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Industrial Policy: Reinforcing competitiveness

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1. INTRODUCTION

The EU economic recovery from the crisis has been relatively slow and remains fragile. Kick-starting the economy and higher growth are necessary to create jobs and wealth, and essential to get the public finances of the Member States onto a sustainable path. The difficult fiscal environment sets limits to policy action, but robust growth will reduce the burden of public deficit and debt, in line with the goals of the Stability and Growth Pact[1].

The main drivers of strong economic growth are competitive firms of all sizes. For this they require an environment that favours new ideas and new businesses. This Communication identifies the following areas as necessary to make significant progress towards the Europe 2020 goals: (1) structural changes in the economy; (2) the innovativeness of industries; (3) sustainability and resource efficiency; (4) business environment; (5) the single market; and (6) small and medium-sized enterprises.

Rising to these challenges can improve the competitiveness of European firms both internally and globally, and the Commission aims to help the Member States to use their limited resources smartly in order to increase the global competitiveness of their industries. Addressing these challenges will improve the growth prospects of all enterprises, whether industry, services or socially oriented.

European industry is of critical importance for the EU as a global economic leader. A competitive industry can lower costs and prices, create new products and improve quality, contributing thus decisively to wealth creation and productivity growth throughout the economy. Industry is also the key source of the innovations required to meet the societal challenges facing the EU.

As part of the *Europe 2020* strategy, the Commission launched in 2010 an ambitious new industrial policy[2] that highlighted the actions needed to strengthen the attractiveness of Europe as a place for investment and production, including the commitment to monitor Member States' competitiveness policies. It also outlined a renewed trade policy.

The fragility of the recovery is reflected in the sentiment that has worsened across the European economy[3]. There are clear downside risks stemming from financial markets, rising energy and raw materials prices, and the need for budgetary consolidation. EU labour productivity is now 1.4% above, but jobs in industry and industry-related services are 11% below the 2008 peak. This average hides great divergence between Member States. Compared with its major competitors, the EU relative unit labour costs improved by 12% since 2008, mainly due to the exchange rate effect.

However, European manufacturing has picked up better that expected. In the second quarter, manufacturing production was 5.3% higher than a year ago although it did not grow from the previous quarter. Manufacturing output is now some 14% higher than its trough in early 2009 but still 9% below its peak in early 2008.

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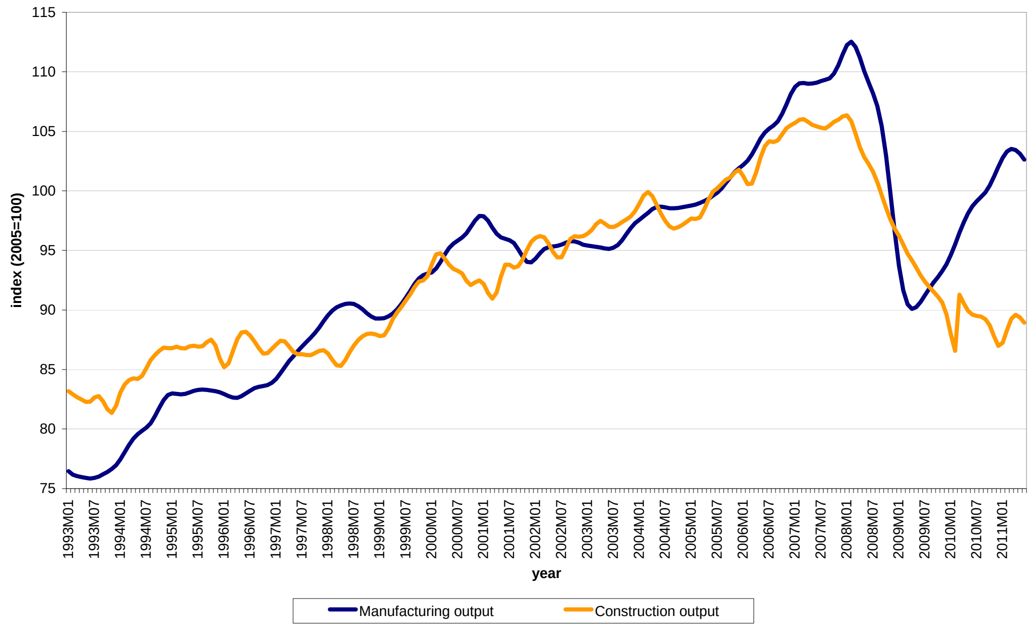
1. http://ec.europa.eu/economy_finance/sgp/index_en.htm
2. An Integrated Industrial Policy for the Globalisation Era. Putting Competitiveness and Sustainability at Centre Stage, COM (2010) 614.
3. http://ec.europa.eu/economy_finance/db_indicators/surveys/index_en.htm

