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A competitiveness compass for the EU

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For a more competitive Europe

The EU agenda for improving competitiveness is missing in action. Economic competitiveness has been a central plank in the development of the European Union – a relentless quest for policies that lead to more prosperity and that make European companies in world markets more successful. However, since the end of the Lisbon Agenda in 2010, economic competitiveness seems to have fallen off the EU map. This Agenda had its flaws, but it rightly sought to make Europe “the most competitive and dynamic knowledge-economy in the world”. The impression now is that Europe is on the retreat and the current European Commission is the first without a strategy to strengthen competitiveness at the EU level since the early 1990s. Hopefully, a course correction may now be on its way. Ursula von der Leyen has promised a “competitiveness check” on new EU policy. With the strong economic headwinds facing Europe and the world, the EU needs to pursue structural economic reforms that raise productivity and growth.

It is for these reasons that the Confederation of Swedish Enterprise commissioned a report from the Brussels-based think tank ECIPE[1], containing analysis and proposals for policies and reforms necessary for the next five to ten years. In presenting a competitiveness compass for the EU to find a new path towards a flourishing society, this publication is informed and inspired by ECIPE’s report. Like ECIPE’s report, it takes aim at faster economic growth in Europe. Growth is not the only target for the economy but is a prerequisite to achieve many of the non-economic objectives that are important. For instance, improved rates of growth are necessary to boost living standards in Europe, and to give many more citizens economic opportunities that have

[1] The European Centre for International Political Economy. Full report available at: https://ecipe.org/publications/guide-eu-policy-in-support-of-business-competitiveness/

been absent after a decade of strong economic turbulence. Faster growth and stronger European competitiveness are also central in an age of increasing geopolitical frictions and war. The West and its allies are economically strong and innovative. But it is equally obvious that their economic power to command the direction of the world economy has weakened, and that the only way to fight against the economic gravity that takes more business, investment and innovation to China and other emerging economies is to make our own economies more competitive. Moreover, there is no environmental sustainability without innovation. To address climate change, Europe need as much technological progress as it can muster.

Competitiveness may be an ambiguous concept, but it has shaped much of EU policies over the years. It is built on two foundations. First, improving competitiveness means growing the level of productivity in the economy. Second, competitiveness is about how firms and economies perform in an international context. This is not a zero-sum game in which a country performs better by blackballing other countries. In fact, one country's level of competitiveness is based on open conditions for cross-border exchange, technology, and competition. Competitive economies thrive on the success in other regions: they imitate or learn from countries that are at the frontier of technological change, business development, and productivity growth.

The EU economy can grow faster

There are good reasons to be optimistic about Europe's economic prospects. The economic performance of the EU is trailing behind the United States and other global leaders, and the shift in the economy from manufacturing to services and emerging technologies have proven especially difficult for Europe. But the gap between Europe and the global leaders at the frontier of growth and innovation can be closed. The 27 Policy Recommendations included in this publication are designed to boost EU competitiveness, productivity growth and expand the EU economy at a faster rate.

Unfortunately, the EU economic performance over the last decades has been poor. The increase in EU Gross Domestic Product per capita has been slower than in the United States and members of the OECD; labour productivity has also grown faster in the US than in mature European economies, particularly as a result of lower rates of technology and innovation growth. There are many structural explanations behind the lagging rates of growth: low economic dynamism, reduced market churn, inadequate investments in infrastructure, and secular trends like population decline and rising energy costs. The combination of these and many other factors have contributed to falling rates of growth and competitiveness.

At the sectoral level, Europe's productivity problem is not due to the type of industries that make up its economy but the result of low levels of productivity within rather than across sectors. Notably, in the manufacturing sector, where the slowdown in productivity has happened across all firm sizes. There is a significant productivity gap when European firms are compared with its US counterparts and that gap extends to input factors like corporate-level spending on R&D as well as output factors like corporate profitability. Between 2014 and 2019, European firms grew on average 40 percent slower than their US peers and spent 40 percent less on R&D. This is also reflected in the generation of new knowledge and technologies. The US outperforms Europe in all classes of transversal or cutting-edge technologies.

To become more competitive, the EU needs to pursue new policy initiatives in several areas. A new competitiveness agenda in the EU should focus on policies at the EU level and where the EU carries legal competence. Such an agenda will reflect the Single Market Programme rather than the Lisbon Strategy, and it will aim at policies where there is a strong need for fresh initiatives that can help to make businesses, sectors and economies better equipped and motivated to compete globally.

