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COMMISSION STAFF WORKING DOCUMENT

**Member States Competitiveness Performance and Implementation of EU Industrial
Policy**

4.13. Cyprus

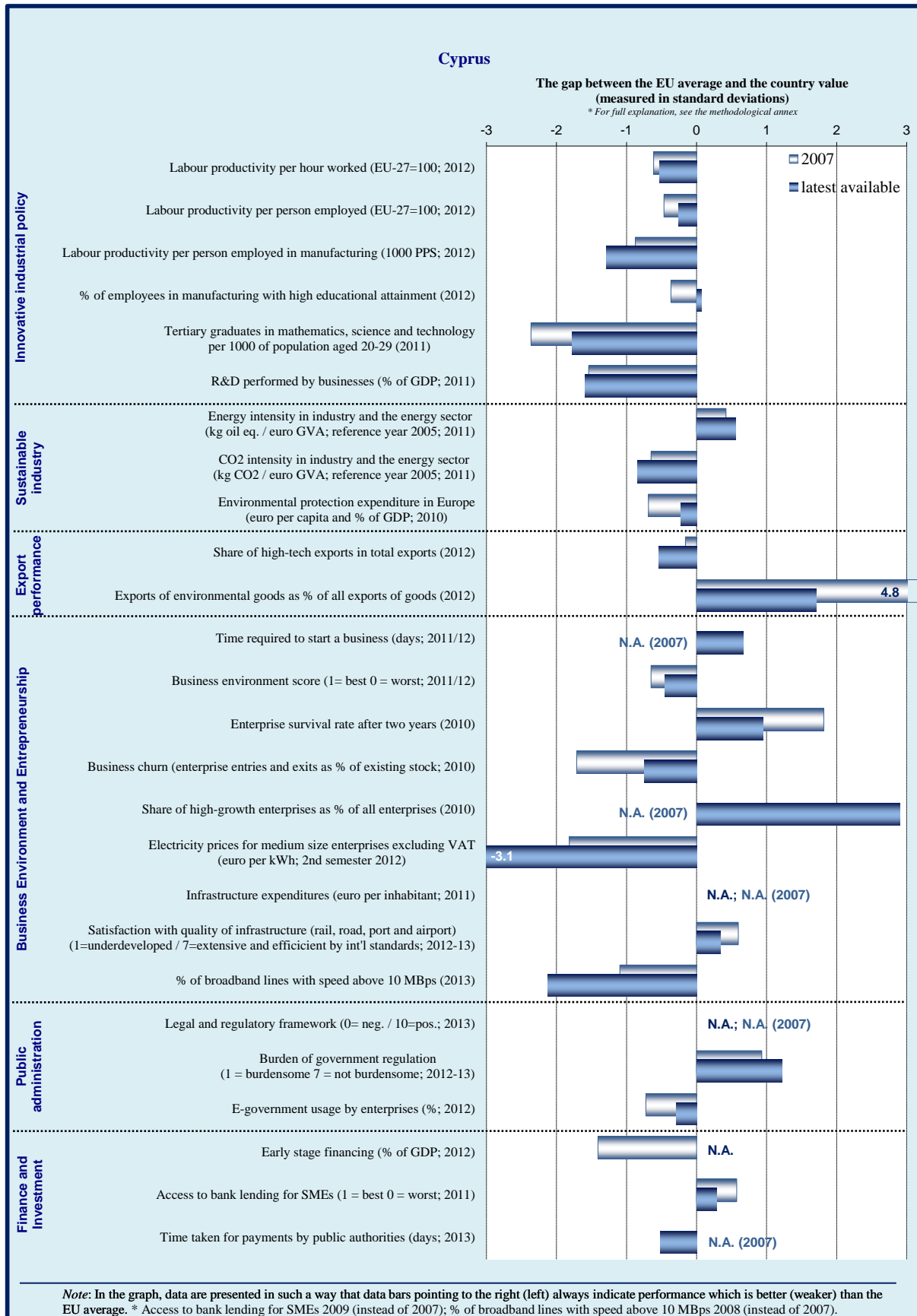
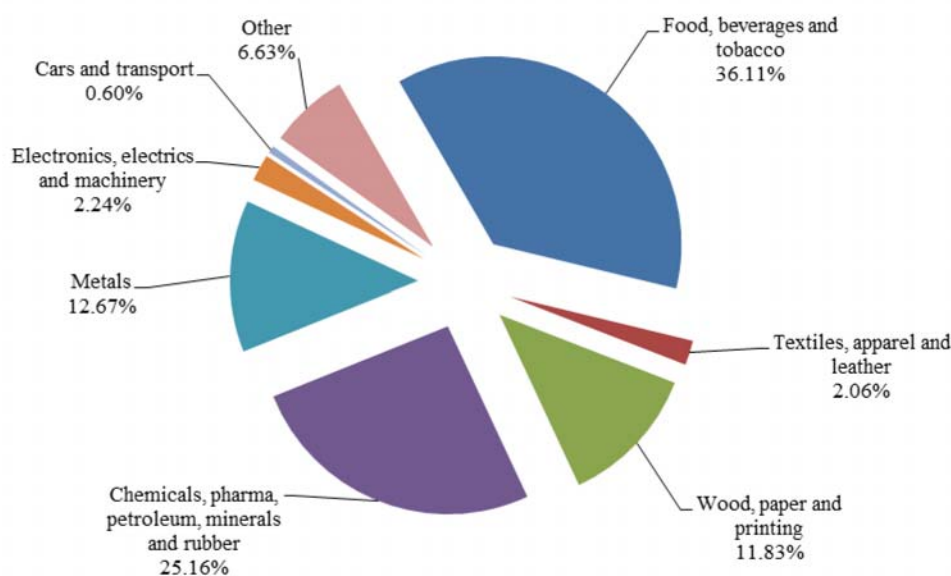


Figure Error! No text of specified style in document..1: Manufacturing sectors – Cyprus (2010)

Note: No data available for sectors C12 (tobacco products), C19 (coke and refined petroleum products), C26 (manufacture of computer, electronic and optical products) and C27 (manufacture of electrical equipment)

Source: Eurostat

4.13.1 Introduction

Any assessment of microeconomic reforms aimed at enhancing the competitiveness of Cyprus has to take into account the dire macroeconomic environment. Economic activity in industry weakened significantly in 2012, with a real GDP decrease of 2.4%. The introduction of the economic adjustment programme in April 2013, which involves the downsizing and restructuring of the banking sector, will have an effect on day-to-day business transactions and could threaten the viability of many firms and further reduce confidence. In 2013, real GDP is expected to decline by 8.7%. The structural measures and reforms of the economic adjustment programme will support competitiveness and underpin sustainable and balanced growth in the long term, but will have a negative effect in the short term.

Cyprus is a small service-oriented open economy, with tourism, financial services and real estate the most important sectors. The role of manufacturing is less important than on average in the EU (6.1% of value added against 15.4% in the EU as a whole), employing slightly over 10% of the total

workforce, the lowest rate in the EU (EU average 17.5%).

The cost competitiveness of the economy has deteriorated significantly since EU accession in 2004. While labour productivity has since grown by seven percentage points, nominal unit wage costs have gone up by 20 percentage points, leading to the gradual decline of the manufacturing sector.

4.13.2 Innovation, skills and sustainability

Innovation

The Innovation Union Scoreboard places Cyprus among the 'innovation followers', with an innovation performance close to the EU average. Cyprus has a very low level of R&D expenditure as a percentage of GDP (0.49%), which is in line with its national commitments under the Europe 2020 Strategy, but far short of the EU average (2.0%). Moreover, the innovation system relies mainly on public expenditure, as business contributions to R&D investment are among the lowest in the EU (0.1% of GDP against an EU average of 1.25%).

However, a closer look reveals a degree of vitality in Cypriot SMEs when it comes to innovation activities. Their level of participation in European research programmes is the second highest in the EU, and the INSEAD Global Innovation Index ranks Cyprus 27th. Still, less than 15% of the Research Promotion Foundation's budget went to enterprises in 2008-12. According to the Cyprus Association of Research and Innovation Enterprises, this is because firms are discouraged from declaring R&D expenditure by the absence of fiscal incentives, despite several attempts to introduce such measures in recent years.

On the policy side, the crisis and the fiscal austerity measures had led to a considerable reduction in budget allocations to R&D even before agreement was reached on the adjustment programme. A National Strategy for Research has been announced but not yet adopted and it is now expected that nothing will happen until the completion of the smart specialisation strategy for the next Structural Funds programming period. In this context, the Ministry of Commerce, Industry and Tourism (MCIT) is coordinating the bottom-up approach of smart specialisation and has called on enterprises to express their views during public consultation meetings. A web page has been developed where stakeholders can make proposals.

The MCIT has also been charged with managing project grants to enhance business innovation. A scheme with a total budget of EUR 4 million has been set up to support SMEs investing in research and innovation in developing competitive products and services that they plan to bring to market. In the evaluation process, extra points are given to proposals that fall within one of the six priority action lines of the EU's industrial policy communication. So far, proposals have been submitted in the field of sustainable construction.

The creation of five mediation agencies in various universities signals an effort to strengthen cooperation between academia and business, which is one of the major weaknesses of the R&D system. However, the MCIT is aware of the need for a cultural shift in universities, in particular by giving professors the right incentives to build links with local industry.

Skills

Wage indexation has affected competitiveness, but the government has taken steps to reform the indexation mechanism by reducing the frequency with which it is adjusted (once instead of twice a year), introducing a mechanism for automatic suspension in response to adverse economic conditions, and moving from full to partial indexation (50% of past inflation). However, the application of indexation is now suspended in the public sector, while it is expected that the new system will be extended to the private sector under a tripartite agreement. Cyprus also has one of the highest minimum wages in the EU and this has risen in recent years to EUR 870 a month (EUR 924 after six months of employment).

Links between the labour market needs and the educational system are still weak. There is little upper secondary vocational education and training and Cyprus has one of the lowest shares of young graduates in mathematics, science and technology.¹ There is no intermediate level of certification, especially for engineers and IT specialists due to low participation in vocational training (the lowest in the EU), and there is a great need for skills in the energy sector. Adult participation in lifelong learning remains below the EU average, although there is a need to increase occupational mobility and to prepare people for the coming structural change.

The government has sought to address this by creating new post-secondary vocational education and training institutes in 2012, with a view to combating youth unemployment and skills mismatches. A new modern apprenticeship system directed to 14-25 year olds will be fully operational in the 2014/15 academic year. Additionally, an initiative seeks to facilitate the employment of tertiary education graduates, another has accelerated initial training of newcomers, and there is a scheme for the enhancement of youth entrepreneurship.

¹ The 2011 share of MST graduates among 20-29 years old in CY is 5.1 % versus an EU average of 14.4 %.

Sustainability

High electricity prices (the 2012 prices for industry were the highest in the EU) are pushing Cyprus to build a more diversified, secure and sustainable energy system. In particular, Cyprus should ensure the full implementation of the Third Energy Package, particularly during and after the transformation of the energy sector related to the foreseen introduction of natural gas, though it is unlikely that this will improve the situation in the short term as the import of gas is expected to start in 2015 the earliest. The domestic offshore gas fields will not be exploited before 2018, when a pipeline to shore is scheduled to be completed.

Also promising are the developments in photovoltaic energy generation, where a bidding process was completed in January that resulted in the selection of 23 firms to construct photovoltaic parks for electricity production with a total capacity of 50 megawatts. Once completed, the projects are expected to generate around 80 GWh of energy annually. The offers received led to an average tender price of EUR 0.0866/kWh. Thus, the incumbent state-owned electricity company EAC, which is required to purchase all power from renewable energy sources, might be able to buy the generated power at lower prices and generate savings in the process.

Transport represents more than half of the total CO₂ emissions from non-ETS activities in Cyprus, and it is around 75% more energy intensive than EU average. Reversing the trend in CO₂ emissions from transport is essential for Cyprus to meet its 2020 targets. The state of transport infrastructure is relatively good. However, the main challenge relates to the excessive reliance on car while public transport, which could contribute to reducing emissions and congestion, is underdeveloped.

4.13.3 Export performance

About 57% of Cyprus' domestic exports go to other EU Member States. The island's main export partners are Greece, Germany, the United Kingdom and also Israel. The main export commodities are

pharmaceuticals and photosensitive semiconductor devices. However, despite a relatively strong performance in high-tech and environmental exports, overall the revealed comparative advantage of Cyprus is concentrated in low and medium-to-low technology sectors: food, beverages and tobacco.

Cyprus' trade balance is traditionally in deficit, because it has to import extensively to satisfy domestic demand and depends on oil imports for energy. However, the trade deficit shrank to EUR 4.9 billion in 2011, down from EUR 5.4 billion in 2010, with exports up by 24% and imports down by 4.3%.

On the policy side, the MCIT coordinates efforts to help firms raise their international profile, in particular by participating in international trade fairs, providing financial assistance to SMEs wishing to participate in such events or to carry out market surveys and offering business advice through trade centres in 11 other countries.

4.13.4 Business environment and public administration

According to the World Bank's government effectiveness measure (2012-13), a comprehensive assessment of the overall quality of a public administration, inefficient government bureaucracy is the second biggest problem for those wishing to do business in Cyprus. Along with the wastefulness of government spending and perceived favouritism, particularly complicated areas are services for improved business performance and corporate governance.

Cyprus has failed to address some of the main problems in the business environment. The performance of the judicial system could be considerably improved – the time needed to resolve civil and commercial cases is particularly long as compared with that in other Member States. The trial and judgment period makes up 73% of the total time it takes to enforce a contract. Some of the

shortcomings² are going to be tackled under the economic adjustment programme,³ which also contains measures to improve the real estate market, notably the slow pace of proceedings before national courts.

Further, dealing with construction permits is also time-consuming, as it takes six months on average to obtain a planning permit in towns and another six months to obtain a building permit. Once the building has been completed, it takes another 75 days on average for the final inspection to take place and the conformity certificate to be issued.

However, Cyprus has taken steps to reduce by 20% the administrative burden caused by national legislation. A number of proposals have been submitted in each national priority area, based on a consultant's recommendations and wide consultation of relevant government departments and the private sector.⁴ In particular, these concern the promotion of electronic government, simplifying tax return forms,⁵ and the reduction of administrative burden on businesses by measuring the time and cost for taxpayers to complete revenue administration procedures, and achieving voluntary compliance to the widest possible extent.

The majority of these proposals (19 out of 23) have already been implemented and it is expected that the remainder will be implemented soon. Those already implemented reduce the administrative burden by around 18%, but their full efficacy remains to be seen. For example, the Nicosia Chamber of Commerce and Industry has complained that some measures, e.g. on e-government, have led only to putting existing services online, while procedures remain the same and there is still a need for integration and

coordination between the different services. Although this initiative was announced in the broader context of a better regulation project, improvements to the impact assessment of legislation have yet to be introduced due to budgetary restrictions and a lack of human resources.

4.13.5 Finance and investment

The problems in the banking sector and new restrictions on both domestic and external banking transactions have limited liquidity in the financial markets and led to problems of access to working capital, which may threaten firms' viability. Over 95% of Cypriot businesses have fewer than 10 employees and small firms are less likely to have large reserves of cash and are therefore more vulnerable to any liquidity crisis that may be caused by the capital controls. Thus, there is a high degree of uncertainty about the ultimate effects of banking sector downsizing and capital controls on the real economy, directly and indirectly through business and consumer confidence.

In December 2012, the lending spreads for loans to non-financial corporations were already more than 6.5 pps above the financial institutions' interest rates. Shortage of capital, banks' difficulties in attracting deposits, concerns about the economy and potential loan repayment problems have since further increased loan spreads and margins, without commensurate changes in the respective terms and conditions, i.e. non-interest rate charges and maturity of loans.

Negotiations are ongoing between the Ministry of Finance and the European Investment Fund (EIF) on a National Guarantee Scheme for SMEs, with a total budget of EUR 100 million (50% from the EIF and 50% from the Finance Ministry). The Scheme will involve the creation of a holding fund, to be managed by the EIF, and provide guarantees to commercial banks and subsidised loans to improve SMEs' access to finance.

² See EU Justice Scoreboard 2013 at http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_communication_en.pdf

³ Memorandum of Understanding on Specific Economic Policy Conditionality.

⁴ Civil Registry and Migration Department, Department of Agriculture, Inland Revenue Department, Department of the Registrar of Companies and Official Receiver, Department of Social Insurance Services, Department of Environment, VAT Service, Cyprus Tourism Organisation.

⁵ By enhancing the use of e-filing of tax returns and e-payment, and by facilitating information exchange between tax administration entities.

4.13.6 Conclusions

The crisis has revealed the risks of an economic model heavily dependent on financial services. There is now an opportunity to restructure and modernise the economy along more sustainable lines. Advantage could be taken of the negotiations for the new Structural Funds programming period to provide partial funding to develop a more balanced economic model and fund projects in sectors that suit Cyprus' infrastructure and human capital.

4.14. Latvia

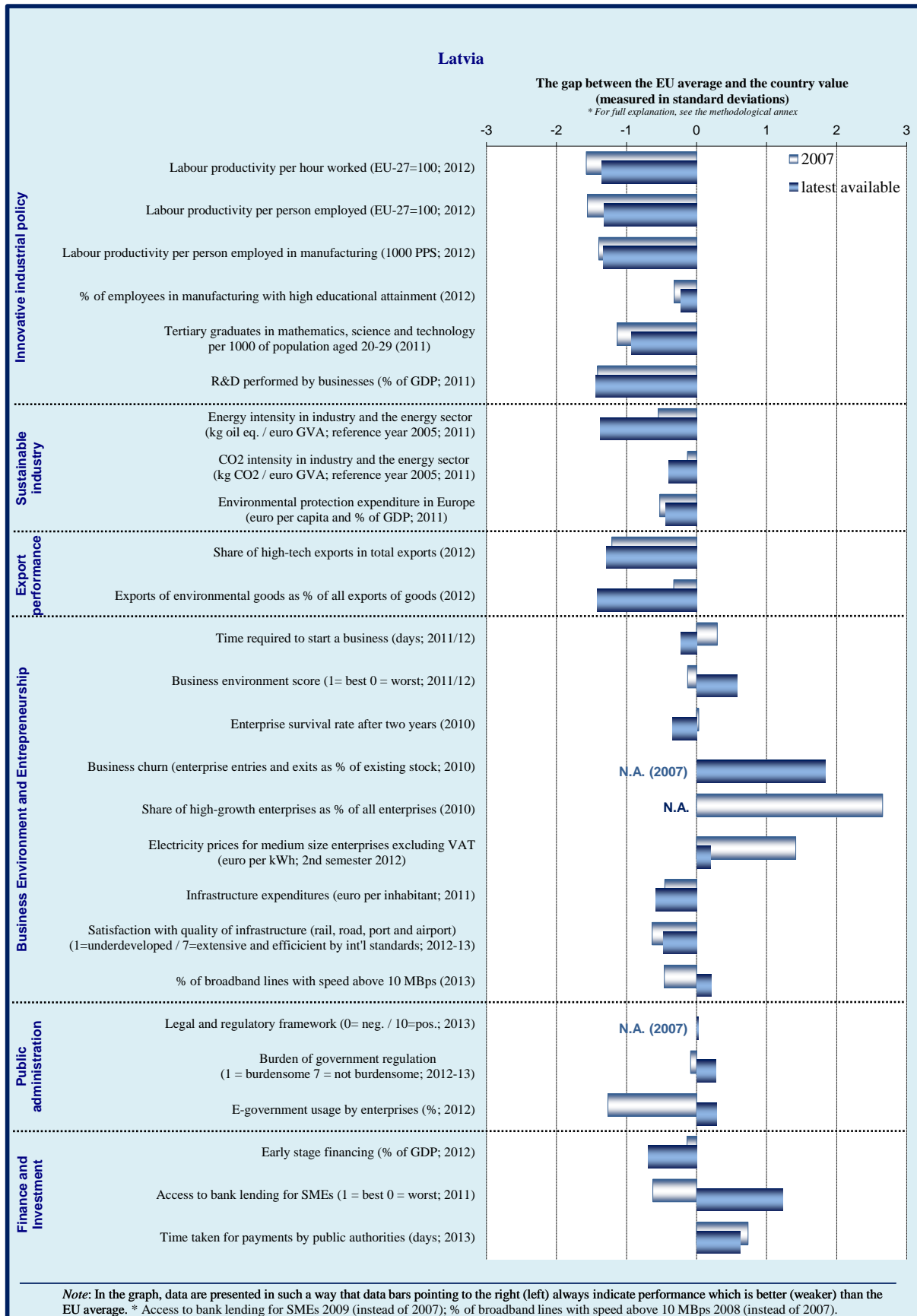
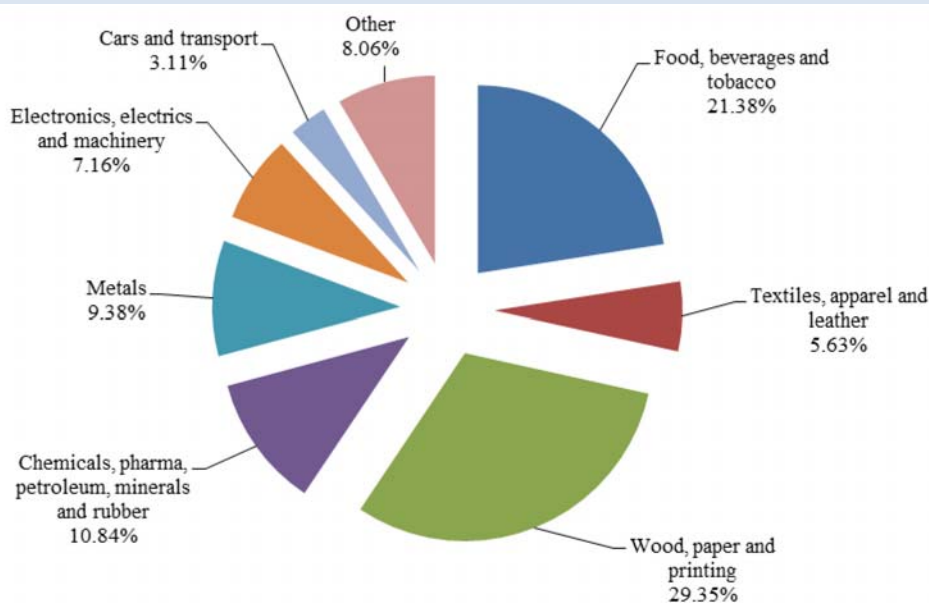


Figure Error! No text of specified style in document..2: Manufacturing sectors – Latvia (2010)

Note : No data available for sectors C12 (tobacco products), C21 (manufacture of basic pharmaceutical products and pharmaceutical preparations) and C32 (other manufacturing)

Source: Eurostat

4.14.1 Introduction

Latvia has seen a fast economic recovery due to regained cost competitiveness and improvements in non-cost competitiveness, driving investment, exports and private consumption. Construction and manufacturing were the fastest growing supply components of GDP. Despite some slowdown, the country's economic growth is forecast to remain among the highest in the EU, at 3.8% in 2013 and 4.1% in 2014.⁶ Labour productivity has increased in five years from 48.9% of the EU average in 2006 to 62.4% in 2011.

Manufacturing is a relatively large part of Latvia's economy (14.5% in 2012, close to the EU average of 15.2%),⁷ and contributes considerably to growth. Processed products — based on natural resources such as food and wood — constitute a half of all manufacturing. Along with metals and machinery, these also contribute considerably to exports. In 2012, industrial production volumes exceeded pre-crisis levels, with all manufacturing sectors up in volume. The highest growth was achieved in the repair and installation of machinery

and equipment, manufacture of basic metals, and manufacture of electrical equipment.

However, the economy faces a number of challenges: despite the improved relative position, the productivity is still low; low-tech (60%) and medium-low-tech (22%) industries are too dominant; and there needs to be a transition from a resource-based to a knowledge-based economy.

4.14.2 Innovation, skills and sustainability

Innovation

The 2013 Innovation Union Scoreboard⁸ puts Latvia in the 'modest innovators' group. Nevertheless, it is one of the rapid growers, with an average annual growth rate of 4.4%, and is one of the few moderate or modest innovators that have managed to improve their innovation performance since the launch of the Europe 2020 Innovation Union flagship initiative in 2010.

Latvia's Europe 2020 target for R&D intensity is 1.5% of GDP. The current level is only 0.7% and

⁶ Commission spring forecast 2013.

⁷ Eurostat 2011.

⁸ Innovation Union Scoreboard 2013. The modest innovators show a low performance level more than 50% below that of the EU-27.

business R&D intensity is the lowest in the EU at 0.19% of GDP in 2011. Licence and patent revenues are relatively low. SMEs are not particularly innovative. Only 17% of SMEs innovate by introducing a new product or a new process, the lowest level (along with Hungary) in the EU.⁹

institutions to increase exports from cluster firms, enhance innovation and develop new products.

The main challenges in research are the shortage of qualified staff, a poor and fragmented infrastructure, and a lack of cooperation between research institutions and businesses. This results in an inadequate commercialisation of research results. The Global Competitiveness Report of the World Economic Forum¹⁰ assessed that business sophistication and innovation could be greatly improved, and the Latvian competitiveness report¹¹ attributed low research performance and limited innovation activity in part to a lack of highly-qualified scientists and engineers. Latvia has one of the lowest numbers of scientific publications in the EU.

Policy measures seek to improve science competitiveness by: involving state scientific institutes in the training of doctoral students and young scientists; promoting international cooperation; developing infrastructure for R&D projects; promoting projects suitable for commercialisation; implementing fundamental and applied research projects; and supporting the development of private sector capacity for research and innovation.

Nine national research centres have been established recently. The centres concentrate research infrastructure and stimulate business-science collaboration and thereby seek to promote scientific excellence and improve commercialisation of science results. A voucher programme for micro, small and medium-sized enterprises is under consideration to support entrepreneurs in the purchase of external services, such as industrial research. In addition, 11 cluster projects are being implemented under the 'cluster programme' (2012-15). These promote cooperation between companies and research and education

⁹ Research and Innovation performance in EU Member States and associated countries (2013).

¹⁰ World Economic Forum *Global Competitiveness Report* (September 2012).

¹¹ Latvian Competitiveness Report 2011.

Skills

The skills mismatch is high,¹² and there is a problem of over qualification,¹³ as institutions of higher and vocational education do not seem to be able to provide the necessary skills for the workforce, and the availability of high-quality work-linked training is limited.

The employment pattern is likely to become more polarised, with large increases both in jobs requiring high qualifications, and in low-skill jobs. Low-skill jobs are projected to be 16% of total jobs in 2020, below the EU average (18%). Employers are pointing to skills shortages in ICT, pharmaceuticals and engineering, as the higher education system has not produced enough graduates in mathematics, science and technology.

To reduce unemployment and to improve the matching of jobs and jobseekers, a legal framework has been developed to make it possible for the long-term unemployed to accept jobs in regions outside their place of residence. A limited pilot project on regional mobility grants is being implemented. Measures to reduce youth unemployment include support for job creation by employers and promoting volunteering in non-governmental organisations.

Sustainability

The goal is that renewable energy sources should represent 40% of final energy consumption, and 10% in the transport sector, by 2020. In 2011, the energy consumption mix had the second-highest proportion of renewables (32.6%) in the EU-27. Although the Government is committed to the target, there has been practically no improvement since 2004. The Government has expressed its intention to develop a new stable, coherent, predictable and cost-effective support framework for renewables, while avoiding changes that affect the legitimate expectations of investors.

Latvia's energy and carbon intensities are more than double the EU-27 averages, with the largest consumers being households and the transport

sector. A new law on the energy performance of buildings was adopted in 2012; it also includes rules on certification, inspection of heating and air conditioning systems, and promotion of near-zero-energy buildings.

