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Convergence of Production, Investment and the Reduction of Imbalances

Despite all efforts to continuously remove borders, there are still some between the Member States of the EU. From a generalist point of view, further promoting cohesion and getting single economies to converge towards their best performing peers could unleash great economic potential. In this respect, special attention should be paid to the convergence of Central, Eastern and Southeastern European countries not only because they are close to Austria but also because there is still great potential to be reaped for the economic area. In the end, it is the political integration of the Member States which will lead to sustainable economic cohesion. However, there are recently contrary political developments like the Brexit which show that some Member States are refocusing more on national interests than on common targets of the community. This political divergence will inevitably induce an economic drifting apart between Member States, which will directly lead to further economic imbalances.

Why is political integration a crucial factor for investment decisions that industrial companies, like voestalpine, have to take? Why is the opinion of industrial companies about political integration important?

The influence of industrial companies on the economic performance of countries is substantial. The direct and indirect effects of a company's output amount to two to three times higher figures than their actual standalone output. This is the case because the production of these industrial companies simultaneously induces production at suppliers, services and consumption. In addition, investment leads to innovation which is in turn an important driver of productivity. Therefore, it can be stated that investment itself raises the country's attractiveness for further investment. This in turn enhances the divergent development of the economic performance of countries and regions, since investment and engagement in R&D represent long-term drivers of economic development and sustainable growth.

From an industrial company's point of view, differences between European countries are decisive for choosing a future location. Therefore, Member States defining their economic and political framework conditions are seen to be in competition to each other trying to attract a company's investment. It is not the competitive situation at the moment, which counts for the companies willing to invest. Far more important are the expected future circumstances which need to be considered before investing. The CESEE region for example outperformed other locations by offering labor in the manufacturing sector at comparatively low cost in the past. This was one of the major drivers why industrial companies started to invest in local productions. However, in respect to labor cost the CESEE region is not only competing within Europe but with all world regions. Since convergence between countries is increasing in the long-term the advantages gained by differing wage levels might disappear someday. How long will it take until a high level of convergence in labor cost is finally reached and the advantages disappear?

For an industrial company there are different aspects which are crucial for taking decisions concerning the location of operation or investment. The cost of labor is not the single decision criteria anymore. Investment is bound to a location, has to pay back and can only be evaluated in the long term, which means in a time horizon of about 10-20 years. For this reason long-term decision criteria are weighting most heavily.

The tax environment, financing conditions or the situation concerning subsidies in a country are surely considerable factors for choosing the right location for an investment. Nevertheless, these are economic factors which can easily change for political reasons in the medium or even in the short term. This implicates a certain planning risk for an investment. Such topics will for sure affect the calculation of the investment and, therefore, make it more or less profitable. Finally, they will not be of crucial importance for the investment decision because a change of the current tax, financing or subsidy situation can never be completely excluded.

So, what are the crucial long-term criteria for an investment decision of an industrial company? As stated before it cannot be labor cost or the tax or subsidy situation solely, this would make investing in a country like Austria not favorable. Recent decisions are showing that this is not the case.

First of all, demographics and the educational situation in a country are two of the main aspects when it comes to evaluating the potential of a region. The demographic situation is directly connected to potential demand growth in a country. The presence of sufficient skilled labor is the foremost important production factor; even more in times of value chains getting more complex and interconnected. These parameters are directly affecting the operations and, therefore, the performance of the investment. Moreover, subjects like education have to be assessed in an absolute long-term perspective because implementing desired changes in this context takes an enormous amount of time.

Secondly, companies that are willing to invest are looking for politically stable surroundings. In this respect, it is not exactly the stability of the government itself that is decisive. An authoritarian leader can create a stable situation within the government, but this is no substantial evidence for the quality of the political decisions that are taken. It is noticeable that the quality of the governments is widely differing between EU Member States. Issues like corruption, a lack of transparency, erratic legal or official restrictions or, more generally, an insecure business environment makes investment unattractive. This is the case because countries having such administrative problems are in need of structural long-term reforms. Moreover, the local government needs to be able to put those reforms into practice and change the business culture and ethics of a country. One can also question whether an authoritarian style of leadership could induce a worsening of transparency and, thus, of business environment. In my opinion, the quality of the government and its general attitude towards the EU are the most important, long-term criteria for an investment decision.

To sum it up, investment by industrial companies is vital to the economic development within the EU. The relevant decision criteria are those which are unlikely to change in the long-term, like administrative structures, governmental quality or the educational system. From the industry's side, countries which engage in installing such stable business surroundings are making a diligent calculation of future investment possible and should be rewarded. Therefore, the crucial, final question is: Which means or measures does the European Union have to support Member States in promoting stable and qualitatively valuable governments?