Seven focus areas

The competitiveness compass contains seven focus areas that guide the EU towards higher levels of competitiveness over the next five to ten years. These are:

- **Enabling Resilient and Dynamic Markets:** harnessing the growth potential in deepening the Single Market and fostering competition and flexibility in European markets, leading to good framework conditions for bottom-up firm growth.
- **Supporting Global Free Trade:** with many regions of the world growing faster than the EU, trade policy has an important role to open new markets and expand global trading opportunities for EU firms.
- **Developing Innovation Capacity:** harnessing European policy to boost innovation and making sure that the EU will be at the global frontier of current technological shifts.
- **Accelerating the Digital Development:** creating the conditions for faster digitalisation of the economy, better use of existing digital capacities and the development of new ones.
- **Addressing Climate Change and the Energy Transition:** reducing carbon emissions and providing a competitive supply of fossil-free energy.
- **Improving Infrastructure Conditions:** making more investments in transport infrastructure and boosting competition in transport services.
- **Ensuring Better Regulation:** improving the quality and predictability of regulation, and better transparency in the regulatory process.

Obviously, there are more policy areas than these that are important for European competitiveness: for instance, a broad macroeconomic framework and adaptable labour markets. Both areas are in urgent need of action. However, the seven focus areas have been selected because they are critical for competitiveness and long-run economic growth, and because they all are anchored in the political structure of the EU. In other words, the EU has strong legal competence in these fields, and it commands many types of structural and non-fiscal policy instruments that help to substantially improve competitiveness.

Enabling Dynamic and Resilient Markets

Enabling dynamic and resilient markets is crucial for competitiveness. Thriving markets, with a significant number of competitors and low market barriers that allow for companies to enter and exit the market, are more likely to deliver new innovation, resource efficiency and – ultimately – growth in productivity and the economy. These effects are directly linked to the competitiveness of European firms. Notwithstanding obvious needs for Europe to have a better command over its energy supply, it remains the case that open, competitive and dynamic markets are a prerequisite to be more resilient. Crucially, a better resilience in the EU will come from firms and organisations being capable of adapting to new market circumstances – not by relying on a few domestic companies for the supply of key goods.

Policy recommendations

1. An open industrial policy that boosts entrepreneurship, scaleup companies, and growth: industrial policy should be preoccupied with productivity but not target in advance which activities – let alone firms – should become more productive than others. An open industrial policy promotes competition and removes regulation that inhibits the growth of productive companies.

2. Future-proof and deepen the EU Single Market: there should be no barriers to the EU Single Market, and in particular to those industries that drive economic modernisation and technological progress which are in many cases service sectors. Actions to support a future-proof and deepen the EU Single Market include a radical push for liberalisation in services – similar in ambition to what the Delors's Commission did for the Single Market in goods.

3. A strong competition policy: EU competition policy has delivered a framework for market competition which boosted Member States confidence that the rules of the game are fair. Further erosion to EU state aid rules will have a negative impact on competitiveness and productivity since young and productive companies may have to leave the market in favour of less productive ones receiving government support.

4. An open and global attitude to standards: the EU should commit to market-driven standards which do not favour some companies over others according to their nationality. A more political European standard setting process risks taking away what makes it attractive to foreign companies, its broad participation. European standards that are accepted at global level are crucial for EU competitiveness in, for example, the circular economy, where the EU wants to be a leader.

Supporting Global Free Trade

Supporting global free trade is essential for raising competitiveness. Access to cheaper inputs and more customers abroad make firms more competitive and economies more productive. When a growing part of world growth happens outside of Europe, free trade is key to access expertise, technology and important value chains – without which European competitiveness will fall markedly. Moreover, international trade also exposes domestic firms to foreign competition, stimulating constant innovation and rising productivity in companies, in order for them to succeed in the market. Crucially, the competitiveness of EU firms in foreign markets dictates how they can exploit the potential opportunities offered by global markets.

The EU could play an active role in making these opportunities real for European companies. For EU trade policy, which has become defensive – not to say somewhat protectionist – in recent years, there should be a revival of initiatives to get closer to global economic opportunities. While it is a geopolitical necessity to avoid dependence on hostile and totalitarian regimes for the supply of critical goods and technologies, such problems should not be exaggerated. Nor should the problems be addressed by making access to Europe's market more difficult for everyone else – including our geopolitical allies. This strategy will drive up the cost for producers and consumers in Europe, and ultimately make it harder to reduce specific dependencies.

Policy recommendations

5. Focus on market access and re-build a free trade strategy: most global growth in the next few years will take place outside the EU. To remain competitive, the EU should focus on increasing trade opportunities. Moreover, the EU should strive to implement the new EU trade defensive instruments in a way that causes as little red tape and costs as possible for trading firms and reduces the risks of retaliation from partner countries.

6. Make the EU market resilient: to diversify its suppliers, the EU needs to look for trade partners with the needed products which will not exploit EU dependencies for political gains. If properly designed, EU policies on the circular economy will also support the EU's goal to reduce its trade dependencies.