Ten projects have recently received financing through an aid scheme that supports the construction of co-generation plants utilising renewable energy resources. In 2012, several projects were completed using the climate change financial instrument that promotes energy efficiency, the increase in the use of renewable energy resources in energy production and the reduction of greenhouse gas emissions.

The Eco-Innovation Observatory ranks Latvia 20th in the EU on its eco-innovation scoreboard.¹⁴ It was less likely to introduce resource-efficiency measures than other Member States, and such measures were unlikely to benefit from public support. A programme on green industry innovation that primarily targets SMEs was launched in 2012, with funding from the Norwegian government. The programme is designed to make new and existing businesses greener, and to stimulate green entrepreneurship and environmental innovation.

Waste generation remains low compared to the EU average. However, 88% of municipal waste goes to landfills and only 10% is recycled — and many agglomerations do not even collect all waste water. A new waste management plan for 2013-20 is looking to break the link between economic growth and waste generation and its impact on the environment. It seeks to reduce the generation of waste, promote re-use and extended use, and reduce the materials and products used in the production of harmful substances. Water supply and waste water treatment services were upgraded in 2012, and waste management projects concerning landfills and collection were implemented in 2012.

4.14.3 Export performance

Growth has recently been driven by an increase in exports, mainly in goods. The value of exports increased by 15.5% from 2011 to 2012, and the exports of goods and services were growing faster than imports. The main export partners are the EU

¹² Skills mismatches and labour mobility, http://ec.europa.eu/europe2020/pdf/themes/27_skills_gaps_and_labour_mobility.pdf.

¹³ See figure 4.15 below.

¹⁴ Eco-innovation in Latvia, EIO Country Profile 2011.

(69%) and the Commonwealth of Independent States (16%).

Although exports remain to a large extent dependent on low value-added industries with low technology intake, exports of knowledge-intensive goods and services have grown more rapidly than total exports over the last five years.¹⁵ The most important exports are agriculture and food products (20%), wood and wood products (15%), metal and metal articles (14%) and machinery products (14%). Domestic demand and exports are projected to expand at similar rates in 2013.¹⁶

To improve access to export markets, export guarantees and advice are available. In addition, the integration of businesses into international supply chains is promoted by encouraging them to participate in international exhibitions and trade missions. The network of Latvian foreign economic representative offices abroad expanded in 2012 and there are currently 14 such offices.

4.14.4 Business environment and public administration

Business environment

Latvia was ranked 25th of 185 countries (8th in EU) in the World Bank's Doing Business report 2013.¹⁷ It increased its global competitiveness ranking from 64th to 55th in the 2012–13 report of the World Economic Forum. Its administration is responsive according to the Small Business Act fact sheets on implementation.¹⁸ Latvia scores substantially below the EU average only in the indicator on the time needed to comply with major taxes, but considerably above the EU average in four indicators: paid-in minimum capital, cost required to transfer property, number of tax payments by year and full online availability of basic public services to businesses.

The joint state and municipal e-services portal (latvija.lv) provides access to 60 e-services, of

which 11 were introduced in 2012. The main achievements of the 2012 action plan to improve the business environment have been the introduction of electronic registration of businesses in the commercial register, and an e-treasury (no need to submit a statement as a proof of paid services, state fees and tax payments). Further, amendments were made to the commercial code to protect investor rights. After changes in VAT regulations, the time required to register a business in the state revenue service was reduced from 10 working days to 5 from the beginning of 2013.

Several programmes promote entrepreneurship, in particular the creation and growth of new businesses, especially innovative ones. So far, more than 28 000 businesses have opted for the simplified taxation regime for micro-enterprises introduced in 2010.

A national broadband strategy for a substantial upgrade to broadband infrastructure was adopted in December 2012. In terms of internet connection speeds, Latvia is already ranked the best country in Europe.¹⁹ However, there is room for further improvement in rural broadband coverage. In 2012, a procurement procedure was launched for the 'Next generation network for rural areas' programme, and construction will begin in 2013.

Investments in transport infrastructure have not been sufficient in the last 20 years. EU financing is gradually improving it, but not enough to radically improve the road network quality.

Public administration

The quality of public administration is considerably below the EU average as measured by the World Bank's government effectiveness indicator.²⁰ Perceptions of the quality of public services were in particular below average. Better than average performance was seen in the use of tools for administrative modernisation. The costs of starting a business are significantly lower than the EU average and licensing procedures are convenient. However, obtaining licences and permits is still problematic in construction.

¹⁵ See figure 1.12.

¹⁶ EU Economic forecasts, Spring forecast 2013.

¹⁷ Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises. It should be noted that the adoption of a Construction Law, which will step into force in February 2014, should lead to improvements in the next edition.

¹⁸ The SBA Fact Sheets (2012).

¹⁹ Akamai: State of the Internet report Q4 2012.

²⁰ Excellence in public administration for competitiveness in EU Member States.

The 2012 Corruption Perceptions Index ranks Latvia 21st in the EU.²¹ The Corruption Prevention and Combating Bureau has identified specific corruption risks in public procurement and utilities, local government and state-owned companies, and also in other areas where legal norms are ambiguous.

According to the 2013 EU justice scoreboard,²² the Latvian judicial system has lengthy proceedings for civil and commercial first instance cases, and low clearance rates increase the backlog of court cases. The human resource management and professional development within the judiciary could be improved. Recent reforms include amendments to the law on judicial power, and to civil, administrative and criminal procedural law, but it is too early to assess whether they are sufficient to fully address all the shortcomings. The reforms have been proposed or partly implemented, and amendments have also been proposed to certain aspects of insolvency law. Communication between courts and the general public has been improved through information and communications technologies (ICT), which should increase quality and transparency in the system.

To reduce labour taxes, Latvia has a three-year strategy to lower the personal income tax rate from 25% to 20%. The first step (lowering to 24%) came into effect in January 2013. The standard VAT rate, which had previously been increased significantly during the crisis, was lowered by one percentage point to 21% from 1 July 2012.

Since the end of 2011, Latvia has introduced new measures to fight VAT fraud in the fields of construction and scrap metal. Several legislative measures were carried out in 2012 as part of the plan for combating the grey economy and ensuring fair competition for 2010–13. Measures included amendments to the law on taxes and fees, simplification of tax payment regimes, and promotion of closer, more efficient cooperation between taxpayers and the tax administration by reducing administrative burden. Moreover, the new law on individual property declarations and reporting of undeclared income makes it possible to regularise previously undeclared taxable income. It

aims to improve oversight of an individual's financial position. The impact of recent policy measures is gradually translating into improved tax collection rates, particularly visible in 2012, when the annual increase in total tax revenue as reported by Eurostat was above GDP growth. According to the World Bank Paying Taxes Report 2013,²³ the costs of tax compliance in Latvia are relatively high despite recent improvements.

4.14.5 Finance and investment

On average, relatively few SMEs indicate that access to finance is their most important problem.²⁴ Most indicators on access to finance are considerably better than the EU average, including in access to public financial support, the perceived willingness of banks to give a loan, the strength of legal rights and the interest rate difference between loans above or below EUR 1 million. The World Bank²⁵ ranks Latvia among the top performers for ease of getting credit and for the level of legal rights for borrowers and lenders. An important initiative — long awaited by business organisations — is the creation of a single institute responsible for all support instruments; a one-stop shop for access to finance should be operational by the end of 2013.

Investment incentives include corporate income tax rebates on large-scale investment projects, a beneficial depreciation ratio for new technological equipment, a carry-forward of losses, and several labour-related incentives at different stages of the hiring process. There are also four special economic zones and a corporate income tax rate of 15%, which is one of the lowest in the EU. Financial incentives include state and EU-supported loans, credit guarantees and venture capital. A recently implemented investment strategy focuses on an alliance between seven major stakeholders from the public, private and academic sectors aiming to promote foreign direct investment in Latvia.

At the end of 2012, investment from EU Member States was 72% of total foreign investment stock, with Swedish firms the biggest investors (24%). The main sectors were financial services and insurance (27%), wholesale and retail trade (14%),

²¹ Transparency International Corruption Perceptions Index 2012.

²² EU Justice scoreboard 2013.

²³ Paying Taxes 2013, The global picture.

²⁴ See the SBA Fact Sheet for Latvia 2012.

²⁵ The World Bank *Doing Business* (Oct 2012).

real estate (13%) and manufacturing (12%). Efficient company start-up procedures and free tailor-made services are examples of support for foreign investors. The total number of foreign direct investment projects has almost doubled to 90, with initial inquiries tripling to 381 between 2009 and 2012.

4.14.6 Conclusions

One of the main challenges for Latvia is the transition from low to medium and high technology sectors. This would require investment in research and innovation, but R&D funding and involvement from industry, and the current R&D intensity, are low.

However, Latvia offers an attractive financing environment, and many well-established and export-oriented companies seem to have little trouble accessing credit. Growth is expected to continue to rely on improved competitiveness, driving investment, exports and private consumption.

4.15. Lithuania

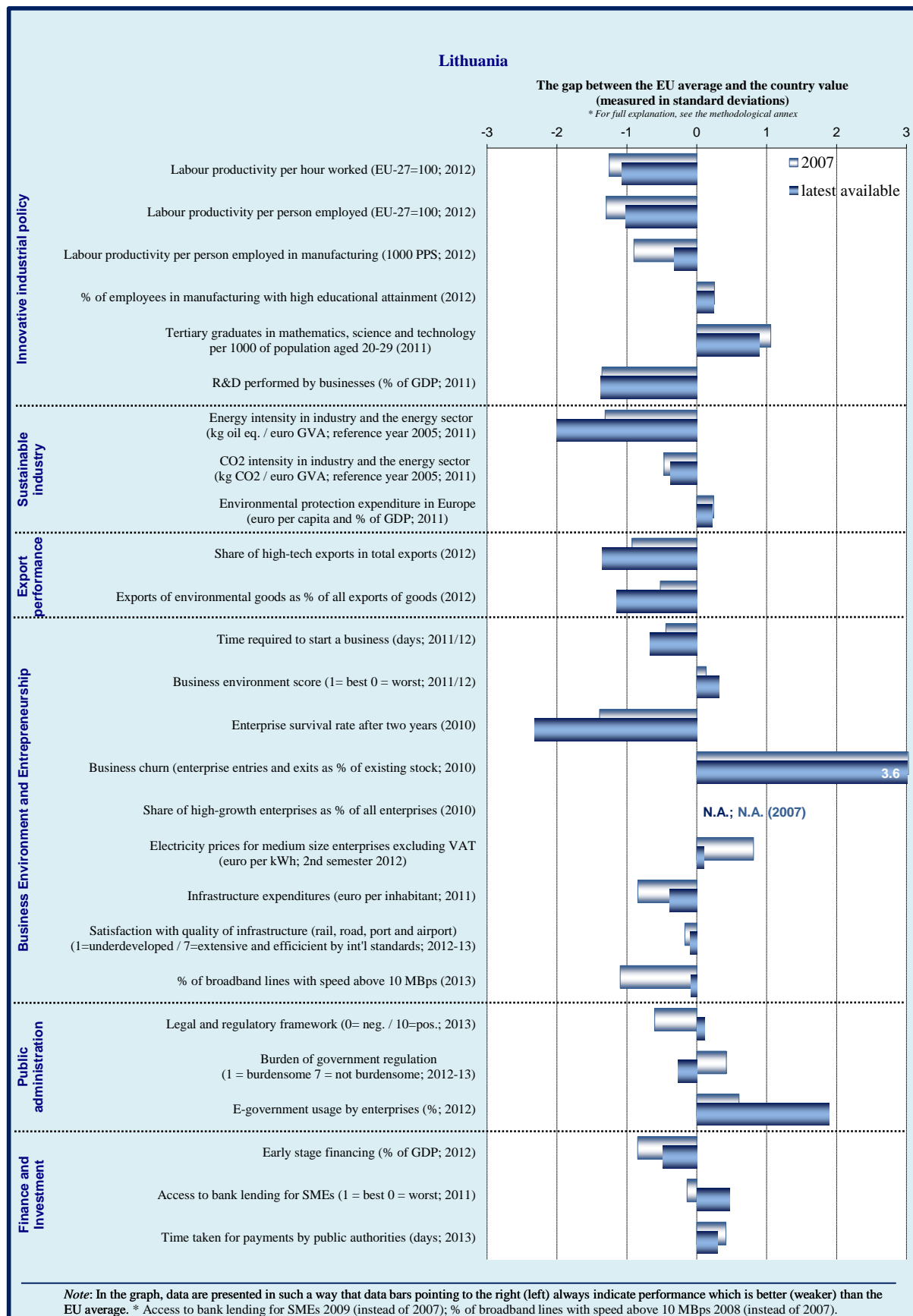
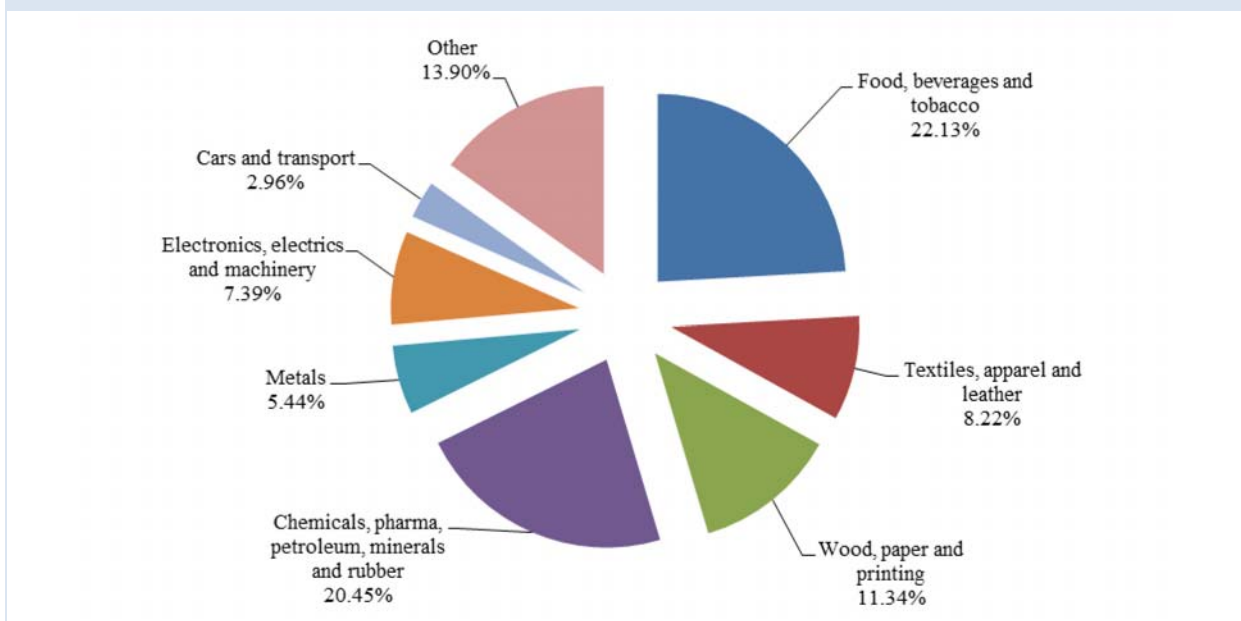


Figure Error! No text of specified style in document..3: Manufacturing sectors – Lithuania (2010)

Note: No data available for sectors C12 (tobacco products) and C19 (coke and refined petroleum products)

Source: Eurostat

4.15.1 Introduction

Lithuania's relatively large manufacturing sector (about 20% of gross value added) mainly comprised of low-to-medium technology industries. It is specialised in labour-intensive (wood, paper and printing) and marketing-driven (food and beverages) industries in terms of value added and exports. It also specialises in capital-intensive industries (e.g. refined petroleum products). At the more aggregated sector level, low and medium-low innovation and education sectors (clothing, inland transport) and medium-high sectors (textiles, coke and refined petroleum) are a major base for Lithuania's exports.

Labour productivity (output per person employed) in Lithuania is 65% of the EU average.²⁶ Both nominal and real unit labour costs have fallen since 2009 due to subdued wage levels and rising output. The significant fall in the real effective exchange rate²⁷ has driven a rebound in exports. Although productivity has continued to grow in line with the long-term trend, there is a risk that these gains could be partially undermined as the labour market continues to tighten. Additionally, the Lithuanian

government recently increased the minimum wage by around 25%, which may put further upward pressure on wages. Despite labour market shortages, unemployment remains high and continues to act as a major drag on growth despite falling since 2009.

The services sector is the largest in the Lithuanian economy, accounting for just under two-thirds of GDP and attracting around a half of total foreign direct investment. The Lithuanian government has set a strategic goal to become the northern European service hub by 2015, when services are expected to make up around a half of Lithuania's exports. One of the most important sub-sectors is information and communication technologies (ICT); Lithuania's well-developed ICT infrastructure has helped it attract business outsourcing services from some of the EU's largest corporations.

4.15.2 Innovation, skills and sustainability

Innovation

The Lithuanian economy has been upgraded to 'moderate innovator' in the most recent edition of

²⁶ Productivity per person employed, based on the latest available figures from Eurostat (2011).

²⁷ Based on unit labour costs.

the Commission's Innovation Union Scoreboard.²⁸ Previously, it had been a 'modest innovator' – the lowest performance group – for several years. The upgrading is due to marginal improvements in innovation performance across all eight dimensions measured. Lithuania's innovation performance grew by 5% compared with 2012, exceeded only by Estonia, and the five-year innovation growth rate accelerated from 4.2% to 5%. Lithuania is the growth leader in the group of 'moderate innovators'. However, despite recent progress, Lithuania's innovation performance is still well below the EU average.

The Lithuanian economy is still comparatively weak in the categories of 'open, excellent and attractive research systems', 'linkages and entrepreneurship', 'intellectual assets', 'innovators' and 'economic effects', where it scores well below the EU average. The only category where Lithuania scores above the average is in 'human resources'. As for 'firm investments', weak private sector R&D expenditure is offset by comparatively high non-R&D innovation expenditure. Lithuania's R&D intensity increased substantially in 2011 to reach 0.92% of GDP, after five years of relative stagnation at around 0.8%. However, this is still less than half of Lithuania's target of 1.9% for 2020. Most of Lithuania's R&D investment gap with the other EU countries is due to a lack of business investment, which was 0.24% of GDP in 2011. The Innovation Union Scoreboard also indicates underperformance in collaboration between public research organisations and businesses, knowledge transfer and commercialisation of research results. The composition of Lithuanian industry, which is biased towards less R&D-intensive industries, is a further contributing factor to the gap.

Lithuania's authorities are continuing to implement measures to foster innovative businesses and collaboration between science and industry, in particular, through the development of five clusters ('valleys') which bring together universities, research institutes and businesses. Lithuania has also introduced financial incentives, including R&D tax credits and innovation vouchers, to help businesses procure R&D services and to contract technical feasibility studies from universities and

research institutes. Although there has been robust growth in intellectual assets over the last year, this has been from a low base.

Skills

Business organisations have indicated the lack of technical and business skills as a restraining factor on employment growth. Significant skills mismatches hinder labour force adaptability and productivity. This is further aggravated by the low participation in vocational and educational training, apprenticeships and childhood education. Participation in lifelong learning is one of the lowest in the EU²⁹, further amplifying challenges to equip low-skilled and older workers with the possibility to respond better to labour market needs.

The schools produce relatively weak results in terms of basic skills: 15-year olds' performance on PISA tests remains below the EU average in reading (the share of low-achievers is 24.3% vs. the EU average of 20% in 2009) and maths (the share of low-achievers is 26.2% vs. the EU average of 22.2% in 2009). However, Lithuania reached two European targets in education – tertiary attainment rate was 48.7% and early school leaving was 6.5% (2012). While tertiary educational attainment among women aged 30-34 is high at 53.3%, the figure for men is much lower (37.6%) and the early school leaving rate for men is twice as high (10.6% as compared with 5.0% for women in 2011).

Sustainability

Lithuania is one of the EU's most energy and carbon-intensive economies, with a level of environmental taxation below the EU average. Its energy consumption is more than twice the average and has been increasing over the last decade, mostly because of the emissions-intensive transport sector, but also due to the residential and service sectors. Household heating, particularly in apartment blocks, is inefficient and in need of renewal. Although the quantity of waste per capita in Lithuania is amongst the lowest of EU Member States, the waste management system remains heavily dependent on landfill, and the re-cycling level (6% in 2010) is one of the lowest in the EU.

²⁸ Moderate innovators are 50-90% of the EU average in terms of innovation performance.

²⁹ Latvia 5.2%, EU average 9%.

The authorities are continuing to consolidate local landfill sites into upgraded regional facilities and have introduced several green waste composting facilities.

4.15.3 Export performance

Lithuania's exports are mainly composed of goods, which make up around 83% of all exports, in line with the slight industrial bias of the economy compared to the EU average. Lithuania's goods exports are mainly concentrated in low-to-medium technology sectors, notably mineral fuels (25%), transport (7%), machinery and mechanical appliances (6%), plastics (6%) and furniture (5%). Exports of high value-added industries, such as electronics, computing, and pharmaceuticals, are comparatively small but growing. The computer and optical equipment sector, the most sizeable high value-added industry, has been able to expand into niche export markets. Lithuanian lasers for scientific research have proven to be competitive in international markets. High-tech exports currently represent 5.6% of overall exports, compared to 15.4% in the EU. Services exports are a small proportion of overall exports, but have been growing rapidly in recent years. The main sectors are transportation (including freight forwarding and warehousing) and tourism, which has been boosted by improved transport links, IT services and construction services.

Lithuania's main export partners in 2012 were the EU and the Commonwealth of Independent States (CIS), accounting for 61% and 30% of exports respectively. Within the EU, Latvia is by far the largest export destination, receiving around 11% of exports, followed by Estonia and Germany. Since 2009, exports to the EU have declined by two percentage points, on account of weak demand, while exports to the CIS have grown significantly by seven percentage points, partly due to an expansionary fiscal policy in Russia. Net exports were the main driver of growth in 2012, aided by a continuing decline in the real effective exchange rate, which has helped sustain a rebound in exports since 2009. Exports rose 15% year-on-year, pulled by strong demand from Russia as well as a bumper harvest that boosted the supply of food exports. The trade balance turned marginally positive in 2012, helped by an improvement in the terms of trade, partly driven by higher cereal prices and lower oil prices.

Export policy is based on various elements: support and advice to businesses provided by the government agency, Enterprise Lithuania, and the network of overseas trade delegations; EU-supported schemes to encourage businesses to forge partnerships with other EU businesses; and guarantees for export credit insurance, provided by the agency Invega, which promotes small and medium-sized enterprises (SMEs). Lithuania is well positioned to take advantage of EU export markets in high value-added industries given its well educated workforce and comparatively low labour costs.

4.15.4 Business environment and public administration

Business environment

Lithuania's overall rank in the World Bank's 2013 Doing Business report fell one place from 26 to 27, compared with 2012. The regulatory burden (e.g. number of procedures and time required to complete them) associated with individual business indicators remained roughly the same, or in some cases showed some slight improvement as compared with the previous year. The cost of completing business procedures fell in most cases, in terms of percentage of income per capita, particularly for 'starting a business'; online registration was implemented for limited liability companies and the need for a notary was removed. The required level of paid-in capital is still comparatively high but fell slightly in 2012. A new category of limited liability company — 'small partnership' — was created in 2012, characterised by no minimum level of paid-in capital, simple and flexible management structure, possibility to register online (in no more than three working days after filing the necessary documents), and lower registration costs (less than EUR 100). Export and import procedures were revised to reduce costs for businesses and administrative delays. Lithuania's rank on 'getting electricity' is brought down by the length of time necessary to complete procedures, even though the costs to businesses associated with the procedures themselves are comparatively low.

Electricity and gas prices for businesses are high compared with the EU average, partly on account of weak interconnectivity. Lithuania has some of the highest electricity network costs in the EU, which account for a significant portion of the price.

Several initiatives to connect with EU gas and electricity networks are on-going and are at contractual and implementation stages. For the gas sector, authorities have launched several projects to improve transmission, interconnectivity and diversification of supply. In June 2012, Lithuania joined the Nord Pool Spot international electricity exchange to increase integration into the EU electricity market. The Lithuanian authorities are also developing a liquefied natural gas (LNG) terminal and plan to construct an interconnector between Lithuania and Poland. For the electricity sector, the Lithuanian and Swedish authorities have recently given their approval to the Nordbalt/SwedLit project, involving the construction of a submarine power cable between Klaipėda in Lithuania and Nybro in Sweden. The project aims to promote trading between Baltic and Nordic electricity markets and increase the security of power supply.

Improving the transport infrastructure, in particular rail transport, could facilitate business transports considerably. Electrification and a north-south link as part of the Rail Baltic project would also help access to European markets.

Public administration

Lithuania plans to introduce systemic changes in its administration by implementing the Public Management Development Programme for 2012-20, which was adopted in 2012. Additionally, the government has pledged to continue improving the efficiency and client orientation of public administration, by simplifying administrative procedures for citizens and businesses, improving impact assessment and public financial management, and increasing public involvement in decision-making processes. Lithuania is undertaking a major regulatory reform project to streamline business inspection institutions. Currently business inspections are carried out by 60 public institutions; the reform aims to consolidate and optimise their functions by 2016. In 2012, authorities began to evaluate the effectiveness of business inspection institutions as part of the exercise. The Lithuanian authorities have also started to review business permits, with the aim of reducing the number of permits for which businesses have to apply. The review should be completed by the end of 2014.

Since 2010, the government has been undertaking a far-reaching reform of state-owned enterprises (SOEs), covering 136 entities engaged in economic activities with a combined asset value of around 25% of GDP. The objective is to restructure corporate governance, increase transparency and enhance competition and efficiency. The reform involves legislative and organisational changes, and performance targets. The legislative aspects of the reform have been completed. Transparency and accountability have significantly improved as reports are now published on a quarterly and annual basis and clear enterprise objectives have been established. The government should continue monitoring progress on implementation of the resolutions adopted.

4.15.5 Finance and investment

The banking sector remains stable with improving fundamentals: the level of non-performing loans, albeit still high, has fallen, capital adequacy has risen and profitability has recovered. Interest rates for private sector loans are at record low levels and the central bank has maintained its commitment to the LTS/EUR currency peg, which continues to underpin euro-based lending. Only a very small number of businesses have reported a negative impact on the supply of lending from the collapse of Bankas Snoras.³⁰ A second bank, Ukio Bankas, with a share of around 4% of market lending, collapsed in February 2013. The good assets and insured liabilities of the bank have been taken over by Siauliu Bankas, while the bad loans and uninsured liabilities will be offered to the market in the course of bankruptcy proceedings.

There is not expected to be any negative impact on lending to businesses. In spite of these factors, lending to business rose only slightly in 2012 as demand remained weak. This is mainly due to the uncertain economic outlook, while some SMEs have found credit restricted due to the sharp fall in collateral values as a consequence of the crisis. The latest indicators have shown some improvement in confidence, in both manufacturing and service sectors, which may spur credit growth in future. Optimism amongst SMEs is also starting to grow, but they are continuing to reduce their debts

³⁰ Based on a recent government survey, 1% of businesses reported a negative impact on the availability of finance due to the collapse of AB Bankas Snoras.

(deleverage) and remain cautious about embarking on new investment.

The government continues to support SMEs through EU structural funds.³¹ In 2012, the government launched a new Creation Innovation Fund to support innovative start-ups, administered by the national holding fund Invega. A call for tender for a fund manager is currently ongoing. In September, the European Investment Fund (EIF) and the governments of Lithuania, Latvia and Estonia launched a new and innovative investment initiative, dedicated to boosting equity investments in Baltic SMEs. The Baltic Innovation Fund will invest EUR 100 million in private equity and venture capital funds focused on the Baltic States over the next four years. The EIF will require private investors to provide 50 % of the finance, so the total amount of funds available for investments will double to EUR 200 million.

