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Insight Report

# Rebuilding Europe's Competitiveness

In cooperation with Roland Berger Strategy Consultants

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# Preface

This Report on *Rebuilding Europe's Competitiveness* is published at a critical time for Europe, as the region struggles to emerge from one of its most difficult periods since World War II. Recent years have seen stagnating economic growth, rising unemployment leading to social tensions, and sovereign debt crises in several European countries, exacerbated by the fact that the future outlook remains uncertain. There is widespread agreement that the root causes of this prolonged crisis lie in the lack of competitiveness of many countries.

Over the past half-decade, the region has focused its efforts on addressing the most immediate challenges associated with the financial crisis and preventing the disintegration of the Eurozone. However, more recently Europe has started to implement deeper reforms to rebuild competitiveness, paving the way towards a more sustainable path of prosperity. More precisely, several European countries have adopted important reforms aimed at enhancing competitiveness such as measures to make public finance more sustainable, the banking system more reliable and efficient, mend dual labor markets, and increase the efficiency of product markets. Consequent and sustained implementation of these measures will be required in order to ensure their full impact. In this context, galvanizing the support of all stakeholders within society is critical for success.

Against this backdrop, this Report identifies and discusses several competitiveness practices that selected European countries have undertaken in order to boost their competitiveness and that could serve as an inspiration for others. It contributes to the ongoing work of the World Economic Forum aimed at supporting Europe in tackling its current challenges. Further, this *Report* complements my recently launched book entitled "The re-emergence of Europe" by providing a specific analysis of measures that can improve Europe's capacity to boost innovation and entrepreneurship, mobilize talent and enhance product market efficiency.

We hope that this *Report* will provide policy makers, business and civil society leaders with an important tool in adopting the measures needed to rebuild Europe's competitiveness and inspire a strategic dialogue between stakeholders.

This *Report* was written in close collaboration with Roland Berger Strategy Consultants, who have brought their unique perspective from strategic business and government projects to this joint effort.

I wish to thank the authors of the *Rebuilding Europe's Competitiveness* Report, Beñat Bilbao-Osorio, Jennifer Blanke, Margareta Drzeniek Hanouz, Thorsten Groth, Caroline Ko and Alexander Molterer for their energy and commitment in producing this study, as well as the other members of the Competitiveness and Europe teams. I am also grateful to Anne Mettler, Executive Director of the Lisbon Council and Mark Spelman, Chief Strategist at Accenture for their valuable comments and continued commitment to our competitiveness work on Europe. Moreover, we are grateful for the additional insights and stimulating debate from the participants of the "*Rebuilding Europe's Competitiveness*" workshop in Rome on 30 October 2012 and the ongoing support from the World Economic Forum's Global Agenda Councils on Europe and on Competitiveness.

Finally, we would like to convey our gratitude to our network of Partner Institutes worldwide, and particularly in Europe, without whose valuable input this Report would not have been possible.

Klaus Schwab
Founder and Executive Chairman
World Economic Forum

# Executive Summary

Europe has been successful in securing high and rising living standards for its citizens for more than half a century. However, it is currently facing critical economic and social challenges, and the resultant lack of confidence is causing many undesired effects: insufficient financing and investments; stagnating or declining growth; rising unemployment, which in several countries has reached socially unsustainable levels; and fiscal instability leading to sovereign debt crises and the need for international intervention through sovereign bail-outs. This situation is driven mainly by Europe's persistent competitiveness shortfall as compared to other advanced economies such as the United States (US), accompanied by the rising economic might of emerging markets. The stark competitiveness divide among Europe's 27 Member States (EU27) lies at the heart of this competitiveness challenge and reflects the inability of several Member States to adapt to a rapidly changing globalized economy.

This is a crucial moment for Europe to exercise common leadership and address weaknesses to strengthen the economic potential of the European Union - EU as well as its Member States. During the last four years, Europe has remained focused on short-term "firefighting" to remedy the financial crisis, but the tide is now turning and several Member States are implementing a series of significant reforms and measures to boost their competitiveness within a short time span.

Adopting these reforms will not be easy. Political leaders will have to re-balance key elements of their countries' social and economic systems, while winning public support to galvanize change. In the past, several European countries have proved their capacity and willingness to reform and have achieved greater levels of competitiveness and more robust economies. Now, more measures throughout the whole of Europe are needed, and countries undergoing this process can find inspiration from past examples.

Against this backdrop, this Report describes a series of competitiveness practices that have been adopted in Europe. The examples show that multistakeholder approaches can be instrumental to bring about change, as long as they are accompanied by clear communication and educational campaigns that properly lay out their logic to ensure a general buy-in. Policy consistency and sustained political leadership are also indispensible.

Should the recent efforts to boost competitiveness continue to be implemented and scaled, the current period of difficulties that Europe is facing should not be regarded as a sign of inevitable decline, but rather as a step towards rebuilding Europe's competitiveness. This competitiveness can achieve higher levels of sustained prosperity for all in Europe.

# Rebuilding Europe's Competitiveness

**By Beñat Bilbao-Osorio, Jennifer Blanke, Margareta Drzeniek Hanouz, Thorsten Groth, Caroline Ko and Alexander Molterer**

**Over the past half century, European countries and the European Union (EU) have been successful in securing high and rising living standards for their citizens.** Starting with the European Steel and Coal Community in the aftermath of World War II, the European integration process has been able to support higher levels of economic and social prosperity for an increasing number of countries and people. This development process has been guided by a set of principles that include economic efficiency, sustainability, and territorial and social cohesion. Above all, by fostering economic integration, the EU has helped to secure continued peace and prosperity for the continent, as recently recognized by the Nobel Peace Prize Committee.

**Despite past success, the financial and economic crisis of the last five years has led several European economies and the EU itself to one of their most difficult moments in the post-World War II period.** The overall lack of confidence in the European economy – with a banking system hesitant to provide funding, coupled with sovereign debt crises in several Southern European economies and Ireland – has led to a scenario of stagnating or sharply declining economic growth. Unemployment is rising, especially among the young, creating social and political upheavals within and across countries. More precisely, Southern European economies have found themselves in the headlines for their inability to obtain affordable financing from the international markets, highlighting their unsustainable economic fundamentals. While Italy and Portugal have struggled for a decade to overcome economic stagnation, the more recent growth paths of Greece and Spain have also proved unsustainable. At the European level, policy-makers are still struggling to define a shared vision and strategy to address the current challenges, fuelling uncertainty and questioning the very viability of Europe's integration process.

## Box 1: The World Economic Forum's Work on Analysing and Assessing Competitiveness

For more than 30 years, the World Economic Forum has studied and benchmarked the many factors that provide the basis for sustained competitiveness. From the outset, the goal has been to provide insights and stimulate discussion among stakeholders on the best strategies, policies and activities to overcome obstacles to improve competitiveness. Starting with the first study in 1979 covering a set of advanced economies, *The Global Competitiveness Report* has increased its coverage to a record 144 economies in its 2012 edition. Over the years, a family of reports has been developed, each shedding light on a particular area for improved competitiveness, such as *The Global Information Technology Report, The Global Enabling Trade Report, The Travel and Tourism Competitiveness Report, The Financial Development Report* and *The Global Gender Gap Report*. Each year a number of regional assessments are also carried out, such as *The Africa Competitiveness Report, The ASEAN Travel & Tourism Competitiveness Report*, and *The Arab World Competitiveness Review*. All these reports benefit from data compiled by a set of international organizations including the World Bank, UNESCO and the ITU, and from the Forum's annual Executive Opinion Survey[1], in which more than 15,000 business leaders from across the globe are polled on different aspects of competitiveness.

From the outset, Europe's competitiveness has been a focal point of analysis. Indeed, the flagship *Global Competitiveness Report* was, at its inception in 1979, primarily concerned with Europe's competitiveness compared with that of the US. The *Lisbon Review* series, carried out on a biennial basis during the decade of its existence, reviewed Europe's progress in meeting the Lisbon Strategy goals. Building on this past work, the World Economic Forum has more recently published *The Europe 2020 Competitiveness Report: Building a More Competitive Europe*, as a first in a series that assesses Europe's progress towards achieving its Europe 2020 Strategy. By including variables from the Forum's Executive Opinion Survey, the Report complements Europe's own Europe 2020 indicators by bringing in the perspective of the private sector.

More recently, the Forum has taken another step towards advancing the discussion on the "how" of competitiveness through a project to create a platform of practices informed by the Forum's "12-pillar approach" to competitiveness. To begin with, actions that have been, or can be, taken in order to spur national competitiveness will be identified by leveraging the Forum's network of partner institutes around the world, with the aim to build a multistakeholder community that will bring in new ideas and perspectives.

**Putting Europe back on a sustainable growth path will require a thorough understanding of the root causes of the European crisis.** Much of the discussion to date on how to resolve the Euro crisis has focused on the need for Southern European economies to balance their public accounts by curbing government spending, reducing public debt and raising fiscal revenues. This prescription can, however, have negative effects in the short term, potentially setting economies into a vortex of contracting growth and lower fiscal revenues necessitating further reduction in public spending.

**Raising competitiveness is crucial to sustaining economic and social progress in Europe.** While the fiscal troubles and tensions in the financial markets, and the transfers of part of the banking sector's debts to sovereign budgets, are the most visible effects of the current crisis, there is widespread agreement that the relatively weak overall competitiveness of Europe is the fundamental cause of the crisis. On average, EU Member States have trailed behind other advanced economies such as the US in terms of national competitiveness. At the same time, there exists a stark competitiveness gap that divides Europe into two broadly defined blocks: a highly productive, export-oriented North and a less productive South and East. This divide is at the heart of the perilous macroeconomic disequilibria that have plagued Europe, and especially the Eurozone, in recent years. Addressing this divide will boost the region's overall competitiveness and improve the continent's economic and financial stability.

Although in recent years short-term "firefighting" to alleviate the immediate effects of the ongoing crisis has attracted significant attention, the need for raising competitiveness across the continent has been widely recognized by EU policy-makers. The Lisbon Strategy, launched in the year 2000, aimed to boost competitiveness by fostering and speeding up the EU's transition towards a knowledge-driven economy by 2010. It did not produce the intended result, mainly because of a lack of focus. Now, the EU has embarked on a more closely calibrated initiative, the *Europe 2020 Strategy*, which aims to boost competitiveness by achieving innovation-driven, sustainable and inclusive growth. Under this strategy, several countries presently facing difficulties have undertaken a number of important reforms at the national level to boost their competitive edge.

**Designing and implementing measures to boost competitiveness is a complex task that needs to be tailored to the specific circumstances of each country. Countries can, however, find inspiration and learn from measures that have already been adopted elsewhere and have borne good results.** Enhancing competitiveness, especially in those countries that trail behind by a wide margin, will require structural reforms and growth-enhancing investments in areas such as education and innovation. These measures may face resistance because of the scale and nature of changes they are expected to bring about.

Against this backdrop, the objective of this Report is to illustrate the key competitiveness challenges that are holding back Europe's potential, particularly in certain countries, and to describe selected competitiveness-enhancing measures from across the region that could serve as an inspiration for economies willing to reform. The Report aims not only to describe the measures and their expected impact, but also to highlight the potential bottlenecks they may encounter as well as the enabling factors that can ensure their successful implementation. Addressing the competitiveness challenge will require joint efforts by the EU and all its Member States.

With this objective, the Report begins in Section 2 by describing the competitiveness challenge facing the EU as a whole and some of its Member States in particular. Section 3 illustrates a number of selected measures adopted or designed to boost the region's competitiveness. Section 4 identifies some of the key learnings from these practices, and Section 5 concludes by highlighting that the current crisis can and should be regarded as an opportunity to transform Europe's economy to lead to higher and more sustainable levels of prosperity by implementing appropriate actions today.

This Report builds on the World Economic Forum's work on competitiveness, both at the global level as covered by *The Global Competitiveness Report* as well as the specific work on Europe as reflected in *The Europe 2020 Competitiveness Report* (see Box 1). This work originated from the Forum's initiative on Rebuilding Europe's Competitiveness (see Box 2) and complements the recently published book on "*The re-emergence of Europe*" that explains in simple terms what is currently unfolding in Europe and renews certain policy options under consideration to resolve the ongoing crisis.[2] The project constitutes a pilot project on a broader global initiative that will collect and display successful competitiveness practices from around the world in order to inform action in countries that wish to improve their competitiveness.

## Box 2: Rebuilding Europe's Competitiveness

The Rebuilding Europe's Competitiveness initiative is a joint effort of the World Economic Forum and Roland Berger Strategy Consultants. It is a multistakeholder endeavour to catalyse the process of rebuilding a more competitive European economy within a complex, interdependent and fast-changing global reality. The objective is to generate knowledge on how to close the competitiveness gap within Europe and to rebuild Europe's competitiveness in the world economy. To this end, the initiative aims to identify reform approaches that have strengthened the competitiveness of European economies in the past so as to understand what challenges they faced, how they succeeded and what lessons can be learnt from their approaches.