EU27 production indices 1993 – 2011 (trend adjusted)



Source: Eurostat

This Communication is a new yearly initiative that looks specifically at the competitiveness of the Member States, based on the *European Competitiveness Report 2011* and the *Member States' Competitiveness Performance and Policies.* It will contribute to the evaluation of the Member States under the broader framework of the European semester and Europe 2020. More detailed arguments and EU actions are laid down in the documents accompanying this Communication.

2. IMPROVING INDUSTRIAL COMPETITIVENESS

2.1. Industrial change

Looking back to the **longer-term changes** in the industrial structures of the Member States in 1999-2007, industries have followed different paths towards higher technology or higher skills industries that tend to have higher productivity growth and their prices have suffered less from global competition. For analytical purposes the industrial structures of the Member States can be looked at based on similarities in character and trade trends, although this can still mask substantial differences within each group.

In the first group of countries, the industrial structure is dominated by technologically advanced sectors. A key development in this period has been that the specialisation of this group in technology-driven industries and sectors with high innovation or high education intensity increased further. The countries in this group are Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Netherlands, Sweden and the United Kingdom. The value added contribution of industry varies from 10.6% in France to 24.2% in Ireland.

The second group includes countries with industry specialisation in less technologically advanced sectors, despite the presence of some highly competitive industries. The prevalence of labour intensive industries, low innovation and relatively low knowledge intensity lead to fewer high-growth firms, at least compared to the first group of countries. The countries in this group are Cyprus, Greece, Italy, Luxembourg, Portugal and Spain, with industry value added varying from 6.5% in Luxembourg to 16.1% in Italy.

The third group comprises countries that are catching up in terms of GDP per capita, and whose trade specialisation is in high-innovation intensity sectors and technology-driven industries. They have achieved a structural change from labour-intensive industries towards technology-driven industries on both production and trade. The group consists of the Czech Republic, Hungary, Malta, Poland, Slovakia and Slovenia, with industry value added between 13.3% and 23.6% of the total.

The fourth group of countries are those that are catching up, but with trade specialisation in technologically less advanced sectors. These countries resemble those of the second group with which it also shares the trend towards sectors with higher educational intensity. However, a major difference is the much stronger than average presence of high-growth firms in this group, and the large increase in industry and trade specialisation in technology-driven industries. This group consists of Bulgaria, Estonia, Latvia, Lithuania and Romania, with industry value added between 9.9% and 22.4%.

Within each group of countries there are competitive industries and growing firms. To boost competitiveness it is necessary to move towards innovative, knowledge-based sectors, decisive actions to facilitate change by improving product market regulation, supporting innovation and investing in education and training throughout the lifecycle are necessary.

2.2. Innovative industry

Research and innovation drive productivity growth and industrial competitiveness. New technologies make it possible to produce commercially at ever smaller volumes and advanced materials, low-carbon technologies, biotechnology and nanotechnology are changing the nature of competitive advantage. EU industry must accelerate its efforts to adopt these technologies to keep its competitive edge in the world.

