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The Lisbon Scorecard III

The status of economic reform in the enlarging EU

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Foreword

KPMG is again delighted to sponsor the CER's annual assessment of European economic reform. Three years on from the Lisbon Summit, the Scorecard is now established as the independent review of progress and, once more, the CER has provided an incisive and hard-hitting perspective on what has been achieved – and what remains to be done.

When the EU leaders set the target of becoming the "world's most competitive and dynamic knowledge-based economy by 2010", no one thought it would be easy. But few, if any, can have envisaged the dramatic deterioration in the global economic and geo-political backdrop which was just around the corner.

However, while weak growth and heightened uncertainty may make the reform process more difficult, they cannot be an excuse for inaction. Rather, they highlight the need for change if Europe is to emerge more dynamic, flexible and resilient. More than ever, all of us with an interest in the future – and that includes everyone from politicians, officials and businessmen, to the man in the street – should keep our eyes firmly fixed on that goal.

This, the third edition of the Scorecard, provides grounds for cautious optimism. It is encouraging that some of the accession countries of Central and Eastern Europe already show up as 'heroes' of reform, but disappointing that existing member countries appear all too often as 'villains', dragging their feet.

2003 promises to be another tough year, but that makes it all the more important that political leaders confront the hard choices and provide the necessary momentum for change, so that Europe can meet the competitiveness challenge of the twenty-first century.

Mike Rake
European Chairman of KPMG

1 Introduction

When EU leaders assembled at the Lisbon summit in March 2000, Europe appeared on the cusp of a new economic golden age. The EU was enjoying its highest economic growth for nearly a decade. Governments talked optimistically of Europe benefiting from the same kinds of productivity gains that had driven the stellar US economic performance in the late 1990s. Heads of government managed to cast aside their traditional political differences and agreed on an economic reform programme, 'the Lisbon agenda', that was designed to close the economic gap with the United States.

Three years on, the economic and political circumstances could not be more contrasting. The 'dot.com' boom has long since bust. Europe's economy is stagnating. The EU heads of government, who assemble in Brussels in March 2003, are more divided than at any point in recent memory over Europe's response to the crisis in Iraq.

The Brussels summit is supposed to provide member-states with the opportunity to discuss progress towards meeting the key Lisbon goals, such as increasing employment, promoting innovation and improving Europe's growth record. But finance ministers, who also attend the summit, are as much preoccupied with the immediate difficulties posed by the economic downturn.

The EU recorded average growth of just 0.9 per cent in 2002. The Organisation for Economic Co-operation and Development (OECD) expects EU GDP to recover to 1.9 per cent in 2003, but this does not account for the possibility of further economic disruption caused by a war in Iraq.[1] Weak economic growth means that many member-states are

[1] *OECD, 'Economic Outlook, No 72', December 2002.*

struggling to keep their budget deficits in check. France and Germany may well use the summit to propose amendments to the EU's Stability and Growth Pact – which prohibits eurozone governments from running budget deficits above 3 per cent of GDP.

Businesses and commentators are lining up to pronounce the Lisbon economic reform process as, if not quite dead, comatose. Some member-states – including the eurozone's three largest economies, France, Germany and Italy – have made little attempt to fulfil their Lisbon promises. The new French government has not yet used its healthy parliamentary majority to push forward with pension reform or ease the regulatory burden on business. Equally, the Italian government talks incessantly about the need to overhaul the country's sclerotic labour market, but has only succeeded in introducing some modest reforms. Too often the Berlusconi government appears more interested in protecting its own vested interests than in pushing forward with reforms for the good of the Italian economy.

Above all, the sputtering German economy is casting a long shadow across Europe. The German economy grew by just 0.2 per cent in 2002, and even the most optimistic forecasts suggest that growth will amount to no more than 1 per cent in 2003. Unemployment jumped by 62,000 in December to 4.23 million, or 10.3 per cent of the labour force, the highest rate for five years. Many economists believe that Germany may now be in recession. Yet Gerhard Schröder's enfeebled government appears unable, or unwilling, to push forward with labour and product market reforms.

The European Commission has taken a tough line in it its annual report on the Lisbon agenda, criticising member-states for the "sluggish pace of reforms".[2] The Commission concludes: "The overall picture that emerges from this review is rather disappointing. The reaction to the slowdown in economic growth is characterised by policy inertia and backtracking."

[2] *European Commission, 'Choosing to grow: knowledge, innovation and jobs in a cohesive society', Report to spring European council, January 2003.*

But not all member-states are reneging on their Lisbon commitments. On most measures, the Nordic economies are already world-class performers. The World Economic Forum, for instance, ranks Finland second and Sweden fifth in its annual competitiveness report.[3] The International Institute for Management Development (IMD) scores Finland second and Sweden eighth in its competitiveness scorecard.[4] The success of Sweden and Finland shows that is possible to improve an economy's performance without simply importing the Anglo-American economic model.

[3] *World Economic Forum, 'Global competitiveness report 2002-2003', Oxford University Press, 2002.*

[4] *International Institute for Management Development, 'World competitiveness yearbook 2002'.*

A second tier of countries – including Britain, Ireland, the Netherlands and Luxembourg – have made credible progress towards meeting their Lisbon targets. Indeed, the IMD places Luxembourg third, the Netherlands fourth and Ireland seventh on its scoreboard. Other member-states, such as Spain and Portugal, continue to push through economic reforms in an effort to catch up with Europe's best. For example, Spain has succeeded in increasing the percentage of its working age population in employment from 48.9 per cent in 1992 to 57.7 per cent a decade later.

Moreover, EU member-states did reach agreement on some key elements of the Lisbon agenda during the last year. The Danish Presidency during the second half of 2002 was especially energetic, brokering deals on energy liberalisation, financial services integration and a 'single sky' for air transport. And several member-states, including Austria and Spain, successfully reduced the administrative obstacles to business start-ups, demonstrating that the open method of co-ordination – the EU's system of peer pressure, benchmarking and the exchange of best practice – can yield positive results. Most EU countries have also made rapid progress in increasing internet access and encouraging the spread of other new technologies, such as broadband. This year's CER scorecard demonstrates that while the EU should work harder

towards meeting the Lisbon targets, the economic reform process is far from dead.

The accession countries are now formally part of the Lisbon strategy, ahead of their entry into the Union in 2004. Their inclusion represents both a threat to the EU's hopes of meeting its economic reform targets, and an opportunity to reinvigorate the Lisbon agenda. The accession countries pose a threat because they are poorer and economically less well developed than the EU as a whole. The EU will find it harder to meet targets such as raising the average employment rate to 70 per cent, or increasing research and development spending to 3 per cent of GDP. Some existing member-states may even be tempted to use enlargement as an excuse to hide their own failings and water down the Lisbon targets.

But the arrival of the new member-states also presents an opportunity to increase the pace of economic reform. The accession countries are fast-growing dynamic economies, and their low-cost but skilled workforces should increase competitive pressures within the EU. The accession countries are highly committed to the reform process and are used to taking tough political decisions, for instance on pensions and labour market reform. The new members also have considerable experience of objective benchmarking, as part of the accession process, and take such exercises seriously.

This is the third edition of the CER's Lisbon scorecard. It largely follows the format of the previous two scorecards, except for some minor amendments to take account of the evolution of the EU's economic reform agenda. For instance, telecoms liberalisation was a key issue in the first two years of Lisbon. Now the legislative framework is largely complete and the EU's efforts are focused on policing competition to ensure that prices continue to fall. On the other hand, the EU is only just beginning to make progress with transport liberalisation, so we have moved this into a separate section.

The CER's assessment of progress includes an important subjective element that focuses on the politics behind economic reform. Countries that are pushing hard for reform, as well as those that already show best practice, achieve 'hero' status in our scorecard. Those that are least willing to improve are designated 'villains'. The EU is producing data of an increasing quality, and quantity, which make it easier to determine which countries are genuinely trying to meet the Lisbon goals, irrespective of their economic starting-point.

On this basis, Germany and Italy are the 'villains' of the 2002-03 scorecard. Germany's failure to make substantial reforms is especially galling because its economy still possesses many strengths – in terms of its knowledge base, innovation and productivity record. As Europe's largest economy, Germany's weakness also has a disproportionate impact on its neighbours, both to the east and west. In Italy, the Berlusconi government seems intent on blowing the best opportunity for full-scale reform in a generation. France, however, no longer occupies the 'villain' category this year, owing to its change of heart on energy liberalisation and strong record on job creation – although the French government continues to obstruct many aspects of the Lisbon agenda. Denmark receives recognition for the good work of its 2002 presidency, its excellent employment record, and its continuing reform efforts. Finland is the other 'hero' of our third scorecard, for its strong all-round economic performance.

The Lisbon process	**C+**
Heroes	**Denmark, Finland**
Villains	**Germany, Italy**

2 The Lisbon Agenda

The key elements of the Lisbon agenda are set out below. For the purposes of the scorecard, we have grouped the main targets under five broad headings.

★ **Innovation**

Europe will not be able to compete in the global economy on the basis of low-tech products in traditional sectors. Europe's record in generating new ideas is good and it possesses a skilled workforce. But with a few notable exceptions – such as pharmaceuticals and mobile phones – the EU has struggled to commercialise its inventions for international markets. European businesses still spend too little on research and development. The United States and Japan look set to maintain their dominant position in the production of hi-tech products unless the EU rapidly improves its performance.

★ **Liberalisation**

In theory, the EU succeeded in creating a single market for goods and services in 1992. In practice, many barriers to cross-border business remain in place. At Lisbon, heads of government agreed to complete the single market in key sectors such as telecoms, energy and financial services. The liberalisation of these markets should help to reduce prices for businesses and consumers alike, and accelerate the EU's economic integration.

★ **Enterprise**

Dynamic new firms are the key to job creation and innovation. But Europe does not sufficiently reward entrepreneurial success, or accommodate failure. Europe's citizens are averse to taking financial risks, and small businesses often face obstacles to expansion, such as regulatory red tape. The EU also needs to ensure that member-states reduce market-distorting state subsidies; and that competition policy promotes a level playing-field for all businesses in the single market.

