Sharing the same vision – the cornerstone of a new industrial policy for Europe

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Introduction

EU leaders have recently missed the opportunity to give industrial policy the weight it desperately requires on the EU agenda. The decision to cancel the February 2014 European Council as well as the low attention that industrial policy received at the March European Council are some examples. They have fuelled a feeling of disenchantment over the European business community, which is convinced that, despite the recent Communication of the European Commission entitled *"For a European Industrial Renaissance"*[1], 'business as usual' remains the prevailing mantra.

However, the results of the European elections, marked by the rise of anti-EU forces and the still very small turn out, have sent, once again, a strong message. The disconnect is profound. There is an urgent need to address, on the one hand, the disillusionment EU citizens feel about the inadequacy of policies to boost economic recovery and to make the European Union (EU) a robust global player, and on the other hand, to respond to large expectations of the business community. These expectations are all the more significant as the EU has sent, over the last years, strong signals indicating its firm intention to become a more active supporter for European industries.

However, the simple act of putting industrial competitiveness on the agenda and reiterating well-known statements are not sufficient. EU heads of state and government have now to provide industry with what it needs most: an unambiguous and well-defined strategic plan for the decades to come. To this end, they have to courageously face the key questions, which can no longer be ignored. These questions include:

- What are the main factors challenging the competitiveness of European industries and what would be the added-value of EU actions in addressing them?
- What should European and national authorities do and, equally importantly, not do as part of a new industrial policy?
- What is the role that manufacturing should play in industrial policy and Europe's recovery?
- Should Europe aim at a precise target for manufacturing production – irrespective of its nature – or should it focus on certain types of industrial activities?
- How to make the best use of EU industrial policy to benefit Europe's economy and support national re-industrialisation strategies?

In this article, I describe current prospects for European manufacturing industries and give an overview of EU actions, past and present, to re-industrialise Europe. Based on this assessment, three possible scenarios with several policy implications are outlined. They represent very different ways in which an EU industrial policy could evolve in the coming years and present strategic options that should be taken seriously by policy-makers. Fostering a frank debate around these three scenarios is urgently needed as it would provide the right framework to answer the key questions mentioned above. Finally, a series of concrete proposals have been suggested, which would, if endorsed by EU heads of state and government, lay the foundations for an EU industrial strategic plan and respond to the most pressing expectations of both EU citizens and the business community.

Part 1: Gloomy prospects for European manufacturing industries

The decline of manufacturing in Europe is nothing new. The sector has been facing serious difficulties for a long time (a situation, which has been aggravated by the economic crisis in some countries), illustrated by the constant reduction of the manufacturing share in almost all indicators. The share of manufacturing in GDP has fallen from 15.8% before the crisis to 15.1% in 2013 and 3.5 million jobs have been lost since 2008[2]. While such trends reflect, to some extent, a structural shift to the service sector and the changing nature of manufacturing, which mirrors the move towards a more knowledge-intensive and green economy, they also reveal a profound weakness in EU manufacturing.

The steady decline over the last decades is the result of two simultaneous developments: ever-mounting external pressure and the growing role of emerging economies at a global scale (1) as well as a profound fragmentation in the way industrial policies are pursued across Europe (2). The combination of those developments and the EU's incapacity to respond to a changing environment with one clear and common vision has significantly weakened its industrial base, making it uneven across the territory and ill-equipped for global challenges.

Ever-mounting external pressure

The ever-mounting external pressure has led to the emergence of a new global distribution of manufacturing production and, as a result, to the decreasing importance of manufacturing in Europe's economy, which has intensified over recent times and has been driven by several factors.

First, productivity in Europe is running out of steam and progression is much slower than in other parts of the world (despite a relative strong productivity growth in manufacturing compared to the one in services). Not only do the usual competitors, which are also undertaking a 're-industrialisation strategy', such as the United States, out-perform Europe, but the productivity in emerging industrial giants is catching up at high speed. Innovation and investment in research and development undeniably plays a significant role in explaining this growing productivity gap. However, more importantly, it is the capacity to translate research into the commercialisation of products, which is key. Looking at innovation output instead of input shows that the EU is underperforming with too much focus on basic research.

Second, production costs play a role in determining the location of manufacturing production in different countries as they represent a key competitiveness factor and affect the final price of a product. Among them, energy costs feature as one of the top concerns of European industries due to the increase in energy price differential between Europe and its major competitors.