The recent report on Key Enabling Technologies[4] highlighted the need to invest in industrial innovation to **bridge the gap between basic research and markets.** An integrated approach to bringing new products and services to the market should include support for demonstration projects and pilot test facilities as well as specific measures in terms of state aid, regional cohesion and trade policies. Incentives are needed for researchers at universities to commercialise their research and to collaborate with industry. Customer needs and market potential should be considered from the start of research and innovation funding, and potential outside investors should be brought in early. Support for the development of more innovation friendly markets can be achieved

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4 http://ec.europa.eu/enterprise/sectors/ict/files/kets/hlg_report_final_en.pdf

through demand side measures, such as smart regulation, customer information, standardisation or increased public procurement of innovative solutions.

All this requires **additional skills and competences** e.g. in marketing and management. In general, an entrepreneurial and better-trained workforce contributes to productivity growth, but the Member States have made only variable progress in investing in human capital. A particular problem is that although EU unemployment continues to be relatively high, some firms are facing increasing difficulties in recruiting qualified staff.

Although many Members States have taken steps to intensify their support for research and innovation, to ensure the most efficient use of limited resources they should **reduce the fragmentation of support schemes**. Widely used measures include loan schemes for technology investments, access to funding for key enabling technologies and grants for technology upgrading (Germany, France, Sweden, Italy, Portugal, Slovenia). Some have set up innovation support services and backed the emergence of clusters (Denmark, France, Germany, Poland, Sweden, Belgium).

However, there is little alignment of investments between Member States for supporting the uptake of innovative technologies. A **greater coordination and pooling of national resources** would allow mobilising them around common goals and provide improved innovation capacities and appropriate critical mass of funding, increasing the efficiency and effectiveness of investments. Large scale demonstration projects and pilot test facilities located around Europe (e.g. in the context of the European Innovation Partnerships or the Strategic Energy Technology Plan) could help companies to test and create prototypes quicker. Time to market of new products and services could be considerably shortened by enhanced transnational cooperation between clusters and networks, and improved knowledge of manufacturing capabilities.

A modern intellectual property regime will protect the initial innovator without hampering further developments of existing ideas. The unitary EU patent currently being negotiated among Member States will significantly improve the framework while reducing costs for patent applicants.[5]

Competitiveness would be strengthened by:

- Pooling scarce resources to help to achieve critical mass in bringing innovation to the market; and by increasing cooperation in innovation to create large scale demonstration projects and pilot test facilities, for example using the model of the European Strategy Forum on Research Infrastructures (ESFRI).

- Reducing the fragmentation of innovation support systems, facilitating bringing innovative solutions to the market, and increasing the market focus of research projects. Denmark and Austria have successfully reduced the fragmentation and the United Kingdom has schemes to bring innovative solutions to the market.

[5] Proposal for a Regulation of the European Parliament and of the Council implementing enhanced cooperation in the area of the creation of unitary patent protection. COM(2011) 215 final, 13.4.2011.

2.3. Sustainable industry

A transition towards a sustainable, resource efficient and low carbon economy is paramount for maintaining the long-term competitiveness of European industries. During the last decade the economies of many Member States have grown without an increase in energy consumption, while in others the increase has been less pronounced than expected. In particular, the new Member States are catching up fast, despite their different starting points.

Overall, Member States have made significant progress in defining and implementing consistent national legislative frameworks for stimulating energy efficiency. However, some lack the experience and the administrative capacity to do this and for these countries the framework legislation at the EU level can provide guidance and support.

In spite of the progress made, rising world market prices for energy and national distortions have been reflected in higher prices for enterprises, in particular for SMEs. The energy and resource-intensive process industries such as metals, chemicals, and paper and pulp face specific challenges. In order to facilitate the transformation towards more sustainable ways of production, a coherent and effective mix of policies could include measures to support research, innovation, resource efficiency and deployment of cleaner technologies, especially in process industries.

Member States have designed support schemes for improving the energy efficiency of industry, in most cases accompanied by energy audit schemes (Austria, Belgium, Bulgaria, Czech Republic, Finland, Germany, Portugal, Slovakia), or have pursued voluntary agreements with industries (Denmark, Greece, Netherlands, Slovenia, UK). The *Strategic Energy Technology Plan*[6] seeks to accelerate the development of low carbon energy technologies and to bring them more quickly to the market. Some positive developments concern targeted interventions for supporting energy performance by SMEs (Greece, Ireland, Lithuania) although more could be done.

