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A new competitiveness approach in the European Union: Dealing with misconceptions

This paper investigates the renewed interest in competitiveness which can be witnessed in the EU once the acute phase of 2008+ crisis abated. This revival is expressed in several initiatives, such as the idea to set up national competitiveness boards, the Euro Plus Pact or the ECB research network CompNet. By reviewing the recent literature and experts' opinions as well as drawing on the new theoretical approach and the insight from the German reunification, this papers identifies main promises and pitfalls of selected European proposals. In particular, it stresses the need of a more nuanced approach to competitiveness, which goes beyond the narrow perspective centred on the synchronisation of cost developments. The evolution of salaries and productivity must be aligned and certain level of convergence among the European Monetary Union members is necessary. Nevertheless, reducing competitiveness to such an issue seems inadequate, as it ignores the 'high-road' and 'beyond GDP' competitiveness which is the reality for the mature European economies.

Keywords: competitiveness, European Union, eurozone, Germany, 2008+ crisis

JEL classification: E02, O10, O40, O52

O niewłaściwym podejściu do konkurencyjności w Unii Europejskiej

Niniejszy artykuł analizuje zainteresowanie kwestiami konkurencyjności, jakie można zaobserwować w Unii Europejskiej po ustąpieniu pierwszej ostrej fazy kryzysu finansowego roku 2008. Świadczą o nim między innymi takie inicjatywy, jak Pakt Euro Plus, Raport Pięciu Prezydentów proponujący utworzenie narodowych rad konkurencyjności czy sieć badawcza Europejskiego Banku Centralnego CompNet. Na podstawie przeglądu wybranej literatury i opinii ekspertów, a także odnosząc się do najnowszych ujęć teoretycznych i doświadczeń Republiki Federalnej Niemiec, artykuł stara się zidentyfikować szanse i zagrożenia, jakie wiążą się z tymi propozycjami. Zwraca uwagę na potrzebę szerszego podejścia do konkurencyjności, wykraczającego poza lansowaną synchronizację kosztów. Bez wątpienia UE, zwłaszcza strefa euro, do sprawnego funkcjonowania wymaga pewnej konwergencji między jej członkami i dostosowania zmian płac do zmian wydajności, jednak redukowanie konkurencyjności do aspektu harmonizacji kosztów pracy wydaje się nieadekwatne i ignoruje specyfikę dojrzałych gospodarek UE.

Słowa kluczowe: konkurencyjność, Unia Europejska, strefa euro, Niemcy, kryzys 2008+

Klasyfikacja JEL: E02, O10, O40, O52

Introduction

In the last decades, 'competitiveness' has become a buzzword [Aiginger, Vogel, 2015]. The concept is as fashionable as it is misused or misunderstood and elusive. Worshipped by some as a remedy for all economic troubles, criticised harshly by others as a meaningless and inappropriate category [Krugmann, 1994], it is persistently used by politicians, economists and journalists, and constitutes an inevitable part of contemporary economic analysis or policy advice. The competitiveness of nations or regions (as opposite to firms), though, remains an amorphous and very broad term. For instance, the Global Competitiveness Report [WEF, 2014] produced by World Economic Forum defines competitiveness as a set of institutions, policies and factors determining the productivity of a country, which is captured in 12 pillars (e.g. infrastructure, health or technological readiness). Cursory review of the available literature devoted to competitiveness allows in general to distinguish two main streams of works. The first strand, associated with the research in international business (IB), focuses on competitiveness mainly in relation to the famous Porter [1990] approach. It highlights the role of clusters, spill-overs, friendly business conditions, social capital, etc. The second strand encompasses works representing a more macroeconomic perspective. They regard competitiveness in terms of the alignment of salaries and productivity, focus on the developments of current accounts and compare the cross-country evolution of costs [Sinn et al., 2015]. Low competitiveness or even lack thereof has been often revoked in the context of the global crisis and identified as the roots of the malaise of southern Europe countries.