Labour cost also plays a role in total production costs. Its relation to productivity, in addition to trade liberalisation, has contributed to favour the migration of manufacturing employment outside Europe. Indeed, labour cost differs enormously between EU countries and emerging economies, making it impossible for Europe to compete on this aspect. In this context, dealing with the cost of offshoring and coordinating activities between and within companies has become more profitable for European industries than concentrating all activities in one location. Hence, globalisation has profoundly changed how manufactured goods are produced and delivered to final consumers. Production processes have internationalised, leading to an increased fragmentation of the value chain and the disappearance of certain types of manufacturing employment in Europe.

Third, recent macro-economic forecasts have shown that a large part of economic growth will be located outside Europe in the years to come. Where demand for manufactured goods is stagnating in Europe due to oversaturated markets, the rapid expansion of the middle class in other parts of the world is creating a large cohort of new consumers. This will shape the global distribution of manufacturing production even further, raising both opportunities and challenges for European manufacturing. European industries are therefore likely to continue to migrate their activities outside Europe in order to have direct access to those new consumers and to enable businesses to grow.

The European Union... let's call it European fragmentation!

Despite the creation of the Economic and Monetary Union (EMU), the EU has been characterized by significant divergences in manufacturing performance and there is no doubt that the EMU is far from being homogenous in this regard. Major drivers of competitiveness, be it productivity level[3], capacity to export, or the structure and diversity of the manufacturing base, have evolved in different ways across the territory. Both structural and institutional factors explain huge competitiveness differences among member states and the long and persistent fragmentation of the European industrial landscape, which has led to the co-existence of exports-oriented (such as Germany) and demand-driven (such as France, Spain, Italy) models in Europe[4].

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In addition to structural and institutional factors, the co-existence of such different models is due to the fact that industrial policies are shaped by national interests. Industrial and innovation policies are driven by national concepts and strategic choices do mostly reflect the role played by specific sectors in each country and the nature of the relations between relevant stakeholders. Such differences are difficult to overcome as they both reflect deep-rooted traditions and because industrial policy has always been seen as a national preserve. A diversified industrial policy across the EU could undeniably benefit Europe's economy, yet it is the predominance of national interests and the absence of coordination between different models, which bear specific risks.

The risky consequences of uncoordinated industrial policies

Pursuing economic integration whilst having very different industrial models has been often considered risky in several respects. From an internal market point of view, both the divergence of manufacturing output as well as the predominance of national interests in the way industrial policy is carried out, represent clear obstacles to the well-functioning of the internal market. Given that innovation and national investments are primarily driven by national traditions, picking out common priorities is difficult. Furthermore, this diversity of non-coordinated investments does not favour cross-cutting trans-border projects or the emergence of pan-European networks, therefore hampering potential growth. In such a context, completing the single market and streamlining investments are condemned to remain marginal. From a monetary perspective, the strong cleavage between the demand-driven and the exports-oriented models represents weak foundations for the currency union.

Part 2: A new motto 're-industrialise Europe' – too little, too late?

Against this dismal background, it is questionable whether Europe is doing enough to create the right framework conditions for boosting the competitiveness of its manufacturing industries. Despite a recognition of the importance of manufacturing for the economy, the weakness of the current policy framework, both regarding the lack of clarity of EU strategic orientations and their questionable impact on national policies, seems unsuited to meet ongoing challenges.

A large recognition in the role of manufacturing industry

'Industrial policy matters!' is the new slogan citizens hear all over Europe. Alongside fierce campaigns to keep the industrial base on the national territory, governmental reports and communications highlighting the key role that manufacturing may play in reviving national economies have proliferated. Even in countries such as the UK where the largely dominating neoliberal economic doctrine has allowed market forces to shape the economy for the last 30 decades and to

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shift it away from its traditional strengths in manufacturing towards financial services, the rhetoric has now changed[5]. De-industrialisation is no longer perceived as a natural process of economic development and the focus on the services sector has somewhat faded away. In addition, the comparative resilience of some EU countries with a strong industrial base to the economic recession, together with the positive role that the state played in robust and/or emerging economies, encouraged EU member states to recognise both the need for industrial policy and the importance of having a proactive state supporting strategic industries.

