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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

Some Key Issues in Europe's Competitiveness – Towards an Integrated Approach

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1. INTRODUCTION

Europe must become more competitive. A competitive European economy will give us the means to support our social model and to ensure a high level of consumer, health and environmental protection, thus enabling us to enjoy a high quality of life and to raise our standards of living.

The 2003 Spring European Council placed competitiveness firmly at the centre of political attention. It set the Competitiveness Council[1] the task of reinforcing the economic dimension of the Lisbon Strategy by asking it to "actively assume its horizontal role of enhancing competitiveness and growth in the framework of an integrated strategy for competitiveness to be developed by the Commission, reviewing on a regular basis both horizontal and sectoral issues".

The purpose of this Communication is twofold:

- First, to alert the Council to the range of issues that must be addressed and kept prominent in its policy agenda and to propose a method of work which will make it possible to systematically identify and respond to competitiveness questions. These issues clearly constitute elements of an integrated approach to competitiveness;

- Secondly, to respond to the request of the October 2003 European Council and address in a preliminary manner recent concerns about the process of de-industrialization, a risk which Europe is apparently believed to be facing. The Commission will provide a more complete response in the coming months and it will study in depth the conditions affecting Europe's specialization and place in the international division of labour. The Commission's reflection will take place in the context of its forthcoming review in an industrial policy Communication and in light of the preparation of the new Financial Perspectives.

Clearly, deindustrialization and competitiveness policies are closely related. Policies supporting competitiveness will contribute to arresting the de-industrialization process; such policies will also contribute to the orderly transition towards a modern industrial economy. This transition will entail changes in the distribution of employment across sectors. Historically, losses in manufacturing employment have been more than compensated by employment increases in the service sectors. While these structural changes will continue to take place, it will become increasingly difficult for the low-skilled to regain employment. This is a particularly vulnerable segment of our labour force in the adjustment process. Whereas it is undeniable that such adjustments can be onerous in local economies and in social terms, the resulting better resource allocation will improve national income and welfare. Policies that raise our innovation potential and our human capital base will also raise labour productivity and strengthen our comparative advantage internationally.

In this respect, and with a view to improving our competitiveness, the Communication points to (outstanding) decisions and actions of high political significance or economic urgency that the Council, the European Parliament, Member States and the Commission should take to close the delivery gap on economic reform. The 2003 Spring European Council stressed that the Lisbon goal will not be achieved unless efforts to adopt and implement structural reforms

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[1] The Council streamlined the way it works in the summer of 2002. As a result the Competitiveness Council was created regrouping the former Internal Market, Research and Industry Councils.

in Europe are significantly stepped up. In many of these reform areas poor progress flies in the face of the commitments and timetables agreed by Heads of State and Government within the European Council.

2. SOME COMPETITIVENESS POLICY ISSUES IN THE EU

It should be stressed at the outset that preoccupations about Europe's competitiveness are not new but have been central in the Council's and in the Commission's policy reflections. Indeed,

- The Union has launched a comprehensive 10-year road map for economic, social and environmental reform through the Lisbon Strategy which incorporates the Gothenburg European Council. Over the last twelve months the Commission has presented **a number of mutually reinforcing political or strategic documents that have an immediate impact on competitiveness**. These concern issues such as how to maximise the advantages of an enlarged Internal Market, how to foster industrial competitiveness, and how to promote research, innovation and entrepreneurship[2]. The Commission is also carrying out an ambitious programme of policy reforms in antitrust, merger and State aid fields in order to improve the effectiveness of its competition policy instruments. Moreover, the Broad Economic Policy Guidelines (BEPG) call for sound economic governance and more rapid economic reforms in order to raise the EU's growth potential by giving an additional stimulus to labour productivity and business dynamism. Most recently, the Commission has launched a European initiative for growth, which is intended to boost investment in the two critical areas of investment in networks and knowledge.[3] In its final report on the Growth initiative, the Commission has identified a quick start programme of projects in the areas of Trans-European Networks for transport and energy, as well as for broadband or high-speed internet, and in research and development and innovation. These are projects which are ready to start immediately, have a strong cross-border impact and will yield positive results of growth and jobs.

- Europe is not implementing reforms fast enough according to the 2003 Spring European Council. Therefore, rather than proposing yet another strategy, this document's purpose is to mobilise **sufficient forces for an integrated approach to competitiveness** in order to build renewed momentum for change. The added value of an integrated approach is that **the whole is more than the sum of its parts**. Many of the actions before the Council and the European Parliament produce benefits which go far beyond their immediate scope, triggering positive changes across many areas. An example is the Community Patent. Once implemented it will not only improve the functioning of the Internal Market, but also provide more affordable ways of translating research results into commercial applications. Every day that passes without companies being able to protect their inventions affordably on an EU-wide basis will see Europe losing important productivity gains arising from the Internal Market, research and development and entrepreneurial initiative.

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[2] These documents are the Communication "Internal Market Strategy Priorities 2003 – 2006" (COM(2003)238 final) of 07.05.2003, the Communication "Investing in research: an action plan for Europe (COM(2003)226 final/2) of 04.06.2003, the Communication "Industrial Policy in an Enlarged Europe" (COM(2002)714 final) of 11.12 2002, the Green Paper on Entrepreneurship in Europe (based on COM(2003)27 final) of 21.01.2003 and the Communication "Innovation policy: updating the Union's approach in the context of the Lisbon strategy" (COM(2003)112 final) of 11.03.2003.

[3] "An initiative for growth: investing in Trans-European Networks and major R&D projects", SEC(2003) 819, 09.07.2003 as well as the final report to the European Council "A European initiative for growth: Investing in networks and knowledge for growth and jobs", COM(2003)690 final, 11.11.2003.

– Competitiveness is determined by productivity growth; a competitive economy is one that experiences high and sustained productivity growth leading to an increase in standards of living. **Many factors determine productivity** performance. Key among these are: opportunities provided by market reforms to stimulate investment; the level of competition; the ability to innovate, both through increased investment in R&D and human capital development, notably through education and training; the capacity rapidly to transform technological and non-technological innovations into economic goods; the reorganisation of working practices through the adoption of information and communication technologies; competition regulations and consumer protection rules that ensure that competitive pressure operates fully in the Internal Market[4] (inter alia in areas where the obstacles to competition and competitiveness take the form of restrictive regulations and monopoly) thus maintaining incentives for higher productivity; and an integrated market for goods and services that ensures that all potential gains are realised.

– The **European institutions and the Member States each have important roles to play as "guardians of competitiveness"**. Their common aim is to put in place the framework conditions which will enable European companies to grow and compete successfully in a fiercely competitive global market. The emergence of strong new competitors from South East Asia and Latin America makes meeting this challenge all the more important. In order to ensure that the European Union is on the right track we must systematically monitor developments and review the state of competitiveness of our economies and our enterprises. Moreover, the Commission must assess the economic, social and environmental impact of its key legislative proposals whilst ensuring that its policy choices take full account of their effects on competitiveness. Public consultation and thorough impact analysis are crucial instruments to this end. The impact assessments carried out on major Commission proposals should also allow the Council and the European Parliament to appreciate their effects on competitiveness. However, the latter institutions should also ensure that the impact assessment process continues as proposals advance through the different stages of the legislative process.

3. EUROPE'S COMPETITIVENESS CHALLENGES

Europe's overall productivity growth has slowed down markedly, although performance across the Member States has been mixed, since 1995. The Commission has stressed on several occasions the importance of this development[5]. A review of the key factors influencing EU competitiveness paints a worrying picture. The principal causes of the slowdown are our weakness in taking advantage of information and communication technologies (ICTs), slow innovations in our work environment and development of new and relevant skills, and weak organisational change.

The efficiency of hourly work in the EU is below that of the US; in 2002 productivity per hour worked in the EU was at 86.8% of the US level[6]. However, this figure masks wide

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4 This concerns both the level of retail and B2B transactions. The fact that the full force of competition has not been felt in the B2C Internal Market is illustrated by the substantial variations in prices for identical goods and services from one Member State to another, as recent price surveys and the latest Cardiff report confirm.

