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Reindustrialising Europe

Member States' Competitiveness Report 2014

3.9 Spain

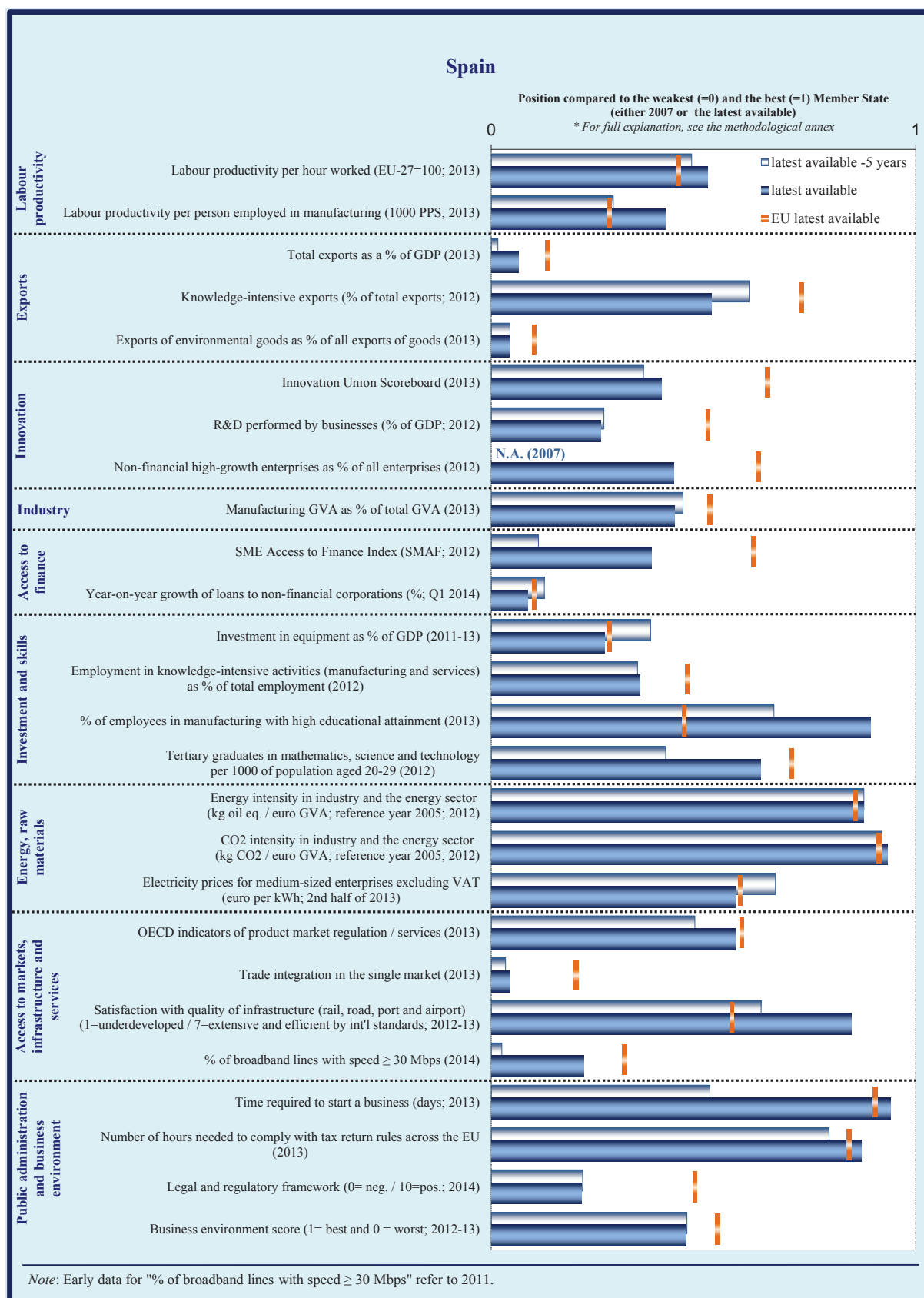
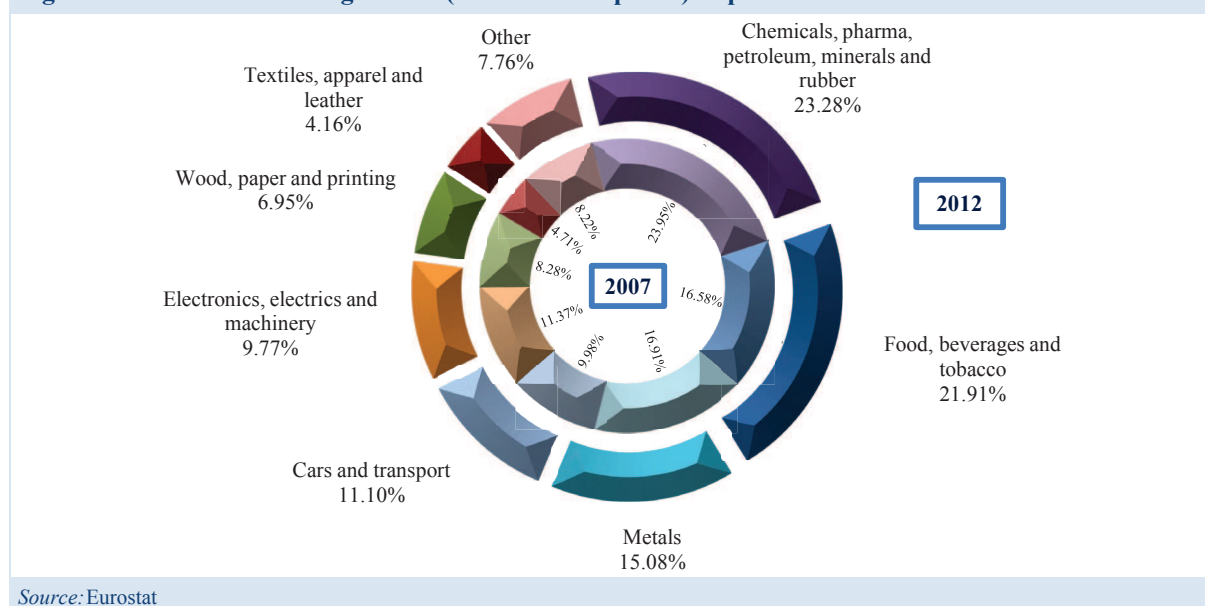


Figure 3.9.1: Manufacturing sectors (GVA at basic prices) - Spain

3.9.1 Introduction and performance

Since the beginning of the crisis, Spain has made considerable progress in making up for past losses of its price and cost competitiveness. During the boom period, growth in Spain was driven mainly by an increase in labour utilisation, while productivity measured by total factor productivity made a negative contribution. Since 2007, labour productivity per person employed has been improving. However, part of this adjustment has been due to cyclical factors, in particular the sharp fall in employment.

Spain has significantly improved its export performance. Exports have grown considerably since 2009 because of an improvement in both cost and non-cost factors. The number of exporting firms has increased, and Spain now exports to a wider range of countries. While cyclical factors explain some of the improvement in the trade balance, a structural improvement of Spain's export capacity is taking place. ⁽²⁹²⁾

The government adopted in July 2014 an action plan for strengthening the industrial sector in Spain. It comprises a series of proposals that contribute to mainstreaming industrial competitiveness aspects across various policy fields, including: transport, investment, smart regulation, energy, R&D, SMEs,

⁽²⁹²⁾ See Macroeconomic Imbalances – Spain 2014, European Economy, Occasional Papers 176, European Commission, March 2014.

education and skills, access to finance, internationalisation and trade policy.

Despite the progress achieved, the economy remains vulnerable, given the large stocks of accumulated imbalances. Sustainable rebalancing of the economy requires Spain to remove obstacles to competition in product and service markets and barriers to the growth of firms as recognised by the Commission in its assessment of the 2014 national reform programme and the proposed country-specific recommendations. Spain should also foster a more innovation-friendly environment to support the transition to a knowledge-based economy.

3.9.2 Access to finance and investment

While the availability of bank financing has recently improved, Spanish SMEs still face tougher financing conditions than SMEs in other euro area countries. Against a backdrop of significant deleveraging needs, access to finance remains a major concern for Spanish SMEs ⁽²⁹³⁾, although flows of new credit ⁽²⁹⁴⁾ are gradually improving. The credit contraction is proving steeper for SMEs, given their higher dependency on bank lending. Spanish SMEs still face tougher financing conditions than those in other euro

⁽²⁹³⁾ See SAFE survey (October 2013) http://ec.europa.eu/enterprise/policies/finance/files/2013-safe-analytical-report_en.pdf.

⁽²⁹⁴⁾ Loans to non-financial corporations with a nominal amount below EUR 1 million are used as a proxy for loans to SMEs.

area countries. ⁽²⁹⁵⁾ Interest rates remain high compared to other Member States, also owing to the weak macroeconomic situation and heightened corporate credit risk. The availability of equity and mezzanine financing remains limited, in particular in the early stages of business development.

Spain has adopted a variety of instruments to stimulate bank lending to SMEs. One of the main measures has been to step up public guarantee schemes to cover, at least partially, the risk inherent in lending. In 2013, SMEs received EUR 13.9 billion through Public Credit Institute (ICO) credit lines, and EUR 17 billion has been allocated for 2014. Mutual guarantee companies have been strengthened and the definition of an SME for banks' capital requirements purposes has been amended ⁽²⁹⁶⁾ to facilitate lending to SMEs. Furthermore, in January 2014 Spain successfully concluded a financial sector programme to recapitalise its financial institutions.

Initiatives to promote non-bank financial intermediation have also been put forward. Capital funds ⁽²⁹⁷⁾ are being developed. The first tender for allocating investment commitments has been awarded and more tenders are planned in 2014. An alternative bond market for SMEs ⁽²⁹⁸⁾ has been set up. The first issuance on this market occurred in December 2013, and several others are in the pipeline. Other measures adopted include the introduction of more flexible securitisation rules, together with tax incentives for equity financing and for business angels' networks.

The government is currently working on a package of legislation to foster business financing. The measures under consideration include: provision of financial information to SMEs by banks; enhancing provision for securitisation; easing transfers between the traditional and the alternative stock markets; and creating a framework for crowd funding.

In July 2014, the government adopted a draft law regulating venture capital companies and closed-end collective investment schemes. This law is expected to create new institutions known as 'SME-venture capital companies' which will benefit from a more flexible financial framework to make use of debt instruments. They would be required to invest at least

70 % of their assets in SMEs, to take part in their management and to provide them with advisory services. The law is also expected to reduce administrative burdens and speed up administrative procedures for venture capital companies.

Business liquidity problems have been aggravated by long delays in receiving payment, particularly from the public sector. Spain remains one of the Member States with the longest payment delays by public authorities, well above the EU average. ⁽²⁹⁹⁾ The government notified the Commission of the national transposition measure for the Late Payments Directive, which requires the public sector to pay within 30 days. The government has also taken measures to address the situation, notably paying EUR 42 billion in commercial arrears owed by regional and local governments. ⁽³⁰⁰⁾

3.9.3 Innovation and skills

Innovation

Spain's innovation performance improved overall between 2006 and 2013, but the gap with the EU average has increased. The latest Innovation Union Scoreboard ⁽³⁰¹⁾ continues to place Spain in the group of moderate innovators with performance below the EU average. Relative weaknesses include low licence and patent revenues from abroad, and a lack of knowledge-intensive services exports. Relative strengths are the publication of scientific research and the commercialisation of innovation. The government is now focusing on implementing the 'Spanish strategy for science, technology and innovation' adopted in early 2013.

R&D investment has been adversely affected by the economic crisis. ⁽³⁰²⁾ This follows substantial growth over the last decade which nevertheless failed to foster the transition to a more knowledge-based economy.

Skills

The transition from education and training to work remains the most pressing issue; the early school leaving rate is still high, not enough use is made of

⁽²⁹⁵⁾ Survey on SME's access to finance, April 2014, European Central Bank.

⁽²⁹⁶⁾ Banco de España Circular 4/2013.

⁽²⁹⁷⁾ ICO Global funds, EIF-AXIS business co-investment fund 'Fondo Isabel la Católica'.

⁽²⁹⁸⁾ Mercado Alternativo de Renta Fija (MARF).

⁽²⁹⁹⁾ Source: European Payment Index 2014, Intrum Justitia,

⁽³⁰⁰⁾ 'Plan de pago a proveedores'.

⁽³⁰¹⁾ Innovation Union Scoreboard 2014, European Commission.

