Position Paper

Brussels, 7 November 2017

European Commission Communication on "Investing in a smart, innovative and sustainable Industry: A renewed EU Industrial Policy Strategy" (COM(2017) 479 final)

Executive Summary

Orgalime represents the interests as a whole of the EU's metalworking, mechanical and electrical engineering and electronics industries, which in the EU employs some 11 million staff generated a turnover of more than €2000 billion in 2016. The industry whose exports out of Europe reached an estimated €500 billion output in 2016 is also Europe's leading manufacturing export industry.

Orgalime which has long advocated the need for a modern forward-looking EU industrial policy, therefore welcomes the European Commission Communication on "Investing in a smart, innovative and sustainable Industry: A renewed EU Industrial Policy Strategy".

In the present position paper, we comment on this Communication and make concrete proposals focusing on those EU policy tools where we believe that the EU can provide real value added.

We also reaffirm our commitment to collaborating closely with the European Commission, the European Parliament and the Member States to deliver these policies which we believe are essential if the EU is to continue to continue to be supportive of attracting manufacturing investment and, in an increasingly digitalised world allied services, now that at last we are beginning to see the share of manufacturing output in the EU's GDP rise for the first time since 2009. Indeed, our most recent forecast indicate a real economic recovery for our sector, with an output of + 4% in 2017 and 3% in 2018, exports increasing by +6% in 2017 and +4% in 2018, investment +6% in 2017 and the same in 2018 and employment +0.7% in 2017 and +0.9% in 2018.

Introduction

Orgalime welcomes the European Commission's initiative of 13 September 2017 to present a Communication highlighting its ambition for "a smart, innovative and sustainable European industry contributing to competitiveness, jobs and growth, for the benefit of all" (COM(2017) 479 final).

It is the first Commission Communication on the topic of Industrial Policy since January 2014, in which the Commission pleaded "For a European Industrial Renaissance" (COM(2014) 14 final). This new document has been long awaited by the other EU institutions and all stakeholders, including the European engineering industries represented by Orgalime, which have over the last three years witnessed and contributed to considerable changes in the way products are designed, manufactured, sold and serviced, powered, used and disposed of.

Orgalime, the European Engineering Industries Association, speaks for 41 trade federations representing the mechanical, electrical, electronic, metalworking & metal articles industries of 23 European countries. The industry employs nearly 11 million people in the EU and in 2016 accounted for some €2,000 billion of output. The industry represents over a quarter of the output of manufactured products and over a third of the manufactured exports of the European Union.

ORGALIME aisbl | BluePoint Brussels | Boulevard A Reyers 80 | B1030 | Brussels | Belgium
Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
Ass. Intern. A.R. 12.7.74 | VAT BE 0414 341 438

Orgalime is pleased to read, both in the Communication and in President Juncker's speech on the State of the European Union made on the same day in front of the European Parliament, that the Commission wants to make industry become stronger and more competitive and to help it "stay or become leader in innovation, digitisation and decarbonisation".

1. From the Coal and Steel Community to the Digital Union: a strategic role for the EU

The fourth industrial revolution is moving fast at global level, other nations and regions in the world are fully embracing it with the strong support of their public authorities. China in particular, with its "China Manufacturing 2025" Roadmap and its "Made in China 2025" Strategy, has developed and is deploying a holistic approach to restructure its entire industry[1],

It is among the responsibilities of the EU and the Member States, per article 173 of the TFEU, to "ensure that the conditions necessary for the competitiveness of the Union's industry exist", for the Member States to "consult each other in liaison with the Commission and, where necessary, to coordinate their action", whereas "the Commission may take any useful initiative to promote such coordination". Indeed, it is for us as important to have an EU Industrial policy strategy as having it coordinated with the Member States both to mutualise European strengths and to avoid developing unequal playing fields inside the EU.

In fact, support to industry is at the core of the EU's project, since the creation of the European Coal and Steel Community in 1951. The EU has always accompanied the reconstruction, the development and the modernisation of Europe's industry, starting with setting up the coal and steel Common Market, and moving all the way to accompanying the digitisation of all European industry sectors, while supporting their competitiveness as well as their deployment at home and internationally. At this current time of tensions and the revival of barriers to trade both on the EU Internal Market and at international level it is important to recall this historical mission.

2. The Juncker Commission action so far: steps in the right direction

We fully acknowledge and welcome many of the initiatives taken so far by the present European Commission: indeed many of the ten political guidelines presented in July 2014 are directly aimed at supporting industry, notably by strengthening the Internal Market and supporting its growing digital dimension. Major initiatives such as the Juncker Investment Plan, the Digital Single Market with the Communication on "Digitising European Industry", the Energy Union with the "Clean Energy for All" Package, or the Circular Economy Action Plan are providing building blocks - even if their content can be improved from an industrial competitiveness perspective - for an industrial policy strategy. The Skills Agenda and the further implementation of Horizon 2020, notably via the very effective Private Public Partnerships, properly complement these.

We see the Communication of 13 September more as a stock-taking exercise recalling these initiatives. The Commission is right to focus on the Internal Market, on digitisation, on supporting European green production and clean energy technologies, on investment including a better coordination of the EU public investment tools, on innovation, including fiscal aspects, and on supporting a fair international trade.

<u>But we lack a real long-term vision</u>.

