IfM-Background Paper

The corona pandemic as a chance for a forward-looking EU Mittelstand policy

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The most important facts in brief

International economic relations and value chains, which are mainly optimised according to (short-term) efficiency and cost aspects, have already proved susceptible to exogenous shocks in the past. The corona pandemic currently represents a globally unique impairment of international economic relations and social welfare.

Fundamental freedoms are essential for a functioning EU Single Market

The European Single Market is by far the most important sales and procurement market for Mittelstand businesses. Its harmonised regulatory system reduces transaction costs and gives companies access to a larger overall market. The four fundamental freedoms (free movement of persons, goods, services and capital) are of crucial importance in this respect. However, the corona pandemic is currently causing considerable restrictions on these fundamental freedoms. As a result, an important market is breaking away for Mittelstand enterprises. In addition, there are problems in the value chains due to supply disruptions. It is therefore extremely important to reduce these restrictions as soon as possible in order to restore the functioning of the Single Market.

The European Commission published guidelines and recommendations on May 13, 2020, for a phased, differentiated and coordinated lifting of restrictions on the free movement of persons. However, the coordination mechanisms it has created are more of a recommendatory nature. Ultimately, the decision-making competence lies at the level of the member states. Nevertheless, the intention declared by the European Commission to continuously assess the proportionality of existing restrictions on the free movement of persons in the member states and to intervene if disproportions are identified sends out a certain positive signal.

Ultimately, the current problems also show the enormous opportunities that can result from increased digitisation. However, this will require the development of a modern digital infrastructure across the EU, which in turn will require appropriate investment in digital capacity and cybersecurity. In this context, the official inclusion of "freedom of data movement" as the fifth fundamental freedom of the Single Market could send an important symbolic signal.
Short-term EU SME support policy no longer up to date

The Corona pandemic illustrates the interconnectedness of Europe's economy and the importance of the Single Market for economic recovery. The EU therefore has an important role to play in developing and coordinating an effective and coherent strategy for the recovery of small and medium-sized enterprises (SMEs) and Mittelstand businesses in all EU member states. However, the European SME policy to date and the EU SME strategy presented in March are primarily support policies that address the – supposedly – size-related disadvantages of SMEs and Mittelstand businesses with small-scale and short-term measures. Yet, there is no fundamental economic policy foundation or strategic guideline.

The corona pandemic offers a real opportunity to implement such a long-term approach: All countries depend on a strong economy to overcome the considerable economic and societal consequences and are therefore potentially more willing to consider solutions that are off the beaten track. This opportunity should be used to initiate a fundamental reorientation of EU SME policy towards a Mittelstand policy. Here, market economy/ordoliberal approaches with social balance should be considered. State intervention, on the other hand, should be limited to the minimum necessary.

German EU Council Presidency as an opportunity for a forward-looking European Mittelstand policy

At present, macroeconomic aspects dominate strongly in European economic policy. In contrast, economic policy measures with effects on SMEs and Mittelstand businesses have so far only been implemented nationally and have not been coordinated at European level. At the same time, Europe's SME and Mittelstand economy is in many respects undergoing a major transformation process – even beyond the problems caused by the corona pandemic – which is similarly challenging all member states. Germany should, therefore, advance the concept of a forward-looking European Mittelstand policy within the framework of its forthcoming EU Council Presidency.

The corona crisis is not primarily a crisis of the market economy or private enterprise. On the contrary, both are urgently needed in order to contain negative welfare effects, but also to develop innovative solutions that complement the traditional focus on quantitative growth with qualitative components (working conditions, environmental aspects, etc.).
1 Preface

In coordination with numerous other policy fields and actors, (national) economic and SME policies are currently facing the major challenge of mitigating the negative effects of the corona pandemic and at the same time setting the course for the economy and society in the post-corona period. This task is being faced simultaneously in the European Union (EU) and worldwide by almost all countries. A (national) economic policy that focuses exclusively on domestic enterprises would disregard important international interdependencies and potential coordination advantages and would therefore clearly be inadequate.

