Regional competitiveness in the EU

SUMMARY

Competitiveness has been an important issue on the EU’s agenda for several decades. Understood in a more comprehensive way – as including both productivity and prosperity – it can be seen as a way to create favourable business conditions for companies and to increase the standards of living of the population. Supporting competitiveness, especially in the case of nations and regions, requires creating framework conditions to develop the necessary infrastructure, human capital, technology and efficient markets that can help attract talent and investment.

In the 2016 edition of its Regional Competitiveness Index, the European Commission presents a ranking of regions according to their attractiveness for both firms and residents. This broader vision of competitiveness can have implications for policy decisions and the choice of investment priorities. Data on the diverse dimensions of the Index, such as innovation, education and institutions, can help authorities to identify respective regional strengths and aspects to be improved.

Increasing regional competitiveness is also a task relevant to EU cohesion policy. While the main role of EU regional funding is to ensure cohesion and reduce disparities between regions, competitiveness is important for supporting dynamic regional development. Therefore, the right balance in the policy mix between supporting competitiveness and convergence is required.

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Background

According to the Treaty on European Union (Article 3), working towards a competitive economy is one of the EU’s goals. Similarly, improving Europe’s competitiveness is among the aims of the Europe 2020 strategy for smart, sustainable and inclusive growth – the successor of the Lisbon Strategy aimed at making the EU 'the most competitive and dynamic knowledge-based economy in the world'. Competitiveness is also an important theme on the agenda of the current European Commission. The EU supports competitiveness through policies aimed at creating a business-friendly environment, improving innovation, modernising the industrial base, varying sectoral support and encouragement for structural reform through the framework of economic policy coordination (European Semester). Funding for such support is available under different EU programmes, such as the programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME), and the European Structural and Investment Funds (ESI Funds).

Competitiveness can be understood in different ways and applied to different units of analysis, such as countries, regions or enterprises. The Global Competitiveness Report published by the World Economic Forum defines competitiveness as 'the set of institutions, policies, and factors that determine the level of productivity of an economy, which in turn sets the level of prosperity that the country can earn'. Consequently, the well-known Global Competitiveness Index (see Figure 1) includes dimensions relating to institutions, macroeconomic environment, infrastructure, markets, human capital (health and education), business sophistication, technology and innovation.

Following the reasoning that 'it is firms, rather than countries that compete on global markets', the head of the European Central Bank defined a competitive economy as one in which 'institutional and macroeconomic conditions allow productive firms to thrive and in turn, the development of these firms supports the expansion of employment, investment and trade'.

However, competitiveness of companies, countries and regions must be conceptualised differently. While the main goal of standard enterprise competitiveness is survival on the market, growth and profit maximisation, the ultimate goal for a country or region is to improve the standards of living for its population. This wider view of competitiveness is reflected in the European Commission definition of regional competitiveness as 'the ability of a region to offer an attractive and sustainable environment for firms and residents to live and work'. Whereas the role of firms and company productivity in maintaining competitiveness is crucial, this definition also takes into account the perspective of residents, as well as the long-term development potential. Thus, it goes beyond the typical focus on market processes and the ability to maintain a competitive position vis-à-vis others. This broader notion of competitiveness, with the ultimate goal of raising prosperity and living standards, is becoming increasingly popular.
Drivers of regional competitiveness

The concept of competitiveness is inextricably linked with competition. What do regions compete for? Regions might compete with each other over various factors: inhabitants, workers, entrepreneurs, private investment, market share, tourists and public funds. While specific lists of competitiveness drivers may vary, several categories are commonly mentioned. Regional competitiveness requires an efficient structure of the economy and the labour market, a business environment conducive to entrepreneurship and innovativeness, conditions supporting human capital development (tertiary education institutes, science and research institutions, healthcare facilities), good physical infrastructure and a favourable institutional framework (easy access to public services, efficient administration, rapid administrative procedures). Some natural characteristics, such as geographical landscape or internal diversity, may also play a role in shaping the economic profile of a region and its attractiveness.

Regional competitiveness can be seen as driven by the productivity of firms located in a given region. The policy implication of this traditional approach would be to focus on highly productive firms or sectors, through creating favourable conditions in which they operate, so that the economy efficiently allocates labour and capital towards them. It would also require swift responses to the changing patterns of global trade and the international fragmentation of production. Regional competitiveness is not static, as the national and global environment is constantly evolving. Various sources and factors of competitive advantage may change over time, and restructuring may be required in case of changes such as the declining role of heavy industry and coal mining as well as the growth of services. This may require adjustments in the economic profile of a region. Thus, putting firms at the centre of competitiveness policy involves shaping economic policies and regulatory framework conditions, sensitive to the outside context.

