

Brussels, 28th October 2010

"An industrial policy for the globalisation era" – Elements of the Commission's strategy

The European Commission's flagship initiative on an industrial policy for the globalisation era, part of the Europe 2020 Strategy, highlights the need for industry to play a key role if Europe is to remain a leading economic power. The main policy document "An integrated industrial policy for the globalisation era" is accompanied by a report on the competitiveness performance of the Member States, and the European Competitiveness Report 2010. This memo informs on the various elements of this European Commission flagship initiative.

The Economic Recovery in Europe, October 2010

Latest data show that the **economic recovery in industry and manufacturing continues**, albeit at a slower pace. Also, industrial confidence and the business outlook continue to improve, despite global uncertainty (see Graph 1). Both have been stimulated by positive developments in incoming orders.

Data on manufacturing production for August 2010 show a **growth of 8 %** over the previous year. The growth trend in manufacturing production has been positive since April 2009. Nevertheless, output is still some 12% below its former peak in early 2008.

It also looks as if **sectors affected most negatively in the downfall** continue recovering the most rapidly in the present upswing, even if there have been some signs of a deceleration of this upswing in recent months. On the other hand, the outlook for **construction** is rather uncertain, as its output is still around its low levels with no clearly visible trend for revival. Data and forecasts for tourism are more positive, although the situation still varies across countries.

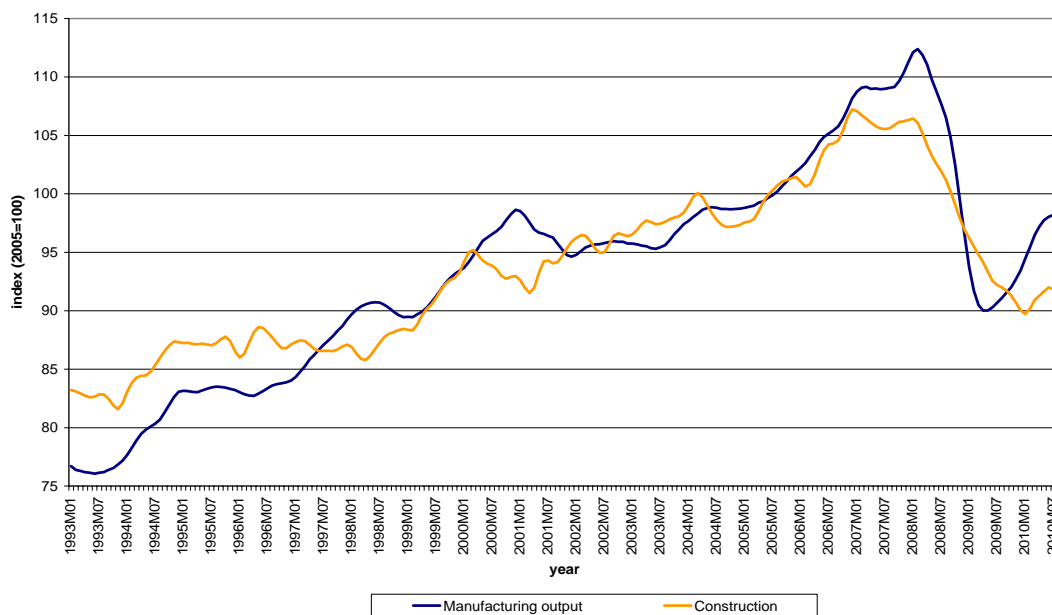
The extremely dynamic expansion of **exports** has been moderating recently. The internal demand and private consumption are still rather weak as the unemployment rate stays at a high level.

There are also some **substantial differences in the situation among the Member States**. Countries that suffered from the bursting of real estate bubbles are coming out of the economic crisis much slower than the countries having suffered from a temporary collapse of manufacturing production only. Moreover, the macroeconomic conditions of the eurozone are still fragile as illustrated by the sovereign debt problem and uncertainty about fiscal consolidation. Also, the unpopular austerity measures proposed might drag on consumer climate and public and private demand. The looming exchange rate uncertainties are working in the same direction.

