Evolving Europe, Evolving Competitiveness Policy

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Evolving Europe

- Europe has changed a great deal since 1980
  - From 9 to 27 countries
    - Core N/W Europe
    - Emerging S/E Europe
- But also the economic environment
  - Globalization
  - Technological change
- Competitiveness policy has also evolved
  - Industrial policy: industrial competitiveness
  - Cohesion policy: territorial competitiveness

INDUSTRY

Article 173 TFEU (ex Art 157 TEC)

The Union and the Member States shall ensure that the conditions necessary for the competitiveness of the Union's industry exist

Two eras of industrial policy

- 1950s, 1960s and 1970s
  - Sectoral industrial policy, mostly at national level
- Since the 1980s
  - Shift towards horizontal industrial policy
  - Emphasis on EU instruments

Thirty years ago...

- Geroski & Jacquemin's assessment*
  - European industry is suffering a competitiveness crisis
  - The cause is not the small size of enterprises...
  - ...but their inability to initiate, and respond to, changes

*"Industrial change, barriers to mobility, and European industrial policy", *Economic Policy*, 1985

Thirty years ago...

- G&J's general recommendation
  - Increase market flexibility
  - Lower mobility barriers
  - Foster adaptability within firms
  - In short: increase the competitive environment within which European firms operate

Thirty years ago...

- G&J's recommendation w.r.t. to industrial policy

  – Industrial policy should be designed to alter market processes, not to seek specific outcomes. It should comprise of
    - A strong competition policy
    - The removal of financial barriers to entry that favor incumbents
    - The creation of a truly Single Market and the removal of barriers that protect national champions

EU industrial policy Mark I (1990)

- "IP in an Open and Competitive Environment"
  - IP = effective coordination and implementation of all areas affecting industrial structural adjustment of industry. It entails
    - Maintaining a favorable business environment
    - Implementing a positive approach to adjustment
    - Maintaining an open approach to markets
  - The Single Market program constitutes industrial policy par excellence

EU industrial policy Mark II (2002)

- "IP in an Enlarged Europe"
  - IP is horizontal in nature and aims at securing framework conditions favorable to industrial competitiveness
  - However, it needs to take into account the specific needs and characteristics of individual sectors
  - IP therefore inevitably brings together a horizontal basis and sectoral applications
  - Most IP is not carried out at the EU level, but under the competence of the member states

EU industrial policy Mark III (2005)

- "Towards a more integrated approach to IP"
  - The main role of IP is to provide the right framework conditions for enterprise development and innovation in order to make the EU an attractive place for industrial investment and job creation
  - Commitment to horizontal nature of IP and to avoid a return to selective interventionist policies.
  - However to be effective, IP needs to take account of the specific context of individual sectors.

EU industrial competitiveness policy

- What DG Enterprise says on its website (last update 12/12/2009)

- EU industrial competitiveness policy is about
  - Stimulating innovation and competition and investment in know how
  - Guaranteeing a level playing field in the Single Market and outside of it in third countries
  - Reducing frictions and transaction cost in the European economy, such as administrative burden

EU industrial competitiveness policy

- It is not about
  - Ad-hoc intervention, picking winners or bailing out losers, or similar concepts
  - More regulation or more state aid

Yet problems remain

- New entrants continue to face barriers
  - The degree of competition remains insufficient in Europe, especially in services
  - Financial markets continue to hinder the development and growth of new, innovative firms
- While the competitive position of large European incumbents remains relatively good both within and outside Europe

Contrast with the US

- In Europe governments have often continued to protect incumbents, at least implicitly
- By contrast the US economy has generated new entrants
- Outcome: among the top FT500 in 2007
  - Only 3 newly-created European companies
  - But 26 in the US

