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From: Presidency
To: The High Level Working Group on Competitiveness and Growth
Subject: The European construction: challenges and the role of global value chains

Delegations will find in Annex a Presidency discussion paper on the European construction in view of the meeting of the High Level Working Group on Competitiveness and Growth on 7 September 2017.

The European construction: challenges and the role of global value chains

1. Introduction

Construction is a prime driver of economic growth and employment in every country but also for the whole European economy. It does not only crucially contribute to the EU GDP and to employment rates, it impacts also directly on daily life of EU citizens affecting the functioning of the economy, quality of life, use of natural resources and the environment.

The performance of the construction value chain – and the policies that support it – are paramount to respond to the societal and economic challenges that Europe and the rest of the world will face. These challenges in turn represent significant market and employment opportunities for the value chain, in particular energy efficiency in buildings.

Despite the significant achievements already made, there is still considerable potential for the construction sector to better address major economic, societal and environmental challenges facing the European Union. If strategic objectives are to be met (within defined timeframes), there is an urgency to act now.

2. Societal and economic challenges impacting construction

Cities have to face an increasing number of challenges. They need to be smart and sustainable, but also liveable, affordable, welcoming and resilient. Some cities are more successful than others in attracting investments, as local frameworks and governance vary considerably. In particular, there is a need to put in place appropriate channels and tools to make the necessary investment and to create a favourable business environment to foster transition to smart urban development in second tier cities.

Action is needed to develop cities and towns' capacity to exercise leadership and build up and use capacity, including expertise on urban planning, information and telecommunication infrastructure and financing. The EU Urban agenda for the EU is facilitating the creation of voluntary partnerships between cities, central governments, the European Commission and stakeholders to develop and implement concrete actions.

Sustainability and resource efficiency are likely to affect both the construction process and the built environment itself. There is a massive need to accelerate in buildings' renovation to ensure the transition to a low carbon and circular economy. Buildings account for 36% of CO2 emissions in the EU and around 75% of them are energy inefficient. Construction also produces an enormous amount of waste, so the more efficient use and recycling of raw materials offer huge potential benefits. Sustainability also embraces the needs in terms of occupants' health and impacts on the environment throughout the lifecycle of buildings.

Despite rising awareness and increased regulation, much progress still needs to be made in order that sustainability becomes a major factor influencing construction and real estate business operations. There are many initiatives at European and national level to drive demand, but the market looks for clarity and long-term certainty regarding the objectives of sustainable buildings. A common framework to assess various aspects of sustainability should facilitate better-informed decisions and lead to a more sustainable building stock. It can help financial institutions to deploy financial products for sustainable buildings and infrastructure for recycling construction and demolition waste.

Regarding infrastructure, there are growing concerns over natural hazards (e.g. flooding, hurricanes and earthquakes), and a call for enhanced resilience of the built environment, especially in urban areas. Infrastructure is ageing in many regions of the EU and requires proper maintenance and upgrading. Public-sector funds alone would be probably insufficient to bridge the investment gap. The Investment Plan for Europe helps to leverage private capital to finance infrastructure construction projects of common interest.

3. Transformation needs in the construction value chain

The construction value chain is expected to undergo significant changes in the next decade to deliver as soon as possible buildings and infrastructure solutions that meet these trends and future demands from the end users. At present, this transformation is driven by the transition to a low carbon economy, but the future of the sector will also be shaped by demographic and social changes, scarcity of resources and urban redevelopment.

A radical change of production methods and organisation is needed to modernise the construction value chain. Digitalisation, new technologies, new materials and recyclability will raise efficiency of construction processes and enhance the quality of buildings, safety, working conditions and environmental compatibility.

While many innovative solutions are already applied on a small scale, the industry still needs to better adapt to current technological developments. Transformation will require new forms of collaboration within the construction value chain and new contracting models to align incentives for all parties to improve the overall project outcome. Start-ups and major technology companies entering the sector with radical new business models will increasingly challenge traditional operators in the construction sector. Trade associations could play here a role to enhance coordination and cooperation across the value chain, and jointly define standards and agree on common goals.