7. Build partnerships and make new friends: given the increasing importance of forming strategic alliances in the new global order, the EU needs to ratify the Free Trade Agreements (FTAs) that have been finalised or that are under negotiation, and continue engaging with the World Trade Organization.

8. Embrace digital trade: there are many opportunities in digital trade. The EU should include ambitious digital chapters in its FTAs; continue its trade and technology dialogues with the US and India; and participating or forging Digital Economy Agreements with other countries.

Developing Innovation Capacity

Innovation is at the heart of productivity growth and competitiveness. In essence, innovation is about a dynamic market economy that allows experimentation and change – and is about so much more than just technological change. Innovation happens by firms who develop new business models and find new ways to reach customers. That process can be based on a new technology, but it is equally common that it is not. Innovation is not a given and depends crucially on the overall business and regulatory environment: many of these factors are covered in other chapters.

The policy recommendations presented in this focus area emphasise three elements of innovation policies. First, the amount of investment in R&D and the quality of the inputs inserted in the innovation process. Second, the regulatory frameworks for emerging innovation, including the protection of innovation through clear and well-implemented Intellectual Property Rights (IPRs), which include protection of innovation, value creation through commercialization, and new opportunities for innovation through new ways of handling IPRs. Third, the amount of innovation or output produced out of R&D investments which leads to higher levels of productivity.

Policy recommendations

9. Mobilise resources on European R&D: The EU should prioritise R&D in its own budget even if that means reducing its budgetary spending in other policy areas. Moreover, given that two thirds of EU R&D is invested by companies, the EU should focus on incentivising European businesses to increase their R&D spending.

10. Support global success in research and universities: the EU spending on higher education should support European Universities and research institutions at the global frontier. The EU should increase mobility for European researchers inside and outside Europe to be able to join international networks.

11. Urgent need to attract talent: Knowledge is a key force behind technological change and defines the ability of an economy to absorb new technology and new ways of doing business. The EU should work with Member States to facilitate international labour migration into the EU, make the EU an attractive destination for foreign workers with skills that are needed in the European labour market, and support and encourage human capital flows between Member States and sectors so that labour finds the place where it can be more productive.

12. Harmonise and strengthen innovation protection: the EU needs to provide legal certainty and harmonisation of IPRs in the EU's Single Market especially on copyright as many innovations are produced in the digital economy.

13. Address the productivity gap of European businesses: low productivity firms struggle with obtaining access to knowledge and skills, data, and technologies, similar to those of high productivity firms. EU regulation, particularly in the digital economy, that includes experimentation clauses and sandboxes as well as investments in open infrastructure for testing and demonstration are two actions that the EU can take to shrink the productivity gap.

Accelerating Digital Development

If not before, the COVID-19 pandemic amply demonstrated that the use of digital technologies affects a nation's ability to prosper. When used effectively, digital technologies not only make it possible for work and education to move online, but they also offer effective ways to coordinate business operations and governmental procedures. Many of the latest and most promising technologies, including AI, 6G, quantum computing, virtual worlds like the Metaverse, 3D printing or robotics will have digital inputs or will be delivered through the Internet. Therefore, the growth of the digital economy, and its interplay with new technologies, is the prime force for new patterns of productivity and competitiveness. If Europe continues to lag behind global frontrunners in the deployment of new digital technologies and growth of new digital businesses, it will drop substantially in prosperity rankings over time. Moreover, as the fundamental nature of business changes with the advent of the digital economy, domestic industries – particularly in services – will be more exposed to international competition.

Policy recommendations

14. Digital regulations should support competitiveness and growth: digital rules should not be cumbersome for businesses to follow or impede the development of new digital technologies. The EU needs to simplify and streamline digital regulation before the amount of regulation hurts competitiveness.

15. Improve infrastructure and connectivity: digital infrastructure can raise the productivity of all factors of production, broadening the productive capacity of the economy as a whole. The EU should put its attention into fibre, 5G, spectrum access and satellites.

16. Encourage venture capital in digital technology: for technological start-ups to scale up and realise their ideas, access to capital is essential. The EU should change its financial regulation to encourage investment by pension funds into venture capital funds. These funds will support the growth of European technology companies in Artificial Intelligence (AI) development where access to finance is insufficient.

Addressing Climate Change and the Energy Transition

Policies that address climate change and the energy transition have a direct impact on firm's competitiveness. First, the definition of competitiveness must incorporate the concept of environmental sustainability. A society that is not environmentally sustainable will not be competitive in the long-term. Moreover, there is no sustainability without innovation. To address climate change we need as much technological progress as we can muster. Second, the transition towards a one-hundred percent fossil-free electricity system will impact the cost of electricity, which is one of the key energy inputs for the economy. Third, consumer preferences have shifted in favour of sustainability. Consumers seek environmentally sustainable products and are willing to pay higher prices for them. At the firm level, competitiveness typically refers to a company's ability to survive in the market and make a profit. Therefore, if consumers value sustainability, companies that produce environmentally sustainable products will be more successful business and therefore more competitive.