Access to non-energy, non-agricultural raw materials is another essential factor for the competitiveness of EU industry. The high and fluctuating prices for these raw materials, and their location mostly outside the EU poses risks to many firms and both the EU and the Member States – complementing EU's external policies – should design policies that address the scarcity of primary raw materials by exploiting European resources in a sustainable way; supporting research and innovation with the aim of generating alternative solutions; increasing resource efficiency; and promoting better recycling techniques on a wider scale, including for valuable materials used in small quantities.

The further integration of environmental and social issues into business operations and strategy is increasingly important to the competitiveness of European industry. The *Roadmap to a Resource Efficient Europe*[7] contains a set of actions at EU level and recommendations for Member State action to tackle the unsustainable use of resources.

Competitiveness would be strengthened by:

6 http://ec.europa.eu/energy/technology/set_plan/set_plan_en.htm
7 Communication "Roadmap to a Resource Efficient Europe", COM(2011) 571 final, 20.09.2011

- Favouring energy and raw material efficiency and promoting innovation and deployment of cleaner technologies along value chains with the use of long-term incentives that encourage market creation and facilitate the participation of SMEs in these processes. As outlined above, many Member States have made considerable progress with these issues.

- Ensure fair and undistorted pricing of energy, and continue to work on upgrading and interconnecting energy distribution networks.

Developing social entrepreneurship, social businesses and the social economy is another important tool for strengthening the competitiveness and the sustainability of the European industry.

The social economy employs over 11 million people in the EU, accounting for 6% of total employment[8] and approximately one in four businesses founded in Europe is a social enterprise. This figure rises to one in three in Belgium, Finland and France[9]. These companies are often highly productive and competitive, due to the very high level of personal commitment on the part of their employees and the better working conditions that they provide[10].

In order to reinforce a 'highly competitive social market economy', the Commission has placed the social economy, social responsibility and social innovation at the heart of its concerns for new solutions to a more sustainable economy, under the Europe 2020 strategy[11], the flagship initiative 'The Innovation Union'[12], the European Platform against Poverty and Social Exclusion[13] and the 'Single Market Act'[14] (SMA).

The public consultation for the SMA[15] revealed a high level of interest in the capacity of social enterprises and the social economy in general to provide innovative responses to the current economic and social challenges by developing sustainable jobs.

The Commission is therefore willing to launch an important debate on means to develop this new kind of economy and a first step will be achieved in some weeks with the Social Business Initiative Communication and the Corporate Social Responsibility Communication which will present key actions for promoting social business.

Competitiveness would be strengthened by:

- Favouring and promoting social entrepreneurship in Europe, in particular in

8 CIRIEC 'The Social economy in the European Union' page 48

9 Global entrepreneurship Monitor, Executive report 2009

10 For example, in France, absence due to sickness is significantly less than in companies in general: 5.5% as opposed to 22%, 'Absence from work for health reasons in the social economy', Chorum, April 2011, http://www.cides.chorum.fr

11 Europe 2020 – A strategy for smart, sustainable and inclusive growth, COM(2010) 2020

12 Communication on the Innovation Union COM(2010) 546 final, 6 October 2010

13 Communication on the 'European Platform against Poverty and Social Exclusion: a European framework for social and territorial cohesion' COM(2010) 758 final of 16 December 2010

14 'SMA – Twelve levers to boost growth and strengthen confidence', COM(2011) 206 final of 13 April 2011

15 http://ec.europa.eu/internal_market/smact/consultations/2011/debate/index_en.htm

enhancing its public profile and its access to public and private finance (especially through Social investment Funds).

3. TOWARDS A MORE BUSINESS-FRIENDLY EUROPE

3.1. Business environment

An open, efficient and competitive business environment is a crucial catalyst for growth in a global context. Improving the business environment covers policies in areas ranging from improving infrastructure to shortening the time needed to obtain a building license.

