CONFRONTATIONS EUROPE

OPEN LETTER

Philippe Herzog appeals to economic and social players and to political leaders for the adoption of a

European industrial competitiveness strategy based on integration and solidarity

In this powerful appeal, Philippe Herzog makes six recommendations to economic and social players and to political leaders, and puts forward the need of a European industrial competitiveness strategy based on integration and solidarity at the heart of the national and European political agendas.

His appeal follows on from and completes the discussions held by Confrontations Europe, and the actions it has taken to establish a competitive and inclusive Europe. It is released in a particularly burning context. The dilemma between austerity and growth is fake. The indispensable restrictive policies are, against all intentions, creating austerity, while economic growth remains elusive. The important decisions taken during summer to increase stability have left us more time, but the fundamental goal is to start reforming our welfare and economic systems to create a new sustainable growth potential. This potential is very low in Europe today.

Philippe Herzog stresses once more that industrial renewal is key to solving the issue, as it drives research, productivity and export growth. But this renewal, he says, cannot be brought about solely by the experts at the Ministries of the Economy and Finance; a number of conscious social choices also need to be made.

We need to instil new motivation into young people to steer them towards sciences, technology, manufacturing and sales, and convince workers to accept restructuring programmes and job-to-job transitions that will bring fresh hope. This is why the very large-scale reforms of the training sector and the labour markets must be given absolute priority.

In addition, Europe's economic, social and political players must win the war of innovation in all sectors. This will only be possible if the different countries, starting with France, can rely on an integrated and inclusive European industrial area. The opportunities created by the single market cannot be seized if Europe remains divided by rivalry and by uncooperative strategies. And the only way to ensure that new technologies are embraced across all regions and industrial sectors is to introduce new common policies. Similarly, the valuation and financing of medium and long-term investments require Europe to regain control of the value of its potential and its projects, which the Union has largely entrusted to the financial markets.

Philippe Herzog and we believe that national and European political leaders have a duty to define the mandate and the mode of governance needed for a common industrial strategy. We invite all economic and social players to set up more new initiatives, cooperation agreements and jointly-coordinated projects.

Claude Fischer, President of Confrontations Europe

Argument

The ECB's new policy, the decision to build a banking union, and the introduction of a centralised control of national budgetary policies mark significant progress in the search for a macro-financial stability framework in the Eurozone. However, since it is now generally accepted that we will not achieve stability without the return of sustainable economic growth, we still have a long way to go. The deleveraging process has not yet begun, and by supporting countries in difficulty through loans – in other words creating new debt, despite fears of insolvency in some States due to structural competitiveness weaknesses – we are playing for time without solving the underlying problem. To evict the Eurozone's least competitive countries would be to take a huge risk. It is crucial that we assume the great heterogeneity of member countries and that we increase cooperation and active solidarity to strengthen their growth potential along with that of the Eurozone and the Union as a whole. This will require major reforms in structures and in market and management models, not only in Member States but also at Community level. The Commission's "Growth Pact," approved by the Council on 29 June, is extremely limited because it does not address the crux of this challenge. The process of building sustainable growth is not currently on track.

> *The European industrial revival calls for great strategic ambition, comparable in magnitude to the great post-war reconstruction. Our political leaders and our societies have not set the same ambitions, et our industrial policies are non-cooperative.*

At the heart of the problem is a European industrial revival at a time of information and technological revolution, of global competition and of sustainable development. This calls for great strategic ambition, comparable in magnitude to the great post-war reconstruction. Our political leaders and our societies have not set the same ambitions.

There is an unprecedented need to concentrate our efforts on diagnosis and argumentation, because we are continuing to ignore the fundamental realities.

More than ever before, the industrial sector and its associated services are the drivers of growth and productivity. The great majority of R&D and export potential is concentrated here, and it needs to generate sufficient added value to guarantee funding for other forms of business.

Yet in the Union as a whole, the slowdown in industrial productivity growth has been glaringly obvious since the mid-1990s and it is stagnating in the services sector. The surpluses of the manufacturing industry do not compensate for our growing energy dependence on fossil fuels. There are obvious deficiencies in research and qualification, in productive and labour investment. The European industry's global competitiveness is therefore under threat at a time when the emerging powers are progressing rapidly in all fields, from technology to production.

In addition, the industrial growth and competitiveness gaps dividing member countries, which have further widened since the 2000s, are increasing with the crisis. While the polarisation of industry in Germany and some neighbouring countries was growing stronger, other countries were experiencing accelerated deindustrialisation. These phenomena reflect the huge competitiveness disparities on a European market in which competition has become more and more intense. They have led to current account imbalances for which funding was provided before 2008, while creating a strong asymmetry in creditor and debtor positions. This, I repeat, is the main contributing factor in the potential collapse of the Eurozone, an area in which 17 countries share the same currency.

The Member States and the EU have consented to neither an analysis of nor an in-depth public debate on why the previous growth strategy failed. If we accept that industry is today a concern, then we must pinpoint the reasons why it is failing so badly (except in some countries), along with the dogmas and biases of EU policy. Faced as we are with a systemic problem, this paper points to four groups of structural and operational issues.

• *The system of social and industrial relations,* with at its heart training and employment: obsolescence of school systems and labour markets, which are increasingly discouraging our young people and active populations from embracing production and entrepreneurship.

