentralized business operations, in communicating, storing and retrieving information, and in transporting goods across borders and over greater distances. The restructuring and internationalization of product and supplier markets has opened the way for SME’s as well as MNE’s as foreign investors to take advantage of the host country opportunities because of their better access to capital or to a technology unavailable to local firms, but also through the opportunity of a multi-locational operation or “fragmentation.” (Brown/Deardorff/Stearn 2002: 24f.)

INTERNATIONALIZING PRODUCTION AS A STRATEGY FOR REGAINING COMPETITIVENESS

The opening of CEE presented enterprises—especially those from the EU—with an enormous opportunity to strengthen their competitiveness and establish themselves in new markets. As one observer has summed it up,

... the opening up of CEECs brings together economies characterised by large wage differentials. This offers EU firms an alternative production base, something which comes at a particularly appropriate moment during a period of heightened world-wide competition. From a Western perspective, CEECs’ comparative advantage in labour-intensive goods is associated with proximity, thus enabling Western firms to take advantage of lower production costs in their immediate vicinity. (Pellegrin 2001: 5)

The relationship of these various factors to each other will be discussed more fully below in regard to our case studies. But as a general orientation on this point, suffice it to say that decisions by enterprises from the EU on new business activities in CEE are affected by both “push” and “pull” factors. On the “push” side of the equation are the highly developed and, especially in the case of Germany, highly regulated economies of western Europe which are going through processes of adjustment (i.e. deregulation, globalization, technological change); on the “pull” side are the transitional CEE countries which offer certain advantages. Among the most sought-after are new markets, reduced production (labor) costs, and a lower level of state regulations and taxes.

In the literature on the internationalization of business, attention is focused on trade and FDI as the primary instruments firms use to extend their business activity to a new region. But in the case of EU enterprises and the CEE countries in the 1990s, normal trade relations were not necessarily a viable option. In many sectors, the CEE countries lacked developed markets for industrial products from the West. Secondly, the “push” problems faced by EU enterprises fostered the need for more

binding arrangements and involvement in production development, such as contract production, licensing, joint ventures or ownership.

With its program “outward processing traffic” (OPT), the European Commission found a way to meet these needs without relinquishing trade as an economic instrument. The OPT regulations relaxed restrictions (tariffs, quotas) on a variety of goods (especially labor-intensive) produced in the CEE countries and allowed them to be imported. For such goods to qualify under this program they had to be manufactured in the CEE region by local producers under contract to enterprises from EU member countries, which supplied the materials and, in some cases, even the machines and the transportation. The host firm was responsible only for providing the labor (passive job processing) and meeting the production date. OPT arrangements enabled EU firms to “re-import” manufactured articles against which EU restrictions discriminate when their source is a non-OPT producer in CEE. (Pellegrin 2001: 34)

Hungary provides a good example of the importance of OPT during the first decade of transformation. In 1993, 20 percent of its exports to the EU resulted from OPT arrangements. As trade volume with the EU grew by 25 percent between 1993 and 1998, the OPT portion fell to around 7 percent, a trend which Pellegrin attributes to a statistical effect (34), to increased trade as EU restrictions are relaxed, and to a transformation of OPT relationships into ones of capital investment. (Pellegrin 2001: 63f.)

In particular, German enterprises have approached the opening of CEE as a strategic answer to the growing challenges to the production model, especially since the end of the bloc confrontation in Europe. Not surprisingly, the statistics show that German enterprises have been far more likely than their competitors from other EU countries to take advantage of OPT regulations, and that in Hungary, for example, “the German share in EU OPT is 80 percent, whereas the German share in FDI ranges between 40 per cent and 45 percent” (Pellegrin 2001: 15), which is still much larger than the share of any other country.⁵

Indeed, the statistical record shows a similar dominant position taken by German enterprises with regard to FDI in all CEE countries. Not only is there a very high level of German FDI in absolute terms, but compared to the investments of the United States and other EU members, there is a noticeably disproportionate regional concentration of German foreign investments in CEE. Estrin, Hughes and Todd (1997: 45ff.) explain this to be primarily a result of geographic proximity, historical ties, language (German) affinity, and labor cost differentials. Again, Hungary is a good example of this predominance: In 1998, for example, “40 percent of foreign capital invested in new foreign undertakings came from Germany, 15 per cent from France ...” (Hungarian Ministry of Economic Affairs 1999)

CEE: WHAT IT HAS TO OFFER FOREIGN INVESTORS

Such statistics point to the fact that since the end of the Cold War, central and eastern Europe has been in a particularly strong “pulling” position regarding foreign investments. As reported by UNCTAD, FDI flows have continuously grown in the region. Between 1993 and 1997, overall FDI increased by 28.5 percent per year. While the distribution among the countries was quite uneven, with Poland, Hungary and the Czech Republic accounting for the lion’s share, all of the CEE countries showed a high level of investment in manufacturing. Of interest as well is the fact that the EU continues to account for most FDI flows into CEE. (Dörrenbächer et.al. 2000: 437)

Several factors may be highlighted as contributing to the investment drawing power of the CEE region. One is its geographical proximity to the EU, an advantage valued in particular by small and medium sized enterprises and by those firms making their first foreign investment (Meyer 1998: 85) as a means of “testing the waters.” The CEE region has also offered firms low wage levels:

⁵ Pellegrin’s assumption from the statistical difference between the German shares of OPT and FDI in Hungary that Germans prefer OPT to FDI is debatable, but the issue will not be pursued here further.