This traditional approach, however, does not fully capture the angle of competitiveness that relates to prosperity, i.e. translating it into higher living standards. A cost-oriented perspective may lead to lowering social and environmental standards, causing a reduction in wages and quality of life. Seeing competitiveness from the more comprehensive 'outcome' perspective allows the adoption of a more socially inclusive and environmentally sustainable path. Therefore, a more comprehensive notion of competitiveness would mean improving a region’s ability to provide not only favourable conditions for business to operate in but also to deliver a higher quality of life. This requires taking into account a wide variety of possible drivers. Findings of the 2017 Commission report on ‘Competitiveness in low-income and low-growth regions’ (the 'Lagging regions report') show that it is mainly the structural factors that prevent some regions from reaching the expected development levels. Far from being limited to business competitiveness alone, these structural factors also embrace a wide range of other aspects, such as educational attainment, institutional quality, regional innovation systems, in/out-migration of qualified workers, as well as the level of public and private investment.

Local and regional authorities have a key role to play in selecting public investments to best target the priority areas and respond to the changing environment. Public intervention (including through EU funds) can affect regional competitiveness by investing in human capital development, infrastructure modernisation and improving the business conditions. As one-size-fits-all policies can hardly be replicated across regions, it is important to exploit specific regional strengths and adopt solutions suitable to the different levels of development.
EU Regional Competitiveness Index

The EU Regional Competitiveness Index (RCI) is inspired by the Global Competitiveness Index of the World Economic Forum. It has been published every three years since 2010, coinciding with the European Commission reports on economic, social and territorial cohesion. It covers 263 regions at NUTS2 level. The index is based on 74 indicators grouped in 11 pillars corresponding to various aspects of regional competitiveness, such as innovation, infrastructure, human capital and governance (see Figure 2). These aspects have been selected in line with the definition of competitiveness quoted above, used by the European Commission for the purposes of the RCI (‘the ability of a region to offer an attractive and sustainable environment for firms and residents to live and work’). According to the authors, this allows the extension of the traditional analysis of competitiveness to integrate the perspectives of both businesses and inhabitants, taking into account both business success and personal well-being.

The RCI interactive tools allow not only for monitoring and assessing a region’s development over time, but also comparing it with others (other EU regions, the best performer, the national average and the EU average). Performance can also be compared with ‘peer regions’ in terms of GDP per capita, as the RCI rankings can vary among regions with a similar level of economic development. The index may be used to facilitate benchmarking, identify regional strengths and weaknesses, and support policy-making by informing regional development strategies to target the areas which need improvement with suitable investment priorities. Its regional granularity also helps illustrate within-country variations.

Findings

The findings from the most recent (2016) edition of the RCI show a polycentric pattern, with capital regions and regions with large metropolitan areas scoring the highest on the index (see Map 1). In most of north-western Europe, such regions tend to generate spillovers (i.e. boost the competitiveness of the neighbouring regions), while this is less the case in eastern and southern states.

The best performers in the 2016 edition were several UK regions (London and its commuting zone; Berkshire, Buckinghamshire and Oxfordshire; Surrey, East and West Sussex; Hampshire and the Isle of Wight), Utrecht (the Netherlands), Stockholm (Sweden), Hovedstaden (Denmark), Luxembourg, Ile de France (France) and Oberbayern (Germany). The bottom performers were several Romanian regions (Sud-Muntenia, Sud-Vest Oltenia, Sud-Est), Greek regions (Ionia Nisia; Dytiki Ellada; Peloponnisos; Sterea Ellada; Anatoliki Makedonia, Thraki), the Bulgarian region of Severozapaden and...
French Guyane. Compared with the previous two editions (2010 and 2013), Malta and several regions in France, Germany, Sweden and the UK have improved, while scores went down in Cyprus and some regions in Greece, Ireland and the Netherlands. In eastern EU regions, competitiveness has largely remained stable. High within-country variations were often observed due to a significantly outperforming capital region. This gap was particularly wide in Romania, Greece, Slovakia, Bulgaria and France, and relatively small in the United Kingdom, Austria and Belgium. However, the capital region was not the most competitive region in Germany, Italy or the Netherlands.