While all Member States have adopted national targets for **reducing administrative burden**, not all of them have made progress in measuring the current burden or proceeded to cut it. In 18 Member States impact assessments for new legislative proposals are mandatory, albeit not all of them comply with the requirement, and impact assessments are not always comprehensive in terms of economic, social and environmental aspects, limiting their effectiveness.

The high quality and availability of **infrastructure** (energy, transport, and broadband) make an important contribution to a business-friendly environment. Given that improving the transport infrastructure is a major challenge especially in the new Member States, significant investments for rebuilding and modernisation should continue, including with the support of Structural Funds and the Connecting Europe Facility.

Businesses need a **modern public administration,** able to deliver efficient and high quality public services. Reforms should emphasise e-government initiatives like unified service centres for the public, shared networks and data centres. Many e-government initiatives also allow enterprises to spend less time on administrative procedures and devote more resources to business opportunities. E-procurement must in this regard be promoted to the widest extent possible. Making available well-performing one-stop-shops (so-called "Points of Single Contact") to businesses seeking to operate across borders is also key to saving time and resources, and to reduce the room for corruption. While considerable progress has been made, there is still room for improvement.

An important area providing scope for improvement is the **taxation** of businesses. While the overall effective corporate tax rate and the balance of taxes on labour as opposed to resource use are issues where further reflection is needed at the EU and Member State levels, the reduction of compliance burden deriving from taxation can greatly improve the business environment. This implies increasing transparency and reducing the complexities of tax codes and compliance regulations, simplifying payment procedures, including through the use of e-government, and ensuring the stability of taxation legislation. The Commission proposal on a Common Consolidated Corporate Tax Base is an important step forward.[16]

Competitiveness would be strengthened by:

[16] Proposal for a council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM (2011)121 of 16.03.2011.

- Reducing the administrative burden on businesses by evaluating the current burden (including that due to the tax code) and rapidly reducing burdens to targets. For example, the Netherlands has been a pioneer in measuring and evaluating the reduction of administrative burden and in setting ambitious targets, resulting in a globally recognised efficiency.

- Promoting competition among service providers that use the infrastructures in broadband, energy and transport.

3.2. Promoting industry and services

Services are the largest part of the EU economy and their integration with manufacturing has grown as specialised services are used to manage the production and product distribution processes. Manufacturing firms have started to offer services packaged with products and service providers use complementary products and integrate manufacturing within their value chain.

Service innovations that address customer needs can transform value chains, sectors and markets[17] irrespective of whether they come from service or manufacturing firms. The importance of **business-related services** is growing as a source of innovation, new technology and improved performance. These services have become integrated in the value chains of other industries by means of intermediate consumption, knowledge production and technology flows, which represents an opportunity for the European manufacturing sector to open up new markets and find new sources of revenue around their products.

The Single Market could contribute more to growth if all the European legislation currently in force was fully implemented by all Member States. The goal is to put an end to market fragmentation and to eliminate barriers to the movement of goods, services, innovation and creativity as noted in the Single Market Act.[18] The proposed Regulation on European Standardisation[19] has extended European standards setting to the services sector to reduce multiple and conflicting national standards.

Intra-EU trade in services lacks dynamism as it represents only one-fifth of total intra-EU trade. Since 2004, trade in services between the EU and the rest of the world has been growing faster than intra-EU trade. The implementation of the Services Directive[20] has been a critical milestone, although the recent mutual evaluation process[21] has identified a number of areas that still need improvement.

Competitiveness would be strengthened by:

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17 http://www.europe-innova.eu/web/guest/innovation-in-services/expert-panel/about

18 Single Market Act. Twelve levers to boost growth and strengthen confidence - "Working together to create new growth", COM(2011) 206 final, 13.4.2011.

19 Proposal for a regulation of the European Parliament and of the Council, COM(2011) 315 final, 01.06.2011

20 Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market.