[1] EU Chamber of Commerce in China, "China Manufacturing 2025", 2017

ORGALIME aisbl | BluePoint Brussels | Boulevard A Reyers 80 | B1030 | Brussels | Belgium
Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
Ass. Intern. A.R. 12.7.74 | VAT BE 0414 341 438

3. Engineering industries provide solutions to global societal challenges

Does the Commission really see industry, and particularly ours, as a partner for the Juncker "Agenda for Jobs, growth, Fairness and Democratic Change"?

For many years, Orgalime has been pushing for policies to counteract the constant decline of the industry's share of the EU's GDP. The goal of 20% - which was introduced in 2014 - might be challenged if not taken as a trend more than a concrete objective, but the most important - and this is probably the best news brought by the Communication - is that the decline has been stopped. Even better from 14.9% in 2009 to 16.1% in 2016 Industry's share of the EU GDP is increasing again. The European engineering industries, with a turnover of some €2000 billion in 2016 and employing directly 11 million people, have contributed to this recovery: our industry has enjoyed a modest but sustained growth in employment, output and exports over the last four years. Nevertheless, as we highlight in the annexed paper on investment in the EU, we believe that a clearly articulated long term industrial strategy is needed to ensure that this recovery that we are seeing is sustained.

We strongly believe that only with a solid industrial base, supported by an innovative industrial services ecosystem, which mutually nurture each other, can the European economy as a whole prosper and remain competitive. It should be recalled that 40% of EU exports come from the manufacturing industry

More particularly the engineering industries, providing capital equipment to the entire industry value chain, play a central and pivotal role: as described in our Vision Paper updated in 2016, most technologies transforming industrial production in all sectors interweave mechanical, electro-technical and IT (software and hardware) elements. In turn, these technologies and the products and services which they contribute to manufacture and to provide deliver solutions to the societal challenges faced by our societies, not only in Europe but also globally. We gave examples and illustrations of these in our updated Vision Paper, but these include:

- Digital and energy infrastructures: high-performance, secure digital networks and related infrastructures (data centres) and services (for example, via cloud computing) are the lifeblood of a digitised industry. They interact with energy (notably electricity) networks to increase the integration of renewables and improve the energy efficiency of the networks. Buildings and how they interact with transport, energy and communication infrastructures: many new services can be offered such as technology-based eco-design for buildings, including energy efficient designs and production/storage of energy, quality of air, noise levels, security, and communication with service providers
- Mobility: this includes the "connected car", the electric car, infrastructure management (fluidity, safety) and new practices of car-sharing or car-pooling
- Security/digital trust: improvement of security in networks (notably critical installations) and connected objects will increase trust and may contribute to dematerialisation trends
- Connected objects: this is a huge market as these objects can provide solutions in areas such as nutrition, transport, sports, health (including home care) and security – but also with regards to environmental factors (air quality control, waste management, energy consumption and reparability of the object itself).
- "Physical security": technological solutions can help to address growing threats of a criminal, geopolitical or terrorist nature, or the need to better organise the flow of migrating populations.
- Both in agriculture and in industry, smart production contributes to major savings in raw materials, water and energy and therefore to the achievements of the EU Circular Economy objectives.

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Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
Ass. Intern. A.R. 12.7.74 | VAT BE 0414 341 438

Generally speaking our industries also have been net creators of jobs over the last years, with some 11 million employees in 2016 against 10 million in 2011. This is also due to the productivity gains brought about by digitisation, which has increased the competitiveness of our industry in the EU and with it a growth in output and employment.

It is somewhat regrettable that in a Communication on Industrial Policy the Commission would not include examples of European industry's achievements and contribution to our European society as a whole.

4. Strategically using the EU policy tools where the EU can provide real value added

As most public authorities, the EU institutions have two major tools at its disposal to design and implement the EU's public policies: the regulatory and budgetary tools.

4.1 Digitisation: regulatory aspects

In its Communication, the Commission recalls that the implementation of the Digital Single Market (DSM) is on its top priority list. This is fundamental for Orgalime as we strongly believe that digitisation is the main structuring driver for all changes which industry will be undergoing during the net years. As a result, we welcome that, in parallel to this Communication, the Commission has presented a Regulation proposal on the free flow of data and a cybersecurity package: both are cornerstones of any regulatory regime supporting industry's digitisation and we will provide separately more detailed comments on these proposals
.
But, whereas the Regulation Proposal on free flow of data is based on article 114 TFEU, we do not completely recognise in the Regulation proposal on the EU cybersecurity agency and certification schemes, the New Legislative Framework (NLF) approach with the possibility of manufacturers' self-declarations (see below).

Also for the Digital Single Market we call upon the Commission to make full usage of the Single Market approach, as our companies operate in a Single "Single Market", and of the Better Regulation governance tool: to ensure a proper development of European industry in the digital age, we recommend legislation to be as future-proof as possible, which also means that the regulators should remain prudent before enacting any new legislation in this area.

However, digitisation must not be (mis)used in all aspects of EU policies without undermining benefits gained from its development. In particular, we are concerned to see under the proposal for "digital resource factsheets for products" and "a single product information system" measures which request manufacturers to make widely available such sensitive information as material bills, product composition or disassembly sequences, which means no less than providing our competitors with the results of years of hard and costly private and public-funded research, development and innovation investment on a plate. Product transparency requirements, also in the Circular Economy and in the Digital Age, have to find their limits where European companies' Intellectual Property Rights (IPR), trade secrets, their to protect their know-how and confidential business information and data would be compromised: the principle of "freedom of contract" should remain valid for data exchange and flow of data in business-to-business (B2B) relationships.