★ **Employment and social inclusion**

The Lisbon agenda spelt out the vital role that employment plays in reducing poverty, and in ensuring the long-term sustainability of public finances. The EU needs to continue to attract people back into employment and to equip its citizens with the skills that are necessary to compete in the workforce. EU member-states must also tackle the problems of an ageing population by reducing the burden of pensions on state finances, while at the same time ensuring that pensioners are not pushed into poverty.

★ **Sustainable development and the environment**

The EU added the objective of sustainable development to the Lisbon agenda during the Swedish presidency of 2001. The EU is aiming to reconcile its aspirations for higher economic growth with the need to fulfil its international environmental commitments such as the Kyoto greenhouse gas targets.

3 The Scorecard

A. Innovation

A1. Information society

★ Increase internet access for households, schools and public services

★ Promote new technologies such as 3G mobile phones and broadband internet

The EU aspires to match the success of the US in encouraging businesses and consumers to make use of new technologies, such as the internet. The first 'eEurope' plan, which ran until the end of 2002, sought to increase internet access, stimulate e-commerce and create a clear legal framework for electronic communications. The European Commission has described the eEurope action plan as a "major success".[5] But Europe is still some way from reaping the full economic benefits of new information technologies – and that is one of the key reasons it continues to lag behind the United States in terms of productivity growth. As a result, the EU agreed in May 2002 to introduce a second 'eEurope' plan, designed to accelerate the use of new technologies by governments, businesses and consumers.

[5] *European Commission, 'eEurope 2002 final report', February 7th 2002.*

The EU has made good progress in terms of increasing consumer internet access. The EU's statistical office, Eurostat, reports that the number of households with internet connections increased from 18 per cent in 2000 to 43 per cent in November 2002. In the

Netherlands, Sweden and Denmark, nearly two-thirds of households are connected on-line. But Greece recorded a decline in the number of households with internet connections, to less than 10 per cent, although Eurostat admits the fall may be due to a sampling error. Spain and Portugal also remain below the EU average for internet connections, at 29.5 per cent and 31 per cent respectively, but both have recorded rapid growth over the last two years.

The number of internet users in the accession countries increased by 40 per cent in 2001 – a higher growth rate than in existing EU member-states.[6] The number of households with internet access rose from 21 to 24 per cent in Slovenia in 2001, and from 14 to 20 per cent in Cyprus. But in Latvia, Hungary and Lithuania just 3 per cent of households are on-line.

[6] *Eurostat, 'Information society statistics: data for the candidate countries', 2002.*

The EU is also close to meeting its target of ensuring that all schools have access to the internet. The Commission reports that 93 per cent of Europe's schools had internet access in February 2002. Member-states have now set a new target of ensuring that schools possess at least one on-line computer for every 15 pupils. At present, there are 17 pupils to every on-line computer in EU schools, compared with 25 in 2000.

The eEurope action plan also requires governments to provide core services, such as tax returns and car registration, via the internet. A recent survey by Cap Gemini Ernst & Young, an IT consultancy firm, found that 86 per cent of national, regional and municipal governments within the EU provide core services on-line. Sweden and Ireland provide the most sophisticated on-line public services, while Belgium and Luxembourg supply only basic information via the internet.

The cost of using the internet continues to decline in most EU member-states. The average EU cost for 30 hours of internet usage is now €20.70, only marginally more expensive than in the US.

But the cost remains much higher in most accession countries: Hungarians pay as much as €80 for 30 hours usage. European consumers also remain reluctant to shop on-line, despite the spread of internet access. A Eurobarometer survey in June 2002 found that although 35 per cent of internet users have purchased products on-line, just 4 per cent regularly shop on the internet. Consumer internet sales represent just 1 per cent of total retail sales within the EU.

The stock market collapse has hindered the EU's attempts to encourage the spread of broadband and 3G mobile phones. Telecoms companies in many member-states have delayed the long-awaited introduction of 3G mobile technology, which enables users to send high-speed text and graphics via mobile phones. Equally, the failure of a number of cable companies resulted in broadband usage falling in Britain and Ireland in 2002. In these two countries less than 5 per cent of homes have broadband access. Luxembourg and the Netherlands lead the way in broadband usage – more than 30 per cent of households have access, according to the Commission's enterprise scorecard.[7] Belgium is also rapidly introducing broadband services, with the number of users increasing from 15 to 24 per cent between 2001 and 2002. Across the EU as a whole, around 13 per cent of households had broadband access in 2002.

[7] *European Commission, 'Benchmarking enterprise policy: results from the 2002 scoreboard', November 7th 2002.*

The problems faced by the telecoms companies in introducing new technology are likely to prove temporary. More worryingly, most member-states continue to lag behind the United States and Japan in terms of their total expenditure on information and communications technology (ICT) as a proportion of GDP.[8] ICT spending within the EU averaged 6.9 per cent of GDP in 2001, virtually unchanged from 2000, which suggests that EU businesses are still not investing sufficiently in new technology. Meanwhile, the United States spent 8.2 per cent of its

[8] *European Commission, '2002 European Innovation Scorecard', December 9th 2002.*

GDP and Japan 9 per cent on ICT in 2001. Britain, Sweden and the Netherlands all spent more than the United States in 2001. Greece, Spain and Italy spent the least among EU member-states.

The ICT data for the accession countries are not strictly comparable with the figures quoted above. However, the Commission calculates that the Czech Republic, Estonia and Hungary spent more on ICT than the EU average. Romania and Bulgaria devoted the least expenditure to ICT, despite the desperate need to upgrade equipment in both countries. The Commission's figures are supported by the World Economic Forum's index of 'networked readiness', which places Estonia in 24th position, higher than a number of existing member-states including Italy and Spain.[9] But Bulgaria and Romania continue to lag the other accession countries badly: WEF ranks Bulgaria in 68th position and Romania 72nd out of the 82 countries surveyed.

[9] *World Economic Forum, 'Global information technology report 2002-2003 – Readiness for the networked world', Oxford University Press, 2003.*

Information society	**B-**
Heroes	**Netherlands, Sweden, Estonia, Slovenia**
Villains	**Greece, Bulgaria, Romania**

A2. Research and development

★ Community Patent by the end of 2001

★ EU average R&D spending to reach 3 per cent of total GDP by 2010

Europe's failure to improve its research and development (R&D) record is summed up by the sorry saga of the Community Patent. As far back as the 1960s, European governments considered developing a cheap and efficient single patent regime as a means of cutting costs for innovative businesses. The Commission estimates that a Community Patent would save European businesses around €500 million a year, or €5,000 per patent, because firms would no longer need to register their invention in all the different national patent offices. Moreover, the introduction of the new patent would provide the European companies with a one-off boost worth €18 billion, because patent portfolios would increase in value owing to lower legal costs.

At Lisbon, heads of government committed themselves to reaching agreement on the Community Patent by the end of 2001. But member-states took until March 2003 to finally reach a broad agreement. First Italy, Spain, Greece and Portugal blocked progress because of a proposal to restrict patent applications to English, French or German, even though three-quarters of all applications within the EU are already made in English. Spain succeeded in brokering a messy compromise in the summer of 2002 which would allow some parts of the patent application to be written in other languages. However, the Spanish compromise would increase the costs of making a patent application. Then Germany stalled on the deal because of concerns that its courts would lose jurisdiction over patent infringement cases. The German government finally accepted the proposal after winning a seven year transition period, before its courts lose powers over patent cases.

In their efforts to find a compromise, the member-states risk defeating the original objective of creating a cost-effective patent system. Member-

states have only reached general agreement and many technical issues still needed to be resolved later in 2003. The Commission may yet need to act on its threat to withdraw the proposal, if member-states fail to agree on a cost-effective patenting system.

The EU's attempts to stimulate biotechnology research have fared little better. In November 2002, the EU's competitiveness council, which brings together member-state industry ministers, endorsed a new action plan for life sciences and biotechnology with the aim of providing stronger intellectual property rights to biotech inventions. Biotechnology is also one of the priorities for the EU's sixth research framework programme. The Commission intends to allocate some €17.5 billion in total to European researchers over the next four years.

But at the same time, the Commission is beginning infringement procedures against nine member-states, including Germany, France and Sweden, which have so far failed to implement a 1998 directive designed to protect biotech intellectual property rights. Moreover, the EU continues to impose a *de facto* moratorium on the development of genetically modified products. The moratorium is not only causing trade tension with the United States but it is also obstructing European advances in the biotech field. As UNICE, the European employers federation, has said: "The ambivalence of European biotechnology policy is symptomatic of a climate which all too often hinders innovation or drives it out of the EU."[10]

[10] UNICE, 'Lisbon strategy 2003 status', December 18th 2002.

Businesses are deeply sceptical about the EU's ability to meet the Lisbon headline goal of increasing R&D expenditure to 3 per cent of GDP by 2010. In 2001, the EU spent 1.94 per cent of total GDP on research and development, compared with 2.7 per cent in the United States and 3 per cent in Japan. Moreover, the EU is expecting that much of the extra spending needed to meet the target will come from the private sector. The EU is hoping to raise private sector spending on R&D from 55 per cent of all R&D spending now to more than 66 per cent by 2010.

Member-states have failed to devise a clear strategy for meeting these targets. Indeed, the European Roundtable of Industrialists warns that business R&D spending in Europe is unlikely to increase in the next three years.[11] The ERT found that its member firms, which are responsible for around 13 per cent of the EU's total research and development expenditure, are much more likely to raise their spending levels outside Europe. Companies are particularly critical of the lower subsidies provided to R&D spending in Europe, compared with the US.

[11] European Roundtable of Industrialists, 'Is the 3 per cent target for R&D for 2010 objective unrealistic?', ERT view, October 22nd 2002.

