

## EXECUTIVE SUMMARY

The 2012 edition of the European Competitiveness Report provides new empirical evidence for understanding the drivers of industrial competitiveness and the opportunities and constraints faced by European enterprises in the post-crisis recession.

The focus of this year report is on maximizing the benefits of globalization. It studies:

- **the development of global value chains and their impact on the value added of exports;**
- **energy efficiency as a determinant of export performance;**
- **the potential of FDI flows;**
- **the role of business networks; and**
- **the potential of European neighbourhood policies for reaping the benefits of globalisation.**

*The 2012 report seeks to identify opportunities to make European industries more competitive by maximising the benefits of globalisation*

These topics are important because many of the drivers of and the challenges to the recovery of industrial demand and employment are to be found outside Europe. The new industrial markets outside the EU are key to European competitiveness, particularly in the context of the recovery. More importantly, however, they are crucial for European industrial competitiveness in the long term. This is because the emerging industrialised economies are increasingly competing with Europe not only in traditional exports but also in knowledge-intensive industries. Fast-growing new industrial powers outside Europe present European firms with both challenges and opportunities. These have either not been fully studied or their implications for European industrial policies have remained ambiguous.

*The single market and, especially, the expansion into markets outside the EU have made EU economies more open and more specialised. Demand from non-EU countries for*

The report starts by putting the stalled recovery into the context of Europe's external trade performance. It argues that even though trade plays an important role in the recovery from the crisis, exports alone will not lead the EU out of the current crisis. The opportunity to rely on foreign demand can be very important in the short term when domestic demand is particularly weak but in the long term sustainable growth will be generated through technical progress and productivity growth. It is in that sense that **the modernization of the industrial base** and the **removal of institutional impediments to entrepreneurship** can be seen as crucial for the European enterprises' competitive performance in and outside Europe.

The recession began when accumulated speculative bubbles in the US

*EU exports is thus a powerful driver of recovery. The actual impact, however, differs from one EU country to another.*

*Economies affected by the pre-crisis real estate bubble are undergoing painful adjustment and deleveraging. The resultant drop in internal demand cannot be fully offset by demand from outside the EU.*

*Outsourcing of production is important driver of cost optimisation*

and certain EU Member States finally burst. These overpriced assets, and the related distortions of allocative efficiency, are typical for long periods of stability such as 1993-2007. In countries affected by the bubble (e.g. Spain and UK), the subsequent crisis is followed by a long period of slow deleveraging that explains the difficult recovery. In these countries the bursting of the bubble and the deleveraging of firms and households is a process of painful adjustment. Countries that did not accumulate internal imbalances in the period 2000-07 (e.g. Germany), the contraction in GDP is almost entirely due to **shrinking intra-EU exports** of goods and services and to **postponed investment** given the uncertain business conditions of the EU. Consequently, the recovery is expected to be faster in countries in the latter group as uncertainty fades away. In the future **recovering exports to fast growing economies outside the EU will certainly contribute compensating for weaker domestic and EU demand in both groups of countries.**

The analysis of export specialization trends of EU member states also sheds light on the impact on recovery of the different patterns of export specialization. In the last two decades the **EU member states increased their openness** in terms of share of exports relative to GDP. For EU-15 Member States the Single market explains only part of this increase in the early 1990s. After that the share of exports to the EU remains relatively stable: the export expansion is mainly outside the Single market. This expansion is accompanied by **increased specialization in exports of manufactures or services**. Even if manufacturing and services are increasingly interrelated, traditional manufactures exporters like Germany or France specialize further in this direction. Meanwhile, UK, Denmark, Greece and Ireland display a notable increase in the export of services.

The study also looks at how competitiveness is fostered by the **institutional and regulatory environment**. It is argued that structural and institutional reforms may not offer quick-fix solutions but given the current fiscal constraints they appear plausibly as a key element of a cost-effective policy response for a way out of the crisis. In the longer term growth depends on the ability of an economy to adopt and develop new ideas. In turn, this ability depends crucially on having the right institutional and regulatory environment.

