Talking point

The industrial sector's share in the EU economy is stabilising

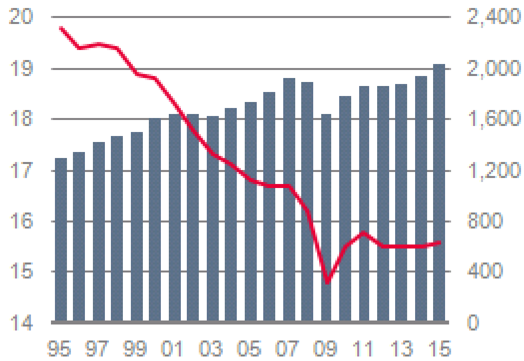
August 29, 2016

Nearly four years ago, the European Commission set its sights on increasing the share of manufacturing in total gross value added from 15.5% at that time to 20% by 2020. This target will probably not be met. After all, in 2015 the share of manufacturing was only around 15.6% and thus scarcely higher than in 2012. However, industry's contribution to EU output has at least stopped decreasing since 2012. Furthermore, industrial gross value added has picked up (slightly) in the EU in recent years in both nominal and real terms. In a few member states, there have been highly contrasting developments in the significance of manufacturing in the economy. It is striking that the industry share in the three large Eastern Europe member states has increased sharply since 2012. Spain and Italy have reported modest gains. Germany has seen its industry share decline slightly in 2015; however, at 22.8% it still far outstrips the EU average.

In autumn 2012, the European Commission set its sights on increasing the contribution of manufacturing (also referred to in the following as industry, NACE code C) to total gross value added in the EU to 20%. Back then, industry's share came to 15.5%. In the years before, it had already been trending downwards (1995: 19.8%). To meet this target, the EU focused on boosting investment in new technologies, strengthening the single EU market and improving funding possibilities especially for small and medium-sized enterprises. There were several reasons for policymakers to attach greater value to industry, and these still apply today: for example, Germany reported higher growth rates than many other EU countries after the economic crisis in 2008/09 thanks partly to its high manufacturing share and the international competitiveness of its industrial companies. Moreover, policymakers are increasingly realising that manufacturing companies account for a large share of R&D spending in the economy. The share in Germany, for instance, regularly tops 80%. Furthermore, strong manufacturing companies are important customers for business-related service providers and they can tap new markets due to their above-average focus on exports.

Downward trend halted

Gross value added in EU manufacturing



Source: Eurostat

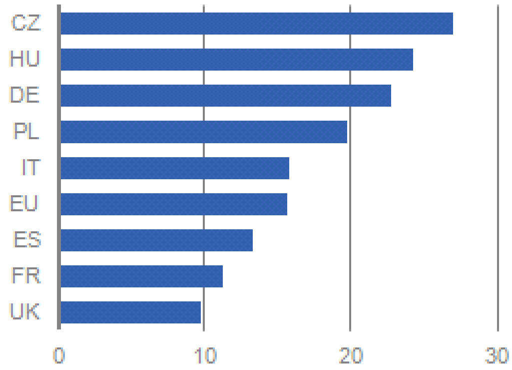
We are now close to the halfway point between the EU setting its objective in autumn 2012 and the target date of 2020, so it is worth drawing an interim conclusion. Going by the target industry share, the initial assessment is negative. In 2015, manufacturing accounted for “only” 15.6% of the EU's total gross value added, so virtually no progress has been made towards the actual target. The original political objective was overly ambitious anyway, a fact underscored by the following model calculation: if the gross value added of all economic sectors except for manufacturing had grown by 1% p.a. from 2012, manufacturing would have to have grown by 5% per year in order to reach the target 20% share by 2020. However, the development since 2012 can also be interpreted more positively. For one thing, the industrial sector's share of the economy has at least stopped decreasing in recent years. For another, absolute gross value added in the EU manufacturing sector increased in both real terms (+3.8%) and nominal terms (+9%) between 2012 and 2015. This is by no means heady growth. Still, manufacturing was able to keep pace with the growth of the services sector, which it failed to do in the years prior to the global economic crisis in 2008/09.