Wherever the gap in labour costs is particularly wide, as between the industrialised and the developing countries (“North-South”), but also within the same (large) country, and increasingly between Eastern and Western Europe, the question arises how relevant low labour costs are in locational decisions. With capital and technology increasingly mobile internationally, differences in the cost and the quality of (immobile production factors such as) labour can be expected to weigh heavily in locational decisions, provided labour is used productively and labour costs make up a significant portion of total cost. Where this is the case, as in clothing or footwear among others, the attractiveness of low labour cost areas is likely to be irresistible. Where automation is technically impossible there is a strong financial incentive for the labour-intensive activity to move to or remain in a low labour cost area. (van Liemt 1992: 313)

Of additional importance for manufacturing investors is the relatively high skill level and industrial production experience of the workforces in some of the CEE countries,⁶ which enables them to set up subsidiaries to produce for the world market. Winters and Wang (1994) even place the level of skills and educational achievement above that of Southern Europe. They conclude from this that the CEECs have the potential to become a producer of sophisticated industrial goods. A certain (European) cultural affinity seems also to serve as a drawing card. Finally, the CEE countries have devised a broad range of programs, including investment subsidies and tax breaks, to bring in investors.

The case of Hungary

Hungary's advantages

There are a variety of reasons why German enterprises regard Hungary as a preferential host country for investment. Among its particular “pull” factors, Hastenberg (1999: 64-66) refers to Hungary's reputation for having a fairly unorthodox economic policy (“goulash communism”), which, together with FDI-conducive legislation, was a seedbed for the post-1989 privatization policy aimed at attracting western capital⁷. Historical links (German speaking population) and geographical proximity have also been conducive to German investment. But Hungary was also preferred because its proximity had an impact on costs, flexibility and delivery time. According to a summary of the literature presented by Estrin, Hughes and Todd (1997: 13), “factor cost incentives, and in particular lower labor costs, are found to be more important [than new market entry – MF] for small firms and firms from neighboring countries such as Germany and Austria. German firms also appear to use outward processing contracts relatively more frequently, so as to exploit the differential with domestic costs of production.”

Surveys conducted by the Deutsch-Ungarische Industrie- und Handelskammer among its membership (see Table 1, p. 10) show new market entry to have been the strongest motive overall as measured by the number of firms that chose this option. Low labor costs, at least through 1999, was a further leading motivation. In another study, these two motives were disaggregated along sectoral lines, showing that cost reduction outweighs market entry as a preference on the part of manufacturers, while for commercial investors, the preferences are the other way around. (Hastenberg 1999: 67, 90) In the early years of the transformation process in CEE, investors also gave high priority to the stable political and economic environment that Hungary represented. More recently, this has come to be expected and as such, less important for an investment decision.

Further motives reported by the DUIHK surveys were geographical proximity and the presence of a highly skilled and industrially experienced labor force. (DUIHK 2000: 128) Finally, among other advantages that investors attributed to Hungary are the favorable tax and investment

⁶ Not surprisingly, there is a strong correlation between the level of FDI and the skill level of the work force. Those countries with sizeable amounts of FDI are also those with the most highly skilled workforces.

⁷ Hungary had accrued a sizeable foreign debt by 1989 and was therefore highly interested in acquiring hard currency.

regulations, language skills (German and English) as well as weak labor unions (EIRO-online 2002) and the prospects of EU membership.

Table 1:
Foreign Investments in Hungary, 1995/1999. Motives

Motive	Priority Level 1995	Priority Level 1999
New Market Entrance	1	1
Political Stability	2	4
Low Labor Costs	3	2
Location – Proximity	4	5
Labor Skill Level	5	3
Comparatively less red tape	6	7
Low Taxes	7	6
Overcoming import barriers	8	8
Minimal environmental regulation	9	9

DUIHK Survey 2000

Hungary's drawbacks

As part of the same DUIHK survey, members were asked to respond to a list of problems they have faced in Hungary as investors. Over half of the respondents pointed to bureaucratic practices, while over 40 percent referred to the unavailability of qualified labor. Since this answer was not explained more fully in the survey, we have no indication as to whether this is the result of lower skill levels than expected or of a tight labor market. That the former cannot be excluded seems to be indicated by the fact that along with black market and corruption (38 percent) and deficiencies in the legal framework (37 percent), the qualification level of the workforce (38 percent) was one of the most frequently named problems. A third of the respondents also listed the lack of employee motivation, poor infrastructure and low productivity as drawbacks to their investment in Hungary, while one-fourth of them were dissatisfied with the reliability of suppliers. (DUIHK 2000: 102)

GERMAN ENTERPRISES IN HUNGARY: A REVIEW OF CASE STUDIES

A comparison of the above findings with those from our sample shows many similarities. The only significant differences result from the composition of our sample, which included only enterprises in manufacturing. Our respondents confirmed Hastenberg's findings (2001: 90) that the most prevalent motive among manufacturers is not new market entrance (meaning the Hungarian or CEE market) but rather lower labor costs in order to remain competitive for products being sold in the EU or on the world market. At the same time, our respondents emphasized the importance of the generally high skill level and industrial experience of the workforce in Hungary as a decisive criterion.