4.2 The legal level playing field: a "Single" Single Market

Europe needs a predictable investment environment to give potential investors enough incentives to make use of the existing investment funds. This means:

- Sound fiscal policies predictable pro-industrial taxation policies among the EU Member States,
- A more efficient law-making process that is better coordinated with business players and therefore more predictable and applicable for companies, leading to a stable regulatory environment,
- Less administrative costs of doing business in the EU.

To do so, the European Union has at its disposal an instrument which is unparalleled among all economic integration organisations in the world: the Single Market based on the NLF and supported by the Better Regulation governance instrument. Why is the Commission no longer fully behind this tool, which it has created, which has so powerfully underpinned the competitiveness of European businesses and which has put the EU so high as global trade player?

More and more, the Member States set up new technical barriers to trade between themselves or adopt diverging interpretations of EU law. Less and less, the Commission seems to be willing to use all its powers as Guardian of the Treaties to address these, while the Single Market remains fragmented and heterogeneous. Even worse, it is developing a vision of standardisation and an interpretation of the role of harmonised standards which could severely damage the NLF. It is sometimes even, such as in the proposal for a regulation on conflict minerals, encouraging Member States to re-introduce barriers to trade.

In the Communication, the Commission recalls or announces a number of important elements which can contribute to reverse this tendency. This includes:

- The compliance package adopted in May 2017
- Upcoming rules on simplifying the functioning of mutual recognition
- Upcoming revision of the market surveillance rules

We welcome these but regret that they only partially address the overall issue of the Single Market's fragmentation.

Finally, on regulation as a whole, industry needs manageable and "clever" legislation: moving towards requiring manufacturers to provide disassembly instructions and details of the composition of all components, supposedly to contribute to the EU Circular Economy policy - is really giving our competitors a free lunch by giving them the results of years of hard research, development and innovation investment on a plate.

On 1st January 2018, the Single Market will be 25 years old: we suggest that the Commission uses this milestone to take stock of its achievements and shortcomings.

4.3 A strategically powerful budget linked to a modern investments policy

Though relatively modest (it amounts to 0.98% of the EU's GDP, and this share is in constant decline since the beginning of the 1990s), the EU budget can powerfully contribute to the implementation of an industrial policy strategy if it is used as a strategic tool: a stated by President Juncker "We need a budget to achieve our aims. The budget for us is (…) a means to achieve our political goals"[2].

A new cycle of negotiations will start in spring 2018 on the next EU Multiannual Financial Framework (MFF) for the period post 2020. This offers an excellent opportunity for a debate on the size, the resources, and the allocation of expenses of the future EU budget. The negotiations are likely to be extremely complex and tough and we urge the EU Institutions and above all the Member States to stick to basic concepts throughout the MFF adoption process:

[2] Quoted in "Reflection paper on the future of EU Finances", European Commission, 28 June 2017

- Devote the entire budget to accompanying policies that can provide real European value added and not to a distribution to each Member State based on the calculation of a supposed net balance between contributions made and funds received, whereas it has been demonstrated that the EU budget provides cross border effects and EU-wide benefits
- Make full usage of all reflections contained in the "Reflection paper on the future of EU Finances" presented by the European Commission on 28 June 2017, notably those devoted to "simplification, focus on performance and efficient management of the EU budget".
- Better align the EU budget with the EU financial instruments promoting cross-fertilising public and private investment, particularly the European Fund for Strategic Investments (EFSI)
- Boldly address the consequences of Brexit on the EU budget by ensuring that it is not reduced more than proportionally to the UK's net contribution and review accordingly the political ceiling of 1% of the EU Gross National Income (GNI)

To accompany a powerful Industrial Policy Strategy, Orgalime suggests to carefully read the recommendations of the High-Level Group on Own Resources, presented in December 2016 particularly its developments on "European Added Value" and to focus the EU budget on:

a) R&D&I

We are convinced that engineering technologies allied to digital technologies are proving today to be the real enabling technologies. They are the key to resurgence of manufacturing investment and to providing all parts of the economy with the solutions expected - whether at the level of resource including energy efficiency, the development of the circular economy, new manufacturing investment ad with it jobs and growth. This was clearly recognised in Horizon 2020 where the Commission really struck the right balance between modernising the industry pillar of R&D by investing in innovative production technologies, data and connected technologies and through the innovation hubs, helping to bring to companies of all sizes, the possibility to test digital technologies new products and processes. In this respect PPPs such as Factories of the Future have proven to be an effective instrument.

It is therefore of crucial importance, not to lose the focus on industrial research in the next FP9. Such a loss of focus would harm the competitiveness of companies: by keeping and reinforcing the industrial pillar in FP9, we will send a clear signal to global investors that Europe is still serious about innovation. And of course, investing in digitisation is one of the key answers to attract investment if labour and capital productivity is high enough and at a competitive level.

b) Infrastructures

We support the further deployment of the Connecting Europe Facility (CEF) as the main EU funding instrument to support targeted infrastructure investment at European level as it contributes to the development of interconnected trans-European networks in the fields of transport, energy and digital services. We also welcome its architecture consisting of both grants financial and instruments such as guarantees and project bonds.

With regards to energy, Orgalime recommends the following improvements for the current and above all next CEF: a) support to the full modernisation of the energy infrastructure, which implies a much stronger focus of projects of common interest on PCIs on smart grids and b) support to more innovative PCIs with sustainability and energy efficiency as binding selection parameters: such projects not only generate benefits in terms of energy savings, emissions reduction and energy security, but also strengthen industrial competitiveness and job creation in the EU.