• *The system of industrial innovation:* the dogma according to which competition alone is the major stimulus, which does not withstand scrutiny. Admittedly, the EU has funded research and development programmes, but it has neglected the building of networks, platforms and cooperation between companies, yet this is essential in the presence of high fixed costs and deferred returns. In addition, it has failed to bring innovation down to production and market level. Moreover, the dogma according to which the engine of future growth is to be found in the services sector has held sway in both the Member States and the Union, yet it is vital that we build complementarity between industries and services. The EU has focused on opening up the services market with mixed results, particularly disappointing in the case of industrial services; it has banned sectorial industrial policies. The sustainable development policy has consisted in setting standards and objectives, without considering the conditions under which the industrial sectors must pursue them. It did not realise the magnitude of the cost and of the market share issues in the competitive international market, or correctly calculate the time required for learning processes. It has funded the introduction of new technologies without regard for the construction of value creation chains and the reorganisation difficulties of the productive sectors. We are left with an already high final consumption of digital technologies, in addition to serious production delays and even job losses. As for green jobs in renewable energy, the net creation is insignificant due to the additional costs incurred by final energy demand and industrial consumption, and it is China that is creating these jobs to produce and export as world leader. It is time we understood that new technologies must be introduced in and by traditional industries, and not only through the separate creation of new sectors.

• *The financial system:* by giving priority to financial markets, the EU has left them free to select the investments. As a result, certain investments have been overvalued by taking bets, notably in the field of new information technologies, while others have been neglected. This has created bubbles, many of which are now bursting, and risk aversion on the part of financiers is today high.

• *Finally, the EU has built its internal market by diluting it in the global market*, with a trade policy that prioritises consumption over supply, and access to external markets without creating unity among the European States.

All these biases reflect *two major shortcomings of the EU framework*: *i) the fragmentation and rivalry between Member States with anti-cooperative practices; and ii) the refusal of common industrial policies as a complement to market policies,* as a result of which the single market could not serve as a springboard for new growth.

Although we are becoming more aware of these problems, we still have a long way to go… yet time is running out. Our political leaders need to assume their responsibilities and our European populations must have the opportunity to involve themselves in these very real issues, which cannot be reduced to a vague balance between austerity and growth.

We propose to develop and put in motion a European industrial competitiveness strategy based on integration and solidarity. *Integration*, because since the ECSC and a few important but one-off initiatives, industrial integration has come to standstill. *Solidarity*, because if we do not help the weaker countries and regions increase their competitiveness, it is not only the euro but also the domestic market that will be threatened with disintegration, and all the European countries will lose out.

> *The Single market renewal and the competition policy reform should offer a solid and coherent basis for the implementation of new common policies, requiring the mobilization of economic and social actors inspired by hope and by the ability to participate.*

We are appealing to the economic and social players, as well as to our political leaders and institutions, and we are calling on them to pool their ideas and their strengths. Our proposals are based on our long experience of Community life, and on initiatives that are either planned or have been implemented and which should now be harmonised, multiplied and integrated into a political agenda.

Six recommendations

Let us be clear about what kind of Community public policy is needed in terms of spirit and organisation. We need to encourage cooperation between industry and public bodies, and between the Member States and the Union around common goals and long-term commitments. Companies are increasingly called upon to resolve employment and training problems as well as issues relating to innovation, production and liberalisation, while government bodies clearly feel a sense of powerlessness. Rather than antagonising relations, we should instead be helping businesses to succeed in the world of commercial competition while also performing new public-interest functions. Meanwhile, the States need to better assume their own responsibilities.

The European Union should incentivize Member States and regions to multiply decentralised cross-border cooperative initiatives as well as assume its own responsibilities in the exercise of several functions: building a dynamic and integrated Single market as a base camp for firms in a globalised world; fostering an Innovation Union; renovating the financial system to properly evaluate economic investments.

We must give the EU a clear and distinct industrial role in industry. The EU is not going to replace the Member States, and it must stop denying the need for and unilaterally denigrating national industrial policies. Each country has to be able to define and promote its own specialisations, depending on its history, its culture and its geography, otherwise it will sink into underemployment. And we must acknowledge the fact that it is not possible to harmonise the distribution of specialisations between Member States. Contrary to the expectations raised by Ricardo's old theory of comparative advantage, the European countries have not strengthened their specialisations in product blocks as a result of the single market, but within individual branches and product ranges.

• *The EU must first set incentives for Member States to cooperate and assume its place in decentralised cross-border cooperative initiatives, which need to be multiplied.* It must move away from the rhetoric of undifferentiated objectives for all Member States (one size fits all), and help promote cross-border networks, platforms and production capacity.

• *Secondly, the EU must assume primary responsibility for certain functions.* For example the building of a more integrated and efficient single market, providing pertinent price signals and regulatory stability and encouraging Community public-interest investments. The creation of an Innovation Union (an EU 2020 objective), breaking the fragmentation between national markets and encouraging a swing from upstream (R&D, etc.) to downstream (production and markets), which is impossible without sectoral and territorial cohesion policies in strategic areas. The recreation of a system for financing the economy. And the transformation of the single market into a base camp for businesses in the global market, supported by long-term partnerships with other regions of the world.

1. Redefining training and employment policies and building a European socio-industrial relations framework

The renewal and reconstruction of the industry of the future will only be possible if it is a choice of society. Germany takes care of its industry through a co-determination system, which is its greatest asset. In many countries, governments try to prevent business closures and to encourage innovation. They subsidise unskilled service jobs, without any form of social mobilisation inspired by hope and the opportunity to participate.

