

Industrial Policy for Europe's Peripheries

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Paper outline

1. **Industrial Policy in Europe** (Renewed EU Industrial Policy Strategy 9/2017 & Smart Specialisation Strategies S3 2014-2020)
2. **What is missing?** How are “Europe’s Peripheries” (*lower/medium income countries and regions within countries – LMIC&R*) accounted for?
3. Macro-requirements and macro-coordination of the strategy: **the weaknesses of the tradable sector in LMIC&R**
4. Meso-micro requirements of the strategy: **the concentration of manufacturing industries (and KETs) among countries (“core”) and across regions (“islands”)**
5. **What industrial policy for Europe peripheries?** Feasibility, appropriateness and potential impact of **different types of policy instruments at different levels of policy action** – i.e. regional, national and EU-level. What policy governance reforms for coordination and multi-layered policy alignment?

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Industrial policy in Europe

- COM(2010) 546 **Europe 2020 Flagship Initiative Innovation Union**
- COM(2010) 553 **Regional Policy contributing to smart growth in Europe 2020**
- COM(2010) 614 **An Integrated Industrial Policy for the Globalisation Era Putting Competitiveness and Sustainability at Centre Stage**
- COM(2010) 2020 **A strategy for smart, sustainable and inclusive growth**
- COM(2012) 341 **A European strategy for Key Enabling Technologies – A bridge to growth and jobs**
- COM(2012) 582 **A Stronger European Industry for Growth and Economic Recovery - Industrial Policy Communication Update**
- COM(2014) 14 **For a European Industrial Renaissance**
- COM(2014) 903 **An Investment Plan for Europe**
- ...
- **Smart Specialisation Strategies (S3) 2014-2020**
- **Renewed EU Industrial Policy Strategy 9/2017**

Investing in a smart, innovative and sustainable Industry

What is missing? Europe's Peripheries (1)

- the main thrust of the Commission's industrial policy is mainly directed at **doing well in 'technological frontier' areas** (see the various technological trajectories that are named in these documents).
- **lacks a proper complementary analysis of the role of industrial policy in Europe's Peripheries: lower/medium income countries (LMICs) and regions (LMIRs) in Europe** (including countries that are not current members of the EU but whose industries gravitate around the EU industrial system)
- **lacks specific measures targeting the causes of increasing *structural dualism* across Europe**

Smart Specialisation Strategies (S3) 2014-2020

What is missing? Europe's Peripheries (2)

- lacks sufficient overview of the **macro-requirements and macro-coordination of such a strategy**
- **lacks selectivity at micro level**: S3 might reinforce dualistic industrial/innovation structure and concentration patterns – **S3 works best for those regions who do not need support!**
- lacks a strategy to **avoid regional duplication** and potential unproductive competition, while development of **industrial complementarities across European regions are still limited within national boundaries** (or across leading regions)

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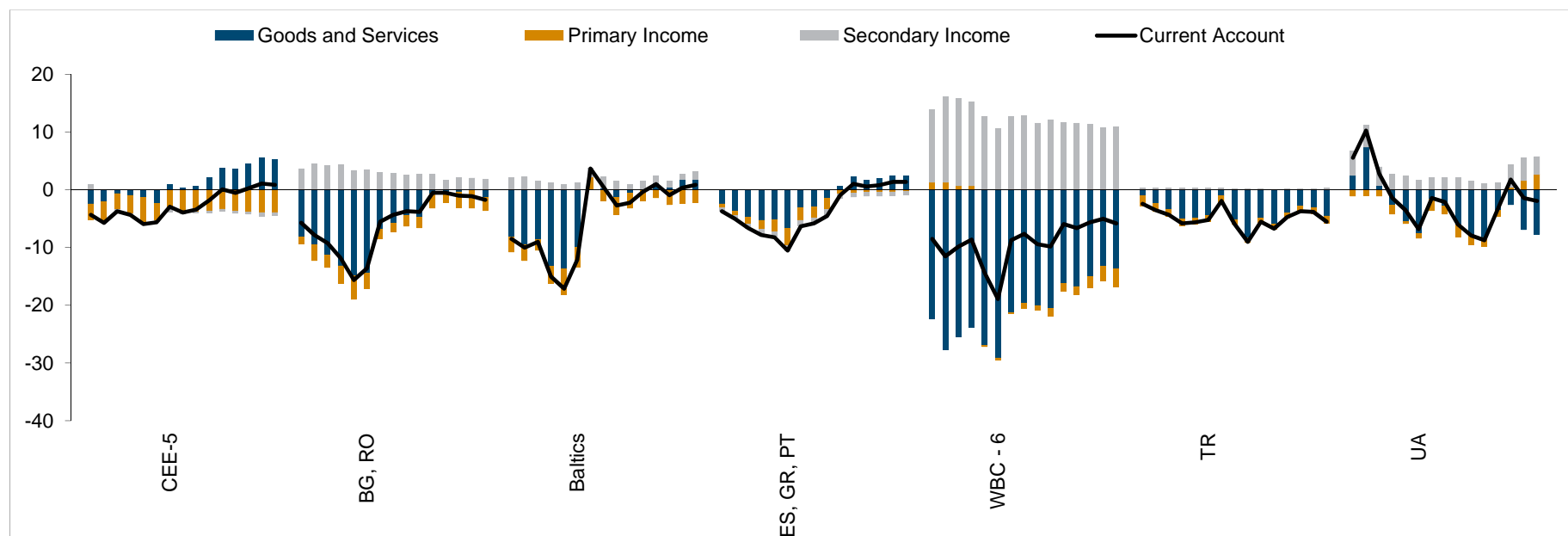
Macro-requirements and macro-coordination of the strategy: the weaknesses of the tradable sector in LMICs