With regards to telecom, Orgalime recommends that the EU budget supports more strongly the acceleration of the deployment of broadband infrastructures, by pooling and coordinating the various instruments in place, notably the CEF-Telecom, the European Fund for Strategic Investments

ORGALIME aisbl | BluePoint Brussels | Boulevard A Reyers 80 | B1030 | Brussels | Belgium
Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
Ass. Intern. A.R. 12.7.74 | VAT BE 0414 341 438

(particularly the Connecting Europe Broadband Fund set up in December 2016), and the European Structural and Investments Funds where some €21.4 billion are available for ICT investments over the 2014-2020 funding period. This should more strongly help realising the Digital Single Market target:

- all European households should have access to internet connections of 30 Megabits per second by 2020 and the targets fixed in the strategy "Connectivity for a Competitive Digital Single Market – Towards a Gigabit Society": by 2025
- all schools, transport hubs, main providers of public services and digitally intensive enterprises should have access to internet connections of 1 Gigabit per second.
- all European households, should have access by 2025 to networks offering a download speed of at least 100 Mbps, and all urban areas as well as major roads and railways should have uninterrupted 5G wireless broadband coverage.

c) Large projects of common interest

The next MFF must guarantee the further financing of such projects as ITER (fusion energy), Galileo (and the space sector in general), and deploy instruments in the areas of defence and internal security, which all are pervasive elements of an industrial policy strategy.

What would be further required in the preparation of the next MFF is a holistic approach of the means at the disposal of the EU to support industry's competitiveness and investments, which include the cohesion and the infrastructure policy aspects of the EU budget, but also the investment policy including the EFSI and the interaction with the European Bank of Investments (EIB) or the public procurement policy.

Bearing this more holistic approach in mind, Orgalime proposes that the following type of activities should be prioritised in the next MFF, including for each priority increasing the investment in skilling and reskilling staff:

- Advanced manufacturing
- Digitisation
- Broadband infrastructure
- Energy
- Cybersecurity.

d) Investments

As the EU budget will remain modest, it is especially important to link it the strategic objectives of jobs, growth and output by setting up a strong EU investments policy. The present investments in EFSI and Industry R&D, and more focused EU regional funding demonstrate that it can be achieved. However, we feel that more has to be done as we see structural issues that have not been resolved. We provide in an annex to this position paper a more in-depth view on investment, based on our belief that the EU needs to be a top destination for manufacturing investment, leading to an increase of manufacturing in Europe. At the moment, we face structural problems that demand structural action: Europe is clearly falling behind compared to the USA in terms of investments in tangible and intangible assets.

We also are closely monitoring the Commission Regulation proposal (COM(2017) 487 final) presented on 13 September, which aims at establishing a framework at for Member States (essentially) to screen foreign direct investments into the European Union.

Conclusion: Towards a long-term vision

To conclude then, Orgalime welcomes the European Commission's Communication on "Investing in a smart, innovative and sustainable Industry: A renewed EU Industrial Policy Strategy" and hopes it is a first step towards the long-term EU industrial strategy which we feel is necessary: industry's investment decisions depend on a clear and predictable framework rather than on the next election.

In the short term, we are committed to working with the EU institutions, particularly the Estonian Presidency in view of the Competitiveness Council meeting in November 2017, and with the European Commission to shape the agenda of the "Industry Day" and to set-up the High Level Industrial Roundtable. In this respect, we would propose the Industry Day to become an Industry Week, on the models of the Green and the Energy Sustainability Weeks. We will also work with the European Parliament whose support for an EU Industrial Policy has been constant and determined throughout the recent years.

Beyond that, we believe that the digital transformation of industry, which embraces over all sectors from more traditional - yet strategic such as primary metal working sectors - to knowledge-based and smart industries, requires a strategic partnership between companies, industry associations, clusters and policy makers at regional, national and EU levels: this should be the goal for "Laying the Foundations"[3] of a European Vision for Industry.

Such an approach, however, is not just a short-term project, but requires a commitment of policymakers over the longer term. We count on the Commission and the EU institutions as a whole therefore to move toward a modern, forward looking and long term industrial strategy where both policy tools and financing focus on providing real EU value added.

Manager in charge: Pierre Lucas, pierre.lucas{at}orgalime.org

[3] The UK's Industrial Strategy Commission, Laying the Foundations, July 2017

Annex: Orgalime's views on investment

Executive summary

Orgalime is the prime voice of the EU engineering industry as whole. This is a growing industry both in terms of jobs and turnover. The industry employs nearly 11 million people in the EU and in 2016 accounted for some €2000 billion of output. Most of the growth in our industry arises from the innovative products, processes and systems which our companies develop in the EU and then market worldwide. Our sector is at the heart of the transformation currently taking place in industry, which centres on the merging of manufacturing and data technologies. It is at the core of strategic European value chains and of crucial challenges like sustainability and energy. Orgalime's Industry is an enabler of growth and productivity in other sectors. **With more investment, we can contribute to a higher competitiveness for the whole economy. Manufacturing has a proven track record in generating growth and jobs – not only in our own sector but throughout the economy. If policymakers can help us build on this, it is Europe's citizens who will reap the rewards.**

European engineering companies in many market segments are still maintaining and even developing their market shares. However, competition from Asia and America is fierce. The high level of investment in these continents puts European engineering and manufacturing industries under high pressure.

The EU needs to be a top destination for manufacturing investment, leading to an increase of manufacturing in Europe. We want our industry to still be able to do business and create growth and jobs in a decade. This paper expresses our rationale to make it happen.