5 See the 2001, 2002 and 2003 editions of the *European Competitiveness Report*, SEC (2001) 1705 of 29 October 2001; SEC (2002) 528 of May 2002; and SEC (1299) of 17 November 2003, respectively. The Commission has also alerted the Council and the European Parliament of the risks involved in the Communication "Productivity: The Key to Competitiveness of European Economies and Enterprises", COM (2002) 262 final of 25 May 2002.

6 See *European Competitiveness Report*, 2003 edition, op. cit. footnote 5.

differences between Member States' performances[7]. Labour productivity growth per hour worked advanced at a rate of 2.5% per annum in the EU during 1990-1995, but slowed down to 1.3% over the period 1995-2000. In the US, the corresponding figures are 1.1% and 1.9%.

Europe's economic integration remains far from complete. In particular, the Internal Market's benefits have not yet been effectively felt in those areas where there has been less reform, and consequently, less competition such as energy markets, transport and service markets. Intra-EU trade in goods grew faster than GDP between 1996 and 2000, but has lost momentum since 2001[8]. Trade in services has almost doubled since 1993 from € 194 billion to € 362 billion, but there is clearly a potential for further integration through enhanced trade and FDI.

Europe's R&D efforts lag behind those of the US and Japan. Despite positive initiatives in some Member States, measures to increase the volume of, and improve the environment for, research investment have been fragmented and sluggish. While the latest available figures (2001) show overall R&D investment in the EU15 increasing slowly and approaching 2 % of GDP, its highest level ever, the average annual growth rate of 1.3 % remains wholly insufficient to catch up with the levels in the US and Japan and meet the 3 % target by 2010. Furthermore, the R&D investment gap with the United States has continued to widen from € 120 billion in 2000 to € 140 billion in 2001 mainly due to comparatively lower private expenditure in the EU.

Europe's innovation performance also continues to lag behind its main competitors. The latest data[9] show that, for a range of key indicators, large gaps remain between the EU and the US. The European weakness in patenting persists, in particular in high-tech areas. The data also suggest a worrying decline in life-long learning. This needs to be seen in context of the general lack of private sector investment in higher education and vocational training in Europe compared to its main competitors[10]. But some of the indicators justify a more positive note. For instance, the share of Science and Technology graduates among all new graduates in the EU is significantly higher than in the US, and the gap in ICT expenditures has been cut by half since 1996.

Europe continues to suffer from an "entrepreneurship gap"[11]. Entrepreneurship is far less frequently considered as a professional option than in the US. It is essential to improve attitudes towards entrepreneurship and to strengthen the incentives for self-employment.

Europe not only needs more entrepreneurs, but also needs **conditions that support enterprise growth**. Lack of financial support, complex administrative procedures and lack of skilled labour are still identified as the key barriers to starting and expanding a business. This is particularly true for technology-intensive sectors such as biotechnology, where the number

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7 During the period 1996-2002 average hourly productivity growth was higher in Belgium (2.16%), Greece (3.16%), Ireland (5.12%), Luxembourg (2.04%), Austria (2.43%) and Finland (2.58%) than in the US (1.86%); also, while GDP per hour worked in the EU was 86.8% of the US level in 2002, hourly productivity in Belgium, France and Luxembourg exceeded that of the US; see *European Competitiveness Report*, 2003 edition, op. cit. footnote 5..

8 See "Economic Reform: Report on the functioning of community product and capital markets" (COM(2002)743 final) of 23.12. 2002

9 See "2003 European Innovation Scoreboard", SEC(2003)1255 of 10.11.2003

10 See "Education & training 2010 – The success of the Lisbon Strategy hinges on urgent reforms (Joint interim report on the implementation of the detailed work programme on the follow-up of the objectives of education and training systems in Europe), COM(2003)685 final of 11.11.2003

11 See *Benchmarking Enterprise Policy: Results from the 2003 Scoreboard*, SEC(2003)1278 of 11 November 2003.

of new start-ups has recently been larger in Europe than in the US, but whose growth is severely hampered by inadequate access to risk capital.

4. RECENT DEVELOPMENTS IN INDUSTRIAL COMPETITIVENESS

Europe's competitiveness problems have been reflected in **concerns about the risk that Europe might be heading for de-industrialisation**. In recent months such concerns have been raised in public debates and also at the highest political levels, most notably in a letter to the President of the Commission from the Heads of State or Government of France, Germany and the UK. These concerns are not new and are invariably strongest during periods of slow economic growth or in recessions[12]. There is no doubt that the adjustment process associated with the changing structure of our economies can be very costly, especially at the local level. However, good macroeconomic performance will provide not only the environment for the EU manufacturing sector to improve its productivity and ultimately to compete internationally and to create jobs but also the conditions for the growth of the service sector.

Section 4.1 discusses some elements related to de-industrialization and the following section reviews some ideas about de-localization. These issues are emerging as **part of a wider reflection about the performance and future of the EU industry**. This perhaps reflects an ambition that Europe remains a global power in industrial sectors that are considered essential for strategic or other reasons. Moreover, this could reflect an ambition to restore performance in areas where Europe has been weak. This echoes the concern that, because the EU industry is less specialised in technology-based sectors than in the US or Japan, it must retain its present strong position in traditional, mature sectors, even if this will not be enough to ensure long-term economic success[13]. Finally, enlargement may accelerate the pace of structural change in some industrial sectors in the EU.

4.1. Productivity growth and de-industrialization[14]

De-industrialization is a process of structural change. The decline in the relative presence of the manufacturing sector in national income primarily during the post-war II years mirrors the decline in the share of the primary sector in earlier years.

Developments in EU industry competitiveness in recent years show considerable diversity; see Annex 2. Productivity growth in manufacturing began to decelerate in the mid-1990s and it has since fallen behind the US. The sectors that have contributed to the widening of the productivity gap are mainly high-tech sectors. However, European ICT-producing manufacturing and services have performed extremely well, but productivity growth in ICT-using sectors has not accelerated as in the US. It is clear that ICT has been a key factor in sectoral productivity performance.

Productivity developments would play a key role in any process of de-industrialization because they influence directly the competitiveness of enterprises. It is important to consider how our performance compares to that of the US as a benchmark.

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12 During the early 1980s in the US and in the UK, for example, a severe process of de-industrialization was set in motion but it subsequently led to restructuring and recovery of enterprises and to a more general change in the structure of the industrial sector.

13 Communication "Industrial Policy in an Enlarged Europe" (COM(2002)714 final) of 11.12 2002

14 The data discussed in this section are from M. O'Mahony and B. van Ark (ed., 2003): *EU Productivity and Competitiveness: An Industry Perspective Can Europe Resume the Catching-up Process?*, a study prepared for the Enterprise Directorate-General.

De-industrialisation is the long-term (not cyclical) decline of the manufacturing sector[15]. This implies an absolute decline in employment, production, profitability and capital stock in the manufacturing sector, as well as an absolute decline in exports of manufactured goods and the emergence of persistent manufacturing trade deficits.

Throughout the post–1979 period and in sub-periods therein the manufacturing sector has experienced employment losses. The largest declines in employment during the period 1979–1995 were registered in the primary sector but also in the telecommunications equipment, radio and television and transport equipment sectors. These employment losses continued, with some small exceptions, through the period 1995-2001 and during more recent quarters reflecting the slowdown in economic activity.

Nevertheless, growth in value added advanced at a considerable pace during the 1979-1995 period. The largest increases were noted in chemicals (3.5% compound annual rate of value added in 1995 prices), office machinery (6.9%), electronics (6.3%), telecommunications equipment (4.4%), and scientific instrument and other instruments (2.4%). Growth rates in added value in the period 1995-2001 have generally been robust and diverse. Sectors that stand out in this respect are electronics (value added up by 14.7% compound annual rate), telecommunications equipment (up by 15.5%) and radio and television receivers (up 10.1%).

Only in a minority of sectors has employment and output declined. These sectors are textiles and clothing, leather and footwear, mining and quarrying, mineral oil refining, coke and nuclear fuels. The share of the latter sectors in manufacturing output declined from 14.1% in 1979 to 8.7% in 2001, but the shares of sectors such as chemicals, telecommunications equipment, office machinery and electrical equipment have seen marked increases[16].