There is ample other evidence of Europe's inability to innovate as effectively as either the United States or Japan. In 2001, European businesses filed 154 patents per million of population at the European Patent Office (EPO), according to the Commission research directorate, marginally less than either the US or Japan.[12] But the US and Japan recorded much higher patent rates than the EU at the United States Patent and Trademark Office (USPTO). In 2001, the US filed 322 patents per million of population, while Japanese companies recorded 265 per million. In contrast, the EU filed only 80 patents per million of population in the USPTO. The low number of patents is partly the result of a smaller share of workers employed in research in the EU. Japan employs 9.26 researchers per thousand workers while the United States employs 8.0. The EU averages just 5.4 researchers in every thousand workers.

[12] European Commission, 'Science, technology and innovation: key figures 2002', 2002.

The EU already faces an uphill struggle to match the innovation performance of the US or Japan. Enlargement will make it even harder for the EU to meet its headline goal of 3 per cent expenditure on R&D. Of the accession countries, only the Czech Republic, at 1.24 per cent, and Slovenia with 1.5 per cent spend more than 1 per cent of GDP on R&D. Slovenia also leads the way in terms of patent applications, but at 22 per million of population lags far behind the EU average.

But the outlook is not all doom and gloom. For Europe already possesses two world-class knowledge economies in Sweden and Finland. These two countries outscore the US and Japan on most of the research and development indicators: proportionately they employ more researchers, spend more on R&D and file more patents.

Moreover, some of the EU's weakest performers are showing signs of improvement. Portugal and Greece are recording fast growth rates in terms of R&D expenditure, patent applications and the number of researchers, albeit from a very low base. The performance of Britain, France and Italy is of much greater concern. R&D expenditure fell in Britain and France between 1995 and 2000. Italy recorded a small level of growth in the same period but only spends around half of the EU average on research and development. All three countries are below the EU average – and showing the slowest growth rates – in terms of patent applications. In 2002, the British government unveiled a series of new measures designed to reverse this decline in R&D expenditure, including tax credits for business R&D worth up to £500 million each year.

The EU does have a good record in training the scientists needed to lead research and development efforts. The EU grants proportionately more science and technology PhDs each year than either the United States or Japan. Indeed, Sweden and Finland award more than twice as many science PhDs per thousand of population as the US. The key for the EU as a whole is to learn from the experiences of Sweden and Finland. The EU needs greatly to improve its record of turning leading-edge research into competitive business propositions.

Research and development	**C-**
Heroes	**Finland, Sweden, Slovenia**
Villains	**France, Italy**

B. Liberalisation

B1. Telecoms and utilities

★ Increase 'local loop' competition to reduce internet access charges

★ Liberalise gas and electricity markets

By the time of the Barcelona summit in March 2002, the inability of EU leaders to reach agreement on energy liberalisation had become symbolic of the Union's wider failure to deliver on its economic reform promises. At that summit, heads of government reached a face-saving deal to liberalise the energy market for business users by 2004. But the agreement fell well short of the Lisbon commitment to open the EU's energy market fully to competition.

The election of a new government in France in May 2002 removed one of the major obstacles to a final agreement. In November 2002, the Danish presidency succeeded in brokering a deal for full energy liberalisation by 2007, two years later than was originally envisaged.

The energy agreement is a major step forward and should eventually lead to lower prices for both industry and households. But at present the EU remains some distance from enjoying the full benefits of a single market in energy. The Commission calculates that average electricity prices for industrial users have fallen by nearly 10 per cent in the last five years. But businesses still pay more than twice as much for their electricity in Italy and Ireland as they do in Sweden. Moreover, average EU household prices for electricity have declined by less than 5 per cent in the same period.

The Commission will need to keep a watchful eye on competition within the energy market. In Belgium, France, Greece and Ireland, just one company controls more than 90 per cent of the electricity market. These near monopolies could use their dominant position to keep out

competitors. In contrast, the largest players in Austria, Britain and Finland control less than a third of the total market. Analysts are particularly sceptical about the ability of new entrants to compete with Electricité de France (EdF). This state-owned company has conducted an aggressive overseas expansion strategy in recent years, while preserving its domestic monopoly. The French government recently delayed the privatisation of the company, partly owing to opposition to proposed reforms of EdF's generous pension scheme.

Many accession countries have made good progress in liberalising their energy markets. In Poland, the largest operator controls just 19 per cent of the market and the government is scheduled to introduce full energy market liberalisation by 2005. But in Cyprus, Latvia and Estonia, one company continues to control more than 90 per cent of the market. Accession countries face the added difficulty of having to overhaul outdated power stations to meet the EU's environmental rules. Some accession countries, such as the Czech Republic and Hungary, are still subsidising household energy prices, and paying for this by overcharging industrial users.[13]

[13] *Deutsche Bank, 'Enlargement poses big challenges to European energy policy', EU Enlargement Monitor, April 2002.*

In contrast to energy, the EU has virtually completed the liberalisation of the telecoms market. The EU adopted the last major telecoms package in December 2001 and the new rules come into effect from July 2003. Member-states have already succeeded in pushing ahead with one key element of this package, the introduction of competition into the local telephone infrastructure in January 2001.

Telecoms liberalisation has helped to reduce the cost of national and international calls. The average price of national calls within Europe has more than halved in the last five years, while the price of international calls is a third of its 1997 level. But national calls remain twice as expensive as in the US. Moreover, the 'unbundling' of the local loop – that is, opening up the market for local calls – has not yet driven down charges. The average EU price of local calls fell

by just 2 per cent between 2001 and 2002 and is three times more expensive than in the United States. Surprisingly, the UK, which was once regarded as a leader in the liberalisation of the phone markets, is among the most expensive places for making calls within the EU. The average cost of a ten-minute local call is €0.64 in Britain, compared with €0.23 in Finland, the EU's cheapest member-state, and €0.13 in the United States.

Telecoms companies complain that it is simply too expensive for new entrants to compete for local calls. In most EU countries, the former state-owned telecom utilities preserve a dominant position. Commission figures, albeit dating from 2001, show that new entrants have not succeeded in taking control of more than a third of the total market for local calls in any member-state.

The Commission has vowed to continue promoting access to the local loop to force down call charges and internet costs. It has launched infringement proceedings against Germany, France, Ireland, the Netherlands and Portugal for failing to provide fair access. Mario Monti, the competition commissioner, has also warned Deutsche Telekom about the use of unfair pricing practices to squeeze out competitors.

Similarly, the Commission is taking a tough line against government subsidies for ailing telecoms giants. Many telecoms companies are facing a debt crisis brought on by the stock market collapse, expensive takeover deals and costly 3G mobile licences. For instance, the French government last year offered France Telecom emergency help to restructure its €70 billion debts. President Chirac has subsequently suggested the EU should 'relax' its state aid rules for the telecoms sector. But the Commission has rightly rejected the French proposal, claiming that the aid would be used to prop up dominant players such as France Telecom at the expense of new entrants.

Most accession countries have opened up their phone markets for national and international calls. Indeed, the World Bank has

commended Estonia for developing one of the most modern networks in the world.[14] But Slovenia and Hungary are the only accession countries so far to have liberalised the local loop.

[14] *World Bank, 'A preliminary strategy to develop a knowledge economy in European Union accession countries', 2002.*

Telecoms and utilities	**B-**
Heroes	**Denmark, Finland, Poland, France (for energy)**
Villains	**Ireland, Italy, France (for telecoms)**

B2. Transport

★ Increase rail services competition

★ Create a European 'single sky' by 2004

The EU's transport policy used to amount to little more than the provision of funding for major infrastructure projects, particularly new roads. But at the Lisbon summit, EU leaders committed themselves to increasing competition in the highly protected rail and air transport markets.

The Commission estimates that just 8 per cent of the EU's goods is carried by rail compared with 21 per cent in 1970. The average speed of international freight services has fallen below 18 kilometres per hour – which is roughly the same speed an icebreaker travels through a frozen sea. In supposedly gas-guzzling America, 40 per cent of freight goes by rail.

Member-states should complete the implementation of the first railway package, which introduces competition into cross-border freight markets, by March 2003. The legislation seeks to open up 50,000 kilometres of the EU's international railway network to competition from that date. International freight services would then be able to compete across the entire network by 2008. Denmark is the first member-state to have fully implemented the new rules.

The Commission, however, is now working towards a far more ambitious liberalising agenda. Loyola de Palacio, the transport and energy commissioner, has put forward a 'second railway package' which would create a single market in all freight services. The new package would create licensed operators which could bid for freight services in any member-state. The new legislation would also bring forward the deadline for opening up the international freight network to 2006. Moreover, the European Parliament has proposed amending the legislation to extend full competition to international passenger services by January 2008.

The new railway package would represent a major step towards introducing competition into a moribund sector. But member-states are under no obligation to privatise their rail companies and doubts remain about the ability of new entrants to compete with powerful state-owned players such as SNCF, the French railway company, and Deutsche Bahn. The French government, for instance, has only grudgingly fulfilled an EU requirement to ensure that companies which provide rail services do not also own the railway infrastructure. The French government has chosen to set up a new infrastructure company which has subsequently leased back the management and operation of the railways to SNCF, leaving SNCF in complete control of the network. However, the French government can argue that full-scale rail privatisation in countries such as Britain and the Netherlands has not yielded many benefits for passengers or freight customers.

In December 2002, the EU finally reached political agreement on a 'single sky' for European air transport – some 40 years after the plan was first mooted. The Danish Presidency described the decision as the most important development in European transport policy for 20 years.

From 2005, Eurocontrol, the European airspace agency, will have responsibility for airspace above 28,500 feet. The Commission estimates that unitary control will cut delays by a quarter and reduce flight times and fuel costs, with aircraft no longer required to zigzag through national air routes. Britain, France and Spain had long led opposition to the creation of a single sky, because of fears it would interfere with military airspace. The Danes succeeded in brokering a deal which initially exempts military airspace from EU control. But member-states have made a non-binding commitment to increase the co-ordination of military space in the future. The single sky plans also face opposition from air-traffic controllers, who have already caused transport chaos with a series of strikes in France, Italy, Germany and Hungary in the summer of 2002.

The Commission is now calling for powers to negotiate bilateral 'open sky' agreements with other countries, especially the United States. It argues that EU-wide open sky agreements would accelerate much-needed consolidation within the airline industry and reduce the cost of transatlantic flights.

