Monthly note

European Commission

Industrial policy indicators and analysis

January 2014

On 22nd January 2014 the Commission has adopted the Communication "For an European Industrial Renaissance".

The 2014 Communication fully endorses the industrial policy approach put forward in the 2010 and 2012 Communications while highlighting the need to take action now in order to assure their full implementation. In particular it identifies seven key priorities for policy guidance:

1. Mainstreaming industrial competitiveness objectives
2. Accessing financial resources to make the industrial renaissance happen
3. Improving the business framework
4. Easier access to critical production inputs
5. Maximise the potential of the internal market
6. Internationalization of EU firms
7. Improving education and training –facilitating mobility

This note is prepared by Directorate General Enterprise and Industry - Unit A4 "Industrial Competitiveness Policy for Growth".

Previous issues are available here:

http://ec.europa.eu/enterprise/policies/industrial-competitiveness/economic-crisis/monthly_notes_en.htm

SPECIAL ISSUE: THE 2014 INDUSTRIAL POLICY COMMUNICATION "FOR AN EUROPEAN INDUSTRIAL RENAISSANCE"

On 22nd January 2014 the Commission adopted the Communication "For a European Industrial Renaissance", in which it invites the Council and the Parliament to take action to pursue the reindustrialisation of Europe and to foster growth and competitiveness.

The 2014 Industrial Policy Communication sets out the Commission's key priorities for industrial policy. It draws on the Annual Growth Survey, provides an overview of actions already undertaken and puts forward selected new actions to speed up the attainment of these priorities.

The Communication shows that industrial policy and other EU policies are getting increasingly integrated, as shown in the flagship industrial policy communication in 2010, but proposes to deepen this mainstreaming process. This communication stresses the importance to work in favour of a good business environment that enhances investment, encourages technological change and stimulates modernisation of the European industry. Such transformation also requires an effort of governance with a focus on anticipation to manage change and winning strategy choices.

The communication details the resources already available for industrial policy (ESIF, Horizon 2020, COSME), provides a credible and consistent rationale for a European industrial policy, and asks all other stakeholders to coordinate for synergies and to grasp the opportunities of collaboration.

1 Introduction

This number of the Monthly note is dedicated to the presentation of the policy priorities and main initiatives outlined in the 2014 Communication.

Section 2 briefly illustrates trends and the impact of the crisis on the industrial sector, as an introduction and basis for the verification of the current state of European manufacturing industry. The following section presents the policy priorities and main initiatives proposed in the 2014 Communication.

2 The current state of the European manufacturing industry

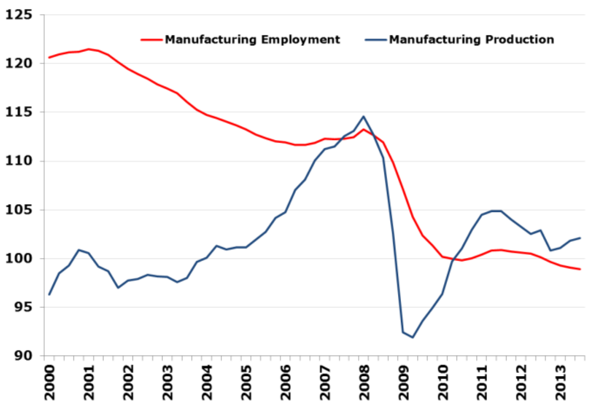
2.1 Manufacturing production

The European Union is emerging from the longest-ever recession. GDP in the EU28 grew by 0.2% in the third quarter of 2013. Positive signs are being registered in business sentiment and confidence indicators suggesting that structural reforms, macroeconomic governance improvements and measures in the financial sector have succeeded in stabilising Europe's economy.

Although the EU is on the right track, the recovery remains modest, with Commission forecasts of 1.4% GDP growth for the EU28 in 2014 and unemployment rates close to 11% for the next two years.

Manufacturing production fell sharply in 2009 and recovery has been slow and partial. Indeed, despite a relative revitalisation in the last months of 2013, production remains well below its pre-crisis peak. Employment in the manufacturing sector also fell sharply after the crisis but has since then returned to its long-term gradual declining trend (figure 1).