The fundamental determinant of manufacturing output growth has been rapid productivity growth. Reflecting the productivity convergence process under way during the period up to 1995, output per person employed grew virtually in all industrial sectors in the EU. However, the growth rate of productivity slowed down significantly in several sectors in the period 1995-2001 even though it remained positive across virtually all. Yet, even in the latter period productivity growth accelerated in several cases, growing by a compound annual rate of 14.7% in the telecommunications equipment sector, by 12% in electronics, by 9.7% in office machinery and by 5.2% in electricity, gas and water supply.

The EU manufacturing sector is also performing well in international trade. The surplus on manufactured goods has improved over time, rising from € 31.5 billion (0.6% of GDP) in 1989 to 95.2 billion (1.1% of GDP) in 2001. Only those few industry sectors, mentioned previously, that have experienced an absolute decline in output have recorded increasing trade deficits. With few other exceptions, all other manufacturing sectors experienced increasing surpluses over the period 1989-2001.

One should keep in mind that, as mentioned earlier, a process of relative de-industrialisation[17] has indeed been taking place throughout history. High productivity growth in the manufacturing sector has contributed to raising real incomes and to making manufactured

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15 Secular or absolute de-industrialization should be distinguished from relative de-industrialization. The latter is the decline in the share of manufacturing in GDP. This is also a longer-term process that reflects the rapid growth in productivity in manufacturing, the consequent increases in real incomes and the rising demand for the output of the service sectors. Under these conditions the decline in the share of manufacturing in GDP reflects a process of structural change towards a service-dominated economy.

16 See Annex 2.

17 See footnote 15 for the concept of relative de-industrialization.

good relatively cheaper than goods produced in the services sectors. Thus, inevitably, the share of manufacturing in national income and employment will follow a trend decline. This has already occurred and it continues to occur in our economies.

For better understanding of the process of structural change, and despite the obvious short-term costs adjustment costs associated with the process of structural change, it is important to ask what the economic implications of some form of de-industrialisation would be, should they begin to emerge.

It should be noted at the outset that concerns about de-industrialisation appear to be based on a partial view of economic realities. Relocation of industrial activities internationally is a reflection of changing comparative advantages:

- However, international trade linkages ensure that such relocations do not benefit exclusively the host countries. Increased exports from them will be matched by increased imports by them. It is clear that relocation implies that EU exports will inevitably increase as economic growth abroad accelerates, thus contributing to output and employment growth in our economies albeit in other sectors/industries. Jobs will, therefore, permanently decrease in regions from which industries leave only if they are not matched by exports to the regions where industries have migrated. That said, this process will take time to complete and it will involve considerable adjustment costs; hence, the need for an adaptable labour force with skills that are continuously upgraded.

- Secondly, the share of imported manufactured goods from the host countries will continue to be only a small fraction of total expenditure in the EU. Domestically produced goods, but primarily services, will continue to dominate domestic expenditure and support employment growth.

- Finally, it is important to recall that the nations towards which industries are likely to migrate are invariable less wealthy, developing, nations. These nations need capital imports to develop their economies, which implies that they must run for the foreseeable future trade deficits. These deficits will mirror the rest of the world's, (including the EU's), capital exports or, correspondingly, trade surpluses. It is unrealistic to believe that developing nations, where industries could migrate, would become major exporters of capital to high–wage nations in the industrialized world such as the EU.

On the basis of the data reviewed here, there is **no evidence that the EU economy is showing signs of de-industrialisation**. Nevertheless, it is possible that during a period of slow growth and poor productivity and innovation performance, conditions contributing to setting out such a process might emerge.

This suggests that **policy makers should be alert to this potential risk**. Moreover, it is essential that the Competitiveness Council is regularly informed and the Commission monitor on a systematic basis such developments in industrial performance.

4.2. De-localization

De-localization concerns the transfer of production and of other manufacturing activities to locations outside the home country. De-localization has already taken place within the EU and reflects the changing comparative advantage of different locations and/or different policy conditions.

De-localization has created significant concerns among policy-makers, the social partners and the public more generally. These concerns were already expressed when EU enlargement to countries of Central and Eastern Europe was first discussed and has resurfaced in the context of globalisation. Clearly, **better cost conditions abroad will inevitably attract industries that are unable to produce in the high-wage environment of modern industrial economies;** this, of course, is contributing to the growth of less wealthy trading partners.

De-localisation has, indeed, been limited to low-technology, labour-intensive activities. However, such re-location is often accompanied by the retention of, or creation of new, jobs in Europe in service areas such as design, marketing and distribution. This changing specialisation is a reflection of a changing comparative advantage where the EU retains those jobs that are human capital– and technology–intensive and characterised by high productivity and correspondingly high real wages. One lesson that can be drawn from this is that, today and in the future, Europe must develop and strengthen further its competitive manufacturing base. To achieve this, it is necessary to raise its R&D and innovation performance, to strengthen its human capital base and to develop conditions supportive of enterprise and of productivity growth.

However, **other aspects of de-localisation, such as the migration of R&D activities, constitute genuine threats to Europe's future**. Companies are conducting a growing share of their research outside Europe, particularly in **high-technology, research-intensive sectors** such as pharmaceuticals or biotechnology. These activities increasingly move to the US to take advantage of more favourable regulatory, structural or finance conditions and of the availability of skilled workers. According to a survey carried out by the European Round Table (ERT) in 2002, major European firms warned that unless framework conditions improved drastically most of their new R&D investment would take place outside the EU where they already locate 40 % of their R&D. This warning should alert policy-makers to the risk that science- and knowledge-based activities promising for our future standards of living may become marginal in the EU.

Clearly, while **there are economic forces about which EU policy makers can or should do little**, there are others where they should play an active role. For example, they should take into account the current process of industrial transformation by facilitating the increasing osmosis (or interpenetration) between manufacturing and services. **They should also be alert to the** role **that industrial framework conditions play in decisions to relocate**. For example, if the potential migration of some of Europe's most competitive industrial sectors were to be motivated by uncompetitive framework conditions in the EU rather than costs or market access, the policies in question should be reconsidered. In the event, this would raise serious questions about Europe's ability to retain its leading roles in these sectors which generate important spill-overs in the rest of the economy.

A further enlarged EU, with its increased variety of wage structures and technological skills, will provide European industry with opportunities for competitive reorganisation. Furthermore, the **objective of offering the prospect of a stake in the EU's Internal Market** to the neighbours of the enlarged EU[18], in particular Russia, the countries of the Western NIS and the Southern Mediterranean provided that these countries fully align their legislation with and implement the "acquis", **will** – like the Europe Agreements a decade ago – **offer EU enterprises both a large domestic market and with easier access to abundant human or**

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[18] As spelt out in the Communication "Wider Europe – Neighbourhood: A new Framework for Relations with our Eastern and Southern Neighbours" (COM(2003)104 final of 11.03.2003.

physical production factors. This will strengthen the competitiveness of EU producers and will enable them to remain present in market segments characterised by strong competition from Far East producers. Such patterns of co-operation are already being developed by EU textile and apparel producers in some of the Mediterranean Partner States, and other industry or service sectors could certainly take advantage of similar arrangements.

Although a firm's competitiveness ultimately depends on the efficiency with which it combines the various resources that are available to it, public authorities can play an important role in facilitating this process, by helping create appropriate framework conditions. It is clear that **inappropriate framework conditions and a poor business environment can act as significant burdens on business activity, not to speak of the cumulative effects of additional layers of regulation.** Clearly, the policies in question range widely and concern both the Member States and the Commission and the European Parliament, as will be discussed in section 5 below[19].

5. HOW TO BETTER ADDRESS COMPETITIVENESS ISSUES

5.1. Competitiveness analysis as the foundation for action

In order to be properly targeted and effective, EU competitiveness policies must be based on sound economic analysis. This concerns both the horizontal and the sectoral aspects of such policies. Over the last twelve months the Commission has presented a number of analytical documents addressing different policy areas[20].

The Commission's **competitiveness analysis has both a general and a specific character**, and it involves instruments that are directly and singularly aimed at competitiveness issues and others that are less so – education policies and regional policies, for example. The specific analytical instruments are the Commission's annual Competitiveness Report and ad hoc competitiveness studies that accompany reviews of sectoral economic performance. This year, a new study[21] will enable us to get a clearer picture of the productivity performance of individual industrial sectors as well as provide a coherent statistical basis, which will be updated annually, on which to build sound analysis.

