

## Reindustrialization of Europe at crossroads.

Preliminary discussion note for ELEC<sup>1</sup>

### From 'délocalisation' to 'reindustrialization'

Nine years ago this ELEC-commission held a meeting on the probable 'délocalisation' of economic activities to the then recently expanded economic area through the admission of the new member states in Central and Eastern Europe. In addition, attention was given to the consequences of production shifts to Asia, in particular to China.<sup>2</sup>

Now, almost a decade later, many European economies the situation with regard to employment, output and income is even more problematic. The banking crisis and the resulting adverse financial, budgetary and financing conditions have worsened the prospects for a rapid and sustained recovery of economic activity. Although recent figures give hope for an economic recovery, it will take considerable time before 'normal' settings will materialize.

Since the late 'nineties the share of manufacturing industry has become smaller in Europe's economy.<sup>3</sup> This stagnation has recently received attention from national policy-makers but also, and more strongly, from the European Commission. In particular from Messrs. Barroso and Tajani who urged for the growth of industry's share in GDP from 16 percent now to 20 percent in 2020.<sup>4</sup>

With the increasing openness of the continental economy – to be further accessible as a consequence of an eventual Free Trade Agreement with the USA – the fabric of the dominant socio-economic system in the EU is at serious risk.

It is evident that since the mid-nineties average wages have stagnated at best<sup>5</sup> and the income distribution has become much more skewed. Furthermore, with the start of the - largely imported - banking and public financial crises national income dropped, unemployment rose significantly, household income stagnated or declined, while the extent of poverty in the great majority of member states expanded considerably.

Under these worsened circumstances, it is evident that governments and the European Commission feel obliged to attempt altering the course of the (working of) economy in order to expand employment opportunities and improve income levels. This in the first place by putting

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<sup>1</sup> Prepared for ELEC's Economic and Social Commission meeting on the need for a reindustrialisation policy in the EU (Paris, 15 May 2014) Some emphasis is given to Italy..

<sup>2</sup> At that time I prepared the discussion note 'The Dynamics of Relocation of Economic Activities'(attached)

<sup>3</sup> In its latest yearly economic outlook the CPB Netherlands Bureau for Economic Policy Analysis mentions the decline in the investment quota of manufacturing industry in major EU-member states between 2000 and 2011 which "*coincided with de-industrialization of many western economies*" (Centraal Economisch Plan 2014, p. 41)

<sup>4</sup> On 22 January 2014 the Barroso and Tajani gave on behalf of the Commission a statement to the press on the policy on the *Industrial renaissance*. On 28 February the policy paper was discussed with the 28 EU's ministers of industry. On 20-21 March 2014 the Commission's comprehensive *Communication 'For a European Industrial Renaissance'* was discussed in the meeting of the heads of states and governments.

<sup>5</sup> Recent data indicate that average wages and family expenditures in Italy declined significantly since the turn of the century. In 2013 in the Netherlands minimum wages amounted to 45 percent of the average wage income compared with above 60 percent three decades ago. Furthermore, presently 6,2 % of the labour force has a minimum wage, as against less than 3 % two decades ago. Some observers state that the country has become competitive world-wide because of the prevailing high labour-productivity.

emphasis on stimulating private sector initiatives for high-productive and innovative manufacturing industry.

However, because of EU-competition rules and, more significant, the poor state of public finance<sup>6</sup>, restricted bank resources and the limited self-financing potentials of the business community, it will be no easy task to steer capital resources to finance technological upgrading of large-scale plants and to restructuring entire industries to make them competitive on the world market, without jeopardizing the major principles and characteristics of the social market economy.

## Re-industrialization

The Commission *Communication* makes it very clear that the two categories of industrialisation are not envisaged:

a. Repatriation of 'traditional' capital-goods and durable consumer goods producing industrial activities. Since the 'seventies these have been relocated to newly industrialized or emerging economies such as the Republic of Korea, Taiwan, Brazil, Turkey, and more recently China, Vietnam and India. Non-specialized large-scale shipbuilding and steel plants are examples. In addition, the production of transport vehicles, electronics and home appliances have been located in some of these countries following the initial example of the 'growth miracle' Japan of the 'sixties and 'seventies.

b. Repatriation of production of labour-intensive consumer goods (apparel, foot-wear, furniture, etc.) and semi-finished products which are massively produced by China, India, Bangladesh and Asian countries. The flow of investment resources from the USA and Europe for increasing output capacity in China, Vietnam, etc. - thereby creating additional jobs - is still expanding. It implies added 'opportunity cost' for labour markets in higher income EU member states in the form of diminishing low-productivity employment opportunities. Unless a 'race to the bottom' in wages is commenced.