⁽³⁰²⁾ In 2012, Spain's R&D intensity stood at 1.30%, versus 1.39% in 2009, despite a shrinking GDP.

vocational education and training, and there are skills mismatches between education and the labour market. To address these challenges, Spain has continued to implement the reform of its vocational education and training system. Work-based learning is being strengthened and apprenticeships are being encouraged.

Spain has adopted a new education reform act ⁽³⁰³⁾ which aims to improve the quality of the education system and its links with the labour market. The reform establishes a new ‘basic’ two-year vocational training level that would allow those without a basic compulsory education diploma to access vocational training. The reform also introduces entrepreneurship-related content in the secondary school curriculum. Spanish regions have also set up entrepreneurship workshops for their primary and secondary schools and have developed education laws that include these subjects in the curriculum at the education levels yet uncovered.

3.9.4 Energy, raw materials and sustainability

In the electricity sector, an important reform was initiated in July 2013 to contain the so-called tariff deficit, ⁽³⁰⁴⁾ following various measures adopted in 2012 and 2013. In December 2013, Spain adopted a legislative package which among other things foresees a review of the support for renewable energy sources, a reduction of the remuneration of transmission and distribution activities, and an increase of network access tariffs for consumers. If these measures fall short of reducing the tariff deficit, an automatic balancing mechanism would be triggered and access tariffs increased further.

The government has taken steps in 2013 to promote efficient use of energy, including environmental taxes; and the suppression of some tax exemptions for gas and coal. A new national energy efficiency action plan is being prepared.

Capacity for cross-border transmission to France is being increased. A new electricity line should be operational in 2015, doubling the interconnection capacity between both Member States. The low

interconnection level between the Spanish and French gas systems remains a major infrastructure bottleneck. A study is also being carried out on the scope for integrating the Iberian gas market; it is expected to be finished in 2014.

3.9.5 Access to markets, infrastructure and services

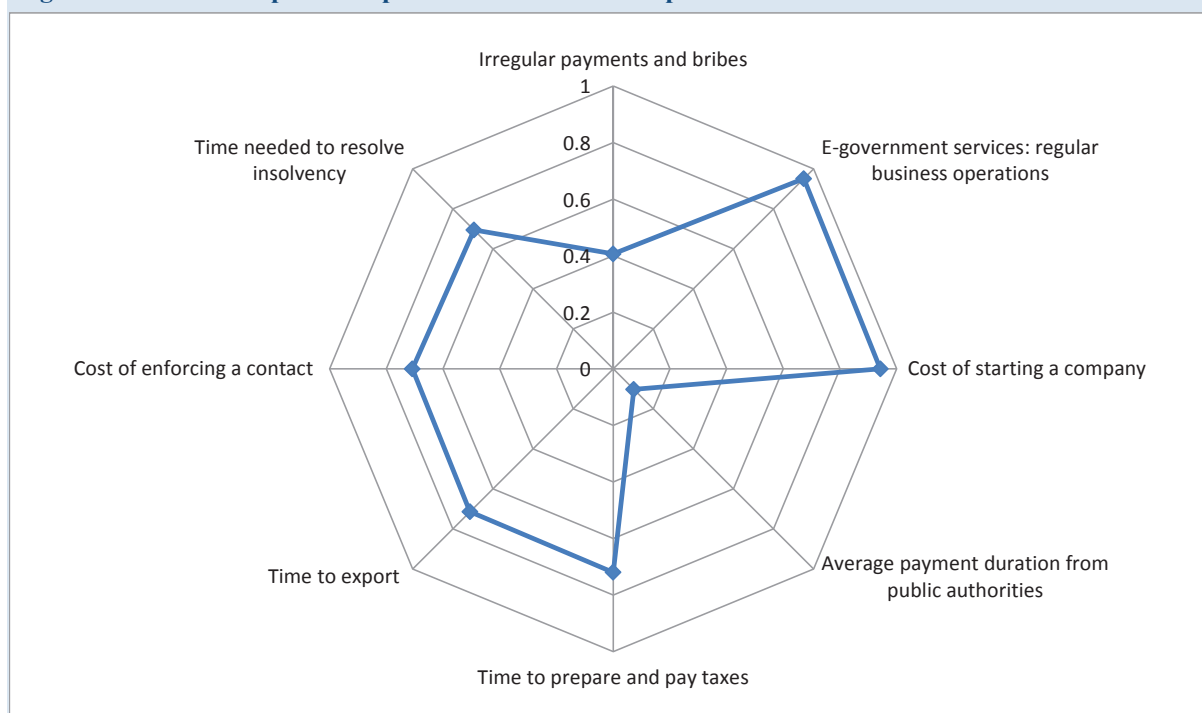
Exports have grown considerably since 2009 on the back of a rapidly increasing export propensity of Spanish firms both at the intensive and extensive margins. The number of exporting firms has increased by more than 30 % since 2010, and the range of countries towards which Spain exports is broader. Improvements in both cost and non-cost factors have supported this positive development. As unit labour costs have decreased, product and geographical diversification have helped to sustain export performance. Lower recent demand from outside the EU has been offset by redirecting exports to European markets. High technology exports increased in 2013 by 10.2 % to represent 10.1 % of total manufacturing exports, up from 9.7 % in 2012. The exports of non-tourism services have also increased and account for more than half of the exports of services.

The government adopted in February 2014 the strategic plan for the internationalisation of the Spanish economy 2014-2015. The plan comprises 41 measures centred on the following six areas: business environment; access to foreign markets; access to finance; trade promotion and business support; fostering a culture of internationalisation, including training activities; and fostering innovation. The plan is expected to be updated every two years.

Spain adopted in November 2013 a new strategy on logistics with a view to streamlining the transport of goods. The strategy comprises 18 priority actions, including: a single window for administrative procedures, increasing the competitiveness and connections of ports, and enhancing the liberalisation of rail freight. At the same time the liberalisation of passengers’ railway services will be proceeding gradually during 2014. Freight and passenger rail liberalisation will be supported by measures such as the current splitting up of the incumbent Renfe Operadora into four entities and a review of infrastructure access charges.

⁽³⁰³⁾ Law 8/2013, of 9 December 2013.

⁽³⁰⁴⁾ Gap between regulated ‘access tariffs’ paid by consumers and various regulated costs — including distribution costs and subsidies for renewable energy production.

Figure 3.9.2: Overall profile of public administration - Spain

Note: Values have been scaled so that the best observation (Member State) gets 1 and the worst gets 0.

Source: World Bank Doing business; Intrum Justitia; OECD; World Economic Forum; European Commission

3.9.6 Public administration and business environment

Business environment

Several recent and on-going important initiatives aim at improving the business environment and fostering greater competition. However, starting up a business remains more time-consuming than in the EU on average, although it is less costly. Several measures have therefore been adopted to ease licensing procedures, though their impact is not yet clear. They include: limits on the need for authorisations from local authorities; ⁽³⁰⁵⁾ greater use of the ‘express licence regime’, ⁽³⁰⁶⁾ although it remains mostly limited to small or medium-sized retail and services; adoption of the general principle of a single licence for the whole of Spain in order to gain access to an economic activity or perform it; and new rules for environmental impact assessments, which now have to be transposed into regional law.

In September 2013, the omnibus law on entrepreneurship ⁽³⁰⁷⁾ was approved. It included a number of measures to facilitate SME access to capital markets, support the internationalisation of businesses, promote the participation of SMEs in public procurement, simplify the business environment to ease company start-ups, and introduce entrepreneurship content in education. Spain has also decided to adopt the ‘one-in, one-out’ principle to reduce administrative burdens, but this awaits the approval of implementing regulations.

The law on entrepreneurship has also enhanced the insolvency framework for corporates by introducing a new debt refinancing procedure with the possibility of a partial debt discharge. The law has also facilitated out-of-court debt refinancing agreements and has narrowed the personal liability of limited liability entrepreneurs. The government has also adopted a new law on the refinancing and restructuring of corporate debt ⁽³⁰⁸⁾ which aims to facilitate these procedures by speeding them up and increasing their flexibility.

⁽³⁰⁵⁾ Law 27/2013, of 27 December.

⁽³⁰⁶⁾ Royal decree-law 19/2012, of 25 May; law 14/2013, of 27 September; and law 20/2013 of 9 December.

⁽³⁰⁷⁾ Law 14/13, of 27 September 2013.

⁽³⁰⁸⁾ Royal decree-law 4/2014, of 7 March 2014.

The law on market unity ⁽³⁰⁹⁾ was adopted in December 2013. It ensures that any product or service which complies with one region's legislation can be traded throughout the country, based on the single licence principle. It should allow businesses to benefit from economies of scale and scope and tackle conflicts stemming from overlapping regulations which hamper the launch or pursuit of economic activities. The law has also prompted moves towards simpler regulation of business at all administrative levels.

A new law on the Chambers of Commerce was adopted in April 2014. One of its effects is to transform the 'Consejo Superior de Cámaras' into Spain's Chamber of Commerce, which would play a more significant role in helping businesses expand abroad and support increased cooperation with the education administration on the implementation of a dual vocational education and training system.

In 2014, the government plans to approve the delayed law on professional services. The law is expected to change the rules on registration with a professional association, membership fees, and the transparency and accountability of professional bodies.

Public administration

Several initiatives to modernise public administration are under way. Spain is implementing the set of measures recommended by an experts' committee ⁽³¹⁰⁾ report on the reform of public administration, issued in June 2013. These measures fall into four categories: (i) removing overlapping administrative bodies between central and regional government; (ii) reducing administrative burdens; (iii) improving the management of common services and reducing overheads; and (iv) rationalising the so-called institutional administration of central government. A monitoring body to assess and report on their implementation has been set up. ⁽³¹¹⁾ At this point, most of the suggested measures have been or are close to being implemented. ⁽³¹²⁾

⁽³⁰⁹⁾ Law 20/2013, of 9 December 2013.

⁽³¹⁰⁾ Comisión para la reforma de las administraciones públicas (CORA).

⁽³¹¹⁾ Oficina para la ejecución de la reforma de la administración (OPERA).

⁽³¹²⁾ As of March 2014, 63 measures have been completed and 158 are being implemented, of which 137 are at an advanced stage.

The reform of local administration was approved in December 2013. ⁽³¹³⁾ It aims among others to clarify the remit of municipalities, increase budgetary discipline, and rationalise their services. As part of its work on e-government, Spain adopted a new law on e-invoicing in December 2013. ⁽³¹⁴⁾ Measures are also being taken to foster the use of electronic ID.

As concerns the judicial reforms, the government adopted amongst others measures to foster out-of-court settlements (September 2013) and to reform the criminal code (October 2013) and legal aid (October 2013). In December 2013, Spain also completed the implementation of the mediation directive. ⁽³¹⁵⁾ An ambitious draft reform of the judiciary is currently in the process of adoption. The implementation of previous reforms continues, such as the development of the Oficina Judicial, a common pool of resources to assist judges, and of links between regional electronic case management systems. Data available for 2010-12 show that length of proceedings and rate of resolving cases improved for litigious civil, commercial and administrative cases in the court of first instance ⁽³¹⁶⁾.

An anti-corruption legal framework is largely in place in Spain and law enforcement has shown good results in investigating corrupt practices. However, political corruption and shortcomings in checks and balances are particularly challenging, notably in regional and local public spending and audit mechanisms. Against this backdrop, Spain has adopted a law on transparency, public access to information and good governance. ⁽³¹⁷⁾ The government has approved two bills on supervision of party funding and accountability of high-ranking officials, and in December 2013 reported plans to reform criminal law and criminal procedure law to tackle corruption more effectively.

⁽³¹³⁾ Law 27/2013, of 27 December.

⁽³¹⁴⁾ Law 25 / 2013, of 27 December.

⁽³¹⁵⁾ Directive 2008/52/EC of 21 May 2008 on certain aspects of mediation in civil and commercial matters.

⁽³¹⁶⁾ Source: The 2014 EU justice scoreboard, COM(2014) 155 final, European Commission.

⁽³¹⁷⁾ Law 19/2013, of 9 December.

3.9.7 Conclusions

Spain is in the process of regaining competitiveness. There have been visible advances in the reform agenda. Timely and effective implementation of the measures adopted is critical to facilitate business growth and regain competitiveness.

The implementation of a large number of structural reforms is improving business conditions and the functioning of markets. The measures adopted, particularly the law on market unity and the law on entrepreneurship, have the potential to improve the Spanish business environment. Spain is also taking various steps to reform its public sector, which may help simplify administrative procedures.