In the autumn of 2002, the European Court of Justice concluded that bilateral deals struck with the US by eight member-states, including Germany, discriminated against carriers from other EU states. However, the court stopped short of ruling that the Commission should have the power to conclude an open sky arrangement with the US. The problem with bilateral deals is that they tie an airline's valuable US landing rights to the nationality of the carrier. For instance, British Airways' attempt to merge with KLM in 2000 failed in part because of concerns that the merged group would lose US landing rights as it would no longer be recognised as a Dutch carrier. The Brattle group, an economics consultancy, calculates that the creation of an EU-wide open sky for transatlantic flights would save consumers a total of $5.2 billion a year and increase passenger numbers by nearly a quarter.[15]

[15] *Brattle Group, 'Assessment of the economic impact of an EU-US open aviation area', January 7th 2003.*

In June 2002, member-states also reached agreement on a directive designed to increase competition for services in Europe's ports. The directive will prevent port owners from forcing shipping companies to use their own cargo handling or piloting services. In future, ports will have to allow other companies to offer such services directly to the shipping firms.

Transport	**B-**
Heroes	**Denmark, European Parliament**
Villains	**France**

B3. Financial services

★ Complete the financial services action plan by 2005

At the Lisbon summit, EU heads of government signed up to an ambitious programme that is designed to achieve a viable single market in financial services by 2005. The financial services action plan (FSAP) aims to reduce the legal obstacles which still prevent businesses – whether retail banks, insurance companies or stock exchanges – from selling their services seamlessly across the EU.

A well-functioning financial services sector is vital for the competitiveness of the European economy. It ensures the efficient allocation of capital, mobilises savings and helps to discipline company management. Access to low-cost capital promotes the growth of new and innovative businesses. The Commission has published research showing that a single market in financial services would increase EU GDP by 1.1 percentage points over the next ten years and raise employment by 0.5 percentage points.[16]

[16] *European Commission/London Economics, 'Quantification of the macro-economic impact of integration of EU financial markets', November 2002.*

The EU has so far signed off an impressive 31 of the financial services action plan's original 42 measures, including important legislation such as an EU company statute and a market abuse directive.[17] Last autumn, after a hiatus caused by the French and German elections, member-states reached agreement on a prospectuses directive and on legislation that is designed to permit occupational pension funds to operate across national borders.

[17] *European Commission, 'Progress on meeting the financial services action plan: seventh report', December 3rd 2002.*

The EU has arguably made greater progress towards meeting its Lisbon goals in financial services than in any other policy area. It has also successfully introduced a series of institutional reforms, based on recommendations made by the Lamfalussy group of experts, which is designed to ensure that complex financial legislation is more effectively implemented in the future.

However, member-states have not reached agreement on some of the most important, and politically contentious, elements of the FSAP. For instance, the Commission's proposed revisions to the investment services directive have already sparked controversy. The directive is the cornerstone of the EU's single market in financial services, providing common rules for investment firms and stock exchanges which wish to compete across European borders. Investment banks claim that the Commission – under pressure from the Italian government – amended the proposals at the last minute. The banks claim the changes would make it more expensive to trade shares on their own books, a practice known as internalisation. As a result, Britain, where most of Europe's major investment banks are based, is likely to resist the Commission's revisions. Indeed, Britain has consistently fought against amendments and compromises which reduce the liberalising impact of the EU's financial services legislation.

Moreover, the Commission faces an uphill task in pushing through the latest version of the takeover directive, which seeks to establish common rules for corporate mergers and acquisitions. The European Parliament killed the last version of the directive in 2001 after heavy lobbying by the German government. The Commission issued a revised directive last autumn, which sought to address many of the German government's criticisms.

But German business groups and politicians continue to complain that the revised directive would discriminate against German companies because it would outlaw 'poison pill' defences, such as the right of directors to sell off subsidiaries of the company without the prior approval of shareholders. On the other hand, the Commission's new draft does not attempt to ban differential voting rights for a company's shares, which are used to preserve family control of businesses in some member-states, most notably Sweden. Klaus-Heiner Lehne, the European Parliament's rapporteur for the directive, has already said that he intends to amend the directive to encompass a crackdown on multiple voting rights.

The Commission will also need to offer extra help to the accession countries to ensure that the new rules are evenly applied across an enlarged EU. Central and East European capital markets are far less developed than those in the west of the continent. Investors have shied away from many of the new markets because of weak corporate governance rules and a lack of liquidity. Many companies have ended up delisting because of the lack of interest in their shares. In Prague, for example, thousands of companies were floated on the exchange during the 1990s privatisation programme. Now barely a hundred are still listed and only a handful are actively traded. Indeed, only the Warsaw stock exchange is likely to have a long-term future, and that only with a West European partner. The Warsaw market is capitalised at $26 billion, more than all its Central European neighbours put together. Moreover, the Polish government's pension reforms have prompted the creation of institutional funds which are keen to invest in Polish shares.

Financial services	**B-**
Heroes	**Britain, Poland**
Villains	**Germany, Italy**

C. Enterprise

C1. Business start-up environment

★ Develop a programme to support enterprise and entrepreneurship

★ Develop and implement a European charter for small businesses

Europe's six million small businesses employ nearly three-quarters of the EU's entire workforce. Small businesses, and start-ups in particular, are crucial for improving employment levels. A recent study found that in the United States just 35,000 fast growing firms were responsible for the creation of two-thirds of all new jobs during the mid-1990s.[18] But it is only in the last couple of years that the EU has begun to develop policies that are specifically aimed at helping entrepreneurs and small businesses.

[18] *European Commission, 'Thinking small in an enlarging Europe', January 21st 2003.*

In June 2000, the EU agreed on a small and medium-sized enterprise charter, which is designed to tackle common problems faced by small businesses. In the autumn of 2002, member-states also submitted to the Commission their own national targets for improving the small business environment.

A number of member-states have made substantial progress in reducing the costs and difficulties involved in setting up a new company, demonstrating that the 'open method of co-ordination' can yield concrete results. In January 2002, the Commission published an investigation into business start-ups which revealed that in countries such as Austria, Spain and Greece, it may cost more than €1500 and take up to six weeks to set up a new company. One year later, the Commission reported that Austria had introduced an on-line business registration system, which made it possible to register a company in as little as one day and at a minimal cost.[19] Spain is also moving in the right

[19] *European Commission, '2003 report on the implementation of the European charter for small businesses', January 2003.*

direction and has introduced new procedures to allow company registration in just two days. But budding Greek entrepreneurs must pay around €1700 to set up a company, compared with zero in Denmark. The accession countries are also committed to making it easier to establish a new company. But entrepreneurs must wait two to three weeks to register a new company, even in the best performers such as Latvia, Lithuania and Romania.

Many member-states are also undertaking reforms of their tax and legal systems, to encourage entrepreneurs and small business development. Spain, France, Italy and Portugal are overhauling bankruptcy laws with the aim of reducing the financial penalties and stigma associated with bankruptcy. Similarly, Estonia has passed new legislation which enables failed entrepreneurs to settle their debts quickly and to make a fresh start. Sweden has introduced a loan guarantee scheme for small businesses, inspired by schemes already in operation in Finland and the Netherlands.

Some EU governments – including Belgium, Denmark and Ireland – have made tax reductions that are designed to encourage small business development. Lithuania has introduced a reduced rate of corporation tax for micro-enterprises (those companies with less than ten employees). Estonia has abolished the tax on reinvested profits. The Estonian government reports that investments by small businesses rose by 30 per cent during the first six months after the tax was abolished, compared with a 7 per cent increase among companies not eligible for the tax break.

But the EU must do more to encourage its citizens to become entrepreneurs. The Global Entrepreneurship Monitor, which provides an annual snapshot of new business activity, shows that Europe continues to lag the United States in terms of entrepreneurial activity.[20] The percentage of the US population involved with new ventures fell sharply from 16.6 per cent in 2000 to 10.5 per cent in 2002, owing to the end of the 'dot.com' boom. Within the EU, Ireland was

[20] *Babson College et al, 'Global entrepreneurship monitor 2002', GEM, 2002.*

the most entrepreneurially minded country in 2002 – 9.1 per cent of the population participated in a new venture. In France and Belgium, however, only around 3 per cent of the population were active entrepreneurs. Among the accession countries, Hungary recorded the highest rate of activity at 6.6 per cent.

Europeans remain far more risk averse than Americans. In Europe, 45 per cent of citizens say they would like to start their own business compared with more than two-thirds of Americans.[21] Just as importantly, nearly half of Europeans believe that you should not start a business when there is a risk of failure, compared with 25 per cent of Americans.

EU member-states are slowly beginning to address this problem through education. In 2000, only the Nordic countries included lessons on entrepreneurship in school curricula. Subsequently, Belgium, Greece, Ireland and the UK have introduced secondary school courses on entrepreneurship. Finland, Ireland, Sweden and the UK are now teaching entrepreneurial skills at primary school level. Among the accession countries, Poland, Lithuania and Cyprus have also recently introduced similar courses. Governments cannot expect to change deep-seated attitudes overnight. Unfortunately, it may be a generation before Europe produces as many budding entrepreneurs as the United States.

[21] *European Commission, 'Green paper on entrepreneurship', January 2002.*

Business start-up environment	**B-**
Heroes	**Austria, Finland, Ireland, Sweden, Estonia, Poland**
Villains	**France, Greece**

C2. Reducing the regulatory burden

★ Simplify the EU's regulatory environment, to reduce the burden on businesses

★ Member-states to implement 98.5 per cent of all EU legislation by 2002

Poorly framed and cumbersome legislation is a growing burden for European businesses. Smaller companies, which lack the well-staffed legal departments of multinationals, find compliance with many EU directives and regulations especially costly and time-consuming. The Commission has calculated that better regulation could save businesses around €50 billion a year. It admits that the 80,000 pages of the *acquis communautaire*, the EU's consolidated body of law, are "clearly cumbersome for economic operators and the man in the street alike".[22]

[22] *European Commission, 'Simplifying and improving the regulatory environment', December 2001.*

At the Barcelona summit in March 2002, EU leaders endorsed the conclusions of the Mandelkern committee on better regulation, including a proposal for a 40 per cent reduction in the quantity of EU legislation by 2005. The Commission issued its own paper on better regulation in June 2002, which included promises to consult more widely before drafting legislation, to conduct regulatory impact assessments on 40 major pieces of legislation during 2003, and to reduce the quantity of EU legislation by 2005. In February 2003, the Commission presented a further proposal on updating and simplifying the *acquis*. Romano Prodi, the Commission president, is promising to cut the number of pages in the EU's law-book by at least a third by 2005. The Commission will also undertake a long-term programme of codifying and simplifying European law, so that it becomes far easier for businesses and citizens to understand and apply.