The global financial crisis has had a profound impact on the Lithuanian economy. The level of investment fell sharply in 2009, forcing some restructuring of industry. Partly as a consequence, the economy has undergone a shift to higher value-added services and goods. Investment recovered in 2011, reaching the pre-crisis level of foreign direct investment. Expenditure on infrastructure (euros per inhabitant) is approximately 11 % below the EU average. The weak economic outlook, at home and for Lithuania's main trading partners, has diminished confidence in further expansion. According to business surveys, up to 90 % of businesses consider their production capacity to be sufficient or even excessive.

4.15.6 Conclusions

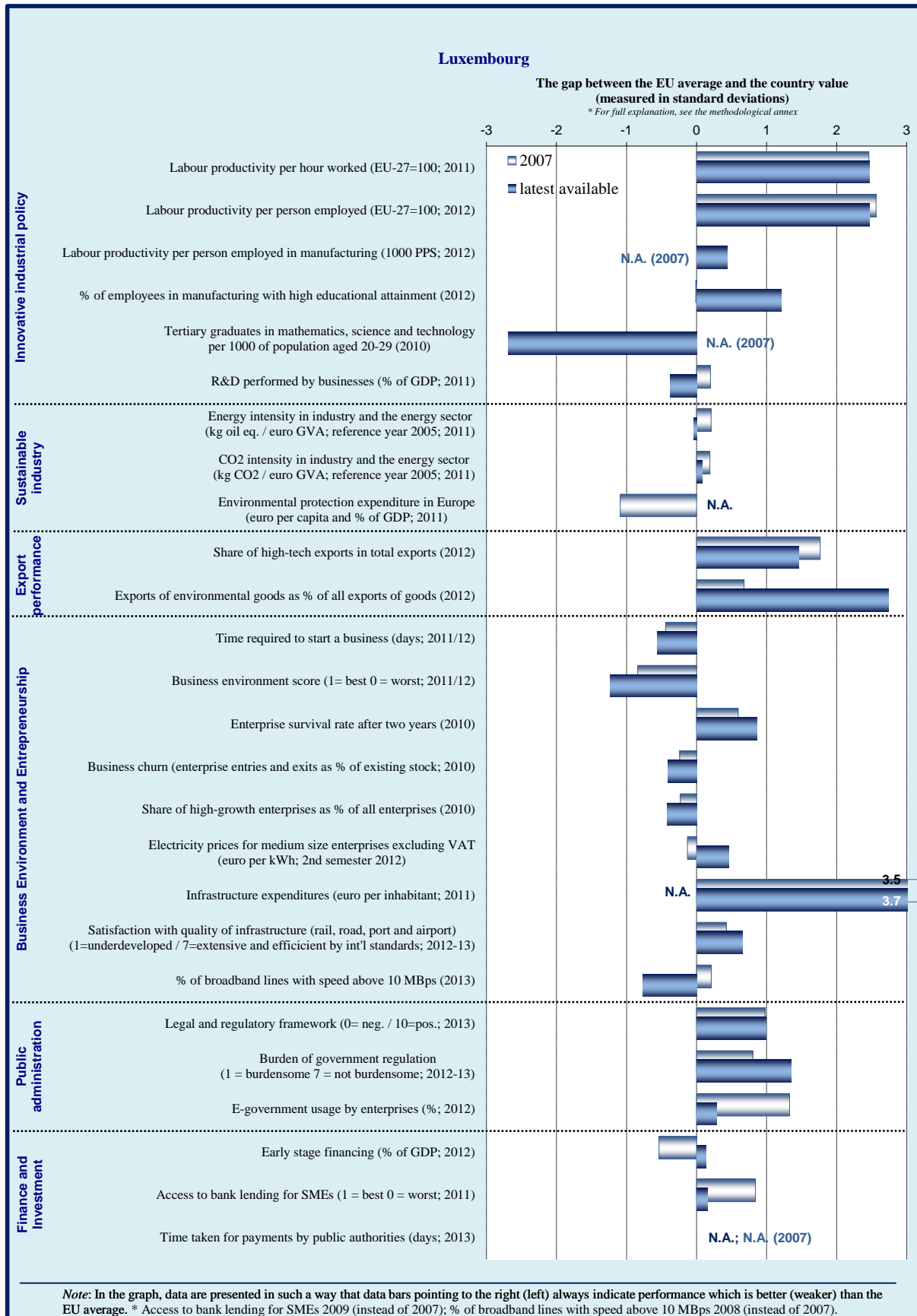
The Lithuanian economy has rebounded quickly from the crisis mainly due to rising exports partly driven by an improvement in price competitiveness. The economy has the potential to continue to grow strongly, thanks to a well-educated workforce, strong trade links and a strategic position. Industry is gradually shifting from low-to-medium to higher value-added manufacturing and Lithuania is

developing expertise in knowledge-intensive services, such as IT outsourcing.

Nevertheless, there are challenges remaining. Electricity and gas prices for businesses are high compared to the EU average and Lithuania is one of the most energy and carbon-intensive economies in the EU. Although the administrative burden for businesses has been lightened, there is still room for further progress in several areas, particularly for licences and permits and the number of inspections by government agencies. Businesses still report a lack of technical and business skills and investment remains weak, particularly in R&D, which is restraining potential growth. Finally, reform of state-owned enterprises should be completed to ensure transparency.

³¹ There are two holding funds in operation funded by the ERDF with a total allocation of EUR 228 million: the JEREMIE Fund administered by the EIF (EUR 170 million), and a fund administered by Invega (EUR 58 million).

4.16. Luxembourg



4.16.1 Introduction

Luxembourg's economy is strongly service-oriented, as manufacturing industries represented less than 7 % of value added in 2012 (15.3 % in the EU). Luxembourg is specialised in capital-intensive industries (basic iron and steel, cement, basic non-ferrous metals), mainstream manufacturing industries (rubber products) and technology-driven industries (media, information and communication technologies). Manufacturing industries employ about 9 % of the labour force (22.6 % in the EU).

Labour productivity is among the highest in the EU, but it has lost some of its price competitiveness over the last decade mostly due to high wage increases coupled with low or negative productivity growth. Economic growth was sluggish in 2012, and this is projected continue through 2013. GDP growth was on average 3.1 % over the period 2000-11. The domestic consumption and export of services, in particular financial intermediation but also transport, communications, insurance and other business services, largely contributed to this result.

The factors that supported employment in 2012, such as labour hoarding or a reduction in the number of hours worked, are projected to have a smaller impact on the labour market in 2013 because of the continuing uncertainty, and unemployment that has already been rising since the second half of 2012 is likely to continue to rise, also due to the growing labour force. Youth unemployment is relatively high at 18.0 % of the total active population in 2012, compared to an overall unemployment rate of 5.0 %. The situation for migrants and young people with low skills remains difficult, despite a number of policy initiatives. Added to the recent slowdown of the economy's main growth engine, the financial sector, the country's vulnerability has become more visible.

4.16.2 Innovation, skills and sustainability

Innovation

The 2013 Innovation Union Scoreboard ranks Luxembourg as an innovation follower with innovation performance above the EU average.

Despite an open and attractive research system, relative weaknesses remain in corporate investments (business R&D expenditure, innovation by non-R&D firms) and in the diffusion of innovation (sales of new-to-market products).³²

Public funding of research and innovation has increased,³³ with the second generation of performance contracts for 2011-13 signed between the Ministry of Higher Education and Research (MESR) and the National Research Fund and Public Research Centres (PRCs), and between the MESR and the Ministry of the Economy and Foreign Trade and Luxinnovation. A contract for 2010-13 has also been concluded between the state and the University of Luxembourg. Under the law that provides subsidies to private-sector R&D and innovation, the goal is to support 240 programmes and projects during 2011-13, compared to 143 in 2008-10. The funds allocated are expected to increase from EUR 46 million in 2011 to EUR 65 million in 2013.

Despite the increase in public R&D funding, the R&D and innovation system faces several challenges. There is a requirement for public research institutions to generate third-party funding as a prerequisite for receiving government funding, and the funding received is expected to generate spin-offs, patents and other forms of IP, these goals have not been met. Further, a critical mass of researchers is needed for R&D in order that enough of the output results in innovation.³⁴ Third, there is a need to increase participation in international consortia³⁵ through programmes such as FP7; and fourth, innovation in services should be enhanced³⁶ (special action plans for the benefit of logistics, health technologies, eco-technologies and eco-innovation are currently being implemented —

³² For details see "Research and Innovation performance in EU Member States and Associated Countries, Innovation Union progress at country level, 2013".

³³ Source: PRO INNO Europe.

³⁴ The ATTRACT and PEARL 2008-13 programmes of the National Fund for Research (FNR — *Fonds national de la recherche*) aim to attract researchers to Luxembourg and keep them in the country.

³⁵ Luxembourg already has numerous cross-border cooperation agreements, in particular with other EU Member States.

³⁶ This is one of the priorities of the CORE programme of the National Fund for Research.

some of them comprising the development of clusters).

Luxembourg has over the last two decades rapidly built up its public research capacities, from a situation where, 25 years ago, the public research system was non-existent. The contribution of these efforts to the economy remains limited, in particular in terms of the relatively modest level of cooperation between public research institutions and firms, and taking into account the sharp decline of business R&D intensity (from 1.53% in 2000 to 0.98% in 2011). The development of a more focused smart specialisation strategy could play a crucial role in maximising the economic impact of public research funding, in particular through ensuring a more significant leverage effect on private investments. In this context, support for clusters has the potential to play a much more important role in the R&D and innovation policy.

Skills

The situation for workers with low skills (in particular migrants and young residents) is difficult despite a large number of government and business initiatives. Young residents face fierce competition for jobs from non-residents, who are often more skilled. This raises the question of the performance of the education system, as PISA tests³⁷ indicate it is around or below the EU average. A further challenge are the language requirements that are especially challenging given the high proportion of foreign-born people in the population (40%) who have an additional family language.

Further, specific skills are required by the highly specialised labour market (in particular in financial and legal services, and in technologically advanced professions). A reform of secondary schools is currently being prepared and new guidance will be given this year for classes from primary education to the lower secondary school. Adult participation in lifelong learning has increased over the last few years and reached 13.6% in 2011, but an even higher adult participation rate is needed to tackle the country's structural unemployment, as residents are facing competition from a large pool of often highly skilled potential workers from neighbouring countries. Further focus on employability of the

³⁷ There has been a negative trend in reading, mathematics and science since 2006.

population aged 55-64 with a low education level is needed.³⁸

Sustainability

Luxembourg has committed itself to reducing its greenhouse gas emissions not covered by the European trading system (ETS) by 20% in 2020 compared to 2005. It is unlikely to meet the target solely through national measures — based on existing actions, emissions are projected to increase 0.3% by 2020 compared to 2005, leading to a gap of over 20 percentage points. This issue was included in a country-specific recommendation both in 2012 and 2013.

The transport sector was responsible for 68% of non-ETS emissions in 2011. In January 2013, the excise tax on diesel was increased from EUR 330 per 1000 litres to EUR 335. However, the still relatively low fuel taxes weaken incentives to use public transport, and create strong incentives for both private car owners in the region and drivers of heavy vehicles in transit to make a detour to fill up their tanks in Luxembourg. The efficiency of newly registered vehicles improved substantially between 2005 and 2012, but at 138.4 g CO₂/km driven they were still 5% above the EU average.

The efforts to promote energy efficiency focus mainly on buildings, with various initiatives to reduce energy use in the residential sector. A voluntary agreement is in place with 66 private companies to implement an energy management system and to establish an action programme to conserve energy. The effect is expected to be relatively limited in terms of energy efficiency. Several energy efficiency programmes aim to increase cooperation and sharing of best practices, both within Luxembourg — in the context of the *climate pact* with municipalities — and with its neighbours. Between 2005 and 2011, renewable energy consumption as a proportion of total consumption doubled in Luxembourg to 2.9%, which is still far from the 11% target for 2020. The use of renewable energy in transport is lagging behind: in 2011, the share of renewable energy (mainly biofuels) in all energy consumed in

³⁸ A White Paper on lifelong learning strategies was published in November 2012. LLL in the private sector will be co-financed by the state at a rate of 20% instead of 14.5% (35% for young unskilled workers and older workers), in line with Euro Plus Pact commitments.

transport was only 2%, some distance from the 2020 target of 10%.

4.16.3 Export performance

Luxembourg has achieved excellent export performance in terms of knowledge-intensive services (about 80% of total service exports, three quarters of which are financial services) and in high-tech exports of goods (about 30% of total goods exports).

However, although largely positive in the 2000s, the contribution of the balance of goods and services to GDP has been negative since 2010 — whereas trade has contributed positively to growth both in the EU as a whole, and in the euro area, which is Luxembourg's principal export market. The economy remains very sensitive to the export performance of financial services. Even with a return of growth to the euro area, any further unrest in financial markets worldwide could limit the contribution of trade to growth in Luxembourg.

4.16.4 Business environment and public administration

The results of the World Bank's 2013 Doing Business survey are in line with those of the previous survey. Enforcing contracts and paying taxes remain very strong points. Out of 185 economies, Luxembourg ranks first for the first item and 14th for the second one, thanks to the very short time needed to prepare and file tax returns and to pay taxes. The time required to start-up a company remains 19 days, well above the EU average of 6.5 days.

The Small Business Act 2012 factsheet for Luxembourg highlights that in terms of value added, SMEs contribute much more to the country's economy (almost 73%) than in the EU on average (58%).³⁹ The sector distribution of SME activity clearly underlines the fact that Luxembourg is a service-based economy, where SMEs active in services represent 58% of all businesses (EU average 45%), account for 45% of total

employment (EU average 40%) and contribute two thirds of total value added (EU average 43%). More than a third (36%) of all service-oriented SMEs are knowledge-intensive (EU average 28%). High- and medium-high-tech SMEs represent only 9% of Luxembourg's enterprises (EU average 12%) and contribute only 17% to total value added (EU average 30%).

Luxembourg's economy remains open and business-friendly. The efforts to provide an environment conducive to SMEs are reflected in the policy measures taken recently, such as the *National action plan for SMEs* (the fourth one being about to be put in place), or the creation this year of a high-level committee for the support, development and promotion of industry. The national SME envoy (appointed in April 2011) has been monitoring delays and advances in the implementation of Luxembourg's third action plan for SMEs and has ensured that the interests of SMEs are taken into account in major pieces of relevant legislation. Hence, the government has demonstrated a strong commitment to the interest of businesses (and in particular SMEs), along with a determination to learn from good international practices. More comprehensive reforms would include the need to further address issues such as insolvency, reforming the rules on second-chance entrepreneurship, transparency of the public procurement system, and a more comprehensive administrative reform.

In terms of overall public administration performance, Luxembourg remains above the EU average. The quality of public services is regarded as high, and the same goes for policy implementation. The take-up of e-government services by citizens and enterprises is one of the highest in Europe. One-stop-shop and e-government services are multilingual and available to businesses mainly through the '*Guichet Entreprises*', which is one of the two main sections of the '*Guichet.lu*' national website.

A report⁴⁰ on the functioning of EU judicial systems recommended that the procedure for registering property should be simplified, the cost of registering property sharply reduced, and the cost

³⁹ The data cover the 'business economy', which includes industry, construction, trade and services (NACE Rev. 2 Sections B to J, L, M and N). The data do not cover enterprises in agriculture, forestry or fishing or largely non-market services such as education and health.

⁴⁰ The functioning of judicial systems and the situation of the economy in the European Union Member States, CEPEJ, January 2013.

of insolvency and bankruptcy procedures cut by about 5 points to reach 10%. The recovery rate from such procedures should also be increased.

4.16.5 Finance and investment

Credit tightening has been less marked in Luxembourg than elsewhere in the euro area, and SMEs have continued to enjoy good access to finance. Smaller loans of less than EUR 1 million, which are almost exclusively for SMEs, are much less expensive in Luxembourg than elsewhere in the EU. Venture capital is much more accessible than in the EU on average. A fund targeted at SMEs active in innovative fields (ICT included) was launched in 2012, in close collaboration with the European Investment Fund (EIF). Another fund specialised in life sciences was launched on the same date with a London-based venture capital partner. With a lifespan of at least 15 years each, both funds are aimed at diversifying Luxembourg's economy and rendering it more sustainable.

A set of different loan schemes for enterprises continue to apply (equipment loan; start-up/takeover loan), along with the *vaccin anti-crise*, which provides counselling services to companies suffering from financial difficulties.

There are remaining challenges revealed by indicators that are directly affected by policy decisions, including information on credit that is perceived as relatively unclear in Luxembourg (thus hampering the provision of loans). Public financial support through EU funds (regional and structural) is focused much less on SMEs in Luxembourg than in the EU on average.⁴¹

4.16.6 Conclusions

Among EU countries, Luxembourg still scores well in terms of overall competitiveness. Nevertheless, the cost competitiveness of the economy poses the main medium- to long-term challenge, in particular due to high wage increases and coupled with low productivity growth. Nominal unit labour costs, especially in manufacturing, are increasing faster than in neighbouring Member States. Luxembourg has recently temporarily modified the automatic indexation of wages by introducing a minimum

interval of 12 months between each wage indexation and limiting the indexation to 2.5%. However, from 2015 on the automatic indexation will again be applied in the normal way. Further, the system does not comprise mechanisms that would keep unit labour cost developments in line with neighbouring countries.

Financial services have been the prime source of growth in the past decade, and only limited progress has been made towards a more diversified, knowledge-intensive economy. The development of a more focused smart specialisation strategy could give stronger leverage to research and innovation funding, in particular through more support to clusters.

The situation for workers with low skills (in particular migrants and young residents) remains difficult despite a large number of government and business initiatives. Greater adult participation in lifelong learning is needed to tackle the country's structural unemployment. Finally, another challenge is achieving the national target for the reduction of greenhouse gas emissions.

⁴¹ SBA factsheet 2012.

4.17. Hungary

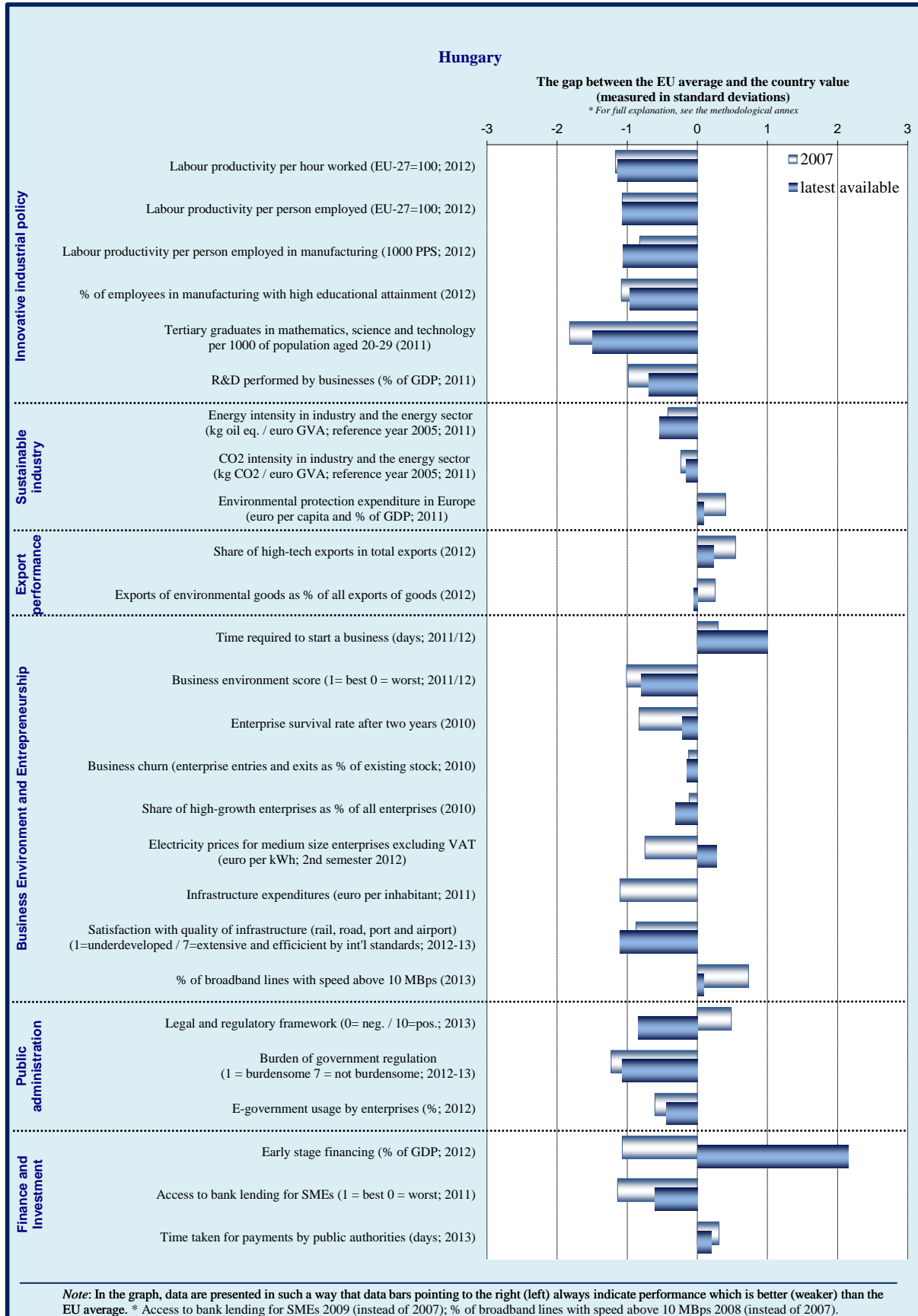
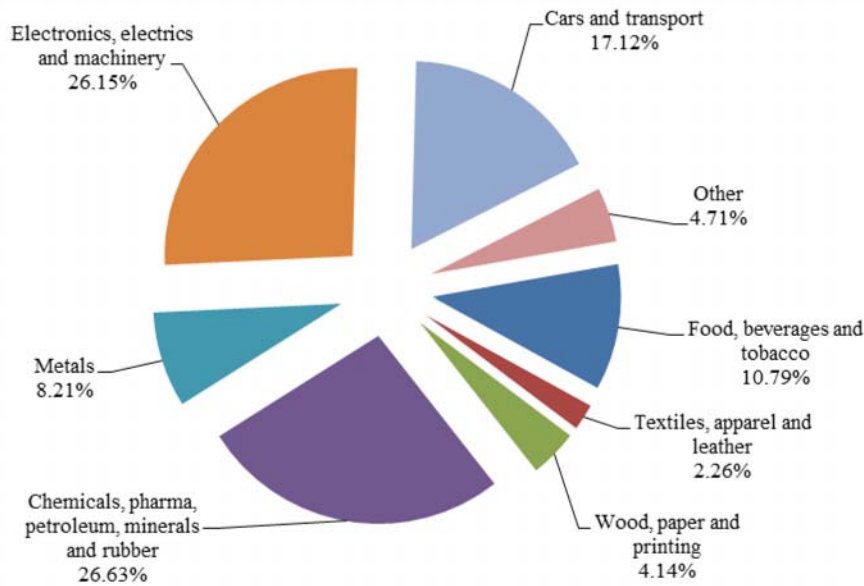


Figure Error! No text of specified style in document..4: Manufacturing sectors – Hungary (2010)

Source: Eurostat

4.17.1 Introduction

Manufacturing is more important⁴² in Hungary than in the EU on average. The country specialises in technology-driven industries (production of transport equipment, computers, electronic and optical products, food, and machinery), both in value-added and exports. Of services, wholesale and retail trade, business services, real estate activities, transportation, and information and communication are the biggest contributors.

The cost competitiveness of the economy has deteriorated over the last decade. Labour productivity is about 40 percentage points below the EU-27 average.⁴³ However, in manufacturing, labour productivity is somewhat higher than the national average, while still low compared to the EU as a whole.

4.17.2 Innovation, skills and sustainability

According to the Innovation Union Scoreboard, Hungary is a moderate innovator. The research and innovation landscape is characterised by a dual

structure. The proportion of high-tech product exports⁴⁴ is among the highest in the EU, while on other indicators, Hungary is lagging behind and scores worse than its regional competitors. Similarly,⁴⁵ large multinational firms use cutting-edge technology and invest in research, but only about 11 % of SMEs are innovative.⁴⁶ Most high and medium-tech sectors have increased their R&D intensity, but pharmaceuticals, ICT and transport vehicle manufacturing remain at the top.⁴⁷

The new innovation strategy (2013-20), adopted in June 2013 after a considerable delay, has identified the most crucial challenges and it attempts to tackle these.⁴⁸ The following priorities were set: support of globally competitive research centres; intensifying knowledge flows (e.g. by enhancing cooperation between business and academia, and providing integrated innovation support services);

⁴² The value added in manufacturing accounted for 23.2 % of the total value added in 2011 (EU-27: 15.3 %). More than 21 % of the total workforce is employed in this sector.

⁴³ Ranking 21st, Eurostat 2012.

⁴⁴ Share of high-tech exports in total exports (2011) 20.8.

⁴⁵ R&D performed by businesses (% of GDP; 2011) 0.75.

⁴⁶ <http://www.oecd.org/hungary/sti-outlook-2012-hungary.pdf>.

⁴⁷ Jelentés a vállalati KFI helyzetéről 2012, Nemzeti Innovációs Hivatal; Research and Innovation performance – Innovation Union progress at country level 2013)

⁴⁸ Challenges are grouped in 3 main areas: knowledge generation (lack of competitive knowledge centres, researcher capacities, obsolete R&D infrastructures, inadequate financing), knowledge flows (weak intersectoral links, inadequate international embeddedness and technology transfer) and knowledge utilisation (the striking gap between foreign and domestic companies)

and efficiently targeting support measures in all segments of the economy to boost companies' RDI activity. Both large companies and SMEs are to be targeted, with measures tailored to their needs.

Addressing horizontal problems such as lack of financing (including funding for basic research, availability of venture capital, seed capital) and the changing regulatory environment⁴⁹ would help to create an environment favourable for research and innovation. It will be crucial to implement the new strategy effectively to maximise the effectiveness of investment and its impact on growth and jobs.

The market for public procurement does not seem to work properly, as in about half of the cases there has been only one single bidder in 2010 and 2011. This might be explained by the fact that below a certain threshold only SMEs can submit offers, which has a negative impact on competition.⁵⁰

Skills

Tertiary education attainment has been improving, but it is still well below the EU average. The distribution of graduates by field is also out of balance. The number of maths, science and technology graduates is especially low compared to the average in the EU. Since 2011, there have been reforms to tackle these issues by cutting back the number of state-financed places in many fields,⁵¹ but the final outcome of the reform is unclear, as applicant numbers have also decreased.

There are also reforms underway in vocational training. The training period has been shortened, and apprenticeship and the vocational content are being strengthened in cooperation with industry,⁵² while less time will be spent on formal competencies.

On entrepreneurship, there was a drop in the share of the population that believes it has the skills and knowledge to start a business, down by 3 percentage points between 2006 and 2011,⁵³ and the score fell to 40 % (EU average 42.0 % in 2012).⁵⁴

Regarding life-long learning, Hungary has one of the worst records in the EU, with a very low participation rate.⁵⁵ The content of courses on offer is also a problem, as many of them do not match the needs of the market. According to the 2013 national reform programme, the government is also planning reforms in this area.

Sustainability

The energy and CO₂ intensity of the industry and energy sector is higher⁵⁶ than the EU average, due to both inefficient infrastructure and obsolete technology. The national energy efficiency action plan was adopted in 2011, though its implementation has been delayed. Government support for energy efficiency projects⁵⁷ seem to be lacking, as available funding is quickly exhausted. There is a plan to launch a new green economy financing scheme in 2013,⁵⁸ to improve the energy efficiency of buildings and support other climate protection measures. The share of renewable energy sources in total energy consumption rose to 8.79 %⁵⁹ in 2010.

