



Talking point



EMU countries in systems competition: Winners and losers

February 18, 2010

Anyone analysing the competitiveness of the euro area should not focus solely on prices and costs, but also on the value-added structure of the respective economies, their innovative capacity and degree of economic freedom. This non-price competitiveness is partly a result of historical developments and partly a result of good economic policy. Proper infrastructure, reliable institutions and efficient markets can create a sensible environment that is conducive to business success. The eurozone economies also differ from one another in this regard – and in some cases appreciably.

First of all, differences are to be found in **value-added structures**. In Germany, Austria, Slovakia, Finland and even Ireland, manufacturing, mining and energy generate a very large share of value-added (over 30%). Industry in these countries is competitive because international competition compels companies to offer high-quality production, structural flexibility and reliable delivery.

For countries featuring a strongly developed services sector, **knowledge-intensive services** are the key to greater competitiveness: such services increase the innovation potential of an economy, boosting its productivity in the long run. In the eurozone, the shares of knowledge-intensive services vary: while Belgium, the Netherlands and France show employment in knowledge-intensive services at over 38%, Eurostat says Portugal and Greece have readings of less than 25%.

A further key to success is the **innovative capacity** of an economy and its business sector. A good indicator in this context is the level of public and private expenditure on research and development (R&D). Here, too, there are major differences between the EMU members. Luxembourg, Germany and Austria are in the vanguard. These countries invest more than EUR 700 per capita in research and development every year. Portugal, Greece and Slovakia bring up the rear with R&D spending of less than EUR 120 per head.

In order for value-added structures and innovative capacity to be able to develop their growth potential it is vital that a regulatory framework guarantees **economic flexibility**. With its uniform business legislation the single European market has already achieved this high degree of economic freedom. The national values of the Fraser Index of Economic Freedom (which measures the overall degree of freedom of individual countries on a scale of 0 to 10) vary for the EMU countries by 10% at most from their average value of 7.4.

As regards the **flexibility of their labour markets**, the EMU countries rank around the international average. On a scale of 0 to 6, the OECD's Indicator of Employment Protection rates the flexible labour markets of Ireland, the Netherlands, Slovakia and Finland with scores of below 2.3. At the same time, the markets of Spain, Greece, France and Portugal still exhibit colossal catch-up potential with readings of over 2.9.



Besides the foregoing there are also **other qualitative factors**, such as institutional quality, infrastructure, macroeconomic stability and the efficiency of goods and financial markets. The Competitiveness Index of the World Economic Forum reflects these factors as a composite indicator. The chart shows Finland, Germany and the Netherlands at the head of the class. Portugal, Slovakia, Italy and Greece trail the field.

This plethora of parameters highlights that non-price competitiveness provides greater latitude for businesses and economic policy than price competitiveness. Nonetheless, the related implications for the EU are no less relevant.

Where can the **politicians** come in? Inconsistent targets and a lack of national commitment to reforms made the Lisbon Agenda, at best, only a partial success at the EU level. True, the Open Method of Coordination achieved a certain amount of success in raising labour participation rates. In other policy fields, however, this soft form of coordination failed to really get off the ground.

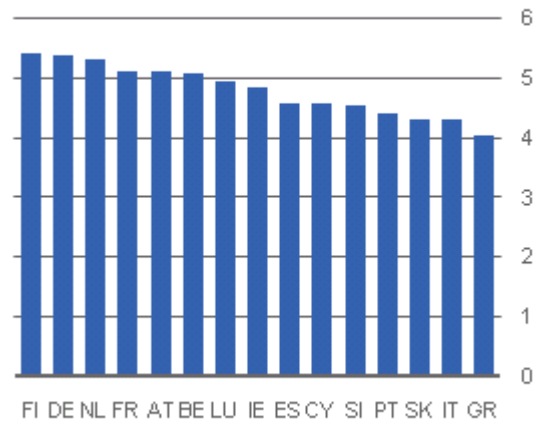
With the post-Lisbon strategy, *Europe 2020*, horizontal voting between member countries is meant to be supplemented by vertical elements.

- Already today, the **Treaty of Lisbon** enables the Commission to issue economic policy recommendations directly to individual member states (without having to go via the Council) and facilitates closer policy coordination among the EMU countries.
- Moreover, the recent proceedings of the Commission and the Council against Greece show that the Broad Economic Policy Guidelines and annual stability programmes, hitherto criticised for being non-binding, can be effectively linked with the **sanctions horizon** of the excessive deficit procedure.
- Furthermore, the smoke and mirrors tactics of several member countries have **sensitised** their peers in the **Council of Ministers**. Deviating from a common growth strategy is likely in future to be sanctioned politically, with individual countries being rapidly isolated. Intergovernmental pressure will be stepped up.

These options will be supplemented by the reactions of the capital markets. They will increasingly shift their attention away from government deficits per se towards their causes, and going forward they will even intensify their punishment of countries lacking a willingness to implement reforms. Structural reforms which raise competitiveness will become key signals for the capital markets. For many countries, the party is over.

Competitiveness survey

WEF Competitiveness Index: EMU countries



Source: World Economic Forum



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