The age pyramid of 2007 top FT500

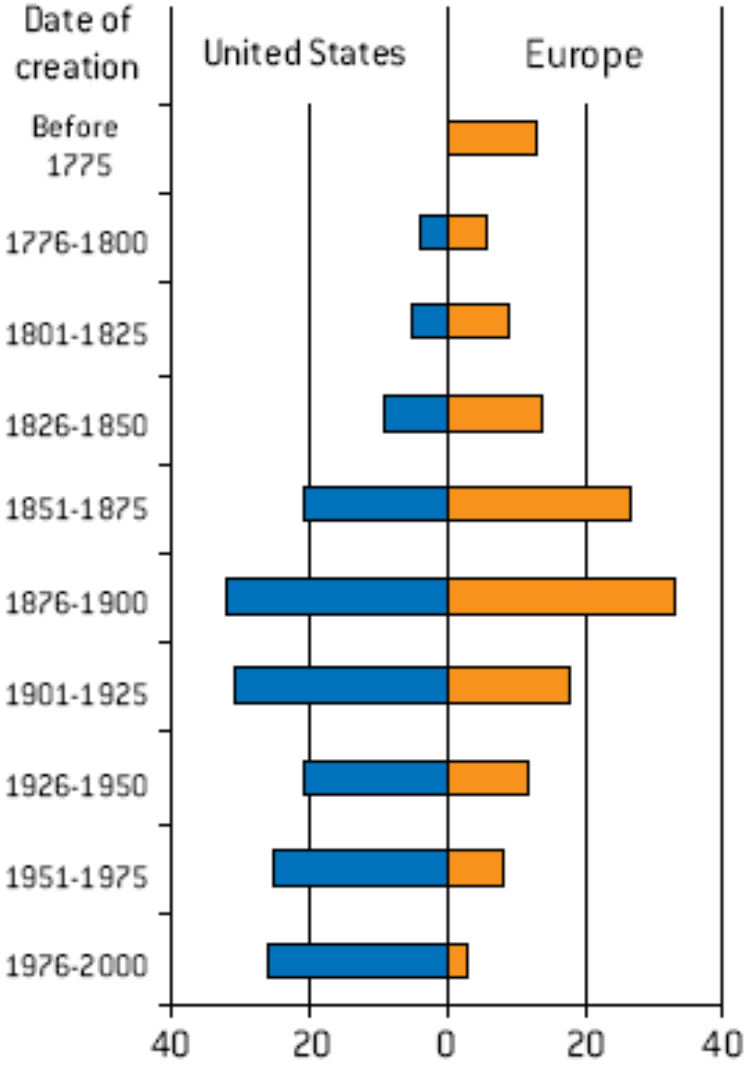
Firm number

Europe: 150

USA: 170

Firm size

identical



Source

T. Philippon and N. Véron, Bruegel Policy Brief

January 2008

Europe 2020

- Three priorities
  - Smart growth: developing an economy based on knowledge and innovation
  - Sustainable growth: promoting a more resource efficient, greener and more competitive economy
  - Inclusive growth: fostering a high-employment economy delivering social and *territorial cohesion*

- Seven “flagship initiatives” at EU & nt’l levels

Sustainable growth

- Three “flagship initiatives”, including
  - An industrial policy for the globalization era to improve the business environment, notably for SMEs, and to support the development of a strong and sustainable industrial base able to compete globally

Industrial policy for globalization era

- At EU level, the Commission plans to
  - Establish an industrial policy creating the best environment to maintain and develop a strong, competitive and diversified EU industrial base
  - Develop a horizontal approach to industrial policy combining different policy instruments: "smart" *regulation*, modernised *public procurement*, *competition rules* and *standard setting*
  - Improve the business environment, esp. for SMEs
  - Promote the restructuring of sectors in difficulty

Industrial policy for globalization era

- At national level, member states should
  - Improve the business environment especially for innovative SMEs, including through *public sector procurement* to support innovation incentives
  - Improve the conditions for enforcing *intellectual property*
  - Reduce *administrative burden* on companies, and improve the quality of *business legislation*