The relocation of the first category, should this imply the end of all 'heavy' industrial activity in Europe? The present situation in *Italy* is maybe characteristic for many other European economies. On 25 April 2014 the steel factory Lucchini in Piombino was closed. Some 3000 persons became unemployed. It is likely, that in past periods other local or European steel companies or public funds would have intervened and given opportunities for a new start. However, present adverse market conditions and high unit production cost are prohibitive factors. However, it is still surprising to note that efforts have been made to interest the Tunisian Smc, controlled by the Jordan's Khaled El Hababbeh, in investing in the plant. But, it would be more probable that the Jsw group of India would be willing to consider a participation in the steel mill.<sup>7</sup>

This case would indicate the possible dependence of Italian large-scale industrial activities on non-EU capital resources and eventual entrepreneurship, as already experienced in other EU-economies. Would the Union's economy become dependent structurally on investment funds arriving from Gulf-countries and the BRICs?

Italy's and Europe's biggest steel plant ILVA in Taranto was threatened to halt production entirely in the summer of 2012 because of the very adverse environmental impact (severe air pollution during many years) on the city and its inhabitants. In 2013 the company came under government tutelage.<sup>8</sup> Soonest this plant must become more competitive and environmentally sound. In

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<sup>6</sup>In other words the 'shock-absorption' capacity of governments has been severely affected.

<sup>7</sup> Source: 'Corriere de la Sera' 26 April 2014.

<sup>8</sup> In a recent meeting with the prime minister Renzi it was estimated that the environmental upgrading would cost € 3 to 4 billion.

February 2014 ArcelorMittal would have expressed interest to take over the money losing steel giant. In addition, Russian and Chinese investors were mentioned. Thus far, no merger with or take-over by a foreign or Italian company has been announced.

### **Re-industrialization in a competitive world economy.**

The globalized competition in non-local products and services is having a great impact on sectors which have been the mainstay of the economy in European countries. High quality production activities have already been halted because of competition emerging in low-cost economies.<sup>9</sup> The import from these economies soared tremendously, the low prices of these goods attracted the consumers in the 'industrialized' economies.

Since the 'nineties 'consumers' in the most EU-countries gradually became less 'producers'. This occurred either by the relocation of production to new member countries of the EU in the first decade of this century - and the considerable inflow of their citizens to the earlier member states, or by the great shift of production of goods and services to the emerging economies.

These are facts of life. One should not forget that a more equal international division of labour, i.e. industrial production, was a main element of UN development policy since the 1960's. In the Declaration of Lima in 1975 this strategy for spatial diversification of industrial output was envisaged.<sup>10</sup> It is without any doubt that industrial output has spread over a much wider group of countries, though in the Near-East, North Africa and sub-Sahara Africa the progress made is limited.

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The Commissions *Communication* emphasizes that 'EU companies cannot compete on low price and low quality products. They must turn to innovation, productivity, resource-efficiency and high-value added to compete in global markets.' (pp.8,9 ) At the same time, Europe's industry should be energy-saving and be green.

The Commission considers as principal enabling strategies the following instruments: stimulating investment in innovation and new technologies; increasing productivity and resource efficiency , and facilitating access to affordable production inputs; upgrading skills and facilitating industrial change.

Productivity of labour and capital must be raised in many sectors and countries according to the Directorate General for Economic and Monetary Affairs of the Commission. This is the case in particular for Italy. For this country main stumbling blocks have been the inefficiency of the public sector, excessive use of resources in less productive sectors and low investment in research and development.<sup>11</sup> These obstacles to innovation and growth have been observed also in other countries.

New business strategies imply major restructuring which, generally, are accompanied by job reductions. Recently, Siemens announced that five to ten thousand positions would be scrapped. This fall in employment opportunities in manufacturing has been taking place all over the EU in the

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<sup>9</sup> For instances in the Netherlands almost the entire textile industry disappeared in the 1980's and 1990's. In cities such as Enschede, Almelo and Tilburg the local economy had to be transformed radically. All over Europe this occurred.

<sup>10</sup> Not only in small-scale activities: '*developing countries should devote particular attention to the development of basic-industries such as steel, chemical, petro-chemicals and engineering, thereby consolidating their economic independence while at the same time assuring an effective form of import-substitution, and a greater share of world trade*' (Article 52) Second UNIDO Conference. This article reflects the call for a more equal world economy made at the time of focus on the New International Economic Order. Forty years later virtual all developing countries want to participate actively in the global economy.