Figure 1 - EU manufacturing production and employment (2010=100)



Source: Eurostat

Industry´s recovery has been highly differentiated across Member States and sectors. In several Member States manufacturing production has surpassed its pre-crisis peak whereas in others it is still well below. In general, manufacturing has rebounded more quickly in those new Member States with a relatively large industrial sector compared to the EU average.

2.2 Employment and skills

The crisis created a sharp fall in employment from 2008 to 2010 but for the manufacturing sector this was just an acceleration of a declining trend due to two structural drivers: a) higher-than-average productivity growth in manufacturing, and b) falling share of labour intensive manufacturing in favour of more capital-intensive high value added activities.

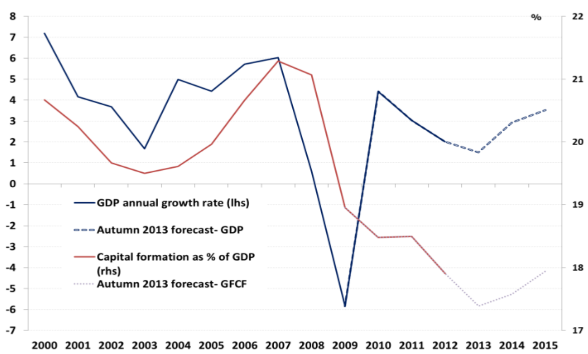
Expanding manufacturing industries increasingly need more skilled employees to keep up with technological change and remain competitive and more sustainable, on the basis of a circular economy approach. Skills mismatch is an issue, with several high-growth sectors struggling to find trained specialists. This is the case in a variety of sectors such as pharmaceuticals, coke and refined petroleum, and computers, electronic and optical equipment.

2.3 Investment

One of the main reasons for the unsatisfactory performance of the EU manufacturing sector is the persistently sluggish behaviour of investment, and in particular the collapse in the construction related investment sectors.

Economic recovery requires investment to pick up, but in the EU investment has stayed well below long-term values apparently unresponsive to policy actions. It is very difficult to identify when investment will rebound and one can speculate about the reasons for the delay. Both high input costs and macroeconomic uncertainties have been identified as influencing factors (figure 2).

Figure 2 - GDP growth and gross fixed capital formation (EU, current prices in euro)

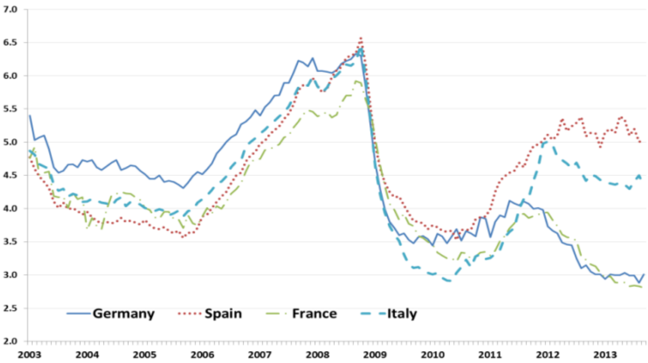


Source: AMECO database and European Commission economic forecasts

2.4 Access to finance

Difficulties in financing investments seem also to be of relevance in most vulnerable Member States, both in the form of high financing costs or quantity rationing. In relation to the former, borrowing has been much more expensive in countries facing greater financial and economic difficulties (e.g. Spain, Italy) compared to others (figure 3).

Figure 3 - Interest rates of new loans to non-financial corporations



Note: Annualised agreed rate (AAR) / Narrowly defined effective rate (NDER); Up to and including EUR 1 million
Source: European Central Bank

The low rate of investment is examined in detail in the DG ECFIN´s Product Market Review[1]. Results showed that in most vulnerable Member States firms' investment rates are lower than what is expected based on fundamentals. This means that for two firms in the same sector, of similar performance, size and indebtedness, investment levels significantly differ depending on whether they are based in a vulnerable Member State (e.g. Italy, Spain, and to some extent Portugal) or not.

A recurrent theme in the policy discussion is whether the decline in bank loans as observed during the economic crisis is driven by reduced demand or by tightening of supply (a so-called credit crunch). Probably both factors affect this situation simultaneously. In order to identify the relative weight of each factor, DG ECFIN´s Product Market Review analysed firms' perceptions on access to bank loans in the EU. The report points out that data allow for a distinction between demand-side (e.g. the firms' needs for bank loans) and supply-side (e.g. the banks' willingness to provide loans) indicators (table 1).

