The Lisbon Scorecard IV

The status of economic reform in the enlarging EU

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ABOUT THE AUTHOR


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Foreword

KPMG is delighted to sponsor the CER’s annual European economic reform ‘scorecard’. This is the fourth assessment of progress towards the EU’s target, declared in 2000, of becoming the world’s most competitive and dynamic knowledge-based economy by 2010. Once again, the CER has provided an independent and hard-hitting analysis and critique of the programme.

As the halfway point rapidly approaches, it is vital that the EU takes stock of what has been achieved and, more pressingly, what remains to be done. While we can celebrate some notable milestones so far, it is clear that the speed of reform needs to accelerate if the prize is to remain within our grasp. The challenge requires a sense of purpose and co-ordinated effort but it has been demonstrated before that Europe can achieve a great deal when its member-states work together in pursuit of a common goal.

The eastward expansion of the EU should galvanise thinking. While regarded in some quarters as a threat, it actually represents an opportunity to re-invigorate the reform programme. And the new members’ active participation in the Lisbon process is essential if the political ‘iron curtain’, which for so long divided Europe, is not to be replaced by an economic divide. With our many offices from Belfast to Bucharest, KPMG knows very well how much these countries can contribute to a united Europe.

It has been another difficult year for the European economy but the clouds are beginning to lift and the Lisbon strategy provides a clear road map of the way ahead. Businesses across the continent are ready to play their part. But political leaders must confront the hard choices and provide the leadership that Europe badly needs, if we are to meet the challenge of improving competitiveness in the twenty-first century.

Mike Rake
International Chairman of KPMG
1 Introduction

At the Lisbon summit in the spring of 2000, EU leaders signed up to an ambitious economic reform programme that is designed to close the economic gap with the United States. Member-states agreed at Lisbon to make their labour markets more flexible, stimulate innovation, encourage entrepreneurs, spend more on research and development and complete the single market. The European Commission calculated that the reform programme, quickly dubbed ‘the Lisbon agenda’, could increase the EU’s underlying annual growth rate by up to 0.75 percentage points over the next decade, bringing it into line with the US.

Four years on, EU heads of government will assemble in Brussels in March 2004 to review progress towards these ambitious targets. Even the most enthusiastic proponents of the Lisbon agenda can only describe the EU’s performance over the last twelve months as mediocre.

After a second consecutive year of disappointing economic growth, it is already apparent that the EU will miss some of its key targets. EU GDP grew by just 0.8 per cent in 2003. While the Organisation for Economic Co-operation and Development predicts an improvement to 1.9 per cent in 2004, it also forecasts that US growth will climb to 4.2 per cent.¹ The Commission admits in its report for the spring European Council that the EU will not close the economic gap with the US by the end of the decade.²

Employment growth in the EU also ground to a halt in 2003, the first year out of the past five that the number of people in work did

not increase. The EU will miss its interim employment target of 67 per cent of the working age population in jobs, and almost certainly fail to reach its overall Lisbon goal of 70 per cent employment in 2010.

In the run up to the Brussels summit, various coalitions of EU leaders desperately cast around for ideas to reinvigorate the Lisbon process. The Irish, Dutch, Luxembourg and British finance ministers called for the EU to cut red tape. Meanwhile, the British, French and German governments suggested spending more EU money on research and development and proposed the creation of a ‘Lisbon commissioner’ to oversee the EU’s economic reform efforts (see conclusion). In reality, most of these supposedly new ideas were simply restatements of existing proposals and commitments. In contrast to previous years, EU leaders have failed to find a high-profile issue, such as the liberalisation of energy markets, to demonstrate their continuing commitment to economic reform. Worryingly, EU governments look bereft of new ideas to reinvigorate the reform agenda just as the EU begins a mid-term review of the Lisbon process.

But the EU’s disappointing record over the last year does not mean that the Lisbon agenda should be consigned to history. This scorecard will show that certain countries have taken their commitments very seriously. In particular, France and Germany – having faced repeated criticism for their failure to achieve Lisbon goals – respectively pushed through painful pension and labour market reforms in 2003. Germany deserves special credit for its Agenda 2010 package of labour market measures, which included cuts to unemployment benefits, the loosening of employment protection laws and reform of its job seeking agencies. The Commission also continues to do valuable work, whether pushing forward the financial services action plan or clamping down on illegal state aid.

Nor should the EU’s patchy overall performance obscure the impressive performances of some countries. The Nordic member-

states, Denmark, Finland and Sweden, score well in almost every aspect of the Lisbon agenda. Their economic strength is borne out by surveys of international competitiveness, such as the World Economic Forum’s (WEF) global competitiveness index. The WEF places Finland top for the second consecutive year. Third-placed Sweden and fourth-placed Denmark recorded marked improvements in their overall scores, with Sweden almost overtaking the US in second place. Their success is a reminder that a country can achieve high levels of competitiveness without importing wholesale the Anglo-American economic model.