This paper surveys recent EU initiatives in the area of competitiveness with the view to reflecting upon certain misconceptions pertinent to this approach. It seeks to identify and evaluate the main challenges related to such perception. It reviews the recent research reports and expert opinions on selected EU proposals with respect to competitiveness. First, it outlines the basics of three European initiatives. Next, it broadens the perspective and discusses the case of German post-unification economy and the 'quality', 'beyond GDP' competitiveness. Finally, it concludes with diagnosing the possible benefits and threats of the dominating approach to competiveness as observed recently in the EU.

1. Competitiveness on the EU agenda

Competitiveness, in particular the improvement thereof, belongs to the EU aims along with maintaining the social market economy model and increasing its resource efficiency as enshrined in Europe 2020 Strategy, which sets agenda for

smart, sustainable and inclusive growth [EC, 2014a]. Competitiveness lies at the heart of the annual European Competitiveness Reports [EC, 2014b]. Involvement of suppliers, optimal cooperation along the value added chain, monitoring of implementation of the European Research Area, Digital Agenda and Innovation Scoreboard or flagship project Industrial Policy, as well as the Competitiveness and SME (COSME) programme are all aiming at buttressing the EU competitiveness. Notwithstanding the high profile of many of these initiatives, they seem limited to the benchmarking practices, 'naming and shaming' or establishing some scoreboards and rankings. They unfortunately have not yet featured much in the public debate on the competitiveness.

However, a renewed interest in these issues can be observed recently, once the acute phase of financial turbulences in the EU receded and measures other than emergency rescue mechanisms have come to the forefront. More attention being paid to competitiveness derives also from the conviction that Europe's debt crisis is in fact a competitiveness crisis that divides the eurozone's core from its periphery [Dadush, 2012]. The Euro Plus Pact approved in March 2011 stipulates a range of quantitative targets meant to strengthen competitiveness and convergence among the EU members. It focuses in particular on labour costs which are regarded as responsible for cumulating imbalances. Whereas not denying certain contribution of costs to deteriorating current account balances, it needs to be stressed that this impact is anything but clear [Gabrisch, Staehr, 2012]. Another initiative is the ECB Research Network CompNet [2015] which takes a more comprehensive attitude to competitiveness and distinguishes a microeconomic (firm level) and macroeconomic (country level) perspective as well as the global value chain dimension. The idea of setting up national competitiveness councils or boards has featured in the famous Five Presidents' Report of 2015. These boards would be mainly tasked with handling the harmonisation among the member states in order to safeguard the minimum convergence. Next subsections outline the basic premises of the above-mentioned initiatives.

1.1. The Euro Plus Pact

The Euro Plus Pact originates in the 2011 Franco-German proposal of a 'Competitiveness Pact' [EPSC, 2015]. Being an intergovernmental initiative, it reflects the growing awareness of the need for a more rigorous approach towards economic and financial imbalances. It has been conceived as a way to mobilise relevant stakeholders to accelerate structural reforms and to achieve a new quality of economic policy coordination, thus improving competitiveness and avoiding harmful divergences. Despite its broad scope and its membership open to non-euro area countries, the Pact has often been criticised as being excessively focused on the differences in cost competitiveness in the euro area. Its signatories are com-

mitted to implementing reforms via the open method of coordination (OMC) which relies on the peer pressure. To that end, the European Commission pledges collecting and publishing various indicators that capture the progress of individual countries.

There are four main pillars of this Pact – competitiveness, employment, sustainability of public finance, and financial stability. As stipulated, improving competitiveness would require either reducing labour cost or increasing productivity. The Euro Plus Pact recommends carrying out competitiveness check-ups, which would serve to monitor the cost competitiveness of national economies. This system shall take into account the developments of unit labour costs (ULC) in the trading partners of a given member state. It has been argued that large and persistent erosion of such cost competitiveness, especially if combined with a widening current account deficit and declining market shares for exports, requires special attention. Adequate policy steps in such a situation should include measures to ensure that costs developments are in line with productivity and provide instruments aiming at increasing productivity.

Summing up, the Euro Plus Pact vision of competitiveness is centred around costs, in particular developments of ULC which have to be aligned with the productivity evolution. Whereas there is obviously nothing wrong with such an orientation, this approach seems too narrow and does not capture the broader range of competitiveness factors. With the hindsight of further developments, it is regrettable that the second aspect of the Pact's competitiveness pillars, i.e., improving the productivity, has been side-lined by the focus on the wage developments.

