**Presidency Note**

**State of play of the European construction sector**

**Lunch at the Competitiveness Council, 29 September 2016**

**I. INTRODUCTION**

Construction is an important driver of economic growth and employment in every country but also for the European economy as a whole. The sector not only makes an important contribution to the EU's GDP and to employment rates, it also impacts directly on the daily life of citizens, affecting the quality of life, the use of natural resources and the environment.

The performance of the construction sector – and the policies that support it – responds to long-term societal challenges that Europe will face, especially jobs and growth, demographic changes, climate change, creating smart cities and resource sustainability. These challenges in turn represent opportunities for the sector, in particular to increase energy efficiency in buildings.

Despite achievements over the years, much remains to be done if the construction sector is to address Europe's economic, societal and environmental challenges in a better way than it does at present.

The Strategy for the sustainable competitiveness of the construction sector and its enterprises from August 2012, which includes an Action Plan running until 2020, addresses the main challenges the industry faces up to 2020 and sets out strategic priorities for it to grow strong and more viable in the future[[1]](#footnote-1). During the past four years, progress has been made in the implementation of the Action Plan. But developments in the sector and changing challenges need to be closely monitored. With respect to the Single Market Strategy, the very low level of cross-border trade and cross-border investment in this important sector also calls for attention.

**II. BACKGROUND**

The construction value chain, including contractors, the supply of construction products and equipment, and construction-related professional services, sustained 23 million jobs in 6.2 million companies, 8.2% of EU's GDP and an added value of 1.14 trillion EUR in 2014.

Contractors constitute the core of the value chain. They experienced a severe contraction during the economic and financial crisis from which they have not yet recovered. Having peaked at around 4.8% in 2007-08, contractors' share of GDP fell to 3.5% in 2014. The sector’s share of total employment reached 7.7% by the second half of 2007 but has subsequently fallen to 6.2%.

In the meantime, the growing demand for energy-efficient buildings has created new business opportunities for enterprises, particularly for the renovation of residential housing. The turnover resulting from energy efficiency building work in residential buildings is estimated to have been around € 500 billion between 2010 and 2014, i.e., about 16% of the total residential building market.

***1. Investments***

The crisis has had a major impact on investment in the construction sector, although the situation varies considerably within the EU. Data show that in most countries investment fell sharply in relation to GDP after 2007 and that investment levels remained comparably weak in all countries.

The European Investment Bank estimates that aggregate investment in Europe is some 15% below pre-crisis levels, with depressed investment in new dwellings and the maintenance and upgrading of infrastructure. In particular, continued underinvestment in infrastructure may constrain growth in the future. In many Member States the quality of infrastructure is negatively affected by insufficient investments in upgrade and maintenance[[2]](#footnote-2), with important knock-on effects on the efficiency of the European transport system and industrial competitiveness.

The shortfall in investment is not due to a lack of liquidity but to low investor confidence because of economic volatility and regulatory uncertainties. Governments can increase funding by raising user charges or selling existing assets and using the proceeds for new infrastructures. Public-private partnerships have taken on a greater role in infrastructure and will continue to be an important source of financing in the future.[[3]](#footnote-3)

The need to boost infrastructure investment has been recognised by the EU, which has launched the European Fund for Strategic Investments (EFSI) to leverage private finance and provide additional risk-financing for high-risk projects.

Financial instruments need to be made more attractive for new private investors. This could be achieved by standardised financial products which increase the transparency of reporting and compliance systems.

Regarding buildings, investor knowledge of long-term risks and the benefits of investment projects needs to be improved, for example by access to reliable and verifiable information on sustainability. Several national and local schemes have tried to provide such guidance to individual home owners already. For example, in the Czech Republic a simple and clear calculation tool was developed for non-professional users under the state programme EFEKT to verify the quality of issued Energy Performance Certificates in case of doubts. In Denmark, “Better Home” is a new scheme started in 2014 to create a “one stop shop” for energy renovation. Private home owners can get advise from a single certified advisor who follows the project all the way from design to completed renovation.

Another approach is for construction firms and installers, or intermediaries like utility companies, to take on some of the risks that would otherwise fall on the property owner or user by recovering the cost of renovation or retrofitting improvements out of future savings in utility bills.