EU member-states must also recognise that national rules and regulations pose as great a burden on European businesses as EU directives. Many member-states consult far less than the

Commission and do not systematically conduct impact assessments on new legislation. The Swedish federation of businesses estimates that only 10 per cent of business regulations in that country derive directly from the EU. Italy has around 150,000 different laws on its statute book. Few member-states are yet making systematic attempts to reduce the regulatory burden: Britain employs a 'better regulation task force', which has sought to raise the quality of British legislation with mixed results. Just three member-states – Belgium, Denmark and the Netherlands – have set national targets for reducing the administrative burden on businesses.

Most of the new member-states from Central and Eastern Europe face an on-going battle to overhaul their cumbersome regulatory frameworks, part of which is inherited from the communist period. For instance, the OECD has recently praised Poland's efforts at reform but notes that businesses still find Polish bureaucracy time-consuming and unpredictable.[23]

[23] *OECD, 'Poland: from transition to new regulatory challenges', July 2002.*

The EU does not yet supply an indicator of regulatory performance. The Heritage Foundation, a right-wing American think-tank, does provide a crude ranking system in its index of economic freedom. The index measures taxes, property rights and the level of government intervention in the economy – rather than the quality of regulation. In 2002, Hong Kong and Singapore ranked at the top of the table. Three European countries – Luxembourg, Denmark and Estonia – scored higher than the United States which was ranked sixth. However, France was placed at 40th and Greece 56th, while Bulgaria and Romania ranked below 100. Sweden and Finland, which score very highly in most of the general competitiveness surveys, fare less well in the Heritage index owing to their high tax rates.

The failure of member-states to implement EU legislation in a timely and efficient manner can also become a burden to businesses. Companies cannot take full advantage of the single market if key legislation is not properly implemented throughout the Union.

At the Stockholm summit in March 2001, EU member-states promised to reduce the quantity of legislation not yet 'transposed' – that is written into national laws – to less than 1.5 per cent within one year. They missed this target and set a new deadline of March 2003. The Commission's latest internal market scoreboard, published in November 2002, suggests that member-states will again fail to fulfil their promise. In fact, the proportion of legislation not yet transposed into national law increased from 1.8 per cent in March 2002 to 2.1 per cent in November. Only five countries – Sweden, Finland, Denmark, the Netherlands and the UK – met the 1.5 per cent target. Just one member-state, Finland, met a supplementary target of ensuring that all EU legislation more than two years old was implemented.

France is by far the worst offender: the Commission calculates that France will need to complete the transposition of 73 directives between November and March to reach the target. France, closely followed by Italy, also tops the table of members which are subject to infringement proceedings for breaches of EU law.

EU enlargement will make the Commission's task of enforcing EU legislation even more difficult. The Commission will face the problem of monitoring the implementation of EU law across 25 member-states. Inevitably, the number of infringement cases will increase. Although all the new members have worked hard to implement the EU's existing *acquis*, questions still remain about their administrative capacity after accession. The EU will need to continue to support the new members' efforts to strengthen their inefficient and slow-moving bureaucracies, and to fight widespread corruption.

Reducing the regulatory burden	**C+**
Heroes	**Commission, Denmark, Finland, Estonia, Poland**
Villains	**France, Italy, Bulgaria, Romania**

C3. State aid and competition policy

★ Promote competition and reduce subsidies to industry

★ Overhaul public procurement rules and make them accessible to SMEs

The Commission's latest state aid scoreboard, published in May 2002, indicates a steady decline in the amount of subsidies paid by EU member-states to industry. The total amount of aid fell from €105 billion in 1996 to €82 billion in 2000, equivalent to 1 per cent of EU GDP. The UK granted the lowest subsidies, at 0.46 per cent of GDP. Surprisingly, Finland spent the most on state aid – 1.44 per cent of GDP – mainly owing to support for its highly uneconomic agriculture in northern regions.

Member-states have also made some progress in switching subsidies from help for specific industries, such as coal or shipbuilding, to 'horizontal' forms of aid. These are supposed to be less-market distorting as they are designed to be available to a wide range of businesses, whether through support for research and development or aid for small company development. Within the EU as a whole, around half of all aid now takes this form. However, Germany and Spain still spend more than a third of their total aid budgets on the coal industry. Finland and Denmark continue to give substantial subsidies to their shipbuilders.

The accession countries spent an average of 1.3 per cent of GDP on subsidies in 2000.[24] Hungary and Romania made the largest state aid payments, at 1.7 per cent and 1.9 per cent of GDP respectively. Estonia and Slovakia have succeeded in restricting subsidies to less than 0.5 per cent of GDP.

[24] *European Commission, 'State aid scoreboard, special edition on the candidate countries', November 27th 2002.*

The high level of aid in Hungary reflects the country's use of subsidies to attract foreign investment into 'special economic zones'. Across the accession countries, nearly 50 per cent of aid is

paid in the form of tax exemptions to the manufacturing industry, compared with 29 per cent in existing member-states. The Commission is likely to take a tough line on reducing this form of aid during the final preparations for enlargement. However, the Commission does note that if state aid is considered in terms of spending per capita (taking into account the different purchasing power standards of the various countries), all the accession countries, bar Hungary, spend less than the EU average.

The Commission is conducting a review of its state aid policies during the spring of 2003. Hopefully, the review will conclude that member-states must make further efforts to reduce the payment of market-distorting subsidies. However, Mario Monti, the competition commissioner, set an unfortunate precedent in February 2003 by withdrawing an investigation into preferential tax schemes in Belgium, Ireland, Luxembourg and the Netherlands. The Commission apparently ended its investigation as part of a deal to push through an EU savings tax directive.[25] The Commission's decision could embolden those member-states, such as France and Germany, which wish to see state aid rules applied less strictly.

[25] *See Financial Times, 'Monti's cave-in', February 14th 2003.*

The Commission is also in the process of overhauling its approach to mergers. The competition directorate, which had never previously lost a merger case appeal, suffered three serious defeats in the European Court of Justice during 2002. The Commission must move quickly to restore confidence in its competition policies or face further challenges from member-states and powerful multinational companies. The Commission's efforts to enforce competition policy remain vital: Eurostat figures show that the convergence of prices across Europe – a key indicator of the effectiveness of competition – has stalled since the mid-1990s.[26]

[26] *See Eurostat, 'Price convergence between member-states', EU structural indicators, February 2003.*

The Commission also needs to increase pressure on member-states to allow full competition for public procurement contracts. Each

year member-state governments grant contracts worth 16 per cent of EU GDP. Yet only around 15 per cent of contracts are openly advertised. Member-states advertised public contracts worth 2.5 per cent of GDP in 2001, compared with 2.4 per cent in 2000 and just 1.4 per cent in 1995, according to the Commission. Sweden and Greece are the most transparent countries, advertising contracts worth more than 4 per cent of GDP. Germany, however, advertises contracts worth less than 1 per cent of GDP.

State aid and competition policy	C+
Heroes	Britain, Greece, Sweden, Estonia, Slovakia
Villains	Finland, Germany, Hungary

D. Employment and social inclusion

D1. Bringing people into the workforce

★ Raise the overall workforce participation rate to 70 per cent by 2010

★ Raise the participation rate for women to 60 per cent by 2010

★ Raise the participation rate of older workers to 50 per cent by 2010

Europe has made solid if unspectacular progress in reducing unemployment and enticing its citizens back into the workforce over the last few years. The EU has rightly focused its efforts on increasing employment rates, rather than on simply reducing the headline unemployment numbers. In some countries, the numbers of unemployed – that is, those actively seeking work – have remained low because workers have given up looking for work and taken sickness benefits or early retirement. But the EU will not be able to raise its economic growth levels, as well as reduce the burden of funding its pension systems, unless it increases the number of people in the workforce.

The Commission estimates that the EU-15 have created 12 million new jobs since 1995. Moreover, Europe created 500,000 extra jobs in 2002 alone, despite the economic slowdown. As a result, the proportion of the working age population in employment increased from 63.4 per cent in 2000 to 64.1 per cent in 2001, compared with 74.1 per cent in the United States. Four member-states – Denmark, the Netherlands, Sweden and the UK – already meet the Lisbon goal of a 70 per cent or above employment participation rate. Three further countries, Portugal, Austria and Finland, fulfil the EU's interim target of a 67 per cent employment rate by 2005. But the employment rate stands below 60 per cent in Belgium, Italy, Greece and Spain.

Enlargement will only make it harder for the EU to meet its Lisbon employment targets: most of the accession countries have lower overall employment rates. Thus, the employment rate for the EU-25 averages 62.6 per cent. None of the accession countries meets the EU's interim target of 67 per cent, and only the Czech Republic and Cyprus possess employment rates greater than 65 per cent. Indeed, employment rates in a number of the accession countries, including Slovakia, Estonia and the Czech Republic, have fallen in the last three years.

Even in existing member-states, there are ominous signs that job growth could grind to a halt in 2003. Germany reported a large increase in unemployment in January 2003. In the EU as a whole, unemployment edged up from 7.4 per cent in 2001 to 7.8 per cent in December 2002. Japan and the United States also reported increases in unemployment in 2002, but the numbers out of work still stand well below the European average, at 5.4 per cent and 5.8 per cent respectively.

Many European countries have not done enough to reform their labour markets and ensure a sustainable rise in employment rates. The OECD provides an estimate of the 'structural' rate of unemployment – the level to which unemployment could fall without sparking higher inflation. The structural rate provides a rough and ready measure of an economy's capacity to generate high levels of employment.