Table 1: Drivers of access to loans

Reduced demand	Tightening of supply
Decreased needs of firms for bank loans Top 4: EE, FI, NL, SK	Firms indicating access to finance as the most pressing problem Top 4: ES, EL, IE, SI
Discouraged borrowers Top 4: EL, IE, LU, NL	Decreased availability of bank loans Top 4: EL, IE, PT, SI
	Decreased willingness of banks to provide a loan Top 4: ES, EL, PT, SI
	Received not all the financing requested Top 4: ES, EL, IE, NL

Source: Product Market Review 2013 using data from SAFE survey

2.5 The single market

Since the establishment of the single internal market in 1992 there has been a steady growth in actual trade in goods between member States. The share of trade in goods as a percentage of EU GDP grew from around 17% of EU GDP in 1999 to close to 21.5% in 2012.

The business environment has improved in the EU overall and particularly in some Member States, yet progress remains uneven: inflexible administrative and regulatory environments, rigidities in some labour markets and weak integration in the internal market continue to hold back the growth potential of firms, especially SMEs[2].

Before the great recession of 2008-2009, intra-EU and extra-EU trade were evolving broadly in parallel, but since then extra-EU trade grew at a much steeper pace than intra-EU-trade.

2.6 Trade

Overall, manufactured products represent more than 80 % of exports in goods and generate a massive trade surplus for the EU (€365 billion in 2012 compared to €125 billion in 2006, nearly a threefold increase), generated mainly by a few high- and medium-technology sectors. They include the automotive, machinery and equipment, pharmaceuticals, chemicals, aeronautics, space and creative industries sectors, and high-end goods in many other sectors, including food. This trend appears to continue in 2013, as in the period from January to July, the EU has achieved a trade surplus in manufactured products of €233 billion (compared to €200 billion in the same period of 2012).

[1] European Commission, Directorate General for Economic and Financial Affairs, Product Market Review 2013, *Financing the real economy*. European Economy, 8, December 2013, chapter 3.

[2] See full details in European Competitiveness Report 2013 'Towards knowledge-driven Reindustrialisation and 'Member states Competitiveness Performance and Implementation of EU Industrial Policy'.

Extra-EU exports have been the main driver of EU growth and of industrial activity since the beginning of the crisis. In a very depressed economic context, net exports have been the most dynamic component of EU GDP growth since 2010, and in fact the only positive one both in 2012 and in 2013[3]. Although EU growth in 2014 and 2015 should become less export-dependent, in view of a slowing down of emerging economies, the fact remains that growth prospects in other regions of the world, and notably Asia, should remain more dynamic in the foreseeable future, therefore providing important business opportunities for the EU industry.

Foreign direct investments greatly contribute to growth and employment in the EU, but while Europe still attracts very important FDI flows estimated at USD 230 billion in 2012, the EU is becoming a less attractive destination of FDI. Its share of world FDI declined from 30% in 2008 to 16.8% in 2012. In the same period, the share of China increased from less than 10% to more than 18%, and emerging economies are playing an increasingly large role as FDI partners[4].

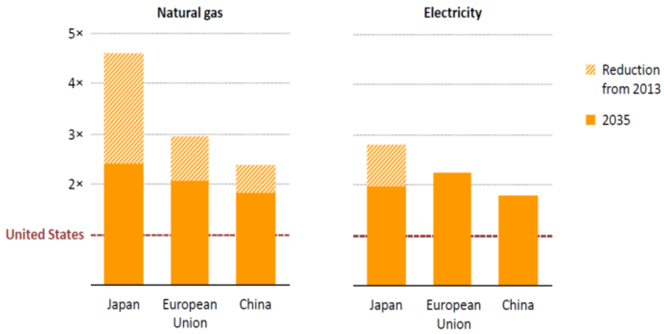
2.7 Energy

Energy costs are obviously particularly important for Energy Intensive Industries (EIIs)[5] that, in addition, are often exposed to international competition and have a strategic positioning along the economic value chain. Simultaneously to the launch of the Industrial Policy Communication, the Commission also presented a communication on Energy Prices and Costs in Europe[6].