The financial crisis in 2008/2009 showed us clearly that there is no alternative for Europe than to promote our industry and keep it in Europe to create sustainable employment and demand for other sectors of the economy.

We face structural problems that demand structural action in Europe. Once we stray away from the economic growth path it gets very difficult to catch up again. Europe is clearly falling behind compared to the US in terms of investment in tangible and intangible assets.

Europe is about to enter a more favourable phase of the business cycle. When that happens, the state of our economy needs to be ready to make investments and the capital stock grow again. There are several ways forward and measures that can be taken.

Among the most crucial ones is a focus on digitisation that can be promoted by giving incentives to invest in intangible goods. **Higher productivity is the key to competitiveness and jobs in the future, so there is no time to lose on prioritising the modernisation of our industry**.

To attract more foreign investment and keep our factories in Europe we need to improve our competitiveness also by supporting national fiscal initiatives with regards to investments and corporate taxation.

The European Commission established the European Investment Plan. This initiative is potentially helpful but needs milestones and further elaboration to channel the money into the right projects that have the potential to lead to increasing productivity in the future.

The European Commission put several very important initiatives on its agenda, including the Digital Single Market, the Banking Union, the Capital Market Union and the continuous improvement of the EU Single Market. This should lead to a level playing field for all potential investors and a more sound and predictable investment environment.

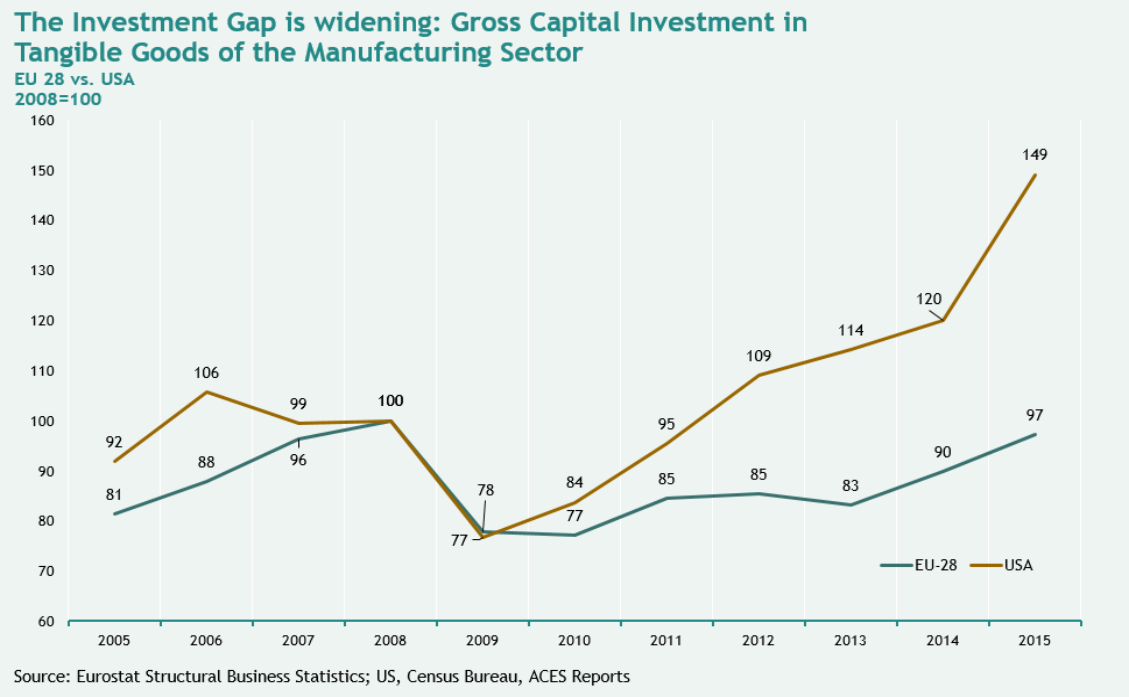
We present our detailed arguments hereafter.

Foreword: poor investment endangers technological progress and future growth

Orgalime believes that Europe – and our sector in particular – has the resources to contribute to a European industrial renaissance. However, we note that low level of investment could be a major hurdle if we want companies to be able to invest in Europe in the coming years. Indeed, the European Commission has acknowledged that **lack of investment is one of the biggest threats to economic recovery and restricts future growth potential.**

The engineering industry has continued to invest in Europe (EU 28) at an average of almost 61 billion Euros a year throughout the past decade.

In the USA, however, investments in the manufacturing sector have exceeded the level of the pre-crisis years by nearly 50% whereas in **Europe we were still below that benchmark in 2015**. It is an undeniable fact that **Europe is clearly falling behind**. Falling investment rates have a huge impact on future growth perspectives. A falling capital stock over a long period removes the basis for technological progress.