A second group of countries, including Britain, Ireland, the Netherlands and Spain, are highly committed to the Lisbon process and perform well on many, although not all, measures. Ireland, in particular, has made remarkable progress in raising both its employment and productivity levels over recent years: it now has the highest productivity level (measured as output per hour worked) in the EU. Its education and employment policies offer a good example to other member-states, particularly accession countries that are keen to catch up with West European income levels. However, Ireland cannot yet match the Nordic countries in terms of its innovation record, while its rising wealth is not shared evenly across the country.

The third group includes the eurozone’s two largest economies, France and Germany. Both countries possess many strengths and remain among the richest EU member-states. The WEF ranks Germany 13th in its competitiveness index, which is ahead of the UK. Some of Germany’s problems can be attributed to the ongoing after-effects of reunification. However, unemployment remains far too high in Germany and France, while the former’s poor growth rate acts as a drag on the rest of the eurozone. The reforms introduced by the French and German governments over the last year are significant, but are unlikely to ensure the two countries achieve their Lisbon goals.


Finally, there are the laggards. Greece and Portugal score poorly on most Lisbon measures but at least are pushing through some reforms. Italy, Europe’s fourth largest economy, appears to be sliding backwards. Its employment rate is now the lowest in the EU-15. Italy has slipped from 33rd to 41st in the WEF scorecard – not only the lowest among the EU-15, but also behind the three Baltic states as well as Slovenia, the Czech Republic and Hungary.

It remains hard to provide a definitive assessment of the performance of the accession countries. The new entrants are starting from a much weaker economic base than the existing EU member-states and there are still gaps in the data. However, several accession countries are in better shape than some of the existing members. Estonia scores highly in a range of surveys. For example, the WEF competitiveness survey ranks it 22nd, ahead of France and Spain. Malta comes 19th in that survey, while Cyprus can be proud of its strong employment record.

This paper is the fourth edition of the CER’s Lisbon scorecard. We have largely followed the format of the previous three scorecards, except to make minor changes that take account of the evolution of the EU’s economic reform agenda. For instance, this edition includes a short section on the liberalisation of (non-financial) services, which is likely to form a key element of the Lisbon agenda over the next few years.

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 as ‘villains’. The EU is producing data of an increasing quality, and quantity, which makes it easier to determine which countries are genuinely trying to meet the Lisbon goals, irrespective of their economic starting point.
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 is supposed to have almost completed the creation of the single market. In practice, many barriers to cross-border business remain in place. At Lisbon, the 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.
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 Lisbon European Council in March 2000 was dubbed the ‘dot.com summit’ by the media. Four years on, the new economy hype may have faded but the importance of new technologies to the long-term health of the European economy continues to increase.

The EU is half way through its second ‘eEurope’ action plan, a series of measures designed to encourage businesses, consumers and governments to adopt new technologies. On many measures the ‘eEurope’ action plans have been successful. The proportion of the EU-15 households with internet access more than doubled between 2000 and 2003 to 47 per cent, according to Commission data. In Sweden and Denmark 64 per cent of the population have internet access at home, compared with 54 per cent in the United States (Iceland has the highest rate in the world at 69 per cent). Even in Greece, which has the lowest level of internet access among existing EU members, the number of households on-line has tripled to 16 per cent since 2000. Two of the accession countries, Cyprus and the

★ Enterprise

Dynamic new firms are the key to job creation and innovation. But Europe does not reward entrepreneurial success sufficiently, 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 and its governments need to ensure that small firms face a more benign environment. It should also 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, as well as in ensuring the long-term sustainability of public finances. The EU and its governments need to find ways of persuading people to take up jobs, and of helping them to acquire the skills necessary to compete in fast-changing labour markets. 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

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.
Czech Republic, have household internet penetration rates above those of Greece.

Over the last year, the EU has also seen a rapid spread of other cutting-edge technologies, such as broadband and 3G (third generation) mobile phones. After a delay caused by debt problems in the telecoms sector, companies have started to offer 3G services in five member-states. Meanwhile, the number of households with broadband doubled to 17.5 million in the year to July 2003. Denmark, Belgium and Sweden all have broadband penetration rates of more than 10 per cent. Belgium is the first member-state to have complete coverage, meaning its citizens can access broadband as easily as the telephone. On the other hand, less than 1 per cent of people in Ireland and Greece have access to broadband.

Despite these encouraging developments, overall the EU continues to lag behind the US in the use of new technologies. There are, however, large differences between the individual EU countries. On the ‘network readiness index’ – a World Economic Forum (WEF) measure of new information technology use – the US continues to lead, followed by Singapore. The EU’s Nordic members occupy the next three places on the list. Among the accession countries, Estonia is placed a credible 25th, ahead of four existing EU members: Spain, Italy, Portugal and Greece. The WEF ascribes Estonia’s relative success to the government’s heavy investment in new technology, although internet usage among businesses and individuals remains relatively low.