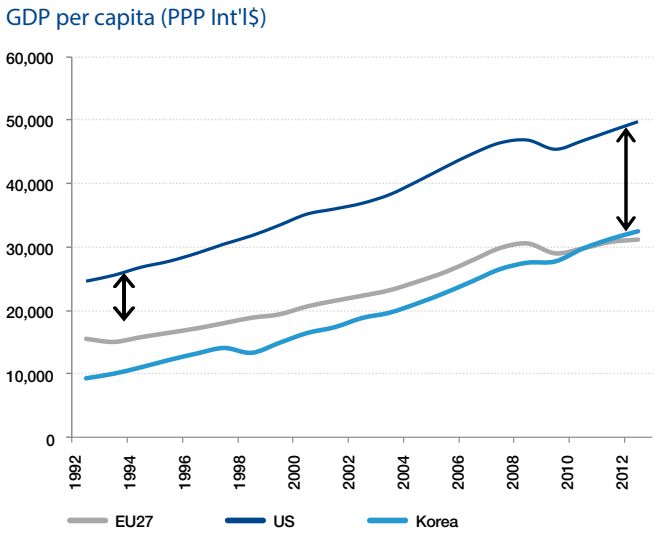
As part of the initiative, a workshop with more than 140 leaders from government, business and civil society was held in Rome in October 2012. The workshop, which was organized in close collaboration with the Italian government, provided a vehicle for collecting and input feedback from government and business leaders on the practices presented in this Report. Additionally, the World Economic Forum's Global Agenda Councils on Europe and on Competitiveness made valuable contributions, as did a number of partner institutes.

# 1. Europe's Competitiveness Challenge

**Since the creation of its initial institutions in the 1950s, the EU has secured rising standards of living for its citizens.** After World War II, the EU embarked upon a process of rapid and sustained economic expansion that lasted three decades in many countries[3] and allowed the average income in the EU to converge towards that in the US.

**However, since the mid-1990s, the trend has changed and growth patterns – measured by growth of gross domestic product (GDP) – between the US and the 27 EU Member States (EU27) have started to diverge** (see Figure 1).

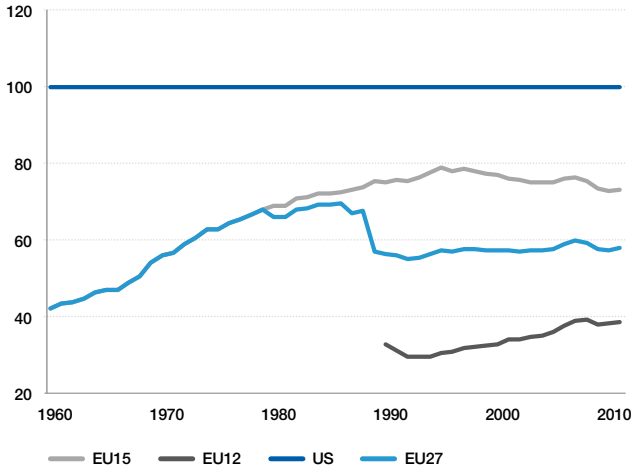
### Figure 1: Diverging Patterns Of Prosperity – The Transatlantic Divide




Source: IMF, *World Economic Outlook*, October 2012 and authors' calculations

**At the core of the diverging incomes in the EU and the United States lie their starkly different performances in productivity and, hence, competitiveness.** As Figure 2 shows, on average, the productivity of EU member states converged towards US levels until the mid-1990s. Around this time, a divergence in prosperity started to take hold, suggesting the rise of new sources of productivity gains that the United States was better able to leverage. A competitiveness gap between the EU and the United States started to emerge.

### Figure 2: GDP per Hour Worked in Int'l$ (US = 100)

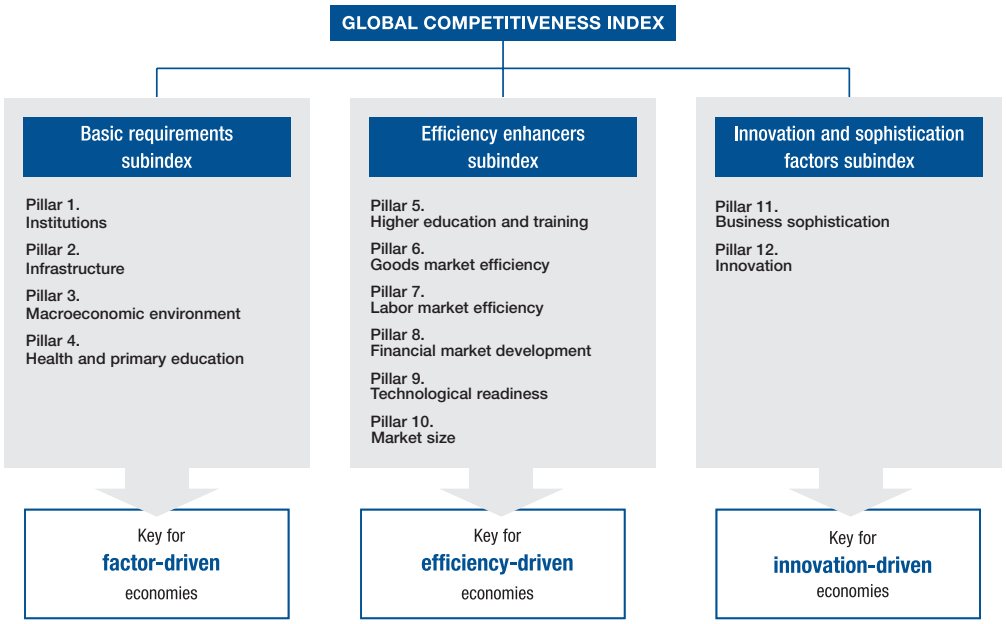



Source: The Conference Board *Total Economy Database*, January 2012 and authors' calculation

**Understanding the drivers behind these differing paths of productivity – which determine the competitive edge of economies – is the objective of the competitiveness work of the World Economic Forum.** In its annual Global Competitiveness Report, the Forum defines competitiveness as "the set of institutions, policies, and factors that determine the level of productivity of a country".[4] Clearly, more competitive economies are able to produce higher levels of income for their citizens.

The measurement of competitiveness, however, is a complex undertaking. The Global Competitiveness Index (GCI) captures the idea that many different and interrelated factors matter for competitiveness, as reflected by the "12 pillars" of the index (see Figure 3).[5]

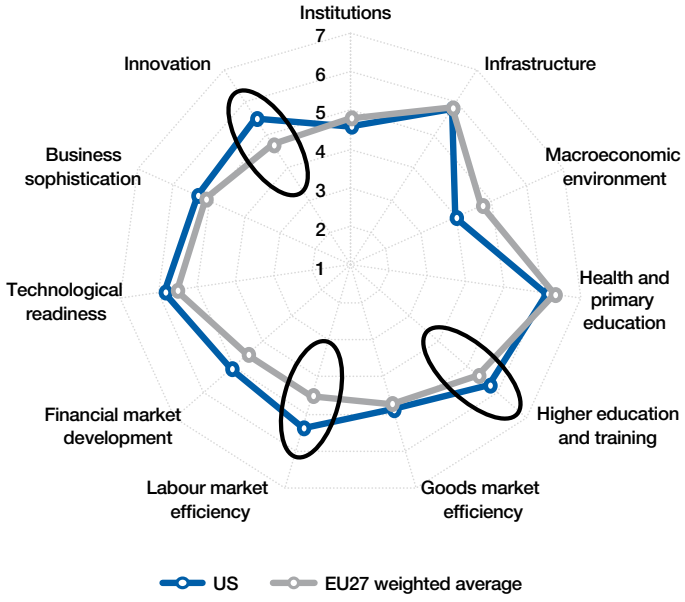
## Figure 3: The Global Competitiveness Index Framework




Source: World Economic Forum

**The EU underperforms in terms of competitiveness against other advanced economies in several pillars of competitiveness.** Based on the GCI methodology, Figure 4 shows that the US consistently outperforms the EU27 average across all pillars of the GCI (except macroeconomic environment). Europe particularly lags behind in three areas: innovative capacity, i.e. the capacity to generate and use knowledge to create new products and processes to lead to more value added; higher education and training systems, which are required to develop the skills needed to power a knowledge-based economy; and the creation of an efficient labour market, which allows for an effective mobilization of the talent available in a country.[6]

## Figure 4: US-EU 27 Competitiveness Gap

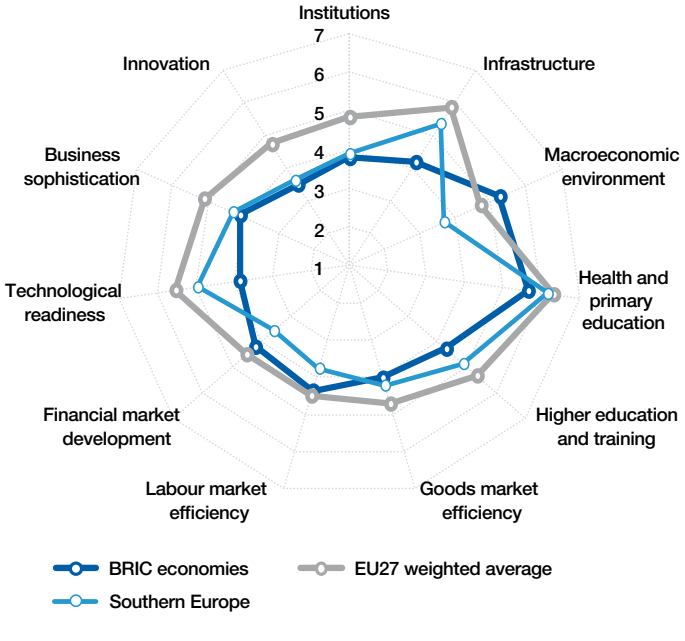



Note: The market size pillar (Pillar 10 in the GCI) is not shown in this graph

Source: *Global Competitiveness Index 2012-2013*, World Economic Forum and authors' calculations

**At the same time, Europe must stand its ground against the new countries that have emerged on the global scene and have been improving their competitiveness, sometimes overtaking some of the European economies.** Many emerging-market economies have been catching up with the high-income group. Figure 5 demonstrates how the BRIC economies perform similarly to Southern European countries in areas such as innovation, business sophistication and goods market efficiency, and outperform them in labour and financial market efficiency. At the same time, wages in these countries are significantly lower, which makes it more difficult for Southern Europe to remain an attractive destination for foreign direct investment (FDI) and able to compete based on low costs. As a result, improving the competitiveness of Southern European countries is not only critical for closing Europe's competitiveness divide, but also for ensuring that Europe as a whole can continue to perform well in the future at a global scale.

## Figure 5: The Rise of Emerging Markets – BRIC Economies vs Southern Europe

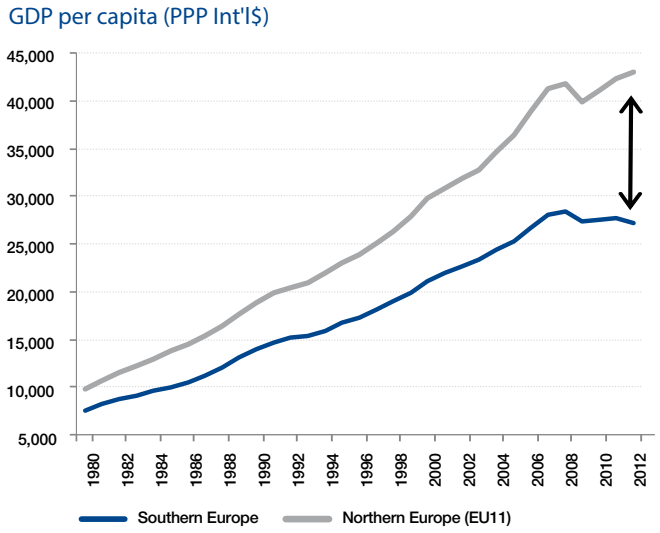



Note: The market size pillar (Pillar 10 in the GCI) is not shown in this graph

Source: *Global Competitiveness Index 2012-2013*, World Economic Forum and authors' calculations

**Aggregate prosperity figures mask important differences among EU27 Member States** (see Figure 6). Although both Northern and Southern European countries have registered improvements in their prosperity since the 1980s, their paths have nonetheless been slowly but steadily diverging up until 2008-2009, when the financial crisis marks a sharp accentuation of this trend. While on average EU Member States have experienced a dip, the Northern members have been sufficiently resilient to bounce back, whereas Southern members have slipped down a slope.