The Communication on Industrial policy of December 2002 stressed that **industrial policy, while horizontal in its nature, will have to take into account the competitive situation of individual sectors.** This approach was confirmed by the recent European Council in October 2003. The Commission will continue to provide **analysis of individual industry sectors**, both as a basis for identifying sector specific competitiveness problems and for ensuring the optimal mix of measures across an array of policy areas that influence that sector's framework conditions. This should also allow the Commission to reflect on instruments to anticipate industrial sector restructuring. These analyses will be carried out **in close dialogue with all interested parties**. They express their views in the form of recommendations for actions to be taken on EU and national levels. One example for this approach is the **"G10 Medicines" initiative**. A study in 2000 highlighted this sector's alarming competitiveness problems and

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19 For a more detailed discussion of framework conditions see the "Communication on Industrial Policy in an Enlarged Europe' (COM(2002)714 final) of 11.12.2002.

20 These include the Cardiff Report on the functioning of the Internal Market for goods and capital markets, the Competitiveness Report, the Internal Market Scoreboard, as well as the Scoreboards on enterprise policy and innovation.

21 See M. O'Mahony and B. van Ark (ed., 2003), op. cit., footnote 14.

pointed to a need for actions to improve its framework conditions. As a result a small group of 11 high level decision-makers[22], representing Member States and stakeholders, met to reach consensus on the future of this industrial sector. The group agreed on 14 wide-ranging recommendations[23] in 2002. In response, the Commission proposed a series of actions through which it and Member States can work together to implement these recommendations. The Council adopted substantive conclusions underlining the importance of retaining a competitive pharmaceutical industry in Europe to support our science base, high quality employment and play a full role in meeting our public health objectives. The Council invited Member States to look on ways to improve their pricing and reimbursement schemes and the Commission to launch a reflection to support this process. Other examples of this approach include **STAR 21 for the aerospace industry**, and **LeaderShip 2015 for the shipbuilding industry**.

The Commission is currently involved in an exercise concerning the competitiveness of the textile and clothing sector, and is also turning its attention to business services. Other initiatives, notably on the **mechanical engineering** and **automotive sector**, will soon follow. The automotive industry is one of the backbones of the EU's economy. The Commission plans to set up a high-level group to analyse major challenges affecting this sector, identify ways and means to improve the industrial framework conditions, so as to fully exploit and develop its industrial assets and contribute to an integrated policy approach. This will enable the competitiveness of this sector to be reviewed including assessment of the consequences of previous and forthcoming regulatory and other decisions.

5.2. Get the regulatory framework right

As part of its contribution to the EU's "Better Regulation" initiative, the Commission is committed to consulting extensively all stakeholders and has put in place an effective system for assessing the economic, social and environmental impact of its proposals before deciding whether a legislative initiative is appropriate. Challenging the very necessity of a legislative response and considering possible alternative approaches to legislation is an important element of this process. In 2004, around half of the Commission proposals in the main part of its work programme will benefit from an extended impact assessment in contrast to around 20 percent in the first year of the system's operation. Overall, the Commission will strengthen its efforts to ensure that competitiveness is properly taken into account in the proposals it presents to Council, the European Parliament and the Member States will be strengthened.

A simple and effective regulatory environment is essential to achieve our competitiveness goal, and at European level this means in particular a well-functioning and vibrant Internal Market and effective competition rules. Council, European Parliament and Member States each have to contribute to speed up the reform process in this area.

5.2.1. Deliver on pending legislative issues

Since the launch of the Lisbon Strategy more than 25 legislative measures have been adopted to extend the reforms in these areas, and a further twenty proposals are pending before Council and the European Parliament. The Internal Market Strategy 2003-2006[24] sets out a comprehensive programme for action to achieve maximum benefits from the Internal Market

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22 The High Level Group on Innovation and the Provision of Medicines

23 The Group's 2002 report and other G10-related material is available at: http://pharmacos.eudra.org

24 Communication "Internal Market Strategy Priorities 2003 – 2006" (COM(2003) 238 final) of 07.05.2003.

after enlargement. **This programme is important as a whole and must be implemented vigorously.**

There remain, however, **a number of pending legislative proposals** on which **Council and the European Parliament need to decide quickly**. These proposals form important building blocks to the competitiveness of an enlarged Europe, but only if their inter-relationships and complementarities are properly taken into account will they result in maximum benefits to the business environment. This Communication does not claim to provide a comprehensive list of these proposals. However, by referring to some selected examples of high political or economic significance it aims to illustrate the strong cross-cutting synergies which Council and European Parliament should consider:

– The Community framework for the **protection of intellectual property** is an essential element of an efficient Internal Market, but also underpins research and innovation. If the EU is to remain attractive for investments in research, innovative ideas and products, it must ensure that intellectual property is protected across its Member States. At the same time, we must ensure that protecting intellectual property does not hinder the process of innovation and its dissemination, for example by introducing unduly long protection periods, and that it is not used to hinder competition. Although considerable progress has been made in this area over recent years, the Council and the European Parliament must rapidly finalise and implement pending legislative proposals that form key components of an effective intellectual property system. These include

  - The draft Regulation providing for a legally secure and affordable **Community Patent.** The Commission will shortly be submitting a formal proposal concerning the jurisdiction. The Community patent system also requires also a revision of the European Patent Convention.

  - The draft Directive on the patentability of computer-implemented inventions.

  - The Draft Directive on **measures and procedures to ensure enforcement of intellectual property rights**. This proposal complements the recently adopted Regulation to facilitate seizures by customs of counterfeit and pirated goods from outside the EU[25].

– The proposal for a Directive on **permits for the entry and stay of third country researchers** needs to be seen against the background of a broad and dynamic European knowledge base, with sufficient and highly qualified human resources. This proposal as well as the coherent development of actions at national level (see section 4.2) is necessary to make Europe more attractive for the best researchers in the world and ensure the availability of the human resources required to sustain increased investment in research.

– Europe needs a business environment that ensures a fair competitive environment and allows European-based companies to adapt more efficiently within the Internal Market in order to reinforce their competitiveness. The Commission proposal on the **take-over bids Directive** will help business development: it will subject company managements to effective market-disciplines, and facilitate corporate restructuring whilst maintaining essential protection rights. The new **Merger Regulation** currently under discussion in

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[25] Council Regulation (EC) No 1383/2003 of 22.07.2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights, OJ L/196/7 of 2.8.2003.

Council and European Parliament provides for a simplification for the referral of merger cases from the Commission to the Member States competition authorities for investigation, clarifies the substantive test to assess the competitive impact of mergers, and introduces a degree of flexibility in the timeframe for merger investigations. This regulation should be adopted by the end of 2003.

- Adoption and effective implementation of the legislative package is essential to modernising Europe's **public procurement system** and making it more transparent and open to competition. The European Union's public procurement market, representing around 16 % of EU GDP, is still far from having reached its full potential. Public procurement is a driver of entrepreneurial activity since it is a major or even leading component of demand in a number of sectors such as health care, transport, environmental protection and defence. Furthermore, public procurement often plays a crucial role in the development of core technologies. Without this proposed legislative package neither a Europe-wide "electronic procurement" market can be achieved, nor will Europe have a legal framework suitable for complex contracts, such as Trans-European Networks. At the same time, open procurement demands a pro-active competition policy to ensure that anti-competitive practices (i.e. state aids, cartels) do not undo the benefits that open procurement procedures can bring.

- A dynamic Internal Market for retailing will enable both economic operators and users, including final consumers, to reap the full benefit of the Internal Market. It must ensure that consumers are able to choose the goods and services that best meet their needs anywhere in the internal market through a vigorous EU consumer policy. However, much remains to be done in the retail area, as regards both goods and services, to ensure the proper functioning of the Internal Market and to spur cross border transactions. The proposal for a **framework directive on unfair commercial practices** and the proposal for a **regulation on administrative co-operation** are important initiatives to reduce fragmentation of the national consumer legislation in the EU and market fragmentation.

- Improving framework conditions for industrial sectors requires actions in the non-regulatory field as well as in the regulatory field. Key examples in the regulatory field include the review of the **EU's pharmaceutical legislation** currently being discussed by Council and European Parliament, and more recently, the Commission's **proposal for the new Chemical legislation** which was significantly revised after a public consultation and a thorough impact assessment. The October 2003 European Council stated that EU legislation should not be a handicap to EU competitiveness compared to that of other major economic areas. Against this background, it stressed that the proposal for the new Chemical legislation will be the first test for implementing this approach. It will provide industry with a stable, predictable framework within which it can plan and develop, and will safeguard competitiveness and encourage innovation.