On the other hand, we find **economic sentiments** that remain positive despite worrying information on public debts. Also, the **labour-market outlook is improving**, and the strong growth in Asia continues, which should stimulate the growth of export and output in Europe as well.

Looking further ahead, there is still an unresolved risk that the continued limited availability of finance to firms on favourable terms could slow down the economic recovery. As shown in the recent ECB lending survey, increasing demand for loans has not yet been coupled with more favourable lending conditions or higher availability of funding, although there are some signs that the overall financial situation is now starting to ease.

Graph 1: EU27 manufacturing production index (2005=100)



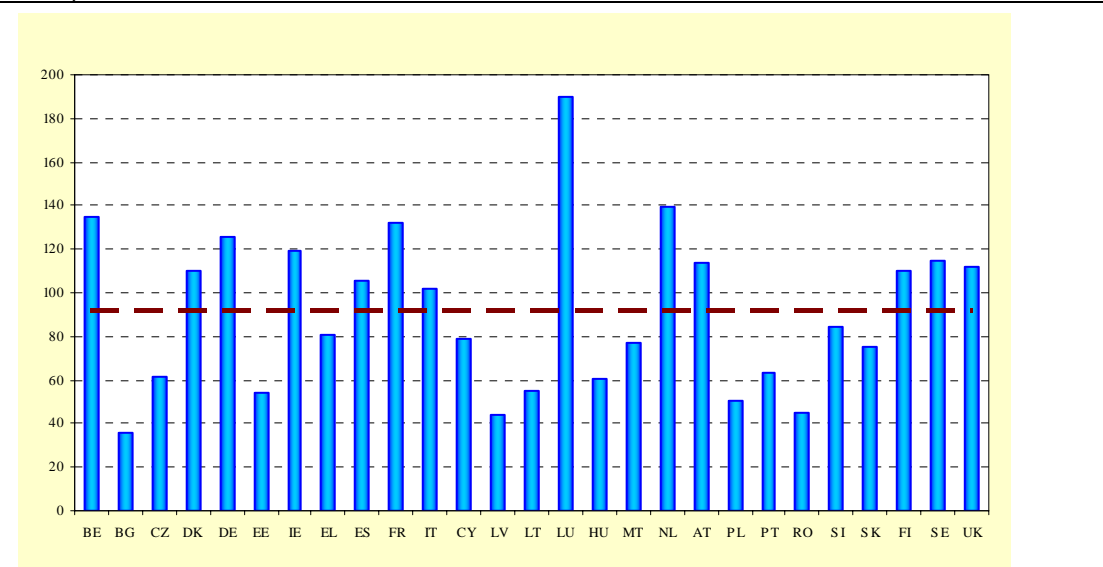
Source: Eurostat

International competitiveness of the EU is weakening

The report *Member States' competitiveness performance and policies* demonstrates that there is room for improvement across the board. Studies on the international competitiveness position of the Member States and their attractiveness as a location for foreign direct investment suggest that the international competitiveness of the EU is weakening¹. The policy framework at the EU level – Europe 2020 strategy with its flagship actions and Article 173 TFEU on industrial policy – provides a range of means to encourage Member States to step up their efforts.

Average productivity in the EU one third below the US level: The industrial specialisation of the EU Member States shows a continued reliance on medium-skill, medium-technology industries instead of the high-skills, high-technology edge. Average productivity in the EU remains almost one-third below the US level (see Graph 2). Studies on the international competitiveness position of the Member States and their attractiveness as a location for foreign direct investment suggest that the international competitiveness of the EU is weakening (for the Member States' competitiveness performance see also [MEMO/10/533](#))

Graph 2-. Labour productivity per hour worked in the total economy (EU 27 = 100; 2008)



Source: Eurostat, Notes: unweighted averages

Action at national level to be monitored: A large part of the policy instruments which can improve industrial competitiveness are national, and the success of EU industry critically depends on national action. It is important to keep an overview over national measures to foster industrial competitiveness because the design of EU level measures has to reflect the circumstances and existing national policies.