### Figure 6: Divergence in Prosperity within Europe



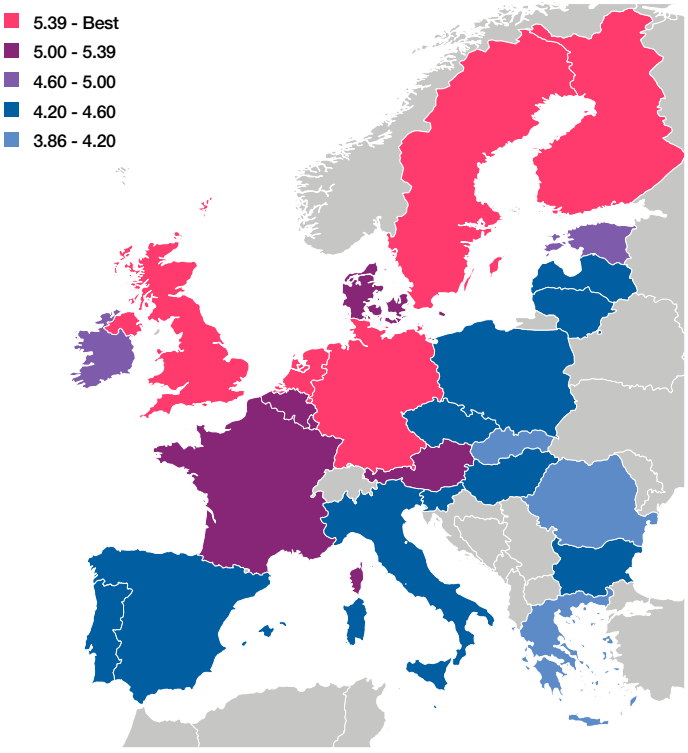

Northern Europe: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, Netherlands, Sweden, United Kingdom

Southern Europe: Greece, Italy, Portugal, Spain

Source: IMF World Economic Outlook, October 2012

**Like the US-EU gap, diverging prosperity within Europe is driven by a significant competitiveness divide between Northern and Southern Member States.** As can be seen in Figure 7, Northern Europe[7] consistently outperforms Southern Europe[8] in terms of overall competitiveness. It is this divide that lies at the heart of the many difficulties European countries are facing in their efforts to lift their economies onto a soundly positive growth path. While immediate short-term challenges range from a credible commitment to improving fiscal discipline[9] and reassuring the markets that banks are well-capitalized, closing the European competitiveness divide will be a critical long-term challenge for sustaining growth.

### Figure 7: Europe's Competitiveness Divide




Source: *Global Competitiveness Index 2012-2013*, World Economic Forum

**The North-South competitiveness divide within Europe is particularly marked in certain areas.** Figure 8 confirms that Europe is characterized by wide divergences in competitiveness across all 12 pillars of the GCI, with strong performance in the North and weaker performance in the South, especially in terms of institutional capacity.

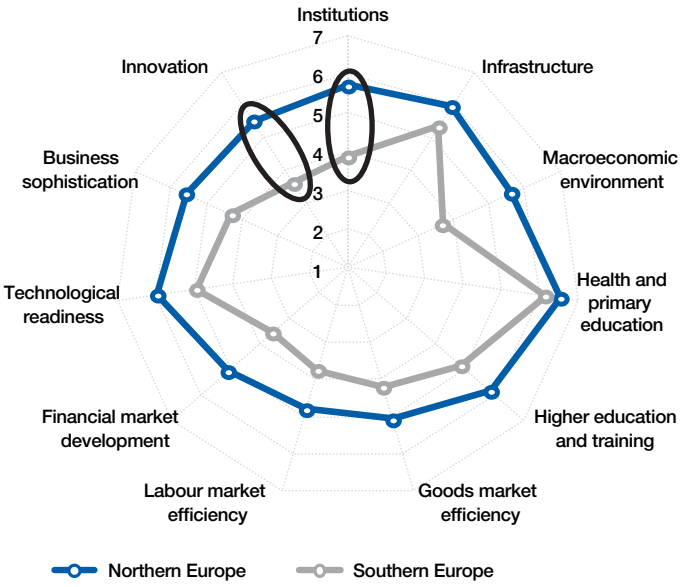
The institutions pillar of the GCI captures factors such as the efficiency of government institutions, the degree of corruption and undue influence, the protection of property rights, and physical security. This pillar encapsulates to a large extent the capacity of the public sector to introduce and enforce measures essential for an economy to run efficiently. Improvements in institutions can generate spillovers into other dimensions of competitiveness.

Figure 8 also reveals important differences within the EU in the following three areas which, therefore, form the focal point of this Report:

- **Innovation and entrepreneurship:** The capacity to innovate is a key driver of a knowledge-driven economy. In the GCI, a country's ability to innovate is depicted by three interrelated pillars: the technological readiness pillar, relating to the availability of technology and the uptake of information and communications technology (ICT); the business sophistication pillar; and the innovation pillar. Figure 8 shows that Southern Europe demonstrates lower technological readiness, business sophistication and, more generally, innovation capacity than Northern Europe. Innovation is particularly critical for Western Europe, and increasingly so for Eastern Europe as well, given their growing need to enhance productivity and competitiveness.
- **Mobilizing talent:** Innovation and entrepreneurship are closely intertwined with the efficiency of the labour markets and the quality of the education and training systems. A highly-trained labour force provides the basis for innovation and entrepreneurship, while a flexible labour market ensures that labour is allocated to its most efficient uses. Countries across Europe demonstrate significant differences in both these pillars too.
- **Making markets work better:** Finally, there is a difference in the effective functioning of the markets for goods and services. Efficient distribution of resources is, to a large extent, based on the existence of sufficient levels of competition, especially in sectors such as transport, energy and telecommunications, which are crucial for all other areas of the economy. Although on average Europe does not trail the US in terms of the efficiency of its goods markets, this dimension is included for two reasons. First, both the US and the EU display only mediocre results in this category. Second, much of the economic gains from European integration are due to efficiency obtained through greater integration of markets – indeed, the internal market is the very basis of the European project – and currently the European market is underperforming due to the ongoing fragmentation in its internal market for services.

Addressing these competitiveness challenges across Europe, and especially in particular countries, will be crucial to boosting Europe's overall productivity, which is essential for putting Europe's economy on a more solid footing and avoiding a "lost decade".

**Figure 8: Europe's Competitiveness Divide – Northern vs Southern Europe**




Source: *Global Competitiveness Index 2012-2013*, World Economic Forum and authors calculations
Northern Europe: Finland, Germany, Netherlands, Sweden
Southern Europe: Greece, Italy, Portugal, Spain

# 2. Addressing the Competitiveness Challenge

## 2.1 Ongoing Efforts to Improve Europe's Competitiveness

**The competitiveness challenges presented in the previous section have long been holding back Europe's growth potential. These weaknesses are widely recognized, and in recent years several countries have embarked on a series of structural reforms aimed at improving their competitiveness.**

Box 3 presents some of the foremost reforms that Southern European economies have been adopting in order to address the most acute of these challenges.

### Box 3: Key Reform Approaches in Southern Europe since the Onset of the Financial Crisis[10]

Following the financial and economic crisis, Southern European governments have embarked on efforts at large-scale reform, starting with fiscal consolidation and financial sector restructuring. In an attempt to strengthen public finances, countries have taken steps to improve fiscal governance through a range of mechanisms: strengthened budget monitoring (Portugal), review of spending (Italy) and implementation of spending curbs and control mechanisms for all levels of government (Spain). On the revenue side, governments have opted for VAT increases (Spain, Italy, Portugal), and on the expenditure side, a reduction in public sector wages and pension entitlements. Financial sector reforms have been accorded primacy, particularly large-scale bank recapitalization (Spain, Greece) and steps to strengthen regulatory frameworks.

These measures are imperative to improve the situation in the immediate short- to medium-term, but policy-makers need to undertake further reforms to significantly enhance competitiveness over the longer term. In this context, Southern European governments have indeed embarked on structural reforms that aim to improve the microeconomic foundations of their economies. Labour market reforms, with a focus on addressing labour market dualities, are a common denominator in all countries, and include efforts to align collective wage-bargaining processes with business needs (Portugal, Spain, Italy). Other efforts include the introduction of flexible work-time arrangements during times of crisis (Portugal, Greece), and easing restrictions on hiring and firing. Governments have also announced a review of active labour market policies to provide a better fit between available skills and business needs.

Southern European governments have also taken preliminary steps to improve the functioning of their goods and services markets through measures including the reform of competition and network industry regulators (Greece, Italy, Portugal, Spain), initial privatization of network industries (Portugal, Italy) and the initial liberalization of professional services and retail trade (Spain, Italy). Other reform attempts include privatization programmes (e.g. sale of Energias de Portugal) and energy reforms (Spain, Portugal, Greece, Italy).[11]

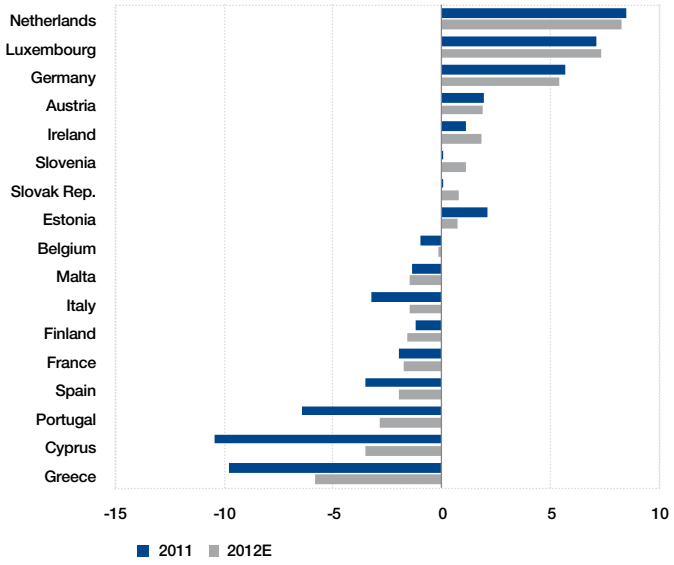
In addition, some countries have endeavoured to improve their governance of innovation policy. Spain, for example, moved innovation competencies to its newly-created Ministry of Economy and Competitiveness. Portugal established a Ministry of Education and Science, and a new Science and Technology National Council to facilitate the coordination of science, technology and innovation policies. Efforts to facilitate entrepreneurial activity (e.g. Portugal's entrepreneurship and innovation programme and Italy's Industry 2015 programme) and to foster university-business collaboration (Italy) are yet more steps in this direction.

Going forward, it will be crucial for policy-makers to maintain the reform momentum and forge ahead with competitiveness-enhancing actions in these areas. Capital investment for strengthening knowledge-driven societies will require continuous funding. Undoubtedly, in the current economic context of significant pressures to reduce public budgets and achieve fiscal consolidation, governments will need to strategize carefully to decide where to cut spending while ensuring that investments are made in those areas that will allow their economies to be restructured towards more productive activities.

**These reforms are starting to bear fruit**, suggesting that Southern European countries are headed in the right direction. Although it is too early to assess the effect on productivity or its underlying drivers, some changes can be observed with respect to current account deficits, which may be an initial indication of some fundamental changes because in the longer run, high levels of productivity tend to be reflected in on current account surpluses.

As shown in Figure 9, the Southern European countries run current account deficits, led by Cyprus, Greece, Portugal, Spain and Italy, whereas Northern European economies run surpluses. However, the current account deficits of Southern European economies have shrunk in 2012 compared with the previous year, indicating that some rebalancing may be taking place between Southern and Northern Europe.

### Figure 9: Current Account Balance of Eurozone Countries (as % of GDP)




Source: IMF, *World Economic Outlook*, October 2012

**However, further measures will be needed to boost competitiveness; designing and implementing them will be a complex task.** Policy-makers will have to take into account the specific circumstances prevailing in each country and ensure that the proposed reforms are not only passed by the country's law-making bodies, but also fully implemented across all levels of the public sector while winning the support of society at large. Understanding the barriers these reforms may face and identifying methods to overcome them is therefore crucial. Against this backdrop, the following sections of this Report analyse selected practices for enhancing competitiveness that have been adopted across Europe.

## 2.2 Identifying Competitiveness Practices in Europe: Overview and Criteria Applied

As discussed in the previous section, Europe as a whole is facing a competitiveness challenge, more pronounced in particular countries and areas than in others. Overall, there are three areas where Europe is lagging behind: entrepreneurship and innovation, mobilizing talent, and making markets work better for Europe. These are also the areas where Southern European countries currently suffer from a competitiveness gap compared with their Northern neighbours, and need to strengthen the capacity of their institutional frameworks for the successful implementation of targeted reforms.

Against this backdrop, the following sections will offer a deep dive into the competitiveness challenges in these three areas and discuss selected case studies from European countries which can provide inspiration for stakeholders in government, business and civil society. Each case study highlights both the kind of reform measures that were undertaken ("what was done") and the process of implementation ("how it was done"). Table 1 provides an overview of the 11 selected case studies, classified into the three areas.

### Table 1: Overview of Topics and Case Studies Discussed

| | Entrepreneurship and Innovation | Mobilizing talent | Making markets work for Europe |
|---|---|---|---|
| Case studies | • EXIST early stage financing programme (Germany)<br>• Dutch Leading Technology Institutes<br>• Basque region R&D policy (Spain) | • Hartz labour market reforms (Germany)<br>• Danish flexicurity model<br>• Dutch part-time programmes<br>• German dual system of apprenticeships<br>• Finnish education reforms | • Swedish network liberalization<br>• Single Euro Payments Area (SEPA) initiative<br>• EU Services Directive |

These competitiveness practices have been selected based on discussions with political and business leaders, and are described in boxes 4 to 6 and 8 to 15. The main criteria in choosing the case studies were for them to have been carried out in European countries, thus providing inspirational practices for other European leaders. The cases were also required to have a high and/or system-wide impact, thus allowing for learnings about the implementation process.

The case studies were initially analysed based on desk research drawing upon findings from primary and secondary sources (e.g. OECD, European Commission, World Bank) as well as interviews with selected experts. They were subsequently discussed with political and business leaders at the World Economic Forum's Workshop on Rebuilding Europe's Competitiveness in Rome in October 2012, and finally validated by the Forum's network of partner institutes and selected members of the Global Agenda Councils.