Bank financing conditions remain tight, in particular for SMEs, thus hampering the growth of viable businesses and innovative companies. The government is taking measures to both facilitate access to bank credit and to foster alternative sources of financing. Companies' liquidity problems continue to be made worse by long delays in receiving payment, in particular from the public sector. Fostering a more innovation-friendly environment and tackling the skills mismatches between education and the labour market are still major challenges.

3.10 France

Figure 3.10.1:

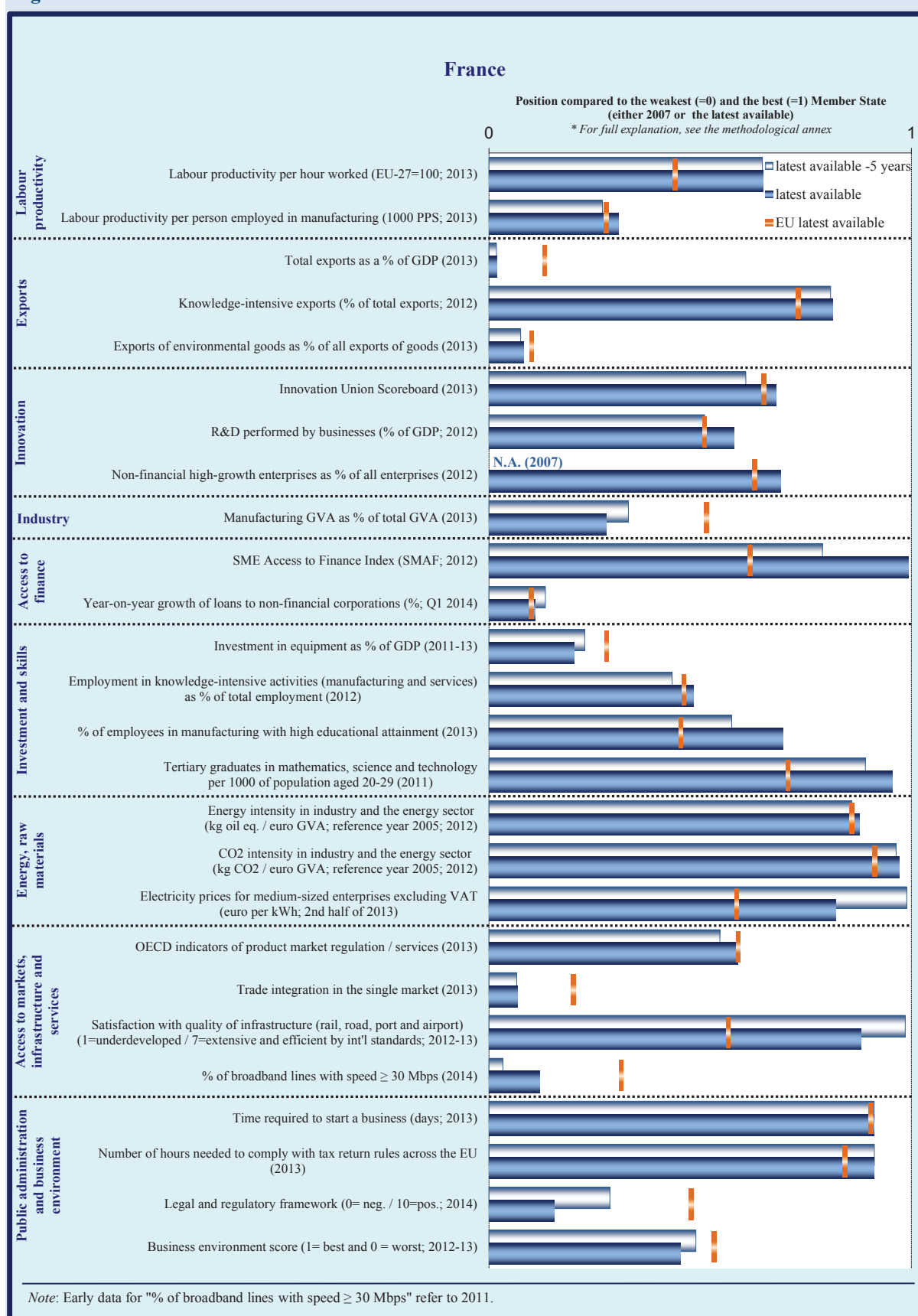
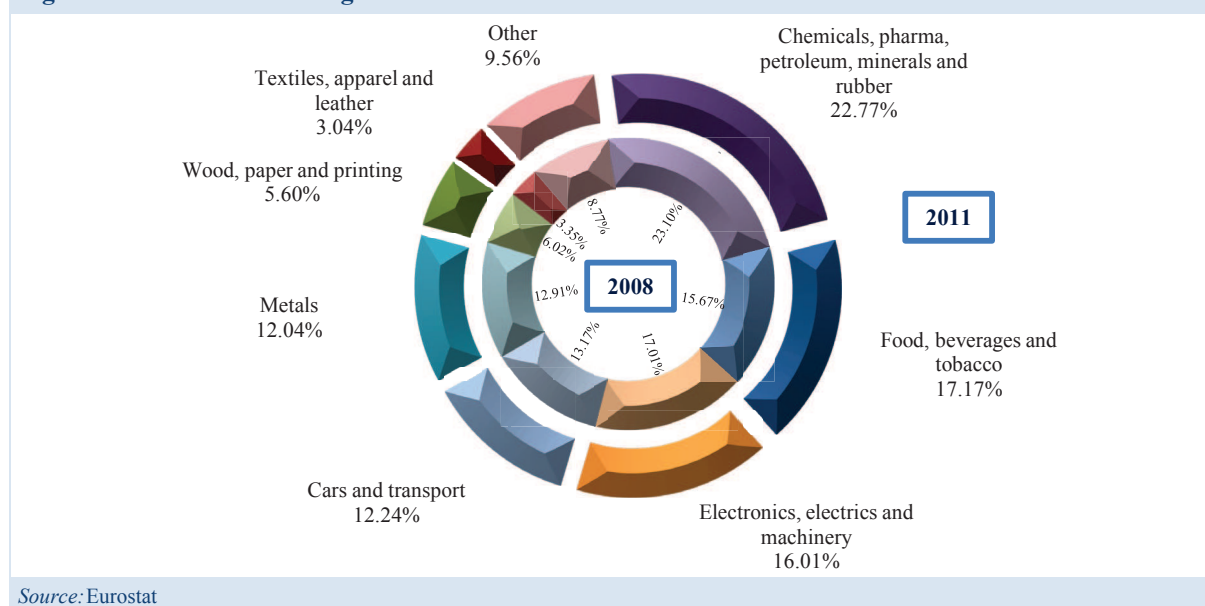


Figure 3.10.2: Manufacturing sectors — France

3.10.1 Introduction and performance

Manufacturing competitiveness has been undermined by cost and non-cost factors in recent years, while exports maintained their levels. In 2013, GDP grew by 0.3 %, unemployment increased to 10.3 % and public debt reached 93.5 % of GDP. Manufacturing contribution to the French economy decreased from 11 % in 2008 to 10.25 % in 2012 and is lower than the EU average (15.3 %). In terms of the sectoral breakdown, France is specialised in goods and services of medium-high innovation, in sectors that are both technology-driven (e.g. manufacture of aircraft and spacecraft, pharmaceuticals), and marketing-driven (e.g. luxury goods industry, cosmetics). Compared with other Member States, France is less specialised in high innovation sectors such as electronics and computing machinery.

Although labour productivity was 15.4 % higher than the EU average in 2012, the increase in labour costs has deteriorated the profitability of French industrial firms, dampening their ability to invest and upmarket. Gross operating surplus of manufacturing firms fell to 28.9 % of value added in 2012, while France's market share of global merchandise exports stabilised at 3.1 % over the last two years, down from 4.7 % in 2000. France has not reduced the gap with EU leaders in terms of innovation, although R&D intensity reached 2.29 % in 2012, with an annual average growth rate of 1 % over the period 2010-12.

In 2014, the government has put competitiveness at the centre of its economic policy. It has announced a EUR 20 billion cut in labour costs through a tax credit, and measures to cut an additional EUR 10 billion by 2017. The government is also planning to decrease corporate taxes and give a new impulse to the modernisation of public administration and improvement of the business environment. Moreover, a new industrial policy strategy has been developed, the tax credit on research activities has been maintained and new funds have been allocated to promote innovation. These reforms are ongoing and might bear their full fruits in terms of improved competitiveness in the long term.

3.10.2 Access to finance and investment

France is among the best countries for delivering access to debt financing for small and medium-sized enterprises (SMEs) and above average for equity financing. The French banking system has weathered the financial crisis relatively well due to the resiliency and good capitalisation of banks. The creation in 2013 of a unique institution (Bpifrance) in charge of managing public funds and guarantees and seeking to facilitate access to finance can further improve these results. Investment in equipment as a share of GDP fell by 5.5 % in the 2011-13 period, compared with 2006-08, mainly as a consequence of weak demand and negative expectations of entrepreneurs.

Bank lending

New credits amounted to EUR 52 billion in the third quarter of 2013, while they had reached a peak of EUR 83 billion in the first quarter of 2008, partially due to the ongoing debt mix rebalancing of French non-financial companies. Surveys of both banks and SMEs indicate that access to finance is good and report a greater availability of credit for investment in 2013. These evidences are mainly a consequence of lower demand for loans and the conditions for working capital financing have deteriorated due to increasing demand and to the high stock of private debt of companies. The amount of outstanding credit to SMEs in December 2013 was EUR 36.1 billion, up 0.5 % compared with 2012. The trend of new credit for the period 2006-12 is decreasing, despite the positive impact of the 'Médiateur du Crédit' (credit mediator), which helped 4077 companies with financing issues in 2012, reporting a success rate of 58 %.

Venture capital and other finance

The government has taken some measures to improve alternative forms of financing and prevent possible tensions connected to the structural high dependency on credit and the limited self-financing capacity of SMEs. A dedicated listing platform has been created and the implementation of crowd-funding platforms has been promoted. To direct savings towards business the taxation on capital gains has been reduced and new financial products have been developed. However, the share of household savings directly invested in industry is low. Real estate represents two thirds of household assets, while the remainder is mainly oriented to short-term and low-risk products (mutual funds, government bonds).

3.10.3 Innovation and skills

R&D intensity is below the national target of 3 %, due mainly to the sectoral composition of the economy, where medium-high and high-tech manufacturing sectors represent a relatively modest and decreasing share. ⁽³¹⁸⁾ Low R&D intensity in the private sector accounts for most of the gap, as it reached 1.5 % of GDP in 2012, compared with a value approaching or above 2 % in the best

performing countries. Despite the erosion of France's industrial base, business R&D expenditures in current prices increased by 22 % between 2007 and 2012, to which recent government efforts in favour of business R&D might have contributed.

Innovation

France has not caught up with innovation leaders and remains among the followers, with a performance just above the EU average ⁽³¹⁹⁾ in 2013. Relative strengths include international scientific co-publications, non-EU doctorate students and the population with tertiary education. Relative weaknesses are in non-R&D innovation expenditure, community trademarks and knowledge-intensive services exports. ⁽³²⁰⁾

Some measures have been taken by the government to increase innovation in 2013. The tax credit on research (CIR) has been continued and an innovation tax credit for SMEs was put in place. Fiscal advantages for young entrepreneurs and innovative start-ups have been reinforced and a new EUR 12.5 billion tranche of the 'Investment plan for the future' has been decided, including EUR 1.7 billion for industrial innovation. Implementation of the 34 plans under the new industrial policy strategy has started, led by industry managers. The government has pursued a retargeting of the 'Pôles de Compétitivité' policy aimed at increasing their impact in terms of growth and jobs, while the 'France Broadband' plan should ensure the access of French households to a high speed infrastructure by 2017. In addition, the 'New deal for innovation' has been launched, composed of four themes and 40 actions. Among these, the 'Concours Mondial d'Innovation' combines financing tools to support the commercialisation of new products and services, and the 'La French Tech' programme aims at structuring 'favourable ecosystems' for start-ups, to accelerate their growth and their international visibility. In addition, the strategy focuses on making technology transfer more efficient, including measures to promote entrepreneurship in universities, to increase the efficiency of public funding and to reduce the risk of overlaps and duplications.

⁽³¹⁹⁾ Source: Innovation Union Scoreboard 2014.

⁽³²⁰⁾ See the Commission Communication "Research and Innovation as sources of renewed growth" (COM(2014)339 final)

⁽³¹⁸⁾ The medium-high and high technology sectors represented 40 % of value added in manufacturing in 2010, a 4 % decrease since 1999.