All these dynamics are likely to pose a huge adaptation challenge to SMEs and low skilled workers. The public sector and trade associations should mitigate the potential negative impacts of changes. At the same time, considering the fragmentation of the construction industry, the digital agenda will also bring challenges in terms of ensuring cybersecurity.

Working towards an improved built environment – meeting higher standards, working in new partnerships, enhancing productivity, promoting energy efficiency, working with new technologies – it all requires new skills and modernisation of training. This is all the more necessary as the industry needs to improve the image of the sector in order to attract young people and educate them, and to face increasing competition for talent with other industries. The sector also needs to re-educate existing workers. While action will need to come from the industry itself, EU and national initiatives could facilitate cooperation between social partners, business and education and training institutions, allowing a common strategy on development of future skills in the sector.

Increased global competition in the construction sector will challenge EU companies to adapt their international strategy. Many Asian construction firms have significant cost advantages and capabilities to respond to international clients' demand for operation and financing services. Instead, EU banks are faced with stricter regulation regarding long-term capital-intensive loans, which makes EU construction companies cautious with respect to offering project financing services. Blending financial instruments, including export guarantees, should help to raise the financial capacity of EU firms in international projects.

4. Policy support for the transformation of the construction value chain

Simplifying and harmonizing building codes and standards can improve the functioning of the construction sector. Streamlining procedures for construction permits and environmental approvals can greatly reduce project delays.

Governments should provide appropriate support to research organisations and industry for the development and deployment of technological innovations in construction. Governments can also agree with stakeholders a national agenda to improve the overall performance of the construction sector at national and international level.

As the public sector is a major client of the construction industry, governments can also lead by example. Innovative Public Procurement can support the replication of innovative ideas and make technologies and best practices available to the industry as a whole. Central procurement bodies can drive digitalisation and better information management in construction public projects. More generally, fair and transparent procurement procedures, contract registers and transparency in costs and performance can reduce informality and corruption and increase competition.

Regarding the EU market integration, the construction sector within the Single Market is only happening at the margin of national economies. Intra-EU trade of construction products represents 5 to 10% of industry turnover. Efforts are still necessary for a uniform implementation of the Construction Products Regulation and for removing obstacles to free movement of construction products. A consultation process with stakeholders is ongoing and EC services have launched an evaluation and an impact assessment, possibly leading to a revision of the Regulation.

Construction services are characterised by a low intra-EU trade level (0.7%). Service providers that go cross-border today face a range of lengthy and complex administrative obstacles. This can lead to compliance costs of several thousand euros. The European e-Services Card is intended to offer a comprehensive simplification and streamline several formalities into one, as negotiations on this dossier have only just started.

Creating a more integrated Single Market for construction products and services provides a framework which can stimulate competition, create jobs and help moving towards a more sustainable circular economy.

5. Exchange of views

The Construction 2020 Strategy and Action Plan addresses many of the challenges faced by the construction value chain¹. The “Clean Energy for All Europeans” package² presented in November 2016 sets out a number of specific actions related to investments financing and construction competitiveness in its annex “Accelerating clean energy in buildings”³.

The High Level Working Group on Competitiveness and Growth is invited to address the following questions:

1) What can be done at national and regional level to attract more investments in sustainable urban development and built environment in second tier cities?

2) What can be done at national and regional level to move the sustainability and resource efficiency agenda from niche to mainstream markets? What could be role of legislation, standards and green and innovative public procurement?

3) What action could the European Commission and Member States take to promote digitalisation and innovation in the construction value chain, especially in SMEs, as well as the integration of smart technologies in buildings and infrastructure? How to mitigate the potential negative impacts of the digital shift?

4) What are the most severe regulatory barriers construction companies face trying to trade construction products and provide services cross-borders in the EU? How EU policies could facilitate removing these barriers?

¹ COM (2012) 433 final of 31st July 2012 - “Strategy for the sustainable competitiveness of the construction sector and its enterprises”

² http://eur-lex.europa.eu/resource.html?uri=cellar:fa6ea15b-b7b0-11e6-9e3c-01aa75ed71a1.0001.02/DOC_1&format=PDF

³ http://eur-lex.europa.eu/resource.html?uri=cellar:fa6ea15b-b7b0-11e6-9e3c-01aa75ed71a1.0001.02/DOC_2&format=PDF

EU construction sector overview

The construction value chain, including contractors, the supply of construction products and equipment, and construction-related professional services, contributed to 23 million jobs in 6.2 million enterprises, 8.2% of EU's GDP and to a value added of €1.14 trillion in 2014.