After the first two background papers of the IfM Bonn have analysed the corona crisis mainly from the perspective of German SME and Mittelstand policy, it is, therefore, reasonable to examine the economic and socio-political crisis management also from a supranational, European perspective. The paper is based on the assumption that the European Single Market and a European approach to SME policy could provide important impulses for a coordinated overcoming of the crisis and the shaping of the future beyond the current level. To realise its potential, however, a new and above all strategically oriented Mittelstand policy of the EU, strongly oriented towards levelling the playing field and fostering the strengths of small and medium-size enterprises, is needed instead of the previous and currently dominating short-term oriented support policy. In the current pandemic, this policy must also be flanked by health policy and epidemiological considerations at European level, without being discussed in the following.
2 The importance of the European Single Market for the Mittelstand

International economic relations based on comparative cost and innovation advantages have generated positive income, innovation and growth effects in many countries over the past decades, thus contributing significantly to overall economic welfare increases. For the majority of SMEs and Mittelstand businesses in the EU, internationalisation is synonymous with opening up the European Single Market. For almost all member states, the European Single Market is by far the most important sales and procurement market and the main target region for direct investments. This is particularly true for the German export industry: 85.1% of all German exporting companies are also active in the EU. For Spain (74.4 %) or France (56.2 %), this applies to a much lesser extent. However, when looking at export volumes, the differences are smaller: intra-EU trade accounts for the bulk of the export volume of Spain (66.3%), France (58.8%) and Germany (58.5%).

At the same time, the European Single Market also serves as a springboard for smaller companies, in particular, to enter non-European markets, e.g. for their integration into global value chains in which a considerable proportion of world trade takes place. Current estimates by the World Bank and the WTO assume a percentage share of about two thirds (cf. World Bank/World Trade Organization 2019). This applies equally to the German economy (cf. OECD 2018a): In 2015, almost one third of value-added was attributable to foreign final consumers, in the manufacturing industry even about 60%. Similarly, international integration is of paramount importance for the labour market: In 2015, around 28 % of all jobs in Germany depended on foreign final customers – the highest figure of all OECD countries (cf. OECD 2018b). Here, integration into European value chains is dominant, which underlines the importance of the European Single Market for the German economy.

At present, the functionality of the European Single Market is severely restricted due to the corona pandemic – a critical market has thus been lost to Mittelstand businesses, not only in Germany. In the value chains, especially in the manufacturing sector, problems quickly arose due to delivery failures (cf. Wiechers/Steinwachs 2020), because these networks are often very complex structures that cannot be fully overseen even by the lead companies. Just-in-time production with a tendency towards low inventory levels means that international value chains can exhibit a high degree of fragility, especially when exogenous shocks occur. It is true that "representation arrangements" do exist in some cases within a chain, whereby members are required to maintain capacities and expertise in order to be able to step in in an emergency. However, these
are of course not designed for such large-scale failures as those caused by the corona pandemic.

In addition to its (market) size, a significant advantage of the Single Market for Mittelstand businesses is its largely harmonised regulatory system. The harmonisation of the (economic policy) framework conditions and procedures reduces transaction costs and gives companies access to a larger overall market. The latter, in turn, enables economies of scale, productivity and cost advantages to be realised, thereby increasing innovation capacity and competitiveness. Nevertheless, even after 27 years, the Single Market has not yet reached its full potential. On the contrary, there are still numerous (bureaucratic and regulatory) obstacles that hamper its dynamism.

These problems are exacerbated by "nationalisation tendencies" within the EU, e.g. in the form of border closures. The associated restrictions on the free movement of persons also naturally pose a challenge to the complex economic relations within the EU. For example, the lack of harvest workers has led to considerable problems for the agricultural enterprises concerned. Restricted free movement also affects craftspersons and construction companies, which often operate across national borders in border regions. However, sales and service activities abroad are also of great importance for Mittelstand businesses in the manufacturing sector due to their high quality and customer orientation. It is, therefore, essential to be able to send employees and service teams to foreign customers if required.

Even more severe are the current distortions for value chains caused by the corona pandemic. The increase in protectionism and trade policy uncertainty in recent years has already shown how vulnerable international economic relations and value chains are to exogenous shocks if they are optimised primarily according to (short-term) efficiency and cost aspects (cf. Holz et al. 2016). While these shocks were primarily motivated by trade and power politics, the current coronavirus pandemic has led to an impairment of international economic relations and social welfare that is unique in this global dimension.
3 The road to revitalising and fully implementing the EU Single Market

At the heart of the Single Market are the four European freedoms of movement (persons, goods, services and capital). However, the first three, in particular, have been radically curtailed or even completely abolished because the coronavirus pandemic has raised and continues to raise new and serious challenges to all European countries. In order to avoid overburdening their health systems, all EU member states adopted rigid measures that restricted public and economic life. The pandemic also affected the member states at different times and to varying degrees. As a result, each member state decided on its own measures. No concerted action was taken. As it is still not foreseeable when vaccines or at least effective drugs to combat the health consequences of the Sars-CoV2 virus will be available, a return to the old normality and an unchanged continuation of previous strategies and policies do not seem likely at this point in time. Accordingly, the economic and societal, but also the cultural and psychological consequences of the corona crisis will continue to occupy politics, business and society for a long time to come.