Europe 2020 (2)

- Two “flagship initiatives”, but none concerning territorial cohesion specifically

Cohesion policy and its structural funds, “while important in their own right, are key delivery mechanisms to achieve the priorities of smart, sustainable and inclusive growth in MS & regions”

TERRITORIAL COHESION

Article 174 TFEU (ex Art 158 TEC)

In order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion

Article 176 TFEU (ex Art 160 TEC)

The European Regional Development Fund is intended to help to redress the main regional imbalances in the Union through participation in the development and structural adjustment of regions whose development is lagging behind

What does “lagging region” mean?

- How do we define “regions”?
  - Economic or political/administrative definition?
- What does “lagging” mean?
  - Absolute or relative measure?

> In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions.

Three types of lagging regions

- Lagging country with all regions lagging (Bulgaria, Romania)
- Lagging country with some regions lagging (Hungary, Poland)
- Advanced country with some regions lagging (France, Italy)

Regional Disparity - Theories

- Old and new economic geography: Location results from a trade-off between
  - Mobility cost savings. Proximity customers/suppliers
  - Production cost savings. Scale economies
    - Internal to firms
    - External to firms, but internal to sectors or locations (AGGLOMERATION ECONOMIES => DIVERGENCE?)
- Neo-classical vision: decreasing marginal returns => CONVERGENCE through Single Market

Williamson (1965)

- Inverted U-curve relationship between national income and regional disparity

- This suggests a distinction between

  – Low income countries (LHS of curve), where agglomeration effects dominate

  – High income countries (RHS of curve), where neoclassical effects dominate

  – Question: on which side of the curve are the cohesion countries???

Krugman-Venables (1990)

- Southern EU enlargement: Economic fears and political opportunism

- Inverted U-curve between level of barriers and manufacturing production & incomes
  - High barriers: low disparities
  - Medium barriers: high disparities (agglomeration)
  - Low barriers: low disparities (decreasing returns)

- Deals with countries, not regions
- Static analysis >> Endogenous growth

Regional Policy: On what Grounds?

- Efficiency: Market failures?
  - No => no need for RP
  - Yes => need for RP but
    - There can be TOO MUCH AGGLOMERATION
    - There can be TOO LITTLE AGGLOMERATION
- Equity/political acceptability of growth policies (e.g. economic integration) pursued by national government, especially with no migration

Balassa (1961)

- Ch 7: Regional Problems of a Common Market

- Polarization is a potential problem but should not be overrated. On balance he recommends

  – Intensify national regional policies
  – But beware of “fetishization” of balanced growth which would prevent gains of regional specilization
  – Coordinate national policies at supranational level for efficiency reasons

Growth and Disparity in the EU

- Can and should EU policies aim at
  - Fostering EU growth/competitiveness?
  - Reducing disparities between countries?
  - Lowering regional disparities within countries?

Growth and Disparity in the EU

- Can and should EU policies aim at
  - Fostering EU growth/competitiveness? YES
  - Reducing disparities between countries? YES
  - Lowering regional disparities within countries? NO

A case against EU regional policy?

- Balassa argues in favour of national regional policy, albeit with EU coordination
- Krugman-Venables argue in favour of EU policy for peripheral countries
- But neither argues in favour of EU regional policy

Convergence – Empirical evidence

- Countries: clear evidence
- Regions: mixed evidence

EU-15: GDP per head convergence

	Common intercept	Fixed effects (one-way)	Fixed effects (two-way)
β	-1.91*** (0.20)	-3.02*** (0.37)	-4.88*** (1.41)
Obs.	56	56	56
R^2_{adj}	51.3%	62.3%	62.4%

Unconditional β-convergence

Figure 2: Real GDP per capita dispersion: EU-15 countries 1960–1998

Source: Crespo-Cuaresma, Ritzberger-Grünwald and Silgoner (2008)