These measures should have a positive impact on innovation in the coming years. However, the coherence and the impact of the resources dedicated to spur business investment in R&D and innovation performance were only partially monitored and evaluated, negatively affecting the potential of France's innovation strategy.

Skills

The educational system and the share of the population having completed tertiary education are above the EU average. Nevertheless, concerns about a skills mismatch and low adult participation in lifelong learning (5.7 % in 2012) should not be underestimated.

The government has taken two main initiatives in this respect: the reform of tertiary education and reform of vocational training. The former aims at improving the employability of researchers, the relations between academia and industry, and the efficiency of management in academic institutions. The latter transfers responsibility for lifelong learning to the regional level, clarifies the overall governance of the system and dedicates more funds to jobseekers and companies with fewer than 10 employees. In addition, it foresees the creation of a personal training account that should facilitate access to training that is particularly difficult for older and low-skilled workers and for the unemployed.

In addition, specific measures have been taken to promote apprenticeships, as the number of new entrants in saw an 8.1 % decrease compared with 2012, at odds with the government's commitment to the objective of 500 000 apprentices by 2017.

3.10.4 Energy, raw materials and sustainability

Energy use and price

With a level of per capita emissions at 8.2 tonnes of CO₂ per year, France is among the industrialised countries with the lowest emissions, and business benefits from an energy price below the EU average. The share of energy from renewable sources grew to 13.4 % of gross final consumption in 2012, which is below the EU average (14.1 %) but in line with the planned trajectory toward the target of 23 % set for 2020.

The government has committed to improve energy efficiency and achieve the target of a 17.4 % reduction in final energy consumption and has developed a comprehensive policy package for industrial and tertiary sectors comprising financial incentives, regulations and support for information and audits. In 2013, a series of measures were adopted to accelerate the uptake of renewables and to increase their share in energy consumption.

A number of infrastructure projects are ongoing to improve the energy network and reinforce the electricity interconnection of France with neighbouring countries. Similarly, the gas network is being strengthened and ongoing projects should improve interconnection, in particular with Belgium and Spain, by 2015.

Other sustainability issues

The landfill tax is currently low compared with other Member States, reducing incentives for recycling. A number of reforms are considered as part of the 'Second roadmap for ecological transition' defined in September 2013. However, the actual measures remain to be fully defined and implemented, while further efforts seems to be needed to increase the share of recycled materials and the incentives to reduce waste.

3.10.5 Access to markets, infrastructure and services

Single market

Restrictions on access to and exercise of professions in the services sector persist and affect the potential growth of the sector, that is composed mainly of SMEs and account for 14 % of French GDP and 14.6 % of employment. Burdensome regulation concern notably legal form, shareholding structure, quotas and territorial restrictions. The simplification exercise initiated in November 2013 provides an opportunity to reform rules in services; so far restrictions have been eased for a limited number of professions and barriers still exist in the health sector, for legal professions and for taxi services.

The government committed to improving the competition environment through the 'Act on the modernisation of the economy' and through measures such as easing capital requirements for accountants or

removing the active marketing prohibition for lawyers. The recently adopted law on consumer protection reduces restrictions in a number of sectors and introduces a collective redress mechanism that could spur competition. However, the authorities have not undertaken any horizontal assessments of the necessity and proportionality of restrictions affecting regulated professions so far.

In the retail sector, which contributes 4.3 % of GDP and employs 7.5 % of the workforce, requirements for the opening of trade outlets have been reformed, simplifying the procedure for delivering authorisations, while the ban on ‘sales at a loss’ still has an adverse impact on competition and on consumers. Restrictive requirements affect the structure of the market in the already concentrated grocery retail sector.

Internationalisation

Competitiveness of manufacturing is adversely affected by the relatively small size and low profitability of firms, in particular due to the high tax burden on labour, which reached 26.6 % of value added in 2012 ⁽³²¹⁾ and is among the highest in the EU. Non-financial companies are among the least profitable in the EU in terms of gross operating surplus, after suffering a 3 % decrease since 2008 while the average firm counted 5.8 employees in 2012, compared with 6.4 on average in the EU. These characteristics hamper the ability to invest and engage in export activities.

The government committed to reinforce the capacity of firms to compete in international markets, by reducing labour costs and corporate taxes and developing a comprehensive strategy focusing in particular on supporting SMEs internationalisation. This strategy couples the rationalization and improvement of financial instruments, through the constitution of the ‘Bpifrance export’ label, with a reinforced promotion of national products and services.

Business services and network industries

Entry barriers in the transport and energy sectors are still hampering the efficient functioning of the market. France has not opened up its domestic rail

passenger market to competition, except for international services. A reform of the railway system has been launched to make it financially more sustainable, although it risks restricting access to the network for alternative operators.

Progress has been made in phasing out regulated prices in electricity and gas for non-household customers and in developing inter-connections. However, market concentration both at wholesale and retail levels remains high and the decision to postpone the tendering of hydro-concessions, which represent some 20 % of the total installed electricity capacity, is a missed opportunity to attract investment and to develop competition.

Infrastructure

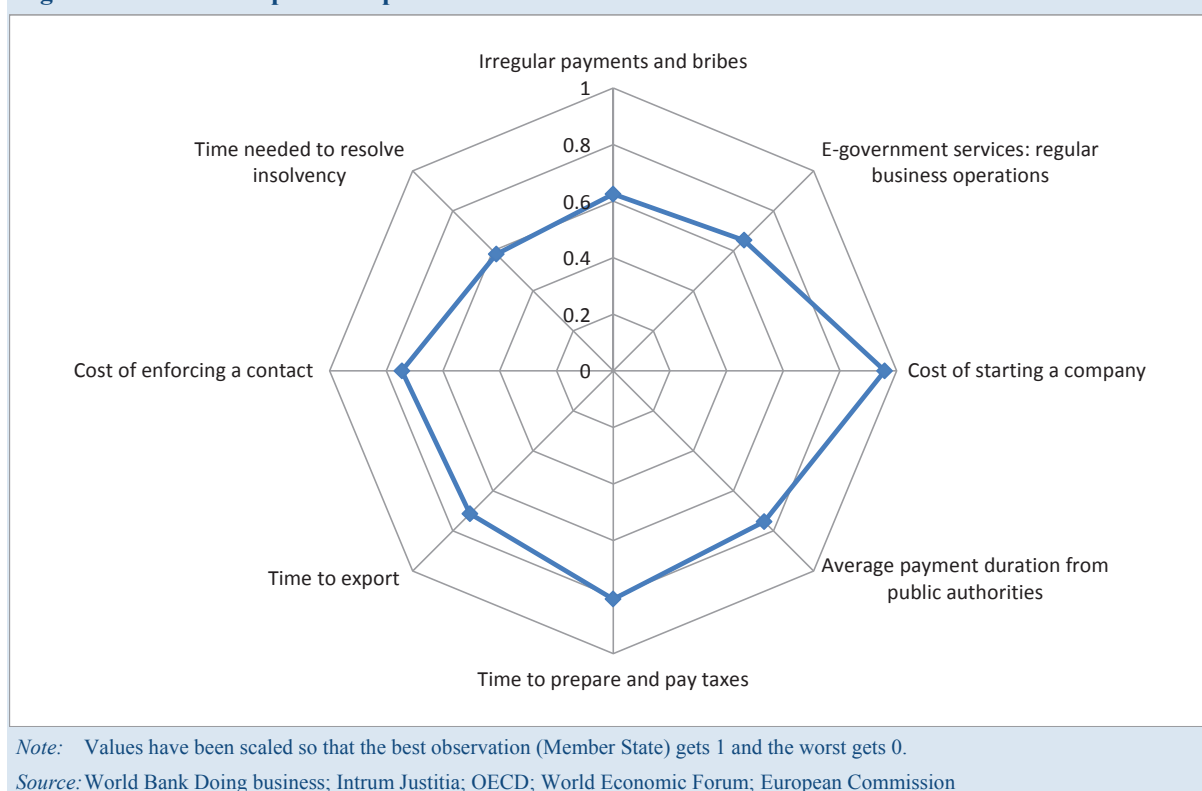
The low capacity of cross-border connections for both freight and passenger transport, in particular with Spain and Italy, represents a constraint for French competitiveness. In addition, ports perform unevenly and are not exploited to their full potential, limiting their contribution to growth.

3.10.6 Public administration and business environment

France was ranked 38th globally and 16th in EU in the World Bank’s Doing Business report 2014, down three positions with respect to 2013. There is considerable scope for improving the business environment, which is perceived as a burden to the growth and export potential for SMEs. Overall performance is dragged down by the number of administrative procedures needed to comply with taxes and register property, by the instability of legislation and by the numerous regulations associated with size-related thresholds, which reduce SMEs’ incentives to growth.

The procedures and costs for starting a business appear favourable with respect to the EU average, as do the costs for enforcing contracts. The SME test, which consists of analysing the effects of a legislative proposal on SMEs, has been partially implemented as a pilot exercise while making it a systematic procedure could allow a better targeting and coordination of new measures in favour of competitiveness.

⁽³²¹⁾ Source : Eurostat – Prélèvements fiscaux et sociaux/valeur ajoutée, sociétés non financières et sociétés financières, 2012

Figure 3.10.3: Overall profile of public administration — France

Administrative modernisation

The government committed to implement a decentralisation strategy. This aims at simplifying the public administration by better coordinating the actions of central administration with local institutions and determining the responsibilities for implementation of reforms. The development of a French point of single contact is a priority and the latest data on the use of this tool are encouraging. However, accessibility for service providers from other Member States is difficult and the number of procedures that can be completed online is to be increased. Take-up of e-procurement is rather low as many regions, counties and towns have their own, often non-interoperable, systems.

Reducing administrative burden

A comprehensive policy framework aimed at reducing administrative burden was launched with the appointment of a minister for state reform and simplification and the creation of a business simplification committee. The implementation of the ‘simplification shock’ led to the adoption of the ‘law for the simplification and the securing of enterprises’ life’ and to the creation of a national council, which presented 50 priority measures in April 2014. Two

laws have been adopted to simplify relations with public administration and to allow the government to legislate by decree in a number of areas related to the business environment. Other encouraging measures are in the pipeline for adoption, including the ‘tell us only once’ and the ‘tacit consent’ principles in correspondence with public administration, and the ease of social declarations for small and micro enterprises.

Facilitating tax payments

The number of taxes paid by companies is high and procedures are complex. The administrative fiscal burden is expected to be reduced as part of the ongoing review of fiscal policy. A number of taxes affecting small niche markets and entailing low returns have been identified although so far no concrete actions have been taken to comprehensively address this issue.

3.10.7 Conclusions

Restoring the competitiveness of industry is the key challenge of the public reform agenda. The export performance and labour market conditions have deteriorated in the last decade, although the former

has stabilised over the last few years. Investment in R&D has increased but the gap with EU innovation leaders has not been reduced. Addressing the low rate of profitability of firms is a major concern, since low profits reduce a firm's capacity to invest, innovate and internationalise, adversely affecting the capacity to grow and create jobs.

The government is committed to this objective, addressing both cost and non-cost competitiveness. It is implementing a number of measures to reduce labour costs, improve access to finance, rationalise public intervention, support innovation, encourage entrepreneurship and improve the business environment. Further measures have been announced for the coming months, in particular for administrative simplification.

The announced measures seem to be in line with France's ambitious objectives in terms of competitiveness and innovation. Improving coordination among different actions addressing cost and non-cost factors, for example through enhanced *ex ante* impact assessments and *ex post* evaluations, could ensure a more efficient allocation of public resources, maximising the beneficial effect on growth and competitiveness.