1.2. The Five Presidents' Report: Economic union and national competitiveness boards

The slow progress in implementing the provisions of the Euro Plus Pact, among other factors, has inspired the joint initiative of the five presidents of leading EU authorities. The Five Presidents' Report envisages the creation of a genuine economic union (along with the financial, fiscal and political unions) which would rest on convergence and competitiveness [EC, 2015b]. In order to safeguard the latter, it is recommended to set up national competitiveness boards. They are supposed to provide a better ownership of necessary reforms and offer the whole convergence processes more public endorsement [EC, 2015a]. The system of national boards would improve the quality and independence of policy expertise at the level of member states. It would strengthen the policy dialogue between members as it should take into account the broader perspective of the euro area and the whole EU. This idea envisages the need to go beyond the classic competitiveness measures like wage dynamics and include such drivers of productivity as innovations or investment attractiveness. While the eurozone coun-

tries are recommended to set up such boards, non-euro members are encouraged to do so. The boards are supposed to monitor and advice on competitiveness developments. They would deliver important information on collective bargaining. Nevertheless, they should neither interfere in the wage setting process, distort the role of social partners, nor harmonise the national systems which reflect the idiosyncrasies of each member state's industrial relations. It is highly recommended to assure a certain level of board's autonomy. This would guarantee an independent expert judgement. The European Commission sees its role as facilitating the coordination between the national boards, exchanging views with them and safeguarding the broader European perspective.

The idea of competitiveness boards is anything but novel. Many EU members already have such bodies. They focus on the issue of competitiveness, though their scope, structure, and functioning vary significantly. Given the complex national landscape of the already existing competitiveness bodies, it remains important to ensure that the setting up of competitiveness boards (or redesigning the existing ones) would reflect and fulfil the requirements envisaged for them. Summing up, it seems that this approach reduces in fact the competitiveness to the constrained aspect of costs development and sees it as the prerequisite for the convergence among the member states.

1.3. The Competitiveness Research Network of the European Central Bank

The Competitiveness Research Network (CompNet) created under the auspices of the ECB in 2012 aims specifically at identifying what drives the dynamics of competitiveness and productivity in the European countries and firms, and how such indicators relate to the policy outcomes. Such an initiative, focused mainly on research, is seen as crucial for the surveillance and analysis of the EU countries. It is paramount for precisely identifying factors that may hamper efficient monetary transmission in the euro area. Contrary to the strong cost focus of the Euro Plus Pact, the CompNet argues that classic indicators (price/cost-based) have increasingly exhibited lower explanatory power for trade developments and related imbalances. The ECB's understanding of competitiveness combines three dimensions: the aggregate macroeconomic perspective, firm-level analysis and the Global Value Chains (GVCs) approach. It is argued that only by pooling all three perspectives a comprehensive view of a country's competitiveness is possible.

The main value added of the ECB CompNet initiative lies not only in its advanced methodology, strong research focus, and network benefits as the Central Banks of the EU member states contribute to provide the evidence-based knowledge; it rests in its distinctive approach, which significantly improves the existing analytical framework of competitiveness [Karadeloglou, Benkovskis, 2015]. In the

current international context, measuring competitiveness solely by the ULC developments risks conveying misleading signals. Structural policies should aim at promoting the reallocation of resources towards the most productive firms, as the granularity concept and the story of 'happy few' demonstrate [Mauro, Ronchi, 2015].

Summing up, in comparison with the two other initiatives, the ECB's approach to competitiveness seems to be the most comprehensive and methodologically advanced one. Its strengths rest on the broader perception of factors and layers of competitiveness. Even the costs analysis indispensable for competitiveness assessment expands the cage of ULC as it stresses the role of other production costs subject to reforms. It also recognises the existence of GVC and highlights the importance of the position occupied by the country along such a chain. A competitiveness diagnostic tool encompasses a set of numerous novel indicators which are not simple and easily available data but derive from models, assumptions and approximations. With the ambition of bridging research and policy-making, CompNet stresses that it is not possible to establish a general ranking of the explanatory power of the different competitiveness indicators. This certainly makes the country-specific analysis warranted. Next section thus looks into the case of Germany and discusses the Reunification experiences with competitiveness.