A clue to maximizing the competitive gains from globalization is the understanding of the **value chain positioning and performance of EU industries**. This report studies trends in the internationalisation of production and the related challenges and opportunities for EU industrial policy. Thanks to globalisation and improved cross-border transport and technological progress, outsourcing production is now an important driver of cost optimisation and new market penetration. Different parts of firms' production processes are now located in different parts of the world, chosen according to the comparative advantages of the locations and their sales potential. The internationalisation of industrial value chains has resulted in a sharp

*and new market penetration.*

*Hence EU industries' positioning and performance in the global value chain, measured through their domestic content of exports becomes an important guide to policy-making as the traditional measures based on export of finished goods.*

*The share of the domestic content of EU exports is slightly lower than that of US and Japan, but the difference reflects the higher reliance on foreign inputs of EU-12 exports.*

*China's share in EU exports is increasing, but less rapidly than its share in US and Japan's exports.*

**increase in trade in intermediate and semi-finished products.** The related challenges, risks and opportunities for industrial performance have significantly changed the way firms compete. Today, their positioning in the global value chain — i.e. their **value-chain performance** — is becoming a more important measure of competitiveness than the traditional emphasis on *export performance* measured through market shares and comparative advantages.

How can EU industrial policy help European firms achieve the best position in global value chains? This question is especially important for small businesses (SMEs), which – for a number of well-documented reasons – cannot easily find their way to the world markets.

This report tries to inform policy-making by shedding light on how industrial value-chain competition develops, and what influences firms' decisions to outsource. It uses a **new way of measuring vertical specialisation** — the *import content of exports*, derived from the recently-launched World Input-Output Database (WIOD) — to analyse vertical specialisation patterns. According to the findings, the import share of EU 15, Japan and the US is about 10-15 %, while for the EU 12 it is significantly higher, rising to 34% during the boom period and brought down by the crisis to 30%.

The analysis of the foreign value of EU exports shows that **China's role is growing**. From 1995 to 2007 the share of imports from China in the EU exports expanded from below 1% to about 10% for EU 12 and from 5% to 15% for EU 15. In fact, from the mid-1990s, China's share in EU-15's exports grew faster than EU-12's share. Chinese manufacturers captured even larger shares (about 20%) of US and Japanese exports. During the crisis, only China managed to increase its share of exports from the EU, US and Japan. Imports from China increased in all major economies during the trade slump. The chapter in question shows that China's share in European, US and Japanese exports has grown mainly at the expense of domestic suppliers. The increased use of imports, including those from China, in European exports has made EU firms more competitive on the world markets.

The chapter looks at **four sectors** which form the backbone of the EU's industrial base: chemicals, transport equipment, electrical and optical equipment and machinery. The share of trade in parts and components in each of these sectors offers new insights into the challenges of recovery. During the trade slump, trade in parts and components declined more sharply than trade in finished goods, probably because of some multiplier effect and inventory adjustment higher up the value chain. The three sectors other than chemicals depend largely on the supply of parts and components, which grew fast in the pre-crisis years and was severely interrupted by the trade slump. This could partly explain why recovery in these sectors is so difficult and is taking so long.

Finally the chapter uses survey data to analyse **determinants of the**

*Offshoring seems to be mainly cost-driven. Upstream quality gains may provide a viable alternative to cost-driven relocation.*

*Pro-active industrial policy may consider FDI promotion and support for the optimal positioning of the SMEs in the global value chains, as well as better-targeted instruments to encourage investment in intangibles and in process and marketing innovations*

*In addition to the domestic content of exports, the reports*

**decision by firms to offshore** as well as their choice of destinations. It finds that, other things being equal, larger companies or those with higher revenue per employee are more likely to offshore their production. Consequently, any industrial policy that helps companies grow would also improve their positioning in the global value chain. The evidence shows that **offshoring might be primarily cost-driven**. First, more sophisticated products seem less likely to be offshored. Second, offshoring firms tend to spend less on R&D than non-offshoring firms, but are more likely to upgrade their products more often. This finding might mean that **in-house R&D and specialisation in knowledge-intensive products** is an alternative to offshoring to lower-cost locations. The report also considers whether relocation may be driven by excessive regulatory costs in the source country, but does not find empirical evidence in support of this hypothesis.