The share of eco-industry goods in total exports has risen to 0.75 %, reaching the EU average by 2010, suggesting that it is gaining strength.⁶⁰

⁴⁹ The high-level political body in the field of STI policy, the National Research, Innovation and Science Policy Council (NKITT),) was dissolved in July 2012, when the Governmental Development Cabinet, body chaired by the prime minister, was set up. As of 2011, companies cannot deduct the costs of their in-house R&D from the innovation levy.

⁵⁰ Assessment of the 2013 national reform programme and convergence programme for Hungary, SWD(2013) 367.

⁵¹ Such as law, economics, and humanities.

⁵² The Hungarian Chamber of Industry and Commerce is in charge of preparing the technical content of the new curriculum to be used as of 1 September 2013.

⁵³ From 43.0 % to 40.0 %.

⁵⁴ http://ec.europa.eu/education/news/rethinking/sw377_en.pdf.

⁵⁵ 2.7 % as opposed to 8.9 % EU average http://ec.europa.eu/education/news/rethinking/sw377_en.pdf.

⁵⁶ Eurostat.

⁵⁷ Typically co-financed via the EU Structural Funds.

⁵⁸ NRP 2013.

⁵⁹ According to data provided by the Hungarian Government.

⁶⁰ Though most probably this strengthening can be attributed to the increased investments (largely via Structural Funds) and to the activities of upgrading the environmental infrastructure, such as water supply and treatment, and waste management, etc.

4.17.3 Export performance

Exports continue to perform relatively well compared to the EU average. Exports grew 2 % in 2013 and imports decreased 0.1 %.⁶¹ Exports of transport vehicles have grown dynamically, though this was offset by a contraction in the volume of ICT products exported, which fell by 20 %.⁶² High-tech exports continue to play an important role at 22.3 % of total exports. Other export sectors performing well are pharmaceuticals and professional equipment manufacturing.

Three quarters of exports go to the EU-27. The biggest trading partner is Germany, followed by neighbouring countries. The Government has started to formulate a strategy called “Opening to the east”, to expand exports to Russia, China, India, and the Middle East.⁶³ Policies⁶⁴ are in place to support indirect exports to improve the capabilities of SMEs to integrate into the supply chain of multinationals in the country.

4.17.4 Business environment and public administration

Improving the business environment has been an important priority in recent years, but measures adopted so far do not yet seem to have brought about the expected positive impact. According to the World Bank’s Doing Business 2013⁶⁵, Hungary ranks 54th, down from 51st in 2012. It also ranks lower than last year in the World Economic Forum Global Competitiveness Index (60th from 48th).⁶⁶ The most problematic areas are policy instability, tax burden (both financial and administrative), access to finance, inefficient bureaucracy and corruption. Such an unfavourable business climate

makes Hungary difficult for both domestic and foreign firms, and hampers investment and competition.

To reduce the administrative burden on businesses, the government has started its programme⁶⁷ of cutting red tape. This includes 114 measures intended to save a total of about HUF 500 billion⁶⁸ by 2012. However, implementation has been somewhat delayed.⁶⁹ By mid-2013, 93 measures had been adopted.⁷⁰ Some important measures, such as e-government, have been postponed beyond 2014.

The most notable achievements so far are shortening the time it takes for administrative procedures from 30 days to 21, and simplification of the procedure for construction licences. Adequate monitoring arrangements⁷¹ will be needed, together with an evaluation to check if reforms have achieved the targeted savings, and whether further measures are desirable.

Services such as trade, tourism, finance and other business services account for most of the service sector. However, Hungary continues to place restrictions on various sectors,⁷² leading to further deterioration of the business climate.

The potential for growth and jobs in the digital economy has not been fully seized. Rolling out of broadband infrastructure is proceeding well, but its take-up remains below the EU average.⁷³ The motorway network is well developed, but the secondary and lower level road network is quickly deteriorating and would require maintenance.⁷⁴ For railways, the density of the network is above the EU average, but the infrastructure and rolling stock is obsolete, increasing travel time, energy

⁶¹ For a detailed economic forecast see the Commission services’ 2013 spring forecast at: http://ec.europa.eu/economy_finance/eu/forecasts/2013_spring/hu_en.pdf

⁶² Hungarian Central Statistical Office <http://www.ksh.hu/docs/hun/xftp/gyor/kul/kul21212.pdf>.

⁶³ Part of this strategy is the setting up so-called merchant houses in the target countries, which would help SMEs with competitive products to access these markets.

⁶⁴ <http://www.hita.hu/Supplier/register>.

⁶⁵ http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-Chapters/Country_tables.pdf.

⁶⁶ http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf.

⁶⁷ <http://egyszeruallam.kormany.hu/>.

⁶⁸ Approximately 1.7 % of GDP.

⁶⁹ Government Decision 1416/2012 (X.1.).

⁷⁰ NRP 2013.

⁷¹ No information on the work of the committee that oversees the Cutting red tape programme is publicly available.

⁷² After the plaza-stop law, the pharmaceutical retail sector, meal voucher providers, waste treatment, the financial sector and the tobacco retail sector were also subject to extensive government regulation in 2012.

⁷³ 61 % of households and 87 % of business have broadband connection as opposed to the EU average (67 % and 87 %, respectively).

⁷⁴ A high share of roads is unable to take 115kn axle loads; the proportion of public roads in poor condition was 30 % in 2000, but over 50 % in 2010; State Audit Office, 2012

consumption and pollution. Commuting times to county capitals by public transport are long, making the mobility of employees more difficult.⁷⁵ Similarly, the sub-optimal conditions for navigation on the Danube remain a barrier to competitiveness.

Public administration

Reforms have also been implemented to improve the efficiency of public administration, which has been unfavourably assessed in international comparisons.⁷⁶ There were reforms in 2012⁷⁷ that had a positive impact on the business environment.⁷⁸ A simplification programme⁷⁹ was launched in 2011 to streamline administrative procedures and make them more accessible to citizens. Most of the measures will come into effect in 2013, so it is too early to assess their impact.

The administrative structure of the country has been reorganised so that previously autonomous sector-specific bodies have been integrated into county government offices, with the aim of cost-cutting. At territorial⁸⁰ level, the Government has set up district offices. The system of the so-called “government windows” (one-stop shops)⁸¹ will be extended in 2013 to district offices.

Tax regulation in Hungary is identified as one of the main problems. For businesses, the total tax compliance time⁸² is estimated at 277 hours per year. On average, firms need to make 12 tax payments a year.⁸³ To reduce the tax compliance burden, a simplified electronic payment system has been made legally possible, but it has not yet been implemented. The corporate tax system has become more complex, as it consists of six different rates. Two new simplified tax schemes were introduced

in 2013⁸⁴ for SMEs, on top of an already existing simplified business tax scheme.⁸⁵

Although the ordinary corporate income tax rates are relatively low (10 % and 19 %), a significant part of the tax burden on the corporate sector is linked to specific additional taxes.⁸⁶ The temporary surtaxes introduced in 2010 for the telecom, energy and financial sectors were increased⁸⁷ and became permanent while further surtaxes were introduced on the utility service providers. As these sectors provide crucial services to businesses, the negative impact of additional taxes is felt right across the economy.

The fight against corruption suffers from a lack of transparency and perceived fairness.⁸⁸ The implementation of measures announced in the corruption prevention programme for 2012-14⁸⁹ is underway, with some delays. In early 2013, the government adopted a law on the integrity management system. A new whistle-blower regulation is being drafted and should be adopted in 2013. The Hungarian Accounting Office (ASZ) is implementing an integrity programme that aims to map risks of corruption in public administration.⁹⁰

Besides the complexity of administrative procedures, the uncertain regulatory framework, in which rules change frequently at short notice, is also an often evoked problem. In some cases, public consultations do not leave adequate time for stakeholders to contribute.⁹¹ There should be more effort to make improvements in this area, especially to optimise impact assessments, fitness checks and monitoring arrangements.

⁷⁵ Hungarian Partnership Agreement for the 2014–20 programming period, final draft, July 2013.

⁷⁶ IMD World Competitiveness Yearbook 2011.

⁷⁷ The implementation of which is aided by the OECD-Hungary Strategic Partnership for Public Administration Reform launched in 2012, see Government Decree 62/2012. (IV. 2.).

⁷⁸ The administrative burden related to the identification of companies and their representatives in administrative procedures has been removed.

⁷⁹ Government Decision 1304/2011 (IX.2.).

⁸⁰ An organisational entity between local and county levels.

⁸¹ Set up as of 1st January 2011.

⁸² The time it takes to prepare, file and pay corporate income tax, value added tax and social contributions.

⁸³ World Bank Doing Business 2013.

⁸⁴ Lump-sum Tax of Self-employed (“kata”) and Small Business Tax (“kiva”).

⁸⁵ Simplified Entrepreneurial tax (“eva”) introduced in 2003. European Commission: Macroeconomic Imbalances, Hungary 2013, Occasional Papers 137

⁸⁶ The design of these surtaxes have been reviewed over time.

⁸⁷ Hungary ranks in the bottom third out of 144 countries for several indicators, e.g. diversion of public funds, wasteful government spending, favouritism in decision-making of government officials
http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf.

⁸⁸ Government decree 1104/2012(IV.6.) on anticorruption measures and the adoption of the Programme on Preventing Corruption in Public Administration.

⁸⁹ http://integritas.asz.hu/uploads/files/2012-es%20eredm%C3%A9nyek_%C3%B6sszefoglal%C3%B3.pdf The report shows no improvement in 2012 in comparison to the previous year.

⁹⁰ <http://www.transparency.org/country#HUN>.

An independent and efficient justice system is an important structural component of an attractive business environment and ensures the effective and timely enforcement of contracts and competition rules. Hungary ranks low on the perceived independence of the judiciary: 21st out of 27 in the EU, and 72nd out of 144 in the world.⁹² Internal developments in 2012 and 2013 have further increased concerns about the independence of the judiciary in Hungary⁹³ and the 2013 country specific recommendations included the requirement to strengthen further the judiciary.

4.17.5 Finance and investment

The stock of foreign direct investment is about EUR 78.5 billion,⁹⁴ one of the highest per capita figures in the region. Most of this is in service and processing industries.⁹⁵ Of all foreign direct investment in Hungary, 77 % is from EU countries, about 30 % of it from Germany. However, the negative business climate is likely to hamper further investment.

Bank lending contracted in 2012 due to the recession. SMEs were particularly badly affected, as banks seemed more risk averse and unwilling to lend. However, as demand for investment has also been lower, the relative weight of these factors is difficult to estimate. The additional tax on the financial sector has further restricted banks' willingness to lend.

The Szechenyi Card Programme, which provides credit card-based low-interest loans for micro- to medium-sized enterprises, continues to be an important tool in the financing of SMEs. Over 218 000 cards had been issued by 2012. New types of loan were introduced in 2012 to help SMEs participate in EU tenders.⁹⁶ In December 2012, the

government decided to continue investing in this programme.

After its 2011 reform, the Jeremie⁹⁷ structural fund scheme was successful in disbursing funding for SMEs. However, quick absorption means that Hungary is running out of EU funds for SME support, limiting the availability of resources for 2013.⁹⁸

4.17.6 Conclusions

On most indicators of competitiveness, Hungary's position is medium to low, though export performance is very good. The ongoing reform of public administration still has a lot of potential to improve the business environment, preferably complemented by a stable, predictable regulatory framework, without artificial distortions or corruption.

The business environment continues to be a major obstacle to improving competitiveness. The worsening business environment acts as a drag on the growth performance, creating a rapidly-changing regulatory framework, distortive effects of government policies eroding trust, lack of predictability and a low rate of investment.

In addition, there are concerns on the compatibility of some Hungarian legislation with EU legislation and with the principles of the rule of law, creating further uncertainty.⁹⁹

In the longer run, the need to switch to a more knowledge-intensive economy poses major challenges. A favourable research and innovation policy is essential if growth-oriented innovative enterprises are to emerge. To maintain and improve international competitiveness, it would be helpful if Hungary could address problems in labour productivity and skills levels. Timely, effective and consistent implementation of reforms is crucial to improve competitiveness in the long term.

⁹² World Economic Forum; based on data collected in 2011 – 2012 (reflected in the 2013 EU Justice Scoreboard)

⁹³ See speech by President Barroso at the European Parliament Plenary of 2 July 2013 on the situation of fundamental rights: standards and practices in Hungary, http://europa.eu/rapid/press-release_SPEECH-13-608_en.htm.

⁹⁴ According to Hungarian National Bank's 2012 Q4 data.

⁹⁵ Automotive, machinery, computer and electrical equipment manufacturing.

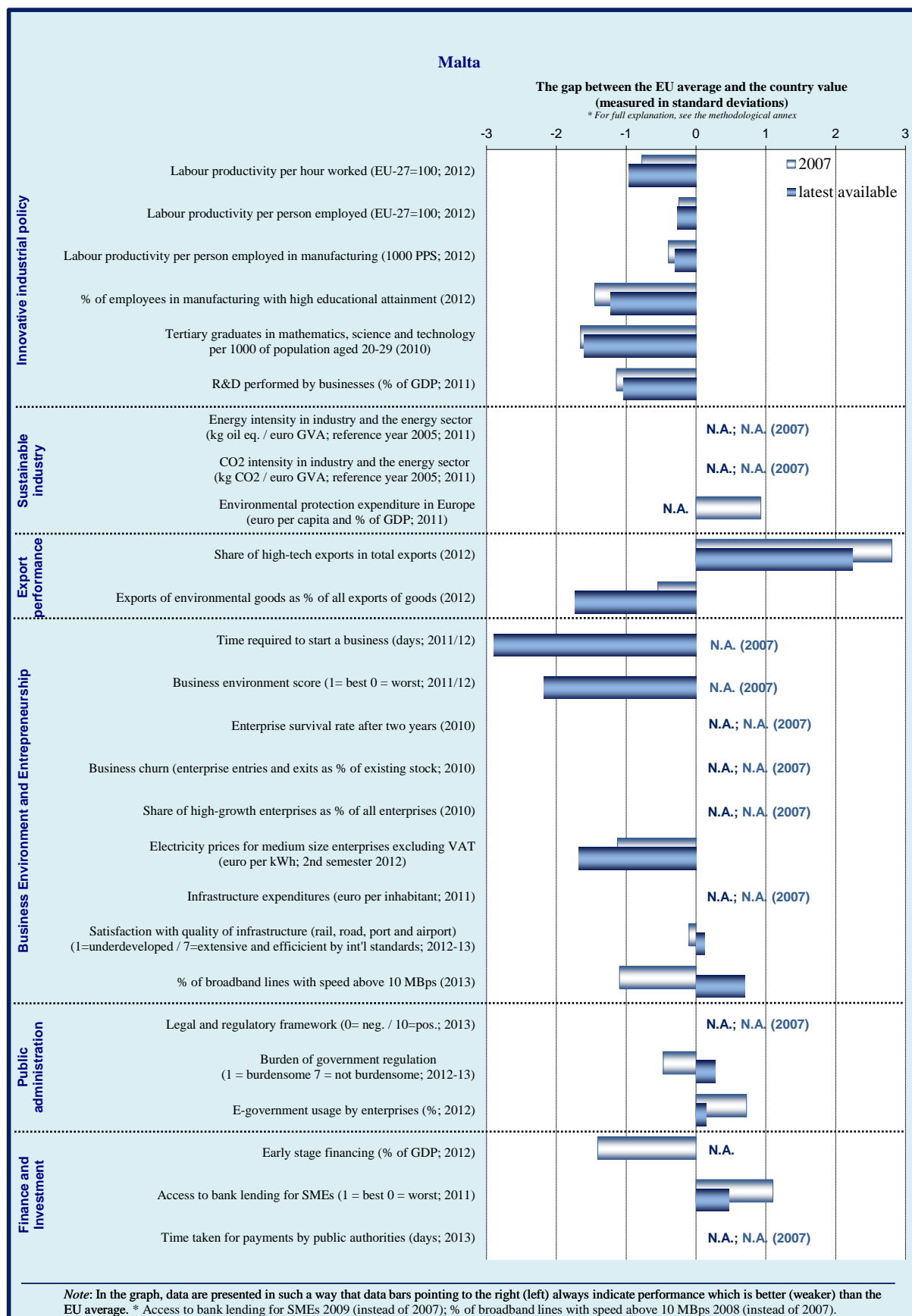
⁹⁶ (Szechenyi Önerő Kiegészítő Hitel and Szechenyi Támogatást Megelőlegező Hitel, i.e. *own contribution supplementary loan and pre-grant advancement loan*).

⁹⁷ Joint European Resources for Micro- to Medium-Sized Enterprises.

⁹⁸ This happened in particular through the Combined Microcredit Programme, which provides loans combined with non-refundable grants to very small enterprises. New calls focusing on seed financing have been published under JEREMIE's Venture Capital Programme.

⁹⁹ Assessment of the 2013 national reform programme and convergence programme for Hungary, SWD(2013) 367.

4.18. Malta



4.18.1 Introduction

Manufacturing in Malta has a share of value added of only about 13%, but some sectors have seen significant growth, in particular pharmaceuticals (part of ‘chemical products’ in the graph) and the aviation maintenance industry (‘transport’ or ‘electrical equipment’, and ‘other manufacturing’ in the graph). The service economy has traditionally been dominated by tourism (10% of GDP at direct impact level, rising to about a quarter of GDP when the full impact is estimated). Tourism has grown further recently, but the service economy is now significantly more diversified as other activities are also growing. These include financial intermediation, business services (including auditing and legal services), entertainment (film production), online gaming and other computer-related activities. Export market shares in a number of these emerging industries are also increasing.

Productivity growth has lagged behind the euro-area average over the past decade and has been notably weaker than in the other “new” Member States.

The Labour Party came to power at the beginning of March, but the new government has retained the great majority of measures to improve competitiveness set out in the November 2012 budget speech.

4.18.2 Innovation, skills and sustainability

Innovation

The government has stated its aim of building a knowledge-based economy with research and innovation at its core. The modest level of expenditure on research and development (0.73% of GDP in 2011, up from 0.67% in 2010) has already exceeded Malta’s Europe 2020 target, thanks to increases in higher education and business spending (of which more than 80% is spent by foreign-owned companies). Central government provides funding for public research, higher education institutions and private sector research.

However, businesses largely fund their own research and cross-funding between sectors is limited. Nevertheless, the draft National Strategic Plan for Research and Innovation 2011-20 maintains a strong business orientation in the areas

of ICT, health and biotechnology, energy and environmental technologies, as well as value-added manufacturing and services.

In 2012, the Malta Council for Science and Technology launched a commercialisation programme to assist research-oriented and innovative firms. In particular, in the innovation field, progress has been made with several initiatives, such as Business First, a one-stop-shop for businesses, and the R&D&I Trust Fund set up by the University of Malta. In addition, a number of industry sectors have been identified for future specialisation, e.g. digital gaming, for which a strategy was published in early 2012 to lay the foundations for the development of a gaming industry in Malta.

Further alignment of the draft National Strategic Plan for Research and Innovation 2011-20 with the requirements for a ‘research and innovation strategy for smart specialisation’ is important if the progress achieved so far is to be maintained. It would also help if research and innovation capacity in support of smart specialisation and links between knowledge institutions and business were to be strengthened. With ERDF funding, Malta Enterprise is currently building a life-science centre. It is envisaged that, when completed, this project will contribute towards encouraging further interaction between scientific centres, public institutions (including hospitals), self-government authorities and business.

Skills

The challenge of skills mismatches is related to the high (though steadily falling) rate of early school leaving, coupled with a modest level of tertiary education attainment. According to some business representatives, skill shortages are emerging and coming more into focus in areas such as the green economy and other areas in which expertise is required, e.g. specialised printing and design. The need to raise skill levels is set to become even more relevant in the future as the employment pattern is forecast to be characterised by a strong increase in medium and high qualification jobs and a marked decline in low qualification ones.¹⁰⁰

¹⁰⁰ By the year 2020. European Centre for the Development of Vocational Training (Cedefop).

To address this skills challenge, significant investments are being made to improve the vocational training facilities and systems available. A sector skills committee will be established by the second quarter of 2013, composed of representatives from industry, education and training institutions, mainly to advise the National Commission for Further and Higher Education on matters relating to validation processes, while assisting in the development of the corresponding occupational standards wherever skills shortages are identified. A number of schemes and initiatives complement the policy development under way.

Sustainability

Malta is heavily dependent on imported oil, but the energy sector is to undergo important, efficiency-boosting changes in the near future. First, the electricity interconnector with Sicily is expected to become operational in 2014. This represents an important change to the energy system, since Malta will no longer be isolated in terms of energy supply. Supply will therefore be more secure and electricity generation is likely to become cheaper. Secondly, the increased capacity will mean that the inefficient Marsa power plant can be switched off, which will improve overall efficiency.

The connection to the continental European grid will also raise the capacity to integrate energy produced from renewable sources, thereby helping to reduce the overwhelming use of heavy oil in electricity generation. Finally, the government is taking steps towards switching to cheaper and more environment-friendly liquefied natural gas (LNG) as its main energy source, which would also contribute towards lowering generation costs and cutting carbon emissions. The available options need to be carefully assessed to ensure that security of energy supply is strengthened and the associated costs are minimised.

There is room for improving efficiency and cutting emissions in the transport sector. Road transport accounts for about half of total emissions coming from non-ETS sectors, and a strong increase in emissions is likely by 2020. The number and increasing age of cars, an inefficient road network and the preference for driving have resulted in significant road congestion problems and increased carbon emissions. Therefore, measures to upgrade the road network and to improve the effectiveness

of public transport will be important in ensuring sustainable internal mobility. Measures introduced to make the car fleet more sustainable, such as a minimum level of biofuels in petroleum fuel in all transport modes, a differentiated car registration tax, a car scrapping scheme and continued financial support to electric and hybrid vehicles are relevant towards diversification and decreased dependency on fuel imports.

4.18.3 Export performance

International trade remained a key driver of economic growth in Malta in 2012, despite the challenging environment, because of a favourable composition of exports and geographical orientation of trade, in particular in goods. During 2012, exports of goods and services increased by 5.2% in real terms. Malta stands out in the EU for the proportion of its exports accounted for by high-tech products. The ‘strengthening market entry and internationalisation’ incentive, available until the end of 2017, aims to facilitate access to foreign markets by allowing enterprises to explore growth opportunities, establish business contacts and consolidate existing markets. This scheme provides part-financing for companies to participate in international trade events, fairs and trade missions. Towards the end of April 2013, Malta Enterprise launched a continuous tracer study among participants of its internationalisation events to determine what the benefits have been.

4.18.4 Business environment and public administration

Business environment

The Malta Small Business Act (SBA), which emphasises the importance of small and medium-sized enterprises (SMEs) for growth and competitiveness, has been in place since October 2011. Stakeholders are looking forward to the introduction of the ‘SME test’ (gauging the potential impact on enterprise of all new proposed legislation) and the two-month standstill period between publication and entry into force of new legislation. The SBA implementation unit has been holding meetings with ministries and other entities to explain its role and improve their understanding regarding application of the SME test.

The Enterprise Consultative Council holds a regular dialogue with the regulatory authorities and business organisations in order to bring about greater synergy for a better business environment, particularly for SMEs. It meets every quarter and has been quite effective as a channel for communication with the business community, mainly through its representative organisations. The Council has held a number of meetings on specific issues (family businesses, youth entrepreneurship, the specific situation of the business sector in Gozo, etc.). Some business representatives are calling for it to be more sharply focused on the interests of enterprise.

The Business First one-stop-shop run by Malta Enterprise since the beginning of 2012 has been quite successful. It is based on a network of service-level agreements with a number of government entities. In 2012, there were 25 cases registered among these service providers of the prescribed deadline not being kept, i.e. 5% of the total number of applications. It takes approximately two days to register a company with the Malta Financial Services Authority and, unlike the World Bank in its *Doing Business* survey, Malta Enterprise estimates that starting up a company in Malta takes no longer than 13 working days, especially as registration processes can run in parallel.

As regards business support infrastructure, works being carried out by the authorities on existing industrial estates will be continued with EU and national funding. The 2013 budget provides for a number of new projects, in the following areas in particular: digital games hubs, an aviation centre, a maritime park, a business centre in Gozo, and a facility with flexible use of ICT in the incubation centre in Kordin.

In 2012, the Department of Contracts sought to achieve full transition from conventional to electronic procurement. A number of initiatives have been taken since March 2012 and the complete transition to electronic procurement for tenders published by the Department has been set for 2013. All new tenders issued by the Department since January 2013 have been e-tenders. The transition to e-procurement and the parallel streamlining of procedures are aimed at encouraging greater participation from European SMEs.

The Late Payments Directive was transposed into Maltese law in August 2012, with ancillary training activities ensuring its informed application. The government has conducted three information seminars on the topic for government departments, public entities and local councils. In addition, the Malta Association of Credit Management organised an information session for the business community.

With regard to the simplification of administrative procedures for accessing EU programmes, Malta Enterprise is currently providing an exploratory award scheme providing cash grants to help SMEs develop project proposals for the Commission's Seventh Framework Programme (FP7) and the Competitiveness and Innovation Programme (CIP). The Employment and Training Corporation has taken steps since 2011 to simplify the administrative process for the training aid framework and the employment aid programme.

The guidelines of the Entrepreneurship through Education Scheme have been revised so as to ensure better organisation. 28 projects were identified for funding in 2013. The government has indicated in the 2013 budget that it will be preparing an entrepreneurship action plan ranging from primary to tertiary levels. A Youth Entrepreneurship Act to help prepare young people for the world of business has also been signalled for 2013, along with the corresponding Youth Entrepreneurship Scheme announced this year.

Although electricity prices in Malta are far above the EU average, which dampens the competitiveness of enterprises, positive changes are expected in the medium term (see above) as a result of the shift from heavy-oil to gas-fired energy production based on a public-private partnership for building new generation facilities, which will bring cost savings of around 25% to industry in 2015. The electricity interconnector is also expected to be completed in 2014, while the Ministry for Energy and the Conservation of Water will promote independent investment in the energy infrastructure in the form of new facilities, favouring the import, storage and processing of LNG.

Despite positive scores for Malta's judicial system on some points, the EU's Justice Scoreboard highlighted serious shortcomings in efficiency due to the time needed to resolve non-criminal (in particular, civil and commercial) cases, which is

among the longest in the EU.¹⁰¹ The courts' backlog has been increasing, with a high number of pending cases at first instance and a seemingly low clearance rate, indicating that more cases arise each year than are being resolved. In March 2013, very soon after taking office, the new government announced the launch of a judicial reform. A commission appointed to look into the judicial system and recommend reforms as necessary is due to submit a review report within three months, to be followed by a consultation process. It is envisaged that implementation of the main reforms suggested by the report and the consultation process will start by the end of 2013.

According to the 2012-13 Global Competitiveness Report, users of Malta's transport system are reasonably satisfied overall with both the efficiency and the extent of air, sea and land transport infrastructures.

The last 15 years have seen heavy investment of national funds, backed by EU co-financing (Cohesion Fund, ERDF and TEN-T financial instrument), which has directly resulted in a substantial improvement in port and airport infrastructure and visibly improved safety and operational efficiency — relatively high levels of satisfaction are now being expressed by users of airport and seaport infrastructures.

Significant investment has also taken place in upgrading road infrastructure, particularly under the EU Cohesion Fund and ERDF following Malta's EU accession. By the end of the current operational programme (2007-13), some 62% of Malta's roads will have been upgraded in terms of quality, safety and capacity. The last three years have seen unprecedented levels of upgrading work at key road traffic bottlenecks. Naturally, opinion surveys of road users carried out in Malta in 2011-12 (such as the poll in the 2012-13 Global Competitiveness Report) reflect lower-than-expected levels of user satisfaction given the network-wide impact that major road works were then having on traffic congestion and journey times. However, it is to be expected that satisfaction rates for the road infrastructure will match those for ports and

airports once all work on the major TEN-T links has been completed.

