

Global production patterns from a European perspective: insights from a survey of large euro area firms

In the aftermath of the Great Recession, global trade growth has remained exceptionally weak, barely increasing as a ratio of world GDP. These developments represent a marked change compared with the strong growth in global trade seen in the preceding decades. Various explanations have been suggested for the protracted period of below-average trade growth seen over recent years, covering both short-term, cyclical and longer-term structural factors (see Box 1 in this issue of the Economic Bulletin).

Table

Summary statistics from the survey

Sectoral decomposition	Number	%	Share in EEA business sector value added
Industry, including construction	25	(57%)	51%
Services	19	(43%)	49%
			Share of total EEA business economy
Employment (thousands)	2,193		1.6%
Revenue (EUR million)	607,785		2.1%

Sources: Eurostat, trade survey and ECB calculations.

Note: Business sector excludes agriculture, forestry and fishing, and non-market services (including public sector).

This box reports on the drivers of recent global trade and production developments from an ad hoc survey of leading euro area businesses.²² The table summarises the breakdown of the 44 participating firms. 25 of the responses came from the broader industrial sector (including construction), and 19 from the services sector. Together, these large and often multinational companies employed around 2.2 million persons and their turnover amounted to over €600 billion, which equate to around 1.6% of total 2013 European Economic Area (EEA²³) employment and about 2.1% of 2013 EEA turnover respectively.²⁴

Respondents highlighted fast-moving technological developments, demand concerns and labour market issues as the main global challenges that their sectors are faced with at the present time (see Chart A). Almost half of respondents cited technological advances due to rapid digital progress among the three main global challenges that their sectors currently have to contend with. Firms reported that there had been an impact on all aspects of operations – from ways of reaching customers (e-commerce) to data protection issues, price and cost implications, and effects that enhanced technologies have on the location of production/operations and logistics. Demand concerns – globally and within the EEA – were cited by just over a third of respondents, which was the same proportion that mentioned labour market challenges (concerns about relative European labour costs in particular, as well as wider labour supply constraints and skill needs). A quarter of firms highlighted changing patterns of global consumption and issues related to geopolitical instability (including concerns surrounding commodity price evolutions and the potential impact that terrorism could have on activity) among their main global challenges.

²² The survey was carried out in the spring of 2016.

²³ The EEA comprises the European Union and also Iceland, Liechtenstein and Norway. Although not a member of either the European Union or the EEA, Switzerland was included in the survey because it has access to the Single Market under the same terms as other EU businesses.

²⁴ Taken from Eurostat's structural business statistics (SBS), available for the EEA up to 2013 only.

Manufacturing firms in particular also highlighted the existence of trade barriers – including local content regulations, tariffs and customs duties, and the rise in less formal barriers (so-called “murky protectionism”) – as major concerns and impediments to economies of scale. Firms operating across several geographical jurisdictions highlighted the difficulties posed by the increasing incidence of “double” corporate taxation. In addition, respondents highlighted growing global competition in product markets, changing customer preferences and commodity price volatility as ongoing global challenges for their sectors. Financial constraints and concerns about maintaining access to finance were hardly mentioned.

Chart A

Main global operational challenges at the present time

(percentage of responses, ranked from most frequently cited)



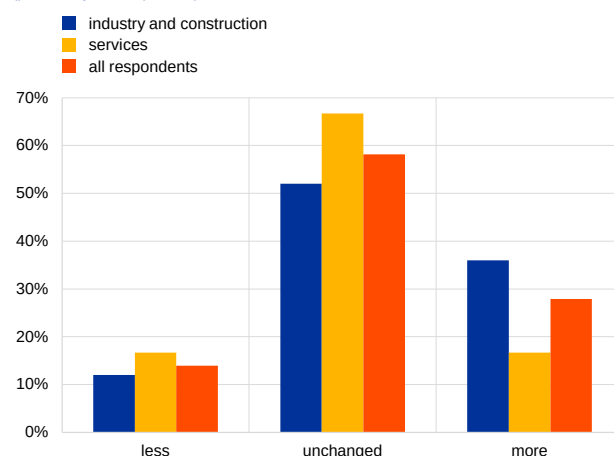
Sources: Trade survey and ECB calculations.