The findings of this chapter are **important for policy-making in three ways**. *First*, they provide useful input for an EU policy that would allow industry to reap the benefits of the global value chain. Pursuing policies that increase openness to trade helps local companies to become part of global value chains and thus become more productive. This is important since more than two thirds of EU imports consist of intermediate products which boost EU industry competitiveness and productivity.

*Second*, off-shoring could help European industry maximise cost/quality gains with regard to finished goods. This would require a policy mix that increases the EU's share of exports of finished goods from its trading partners, especially the fast-growing new industrial powers.

*Third*, the chapter's insights are important since the EU aims to maximise the domestic value of its exports. Case studies show that most of the value is created at the beginning and end of the value chain. Industrial policies should therefore look at the knowledge-creating upstream parts of the value chains and at process and marketing innovations in the downstream parts of those chains.

This goes beyond the mere increase of market shares in goods and services. It includes targeted promotion of **foreign direct investment (FDI)**, support for the **optimal positioning of SMEs in the global value chains**, and new instruments to encourage **investment in intangibles and in process and marketing innovations**.

The report goes deeper into the **structure of the value-added of exports** to examine in particular how **energy efficiency contributes to external competitiveness**.

Energy is an important component of production costs and competitiveness. The prices of energy commodities, particularly oil, have **risen sharply** in the last decade. Some of the causes are **structural** — such as globalisation and the increasing demand from

*studies their energy content and presents new empirical evidence on how energy efficiency contributes to export competitiveness.*

*Energy efficiency gains are seen in almost all Member States.*

*The EU leads in reducing the domestic energy content of exports, outperforming the USA and Japan.*

developing countries, limited fossil fuels resources and overall increasing exploration costs — and tend to lead to permanent energy price increases. The recurrent energy price hikes and volatility seen in the past were often due to **cyclical factors**. These included the considerable rigidity of energy demand in the short term, the failure to fully anticipate its fast growth (as evidenced by low levels of exploration investments and lack of spare capacity), or concerns related to geopolitical events.

Rising energy prices and volatility directly affect **businesses', production costs, their economic activity, external accounts and competitiveness**. The competitive losses are greater for countries or sectors that are less energy-efficient, more specialised in energy intensive products or more energy-dependent. These include countries that depend heavily on imported fossil fuels and where low-carbon (i.e. nuclear and renewable) sources account for only a small share of the energy mix.

Global competition and the cross-border integration of production chains call for improved energy efficiency and offer new business and energy-saving opportunities. As a result, **energy efficiency improvements** can be observed in almost all countries over the period 1995-2009. In Europe, the EU-12 economies improved significantly their initial low levels of energy efficiency and the European Union as a whole consolidated its overall lead in terms of energy efficiency.

In general, over the period 1995-2009, EU countries were able to export more and at the same time **significantly reduce the energy embodied per unit of exports**, in particular the part of energy that is sourced domestically. The EU has a higher share of foreign-sourced energy in its total exports (34% for the EU-15 and 28% for the EU-12 in 2009) relative to Japan (33%) — a country that is also heavily dependent on imported fossil fuels. The figure for the US is much lower (around 18% in 2009). Emerging economies such as Brazil, Russia and especially China are becoming increasingly important sources of the energy embodied in exports of advanced economies.

The **European economies have been leading** the world in reducing the domestic energy content of exports. For the EU-12 this was primarily due to a significant drop in the energy incorporated domestically in manufacturing exports. For the EU-15, the most important contribution came from the drop in the domestic energy content in service exports. This has helped mitigate the adverse effects on competitiveness and terms of trade arising from the increase in the relative price of energy.