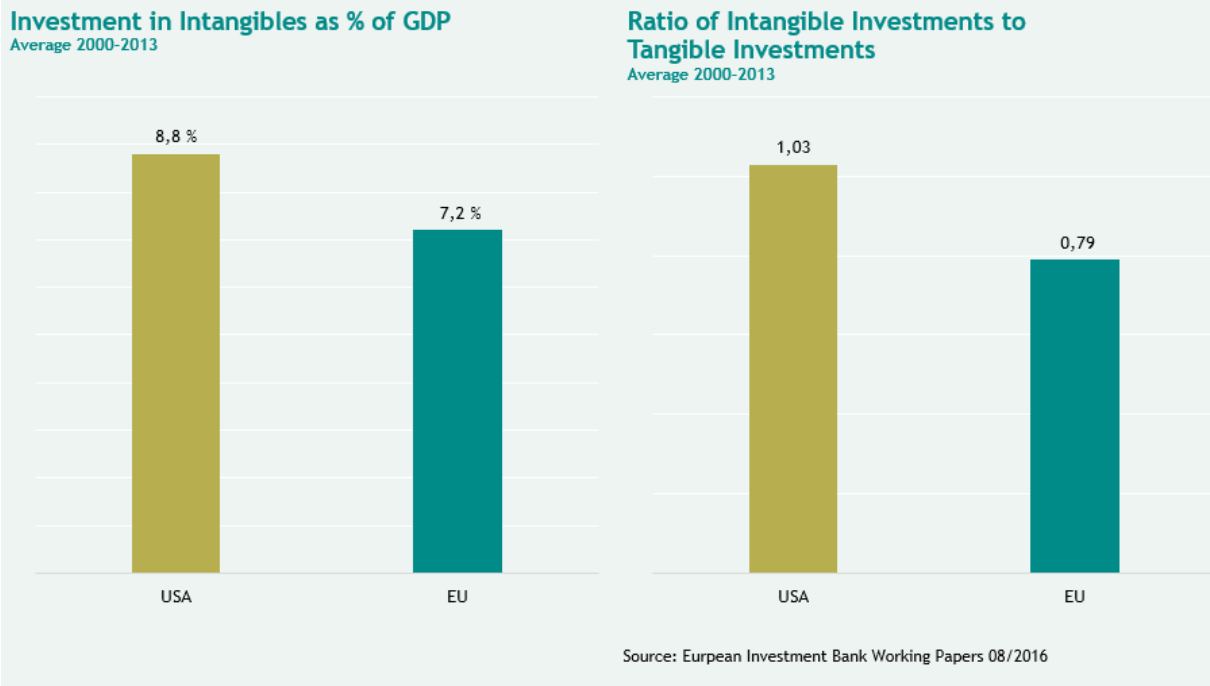


Similarly, **the situation is worrying for intangible assets**. The Council of the European Union underlined[4] that *"the stock of intangibles is still relatively low. The EU as a whole is still lagging behind the USA in this type of investments, without any sign of catching-up. Intangible assets are critical elements of a knowledge-based economy {…} Investment in intangibles are a driver of productivity and economic growth."*

This was also noted in the OECD Science, Technology and Innovation Outlook 2016 *"intangible assets investments have been very dynamic during the crisis, including in recent years, in Korea, Israel and Australia. Such investments have also recovered markedly in the United States since 2010, but have grown only slowly in Japan and the euro area. Noticeable cross-country differences in investment profiles exist even within Europe, signalling a growing threat to the continent's future economic cohesion"*.

According to the European Investment Bank[5], overall the countries that were more intangible intensive before the crisis (2000-2007) were less affected by the crisis or experienced a faster recovery.

[4] http://data.consilium.europa.eu/doc/document/ST-5252-2017-INIT/en/pdf
[5] http://www.eib.org/infocentre/publications/all/economics-working-paper-2016-08.htm



Additionally, **net investment rates are falling much faster than the gross investment rates**. We want to draw attention to the fact that publication of gross investment rates is misleading and masks a very unpleasant truth behind the figures.

Given that the difference between those figures is depreciation, the evolution of low investment figures (that are always in gross terms) is even worse if depreciations are subtracted. Gross investment has risen until 2008; an increasing capital stock leads to higher depreciation in the following years.

Consequently, with average depreciation rates rising afterwards, gross investment would need to be higher than historical benchmarks in order to avoid that net investment should become negative and the capital stock fall.

Estimates of real net investment for business and government combined, derived from new OECD estimates of the real productive capital stock, suggest that they are much lower than prior to the crisis.

According to OECD figures, the net investment is down by 69 % in 2014 compared to 2008. This is an important contributory factor behind the post-crisis weakness in potential output growth. **The major part of current investment is therefore in replacements and not new investment in innovative technology.**

There is an ongoing **structural change that might become irreversible** if action is not taken now. The current lack of investments cannot be explained by weak economic growth and the sluggish business cycle. There is structural change taking place that endangers the future of the core manufacturing industry in Europe.

The future competitiveness of our industry strongly depends on the ability to adapt to the new concepts of digitisation. A highly developed and high salary region like Europe has to be an innovation leader in order to compete with the rest of the world. That is why Europe risks falling behind if we lose the momentum in this critical phase of new rising digital concepts.

ORGALIME aisbl | BluePoint Brussels | Boulevard A Reyers 80 | B1030 | Brussels | Belgium
Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
Ass. Intern. A.R. 12.7.74 | VAT BE 0414 341 438

A. Reasons for weak investment

Orgalime believes that the following elements play an important role in the poor (?) investment climate.