Times are unfavourable. The young and the old are excluded from the labour market and unemployment is increasing. The search for cost competitiveness is provoking negative reactions. In some countries, wage deflation is necessary to realign pay in relation to productivity. In many, the problem is not the pay but the cost of financing social protection, which weighs too heavily on employment. Adjustments should be offset by concrete initiatives capable of recreating a socio-economic progress dynamic. In

this respect, the redefinition of employment and training policies is a major political challenge.
School systems are no longer pushing young people into industry – the working masses cannot find support for retraining and for taking part in transfers. The labour markets exclude and do not facilitate job-to-job transitions. Companies have a huge role to play in solving these pressing problems, by getting involved upstream in initial training, downstream in lifelong learning, and more generally in the promotion of human and social capital. It is the largest of these companies that are most capable of projecting themselves, with their staff, into the international arena with long-term determination; they will be called upon to help SMEs do the same. Correlatively, public policies must revise their concepts and methods to build frameworks of general interest.

Better anticipation and management of restructuring

After an initial Green Paper on restructuring ten years ago and an attempted legislation calling on the social dialogue method, nothing followed, and a new Green Paper is being proposed in 2012. How can we dither in this way?
Restructuring is on the horizon. In the automotive sector, surplus capacity is such that it could quite simply lead to the elimination of activities. Yet restructuring should not be synonymous with rupture, it should be anticipated and managed with a view to redeveloping these activities and revitalising regions. What are we waiting for? Our political leaders and manufacturers need to unite around a concerted strategy. The innovation imperative demands that adaptation and job-to-job transitions be organised. Cognitive, organisational and public resources must be mobilised. It is essential that we engage in sectoral social dialogue, receive commitment from works councils and bring local stakeholders together! The Commission has a duty to establish a framework for such mobilisation, to encourage collaborative solutions, and to create conducive legal and financial conditions. European funds in particular must be diverted towards the appropriate policies. Given today's global market for example, the European Globalisation Adjustment Fund should be replaced by a European Action Fund for restructuring and industrial renewal.

Promotion of skills for innovation and efficient employment

The implementation of "New Skills for Jobs" – a flagship EU 2020 initiative – is at a standstill. However, lack of expertise is at the core of Europe's inability to succeed in innovation and to rehabilitate the popularity of production. The magnitude of the job-to-job transitions expected to accompany retirements should make us treat skills as a public good (let's not forget that we're talking about the knowledge, aptitude and expertise of individuals and work collectives). Vocational and continuous training and skills recognition have fallen into shocking abeyance in several European countries.
Using common indicators to "coordinate" Member States without taking into account the enormous diversity of national situations, and without regard for actual training content, is not holding up. Alone, the important directive on the recognition of professional qualifications will not trigger the kind of mobility we need. Moreover, qualifications are very often out of date and "learning outcomes", in other words the results of experience and on-the-job learning, are not taken into account. We therefore need to complement and enhance action taken in view of reaching European professional certifications. And above all create large-scale European learning and lifelong learning programmes. All workers, including unskilled workers and those excluded from the labour market, should be able to acquire and develop skills.
Huge inequalities are dividing the European nations in this area. We must call on the EU Sector Councils on Employment and Skills and on all forms of interregional cooperation to establish a framework for cooperation.

European organisation of transitional labour markets

National labour market reforms are not embraced with the same fervency in all Member States. More than ever, we need to reconcile flexibility and mobility with security. It is high time that the Commission propose a common framework and incentives.
Young people, unskilled workers and the unemployed must not be simply assisted, protected and paid,

they should be encouraged to train for actual employment opportunities and better jobs – but for this, schemes need to exist! And career and cross-border mobility, which is growing, must be made more secure. Contracts and agreements must be developed to facilitate and better manage these transitions, and public policy should prevent and limit periods of unemployment, by creating training opportunities and preparing individuals for re-employment. This implies a European framework providing access to employment-training services of a higher quality. National bodies must cooperate more closely, spurred on by a new European public service created with the reform of the EURES.

2. *Reforming market and innovation policies and promoting a European production system based on cooperation*

We cannot revive hope of employment, and in particular anticipate restructuring in a positive mindset, if public policy and market mechanisms block project horizons and put a brake on business, sectorial and territorial investment dynamics.

Although as Europeans we share a single market, the Member States are competing in industry. All are pursuing industrial policies – even those who deny it. Germany firmly backs its industry. Britain is fighting tooth and nail to defend its specialisation and position as world leader in financial services. France did have a model, but she lost it 30 years ago and must now build another that is both efficient and sustainable. Many Member States are in big trouble, and are without Community support.

The renovation of the single market and the reform of competition policy

When Michel Barnier began working on the single market reform (the "SMA") in 2010, his objective was to turn it into a base for new growth. But there is no single consensus on market design. Mario Monti called for a historic compromise between the champions of liberalisation and competition, and those in search of common industrial, fiscal and social policies. But the Member States did not want to take this road. Despite some very useful advances, the single market reform has not yet benefited from a determination and drive commensurate with the issues at stake. In fact, the market policies and the national and EU public policies fuelling industrial competitiveness remain unarticulated, hence the biases and inefficiencies on both sides. A new phase of the SMA is needed, meeting not only the expectations of stakeholders in the services sector and infrastructure conditions, but also those of manufacturers. The formation of relevant prices and adequate funding mechanisms for investment are needed. And competition policy must be improved.

In the absence of an industrial strategy, competition policy has reigned. It has prevented such a strategy from emerging, when it should have contributed to its assertion. Its doctrine has not changed, yet technological advances and the emergence of new markets are dramatically affecting its implementation. Platform and network economics are creating natural-monopoly configurations with the clustering of information and the leveraging of social capital by private players, whereas the competition doctrine would like to chop up activities in which cooperation and integration are consubstantial. It is fighting the coordination of funding activities, yet this contributes to the clustering effect. There is evidence that competition policy can only have a positive effect on innovation if it is tailored to individual sectors, and if it pursues a fresh public-good approach in situations of increasing returns to scale and to clustering.