Analysis shows that the competitiveness factors are not evenly distributed spatially. The best performers tend to include capitals and areas with good universities, robust transport connections and market access. Also, higher RCI values are generally associated with higher per capita GDP values. However, this relationship is stronger in the case of less-developed regions (a slight increase in GDP per capita brings a large increase in competitiveness). In richer regions the variations in the same peer group tend to be much wider, i.e. the RCI scores vary despite similar income levels. Some regions outperform their economic level (e.g. London, Berkshire, Buckinghamshire and Oxfordshire, Utrecht, Surrey and Sussex, Hampshire, Stockholm, Hovedstaden), while others have a relatively low RCI score for their stage of development (e.g. Hamburg, Groningen and Bratislava). The RCI weighting system also takes into account the stages of development, by classifying the competitiveness dimensions into three groups: Basic, Efficiency and Innovation. It is assumed that regions with high scores on Innovation are expected to perform well in the previous groups, and vice versa – regions with low scores in the Basic group are unlikely to perform well in the remaining two aspects. Similarly to the results of GDP level comparison, the within-country variations in RCI levels are less prominent in the 'Basic' group. The ‘Innovation’ group shows the highest variability within countries, possibly reflecting the differences in the innovative capacity of regional economies. Lastly, when analysing competitiveness rankings it is important to keep in mind that the choice of variables in indexes such as the RCI is inevitably arbitrary and scores may vary depending on the methodology used. Despite its broad definition, the European Commission concept of regional competitiveness as measured by RCI strongly gravitates towards the business and market dimensions. Therefore, it may not fully reflect certain quality of life aspects that inhabitants of a region may find attractive.
Role of cohesion policy

EU cohesion policy is endowed with €351.8 billion (corresponding to about one third of the EU budget over the 2014-2020 period) with the goal of improving social, economic and territorial cohesion, and reducing disparities between EU regions. This investment covers all regions, although more than half goes to the less developed regions. In the 2014-2020 programming period, the policy is based on 11 thematic objectives. According to a 2015 European Parliament study, 'Review of the adopted Partnership Agreements'; the distribution of overall funding to the objectives related to boosting regional competitiveness is as follows: transport and infrastructure (14.8 %), competitiveness of small and medium-sized enterprises (13.9 %), research and innovation (9.8 %), supporting employment (8.8 %), education (7 %), information technologies (3.3 %) and efficient public administration (1 %). These objectives take into account both the influence of local enterprises on the overall competitiveness of a region and the importance of various investments in the underlying structural conditions. As cohesion policy accounts for a large share of public investment in some countries, it can make a significant contribution to increasing competitiveness when used to support these crucial areas.

While EU regions are currently classified according to their level of development as 'less developed', 'more developed' and 'transition regions', the previous programming period 2007-2013 referred to regions falling into the categories of 'convergence', 'competitiveness and employment' and 'phasing in/out' regions. The regions belonging to the 'competitiveness and employment' category (16 % of the then funding) currently correspond to the 'more developed' or 'transition' ones. It is worth noting that the RCI index calculations are mainly based on data from the 2012-2014 period, thus covering the years when both types of terminology were used. The allocation configuration between actions supporting cohesion and competitiveness also raises the question of the distribution of funds among regions. An overview of regional growth theories suggests that resources allocated to already dynamic and competitive regions may be used more efficiently and produce spillovers. However, as the RCI findings show this is only sometimes the case in practice. According to a February 2008 European Parliament resolution exploring the issue of combining competitiveness and cohesion goals of EU regional funding, 'basic' investments in regions at a lower level of development are a precondition for long-term competitiveness. In the context of the cohesion policy goal of reducing disparities between regions, combining competitiveness and cohesion through channelling larger amounts of funding to the regions lagging behind seems to be a justified approach. The right policy mix can be achieved when both goals are treated as complementary. This has been visible in the evolution of cohesion policy, from its traditional focus solely on disadvantaged regions, to promoting growth and competitiveness across the whole EU. As a region moves up on the scale of competitiveness, the funding can be channelled from basic infrastructure to human capital, productive investments and innovation.

Cohesion policy is also closely related to the concept of smart specialisation. The existence of national or regional Research and Innovation Strategies for Smart Specialisation (RIS3) is one of the required ex-ante conditionalities, necessary for the efficient use of EU funds. By identifying the unique areas of competitive strength, this approach allows funding to be channelled towards harnessing a region’s endogenous potential. According to a 2009 report by Fabrizio Barca, cohesion policy should make better use of hidden, or not properly used, resources and territorial specialisations, and
respond to specific needs of regions. In this context, regional specialisation can be a factor contributing to increasing competitiveness, by capitalising on regional strengths and assets. Such smartly designed regional specialisation strategies may help reduce the within-country gaps in competitiveness, thus having a positive impact on overall national competitiveness.