An index decomposition analysis shows that, from 1995 to 2009, manufacturing in the European Union moderately increased its gross output while at the same time keeping its energy use fairly constant thanks to continuous technical improvement. Japan, like the EU, is a world leader in energy efficiency in manufacturing but did not improve its technical efficiency over this period. Manufacturing output and technical efficiency both improved in the US, but less than in the EU.

*The EU is also leading the internationalisation and cross-border flows of eco-investment and eco-innovations.*

*Eco-innovating firms are, on the whole, more successful than conventional innovators.*

*The report provides new empirical confirmation of the effectiveness and efficiency of the EU's sustainable industrial policy and its importance for the overall competitiveness of European firms.*

*FDI inflows bridge investment gaps and lead to spillovers and technology transfer*

*Outward FDI positions EU firms in the global value chain*

*The EU maintains its lead in inward and outward FDI but is losing its attractiveness as an FDI destination*

Manufacturing output increased and technical efficiency improved in almost all EU-27 Member States, but their individual performances vary significantly. The highest increases in manufacturing output were seen in the EU-12 countries and Ireland, and these were also the countries that tended to achieve the greatest improvements in technical efficiency. There was a shift towards less energy-intensive sectors in the EU-12 Member States, with only a few exceptions.

Looking at how eco-innovation affects competitiveness, the report finds that EU firms introducing new products with energy-saving features tend to be **more successful innovators**, particularly in the case of manufacturing firms. Controlling for other determinants of innovation success in the market, these eco-innovators sell more new products than conventional innovators, and this may give them an important competitive advantage.

Overall, **EU firms are world leaders** in the increasing cross-border 'eco-investments' in clean and more energy-efficient technologies and products and services. For instance, EU firms account for almost two thirds of the FDI by multinational enterprises (MNEs) worldwide in renewable energy in the period 2007-2011. They are also global frontrunners in other eco-technologies (such as engines and turbines) used to provide environmental goods and services. However, **international competition is increasing**, including from MNEs based in the emerging economies. To remain competitive, EU firms need to focus on exploiting the business opportunities offered by global environmental and societal goals and challenges.

This year's report attaches primary importance to the potential of **Europe's foreign direct investment (FDI) policy** for fostering industrial competitiveness. It examines the EU's positioning as a source and destination of cross-border capital flows and the implications for the competitiveness of European firms.

The European Union is a **major player in global FDI**, both inward and outward. This reflects both the potential of the Single Market and the ability of EU companies to successfully compete in EU and non-EU markets.

In the most recent years, however, the EU's share of global inward FDI has **declined significantly**. The crisis meant a severe drop in intra-EU flows: European firms were less able and less willing to invest in the EU market. Consequently, FDI from non-EU countries became more important. Companies based in developed countries, mainly the US and Switzerland continued to dominate this picture, but FDI inflows from emerging economies also gained in importance. Analysing the structure of inward FDI in the EU, **relatively strong foreign presence** can be observed in some manufacturing industries, such as the **chemical industry and petroleum refining**.

*This is mainly due to a decline in intra-EU flows. Inflows from outside the EU are dominated by advanced economies (the US, Switzerland, Norway) but emerging economies are gaining relative weight.*

*The report finds that the major drivers of inflows have been the single market, the single currency and cost advantages in the case of west-east flows.*

*The importance of fiscal incentives is not confirmed empirically; the impact of unit labour costs and tax rates differs between countries.*

*Since FDI can help boost the competitiveness of European firms the EU must design policies for attracting FDI and maximising its benefits.*

EU firms are the most important direct investors in the world. However, since 2008 European multinationals have curtailed their FDI activities. In outward FDI there has been a **shift from intra-EU to extra-EU flows**. Low growth in the EU as a whole during the economic crisis may lead many European MNEs to seek investment opportunities in fast-growing emerging markets outside the EU. Nevertheless, extra-EU outflows continue to be highly geared towards developed markets, particularly to the US and EFTA countries. EU MNEs seem to be more globally competitive in manufacturing industries (e.g. chemicals, machinery and vehicles) than in service industries. The overall trends in the EU's outward FDI mostly reflect the EU-15 pattern. However, over the last decade, there have been several signs that the EU-12 is gradually catching up. Investments by EU-12 companies is concentrated within the EU and dominated by the service sector.