> *In the absence of an industrial strategy, competition policy has reigned. It has prevented our industry from asserting itself, when it should instead have been promoting such behaviour.*

Although competition policy has lacked the ability to anticipate (this is flagrant for financial activities), we could make up for this by using its tools to help restructure companies and sectors with the aim of making best use of innovation, redeploying activities (rather than abandoning them), and structuring an integrated and horizontal field where necessary. Competition policy would thus play a very important role in encouraging large companies to be part of an industrial cooperation strategy, as well as in the development of SMEs.

State aid modernization is on the agenda. It would be absurd for it to be designed unilaterally by DG

Competition. On the one hand, we must no longer hide the fact that many national and joint aid schemes for research, development and environmental protection, among others, are either duplicated, useless or ineffective. On the other, it is essential that we reach agreements and pool aid to share industrial projects of public interest, build partnerships and launch investment initiatives despite today's context of very serious uncertainty and aversion to risk. But we are facing major obstacles.

Valorization and dissemination of innovation

The extension of the intellectual property law and its application on the one hand and the dissemination of innovation on the other, the two being perfectly compatible, are on top of the agenda. Rearguard battles are still hindering the creation of a European patent, which would significantly lower costs. But beyond this, we need to orchestrate technological dissemination! We need to create a legal framework that will break fragmentation and retention. The patent markets are developing in the United States and elsewhere, not in Europe.

The Tajani communication on industrial policy addresses important issues, such as patent quality, disclosure of information, the estimation of patent "pools" value, the use of intellectual property rights in financial transactions and the abuses in standardization (patent ambushes). As part of this new phase in the reform of the internal market, we need to create European patent funds, structures for the valorization of public research, demonstrators, pilot units and platforms, in particular to facilitate access for SMEs.

We also need to prioritise the standardisation of product-related B2B services, the harmonisation of licensing and the formation of long-term contracts in the network industries.

Sectorial policies in all areas of strategic European interest

Until recently, the EU has advocated an exclusively horizontal approach – it believed that industry needed only a regulatory framework and an environment conducive to private initiative for it to develop. Experience shows this to be false. The major groups are making innovation efforts by themselves, but the SMEs are missing out, and the decision-making and investment centres are generally moving outside of Europe. Market logic must be supplemented by public policies tailored specifically to individual sectors, and which should be particularly careful to reconcile "old" and "new" sectors within developing fields. To this end, the EU should identify "areas" of common interest and design associated sectorial/fields policies. Let's take a few examples (we will discuss later the two fundamental requirements that are digitisation and decarbonisation).

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• *Restructuring in the automotive sector* will be a massacre if the EU does not want to coordinate the reduction of overcapacity and the deployment of innovation from a sustainable mobility perspective. The strategies of leading groups and national policies aimed at supporting local production are non-cooperative. The EU should provide a framework to ensure redeployment meets a common interest, i.e. the standardisation of clean vehicle components and infrastructure, skills training, the harmonisation of aid, financing facilities, etc. Manufacturers should develop cooperative business models to share fixed costs before competing on products.

• *In the field of ??health*, the pharmaceutical companies know that biotechnology is a matter of long-term survival in the competitive market and the context of aging. Yet there is no single European market (the pricing and financing structures are national), prices are not comparable and the price signals for investment do not work. Venture capital is absent, and the USA is polarising industry and finance.

The European space industry is a micro-industry, the space policy remaining confined to government orders for launch vehicles and satellites. To seize opportunities opened up in this area, services need to be geared to multi-sectoral applications, with the creation of public-interest interfaces and user training.

• *The Tajani communication proposes to set up six new promising markets,* i.e. key enabling technologies, electric and hybrid vehicles, technologies for cleaner production, industrial and green building products, and organic products.

A scathing report by Jean Therme on generic technologies drew attention to "the valley of death" creating a divide between ideas and the market. It has been shown that because of its lack of infrastructure, prototypes and shared resources, Europe has reached an impasse. These platforms can only work in the context of sectoral policies, because technologies are applied differently from one sector to another. Local players will have to be able to connect to these structures. The obstacles to cooperation created by competition policy will have to be removed. Many of these key enabling technologies are not yet active because this requires capital-intensive investments – which once more underlines the issue of funding and of the creation of major public-private partnership initiatives.

Promotion of regions and of interregional cooperation for local economic and social cohesion

Regional public authorities, in cooperation with economic stakeholders, are expected to play an ever-increasing role at the local level in competitiveness strategies. They are expected to organise value creation chains, help companies set up their projects, provide training for regional businesses, conglomerate sources of knowledge and innovation and connect regions with transnational networks. They are also responsible for the vast majority of public investment. In many countries, however, they are not currently able to carry out industrial functions effectively, partly because of the decentralisation delays and failures of public institutions, and partly because the European institutional system nurtures fragmentation. State structures are preventing common regional policies from developing; finding funding for joint projects is a bureaucratic nightmare, yet we need to be able to quickly and effectively aggregate structural funds, national funds, private funds and credit. The Commission's New Financial Instruments are ill-adapted to regional markets, where dedicated investors are needed.