- External imbalances in the European economy – focus on lower-/medium-income countries (LMICs)
- Specific issues for catching-up economies in the European integration context
- We focus on differentiation between:
 - **EU-South** (ES, GR, PT)
 - **CEE-5** (CZ, HU, PL, SK, SL)
 - **Baltics** (EE, LT, LV)
 - **BG, RO** (at times HR)
 - **Western Balkans** (WBC-6; AL, BA, MK, ME, RS, XK)
 - **Turkey, Ukraine**

The weaknesses of the tradable sector in LMICs

Development of the current account of the balance of payments, 2003-17, in % of GDP

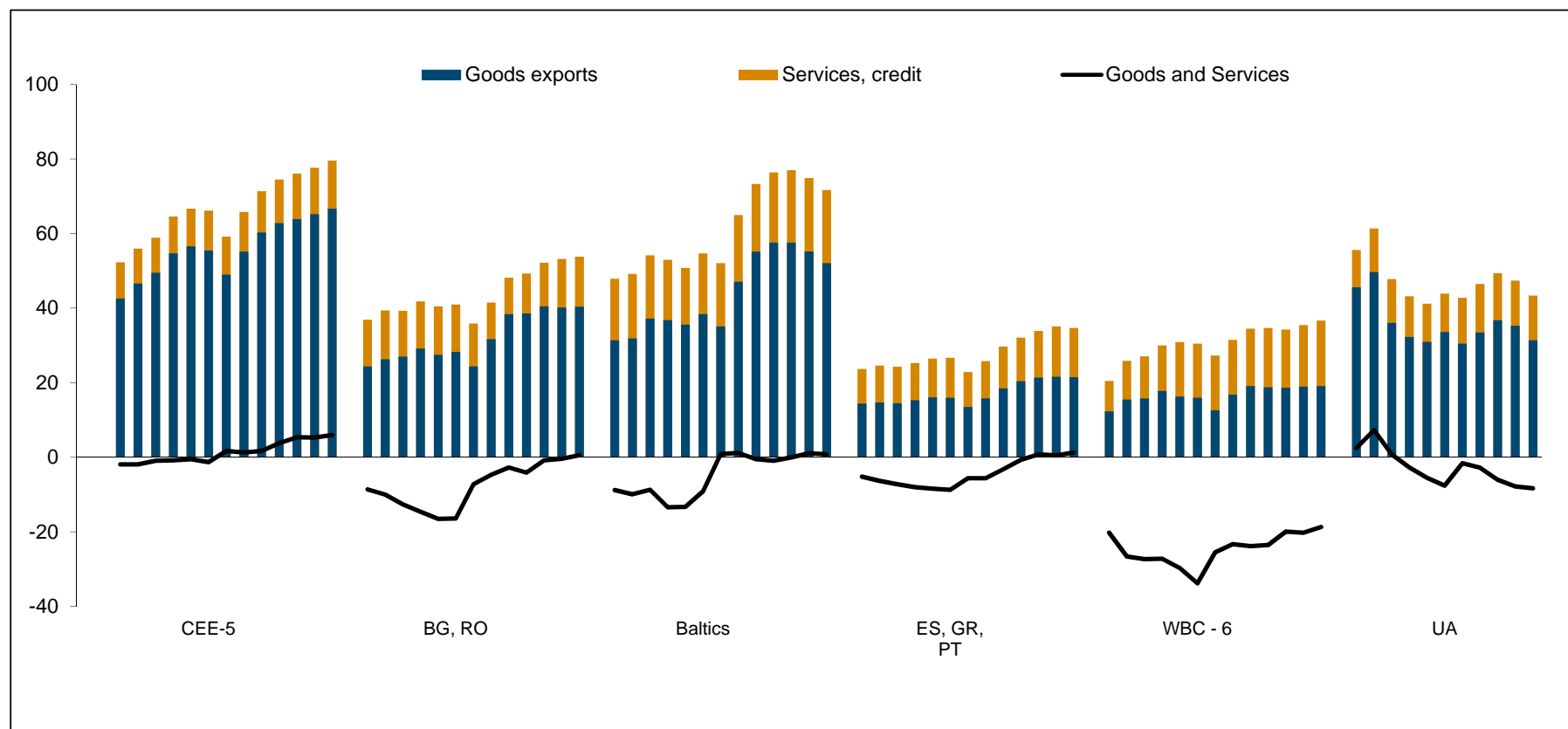
- pre-crisis: run-away deficits in some countries (trade balances, capital inflows);
- post-crisis: 'sudden stop'; income effects