4.18.5 Finance and Investment

SMEs are benefiting from an increasing range of access to finance and the 2013 budget contains a number of measures to ensure that this remains the case. The Microinvest scheme will be extended for a further two years following the overwhelming success of measures particularly relating to new job creation. The Jeremie scheme (a first-loss portfolio guarantee instrument for loans between EUR 25 000 and EUR 500 000) will also be extended.

A new tax incentive scheme will be launched to encourage established enterprises to invest seed capital in new undertakings. Another new scheme, for the benefit of clusters and networks and local small businesses, will be aimed at supporting setting-up costs such as property rent and the development of e-tools. The Investment Aid Tax Credits Scheme supports firms in investment and job creation and is mainly focused on attracting new investment projects and promoting the expansion or diversification of existing enterprises. This scheme has been extended to hotels, with support capped at 15% of the amount invested.

4.18.6 Conclusions

Malta continues to withstand the impact of the international crisis relatively well. Given the large size of its financial sector and the high exposure of domestic banks to the real estate sector, maintaining financial stability remains crucial.

In terms of structural reforms, medium- and long-term sustainable growth will depend on the successful move to a more knowledge-based economy, further improving skills and the utilisation of human capital, and adopting more ambitious R&D targets (the current ones have already been exceeded).

Investment plans for improving the energy supply are encouraging as they promise to reduce dependency, improve cost competitiveness and boost efficiency. Policy measures to address the challenges involved in meeting climate and renewable energy targets need to be maintained and stepped up. Efforts to implement the Small

¹⁰¹ See EU Justice Scoreboard 2013 available at http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_communication_en.pdf.

Business Act with the support of the business community should be maintained.

4.19. Netherlands

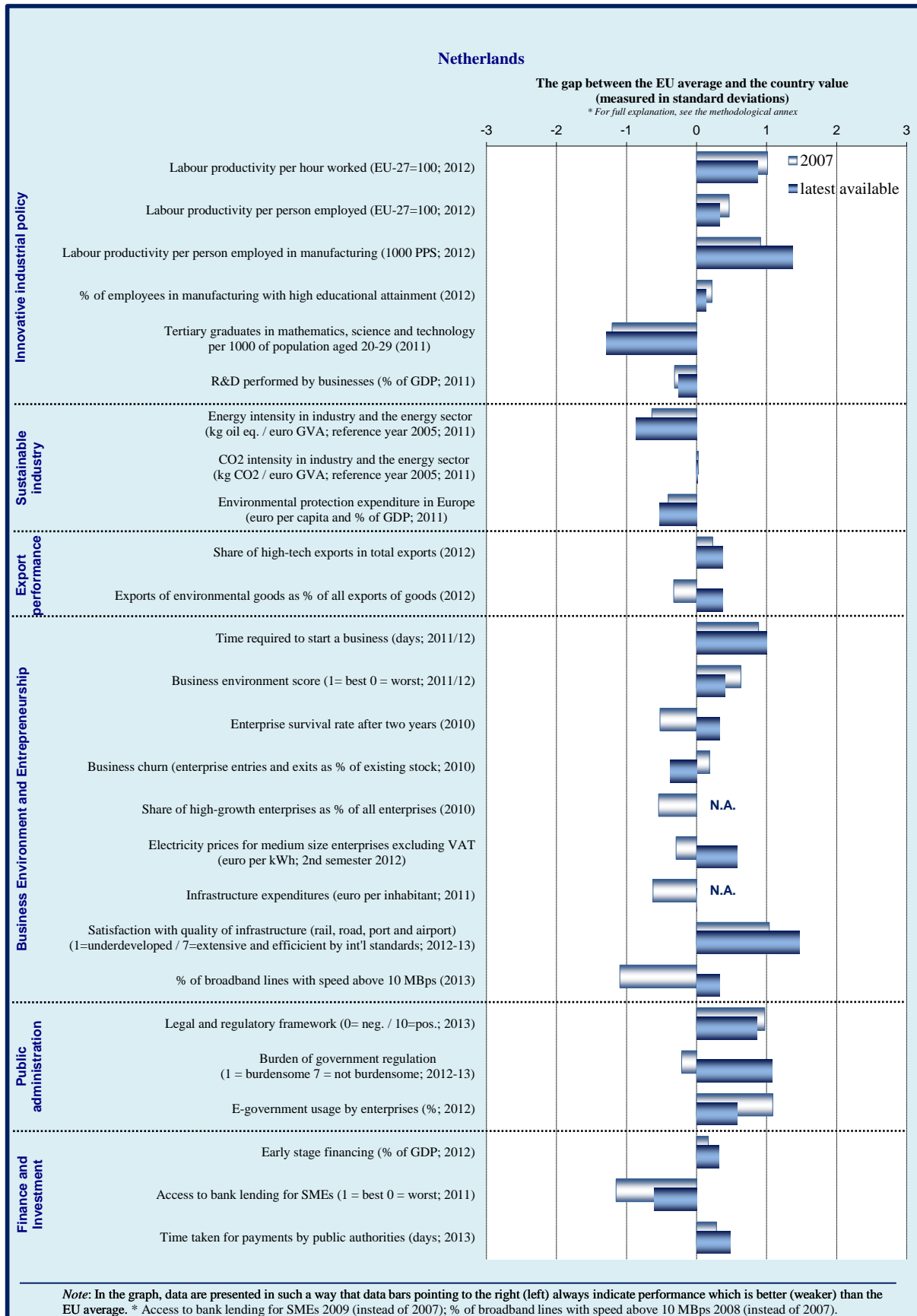
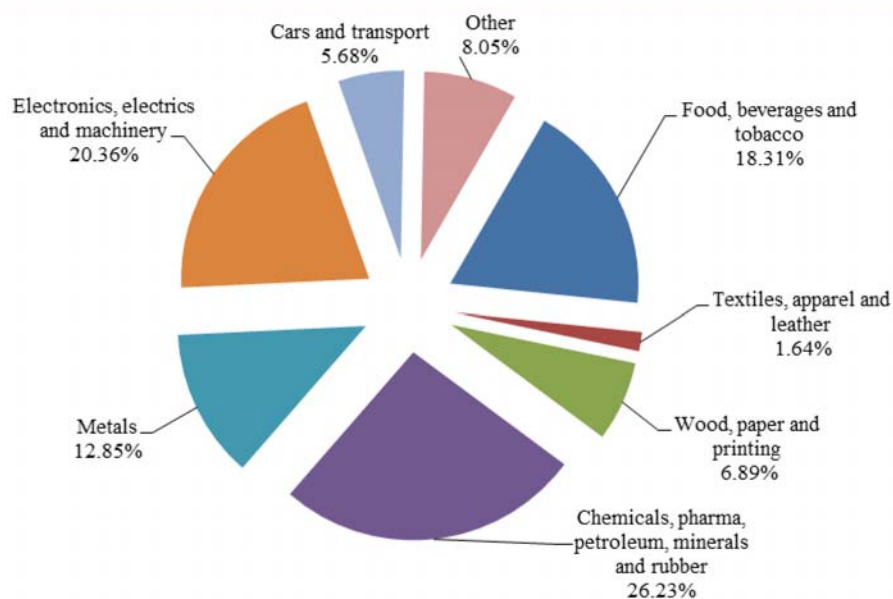


Figure Error! No text of specified style in document..5: Manufacturing sectors – Netherlands (2010)

Source: Eurostat

4.19.1 Introduction

The Netherlands is specialised in capital-intensive manufacturing and medium-tech sectors such as chemical products, refined petroleum, electronics and machinery, transport equipment and foodstuffs. Manufacturing contributes 12.9 % of the total value added, which is slightly below the EU average (15.3 %).¹⁰² The World Economic Forum's Global Competitiveness report ranks the Netherlands in eighth place.¹⁰³ The price and cost competitiveness indicators are in line with euro area averages, and with other industrialised countries. Labour productivity per hour worked is about 30 percentage points above the EU average and about 17 percentage points above the euro area average.¹⁰⁴ Overall, Dutch industrial competitiveness is good, but maintaining and improving its competitive position in the future will be a challenge.

4.19.2 Innovation, skills and sustainability

Innovation

The *Innovation Union Scoreboard 2013*¹⁰⁵ puts the Netherlands in the group of 'innovation followers' with above-average performance. It has further improved its ranking (from seventh to fifth place) and is now the first in its group. It is further catching up as regards non-R&D innovation expenditure and the innovation performance of SMEs.

The government has reaffirmed its intention to reach an R&D intensity of 2.5 % of GDP by 2020. However, in 2011 the R&D intensity was only slightly above the EU average of 2.03 %, in particular due to relatively low private R&D expenditure, which declined on average 1.8 % between 2000 and 2011, indicating a shift towards less research-oriented activities.¹⁰⁶ The economy has a particularly large service sector, which is generally less R&D intensive, and manufacturing is geared towards medium-tech products with less R&D. Moreover, a significant proportion of private

¹⁰² Eurostat data for 2012.

¹⁰³ <http://www.weforum.org/issues/global-competitiveness>.

¹⁰⁴ Eurostat data for 2012.

¹⁰⁵ Innovation Union Scoreboard 2013, European Commission, <http://ec.europa.eu/enterprise/policies/innovation>.

¹⁰⁶ Research and Innovation performance – Innovation Union progress at country level 2013.

R&D expenditure is concentrated in a few large multinational firms.

Stronger innovation performance and further private R&D investments are important objectives of the enterprise strategy called *'to the top'*,¹⁰⁷ which is being implemented. The strategy's *'top sector approach'*¹⁰⁸ addresses a weakness in the Dutch innovation system by bringing researchers closer to businesses and by putting businesses in the driving seat when designing public-private partnerships for innovation. In 2012, there were 19 'top consortiums for knowledge and innovation', and they have started to implement the research agendas set out in their innovation contracts.¹⁰⁹ Stakeholders are closely involved in the process and SME participation is given particular attention. Several investment commitments were announced in 2012. Ongoing reforms of higher education should contribute to further improving the linkage to the human capital and R&D needs of the top sectors. So far, the strategy seems promising, though it is still too early to assess the extent to which it will be able to mobilise additional private investments while preserving sufficient public funding.¹¹⁰

Over the last few years, specific innovation subsidies have been considerably reduced and transformed into generic tax incentives.¹¹¹ A R&D tax incentive scheme,¹¹² which allows for the deduction of R&D wages for tax purposes, was evaluated in 2012.¹¹³ The results of the evaluation point to a positive impact in terms of mobilising additional private R&D expenditure, while the thresholds used had ensured a particular focus on

SMEs. In 2013, the budget for the scheme is EUR 735 million. Moreover, since 2012 the revolving SME innovation fund has been providing innovation loans to SMEs and mid-cap companies. The total budget of the fund is EUR 500 million until 2015.¹¹⁴

Skills

The proportion of tertiary graduates in science and technology has long been below the EU average, reflecting the service orientation of the economy. However, skills shortages, especially in engineering and technology-related professions, are becoming an increasing concern and a potential barrier to growth.

In response to these challenges, the government recently announced its *Techniekpact* strategy,¹¹⁵ under which concrete measures for better adapting the educational system and the labour market to the changing requirements of the technology sector are currently being developed. Effective implementation of the strategy will be crucial to preserving and enhancing the innovative capacity of high-tech companies in the Netherlands.

Sustainability

The 2012 coalition agreement says that the Netherlands strives to create a resource-efficient and ultimately regenerative circular economy, but there is a need to further clarify how this will be achieved, including how SMEs can genuinely improve their resource and energy efficiency. The main sustainability initiatives of the current government are (i) the 'top sector approach' activities regarding the energy sector, (ii) the incentive scheme SDE+ for renewable energy investments and (iii) 'green deals' for energy efficiency and other environmental projects.

Environmental sustainability is now officially mainstreamed in all 'top sectors' and is also taken up by the cross-cutting theme of bio-economy. The effectiveness of integrating environmental aspects and resource efficiency into the top sector approach still needs to be evaluated.

¹⁰⁷ 'To the top: towards a new enterprise policy' <http://www.rijksoverheid.nl/documenten-en-publicaties/rapporten/2011/09/13/naar-de-top-het-bedrijvenbeleid-in-actie-s.html>.

¹⁰⁸ 'Investing in top sectors' www.government.nl/issues/entrepreneurship-and-innovation/investing-in-top-sectors.

¹⁰⁹ National Reform Programme 2013.

¹¹⁰ See also the Staff Working Document 'Assessment of the 2013 national reform programme and stability programme for the Netherlands', <http://ec.europa.eu/europe2020>.

¹¹¹ The most important instruments are the SME+ Innovation Fund ('Innovatiefonds MKB+') and tax facilities, such as the tax credit for R&D ('WBSO'), the Research & Development Allowance ('RDA') and the tax relief for innovation ('Innovation box').

¹¹² WBSO: <http://www.agentschapnl.nl/programmas-regelingen/wbso-research-and-development-rd-tax-credit>.

¹¹³ <http://www.rijksoverheid.nl/documenten-en-publicaties/rapporten/2012/04/02/hoofdrapport-evaluatie-wbso-2006-2010.html>.

¹¹⁴ Innovatiefonds MKB+.

¹¹⁵ Nationaal Techniekpact 2020' <http://www.rijksoverheid.nl/documenten-en-publicaties/convenanten/2013/05/13/nationaal-techniekpact-2020.html>.

The share of renewables in energy use rose from 3.8% in 2010 to 4.3% in 2011, bringing the 2011/2012 interim target of 4.7% within reach. Nevertheless, despite more ambitious policies to promote renewables, including continuation of the sustainable energy production scheme with a budget of EUR 3 billion for 2013, the gap between the Netherlands' current renewable energy share and the 2020 target is still one of the widest in the EU.¹¹⁶

The 'Green deals' instrument is proving successful in supporting local projects and collaboration among stakeholders. Over 150 'Green deals' have been signed since 2011.¹¹⁷ The scheme has been broadened beyond sustainable energy and energy-saving projects.

The criteria for green public procurement were revised in 2011 on the advice of MVO, the main corporate social responsibility organisation. For the sake of simplicity, the number of environmental aspects for award criteria has been reduced and the use of functional requirements instead of detailed technical requirements is encouraged. By 2015, all public authorities aim to purchase products that are 100% sustainable.

4.19.3 Export performance

Overall, the Netherlands accounts for 9.1% of EU exports¹¹⁸ and has one of the highest current account surpluses as a percentage of GDP in the euro area.¹¹⁹ The goods balance is increasingly driven by re-exports, due to the country's role as a major transit hub for global trade and supply chains.

However, as the value added of re-exports is relatively low, initiatives to maintain a competitive edge across exporting industries, and to safeguard the value added derived from the total export volume, are important. Exports with high domestic value added include agricultural products,

foodstuffs, chemical products, rubber and plastics, machinery and transport equipment. Nearly 80% of goods exports go to the EU. Compared to the EU average, Dutch SMEs tend to be more active internationally.¹²⁰ Since growth in many export markets tends to be slow, especially in products like foodstuffs, venturing into new markets will be necessary if global export market shares are to be maintained. The government supports the internationalisation of businesses, especially SMEs, through various measures, including spreading information about key markets and customs procedures, but also through export credit insurance instruments. An internet portal¹²¹ provides enterprises with useful information on how to expand their business abroad.

4.19.4 Business environment and public administration

Business environment

According to the World Bank's Doing Business 2013, the Netherlands has a favourable business environment that encourages the competitiveness of enterprises, although there may still be scope for further improvement in certain areas.¹²² Overall, the Netherlands has maintained a very good network infrastructure and a high level of service quality in public transport, without overtly high levels of subsidies.

The Netherlands has a tradition of efficient public services and light administrative burden for businesses. In April 2013 a new programme was launched, focusing on a more qualitative approach towards reducing all regulatory burdens.¹²³ By 2017, a reduction of EUR 2.5 billion should be achieved in the regulatory burden on businesses, professionals and citizens, through the introduction of new regulations linked to the revision or scrapping of existing rules.

¹¹⁶ See also the Staff Working Document 'Assessment of the 2013 national reform programme and stability programme for the Netherlands', <http://ec.europa.eu/europe2020>.

¹¹⁷ <http://www.rijksoverheid.nl/duurzame-economie/green-deal>.

¹¹⁸ Eurostat, 2012.

¹¹⁹ European Commission, In-depth review for the Netherlands, 10.4.2013 http://ec.europa.eu/economy_finance.

¹²⁰ SBA Fact Sheets, European Commission, <http://ec.europa.eu/enterprise/policies/sme>.

¹²¹ <http://www.antwoordvoorbedrijven.nl> and since 2013 the new portal www.ondernemersplein.nl.

¹²² The Netherlands is ranked 31st out of 185 for doing business by the World Bank.

¹²³ www.rijksoverheid.nl/onderwerpen/regeldruk 'Goed geregeld, een verantwoorde vermindering van regeldruk 2012-17', 24 April 2013.

Tax compliance and tax administration are more efficient than the EU average. It takes businesses considerably less time to pay taxes and the associated administrative costs are below the EU average. New reforms have recently been announced to further simplify wage taxes. Moreover, a number of measures have been introduced to promote the use of ICT, such as the application of *Standard Business Reporting* in the tax domain. The introduction of an electronic business file for exchanging data with authorities is expected to further contribute to increasing efficiency and reducing the regulatory burden.

Since 2012, the procedures for starting a business have been further simplified and the minimum paid-in capital requirements abolished. The time required to start a business is one of the shortest in the EU.

Several important services are included in the ‘top sector’ approach and therefore receive significant policy attention (e.g. energy, transport/logistics and creative industries). Competition in electricity supply seems to work well and changing supplier is relatively easy, unbundling has worked well and the provision of information by suppliers to consumers is supervised by the competition authority.¹²⁴ Regardless of this, the number of consumers switching supplier remains low.

Public administration

The perceived quality of public services is relatively high.¹²⁵ The use of tools to improve public administration (such as e-government, performance and service orientation) is more widespread than average in the EU. By 2017 all enterprises will have the right to communicate and to do business with the authorities online.

In general, enterprises benefit from relatively swift payment by public authorities and public procurement processes seem to be quite efficient and transparent. In 2011, the Dutch government formally introduced an ex-ante framework to systematically assess substantial impacts of new policy and legislation. In 2013, an impact

assessment commission chaired by the Prime Minister was introduced and the mandate of the Dutch advisory board on regulatory burden will be extended until 2017. On implementation in practice, however, there may be room for further improvement.

The Chamber of Commerce and the innovation agency *Syntens* are currently being merged and restructured, which may lead to reduced local or regional presence but should enhance electronic information and services provided through a digital one-stop shop for entrepreneurs.¹²⁶ Moreover, mandatory membership fees for enterprises have been abolished and the Chamber of Commerce is now directly financed by the state budget. Alongside this streamlining it will be important to ensure continued high quality and availability of key business support services.

A large part of the planned state budget consolidation should be achieved through reducing the size of the public sector and modernising public administration. Although this reduction entails considerable potential efficiency gains, it is subject to implementation risks, including preserving the high quality of public services. In addition, the government is planning to decentralise a large number of responsibilities to municipalities. It remains to be seen whether these efficiency gains can be fully realised within the envisaged time frames.

4.19.5 Finance and investment

Access to finance is not as good as in some other euro area countries. The impact of the crisis on the economy and the balance sheet composition of banks arguably have been the factors behind the relatively tight credit standards.¹²⁷ Although there has been improvement since last year, interest margins and the rate of rejected loans remain higher than the EU averages.

The authorities have taken a number of measures to support access to finance for SMEs, for example by continuing existing guarantee schemes, by

¹²⁴ Autoriteit Consument & Markt.

¹²⁵ European Commission, ‘Excellence in public administration for competitiveness in EU Member States’ <http://ec.europa.eu/enterprise/policies/industrial-competitiveness/monitoring-member-states>.

¹²⁶ <http://www.antwoordvoorbedrijven.nl> and since 2013 the new portal www.ondernemersplein.nl.

¹²⁷ European Commission, In-depth review for the Netherlands, 10.4.2013 http://ec.europa.eu/economy_finance.

increasing available budgets and by increasing the maximum ceiling for micro-credits.¹²⁸ In order to further improve access to risk capital, the government cooperates closely with the European Investment Fund and the European Investment Bank in developing additional financial instruments for SMEs. For example, in 2012 a fund-of-funds was created that had an initial capital of EUR 150 million, which will provide later stage funding for fast-growing innovative or high-tech businesses.¹²⁹

The ‘Netherlands Foreign Investment Agency’,¹³⁰ provides investors with a wide range of information and support services. The country attracts foreign direct investment in particular from Asia and North America. The location, good infrastructure and favourable business environment are important factors, but also the tax system offers a number of advantages that are particularly attractive for multinational firms.¹³¹

skills shortages are emerging especially in engineering and technology-related professions, a situation which is becoming an increasing concern and a potential barrier to growth.

4.19.6 Conclusions

Overall, the Netherlands ranks among the top performers in many of the competitiveness indicators of the Industrial Performance Scoreboard. The business environment supports the competitiveness of enterprises and there is a tradition of efficient public services and low administrative burden on businesses. Strengths include in particular the favourable business environment, the quality of institutions, the education system and science base, the efficient goods market as well as the technological readiness.

Despite the favourable framework conditions, the country is likely to face challenges in maintaining and improving its competitive position in the future. While the Netherlands has managed to improve its innovation performance in some areas, the relatively low private R&D investments may weaken its competitiveness in the future. Moreover,

¹²⁸ For example, the budget for the guarantee scheme ‘*Borgstellingskrediet MKB*’ has been increased from EUR 750 million to EUR 1 billion while other guarantee schemes such as ‘*Garantie Ondernemingsfinanciering*’ and ‘*Groeifaciliteit*’ are also being continued. Moreover, the maximum ceiling for micro-credits has been raised from EUR 50 000 in 2012 to EUR 150 000 in 2013.

¹²⁹ <http://www.eif.org>.

¹³⁰ <http://www.nfia.nl>.

¹³¹ See also the Staff Working Document ‘Assessment of the 2013 national reform programme and stability programme for the Netherlands’, <http://ec.europa.eu/europe2020>.

4.20. Austria

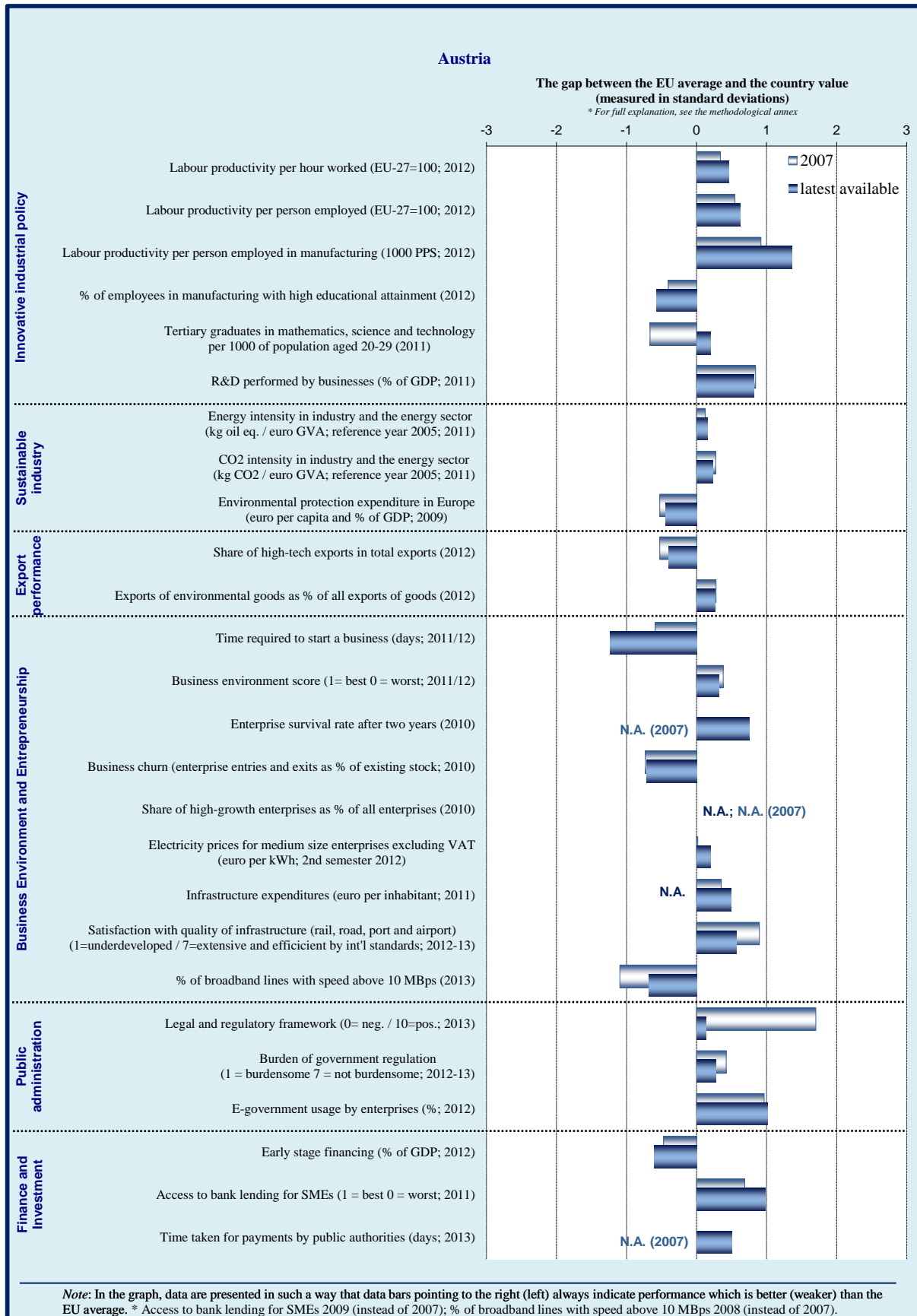
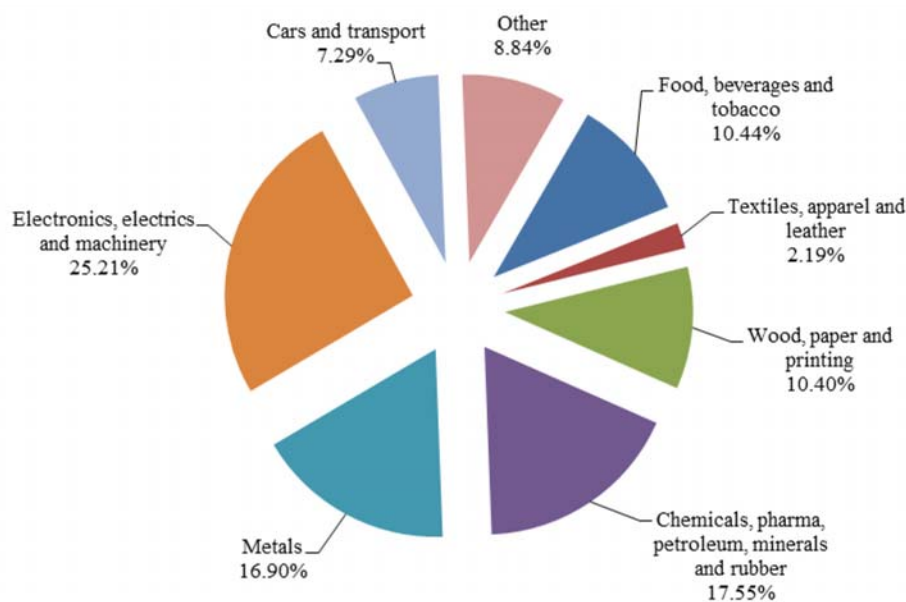


Figure Error! No text of specified style in document..6: Manufacturing sectors – Austria (2010)

Note: No data available for sectors C12 (tobacco products) and C19 (coke and refined petroleum products)

Source: Eurostat

4.20.1 Introduction

Manufacturing contributes 18.7% of total value added, against an average of 15.3% in the EU as a whole. If construction is included, the share is over 25%, also above the EU average. Productivity is higher than the EU average regardless of the indicator used (productivity per employee or per hour worked; productivity in manufacturing); in addition, productivity growth has been slightly above the EU average recently. The relatively low share of employees in manufacturing with tertiary education does not seem to have had an impact on this performance.