Evidence over the last decade is clear about the uneven developments of energy prices across regions and markets and, in particular, about the comparative disadvantages the EU economy and industry players are confronted with.[7]

Striking price differences are certainly more evident with regard to two fundamental energy inputs, i.e. electricity and gas. Widening gaps compared to most of EU direct competitors worldwide have been observed and are expected to stay in the medium-to-long term – in particular following the so-called shale gas "revolution" in the US (figure 4).

Figure 4 - Ratio of industrial energy prices relative to the United States



Source: World Energy Outlook 2013

Implementing solutions to climate, energy and environmental challenges must be compatible with keeping the EU an attractive place for investment, but also with maintaining or even increasing EU competitiveness. The "Climate and Energy package" presented simultaneously with this Communication acknowledges this, and it sets an ambitious target of CO_2 reductions by 2030 (40% compared to 1990) and renewable energy (27% of total supply by 2030). It also maintains existing provisions on carbon leakage and does not set country specific targets for renewable energy. Moreover, attention will be paid on the type of instruments used to minimize the impact on prices of promoting renewable energy.

2.8 Conclusions

The economic importance of industrial activities is much greater than suggested by the share of manufacturing in GDP. Industry accounts for over 80% of Europe's exports and 80% of private research and innovation. Nearly one in four private sector jobs is in industry, often highly skilled, while each additional job in manufacturing creates between 0.5 and 2 jobs in other sectors.

Overall, EU industry has proved its resilience in the face of the economic crisis. It is a world leader in sustainability and returns a EUR 365 billion surplus in the trade of manufactured products (EUR 1 billion a day.

Nonetheless, the legacy of the crisis is severe: since 2008, 3.5 million jobs have been lost in manufacturing; the share of manufacturing in GDP has fallen from 15.4 % to 15.1 % in the last year; and the EU's productivity performance continues deteriorating in comparison to that of our competitors. Internal demand remains weak, keeping intra-EU trade subdued after the crisis and undermining European companies' home base.

Energy issues have gained relevance in the discussions on how to maintain and further develop a

---

[3] European Commission, DG ECFIN, European Economic Forecast, Autumn 2013, table I.2.

[4] OECD FDI in figures, October 2013.

[5] Petrochemicals, fertilizers, primary aluminium, cement, iron & steel, pulp & paper, other chemicals, glass.

[6] Communication "Energy prices and costs in Europe" (COM(2014) 21).

[7] See COM SWD 19 "Energy Price and Costs Report" and Energy Economic Developments in Europe (European Economy 01/2014, DG ECFIN).

solid and competitive industrial base in the EU. Evidence over the last decade highlights the uneven developments of energy prices across regions and markets, and points to an increase of energy price pressure affecting the EU economy as a whole and energy intensive industry players in particular.

3 The Industrial Policy Communication 2014

Europe urgently needs to strengthen the basis for post-crisis sustainable growth and modernisation. To that end, it must send a clear signal of its commitment to reindustrialisation, the modernisation of Europe's industrial base and the promotion of a competitive framework for EU industry.

The importance of the challenges ahead for Europe calls for attention and policy guidance at the highest political level, i.e. the European Council. This is vital to ensure the coherent use of all instruments at the EU's disposal in support of competitiveness. An industrial strategy cannot be put into practice as an industrial stand-alone policy as it has numerous interactions and overlapping effects with many other policy areas.

For this reason, the Commission calls on Member States to recognise the central importance of industry for boosting competitiveness and sustainable growth in Europe, and for a systematic consideration of competitiveness concerns across all policy areas.

Key priorities to support the competitiveness of European industry are:

- *Continue deepening the* ***mainstreaming of industrial competitiveness in other policy areas*** *to sustain the competitiveness of the EU economy as a whole. Particular attention must be paid to increasing productivity in business services, to increase industrial competitiveness, and the competitiveness of the EU economy.*
- ***Maximising the potential of the internal market*** *by developing the necessary infrastructures, offering a simplified and predictable regulatory framework favourable for entrepreneurship and innovation, integrating capital markets, improving the possibilities for training and mobility for citizens and completing the internal market for services as a major contributing factor to industrial competitiveness.*
- *Decisively* ***implementing the instruments of regional development*** *with national and EU instruments in support of innovation, skills, and entrepreneurship to deliver industrial change and boost the competitiveness of the EU economy.*
- ***Accessing critical inputs, and in particular, energy and raw materials, at affordable prices*** *that reflect international cost conditions is vital to encourage investment. Policy instruments for different objectives both at EU and national levels must not result in price distortions. Action should also be taken in the internal market and at international level to ensure the adequate provision of these inputs.*
- ***Integrating EU firms in global value chains*** *to boost their competitiveness and ensure access to global markets on more favourable competitive conditions.*

Finally, the objective of revitalization of the EU economy calls for the endorsement of the reindustrialisation efforts in line with the Commission´s aspiration of raising the contribution of industry to GDP to as much as 20% by 2020.