While these motives are undoubtedly essential elements of the decision to invest in Hungary, both the choice of that country and the initiation of the process of investment, transfer and relocation are affected by actions and decisions, to which it is difficult to attach the label "rational choice." The driving forces of the search for new markets and the need to maintain cost competitiveness are not always catalysts for a rational strategic course of action. Whereas very large corporations may follow the rational choice methods laid out in economic textbooks, we have found that SME's and even enterprises which by definition are large, often have not taken a strategic approach to initiating and implementing FDI. As Meyer and Skak (2002: 179) have written, newcomers to internationalization and smaller firms lack the specific kind of knowledge about international business and about business in the host country that is needed. To overcome this

deficit, they may rely on a variety of sources (“business networks”) ranging from personal connections to government agencies. However, since such firms are outsiders with regard to such networks, “their strategies are subject to high degrees of *serendipity*, i.e. fortunate and unexpected discoveries made by chance. The ability to react to chance events in the network thus can be critical for their survival and growth.”

In our sample, this was indeed the case. While a number of firms clearly profited from the experience gained via OPT and contract processing, enabling them to develop some rational criteria for a direct investment, their original choice of business partner and country of location was more often the result of chance or trial-and-error. Particularly among the smaller firms, the presence of someone in the firm with family connections or previous business contacts to Hungary, or even a chance vacation acquaintance, were important factors contributing to the decision to “test the waters” there. Moreover, in the context of the socio-economic and political transformation in CEE, institutions and organizations were in flux and many persons were on the lookout for new business opportunities, seeking to take advantage of the contacts opening to the West. Here was a great source of potential for harnessing the needed “country-specific expertise” (Meyer/Skak 2002), provided of course that the right selection was made.

The Investment Process

Once contacts were made, the first step for our sample enterprises—indeed, for all of the SME’s in the sample—was to extend a production order, usually for a small quantity of a single product or a well-defined, standardized product group. In general, the German firms supplied the basic components and materials in order to take advantage of OPT regulations. Once up and running, it was exceptional for a firm to terminate this relationship. The preferred approach was to work out problems and achieve satisfactory results with the chosen partner. Having reached this stage, additional orders for larger quantities or for different products were tendered, setting a process of deepening involvement in motion.

As for the decision of these enterprises to take over full ownership of their Hungarian production sites, two types of reasons were given. In the first category were those that were related to the privatization process in Hungary. For some of the enterprises, privatization provided them with a bargain opportunity; for others, it was the choice of either acquiring the production site with which they had been doing contract or OPT manufacturing, or moving to a new site.

The second category of reasons for in-house production involves issues of ownership and knowledge. Across the board, our case studies felt that in the long run, they could not achieve adequate results for all of their product lines via contract or OPT manufacturing. For them, the introduction of and adherence to a company-specific production model was of prime importance for the integration of the Hungarian site into the overall company production strategy, for the attainment of quality standards equal to those which had existed in Germany, for the diffusion of knowledge and for the focused development of new products and the acquisition of new market shares.

Having decided to relocate the production of a complete product or some of its components, or to move into a new product line by a capital investment in production capacity, the next step for enterprises was to make choices regarding the geographical location and the kind of investment they were prepared to risk, i.e., whether to acquire an existing production site or enterprise, or to embark on an independent new start by buying the land and erecting their own facility. The latter choice in favor of a “greenfield” site also made it necessary to consider regional location factors as well, whereas with the acquisition of a “brownfield” site, the location had already been decided upon.

The majority of enterprises in our sample showed a clear preference for the acquisition of an existing plant or facility over the investment in a completely new site. From our interviews, this seems to be a further sign of the cautious approach pursued by most enterprises in establishing their presence in Hungary (“testing the waters”), independent of the extent of their previous foreign investment experience. Having gathered essential experience from their contract and OPT business

arrangements and convinced themselves of the viability of the operation, most enterprises opted for continuing along the cautious path and building on known qualities.

However, there are also cases in which the basic distinction between so-called “brownfield” and “greenfield” investments is not as evident. Some enterprises in our sample built new production sites, but recruited personnel from Hungarian enterprises with which they had been doing business. As such, the physical plant was a greenfield investment, but the employees were in a sense part of an acquisition. Other enterprises acquired an existing production site and then set out on a path of completely restructuring and expanding the facility. In at least one case, production employees from the old Hungarian enterprise were hired, but a new (German) management team was put in charge.

Exercising Control Over the Transfer and the Subsidiary

The issues of assigning home country managers to run the host country subsidiary and coping with the dynamics of cultural interaction between home and host country managers have been extensively addressed in the academic literature on management and multinational enterprises. (See for example Oechsler 1997; Holzmüller 1997) However, in our sample, cases of transfer processes, well-structured and managed by an experienced, multicultural team, were limited to a very few large-scale multinational enterprises. (Dörrenbächer 2002: 15) To be sure, all of our enterprises used their own managers from headquarters to oversee relocation and the production run-up at the subsidiary. As Rudolph (2000: 255) has pointed out, the “coordination and substitution of missing local skills” plays an important role in transferring managers. But we also found process control to be an equally strong motivation. Moreover, our sample enterprises did not reflect the institutionalized nature of involvement that characterized Rudolph’s study on Poland. Without extensive organizational and personnel resources, the great majority of our firms had to continue along the path of innovation and chance, and rely on the motivation and abilities of a single manager for success. At the same time, the enterprises were keen on finding and hiring Hungarian managers. To what extent each company entrusted headquarters managers or German expatriates with decision-making responsibilities regarding the daily operations of the subsidiary or delegated such management tasks to Hungarians varied from case to case. Essentially though, with regard to the phase in which the basic elements of production relocation and run-up took place,⁸ all of the cases fit into one of the following four groups:

- Company headquarters delegated or hired a German manager as director of the subsidiary. The position was a long-term assignment with no immediate intention to turn it over to a Hungarian in the near future.
- The directorship was assigned to a German manager with a Hungarian in training to be his successor after a transition period.
- The directorship of the subsidiary was divided between a German and a Hungarian manager. As a rule, the German manager was responsible for managing relations with headquarters and other subsidiaries, while the Hungarian manager's responsibilities were centered around the daily operations of the plant.
- Company headquarters hired a Hungarian manager to run the subsidiary, while one of the top managers from headquarters, usually the technical or production director, made regular visits to the site.

The decision in favor of one of these options depended on considerations involving both the situation in Germany and in Hungary, including the structure and style of management, the availability and interest of a German manager for the job, the presence of a highly capable and trusted Hungarian, and last but not least, the personal “chemistry” between the Germans and

⁸ For managerial developments in later phases, in which production-related activities were relocated to Hungary and new relationships between teams and departments at headquarters and the subsidiary were created, see the following sections.

Hungarians. As for the all-important issue of language, the firms in our sample looked for fluency in German as an important criterion for judging Hungarian managerial candidates, with English language skills of secondary importance.

Beyond such factors, the organization of communication within the enterprise also influenced the kind of relationship set up between headquarters and the Hungarian subsidiary for production. Except for the smallest of the enterprises in our sample, all of them used an IT-intranet with accounting and communications software and were in the process of developing or improving their IT-capacities for data management in product development, production and logistics. More broadly, there is a general trend toward using IT-networks to strengthen overall control of processes throughout the enterprise.

In most of our cases the on-site presence of German managers and their involvement in developing the subsidiary represented a clear contribution to the success of the investment. Yet to what extent this is an indication of a positive influence on the transformation process in Hungary (as measured by the transfer of skills and the assumption of leadership functions) is uncertain. The evidence from our sample seems to suggest that the mere presence of German managers is not decisive. Indeed, we found cases in which the German management has raised the skill level of the workforce, but has not developed a Hungarian management team. In these cases there are indications that the German managers are protecting their skill and knowledge advantages. Nevertheless, management is not the only medium for “the promotion of the transformation process in the host country.” (Rudolph 2000: 253) As will be shown below, a greater impact on transformation results from the organizational and structural upgrading of the investment.

Production Relocation: Elements, Processes and Models

Two aspects of transferring or relocating production are crucial to its understanding and analysis. First of all, it is a process that may be continuous over a period of time or may be clearly marked by different and distinct phases. As such, conclusions regarding the status and extent of transfer must always be connected to a particular time dimension. In this segment, the focus is on the actual process of the first transfer of production and its installation in Hungary. Expansion steps in the investment will be considered in a subsequent segment of the paper.

Secondly, there are several elements of the transfer that contribute to its success. For one, transfer may involve not only technology and real objects such as machines, tools and other equipment, it invariably includes the factor “personnel” as well. A further essential element of transfer is the process of imparting information, knowledge and concepts, i.e. the production model. Without this “software” of the production process, an indispensable ingredient for the functionality of a particular production model would be missing. Understanding this context and the interaction of these factors contributes to determining the extent to which exogenous factors dominate the development of work organization and production processes in German-owned subsidiaries in Hungary. In addition, it may be said that the right combination of these factors is a basic prerequisite for the ultimate success of the relocation process.

Technology Transfer

To begin with the first element, we found that our German enterprises initiated the transfer process by setting up standardized and routine manufacturing and assembly processes. In some cases, this step encompassed only the production of a single part or component, in other cases it was the assembly of components shipped from Germany. To enable production to commence, the technology of production, its machines, tools, and other equipment, were built in Germany and installed at the Hungarian site. This was always the case whenever there was a direct relocation involved; but even when the machines that had been used in Germany were not taken to Hungary, the companies brought in new machinery to either supplement existing machines or to replace them completely. The goal of this renewal process was to be able to use equipment conducive to establishing efficient work routines and achieving a high level of productivity.

Personnel Transfer

The second element of the transfer process involves the use of personnel from Germany. This can and often does take on different forms and may also vary throughout the stages of the process. At the shop floor level, in a few cases, personnel from the unit being shut down or the process being discontinued were sent to Hungary to train their replacements. This involvement usually lasted no more than several weeks. According to our interviewees, this was less difficult than it would seem because the Germans were either scheduled to move to new positions within the company or were retiring. More problematic it seems was the reverse case, i.e., when Hungarians were brought to Germany to be trained on machines scheduled for relocation.

At a different level is the use of German foremen, technicians or supervisors to install the new production and to train the Hungarian employees. The stays of such persons ranged from only a few days to extended periods of several months. The longer the stay the more likely it was for the person to be assigned to a regular position in the leadership hierarchy of the Hungarian subsidiary. As such, the ability of the transferred person to function in a new and intercultural environment was exceedingly important for his contribution to the overall transfer process. Didactic and language competency was at least as important as technical or organizational know-how.