A fundamental "technical assistance" reform is needed to correct the massive imbalance in terms of initiative capacity that divides the different EU regions and vis-a-vis their neighbours. *We believe it is necessary to create decentralised Commission government agencies to bring together stakeholders and create interfaces.* The aim is to encourage the preparation and development of projects, and to achieve a balance between projects and funding sources. The lack of funding and partnerships for cross-border interregional cooperation should be solved. Creating macro-regions to develop the Danube and cooperate in South East Europe would for example significantly contribute to increasing the competitiveness of Europe as a whole (similar to the cooperation developed among the Nordic countries).

Increasingly the renewal of public goods accessible to all is at stake. Regions must be capable of not only redefining missions but also an industrial approach to public services. Delegations to private enterprise and social economy enterprise are a great way forward, but they face many obstacles. The law requires an explicit State mandate; it gets in the way of public-public and public-private partnerships. The EU must build a framework for such partnerships, quite distinct from the concession and public procurement directives. This includes power to build European PPPs for cross-border cooperation (the Commission has recently recognised this need for the digital agenda).

The promotion of the social economy as a set of actors capable of actively contributing to the industrial revival is also drawing attention. A European framework should recognise their specific features, their diversity and their hybrid character (non-market solidarity and market). The internal market and the financing system must provide them with opportunities.

3. Two key strategic objectives: digitisation and decarbonisation of the economy

As a core part of its drive to achieve new growth, the EU has set itself two key objectives: the digitisation and the decarbonisation of the economy. While we can only briefly touch upon the former, we can look a bit more closely at the latter.

The Digital Agenda

The *Digital Agenda* is one of the priorities of the EU 2020 strategy. The EU intends to create a regulated, deep and dynamic single market for services, with adequate infrastructures. To this end, it is calling for more effective national public policies.

It especially aims to promote e-commerce and, particularly, online cross-border trade. But we believe there is also a need for new services to enhance daily life in cities and rural areas and to promote information exchange and communication between Europeans as part of an approach to develop public goods. Does the Internet adequately promote the development of human and social capital? Moreover, while domestic use of the Internet is already very high in Europe, SMEs, public authorities and public services are having to contend with some difficult changes in management models and in qualifications. The quality of the services provided, including distribution and logistics services, is a problem and territorial inequality is huge.

As regards equipment supply, Europe's position has weakened dramatically – Europe accounts for 23% of global output, while its domestic market represents 34% of the global market. The USA invests twice as much in this sector, although the size of its domestic market is comparable and the proportion of public investment is higher. One question begs to be asked regarding the quality of new business models and regulation: are we destroying what existed before or are we creating added value?

A decarbonated economy

As global demand is growing continuously and global warming is an established fact, *the decarbonisation of our energy system* is essential and is instrumental to both competitiveness and growth. Europe has introduced an impressive set of measures, but we must be honest and candid in our assessment of them – the results have been poor and costly. *A complete overhaul of the European energy policy is absolutely necessary.* Reducing CO2 emissions is no great achievement considering that the GDP has still not returned to its pre-crisis level and that Europe exports its pollution while importing massive amounts of fossil fuels. It easily has an above 20% share of renewables in its energy mix, but it is also using more coal and gas and nuclear power has been ostracised.

Energy competitiveness is a major factor in overall economic competitiveness. And Europe has clearly failed: the level of energy dependence (including oil, gas and even coal) is extremely high and climbing; energy efficiency is not improving, owing to sluggish investment in new production methods and housing; and energy-intensive manufacturing industries are being penalised by high energy prices (while the re-industrialisation policy in the United States is based on very low energy prices thanks to the use of shale gas).

Redefinition of objectives

The Energy Roadmap 2050 is on the political agenda for the end of 2012. It is an opportunity for in-depth debate and for change. Two objectives, not three, must be set, i.e. a dramatic reduction in CO2 emissions and increased energy competitiveness (which covers reducing external energy dependence and increasing energy efficiency in production, transportation and usage). The technologies employed to reach these objectives must be chosen by the operators and by the individual Member States… subject to conditions and incentives. The whole challenge lies in finding the right economic model, for an effective decarbonisation leading to a new growth.

Revision of the market model

The market model is not working satisfactorily. Clear, long-term price visibility is vital to stimulate investment, otherwise the level of risk and uncertainty is much too high. This requires a carbon tax

A complete overhaul of the European energy policy is absolutely necessary. Reducing CO_2 emissions is no great achievement considering that the GDP has still not returned to its pre-crisis level and that Europe exports its pollution while importing massive amounts of fossil fuels. Redefining the Energy roadmap, revising the market model and renegotiating a Energy solidarity pact between Member states are indispensable steps forward.

that also acts as a floor price for the carbon market (the volume of which must be reduced), as well as a border compensation mechanism. In addition, renewable energies, which are currently off-market and subsidised – leading to high additional costs – must be brought into the European market. The additional costs generated by intermittency and transportation are currently passed on to the consumer and, since structural differences and major cost variations between countries are not taken into consideration, harmonising prices by aligning them with the markets results in huge implicit transfers between people and companies.

Coordination and complementarity of public policies

A revised market model must be accompanied by effective public policies. The coordination of national policies is a major concern – the threat of European disintegration is real, while the unilateral decisions of the most powerful Member States, such as Germany's decision to phase out nuclear power, have an as yet undetermined impact and result in a forced and unequal socialisation of costs and benefits. We propose to negotiate *an energy solidarity pact between the European Member States in order to establish a complementary energy mix.* Each country would continue to choose its own energy sources, while complying with a few common principles: renewable energies that share the cost of intermittency and transport; gas and coal with carbon capture and storage; nuclear power with high safety standards and a joint control structure, etc. Furthermore, investment in transportation networks must be selected in order to open up peripheral countries and to optimise the cost of the overall European network.