Several member-states have succeeded in greatly reducing the level of structural unemployment over the last decade. For example, in Ireland the structural rate of unemployment has fallen from 14.1 per cent in the early 1990s to 5.9 per cent in 2000. In the Netherlands, the OECD estimates the structural unemployment rate at 3.7 per cent, compared with 6.8 per cent ten years previously. However, in Germany the rate has increased to 7.2 per cent from 6.6 per cent in the early 1990s.

At the Barcelona summit in March 2002, EU leaders spelt out a number of measures that are designed to raise employment rates,

such as reducing the tax burden on low wage earners, and increasing incentives for women and older workers to remain in the workforce. The Commission subsequently published a revised set of employment guidelines.[27] EU heads of government looked set to adopt this new set of targets, including reductions in youth and long-term unemployment, at their summit in March 2003. Meanwhile in February 2003, Britain, France and Germany jointly proposed the establishment of a high-level committee to develop practical proposals for the reform of European labour markets.

[27] *European Commission, 'The future of the European employment strategy, a strategy for full employment and better jobs for all', January 2003.*

EU member-states have made some progress in reducing the tax burden on lower paid workers. The European Commission estimates that the tax 'wedge' – that is the proportion of labour costs made up of tax and social security contributions – declined by 2.1 percentage points to 43.1 per cent between 1997 and 2001.[28] The tax wedge, however, remains much higher in the EU than in the US or Japan. The tax wedge stands at 30 per cent in the US and at just 24.2 per cent in Japan.

[28] *European Commission, 'The EU economy: 2002 review', December 2002. The figures are for a single worker with no children on the average production wage.*

The OECD provides calculations of the tax burden on workers earning two-thirds of the average wage.[29] These show that between 2000 and 2001, the Netherlands reduced the tax wedge for lower paid workers from 40.6 per cent to 36.8 per cent. France, Finland and Germany also made modest reductions in the non-wage labour costs for the low paid. The tax wedge for low-paid workers in Ireland and the UK is lower than in the United States. In most Eastern European countries, non-wage labour costs are higher than even in the worst performing EU countries. Hungary imposes the highest non-wage costs on low paid workers of any European country, at nearly 50 per cent of total labour costs.

[29] *OECD, 'Taxing wages 2000-2001', 2002.*

The EU must attract far greater numbers of women and older workers back into employment, if it is to have any hope of meeting

its overall Lisbon goals. The average percentage of women aged between 16 and 64 employed in the workforce stood at 55 per cent in 2001, compared with 51 per cent in 1997. But the proportion of women in the workforce ranges from over 70 per cent in Sweden and Denmark to barely 40 per cent in Greece and Italy. None of the accession countries yet meets the 60 per cent target, although more than 55 per cent of women are employed in the Czech Republic, Estonia, Latvia, Lithuania, Romania and Slovenia. The EU provides little information on progress towards its supplementary target of ensuring that member-states provide adequate child-care facilities so that women can return to work if they wish. The Commission believes there has been 'some improvement' and notes that ten member-states now employ national targets for childcare facilities.

The EU is likely to find it extremely difficult to meet its target for the participation of older workers in the labour force. Too many member-states still offer incentives for early retirement in an attempt to ease unemployment problems. In Belgium, Austria and Italy less than 30 per cent of people aged between 55 and 64 are still at work. In the EU as a whole, 38.8 per cent of older workers were employed in 2001, up from 37.8 per cent in 2000, but well short of the 50 per cent Lisbon target. Most of the accession countries face similar problems in enticing older workers to remain in employment. Estonia at 48.4 per cent and Romania at 48.2 per cent are closest to meeting the EU's target.

Bringing people into the workforce	**C**
Heroes	**Britain, Denmark, Ireland, Netherlands, Sweden, Romania**
Villains	**Germany, Italy, Hungary**

D2. Upgrading skills

★ Reduce by 50 per cent the number of 18 to 24 year olds with only a basic secondary education, by 2010

★ Foster a culture of life-long learning, with support from social partners

Education is the key to raising Europe's long-term growth rates. The OECD calculates that for every extra year that students remain in education, total GDP rises by 5 per cent immediately and by a further 2.5 per cent in the long run.

The EU, however, is some way from meeting its Lisbon commitment to halve the number of people aged 18 to 24 who have only a basic secondary education. The proportion of 18 to 24 year-olds who are not in education or training fell from 21.7 per cent in 1996 to 18.9 per cent in 2002, according to Eurostat. Portugal has by far the worst educational drop-out rate. Around 45 per cent of students do not continue with any form of education after reaching 18. In Austria, Finland and Sweden only around 10 per cent of students leave all forms of education at 18. The accession countries perform better than the existing member-states on this indicator: on average just 8.9 per cent of 18 to 24 years old are not in education or training. The Czech Republic, Slovakia and Slovenia possess the best educational retention rates in Europe, with only around 5 per cent of their populations leaving all forms of education at 18.

Europe is unlikely to improve its educational performance simply by throwing more government money at schools and universities. Member-state governments spent on average 5 per cent of GDP on education in 1999, marginally less than the 5.2 per cent spent in the United States but greater than Japan's 3.5 per cent.[30] But the United Nations Children's Fund (UNICEF) ranks the overall quality of education in Japan – and in Korea which only spends 4.1 per cent of GDP on education – more highly than anywhere in Europe.[31]

[30] *OECD, 'Education at a glance', 2002.*

[31] *UNICEF, 'A league table of educational disadvantage in rich nations', Innocenti Report Card, November 2002.*

The UNICEF report, which surveys five measures of educational achievement, including literacy, maths and science, scored Finland, Austria and Britain most highly among the EU's member-states. Denmark, which spends 8.1 per cent of GDP on education, and Germany ranked below the United States and close to the bottom of the table in terms of overall educational attainment.

The EU faces a particular problem in attracting adequate private sector investment into education and training projects. Private sector money is particularly important in terms of adult training and in helping to support high quality academic research. Private sector educational expenditure totals around 0.7 per cent within the EU-15, compared with 1.2 per cent in Japan and 1.6 per cent in the US. The US is able to spend twice as much per student on tertiary education than the EU average, owing to the full-scale involvement of the private sector.

Europe's problems in attracting private finance for education are particularly apparent in the EU's modest progress towards its targets for life-long learning. The Commission reports that an average of 8.4 per cent of workers undertook some training (in the month prior to the survey) in 2002, compared with 5.8 per cent five years previously. The Commission also estimates that only around one-third of EU workers have ever undertaken training in information technology. Yet by 2005, Europe is likely to lack 1.7 million trained workers in the ICT industries.

UK employees are the most likely to participate in training, at a rate of 22 per cent according to Commission figures. In contrast, just 3 per cent of French workers took training courses in 2002. The accession countries have also not yet encouraged the spread of lifelong learning. On average, just 5 per cent of their employees took some form of training in 2002.

Upgrading skills	C
Heroes	Austria, Britain, Finland, Czech Republic, Slovakia, Slovenia
Villains	Denmark, France, Germany, Portugal

D3. Modernising social protection

★ Overhaul pensions systems to ensure the long-term sustainability of public finances

★ Increase the effective retirement age by five years (to 65) by 2010

★ Significantly reduce the number of people at risk from poverty and social exclusion

Europe is just beginning to wake up to the fact that it is facing a pensions crisis. The UN is forecasting that over the next half century the number of people above the age of 65 will increase from 60 million to 100 million in the existing EU member-states. The proportion of the population that is over 80 years old will treble to 38 million during the same period. A demographic shift of that magnitude threatens the long-term sustainability of Europe's pensions systems.

The accession countries face a similar demographic problem. Although the average age of the population in Central and Eastern Europe is lower than in the existing EU at present, these countries are ageing even faster. The birth rates in Estonia, Lithuania and the Czech Republic rank among the lowest in the world. The UN predicts that by 2050 the ratio of workers to retired people in the new member-states will be similar to that of Western Europe.

The EU's demographic problems contrast starkly with the situation in the United States. The number of American pensioners is rising rapidly as the 'baby boomer' generation reaches retirement age. However, the birth rate in the United States is much higher than in Europe. Just as importantly, the US continues to accept far greater numbers of immigrants than the EU. On present trends, the US – which only possessed half the EU-15's population in 1950 – will have a larger population than Europe by 2050, 400 million as opposed to 360 million in the EU-15.

The European Commission estimates that EU member-states spent an average of 10.4 per cent of GDP on pension provisions in 2000. This share would rise to 13.6 per cent by 2050, if member-states failed to reform their pensions systems. Some EU governments may need to spend even greater sums. The Commission forecasts that Greece would need to double its spending to 25 per cent of GDP by 2050, if it does not reform its pension system. Germany and Spain would have to devote around 17 per cent of GDP each year to meet their financial obligations to the retired population.

EU governments are just beginning to treat the reform of pension systems as a common problem. While member-states remain responsible for deciding what to do and when, the EU governments have agreed on 11 common objectives for pensions reform, with the purpose of ensuring the long-term sustainability of public finances. In September 2002, EU governments submitted their first national strategy reports on pensions. In December, the Commission issued its own assessment of the EU's progress towards meeting the common objectives.[33]

[33] *European Union, 'Joint report by the Commission and Council on adequate and sustainable pensions', December 2002.*

The Commission concludes that higher economic growth within the EU could alleviate some of the pensions problem. Unfortunately, Europe's ageing population is likely to make it even more difficult to improve the EU's growth record: the Commission forecasts that the impact of demographic change will be to reduce Europe's underlying rate of growth from around 2 per cent now to just 1.25 per cent in 2050.[34]

[34] *European Commission, 'Economic and financial market consequences of ageing populations', European Economy review, November 2002.*

The EU has made an increase in the retirement age a priority of the Lisbon economic reform process. For too long, governments have used early retirement as a means of reducing high unemployment. Moreover, many businesses regard older workers as expensive and unproductive. When companies need to reduce costs, those close to

retirement age are often the first to be shown the door. As a result, the real average age of retirement for EU male workers is 60, compared with the normal statutory age of 65. In Greece, just 20 per cent of male workers continue until 65, while in Belgium the average age of retirement is 57.