It is important to keep in mind that Europe is a diverse region, and that a reform programme that worked in one country is not necessarily directly transferable to another. As such, the case studies should be considered an initial starting point for stakeholders to identify which reforms are needed in their constituencies and how these can be tailored to each country's unique circumstances.

## 2.3 Entrepreneurship and Innovation

Innovation is critical for reaping productivity gains by developing and offering higher value-added products and services and to compete in today's globalized world. Critical factors defining the innovation capacity of a country range from the presence of existing or new companies capable of making effective use of existing knowledge, and of an overall business environment conducive to high-quality business operations and strategies. At the same time, governments need to put in place a regulatory framework and enabling infrastructure conducive to higher rates of entrepreneurial activity, which is the principal driver of productivity and employment generation.

The concepts of innovation and entrepreneurship are closely related. To be successful, businesses need to constantly utilize new knowledge for developing new products and services, or for establishing new business models that enable them to reach the market in more efficient ways. This is particularly true for small and medium enterprises (SMEs), which are among the largest generators of jobs in Europe but often face difficulties in accessing and absorbing the necessary knowledge to develop new products or models, or to get financing to scale up their operations.

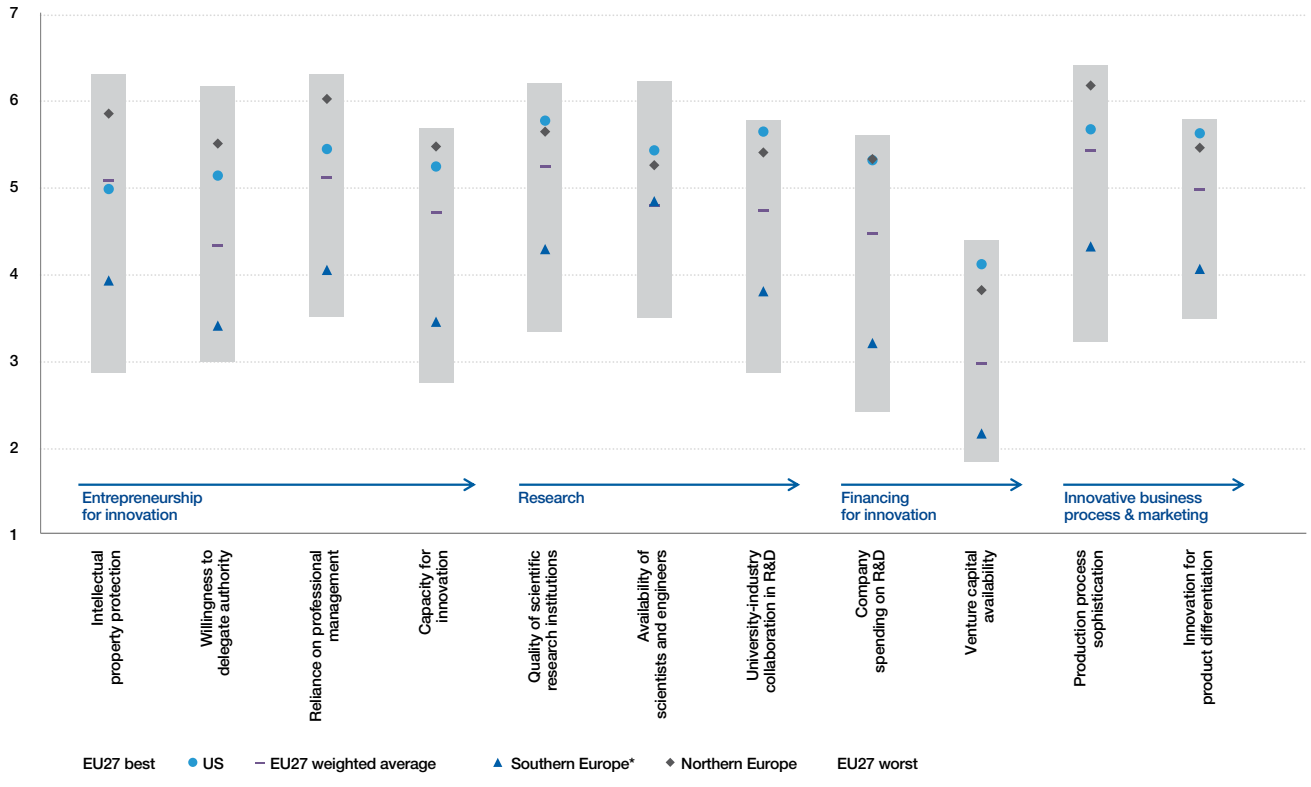
As discussed in Section 2, the GCI captures a country's ability to innovate through three interrelated pillars: the technological readiness pillar, related to the availability of technology and uptake of ICT; the business sophistication pillar; and the innovation pillar.[12] Figure 10 displays selected indicators of the GCI. Each bar stands for one indicator and presents the score dispersion between the best and worst performing European countries for each indicator. The black dash represents the EU average, the grey diamond the average of the Northern Member States, and the blue triangle the average of the Southern Member States. The light-blue circle represents the US.

As the figure shows, Europe's large and persistent competitiveness divide is particularly evident in the wide divergences in the region's innovation capacity. Overall, the US outperforms the EU27 average. However, at a more granular level, the Northern European Member States are either at a par with the US or outperform it, while the Southern Member States consistently trail behind both the US and the EU27 average by a wide margin.

These wide divergences in the entrepreneurship and innovation ecosystems of EU Member States, and the fact that some European countries outperform the US, a global innovation powerhouse, suggest that Europe can already learn a great deal from its best performers to unleash its innovation potential.[13]

One critical concern relates to the low levels of technology transfer from the academic to the private sector. Many European economies have been facing the so-called European Paradox, i.e. a low number of marketable products developed through research despite the presence of high-quality scientific research institutions. The example of the Leading Technology Institutes from the Netherlands shows that there are practices within Europe that can help enhance the knowledge flow between the two sectors to support the innovation capacity of local firms (see Box 4).

### Figure 10: Selected Innovation and Entrepreneurial Indicators




Sources: Executive Opinion Survey, World Economic Forum; *Global Competitiveness Index 2012-2013*, World Economic Forum
Northern Europe: Finland, Germany, Netherlands, Sweden
Southern Europe: Greece, Italy, Portugal, Spain

## Box 4: Dutch Leading Technology Institutes – Improving Long-term Collaboration Between Science and Industry[14]

### Competitiveness challenge and action

Following prolonged periods of economic decline and rising unemployment in the Netherlands, signs were emerging in the 1990s that the Dutch innovation system was losing momentum.[15] In 1997, the Dutch government set up Leading Technological Institutes (LTIs) in four key areas of Dutch industry. LTIs are virtual networks that bring together industry and research institutes to jointly identify critical areas for research in line with the long-term needs of the private sector. Through public-private partnerships (PPP), each LTI was developed to be a holistic tailor-made programme, addressing both sector-specific demands as well as wider issues such as human capital development and framing of supporting regulation.

Each LTI presently has its own focus and structure based on sector-specific challenges. Partners engage in cooperative research, knowledge dissemination and valorization (of intellectual property rights, licensing and product development). At the same time, they also contribute to educating and training the workforce (via doctoral positions). LTIs operate on an evolving cost-share basis: the government initially funds up to 50% and the private sector around 25-30%, with the aim to reverse these shares over time. Research institutes make up the remainder.

### Process

The programme benefited from the presence of strong research institutions and highly-trained staff, but initially there were difficulties in identifying and matching the research needs of the private and research sectors. The requirement for a joint proposal favoured those with a strong industry leader (such as Unilever in the food and nutrition sector) to the disadvantage of SMEs, and discouraged more multidisciplinary proposals from a wider set of constituencies. The lack of SME involvement and the question of how to allocate intellectual property (IP) rights between partners posed significant challenges in the programme's infancy. As a result, the Dutch government stepped in to coordinate and ensure greater standardization. Today, IP rights are determined on a project-by-project basis, and the programme guidelines have been adjusted to allow for more flexible ways for SMEs to participate.

### Results

LTIs show that the government can provide the right stimulus for cooperation between the private sector and research institutions. They demonstrate the need for a good monitoring system to facilitate fine-tuning in accordance with programme objectives, for clear and good IP policies, and for the provision of sufficient flexibility to encourage SME participation. Furthermore, experience-sharing among LTI managers has proven valuable. Since the inception of the programme, the number of LTIs has grown from four to nine. Based on this success, Dutch policy-makers have decided to make the LTI model of PPP a focal point for Dutch innovation policy-making under a new acronym, TKI (Topconsortia for Knowledge and Innovation).[16] Currently, 19 TKIs are being set up, provisioned with a total budget of 500 million euros up to 2015 and a minimum private share of 40%.

In terms of fostering entrepreneurship, especially with regard to innovation that contributes to long-term corporate growth, the US has been particularly successful at promoting new, knowledge-rich businesses that spring from or around universities and research centres and go on to become global leaders. For European businesses to become equally innovative and entrepreneurial, many countries must, as a first step, put in place the right enabling environment, i.e. providing financing mechanisms for knowledge-driven start-ups, raising entrepreneurial awareness, and incorporating entrepreneurial skills in secondary and tertiary education curricula.[17]

Starting a business with an innovative idea based on advanced research faces a whole range of challenges. In addition to the red tape that potential entrepreneurs face in large parts of Europe, it takes a considerable amount of time to turn an innovative idea into a prototype for a new product or service, and often success is far from guaranteed. In this situation, a lack of financing for very early-stage knowledge-driven companies, who are responsible for achieving breakthrough innovations, is a key bottleneck. However, some practices in Europe, such as the EXIST programme in Germany, offer inspiration for ways to promote innovative start-ups incubated in universities or public research centres.

## Box 5: German EXIST Programme – Supporting University-Based Start-Ups and Mitigating Early-stage Funding Gaps

### Competitiveness challenge and action

Like many European countries, Germany had a high-quality research establishment but few businesses springing from it. In order to address this innovation challenge, the German government launched the EXIST programme in 1997 with the aim of establishing a lasting culture of entrepreneurship at institutes of higher research and increasing the number of knowledge-driven start-ups. The programme is a partnership between the government and higher education institutions – the former providing funding and serving as the programme initiator and administrator, the latter promoting innovation to result in entrepreneurial activity. Three EXIST programmes are underway at present: one offers three years of funding for building support infrastructure for knowledge-based university start-ups, and two offer grants to graduates and scientific research staff to establish start-ups.[18] The programme forms part of the German government's high-tech strategy and is co-financed by the European Social Fund.

### Process

The programme was designed by the German federal government to address the lack of an entrepreneurial culture at universities and deal with the complexity of creating innovative new companies. The programme has grown organically since its inception, and can be characterized by a sequence of often overlapping subsequent funding mechanisms.[19] Flexible process management based on continuous re-evaluation and feedback from participants has been a key enabling factor for overcoming initial difficulties. For example, the government did not fix a particular time frame, and rather allowed for an initial trial period of three years. Instead of drafting a comprehensive long-run development strategy, the programme was kept sufficiently flexible to build on learning experiences. Preliminary insights into the kind of instruments and incentives that could activate the target group were gathered from a few pilot projects equipped with a generous financial cushion to allow for experimentation with a range of instruments and initiatives. These strong financial incentives had a significant impact, galvanizing a wide number of actors in the German university and research landscape. Initially, the government assumed that important steps towards the programme's aims would have been taken in the first three years, but it soon became obvious that long-term planning and commitment were required. A total of four different programme phases were eventually developed, each drawing upon past experiences.

### Results

The outcomes of the programme are difficult to quantify, but an independent evaluation suggests it has reached about 190,000 students and researchers in various forms (e.g. lectures, business plan competitions, trainings), and supported over 12,600 ideas which have translated into 3,460 start-ups.[20]

It is important to note that although Southern European countries have been facing significant challenges in recent years, successful practices in particular sub-regions can also be found. The Basque government's innovation system is one such example, demonstrating that all good ideas do not necessarily come from Northern Europe (see Box 6).

## Box 6: Basque Innovation System – Building an Innovation System from Scratch

### Competitiveness challenge and action

In the late 1970s, the Basque economy was in need of deep restructuring to move away from traditional industries towards high-technology and knowledge-based activities. However, the region lacked research infrastructure, had low levels of research and development (R&D) investment and few research-oriented universities or institutes. In the 1980s, the Basque regional government began a process of creating an innovation system. For the first decade, the process focused on creating publicly-funded technology centres. In the 1990s, a policy shift saw enhanced financial support for enterprising R&D units and clusters. Since the year 2000, greater emphasis has been laid on collaboration and excellence in research through the creation of the Basque Excellence Research Centres and cooperative research centres.

### Process

The government assumed leadership in orchestrating change and ensured stability in its policy and objectives. A shared understanding and a commitment by all stakeholders to the imperative of innovation allowed the government to overcome the initial barriers such as limited resources, resistance to cultural change and lack of trust between technology providers, universities and firms.

### Results

The efforts have supported the economic transformation of the Basque region by restructuring industry. An institutional framework for building knowledge and innovation capacity has emerged, and interlinkages between innovation actors have been established. Furthermore, gross R&D investment has shown a positive trend and currently stands at 2% of GDP – similar to the EU average.