NMS: GDP per head convergence

Regression results for β-convergence (CEE-10 & EU-15)

Period	α_0	α_1	*t*-stat. (α_0)	*t*-stat. (α_1)	*p*-value (α_0)	*p*-value (α_1)	R^2	β-convergence	β
25 countries of the enlarged EU									
1996-2007	0.2911	–0.0244	5.94	–4.77	0.000	0.000	0.4974	yes	0.0284
1996-2001	0.1262	–0.0077	1.93	–1.12	0.067	0.273	0.0521	yes	0.0078
2001-2007	0.4228	–0.0367	7.00	–5.99	0.000	0.000	0.6091	yes	0.0415
2 regions (CEE-10 and EU-15)									
1996-2007	0.2862	–0.0246	.	.	.	.	1.0000	yes	0.0287
1996-2001	0.1132	–0.0071	.	.	.	.	1.0000	yes	0.0072
2001-2007	0.4534	–0.0406	.	.	.	.	1.0000	yes	0.0466

Source: Rapacki and Prochniak (2009)

The effect of enlargement on trade

- A. Antimiani and V. Costantini (2009), “The impact of the enlargement process on the export dynamics of the EU”, ETSG Conference, Rome

- Gravity trade equation, 1996-2007
  - 24 exporters: 14 EU-15 and 10 NMS
  - 145 importers
  - Distinction between 4 tech groups

Macro sector	Sector
High-technology industries (SEC-TEC1)	1. Aircraft and spacecraft
	2. Pharmaceuticals
	3. Office, accounting and computing machinery
	4. Radio, TV and communications equipment
	5. Medical, precision and optical instruments
Medium-high-technology industries (SEC-TEC2)	6. Electrical machinery and apparatus
	7. Motor vehicles, trailers and semi-trailers
	8. Chemicals excluding pharmaceuticals
	9. Railroad equipment and transport equipment
	10. Machinery and equipment, others
Medium-low-technology industries (SEC-TEC3)	11. Building and repairing of ships and boats
	12. Rubber and plastics products
	13. Coke, refined petroleum products and nuclear fuel
	14. Other non-metallic mineral products
	15. Basic metals and fabricated metal products
Low-technology industries (SEC-TEC4)	16. Manufacturing, others; Recycling
	17. Wood, pulp, paper, paper products, printing and publishing
	18. Food products, beverages and tobacco
	19. Textiles, textile products, leather and footwear

Table 3 – Estimation of the enlargement effect on EU15 for different macro-sectors