- More broadly, the Commission's European Initiative for Growth has highlighted additional important pending decisions designed to mobilise **public and private investment in trans-European transport networks**, in the roll out of broadband communications and in supporting research, development and innovation. These networks will all be a key factor in improving competitive conditions within the Union. While the complementary roles of public and private sectors in infrastructure need to be explored more thoroughly, the importance of the role of public financing remains clear. Initiatives to be highlighted in this context include recent proposals updating the **guidelines and financing rules for trans-European networks**, modifications to the **Eurovignette system** and proposals in the area of **taxation in relation to the treatment of parents and subsidiaries and of mergers**.

5.2.2. Ensure that competitiveness aspects are properly taken into account

If Europe is to speed up structural reform decisions to boost competitiveness and growth as a means to safeguard our social and environmental objectives, the **Council and the European Parliament should follow the lead of the Commission in ensuring that the measures they adopt take proper account of effects on competitiveness**. To do so requires open consultation of all stakeholders and sound assessment of the economic, social and environmental impact of proposals throughout their legislative lifespan. The Commission is ready to support this effort by providing impact assessments and by helping other institutions, if they so wish, in assessing the impacts of the changes proposed. In this context, the 2003 **Spring European Council** assigned an important role to the Competitiveness Council. **It stressed that the Competitiveness Council should be consulted on any proposals that may have substantial effects on competitiveness - even if they do not fall under its direct responsibility**.

5.2.3. Transpose and implement legislation on national level

It is not enough to adopt sound legislation, based on a serious assessment of its impact. Once adopted by the Council, **Member States must transpose legislation that is not directly applicable, implement it within the given delays** with all the administrative actions this implies, and **apply it correctly in practice**. Recent figures give a rather depressing picture of Member States' commitment in this area. The average time required for adoption and legal transposition of Internal Market directives adopted between 1993 and April 2002 was 2.28 years. Undue delays in transposition beyond the established deadlines delay effective implementation by a further 2.21 years on average. This amounts to an average time lapse of 4.49 years for implementing an average reform measure. For example, only a few Member States have yet transposed the Directive on the legal protection of biotechnological inventions, which should have been transformed into national law by 30 July 2000. This directive, together with the Community Patent, is crucial for providing a clear and effective framework for intellectual property in the knowledge dependant field of life sciences and biotechnology. In the same field, a number of Member States failed to transpose the Directive on the deliberate release of genetically modified organisms, within the deadline set for 17 October 2002. This Directive is, however, essential for providing both a reliable legal framework at EU level for economic operators and a strict, transparent and effective authorisation procedure without which the EU science and technology base in this area will become seriously undermined[26].

5.2.4. Ensure coherence between national and EU legislation

Finally, Member States must be aware of and assess the impact of new and existing national legislation on competitiveness. Member States issue a vast amount of legislation in a number of areas where the Community has no competences, or where the Community has not yet proposed legislation, or where EC legislation leaves Member States a certain room for manoeuvre. In the area of regulations on products and information society services alone, Member States draft between 500 and 600 regulations every year, the majority being in the

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[26] With further decreases in research and development investment in GMOs in the EU, which has already dropped by 39 % in recent years according to a recent study ("Review of GMOs under research and development and in the pipeline in Europe, IPTS/JRC, 2003, ISBN: 92-894-5572-1) and the relocation of innovative research, field trials and commercialisation of new GMOs outside the EU.

fields of food and agriculture, telecommunications and transport[27]. On average, 10% of the drafts notified to the Commission by Member States are incompatible with either the EC Treaty or secondary EC legislation and require modification before adoption. Member States should ensure that new legislation does not have a negative effect on the business environment and that it does not create distortions or unjustified obstacles to trade. In this context, the Commission is encouraging Member States to provide impact assessments when notifying technical regulations on products and information society services.

5.3. Increase efforts to foster research, innovation and entrepreneurship

Creating a business environment favourable to research, innovation and entrepreneurship is crucial. While it is essential to provide an EU-wide regulatory framework favourable to business, Europe still needs to do more to promote competitiveness. The **research investment action plan**[28] aims to make Europe more attractive to private research investment, thereby achieving the targets fixed by the Barcelona European Council in March 2002 of a total investment level of 3 % of GDP of which 2/3rds should come from the private sector. The action plan includes a coherent ensemble of legislative, co-ordination and stimulation measures across several policy fields such as research, innovation, IPR, financial markets, human resources, product-market regulation, fiscal incentives, and competition policy. It is aimed at Member States, the Commission and concerned stakeholders (industry, investors and the public research sector), and as such, it is a good example of a Commission policy document embodying an integrated approach to competitiveness.

Strengthening research, fostering innovation and promoting entrepreneurship are, however, areas **where progress lies above all in the hands of Member States** and their commitment to take the necessary decisions at national level. Here as well, Member States should look at how national policies interact and influence competitiveness. The **open method of coordination** can be a valuable tool by going beyond the question of competence and enabling the EU to contribute to progress in areas where the Union has no legislative powers. Taking into account national differences, it helps to achieve greater consistency and convergence of national policies towards agreed EU objectives by putting in place a mechanism for mutual learning based on the dissemination and exchange of good practices and benchmarking specific topics. It also provides for periodic monitoring of progress made by setting indicators and targets, and conducting peer reviews.

Member States should, in particular, step up efforts to reinforce their commitment in the following areas of application of the open method of coordination:

– In *Enterprise Policy* where the Council invited Member States and the Commission in November 2002 to continue work on quantitative and qualitative targets on a voluntary basis in seven policy areas identified as crucial to competitiveness in the Enterprise Scoreboard, and to consider the organisation of periodic monitoring, evaluation and peer review to discuss policies developed in the Member States. The Council also invited Member States and the Commission to give new momentum to the promotion of entrepreneurship and small businesses by setting quantitative and qualitative targets in the framework of the European Charter for Small Enterprises in order to allow an assessment of progress made over time before the Spring European Council in 2004.

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[27] These measures were notified under Directive 98/34/EC of the European Parliament and of the Council laying down a procedure for the provision of information in the field of technical standards and regulations and of rules on Information Society services.

[28] Communication "Investing in research: an action plan for Europe" (COM(2003)226 final/2) of 04.06.2003.

– In the area of *innovation* where Member States and the Commission should intensify their cooperation in order to strengthen existing processes for the co-ordination of innovation policies at national level in the framework of the Trend Chart on Innovation. Member States and the Commission should also create a framework of common objectives for strengthening innovation in the EU and put in place a mechanism for assessment of progress.

– And most recently in the area of research *policy and the establishment of the European Research Area*. Here the Council invited Member States and the Commission to use the open method of coordination as a tool to share experience, prepare mutually consistent reforms to progress towards the 3 % research investment objectives and in particular to support the implementation of those parts of the action plan on investment in research which depend on Member States. The same applies for actions in the area of human resources for research notably those under the mobility strategy of ERA, and in particular, the urgent measures contained in the recently adopted Communication on researcher careers.[29]

In this context and taking into account their structural weaknesses, the education and training systems require urgent reform in order to achieve the Lisbon strategy goals[30].

5.4. The Commission's contribution

The Commission will contribute to giving the Council, the European Parliament and the Member States a more integrated view to its work related to competitiveness by systematically identifying synergies between policy actions directly contributing to competitiveness. It is currently conducting a "screening exercise" of most EU policies to identify possibilities for improving their contribution to industrial competitiveness.

In its work on competitiveness, the Commission will first provide analysis both at horizontal and sectoral level in order to identify the need for action. Only then, will it take the necessary measures in the regulatory field as well as in the area of research, innovation and entrepreneurship.

Finally, the Commission intends to better highlight the proposals on which it will perform an extended impact assessment when presenting its annual work programme. Annex 1 provides more details on key initiatives aimed at improving competitiveness the Commission intends to launch or pursue in the coming 12 months.

6. CONCLUSIONS

The continuing structural transformation of our economies, with an ever increasing role for the services sector, is economically inevitable. With this, some de-localisation and other adjustments are bound to come. These cause social and economic hardship to those directly affected. The increasing importance of services in the economy does not imply that industrial output should decline. Indeed, this process has so far been associated with a continuous growth in industrial output, despite declining industrial employment, which has been made possible by the steady increase of industrial productivity.

