

# Executive Summary

The European Union (EU) is going through one of the most difficult periods since its establishment, with multiple challenges facing the region's policy-makers. While many countries are struggling to recover from the worst financial and economic downturn since the Great Depression and some economies are even facing sovereign default for the first time in 60 years, political discontent is mounting. Some gloomy forecasts portend a lost decade for growth unless decisive action is taken at scale and speed to address the bottlenecks to reform that are strangling economic development.

The global financial crisis has taken its toll on Europe's economies in recent years. It has exposed the extent to which growth patterns in several countries have been unsustainable, leading to sharp adjustments in the labour markets with rapid falls in employment, salaries or both, as well as creating much stress in the financial markets. Various short- and medium-term efforts aimed at dealing with these financial challenges have been adopted and these issues have captured the world's headlines as well as the European public's attention.

However, amid all of the short-term fire fighting, it is critical not to lose sight of the fact that to address the underlying concerns in the region, Europe must become more competitive. Competitive economies are those that are able to provide high and rising living standards, allowing all members of a society to contribute to and benefit from high levels of prosperity.

Following the well established methodology the World Economic Forum uses to analyse and measure competitiveness, this Report researches and monitors to what extent the EU is making progress to achieve the competitiveness goals set in its "Europe 2020" Strategy to achieve "smart, sustainable and inclusive growth". In addition to a set of country-specific analyses that points out individual competitiveness strengths and weaknesses for all 27 Member States and six acceding and candidate countries, overall the Report finds that:

**In comparative terms, the EU tends to perform better than other advanced economies in ensuring inclusive and sustainable societies...**

The EU fares better in building inclusive societies than the United States but worse than Japan and Canada. The European socio-economic model has traditionally been based on building inclusive societies by developing strong welfare states that would support people during difficult times. To a certain extent, the sharp rise in long-term unemployment in some countries of the EU has put the model under duress and reduced the ability of these economies to provide gainful employment on a sustainable basis. In terms of sustainability, the EU performs relatively well-above the United States and above Japan. Only Canada, among the comparator countries, outperforms Europe in this dimension.

**... but lags behind in terms of becoming a smarter place, hindering therefore its capacity to shift towards truly differentiated, higher value added activities and sustain its economic competitiveness.**

Europe is trailing behind the United States, Japan and Canada in building a smarter economy that can help facilitate the transition to higher value added, more productive activities. The gap is particularly wide vis-à-vis the United States.

**A more nuanced analysis shows that in terms of inclusion, Europe provides better social cohesion policies but fails to provide the right conditions for gainful employment for large shares of its population...**

The European model provides better social cohesion policies but demonstrates weaknesses in providing the right conditions for gainful employment for large shares of its population. Overall Europe has managed to provide relatively good social protection mechanisms during economic downturns by creating social safety nets. However, at the same time, the strong and persistent effects of the financial and economic crisis coupled with comparatively stronger rigidities in the labour markets of several European countries have resulted in sharp increases in unemployment, of a long-term nature in many cases, thus depriving a wide segment of the population of gainful employment. Moreover, the severe fiscal imbalances in several European countries, especially those hit more strongly by the economic crisis, are placing increasing stress on the capacity of governments to support the existing social protection models, calling into question their sustainability unless comprehensive reforms are implemented.

**... and underperforms in every single pillar that builds a smarter, knowledge-intensive society.**

The gap in creating a knowledge-based economy is evident in building a highly skilful, digital savvy, innovative economy with favourable business conditions for entrepreneurship, where the EU clearly falls short compared with other advanced economies. Given the strong interconnections and complementarities among all these areas, the combined result of these weaknesses is even stronger than when analysed by individual dimensions.

**The aggregate data for the EU masks large national disparities. A tale of four very different Europes emerges and shows the important competitiveness divide in the EU, with the Nordic countries leading the way internationally and several southern, central and eastern European countries falling behind...**

The EU is not a homogeneous entity in terms of competitiveness. On the contrary, large disparities exist among Member States, with some countries performing much better than others and well above the EU average or other advanced economies, such as the United States. Four broad groups of countries with distinctive competitive performances seem to emerge. These four "Europes" are: (1) Nordic Europe, (2) Western Europe and Estonia, (3) Southern and Eastern Europe, and (4) Southeast Europe.