A number of EU member-states are also at the vanguard of providing government services electronically. New technology should enable governments to offer cheaper and more efficient services, such as online tax forms or licensing applications. The United Nations ranks Sweden 2nd, Denmark 4th and the UK 5th, behind the United States, in its 2003 survey of global e-government readiness. Estonia again scores relatively highly: the UN ranks the Baltic state at 16th. A separate e-government survey by Accenture, the consultancy firm, produces similar results. Accenture ranks Denmark most highly among the European countries, although it still lags behind Canada, Singapore and the US.

Cap Gemini Ernst & Young, the IT consultancy firm, has conducted more detailed research into on-line government services for the European Commission. It found that although most EU member-states offer a wide variety of services on-line, their scope and sophistication varies greatly. Sweden comes out on top in terms of sophistication, followed closely by Denmark and Ireland. Denmark offers the greatest range of government services electronically (90 per cent of all available services), followed by Austria and Sweden. Austria is the member-state which has made the greatest improvement over the last year: 68 per cent of services are now available fully on-line compared with just 20 per cent in October 2002. In contrast, Luxembourg provides just 1.5 per cent of government services on-line and is also ranked bottom for sophistication. Generally, businesses enjoy a wider range of services on-line than private citizens, including on-line VAT returns, customs declarations and corporate tax returns.

The EU also continues to lag behind the US in terms of its total expenditure on information technology. In 2003 average IT spending in the EU stood at 3 per cent of GDP, unchanged from 2002, but below a high of 3.3 per cent in 2000. The United States meanwhile spent 3.6 per cent of GDP on IT, a slight rise from 3.5 per cent in 2002. Both Sweden and the UK spend more on IT than the US, 4.4 and 4.0 per cent of their respective GDPs. Spain and Greece are the laggards among the EU-15, with IT spending of only 1.6 per cent and 1.2 per cent respectively. Some of the acceding countries, notably the Czech Republic and Estonia, already spend more of their (albeit much lower) GDP on IT than the EU average.

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8 Cap Gemini Ernst & Young, ‘Online availability of public service: how is Europe progressing?’, October 2003.
Of course, IT expenditure provides only a crude measure of a country’s technological development. The figures do not indicate whether spending goes towards games consoles and other consumer electronics or towards productivity-boosting investment. Moreover, the economic impact of IT spending depends on how effectively technology is used in practice. Here, it seems that European companies have much to learn from their US counterparts.

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A2. Research and development (R&D)

★ Community patent by the end of 2001

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

Worried about the EU’s low overall R&D spending, EU leaders used their Barcelona summit in March 2002 to add another target to the list of Lisbon indicators: annual spending on R&D should reach 3 per cent of GDP by 2010. However, this overly ambitious and somewhat arbitrary yardstick has since attracted widespread criticism.

The Organisation for Economic Co-operation and Development (OECD) points out that the target remains out of reach for most EU countries, and that the EU as a whole would have to double its R&D expenditure between 2000 and 2010 to achieve the objective. The OECD argues that the EU should focus on improving the effectiveness of its R&D spending, rather than rushing to meet the 3 per cent target. The Commission, however, insists the 3 per cent figure is “realistic”. It estimates that meeting the target could help create an extra 400,000 jobs each year after 2010.

Although EU R&D spending is on a modestly rising trend, it remains well short of the 3 per cent target. In 2002, the EU-15 spent an average of 1.99 per cent of GDP on R&D, compared with 1.92 per cent in 1999. In 2002 the US spent 2.67 per cent and Japan 3.06 per cent of GDP on research and development.

The member-states have agreed that most of the increase in R&D should come from the private rather than the public sector. Accordingly, the EU hopes to increase the share of private sector R&D spending from 55 per cent at present to 66 per cent by 2010. However, many member-states are unsure about how to encourage private businesses to spend more on R&D. The Commission advocates fiscal incentives, such as tax breaks for companies that...
invest in R&D. It has also promised to modify its guidelines on state aid to allow member-states to support R&D expenditure by small businesses.

In addition, the Commission wants the EU to leverage its own R&D spending by encouraging researchers from different countries to work together. For this purpose, the Commission has proposed the establishment of ‘technology platforms’ – networks for researchers to share information in key areas such as nanotechnology, plant genomics and hydrogen technologies. The Commission is also examining ways in which the EU could stop the ‘brain drain’ of many top researchers to the US. Finally, it has recommended that the EU shift more of its common budget towards R&D spending during the next budget period that runs from 2007 to 2013. In particular, it wants EU R&D spending to rise to €10 billion, which would amount to 10 per cent of total EU public spending. It also wants EU countries to spend more of the structural funds for disadvantaged regions on R&D.

The EU seemingly reached agreement in 2003 on a community patent – some two years after the original 2001 deadline. The Commission estimates that the new patenting system could save European businesses up to €500 million a year because companies will no longer need to register their inventions in every national patent office.

Nevertheless, the OECD reckons that European businesses would still face patenting costs twice as high as competitors in Japan and the US. Companies would still have to translate the first few pages of the patent, which define its legal scope, into all EU languages – an expensive proposition for smaller businesses. But in early 2004 member-states were still fighting over the details of the agreements, leavings its final outcome in doubt. Even if the EU manages to conclude a deal the new patenting system will not become fully operational until 2010 when the EU establishes a patent court in Luxembourg. The Commission concludes that the community patent “may not be sufficient to overcome” the EU’s rather poor innovation record.

