

# Europe's chance to bolster a flagship industry

## Philippe Citroën

Director general, European Rail Industry Association (Unife)

**T**HE European rail supply industry is a diverse and geographically-widespread industry comprising thousands of SMEs and major industrial champions. Employing around 400,000 people throughout the European Union (EU) and with absolute sales of €47bn per annum, it accounts for 46% of the global accessible market for rail products.

This world leadership is attributed to its R&D capacities as well as a reputation for high quality. Indeed, innovation has been at the heart of this European industry which currently invests 2.7% of its annual turnover into R&D.

As Unife's 2014 World Rail Market Study shows, the good news is that rail markets will continue to grow on all continents and there are therefore great business opportunities for European suppliers to seize. However, European companies face a critical challenge to their global market leadership with competition from Asia - especially China - becoming increasingly fierce. This was highlighted by the European Commission's Directorate General Enterprise and Industry in its *2013 Sector Overview and Competitiveness Survey of the Railway Supply Industry*. Two years later, the rapidly-evolving situation has become a serious cause for concern for all European suppliers, which face the prospect of having to adapt to different technical

environments while also competing in a single market with a growing number of European as well as non-European players. This high level of competition brings the challenge of lower margins.

Alongside intensifying competition, Europe's rail suppliers face increasingly-restricted access to some significant markets. Closed domestic public procurement markets provide certain non-European competitors with massive resources that enable them to bid more competitively and take on more risks in the European market, and in other markets where EU suppliers are present. In some cases, they also benefit from competitive financing as state-owned companies, making the rules of the commercial game even more asymmetrical.

The merger last year between CNR and CSR, the two biggest Chinese manufacturers (with combined sales of \$US 31.7bn in 2013) rang alarm bells in the European industry. This merger resulted in the formation of the CRRC Corporation, the world's largest train builder at twice the size of its largest European competitor. Not only does its size and state-sponsored position enable it to benefit from higher combined revenues, increased purchasing power, profit accretion, economies of scale and strong pricing power, it has privileged access to the huge and protected Chinese domestic market.

In this context, Unife welcomes the decision of the European Parliament's Industry Committee (ITRE), under the initiative of MEP Mrs Martina Werner, to prepare and adopt in 2016 an official resolution on the competitiveness of

European rail supply manufacturers, which would mobilise EU institutions to take action on the issue.

This will be a unique opportunity to discuss and define at the European level - for the first time ever - a European industrial strategy to safeguard the world leadership of the European rail industry. During an important event in October 2015 organised in the framework of this future parliamentary resolution, former Unife chairman Dr Lutz Bertling outlined a sectoral strategy for the European rail supply industry based on existing European strategies for car and ship-building industries. This identifies three pillars for an EU co-ordinated industrial strategy to boost the competitiveness of the European rail supply industry.

The first consideration is how the EU could help "strengthen the offer" by enabling European suppliers to continue offering the best products on the world market. Secondly, it is essential to work on improving the business environment in the EU and internationally to ensure that European suppliers can produce and sell their products in fair market conditions. Yet producing the best products and a satisfactory business environment will ultimately be fruitless if there is no demand for rail products. Stimulating demand in the EU and globally is the critical third pillar of the strategy.

When it comes to strengthening the offer, the support of the EU can be instrumental in fostering research and innovation and developing skills and talent. In this respect, it will be essential to ensure all of the R&D activities of the newly-established Shift<sup>2</sup>Rail Joint Technology Initiative are launched this year. Moreover, building the best-quality and most energy-efficient rail products also requires Europe to invest in human capital - as there is currently a skills shortage - and adapt production capacities to new realities, including new technologies and evolving markets.

Concerning the business environment in Europe and internationally, EU action is indispensable when it comes to both improving the internal market and enhancing the industry's ability to export through improved market access abroad. Establishing a well-functioning internal market will undoubtedly make the European rail industry stronger.



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By creating a streamlined and efficient process for rolling stock authorisation with the European Railway Agency (ERA), the Technical Pillar of the Fourth Railway Package will play a key role in this regard, which is why the EU institutions must proceed to its final adoption and implementation as soon as possible. Likewise, Unife urges EU member states to implement the 2014 Public Procurement Directives which will put an end to the “dominance of the lowest price” and ensure that quality and life-cycle are given due consideration in the public procurement of rail products.

Regarding exports overseas, while the EU is recognised as one of the most open and transparent global trading partners in the world, the European rail industry still faces discriminatory barriers or difficulties when trying to enter certain major markets. For instance, the market access situation in

Japan stands in stark contrast with the EU’s, where Japanese rail suppliers have been awarded major contracts. The support that the EU can provide for a level playing field - through bilateral free trade agreements with Japan (see below), the US and the investment agreement with China - is essential.

More generally and considering their vital importance, Unife hopes that this parliamentary resolution will also be the occasion to recognise the role of rail-supply SMEs while outlining a strategy to improve their prospects.