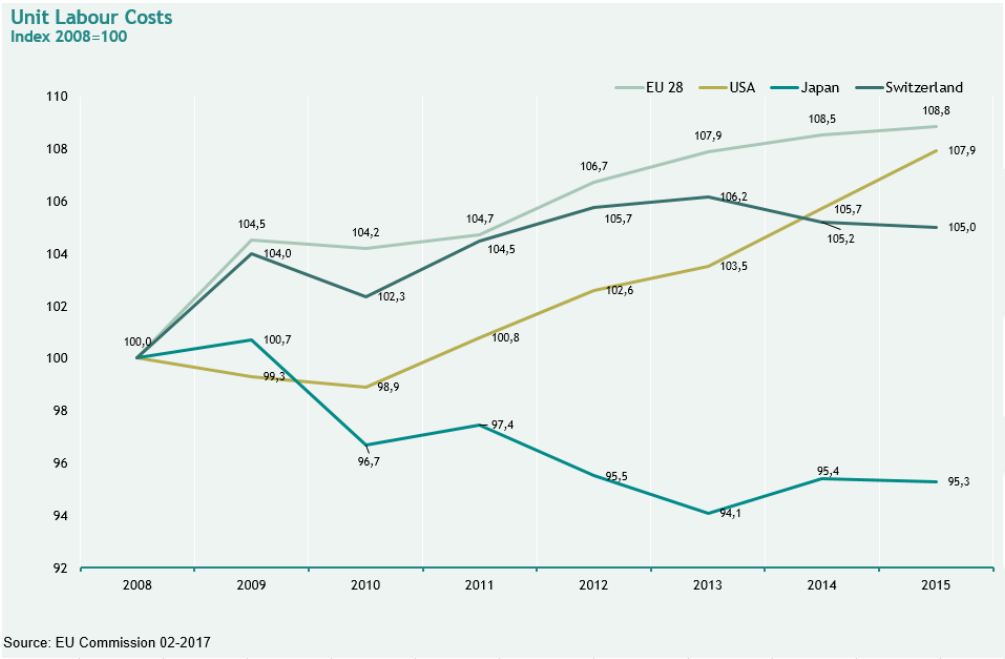
- **Weak growth rates in the last years including the 2008/2009 recession are among the main factors for weak investment.** There is a significant correlation between economic growth rates (output growth) and investment according to the IMF. Broad trends of investment can be explained by output dynamics.

- There was a **high degree of uncertainty and instability**. A sound economic environment and especially solid long term expectations are important factors for investment. This implies a good business climate with optimistic long term expectations. Unfortunately, this has not been the case in the last years. With too little investor confidence in the long term economic development potential, investment will fall or will shift outside the EU.

- Companies that are willing to invest in the **EU need a certain trust that the process of market integration in the EU will not be reversed but driven forward**. There is danger that the process of European market integration not only stops but also leads to tendencies towards disintegration. Discussions about the European Monetary Union and countries leaving the EU must be countered by concepts of deeper market integration in the EU.

- **Secular stagnation is a main issue and linked to a systematic slow-down in productivity**. As Larry Summers, former chief economist of the World Bank, stated, "*there is increasing concern that we may be in an era of secular stagnation in which there is insufficient investment demand to absorb all the financial savings done by households and corporations, even with interest rates so low as to risk financial bubbles*." Furthermore, excessive public deficits that have been triggered also through high money supply caused a crowding out effect: public credit demand crowds out private credit demand and therefore the ability to invest.

- **Competitiveness in Europe is diminishing compared to the rest of the world**. This means that with rising relative unit labour costs, Europe loses ground relating to competitiveness and therefore attracts less investments. This is true for Europe as a whole and even more for countries that could not increase their productivity after the crisis and maintained high labour costs at the same time. Unit labour costs in Europe increased by 8.8 % from 2008 to 2015, compared to 7.9 % in the US, 5 % for Switzerland and even negative figures for Japan (-4.7 %) in the same period**. Europe has lost ground in terms of unit labour costs** in the past and that cannot easily be revised.



Source: EU Commission 02-2017

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Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
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- **Overinvestment took place in the pre-crisis years.** High investment rates, coupled with the assumption of rising demand, led to a growing capital stock in absolute values. With shrinking demand in 2008/2009, the capacity utilisation rate fell together with profitability. Unused capacities reduce the need for new investment.

- **Lower profitability**, or in other words, lower return on capital reduced private investments **in the aftermath of the crisis.** A high capital stock (that has been established in the years prior to 2008/2009) is expensive to maintain and therefore new investments have a low return on investment.

- Despite low interest rates, **companies are frequently complaining about unfavourable credit conditions**. The European Bank Lending Survey shows a severe tightening during and after the crisis of 2008/2009 and only a very cautious and slight easing of credit conditions since then. A major share of the available bank money is used for financing public deficits instead of supplying the private sector with investment capital. This crowding out effect by public credit demand on private credit demand makes financing conditions for private companies in some countries hard, even if the cost of capital is low.

- **The availability of cheap input materials has reduced the pressure on companies to invest in new technology to stay competitive.** In fact, the prices of raw materials and energy have been low in recent years. One example is the energy efficiency technologies that lost momentum due to the relatively low energy prices.

- **In some economies, the capital labour ratio declines despite low capital costs** owing to a large number of unemployed people in some EU Member States. Moreover, a large share of them are unskilled. This increases the labour input relative to capital input and can also explain the reluctance to invest even in a low cost of capital environment.

The caveat we can add is that **customers of our industry increasingly lease equipment** instead of purchasing it. Thus, engineering companies themselves are changing their own business models from selling products to selling services. Therefore, leasing will be accounted for as an operating expense and not as a capital expense and service providers are accounted in statistics as service companies and not as a manufacturing companies.

B. EU initiatives

We acknowledge the work done by the EU in recent years to reverse the trend of low investment in Europe. We certainly welcome the following EU initiatives.