The first step to revive the Single Market is the **coordinated release of the currently restricted European freedoms of movement**. The EU has a key role in developing and coordinating an effective, coherent strategy for the recovery of SMEs and Mittelstand businesses in the member states. With the "Joint European roadmap towards lifting COVID-19 containment measures" of April 15, 2020, it aims to ensure that all temporary measures taken by member states to contain the virus are lifted in a coordinated manner to ensure the full reopening of borders, free movement and the functioning of supply chains. In its Communication of May 13, 2020, the European Commission outlines guidelines and recommendations for a phased, differentiated and coordinated lifting of restrictions on free movement. Both at the (technical) working level and at the political level, the Commission has established mechanisms for coordination between the member states and the EU (including the "COVID-19 Information Group - Home Affairs"). However, since the Commission has no decision-making powers of its own in this policy area, the member states are called upon to make use of these mechanisms and also to coordinate among themselves when reopening borders. On a positive note, the Commission continuously assesses the proportionality of existing restrictions on freedom of movement in the member states and intends to intervene if disproportions are identified.

At present, renationalisation tendencies observed in the wake of the coronavirus pandemic may exacerbate the existing obstacles on the way to fully implement the Single
Market. The individual member states have different, historically based economic policy models, for example with regard to the role of the state in the economy or the importance of state intervention. At the same time, there are different views on the interaction between the players in politics, the economy and society. Despite harmonised European norms, these may therefore be interpreted differently by the respective national administration and jurisdiction and thus ultimately impede the free movement within the Single Market. Such problems were already apparent before the coronavirus pandemic began.

Moreover, by far, not all legislation and administrative or application procedures are harmonised. Another problem is the oftentimes varying degrees of enforcement and control of EU rules by public authorities in different member states. Especially in the light of the current crisis, which is essentially not a national crisis, it is all the more important to implement or revitalise the Single Market efficiently so that it can develop its many welfare benefits.

- The newly to be established **Single Market Enforcement Task Force**, composed of representatives of the member states and the Commission, is expected to make important contributions in the medium term to further raising the potential of the European Single Market. This includes, for example, regularly assessing compliance with Single Market rules in national law, setting priorities with regard to the most important obstacles, tackling unnecessary over-regulation, discussing horizontal enforcement issues and monitoring the implementation of the Action Plan.

With regard to a desirable review of existing bureaucratic and regulatory provisions, the current situation even represents an opportunity. Since most regulations are not completely pointless in themselves, experience shows that it is extremely difficult to reduce them. In times of major crises, a multitude of new (unanticipated) challenges arises, which require innovative ways of reacting. As a result, situations that are not and cannot be fully regulated by law, occur more frequently. The bureaucratic and regulatory requirements developed for "normal operation" prove to be less fitting in the "crisis mode" and tend to lose some importance. Therefore, the Sars-CoV2 virus, to a certain extent, enforces more trust and pragmatism at the government and administrative level. This opens up room for manoeuvre in the European area for testing new possibilities:

- For example, a (not only) temporary reduction of bureaucratic and regulatory obstacles at the EU level could enable companies to dedicate more scarce resources to key business activities and thus release new productivity potential.
It is true that the current coronavirus pandemic poses immense challenges for almost the entire world and threatens the economic existence of millions of companies and employees. However, the crisis also opens up opportunities for those who accept these challenges and demonstrate a high willingness to change. This applies equally to the revival of the European Single Market: During the corona pandemic crisis, border closures often hindered sales and service activities of enterprises in other EU countries. These problems could be partially mitigated by increased digitisation: For example, the experience currently gained out of necessity in the use of video conferencing could help to reduce both travel and labour costs and environmental pollution in the long term. Besides, smart, internet-compatible products can avoid physical contact, e.g. through remote control by the manufacturer/service staff, and also open up fundamental, new potential for value creation.

- However, this will require taking into account the more digitised patterns of interaction and work and the development of a modern digital infrastructure across the EU. Hence, it is vital to make the necessary investments in digital capacity and cybersecurity.

In addition to the – relatively simple – task of creating the digital infrastructure, consideration should also be given to extending the freedom of movement within the Single Market to include the "free movement of data". Although the EU has, in principle, set the framework for the free movement of non-personal data within the Single Market, this framework has not yet been established as a further European freedom of movement.