The crisis-induced decrease in inward FDI to the EU raises some important questions. What are the main factors influencing companies' decisions about investing in the European market? How can the European market be made more attractive? A number of factors can be distinguished:

- institutional factors, including the legal and administrative system and international agreements;
- economic factors, such as market size or labour costs and skills;
- business facilitation, such as investment promotion;
- local factors at the level of individual firms

The empirical analysis shows that the **driving forces behind inward FDI** in the EU are **cost advantages, the euro and EU membership**. The impact of unit labour costs and corporate taxes on bilateral FDI stocks differ from country to country. In particular, the rate of corporate taxes seems to be a key factor in the EU-12 countries, and in the case of greenfield investments in the EU-27. In addition, the analysis shows that rising unit labour costs in some EU-15 countries are a major factor in slowing the growth of inward FDI stocks, and it confirms the importance of having a well-educated workforce.

In general, countries seem to benefit from hosting multinational companies. Their presence can bring in finance, technology, skills, management techniques and good practices, and may ensure market access. The empirical analysis shows that **foreign affiliates do a lot to boost productivity** in EU manufacturing industries. The analysis shows that backward linkages (effects from foreign companies to local suppliers) are more important than horizontal spillovers for productivity growth. The empirical analysis of EU-10 countries suggests that the presence of foreign firms helps to create jobs in the local supply industries. FDI spillovers via backward are greatest for innovative local firms and especially for those that do not export. This would lead to the conclusion that foreign firms act as catalysts encouraging domestic

suppliers to introduce technological innovations. The review of the home country effects of outward FDI shows that the effects on productivity in the home country are mostly positive.

The empirical analyses provide a basis for some policy conclusions. It has been shown that the best way to promote internationalisation through outward FDI is not to provide subsidies and targeted support, but to **promote a competitive business environment**, which ensures that resources are reallocated to the best performing firms. It is also crucial to provide conditions which allow small firms and small MNEs to grow. To attract FDI into the EU it is essential to **improve cost competitiveness**, but a well functioning internal market and the single currency remain key factors. When it comes to promoting investment policy-makers in different Member States could usefully learn from one other about their most successful practices.

The analysis of the impact of FDI suggests that industrial policies should contribute to increase spillovers from MNEs on local enterprises, in particular through networks. Also crucial for maximising the benefits of inward FDI are policies that facilitate technology transfer between MNEs and local firms and that help companies in building their capabilities.

Globalisation changes the way firms compete, but also the way they cooperate. It also **shifts the pattern of their cooperation from clusters to networks**. Networks not only help firms reap the benefits of FDI, as described above, but are also a good way for firms to adapt to globalisation.

*Globalisation is also changing the way firms cooperate.*

This report looks at non-price and non-contractual interactions that are tending to grow among independent companies, such as the formation of clusters and networks. In the case of clusters — firms carrying out similar activities in the same geographical area — the linkages arise automatically from the interplay of market forces. In the case of networks, however, it is up to the firm to establish linkages with other companies without being formally absorbed into their organisational structure.

*Clusters and networks offer additional benefits from inter-firm spillovers.*

Clusters have long been an object of academic study and an instrument of industrial policy for regional and national authorities. Networks of firms, however, have been a more elusive topic — not very easy to identify and not attracting policy recommendations. But **globalisation and the new organisational structures** that firms are adopting in its wake have increased policy-makers' interest in networks and in their usefulness as a policy tool. The important question is to what extent networks can be used to enhance the performance of cluster-based policies and to support SMEs in the process of internationalisation.