The process of building innovation capacity is complex and costly, and hinges on many intertwined factors and conditions. Yet, as the boxes in this section have outlined, there are examples that illustrate how specific regions have succeeded in building and strengthening an innovation system from scratch.

## 2.4 Mobilizing Talent

Mobilizing Europe's talent will be central to rebuilding European competitiveness, as recognized in Europe's 2020 Agenda and its initiatives such as Youth on the Move and Agenda for New Skills and Jobs. In order to ensure the effective and efficient use of available human resources, the workforce needs to be equipped with an appropriate set of skills vital for a fast-changing economy. Such skills can be acquired through appropriately designed education and training systems. For Europe to become more knowledge-driven, a high-quality education system is necessary to create new knowledge for producing higher value-added products and services.

Northern European economies perform very well in terms of education and training indicators, even surpassing the US. Southern Europe, by contrast, is characterized by lower quality of education systems, in particular the quality of math and science education, and for the fact that on-the-job training does not make up for this shortfall.

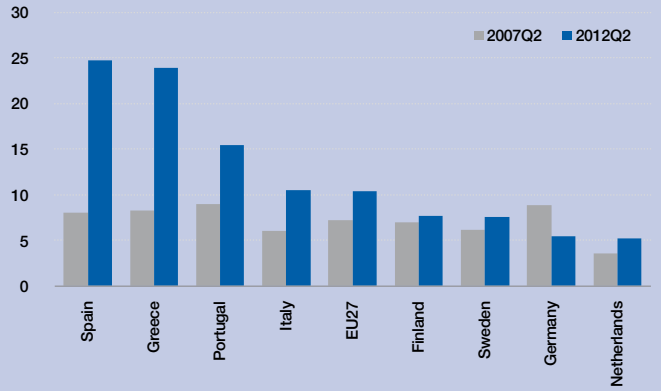
In addition to the availability of talent, flexible and efficient labour markets are important so that businesses are free to hire without the fear that rigid regulations will render them unable to adapt their personnel to their business needs at a later stage. Moreover, flexible labour markets help to avoid the creation of dual labour markets, in which some workers are heavily protected while others work under precarious conditions and short-term contracts, thus reducing the incentive for companies to invest in their training and skills development, with not only individual but economy-wide implications.

Improving both labour market flexibility and education systems are prerequisites for addressing Europe's unemployment challenge, which has become particularly dire for the young (see Box 7).

## Box 7: Europe's Youth Unemployment Challenge

Since the beginning of the financial and economic crisis, Europe has witnessed increasing and persistent unemployment, rising from 7% in October 2007 to 10.7% in October 2012, and now affecting 25 million citizens. Southern Europe has been particularly hard-hit. Similar to Europe's competitiveness divide described in Section 2, aggregate unemployment figures mask wide differences within Europe itself. While Northern European Member States register low unemployment figures, ranging from 5.2% in the Netherlands to 7.7% in Finland, unemployment in Italy and Portugal almost doubled to rise above 10% and 15%, respectively, with Spain and Greece witnessing a vertiginous 25% (see Figure 11).

**Figure 11: Unemployment Rate, Quarterly Average, by Sex and Age (%)**

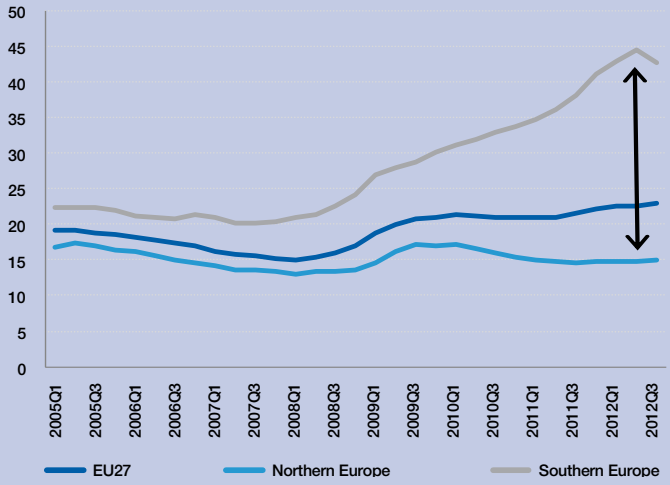



Source: Eurostat, November 2012, seasonally adjusted data

Young people have borne the brunt of the crisis. Unemployment among the youth is frequently twice that among the general population, reflecting frictional costs in the search for first-time employment as well as disincentives in the present system to hire new workers. The crisis has, however, exacerbated youth unemployment in Southern Member States as shown in Figure 2, taking it to a record high of 45% in the second quarter of 2012, meaning that nearly every other young person under the age of 25 is out of the job market. The situation is particularly dire as prolonged periods of high unemployment, particularly among the youth, create significant economic and social costs. As demonstrated in the recent protests in Greece and Spain, unemployment is associated with social discontent and unrest.

Beyond the immediate loss of income, studies have shown that unemployment lowers lifetime earnings, can affect workers' health, and can potentially have a negative impact on the health and educational success of children whose parents become unemployed. For businesses, there are significant costs in the form of labour force de-skilling and a loss in consumer spending power. From an economy-wide viewpoint, unemployment in the Southern Member States has been suppressing aggregate demand and placing additional pressure on government finances in addition to that already created by the need for fiscal consolidation.

**Figure 12: Youth Unemployment Rate (below 25 Years), Seasonally Adjusted**



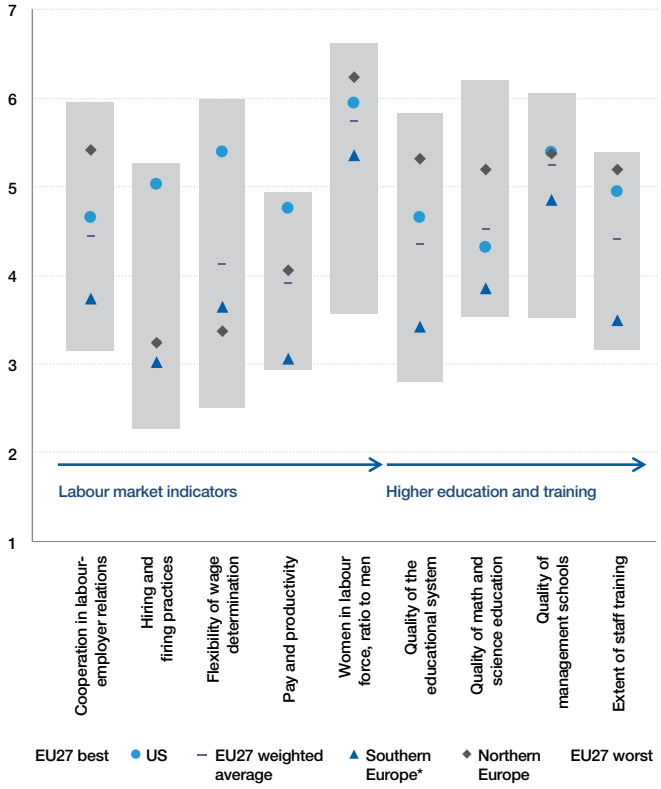

Source: Eurostat, November 2012, seasonally adjusted data

Going forward, the employment challenge will remain particularly complex due to the limited fiscal leeway that governments have to support additional measures, coupled with the urgency to address youth unemployment to avoid a lost generation. In recognition of these needs, the World Economic Forum led a Business 20 (B20) Task Force on Employment to provide inputs to the G20 under the Mexican Presidency in June 2012. In keeping with the criteria applied in this Report, the actions proposed are meant to be scalable with a strong multistakeholder component. These include: frontloading strategic infrastructure, initiating structural reforms of the labour market, facilitating the growth of SMEs and innovative business models, promoting collaboration between businesses and educational institutions to bridge the skills mismatch, and expanding internship and apprenticeship opportunities.

As shown in Figure 13, there is great dispersion with regard to labour market efficiency across Europe. Overall, for each indicator, there are some European economies that depict better measures of flexibility or inclusion than others, outperforming even the US. In particular, Northern Europe fares well in terms of cooperation in labour-employer relations. The US, by contrast, leads in terms of hiring and firing practices, flexibility of wage determination and the relationship between pay and productivity; it hits above the European average in each of these areas. At the same time, Southern Europe ranks below the European and US average in all but one indicator of labour market flexibility.

The European Commission has emphasized the importance of both flexible labour markets for businesses and the security of income for workers in efforts to enhance competitiveness.[21] The Danish flexicurity system is one of the most prominent examples of how labour market flexibility can go hand-in-hand with preserving income security (see Box 8). It has to be noted, however, that the flexicurity model can come at a high cost for taxpayers, especially in countries that do not have the right conditions in terms of business base, skill sets and thus, low overall unemployment rates.

**Figure 13: Selected Indicators of Labour Market Flexibility, and Education and Training**




Source: *Global Competitiveness Index 2012-2013*, World Economic Forum

## Box 8: Danish Flexicurity Model – Combining Labour Market Flexibility with Income Security and Labour Activation Measures[22]

### Competitiveness challenge and action

In an open economy with changing market conditions, businesses must be able to adjust their workforce to their evolving business needs. This flexibility is especially important for small countries like Denmark, where SMEs predominate and do not have the resources to maintain costly employment contracts through an economic or business downturn.

The Danish flexicurity model combines a high degree of labour market flexibility for employers with a high level of social protection for workers. Specifically, the model has three key elements: numerical flexibility, or ease of hiring and firing; income security through relatively generous unemployment insurance or social assistance schemes; and activation and retraining programmes (active labour market policies), which are mandatory to obtain unemployment benefits.

### Process

The Danish flexicurity model combines the liberal tradition of low job protection that has its roots in the early 1900s, with the high unemployment benefits system that was built in the late 1960s and early 1970s, as well as the active labour market policies that were mainly developed as part of Denmark's labour reforms of 1994.

The details of the flexicurity model have been worked out by stakeholders including social partners (representative of trade unions and employers engaged in social dialogue) and the government. A culture of mutual trust and compromise between social partners has allowed the flexicurity system to prosper. However, it must be noted that the Danish flexicurity model has required significant resources; the cost of implementing it is estimated at more than 5% of GDP annually.

### Results

Denmark is recognized for its labour market flexibility – it enjoys a high degree of job mobility and job creation as well as a low average tenure in specific jobs, indicating a certain dynamism in the market. While the flexicurity model can also lead to severe employment reactions during downturns,[23] it is overall considered beneficial for keeping unemployment levels low. Denmark now enjoys the EU's lowest inactivity rate and one of the lowest unemployment rates at 7.6% in 2011 and 5.2% on average during 2001-2011.[24]

While the Danish flexicurity model has gradually evolved over decades, the **Hartz Reforms** represent a major change in the German labour market within a relatively short time frame (2002-05). Through the reforms, the incentives to take on work were strengthened and a lower-wage sector was created. Additionally, the reforms strengthened public employment service and provided a range of labour activation measures. The reforms are widely credited for reintegrating a large number of people into the labour market, although Germany still faces difficulties in moving reactivated employees to higher-value jobs over time.

Another successful labour market practice is that of the Dutch labour market reforms of 1997-1999. The reforms introduced more flexible regulations on fixed-term and temporary employment and eased dismissal notification procedures, resulting in positive employment effects, particularly for part-time and fixed-term employees. The reforms were facilitated by an agreement negotiated between Dutch social partners in a tradition of consensus-based decision-making.

## Box 9: Germany's Hartz Labour Reforms – More Flexibility in the Labour Market Facilitated by a Multistakeholder Commission[25]

### Competitiveness challenge and action

The German Hartz Labour reforms were enacted during the 2002-05 period, a time of historically low growth and high unemployment in the German economy. Rising overall unemployment was accompanied by increasing long-term unemployment – more than 50% of Germany's unemployed were long-term unemployed. Additionally, there was a placement scandal in the Federal Employment Agency, which discredited the agency and also reflected unfavourably on the labour ministry. As a result of the strong media attention that the scandal elicited, pressure mounted to rebuild the placement system. The combined impact of the placement scandal and rising long-term unemployment created a sense of urgency for reform.

The four laws of the Hartz reform were focused on:

- reform of the unemployment benefit system and the social benefit system;
- activation measures;
- reform of the Public Employment Service (PES); and
- deregulation of labour markets, particularly the temporary work sector.

The reform covered a range of rather complex issues. As a means to incentivise the long-term unemployed to accept work, the German government reduced unemployment benefits for the long-term unemployed and further developed sanction mechanisms to monitor job search activities. Reforms also included integration and activation measures such as wage subsidies and start-up grants. Furthermore, public employment agencies were re-organized in a way that increased their accountability and their understanding of local employment markets. Labour market deregulation lifted restrictions on the maximum duration of temporary work and provided a range of exemptions with regard to dismissal protection and regulation of fixed-term contracts.[26]

### Process

The government set up a multistakeholder Committee for Modern Services in the Labour Market (generally referred to as the Hartz Commission), whose 15 members included social partners, academics, politicians, private entrepreneurs and representatives of consulting companies. Many observers argue that the Hartz Commission was used to introduce a range of reform proposals into the political debate while bypassing opposition in the early stage of the policy-making process.[27] Following its re-election victory in 2002, the government moved quickly by first implementing those reforms that faced the least resistance and required the fewest resources. It then moved on to address the more difficult reforms such as restructuring unemployment benefits. Reforms were facilitated by a sense of urgency on the back of rising long-term unemployment and the placement scandal in the public employment services. A strong commitment by the political leadership ensured that the reforms were not reversed despite strident opposition from unions and widespread protests.