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[29] Communication "Researchers in the European Research Area: one profession, multiple careers" COM(2003) 436 of 18.07.2003.

[30] See footnote 10.

The slowdown in Europe's productivity growth represents a loss of competitiveness. This is a serious cause for concern because of the risks which it implies for our industrial performance and for our capacity to handle structural adjustment. For loss of industrial competitiveness and de-industrialisation are opposite sides of the same coin.

On the basis of available data, there is, at the moment, no compelling evidence that Europe is undergoing de-industrialisation in an absolute sense. Nevertheless, the on-going structural adjustment of our economies is causing hardship in local economies even if the national economy is better off from improving resource allocation. To ease this process and increase employment creation it is essential to raise our productivity potential and to boost our competitiveness. To this end, investments in research, innovation, training and ICT as well as re-organisation of work constitute key ingredients of the transition process. Finally, it is essential to anticipate and to better prepare for these adjustment challenges.

The present Communication constitutes only a preliminary analysis of these developments. In coming months, the Commission intends to deepen further this analysis and to put forward proposals on the occasion of the follow-up to its Industrial Policy Communication. These will also be placed within the framework of the preparatory work for the future Financial Perspectives, which will aim at providing a political project for the enlarged Union from 2006 onwards.

The Commission has repeatedly acknowledged the significance of competitiveness for our economic performance. It will continue to insist on the importance of raising productivity growth and will take the opportunity to address this issue again in the forthcoming Spring 2004 Report.

It is also crucial that the European Parliament and the Council decide on the important proposals pending before them that affect competitiveness. It is also crucial that they both take full account of the competitiveness consequences of all their decisions. The Council has assigned an important task to the Competitiveness Council, that it must be consulted on, and give its views on, major proposals affecting competitiveness that do not fall under its direct responsibility. To carry out this task, the Council must reflect on how its different elements should interact. The European Parliament has already developed such mechanisms.

European competitiveness is also affected by policies at national level. Economic integration means that the competitiveness of the whole cannot be divorced from the competitiveness of the parts. Unless the Member States each take the measures that are needed at their level, the competitiveness of the EU will not be assured.

For its part, the Commission will continue to provide analysis with the aim of identifying key competitiveness issues. Where needed, it will make appropriate proposals, after considering alternatives to legislation, publicly consulting stakeholders and carrying out impact assessment.

ANNEX 1:

Commission's activities and initiatives affecting competitiveness

1. Industrial policy as an instrument for addressing challenges to EU industry

In-depth analysis and regular monitoring of the situation of specific individual sectors enable the Commission to identify actions needed to ensure that the conditions are present for industry to develop and realise its competitive potential. In its Communication on industrial policy of December 2002, the Commission stated that most EU policies have a contribution to make towards creating an environment in which businesses will thrive, thereby creating the conditions to help Europe meet the challenges it set itself in Lisbon and Gothenburg. The Commission insisted in particular on the need to pursue a **balanced approach to the EU's sustainable development strategy**, and to ensure that one pillar of sustainable development is not developed to the detriment of the others.

In 2003 the Commission carried out an **internal screening exercise** of most EU policies. This has led to the analysis of some horizontal issues which underlie various different policies, such as the **role of knowledge as a factor of economic development and growth** or the **interaction between productivity growth and increases in the employment rate**. Another exercise focused on **industrial competitiveness and environmental protection** and aimed to increase the convergence of analyses underpinning environment policy and industrial policy. The screening also identified possibilities for improving the contribution of EU policies to industrial competitiveness, whilst respecting the primary objectives of these policies. As a result of this exercise, the Commission has identified some potential for synergy, for example

- **Regional policy:** Addressing the industrial consequences of enlargement, notably at the sectoral level; better stimulating regional innovation systems.

- **Research and development policy:** Technology platforms as a flagship initiative that will contribute to sectoral competitiveness, both in key technology areas and in mature industries.

- **Information Society Policy**: Stimulating development, adoption and use of ICTs, important source of productivity growth and increased efficiency in the public sector through three pillars: the eEurope Action Plan stimulating competition and investment through a predictable legal environment, and fostering innovation through support to research and development.

- **Education and training policy:** Progress on recognition of professional qualifications, actions to monitor skill shortages and to ensure the supply of skilled labour, partnerships between education and the business community with a view to fostering entrepreneurship would all benefit industry.

- **Trade policy:** Developing the external dimension of the single market, for example by promoting EU approaches to technical regulation and conformity assessment; fostering EU exporters' access to third country markets; as far as the textile and clothing industry is concerned, improvement of competitiveness factors associated to innovation, research, skills, technology and value-added as a

means to adapt, in particular in the perspective of the abolition of remaining quotas in the textile and clothing sector.

- **Environment policy:** Exploring the scope for voluntary alternatives to regulation, developing a sustainable production policy and analysing the conditions for further development of eco-industries, and balancing the short-term costs and the long-term gains of enhanced environmental protection.

- **Competition policy:** Potential for analysis of a range of important issues for industrial competitiveness, such as the issue of the relevant geographic market or how innovation and its diffusion can be stimulated in a way that is consistent with competition rules.

- **Taxation policy:** Exploring the use of home country taxation of SMEs could open a path to facilitate the creation, development and transfer of businesses; increased recourse to a variety of instruments, including the exchange of best practices, could help Member States identify useful improvements to in the tax treatment of businesses without raising competence problems.

- **Internal market:** Optimising defence procurement would bring enormous industrial benefits.

- **Employment policy:** The discussion of competitiveness issues in the sectoral social dialogue would be useful.

- **Health and consumer protection policy:** Ensuring that the aims of a high level of health and consumer protection are achieved without affecting the competitiveness of business, especially SMEs.

- **Transport and energy policies:** Long-term developments in the energy (notably price levels) and transport sectors need to be anticipated, especially with regard to their impacts on industrial competitiveness. In addition, the EU will promote its own approaches to standards issues in international fora such as ICAO or IMO.

The Commission intends to report more extensively on the results of the screening process at the beginning of 2004.

2. Further progress towards a predictable legal framework

The Commission will continue efforts to improve the legislative framework for enterprises by tabling some important initiatives:

– *A thriving Internal Market for goods:* The Commission intends to submit a number of legislative proposals designed to strengthen the functioning of the Internal Market for products. A proposal for a **regulation on the application of mutual recognition** would aim at improving the free movement of goods in non-harmonised sectors. The submission of a **proposal addressing aspects applicable to all sectors covered by the "New Approach system"**, would allow strengthening the consistency of "New Approach" Directives and improving their uniform implementation.

– *A modernised State aid regime*: The Commission is currently taking several initiatives as part of its ongoing work on reforming and modernising the State aid rules. This process

aims to simplify the approval of aid which furthers the economic objectives of the Community while maintaining a strict control of more distorting forms of aid. The proposed initiatives include:

- A draft regulation extending the **block exemption on state aid for R&D to SMEs** is due for adoption in early 2004. This will greatly simplify implementation of schemes to support investment by SMEs in R&D in the Member States;

- A revision of the Community guidelines on **State aid for rescuing and restructuring** companies in difficulty in order to speed up the approval of rescue measures while minimising the adverse effects of longer-term restructuring measures on the competitive environment;

- The Commission intends to launch consultations with Member States before the end of 2003 on a greatly simplified approach for the assessment of certain types of aid which can be considered, by reason of their amount or the sectors in which they are granted, to be unlikely to have significant effects on competition or trade within the Community. This particularly concerns aid directed at achieving important Community objectives, such as promoting research and development, protecting the environment, creating new and better employment, promoting training and promotion of SMEs."