The relatively low number of patents that European companies file at home and abroad reveals how the EU still fails to keep pace with the US. European companies filed 161 patents per million of population at the European Patent Office (EPO) in 2001, while US firms took out 170. The gap is far larger at the United States Patent Office, where US companies filed 322 patents per million of population, compared with just 80 by European businesses.

The EU continues to lag behind the US in most other aspects of innovation policy. According to the Commission’s annual ‘innovation scoreboard’, the EU is ahead of the US in just one of the 12 indicators examined, namely the total number of science and technology graduates. But even this small success is qualified by evidence that the EU does not make good use of its human resources. Many of the EU’s best and brightest move to the US, where research budgets are larger and researchers are likely to get substantially higher pay packages. The Commission estimates that around 400,000 EU science graduates are working in the US at present. In 2001, the US had eight researchers for every 1,000 people, compared with five in the EU.

And the gap is growing. The OECD reports that the number of researchers in the EU is rising by 3 per cent a year. In the US, the growth rate is twice as high, at 6.2 per cent.

In terms of output, EU scientists appear to beat their US counterparts: EU-based scientists account for 41 per cent of all scientific papers published worldwide, compared with 31 per cent for the USA. However, the quality of scientific work matters at least as much as the quantity. One indicator of quality is how often
companies, for example, filed 41 patent applications at the EPO per million of population in 2001.

Eastern Europe now boasts a significant number of dynamic, high-tech companies, thanks partly to large-scale privatisations, and partly to the rapid growth in numbers of start-up companies. But the overall picture remains decidedly mixed, according to a recent report on innovation in the region. Most accession countries continue to suffer from an acute shortage of funding for new ventures. R&D spending in the private sector is much lower than in the EU, while stretched government budgets do not allow for significant new R&D investment. Low R&D spending and the dearth of homemade patents does not automatically represent an immediate constraint on growth. Ireland, for example, achieved very fast catch-up growth by importing technology rather than fostering research at home. But in the longer term, the new member-states will need to improve their innovation record, if they want their economies to draw level with those in Western Europe.

Scientific achievement is not evenly distributed throughout the EU. Sweden and Finland are matching or even out-performing the US. Both countries spend more on R&D than the US (4.3 and 3.5 per cent of GDP, respectively, in 2002). Swedish firms filed 367 patents per million of population at the EPO in 2001, and Finland 338. This stands in stark contrast to the EU’s Mediterranean members. Greek and Portuguese companies file less than 10 patents per million of population at the EPO and spend less than 1 per cent of GDP on R&D.

Among the larger member-states, Germany remains in the lead, with respectable figures for both patent applications (310 per million inhabitants) and above-average R&D spending (2.51 per cent of GDP). Contrast this with Italy, where R&D spending is low and falling (to just 1.07 per cent in 2000, the last year for which it supplied data).

Among the acceding countries, the Commission ranks the Czech Republic, Hungary and Slovenia higher than existing EU members such as Greece and Portugal in its innovation scoreboard. Spending on research and development has suffered from the major budget cuts applied by many Central and East European governments over the last decade. But in the better performing countries, R&D spending has started to recover. In the Czech Republic, it has risen from around 1 per cent of GDP in 1995 to 1.3 per cent in 2001. Some of the accession countries also outperform the EU’s Mediterranean members when it comes to patents: Slovenian


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B. Liberalisation

B1. Telecoms and utilities

★ Increase competition in telecoms markets to reduce charges (particularly internet access charges)

★ Liberalise gas and electricity markets

The EU’s drive to liberalise fully its telecoms markets has been largely successful. Growing competition has driven down phone charges for European businesses and consumers. The Commission calculates that in the last five years, the monthly phone bill of the average EU household has fallen by 13.5 per cent. Businesses have enjoyed even greater savings in the same period: 22.7 per cent. Recently, however, the downward trend in charges has slowed noticeably. In 2002-03, consumers saw their average monthly bill for national calls decline by a mere 0.3 per cent while businesses saved just 0.5 per cent.

The number of operators providing fixed-line telecoms services doubled between 1998 and 2001, and many incumbent operators lost substantial market shares to newcomers. In recent years, however, there has been a slowdown or even reversal of these trends. At the end of 2002, the formerly state-owned telecoms firms controlled 70 per cent of the EU’s markets for long-distance calls, a share only marginally down (by 1.6 per cent) from the year before. In 2001, the fall in market share had been twice as large. Even in some competitive EU markets, incumbents managed to claw back market share from new competitors. For example, Finland’s main operator controlled 45 per cent of the long-distance call market in 2002, up from 32 per cent in 2001. Similarly, British Telecom had 52 per cent of the market in 2002, compared with 48 per cent the previous year.
While the market opening in long-distance telephony appears to have slowed, the EU has recently made more progress in liberalising the local call market, a process known as ‘unbundling’. The Commission reports that the number of ‘unbundled’ lines increased by 828,000 between July 2002 and July 2003, compared with 400,000 over the previous twelve months. The main national telecoms providers saw their share of the local calls market decline from 87 per cent to 81 per cent in 2002. However, local call prices have not fallen as much as expected and were no lower in 2003 than in 1997. The average cost of a local call in the EU remains nearly four times higher than in the US. And in several member-states including Belgium, Greece, Spain, Italy, Austria, Portugal and Sweden local call prices have risen over recent years.

