Modernizing as a road toward recovery

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BERLIN

BY NELSON D. SCHWARTZ

The soaring glass and iron Siemens factory here opened almost exactly a century ago. At first, it churned out turbines to generate electricity, then switched to munitions during World War II before being looted by the Soviets, which required it to be rebuilt at the dawn of the Cold War.

Today, it is manufacturing turbines again — except the models being made now are among the most advanced in the world, each one able to power all the homes in this city of three million people by itself.

"It's not a museum; it's a workshop," said Michael Schwarzlose, a project manager at the Berlin plant.

The same might be said for much of Europe itself, despite American suspicions to the contrary. European companies may not be as nimble as their U.S. counterparts, but in moving to preserve jobs in the midst of the worst global downturn since the end of World War II, they have forged a different path toward recovery.

In doing so, they are making old plants more modern and effective rather than starting over elsewhere or shifting jobs to less expensive locales.

"American companies have been faster to adjust their work forces and quicker in protecting profit margins," said Gilles Moëc, a senior economist at Deutsche Bank. Indeed, while overall profit margins have fallen for both European and American companies, European firms have been willing to accept lower profit and productivity in the short term.

But that does not mean companies on the Continent have fallen behind in innovation, experts say, especially when it comes to green technology, despite increasing pressure from China.

Instead, Europe relies on its large companies to maintain a cutting edge in key industries, a sharp contrast to the American pattern of turning to newer, smaller companies to drive innovation and create jobs.

"The large incumbents in Europe, which might have been considered technological laggards, have used green technology and sustainability as a core new element of growth," said Luc Soete, a professor of international economics at Maastrict University, in the Netherlands.

They are also remarkably resilient. The Siemens factory added 500 workers here during the depths of the economic crisis last year, beginning production of new gas-burning turbines that are the most powerful Siemens makes but emit substantially less carbon dioxide than older models.

Barbara Kux, the chief sustainability officer at the company, points to the state-of-the art products made by the century-old factory as an example of green innovation.

"It's part of sustainability and it shows you think long term and are there to stay," she said. "It gives you the chance to keep experienced people, to keep their knowledge in-house and develop a high level of loyalty and trust so they feel like part of a family rather than just doing a job."

The varying responses to the economic downturn come amid a fierce intellectual debate in the United States about whether the country is headed toward a more European economic model, given Washington's nationalization of big banks and intervention in the auto industry, as well as President Barack Obama's proposal to overhaul the health care system.

"The end result would be an America much closer to the European model of a social-welfare state, which prioritizes cohesion over innovation," warned a recent article in National Affairs quarterly by Jim Manzi, a former software executive who is now a senior fellow at the Manhattan Institute, a conservative research group.

While unemployment has soared into the 20 percent range in hard-hit countries on the periphery of Europe like Spain and Latvia, the relative success of other European countries in avoiding deep job cuts adds a new wrinkle to a long-standing trans-Atlantic argument.

When it comes to jobs, the most powerful political issue in the United States today, "companies in Europe are probably much more aware of the social limits in which they operate," Mr. Soete said.

The overall European unemployment rate of 10 percent matches that of the United States, but northern and central Europe have fared much better, with joblessness at 4 percent in the Netherlands and 5.4 percent in Austria, for example.

Germany's economy contracted by 5 percent last year, yet its unemployment rate of 7.5 percent is actually down from where it was two years ago. By contrast, the U.S. economy shrank 2.4 percent last year as unemployment doubled to 10 percent over the period.

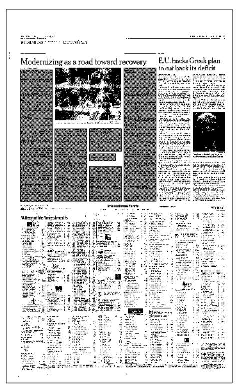
The ability of the German economy, the biggest in Europe, to stanch job losses despite a markedly deeper recession than in the United States is "something of an economic miracle," contends Jorg Kramer, chief economist for Commerzbank in Frankfurt.

Much of the attention on saving jobs has focused on the government's short-work program, in which taxpayers and companies share the cost of furloughing workers. But Mr. Kramer said the government-financed program of shorter work weeks, or Kurzarbeit, was responsible for saving only about 20 percent of jobs.

"Half of this miracle can be explained because firms allowed workers to do less; they tolerated a 2.5 percent drop in productivity," he added. "You can either cut workers or cut hours."

In the more flexible U.S. labor market, where industrial unions are weak and contracts far less rigid, companies responded more often by letting workers go, sharply cutting costs and preserving profit margins.

German companies not only reduced hours on the job, they also made a de-



La modernizzazione come strada verso la ripresa (fo) cision to accept lower profit margins in the short term, Mr. Kramer said, a practice he called "labor-hoarding."

In Germany, profit margins have fallen from 6.26 percent in the first quarter of 2008 to just 0.58 percent in the latest quarter, according to Thomson Reuters Datastream. Similarly, French profit margins have dropped from 6.5 percent to 1.2 percent. By contrast, corporate profitability in the United States have shrunk from 7.8 percent to 3.6 percent.

The choices may have fateful consequences. As the recovery picks up steam, European competitors will be well situated to take advantage of new growth opportunities while American companies are required to rebuild their work forces.

But if the fears of a "double-dip recession" turn out to be true, the leaner profile of big U.S. companies could help them hold up better in a renewed downturn.

Whatever the outcome, European experts say that the varying strategies of companies during the financial crisis, and the different ways they treated their workers, ought to prompt a revision of the traditional American view that Europe's social democracies are condemned to slow growth and high unemployment.

"It's not true that there is a correlation between how much you spend on social policy and welfare and economic growth," said Paolo Guerrieri, a professor of international economics at the University of Rome I.

"The best performing group — Denmark, Sweden, Holland, Germany — are exactly the kind of countries that shouldn't be doing well according to the U.S. stereotype of high taxes and high welfare benefits."

Siemens is an example of the kind of European company that is leading the way.

Although its global work force has shrunk over the past five years as it exited businesses like telecommunications and auto parts, that has not stopped it making advances in facilities like its Berlin factory, even if the setting resembles Fritz Lang's 1927 film "Metropolis."

The 163-year old company spent €500 million, or $700 million, to develop the new turbines being built at the Berlin factory as part of a push into green technology, which it broadly defines to include low carbon-dioxide-emitting turbines and locomotives, solar paneling and wind technology, as well as air and purification equipment.

With revenue increasing 11 percent from 2008 to 2009, Siemens' broad green portfolio is now growing faster than the company's other businesses, Ms. Kux added.

And it managed to save its customers an estimated 210 million tons in carbon dioxide emissions last year, the equivalent of the amount generated by New York, Tokyo, London and Berlin put together.

"The global economic crisis has actually allowed us to increase our green advantage," she said. "It's an opportunity to jump ahead, cut costs, and improve our own resources."