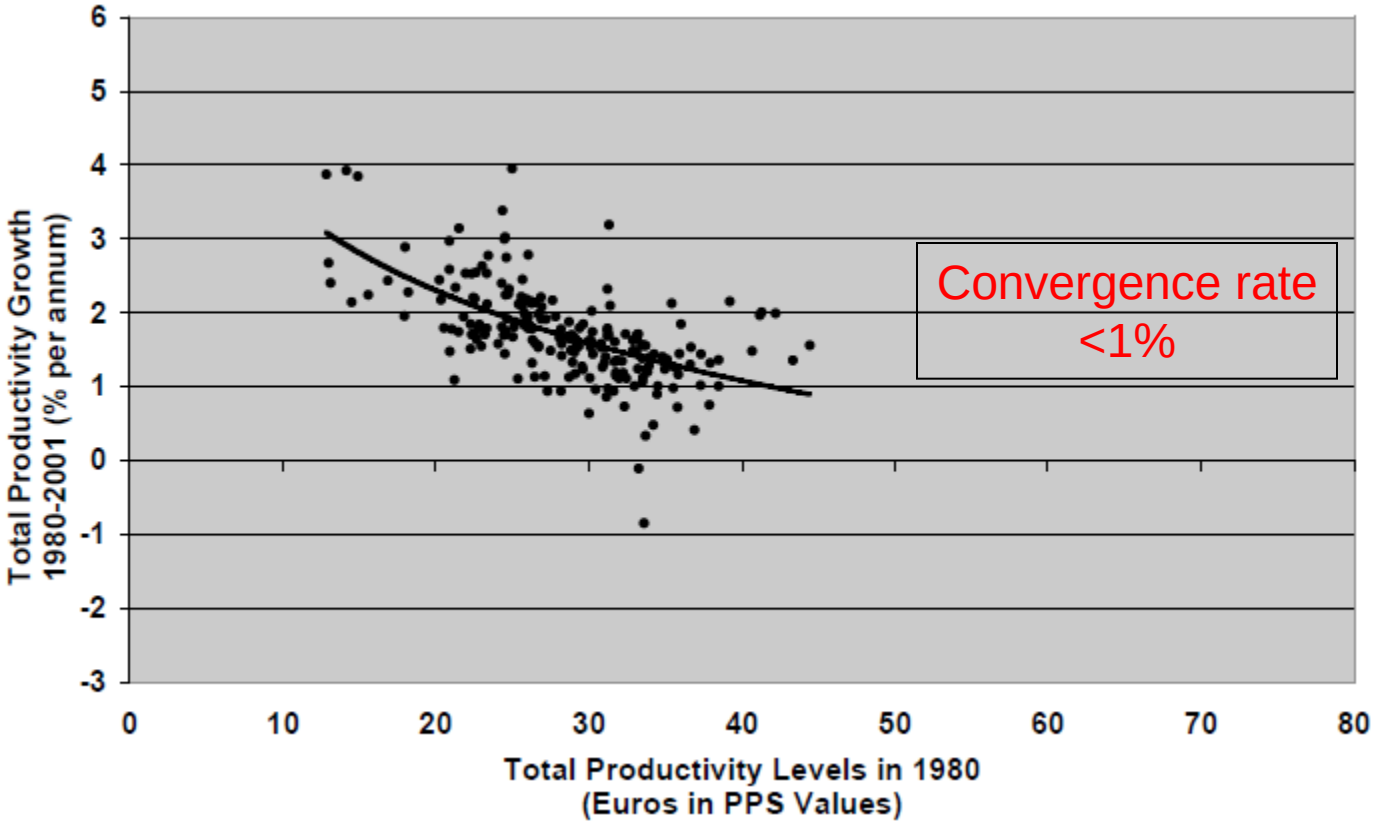
SEC-TEC1	SEC-TEC2	SEC-TEC3	SEC-TEC4
0.108***	0.074***	0.058*	0.081***
(3.58)	(2.68)	(1.77)	(3.36)

Table 4 – Estimation of the enlargement effect on EU10 for different macro-sectors

SEC-TEC1	SEC-TEC2	SEC-TEC3	SEC-TEC4
0.387***	0.278***	0.353***	0.485***
(4.25)	(3.42)	(3.88)	(4.15)

