Europe gets in step with the ‘March of the Makers’

Steve Coulter of the London School of Economics *applauds the European Commission’s new hands-on approach to industrial policy but offers a note of caution about the task ahead*

Industrial policy is well and truly back in fashion. Even in market-liberal states such as the UK, where the idea of governments directing the structure of the economy was previously anathema, industrial activism is now firmly mainstream among policymakers. In France, the European home of industrial intervention, the government continues to produce blueprints for saving French industry even as it pulls back from other areas of the economy.


Harvard’s Phillipe Aghion has long argued for a more activist industrial policy

Now the European Union is getting in on the act. Both the Commission and Parliament have produced detailed proposals to boost European manufacturing over the last six months. What’s new about them, and will they work?

While the EU has a history of attempts at industrial activism, the Eurozone crisis and loss of market share to developing countries has really concentrated minds. European industry’s share of aggregate European GDP has fallen from 20 % to 15 % in 15 years. Since 2008, 3.5m jobs have been loss in manufacturing. Industry accounts for 80% of Europe’s exports and a similar share of private research and innovation, yet productivity in manufacturing is falling and Europe’s relative share of world markets is on the slide.

The Commission’s ambitious but underwhelming ‘Lisbon Strategy’ has done little to reverse this decline. Its replacement, the ‘Europe 2020 Strategy’, set out a number of objectives around the theme of ‘smart, sustainable and inclusive’ growth. But, to critics, Europe 2020 is simply too ‘hands off’. It relies too much on horizontal, sector-neutral policies that often replicate rather than complement national strategies, and accordingly have large dead-weight costs. It’s also far too timid, reflecting years of angst about government’s inability to ‘pick winners’, with the result that the authorities appear too scared to back promising industries of the future. Underlying the Commission’s general approach has been an over-reliance on market-making and trust-busting, with the powerful Competition Directorate taking the lead on policy to the detriment of other areas of the EU that might back more something more proactive.

What’s now changed is that six years of recession and stagnation has produced a new realisation that competitive markets and some limited support for R&D alone won’t produce the desired industrial recovery. Both the Commission and Parliament are now listening to those arguing that new ideas are called for. In 2010 the Commission floated the idea of a fresh approach, which was to complement its existing horizontal, framework policies with more sector-specific support. Key areas, including space manufacturing, clean vehicles and pharmaceuticals were explicitly targeted for growth. This was followed up in January 2014, when the Commission launched a bold-sounding new communication ‘For a European Industrial Renaissance’. As well as deepening the Single market, the Commission is now intent on supporting ‘industrial modernisation’ in key areas nominated as future drivers of growth. Its plans were backed by a European Parliament resolution on 15th January 2014, which called for the EU to pursue innovation towards a ‘new industrial revolution.’

Adoption of such ‘fourth generation’ industrial policy strategies certainly reflects a new mood of confidence (or perhaps desperation) in the EU. It has the backing of those economists who have long argued that the state has a role to play in fostering growth that goes well beyond the ‘night watchman' duties assigned to it by free-market obsessives. Philippe Aghion of Harvard, for example, argues that laissez-faire complacency by many governments has led to mis-investment in the non-tradable sector at the expense of growth-rich tradables. The challenge for governments, says Aghion, is simply how to design sectoral growth-supporting policies that do not expressly undermine competitive markets.

The EU's policy reorientation has also met with cautious approval from unions, although the ETUC criticised its plans for failing to explain how an industrial renaissance could be translated into job growth, given that the EU expects unemployment to average 11% for the next two years.

But, these caveats aside, how far can a sector-specific industrial policy really work in an industrial landscape as institutionally diverse as the EU? For the EU to follow a genuinely activist industrial policy, as opposed to simply following industrial and technological bandwagons, it surely has to develop a vision of how production chains in European manufacturing should be structured. Only then can it design policies and foster institutions to support this. But this brings forth a host of dilemmas.

An EU-wide industrial policy implies to some extent a convergence around one ideal model of capitalism (possibly a hybrid of several existing systems), even if this is not stated explicitly by the policy's architects. Current EU industrial strategies skirt this problem by focusing narrowly on horizontal, sector-neutral policies that address issues to do with basic competitiveness but are not particularly prescriptive about how policies are applied in a national context. The Commission's new approach goes much further than this.

Coordination problems exist with any policy that tries to override or unify national structures. See this by my LSE colleague, Richard Bronk, on the dangers of 'mono-cultures' in EU policymaking. What is to stop all countries using EU support to chase high-value R&D-intensive activities in the same industries? EU intervention may underestimate the dangers of specialization. Given a choice, most advanced country governments would try to focus on upstream, R&D-focused activities. Liberal market economies such as the UK or EIRE might not find this to be a problem as this fits well with the radical innovation model pursued by their leading firms which incentivises them to move continually into more competitive markets.

But existing German or Swedish national policies do not necessarily follow this logic as they encourage research all the way from basic R&D to production of industrial prototypes. The Commission's Schumpterian-sounding proposals could therefore jar with 'stakeholder' oriented economies where firms are reliant on dense institutional networks and slowly-accumulated reputational assets. The EU might have to step in to 'plan' an appropriate community-wide division of labour, but this would imply a major invasion of national sovereignty.

All this is not to argue that a more ambitious, centrally-directed industrial policy is not a good thing. It is high time that the Commission signalled a more ambitious approach to fostering growth beyond parroting the virtues of never-ending austerity. But don't assume it will be easy.

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