*Networks enable EU SMEs to reach*

Networks spring from autonomous decisions of companies that decide it is in their best interest to be inside the network rather than outside it. Unlike clusters, **networks do not need to be concentrated** in a specific area. In fact, a group of companies that cooperate in a region may decide to set up closer links with other groups in more distant areas.

*critical mass, share information and enlarge their industrial scope*

*Public authorities have an interest in helping firms create networks. In practice, in-kind instruments tend to be more effective.*

*EU networks are useful complements to existing regional and national cluster programmes.*

There may be several reasons for these moves: a lack of critical mass in the original region; sharing information with other companies for the purpose of entering new markets; enlarging the firm's industrial scope. Such needs are felt more acutely by SMEs, for whom the cost of access to suitable information on international markets can be exorbitant.

Faced with globalisation, SMEs have an incentive to identify emerging activities that will give them a **new competitive advantage**. Cooperation within a network may be a sensible strategy for preventing the decay of their traditional specialisation. In Italy, for example, the Romagna Creative District is a network focusing on communication, art, design, architecture, theatre, music and literature. It aims to connect and share the resources of individuals and companies for the purpose of achieving new creative projects and spreading them across the Romagna Region. In Germany, the Eastern Ruhr Industry Network is another example of efforts to boost competitiveness in regions undergoing industrial change. In this case, the network brings together firms in traditional manufacturing sectors.

Public authorities may share with firms an interest in building **more effective and widespread networks**. In this case, alongside financial incentives, regional and national governments have at their disposal 'in-kind' instruments such as providing structures to collaborate. Which instruments to choose depends on the activities policy-makers want to encourage.

Generally speaking, the rationale for public policy intervention rests on externality or information asymmetry or on other market or regulatory failures. There is an argument for promoting clusters in terms of the **positive externalities** that an agglomeration of industries may well foster. The case for supporting networks is less straightforward and crucially depends on the activities that networks are engaged in. For example, accessing new markets and developing new products demand very precise information and close cooperation that could be best achieved through a common network. If there is going to be any kind of public involvement, policy-makers must show that it is more efficient to help the network than its individual members.

The removal of administrative barriers and the access to a common knowledge infrastructure and collaboration platform could boost network activities in new areas that are fundamental to growth. Europe-wide network programmes could be a useful complement to cluster-based programmes.

Finally the report looks at the potential of **neighbourhood policies** to contribute to growth and industrial competitiveness. The opportunities of cross-border investment and trade with our neighbours are in a way the low-hanging fruits that have not yet been used to their full potential.

The importance of each neighbouring country for the competitiveness of the EU and its Member States varies depending on the form of cooperation between the EU and the country in question, how deep and

comprehensive the cooperation is, the size and structure of the economy of the neighbouring country, its level of development, trade and investment flows, any bilateral agreements, and migration between the country concerned and the EU. By examining each of these aspects, the chapter endeavours to shed light on the challenges and opportunities for EU competitiveness stemming from its neighbourhood in the context of globalisation, also reflecting the dynamics over time in terms of EU enlargement, the global economic crisis, evolving relations across borders, and internal developments in neighbouring states (such as the Arab Spring).

*Several large economies dominate the EU neighbourhood in terms of population and GDP*

A **few large economies dominate** the neighbourhood: Russia, Ukraine, Switzerland, Norway, and Egypt. Without these countries, the region surrounding the EU would be significantly less important in terms of GDP and have less than half its current population. Oil and gas production plays a central role in a small number of countries – Russia, Algeria, Azerbaijan, Libya, Norway – while most countries are service-based economies, in many cases also with a relatively large agricultural sector.

*Most economies suffer from lack of competitiveness...*

Most countries in the neighbourhood suffer from a **lack of competitiveness**, in many cases as a result of being relatively closed economies with weak business environments. Many of them also run high external imbalances – usually deficits, apart from the energy exporters listed above which all have persistent trade and current account surpluses.

*Asymmetry in partnership*

The EU is an important trading partner for all neighbouring countries. From the point of view of the EU though, they play rather a modest role as trading partners, for the reasons explained above. This **asymmetry in the relative importance of trading partners** has an impact in bilateral negotiations as any development affecting trade relations is likely to have much more impact on the non-EU trading partner than on the EU.

