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Romano Prodi

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For a new industrial policy

Romano Prodi

Former Prime Minister of Italy and former President of the European Commission

Despite numerous claims of recovery or exit, Europe is still in the midst of the crisis and industry appears to be one of its most suffering victims.

Partly because it originated from the financial sector, partly because it translated into a banking crisis which, if spatially extended and prolonged in time, could have destroyed the whole world economy, the complete attention of governments has concentrated on the financial part of the economy.

Still today, the European debate fluctuates between the problems of public deficits and the necessity to produce reforms for the behavioural rules of the financial system.

The discussion of the productive aspects of the economy, on what we used to call the real economy, is almost absent. More precisely, it reaches media and decision-maker's offices only when unemployment statistics are published and, at the microeconomic level, when a company fails or is in crisis.

In other words, concern for European industry is only raised when pathological aspects appear.

I find two reasons for this anomalous situation.

The first reason is historical and consists in the theological interpretation of the free market concept over the last twenty years, which has systematically prevented any mention of industrial policy, although some governments (from the French one) built their industrial policy case by case, while continuing to theoretically adhere to the policy of non-intervention into markets.

The second reason stems from more recent events. The shift of many productive activities to the Orient, which was seen as both a worry and also as an occasion to transform the productive system towards service activities, in a new and necessary phase of the modern economy, has become more impetuous and violent with the crisis, dividing European countries' interests and impeding the birth of a debate and the consequent common policy on the future of industry.

Somehow provocatively, I would add a third reason, internal to academia, namely that the economic profession today tends to reward pure modelling studies, relegating to a secondary role the empirical studies which would be so useful both to prepare an exit strategy from the crisis and to identify the possible future development paths of our industry.

Whatever the reason, the fact is that today, both in Brussels and in individual European countries, necessary investigations and instruments are lacking in order to explain this completely new phase of our productive reality.

Returning after a long time in a (partial) research activity, not only do I find a general lack of empirical studies, but also a difficulty in finding researchers' networks who, by collaborating, could provide the necessary decision elements that help both understanding where we are and formulating, should it be the case, a new industrial policy.

Most of the few available sector studies are realised by economic analysis departments of banks and financial institutions and, as a consequence, although many of these studies are of good quality, they are built for much different purposes than those we have in mind when we consider a wide-ranging reflection on the future of the European industry.

The difficulty to imagine a possible future strategy is even more serious when one looks at the data on the evolution of the European industry over the last years. This

data indeed show a very strong divide in the quantitative and qualitative characteristics of the different countries' industrial systems.

The most striking aspect is how varied is the distribution of manufacturing activity among countries.

Taking the major nations of the EU as an example, the divergences are very wide.

A fact emerges among all.

In Germany, the added value of the manufacturing industry amounts to about 24% of the total value added of the country, while the same data is 12% in France and 11% in Great Britain. Italy is in an intermediary position, with a data similar to the German one in the North and extremely low values in the Southern part of the country.

These Eurostat data would lead us to conclude that the manufacturing industry is concentrating in a cylinder that goes from Hamburg to Florence, while France and Great Britain are specialising in the tertiary sector.

This seems to be a robust finding, but the elements necessary to understand the qualitative aspects of this change are missing, namely the issue as to whether an industrial structure primarily based on large firms as in France or primarily based on more flexible SMEs as in Italy, is better to face the new worldwide labour division. The German model of large firms supported by a dense and efficient network of family firms may also be an alternative.

From this issue stems a second issue, namely which system is more effective, a productive system where final producers are localised close to suppliers and component makers, or a system where producers of final goods are localised in the "old" Europe while suppliers are located in China, in India or in European countries with lower labour costs.

Put it more simply: can a productive system essentially built on large firms and not on an integrated network of producers with different qualitative and quantitative characteristics be efficient?

This issue did not even need to be raised twenty years ago because, apart from some exceptions, the creation of a global network of collaboration and supply was too inefficient and, in any case, too costly. The still elementary communication and transport systems made the building of such an integrated network between firms along the same production process or between firms and service suppliers impossible.

Today, the problem of productive organisation in the era of globalisation should be an absolute priority of the European Commission, all the more so as many prejudices against industrial policy have disappeared, due to, among other factors, the fact that many governments are subsidising the firms assessed as most deserving within the national policy choices, using the crisis as a motive or pretext.

I realise though that the diversity I mentioned above make the formulation of a European industrial policy more complicated, a complication that multiplies when one accounts for the new role played by some countries such as Poland and Romania or, outside the Union, by Balkan countries as a consequence of their different relative costs and technological development levels.

It would be even more useful to look outside Europe, studying how the great success of the Chinese manufacturing industry has been helped by a systemic support from the government, that we have to define as a true industrial policy.

Infant industry incentives, policies in favour of research, tax breaks to support investments, export subsidies do not constitute isolated actions but behavioural lines that become a common asset for the whole national industry.

This industrial policy has changed during the thirty years of the Chinese catching-up, taking the evolution of world markets and the availability of new material and human resources into account.

The crisis has legitimated industrial policy everywhere, starting from the United States, where it has been widely implemented both in mature markets like automobile and in innovative sectors such as renewable energy. It is no longer just about using huge public investment to promote industry, as in the space and defence sectors. Today the US government intervenes by directly pouring resources into single sectors and single firms.

I have doubts that such a radical change is only due to the crisis. To the contrary, I think that this will end up being a constant parameter both in newly industrialised countries like China and in the old industrialised countries that intend to defend against China with all possible instruments, including first and foremost industrial policy.

It is clear that the generalisation of this tendency could bring disastrous results in terms of competitive rules and would translate into an enormous waste of resources and a general fall in productivity. To avoid this, industrial policy must be limited and regulated, all the more so as we have entered a dramatic historical period regarding unemployment that will not end with the crisis but will continue after it.

In order to reopen the serious and fruitful chapter of European industrial policy one must reply to two additional objections. First, industrial policy has become much more complicated given that the interests of the participants to the policy deeply diverge, as is the case in Europe today. Despite this difficulty, I cannot help remembering that in other periods, such as in the end of the 1970s, Europe managed to avoid a catastrophe in the steel sector thanks to the so-called Davignon Plan, that acted not only in the direction of productive capacity regulation but also made a radical restructuring process and large productivity increases possible.

Still the different views between States and between firms seemed absolutely incompatible.

Second, it is clear that an industrial policy based on subsidies and market distortions can absolutely not be proposed today.

The objective must be to help relations and interactions between the different components of the industrial world. In other words, the objective should be the networking of universities, research laboratories, credit and financial institutions, patent offices, component makers and suppliers and the organisations able to open knowledge and sales channels to firms in foreign markets, especially the most distant ones.

After all I make do with little, namely to give industry at least a small part of the attention that in these days of crisis is dedicated to finance. Or do we really think that we can have finance without production?