**... as well as most accession and candidate countries.**

In general, accession and candidate countries, with the exception of Iceland, have a low competitiveness profile, lagging in virtually all analysed dimensions. Preparing them for accession will require the addressing of their specific competitiveness weaknesses.

From this analysis, a number of policy insights can be derived for both individual Member States and the European Union as a whole. The ten key findings and recommendations are highlighted in the box below.

## Ten Key Findings And Recommendations

### 1. High levels of economic prosperity cannot be sustained without high levels of competitiveness.

Defining a comprehensive reform agenda that identifies key measures to address the main competitiveness weaknesses is needed.

### 2. While addressing fiscal imbalances is crucial for short-term stability and to regain confidence, improving competitiveness is essential to supporting medium- and long-term prosperity.

Fiscal rebalancing should be accompanied by a reform agenda that addresses the main competitiveness weaknesses and preserves those investments, e.g. in education, R&D and innovation, that are crucial to building a smarter economy and regaining growth.

### 3. The European Union on average trails the world's most advanced economies on building a smarter economy, hindering competitiveness. Building a knowledge-based society should be a priority to build a truly differentiated offer.

Further investments in generating new knowledge activities that facilitate the creation of more and freer movement of knowledge, via the construction of a European Research Area or a European Education Area should be further encouraged. This should be reflected in the Multiannual Financial Framework 2014-2020.

### 4. A competitiveness divide exists in the European Union. The likely result will be a lack of sufficient economic and social convergence across Member States.

The fact is that while some European economies are among the most competitive in the world, the weaker performance of others is negatively impacting the bloc as a whole. If global market confidence in Europe is to return, then top priority must be given to supporting the weaker performers through their reform and investment programmes. To encourage convergence, cohesion policy and structural funds could be better targeted at addressing the main competitiveness weaknesses of those countries and regions receiving these funds. More emphasis in effectively supporting innovation, information and communications technology (ICT) development and education would be propitious areas of focus as these are the key areas where some member countries are trailing and need more time and effort to catch up.

### 5. In general, candidate countries face important competitiveness challenges.

Enlargement policies should support the build-up of a competitiveness agenda in those countries that are slated to join the European Union. Only by doing so will they be able to build competitive advantage.

### 6. There are no necessary trade-offs between building a smart economy and achieving an inclusive or environmentally sustainable society.

Competitiveness agendas do not need to—and should not—favour one specific dimension at the expense of one of the others. In the long run, all three dimensions are likely to be mutually reinforcing.

### 7. Fragmentation in the internal market for tradable services, insufficient openness to trade and administrative and cultural barriers for an effective free movement of people hinder overall competitiveness in Europe.

European policies that can improve the conditions for business activity and competition, e.g. eliminating the barriers to a single market in tradable services or further opening to trade, should also be supported. In addition, the removal of administrative barriers for the free movement of people, creating a larger and more efficient labour market, should be implemented.

### 8. There is a sense of urgency and scale to undertake the necessary investments and implement the necessary reforms to boost competitiveness and avoid a lost decade for Europe. Innovative financing mechanism need to be further explored.

The comprehensiveness and depth of these reforms, as well as the speed of implementation will be critical to ensuring momentum and avoiding half-hearted attempts that fall short within the desired time frame. The risk of a lost generation is real. Capital investments in building a knowledge-based society will require funding. Innovative financing mechanisms, e.g. a more active role of the European Investment Bank or utilizing the unused funds of the European Financial Stabilisation Mechanism, leveraging private financing and building public-private-partnerships, should be explored.

### 9. The necessary reforms will require political leadership to overcome vested interests and to create shared commitment by all agents of the economy so that the effects of the reforms are perceived as fair and worth the necessary pain.

Implementing reforms must be a shared responsibility of all agents in a society. A shared engagement, with give and take by the government, the business community and civil society will be crucial to ensuring societal support for reform programmes.

### 10. Efforts to raise competitiveness need to be coordinated and sequenced in a way that they generate public support within the political cycle.

The competitiveness agendas of individual Member States and European institutions should be aligned through an enhanced method of European economic governance in order to avoid duplication of efforts and raise the efficiency of resources. More generally, reforms provide short-term specific pains in exchange for future generic gains that may be difficult to communicate to and be understood by the population. The governance of the competitiveness agenda should follow a long-term agenda that moves beyond political cycles while providing the necessary time to maturity for investments and reforms to pay off in the short to medium term.