3.11 Croatia

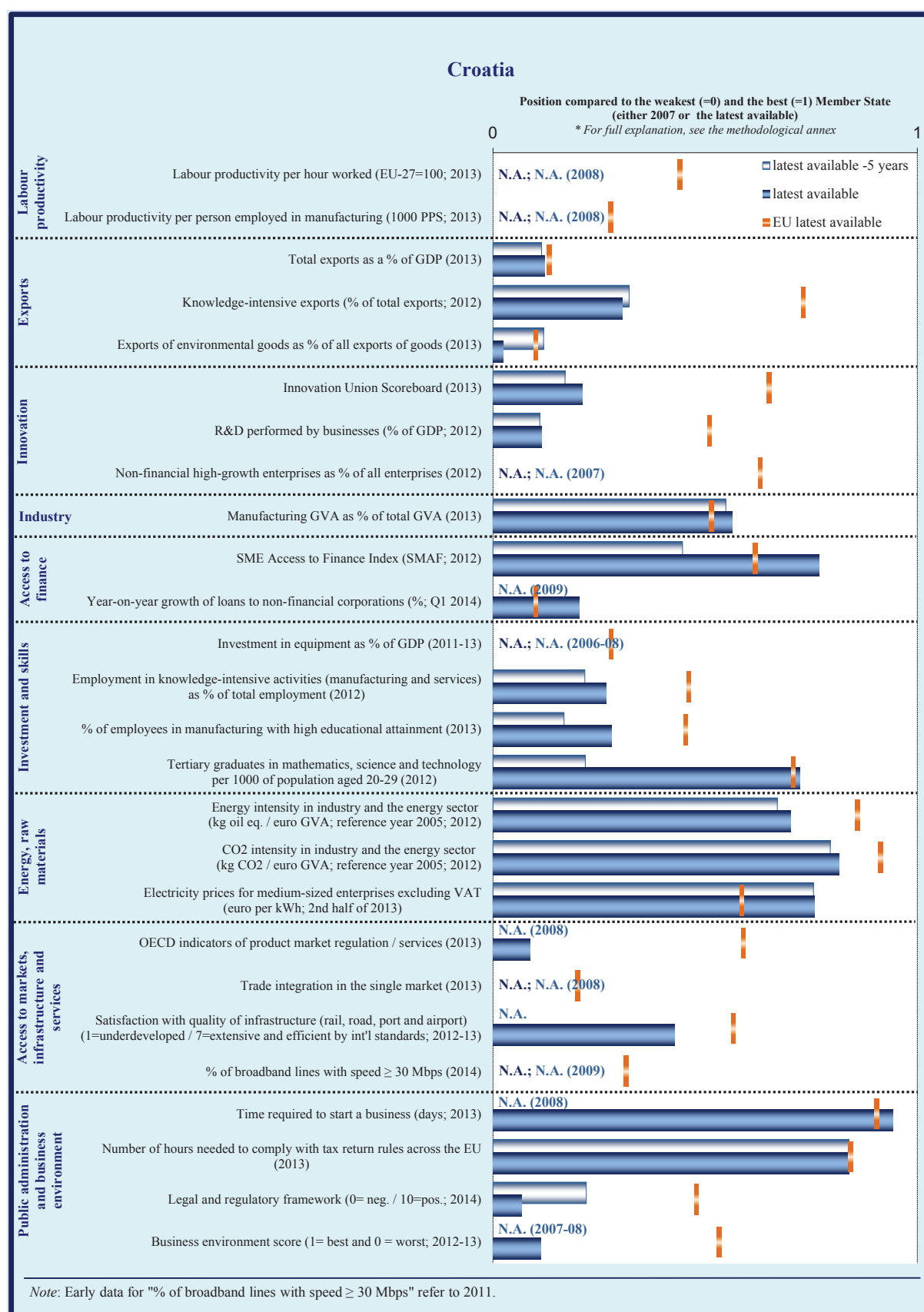
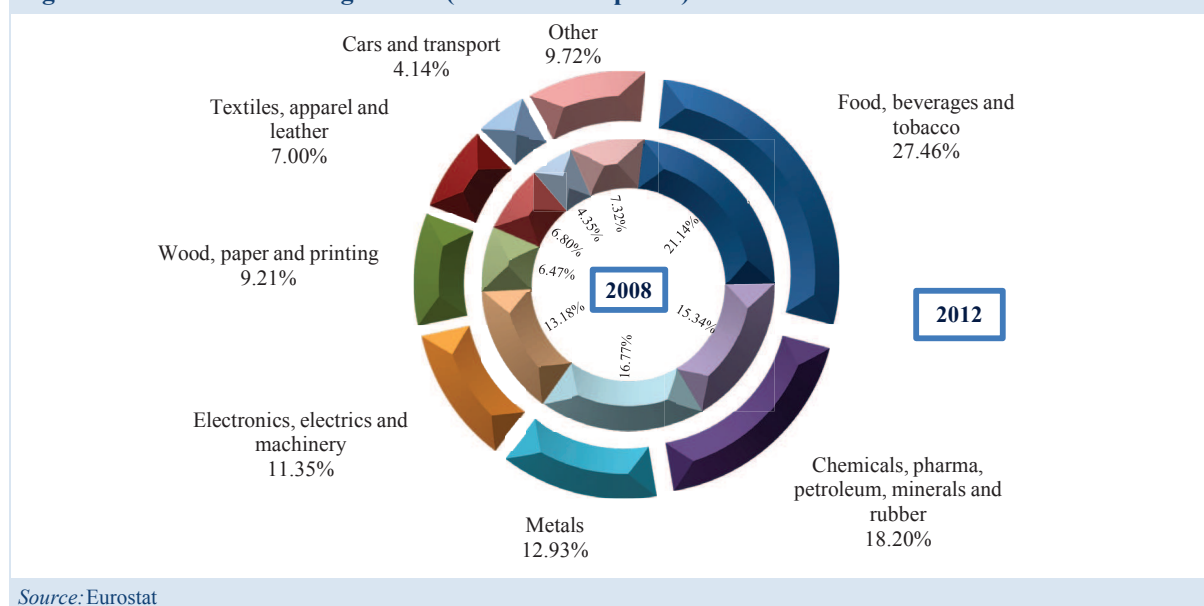


Figure 3.11.1: Manufacturing sectors (GVA at basic prices) - Croatia

3.11.1 Introduction and performance

Croatia's economy continues to suffer from the effects of a long recession — in 2013 growth stood at 1 % and is expected to fall by 0.6 % in 2014. Labour productivity decreased by 0.2% in 2013 comparing to 2012 and stays at 80.1 %. The current account has improved to 0.1 % of GDP due to falling imports, although high-knowledge exports remain low, at 7.4 %. Innovation performance has not improved in recent years and industrial production has been falling since 2009, and, in contrast to most other Member States, did not recover in 2010-11. The manufacturing sector accounts for 16.2 % of GDP. Regional disparities persist, but the Law on Regional Development, to be renewed in 2014, addresses this.

3.11.2 Access to finance and investment

The financial system is conservative and dominated by traditional banking products — bank loans account for more than 75 % of total financing, and for SMEs this figure is 97 %. Only 1 % of SMEs used equity financing in 2013, the second-lowest percentage in the EU.

Access to finance has worsened in recent years, limiting companies' growth potential. SMEs particularly have problems here, as only short-term financing is available at high rates. Their capital position has continued to deteriorate, and this was

reflected in a further deterioration in the quality of loans made to SMEs. Banks that finance SMEs are faced with negative selection, asymmetry of information, and high transaction costs, all of which influence their willingness to give loans to this sector. About 23 % of polled SMEs reported access to finance as their most pressing problem, the third-highest level in the EU. The rate of non-performing loans is high at around 25 %, with an even worse situation in peripheral regions. The use of loans over EUR 1 million has decreased from 7 % to 4 %, and there has been a large drop in banks' willingness to lend. In 48 % of cases, SMEs reported high interest rates as the limiting factor.

The existing support framework is based around two state agencies, HBOR and HAMAG BICRO, providing favourable loans and guarantees. HAMAG BICRO is the result of a merger of HAMAG Invest and BICRO, the business innovation agency. The merger strengthened the agency, which has now signed a contract with the European Investment Fund and started a microloan scheme for SME financing.

HBOR is the Croatian export credit agency, and supports exports by insuring against political and commercial risks. In 2013, it approved 1256 loans for a total of HRK 7.8 billion.

A state venture capital fund instrument exists (the Economic Co-operation Funds) but it has been criticised as being a very slow, rigid and risk-averse system, geared towards restructuring large enterprises

rather than towards start-ups. It has invested only HRK 704 million by 31 March 2014.

An annual support measure called the *Entrepreneurial impulse* is regularly carried out, and in 2013 supported over 1800 companies, mainly in export-related activities. The 2014 impulse will focus on entrepreneurial support institutions, mainly in less developed regions, and on further strengthening the SME sector's export potential.

Investment

Gross fixed capital formation fell in 2012, from 19.6 % to 18.6 %, but is still above the EU average of 17.9 %. Historically, foreign direct investment has played an important role but has collapsed since 2008. In 2013, due to a lack of economic recovery, a high fiscal deficit and no structural reform, rating agencies downgraded Croatia's sovereign rating to the non-investment grade.

The Act on Investment Promotion and Development of Investment Climate started bearing fruit in 2013. The framework conditions have improved due to new investment incentives and a different approach towards strategic investments. The agency for investments and competitiveness, together with other partners, has produced a catalogue of investment projects ready for foreign and domestic co-financing.

3.11.3 Innovation and skills

Innovation

Croatia's innovation performance is below the EU average; it has stagnated in recent years and in some respects deteriorated further. In 2002-12, R&D expenditure decreased from 0.96 % of GDP to 0.75 % (the EU average is 2.6 %), while private expenditure on R&D fell from 0.41 % to 0.34 % (the EU average is 1.3 %). Public research is constrained by limited funds and by the fact that there is little commercialisation of research. Private innovation is also held back by the lack of a venture capital market to provide funding. In the Innovation Union Scoreboard 2014, Croatia fell by one place and is now the sixth worst performer in the EU, doing relatively well on human resources but very poorly on business investment. In the Regional Innovation Scoreboard, the Zagreb region's ranking also fell.

So far, not much attention had been paid to developing and commercialising private innovation. The law on higher education and science was adopted in August 2013, but covers only early aspects of innovation. Three further strategies, on innovation, industrial policy and smart specialisation, aim to restructure the innovation framework and to promote the commercialisation of research. They have been delayed, however.

The innovation strategy aims to increase the share of business sector investment in R&D and innovation by: stimulating basic and applied industrial research in the scientific research sector, fostering the innovation potential of the business sector, increasing knowledge dissemination, and strengthening human resources.

The industrial strategy defines strategic industrial manufacturing activities, and aims to expand production, exports and employment in these sectors. The smart specialisation strategy attempts to create 12 competitiveness clusters by encouraging cooperation between the public, private and research sectors. The clusters were identified during a largely top-down process to emphasise potential for innovation, value added, export potential, and value in the domestic market. The sectors are: automotive, wood processing, food processing, chemical, defence, electrical and machinery, health, cultural and creative industries, ICT, maritime, textile leather and footwear, and construction. However, none of these three strategies has been adopted yet, and the links between them are unclear.

Skills

The quality of education is a challenge across all educational sectors, tertiary education attainment is low (at 17.4 %, compared to 17.1 % in the EU), brain drain is a problem, and there is a significant skills mismatch. Vocational education and training plays a large role with 70.7 % of regular secondary education students enrolled (2011) — the system is currently under reform, as it has not been sufficiently responsive to the needs of the labour market.

Following a skills analysis, new curricula based on competencies prescribed by occupational standards are being piloted in 54 schools. To further analyse skills mismatches, a system of tracing graduates' employment patterns has been introduced. An implementing act for quality assurance in vocational

training and adult education is expected in 2014, and will put in place a system of external monitoring.

The qualifications framework is under development, with the aim of standardising qualification profiles to better fit the needs of the labour market. It is an ambitious project which risks being difficult to implement.

3.11.4 Energy, raw materials and sustainability

Croatia scores lower on sustainability than the EU average, but it performs well in some areas. Reforms in the areas of energy and raw materials are progressing. Although the economy's resource productivity is low, at EUR 0.81 per kg in 2011 (the EU average is 1.59), domestic material consumption is lower, at 10.6 tonnes per capita (the EU average is 14.72). ⁽³²²⁾ Greenhouse gas emissions per capita are lower than in the EU on average, at 6.4 tonnes (the EU average is 9.06). Gas and electricity prices are broadly in line with EU levels. The share of renewable energy in gross final energy consumption is higher, at 15.7 % (the EU average is 13 %), thanks to the use of hydroelectric power and biomass heat. However, small-scale reusable energy sources are still underdeveloped.

In October 2013, a programme for the energy renovation of public buildings was adopted and a feed-in tariff was introduced. HAMAG BICRO launched a pilot project providing business advisory services to 25 participants in the fields of energy efficiency, renewable energy sources and environmental protection. Energy renovation programmes for family houses, residential buildings and commercial non-residential buildings are under preparation.

The Act on Sustainable Waste Management was adopted in 2013. It brought regulations in this area in line with EU directives, and increased landfilling fees. Local governments are required to introduce separate collection by July 2014.