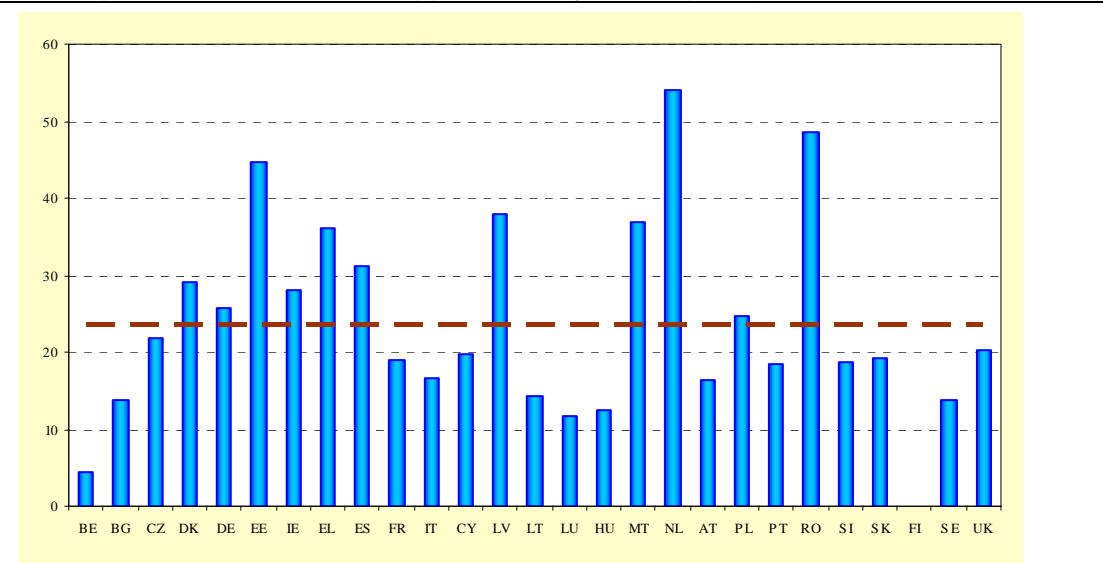
¹ In the *Ernst and Young's European attractiveness survey*, Western Europe has lost its position as the world's most attractive location for FDI to China during recent years, while the attractiveness of Central and Eastern Europe has also collapsed. In the 2006 survey, as many as 68% of businesses had ranked Western Europe and 52% Central and Eastern Europe among the world's 3 most attractive FDI locations. In 2010, their shares were 38% and 24% respectively. In particular India and Brazil became more attractive over the same period.

Main Challenges and Policy Responses

Access to finance: still a bottleneck

In all the Member States, access to finance became more difficult during the financial and economic crisis. In particular SMEs experienced tightening credit conditions. Most governments have therefore introduced or expanded public guarantee schemes or provided direct state aid. In the meantime, the situation has slightly improved, but access to finance remains a critical bottleneck for future growth. Generally, not much progress has been made to reduce late payments. Worryingly, payment times increased in several Member States.

Graph 3: Rejected loan applications, and loan offers whose conditions were deemed unacceptable, as % of all loan applications by SMEs (2009)



Source: Flash Eurobarometer, Notes: unweighted averages

The business environment and SME policies - slow, but steady progress

The large majority of the Member States face notable and identifiable challenges regarding their business environment, especially for SMEs. Efforts to reduce administrative burden, to pursue better regulation and e-government policies, to apply the "think small first" principle and to simplify support schemes should become more systematic and more intense. This is an area where an exchange of best practice among policy makers can make the difference when it provides the real life demonstration that the same objectives can be achieved in less burdensome ways.

In many Member States, increasing competition in the services sector remains a challenge. In a limited number of Member States, problems with infrastructure (mainly road transport, but also energy interconnection and generation) as well as with the efficiency of the public administration constitute important bottlenecks to growth.