Austria is specialised in innovation-intensive sectors such as machinery and, in exports, in medium-innovation sectors (such as wood, basic and fabricated metals), but also in sectors with low innovation and educational attainment, such as hotels and restaurants and auxiliary transport activities. At the more detailed industry level, the country is specialised in mainstream manufacturing (manufacture of railway and rolling stock, electric motors) and labour-intensive industries (builders' carpentry and joinery, sawmilling, machine-tools). Capital-intensive industries (man-made fibres) generate considerable added value, and marketing-driven industries (sports goods, beverages) are prominent exporters.

Overall, competitiveness has been successfully sustained in industries that are not markedly knowledge-intensive, with sectoral upgrading in terms of R&D and quality.

4.20.2 Innovation, skills and sustainability

Innovation

In the Innovation Union Scoreboard 2013, Austria is an innovation follower, with a developed innovation system and an above-average innovation performance. Its R&D intensity is higher than the EU average. The overall investment in R&D grew from 1.93% in 2000 to 2.74% in 2011. Although this growth was faster than in most other EU countries, it represented a slight decrease from 2010. The share of the private sector was about 60% of the total, including a significant portion of R&D investment coming from abroad.

Two-thirds of all enterprises are innovative, specialising in sectors demanding high and low-intermediate labour skills. After several years of improvement from a low base, the number of science and technology graduates was higher than the EU average for the first time in 2011 (16.1% vs. 14.2%).

To boost businesses' R&D expenditure, the government increased the tax bonus on such investments in 2011 from 8% to 10%, with an estimated annual impact of over EUR 80 million. This incentive is particularly important for the sizeable investments coming from abroad and for companies with high R&D investment relative to their turnover. These are often SMEs that are outsourcing research and innovation activities. Another measure that is working well is an innovation voucher scheme for SMEs.

There has been a decline in the private sector share of R&D expenditure, from 49% in 2007 to 44% in 2012, and in this context the relative underdevelopment of the venture capital market as a source of growth capital has also attracted attention.

Guidance on innovation-friendly public procurement was adopted by the government in September 2012, and a pilot project for pre-commercial procurement in the transport sector is ongoing.

An ICT strategy is under discussion following a public consultation in early 2013 launched by the Competence Centre for the Internet Society. The focus is on mobility, healthcare, education and security.

The innovation system suffers from a complex division of competences between several ministries and a number of public and semi-public agencies and bodies. A high-level inter-ministerial task force for research, technology and innovation was established in 2011 to coordinate the activities of government bodies, discuss reform projects and consult stakeholders.

The strategy document from March 2011 'Becoming an Innovation Leader' outlined a series of challenges to the innovation system, such as strengthening links with the education system, increasing the share of tertiary graduates, promoting high-quality research infrastructure and fundamental research, and using public procurement to promote innovation. The strategy addressed all major challenges and formulated feasible objectives. Effective implementation, strong prioritisation of research and innovation, and streamlining of the governance structure will be

crucial to achieving higher outputs from the considerable research and innovation investment.

Skills

Notwithstanding Austria's high productivity, a shortage of skilled workers and researchers is a risk in the longer term. To overcome the effects of an aging society and a more skills-intensive economy, improved performance of the education and training system would be warranted. The untapped skills potential of citizens with a migrant background, and early streaming in the school system contribute to Austria's workforce being under-utilised¹³² and current efforts do not seem to be sufficient.¹³³ The *Red-white-red card*, a system for managing demand-led labour migration, has made it possible to fill some gaps in bottleneck sectors, though its overall impact so far remains limited (only 2800 work permits in 19 months). Increasing enrolment in higher education means that universities need to overcome financial and organisational limitations to increase the relatively low completion rates.

Sustainability

The energy and carbon intensity of Austrian industry has improved over the last decade, and both are below the EU averages. While industries falling under the emissions trading scheme will reduce CO₂ emissions by 21% by 2020, Austria is aiming at a 16% reduction for the other sectors. The key policy document for addressing this and other energy challenges is the national energy strategy of 2010, with three pillars concerned with increasing energy efficiency, energy security and the share of renewables; the latter with an ambitious target of 34% by 2020.

The strategy outlines a mix of cross-cutting and sector-specific regulatory, financial and information measures. About half of the 42 measures have already been or are being implemented. Two of the funding measures appear particularly successful:

¹³² See also the Commission staff working document on the assessment of the National Reform Programme and stability programme on both challenges and on-going reform measures in the education system.

¹³³ The efforts include the introduction of the "Neue Mittelschule" (lower secondary school); a Lifelong Learning Strategy (2012); strengthened counselling services; and efforts to facilitate the recognition of diplomas and skills in particular of the foreign-born population.

the ‘greening of industries’, supporting sustainable management measures in enterprises, with funding of some EUR 90 million in 2011; and an improved and extended instrument for thermal insulation of residential (70%) and industrial (30%) buildings, with a planned annual budget of EUR 100 million up to 2016. In 2012, almost 16 000 projects (15 300 residential and 600 industrial buildings) with a total investment volume of EUR 650 million received funding. A key measure for boosting the share of renewables is the ‘Green electricity act’ that entered into force in July 2012. Austria is on track to achieve its renewables target for 2020.

Since October 2010 an action plan for green public procurement has been in place and in operation at all administrative levels. Among other features, it strengthens the use of ‘social’ criteria. The plan establishes 16 groups of procured goods and services with different criteria that have been fully applied since May 2011, including in electricity, for new contracts and for 70% of all contracts.

Several environmental tax measures (increased mineral oil tax; air ticket tax; and car registration tax reform) have entered into force recently and are expected to substantially reduce CO₂ emissions. Incentives from the car registration tax have helped to reduce emissions: new cars below 120g CO₂/km have 32% of the market. The airline ticket tax of 2011 has been reduced for short and medium-distance flights because of competitiveness concerns.

An implementation plan to boost electro-mobility was adopted in June 2012. It contains measures to promote Austrian technological know-how and export potential in the field, as well as infrastructure and awareness-raising measures to increase the use of electric vehicles.

Austria adopted, in 2010, a plan on primary raw materials and, in 2012, a resource efficiency action plan, including secondary resources. The focus in implementing the resource efficiency plan is on improving data collection and monitoring tools on resource use. One of the implementation challenges is that land-use planning is a *Land* competence. The *Länder* have to integrate the mineral resources plan into their bodies of legislation.

4.20.3 Export performance

While Austria’s share of exports in GDP is clearly above the EU average, the shares of high-tech and green exports are slightly below it. Export intensity grew substantially, from 35% in 1995 to 57% in 2011. The main export destinations are Germany (by far the largest), Italy, the US, Switzerland and France, followed by central and eastern European neighbours and the UK; all EU countries together account for about 70% of exports.

While flows to European countries have been mostly stagnating, those to Asia grew by 2 per cent in 2012. Main export goods are machines and automotive, manufactured goods, chemical products and food products. With more than 24 million international visitors in 2012, tourism contributed significantly to the balance of payments, with a net contribution of EUR 6.8 billion.

Export promotion is run jointly and successfully by the Ministry of Economy and the Chamber of Commerce. A key tool is the ‘go-international’ initiative managed by the Chamber. It comprises services like information, assistance and advice to enterprises, and financial support for such things as market entry costs and events, trade fairs and missions. Measures are organised in five clusters that focus on assistance to SMEs, development of niche markets, exports in services, FDI and communication.

4.20.4 Business environment and infrastructure

Austria has a favourable business environment and a competitive economy. In a continuing effort to make it easier to run a business, it has an administrative burden reduction programme. The most significant measures belong to the second phase of the one-stop e-government portal for businesses *Unternehmensserviceportal* (estimated reduction of EUR 200 million; see also below), the recent introduction of e-invoicing (making them legally equivalent to paper invoices; with an estimated reduction potential of up to EUR 400 million) and the ‘SME initiative’, including measures in trade law (e.g. establishment of a new central trade register). Provided that these reductions will materialise as expected, the EUR 1

billion reduction target set for 2012 will be met, albeit with some delay.

While procedures for setting up a single-person company are relatively light, there is room for further improving start-up conditions for other legal forms, such as limited liability companies.¹³⁴ A reform has been under discussion for several years, and a proposal was forwarded to Parliament in May 2013. It proposes a reduction in the required minimum capital and in the related costs for notarial certification. The minimum corporate tax would decrease proportionately, and the announcement requirement would be abolished.

There is further room for promoting competition and improving choice for businesses and consumers in professional services, in particular pharmacies and some medical professions (e.g. optometrists). In particular, the possibilities of setting up an interdisciplinary firm, including notaries and lawyers, remain more restrictive than in many other Member States. Such services from a one-stop shop could offer substantial efficiency gains and reduce transaction costs for professional and private clients. Demand for them was confirmed by a survey conducted by the Chamber of Commerce among businesses and their associations in 2009.

In some network services and industries there is room for further market opening. The relevant performance indicators and assessment of ongoing reforms were assessed recently by the Commission.¹³⁵

Austria's overall public administration performance, as assessed by the World Bank's government effectiveness indicator, is well above the EU average. Perceived quality of public services, including quality of the civil service and policy implementation in Austria, is high.

E-government, impact assessment, performance and service orientation, and accountability are used more widely to modernise public administration than in the EU on average. There is comprehensive provision of business-related e-government solutions, where Austria is well above the EU average. On the other hand, modern human

resources management tools — like performance-related rather than seniority-based pay or measures to increase the internal flexibility of the civil service— are used less than in the EU on average.

The composite public procurement index indicates some scope for improvement concerning the time needed, and especially the cost of taking part. Whereas the EU average cost of taking part in a tendering procedure amounts to 0.19% of domestic GDP per capita, the equivalent figure in Austria is 0.26%. Payment delays on the part of public authorities are less problematic than at the EU average, amounting to 44 compared to 66 days.

The time needed by businesses to comply with tax obligations is lower than the EU average (170 hours vs. 193 for a benchmark model company), as is the number of payments to be made (12 vs. 17 in the EU on average). A widely used internet portal for paying taxes has existed for some time, but will be integrated in the e-government business service portal.

Austrian states receive the lowest proportion of total tax revenues among the federal states in Europe.¹³⁶ The share of local government revenues (12.0%) is slightly above the EU-27 average (10.8%). The 2009 increase in tax shares of lower levels of government is due to an increased share in revenues agreed as part of the financial equalisation procedure, replacing former transfers to lower levels of government.¹³⁷

While there have been no recent initiatives for a major institutional reform to change the distribution of competences between the national and regional levels with a view to better aligned management of public spending and revenues, there are examples of more limited reforms. A comprehensive reform of the system of administrative courts is being implemented and will enter into force as planned in 2014. It will streamline the system to no more than two instances (nine courts of first instance at regional level; two at national level) with a view to

¹³⁴ World Bank 'Doing Business' survey 2013.

¹³⁵ Commission Staff Working Document 'Assessment of the 2013 national reform programme and stability programme for Austria' 29.5.2013, SWD(2013) 370 final.

¹³⁶ 10% as against more than 20% in Belgium, Germany and Spain.

¹³⁷ European Commission: Taxation Trends in the European Union 2013 (May 2013), http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structures/2013/report.pdf

speeding up procedures. This will replace some 120 specific administrations.

Construction law is a *Land* competence¹³⁸ and remains a difficult area for businesses. In order to lighten the burden, the approval procedures for construction permits for plants¹³⁹ are coordinated, e.g. for constructing iron and steel production plants. The powers of the federal competition authority (BWB) have been increased.

Austrian administration offers a broad and increasing range of e-government solutions to businesses, thus boosting efficiency. Since May 2012, the e-government one-stop-shop business service portal (USP) has been offering extended functions based on a single sign-on for the most important administrative procedures at federal level, e.g. tax declarations (*FinanzOnline*), e-invoicing to federal public authorities, management of a virtual company data file, and data exchange with social insurance bodies. One focus of the next phase, planned for 2014, is the avoidance of multiple declarations, something which also contributes to burden reduction. Other key advantages for businesses include reduced paper use and partly direct interface between the USP and companies' internal systems. The reduction in administrative costs is estimated at up to EUR 300 million, depending on the services provided.

An amendment to the Austrian e-government act introduced an obligation for public authorities to query public registers to verify the accuracy of data used in official procedures before asking citizens or enterprises to provide additional documents.

In January 2013 Austria launched an impact assessment system based on an IT tool that guides users through the assessment of different types of impacts (budgetary, administrative burdens, SMEs, gender equality, consumer protection, environment, etc.). To back the implementation of the system there is training for civil servants; a handbook; monitoring by the federal chancellery; and annual reporting. All this has introduced both an organisational and a cultural challenge. However, one drawback is that the main focus of the analysis is on the envisaged proposal and not on comparing alternative options.

¹³⁸ 'Länderzuständigkeit'.

¹³⁹ 'Betriebsanlagegenehmigung'.

4.20.5 Finance and investment

In most aspects of access to finance, Austria fares better than the EU average. The relatively diversified and stable banking system provides sufficient debt financing for SMEs in the current market environment. In the context of broader diversification of financing sources, the country will have to step up the development of alternatives to bank lending if it is to ensure sufficient access to finance in the long run.

Relative weaknesses persist as regards access to and supply of equity finance. While some progress has been made regarding business angels, the relatively underdeveloped stock market for SMEs, small- and mid-caps and the venture capital industry do not generate sufficient alternatives for raising capital, in particular for early-stage financing. In particular, the size and depth of the venture capital market remain well below the EU average. Improving the legal framework for venture capital thus remains a challenge for 2013, e.g. by increasing the attractiveness and transparency of legal forms used for (i) venture capital funds and (ii) investment vehicles, including measures mitigating possible tax disincentives. The recent proposal to facilitate crowdfunding by making limited changes to the legal framework (the *Kapitalmarktgesetz* and, if appropriate, the *Bankwesengesetz*) is an important step forward in improving SME access to finance and would merit implementation without delay. The government has — notably via *Austria Wirtschaftsservice GmbH* (aws) — implemented several new initiatives to support young entrepreneurs and innovative SMEs. The main purpose is to ensure stable access to finance by mobilising private risk capital across the different stages, up to and including the growth phase.

4.20.6 Conclusions

Austria scores well in the overall competitiveness of its economy; its labour productivity remains above the EU average; and it has no major bottlenecks to cope with in the short run. In the context of a developed high-income country, however, it faces structural weaknesses in some areas, which may harm the long-term potential of its economy.

The knowledge triangle (education, research and innovation) is one of the areas in need of priority action, as reflected in the 'Becoming an Innovation Leader' strategy. Dedicated implementation of this strategy will be instrumental in fully exploiting the potential contribution of research and innovation to the competitiveness of Austria's economy, and thus facilitating the structural shift towards more skill-intensive, higher value-added activities. Other measures that are important in this context are those that increase the quantity and quality of the available workforce and that optimise the utilisation of available skills.

The favourable business environment could be made even more attractive by streamlining start-up procedures for limited liability companies and by increasing the availability of non-banking financing.

4.21. Poland

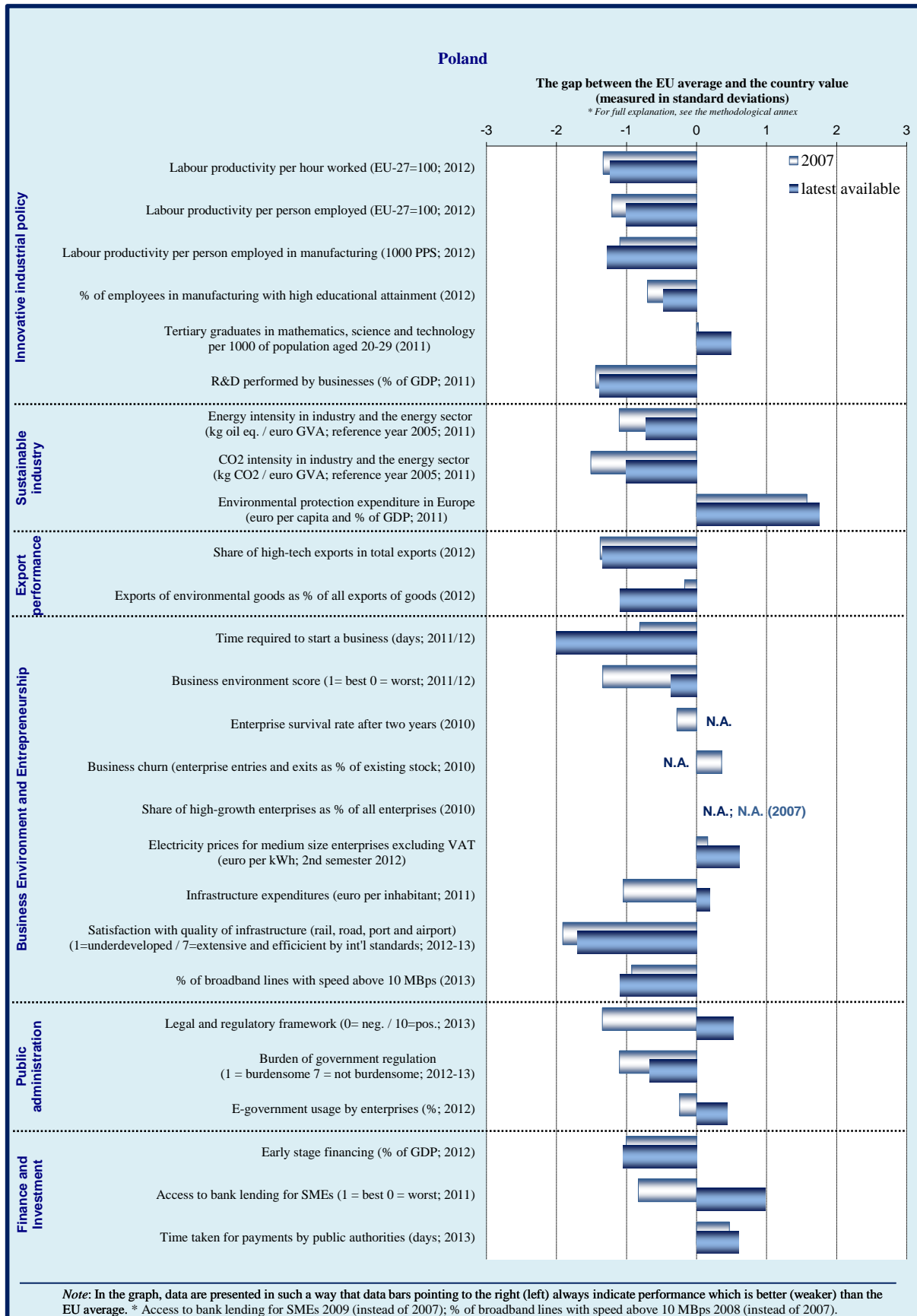
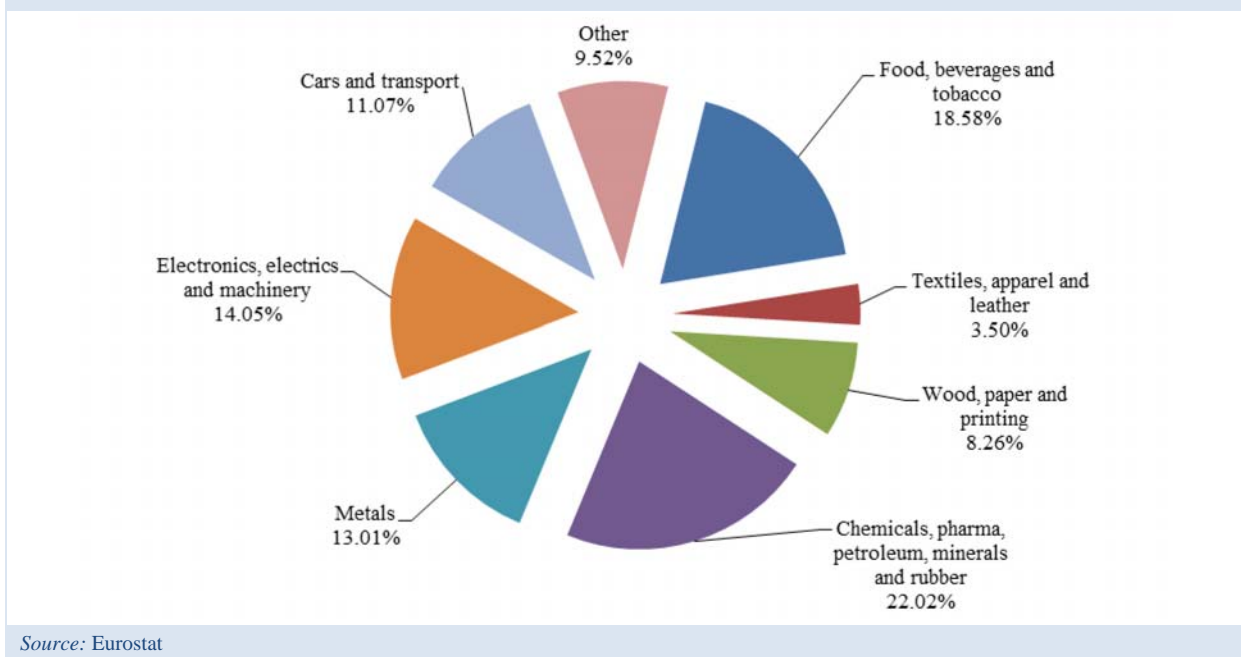


Figure Error! No text of specified style in document.:7: Manufacturing sectors – Poland (2010)

4.21.1 Introduction

Poland's GDP grew by 1.9% in 2012 — due in large part to strong exports. Manufacturing accounts for nearly 18% of GDP (EU average 15.3%).¹⁴⁰ The manufacturing sector is a mixture of low, medium and high-technology sectors. In 2009, the largest sectors were food (14.8%), fabricated metal products (9.7%) and motor vehicles (8.2%). Between 2005 and 2011, high-technology manufacturing grew by 14.5% annually.

Manufacturing accounts for 29% of employment (EU average 22.9%). While labour productivity is relatively low, at about 69% of the EU average, it has continued to improve (up 13 percentage points from 2001 to 2011, by 2% in 2012). The real effective exchange rate based on unit labour costs depreciated by nearly 7% in the last two years.¹⁴¹

4.21.2 Innovation and sustainability

Innovation

Innovation remains a problem area and shows few signs of improvement. In the 2013 Innovation Union Scoreboard, Poland was downgraded to the

lowest category. Over the period 2008-12, innovation performance improved on average by only 0.4% annually, the third poorest performance in the EU.¹⁴² The scoreboard ranks Poland high in the area of human resources, but below average for almost all other factors. The largest problems are the weak innovation performance of most firms, the limited commercialisation of R&D, and the lack of linkages between innovators and business, especially SMEs. Highest shares of innovative companies are found in pharmaceuticals and insurance.¹⁴³

In recent reform programmes the government has recognised that innovation is 'an opportunity for ensuring dynamic growth of the Polish economy, especially in the context of diminishing impact of traditional sources of economic growth'.¹⁴⁴ The National Centre for Research and Development (NCBiR) was given new competences with a view to improving the allocation of funding and promoting research and innovation. The Centre is also responsible for the distribution of relevant structural funds; its 2013 budget was EUR 1.1 billion. It focuses on commercialisation of research — e.g. supporting key enabling technology

¹⁴⁰ Eurostat (2012).

¹⁴¹ ECB (from SWD Assessment of the 2013 reform programme and convergence programme for Poland).

¹⁴² Innovation Union Scoreboard 2013.

¹⁴³ Research and Innovation performance – Innovation Union progress at country level 2013.

¹⁴⁴ National Reform Programme 2013-14 Update, p. 20.

applications, such as graphene. In 2012 it launched 47 new competitions and, with EUR 307.6 million of entrepreneur contributions, approved 1064 research projects¹⁴⁵ — many in cooperation with venture capital funds.¹⁴⁶

In January 2013, the government adopted the *Strategy for Innovation and an Efficient Economy 2020*, which reflects the strategic goals of the European Union. Its implementation programme¹⁴⁷ was subject to public consultation in February and now awaits adoption. The programme focuses on improving the regulatory and financial environment to stimulate innovation.

While reforms are moving in the right direction, R&D expenditure is low, at 0.77% of GDP (EU average 2.03%). Business expenditure on R&D is especially low — around 0.23%, compared with over 1% for the EU.¹⁴⁸ It has also stagnated, reflecting both low R&D investments in the technology sectors, and the structural change towards less R&D intensive sectors.¹⁴⁹ Given the recent level of performance, reaching the 2020 target of 1.7% will be difficult. In the near future expenditure is expected to rise due to the impact of the 2014-20 Structural Funds.

Recent reforms have targeted two major underlying problems of innovation performance. First, there is the reliance of firms on technology take-up rather than innovation that stems from the long period of catching up. Second, efforts have been made to reduce risk aversion, as previous innovation programmes favoured large, mature firms and low and medium-technology industries, with insufficient support for SMEs and innovative start-ups.

Skills

In the long term, improved productivity and the transition to a knowledge economy will depend on the quality of education and skills. In terms of basic skills, 15-year olds' performance in the 2009 PISA outperform the EU average in maths and reading, and improving in science. However, the ICT skills

are low in comparison with the EU average. Tertiary education attainment in Poland is above the EU average (39.1% in 2012 vs. 35.7% EU average),¹⁵⁰ and in case of early school leaving, Poland is one of the best EU performers with 5.7% vs. 12.7% EU average). However, there is a skills mismatch¹⁵¹ and not enough attention is being given to the future skills needs of the economy such as problem solving, critical thinking and teamwork, which could be developed at early stages of education. In response, the government has implemented reforms to improve the provision of technical and science studies, vocational training and transversal skills.

The vocational training system was reformed in 2012, involving employers in curriculum design and flexible exams. A successful pilot programme of 'procured studies' was concluded in 2012, offering incentives to students in the priority areas, succeeding in making science and technology the second most chosen field. Funding for the next round of the programme has been increased.

To improve the quality of education, the government has introduced grants disbursed on a competitive basis to higher education institutions, based on their quality.¹⁵² Further, co-financing is available for universities for implementing internal quality assurance systems. The government also presented proposals of amendments to higher education laws in 2012 to differentiate between academic and vocational higher education institutions and introduced dual studies linking academic studies with practical training in companies, a list of faculties that received a negative opinion from accreditors will be published so that potential students are better informed before making their choice.

Sustainability

In sustainability, Poland lags behind EU performance, but is catching up in some areas. In others, though, reforms have been slow. According to the report *Energy Efficiency Trends in the EU*,¹⁵³ the reduction in energy intensity for final users in 2000-09 was highest in Poland, at almost 3% per

¹⁴⁵ PwC Report, ordered by NCBR, 2013.

¹⁴⁶ BRIdge VC pilot programme.

¹⁴⁷ Programme for the Development of Enterprises.

¹⁴⁸ Innovation Union Scoreboard 2013, Annex B.

¹⁴⁹ Research and Innovation performance – Innovation Union progress at country level 2013.

¹⁵⁰ Rethinking Education: Country Analysis (2012).

¹⁵¹ See section 4.5.

¹⁵² Top institutions achieve KNOW status (Leading National Research Centres) — 6 were chosen in 2012.