The Union itself must make political choices regarding capacity and networks, and not focus only on the completion and regulation of the market. In addition to R&D programmes, it will be responsible for creating the energy fields of the future. This calls for adequate economic models, otherwise, as we are already seeing, the decision to adopt new technologies will result in the creation of "green employment" in China but not here. Thus the "energy supply security" policy must be reviewed. Based on the use of fossil fuels, it does not attempt to reduce energy dependence by consolidating internal production capacity, or by developing a common investment strategy and building international partnerships.

4. *Valorizing and promoting long-term investments*

If competitiveness is the key to further growth, we need to urgently look at investment financing conditions. In many European countries, companies' profit margins are significantly limiting ability to self-finance – this brings us back to the issue of cost/productivity ratio. Savings remain a still abundant source of funding, but they are largely monopolised by public and social deficits – which brings us back to the matter of fiscal consolidation and the re-establishment of growth multipliers. Let's concentrate here on the issues surrounding the transformation of savings and credit into investment. Today, bankers and investors are showing a very strong aversion to risk. There have never been more liquid assets, but very few lasting commitments. Many question the impact of the prudential regulation and supervision introduced since 2008. These are designed to prevent the outbreak of new banking and financial crises, but are they not also having a perverse effect on the financing of the economy? It is not enough to issue calls for faith in the macro-financial stability efforts made, not when we also need to tackle the reform of the management models and structures of the financing system. Commissioner Barnier has launched a consultation on this subject – and all contributions are welcome. These are fundamental questions. Europe has lost control of the value of its assets and debts, and there can be no long-term strategy without regaining it.

Regaining European control of accounting standards

Let's not forget that the "full fair market value" accounting dogma played a major role in short-termism and in the crisis. The United States recently published a report on the IFRS accounting standards, without reaching a decision regarding their adoption. This "non-decision" has been unanimously interpreted as a choice not to adopt them, or at least not for many years. As for Japan, it does not apply them; most major countries are only doing so with strong reservations and with "filters" to adapt them.

Europe has lost control of the value of its assets and debts. The Commission must now regain control on accounting standards and adjust its prudential doctrine in order not to mix financial risk and economic one.

These market valuation rules do not distinguish between financial value and economic value, they favour liquidity over long-term commitment. The Community adopted them in 2002, without any study of the harmful consequences for the economy. The Commission has delegated power and design to the organisation behind the dogma (the IASB), and must now regain control in an authoritative manner. It must establish the principle according to which the representatives of countries not adopting the standards do not vote on them on the executive board of the IASB. Announce that the Union will not automatically adopt these standards. Reform the EFRAG, the group of experts in charge of advising the Commission, which always comes down in favour of the IFRS. And ensure the IASB works alongside the network of national standard setters. Accounting standards that are not adapted to investment activities, or to the reality of SMEs and social enterprises, must be reviewed and specific rules established for the management of long-term assets.

Review of prudential rules

The international rules developed by the Basel Committees, intimately associated with the IFRS, accredit banking management models while also controlling them. In 2008, the G20 commissioned these committees to review the prudential requirements in order to make them stricter. Europe has decided to adopt the future rules and to take action to enforce them throughout the world. But Basel III poses big problems for the financing of the economy. While it is right to strengthen the equity of institutions, it makes no sense to ignore the transatlantic and intra-Community differences and those among agents. The envisaged liquidity ratios would accelerate the race for cash to the disadvantage of investment. The Commissioner has stood up.

The risky outcome is a structurally rarer and more expensive credit, of which SMEs will be the main victims. We are looking for alternatives through market finance. But this may weaken the continental intermediation systems further down the line, and significantly increase dependence on American, Chinese or Arabic investors.

Shadow banking is likely to play a greater role compared with the traditional role of banks. This "alternative finance" system assumes de facto a money creation capacity, and engenders a public socialisation of risk. We will need to regulate "shadow banks" in the same way as banks, along with all market (and pseudo-market) activities, but there is fierce resistance to this from those participating in the system, the very same who were at the origin of the crisis.

The EU must develop its own prudential doctrine compatible with the taking of risks for the real economy. Credit is needed for productive investment, at least in the preparation phase and at project start-up, before the institutional investors then take over. SMEs must have government guarantees and greater support from high-street banks. We would like to send them back to the stock exchange, but who will note them, and using what risk calculation models? The major companies have better to do than to stand in for banks, adding financial risks to those of productive investment.

In the insurance sector, the EU has imitated what Basel has done for the banks. The Solvency II Directive aims to promote the principle of prudence, albeit while also contributing to the excesses surrounding the pursuit of liquidity. While it is true that insurers can today present solvency risks, the rise in the level of liquidity on balance sheets and withdrawal when faced with the financing needs of investment projects have become a general and worrying trend. We need to conduct new impact studies (the most recent looks at data from late 2009) and to prepare reviews.

Generally speaking, the long-term lending capacity of regulated bodies is currently being restricted, while the non-regulated bodies are stealing the lead in the transformation process. Some risks will no longer be shared in the financial sphere, but transferred to investors. The productive economy will be the main victim. Examination of the cash flow statements of non-financial corporations in the Eurozone reveals growth in the share of liquidity in a diminishing total change in assets. On the liabilities side, there is a very big fall in credit.

A new model for transforming resources into investment

Many analysts believe that the financing system is pushing towards the U.S. model of market intermediation. How can we preserve the process of transforming deposits into credit, and how can we design a different European financial intermediation system, moving away from that which caused the financial crisis?