**European Parliament**

In its 2017 *resolution* on 'Investing in jobs and growth – maximising the contribution of European Structural and Investment Funds', Parliament stressed that ESI Funds should be used among other things to stimulate competitiveness, and welcomed the thematic concentration of funding. In its 2016 *resolution* on implementation of the thematic objective 'enhancing the competitiveness of SMEs', it highlighted the need to simplify the business environment and speed up the process of setting up new businesses. It also called on the European Commission to increase funding for competitiveness of SMEs when preparing cohesion policy for the post-2020 period. In its 2015 *resolution* on 'Investment for jobs and growth: promoting economic, social and territorial cohesion in the EU', Parliament emphasised the role of cohesion policy as the main EU instrument aimed at boosting regional competitiveness. In its 2014 *resolution* on 'Hospitalable environment for enterprises, businesses and start-ups to create jobs', it underlined that boosting regional competitiveness and entrepreneurial spirit improves social cohesion, job creation and business opportunities.

**European Committee of the Regions**

In its 2017 *opinion* on 'Smart Specialisation Strategies (RIS3): impact for regions and inter-regional cooperation', the Committee stressed the role of involving all levels of governance, as well as industry, education and research institutions, and citizens. It recognised the smart specialisation strategies as a 'powerful instrument to help tackle social challenges and promote innovation, investment and competitiveness based on socio-economic and territorial specificities'. It also highlighted their role not only in supporting research, innovation and business development, but also in enhancing skills. In its 2017 *opinion* on 'The Future of Cohesion Policy beyond 2020', it emphasised that cohesion policy should not be limited to redressing regional disparities but also promote innovation, competitiveness and sustainable growth. It called for a model supporting a 'balanced relationship based on cohesion, convergence and competitiveness'. In the 2014 *opinion* on 'Measures to support the creation of high-tech start-up ecosystems', it stressed the importance of developing a local innovation ecosystem, cooperation of educational institutions with the business world, promoting a culture of entrepreneurship and risk-taking, as well as developing an approach based on both quantitative targets and a qualitative approach fostering a positive 'path to change'.

**Outlook**

The concept of competitiveness has evolved in recent years, from a focus on market processes and company productivity, to include the dimension of bringing prosperity and improving the standards of living. Thus, it seems to have made the turn from what Paul Krugman called a 'dangerous obsession', arguing that competitiveness of nations (and regions) cannot be compared to that of a corporation. While the concept may still be used in media and more traditional policy circles as mainly aimed at firm productivity and cost competitiveness, it is clear that in the case of nations and regions this is not necessarily a zero-sum game. Raising prosperity in one region or country may translate into more resources to acquire goods and services from other 'competitors'.

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*EPRS Regional competitiveness in the EU*
This broader vision allows public efforts to boost competitiveness to go hand-in-hand with efforts to increase development levels. Such actions target many aspects, such as infrastructure, human capital and institutional frameworks, with only some targeted at the conventionally high-growth sectors. Other interventions can be geared to specific regional assets and specialisations, while still improving overall competitiveness. In this context, public investments through EU regional support in the form of cohesion policy can provide an important contribution, especially in its thematic fields of SME support, skill development, transport infrastructure, and research and innovation.

**Main references**


**Endnotes**

1 The RCI is based on indicators from Eurostat, national statistical institutes, the World Bank Worldwide Governance Indicators, Global Competitiveness Index (World Economic Forum), the Quality of Government Index (Quality of Government Institute), OECD Programme for International Student Assessment (PISA), Regional Innovation Scoreboard, Eurobarometer, Scopus indicators on publications by Science-Metrix, and other indicators developed by DG Regio. Data for two RCI pillars are available at the country level only (Macroeconomic stability; Quality of Primary and Basic Education), while the Institutions and Technological Readiness pillar also includes a national component.

2 Partnership Agreements are strategic documents outlining how EU regional funding will be distributed at the Member State level. In addition, Operational Programmes provide detailed information on concrete measures and expected results.

3 The remaining objectives are related to the low-carbon economy, climate change adaptation, environmental protection, social inclusion and fighting poverty. They are less clearly linked to competitiveness in the traditional sense but may have impact on the quality of life in the regions in the environmental and social dimensions.

4 Some indicators also cover the years 2015 and 2016.

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