The third level of personnel transfer is management. As shown above, we found four different approaches to the involvement of German managers at the subsidiary. More than the other two levels, this level is in the limelight of the transfer process and as such it is assumed that the effectiveness and quality of the relocated production is largely determined at this level. Without a doubt, managers from Germany, the so-called expatriates, made a substantial contribution to the transfer process in all of our case studies. Indeed, problems of the transfer process were especially evident in those cases in which there were also management problems. We found no evidence, however, that problems at the other two levels were of less importance for the overall success of the transfer.

Process and Knowledge Transfer

An important indicator of the competitiveness of an enterprise is its development and use of a more or less specific production process. It is this particular approach to organizing and running the production process that is the mark of each firm. The differences between firms making the same products may not appear to be especially large, but what is decisive is the accumulated experience and skills, and the process knowledge associated with the basic approach, its continuous improvement or the introduction of new modules. This is the key content of the production model of an enterprise.

With respect to the transfer of production to Hungary, we found that all of our sample cases were convinced that their investment could only be profitable if their production model, i.e., the way in which they manufactured a certain component for internal use, a product or a product line, was transferred as completely as possible. They reasoned that in this manner, they could avoid mistakes and control for unforeseen difficulties as well as integrate the new production site into the overall procedures and strategy of the firm. Devising the appropriate factory layout and work organization, and imparting the knowledge and skills required to operate the machines, complete the necessary tasks and, in general, run the process, was regarded as the lifeblood of the transfer. For this aspect, most of our case studies relied on an extensive and detailed production documentation in written or electronic form. However, the usefulness of this as their knowledge basis also depended on the ability (and agility) of the German personnel familiar with the production process in imparting it to the Hungarian colleagues, as well as the readiness and willingness of the Hungarians to adopt the new concepts and methods.

It is on this level that we found both similarities and differences in the kinds of problems experienced by the enterprises in our sample. With few exceptions there was a general preconception on the part of the German managers and employees to whom we spoke that the competitive necessity of relocating production to Hungary confronted the firm with the problem of overcoming developmental deficits resulting from a half century of communism. One of the

responses generally heard from our German interviewees was that the Hungarians were used to a hierarchical command structure and always needed to secure the backing of their superiors before agreeing to doing a certain task or to the introduction of a new procedure. Another commonly expressed problem was that the Hungarians were inclined to quickly agree, even if they disagreed, presumably in the hope of avoiding a conflict. Of course, when the expected response to the agreement did not follow, the existence of differences became evident.

The extent to which such behavior became a problem and as such affected the advancement of the transfer and development of production at the subsidiary varied greatly among our case studies, and as such was indicative of some basic differences in the way in which the firms carried out the process. Companies which invested considerable time and resources in convincing the Hungarian employees of the advantages of the new system, in developing the environment, the organization and the skills necessary for its implementation, and which were receptive to concrete proposals from the Hungarians for specific changes to the norms of the German model were rewarded by the results. In contrast, attempts to implement the transfer without sufficiently embedding the individual processes or even the model as a whole led to greater problems and jeopardized the ultimate success of the transfer.

In a similar vein, some companies were reluctant to make adjustments to their production model and ignored potential advantages offered by specific cultural, technological or process-related skills of their Hungarian employees. This did not always lead immediately to obviously negative results. However, inasmuch as such human resources could presumably be essential for the further expansion and development of the investment, the failure to develop them could prove to be a hindrance and would have adverse consequences in the long run. This assessment is buttressed by results published from the DUIHK survey referred to above. In regard to the transfer of German management concepts, the chamber warned “against copying proven leadership and organizational models exactly to the Hungarian subsidiary without taking the specific cultural and mental characteristics of the local environment into consideration.” (DUIHK 2000: 107)

Wage Payment Systems and Labor Relations

In Germany, wage payment systems are generally contingent upon both collectively bargained contracts and negotiated agreements at the company level. Such systems are also integrated with work organization schemes and working time schedules. While it has traditionally been assumed that labor relations and the negotiation of wage payment systems were a standard element of the German production model, evidence from the few available case studies that examine how German enterprises deal with labor relations and wage issues in foreign countries casts doubts on this assumption. (Bluhm 2001; Ferner/Varul 2000) Further corroboration of these findings have recently been published by researchers using a sample of large multinationals from several countries, including Germany, Poland, the Czech Republic, and Hungary. They found that “the enterprises adjusted their policies according to the existing national standards, as long as this was advantageous for cutting costs, i.e. via reduced social responsibility, lower wage standards, and greater workforce flexibility gained through reduced job security.” Moreover, they found the readiness of “German enterprises to take along their positive experiences at home with cooperative management models of codetermination and make these an integral part of their international corporate culture and identity to be limited.” (Kluge/Voss 2003: 67)

Interestingly, despite the very different samples, our research has turned up quite similar findings. While we found scattered cases of a partial transfer of wage payment systems (adjusted to the much lower Hungarian wage levels) and in general, changes which eliminated the previously used arbitrary bonus systems, the companies in our sample did not include their personnel departments in the transfer process and there was no attempt at a “German style” institutionalization of labor relations at the new site. In general, the German headquarters made no effort to create a conducive environment for cooperation with a collective representation of the employees, and in some cases, they even gave their Hungarian site managers a free hand despite his clearly negative position regarding the recognition of a union and a works council.