Part of the answer lies in *savings policies*. Business assets ought to be valued and structured with a view to re-industrialisation, thus meeting employment requirements. The industry will have to turn to bond-oriented savings and will need shareholders, despite the fact that savers generally prefer liquidity. This is why we need to favour long-term savings, with the harmonisation of taxes in Europe and specific tools (clearly identified savings accounts).

Many analysts believe that the financing system is pushing towards the U.S. model of market intermediation. The UE must now foster a reform of the structures of the financial industry in Europe in the framework of the Banking Union, and elaborate a new model for transforming resources into investment.

A second challenge concerns the *structural reforms* needed for banks and institutional investors to renew their transformation functions.

The decision to set up a banking union aims to break the vicious circle of the toxic links between bank debts and government debts, and to prevent crises spreading from country to country. Government guarantees will be reserved for deposits, and the banking system will have to find its own insurance. But how can we defend the banks' role in productive investment? Separating retail and investment banking, which aspires to being prudential, does not meet this objective. We must fight the speculative use of credit leverage for trading, and rehabilitate the transformation of deposits into productive investment.

And, above all, in coordination with the banks, the role of institutional investors (public and semi-public banks, insurance companies, pension funds) and investment funds should be promoted. The recently created Long-Term Investors Club has put forward promising proposals for a European framework adapted to long-term liability contracts and to asset/liability management, and it aims to develop a European investment-fund and capital-risk industry. Regarding tax, standards, stock exchange complementarity, investors' management models, professional qualification standards and the quality of reports for investors, these are all issues that need to be addressed at European level. The Commission must assume its role, both with regard to rules and to savings instruments and choices of structures.

It is currently more concerned about offering "new financial instruments" to try to reduce the risk aversion of private investors and finance infrastructures. It chooses projects itself, and expects the EIB and other national semi-public banks to put together a portfolio of projects for selection. These institutions obviously have a major role to play in terms of funding, but in terms of choosing investment projects of public interest, the Commission's centralised approach is hardly compatible with the need for decentralised, cooperative and democratic project development methods. We recommend the development of a *European framework for the financing of productive investments of common interest* (not just infrastructure), covering project preparation, PPP contracts and the mixing of public and private funds. To this end, the EU might consider examining and reconciling the established systems of various Member States, while piloting European investments considered to be of a strategic nature. The European budget brings structural funds and provides guarantees, but its role as a lever for investment is not clear, has not been evaluated, and is insignificant. Making investments to restore industrial competitiveness should be an explicit function of the Community budget.

5. *Redefining the trade policy and developing an international investment strategy*

The EU's trade policy dates back to the mid-1990s. Some of the principles behind it are still valid, but the failure to update it is frightening considering how much the world has changed.

Liberalisation is a fundamental principle, which must be defended without fail. This is in the interests of Europe's citizens – international trade is an essential driver of economic growth. It should be governed by rules of good conduct, which boost confidence and reduce uncertainty. This is what the EU has striven to achieve, as a leading player in the drive for a multilateral public policy on trade. The obvious limitations of this action should not prevent it from being pursued. But change gives rise to new challenges.

The tremendous potential for growth in global demand no longer lies in Europe or even the USA, but in Asia and on other continents. Raising export capacity is therefore crucial in terms of employment and growth in Europe, and a major challenge for the industrial sector in particular. However, while the internal European market is the most open in the world, the obstacles to entering external markets are considerable. Hence the recent demands for reciprocity. But being able to export is not enough. To survive and grow, companies must also be able to invest abroad, and foreign investment must contribute to the growth of our production potential. However, international investment – at a time when competition through innovation is all the rage – involves major transfers of technology and of intellectual property. And it is governed by the industrial policy objectives of the most powerful countries. Yet, unlike the traditional and emerging powers, the European Member States have separate and competing external investment policies. A community strategy of mutual interest is needed, which is something that is almost inexistent today. More generally speaking, Europe needs to create a base camp within the global economy having both an internal and an external dimension in order to develop a strategy of sustainable growth.

The principle and practice of reciprocity

It should be pointed out that the principle of differentiation embraced by the WTO for the benefit of developing countries may run contrary to the principle of reciprocity.

But many emerging countries have now become fully-developed world powers (including in the high technology sector), even though they are still under-developed in some sectors and regions, and naivety is now quite out of place, especially since they have started to organise themselves into integrated economic areas.

The Union is striving to develop bilateral agreements, which include provisions on reciprocity in terms of market access and investment. But two flaws have emerged. Firstly, it has failed to develop ambitious, joint policies with other major regions of the world, taking into consideration their differences and their own integration agreements. Secondly, the unequivocally rule-based approach does not take into account the potential economic impact. For example, since the free trade agreement with Korea came into force in July 2011, the trade deficit in Europe's automotive industry has grown significantly. Here as elsewhere, the rules should be defined according to an in-depth analysis of long-term economic and social interests.

That said, Commissioners Barnier and De Gucht have taken the initiative to introduce European legislation on reciprocity. Many countries remain opposed to the very principle. However, regardless of its limitations, it is important we succeed in taking this first step. The initiative focuses on government contracting and aims to eliminate unfair competition. The European markets are much more open than those of the United States, Japan and the emerging countries. Reciprocity is all the more justified because these contracts rely on public funding and play a part in public interest investment.