3.1 Concrete policy initiatives

Mainstream competitiveness

Industrial activities involve interactions with a wide range of sectors that go well beyond manufacturing, from upstream sectors like raw materials and energy to business and consumer services. Moreover, industrial activities are integrated in increasingly complex value chains, linking flagship corporations and small or medium enterprises across sectors and countries.

All policy areas having an impact on competitiveness should take its aspects into account.

An effective implementation implies well-coordinated and consistent industrial policies at regional, national and EU-level.

Use available financial resources

At least €100 billion of European Structural and Investment Funds (ESIF) are at the disposal of regions to finance investments in industrial competitiveness in the six strategic areas identified by the European Commission in 2012. These cross-cutting areas are: advanced manufacturing, key enabling technologies, clean vehicles and transport, bio-based products, construction and raw materials and smart grids.

A relevant part of the €80 billion of the Horizon 2020 Programme is available for taking great ideas from the lab to the market. The integration of industrial and research policy will facilitate more breakthroughs, discoveries and world-firsts and will help make existing industries cleaner and smarter and help Europe lead in the technologies of the future.

The COSME programme counts on an envelope of €2.3 billion to support entrepreneurship. The programme aims at providing direct and counter-guarantees, and, where appropriate, provide co-guarantees and guarantees for the securitisation of SME debt finance portfolios.

The COSME program works side by side with another program of the European Union, the newly launched Horizon 2020. Specifically, while COSME supports all types of SMEs, the Horizon 2020 focuses on the financing of innovative enterprises (SMEs up to those at average market capitalization).

Provide a business friendly environment

Active interactions between firms and clusters are undoubtedly source of potential synergies, enabling access to the innovative technologies and market opportunities. For this reason, and building on the experience of the 6 task forces set up a year ago[8], Member States are invited to combine regional and industrial policy tools to create Smart Specialisation Platforms to help regions roll out smart specialisation programmes which facilitate contacts between firms and clusters.

Under an updated Small Business Act, the Commission will take action and if adequate, propose new legislative measures, to ensure that start-ups in all Member States are able to set themselves up at a maximum cost of €100 and within three days as well as proposing a target of one month to obtain the necessary licences. The Commission will also develop conditions to reduce the duration of court litigation of credit recovery for companies and to give a second chance to honest entrepreneurs and facilitate the transfer of business. The Commission strongly requests Member States introduce the SME Test or an equivalent system in their decision making process and reduce the administrative burden.

There are significant variations in the 28 Member States' public administration's approach towards the private sector. To enable all Member States to tap into the experiences of others, the Commission will present an initiative on Growth-Friendly Public Administration, providing a comprehensive overview of best practices in public administration available across the EU, in particular with regard to e-government tools and public procurement.

Improve the quality of legislation and the regulatory environment to make it fitter, more stable and predictable is key. The implementation of the Regulatory Fitness and Performance Programme (REFIT) and follow-up to the Top 10 regulatory burdens will simplify EU legislation and reduce regulatory burden on businesses.

Cumulative Cost Assessments have been conducted in a number of sectors (steel, aluminium) and will be performed in others (e.g. chemicals and forest-based industries) in an effort to estimate ex-post the joint costs of different strands of national and EU regulations on industrial sectors.

A fitness check of legislation in the oil-refining sector will be finalised in 2014. In the future, the Commission will gradually undertake comprehensive reviews of the competitiveness and regulatory frameworks in each of the main industrial value chains, using fitness checks and cumulative cost assessments.[9]

Facilitate access to inputs

The adoption of the COSME and Horizon 2020 programmes will multiply the financing capacity of public sector funds with equity investments through financial intermediaries, such as venture capital funds and a well-functioning pan European venture capital market. Moreover, European Structural and Investment Funds (ESIF)/the European Social Fund and financial instruments supporting lending to SMEs and small midcaps (cf. COSME, HORIZON 2020) will be available to Member States on a voluntary basis.