The innovation gap is widening

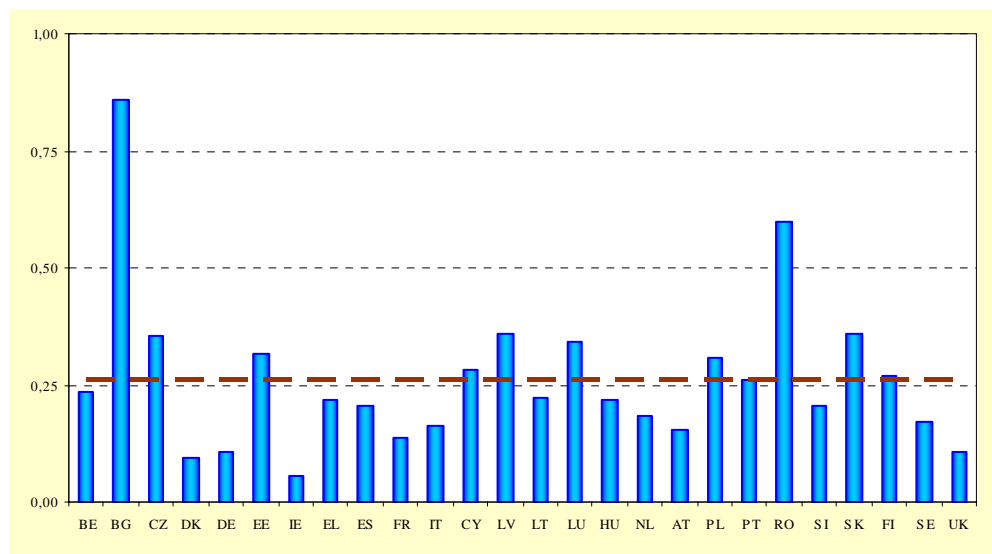
A striking finding is that Member States achieving an innovation performance above the EU average reacted in a positive and proactive way to the crisis by adding new temporary actions encouraging research and innovation to those already existing. This is not generally the case for the countries below the EU average, indicating the possibility of a widening gap. Yet, the need to strengthen the structures of their production basis by increasing the share of technology- and skill-intensive activities is even more compelling in their case.

Access to finance is also an important bottleneck with respect to innovation but is often combined with a lack of complementary skills. Many countries face additional challenges of a more institutional nature such as rethinking their strategy and priorities and simplifying and consolidating their support-delivery mechanism (see Graph 3).

Towards a sustainable industry: still much to do

In most Member States, energy intensity in industry was on a decreasing path before the onset of the crisis. Nevertheless, it remains necessary to decrease further the energy intensity of industry (see Graph 4). The other main challenge in the EU is to increase the share of renewable energy sources and to ensure their successful integration into existing energy systems.

Graph 4: Energy intensity in the industry in kg of oil equivalent per Euro of gross value-added at constant prices (2007)



Source: Eurostat

Many measures outlined in the National Energy Efficiency Action Plans are still awaiting implementation. Measures serving other environmental objectives beyond energy policy are not numerous: There are few explicit strategies supported by concrete action plans, aiming at greening existing industries and encouraging the development of eco-industries; in most cases, actions are isolated or fragmented.

What will the European Commission contribute?

Actions to increase competitiveness have been identified in the Commission Communication "*An Integrated Industrial Policy for the Globalisation Era: Putting Competitiveness and Sustainability at Centre Stage*". While many of these actions are in the Member States competency, the Commission can assist by monitoring progress and helping to organise the exchange of best practice.

3. European Competitiveness Report 2010

This year's edition of the annual European Competitiveness Report presents:

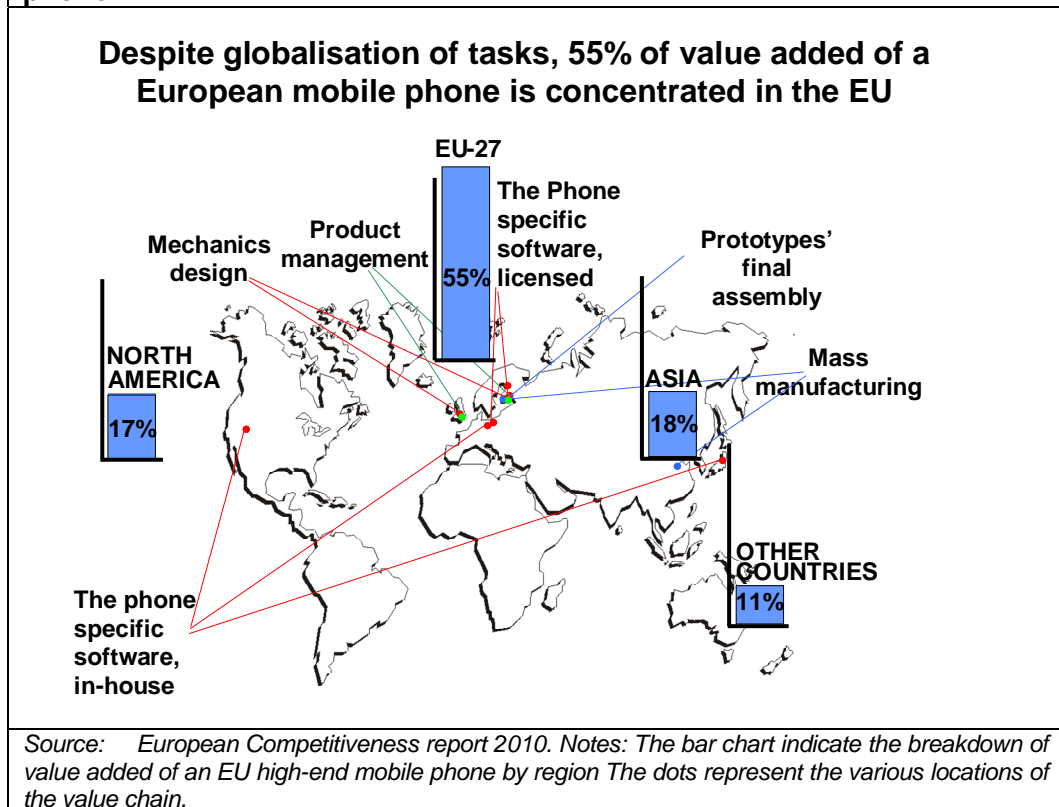
- A **snapshot of recent economic developments** in a period of financial and economic crisis and the beginning of recovery, focusing on productivity - the key factor for competitiveness in the long run;
- Four thematic studies which demonstrate **how globalisation, innovation, creativity and technology can reinforce EU growth** and competitiveness.

In the boom period 2000-07, some European economies accumulated large imbalances associated to mispriced assets, notably houses. Examining this period, there is no overwhelming evidence that it has harmed competitiveness substantially, its most obvious legacy being a strong reallocation of employment.

The EU remains an attractive location for industry and R&D and innovation

The report analyses and provides recent estimates on how globalisation has led to an increasing adjustment and adaption of EU production structures. When considering a particular high-end EU mobile phone assembled both in the EU and China, it is found that 55% of the value added stays in the EU (See Graph 5). When it is assembled in China and sold in the US, 50% remains in the EU. Why is it so? Because the value comes primarily from design, R&D, branding, marketing and management that are still taking place in the EU.

Graph 5: Location of tasks and breakdown of value added of an EU mobile phone



But what if these functions start being located outside the EU? The study of internationalisation of R&D and innovation shows that while the EU has increased its R&D and innovation activities abroad, it also remains a very attractive location. The EU keeps attracting more than 60% of US total overseas R&D. Foreign R&D and innovation complement home-grown activities in the EU countries and fosters the transfer and diffusion of knowledge and innovation. Foreign and domestic firms innovate differently in the EU, but both contribute to productivity and employment growth.

Key enabling technologies have the potential to spur innovation in Europe

The report confirms that the promotion of creative industries, activities at the crossroads of arts, business and technology, can enhance growth and innovation. Extremely fast growing, creative industries are key inputs for the development of other sectors. Activities such as design or software programming are able to reshape the process and product innovations of EU manufacturing industries.

Multi-purpose and forward looking, key-enabling technologies also have the potential to increase growth and productivity. EU's competitiveness in nanotechnology, micro and nanoelectronics (including semi-conductors), industrial biotechnology, photonics, advanced materials, and advanced manufacturing technologies is remarkable, as is the potential world market for their applications. However, factors such as skills, R&D, venture capital, maintaining a manufacturing base and appropriate regulation will be crucial for the future development of key enabling technology applications in Europe.

More information

For the Member States' competitiveness performance see [MEMO/10/533](#)
http://ec.europa.eu/enterprise/policies/industrial-competitiveness/industrial-policy/index_en.htm