The renewable energy sources act is still in preparation.

⁽³²²⁾ Resource Efficiency Scoreboard, Eurostat.

3.11.5 Access to markets, infrastructure and services

Internal market and internationalisation

The development of high-value-added exports is a priority for the government, with many ongoing projects promoting exports, including SME exports.

In 2013, exports of goods and services accounted for 43 % of GDP, with the EU as Croatia's main trading partner. The trade balance has improved since 2008 due to falling domestic demand. However, exports are still dominated by low- and medium-value-added products — the main exports are tourism, machinery, fuels, chemicals, base metals, foodstuffs and transport equipment. High-tech exports accounted for only 7.4 % of total exports in 2012 (the EU average is 15.6 %).

In 2013, a commission for the internationalisation of the economy was set up to coordinate the work of all involved institutions and to provide a single point of contact for exporters. In addition, an action plan for export promotion 2014-15 was adopted in May 2014.

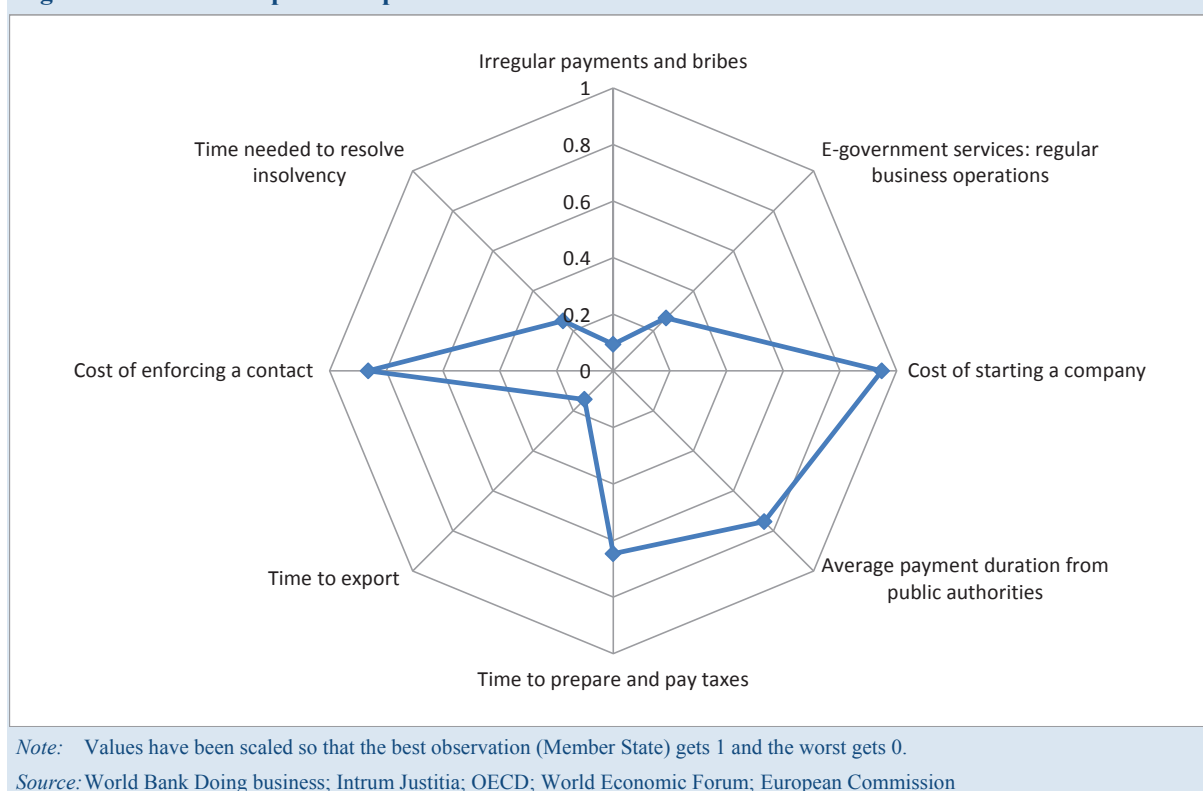
Since the creation of the Agency for Investment and Competitiveness, Croatia is also actively targeting foreign direct investment. The agency supports prospective investors, works to identify the regulatory barriers found most burdensome by businesses and informs the authorities responsible about its findings. This has led to improvements in licensing and specific charges (see below).

Business services and network industries

The market share of the largest electricity generator is high at 73 %, with a growing number of electricity providers due to market liberalisation. The gas market was also liberalised. The Croatian Energy Regulatory Agency was set up in 2014.

Infrastructure

Road transport infrastructure is of high quality. Significant investment (backed by EU funds) is planned for developing railway infrastructure, sea ports and inland waterways. On the digital agenda, the coverage of very fast broadband lines is currently below the EU average, and so is the availability of e-government services.

Figure 3.11.2: Overall profile of public administration - Croatia

In 2013, approximately EUR 165 million was invested through the infrastructure programme, an increase of 20 % in comparison with the previous year. Investment in energy infrastructure in cities and municipalities, reconstruction of roads and business zones, and investment in modernising and extending the work of local and regional government-owned utility companies were the priorities.

3.11.6 Public administration and business environment

Entrepreneurship and Small Business Act

Entrepreneurship and self-employment are not sufficiently developed, but education is seen as a positive factor in developing an entrepreneurial attitude and a strategy for entrepreneurial education has been implemented.

The entrepreneurial infrastructure improvement act was passed in July 2013, supporting the creation of entrepreneurial zones and introducing an entrepreneurial register.

In 2013, the new pre-insolvency procedure was adopted and has been widely used. It increased the

security of entrepreneurs by addressing debt-servicing problems faced by companies in the context of complex, expensive and lengthy insolvency procedures. However, there is still a problem with its fair implementation across the country.

Administration modernisation

Dealing with the public administration remains a significant problem for businesses. Fragmented and inefficient administration is an issue and civil justice remains a challenge despite reforms adopted in 2012 and 2013. Enforcement of rulings on monetary assets has improved following the introduction of immediate enforcement. However, the recovery rate on immovable property is low. The length of proceedings is very high both in civil, commercial and administrative cases, while the backlogs are high in civil and commercial proceedings.

Work has been carried out in recent years to improve the anti-corruption framework, but there is no convincing track record of effectively implementing measures to prevent corruption.

Stakeholders' main complaint is about regulatory instability. It is true that too much legislative activity may lead to overlapping legislation, legal uncertainty

and inefficient implementation. Concerns about regulatory stability, especially when implementation of regulatory changes is uneven across the fragmented and non-transparent local administrations, should be judged against the need to put in place a clearer and more rational legislative framework. Although regulatory impact assessment is carried out, resources are insufficient for this to happen systematically.

Broadening the use of e-government is a priority. A central payroll system is being rolled out in 2014 and will cover employees from education, health, justice, courts, agencies, culture, and all employees paid from the state budget. It will provide transparency and rationalise spending.

The strategy for modernising the public administration, to be presented in 2014, might address the administration's fragmentation. It covers state, agency and local administration authorities, and seeks to improve budgetary monitoring, resource management, service quality, standardisation of rules, and performance management. It reduces the number of regional offices from 20 to five.

Preparations for a law on state information infrastructure are also ongoing. This law will establish a legal basis for the development of integrated systems following the 'just once' principle and including a national identification and authentication system.

Reducing administrative burden

The World Bank's Doing Business Report 2014 ranks Croatia 89th globally, behind all EU countries except Malta. Croatia's position has improved significantly since 2005, but has worsened in the last three years.

Registration of new companies has been significantly streamlined by the 'simple limited liability company' procedure, now in its second year of operation. Better internal coordination has reduced the number of needed documents from 30 to six or seven. Licensing procedures have been shortened with the introduction of 'silent consent' after 30 days — although not for all types of licences. Electronic registration of businesses is planned via the Point of Single Contact, and administrative procedures for particular service activities will be simplified in line with the Services Directive.

A new building act and physical planning act have been adopted, simplifying construction permit procedures. Moreover, linking data of the land registry and that of the cadastre is ongoing, with 50 % completed so far. However, it is the non-controversial cases that were linked first, so completion is still far off.

In 2013, the working group on the business climate and private investment adopted 181 measures to improve the business environment, concentrating on reducing the number of non-tax levies; 52 such levies were eliminated as a result. Non-tax levies are considered a major problem for the business environment, not so much because of the amount due but more because of their number (more than 400) and the associated administrative burden.

Facilitating tax payments

The taxation system is not overly burdensome for businesses and corporate income tax is one of the lowest in the EU. In 2013, tax procedures were simplified with the introduction of an electronic system for social security contributions.

The tax administration is being reorganised to rationalise and unify working methods and ensure the equal treatment of taxpayers. The Large Taxpayers Office introduced in 2013 is not yet operating at full capacity, but authorities estimate that it has already made a significant positive impact.

3.11.7 Conclusions

The manufacturing sector accounts for a somewhat higher proportion of the Croatian economy than in the EU, but in recent years most growth can be attributed to the development of services.

The European Investment and Structural Funds, which are available in Croatia for the first time, represent a great opportunity for investment in key bottlenecks to growth. Strong administrative capacity and strategic planning will be crucial to make efficient use of the funds. To increase the value-added of manufacturing and especially of exports, the planned strategies in the areas of industry, innovation and smart specialisation must be implemented.

Access to finance conditions, worsened by the crisis, pose particular difficulties and are exacerbated by the lack of alternative sources of finance.

The business environment and public administration remain unfriendly to business. The government is aware of this and is addressing the problem. Some progress has been achieved in the field of the business environment and public administration, especially on reducing the regulatory burden, but implementation needs to be complete and consistent for the situation to improve.