– *A real Internal Market for Services:* Services account for almost 70 % of GDP and employment in the EU. However, in many service sectors – such as tourism, distribution, construction, engineering, consultancy and employment agencies - the Internal Market is far from being a reality. Legal fragmentation prevents service providers from realising economies of scale, results in losses of efficiency, stifles competition and holds back the potential of the service sector to create more dynamic entrepreneurs and more jobs. Before the end of 2003, the Commission will make a **proposal for a Directive on services in the Internal Market** establishing a legal framework for providing cross-boarder services between Member States. It will **be complemented by non-legislative measures** aimed at improving the competitiveness of business-related services and promoting entrepreneurial activity in these sectors. A further proposal will **extend the system of notification of national legislation currently applied in the area of goods and telecommunications to the service sector**. Member States should give priority to the rapid adoption and transposition of these proposals if they are to have a real effect on the EU economy before the 2010 deadline set by Lisbon. It is not enough, however, to focus efforts on the forthcoming proposal on services. The **Directive on the mutual recognition of professional qualifications**, the **Regulation on sales promotion** as well as the Framework Directive **on unfair commercial practices** are closely related to the proposal for a Directive on services and are essential if the Internal Market for services is to become a reality.

– *Complete the Internal Market for financial services*: Financial service and market integration will act as a catalyst for competitiveness and growth across all sectors of the economy. It will reduce the cost of capital for businesses, particularly for innovative or high-tech business start-ups. With 36 of the 42 measures foreseen in the Financial Services Action Plan already adopted, reform in this area is well underway. The Commission will present the last proposals provided for under the action plan, including a new **Capital Adequacy Directive**, in 2004 and will launch discussions, involving all major stakeholders, aiming at assessing the state of integration of EU financial markets.

– Much remains to be done in the *retail area*, as regards both goods and services, to ensure the proper functioning of the Internal Market and to spur cross border transactions. The Commission is already committed to **reviewing the existing consumer protection acquis** in order to identify internal market barriers and areas that could be consolidate or simplified. In 2004, the Commission will set out a strategy and work programme for this review.

3. Fostering research, innovation and entrepreneurship

Building on initiatives and actions started in 2002 and 2003, the Commission will pursue efforts and make proposals to foster research, innovation and entrepreneurship across the EU.

– In the context of its efforts to create European Research Area and foster increased investment in research, the Commission is setting up **European Technology Platforms**[31] in key areas of technology development. European Technology Platforms bring together various public and private stakeholders to devise and implement a common vision and strategy for the development and the use of key technologies in Europe. Their aim is to encourage increased and more effective mobilisation of research efforts and to address non-technical barriers. They may also provide valuable input to the work related to sectoral competitiveness.

  At the beginning of September, building on the early experience of European Technology Platforms in the areas of aeronautics and rail transport, the Commission initiated the launching of a **European Partnership for the Sustainable Hydrogen Economy** to contribute to the development of an integrated strategy for this key fuel of the future. Further technology platforms are being set up in key areas[32] and a first progress report is in preparation. By June 2004 the process of launching a first wave of European Technology Platforms should be completed.

– Work to establish European strategies or foster joint technology development in space, defence and security-related sectors will be pursued aiming at ensuring a competitive industrial base in these areas in the long term:

  - The Commission's Communication on "European Defence – Industrial and Market Issues"[33] helped focus attention on the advantages of creating an Internal Market for defence products and the need for greater co-operation in procurement, as well as in defence and security related research. As a result, the Commission will present in 2004 a **Green Paper on public procurement in the defence sector** as well as a **European Handbook on defence standardisation** (to be used for defence procurement contracts). Furthermore, a "Group of Personalities" has been established to **develop a vision and to give guidance on the orientation for a future security related research programme**. In that spirit, in December 2003 a preparatory action on security-related research with a budget of € 65 million between 2004 and 2006 will be proposed. It should be adopted and launched early in 2004. Finally, the Commission will contribute to the work on establishing, in the course of 2004, an **agency in the field of defence capabilities development,**

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31 As announced in the Communication "Investing in research: an action plan for Europe" (COM(2003)226 final/2) of 04.06.2003 and the Commission's initiative for growth.

32 For example plant genomics, road transport, specific areas of nanotechnology and ICTs, and steel.

33 Communication "European Defence – Industrial and Market Issues – Towards an EU Defence Equipment Policy" (COM(2003)113 final of 11.3.2003.

research, acquisition and armaments, as decided by the June 2003 European Council.

- Space is an "enabling" industry that contributes to the implementation of a whole range of Community policies, from environment, agriculture and transport to development co-operation and external relations, and has a tremendous social, economic and commercial potential. The **White Paper on European Space Policy**[34], is a call to mobilise all stakeholder to meet new goal and challenges. It incorporates a strategy, basic guidelines for the roles and responsibilities of the main actors, an action plan, and initial thoughts on resources. The policy objectives include a more secure and predictable framework for stakeholders to plan, invest and build up their share of fast growing commercial and institutional markets. The **GALILEO** international programme for radio navigation by satellite, **GMES** (Global Monitoring for Environment and Security), and its potential to provide broadband access to remote and rural areas with other technologies to bridge the digital divide are among the activities encompassed by the White Paper. Both initiatives will benefit from the mechanism foreseen in the Framework Agreement between the European Community and ESA.

– In **life sciences and biotechnology sectors**, a core pillar of the emerging knowledge-based economy, the Commission established a framework for action in this area in its Communication on Life Sciences and Biotechnology[35]. Its 30 point action plan sets out an integrated approach to the industry's competitiveness that aims at exploiting research and innovation potential whilst widening the scope to include societal and regulatory issues. The lack of sufficient capital supply is a major constraint for biotechnology companies to grow and consolidate from the "start-up" to a more mature stage. The way ahead should be a co-operative action of the Commission, the EIB group and Member States, to examine their respective instruments ranging from investment funds to the fiscal framework, in order to optimise the use of existing capacity. In this field as in other research-based and highly innovative industries, a functioning European risk capital market is of fundamental importance.

– The Commission and the European Investment Bank (EIB) will pursue their close co-operation to ensure both complementarity and synergy between their respective instruments to promote research and innovation. The EIB plans substantial increase in its means of investment support for research and innovation from € 15.3 billion invested since 2000 to more than € 50 billion for the entire decade to 2010 under the new "**Innovation 2010 Initiative" (i2010i).** Furthermore, efforts will focus on making optimal use of the broader range of instruments being put in place by the EIB to respond better to the needs of firms at different stages of their development, in particular for the financing of large trans-national R&D projects (i.e. in the frame of the growth initiative), as well as for improving access to risk capital for high growth companies in technology-based sectors.

– In coherence with the industrial policy objectives and the Action Plan on investment in research, the Commission will identify in the framework of the forthcoming **action plan on innovation**, criteria to define innovative enterprises which will allow a more efficient application of Community policies and better targeting of national initiatives having an

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[34] White paper "Space: a new European frontier for an expanding Union. An action plan for implementing the European Space policy", COM(2003)673 of 11.11.2003.

[35] Communication "Life Sciences and Biotechnology: A Strategy for Europe" COM(2002)27 final of 23.1.2002.

impact on innovation. This Community framework should also reinforce the emergence of a European consensus on "the imperative to innovate" by allowing the definition of precise and quantified objectives relating to the regulatory environment and by encouraging supporting measures. The action plan **should mobilise the actors of innovation** and co-ordinate their efforts through a series of measures designed complete the **concept of a European Research and Innovation Area** by developing the latter with a view to reinforcing trans-national technology transfer and increasing the number and effectiveness of clusters in Europe. This involves for example initiatives for the creation of a "European network of networks" in the field of technology transfer, the professionalisation of local and regional network and support structures for companies, for example through quality charters, labels of excellence or training in the domain of intellectual property, the interlinking of European initiatives with other international actions such as EUREKA, the identification of good practices or possibly a quality charter for clusters (involving the sectors concerned). Innovation is a multi-dimensional phenomenon, and these actions will therefore also cover the non-technological aspects of innovation, such as **management innovation or design**.

- The **Green paper on Entrepreneurship** published at the beginning of this year launched a broad debate on how to encourage entrepreneurial activity and enterprise growth. The responses to the public consultation, which lasted until June 2003, pointed to the need for a wide ranging co-ordinated approach to make initiatives in various policy areas and at different policy levels compatible and mutually supportive. In 2004, the Commission will come forward with **an action plan to tackle the key challenges identified**. The action plan will cover a range of policy fields and address 3 areas: Reducing barriers for Europe's entrepreneurs, in particular SMEs; unlocking entrepreneurs' ambitions for growth; and encouraging more people to start a business. Particular attention will be given to domains where measurable progress needs to be achieved quickly, such as entrepreneurship education, strengthening of balance sheets, better listening to SMEs, social protection of SMEs, building business networks and fostering business support networks.