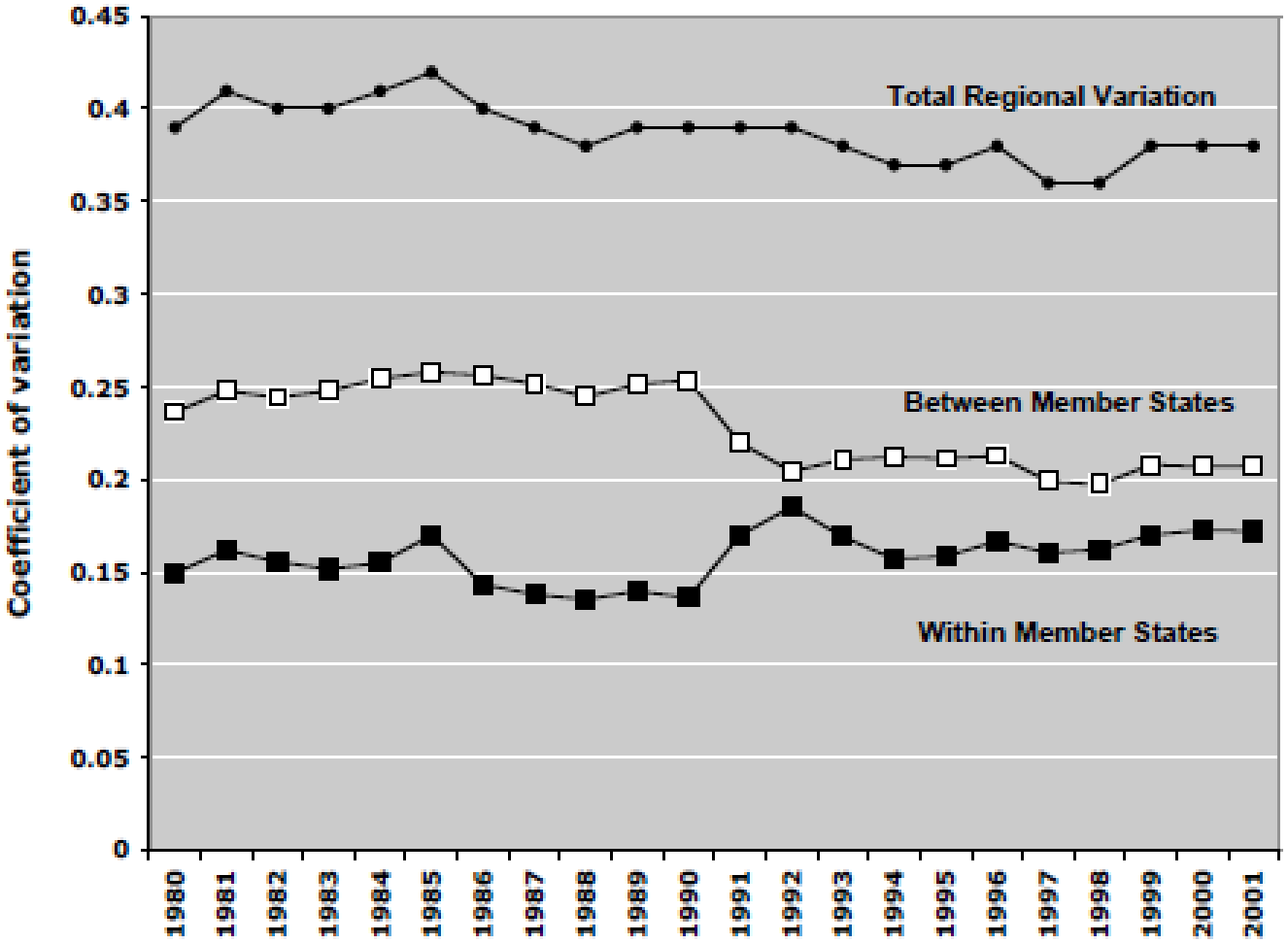
Coefficient of the enlargement dummy variable

Regional productivity convergence



Source: Gardiner, Martin and Tyler (2004)

Regional productivity dispersion



Source: Gardiner, Martin and Tyler (2004)

Convergence – The role of EU policy

- Methodological problems in assessing the relationship between policies and convergence
  - What is the anti-monde?
  - Crucial impact of non-regional policies on regions
- Definition of "regions" is arbitrary or, more precisely, aimed at maximizing transfers rather than convergence. Rent-seeking.

CONCLUSION

From an EU perspective

- The Single Market is at the centre of both
  - EU industrial policy for competitiveness
  - EU cohesion policy for convergence

- But the Single Market, incl. competition policy
  - Is not yet completed
  - Is perhaps necessary (free capital movements?) but certainly not sufficient for either competitiveness or convergence

For other regions

- First, the EU is ‘sui generis’ in terms of
  - The depth of integration
  - Common institutions and policies
  - Size and diversity
- Second, the lessons for S/S integration are unclear