### Results

The Hartz reforms have been an important vehicle for reforming the labour market in Germany. They have been instrumental in decreasing unemployment by reducing the disincentives to work. They helped reintegrate a large number of unemployed people into the labour market, who had previously not been supported by the public employment agency. The OECD estimates that Germany's structural unemployment rate was reduced by 0.5% through the smaller set of reforms termed "Hartz IV" alone.[28] Unemployment in Germany declined from 10.5% in 2004 to 6.0% in 2011, and employment increased by 7.8% from 2005-2011[29] – the highest increase among industrialized peers. The reforms have, however, not been entirely free of controversy. First, critics argue that the government has not been able to effectively explain the reforms to the public in general and to those affected in particular. Second, although the reforms helped to reintegrate a large number of previously unemployed people into the labour market, critics point out the limited chances these workers have of upward mobility, i.e. improving their employment conditions. Nevertheless, the Hartz reforms provide an example of how change can be achieved through a multistakeholder approach, combined with decisive political action and a unique window of opportunity for reform.

## Box 10: Dutch Labour Market Reforms of the Late-1990s – Increased Flexibility of Temporary Employment through Negotiations among Social Partners[30]

### Competitiveness challenge and action

The Netherlands has a long tradition of consensus-based policy-making, characterized by a strong involvement of social partners. In fact, the Dutch Labour Foundation has been central to pursuing positive-sum bargaining strategies in the so-called Polder Model which enabled the famous Wassenaar Agreement of 1982 to reduce working hours in exchange for voluntary wage moderation.

In the late 1990s, businesses came to regard a range of labour market regulations concerning dismissal notification and fixed-term contracts as too bureaucratic and in need of modernization. At the same time, the government wanted to regulate the increasingly important temporary agency work and strengthen the position of on-call and temporary agency workers. Thus, a new balance between flexibility and security aspects was sought.

Against this backdrop, two important pieces of legislation were passed at the end of the 1990s. First, the 1998 Law on the Allocation of Labour through Intermediaries liberalized temporary agency work by abolishing maximum lending times of agency workers and lifting licence or permit requirements for agencies. Second, the Dutch version of flexicurity legislation, the so-called Flexibility and Security Law, was submitted to Dutch parliament in 1997 and entered into force in 1999. The Flexibility and Security Law strengthened labour flexibility by increasing the flexibility of regulations regarding fixed-term employment contracts, i.e. allowing successive fixed term contracts. Additionally, dismissal notification procedures for permanent employees were simplified. The security aspects of the legislation mainly related to the strengthened position of on-call workers, temporary agency workers and workers in small jobs.

### Process

The reforms were largely based on agreements previously negotiated by the Dutch social partners. In fact, the Dutch coalition government was initially unable to reach an agreement by itself and asked the Dutch Labour Foundation, an advisory body whose members constitute the largest workers' and employers' organizations in the Netherlands, to advise on this matter. Given the strong commitment that was created during the consolidation process from social partners and government, the legislation passed parliament without fundamental changes.

### Results

The greater labour flexibility, in particular with regard to fixed-term employment, is also highlighted in the drop in the OECD's strictness of labour legislation indicator on temporary forms of employment from 2.4 in 1998 to 1.2 in 1999.[31] The labour market reforms together with previous reforms dating back to the 1980s have led to significant increases in temporary employment – from 0.8 million employees in 1998 to 1.3 million in 2011, corresponding with an increase in the share of temporary employment from 12.7% in 1998 to 18.4% in 2011.[32] Moreover, unemployment in the Netherlands stood at 5.2% during the second quarter of 2012, well below the European average. Critics argue, however, that more recently the pace of decision making in the Dutch consensus model has been rather slow.

In sum, the Dutch labour market reforms of the late 1990s, which focused on making it easier to hire temporary workers and making fixed-term employment more flexible, resulted in positive effects on unemployment. Social partners were key to finding a politically acceptable reform proposal and getting it passed.

A well-functioning education and training system is fundamental for knowledge-driven economies and the efficient working of their labour markets. Certain European countries have devised some of the best education and training systems in the world. A prime example is the German dual system of vocational and educational training, which combines theoretical teaching in school with more practical learnings in the workplace. It is credited with equipping the young people with employable skills and enabling a relatively smooth transition from education to full-time employment.

## Box 11: German Dual System of Apprenticeships – Preparing for the Workplace[33]

### Competitiveness challenge and action

Today's complex business environment demands a strong emphasis on employees' skills and qualifications. A well-trained workforce equipped with an appropriate skill set is indispensible for a competitive and sustainably-growing economy. In this context the dual system of Vocational and Education Training (VET) has a long history in German-speaking regions and has become deeply embedded and widely respected.[34] It consists of two elements: i) vocational training in private enterprises and ii) part-time teaching in special vocational schools.
Apprenticeships exist for a wide range of jobs – whether in manufacturing, services or agriculture. Over the years, new types of apprenticeships have been added to reflect industry developments – in information technology, for instance – and the system currently offers more than 300 types of apprenticeships which take in about 60% of German youth today.

### Process

The dual system provides an example of a mutually-beneficial collaboration between the private and public sectors. The public sector is responsible for bearing the costs associated with education in the part-time VET schools, while the private sector assumes the cost of providing workplace training (which includes costs for paying trainers, of the equipment used and so on). The private sector also pays monthly apprenticeship salaries, which are determined through collective bargaining.

The system is, however, not easily transferable to other countries, where it can face significant barriers. It requires a corporate culture that has the capacity for in-house training of apprentices. Since it requires companies to shoulder the costs of the apprenticeship programme, it may limit their willingness to participate. On the plus side, however, it allows companies to train their future employees in the specific skills that they require, thereby avoiding friction costs on new hires and ensuring a better fit.

### Results

The key strength of the dual system is that it combines the more theoretical knowledge imparted in school and in-company training with the more practical skills taught at the workplace. This complementarity of theory and practice has proven very successful in enabling a relatively smooth transition to full-time employment. The VET system is at least in part credited for the relatively low youth unemployment in Germany (7.9% as of June 2012) as well as the low rate of people with no qualifications. Overall, the example demonstrates how the public and private sectors can work together and benefit from the collaboration.

In addition to well-functioning training systems, the general educational system remains pivotal for preparing students with the skills needed for a rapidly-evolving economy and society. Education is not only expected to convey general knowledge, but also to equip students with the specific social and personal skills required to foster creative thinking and problem-solving. Yet, skills mismatch – the discrepancy between what graduates have learned up to graduation and the skills that employers need them to possess – is often enumerated as a prime businesses concern. For example, the United Kingdom's most recent Education & Skill Survey (2011) demanded that the new government make imparting employable skills to young people its top education priority.[35]

The Finnish education system is extensively regarded as an outstanding example in this regard. Over several decades, the system has been refined through a focus on decentralization, teacher training and equity, thereby supporting Finland's transformation into a knowledge-based economy.

## Box 12: Finnish Education Reforms for a Knowledge-based Economy – Focus on Equity

### Competitiveness challenge and action

Finland's educational structure has shifted gradually from a highly centralized one emphasizing external testing to a more localized one today, in which highly-trained teachers design curricula around lean national standards. In the 1960s and 1970s, Finland underwent a drastic change, evolving from a largely agrarian society to a Scandinavian welfare state.[36] Yet, the country lacked a sufficient skill base to facilitate this change. There was also a general push for a more equitable and inclusive society as the driving force for the Finnish welfare state, calling for equity to be made a central element of the education system.

All these factors lay behind the introduction of the 9-year comprehensive school (1968-1977), and the abolition of the practice of dividing students early on according to their ability. Other important reforms included the gradual decentralization of the education system from the 1980s to the mid-1990s, through which schools and the teaching force got greater autonomy as well as responsibility. Concurrently, from 1979 to the mid-1980s, a strong focus was brought to bear on improving teachers' qualifications as an enabling factor for decentralization and to ensure high-quality teaching.

Finally, an economic recession in the early 1990s proved a turning point for the country's education reforms, creating space for a new national competitiveness policy designed to support private-sector innovation in sectors such as telecommunications and ICT. This completed the shift from an economy based largely on natural resources to a knowledge-driven society. The new set of skills and knowledge required for the working population in the new economy led to the redesign of the national core curricula and a renewed focus on strengthening vocational training (e.g. through introduction of polytechnic colleges in the 1990s).[37]

### Process

The success of the four-decade-long reform effort is based on strong multistakeholder involvement, which has helped keep education policy consistent over this significant time span. Initial reforms had a strong collaborative spirit, involving a range of stakeholders including the ministries of education and finance, the teachers' union and three predominant municipal organizations (towns, rural municipalities and Swedish-speaking municipalities), thereby overcoming initial resistance from stakeholders such as some elements in the teachers' union. In the mid-1980s, teachers' training was moved from the seminarium (the Finnish equivalent of a teachers' college, comprising just 2-3 years of training) to the university, ultimately requiring all teachers – primary through upper-secondary – to obtain a Master's degree as a precondition for employment. The recognition of the importance of teachers' training has made the profession one of the most sought-after in Finland, attracting the brightest talent. In fact, only 15% of applicants are selected for this highly-competitive programme each year.

Decisions concerning upper-secondary education also involved central labour organizations, while the ministry of education served as a permanent negotiation body in which all parties were represented. During the 1990s, the focus on skills for a knowledge-driven society brought in the private sector, which suggested the kinds of skills and knowledge it required from young graduates, thereby promoting the importance of mathematics, science and technology in the formal curriculum.

### Results

The success of the Finnish education reforms is reflected in Finland's remarkable performance in the OECD's Programme for International Student Assessment (PISA) studies. In addition to the provision of similar learning opportunities to every child, the country enjoys high levels of participation in tertiary education, at 40% of the population aged 25-34.[38] Overall, the reforms have supported the transformation of Finland into a technology- and knowledge-rich economy.[39]

## 2.5 Making Markets Work Better for Europe

By ensuring high levels of competition, well-functioning markets support an efficient allocation of resources to the most productive activities and act as a catalyst for innovation. The establishment of the European Single Market, with the free movement of goods, services, capital and people, has represented an important step towards enlarging and enhancing the efficiency of the European market, particularly for goods. However, as will be discussed below, full implementation of the Single Market, including services and sectors that until now have remained protected at the national level, could make markets work better for Europe. Against this backdrop, this subsection deals with two main aspects: efficiency in the goods market and efficiency in the services market.

Countries with efficient markets are well positioned to produce the right mix of products and services suited to their particular supply-and-demand conditions, as well as to ensure that these goods and services are traded most effectively within the economy. Healthy market competition, both domestic and foreign, is important for driving market efficiency, and thus productivity, by ensuring that the most efficient firms thrive. The best possible environment for the exchange of goods requires a minimum of obstacles to business activity through government intervention, while still ensuring protection for consumers through smart regulation. For example, competitiveness can be hindered by distortionary or burdensome taxes and by restrictive rules on FDI and international trade.

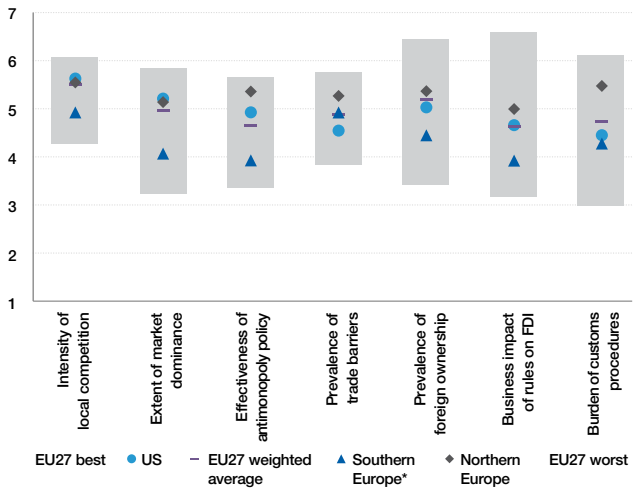
Market efficiency also depends on demand conditions such as customer orientation and buyer sophistication. For cultural or historical reasons, customers may be more demanding in some countries than in others. This can create an important competitive advantage, as it forces companies to be more innovative and customer-oriented, and thus imposes an even higher degree of discipline on them, promoting efficiency in the market.

The Single Market has been the key driver of higher market efficiency in Europe. The removal of barriers to the free movement of goods, services and people within Europe has resulted in a higher level of competition within the region, so that only the most efficient firms can successfully compete. Additionally, firms can realize vital economies of scale, with further increases in firm-level productivity.

Yet, the EU remains a rather heterogeneous entity in terms of market efficiency, and large disparities exist among Member States. The dispersion of performance across European economies pertaining to the indicators of goods market efficiency is displayed in Figure 14. Overall, Northern European economies tend to score similar to or better than the US, whereas Southern Europe trails behind on most indicators. For instance, in terms of the intensity of local competition and the burden of customs procedures, Southern Europe trails behind Northern Europe by a considerable margin.