The change in rhetoric is also explained by some strong evidence showing that manufacturing is an essential pillar of the economy as *"additional final demand in manufacturing generates around half as much additional final demand elsewhere in the economy"*[6]. Indeed, manufacturing represents the major source of investment in R&D (65.3% between 2008 and 2010)[7], a key source of exports (67% of Europe's exports)[8] and a main driver for employment in other sectors, including services (each additional job in manufacturing creates 0.5-2 jobs in other sectors)[9].

In light of this, while manufacturing and services have been considered by some as two incompatible choices of economic strategies in the past, there is now no doubt that the two of them are depending on each other. Services have indeed entered the world of manufacturing in all sequential stages of a product and the service content in manufacturing final output has significantly increased over the last decades.

But despite the recognition in the importance of a large and strong industrial base, some basic questions pertaining to the nature of Europe's re-industrialisation strategy are left in the air. Answering these basic questions are, however, a pre-condition for the design of a robust and coherent EU industrial strategy capable of meeting present and future challenges and of providing European industries with a long-term vision.

The EU strategy – go back to basics!

Looking at what constitutes industrial policy both at EU and national level suggests that it is difficult to get a clear idea of whether a strategic direction has been taken. First of all and from a theoretical viewpoint, it is hard to grasp what is understood by 'industrial policy' as the term is not always used with the same meaning. Where some strategic documents emphasise the need to boost manufacturing production, others have a larger scope and also include the services embedded in it. Hence, defining first what industrial policy is and is not, should provide the starting point of any solid plan.

Secondly, from a more pragmatic viewpoint there is no indication of what the key objectives are that should be pursued by an EU industrial strategy. While EU Industry Commissioner Antonio Tajani announced the Commission's aspiration to raise the contribution of industry to GDP to as much as 20% by 2020[10], the European Commission does not provide any indication of how to reach this target and leaves the following questions open: what kind of production activities should this 20% be composed of?

Is the intention to shift European manufacturing only towards high added-value activities or to re-locate most of the production chain in Europe in order to protect jobs, including those that are low-skilled and low-waged? What is Europe's approach vis-à-vis the increased fragmentation of production processes, which is undeniably leading to job migration but might also augment European industries' competitiveness by allowing them to reduce production costs and to gain new market shares?

Adding to the ambiguity, it is questionable that actions aiming to achieve the 20% will support other EU objectives, in particular relating to climate change and energy. Recent EU communications in those fields have been strongly denounced by the industry as creating additional costs and accelerating Europe's de-industrialisation. This signals a great deal of confusion and a perceived lack of coherence between different EU policies, which in turn, might reduce the attractiveness of Europe for private and foreign investment.

The EU industrial policy: a myth?

As indicated above, it is undeniable that the EU is trying to become more active with regards to industrial policy and to mainstream industrial competitiveness into other policy fields through various ways. For instance, recent developments in the Union's new economic governance have shown that the European Commission is becoming more vocal – in particular through the country-specific recommendations published in the framework of the European Semester – on issues deemed as key drivers of competitiveness such as taxation on labour and wage setting system, the commercialisation of research, the diversification of the industry, energy policy, and the export capacity of firms.

In light of this, EU competences on industrial policy are, however, still limited, and the Union does not have a clear mandate to act in this field. The main reference to industrial policy in the Treaty, Art. 173[11], underlines the EU's role in creating the conditions necessary for the industry's competitiveness but restricts it to measures in support of national actions. As a result, measures aiming to drive industrial change are either relying on instruments from other policies, mainly internal market provisions, competition policy and trade policy, or on soft tools allowing consultation and coordination between member states. Whether this division of competences is optimal is a debate on its own, and goes beyond the scope of this article. However, recent exchanges on state aid surveillance illustrate how aspects of such a framework can create tensions between the European and national level, and indicate how European and national powers can constrain each other.

In addition to constraining aspects of the framework, one may also wonder whether there is sufficient coordination between investment priorities across Europe. In its 2012 communication[12] the Commission decided to complement its horizontal approach with a more vertical one, giving emphasis on specific technologies. Hence, it announced intentions to focus investment and innovation on six priority action lines: advanced manufacturing technologies, key enabling technologies, biobased products, sustainable industrial and construction policy and raw materials, clean vehicles, and smart grids.