We need to go further. The Union should encourage its partners to recognise its standards, and negotiate rules of mutual interest relating to competition and investment policy. It is vital that we review government support rules – intra-Community divisions and the competition policy play right into the hands of foreign competitors. Similarly, investment contracts include clauses on technology transfers and "local added value", which should be subject to a legal framework. Establishing a mutual interest means much more than enforcing market access reciprocity, it must also focus on the sharing of effective economic and social benefits.

Development of an international investment strategy

Investment drives economic growth. Therefore, it should be governed by strategic policies that take into account both the public interest and competitiveness.

We cannot expect too much of the trade policy, which is focused essentially on commercial concerns. Europe has pushed this approach to the extreme – it is even trying to negotiate investments under the commercial umbrella of free trade, although investment involves considerable resources and long-term commitments and is not driven simply by commercial interests as it must respond to the collective functions of growth.

> *The EU's trade policy dates back to the mid-1990s. Some of the principles behind it are still valid: the openness of our economy is a fundamental principle to fiercely defend. But naivety is now out of place. Actions for reciprocity must be encouraged and the UE should adopt a differentiated strategy for international investments.*

The Commission has just set up a small strategy unit that is investigating the major questions surrounding international investment. We must go further than that and obtain a political mandate, organise a massive consultation of economic players and governments, and develop effective and costly analysis and forecasting tools.

The strategy must be differentiated – the problems and opportunities of mutual interest will differ depending on whether we are dealing with Russia, China or Brazil. Of course, the common economic interests of the European Member States must be defined beforehand, with the long-term perspective in mind. Developing such a strategy would also entail revising the competition policy, which until now has focused on consumer interests to the detriment of a policy of competitive industrial supply. This means calling into question the single-focus structure of the Community institutions: internal market policies, external trade policy, defence policy and external policy – among others – are separate things, meaning that there is a lack of coherence and synergy. This is one of the main challenges underlying any future institutional reform!

6. *A mandate and governance for industrial integration*

So far we have called on the EU to implement a strategy. This is simplifying matters, and we need to be clearer: *we must in fact accept the need to move in two distinct circles* (at least).

The European Council must call on the determination of Member States, a determination they will not all share. Germany and France, along with all the Eurozone member countries aspiring to solidarity-based growth, are willing supporters of industrial integration, but it won't come without a fight. The survival of the euro is at stake, but people will not mobilise their efforts around this argument alone. In contrast, Britain and certain other countries want to maintain their independence. Yet they share the same market and the same budget as all the other members of the EU. *Tensions are inevitable, hence the need to seek a historic compromise in favour of market and budget reforms,* and to return to the recommendation made by Mario Monti in this respect in 2010.

We need a mandate for an industrial solidarity and convergence pact among volunteer Member States, and a strong corporate governance for its implementation. Admittedly, it will rely on decentralised cooperation projects aimed at increasing "reinforced co-operations", which are currently rare and restricted. But it will take more than that: centralised coherence and synergy is needed.

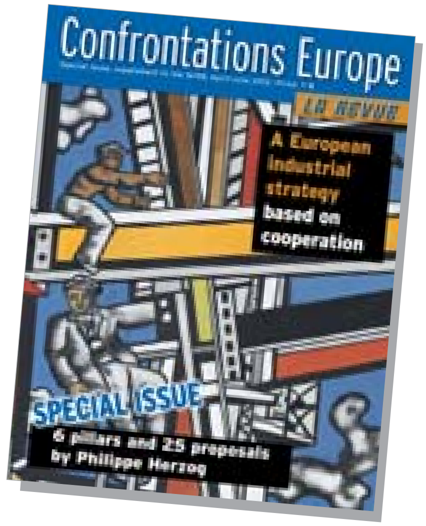
Steps are being taken towards a stronger governance, for fiscal integration aimed at improving stability. Its relationship with the banking union and the ECB is currently under debate, and it is lacking an economic pillar based on industrial competitiveness. We will need to integrate these different functions into *a real economic government,* with a reasoning and operational strength created from the fusion of certain of the Commission's bodies with the Eurogroup in charge of intergovernmental coordination. The legitimacy of this government will require the transparent, responsible and dynamic democratic control of European and national politicians. It will of course need a treasury to pool resources and recreate an investment multiplier, which involves developing an integrated approach to national fiscal policies and to the EU budget. The Commission can only recover its leadership role, which it has a duty to assume, if it questions its internal single-focus divisions, which are eating it away, and if it adopts an effective strategic capacity.

The European Council must call on the determination of Member States, a determination they will not all share. Germany and France, along with all the Eurozone member countries aspiring to solidarity-based growth, should gather to foster industrial integration.

An integrated industrial strategy binding all parties must become a burning obligation for the Member States and societies who subscribe to it – it will have no power if approached from a purely bureaucratic perspective. The participation of economic and social stakeholders in EU policy decisions is currently very poor, when they should be feeding their experience. Cross-border debate should be promoted to this end. Otherwise the system abuses delegation to the many experts, lawyers and consultants on the market. *The creation of a network and a capacity for dialogue and industrial relations at European level* is called for, enjoying their own information-synthesis and prospective faculties, and shared between the socio-economic stakeholders and institutions and capable of clarifying policy decisions: it is what is called *indicative planning*. Is this really something that Europe can forgo?

Philippe Herzog
Founding President of Confrontations Europe,
September 10th, 2012

Since its creation, Confrontations Europe leads studies and debates on the relaunch of the industrial sector in Europe. They have been the topics of working groups sessions, of publications and of the annual Entretiens Economiques Européens...



The special edition of *Confrontations Europe, la Revue* n°98 is dedicated to a European industrial strategy based on cooperation.

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