The differences in goods market efficiency and service sector regulations across the EU suggest that highly efficient goods and services markets coexist with less effective setups within the European Union. Hence, there are examples of good practices that countries with less-efficient markets can follow to design their reform efforts. Past experience suggests that a number of countries have successfully managed to improve their market efficiency. The liberalization of the Swedish goods and services markets in the 1990s demonstrated how enhancing market efficiency can boost the productivity of an economy.

**Figure 14: Selected Indicators of Goods Market Efficiency**




Source: *Global Competitiveness Index 2012-2013*, World Economic Forum

## Box 13: Liberalization of Swedish Goods and Services Markets[40]

### Competitiveness challenge and action

In the 1970s and 1980s, Sweden's economic performance was declining, due to factors including restrictions on competition brought about by strong government regulation, weak anti-trust legislation and trade barriers. By the early 1990s, Sweden's economic situation was characterized by declining GDP and historically high unemployment.

During the crisis situation of the early 1990s, the Swedish government created a new competition authority and sector-specific supervisory bodies, while introducing new competition legislation aimed at prohibiting restrictive agreements and market dominance. At the same time, a number of network industries were deregulated through a transformation of state public utilities and a vertical separation of monopolies, ranging from non-manufacturing sectors, energy, communications and professional services to retail trade and banking.

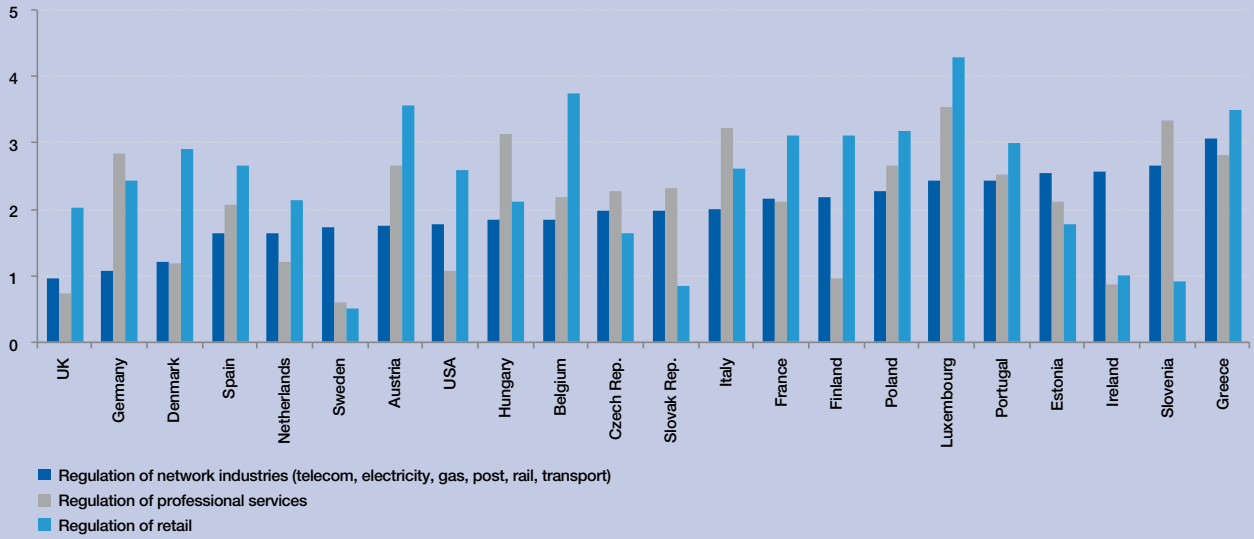
### Process

The Swedish system of government commissions facilitated a common definition of the problem, continuity of reform efforts across governments, and strong institutional performance of the competition authority.

### Results

The policy reforms proved beneficial for realizing net gains for consumers and businesses. According to the OECD, sector-wise deregulation measures produced a significant productivity dividend.[41] The reforms have boosted annual productivity growth by 0.45% since 1988. Conversely, average annual labour productivity growth in the business sector would have been 0.4% lower over the period 1994 to 2003 if product market regulation had remained the same as in 1988. Aggregating the two effects shows that deregulation enhanced Sweden's labour productivity growth by 0.85% during the 1990s.

**Figure 15: Regulation of Services Sectors**




Legend: 0=best; 5= worst

Source: OECD statistical database, OECD (2012)

A significant potential for efficiency improvements exists in liberalizing the services market in Europe, at a time when services are assuming a greater share in the EU's GDP. While the single market for goods has been largely achieved, the systematic liberalization of the markets for various services is still in its infancy. Since competition brought about by market liberalization is an important driver of countries' competitiveness, productivity growth in services in the EU has been sluggish at best, hampered by a range of regulations that prevent the development of a truly integrated European services market. Strong barriers to liberalization exist, as demonstrated by the example of closed professions and services.

Figure 15 shows the degree of regulation of various segments of the services sector, including network industries (telecommunication, electricity, gas, post, rail, air passenger transport and road freight), professional services, as well as retail. Overall, OECD data on the regulation of services markets shows large divergences between various European economies and also between different services segments. As a case in point, Germany has received good marks for having largely liberalized its network industries such as postal services, air transport and energy. However, its professional services market remains heavily regulated and, in many cases, restricted. Thus, with the exception of the United Kingdom, most European economies have some potential to liberalize their services markets in network industries, professional services or retail.

## Box 14: Single Euro Payments Area – Harmonizing Payment Systems, Improving Efficiency[42]

### Competitiveness challenge and action

Traditionally, European countries' payment systems have been disparate with regard to infrastructure and legal requirements (on issues such as licensing, revocability, refund rules and liability for faulty execution).[43] As a consequence, businesses needed to set up separate bank accounts in the various euro area countries they served, leading to additional costs and inefficiencies.

The idea behind the Single Euro Payments Area (SEPA) is to create an integrated retail payment market, which allows businesses to make and receive electronic cash payments throughout the euro area under the same basic conditions from a single account.[44] SEPA covers 32 countries in all – the EU27 Member States as well as Monaco and four members of the European Free Trade Association (Switzerland, Lichtenstein, Norway and Iceland). SEPA requires a harmonization of payment markets in terms of infrastructure and legal aspects.[45]

### Process

SEPA is a self-regulating initiative of the finance industry dating back to 2002. In a market-led approach, the private sector is leading the harmonization of infrastructure, i.e. developing technical standards, payment infrastructure and rule books.[46] The SEPA initiative is observed and supported by the European Commission and the European Central Bank, with the aim to build a more integrated European financial market. The legal harmonization of the SEPA initiative is enabled through the so-called Payment Services Directive (PSD), which ensures that the same legal framework applies to all payment services across the European Union.

The Payment Services Directive was initiated by the European Commission and adopted by the European Parliament and the European Council in 2007. It had to be transposed into national legislation of the EU member states by November 2009. The PSD has three main building blocks: i) harmonization of market access, ii) transparency and information requirements, as well as iii) clarification of rights and obligations of users and providers of services. Additionally, the European Parliament mandated that charges for cross-border payments in euros and payments within a member state (in euros) should be subject to the same fees.[47]

The SEPA project evolved over three phases. In the design phase (2004), standards and security requirements were developed with the support of the European Payments Council. During the implementation phase (2005 to end-2007), the focus shifted towards the rollout of SEPA instruments. In the final migration phase, payment systems will gradually migrate to the new system by February 2014. During the process described above, barriers to the SEPA initiative have mainly related to the large investments required and the economic disincentives for existing payment providers.

### Results

Initial studies estimate the potential benefit of SEPA at up to 123 billion euros over a period of six years.[48] Benefits arise from greater standardization of payments brought about through identical processes, equal time limits and equivalent risk levels. This technical standardization is expected to enhance transparency and competition as incompatibilities are reduced and market access improves. As a result of greater competition, services for consumers improve and prices for cross-border transactions decline. Thus, consumers are expected to be key beneficiaries of the SEPA initiative.

The finance industry initially incurs costs during the set-up and migration phase. However, there is the expectation that with greater standardization, the market for cross-border payments and electronic transactions will grow faster, thereby also benefiting suppliers of payment services. Over time, innovative and more efficient payment solutions can develop in the enlarged market. Moreover, there is the hope that an integrated payment market will allow for an increased surveillance of electronic money flows, helping prevent money laundering.[49] Overall, SEPA has the potential to produce important benefits for consumers. It is an important step towards a more integrated European financial market.

In addition a key European initiative towards services market liberalization is the EU Directive on Services in the Internal Market. Initially, the initiative aimed at removing existing barriers to the single market in services, but it did not fully fulfil these expectations. The European Commission's ambitious original draft of the directive was based on the country-of-origin principle (see Box 15). It provoked strong resistance and was watered down in the political process to remove the country-of-origin principle. However, it eventually fell short of expectations by failing to enable service providers to engage in cross-border activities.

By presenting this initiative, this Report strays from the aim of highlighting reform approaches or practices that have worked well, as important learnings can also be drawn from this middling experience. In this case, proponents of the reform may have aimed to achieve too much at once, creating resistance from many sides. Potentially, a staggered approach towards opening up of services, starting with sectors likely to attract least resistance, could work better going forward.

## Box 15: EU Directive on Services in the Internal Market[50]

Adopted in 2006, the Directive on Services in the Internal Market had a stated goal of removing legal and administrative barriers to trade in the services sector. The origins of the Directive went back to the Lisbon European Council in 2001, where it was requested that the European Commission launch a new strategy to dismantle the remaining barriers to services in the internal market. The Commission initiated a consultation process in which the barriers were identified and, based on the findings, proposed a first draft Directive.

In this ambitious proposal, the European Commission suggested a new legal framework that fundamentally deviated from the previously applied sector-by-sector approach for liberalizing services. It aimed to remove both the obstacles to the freedom of establishment of service providers as well as the free movement of services between Member States across a broad range of service sectors. The latter was meant to be achieved through the application of the country-of-origin principle, according to which service providers would only be subject to the laws of their respective countries of origin, and their provision of services in a different Member State would not be restricted.

The economic gains of this first proposal would have been substantial. Estimates suggested that implementation of the Directive would have resulted in increases in employment, productivity and wages while lowering prices. Net employment was predicted to increase by 0.3% and average real wages by 0.4%. Average prices for regulated services were forecasted to decrease by 7.2%. The study also expected significant gains for SMEs since the Directive would have enabled small firms to engage more and better in cross-border activities.

However, the Directive provoked strong resistance from trade unions, think tanks, public service unions and intellectuals, resulting in strong political mobilization against it. In particular, the country-of-origin principle triggered fears of social dumping – the practice of employers using cheaper migrant labour at home or moving production to destinations with cheaper labour – and the destruction of the European Social Model. The lack of involvement of civil society in the formulation of the proposal ultimately proved a major failure, resulting in high levels of conflict and politicization of the issue. Following a heated debate in the European Parliament, the Directive was diluted under pressure from some countries in the EU Council of Ministers.

Most of the controversial aspects were removed from the final Directive, including the country-of-origin principle. Member States were allowed to exercise a large degree of discretion in allowing free movement of services between states. Additionally, the scope of the targeted services sectors was narrowed down. Other aspects like administrative simplification through the establishment of single points of contact (to allow service providers to complete all administrative procedures at one single point) remained.

Critics argue that the watered-down Directive does not provide the benefits that the earlier version could have and that it does not lead to a full liberalization of services in the EU. Moreover, the integration of the Directive with national legislations has been significantly delayed or has remained deficient in many cases. The right to deviate from implementing the "freedom of services" clause has been widely used, and thus many barriers such as authorization and certification obligations remain. These remaining barriers prevent Member States from reaping the full economic benefits of liberalizing services in Europe. Estimates suggest that a full elimination of barriers in Europe would bring an additional gain of 1.6% of GDP, providing a major stimulus for growth.

A well-functioning government and smooth public administration are considered imperative for the successful execution of reforms. To a large extent, governments must rely on their respective public administration structures to prepare and swiftly execute legislation. Moreover, regulation should be efficient and minimally burdensome for businesses and citizens. In this context, the so-called High Level Group of Independent Stakeholders on Administrative Burdens, led by former Bavarian prime minister Edmund Stoiber, has contributed a range of examples to cut red tape in the EU.[52]

Some examples worthy of consideration include the Mark of Good Services initiative in the Netherlands, which allows the measurement and improvement of municipal services provided to businesses along a standardized framework, and the United Kingdom's "One-in, One-out" rule, which states that a new regulation imposing a net cost on business can only be brought in if another regulation is being cut by an equal or greater amount. These have the potential to effect a cultural change towards smarter regulation to remove bureaucratic hurdles.

# 3. Learnings from the Selected Competitiveness Practices

Section 3 identified some noteworthy competitiveness-enhancing practices implemented or designed in Europe. While each practice pertains to a very country-specific context and has been implemented in response to a particular set of competitiveness challenges, these examples can serve as a source of inspiration for European stakeholders in framing their own policies with the aim to raise their countries' and the EU's overall competitiveness.