The success of turning such action lines into investment with a critical mass will obviously depend on whether similar priorities will be captured by other governance levels, such as the national and regional ones. But looking at the industrial plans of member states having a firm commitment to re-industrialisation, one can observe that national investment priorities do not always correspond to the ones set at EU level[13].

Part 3: Hard but necessary choices for the future of industrial policy in Europe

The two first parts of this article have shown that despite an urgent need to address current challenges, EU industrial policy is trying to be everything for everyone. Bringing more consistency and coherence in the way industrial policy is pursued will certainly require hard but necessary choices, providing the industry with more clarity and better predictability and increasing therefore the attractiveness of Europe for investment.

Ambitious declarations and snappy slogans, including 'manufacturing revolution' and 'industrial renaissance', now need to be turned into tangible deeds. To this end, Europe needs a more in-depth reflection on the adequacy of current framework aspects supported by a sound and evidence-based understanding of the comparative advantage each framework could generate. In other words, Europe should initiate a thoughtful process of evaluating how an optimal framework could ensure the elimination of tensions between European and national competences, offer smooth coordination between EU and national policies and maximise the benefits of EU interventions.

In order to kick-start the reflection process, the following presents three possible framework scenarios – called *Towards the Europeanisation of the Value Chain* (1); *The EU as Facilitator of a Level-Playing Field* (2); and *The Predominance of the Free Market Approach and National Forces* (3) – with very different strategic options for the future of industrial policy in Europe. Where assessing the competitive advantage of each of those scenarios goes beyond the scope of this article and is also a clear matter of political choices, this article focuses mainly on drawing the scenarios' contours and setting the scene for further discussions.

Scenario 1: towards the Europeanisation of the value chain

Moving towards the 'Europeanisation of the Value Chain' implies a deeper integration of EU manufacturing with a high degree of intra-community specialisations based on national comparative advantages, more cooperative industrial relations among member states, and the integration of many policies such as the ones related to research, labour market, innovation, and energy. European investment is streamlined in a coordinated way to ensure higher return and trans-European network projects as well as clusters form a key pillar of scenario 1. Europe is put at the centre of the production process and of the value chain without, however, neglecting the outside world. Such a scenario implies significant transfers of competences to the EU level and key changes in the way member states approach industrial policy. National discourse promoting 'Made in... [national country]' would be replaced by a 'Made in Europe' giving a solid recognition to European champions. A robust EU governance model is a pre-condition to follow this path and should not necessarily involve all member states as such a qualitative leap may only become possible with industrial models sharing a certain degree of similarity.

Scenario 2: the EU as facilitator of a level-playing field

Concentrating on the facilitating role the EU could play in establishing a level-playing field for industry in the EU and beyond its borders is the scenario closest to reality as it implies striking a delicate balance between European and national competencies. Several steps, laying the foundations for such a scenario like the single market - have already been launched for decades. However, the EU's role in creating a level-playing field is far from being optimal. Important steps, some of them still under construction, will have to be pursued so as to turn the current architecture into a coherent bloc in which EU and national policies complement each other in a mutually reinforcing way.

Completing and deepening the Single Market in order to boost intra-EU trade forms the most important pillar of such a scenario and some coordination and convergence mechanisms in areas like innovation, connectivity and cross-border infrastructure are fully activated in order to grasp the full benefits of the single market. In addition, instruments to strengthen the external dimension of EU industrial policy and engage in economic diplomacy will be further developed. This scenario combines an internal pragmatic approach, where member states remain the main agents in the design of the strategic direction of future industrial developments, with a robust external strategy.

Scenario 3: the predominance of the free market approach and national forces

Going back to the mere predominance of national forces in the design and implementation of industrial policy requires not only abandoning moves towards a deeper European integration but also dismantling some achievements of the past. The third scenario does not mean the disintegration of the single market but places it at the centre of its strategy, leaving aside convergence mechanisms. The free market approach is at the core of scenario 3.

The predominance of national forces and interests lead to the promotion of a culture of competition among EU member states, regions and industries. Each member state has its own way to deal with the globalisation process and its possible consequences on domestic industries and specialisation. The co-existence of very different industrial models in Europe is reinforced and industries are likely to be more concentrated in certain parts of the EU territory. In addition, the pursuit of the free market approach is likely to lead to the disappearance of weak industries and to reinforce the position of the most competitive ones. Under such circumstances, divergences between EU member states are likely to grow, putting tremendous pressure on the common currency.

