European companies need stronger signals to deliver a real industrial renaissance

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By setting the goal of increasing industry's share of Europe's GDP to 20% by 2020, the European Commission has rightly placed the importance of revitalising European industry in the political and institutional limelight. The industrial sector, together with related services, contributes greatly to the European economy, creating prosperity and employment.

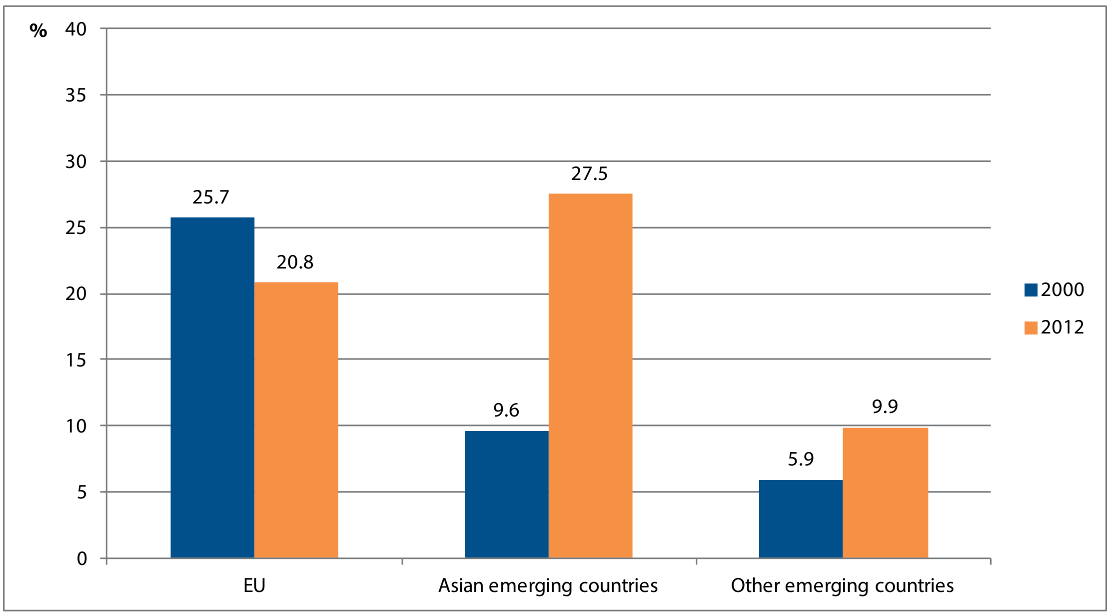
Europe's manufacturing sector is exceptionally productive: an hour of work generates nearly €32 of added value, a productivity level that is about 15% higher than in the services sector. Accounting for 75.6% of merchandise exports and 57% of total exports, industrial companies also drive our international economic performance. With a share of 15% of added value in the total economy, industry is responsible for 65.3% of R&D and 49.3% of innovation investments. Manufacturing directly employs around 32 million people and indirectly accounts for an additional 20 million jobs in related sectors across Europe. Overall, the EU manufacturing sector offers above-average wages in all skill classes, thus providing attractive and high-quality jobs.

Despite its important role in Europe's economy, industry has come under severe pressure in recent years, putting at risk the future high standard of living in Europe. Several factors have resulted in the decline of industry in a number of member states.

Since the start of the new millennium, emerging markets have experienced vibrant growth, turning them into more dynamic drivers of the world economy. Spearheaded by China, Asian emerging markets in particular have significantly raised their share of worldwide manufacturing added value, while Europe's share dropped by 4.9 percentage points between 2000 and 2012. Industry's decline in the share of the EU economy's added value has also, to a large extent, been due to the increased importance of services.

A number of poorly designed, disproportionate or insufficiently assessed EU policies have severely impeded the cost-competitiveness of EU companies. Inconsistent and uncoordinated legislative initiatives also lead to higher costs for businesses and add to the amount of red tape. For example, in the area of energy and climate, the bulk of EU initiatives have subjected businesses to instability, disproportionate energy costs and administrative burdens, thus exacerbating the challenge of effectively competing on the global market.