Policy recommendations

17. Develop a global carbon price: The EU is not alone in its efforts to establish a market to price carbon. The EU should make the EU ETS more attractive to non-EU countries, build links between the EU ETS and other carbon markets and work on initiatives to set a global carbon price for industries where the leading countries have similar policies and objectives on emissions reduction.

18. More research into and deployment of fossil-free technology: investments in R&D to address climate change will make the EU more sustainable and competitive. The EU can channel more of its own resources to R&D activities and design regulatory frameworks that support the creation and adoption of new fossil-free technologies.

19. Produce more fossil-free energy: the energy transition requires a significant investment in fossil-free energy. These investments are not necessarily a detriment to competitiveness, but the energy transition will require a bigger role for tools that ensure stability of the system such as investments in energy storage and baseload capacity.

Improving Infrastructure Conditions

Good infrastructure is central to competitiveness. Transport infrastructure investments have a positive impact on economic growth, create wealth and jobs and enhance trade. In the first place, the sector is important for its direct economic contributions. The transport sector contributes 5 percent to European GDP and directly employs around 10 million workers. Equally important, if not more, is that good infrastructure boosts productivity and growth in other sectors that use infrastructure services. Therefore, investment in infrastructure also brings important supply side benefits to the economy. As the capital stock of infrastructure expands, it broadens the productive capacity of the economy as a whole.

Competitiveness also demands good infrastructure quality. Infrastructure quality means, among other things, the possibility for businesses to get their goods and services in a secure and timely manner, also by improving facilities for supply chains that are important for trade. Moreover, good infrastructure quality helps to limit externalities of transport, like greenhouse gas emissions, noise and water pollution.

Policy recommendations

20. Deregulate transport services to make road and rail transport more attractive: the EU needs to further open up its transport market. Further deregulation in European road and rail markets will result in lower prices and create new business opportunities.

21. Fix the bottlenecks in European transport infrastructure: the EU should continue providing planning and financing to support a Trans-European Transport Network that addresses bottlenecks and facilitates cross-border transport. Moreover, EU-funded research should be channelled to decarbonise the transport sector before 2050.

22. Foster fair competition in international aviation and the maritime sector: the EU should play a leading role in extending open skies agreements with third countries and establishing a global level-playing field in aviation and the maritime sector. In addition, the EU should increase its efforts to cooperate with the International Civil Aviation Organization (ICAO) and the International Maritime Organization (IMO) on an international regulatory framework to further strengthen fair competition, high safety standards, and environmental protection.

Ensuring Better Regulation

Regulation that is effective, evidence-based, and consistent can strengthen European competitiveness. However, when regulations are not carefully designed, they can have negative effects for businesses. Regulation can impact cost competitiveness through compliance costs and higher costs on firms' inputs; reduce the space for experimentation and therefore for technological change; and increase barriers to trade which leads to higher trade costs. There might be good reasons that justify a new regulation. However, governments should always strive for high quality regulation and minimise any negative effect on competitiveness.

The good news is that the EU has built the structure – in the form of guidelines, processes, and institutions – to undertake good regulation. But this structure requires on-going maintenance. Recently, attention towards good regulation has drifted and serious cracks are appearing in the way the EU evaluates, appraises, and proposes new regulation. These policy recommendations do not try to reinvent the wheel but provide much-needed impetus to bring back the good regulation agenda to the centre of EU policymaking and continue progressing on some areas which have been left unattended for too long.

Policy recommendations

23. Increase scrutiny and transparency in EU regulation: the EU should be serious about competitiveness. It has the tools and guidelines, but they are not always implemented to the required depth. The quality of EU impact assessments, consultations, and evaluation must improve.

24. Expand the space for experimentation: instead of being prescriptive about how to use a specific technology, the EU should focus on outcomes and provide space for experimentation to demonstrate how these outcomes are achieved.

25. Empower the Regulatory Scrutiny Board: given the growing number, complexity and importance of EU regulation, the Regulatory Scrutiny Board should receive additional human and economic resources as well as become fully independent from the European Commission.

26. Reduce the regulatory burden: the EU should assess the regulatory burden of its regulation and the cumulative effect of regulation in each industry.

27. Make the better regulation agenda central in EU decision making: the EU could include EU competitiveness as part of the discussion of EU rules on fiscal sustainability in the Economic and Financial Affairs Council (ECOFIN); integrate competitiveness within the EU Next Generation Funds; or assign DG COMPETITION with a standing mission to produce sectoral reviews that include an assessment of how regulation impacts firms and competition within a given sector.

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