***2. The value chain***

Despite the economic downturn, the cost of residential construction has steadily increased, including materials, labour and equipment, transport and energy. For example, Spanish material and labour costs increased by 12.8% from 2007 to 2014. In Germany, construction costs have risen by 10% between 2008 and 2012.

Productivity levels in construction products manufacturing and contractors are still below pre-crisis levels. Given the weight of construction in the overall economy, this is an important issue. While labour market rigidities prevent sector adjustments in some Member States, another reason is that, generally speaking, construction still relies on working methods that have been used for many decades.

A radical change of production methods and organisation is needed to modernise the sector and adjust it to respond both today's and tomorrow's building trends. At present, this is the transition to a low-carbon economy, but the future will bring demographic and social changes, scarcity of resources, and urban redevelopment. In this context, a modern construction sector must be fit for purpose and able to deliver building and infrastructure solutions that meet these trends and the technological requirements of end users.

While change will need to come from industry itself, policy makers should ensure the right framework and support mechanisms are in place.

The solutions to these two challenges go hand-in-hand and will have to address competitiveness and sustainability goals simultaneously and coherently. Among the many potential vectors for change, there are three that stand out:

* ***Industrialisation:*** efforts to optimise construction work processes in order to raise cost efficiency, productivity and quality. This should also cover the renovation of buildings, particularly in terms of greater needs for customisation and prefabrication.
* ***Product service systems:*** efforts to develop new business models enabling companies – from the construction sector or other – to generate revenues after the hand-over of a construction project.
* ***Digitalisation:*** Digital technologies are slowly finding their way in the construction sector, more slowly than in other sectors. The construction sector needs to adjust rapidly to ICT-enabled "smart solutions".

Digital technologies have the potential to raise efficiency of construction processes and in the operation of buildings and infrastructure. They also will facilitate collaborative approaches to drive innovation, attract young and IT-skilled people to the sector and reduce waste. There is a need, therefore, to boost the digitalisation of design, planning, execution and operation in the construction sector and throughout the value chain until it becomes a standard operating procedure for the sector. The construction industry needs to exchange best practices more actively and develop collaboration platforms, as well as ICT systems that work across borders and allow efficient information sharing.

***3. Market integration of products and services***

The construction sector has a significant potential to benefit from the Single Market.

Despite the adoption of the Mutual Recognition Regulation in 2008 and of the Construction Product Regulation in 2011, national requirements and practices continue to block the trade of construction products in the EU, and the same is true for cross-border construction services.

Indeed, some construction services and related professional services are highly regulated in Member States and suffer from formalities required to operate a business or to get authorisations. While some Member States have simplified regulatory procedures, overall intra-EU trade is still very low and among the lowest of services sectors.

To strengthen the Single Market for construction services and related professional services, the Commission is considering a services certificate for key sectors of the economy, including construction services. Moreover, under its REFIT Programme, the Commission is undertaking a Fitness Check of the legal framework affecting construction.

Bringing about a comprehensive shift towards new business practices also implies a significant reform of public and private sector procurement for construction. Public policy should provide a legal and regulatory framework to improve the functioning of markets.

**III. EXCHANGE OF VIEWS**

The 2012 strategy and action plan addresses many of the main challenges faced by the construction sector. The Commission is preparing a mid-term review of the 2012 strategy and wants to refocus and reprioritise the action plan.

Ministers are invited to discuss the main policy objectives and orientations of a new EU construction strategy. The Presidency invites them in particular to address the following questions:

1. *What is the role of public policy in deploying financial instruments and new public-private business models for building and infrastructure investments?*
2. *What action could the EU take to promote digitalisation in the construction sector, especially in SMEs, as well as the integration of smart technologies in buildings and infrastructure?*
3. *What are the most severe administrative and regulatory barriers companies face when trying to sell construction goods and provide services across borders in the EU? How could EU policies facilitate removing those barriers?*

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1. Doc. 13186/12 + ADD 1 of 22 August 2012. [↑](#footnote-ref-1)
2. Source: European Commission, Key areas: comparing Member States' performance - [Transport](http://ec.europa.eu/europe2020/pdf/themes/2016/transport_201605.pdf). [↑](#footnote-ref-2)
3. McKinsey Global Institute, [Bridging Global Infrastructure Gaps](http://www.mckinsey.com/industries/infrastructure/our-insights/Bridging-global-infrastructure-gaps?cid=other-eml-alt-mip-mgi-oth-1606), June 2016. [↑](#footnote-ref-3)