Notes: Responses to question: “What are the three main global operational challenges in your sector at the present time? Please list at most three factors and briefly explain why these are important.”

Chart B

Changes in local production over past five years

(percentage of responses)



Sources: Trade survey and ECB calculations.

Notes: Responses to question: “Over the past five years, has it become more or less common for companies in your sector to produce/operate in the local markets in which goods and services are sold?”

The survey suggests that localisation of production closer to final markets has slightly increased over the past five years (see Chart B). Although most firms reported no changes to global production patterns over the past five years, just over a quarter of respondents reported having relocated production or service operations. Both changing global patterns of demand and high labour costs were cited as important factors driving operations out of the EEA. Local content requirements were also mentioned as an important driver. Other factors impacting on relocation decisions related to a desire to hedge against currency fluctuations, capacity constraints within the EEA, excessive regulation, and economic and political uncertainty.

Changes to global production patterns continue to reduce demand for EEA labour.

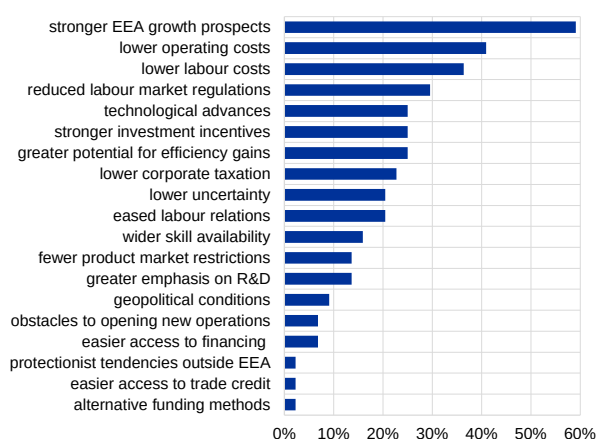
Roughly twice as many firms considered that changes in global trade patterns had reduced demand for EEA labour in their sector as compared with those who saw increases. Declines were particularly strong among “blue collar” operatives (both in industry and services); however, demand was reported to have increased somewhat among the higher skilled occupations (including production technicians and supervisors or those in R&D and product design functions).

Relocations were rare, as new markets were typically served by additional plants. Where they occurred, however, moves have often focused on relocating either within the EEA (particularly into lower-cost central and eastern European countries from higher-cost west European economies, as cited by a third of those relocating) or, to a lesser extent, to countries outside the EEA (cited by around a quarter of relocators). Only a handful of respondents reported having relocated back into the EEA from outside. Relocation incentives by some EEA governments and tendencies towards centralisation of administrative and headquarter functions – usually, in the pursuit of cost containment – were reported to have incentivised relocations back into the EEA.

Chart C

Factors likely to encourage more EEA production

(percentage of responses)



Sources: Trade survey and ECB calculations.

Notes: Responses to question: "Which of the following would be most likely to encourage firms in your sector to increase EEA production/operations in the medium term?" Respondents were requested to give a maximum of five elements.

Raising European production would require stronger growth prospects, stronger cost containment and additional policy measures, according to survey respondents (see Chart C).

Chart C summarises the responses to a question requiring respondents to select five factors most likely to encourage firms in their sector to increase EEA production/operations in the medium term. Priorities were similar across both the industrial and services sectors. More than half of all firms cited stronger growth prospects as an incentive to raising European-based production. Many emphasised the drive for further cost containment, via increased emphasis on technological advances and efficiency gains, as a vital means of restoring competitiveness and boosting profitability in a low-growth environment. Further policy measures to reduce operating costs – in particular, labour costs – and liberalise labour market regulations were emphasised as policy priorities by around a third of firms.²⁵ Just over a fifth of companies stressed the need

for stronger investment incentives, reduced corporate taxation and fewer product market restrictions. Ultimately, the priorities for national policymakers will need to take account of local business environment conditions and a country's position in global value chains along with its comparative advantages. Nevertheless, the results from this survey suggest that, in the view of the firms who took part, high labour and operating costs as well as strong labour market regulation are likely to impact firms' location decisions.

²⁵ Similar sentiments were also raised in an earlier survey in respect of raising euro area investment. See the box entitled "What is behind the low investment in the euro area? Responses from a survey of large euro area firms" in the December 2015 issue of the ECB Economic Bulletin.