Our explanation of this is derived from the following two observations. With few exceptions, the enterprises in our sample are SME's at which the institutionalization of labor relations is generally weak. In many of the enterprises, this was explained to be a result of limits of size and resources. As such, on the German side, none of the actors was interested in or strong enough to ensure the inclusion of structured processes of labor relations in the transfer of the production model. Only in the largest multinational enterprises in our sample did we find this to be the case.

The second point refers to the Hungarian environment and the weakness of its institutions of labor relations. At some sites, there were no works councils although the legal criteria was fulfilled; at other sites, the works council existed but was either weak or lacking sufficient autonomy. Union representation for its part suffered from the same deficits. Indeed, it was indicative of this situation that our interview partners in Germany and Hungary gave us contradictory information regarding the existence, the size and the activities of the works councils, and most of them gave us a puzzled look when we asked about the role of the union at the Hungarian subsidiary.

Supplier Networks

The move to a new location some distance from the original site requires logistical and organizational changes with regard to the supplying of parts and materials to the production⁹. Increasingly, in many manufacturing sectors one finds closely integrated relationships (just-in-time) between producers and suppliers, and indeed, some research indicates that the internationalization of large manufacturers may be accompanied by moves on the part of key suppliers to the vicinity of the new location. In contrast, our sample showed nothing similar. The newly established subsidiaries were supplied either directly from the mother company in Germany or from established suppliers to the company located in western Europe or Asia. Many of the persons we interviewed reported that they would have preferred to have some of their materials or components provided by local suppliers. Yet they had been unable to find partners in Hungary who were both reliable (in terms of time requirements) and could meet their quality standards. This is less a criticism of the low standards of Hungarian manufacturing and craftsmanship than a realistic appraisal of the competitive demands faced by companies with established networks of suppliers whose production is for the world or EU market. However, as will be shown below, some of the new subsidiaries were able to overcome this problem and begin to develop new supply chains in Hungary during later phases of the transfer.

Protecting the Investment. Incremental Development

As shown by the enterprises in our sample, the originally planned dimension of transfer varied greatly in the length of time for its completion. Much depended on the way in which production was withdrawn from Germany, on the kind and complexity of the product or products, and on the ability of the enterprise to get production running at the expected level in Hungary. But once this stage had been reached, each enterprise began to face the question of whether the optimal level of development had been achieved at the Hungarian site and whether the site would continue to be profitable at this level.

A number of our sample enterprises decided not to expand on their initial investment and transfer of production. For some it was a matter of having reached the optimal level of quality and quantity in production, others reasoned that their organizational and logistical capacities would be overtaxed by any further transfers to Hungary. Within this group of enterprises which had no plans to expand their Hungarian investment, there was also a small number that were ready to move on to "cheaper pastures" once the cost advantages were no longer sufficient enough to justify staying in the country.

In contrast, we found that there were also many enterprises in our sample (including those of our in-depth case studies), which either during the initial phase or at its completion began planning

⁹ The finished product must also be transported to a warehouse or to the customer. In most of our cases, the product was returned to a warehouse at the company's main location or to a distribution center in Germany.

and implementing the transfer of additional production segments or production-related services. Under the pressure of competitive “push” factors, management in these firms interpreted the success of their first relocation steps as the basis of an opportunity for a profitable expansion. Nevertheless, this did not translate into an easily realizable plan, especially in those cases in which the transfer of production-related tasks such as product engineering, warehousing, logistics, machine tooling and maintenance, and ordering were involved. It was one thing to eliminate production jobs of mostly unskilled workers in Germany, as had generally been the case with the first stage of production transfer, and quite another when a variety of skilled employees was affected. The difficulties involved seem to have been especially germane to SME’s, where the inter-departmental exchange of information and direct personal cooperation is greater. Moreover, if the transfer of more qualified tasks to the Hungarian site was to be productive and profitable, management had to be certain of being able to hire appropriately skilled Hungarians and for them to be able to reach the level of company-specific product and process knowledge of their German counterparts. Interview partners from the German headquarters of all of our case studies emphasized this point as one that made further transfers beyond the immediate production process a particularly sensitive issue.

In contrast to this position, our interview partners from the Hungarian subsidiaries—indeed, both the local Hungarian and the German expatriate managers—revealed a strong interest in “pulling” in more tasks from the sites in Germany and in developing their position of competency within the enterprise. The approach they chose was one of showing their German counterparts the opportunities such a transfer would bring by pointing to the difficulties they were having with production because certain production-related services were still located in Germany. The first step in their chain of arguments was to point to the need for developing production essential engineering capacity at the Hungarian site as a supplement to or replacement of such positions in Germany. With standard production processes located in Hungary, the need for such support was generally recognized, although there were conflicts over the actual assignments of such engineers and technicians. However, once agreement had been reached, the “pushing” and “pulling” relationship between the German mother company and the Hungarian subsidiary was on a new level of dynamics. Regarding our in-depth case studies, the evidence from our interviews suggests that the subsidiary management continued to create reasons and arguments for the ongoing augmentation of engineering capacity for product improvements or new model development. Parallel hereto, local management began to set up and nurture a local supply network, expand warehouse capacities, improve IT-capacities and prepare for the assumption of larger administrative and financial responsibilities.