2. Recent controversies around competitiveness in theory and practice

2.1. Lessons from the German reunification

The German reunification seems to offer a unique laboratory for the research of competitiveness. The analysis of the recent development path of the reunited Germany enables to diagnose the underlying reasons for different performance and economic output of its two parts – East and West. Taking stock of a quarter-of-a-century long functioning of the previously divided country can shed light on the issues pertaining to some persistent divergences. In fact, it allows identifying the key factors of competitiveness – the building blocks of contemporary competitive market economy. On the occasion of the 25th anniversary of this landmark event, various reports have been published to assess its consequences. As far as economic studies are concerned, two dominating perspectives can be discerned. Not denying the huge historic importance of the reunification and its overall rather positive outcome, they draw attention to certain problems, unfinished tasks and challenges ahead. The first, critical perspective concentrates on the mistakes of the reunification, accentuating the flaws of the process. The second one claims that it has been a success but not an immaculate one. Certain relativism

(a departure from the absolute evaluation) can also be detected in both approaches. This takes the form of the reference to either the current (post-)crisis governance problems in the EU or to the challenges faced by Germany as a whole. Common for these two narratives is the acknowledgement of the need for further actions regardless of the achievements so far.

The mistakes of the German reunification can be seen as wake-up call for the European decision-makers [Sinn et al., 2015]. Such an approach concentrates on competitiveness in a narrow, wage-centred sense. The German experiences shall be considered as important cautionary voice against the plans of the European fiscal union. The generous solidarity payments following the collapse of the Berlin Wall can be compared to the proposed fiscal transfers in the EU. Both should be seen against the background of the Dutch disease[1]. Although the new German *Länder* had not discovered any new minerals deposits, they had likewise become richer thanks to the transfers from West Germany. The implications of such assistance were higher wages – higher than it would otherwise derive from the labour productivity. This distorted the ratio labour efficiency/productivity versus salaries and led to a drop in competitiveness. Specific substitute of such fiscal assistance were, in the case of crisis stricken southern Europe, the extreme low interest rates which had enabled easy access to credits and had led to a massive capital influx. Regardless of whether some happy discoveries imply an export increase, or of explicit money transfers within the solidarity pact, or of the 'ultra-low interest rate' environment enabling huge capital flows, the consequences for economy are always dire. They imply a decline of competitiveness due to the rising wages.

The researchers from the Halle Institute for Economic Research take much broader perspective on competitiveness with respect to the reunification [Gropp, Heimpold, 2015]. Not only the East Germany but the whole Germany and even the whole EU lag behind the United States in terms of competitiveness. But the roots of this situation should be sought not, or at least not only in price developments. Lower innovativeness, stricter and more regulated markets disabling the easy entry and exit of firms, weaker clusters, higher risk aversion, lower social capital or technology readiness – it all needs to be taken into account. Conditions which foster the entrepreneurship dynamic are crucial for competitiveness and hence for the growth. What is important are smoothly functioning financial markets enabling swift and optimal allocation of resources, as well as the availability of venture and seed capital or other types of assistance – expertise, know-how, business consulting, etc. Advancing the growth of East Germany would also require

[1] Dutch disease – a well-known economic problem related to the 1960s Netherlands, when new huge gas deposits had been discovered. This enabled the rise of export, made the country richer and helped to accumulate foreign reserves; nevertheless, it also inevitably led to the wage pressure, first in trading and then in other sectors of the economy. This, in turn, culminated in a significant deterioration in terms of trade and worsened the competitiveness in the country.

modifying the current structure of firm population, i.e., hosting more headquarters of multinational enterprises and more upstream activities such as R&D centres. Since such processes cannot be expected to happen overnight, one has to patiently support and facilitate certain developments. In this respect, clusters as well as the evolution of university spin-offs cannot be underestimated.