<sup>11</sup>'*Pochi investimenti high-tech, lo Stato non aiuta ma frena*': 'Corriere della Sera' 29 April 2014 '

last ten to fifteen years. In some countries at a higher speed than in other. The Eurostat employment figures have made this evident.<sup>12</sup>

### **Need for a *European* policy of re-industrialization**

It is evident that during the last three decades investment in manufacturing industry in Europe decreased, mainly as an outcome of relocation of output in low-cost countries. Such redirections were in the first place aimed at producing simple consumer goods for the European markets. Then, the emerging Chinese, Indonesian, etc. markets were supplied, at least that was the additional objective. By now, it is obvious that plants in China<sup>13</sup> and other Asian countries are increasingly competitive in producing more knowledge and technology-intensive products, implying further impact on employment opportunities in manufacturing industry in the EU.

By opening plants in China European companies risk to be taken over eventually by Chinese investors, such as happened with Volvo. Though plants are (still) located in Sweden, decisions are taken in China or by the Chinese owners.<sup>14</sup>

### *Emphasis on 'champions'?*

It must be obvious that in a globalizing world economic system it is crucial that centres of *decision-making* of large European companies should remain in the EU, if one wants to maintain and sustain the model of business organization as developed since the end of the Second World War. The social market economy – with or without some form of *dirigisme* – has been the main system adhered to.

If this scheme – with a substantive role for employers organizations, labour unions and other sections of society – should continue to persist, it is clear that that decision-makers must be leading companies established in EU member states.

The successful development of Airbus indicates that European collaboration in capital-intensive and high-technology employment is an obvious path to be followed. Though In the case of Airbus one created basically a new enterprise, this kind of bundling of know-how and investment resources could also materialize in the case of existing large companies such as Alstom and Siemens, who are asked by the French government to work closely together in the fields of transport capital goods and energy.<sup>15</sup>

An autonomous and competitive industrial sector should be sustained in the EU if decision-making on investment, productivity and employment would be take place in the Union. In addition to the

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<sup>12</sup> Also in the banking sector the number of discharges has been dramatic. A few days ago the Barclay Bank announced the dismissal thousands of employees in its investment section.

<sup>13</sup> Chinese shoe factories are now established in lower wage countries such as Ethiopia.

<sup>14</sup> The saga of SAAB shows that its acquisition by General Motors in 2000 could not impede the collapse of the company in 2010. After years of negotiations in 2013 it became in the hands of the National Electric Vehicle Sweden company owned by investors in Hong Kong and Japan.

<sup>15</sup> The French minister of Economy, Mr. Arnaud Montebourg, expressed his preference for cooperation between Alstom and Siemens if production would continue in France. The interests of the company, the employees and the economy should be safeguarded. In the week of 23 to 28 April President Hollande, minister Arnaud and other authorities have held discussions on the future of Alstom with the ceo of General Electric Jeffrey Immelt, Martin Bouygues and Joe Kaeser, ceo of Siemens. On 1 May 'Le Monde' paid major attention to the Alstom-case. For the Italian Ansaldo Breda (train and metro builders) and Ansaldo Energia the final outcome of these discussions on the European or non-European future of Alstom will be of great importance. However, meanwhile the Chinese Shanghai Electric and the Korean Doosan Heavy Industries have signed contracts with Ansaldo Energia in the field of financing and technical cooperation. Doosan would eventually become the main shareholder of the company. (Source: Reuters Italia, 8 May 2014)

Alstom-dossier, the takeover struggle for AstraZeneca is presently being highlighted in British and Swedish politics and the press.<sup>16</sup>

The urgency for *competitive* reindustrialisation has been expressed in the Conclusions of the meeting of the European Council held on 20 and 21 March 2014. The final communiqué endorsed the *Communication* 'For a European Industrial Renaissance', and invited the Commission to 'present a roadmap for taking work forward on this basis'. In this connection the Council stressed that industrial competitiveness concerns 'should be systematically mainstreamed across all EU policy areas and be part of impact assessments in view of getting a stronger industrial base for our economy'.

#### *Medium and small enterprises*

These form the backbone of manufacturing industry in countries such as Italy, Austria, Germany France and the Netherlands. Since 2007/2008 in most of the EU-countries they have been confronted with *shrinking markets* and *limited bank resources*. On 22 January 2014 Mr. Tajani in presenting the *Communication* on reindustrialisation stressed the crucial position of the SMEs in the economy and their role in production, employment and exports.

On 30 April 2014 the ECB published its tenth report on the results of the 'Survey on the access to finance of small and medium-sized enterprises in the euro area'. Its main conclusions are the following: a. access to finance remains an important concern, though it is important to note that finding customers and the cost of labour and unit of production are additional adverse factors; b. SMEs reported a deterioration in the availability of bank loans, albeit to a lesser extent than in the previous survey; c. results suggest that financing conditions for SMEs continue to differ significantly across the euro countries; d. loan conditions are in general more onerous than those applied to larger companies.