Some EU countries have barely begun the process of opening their telecoms markets to competition. In Greece the former monopoly provider still controls 99.4 per cent of the local call market, and 95 per cent of long distance and international calls. The picture is mixed even in those countries that have gone furthest in market opening. Finland, for example, has the cheapest local calls rates in the EU, reflecting the government’s determination to cut the cost of internet access. But Finns pay more for international phone calls than other EU citizens. Similarly, the UK was the trailblazer in EU telecoms deregulation, with the result that competition in the UK telecoms market is now fiercer than in most other EU countries. But UK call charges remain high by EU standards. In 2003 a British caller had to pay on average €3.37 for a 10-minute call to the US, the same as in 1998. In the same year the EU average cost for the same call was €2.13. The cost of UK local calls has fallen by 14 per cent since 1997, but at €0.56 for ten minutes it remains well above the EU average of €0.39.

In the Netherlands international call prices have dropped dramatically, from €8.48 for a 10-minute call to the US in 1997 to €0.85 in 2003, the lowest in the EU. The Netherlands, alongside Sweden, now offers the cheapest calls across the board in the EU-15. Among the accession countries, Estonia, Slovenia and Cyprus offer the cheapest calls; Malta and Poland are among the most expensive.

Despite these successes, the EU has some way to go to achieve a truly competitive telecoms market. For example, Tele 2, the Swedish phone group, has complained that the dominant phone operators are clawing back profits lost in the liberalised long distance call market by charging high prices for access to the local infrastructure. In March 2004 the Commission is due to announce new measures to increase telecoms competition. It has also stepped up pressure on governments that have failed to implement fully EU telecoms rules. In December 2003, the Commission opened infringement proceedings against seven countries, including France and Germany, for their failure to transpose and implement the full electronic communications regulatory package by the July 2003 deadline.

Compared to telecoms, the EU’s progress in opening up its energy markets has been painfully slow. It was only in November 2002 that EU governments finally agreed on deadlines for the comprehensive liberalisation of their gas and electricity sectors. Another important step came in November 2003, when the EU established an energy regulators group to oversee the opening up of EU markets.

Most member-states have already begun to liberalise wholesale energy markets. Companies across the EU are enjoying more choice in selecting their electricity supplier. The deadline for full liberalisation for industrial users is July 2004. But for consumers, full market opening has been delayed until July 2007, two years later than originally envisaged. This less ambitious timetable for the consumer market is reflected in price changes. Electricity prices for industrial users fell on average by 13 per cent in the ten years to 2003, compared with a 9 per cent reduction in the average household energy bill.
Electricity prices have fallen most sharply in Spain, which now supplies the cheapest electricity to industrial users. Greece provides the cheapest energy to household users among existing EU members. Italy has the most expensive electricity for both industrial and household users. Among the accession countries, Estonia has the cheapest electricity prices while Cyprus has the most expensive.

Gas prices have risen across the EU in recent years, reflecting world market trends. Yet prices in national markets also reflect the degree of local market opening. The UK, which has fully liberalised its gas market, has the cheapest prices among existing EU member-states. Prices for household users have only risen by 7 per cent in the UK since 1993, compared to 21 per cent in France. Estonia supplies the cheapest gas among the accession countries.

In an effort to remove remaining market distortions, the Commission is getting tougher on governments that subsidise incumbent energy suppliers. In December 2003 the Commission ruled that Electricité de France should repay €1.2 billion of state aid that contravened EU rules (see page 40).

Over the past 12 months, the EU’s focus has shifted from market opening to the security of energy supplies. A series of power cuts, most notably in Italy, has raised fears that Europe could follow the Californian path towards regular blackouts. The risk is that some member-states may try to exploit worries about supply to drag their feet over liberalising energy markets.

In December 2003 the Commission responded to these fears by drawing up an action plan which seeks to encourage energy efficiency and improve cross-border electricity supply connections. The EU has also agreed to give priority funding to a number of cross-border energy projects as part of its ‘growth initiative’ (see next section).

With the legislative process for telecoms and energy liberalisation now nearing completion, the Commission is turning its attention to water supplies. The EU’s water sector has a turnover of €80 billion a year – more than the gas sector. However, water charges vary widely: Berlin charges seven times more for its water services than Rome. The Commission argues that the sector would benefit from modernisation and greater competition. However, the Commission will not express a view on the politically sensitive question of whether water services should be provided by state-owned or private companies.