Studies devoted to the consequences of the German reunification, while taking stock of its economic effects, in fact touch upon the subject of competitiveness. They take a form of two distinctive narratives but seek to construct the analyses in relation to the broader problems as they frame the evaluation in a wider context. The first one focuses on wages or, more generally, on the costs dimension of competitiveness, and sees it as a wider EU problem, particularly dangerous in the context of the plans of a deeper fiscal integration; the other stresses the broader aspects of competitiveness such as the economic structure, market dynamics or business environment. It considers competitiveness as the problem of the whole Germany. Such perspective relates to the recent research insights and updated theoretical approaches to competitiveness such as the 'high-road strategy', discussed in the next section.

2.2. 'High road' versus 'low road': A new approach towards competitiveness

The recent academic studies in the EU in the area of competitiveness seem to promote the broader understanding of this category. The comprehensive approach not only expands the range of critical ingredients of competitiveness, i.e., the variety of input factors, but it also extends the output. Namely, it enriches the narrow economic metric of GDP with other aspects of socio-economic and environmental performance of a country [Aiginger, Vogel, 2015]. Global developments and the emerging new economic order imply the need to move from the quantity (price) competitiveness (e.g. ULC, productivity) to the quality competitiveness encompassing structures (e.g. share of high-skill-intensive and knowledge-based services) and capabilities (social investment and ecological ambition). The peculiar situation of industrialised, high-income countries such as the EU member states results from the reconfiguration of their competitiveness advantages. Persistent and stubborn attachment to traditional costs aspect of competitiveness seems grossly outdated. Not only are these countries no longer in a position to compete with new emerging economies in terms of low wages, costs and prices – they are also supposed to become leaders in setting out new, more ambitious development goals which take into account effects broader than the current account balance or GDP growth (such as social – e.g. at-risk-of-poverty rates or Gini index – and ecological – e.g. energy intensity).

Hence, competitiveness can be defined as the 'ability of a country to deliver the beyond GDP goals for its citizens today and tomorrow' [Aiginger, Vogel, 2015]. Changing the definition also changes the policy perspectives. Whereas the 'low-road' path seeks competitiveness in low costs, 'high-road' strategy focuses on the quality products. Whereas the 'low-road' strategy refers to subsidies, dual labour market, uses import taxes and other protectionism measures, the 'high-road' path sees universities, clusters, trust and business environments as central for achieving more than just the GDP goals. For rich countries, such as the advanced economies of the European Union, there is no other way than to adopt a strategy which stresses the importance of productivity, quality of sophisticated products, high position in global value chains and the facilitating role of institutions as the competitive advantages, and which measures the outcome in terms of high incomes as well as the achievement of ecological excellence and social goals.

3. Getting the competitiveness right

After the acute phase of the crisis was over, competitiveness has started to be seen as part of the European governance. Discussed initiatives have send ripples among specialists. Forwarded proposals have been – if not actually originating in the circles of independent experts – evaluated and assessed by researchers as well as by practitioners in various think-tanks. Competitiveness-monitoring framework seems to be a cornerstone in this respect [Wolff, 2015; Sapir, Wolff, 2015]. Experts began to mull over how national competitiveness authorities should be organised and coordinated, given the diverse labour market and social dialogue processes in the member states[2]. For the moment being, only a very weak mechanism (Macroeconomic Imbalance Procedure) exists to ensure that wage developments are in line with productivity. Eurozone's inherent flaws can be thus traced back to the dissonance between the alignment of nominal wage growth and labour productivity growth at national level on the one hand, and the wider intercountry relations and eurozone-wide developments on the other. Experts clearly tend to operationalise competitiveness by ULC-based real effective exchange rates [Wolff, 2015]. Hence, it is being reduced simply to the national wage formation and collective bargaining among the social partners. As they vary among the EU member states, profound divergences in competitiveness may result. In specialists' opinion, as the truly European labour market assuring free migration won't

[2] An event organised by Bruegel and the Competitiveness Observatory of Luxembourg's Ministry of the Economy in Luxembourg on November 26, 2015, dedicated to the proposal of the five Presidents; an off-the-record workshop 'Economic governance of the EU: Quo Vadis?' organised by Bruegel in Brussel on November 3, 2015, session 'A euro-area system of competitiveness authorities: How can it be designed?'.

materialize any time soon, the element already covered by MIP, namely the wage developments, should be supplemented by a competitiveness-monitoring framework.