The 2008 financial crisis has impacted significantly the construction sector in the EU, resulting in a 25% fall in production and employment over the period from 2008 to 2014. Some signs of recovery are noted from 2014 onwards although there are significant differences between Member States.

In general, the construction cost index has grown relatively steadily and has remained below inflation trends. During the construction bubble from 2004 to 2008, construction prices have been increasing faster than labour costs. Cost and price indexes have re-aligned after the crisis.

Since 2000, the productivity of construction contractors has remained almost stagnant, despite periods of growth from 2000 to 2008. However, several services sectors that are active in the construction value chain⁴ as well as construction machinery have showed higher productivity figures compared to construction contractors, with most of these sectors increasing their productivity after the crisis⁵.

Although many companies went bankrupt⁶, contractors and professional construction services are in a relatively better financial health than other sectors in the value chain. In particular, the better financial health of contractors is partly due to changes towards more flexible contractual arrangements and less permanent employment, as well as more flexible capital structures with more renting and leasing and less purchasing of big capital items (e.g. large cranes, or excavators).

⁴ E.g. architectural and engineering activities; computer related services; employment services; business support services; legal and accounting services

⁵ "The European construction value chain: performance, challenges and role in the GVC", WIIW, Ecorys and WIFO (August 2016)

⁶ Eurostat Structural Business Statistics, Business demography

Intra-EU trade in various parts of the construction sector has overall been moderately growing since 2004, although moderately. New Member States are exporting to a greater number of EU countries and old Member States in turn are sourcing more from other Member States (new as well as old). However, intra-EU trade remained comparatively very modest compared to the overall output of the sector. Especially, contractors and some related services are continuing to show a lack of internal market integration⁷. Over the period 2004-2014, intra-EU trade of construction raw materials and products increased from 47 to 77 billion € or from 10% to 17% relatively to the sectorial turnover. Regarding construction, architectural and engineering services, intra-EU trade stayed almost stable, at a level of 10-15 billion € i.e. 5% of their total turnover.

The final energy consumption of residential buildings declined by 15% while in non-residential buildings it remained almost stable⁸ over the period 2004-2014. Estimates of the cost increase linked to more stringent energy performance requirements on buildings range from 1% to 8%, with an average of 5% across ten countries⁹.

Construction and demolition waste (CDW) is one of the heaviest and most voluminous waste streams generated in the EU. It accounts for an increasingly higher share of all waste generated in the EU, passing from a share of 30% to a share of 35% during the period 2004 – 2014. In terms of weight, CDW increased by 14% over the same period¹⁰. While many Member States have already achieved the target of a minimum of 70% (by weight) of non-hazardous CDW for re-use, recycling or recovery, including backfilling¹¹, other are still lagging behind this target. Assuming an average cost of 50€/per ton, the actual cost of CDW disposal is estimated at more than 10 billion €per year for the EU-28¹².

⁷ See also doc. 5284/17 ADD1 "Impact assessment for the Proposal for a Regulation of the European Parliament and of the Council introducing a European services e-card and related administrative facilities" for further consideration on market integration of construction, architectural and engineering services.

⁸ Source: Eurostat and EC services calculations

⁹ "Supporting study for the fitness check on construction : EU internal Market and energy efficiency legislation", Economisti Associati, CEPS, Milieu and BPIE (Oct. 2016)

¹⁰ Source: Eurostat

¹¹ Waste Framework Directive (2008/98/EC), Article 11.2

¹² EC services estimates

Construction is one of the sectors in which workers are more exposed to accidents at work. While the number of fatal and non-fatal accidents is reducing, the incidence rate¹³ of the sector remains one of the highest of the whole EU economy¹⁴.

¹³ The incidence rate is the number of serious or fatal accidents per 100.000 persons in employment in the sector.

¹⁴ See Ex-post evaluation of the European Union occupational safety and health Directives, SWD (2017) 10 final and Eurostat ESAW