The Commission forecasts that if the member-states succeeded in raising the average retirement age by five years, without increasing the level of pension benefits, the cost of Europe's pension systems would remain stable. However, no member-state has yet devised a clear strategy for encouraging workers to stay in employment longer. A solution need not necessarily involve an increase in the statutory retirement age. But it will require a reduction in early retirement incentives. Member-states will probably need to offer the 'carrot' of increased pension benefits to those who delay retirement. Governments will also need to place greater emphasis on skills training for older workers, to ensure that they can remain competitive within the workforce.

Even if the EU succeeded in increasing the effective age of retirement, most member-states would still need to reduce the cost of providing pensions, to secure the long-term sustainability of public finances. In particular, EU governments need to cap state pension payments, and encourage a much higher level of private provision. Most reform plans will be based around the creation of three 'pillars': a state-funded system which provides a basic financial safety-net; private company pension schemes – and some countries may make membership of these schemes compulsory; and individual pension plans for the self-employed or for workers to 'top up' the other parts of their pensions.

Germany, for instance, introduced reforms in 2001 which capped future social security contribution rates, and increased the incentives for joining private pension schemes. But German workers have so far shown a reluctance to join the new private schemes: the take-up rate is only around a quarter of what had

been expected.[35] France and Italy, meanwhile, have yet to begin systematic reform and have very little private provision. Indeed, the Commission gave a clean bill of health to just two countries, Britain and Sweden, in the pensions report published last autumn. The Commission warned that Greece, Spain, France and Austria face a substantial increase in pension liabilities over the coming years and must urgently reform their systems.

35 Deutsche Bank, 'Riester-Rente off to a slow start – further reforms urgently needed', Frankfurt Voice, July 22nd 2002.

But even Britain and Sweden cannot take the long-term sustainability of their pension systems for granted. The decline in stock markets has left many British pensioners facing a huge shortfall in their expected incomes. British companies are rapidly scaling back the previously generous benefits paid through their pensions funds, and in some cases withdrawing support altogether. A recent report from PricewaterhouseCoopers, the accountancy firm, estimated that on current rates of growth the average British pension would only be worth around 25 per cent of average earnings by 2050.[36] British workers once expected to retire on a pension equivalent to two-thirds of their final earnings. Like the rest of the EU, the UK could find that the pensions crisis is not so simple to resolve.

36 Financial Times, 'Value of average pension set to fall by 25 per cent', February 10th 2002.

Among the accession countries, Estonia, Latvia, Hungary and Poland have already made substantial reforms to their pensions systems. Poland, which is widely regarded as an exemplary model, has introduced a three-pillar system to encourage greater private provision, including compulsory company pensions. The Polish government is also planning to create a reserve fund to help ensure the long-term sustainability of the state pension fund. At the other end of the spectrum, the Czech Republic has so far only undertaken piecemeal reforms. Deutsche Bank estimates that without further reform the Czech government would need to increase pension contribution rates from 26 per cent now to 44 per cent by 2030.[37]

37 Deutsche Bank, 'Pension reform in the large accession countries', EU Enlargement Monitor, October 2002.

The EU's efforts at tackling poverty and social exclusion are difficult to assess. There is a dearth of reliable and consistent data for the member-states and the accession countries. Although the Council of Ministers recently revised the EU's common approach to fighting poverty, the objectives remain ill-defined, beyond the general acceptance that higher employment rates reduce social exclusion.[38] Member-states are due to submit new two-year social exclusion national action plans in the summer of 2003. The Commission will then publish a general assessment of progress, ahead of the 2004 spring summit. The Commission should take this opportunity to provide a far more detailed appraisal of the problems of poverty within the EU.

38 European Council, 'Fight against poverty and social exclusion: Common objectives for the second round of national action plans', November 5th 2002.

The EU's structural indicators do provide some proxy measures for social exclusion. For instance, jobless households are at far greater risk of poverty. Within the EU, Belgium possessed the highest number of jobless households in 2002, at 16.3 per cent. The UK was the second worst offender, at 14.3 per cent, indicating that there remain deep pockets of social exclusion in the UK, despite the low overall level of unemployment. Reassuringly, the number of jobless households in the accession countries is no greater than for the member-states. Bulgaria at 18.3 per cent and Hungary at 15.6 per cent are the only two accession countries above the EU average of 12.1 per cent.

Britain also scores poorly on the EU's measure of 'poverty risk', which is defined as a level of disposable income of below 60 per cent of the country's average. Taking into account social security and benefit payments, 19 per cent of Britain's population was at risk of poverty in 1999 – only Greece and Portugal possess higher rates at 21 per cent. In Sweden, just 9 per cent were at risk of poverty in 1999, on this measure.

Modernising social protection	C
Heroes	Sweden, Poland, Britain (for pensions)
Villains	France, Greece, Italy, Britain (for social exclusion)

E. Sustainable development and the environment

E1. Climate change

★ Reduce greenhouse gas emissions by 8 per cent from 1990 levels by 2010, in line with the Kyoto protocol

★ 22 per cent of electricity from renewable sources by 2010

★ Break the link between economic growth and transport volumes, by prioritising public and environmentally friendly forms of transport

EU heads of government agreed to add a series of environmental targets to the Lisbon agenda at the Göteborg summit in June 2001. Climate change is an area of the Lisbon process where the EU can claim to have made steady, if unspectacular progress, although the data must be treated with some caution as the most recent reporting year is 2000. The EU is committed to meeting the Kyoto target of an 8 per cent reduction in greenhouse gas emissions by 2008. However, the United States has refused to ratify the Kyoto agreement, leaving its long-term significance in doubt.

The EU reduced greenhouse gas emissions by 3.5 per cent between 1990 and 2000, according to the European Environmental Agency, which monitors the EU's environmental performance. In the same period, the US reported an 11 per cent increase while in Japan emissions rose by 10 per cent. However, EU greenhouse gas emissions rose by 0.3 per cent between 1999 and 2000, suggesting that progress towards the Kyoto targets may be slowing.

Five countries – Luxembourg, France, Finland, Sweden and UK – already meet their individual Kyoto targets. Germany still needs to reduce emissions by a further two percentage points to meet its target, but has succeeded in cutting emissions by 19 per cent during the decade. The accession countries have succeeded in reducing

emissions by nearly one-third since 1990, reflecting efforts to overhaul outdated industrial and power station technology in the region. Only Slovenia has so far failed to meet its Kyoto target.

At the other end of the scale, emissions in Spain have risen by a third since 1990, more than double the country's permitted increase under the Kyoto protocol. Ireland is also facing problems meeting its target, recording a 24 per cent rise during the decade.

The EU is also making progress towards meeting its target for renewable electricity production. In 2000, 14.7 per cent of electricity derived from renewable sources, such as hydro-electricity and wind, compared with 14.0 per cent in 1999 and 12.9 per cent in 1991. However, this headline figure conceals major differences between the member-states. Austria, which benefits from a high hydro-electricity capability, produces nearly three-quarters of its electricity from renewable sources and Sweden slightly more than half. However, Belgium, Luxembourg and the UK produce less than 3 per cent of their electricity from renewable sources. Among the accession countries, Latvia, Slovenia, Slovakia and Romania all generate more than the EU average from renewables. Estonia and Hungary, however, produce less than 0.5 per cent of their electricity in this fashion.

The EU has had less success in reducing the strain on natural resources by 'decoupling' – that is breaking the link between economic and transport growth. The overall volume of road freight transport continues to grow at a faster pace than the EU economy, according to data compiled by Eurostat. The percentage of goods carried by road within the EU has increased from 72 per cent in 1991 to 77 per cent in 2000. In contrast, less than 60 per cent of freight goes by road in the United States. In Denmark, Greece, Ireland and the United Kingdom more than 90 per cent of goods are transported on the roads. Even the EU's best performers, Austria, the Netherlands and Sweden, shift around 60 per cent of goods by road. Among the candidate countries, Estonia, Latvia and Slovenia

make the greatest use of their rail and waterway networks: less than 40 per cent of freight in these countries goes by road.

The EU performs slightly better in terms of the proportion of passenger journeys made by car. In 2000, 84 per cent of passenger journeys in the EU were made by car, a figure virtually unchanged since 1995. The EU's performance compared favourably with 95.5 per cent in the United States but not against the 61 per cent recorded in Japan. The UK is the most car-dependent country in Europe, with 88 per cent of passenger journeys made by car. Although comparable figures are not available for the accession countries, data suggest a far lower degree of car dependency: car ownership in the accession countries stands at just 231 cars per 1000 people, compared with 451 in the EU.

The Commission has promised action in 2003 to try to reduce the damage done to Europe's environment by road transport. The Commission is hoping to push through the long-blocked energy tax directive, which it believes could cut emissions by a further 0.5 per cent. The Commission is also preparing a framework directive for infrastructure pricing. At present, road hauliers pay tolls in some member-states but also have to purchase a 'Eurovignette' licence to use motorways in member-states such as Britain and Germany which do not impose tolls. The Commission's proposal would introduce harmonised road tolls for commercial road users, in an effort to reflect more closely the true economic and environmental costs of road transport. However, the Commission is likely to find that member-states are reluctant to pursue the proposal in the face of opposition from the vocal road haulier organisations.

Climate change	**C+**
Heroes	**Austria, Germany, Sweden, Latvia**
Villains	**Ireland, Spain, Britain (for car use)**

E2. Natural environment

★ Reduce exposure to particulates and ozone emissions

★ Improve management of natural resources and stop the depletion of biological diversity

While the EU has made some progress towards meeting its climate change commitments, the rest of its environmental record is less impressive. The EU is committed under the sixth environmental action programme, adopted in July 2002, to meeting a series of targets designed to preserve bio-diversity and reduce exposure to harmful pollution.