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**B2. Transport**

- Increase rail services competition
- Create a single European sky by 2004

During the last twelve months the EU has made some progress in opening up its rail and air transport markets. Member-states are close to finalising the second railway package, a series of measures designed to increase cross-border competition in rail services. The package would create licensed operators who would be able to bid for freight services in any member-state from 2006; it would establish common minimum safety rules and improve the interoperability of railway networks; and it would set up a European railway agency to help oversee international services.

More controversially, the European Parliament has sought to speed up the liberalisation process by amending the legislation to extend full competition to international passenger services by January 2008. Some member-states, most notably France, Luxembourg and Belgium, are strongly opposed to this measure. They point to the sorry state of the British railway network as evidence of the dangers of rapid liberalisation.

At the time of writing (February 2004), the European Parliament and the Council of Ministers had failed to resolve their differences. The Commission has proposed a compromise which would extend the deadline for passenger service liberalisation until 2010. But those member-states opposed to full-scale liberalisation hope that a decision can be postponed until the EU begins work on a third railway package later in 2004.

In June 2003 the EU took an important step towards liberalising the market for transatlantic flights: the European Commission secured a mandate to negotiate for the whole EU on transatlantic air agreements. Previously, individual member-states had had their own bilateral deals with the US. Such deals often protected the preferential transatlantic take off and landing slots of national carriers, and thus restricted competition. The European Court of Justice declared these bilateral deals illegal in November 2002, on the grounds that they discriminate against carriers from other EU states.

The Commission has long pushed a liberalising agenda, claiming that increased competition is vital to the long-term health of the European airline industry. It cites evidence that the creation of an EU-wide ‘open sky’ (single market) for transatlantic flights would save consumers more than €5 billion each year, and increase passenger numbers by a quarter.\(^{17}\)

The Commission began negotiations with its US counterparts in early 2004. Early indications suggest that the Commission faces an uphill struggle in persuading the US to amend laws that protect its airlines from foreign ownership and prevent foreign airlines from providing internal flights. In any case the EU has not yet fully liberalised its own markets, including ground handling services and the allocation of landing and take-off slots to airlines.

While the EU has made progress on liberalising air transport over the last year, it has suffered a setback on port services. The ports services directive would have obliged port owners to conduct open tenders for pilot and cargo handling services. The trade unions of maritime workers, together with the municipally owned ports, lobbied hard against the law, concerned about the impact of liberalisation on jobs and safety standards. And in November 2003 the European Parliament voted down the directive.

Of course, EU transport policy is not only about liberalisation. The member-states have recently put more emphasis on major transport infrastructure projects, jointly funded by the public and private sectors. The initial impetus came from Giulio Tremonti, the Italian finance minister. In June 2003, he unveiled a ‘European action plan for growth’, claiming that the envisaged infrastructure investment of

Moreover, all 56 projects had been included in previous initiatives, reflecting the EU’s inability to complete its infrastructure commitments. The ‘trans-European networks’ (TENs) are a good example. EU heads of governments launched the TEN initiative a decade ago, with the aim of upgrading cross-border infrastructure and thus making it easier for businesses and consumers to take advantage of the newly created single market. At the time, member-states identified 16 priority projects, at an estimated cost of €400 billion. But only three have ever been completed: the Øresund bridge/tunnel link between Denmark and Sweden, a high-speed train link between Brussels and Marseilles, and Malpensa airport in northern Italy.

The EU has struggled to persuade the private sector to back its investment strategy. Large-scale cross-border infrastructure projects are technically complex and financially risky. The fact that at least two member-states must be involved has created legal confusion and sometimes resulted in a lack of project leadership. The Commission has called for the EU to create common rules for cross-border public-private infrastructure investments and to develop new financial support mechanisms to encourage greater private investment.18

Germany and France, backed by Britain, then prepared an alternative proposal. They argued that any EU-wide investment plan should be closely linked to the Lisbon targets and focus on new technologies, such as broadband and digital television, rather than transport. The Commission tried to combine elements from both initiatives, and in October 2003 presented a list of projects worth some €220 billion. The Council of Finance Ministers (Ecofin) subsequently whittled the list down to 56 proposals worth a total of €76 billion. EU leaders approved that package at the Brussels summit in December 2003. Although the member-states hailed it as a major initiative, the investment package is unlikely to boost growth significantly by 2010.

If the package was implemented in full, total fresh investments would amount to just €10 billion a year, the equivalent of 0.05 per cent of EU GDP. What is more, the final list of projects is incoherent, reflecting the attempt to include something for every member-state. Of the 56 approved projects, 31 relate to transport, 17 are in the energy sector, and only eight focus on high-speed communications. The transport projects are heavily skewed towards rail, and include high-speed lines across the Franco-German, Franco-Belgian and Franco-Spanish borders. Other projects aim at speeding up Europe’s busy shipping lanes by creating ‘motorways of the sea’. Member-states have refused to back the Sicilian bridge project, although they will supply funds for the Brenner tunnel through the Alps.

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**B3. Financial and other services**

★ Complete the financial services action plan by 2005

★ Create a single market in services

On paper, at least, the financial services action plan (FSAP) is a success. The EU has reached agreement on 37 of the plan’s 42 measures, which are designed to create a viable single market in financial services by 2005. And the member-states are close to finalising several other key parts of the plan, such as the investment services and transparency directives.