Remark: Components refer to BOP 6th edition as far as available, BOP 5th edition before. Primary income refers to Income Accounts, secondary income to current transfers.

Source: wiiw Annual Database incorporating national and Eurostat statistics.

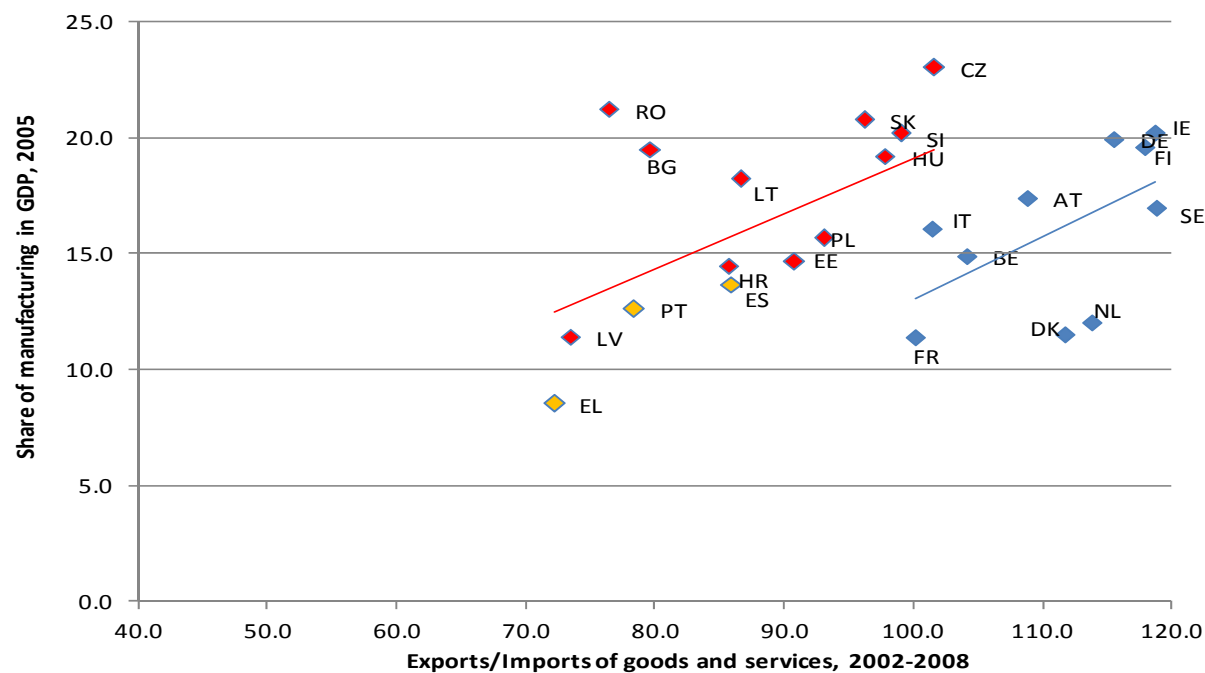
External trade, 2003-2015, in % of GDP - Persistent low export capacity in some groups of countries



Source: wiiw Annual Database incorporating national and Eurostat statistics.