This is not to say that the subsidiary managers were successful across the board in achieving their goals or that all of them laid claim to integration of all of these activities within their site. Indeed, in many cases, the optimal solution for the division of responsibilities between the German and Hungarian sites was to create joint project teams with leadership assigned to the site with the necessary competency. It was evident that the further development and expansion of the original investment was to a large extent—and in many cases, primarily—the result of their “pulling” efforts. This conclusion is derived not only from their activities regarding the transfer of such tasks as referred to above. It is also shown in their initiative efforts to introduce new work structures (for example, group work) and pay schemes, to offer a wide range of social benefits such as subsidized or free transportation to work, cafeteria meals and improved sanitary facilities, and to set up permanent and mandatory job training programs for the employees. In several cases we also learned of efforts by the Hungarian site managers to develop closer ties to nearby vocational schools and colleges, including encouragement and offers of material support for upgrading the curriculum. Without an apprenticeship system as in Germany to rely on, the managers felt that their future prospects for recruiting the skilled labor they needed depended on being able to exert their influence in such a way.

Transfer and Relocation: A Brief Summary

One of the lead questions of our research has been to find out what kind of German-Hungarian mix, or hybridization, has resulted from the transfer of production and its accompanying production model. All of our case studies showed definitively that a hybridization of the German production model had taken place. With regard to the production system, the input of the foreign investor was clearly the dominant element. As I have shown above, the German enterprises in our sample, in a manner similar to other published case studies, had a concept and understanding of their production as an integrated system or model which needed to be transferred in total to function effectively. Indeed, being able to introduce the model and constructing the production process according to its demands had been one of the driving motives for moving from contract to in-house production through a direct investment. Certain core elements of the production model were regarded to be absolutely essential to the production process, as it has been developed in Germany to achieve the necessary quality standards for global marketing. However, to be successful, this approach also had to be pragmatic and to a certain degree flexible: Changes to the model could be accepted in recognition of Hungarian norms, standards and preferences when they did not endanger its functionality or when their adoption in fact contributed to improvements. How this actually turned out in practice may be illustrated by a project report based on interviews in one of our in-depth case study enterprises:

Asking our interview partners about the results of the transfer process, they said that the production system as practiced in Hungary is a real hybrid in which, according to their estimation, the influence of Germany is approximately two thirds and the influence of Hungary one third. The one-third share of the Hungarian influence is basically made up by the general tendency of the Hungarian workforce to break out of the very detailed production system of the company. However, since the production system of the company is not working perfectly at any site up until now, this is not seen as a problem (yet). On the contrary, the high flexibility and creativity of the Hungarian workforce (which is the other side of the coin) fits very well to the imperfect steering system. Referring to the plants in Hungary, one of our interview partners mentioned with very obvious appreciation: "The final product always arrives, no matter what problems occurred."

In comparison to the German-dominated hybridization mix with the production system, nothing similar in regard to labor relations systems as the other part of the German production model could be found at the Hungarian subsidiaries. As was explained above, labor relations, training and wage determination showed little resemblance to their counterpart in Germany. Indeed, management made no effort to effect a transfer, assuming that its production system would function without attempting to replicate the home country employee relationships, and that employee relationships and personnel issues were delicate matters best regulated in the local environment. As such, management involved its personnel departments in the transfer process only in cases of special training programs, and works councils in Germany showed a disinterest resulting from their own plant-specific range of operation and their lack of a legal basis to influence the transfer.

REVERSE DIFFUSION IN GERMANY

Up to this point, the paper has focused on the issue of the "forward diffusion" (Ferner/Varul 2000) of the company-specific modes of the German production model to Hungary via FDI. But what is also of interest is the "reverse diffusion" (Edwards 2000). The use of this term in our context refers not only to the calculated spread of practices and processes from the Hungarian subsidiary to the home country sites of the German mother country, but also to the evidence of changes in Germany effected by the existence and development of the Hungarian investment.

The most immediate and noticeable impact of production transfer is the loss of employment “on the shop floor.” Depending on the actual product, the kind of jobs lost varied to some extent in our sample cases. For the most part, unskilled and semi-skilled positions, mostly held by women, were eliminated. With few exceptions, company works councils were able to negotiate severance pay along with some retraining. A number of companies also provided support in finding new jobs.

Overall, however, after an initial drop due to the loss of production jobs, employment at the German site of many of the companies returned to the pre-transfer level or even increased. Skilled white-collar employees such as engineers, technicians, commercial staff and IT specialists were hired to support the new production arrangement, bolster the marketing strategy and control the growing complexity of internationalized production. Even into later stages of the Hungarian investment, when the subsidiary had begun taking on more production-related responsibilities, the home country site—usually the headquarters at an SME—did not experience a loss of jobs similar to that which occurred in production. When employment cutbacks did occur in Germany, they were the direct consequence of a poor economic performance by that company.