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. London Economics, a UK consultancy, estimates that the benefits from integrating Europe’s wholesale capital markets would amount to €130 billion, or 1.1 per cent of EU GDP, over the next decade.19

However, the implementation of the FSAP has encountered a host of difficulties. Financial services companies are increasingly critical of the quality of the legislation the EU is producing under the FSAP. In a frantic effort to meet the 2005 deadline, member-states have sometimes reached less than satisfactory compromises. At other times, the EU has reneged on its commitment not to produce overly detailed or cumbersome legislation. Bogged down in endless rows over the fine print of new directives, the EU risks losing sight of the plan’s potential economic gains.

The takeover directive, which seeks to create a level-playing field for corporate mergers and acquisitions, is a case in point. In December 2003 – after more than a decade of trying – the member-states finally reached an agreement. But the final text is so riddled with opt-outs that it is unlikely to achieve its objectives. The Commission had proposed outlawing ‘poison pill’ defences against a takeover bid, such as the right of directors to sell off subsidiaries or issue new shares without the permission of shareholders. German businesses and politicians fought hard against this proposal, fearing that prominent German companies such as Volkswagen could become vulnerable to foreign takeovers. Heavy German government lobbying persuaded the European Parliament to vote down an earlier version of the directive in 2001. The final text of the directive does ban companies from taking defensive actions during a takeover battle without the express permission of shareholders. But all member-states retain the right to opt-out of this provision. Moreover, even companies from countries that have not opted out may still use poison pills if the takeover bid comes from a country which allows such defences.

Another controversial clause in the directive seeks to ban multiple voting rights. Some family-run firms issue different classes of shares, some of which possess greater voting rights, to ensure that the family retains control. But member-state lobbying, in this case led by Sweden, has led to a provision that allows member-states to opt out of the general ban on multiple voting rights.

Both the Commission and the European Parliament have expressed their displeasure with the final text. Frits Bolkestein, the internal market commissioner, complained that Europe was not sending “the right message to the markets by adopting this legislation in its current form”. But the commissioner stopped short of carrying out an earlier threat to withdraw the legislation.

Similar problems have bedevilled the investment services directive. This directive provides common rules for firms wishing to compete across the EU and is thus the cornerstone of the EU’s drive to create a single market in financial services. At the time of writing the EU was close to reaching an agreement. The final version, however, threatens to impede some kinds of competition between stock market participants.

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exchanges and investment firms. In November 2003, Italy – which at the time held the rotating presidency – forced through two important amendments to the text, despite the strong opposition of Britain, Ireland, Sweden, Finland and Luxembourg.

The first amendment obliges stockbrokers to carry out a thorough ‘suitability’ background check of potential clients, before buying or selling on their behalf. Financial services firms claim that this requirement would make retail share trading much more expensive, by effectively banning cheap ‘execution only’ share-trading services.

The second amendment would considerably increase the costs that investment banks incur when trading shares on their own books, a practice known as ‘internalisation’. Investment banks claim that the amendment could make share trading more expensive. The British government reckons that the resulting loss in competition could cost EU businesses up to €450 million a year. At the time of writing the European Parliament was considering changes to the directive that would take account of the investment banks’ grievances.

Member-states are also divided over the Commission’s proposals for a transparency directive. The aim of the document is to create common information requirements for all companies listed on EU stock exchanges. The Commission has suggested that all listed companies should produce basic financial results on a quarterly basis. However, a number of member-states, including Ireland, the Netherlands and Britain, oppose the measure, arguing that it would create unnecessary costs. In February 2004, the European Parliament voted against quarterly reporting, ensuring a prolonged round of negotiations on this issue.

The FSAP alone is not enough to create a fully functioning single market in financial services. But the EU should pause to take stock before proposing a second action plan. Many financial firms fear they will suffer from regulatory indigestion as they implement 14 major legislative measures over the next few years. Moreover, businesses are concerned that new institutional arrangements (based on recommendations made by the Lamfalussy group of experts) are not working as well as had been expected. Businesses complain that the Commission and the member-states still produce overly complex directives. They also want regulators to consult more extensively before drawing up the detailed rules that are needed to implement the new legislation.

The Commission has indicated that it will conduct a thorough review of the financial services action plan and that its immediate priority is to ensure that the new measures are effectively implemented in the member-states. Otherwise the EU’s new harmonised legal basis for cross-border financial services risks being undermined by fragmented and uneven implementation. This is particularly important in the far less developed capital markets of Central and Eastern Europe. The acceding countries will struggle to implement the comprehensive package of the FSAP, given that many do not even comply with long-standing EU rules on financial services, such as capital adequacy requirements and deposit insurance. The Commission has also expressed concern about the effectiveness and independence of securities markets watchdogs in countries such as the Czech Republic and Poland.