3.12 Italy

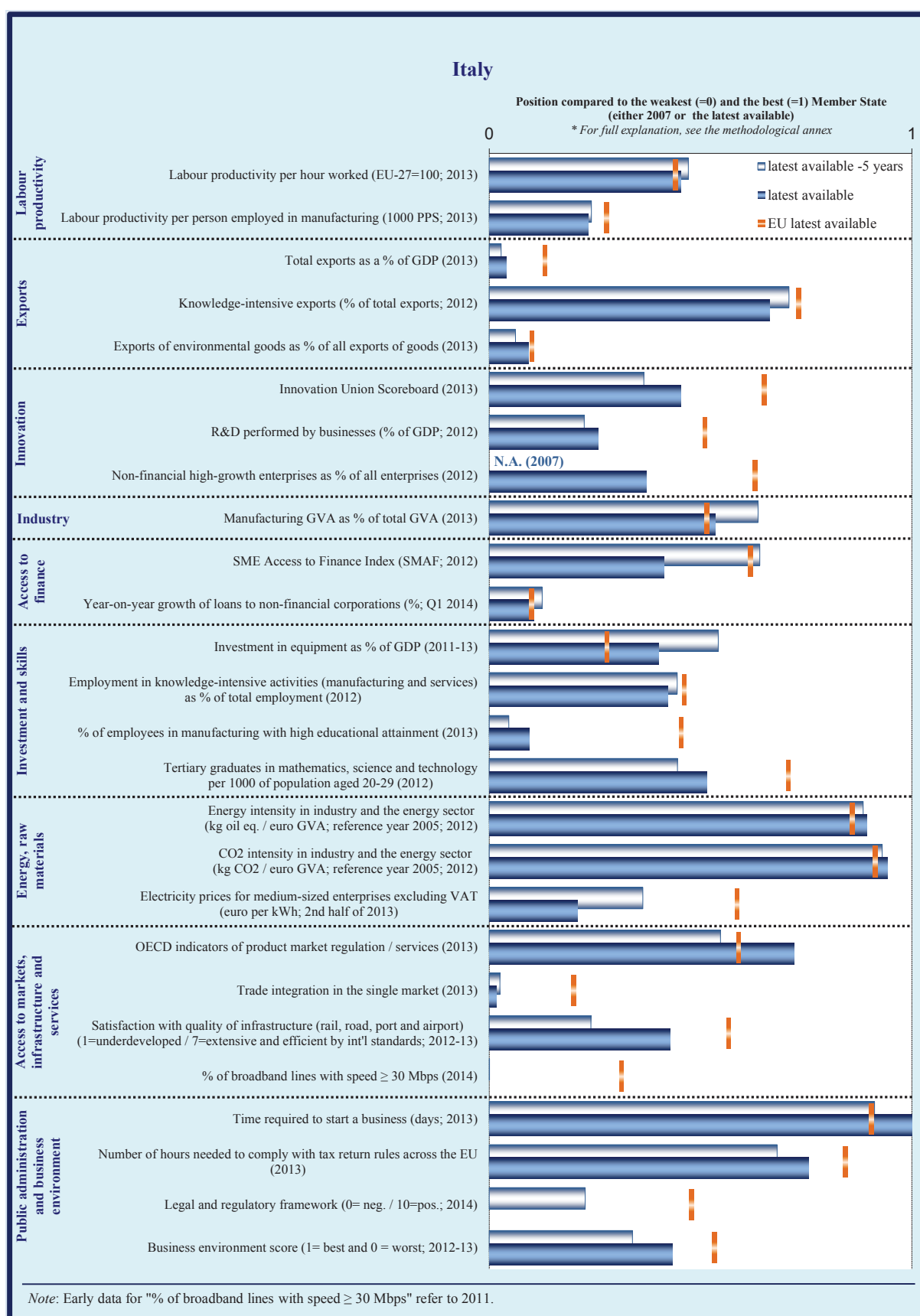
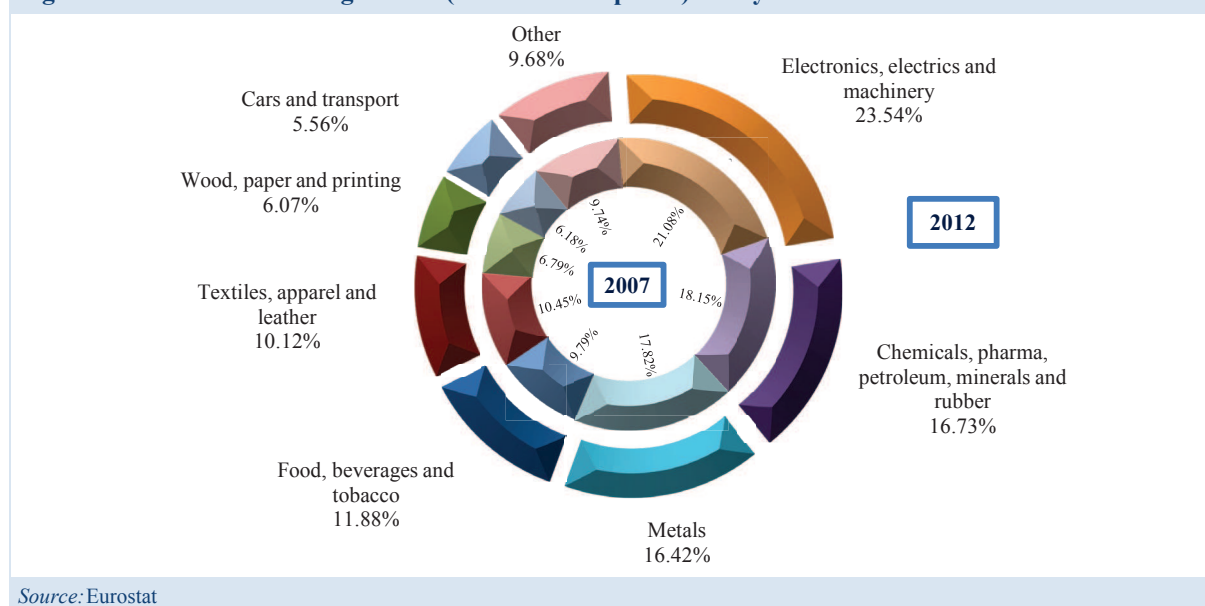


Figure 3.12.1: Manufacturing sectors (GVA at basic prices) - Italy

3.12.1 Introduction and performance

The double-dip recession that started in 2008 bottomed out in summer 2013. Industrial production is experiencing a slow and erratic recovery, driven by improved business confidence based on growth of export orders.

Indeed, since 2011 export performance has been the only component that has contributed positively to growth.

The recession has taken its toll on Italian industry: in the manufacturing sector alone, the number of firms has contracted by about 19 % since 2007, with sectors such as pharmaceuticals, textiles, leather goods and apparel particularly badly hit. Italian manufacturing potential is about 15 % below the pre-crisis level (a decline of at least 20 % was recorded in 14 sectors out of 22, with a peak of 40 % in the automotive industry). This is the result of an average decline of 24.5 % in manufacturing output and a decrease of 8 percentage points in the capacity utilisation rate.

Despite the significant reduction in volumes produced, productivity remained substantially unchanged, widening the gap with major competitors even further.

Because of subdued productivity, in 2013 unit labour costs in industry increased by 3.9 %, even though the increase in hourly labour costs slowed to 1.7 %.

Overall, since the beginning of the crisis, the cost competitiveness of Italian manufacturing has declined only slightly more than that of German industry (-2 percentage points), but this has increased the already wide gap that built up over the previous decade (-35 percentage points from 1997 to 2007).⁽³²³⁾

Slow productivity growth is mostly due to inefficiency in allocating resources. Indeed, Italy's investment rate is comparable to that of other euro-area countries, but its level of capital efficiency is lower and declining.

According to a recent analysis, one of the root causes of modest productivity growth is that labour market reforms have focused mainly on flexibility and have neglected to address rigidities in the wage-setting mechanism. This is producing perverse effects: since 2000 wages have increased more in sectors where labour productivity has grown less, and, in the short term, employment is tending to move towards sectors where labour productivity is increasing less.⁽³²⁴⁾

⁽³²³⁾ Confindustria, *Scenari Industriali*, giugno 2013, No 4. However, disparities in competitiveness indexes are particularly evident in Italy. For example, when using a producer price index-based measure, the gap with Germany is considerably narrower and Italy is not materially less competitive than it was in 1999.

⁽³²⁴⁾ P. Manasse e T. Manfredi, *Flessibilità, mito infranto del lavoro in Italia*, e-book, 2014.

3.12.2 Access to finance and investment

Although there are recent signs of an easing in credit conditions, lending to the manufacturing sector continued to shrink, decreasing by 6.1 % in 2013.

Since July 2012, the interest rates on bank overdrafts and on new loans have remained broadly stable at around 5.2 % and 3.6 %, respectively. But the latter is still 150 points higher than the rate paid on comparable credit in Germany and France.

Both supply and demand conditions are driving the contraction in credit provided to manufacturing firms. Restrictive credit supply conditions have mainly affected SMEs, whereas larger firms have been able to replace bank loans by issuing bonds.

The government has acted by strengthening the traditional tools to tackle the credit crunch, such as broadening the criteria for access to the Guarantee Fund for SMEs, giving support from the National Deposit and Loan Bank for productive investment by SMEs, providing subsidised loans to firms that invest in capital goods, and capitalising Consortia and Credit Guarantee Cooperatives (CONFIDI). In addition to improving these schemes, the government has taken steps to diversify firms' access to finance and reduce the bias towards debt financing. ⁽³²⁵⁾

The corporate equity allowance has been first increased from the initial 3 % to 4 % in 2014, 4.5 % in 2015 and 4.75 % in 2016 and then further strengthened to encourage capitalisation. Mini-bonds, which were established in 2012 to diversify access to finance, especially for SMEs, but have seen only modest take-up so far, have been made more cost-effective by reducing their costs of issuance and stimulating their securitisation. Greater involvement of institutional investors other than banks (namely, insurance companies and credit funds) has also been enacted. The framework for equity crowdfunding for innovative start-ups, which allows limited risk capital to be raised through on-line portals, has been finalised with the necessary implementing decrees.

The success of these measures should help in supporting the recovery of the economy. According to a study by Confindustria, the Italian employers'

⁽³²⁵⁾ Raccomandazione del Consiglio sul programma nazionale di riforma 2014 dell'Italia e che formula un parere del Consiglio sul programma di stabilità 2014 dell'Italia

federation, assuming investment growth over five years in line with pre-crisis levels (+5.2 % annually), there would be a need for between EUR 90 and EUR 150 billion of capital whereas available bank credit is unlikely to exceed EUR 60 billion. ⁽³²⁶⁾

In particular, the reform of mini-bonds has potential to appeal to a large number of family-owned firms, which are more reluctant to sell shares and thus dilute their control.

Finally, the payment of general government commercial debts (EUR 26.1 billion in the year to July 2014) is sustaining firms' liquidity. According to a survey by the Bank of Italy, about one-third of the firms with commercial claims against general government report having received payment of a fairly large sum. They intend to use this to pay off part of their debts to suppliers and staff, reduce their bank loans and make new investments. The payments also appear to have helped to improve prospects for the firms that still had claims against the administration. Recently, the government made available around EUR 9 billion more in addition to the EUR 47 billion already allocated for paying arrears, and it is committed to meeting all arrears by the summer. The exact amount still to be paid is unknown; Bank of Italy estimates, based on a sample survey, point to EUR 75 billion.

3.12.3 Innovation and skills

In 2011, the percentage of GDP invested in research and development slightly decreased to 1.25%, widening the gap with the national Europe 2020 target for R&D, set at 1.53% of GDP.

One of the major weaknesses of the Italian R&D system is the low contribution of private sector to R&D intensity. In fact, despite a slight increase to 54.6% of private contribution to R&D expenditure, this remains very far from the European average (63.1%) as well as from countries such as Germany (67.7%), France (63.9%) and the UK (63.6%).

Nevertheless, Italy experienced growth in most indicators of the Innovation Union Scoreboard 2014. In particular, all but one of the indicators that try to capture the economic effects of innovation activity improved, including the sales share of new

⁽³²⁶⁾ Confindustria, Nuova finanza per le imprese: più capitale, più bond e strumenti innovativi per le PMI, pdf 2013.

innovations and the contribution of medium and high-tech products exports to trade balance, two indicators where Italy is overall in line with the EU average.

This apparent contradiction between enabling factors and output is explained by Italy's industrial structure, which has a preponderance of SMEs, concentrated in low and medium-low technology sectors. The globalising value chains have led these firms to gradually lose their links to larger internationalised firms in Italy. This has reduced the scope for innovation dissemination to these firms.

In such a context, the level of expenditure on R&D may underestimate the innovative effort of an economy, given that SMEs do not account for all the R&D carried out. In addition, in sectors where Italy competes successfully on international markets, capacity for innovation relies less on high spending in R&D than on so-called incremental innovation, which builds upon existing knowledge and involves modest technological change. Indeed, in Italy the share of firms that have introduced product or process innovations without carrying out formal R&D activities is 40 %. This is greater than or close to the level in other major countries except Germany.

However, the effect of innovative activity on the growth potential of such companies is limited. Compared to those that perform formal R&D activities, they have a significantly lower capacity to register patents, a lower share of sales from innovative products and lower overall productivity than those that carry out formal R&D activities. ⁽³²⁷⁾

In addition, the economy's high share of low-to-medium technology sectors is both a driver and a result of Italy's dismal performance in terms of knowledge and skills. In 2011, Italy had the fourth highest share of population in the EU with only basic education and the lowest share of population with tertiary education. Similar evidence emerges regarding skills: in an OECD survey ⁽³²⁸⁾ Italy ranks bottom in literacy among the countries covered, and above only Spain in mathematic skills. The fact that this is the case for all age groups and all levels of education suggests that shortcomings in the education system are being compounded by a lack of professional training and by the fact that work tasks neither contribute to maintaining existing skills nor require workers to learn new ones.

On the policy side, the government has allocated EUR 200 million per year for the period 2014-2016 for tax credits to support companies that invest in R&D. But it is unclear whether this measure also has also the potential to bring to light R&D activities that have so far not been accounted for, as the tax credit is calculated on additional expenditure in R&D compared to the previous year. Other measures worth EUR 250 million in 2014 have been allocated to promoting the recruitment of researchers and to digitalisation and technological modernisation in SMEs. The progressive increase in the allowance for corporate equity in the coming years might also contribute to raising R&D by businesses.

The government is also drafting a National Programme for Research (2014-20) that is designed to take full advantage of the opportunities provided by the EU's Horizon 2020 research and innovation programme and the European structural and investment funds. The National Programme has three pillars: bringing highly qualified human resources into the country's productive fabric, a limited number of major thematic projects with a strong impact on people's welfare and support for innovation by companies.

A prerequisite for the success of the specific measures is a sharp improvement in the performance of administrative bodies. Despite some progress, regulatory instability and uncertainty over disbursement timeframes continue to hold back innovative activities. At the same time the government is trying to overcome the piecemeal nature of its efforts by creating eight national technological clusters that are intended to become the backbone of industrial research in Italy.

3.12.4 Energy, raw materials and sustainability

Electricity prices for end users in industry are among the highest in Europe due to a combination of heavy taxes and levies (the highest in the EU) and high energy supply costs (the third highest in the EU).