- In this respect, it should be considered to what extent the free movement in the Single Market should be extended and "freedom of data movement" should be officially included as the fifth fundamental freedom of the Single Market. This could send an important symbolic signal and underline the importance of a large European digital Single Market.

In this context, greater attention should also be paid to the new, hitherto little discussed form of "digital protectionism". On the one hand, to avoid it within Europe, and on the other hand, to counteract any tendency towards isolation outside Europe: Digitisation enables multiple cross-border, digital economic relations and business models. This often involves conflicting interests of individual countries, enterprises and individuals which have not (yet) been balanced by binding, multilateral regulations. Such a situation often creates incentives to exploit the still missing or incomplete regulatory frameworks to create new barriers to trade.
4 Why Europe needs a strategic Mittelstand policy

In order to cushion the economic impact of the corona pandemic on SMEs and Mittelstand businesses, the individual EU member states take various support measures. The extent of these measures may vary considerably from one member state to another. What they have in common, however, is that they mainly rely on tried and tested formulas to overcome the economic consequences of the corona pandemic: The focus is usually on ensuring the survival and continued existence of previously economically viable companies, e.g. by providing state-subsidised loans. All these measures tend to be short-term in nature and strongly company-oriented. In contrast, longer-term, structural policies and framework conditions or even visionary policy approaches have – so far – hardly played a role.

This small-scale and short-term orientation also characterises the previous European SME policy of the EU as well as the "SME strategy for a sustainable and digital Europe" presented in March 2020: Although it is called "strategy", it is above all a support policy that addresses the – supposed – size-related disadvantages of SMEs. At the level of framework conditions, it limits its scope for intervention to very general institutional measures that are relatively easy to implement, such as the establishment of an SME envoy.

Where specific measures are identified, these are targeted at the smallest subset of SMEs (for example, support for IPOs). Sometimes, problems are identified from purely statistical trends, without it being clear or supported by research whether these figures really indicate difficulties. For example, the SME strategy derives need for action from the low use of risk capital by women-owned enterprises. However, this would only be the case if these companies were actually disadvantaged when it comes to obtaining risk capital, which need not be the case. The lower take-up could also be due to structural differences between women- and male-run enterprises.

This approach – identifying an actual or supposed problem of a very small target group and deriving a (support) measure from it – is a prototype for the current EU SME policy. Effects on the European or national economic order\(^1\) are not being addressed. This can, by no means, be called a holistic strategy.

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\(^1\) The German version of this IfM Background Paper refers to the concept of "Ordnungspolitik". This is a term that only exists in German language and can be roughly translated as "regulatory framework policy". It represents the theoretical underpinning of the German social market economy. Its main goal is to create a clear regulatory and institutional frame-
This approach is also due to the lack of an agreed economic order or at least a strategic guideline in which such measures can ideally be embedded. In the perception of most of the population in the EU member states, there is as yet no pan-European general public, no pan-European political awareness, no common language. The primary political reference point and the space for intra-societal solidarity is still, and increasingly again, the nation-state. This status quo poses particular challenges for a European SME policy in so far as the implementation of and compliance with European SME policy and its guidelines ultimately depends on acceptance by those affected and the population in the member states. A further complicating factor is that the SME policy is not implemented by the EU itself, but – with the exception of the Horizon 2020 programmes in the field of research and development – by the member states. These, in turn, pursue in part very different economic policy models and are characterised by considerable differences in their economic strength. As a consequence, the EU SME policy, following the principle of the lowest common denominator, has mostly been limited and restricted to a rather small-scale identification of alleged or actual problems for which a concrete (supposed) solution is then proposed.

However, an EU Mittelstand policy that is located above the level of the nation-states should ideally go beyond a simple transmission of national SME support to a higher (aggregated) level with centralised decision-making competence. This is important not least because the EU is a federation of states and not an independent state. Accordingly, finding an appropriate balance between solidarity and (market-based) individual responsibility in the relationship between the EU member states is a constant challenge. If the different realities of life "on the ground" are not sufficiently taken into account, there is a danger that latent reservations and animosities that already exist will become entrenched. This can reduce the willingness to cooperate within Europe and possibly even endanger the cohesion of the EU as a whole.