- **The European Investment Plan** ("Juncker Plan") potentially triggers investment. We think that this initiative potentially boosts investment under the right framework conditions.
    - The challenge is to channel the money into the right projects. This means projects that would not have taken place without the support of the fund and projects that are creating long term benefits in terms of productivity increase or technological progress.
    - There must be a suitable communication strategy towards companies and involvement of private SMEs in order to make the European Investment Plan efficient.
    - European initiatives such as the European Investment Plan need to focus more on specific projects that have the potential to increase productivity through modernisation and digitisation.
- Capital cost is currently extremely low in nominal and in real terms. Consequently**, access to funds cannot be the only solution.** The European Investment Plan can potentially be helpful but needs accompanying measures. As previously mentioned, there are structural problems and the European Investment Plan is not enough.

- **The EU Banking Union** that has been agreed on in 2014 to achieve a deeper integrated and better supervised banking sector became necessary after the crisis in 2008/2009. Capital markets will be more efficient and more transparent with a single rulebook that is monitored and implemented centrally. A more efficient capital market will improve the private sector´s access to finance.

- Capital markets are still fragmented even though the free movement of capital is one of the four freedoms of the EU single market. The discussions about the **Capital Market Union (CMU)** have

ORGALIME aisbl | BluePoint Brussels | Boulevard A Reyers 80 | B1030 | Brussels | Belgium
Tel: +32 2 206 68 83 | e-mail: secretariat@orgalime.org
Ass. Intern. A.R. 12.7.74 | VAT BE 0414 341 438

started in 2015 and could help bring back investment to Europe. The Capital Market Union removes barriers for cross border investments and can lead to a harmonisation of insolvency laws. The perspective of the largest EU capital market leaving the EU (UK´s exit of the EU) makes CMU even more urgent. It increases the transparency and liability of capital markets and will therefore have a positive effect on investment.

C. Possible ways forward

Despite the generally low level of investment in the past years, our industry grew. Growth in the engineering branch is all the more encouraging as the digitisation of industry has a pervasive effect across the entire value chain. Nevertheless, as noted in the two preceding chapters, the future of industry is particularly worrying. Yet we believe that some things could be changed to drive investment up in addition to the EU initiatives mentioned in Chapter B.

- Europe needs a **predictable investment environment** to give potential investors enough incentives to make use of the existing investment funds.
    - In a macroeconomic sense that means:
        - **sound fiscal policies among the EU Member States,**
        - **predictable pro-industrial taxation policies,**
        - **a more efficient law-making process that is better coordinated with business players and therefore more predictable and applicable for companies,**
        - **a stable regulatory environment,**
        - **less administrative costs of doing business in the EU.**

The European internal market is still heterogeneous and has to be reinforced. Industry needs an **equal level playing field** like for example in the environmental area. Moreover, the European Commission has put the **implementation of a Digital Single Market** (DSM) on its top priority list. We agree that it is a key issue and believe that a DSM needs to be established as soon as possible. Moreover, the Commission needs to ensure that the internal market rules are effectively applied which increasingly we see is not the case. Moreover this appears to be happening without the Commission seeking the legal remedies.

- To attract investment, it is necessary to **make Europe more competitive as a business location** by:
    - **holding back labour costs and increasing labour market flexibility**
    - **investing in R&D**
    - **taking measures that improve the regulatory framework**
    - **having a comprehensive single market for goods and services**

- **National fiscal incentives can trigger investment**. National schemes that subsidise investment, or taxation policies that trigger investment, have a positive impact not only on investment but on the whole economy. Following the economic crisis of 2008/2009 several countries have undertaken major efforts to boost investments in a difficult economic environment. For some countries, those initiatives have been important steps towards economic recovery and might also play a role in a European wide recovery of investment.

- **All tax incentives that trigger investments in R&D or the replacement of outdated machinery and equipment have positive spill over effects for the productivity of the Orgalime Industries.** According to r the IMF, every Euro that is spent in R&D in the private sector has a positive spill over effect of 50%.
  Moreover, declining balance depreciation rules are among national incentives that have a positive impact on investments with manageable fiscal consequences. Primarily in the first years of an investment, the decrease in value of an investment is particularly high, before it slowly decreases over the time of use. The 25% declining balance depreciation represents this value better than a purely linear depreciation. Hence, commercial law expressly permits declining -balance depreciation. It should therefore be a permissible method of depreciation for tax purposes as well.
  The faster rate of depreciation frees funds which can be used for additional investments and thus lead to more growth and employment. The declining balance depreciation method should be used not only as a crisis instrument to stabilize the economy, but also because it has a delayed impact.

- **Growth of productivity needs digitisation.** Investing in digitisation is one of the key answers to attract investment if labour and capital productivity is high enough and at a competitive level.

Conclusion: a structural change demands structural action

In an era of low interest rates and high Central Bank money supply, the cost of capital should be low enough to attract sufficient investment. This mechanism has not worked for the last 10 years and monetary policy has not proven to be the sole solution in the current economic phase. Despite historically low interest rates, investment has kept on falling or is on a low level.

The investment behaviour of companies is undergoing a structural shift. There is a risk that investment will not automatically pick up when we enter a more favourable phase of the business cycle.

Orgalime thinks that boosting investment is one of the key measures to support an industrial renaissance in Europe as the 20 % target of industry's share in Europe's GDP by 2020 seems difficult to reach. This holds true for both the sector of tangible and intangible investments.

If we want to keep the engineering industry in Europe, we need structural answers to the investment issues that have been raised in this paper.

Adviser in charge: Rozenn Maréchal, rozenn.marechal{at}orgalime.org

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