*Opportunities of export-led growth largely missed*

The type of extensive and successful export-led growth strategy witnessed in recent decades in other parts of the world, with the potential to diversify and upgrade exports and integrate economies into global trade networks, has so far had less success in the countries surrounding the EU. Most of them have not seen their market shares increase on the world market, most likely due to their relatively small shares of manufactured goods in their exports. In addition, several of the neighbouring countries are caught in a situation where rents from natural resources prove detrimental to export diversification and structural upgrading.

*EU is the most important investor in the neighbourhood*

**Outward FDI** from the EU to its neighbours exceeds inward FDI from the neighbours. Around a fifth of all outward extra-EU FDI from Member States goes to the surrounding region, with the exception of 2009 and 2010 when the share was much higher. In the opposite direction, more or less a quarter of all inward FDI comes from the surrounding region, a share which however has dropped recently.

The Southern Mediterranean is an important destination for EU

*Inward labour migration is an opportunity rather than a challenge for EU growth and competitiveness*

investments, in particular **Egypt, Tunisia and Morocco**. While in Egypt most FDI has gone into the petroleum industry, FDI flows into Morocco have been more diversified. Mainly for historical reasons and due to its geographical proximity, the EU is in fact the leading investor in the region.

**Labour migration to EU Member States** is high on the agenda of EU policymakers. Mediterranean neighbouring countries are a major source of EU immigration, the total number of first-generation emigrants from that region ranging from 10 million to 13 million, as for various reasons the EU is the main destination for migrants from the other side of the Mediterranean. Immigrants from the region represent 20 % of the 30 million immigrants in the EU and 6 % of total EU population. The flow of migrants from the region could rise, at least temporarily, against the backdrop of the Arab Spring. Migration is obviously linked to local unemployment, economic hardship and a lack of options. It can represent the only viable alternative to unemployment, and is a natural reaction to social and economic upheaval or internal political conflicts.

Faced with the prospect of **ageing and potentially diminishing populations** exerting serious pressure on their welfare systems and potentially holding back their competitiveness, EU Member States have come to see immigration, not only from the immediate neighbourhood but from further afield as well, as a solution. The Europe 2020 strategy set out to promote a forward looking and comprehensive labour migration policy which would respond in a flexible way to the priorities and needs of labour markets. By matching shortages on EU labour markets with the excess labour supply outside the EU, Member States could sustain their international economic competitiveness, growth and prosperity.

Remittances go hand in hand with labour migration. Both have increased over the last decades, in many cases generating significant welfare gains in the countries to which remittances are sent. Moldova is an extreme case in point as it has the highest share of remittances to GDP (23 %), and remittances contribute to developments on the labour market there. Other countries with high shares of remittances to GDP are Lebanon and Egypt. However, the economic crisis and ensuing austerity packages implemented in many Member States have made it more **difficult for immigrants to find gainful employment in the EU**, and while some of them have returned to their countries of origin, most immigrants have adjusted to the economic crisis by reducing their remittances.

The report is structured as follows. The introductory chapter "*The External Sector in the Recession*" sets the scene by studying the role of the external sector in the European industries' recovery and their sustainable competitiveness. Chapter 2 "*EU Industry in the Global Value Chain*" studies the internationalisation of production and the trends in the domestic value of European exports. Chapter 3 "*Energy Content of Exports and Eco-Innovation*" analyses competitiveness in

the context of energy efficiency of exports. Chapter 4 "***FDI Flows and EU industrial competitiveness***" examines the positioning of the EU as a source and destination of cross-border capital flows and the related implications for the competitiveness of European enterprises. Chapter 5 "***Clusters and Networks***" studies the changes in the way firms cooperate and the room for policy support. The concluding chapter 6 "***Competitiveness developments along the external borders of the EU***" looks at the potential of neighbourhood policies to contribute to growth and competitiveness.