(In Italy, in recent years many of such enterprises in the financial sector affected the performance of parts of the real economy. With the unavailability of refinancing had to close down because of dwindling demand - both local and foreign, natural disasters (earthquakes, flooding), and, even more frequent, the absence of bank credit. The problems of and resources thousands of SMEs collapsed and tens of thousands employees lost their specialized jobs.)

As the *Communication* indicates 'regulatory and administrative cost can impact SMEs up to ten times more than larger companies'. Therefore, simplification of starting procedures and lower cost should materialize.<sup>17</sup>

#### **Financing of re-industrialization**

This could be the most problematic issue. The public sector debt in most EU-countries is way above the limit of 60 percent of GDP. It is likely that that in most member states this percentage will further increase.

All this would imply that financing by public sector resources will not easily materialize as in the past when governments took a stake in a 'strategic' sector or company.<sup>18</sup> In addition, EU-rules are become more strict on subsidies, among other instruments, to (re-)finance private enterprises. Major

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<sup>16</sup> The Financial Times covers the issue on a daily basis (as Le Monde does for Alstom). On 7 May premier Cameron seems to request additional conditions for research activities in the UK. The example of Dutch pharmaceutical Organon provides the eventual consequences of a merger (takeover). In 2007 it was bought by the American company Schering-Plough which in 2009 merged with Merck into Merck Sharp & Dohme (MSD). After several reorganizations research was discontinued and the plant was largely dismantled. .

<sup>17</sup> In Italy the new government under premier Renzi has the reduction and simplification of administrative organisation and procedures as one of its main objectives

national rescue exercises<sup>19</sup> or capital sharing arrangements, as were implemented in former times, would become of less significance.

Secondly, in view of the rebuilding of the capital resources of a high number of banks, required after the banking crisis, will at least temporarily restrict the access to loans. On 29 April the ECB announced that it would give banks six to nine months to cover capital shortfalls after the comprehensive assessment, the results of which will be published in October 2104: 'Recapitalisation measures to cover any shortfalls detected should rely on capital instruments of the highest quality, unless the shortfalls are reduced through other means.'

However, new financing opportunities will be there. On 22 January Barroso and Tajani mentioned that € 100 billion could be used from the European Structural and Investment Funds (ESIF). Second, at least some € 40 billion of the innovation and scientific research funds ( Horizon 2020 Programme) could be allocated as essential sources for innovation and higher-technology and productivity manufacturing. The European Council endorsed this proposal in March..

In addition, the EIB was approached for opening facilities for investment loans especially to SMEs. Unlike large corporations who can look for funds on the bond markets, SMEs are principally dependent on bank financing, in a internal market for bank credit which still is fragmented and where borrowing rates are significantly divers.

The March 2014 European Council requested the EIB to 'further contribute to enhancing European companies' internationalisation and competitiveness'.

In addition, the increasing activity on the bond markets should expand financing opportunities for larger companies.

### **Europe's Industry at crossroads**

The European Council of 20-21 March 2014 emphasized a threefold reindustrialization policy based on growth, competitiveness and employment creation.

During its implementation the following boundary conditions may apply:

- a. Stimulate financing by EU companies, banks or public bodies for 'new' (energy saving and 'green') industrialization and fostering EU-mergers and take-overs in order to minimize the dependence on external financiers and decision-makers;
- b. Stimulating investment in high-tech sectors and large capital goods production companies as well as SMEs;
- c. Maximizing employment generation in such enterprises;
- d. Reduction of superfluous bureaucratic rules and regulations;
- e. Allocation of public resources to these innovation-focused investments should not be at the cost of employment opportunities - especially for the youth - in other sectors of the expanding internal market in goods and services;
- f. While making labour markets more flexible, still safeguarding main elements of the (European) 'social market economy' in an increasingly competitive world economy. This may become the biggest challenge for governments, trade unions and the business sector.

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(The Hague, 10 May 2014)

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<sup>18</sup> As in the case of Alstom in which the French Government some ten years ago obtained a 18 percent share, which was later obtained by Bouygues.

<sup>19</sup>In: 'The economics of state aid for the rescue and restructuring of firms in difficulty: Theoretical considerations, empirical analysis and proposals for reform' Miguel Angel Bolsa Ferruz and Phedon Nicolaides give a critical assessment of 'RR' interventions. (BEER paper no. 27 September 2013, College of Europe, Bruges) .