¹⁵³ OdyseeMure (2012) *Energy Efficiency Trends in the EU*.

annum (EU average 1.2%). Despite this, energy intensity in 2011 was still half as much again as the EU average.¹⁵⁴ Large reductions were achieved in industry — these were due to both structural changes and efficiency improvements. Poland continues to rely heavily on coal, oil and gas in its energy mix, while renewable sources account for 7.3%.¹⁵⁵ The absolute level of greenhouse gas emissions has also continued to rise.

New policy instruments in this area include the white certificates that seek to give incentives to suppliers of electricity, heat and gas to achieve energy savings, or face a penalty payable to a sustainability fund. Also, *Polskie Inwestycje* is a new investment fund providing co-financing for large-scale, commercially viable energy generation and infrastructure projects, planned to start operating in 2013.

Sustainability reforms are proceeding slowly, which has led to infringement procedures against Poland for incomplete transposition of EU directives on renewable energy, the internal energy market and waste management. The reforms (some with drafts dating back to 2011) are awaiting adoption as part of an ‘energy three-pack’. These would contain measures for reducing the regulatory burden and reforming the approach to renewable energy sources, together with provisions for smart grids and a prosumer energy market.

The government is completing its long-term *Strategy on Energy Security and the Environment*. It includes measures on developing nuclear energy (by utilising domestic sources of uranium and domestic research and industry), developing shale gas resources; better reutilisation of waste; and improving the water intensity of industry (which is three times the EU average).

In the long term, improvements to energy efficiency and changes to the energy mix will be needed to comply with the Energy Roadmap 2050. As the effects of the emissions trading scheme become evident, new incentives for improving energy efficiency will arise. A national emissions auction

platform is planned to come into operation by the end of 2013.

4.21.3 Export performance

Exports account for 42.3% of GDP, making Poland a relatively open economy given its size.¹⁵⁶ It is a net importer, but the current account deficit improved from 4.9% in 2011 to 3.5% in 2012.¹⁵⁷ The EU accounts for a large majority of Polish exports.

Despite depressed demand due to the crisis, exports rose throughout 2012,¹⁵⁸ driven by sustained competitiveness gains, a floating currency and a large labour pool. Exports consist mainly of electromechanical products, chemicals, furniture and foodstuffs, although Polish exporters are trying to strengthen their operations in sectors such as sustainable construction and biotechnology.

Polish exporters are supported by a number of public institutions. The Ministry of the Economy runs a network of sections within embassies and consulates that provide information and operational support for exporters and importers. Also, with co-financing from the Innovative Economy Operational Programme 2007-13, the ministry operates a programme of brand promotion in target markets, and runs a network of service centres within Poland, providing high-quality information services to prospective exporters and foreign investors.

Financial support is also available in the form of favourable loans to firms intending to enter foreign markets. Further, financial and training support for the internationalisation of SMEs is available from the agency for enterprise development,¹⁵⁹ and there is a dedicated organisation for export credit insurance.¹⁶⁰ The *GreenEvo* programme offers support for innovators and start-ups in the green economy, providing easy access to existing programmes and promoting innovation.

Exports are expected to benefit in the medium term from a recovery in the European economy. In the

¹⁵⁴ 0.272 kg oil equivalent /euro GVA, c.f. 0.184 for the EU weighted average.

¹⁵⁵ Making the Internal Energy Market Work, Country Report: Poland (2011).

¹⁵⁶ databank.worldbank.org (2012).

¹⁵⁷ Central Statistical Office GUS (2013) *Prices, Trade*, www.stat.gov.pl/gus/ceny_handel_ENG_HTML.htm.

¹⁵⁸ OECD.StatExtracts International Trade (2013).

¹⁵⁹ The Polish Agency for Enterprise Development (PARP).

¹⁶⁰ The Export Credit Insurance Corporation (KUKE).

long term, however, a shift towards higher value-added sectors is needed for continued good performance.

4.21.4 Business environment and public administration

Business environment

Problems in the business environment create an obstacle to competitiveness improvements. The World Bank's 'Doing Business' 2013 report ranks Poland 55th globally. However, in 2012-13 Poland was the top reformer worldwide. In a longer perspective Poland has, since 2005, been the top reformer among OECD countries.

Poland has recently made major advances in making it easier to register property, pay taxes, enforce contracts and resolve insolvency. The time needed to register a firm has been reduced: two new procedures have been introduced, making possible the online registration of sole proprietorship businesses and limited liability companies. The procedure for limited liability companies has been criticised as it offers only restricted options, but the sole proprietorship business procedure is used widely by SMEs. A new bankruptcy law is being drafted, and a codification commission is scheduled to conclude the reworking of the construction code in 2014. However, employment in SMEs has fallen since 2009, and SMEs are below the EU average in terms of technology and knowledge intensity.

In many indicators much improvement is needed, including the tax compliance burden (World Bank rank 114th), and streamlining procedures for construction permits (rank 161th).

The deregulation of professional services was initiated in 2012 by reducing regulatory barriers affecting 230 professions, by reducing or removing qualification requirements and reserves of activities. Currently the reform has been split into three sections. The first, covering around 50 professions, has been adopted. The second, affecting a further 91 professions, has been proposed by the government and is being debated in the parliament.

Infrastructure poses further challenges. Despite sizeable investment in the road network, transport infrastructure remains deficient, but it is the ageing

railway system that is especially problematic, as it never enjoyed more than low priority in the past. Some minor reforms have now been undertaken. In 2012, the government replaced the management board of the state railways, and a task force has been established to monitor implementation of EU-funded railway projects and identify obstacles to development. The budget of the regulator has also been increased. These developments have not, however, produced results so far; clear political and financial commitment from the government would be needed. On road transport, progress has been uneven across regions, with work concentrating on large cities and the TEN-T network. Energy prices are kept high by insufficient competition among incumbent energy providers, and by the ageing generation capacity.

In ICT infrastructure, Poland had the lowest broadband coverage in the EU, both nationally and for rural areas, in 2011. Only around 28% of citizens used online public services in 2011, but 92% of businesses did so, a figure higher than the EU average of 84%.¹⁶¹ In December 2012, public consultation terminated on the National Broadband Plan, coordinating the development of ICT networks, and envisaging full national coverage in 2014.

Public administration

Public administration remains cumbersome and causes high costs for businesses. In the World Bank Worldwide Governance Index, Poland scores high on stability, accountability and regulatory quality, but lower on the rule of law, government effectiveness and corruption. Transparency International ranks Poland 11th most corrupt country in the EU. Business stakeholders have noted some improvement, with more cooperative ministries and more frequent consultations.¹⁶² As regards the judiciary, the increasing average length of proceedings in civil and commercial cases, difficult contract enforcement, long insolvency proceedings and low recovery rates are a source of concern.

Although the low level of taxation provides incentives for businesses to grow, the tax

¹⁶¹ Digital Agenda for Europe, Progress by Country: Poland (2013).

¹⁶² Fact-Finding Mission Report 2013.

administration is inefficient and complex. From the business perspective, the tax compliance burden is high due to the large number of payments and time needed to comply with tax regulations. Additional costs are caused by the low thresholds for compulsory VAT registration.

In 2012-13, reforms aimed at improving the efficiency of public administration concentrated mainly on the increased use of e-government, including the removal of certified signature conditions for e-taxes. The act on the standardisation of application forms in administrative procedures was adopted by the government. Moreover, a legislative amendment to the code of civil procedure made proceedings in business cases simpler and less formal.

In February 2013, the government adopted the *Efficient State Strategy 2020*, outlining a framework for an open, accountable and efficient governance model based on cooperation between civil society and all levels of government.

4.21.5 Finance and investment

Access to finance is significantly easier in Poland than in the EU on average. In terms of the legal and administrative environment as measured by the World Bank, Poland ranks second in the EU, and is tied for fourth place worldwide. Further, due to the favourable macroeconomic conditions, the financial sector has remained profitable. Lending to the non-financial sector grew by 1.2% in 2012,¹⁶³ and long-term interest rates have continued to fall, to 3.93% in March 2013.¹⁶⁴

However, to ensure that the situation stays favourable, the government has taken action. The national loan guarantee scheme had been criticised for operating on a commercial basis only, with fees too high to be attractive. In March 2013, a new guarantee scheme, operating on *de minimis* rules, came into operation. The Polish Growth Fund of Funds, created in 2013 by the European Investment Fund and the state bank, seeks to stimulate investment in venture capital, private equity and mezzanine funds. The role of the *National Capital Fund* is evolving, with a greater focus on the start-

up phase of innovative SMEs. Also in 2012, the authorities took steps to address credit risk in the banking sector. Nevertheless, the lack of venture capital creates a funding gap for private, innovative SMEs at early stages of development. Foreign direct investment remains an important source of funding, with inflows exceeding USD 15 billion in 2011.¹⁶⁵

4.21.6 Conclusions

Poland's competitiveness is an interesting mix of weak institutions and good performance. In 2011, Poland was the country with the second-highest proportion of rapidly growing young firms in the EU — as many as 5% of businesses were so classified.¹⁶⁶ However, the time period in question (2008-11) makes the comparison especially favourable. Exports have been a strong engine for growth — aided by the flexible currency regime. In the medium to long term, the weaknesses in innovation, sustainability and business environment are likely to limit growth and competitiveness unless appropriate reforms are implemented.

The government's *National Development Programme 2020* features nine specific strategies for the necessary reforms and changes. So far, though, the implementation of these reforms has been slow and often delayed, and the reforms have been watered down, especially in the area of renewable sources of energy. On the other hand, the law on deregulation of professional services and the procedures for business registration online are steps in the right direction.

If it is to achieve the goals of its Europe 2020 strategy, Poland needs to become a more knowledge-based economy, which would require significant progress in the areas of innovation, sustainability and the business environment.

¹⁶³ ECB (from SWD Assessment of the 2013 reform programme and convergence programme for Poland).

¹⁶⁴ ECB.

¹⁶⁵ UNCTAD, World Investment Report 2012.

¹⁶⁶ SME's Access to Finance Survey 2011.

4.22. Portugal

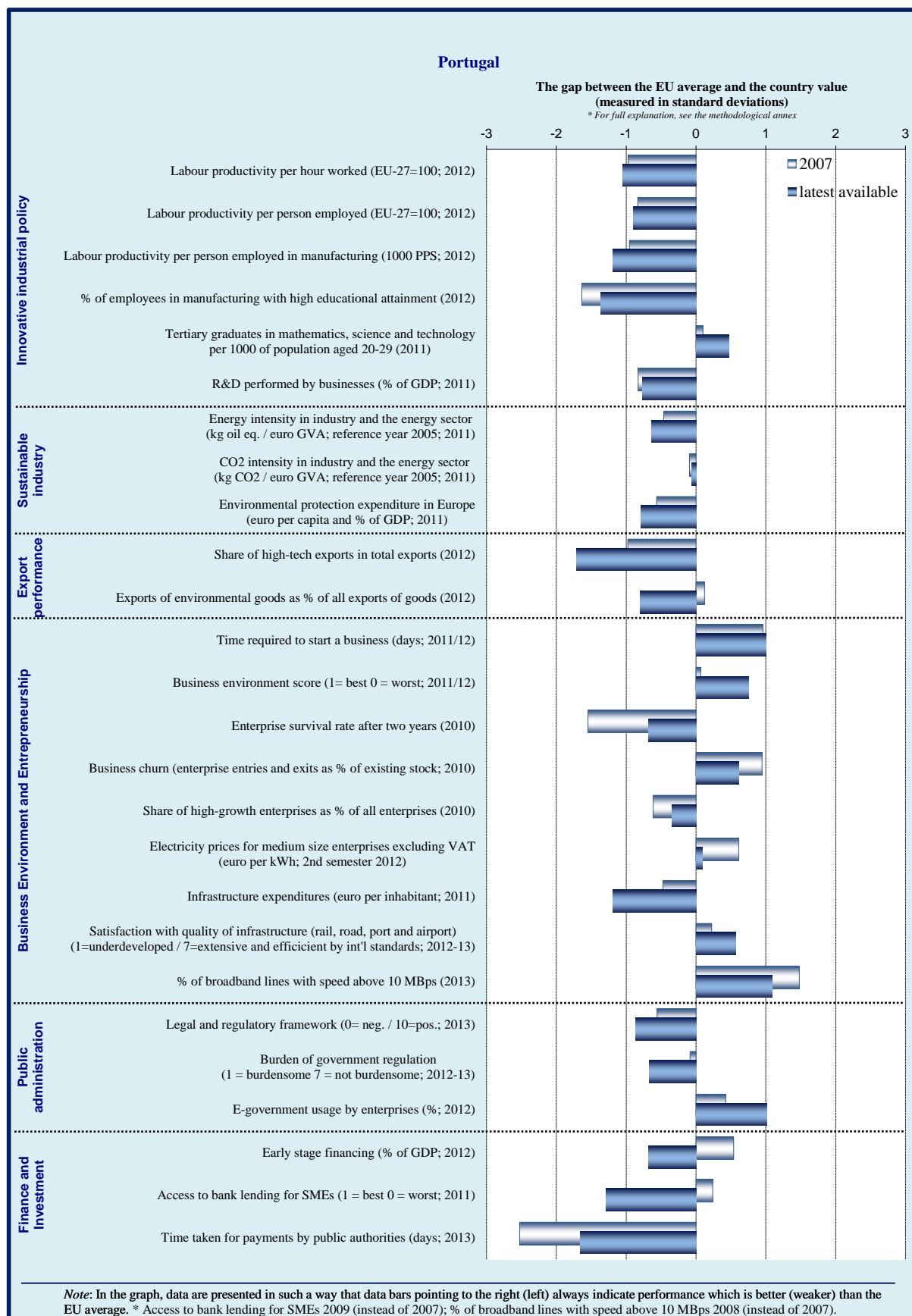
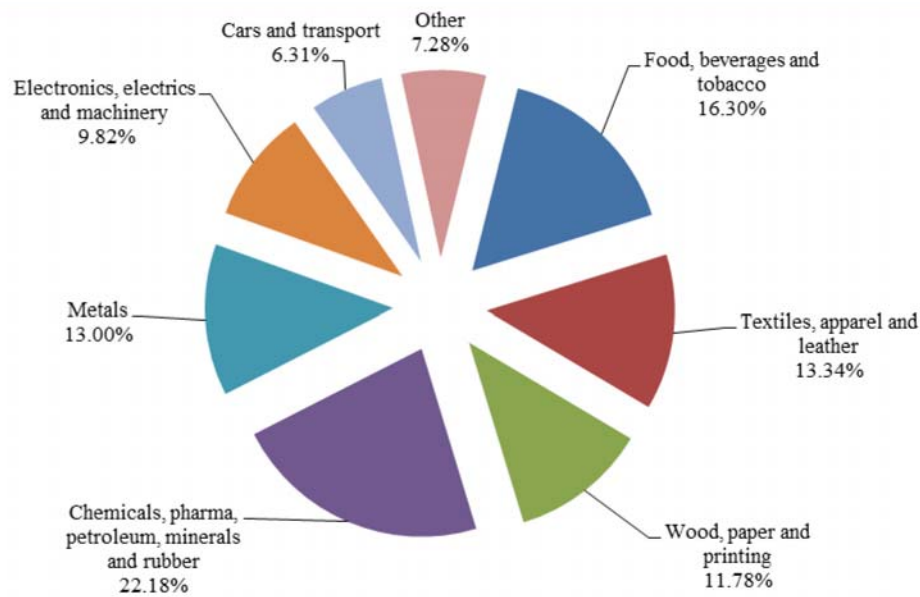


Figure Error! No text of specified style in document.:8: Manufacturing sectors – Portugal (2010)

Source: Eurostat

4.22.1 Introduction

In terms of value added, manufacturing plays a broadly similar role in Portugal to what is observed in the EU as a whole (14.3% against 15.3%). Portuguese firms are specialised in low tech manufacturing (manufacturing of food products and beverages, textiles and wearing apparel, etc.) and less-knowledge-intensive services (trade, accommodation and food services, travel agencies, etc.). High-tech manufacturing and knowledge intensive activities are still under-represented in terms of number of firms and value added.

The pace of productivity growth over the last decade was too slow to achieve convergence with the EU's higher-income Member States. However, productivity as measured by unit labour costs relative to the euro-area average has improved significantly over the last three years, mainly as a result of lay-offs and public-sector wage cuts. Still, total factor productivity is lower than a decade ago and the share of employment in knowledge-intensive activities is still relatively low.

4.22.2 Innovation, skills and sustainability

Innovation

The strong growth of investment in innovation¹⁶⁷ over the last decade has led to a significantly expanded research and innovation system, although R&D intensity has declined considerably since the start of the economic crisis.

The latest Innovation Union Scoreboard ranked Portugal as a moderate innovator with performance below the EU average. Its main weaknesses are the low share of business R&D investment; low venture capital investment; and equally low non-R&D and innovation expenditure. Although there are many innovative SMEs, high-tech knowledge-intensive service exports remain low. There is also considerable diversity in regional innovation performance, as the country is one of only two Member States with at least one region in each of the four different performance groups.

The main measures adopted by the government to foster the commercialisation of research results

¹⁶⁷ Investment in research grew at an average annual real growth rate of 7% between 2000 and 2007. Source: Research and innovation performance in EU Member States and associated countries 2013, European Commission.

include the renewal of US-Portugal partnerships with a focus on innovation and entrepreneurship; the creation of a new national organisation to speed up innovation and technology transfer;¹⁶⁸ and a technology transfer initiative which groups together various institutes and the European Space Agency to facilitate the transfer of space technologies to non-space markets. Furthermore, Portugal continues to use the structural and investment funds to support incentive schemes for promoting innovation by businesses.

Cluster policy is also being rationalised and refocused with the aim of fostering competitiveness and exports. This new approach has served to identify 11 clusters with an international dimension in traditional and high-growth sectors,¹⁶⁹ and eight clusters with national and regional dimension focusing on natural endogenous resources.¹⁷⁰

Finally, a new digital agenda was approved in December 2012 that aims to provide the managers of firms with technological solutions customised to SME needs and practical information on starting up a digital business.

Skills

Portugal's low productivity is partly explained by the lower qualifications of its labour force when compared to other Member States. Although Portugal performs below or close to the EU average in several of the most important indicators on education and skills, it has a low tertiary educational attainment. However, its progress in recent years has been significant and steady.¹⁷¹ The recent increase in cross-border mobility of educated youth may adversely affect productivity growth in the medium term.

In 2012, the government launched a major restructuring of the vocational education and training system to bring it more into line with labour market needs, in particular those of exporters. The reform includes a review of training supply and curricula, the development of incentives

for promoting apprenticeships, and the creation of professional schools in partnership with private stakeholders. The dual training system is also being strengthened with a view to raising its capacity from 30 000 places in 2012 to 100 000 in 2020. New centres for qualification and vocational education were created in 2013 and aim at providing people information and guidance on education and training, and on labour market integration. These centres also aim at developing procedures for the recognition, validation and certification of competences.

From school year 2013/14, work practice requirement will be extended in vocational education and training curricula. This will require deeper involvement of companies in the process, which is also one of the ways that have been identified to achieve higher standards.

Substantial progress has also been made in the area of activation and active labour market policy, with about half of the recipients of unemployment benefits being redirected to training measures. The *Vida activa* scheme, which aims to develop high-employability training modules, and the *Impulso jovem* scheme to tackle youth unemployment are playing an important role.

Sustainability

In the energy sector, full liberalisation of the electricity and gas markets took place in January 2013, and legislation on a new energy regulator has been adopted. To reduce the fragmentation of the Iberian electricity market, the capacity of the interconnectors with the Spanish transmission network is being increased.¹⁷² During 2012, the government also adopted various measures to eliminate the tariff debt and to ensure the sustainability of the system.

As regards resource efficiency, the national plan for the efficient use of water has been updated. It identifies specific measures to reduce water consumption. In early 2013, Portugal transposed the directive¹⁷³ on energy performance of buildings, and the government signed an agreement with the

¹⁶⁸ GAIN — Global acceleration innovation network.

¹⁶⁹ Such as ICT, health, advanced manufacturing, mobility, fashion, engineering and special tools.

¹⁷⁰ Such as agribusiness, wine, the sea, natural stone.

¹⁷¹ Tertiary education attainment was 27.2% in 2012. There has been remarkable progress from rates of about 11% at the beginning of the last decade.

¹⁷² An investment programme has been put in place to almost double the existing capacity. It includes the construction of a new 400 kV line and the construction of two new 400 kV interconnections.

¹⁷³ Directive 2010/31/EU.

industry to promote resource efficiency in construction activities. Several measures have been implemented to lower energy prices, in particular by decreasing subsidies to generators, although the results have not yet been satisfactory. Further, the government has also approved this year its national plan for energy efficiency 2013-16 and its national plan for renewable energy 2013-20. The launch of an eco-innovation roadmap is planned for 2013.

There is a national strategy¹⁷⁴ on raw materials, in particular geological resources, that aims to make the mining industry competitive and to ensure a sustainable supply of raw materials. The strategy establishes a funding strategy for the promotion of the exploration phase with a view to attracting foreign investment to exploitation.

4.22.3 Export performance

Export performance was strong in 2012 and continued the upward trend of previous years, despite weakening in the last quarter. This has continued in the first half of 2013. The share of exports in GDP progressed from 28% in 2009 to 38.7% in 2012, and at the same time exports have become more diversified with more target markets.¹⁷⁵

Facilitating the access to finance of businesses in tradable sectors is crucial to foster their internationalisation. Therefore, various short-term lines of credit insurance have been renewed to enable enterprises to cover the commercial credit risk of external transactions with a public guarantee provided either directly or through the national mutual guarantee system. In addition, a new credit line has been created to support and promote exports.

Portugal has also recently introduced a system speeding up VAT exemptions for exporting firms. This new system should reduce the time required to provide all the necessary information from an average of more than 42 days to just four days so that VAT will be refunded much faster.

A strategy board for the internationalisation of the economy¹⁷⁶ has been set up to bring together public authorities and business trade associations¹⁷⁷ with a view to evaluating the coordination of public policies and private initiatives to promote exports and attract foreign direct investment.

4.22.4 Business environment and public administration

Business environment

Portugal is carrying out a wide array of structural reforms to reduce the regulatory burden on businesses and to improve competition. As a result, starting a business in Portugal and obtaining licences is on average easier than in other Member States, although licensing complexity remains high.

In the area of licensing, a comprehensive programme was launched in 2012 to tackle excessive procedures, regulations and other administrative burdens.¹⁷⁸ It included the revision of legal regimes such as environmental and land-use planning and industrial, commercial and tourism licensing. The overall goal is to move to a new system of ex-ante declarations by firms with ex-post control by the authorities. In addition, the government plans to launch a full stock-take of regulations at all levels of administration, with a view to eliminating overlaps and redundancies. It is also considering adopting the 'one-in, one-out' principle¹⁷⁹ and plans to extend the availability of zero-licensing¹⁸⁰ procedures to most industrial

¹⁷⁴ Resolution of the Council of Ministers No 78/2012.

¹⁷⁵ The shares of exports to Angola, China, the US and Brazil have grown, although starting from low levels.

¹⁷⁶ Conselho estratégico de internacionalização da economia.

¹⁷⁷ This Council is chaired by the Prime Minister, and includes the ministers of finance, foreign affairs, economy and agriculture, together with the presidents of the confederations of industry (CIP), tourism (CTP), trade (CCP) and agriculture (CAP) and the associations of entrepreneurs (AEP) and industry (AIP). The Portuguese agency for foreign trade and investment (AICEP) serves as its secretariat.

¹⁷⁸ Programa da indústria responsável, government resolution 47/2012, published on 18 May 2012.

¹⁷⁹ This principle prohibits the creation of a new regulation without the elimination of an existing regulation or regulations with an equivalent cost.

¹⁸⁰ The 'zero licensing' regime ('licenciamento zero') was launched through decree-law No 48/2011. Its objective is to simplify the licensing procedures necessary to carry out several economic activities by reducing red tape through an electronic point of single contact.

activities.¹⁸¹ The government has also approved a roadmap and work programme to enhance the visibility of all simplification efforts in the point of single contact.¹⁸²

To give failed entrepreneurs a second chance, a new programme has been launched, aimed at changing the legal framework to make it easier to recover businesses that are economically sound but may be close to insolvency. The corporate insolvency law was amended in May 2012 to facilitate the early rescue of viable firms.¹⁸³

The process for construction permits has been simplified, and the land registry has been made one of the world's most efficient, according to the World Bank. A law simplifying the regulatory framework for real-estate activities has also been adopted. Furthermore, draft laws on construction and land reserves and amendments to the urban planning rules and procedures are being prepared.

A new law aims to improve the regulatory framework for regulated professions governed by professional bodies, such as lawyers, accountants and architects. This is a major step towards liberalising the exercise and activity of regulated professions. The new legal framework eases rules governing access to professions and the provision of professional services and ensures that profession-specific regulations do not contain unjustified requirements that could limit competition. In addition, access to some professions not governed by professional bodies will be eased through the deregulation of the profession.¹⁸⁴ A second phase of the review of regulated professions is to be launched to identify and ease requirements for access that may no longer be justified or proportionate.

Significant progress has been made in improving the legal framework for the recognition of professional qualifications¹⁸⁵ and in implementing

the legislative changes required by the services directive. More than two thirds of the sector-specific amendments that are necessary to fully implement the directive have been adopted or submitted to parliament.

A new competition law entered into force in June 2012. This law should ensure that the competition authority is able to effectively enforce the competition rules, and is vested with adequate investigation powers in line with other competition authorities in the EU. The government has also tabled before parliament a framework law setting out the main principles for the functioning of the main national regulatory authorities¹⁸⁶ and the competition authority. This legal framework is an important milestone in conferring strong independence on the regulators, which is a major prerequisite for the efficient functioning of important sectors and for the effective enforcement of competition rules in the economy.

The authorities have worked on a reform of ports by devising a comprehensive strategy to reduce the costs by around 25-30% over the next years. The bulk of the cost reductions are expected to come from the revision of concessions. Other relevant measures include the reduction of port tariffs and taxes¹⁸⁷ and the improvement of port governance through the creation of a centralised entity composed of the ministry for transport and port authorities.

A new legal basis for the transport regulator has also been adopted. It merges the three former regulators (rail, ports and road) into a single entity and makes a clear distinction between administrative and regulatory powers. The principles for the functioning of this new regulatory entity for the transport sector will also depend on the framework law on regulators. The government has also privatised the airport operator and aims to privatise the national air carrier (TAP) and the

¹⁸¹ The responsible industry system ('sistema da indústria responsável') extends the zero-licensing initiative to most industrial services.

¹⁸² 'Balcão do empreendedor'.

¹⁸³ Portugal made resolving insolvency easier by introducing a new insolvency law that expedites liquidation procedures and creates fast-track mechanisms both in and out of court.

¹⁸⁴ Indeed, a law deregulating three professions was already approved in 2012.

¹⁸⁵ Amendments to the law transposing the professional qualifications directive have entered into force in order to

provide further information for professionals about their rights, including advice on the various legally admissible means for a professional to attest professional experience acquired when there is no Portuguese competent authority.

¹⁸⁶ Regulators of insurance, the securities market, energy, communications, aviation, transport, health and water and waste services, in addition to the competition authority.

¹⁸⁷ A 20% reduction in tariffs levied by the port authorities (TUP Carga) has been already approved.

cargo handling subsidiary of the national railway company in 2013.

Public administration

Portugal has made significant advances in rationalising the central administration. In September 2012 it completed the plan for restructuring the central administration, which has significantly reduced the number of managers and administrative units.¹⁸⁸ A new information system on the organisation of the state has been created to provide relevant data on human resources in central government, and new ICT rationalisation measures have been designed for shared services. The recruitment of top management positions is now subject to open competitions for a five-year period, and the mobility and flexibility of public servants has been enhanced.¹⁸⁹ The government is now working on a broader reform of public administration addressing training and requalification with a view to allocating human resources more efficiently.¹⁹⁰ The aim is to simplify procedures and limit compensation in all sectors of the public administration.