However, Italian firms' good performance in terms of energy intensity, which is among the best in the EU, implies that the ratio of energy costs to gross output and to value added is in line with the EU average.

⁽³²⁷⁾ Banca d'Italia, Annual Report for 2012, 31 May 2013

Increasing reliance on renewables will help reduce Italy's dependence on imported energy.

Generally, Italy shows significant progress in all four of the indicators that define sustainable industry. In the period 2007-2012 it is estimated that per year i) waste production was reduced by almost 2 %, ii) Non-disposable waste was cut by 2.7 % and iii) greenhouses emissions were reduced by 2.4 %. Lastly, energy consumption had the best result, thanks to a reduction estimated at 6.3 % per year. Overall, in 2007-2012 Italian manufacturing reduced its environmental impact by 3.5 % annually.

This effort to achieve greater sustainability is making a major difference not only for the environment but also for competitiveness: of the companies that have invested in green technologies, 17.5 % are exporters (compared with only 10% of those that did not make green investments), 23 % introduced product innovations in 2012 (11 % for the other companies) and 54 % increased or consolidated their sales. Of all the jobs created in 2013, 38% are estimated to have come from companies that invested in sustainability.

Sectors investing in energy efficiency and renewables fared better during the crisis, creating new firms and increasing employment. This was particularly the case for renewables and construction, thanks to a system of incentives established by the government, but waste management and electronics also benefitted. ⁽³²⁹⁾

Another dimension of sustainability is the re-industrialisation or reconversion of industrial sites. This is a strategic issue in Italy, whose high population density means there is little land available for building 'greenfield' industrial plants. Given this situation, the government recently further simplified land reclamation procedures, better specifying responsibilities in the different reclamation phases and developing tax relief measures. These provisions are expected to facilitate environmental recovery projects and should have an impact on generating additional investments.

⁽³²⁸⁾ OECD, [Survey of Adult Skills \(PIAAC\)](#)

⁽³²⁹⁾ Fondazione Symbola e Unioncamere — GreenItaly, *Nutrire il futuro*, pdf 2013.

3.12.5 Access to markets, infrastructure and services

After the highs of 2011 (+6.9 %) and 2010 (+12.4 %), the growth in export volumes of goods significantly decelerated in 2012 (+2.1 %) and 2013 (+0.2 %).

Two trends are worth mentioning when assessing export performance. First, there has been a geographical refocusing towards non-EU markets to compensate for the weakness of the EU economy (compared to 2007, the share of Italy's non-EU exports rose by more than four percentage points). Secondly, a modest shift in the export mix has been seen from low-tech to medium- and high-tech goods.

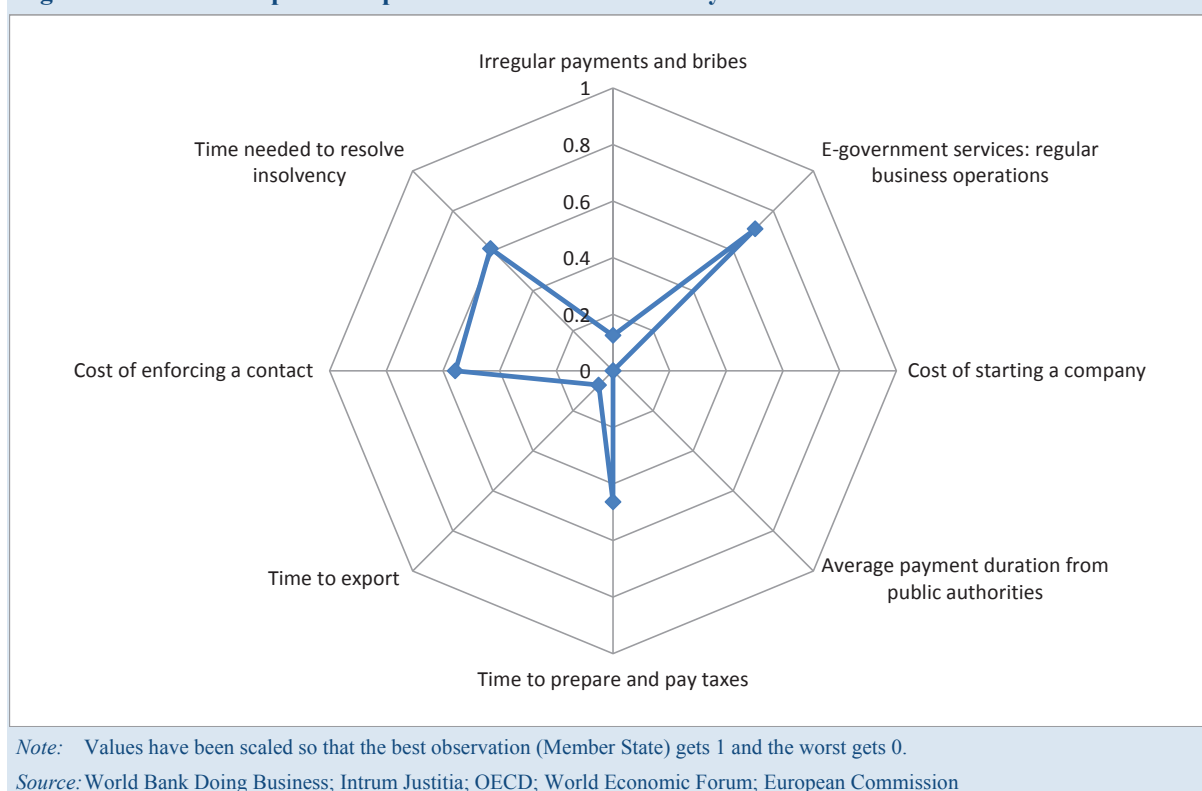
Thus, Italian firms are showing a level of adaptability and resilience that is still a source of strength. According to the WTO/UNCTAD Trade Performance Index, Italy remains the world's top exporter of textiles, clothing and leather goods, and is ranked second in the world (behind Germany) for non-electronic machinery and manufactures (basic and miscellaneous). This seems to suggest that Italian industry is managing in overcoming cost competition injecting innovation and quality in mature productions.

However export strategies adopted by firms remain weak. From a closer look at the characteristics of exporting firms, it appears that only a limited proportion adopt systematic export strategies in their business model, while a majority look to foreign markets only to compensate for weak domestic demand. ⁽³³⁰⁾

With a view to strengthening Italian industry's export base, the government has doubled the budget for promotional activities to almost EUR 60 billion. Agenzia ICE, a government agency for promoting trade and encouraging firms to globalise, is running roadshows in 20 Italian cities to show SMEs the opportunities foreign markets offer and the tools for accessing them. With the same goal, there has been a strengthening both of the financial instruments to support exports to foreign markets and of interest-rate subsidies to export capital goods.

Finally, Italy's trade potential would greatly benefit from better ports management and improved interconnection capacity. The importance of its ports

⁽³³⁰⁾ A. Belloni, *Esportare l'Italia*, Guerini e Associati.

Figure 3.12.2: Overall profile of public administration — Italy

in terms of trade activity is in fact not matched by adequate performances, in particular in terms of lengthy and costly administrative and custom procedures.

3.12.6 Public administration and business environment

The administrative and regulatory constraints that affect the business environment are reflected in Italy's dismal record in attracting foreign capital: in 2013, Italy was the destination of a mere EUR 12.4 billion in foreign direct investments.

According to the government, the duration and number of formalities required by the administration cost SMEs as much as EUR 30.98 billion a year. Typical problems include unclear legislation, lack of communication between different administrations, lack of transparency and the number of procedures to be followed. In addition, paying taxes is particularly time-consuming and costly: 269 hours per year for a total tax rate of 65.8% of total profits (against an OECD average of 41.3%).

To facilitate doing business in Italy, in September 2013 the government launched, 'Destinazione Italia'

a plan to attract foreign investment and enhance the competitiveness of Italian firms. The initiative consists of 50 measures, some of which have already been implemented, affecting a wide range of activities, from taxation to labour and from civil justice to research.

The entry into force of the simplification contained in the 2013 'Decreto del Fare' has brought savings for businesses totalling EUR 8.99 billion (a 27.4% reduction in businesses' administrative costs). Ongoing efforts to shorten some court procedures are bearing fruit, and this is reflected in Italy's improvement in the World Bank's 'Doing Business' latest rankings. ⁽³³¹⁾ Moreover, recent legislation tries to limit the need for implementing acts, which has slowed down the enforcement of the legislative provisions.

However, efforts to move towards a modern and efficient public administration are hampered by two constraints. The first is the often unclear division of responsibilities between the state and the regions that resulted from the 2001 constitutional reform; this is limiting the effectiveness of simplification measures taken at central level. The government is working

with the regions and local administrations on ‘An Agenda for simplification’ whose effectiveness remains to be seen.

Secondly, all the provisions mentioned above were adopted by decree-laws, which do not seem appropriate for enacting ambitious structural reforms as they contain provisions regulating very diverse matters and, for the sake of urgency, do not require an impact assessment. In the meantime, a more comprehensive draft law on simplification is still awaiting adoption.

3.12.7 Conclusions

The toll taken by the crisis on Italian industry has been huge in terms of output and employment. Industrial production is around 25 % below the pre-crisis level, a general decrease that also affects sectors — such as automotive, consumer appliances and footwear — that have long been the backbone of Italian industry.

However, Italian manufacturing maintains a percentage of gross value added to GDP (15.5 %) which is still above the EU average (15.1 %). Moreover, it is a key source of innovation and competitiveness: it contributes 70 % of private R&D expenditure and accounts for almost 80 % of exports. It is also a driver for the service sector: 40 % of the total value of industrial exports incorporates value added by the service sector. ⁽³³²⁾

Thus, there is a need to strengthen the process that is already under way, i.e. a consolidation of firms and sectors able to manufacture with sustainable methods of production and to face up to international competition. Niches of scientific excellence that exist in advanced materials, nanotechnology, photonics, electronics, robotics and drones have the potential to underpin the modernisation of more traditional sectors and facilitate the upgrading of the industrial base. The potential for Italian companies to become more global-minded is an opportunity to be seized: in addition to increasing the budget for promotional activities the government is also working on a plan to raise the number of exporting firms, including by

enhancing export finance tools and simplifying and speeding up customs procedures.

A prerequisite for growth is the creation of a competitive business environment. Despite the government’s efforts, the business environment and the public administration continue to weigh on Italy’s competitiveness. The time it takes the public administration to pay its bills - 180 days on average – remains a problem; in the fourth quarter of 2013, 62.5 % of the value of invoices due had not been paid.

Some progress has been achieved in the field of civil justice but proceedings are still lengthy and the number of cases pending remains high. ⁽³³³⁾ The anti-corruption law has strengthened the means to fight corruption, but its effective implementation needs to be watched closely. Some progress towards administrative simplification has also been achieved. But, overall, continued and comprehensive efforts are still needed for a competitive business environment to emerge.

Thus, there is a need to strengthen the process that is already undergoing, i.e. consolidating firms and sectors able to manufacture with sustainable methods of production and to face international competition. Niches of scientific excellence that exist in advanced materials, nanotechnology, photonics, electronics, robotics and drones have the potential to underpin the modernisation of more traditional sectors and facilitate the upgrading of the industrial base. The potential for internationalization of Italian companies is an opportunity to be exploited: in addition to strengthening the budget allocated to promotional activity, the government is also working on a plan to increase the number of exporting firms, also by enhancing export finance tools as well as simplifying and speeding up custom procedures.

A prerequisite for growth is the establishment of a competitive business environment. Indeed, despite the efforts taken by the government, business environment and public administration continue to drag down competitiveness in Italy. Time to get paid from public administration remains problematic: 180 days on average; still in the fourth quarter of 2013, 62.5% of the value of invoices due had not been paid.

⁽³³¹⁾ Part of this improvement is due to a different interpretation by the World Bank of the total number of procedures.

⁽³³²⁾ Banca d’Italia, *Il sistema industriale italiano tra globalizzazione e crisi* (The Italian industrial system between globalisation and crisis), Occasional papers No 193.

⁽³³³⁾ In June 2014, the government announced a new major reform, where both the length of civil proceedings and the backlog of cases would be addressed. However, the details of the reform are not available yet.

Some progress has been achieved in the field of civil justice, but duration of proceedings and the number of pending cases remain high. The anti-corruption law strengthened the means to fight corruption, but its effective implementation needs to be monitored. Some progress towards administrative simplification has also been achieved. But, overall, a constant and coherent effort is still needed for a competitive business environment to emerge.