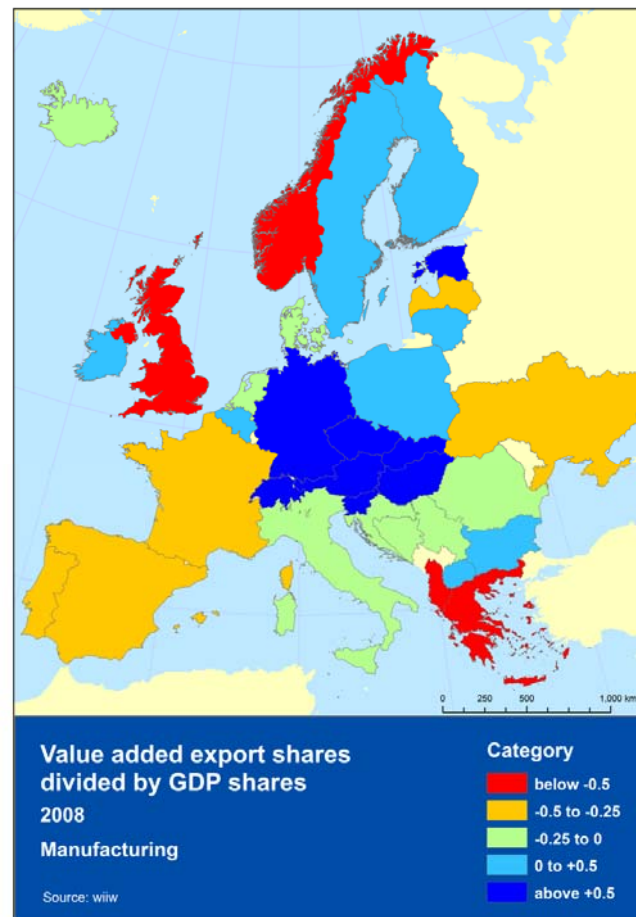
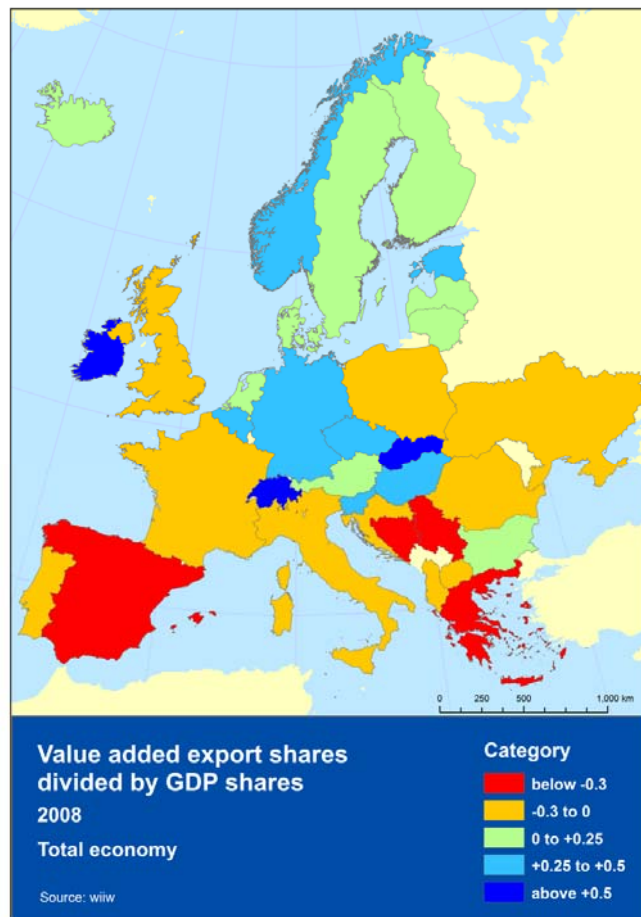
Position of manufacturing and longer-term trade balances

Share of manufacturing in GDP in 2005 and exports/imports of goods and services, average 2002-2008 – **manufacturing particularly important for medium-income countries!**



Source: Eurostat and wiiw own calculations.

Strong agglomeration of manufacturing industry – IIRPNs (international, inter-regional production networks)



Central manufacturing core:
The 'value added exports' indicator (or more precisely the shares of different European countries in total European 'value added exports' divided by the different countries shares in Europe-wide GDP) refers to direct and indirect contribution of a country to value added exports of Europe as a whole.

Note: On the left-hand side we show these shares – 'normalised' by GDP shares – for exports as a whole and on the right-hand side, for manufacturing alone.

What industrial policy for Europe peripheries?