And yet some experts argue that the system of such boards would make the EU governance and the functioning of the European Semester even more tricky [Gros, Alcidi, 2015]. It is unlikely that the boards would generate significant impact in large countries and those with poor governance. The situation would improve if there existed dedicated procedures safeguarding that national wage norms are consistent at the eurozone level. This seems, however, a very difficult objective to achieve. Experts fear that besides the duplication of tasks, the opinions produced by national boards might deviate from the Commission's recommendations [Gros, Alcidi, 2015]. One also has to bear in mind the likely conflict of interests among the councils as epitomised by the 'N-1' problem, when the gain in competitiveness by any one country represents a loss for another (zero-sum game). The Commission has ascertained that proposed councils should be seen as the necessary building block of the genuine economic and monetary union (EMU) and the key aspect of the European governance. While launching some long-awaited reorientation from the so-far dominating approach (fiscal and monetary focus), this initiative raises several doubts. The European Trade Unions Confederation (ETUC) questions the focus of the planned boards and insists to abandon the narrative of (cost) competitiveness [ETUC, 2015]. It also stresses the risk of further side-lining the social aspects of the eurozone.

On top of these considerations, it can be added that there exists a certain value added of all these initiatives. Namely, competitiveness can get more clout than is ascertained by the advice and recommendations of think-tanks for the time being. The recent attention paid to the competitiveness may signal some policy reorientation and boards could provide a fresh impetus to the implementation of structural reforms [Economic Bulletin, 2015]. That notwithstanding, there is also a risk that councils would stay concentrated on the costs dimension of competitiveness and that they would be seen as a cover-up for the future, more or less enforced harmonisation in this area. It remains to be seen how the benefits of competitiveness boards such as the reduced divergence and more national ownership of reforms would play out against the potential risks of the increased complexity and duplication.

Conclusions

As shown by the recent crisis, in the situation of missing flexible exchange rates and other adjustment mechanisms the uncontrolled build-up of imbalances within the EU requires that special attention be paid to competitiveness. The aim

of this paper has been to identify the pitfalls and promises of the renewed EU interests in competitiveness by surveying these proposals and expert opinions as well as by drawing on the German reunification experiences and a new comprehensive theoretical approach. The European attempts to go beyond the fiscal policy, macroprudential supervision and monetary instruments shall be undoubtedly welcome. However, the current emerging trend to centre on the quantitative aspects, on the easily measurable and comparable dimension of competitiveness such as the wage developments, must be treated with caution. Although relatively easy to coordinate and pursue as a synchronisation tool among the eurozone's 19 countries (or, as foreseen, all 28 EU member states), it does, however, obscure the deeper meaning of competitiveness. It ignores the 'high-road' and 'beyond GDP' competitiveness, which is the reality for such advanced countries. Obviously, the EU has generated mechanisms and monitored the developments in areas such as innovativeness (e.g. innovativeness scoreboards) which proxy the more nuanced definition of competitiveness; they are not, however, harnessed to the mainstream governance framework.

Initiatives such as the Euro Plus Pact and the ECB's CompNet or plans to set up national competitiveness councils signify the (post-)crisis revival of interest in different aspects of competitiveness. In its current form, characterised by strict focus on wages and harmonisation, it seems, however, to abuse the term 'competitiveness'. It goes without saying that the evolution of wages and productivity must be aligned. Certain level of convergence among the EMU members is also necessary. Reducing competitiveness to such an issue, though, seems inadequate. In other words, the promoted narrow attitude aiming at wage synchronisation does not deserve to be called and regarded as competitiveness coordination. Hopefully, it will not be considered in the same way the nominal Maastricht criteria were once regarded – as some artificial thresholds which do not necessarily reflect the real economic conditions and cannot be the exact proof of the soundness of country's macroeconomic policies. Competitiveness should be understood as more than only certain resilience and adjustment capacity. Hence, there is a clear need for getting the competitiveness concept in the EU right. The reflections presented in this article might be regarded as setting the stage for future more specific analyses. The diagnosed mismatch between the policy agenda and the research insight might give rise to some concern, which makes the further study even more warranted.

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