Share of world manufacturing's value-added in %



Source: UN (2013), OECD (2013), Eurostat (2013), calculations by IW

Even if European industry has been subject to increasing pressure in recent years, opportunities exist for reversing the trend of deindustrialisation. Europe is the cradle of industrial societies. The Single Market is the world's largest market with more than €12.6 trillion in GDP. To regain lost ground, European industry must be able to quickly adapt to global trends and to seize the opportunities provided by developments on the global market. Two main paths offer significant growth potential: increasing internationalisation and integration in global value chains, and driving more cooperation in innovation.

Industrial production and activities are increasingly organised in trans-national and global value chains and production networks. Production in Europe increasingly entails value chains involving a range of countries, with each country specialising in one or several stages. Besides, as industrial products and processes evolve, manufacturing no longer acts as a secluded sector, but is extensively linked with other sectors through the deliveries and purchases of intermediates. To regain lost ground and to succeed on the global market, European industry must better harness the potential of cooperation and integration in value chains across firms, sectors and national borders. Increasing this interconnectedness will be key for Europe's future competitiveness.

Compared with other branches of the economy, the manufacturing sector is far more innovative with respect to all indicators (innovation intensity, innovator rate, R&D activity rate, turnover shares from innovative products, share of cooperation). Innovation intensity in large manufacturing companies is twice as high as in large companies in other sectors. Thus, industry plays a key role in driving progress in the EU and around the world. However, there are large differences in innovation levels depending on company size, the economic sector and networking abilities in Europe. To close this gap and for European industry to capitalise on its innovative potential, increased transnational cooperation for research and innovation is vital.

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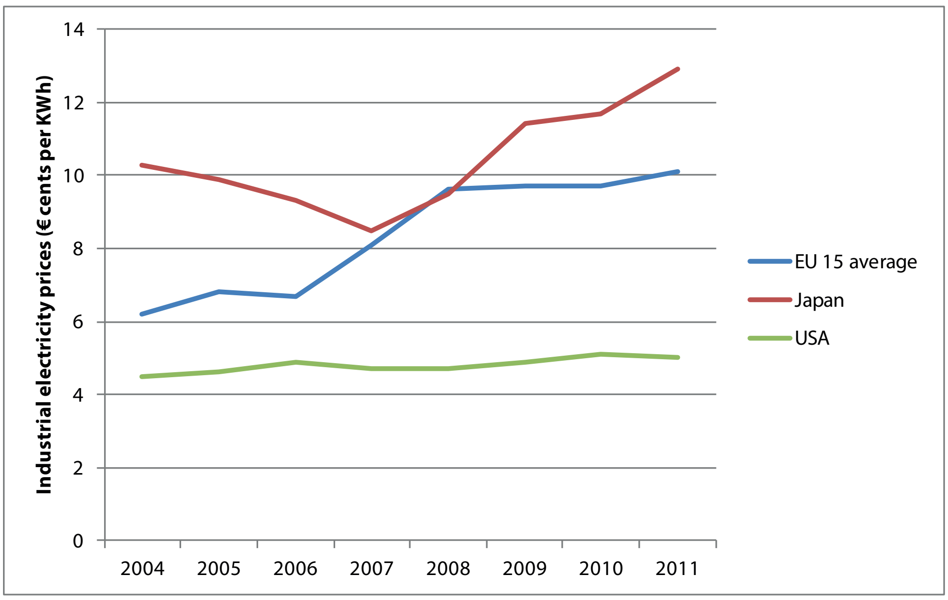
European industry has the potential to regain lost ground and to compete successfully on the global market. Improving industrial competitiveness in Europe is predominantly the task of business. Companies must adapt to new trends such as the increasingly stronger competition from emerging markets and knowledge intensification by further integrating into global value chains and engaging in more cooperation for innovation.

However, to effectively exploit the opportunities of the global market, business needs the right framework conditions that allow companies to develop their full potential and improve their competitiveness. EU policies must not undermine the cost-competitiveness of industry by over-regulation, thus burdening companies with disproportionate cost and administrative requirements. European companies need stronger signals to deliver a real industrial renaissance. A new approach to EU industrial governance will be key to prioritising competitiveness across all relevant policy areas.

At its annual conference, BUSINESSEUROPE Day, held in Brussels on January 28, BUSINESSEUROPE proposed that European institutions and member states agree on an *Industrial Compact for Europe*. 'Industrial Compact' means a 360° strategy based on a shared vision that industrial competitiveness is a prerequisite for maintaining a high standard of living in Europe. BUSINESSEUROPE's recommends that this Compact provide competitive framework conditions that facilitate the growth of the more than ever interlinked European industry and services, drive investment and trade, support dynamic enterprises and enable the development

Trends in industrial electricity prices



Source: International Energy Agency, energy prices and taxes (derived from DECC, 2013) and commercialisation of innovative technologies.