The scenarios described above represent three different strategic options for the future of industrial policy. Although scenarios often bear the risk of over-simplification, they also offer the advantage of putting the cards on the table and clarifying what is at stake. Fostering a debate around them and their policy implications, ranging from institutional aspects, division of competences, policy reforms to budget considerations and EU fiscal capacity, will put EU member states in front of essential questions, forcing them to confront the future strategic direction of EU industrial policy.

Developing a shared vision around one of these scenarios will obviously not occur overnight. It takes a long process requiring the involvement of all relevant stakeholders, including the industry, and the full commitment of our policy-makers.

In order to achieve such an objective, three concrete and ambitious steps listed below should be seriously implemented and undertaken by the EU heads of state and government:

First, there is no doubt that clear-cut choices in EU industrial policy will not be achieved without a high-level political commitment. A coalition of EU countries needs to take the lead in order to form governmental alliances and to work on the design of an EU industrial compact, which would complement the Compact for Growth and Jobs. The already existing group of EU countries called 'Friends of Industry'[14] could serve as a forerunner for such a group but it will need to be endowed with clear objectives and a real action plan.

Second, this coalition of EU countries should establish a reflection group of high-level experts with a clear mandate to carry out analysis on cross-cutting and cross-sectoral issues, which are at the core of any industrial strategic plan. The starting point of this analysis should address the questions raised in the introduction of this article.

In addition, the group of high-level experts should reflect upon the policy implications of the three scenarios mentioned above in the view to identify the opportunities and challenges each of them would raise. Such an exercise and the clear mandate given by a coalition of member states would provide a right balance between experts' analysis and political choices. Indeed, the objective would be to feed the analysis findings into the choices made by the coalition.

Third, the coalition of EU countries would need to agree on some concrete proposals addressing the main obstacles, which are currently threatening industrial competitiveness in Europe. The priority should be given to three main issues perceived as top concerns by European industries: the financial fragmentation and the difficulty to access finance in some parts of Europe; energy prices and the high price differential with Europe's competitors; and the absence of a level-playing field with other regions of the world. This should be addressed by the revision of the EU's state aid framework and the opening of foreign markets to EU industries through for instance, a stronger focus of trade negotiations on EU industries' access to foreign public procurement markets.

These three concrete steps are undeniably ambitious. But they could offer a real action plan with concrete long-term solutions to the more pressing issues together with a clear vision on the future of the EU industrial policy. ■

1. See European Commission (2014), For a European industrial renaissance, COM (2014) 14/2, p.22.
2. See European Competitiveness Report 2013 (2013), Towards knowledge-driven reindustrialisation, Commission Staff Working Documents SWD (2013) 347 final.
3. While countries like Denmark, Ireland and Luxembourg had a productivity level of above €50 per hour worked in 2012, the level of a large number of Eastern and Central European countries as well as some Southern countries was below €25. See Eurostat data.
4. For more details on the different industrial models, see the long version of this article: http://www.epc.eu/documents/uploads/pub_4279_sharing_the_same_vision.pdf
5. See a recent speech of Vince Cable, UK Secretary of State for Business, Innovation and Skills: www.gov.uk/government/speeches/industrial-strategy-conference-2013
6. See Competitiveness Report 2013 Memo : http://europa.eu/rapid/press-release_MEMO-13-815_en.htm
7. Data collected by BUSINESSEUROPE. See BUSINESSEUROPE (ed.) (2014), Industry matters – Recommendations for an industrial compact, p.6
8.. See Veugelers, Manufacturing Europe's future, p.8
9. See JM Rueda-Cantuche, N Sousa, V Andreaoni, and I Arto (2012), The Single Market as an engine for employment growth through the external trade, Joint Research Centre, IPTS, Seville.
10. From its current level of around 16%.
11. See: http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=OJ:C:2007:306:TOC
12. European Commission (2012), A stronger European industry for growth and economic recovery, COM (2012) 582 final.
13. For a more detailed analysis of the priorities of three member states (France, Italy and UK), see the longer version of the article.
14. This group of 17 member states met for the second time in January 2014 and agree upon a joint communication. See: http://www.amblavalletta.esteri.it/NR/rdonlyres/54799E38-077A-43F4-8F36-E2FFC17699A6/73652/Final_Declaration_rev.pdf