Mittelstand policy is already a very complex (interdisciplinary) policy field in the individual EU member states, affecting many policy and scientific areas. At its heart are entrepreneurs, who are generally characterised by special values and management principles. These combine sustainable economic success and social responsibility. Key principles include entrepreneurial liability for economic decisions, assumption of responsibility and regional integration. For Mittelstand business owners, their own success tends to be linked to the success of the stakeholders involved or addressed. In work order which ensures competition and guarantees the freedom of the individual to engage in economic activity. The state largely refrains from intervening in market processes but has an important role in reaching social balance through incentive-compatible social policies.
this respect, owner managed Mittelstand businesses differ from the large listed stock corporations. They need Europe, in particular, to overcome the crisis and can at the same time, make an important contribution to its revival. Embedded in a strategic European Mittelstand policy, the Single Market, for example, can offer efficiency advantages and (planning) security in a world characterised by a wide range of uncertainties and thus possibly develop even greater attractiveness for economic players from other regions of the world.

Particularly with regard to European SME policy, the corona pandemic could be an occasion for a rethink, since – apart from the current short-term measures – all countries are dependent on a strong economy in the medium and long term to overcome the considerable economic and societal consequences. It is therefore quite conceivable that the individual member states are prepared to rethink economic policy approaches to which they have traditionally been more reserved. Thus, economic policy approaches that have not yet been in line with the ideas of all member states could now become capable of consensus, facilitating a fundamental reorientation of EU SME policy towards an EU Mittelstand policy.
5 From the EU SME strategy to European Mittelstand policy – an opportunity for the German EU Council Presidency?

Especially against the background of the upcoming German EU Council Presidency, Germany could advance the concept of a future oriented European Mittelstand policy. This should go well beyond the SME strategy mentioned in the previous chapter. The macroeconomic aspects of European economic policy still dominate – not only in the public debate – for example, in the discussion on corona bonds. In contrast, economic policy measures with an impact on owner managed Mittelstand businesses have so far only been implemented nationally and have not been coordinated at European level. In many respects, however, the European SME and Mittelstand economy is undergoing a major transformation process which is challenging all member states in a similar way. In addition to overcoming the corona crisis, the main challenges are digitisation and sustainability (Green Deal) and the associated industrial transformation. Besides, social balance, social cohesion and a free democratic order for the economy and society must be preserved. Overall, due to the current situation, many things are in flux and can, therefore, be shaped differently.

In principle, the corona pandemic also represents a challenge in the international competition between different economic and societal systems, e.g. between China, the USA and the EU. Each of these systems is faced with the challenge of finding a balance between the poles of “freedom/dynamics/growth”, “equality/stability/security” and “solidarity/social balance/justice”. Depending on how successfully the different systems manage the crisis in the short, medium and long term, they can also serve as a model for other countries with less successful systems.

The German EU Council Presidency could therefore also be used to present the advantages of a consensus- and cooperation-oriented social market economy on an “Ordnungspolitik”-related basis within a discussion and exchange process on the (different) economic policy models in the EU member states. At the same time, it can highlight how entrepreneurial (innovation and solution) potentials can be released, and growth initiated through appropriate economic policy.

After all, the corona crisis is not primarily a crisis of the market economy or private enterprise. Rather, these core components of our economic order are needed in order to contain foreseeable negative welfare effects and to develop innovative approaches to solutions that in future may complement the traditional focus on quantitative growth with a qualitative component (working conditions, environmental aspects, etc.). State intervention should be limited to the minimum necessary. For example, it should be left to the participating companies to make decisions on possible adjustments to value
chains. Specifications, such as increased regionalisation, should be avoided. A possible increase in the pursuit of self-sufficiency and protectionism in the wake of the corona pandemic should be counteracted. The social partners should be involved in the necessary adaptation and recovery process in order to keep resistance that may arise as low as possible.

An appropriate strategy must be based on the recognition that the number of competitors with different ideas, perspectives and (cultural) backgrounds is fundamental to unleashing entrepreneurial initiative and solutions. Both the Single Market (expansion of the relevant market size; realisation of economies of scale) and SME policy (alleged size-related disadvantages) in particular should not be limited exclusively to quantitative goals, but should also keep an eye on the qualitative expansion of competence, innovation and cooperation.

From the above considerations, the necessity arises to pursue a rules-based, cooperation-promoting European SME and Mittelstand policy above the level of the nation-states, which releases the diverse entrepreneurial potentials in the EU member states and brings them into productive exchange with each other. The Single Market will only be truly successful if it is generally perceived as an advantageous, "fair" instrument in all (heterogeneous) member states. This requires a strategic medium- and long-term vision for the economy and society in the future at European level that goes beyond the crisis management that currently dominates. In a world marked by uncertainty and increasing antagonism, Germany, the EU and the Single Market could, in the best case, prove to be an "island of stability" and of social, societal balance.
Sources