- The **European education and training systems** show structural weaknesses and require urgent reform to achieve the Lisbon Strategy goal. Without resolute reforms and investments the deficits in this area will no doubt increase. On the basis of the conclusions of the working groups set up in the framework of the "Education and Training 2010" initiative and the national reports on education, life-long learning and mobility, the Commission has developed proposals for reform set out in its recently adopted Communication[36] on this issue. These focus on 4 priority levers: Concentrating reform on investments on key points in each country; making life long learning a reality; create a Europe of education and training, and give "Education & Training 2010" its rightful place in the implementation of the Lisbon Strategy.

- In 2004, the Commission and the Member States will continue the discussion of the policy and regulatory framework for structural and cohesion funds interventions after 2006. Support for research, innovation and entrepreneurship will be at the core of future regional development strategies.

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[36] See footnote 10.

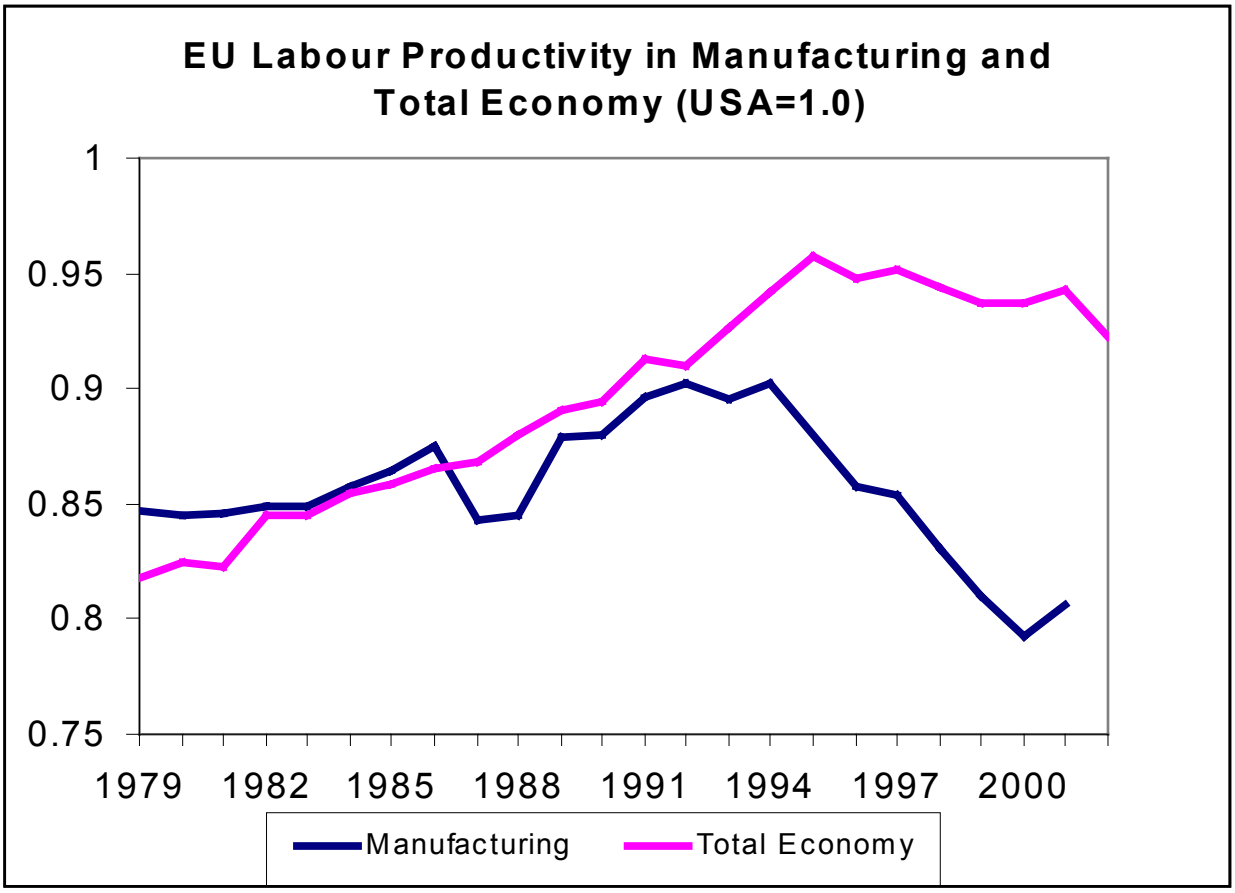
Annex 2: Basic data on the manufacturing industry

	Value added, employment and labour productivity growth, 1979-2001* (Compound annual growth in percent)			Share of manufacturing* (in percent of value added, 1995 prices)		EU15 trade balance+ (EUR billion)	
Industry	Value added (1995 prices)	Employment	Labour Productivity	1979	2001	1989	2001
Electronic valves and tubes	8.5	-0.1	8.6	0.2	1.0	na	na
Telecommunication equipment	7.3	-1.2	8.6	0.4	1.6	na	na
Office machinery	7.4	-0.6	8.0	0.3	1.2	- 16.3	- 33.5
Radio and television receivers	3.9	-2.3	6.3	0.3	0.6	- 11.9	- 17.7
Mining and quarrying	-0.2	-5.1	4.9	3.4	2.5	na	na
Chemicals	3.4	-1.3	4.7	4.7	7.5	14.0	53.5
Other instruments	2.5	-1.8	4.4	0.4	0.5	na	na
Basic metals	0.7	-3.1	3.7	2.9	2.6	- 5.1	- 15.6
Electricity, gas and water supply	2.2	-1.2	3.4	7.1	8.6	- 0.5	0.6
Clothing	-0.2	-3.4	3.2	2.2	1.6	- 9.1	- 29.1
Other electrical machinery and aparatus nec	2.5	-0.7	3.2	2.4	3.2	3.5	4.6
Building and repairing of ships and boats	-0.1	-3.3	3.1	0.6	0.5	na	na
Pulp, paper & paper products	2.0	-1.0	3.0	1.8	2.1	0.8	5.3
Railroad equipment and transport equipment nec	0.7	-2.1	2.8	0.4	0.3	34.7	68.3
Aircraft and spacecraft	2.1	-0.6	2.7	0.9	1.1	na	na
Scientific instruments	2.4	-0.2	2.6	1.1	1.4	- 1.6	0.8
Textiles	-0.8	-3.2	2.3	3.7	2.3	- 0.2	- 0.8
Non-metallic mineral products	1.1	-1.3	2.3	3.6	3.4	5.4	7.6
Motor vehicles	1.6	-0.7	2.3	4.5	4.8	16.7	43.3
Leather and footwear	-1.1	-3.3	2.2	1.4	0.9	0.9	- 3.0
Wood & products of wood and cork	1.1	-1.0	2.1	1.7	1.6	- 4.4	- 4.8
Insulated wire	1.1	-1.0	2.1	0.3	0.3	na	na
Rubber & plastics	2.4	0.6	1.8	2.7	3.5	2.5	4.4
Food, drink & tobacco	1.1	-0.6	1.7	7.1	6.9	2.3	7.0
Printing & publishing	1.6	-0.1	1.7	3.7	4.0	1.7	3.1
Mechanical engineering	0.6	-1.1	1.7	7.7	6.7	na	na
Fabricated metal products	0.8	-0.8	1.6	6.7	6.1	5.4	6.9
Furniture, miscellaneous manufacturing; recycling	0.4	-0.7	1.1	3.2	2.7	2.0	- 6.2
Mineral oil refining, coke & nuclear fuel	-3.6	-2.0	-1.7	2.8	0.9	- 7.5	- 6.4

Source:* M. O'Mahony and B. van Ark (ed., 2003): *EU Productivity and Competitiveness: An Industry Perspective Can Europe Resume the Catching-up Process?*, a study prepared for the Enterprise Directorate-General..
+ Eurostat: Panorama of European Business, 2002 edition; na = not available.

ANNEX 3:

The slowdown in EU manufacturing productivity growth in recent years is also reflected in the substantial opening of the productivity gap against the US



Source: M. O'Mahony and B. van Ark (ed., 2003): *EU Productivity and Competitiveness: An Industry Perspective Can Europe Resume the Catching-up Process?*, a study prepared for the Enterprise Directorate-General.