The Industrial Compact requires a fundamental change in European governance. It is necessary to prioritise and mainstream industrial competitiveness throughout all policy areas (energy, climate, environment, innovation, employment, financial services, corporate governance, etc.), and decision-making levels (European Commission, European Parliament, different Council formations, implementation by member states). To this end, the following steps need to be taken:

1. The role of the Competitiveness Council must be strengthened to become the gatekeeper of competitiveness in the EU;

2. The progress made in pro-competitiveness reforms should be monitored and evaluated every year at the Spring EU Council (as is the case for growth and employment enhancing reforms);

3. A permanent Industrial Competitiveness Coordination Group, made up of the Commissioners most relevant to industrial competitiveness, should be established to ensure that all Commission proposals are well coordinated and positively impact competitiveness.

In its recommendations, BUSINESSEUROPE furthermore identified seven policy drivers to foster Europe's industrial competitiveness.

1. Strengthening competitiveness in energy and climate policy. The EU needs to reassess its approach to energy and climate policy. The high cost lessons from the current EU policy need to be fully addressed while taking game changers such as the shale gas revolution in the US and the very limited progress in global climate talks into account. This requires an energy and climate policy that secures a supply of affordable energy and strengthens the competitiveness of Europe's internationally competing industry.

2. Opening foreign markets and unleashing the potential of the Single Market. The Single Market is one of the EU's most powerful achievements. If properly implemented, it can offer enormous opportunities for citizens and businesses alike. The Single Market is an asset which should be used as a springboard to meet the challenges and seize the opportunities of the global market. To sustain and improve its global competitiveness, Europe must also increasingly direct its focus to foreign markets and match itself with other economic regions of the world. Due to the ongoing integration of manufacturing industry and services, increased manufacturing exports can also serve as a driver of trade in services.

3. Promoting cooperation for innovation. The manufacturing sector is the main source of research and development in most European countries, amounting to two thirds of R&D expenditure. Innovation increasingly relies on cooperation among businesses. Highly dynamic and innovative enterprises comprising a high innovation potential, broad-based international business activities and an active participation in networks, act as front-runners and trigger important economic multiplier effects.

4. Expanding trans-European (and national) infrastructure. Infrastructure networks are the arteries of the economy. Strong and efficient infrastructure not only enables trade within and across borders, but serves as a key prerogative for businesses to engage in international value chain integration and cooperation. To ensure cost-effective and internationally accessible infrastructure, remaining regulatory, administrative and technical barriers in all modes of transport need to be removed.

5. Improving access to finance. Access to finance on reasonable terms is vital for the survival and growth of companies of all sizes. Yet, access to credit is currently restricted, particularly for SMEs. Within the euro area, interest rates charged to businesses continue to diverge significantly between member states. As well as restoring normal bank lending conditions across the EU, access to finance for European businesses needs to be improved by strengthening non-bank financing routes. A properly functioning banking union is also urgently needed. It will lead to deeper and more liquid markets, more resilient to financial shocks, and better able to support cross-border trade and investment.

6. Making labour markets more dynamic, strengthening flexicurity and productivity. More needs to be done to effectively implement national structural labour market reforms and to ensure the financial sustainability of national social protection systems. The overall objective is to ensure open, dynamic and mobile labour markets through reforms focusing on stimulating job creation and employment participation, smoother labour market transitions, and better allocation of labour based on employers' needs.

7. Making education and skills fit for industry. Achieving growth, productivity, and a better match between skills and jobs in Europe relies on a more effective management of human potential. The overall objective is to provide the skills needed to foster Europe's industrial growth. Governments should ensure that available resources are used by priority to bring to Europeans of all ages the knowledge and skills they need to succeed on labour markets. An important part of this is to address in the short-term shortages in terms of science, technology, engineering, mathematics – STEM – skills.

The beginning in 2014 of the next five-year European legislative term is a unique opportunity to define the elements of a comprehensive industrial strategy for Europe. BUSINESSEUROPE already called on the European Council to agree on an ambitious action-oriented Industrial Compact and calls on all European institutions and member states to contribute to the implementation of this Compact over the next political cycle.

We must act now, tomorrow will be too late. ■