Industry's share rising in many countries in Eastern Europe

A look at the large EU countries shows notable variation in the way the contribution of industry has developed since 2012. It is striking that manufacturing's share in gross value added has increased in the three large Eastern European countries (Poland, Czech Republic and Hungary), in some cases noticeably. In the Czech Republic, for instance, it is up by 2.3 percentage points (pp). This reflects these countries' continuing integration into the global industrial value chains. In each of these three economies, the absolute gross value added generated in the manufacturing sector has increased much more sharply than across the EU on average. There were noticeably fewer changes in the industry share in the large countries of Western Europe. Italy reported an increase of 0.4 pp, Spain 0.2 pp and Germany 0.1 pp, while France and the UK each reported a decrease of 0.1 pp. This means that in recent years the long-term decline in the significance of industry previously observed in France, Italy and Spain was halted. Nevertheless, the nominal growth of gross value added in these countries equalled only about half the EU mean between 2012 and 2015. For one thing, this mirrors the generally only weak dynamics of their economies. For another, it underscores that private consumption was the main growth driver in the period under review, with services tending to benefit more appreciably. By contrast, demand for investment and exports, traditional domains of industry, has remained feeble. Germany still boasts a large industry share (2015: 22.8%) even though it has relinquished some ground in 2015. Since 2012, nominal economic growth in Germany (+10.5%) has exceeded the EU average (+9%). All in all, the industry share reportedly fell in 11 of the 28 EU countries between 2012 and 2015 and it stagnated in three countries (data for Bulgaria and Romania are still not available).

Significance of industry varies considerably

Share of manufacturing in total gross value added, 2015, %

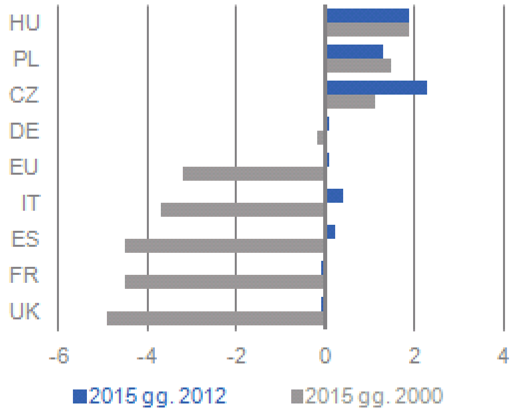


Source: Eurostat

At the European and national levels, a number of programmes and measures are in place that are meant to boost industry in Europe. Nonetheless, the data outlined above show it is not possible to achieve a given industry share simply on the back of political measures alone. Individual EU countries are pursuing different “business models” that have largely evolved over time and which cannot be replicated arbitrarily. In a report we published in 2013, we called for the EU and the national states to focus on providing a good economic environment for all companies rather than banking on industry-specific measures. These include investment in education, research and infrastructure, an open investment climate, increased free trade with third countries and affordable energy prices. The political message, that a robust industrial sector is fundamentally important for a successful economy, is still correct. However, it is questionable whether this should be pegged to a concrete target for a specific manufacturing share. Ultimately, there is reason to doubt that increasing the industry share is generally the right approach for all EU countries – not least because competition from the emerging markets will remain intense.

Rising share of industry in Eastern Europe

Change in manufacturing's share in total gross value added, pp



Source: Eurostat

The current political situation in the EU is not rosy; take the Brexit vote and the rise of political extremism, for instance. Economically, the pace of growth in the EU is still not exceptionally high. The growth prospects in key markets outside Europe have become relatively dim over the past few months. Moreover, the ECB's (unconventional) expansionary monetary policy has so far failed to develop the hoped-for positive impact on investment activity. The weakness of world trade, which is partly structural in nature, will probably persist for a while given rising resistance to major international trade agreements – placing a particular strain on industry. All in all, corporate EU is in a challenging environment. Against this backdrop, many economists are rightly calling for (further) structural reforms; these should be aimed at stimulating entrepreneurial activity across all sectors of the economy (and not just industry). This will require a certain amount of patience at the least, as structural reforms only kick in with a time lag. Ideally, though, they lead to better growth prospects in the long run.

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