The European Environment Agency (EEA) monitors ozone and particulate levels in the air. The EEA concludes that (ground) ozone levels in the EU appear to have increased over the last ten years. In 2000, 20 per cent of the EU population was exposed to ozone levels above the agreed safety limits for more than 25 days, compared with just 7 per cent in 1991. Austria and Italy recorded the highest ozone levels in 2000 – 90 per cent and 75 per cent of their respective populations were exposed to excessive levels for more than 25 days. However, the EEA cautions that it is difficult to detect an overall trend: ozone levels naturally fluctuate from one year to another, owing to weather conditions.

Similarly, the EEA is unable to reach a firm conclusion about the trend in particulate levels, owing to the lack of coherent data. But the EEA does state that a "large" proportion of Europe's urban population is exposed to particulates above the limits set for protecting human health. Some 38 per cent of the EU's urban population was exposed to high particulate levels on more than 35 days in 2000, including virtually the entire urban populations of Italy, the Netherlands, Portugal and Spain.

The EU is also struggling to reduce the vast quantities of waste it produces. The Commission estimates that the EU generates around 1.3 billion tonnes of solid waste every year. Around two-thirds of this waste is either burnt in incinerators or dumped in landfill sites – disposal practices which further contribute to pollution. The OECD predicts that on current rates of growth, the EU will generate nearly twice as much waste in 2020 as it did in 1995.

The Commission is therefore targeting a 20 per cent reduction in non-recycled waste by 2010. However, the quantity of domestic waste continued to rise in 2000, the last year for which data are available. Each European citizen threw away some 550 kilograms of domestic waste in 2000, compared with just 370 kilos a decade previously. The Spanish, Danish and Irish emerge as the EU's biggest litterbugs. Among the accession countries, Cypriots dispose of 768 kilos of waste each year, nearly as much per person as the Americans.

The EU has made progress in reducing the amount of waste that is dumped in landfill sites – 232 kilos per head of population in 2000, compared with 338 kilos in 1995. Ireland and the UK, however, continue to fill up landfill sites at a faster rate than any other member-state. Belgium, Germany, Luxembourg and the Netherlands have all reduced their reliance on landfill sites. Cyprus and Estonia make greatest use of landfill disposal sites among the accession countries.

The EU made a first attempt to try and reverse the destruction of natural habitats and wildlife as far back as 1979, when it reached agreement on a wild birds directive. In 2002, nearly 8 per cent of the EU's landmass was designated for protection under this directive. Similarly, the member-states are committed to protecting 14 per cent of the landmass under the habitats directive. The directive seeks to preserve some 200 habitat types and nearly 700 flora and fauna species from extinction. But the European Environment Agency estimates that 38 per cent of bird species and 45 per cent of butterfly species in Europe are vulnerable to extinction, despite these two directives.

For all the EU's efforts to improve its environmental record, its agriculture and fisheries policies continue to take a heavy toll on Europe's eco-systems. The vast majority of the EU's fishing grounds are heavily over-fished. Indeed, North Sea cod is on the verge of extinction.

Franz Fischler, the agriculture and fisheries commissioner, proposed a radical reform of the fisheries policy in the summer of 2002, including the virtual closure of the North Sea cod fishing field, and a substantial reduction in the number of fishing trawlers. However, the EU member-states – led by Spain – succeeded in watering down the Commission's reform plan. The Commissioner has also put forward a wide-ranging plan for the reform of the CAP, including the diversion of subsidies away from intensive farming towards more environmentally friendly farming methods. At the time of writing, however, France was mounting a concerted campaign against the Commission's proposed reforms.

Natural environment	**C**
Heroes	**Belgium, Germany, Netherlands**
Villains	**France, Ireland, Spain**

4 Conclusion and summary of results

★ Develop the world's most competitive and dynamic knowledge-based economy by 2010

★ Ensure average annual economic growth of 3 per cent, leading to the creation of 20 million jobs by 2010

Three years into the Lisbon reform agenda, the EU remains some distance from achieving its overall goal of becoming "the world's most competitive and dynamic knowledge-based economy by 2010". The Commission estimates that the United States was around 40 per cent richer than the EU in 2002 in terms of GDP per capita, although the gap has narrowed slightly since the mid-1990s. The Commission also estimates that the productivity gap between Europe and the United States widened in 2002, which suggests that the EU will struggle to keep pace with the US economy in the near future. The Commission concludes in its report to the 2003 spring economic summit that "under present circumstances the global ambitions of the Lisbon strategy will be difficult to realise".

However, the third CER scorecard also demonstrates that the EU has made good progress in many areas of the Lisbon reform agenda. The EU has successfully encouraged the spread of new technologies, such as the internet, and reduced the administrative barriers to the creation of new businesses. Member-states have also put aside their differences to agree on a number of key liberalising measures, such as opening up the EU's energy market.

The Commission deserves credit for its role in pushing the Lisbon agenda forward. It is becoming much more robust in its criticism of

the performance of member-states. The Commission's annual report on the Lisbon agenda and its various scorecards now clearly identify those countries that are not fulfilling their economic reform commitments. In future years, the Commission should combine trenchant criticism of the EU's performance with an analysis of how some member-states, such as Finland and Denmark, are succeeding in meeting the Lisbon goals.

The EU should certainly improve its decision-making processes further. The Commission notes that it still takes, on average, four and a half years from a proposal for new legislation to its implementation by member-states. In some cases, such as the proposed takeover directive and Community Patent, the legislative process is considerably longer. And even when Europe does agree to legislation, member-states too often fail to implement the new rules in a timely and efficient fashion.

The Centre for European Reform has made a number of suggestions as to how the EU can reform its economic decision-making structures.[39] For instance, Ecofin – the council of finance ministers – should in future oversee the Lisbon reform agenda, while the Commission should gain stronger powers of enforcement. The Convention on the future of Europe is discussing a number of these ideas at the time of writing.

[39] *Alasdair Murray, 'European economic reform: Tackling the delivery deficit', CER, October 2002.*

However, institutional reform is no substitute for political will. This scorecard shows that the EU's most persistent failings are in those areas of the Lisbon agenda where its aspirations are most vague, such as labour market and pension reform. These are also the parts of the Lisbon programme where political sensitivities are greatest and where member-state governments alone can decide how and when to take action. Unless some EU member-states, most notably Germany and Italy, are prepared to show greater political willingness to push forward with reform, the EU has no hope of meeting its Lisbon targets.

The EU should provide a clearer 'road map' for reform in the key areas of the Lisbon strategy. All parts of the Lisbon programme are important. But in the short term, some are more important than others. The eEurope and financial services action plans show how a series of well-defined targets can help the EU to make steady progress towards specific Lisbon goals.

In this context, the British, French and German governments have suggested that the EU should establish a high-level committee to investigate European labour market problems. This is a welcome proposal, so long as the committee can provide a clear action plan and fresh political impetus to the challenge of raising EU employment rates. But the proposal should not be used as an excuse to delay much-needed reforms. The EU has only recently completed a review of its labour market policies. Heads of government should reach agreement on a new three-year employment strategy at the 2003 spring European Council. Member-states need to push ahead with reform on the basis of the new employment strategy, rather than wait for the high-level committee's report.

Overall, the EU should make a priority of the following themes during the coming year:

★ The completion of the single market in utilities, transport and financial services.

★ The creation of a single market in business services. The service sector – including accountancy and consultancy firms, information technology companies and leisure groups – accounts for around 70 per cent of employment in the EU. However, cross-border trade in services has not grown since the creation of the single market in 1992. The Commission is due to bring forward proposals for reducing the barriers to the provision of cross-border services in 2003. Many services, such as hairdressing, cannot be easily traded across borders. Others,

such as education or health services, are politically sensitive and remain under state control in most member-states. Thus the Commission should initially focus on liberalising the market for those service companies, such as accountancy and consultancy firms, which already operate across member-state borders.

★ A research and development 'road map' that would provide concrete suggestions on how member-states can stimulate greater investment in innovation. In particular, the EU should examine how changes in taxation could encourage businesses to invest more in R&D.

★ A renewed focus on labour market reforms. In particular, the proposed high-level committee should provide guidance on how member-states can raise the effective rate of retirement. The EU would have a much greater chance of meeting both its employment and pension goals if it succeeded in keeping older workers in employment longer.

Overall assessment of results: C+

The Scorecard

Issues	2003	2002	Heroes	Villains
A. Innovation				
Information Society	B-	C+	Netherlands, Sweden, Estonia, Slovenia	Greece, Bulgaria, Romania
Research and development	C-	C+	Finland, Sweden, Slovenia	France, Italy
B. Liberalisation				
Telecoms and utilities	B-	B+*	Denmark, Finland, Poland, France (for energy)	Ireland, Italy France (for telecoms)
Transport	B-	D-*	Denmark, European Parliament	France
Financial services	B-	B-	Britain, Poland	Germany, Italy
C. Enterprise				
Business start-up environment	B-	D	Austria, Finland, Ireland, Sweden, Estonia, Poland	France, Greece
Regulatory burden	C+	D+	Commission, Denmark, Finland, Estonia, Poland	France, Italy, Bulgaria, Romania
State aid and competition policy	C+	B-	Britain, Greece, Sweden, Estonia, Slovakia	Finland, Germany, Hungary
D. Employment and social inclusion				
Bringing people into the workforce	C	B-	Britain, Denmark, Ireland, Netherlands, Sweden, Romania	Germany, Italy, Hungary

Issues	2003	2002	Heroes	Villains
Upgrading skills	C	D	Austria, Britain, Finland, Czech Republic, Slovakia, Slovenia	Denmark, France, Germany, Portugal
Modernising social protection	C	C+	Sweden, Poland, Britain (for pensions)	France, Greece, Italy, Britain (for social exclusion)
E. Sustainable development and the environment				
Climate change	C+	C	Austria, Germany, Sweden, Latvia	Ireland, Spain, Britain (for car use)
Natural environment	C	C-	Belgium, Germany, Netherlands	France, Ireland, Spain
Conclusion				
The Lisbon process	C+	C-	Denmark, Finland	Germany, Italy
Overall assessment of results	C+	C		

* In the 2002 scorecard, utilities and transport were assessed in one section, and telecoms separately. Consequently, the scores do not exactly correspond.