The industrial strategy for LMIC&R in Europe is confronted with two key challenges:

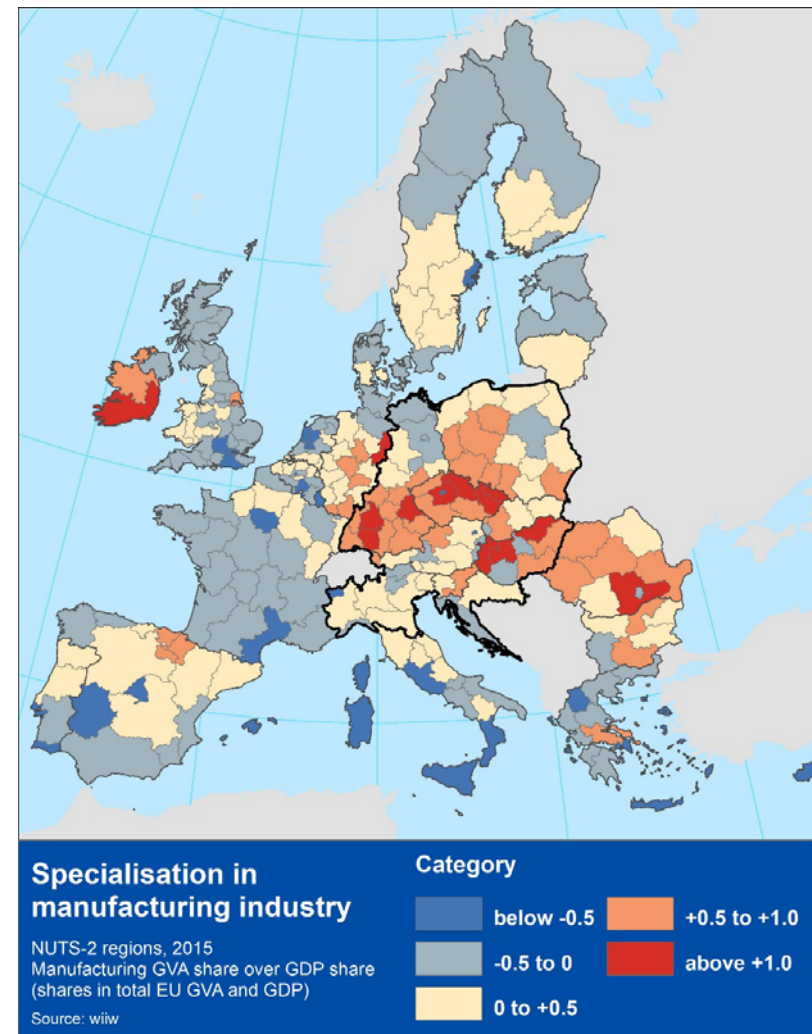
- **Weaknesses of tradable sectors in LMIC&Rs**
 - generate severe fragility of macro-stability of development paths;
 - very often the weakness of the tradable sectors in such economies is the result of capital inflows that favoured the non-tradable sectors (real estate, retail and wholesale distribution etc.) and is thus the result of full capital market openness in Europe (extending beyond the EU itself);
 - the legacy of such capital inflows has become ingrained in the sectoral economic structures of many LMIEs (i.e. over-expanded non-tradable sectors).
- **Concentration at the country and regional levels have been very strong in manufacturing in Europe.**
 - This is true at the country level with the shift towards the 'Central Manufacturing Core', but it also implies a certain dynamic at the regional level where the beneficiaries of IPNs are either on the Western borders of the LMIC&Rs or in the capital cities (supplying headquarter and other services inputs).
 - This resulted even in countries that benefited greatly from IPNs (such as Slovakia or Hungary) to show extremely strong regional imbalances and thus experience strong 'peripherisation' of regions.

Meso-micro requirements of the strategy: the concentration of manufacturing industries among countries (“core”) and across regions (“islands”)