21 “Towards a better functioning Single Market for services – building on the results of the mutual evaluation process of the Services Directive”, COM(2011) 20 final, 27.1.2011.

- Developing support for innovative services based on measureable outcomes; and by participating in the Innovation Partnerships and in large-scale demonstration projects.
- Fully implementing the Single Market legislation, in particular the Services Directive and promoting business services. Malta is leading in transposing Single Market legislation with only two directives awaiting transposition.

3.3. Small and medium-sized enterprises

To fully unleash the potential of small and medium-sized enterprises requires coherent actions across the EU in line with the SBA Review Communication.[22] Large, exporting enterprises have been in the forefront of the recovery, but many SMEs still face lack of demand because of time lags, but also because of difficulties in accessing finance and export markets. Among high-growth firms, as measured by employment expansion rates, small firms exhibit higher net job creation rates than larger ones. High-growth firms are found in all industries and in all regions, and tend to be innovative.

The tightening of credit conditions during the crisis has made **access to finance** difficult, especially for SMEs. In response, many Member States have adopted corrective measures such as increasing the capacity of loan guarantee schemes, investing in equity funds and microcredit programmes, and facilitating bank lending through advantageous loan conditions or credit mediators. As access to finance continues to be difficult, further efforts should be made to facilitate the availability of appropriate forms of finance, including loans, equity and their combinations. In addition, the development of specialised finance providers for small businesses, including socially-oriented firms, should be encouraged. As mentioned in the Single Market Act[23], the Commission will adopt before the end of this year a legislative instrument to facilitate the development of Social Investment Funds in the European Union.

Trade promotion by Member States improves the global presence of European firms and most Member States support the **internationalisation of SMEs,** providing finance, information and support on market access and regulation. SMEs that use these services are relatively satisfied, although only 27 % of internationalised SMEs said that they were aware of existing public support measures and 7 % actually used them. These results suggest that the awareness and accessibility of public support could be further improved.

The average payment delays can be very long in some Member States, threatening the survival of small firms. The situation has not improved during the last year, and has even deteriorated in some Member States for payments from public administrations (Czech Republic, Greece, Cyprus, Hungary, Austria, Slovakia). The late payment directive[24] requires payments by public authorities to be processed within 30 days. Meeting this objective will be a challenge for many Member States, but in particular for Greece, Spain, Italy and Portugal.

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22 Review of the "Small Business Act" for Europe, COM(2011)78/3, 23.02.2011.

23 Key action of lever 8 on Social entrepreneurship

24 Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (recast).

Competitiveness would be strengthened by:

- Facilitating the growth of SMEs by ensuring that regulations do not pose obstacles to expansion; by favouring access to appropriate finance; and by providing support services for accessing new markets, and publicising these.

- Ensuring that public administrations reduce payment times and adhere strictly to the Late Payments Directive.

4. CONCLUSIONS

This Communication has argued that to achieve sustainable growth and to kick-start the economy require coherent and coordinated industrial policies from the Member States as well as deep structural changes. A considerable impact can be had by facilitating change, enabling innovation, promoting sustainability, improving the business environment and benefiting from the single market. The implementation of these policies should be a priority in national capitals as it is at the Commission.

A greater coordination of policies at national level can leverage scarce funds to foster innovation and growth in times of budgetary austerity. At EU level, the Commission's proposal for the Multiannual Financial Framework[25] has been designed to prioritise these objectives, strengthening the capacity of the EU to invest in industrial innovation by reducing fragmentation, simplifying rules for beneficiaries and increasing the focus on bringing innovation to the market.

The Commission will strengthen its support for the Member States' efforts within the context of Europe 2020, based on a coherent approach to monitoring progress over time, and providing the necessary forum for identifying good practices.

The Commission will:

- Strengthen the coordination of Member States' industrial policies by promoting and monitoring growth-enhancing structural improvements to achieve the targets of the Europe 2020 strategy.

- By first quarter of 2012 provide a forum for identifying and discussing good practices in promoting growth through industrial policies.

[25] A Budget for Europe 2020, COM(2011) 500 final.