A second observation is that teamwork at the German site was intensified, both within the site and—necessarily—with the new production subsidiary. The introduction of such German-Hungarian teams proved to be an experiment in intercultural cooperation, in which the Germans had the advantage of language as well as the initial privilege of greater company-specific and product-related knowledge. But they also had to deal with the uncertainty of the future of their positions in respect to the further growth and development of the subsidiary. Many of them expressed their worries to us that by working together with the Hungarians they were in effect training their replacements. Their uneasiness over this situation was mitigated however by the strength of their skill and knowledge level, both in general and in regard to company-specific processes. What came across was a certain feeling of being indispensable to the company, and therefore not easily replaceable, supplemented by a strong dose of confidence in their ability to easily find a new job if necessary.

A third observation concerns the status of industrial relations and the role of the works council at the German site from which production was relocated. The “delocalization” of production as a strategic response to competition (Abraham/Konings 1999: 591) is the process we are studying in this research and it entails the transfer of the routine and standardized processes to Hungary and the retention of high value-adding activities in Germany. With few exceptions, this transfer resulted in the removal of the core of labor relations at the German site: The organizational density of union membership declined proportional to the loss of production workers and the backbone of support for the role of the works council as the representative of workers’ interests was eliminated. With the disappearance of a sizeable contingent of workers, the workforce became inevitably almost fully white-collar, more non-union and characterized by strong individual career interests. As a consequence, the coordinates of management—workforce relations were redrawn. New topics appeared on the agenda of the works councils at these sites and at election time, they went through membership shakeups that reflected this extensive shift in the composition of the workforce. This did not necessarily mean that works councils became generally irrelevant. Although this was the case at some enterprises, at others, their role was not questioned but was launched on the path of redefinition.¹⁰

The final observation on reverse diffusion is in reference to the effects of the transfer on overall corporate strategy and organizational restructuring. Delocalization of core production processes represented a substantial qualitative organizational change even in enterprises with sales subsidiaries and some modest production facilities in various regions of the world. New and affordable information technology systems (for example, SAP) presented both an opportunity and satisfied a need to control this process in such a way that the previously acceptable independence of

¹⁰ The fact that German site works councils had very little or no knowledge of the situation of the workforce at the Hungarian subsidiary and no contacts to either the Hungarian works council or the plant union will not be discussed further in this context.

far-flung subsidiaries could be overcome, their operations harnessed in the interest of an holistic enterprise strategy.

Within the enterprises of our sample, there were ongoing struggles in management over the dimensions of restructuring and the advantages of a centrally-steered course of operation as a control framework for the overall coherence of the enterprise. The introduction of new IT-systems presented both a chance for the subsidiaries to use central data to improve their operations and for headquarters management to keep an up-to-date eye on the external operating units. The overarching capabilities of such instruments thus dovetailed with the new productive capacities resulting from the transfer process to generate potentially dynamic and innovative approaches. How each of the enterprises was actually meeting this challenge differed markedly and will presumably lead to a variance in the outcomes on this level. However, a founded presentation of these differences will have to await a completion of the analysis of all the material collected during the research field work.

THE EUROPEAN SOCIAL MODEL: QUO VADIS?

The focus of our research is on the changes at the workplace and within the enterprise resulting from FDI and the transfer of production and the production model. From that level to the generality of the European Social Model is certainly a long step, but it is an important one for establishing the context in which to project our conclusions beyond the micro-level.

The concept of a European Social Model was injected into the European debate by former commissioner Jacques Delors in the 1980s as a normative goal for the social development and integration of Europe (Kohl/Platzer 2003: 46). Characterized by the “indissoluble link between economic performance and social progress” (European Commission 2002: 45), it was reaffirmed and given a political boost at the summit meeting in Lisbon in 2000 and then a year later with the adoption of the European Social Agenda at the Nice Summit.

As the academic discussion has shown, the model is characterized by a “richness” in institutional variety at the level of national states and regions, where it is a functioning socio-political reality. (Ebbinghaus 1999: 24) At the supra-national level, there is a general consensus that the European Social Model is a project toward the integration of Europe, “within the framework of which the structural coupling of economic growth and social cohesion ... are made the object of supra-national and transnational regulations and institutions.” (Aust/Leitner/Lesenich 2002: 273) Arguably, in extension of institutional practice at the national level, the collective regulation of labor relations and employment practices and workplace issues is a core element of the model, ensuring “the existence of a ‘collective voice’ for employees at the establishment level through different forms of workforce representation and through coverage by collective bargaining.” (Krieger/O’Kelly 1998: 216) Even though the model as a unified and institutionalized norm throughout the EU is still more of a goal than a norm (Hemerijk 2002), it’s meaning and political relevance as a throttle to further deregulation and an uncontrolled “downward spiral” (Flecker/Schulten 1998: 106) has not been lost on the accession countries and their transformation policies.

Has the considerable flow of FDI to Hungary and many of the other candidate countries of central and eastern Europe contributed to the implantation of high standards and the creation of a foundation for the realization of the European Social Model? FDI has certainly made an enormous impact on overall economic development in Hungary as well as on the integration of those sectors into the European economy in which FDI is dominant. At the level of foreign owned enterprises, and here in particular the German-owned ones, there has also been a process of upgrading in regard to production skills and technology. In contrast, the social cohesion side of the model’s equation has not been equally supported. The “collective voice” is still underdeveloped, and the accession process has not fostered a new course. (Vickerstaff / Thirkell 2000) While this may not prove to be intrinsically harmful for Hungary’s chances of taking the “high road” of development, it is likely to

be a harbinger of a new variation on the model or indeed the introduction of a new, less institutionalized and regulated “model.”

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