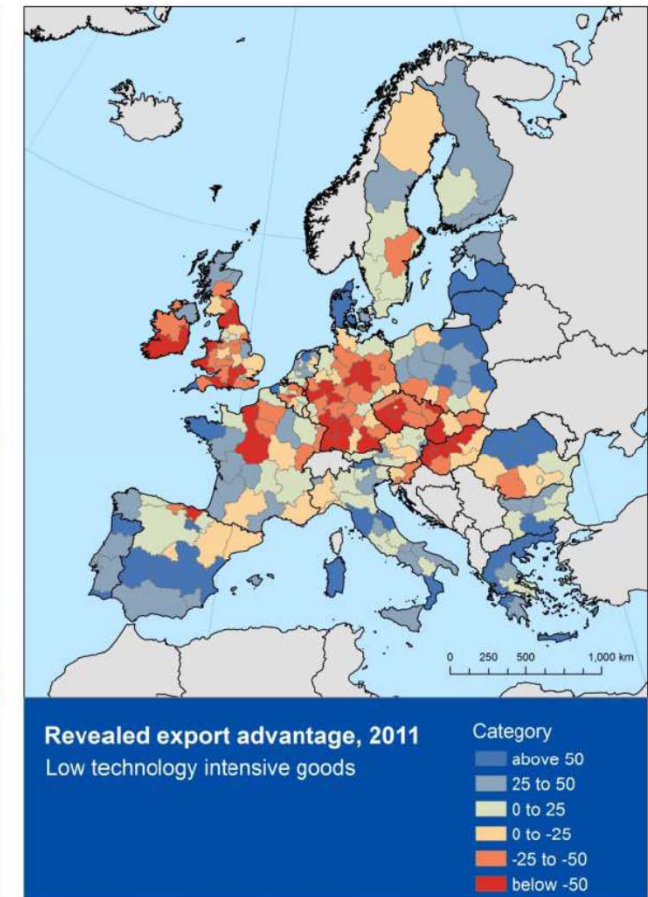
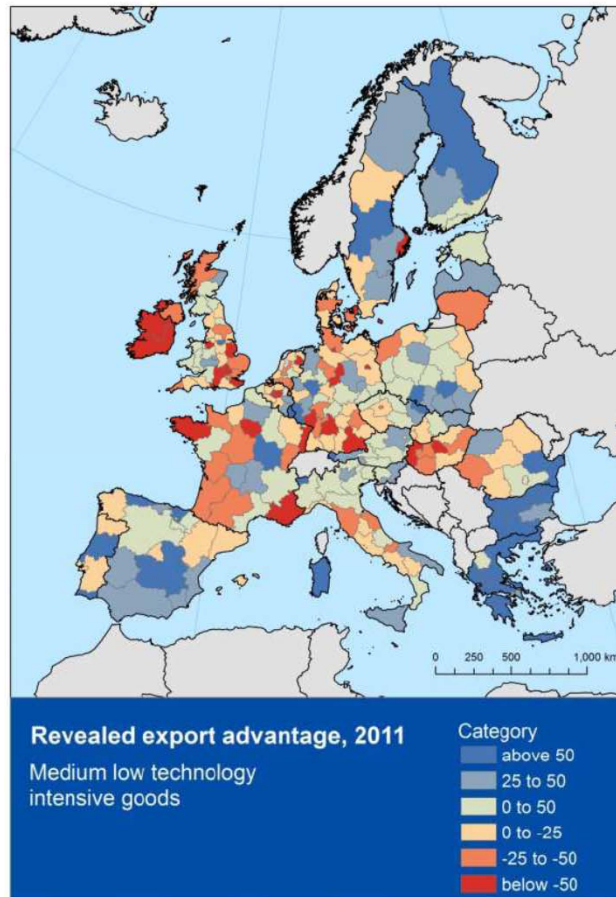
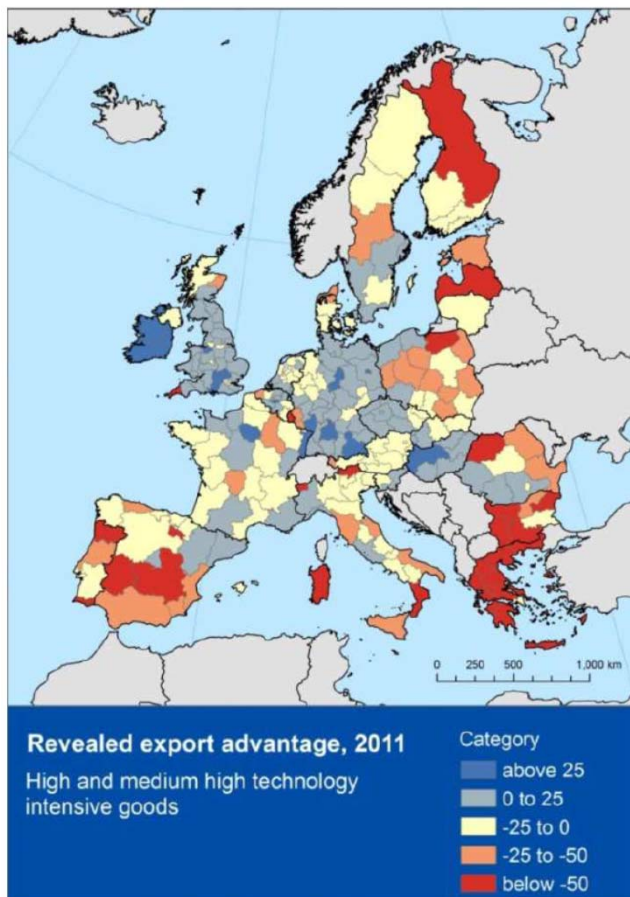
- The tradable sector in LMICs is largely about manufacturing products (directly or indirectly).
- **Structural dualism:**
 - **Among countries:** a very strong tendency over the past two decades of industrial production getting very strongly concentrated in – what Stehrer/Stöllinger called the ‘Central Manufacturing Core’
 - **Across regions:** Regional industrial ecosystems within and across European countries have been also diverging with respect to value creation and capture performances, and the underlying patterns of diversification, technological specialisation and integration in European and global production networks – this lead to **de-industrialisation in certain regions and the emergence of fragmented “manufacturing islands”**