Finally, stimulating demand for rail products will be of equal importance to securing economic opportunities for European suppliers. In this respect, the EU together with all of its member states, regional and local authorities play a key role through the public grants they provide for rail projects.

But while public financing is of central importance to enabling rail

projects, it is now also essential to work together with the EU Institutions and the European Investment Bank to ensure that EU initiatives aimed at mobilising private investment for strategic projects will also benefit the rail sector in Europe. This is Unife’s aspiration for the new European Fund for Strategic Investment. Last but not least, European transport policy that further boosts the attractiveness of rail and promotes modal shift is imperative to stimulate demand for rail products.

The European rail industry aims not only to maintain the leadership of the global market but also continue to build a more attractive railway system that encourages a shift to rail transport around the world. With such a modal shift, the environmentally-friendly and societal virtues of rail can be fully unleashed and play a central role in the reduction of CO<sub>2</sub> emissions in a world with an increasing demand for mobility.

## EU-Japan trade: is a breakthrough imminent?

Keith Barrow

Associate editor

**J**APAN is the European Union’s (EU) biggest trading partner after China, but the trade in railway equipment between the two economic powers is a poor reflection of this status and the scale of their respective railway markets.

East Japan Railway Company (JR East) invested €1.64bn in new equipment in 2015, but EU suppliers accounted for less than 5% of this. Japan’s total market for railway equipment is worth €5.8bn but only 0.03% of rolling stock is imported.

In recent years Japanese suppliers have made gains in the European market. Notably last year Hitachi opened a new plant in England to assemble regional and long-distance trains for Britain and completed its acquisition of Finmeccanica’s rail business. Yet sales of Japanese railway equipment in Europe arguably do not reflect the technical standards being achieved by Japanese suppliers, or their success in other parts of the world.

However, there are signs the stalemate may be broken in 2016. In 2013 the Japanese government and the EU began discussions on a free trade agreement (FTA), and negotiations have been intensive with 13 rounds of talks between April 2013 and November



*Hitachi has established a major presence in the European rolling stock market in recent years - could a European supplier do the same in Japan?*

2015. Now, policymakers in Brussels and Tokyo sense that an agreement is within their grasp, and many believe the deal can be done this year.

“This is a strategic priority for the EU and we want it happen sooner rather than later during 2016,” Mr Mauro Petriccione, deputy director general for the European Commission’s (EC) Directorate General for Trade told delegates at a seminar on the FTA, which was hosted by German Rail (DB) and JR East in Brussels on November 18. “It wasn’t easy to turn decades of disinterest in Japan into what we have now. We don’t want to lose momentum. We have identified the gaps and both sides know how we can bridge them.”

According to Petriccione, many of these gaps are in agriculture, and both parties have largely found common ground on the rail element of the FTA. “Our original objective in these negotiations was to achieve a level playing field for rail, but things have moved on to a strategic vision for what the FTA can do for the sector,” he says.

There are two notable non-tariff barriers that still need to be overcome - the Operational Safety Clause (OSC), which enables Japanese railways to opt out of the World Trade Organisation Government Procurement Agreement for safety-specific reasons, and the procurement policies of the seven JR Group companies, which collectively

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account for 60% of the market.

"The OSC ensures commonality between all operators, but we don't want to use the OSC to stop companies entering Japan," says Mr Ichiro Takahashi, executive director of JR East's Brussels branch. "The focus on the OSC makes it look like safety is the only issue - this is a misunderstanding. Safety is only part of the picture, quality is also very important. Our interest is in broadening the railway sector."

Petriccione questions the need for the OSC, and notes that Japan's Ministry of Land, Infrastructure, Transport and Tourism has put forward some "good ideas" to achieve a compromise. "Why should an instrument as blunt as the OSC apply to European suppliers when European and Japanese suppliers give the greatest attention to safety?" he says.

Unife is less satisfied with progress towards the FTA and has expressed concern that a so-called one-year package on railways agreed by the EC and the Japanese government, which came into effect in 2014, will not in itself create a level playing field. "The one year package is only a first step towards greater transparency," says Unife director general Mr Philippe Citroën. "In terms of business, concrete signs of market opening are still very limited. We want a swift agreement to provide a better business environment, but the timing of negotiations should not be at the expense of quality."

JR East says it is already actively encouraging bids from international suppliers as part of its policy of seeking "best-in-class products from all over the world." The company has held supplier tours in Europe to meet prospective suppliers and the procurement section of its website now includes upcoming tenders. "There is a need for mutual understanding and effort by both the customer and the supplier if we are going to increase European suppliers' share of the market," Takahashi says.

Feeding into the work on the FTA, the fourth EU-Japan Industrial Dialogue on Railways was held in Chiba, Japan, in November with the aim of deepening mutual understanding between the railway markets in Japan and the EU.

Last month the prime ministers of Japan and Luxembourg - which currently holds the EU presidency - reaffirmed their commitment to concluding the FTA at the earliest opportunity. This development will be broadly welcomed by the rail industry - providing the final deal comprehensively addresses the issues which have stifled mutual trade in this sector for so long.