In the area of taxation, the government has adopted a special VAT regime allowing small companies to defer the payment of VAT to the state until the invoice has been collected. The tax regime for supporting investment has been strengthened.¹⁹¹ Furthermore, a comprehensive reform of the corporate income tax¹⁹² and tax credit schemes has been launched to foster investment and competitiveness.

To complement a local administration reform, the government is also finalising a new law defining competences at the local administration and inter-municipal levels. The new law should avoid

¹⁸⁸ According to the Portuguese authorities, the outcome of PREMACE has been a 27% reduction in management positions and a 40% reduction in administrative units.

¹⁸⁹ New legislation on working time and geographical mobility has been submitted to parliament.

¹⁹⁰ A reform of the 'special mobility' scheme is expected in 2013 to support a broader public administration reform with a view to allocating human resources more efficiently.

¹⁹¹ The measures include: raising the threshold of deductible tax benefits, reducing the minimum eligible investment threshold, reducing the time taken to issue binding tax information and creating a special unit in the tax administration to support international investments.

¹⁹² The following aspects are being considered: the rate structure; the tax base; and international tax policy.

potential overlaps between decentralised services of the state and those of the local administration.

The reform to speed up the judicial system has been continued. A comprehensive roadmap to reduce the number of courts, streamline the court structure and improve the management of courts has been enacted by the parliament. There is now tighter control and supervision of enforcement agents, and the backlog of cases has been reduced. Specialised courts on competition matters and on intellectual property rights also became operational in 2012. Further, alternative dispute resolution mechanisms have been strengthened to facilitate out-of-court settlement.¹⁹³

A revised legal framework for public procurement has also been adopted. It addresses in particular the regime for awarding additional works and services, errors and omissions; the elimination of exemptions permitting direct awards; and the removal of the requirement to invest in R&D projects for contracts above EUR 25 million.

4.22.5 Finance and investment

Access to credit remains costly and difficult, in particular for SMEs. Furthermore, the difficulties in the sovereign debt markets have also been reflected in higher interest-rate differentials than in many other Member States. The credit constraints are pushing companies to find alternative financing mechanisms, although most of these remain underdeveloped due to lack of both demand and supply. The fiscal consolidation efforts have limited the ability of the public bodies to grant further financial support.

The government has taken various measures to ease credit constraints, in particular for SMEs in the tradable sectors. A state-guaranteed line of credit¹⁹⁴ was introduced at the beginning of 2012 and has been renewed in 2013 with an allocation of EUR 2

¹⁹³ The legal framework for financial institutions to engage in out-of-court debt restructuring for households was enacted by decree-law No 227/2012 (general regime). Among other things, this instrument requires banks to develop risk management systems to monitor and prevent the risk of default by households (PARI) and lays down a standard negotiation procedure between the credit institution and the bank client aimed at amicable settlement of debts (PERSI).

¹⁹⁴ PME Crescimento ('SME Growth').

billion. The aim is to ensure and improve access to credit for economically viable enterprises, and to improve the growth and investment capacity of firms. Further, Portugal has reprogrammed structural funds to provide a credit line for businesses to finance eligible projects. An agreement with the European Investment Bank allows the Portuguese state to counter-guarantee up to EUR 2.8 billion of EIB lending via banks to Portuguese firms.

The government has recently announced its plans to create a financial development institution for financing the private sector and promoting industrial development, which would be fully operational in 2014. Portugal is also adjusting the mission of its public bank ('Caixa geral de depósitos') to reinforce its financing role in the economy.

As regards alternative financing mechanisms, the reform of the public venture capital sector was completed in June 2012 with the merging of three previous institutions into a single operator, *Portugal ventures*.¹⁹⁵ The aim was to rationalise the available resources and focus them on strategic industries, particularly in tradable goods, services and tourism. *Portugal ventures* has launched a seed capital facility to invest in scientific and technology-based projects. The government is also preparing a pilot joint issue of corporate debt instruments for the capital market, with a public capital guarantee.

The liquidity problems of enterprises have been aggravated by long delays in payments, in particular by the public sector.¹⁹⁶ Although the arrears have been significantly reduced, particularly in the health sector, further efforts are needed, in particular in the local administration. The effective implementation of the late payments directive will be critical to avoid the build-up of additional arrears.

4.22.6 Conclusions

Portugal's biggest challenge is to restore the competitiveness of its economy after a decade of low productivity growth and growing indebtedness. The economic adjustment programme¹⁹⁷ is contributing to the implementation of a series of reforms to improve productivity and competitiveness. Future economic growth should be based on the ability to export goods and services with high added value, together with the ability to attract foreign investment. The government is therefore rebalancing the economy towards export-led growth by putting exporting companies at the core of its policy initiatives in many areas, such as innovation, education, transport, or access to finance.

The lack of access to finance is a major factor constraining the operations and growth of SMEs. Businesses are disadvantaged by interest-rate differentials compared to many other Member States. The government is trying to ease these credit constraints by strengthening its existing instruments, e.g. state-guaranteed lines of credit, and fostering the use of alternative financing mechanisms.

Significant progress has been made in streamlining the business environment, in particular in the area of licensing, and enhancing competition in services. Consequently, starting up a businesses and obtaining licences is now mostly easier than in most Member States, although some licensing complexity remains.

Portugal has also adopted measures to raise the quality of research and knowledge creation. However, there is still a significant gap between knowledge creation, knowledge transfer and its translation into economic value through innovation, which partially is due to the low share of research-intensive sectors in the economy.

¹⁹⁵ Portugal ventures has EUR 140 million available to pursue its investment policy.

¹⁹⁶ Portuguese public authorities pay their invoices after 139 days on average, which is on average 82 days late with respect to the due date. Source: European Payment Index 2012. Intrum Justitia.

¹⁹⁷ Following a request by Portugal on 7 April 2011, the troika, consisting of the European Commission, the European Central Bank and the International Monetary Fund, negotiated with the Portuguese authorities an economic adjustment programme, which was agreed by the European Council on 30 May 2011. The programme covers the period 2011-14. Its financial package comprises up to EUR 78 billion for possible fiscal-financing needs and support to the banking system.

4.23. Romania

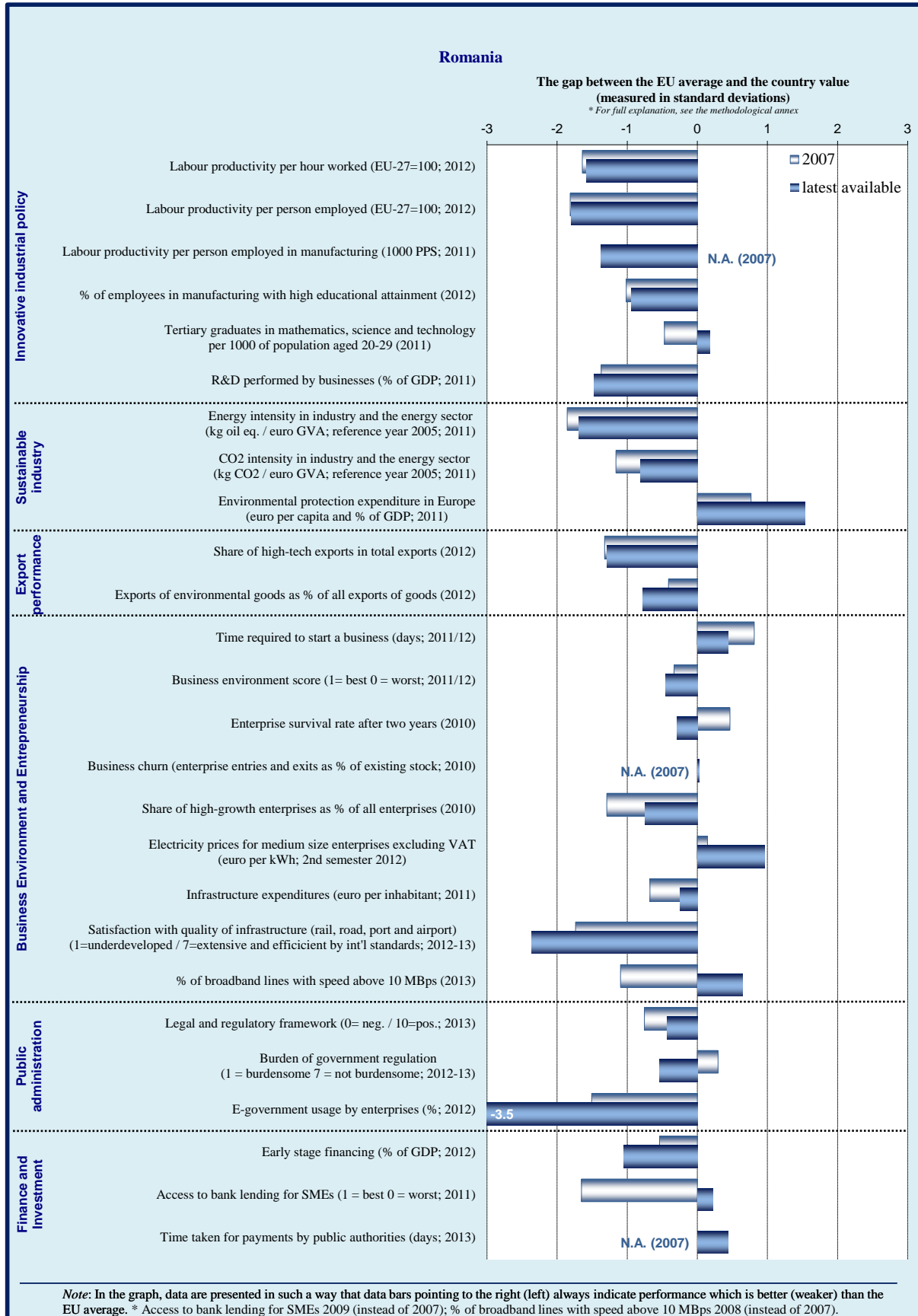
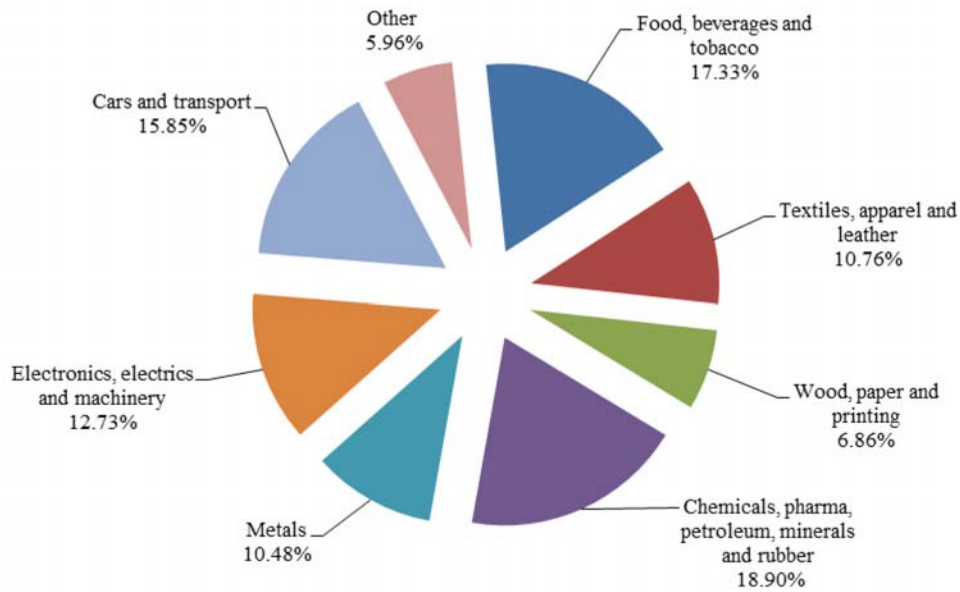


Figure Error! No text of specified style in document..9: Manufacturing sectors – Romania (2010)

Note : No data available for sectors C12 (tobacco products) and C19 (coke and refined petroleum products)

Source: Eurostat

4.23.1 Introduction

Manufacturing plays a bigger role in Romania than in the EU on average (24.7% as compared with 15.5% of total value added in 2011), but has low productivity and competitiveness. At the same time, administrative capacity for policy-making and implementation is poor.¹⁹⁸ Strengthening the industrial base through increased competitiveness and innovation has recently become one of the main policy objectives. An industrial policy document based on consultation of stakeholders is currently being drafted as part of the forthcoming 2014-20 National Strategy for Competitiveness, which is intended to ensure a horizontal approach in the areas of industry, research and innovation, business environment and SMEs, exports, implementation of the digital agenda, employment and rural development.

¹⁹⁸ A strategy document for industrial policy and an accompanying Action Plan were in place for 2005-08, but were not replaced. The 2011-13 National Reform Programme is rather brief on industrial policy initiatives and refers to the Increase of Economic Competitiveness operational programme as the most important instrument for improving economic performance.

4.23.2 Innovation, skills and sustainability

Innovation

In R&D investments, both public and private, Romania lags significantly behind other EU countries, including its regional peers. According to the Innovation Union Scoreboard 2013, Romania is a 'modest innovator', with a performance at the bottom end of the ranking (26th out of 27 Member States). Its innovation performance deteriorated between 2010 and 2012 (-5.1%), slowing down the convergence. The number of SMEs innovating in-house and introducing technological innovation remains well below the EU average, and is declining. Also, fewer SMEs adopt non-technological innovation than on average in the EU.

A number of incentives have been introduced to strengthen research and innovation capacity. An innovation voucher scheme became operational in 2012. Tax deductibility for R&D investment was increased in 2013 from 20% to 50%. Further, a new Strategy for Research, Technological Development and Innovation for 2014-20 being drafted in the framework of the competitiveness strategy should ensure more integration and coordination between policies for research,

innovation and industry. In this respect, as highlighted by the Commission's 2013 country-specific recommendations and accompanying Staff Working Document, the main challenge is to prioritise research and development activities with potential to attract private investment.

At the same time, more effort will be needed to translate knowledge into the production of goods and services, and improve the climate for private research and innovation. A number of challenges remain, in particular improving the matching of research and innovation capacity with business needs, increasing firms' research and innovation capacity, providing SMEs with tailored high-quality innovation services, supporting knowledge-based start-ups through appropriate support and funding for product development and launch, and developing incentives for collaboration between large firms, innovative SMEs and universities.

Skills

There are mismatches between skills and labour market demand in a large proportion of vocational and tertiary education programmes, with the poor level of vocational skills being a specific challenge. The high unemployment rate among tertiary graduates and the rate of over-qualification make a further alignment of tertiary education with the labour market a high priority. To address these issues, a two-year vocational training system was reintroduced in 2012 based on contracts concluded with business enterprises and public bodies.

Qualitative skills mismatches are less significant in Romania than on average in the EU.¹⁹⁹ However, the proportion of employees with an inappropriate education for their current job is well above the EU average.²⁰⁰ According to skills forecasts up to 2020,²⁰¹ employment in services and knowledge-based sectors will increase, while employment in agriculture and other primary production will decrease. There is thus a danger of a lack of medium- and high-level skills by 2020.

¹⁹⁹ Data from the European Labour Force Survey shows that nearly 10% of Romanian employees were over-qualified, as compared with 15% at EU level, and 10% of Romanian employees were under-qualified, as compared with 21% at EU level.

²⁰⁰ EU Skills Panorama Analytical Highlight (March 2013).

²⁰¹ CEDEFOP forecast.

There is no adequate skills forecasting system. The inclusion of entrepreneurship, innovation, marketing and management skills in university curricula would help to ensure closer links between education and business. Boosting SMEs' capacity to anticipate their employment and skills needs and manage restructuring are vital for competitiveness.

Sustainability

While expenditure on environmental protection is relatively high (Romania comes 6th in the EU-27), the environmental performance of industry remains poor: the economy is the third most carbon-intensive in the EU, has the third-highest energy intensity (2.5 times higher than the EU average) and ranks 22nd²⁰² for its eco-innovation performance.

The 2007-20 Energy Strategy is currently under revision and will include provisions on energy efficiency in industry and on renewable energy. The 2003-13 National Waste Management Strategy, also being revised, aims to prevent waste generation and increase the recycling of industrial waste. The 2013-20 National Strategy for Climate Change has also been completed.

Other recent measures include support for the purchase of new electric cars. Innovation Norway's²⁰³ Green Industry Innovation Programme for Romania provides support for the development and implementation of innovative environmentally friendly technologies, green products and services.

There are a number of controversial foreign investment projects in the areas of energy and non-energy raw materials. Shale gas exploration rights have been granted in the Dobrogea region, and a gold mining project using cyanide (at Roşia Montană) has raised concerns about environmental consequences and costs, but also about transparency and lobbying. A history of accidents and environmental damage indicate that there is room for improvement in the mines' environmental management and exploitation techniques. Illegal logging is also a major concern and the forestry code is currently being revised to tackle the problem.

²⁰² 2011 Eco-innovation Scoreboard.

²⁰³ Innovation Norway (IN) is a public company owned by the Norwegian Ministry of Trade and Industry and all Norway's county councils.

In general, the economic benefits of a resource-efficient and greener economy are not sufficiently reflected in policy-making, nor is there a broader strategy on this that would encourage industries to reduce their impact on the environment and become greener and more resource-efficient.

4.23.3 Export performance

In 2012, Romania had a trade deficit of EUR 9.5 billion.²⁰⁴ Exports were driven by manufacturing, in particular by machinery and transport equipment (accounting for 40.4% of the total) and other manufactured goods (34.1%). Other exports included food products, beverages and tobacco, chemical products, raw materials, and mineral fuels, lubricants and related materials.

Over the past decade, Romania has increased its export market share in goods by 50%.²⁰⁵ High-tech and medium-high-tech industries have increased their share, in particular as regards road vehicles, electrical machinery, telecommunication, and machinery. Romania's exports have a relatively low but rising import content, which could be explained by the fact that the country started from very low export levels and has been catching up rapidly in the past decade.

To facilitate access to international markets, the SME export development programme provides services such as trade missions, co-financing for participation in international trade fairs, a trade portal and market studies. A national export strategy is being prepared for 2014-20.

However, several challenges remain, in particular in providing SMEs with training and practical guidance on export procedures and improving their access to information on new opportunities, to financing instruments, networks and contacts with overseas partners.

4.23.4 Business environment and public administration

The complex regulatory and administrative environment, widespread corruption and poor transport infrastructure create administrative

burdens that drag down performance in international comparisons.²⁰⁶ Some progress has been made on start-up procedures, fiscal reporting requirements, and on the registration and transfer of property, but complex procedures are still in place when it comes to obtaining electricity, paying taxes, dealing with construction permits and resolving insolvency.

The implementation of the action plan resulted from the functional review of the institutional setting in the area of business environment undertaken in the framework of the IMF and EU assistance has been feeble. More political support has been available since 2012, with the nomination of a Minister Delegate for Business Environment, but much remains to be done to ensure a coordinated reform effort.

Building on previous efforts,²⁰⁷ a new Strategy for the Development of Business Environment and SMEs for 2014-20 will also be part of the new competitiveness strategy. The challenge is to define clear principles, objectives, priorities, targets and monitoring indicators. In particular, a functioning governance structure is needed to ensure that policies are actually coordinated, monitored and enforced.

A number of previous entrepreneurship programmes are being continued in 2013. An optional course topic, 'Be active, prepare your access to success', will be introduced in secondary schools. A new regulatory framework on insolvency is being prepared and a new law will incorporate the principles of the Small Business Act into national legislation.

While some progress has been made on the measuring of administrative costs, the application of regulatory impact assessments is almost non-

²⁰⁴ Source: Romanian National Institute of Statistics.

²⁰⁵ Source: UN COMTRADE data.

²⁰⁶ The Global Competitiveness Index had Romania in 76th position in 2013-14 (out of 144 economies), as compared with 76th in 2012-13 (out of 144 economies), 77th in 2011-12 and 67th in 2010-11. The country's performance is even poorer as regards some of the pillars considered as drivers for competitiveness, such as institutions (114th), business sophistication (101th) and infrastructure (100th). Romania's World Bank 'ease of doing business' ranking has also deteriorated, dropping to 72nd in 2013 from 56th in 2011 and 54th in 2010.

²⁰⁷ Two strategies have previously been drafted – the Strategy for the improvement and development of the business environment until 2014, and the Strategy for the development of the SME sector until 2013 – but none of them has been adopted so far.

existent. The 2008-13 Strategy for Better Regulation has been implemented slowly. The key challenge is to align this with the EU Smart Regulation agenda and the strategy for business environment and SMEs, so that costs for businesses and the required performance improvement are addressed immediately. This is likely to require quantified impact assessments, competitiveness proofing and fitness checks to reduce the overall costs of regulation and increase clarity, accessibility and ease of compliance.

Public administration

In terms of overall government effectiveness, Romania performs worst of all Member States on the World Bank index.

An inter-ministerial committee has been set up to analyse the public administration and formulate proposals to restructure it. A strategy on strengthening administrative capacity should be approved by the Government by the end of 2013.

For real change in the public administration, the challenge is to base the strategy on an analysis of the structural causes of administrative inefficiency. These include the poor capacity for strategic and financial planning, the lack of effectiveness in policy implementation and service delivery, insufficient cooperation and coordination between levels of government and between ministries, weak management and control systems, the poorly functioning public procurement system and the absence of strategic and effective human resources management.

The take-up of e-government is still low,²⁰⁸ for businesses the lowest in the EU. Only 5.3% of the population buy online, as compared with the EU average of 44.8%. A national strategy on the digital agenda and a next generation access networks plan are currently being developed.

Romania has sought to improve the quality of justice and the independence of the judicial system but a number of deficiencies persist. These include delays in resolving cases and a lack of consistency between judgments. Progress with judicial reform and the fight against corruption is monitored by the European Commission. Although the time needed

to resolve non-criminal cases, administrative cases and litigious civil and commercial cases is close to EU average (but lags behind for insolvency cases), the case resolution rate for all categories has been falling.²⁰⁹ Significantly wider use of e-justice tools could help, as could regular evaluations of courts' activities and defined quality standards.²¹⁰ The perceived independence of justice in Romania has the second worst rating in the EU.²¹¹ Unfortunately, so far Romania has not been able to implement its commitments aimed at enhancing the independence of the judiciary and that politically motivated attacks on the judiciary have not ended.²¹²

The level of corruption in Romania is perceived as particularly high by European standards. This dampens the efficiency of economic activity and is a serious disincentive to inward investment. Fully implementing the national anti-corruption strategy would increase the confidence of economic operators that commercially significant decisions taken by public authorities are fully transparent.

In spite of the efforts made, further action could be taken to address state capture and other forms of administrative corruption, in particular by establishing transparent lobbying rules, controlling the movement of managers between the public and private sectors, guaranteeing comprehensive access to information legislation and ensuring transparency and integrity in the procurement process.²¹³

The number of tax payments has been reduced from 113 in 2012 to 41, but there is room for further improvement.²¹⁴ The new 2012-16 fiscal administration strategy extends the use of online tax declarations. Tax rules for microenterprises have been modified by having a single regime.²¹⁵ Lastly, the VAT rules have been changed so that VAT is

²⁰⁸ See the 2013 Digital Agenda Scoreboard.

²⁰⁹ The EU Justice Scoreboard: a tool to promote effective justice and growth, COM(2013) 160 final.

²¹⁰ A comprehensive evaluation of the Romanian judicial system <http://courtoptimization.wix.com/ewmi#>

²¹¹ The EU Justice Scoreboard, p.21.

²¹² January 2013 report of the Cooperation and Verification Mechanism, COM(2013) 47 final.

²¹³ According to the Commission's last progress report under the Cooperation and Verification Mechanisms, progress on the prevention and prosecution of corruption relating to public procurement is very limited (COM(2013) 47 final).

²¹⁴ An average firm spends 216 hours a year filing, preparing and paying taxes.

²¹⁵ All legal entities which fulfil the new criteria are liable for 3% microenterprise tax.

payable on reception of payment (within 90 days) and deducted on payment of the received invoice.

4.23.5 Finance and investment

Total lending volumes are the lowest in the EU and interest rates second highest for loans of up to EUR 1 million.²¹⁶ Although the proportion of loan applications rejected fell significantly from 48% in 2009 to 18% in 2011, the proportion of businesses indicating that the banks are less willing to lend has remained stable at 41%, well above the EU average of 30%.²¹⁷ This could be explained by the tightening of credit standards that have discouraged many entrepreneurs from applying for a loan.

Alternative forms of financing and new financial products, in particular venture capital, are not widely available. According to the European Private Equity and Venture Capital Association, venture capital investments have constantly declined since 2007.²¹⁸ The number of beneficiary SMEs has also fallen.

Public financial support to SMEs is being provided primarily via national programmes and guarantee instruments. The Mihail Kogalniceanu Programme aims to facilitate SMEs' access to finance by granting a credit line with subsidised interest and, if need be, partial state guarantees under certain conditions. The Programme for Young Entrepreneurs aims to encourage small business start-ups, targeting entrepreneurs under 35 years of age. However, these programmes could be made more accessible, in particular with easier application procedures.

Before the crisis, investment was attracted by strong GDP growth, large-scale privatisations, the prospect of EU membership, low labour costs and taxes, and the large Romanian market. However, net foreign direct investment has declined since 2009²¹⁹ and came to EUR 1.7 billion in 2012,

which was 6.7% lower than the year before and almost 80% lower than in 2008.

The main beneficiaries of FDI have been manufacturing (31.5% of the total stock), financial intermediation and insurance, trade, construction and real-estate transactions, and ICT. This reflects a shift from exploiting low-cost advantages towards higher value-added production, in particular in manufacturing. New investment has been scarce in clothing and apparel, but healthier in higher value-added segments like furniture and transport equipment.

A range of state aid schemes is available for various investment categories, and assistance to foreign investors is provided by the new Department for Infrastructure Projects and Foreign Investment.

According to Ernst & Young's 2012 European Attractiveness survey, Romania is the 6th most attractive country in Europe for investments over the next three years. However, more could be done to improve the quality of services to encourage stronger commercial links between foreign investors and local enterprises. Also, closer connections between innovation policy and inward investment promotion are needed in order to attract more R&D-intensive FDI.

4.23.6 Conclusions

Romania's declining competitiveness in international comparisons reflects a policy failure, in particular because the major changes to improve the business environment have been postponed. This has resulted in the heavy administrative burden remaining, and there is a lack of moves towards e-government that could improve the situation.

Comprehensive, decisive and effective efforts to foster structural change towards a more knowledge-intensive economy would help to improve the situation. However, the problems in access to finance are dampening investment. Significant improvements in the business climate require solutions, tools and changes across the whole administration. Similarly, considerable efforts would be needed to ensure that the country were able to implement its commitments aimed at enhancing the independence of the judiciary.

²¹⁶ European Central Bank (ECB) statistical data.

²¹⁷ EC and ECB, *SMEs' Access to Finance Survey 2011: Analytical Report* (7 December 2011).

²¹⁸ Total investments in 2007-10 amounted to EUR 947 million (no bank leverage included), falling year-on-year as follows: EUR 318 million in 2007; EUR 289 million in 2008; EUR 221 million in 2009; and EUR 119 million in 2010 (the equivalent of 0.101% of GDP).

²¹⁹ The net FDI flow amounted to EUR 1.8 billion in 2011; EUR 2.2 billion in 2010; EUR 3.5 billion in 2009; and EUR 9.3 billion in 2008.

Several national strategies are currently being drafted and efforts are being made to strengthen competitiveness in areas important for growth. However, effective implementation is required for visible and lasting results. In addition to policy commitment, this would require mechanisms to coordinate, monitor and enforce policy. Further action would also be needed to address state capture and other forms of administrative corruption.

The sustainable and transparent exploitation of raw materials is another challenge, as environmental and health damage will have a negative impact on the medium- and long-term competitiveness of the country.