Meso-micro requirements of the strategy: the concentration of manufacturing industries across regions (“islands”)

- In terms of **industrial output**:
MVA at NUTS2 levels
- Specialisation in manufacturing industry (NUTS-2 regions, 2015) reveals the **emergence of manufacturing “islands”** in all countries, around a “core” set of regions concentrated around German’s southern regions (Baden-Wurttemberg and Bayern) and Czech republic (mainly specialised in automotive, automation, advanced manufacturing systems)



Meso-micro requirements of the strategy: the concentration of manufacturing industries across regions (“islands”)

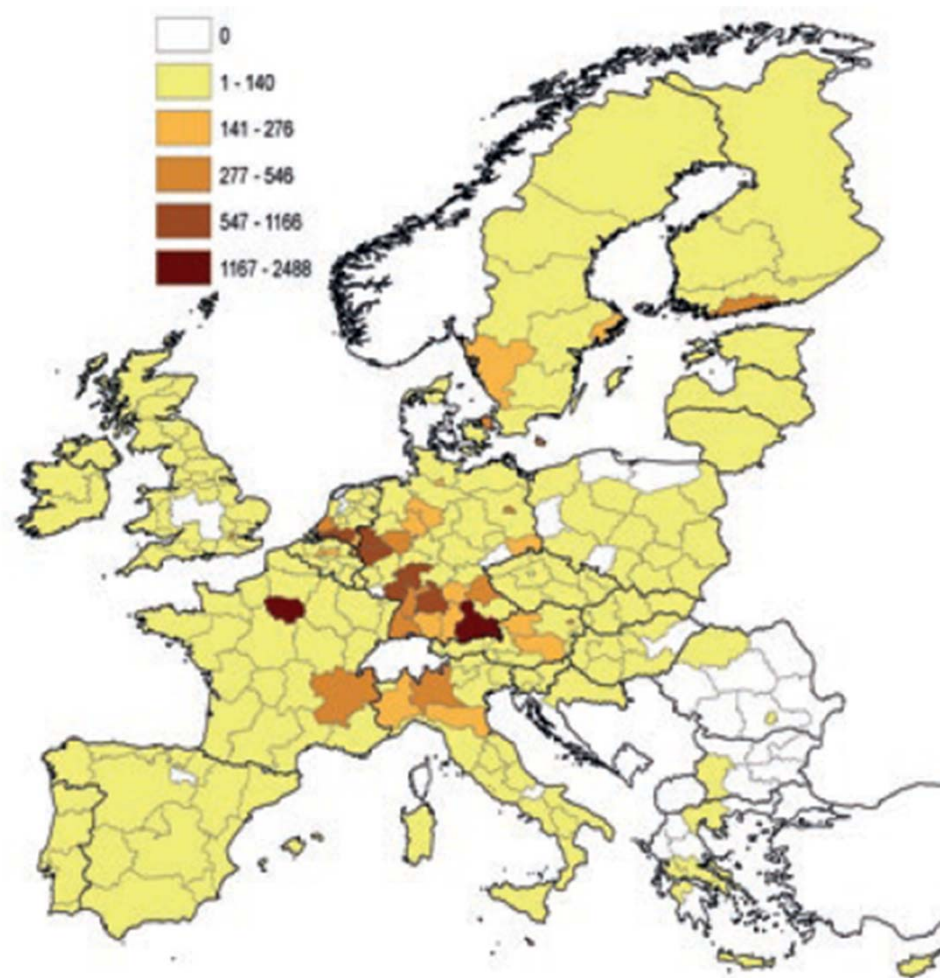


Micro-meso requirements of the strategy: the concentration of Key Enabling Technologies (KETs) among countries (“core”) and across regions (“islands”)

Key Enabling Technologies mapping of the total patent filings across EU Regions 2011

- The number of total KETs-related filings in most European regions is below 140.
- 44% of KETs-related patents originate from only ten regions over 293.
- In the top ten regions, 6 are from Germany, 1 from Italy, 1 from France and 1 from the Netherlands.