Access to raw materials at global market prices is part of our trade policy. Wherever necessary, measures will be proposed to eliminate price distortions that prevent EU firms to have access to key inputs for industry at international market prices.

Industrial competitiveness and energy efficiency remain major objectives of the Union as acknowledged in the Europe 2020 strategy. Different EU policies work to achieve our objectives in the most cost efficient way. For instance, completing a fully integrated internal market for energy and increasing competition in energy markets is important because it will allow industrial and residential users to benefit from lower wholesale prices for energy.

The further development of an efficient pan-European infrastructure for gas and electricity as well as for transporting major feedstock would help reduce transport costs and risks for energy-intensive sectors. Existing pipelines should be linked in particular with

[8] Advance manufacturing, Key enabling technologies, Bio-based products, Clean vehicles and vessels, Sustainable construction and raw materials and Smart grids and digital infrastructure.

[9] In addition, other initiatives are undertaken to facilitate the implementation of regulations in specific areas. For instance, EU waste legislation is under review with a view to make it clear and easily enforceable and to facilitate the recycling of secondary raw materials.

Southern and Eastern Europe to improve synergies between industries from different Member States, and achieve higher energy efficiency across Europe.

The Commission will put in place a strategy for improving education and training systems. Skills mismatches are likely to remain a key challenge for EU industry in the coming years, especially as progress in manufacturing technologies will increase demand for specific skill sets. The Commission is developing the new generation of Erasmus for young Entrepreneurs programme as well as the new Erasmus+ programme, the European Alliance for Apprenticeships and other instruments to make available cross-country traineeships in firms through the active involvement of industry and SMEs and it invites Member States to support these efforts.

Maximise the internal market potential

The Commission will ensure that harmonisation is enforced and will, first and foremost, concentrate on implementing and enforcing the legislative framework in place[10]. In concrete, a new proposal is being considered, aiming at streamlining and harmonising economic sanctions of an administrative or civil nature for non-compliance with Union harmonisation legislation to ensure equal treatment of all businesses throughout the internal market for industrial products.

The Enterprise Europe Network will be reinforced to strengthen support for SMEs in the internal market, and further develop assistance for access to finance, to improve their energy and resource efficiency and to increase the innovation management capacity of SMEs.

The recently updated European Standardisation System will be closely monitored in order to assess whether it needs to be further adapted to the fast-changing environment, so that it can continue to contribute to Europe's strategic objectives, in particular in the field of industrial policy, services, innovation and technological development.

In addition, effective standard setting and the protection of intellectual property (which represents 50 % of total intangible assets in the EU) are crucial for promoting innovation and the development of new technology areas. The Commission will closely follow the on-going debate about the use and role of IPR in standards and assess whether it needs to address the issue in a dedicated initiative.

Full implementation of the Services Directive remains important for Europe's industrial competitiveness. Following the report of the High Level Group on Business Services in March 2014, the Commission will examine the need for further action in this area. There is a clear imbalance between the level of integration in goods and services markets; the functioning of the internal market for services must be further improved to allow industry to modernize effectively.[11]

The objective is to further improve the functioning of the internal market providing scale and efficiency, allowing collaborations, facilitating diffusion of new technologies.

Boost access to external markets

Free Trade Agreement (FTA) negotiations with key bilateral trade partners will continue to pursue and continue to act within the WTO TBT agreement in order to prevent third countries putting up technical barriers to trade.

Missions for Growth will be reinforced and the services of the Enterprise Europe Network be put to better service to support the internationalisation of SMEs.

Dialogues involving SMEs to foster cooperation with our international partners — bilaterally with the U.S., China, Russia, and Brazil and multilaterally in the Eastern Partnership, the EU-MED Industrial Cooperation, the enlargement and ACP countries will continue.

Also the Market Access Strategy will continue as an instrument to address the concrete problems faced by European companies, with a particular focus on SMEs, which often face the greatest challenges in addressing trade barriers in third countries.

[10] The Communication "A vision for the internal market for industrial products" presents actions to achieve a more integrated internal market based on rationalising the existing regulatory framework.

[11] Single Market Integration Report at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0785:FIN:EN:PDF

This note has been edited by Beatriz Velazquez