Yet, the country-specific settings and circumstances also mean that reforms are by no means directly scalable or transferable to other geographies. As such, a key objective of this Report is to point out common bottlenecks that policy-makers have been facing in the course of the reform process in their respective constituencies, and to analyse the key enablers that have proven successful for overcoming these obstacles. Several of the practices presented in the previous section share common elements that have facilitated the reform process and may be worth consideration by key stakeholders in government, business and civil society when introducing new measures:

1. **Engaging in multistakeholder partnerships, with the broad involvement and commitment of various relevant agents in a country, has worked particularly well for building competitiveness practices in the long term**. In successful examples, government typically served as a reform initiator, supported by a strong involvement of the private sector and other important stakeholders such as trade unions and academia. For instance, the Dutch Leading Technology Institutes and the German dual VET system underscore the benefits of involving businesses and industry associations. In both cases, the private sector communicated its needs so that research agendas and vocational schedules could be designed accordingly. The German dual system takes private sector involvement a step further by actively engaging businesses to train future employees 2-3 days a week. In a similar fashion, the private sector was actively engaged in communicating its skills needs when defining the curricula during the Finnish education reforms. The case studies also highlight the benefit of involving civil society, such as labour and teachers' unions. Collaboration and open dialogue can be vital means for aligning vested interests and overcoming resistance by creating a common understanding of the need for, and the aims of, reforms. Often, additional benefits were earned by proactively including all stakeholders, for example by fostering collaboration among groups that otherwise would not collaborate. For example, the German EXIST programme helped to mobilize a wide range of higher research institutions beyond the usual top 10 entities. Likewise, the Dutch LTI programme incentivized collaboration between research institutions with very different research cultures, and also provided a platform to involve SMEs.
2. Multistakeholder partnerships facilitate **policy consistency**, which is another common feature of successful approaches. Competitiveness measures often aim to address complex competitiveness challenges, overcoming which requires a significant amount of time. In the case of the Finnish educational system, for example, overhauling the entire system (from introducing comprehensive schools to launching polytechnic colleges in the early 1990s) took more than a decade. Similarly, consistently sustained policies enabled the development of the Basque innovation system over several decades, thereby supporting economic transformation towards higher technology- and knowledge-based activities. This is particularly important as it can take five years or longer for the first impact of reforms to show, as in the case, for example, of the German labour market reforms and their impact on unemployment figures.
3. In several cases, **sustained political leadership** has been key to pushing the reform process past specific bottlenecks when multistakeholder approaches had exhausted their scope. For instance, unpopular measures such as labour market liberalization are apt to come up against substantial vested interests and, therefore, resistance. In such situations, seeing the reform agenda through requires strong political leadership. In this context, the Lisbon Council argues that to build a pro-reform constituency, "political leaders […] must move from 'why' to 'how', from explaining why reforms are necessary, showing how they can be implemented".[53]
4. Many reform efforts share a **sense of urgency**, which triggers their implementation. The German labour market reforms, for instance, were implemented during the years 2002-05, a time of weak economic performance and rising and persistent unemployment which, among other concerns, threatened to strain future public finances. The sense of urgency united stakeholders and helped to create a window of opportunity for the government to insist on much-required reforms. Likewise, the Swedish liberalization of the services sector was initiated during a time of declining GDP and historically high unemployment, which helped to make the citizens more receptive to reforms. Both crisis situations served as an opportunity to unblock barriers and overcome vested interests.
5. Closely related to the previous point, **strong and clear communication plans** which explain the rationale of reforms to the main stakeholders and ensure their buy-in are fundamental for galvanizing support. The education reforms in Finland and the liberalization of the Swedish goods and services markets are two examples where strong communication plans were put in place in order to obtain broad public support for and participation in reform programmes.

# 4. Outlook and Conclusions

**Europe is currently facing important economic and social challenges. These challenges should not be regarded as signs of "the inevitable decline" of Europe in a globalized world economy, but rather as drivers of a transformational process.** Since the beginning of the financial and economic crisis in 2008, Europe has been in the eye of a storm, facing an intense financial crisis, decline in economic performance and growing public discontent. This is particularly true for countries that have suffered, and are still suffering, sharp adjustments with growth stagnating or declining, unemployment rising to socially unsustainable levels, fiscal instability leading to sovereign debt crises and a deteriorating fiscal situation requiring international intervention through sovereign bail-outs. These trends are proving to be persistent challenges that to a large extent reflect the inability of several countries to adapt to a rapidly-evolving globalized economy. As a result, several analysts have fretted about the potential risk of a lost decade for Europe that would suggest the inevitable decline of Europe in a globalized world. However, the current difficulties could and should be regarded as a call for transformational action to better adapt Europe to a new competitive environment. Where fundamental structures have been stronger from the beginning or reforms have been implemented in a more consistent manner, improving economic conditions offer a more optimistic outlook.

**Rebuilding competitiveness is crucial for addressing these challenges and leading Europe's economies once again towards rising levels of prosperity.** Europe's current economic and social challenges are deeply rooted in a competitiveness gap that is epitomized by a sharp competitiveness divide in Europe. Consequently, Europe needs to rebuild its competitiveness to boost economic growth, create employment opportunities and restore confidence in the Eurozone. Among other steps, important efforts for boosting innovation and entrepreneurship, mobilizing talent and making markets work better for European consumers and enterprises are required.

**Adopting competitiveness-enhancing measures will require reforming parts of the European economy and ensuring productivity-enhancing investments.** A lot of effort, time, resilience and commitment are required to move beyond short-term "fire-fighting" related to the sovereign debt crisis, and to implement the right reforms and measures to raise Europe's productivity and competitiveness over the long term. Reforms often face resistance and are not always easy to implement. However, historically, times of crisis have given governments and other stakeholders the courage to push through necessary reforms, which have later proved very successful. The sense of urgency associated with the current crisis can provide a window of opportunity to overcome the traditional hindrances that several European economies have suffered.

**Countries in deeper need of boosting competitiveness have already started adopting the right set of measures, some of which have started to bear fruit.** A proper and sustained implementation of these measures, and more measures throughout Europe, will allow the EU to boost its competitiveness and to sustain the European social model. Current measures are the first step into the right direction, but more measures throughout Europe will be needed to improve Europe's competitiveness. In this process, political leaders may face vested interests that work against a proper implementation.

**In order to maximize success, countries can find inspiration and learn from past practices that have shown that coherent and well-explained reform schemes building on multistakeholder partnerships, policy consistency and continuity, along with sustained political leadership, provide good results.** For continued reform progress, it is important that political leaders develop a sustained and coherent reform strategy that provides an inspiring vision and a commitment to a socially balanced approach. They should also communicate and explain the need for reforms to the general public, and reforms should be considered a shared responsibility by all stakeholders. More specifically, there is a need to better inform the public of the long-term gains from reform efforts, even though these may exact significant short-term costs. Multistakeholder approaches create a sense of ownership among all agents in society, while policy consistency helps maintain momentum until the efforts begin to bear fruit. Finally, in periods of particular gridlock, political leadership is key to unblocking the situation.

**In rebuilding Europe's competitiveness, the reform process will require a revitalization of the values and the vision that have driven European integration, such as partnership and social inclusion.** Boosting competitiveness is compatible with the development of efficient social market economies. Much of the resistance that some reforms are facing is due to the fear among citizens of abandoning the European development model based on market efficiency while preserving social cohesion, which has cemented European societies since the end of World War II. However, several European countries have adopted significant competitiveness-oriented reforms in the past, while preserving the European values of efficiency and cohesion. The selected competitiveness practices presented in this Report can provide policy-makers with initial inspiration on which competitiveness reforms and measures could be pursued, and how.

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# Notes

1. For more information on the Executive Opinion Survey, please see Chapter 1.3 of The Global Competitiveness Report, 2012-2013, www.weforum.org/gcr.
2. See Schwab, K. 2012.
3. In France, the period between the 1950s and the 1980s is regarded as "30 glorious year" (les trente glorieuses) in reference to the rapid economic expansion that took place.
4. Sala-i-Martin, X., E.V. Artadi. "The Global Competitiveness Index". The Global Competitiveness Report 2004-2005. Hampshire: Palgrave Macmillan, 2004.
5. The 12 pillars are measured using both quantitative data from public sources (on indicators such as inflation, Internet penetration, life expectancy and school enrolment rates) as well as data from the World Economic Forum's Executive Opinion Survey, conducted annually among top executives in all of the countries assessed. The survey provides crucial data on a number of qualitative issues (e.g. corruption, confidence in the public sector, quality of schools) for which no hard data exist. In addition, the GCI explicitly takes into account the fact that countries around the world are at different stages of economic development. Specifically, it distinguishes between three stages of development. In its first stage, economies are factor-driven and countries compete based on their factor endowments, primarily unskilled labour and natural resources. Maintaining competitiveness at this stage depends primarily on well-functioning public and private institutions (pillar 1), well-developed infrastructure (pillar 2), a stable macroeconomic environment (pillar 3) and a healthy and literate workforce (pillar 4). As wages rise with advancing development, countries move into the efficiency-driven second stage of development, when they must begin to develop more efficient production processes and increase product quality. At this stage, competitiveness is driven by higher education and training (pillar 5), an efficient goods and services market (pillar 6), frictionless labour markets (pillar 7), well-developed financial markets (pillar 8), the ability to make use of the latest technological developments (pillar 9), and the size of the domestic and foreign markets available to the country's companies (pillar 10). Finally, as countries move into the innovation-driven stage, they are able to sustain higher wages and the associated standard of living only if their businesses are able to compete with new and unique products. At this stage, companies must compete by producing newer and diverse goods using the most sophisticated production processes (pillar 11) and innovation (pillar 12).
6. For the purposes of this exercise, the "market size" pillar is not shown as it is not strictly comparable in this context.
7. Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, Netherlands, Sweden, United Kingdom.
8. Greece, Italy, Portugal, Spain.
9. Improving fiscal discipline involves making sure that public accounts are sustainable in the long run in terms of public deficits and overall debt levels in order not to hinder and crowd out private activity. In some countries, this may translate into the need to introduce important reforms in their pension schemes and health services.
10. See European Commission. 2012a-c.
11. Overall, reforms in Southern Europe are in different stages of the reform process, which makes them dependent on continued political and administrative support.
12. Other pillars such as the education and training systems and the level of competition are also basic factors that support the innovation capacity and performance of a country.
13. See OECD. 2012a-e. for a review of the science and innovation outlook in Europe and Southern Europe (Greece, Italy, Portugal and Spain) in particular.
14. See OECD. 2004.
15. ibid.
16. Based on information received from agentschap.nl.
17. See the Finnish example.
18. See www.exist.de for details.
19. See Kulicke, M, F. Dornbusch, Kripp, K and M. Schleinkofer. 2012.
20. See Kulicke, M, F. Dornbusch, Kripp, K and M. Schleinkofer. 2012.
21. See European Commission. 2007.
22. See Wilthagen, T., F. Tros and H. van Lieshout. 2003.; Jørgensen, H. and P. Madsen. 2007.; Zhou, J. 2007. for literature on selected flexicurity aspects.
23. During the last financial and economic crisis, Denmark showed an employment reaction that can be considered stronger than in less flexible countries like the Netherlands or Germany.
24. Eurostat, Statistics accessed December 2012.
25. See OECD. 2008b; Wurzel, E. 2006.; Kemmerling, A. and O. Bruttel 2006.; Müller, T. 2009.
26. See Jacobi, L. and J. Kluve. 2007.
27. See OECD. 2008b.
28. ibid.
29. See EIU (2012).
30. See Houwing, H. 2010.
31. See OECD stat. 2012; scale ranges from 0 to 6.
32. OECD stat. 2012.
33. See OECD. 2008a.; BDA. 2012.; Hoeckel, K. and R. Schwartz. 2010.
34. OECD 2010.
35. See CBI. 2012. for details of the survey.
36. See World Bank (2006).
37. See Erkki, A., K. Pitkänen and P. Sahlberg. 2006.; OECD. 2010.
38. See OECD. 2010.
39. See Davies, J., T. Welko, L. Kim and E. Thulstrup. 2006.; Finland also bears evidence that a high-quality education system can be run at fiscally affordable costs, enabled by a decentralized and flexible education system, but requiring highly-trained teachers.
40. See Lindbeck, A., P. Olaf, J. von Hagen and P. Molander. 1993. OECD. 2007b.; Swedish Competition Authority. 1997.
41. OECD. 2007b.
42. See European Central Bank. 2009.; European Central Bank. 2010.; AT Kearney. 2008 and 2010.
43. See OECD. 2007a.
44. See European Central Bank. 2009.
45. See European Central Bank. 2010. for a review of the seventh progress report regarding SEPA.
46. See OECD. 2007a. p. 96f.
47. See Regulation (EC) No 2560/2001 on cross-border payments in euro.
48. See Capgemini. 2007., p. 3; recent comments from market participants, however, suggest that the figure may be rather on the upper end of potential outcomes.
49. See Capgemini. 2007., p. 4; European Central Bank. 2009.
50. See Loder, J. 2011. pp. 566-583; Copenhagen Economics. 2005. See also EU Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market.
51. See European Commission 2012d. for a review of the Directive's economic impact.
52. See HLG (2011): Europe can do better, p. 39ff (report of the so-called Stoiber Commission) for a range of examples on reducing administrative burdens in Europe.
53. See Mettler, A. 2008.

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