Note: KETs include Advanced materials, Advanced manufacturing systems, industrial biotechnology, Photonics, Micro and Nanoelectronics, Nanotechnology



Source: EU KETs Time to Act Report, 2015

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What industrial policy for Europe peripheries?

- There are both macroeconomic requirements and meso-micro requirements, calling for regional, national, EU-level (in some cases Europe wide) industrial policy coordination and better alignment (e.g. technology/innovation policies and industrial/production centred policies)
- Different types of policy instruments can be deployed more or less effectively at different levels of policy action (e.g. technology policies might work better at the regional/cross regional levels, while macroeconomic requirements tend to require macro and EU-level government intervention)

		INDUSTRIAL POLICY PACKAGES							
		Supply side						Demand side	
		Innovation and Technology Infrastructure	Higher education and workers training	Production capacity and advanced mfg operations	Long term capital access	Resources access	Infrastructure and networks	Internal Demand & Public procurement	External demand and Intl Market development
POLICY MODEL & LEVELS OF POLICY ACTIONS	Regional	Manufacturing sectors							
		Manufacturing system	●	●	●				
		Industrial system				●			
	National/Federal	Manufacturing sectors	●						
		Manufacturing system		●					
		Industrial system		●		●			
	Supra-national level (EU)	Manufacturing sectors					●	●	●
		Manufacturing system	●						
		Industrial system			●	●			
	Macro-economic framework	Manufacturing sectors							
		Manufacturing system							
		Industrial system							

What is the most effective governance model (and related level of policy action)?

Regional industrial policy

National industrial policy

Supra-national (EU) industrial policy

What industrial policy for Europe peripheries?

Financial system, infrastructure investments and periphery specialisation strategies

- Development banks, both national and EIB, as critical ‘operational arms’ for industrial finance, also need for a diffused industrial finance infrastructure, based on public financial support schemes (long-term financing, matching grants, pre-commercial public procurement and financial guarantees)
- In the current EU/global situation the connectivity to IPNs plays an important role for export capacities development. Certain countries and regions are favoured by circumstances such as geographic location (e.g. being located near to EU advanced manufacturing core).
- However, the disadvantages of other regions and countries could be counteracted by
 - policies improving transport, communications and logistics costs and also favouring sectors in which transport costs play less of a role.
 - policies coordinating regional strategies (S3 type) towards specialisation in high value manufacturing niches, to avoid duplication and promote complementarities

What industrial policy for Europe peripheries?

Incentives, regulations and intra-European imbalances

- We have to accept in Europe that we cannot replicate East Asian types of industrial policies as the framework conditions of the Single Market with its 4 freedoms i.e. including capital market openness.
- However, **this does not mean that governments and regional authorities should not influence the nature and sectoral distribution of capital inflows, as well as the value distribution across and within sectors:**
 - by discouraging capital flows towards real estate and encouraging investment into the tradable sector.
 - by reducing financialisation of manufacturing companies through corporate governance reforms and financial market regulations
 - by strategically addressing incentive structures regarding value capture along supply chains and value retention at the local level
 - by utilising commercial and pre-commercial public procurement to support business development in peripheral regions
 - by enforcing EU regulations regarding persistent intra-EU current account imbalances (e.g. coordinated demand management policies, tighter financial market regulations)

What industrial policy for Europe peripheries?

Re-industrialisation and the production-innovation nexus

Beyond the Lisbon Agenda's "innovation without production" bias, and towards an augmented S3 focusing on industrial production challenges:

- **Restructuring and integration of national intermediate R&D institutes and R&D incentive schemes:**
 - Better exploitation of European industrial research, 'complementarities discovery' and scale/scope economies beyond effort duplication
 - Supporting cross-regional system integration and re-building of diffused industrial competences at the regional level
 - Providing quasi-public good technologies, de-risking investments in emerging technologies
 - Taking an active role in industrial sectors restructuring and sectoral/regional transitions
- **Revamping the TVET system and favouring *cross-border* opportunities for dual-apprenticeship, internships, specialised training.**

Concluding remarks

An industrial strategy for LMIEs is required to counteract

- (i) macro-disequilibria and
- (ii) strong and persistent agglomeration tendencies in the principal tradable sector of LMIC&Rs, i.e. manufacturing.

Within a multi-layered industrial policy package, interventions at different levels include three main areas:

- **Multi-level governance framework and policy alignment**
- **Financial system, infrastructure investments and periphery specialisation strategies**
- **Incentives, regulations and intra-European imbalances**
- **Re-industrialisation and production-innovation nexus**