In January 2004 the Commission embarked on an equally ambitious plan to create a single market in general services, such as retailing, travel, leisure and information technology. The Commission is preparing a directive that is designed to cut the red tape, such as lengthy licensing procedures, which prevents businesses from offering their services across borders. The directive would also make it easier for firms to send workers abroad on a temporary basis. Commissioner Bolkestein has described the directive as “potentially the biggest boost to the internal market since its launch in 1993”.


C. Enterprise

C1. Business start-up environment

★ Develop a programme to support enterprise and entrepreneurship

★ Develop and implement a European charter for small businesses

Small and medium-sized enterprises (SMEs), and start-up companies in particular, are vital to stimulating economic growth and raising employment levels. But in the EU many potential entrepreneurs are put off from starting a business by administrative obstacles, financing problems and even the stigma of failure. A recent Eurobarometer poll showed that although 47 per cent of Europeans would like to become self-employed, only 17 per cent took action to achieve this goal. Nearly twice as many Americans as Europeans are engaged in entrepreneurial activities, according to Commission figures. These findings are borne out by the Global Entrepreneurship Monitor (GEM) which provides an annual snapshot of new business activity. The percentage of the US population involved with new ventures recovered from a sharp dot.com-related fall in 2002 to reach 11.9 per cent in 2003. Among the EU-15, the Irish appear to be the most entrepreneurial, although the proportion of them involved in new business ventures fell by one percentage point to 8.1 per cent in 2003. Finland, at 3.1 per cent, had the lowest rate among the EU countries surveyed by GEM.

In February 2004, the Commission presented an action plan for boosting entrepreneurship across Europe. It concluded that the EU should take action in five key areas: encouraging more people to become entrepreneurs; offering better training; establishing a fair environment for risk-taking; improving financing opportunities and reducing the regulatory and administrative burden on SMEs.

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Red tape does not only put off budding entrepreneurs, it also undermines the growth potential of existing SMEs. The average EU company has to go through three different administrative procedures to recruit a new employee. The Netherlands, Belgium, France and Spain have the highest number of procedures while Austria, Greece and Ireland have the lowest.

Raising finance is another long-standing problem for European SMEs. One in five small businesses in the EU report that access to finance is the most important constraint on growth, according to a Commission survey. Many EU countries have put in place special financing schemes for SMEs. The EU offers help through the European Investment Fund (EIF), the risk capital arm of the European Investment Bank. Since 1998 around 125,000 small businesses have benefited from the EIF’s loan guarantee fund, which focuses particularly on start-ups and micro-enterprises with ten employees or less.

The EU is aiming to increase the amount of investment capital available to start-up companies through a ‘risk capital action plan’. The EU has sought to encourage the growth of venture capital funds through tax incentives and the removal of regulatory or legal obstacles. Member-states have had some success in achieving this goal, although the collapse of the venture capital market in the wake of the dot.com boom makes definitive judgements difficult. In 2000, venture capital investment in the US was four times higher as a share of GDP than in the EU. In 2002, following the global stock market crash, the gap had halved with US venture capital funds amounting to 0.2 per cent of GDP compared with 0.1 per cent in the EU.

Hungary has proportionally the largest venture capital and private equity industry among the accession countries, reaching 0.23 per cent of GDP in 2001, although this subsequently collapsed to just 0.03 per cent in 2002. The region’s underdeveloped capital markets make it difficult for venture capital or private equity funds to exit investments, which implies that such financing is unlikely to develop rapidly. More generally, Eastern Europe’s SME sectors rival those in Western Europe in terms of employment and importance for the overall economy. Typically, between 50 and 70 per cent of all employees in the accession countries work in SMEs. According to the United Nations Economic Commission for Europe SME development index, Slovenia has the best-developed SME sector among the accession countries, followed by Hungary and Poland. Bulgaria and Romania are at the other end of the spectrum. However, while SMEs employ large numbers of people, they contribute a disproportionately small amount of total GDP in the new member-states which indicates low investment and productivity rates in the SME sector. This appears to be particularly the case in Poland, where a large share of SMEs are micro-enterprises in the farm sector.

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C2. 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

Member-states placed great emphasis on the need to cut red tape in the run-up to the spring summit in 2004. Ireland, the Netherlands, Luxembourg and the UK – the four countries that hold the EU presidency during 2004 and 2005 – launched a new initiative to reduce the regulatory burden in January 2004. They called on all member-states to draw the Commission’s attention to any EU rules and regulations that could stifle business growth. Britain, France and Germany used the occasion of their trilateral summit in February 2004 to remind the Commission of the importance of thorough impact assessments of all new EU legislation.

Few governments now question that poorly framed and cumbersome legislation is a growing burden for European businesses. Smaller companies in particular find compliance with many EU directives and regulations costly and time-consuming. In many countries, small businesses consider an excessive administrative and regulatory burden the main obstacle to growth. The Commission has calculated that better regulation could save EU based businesses around €50 billion a year. Research from the International Monetary Fund suggests that regulatory reform could bolster overall GDP in the EU by as much as 7 per cent over the longer term.

The EU is not short of targets and commitments for reducing red tape. At the Barcelona summit in March 2002, EU leaders endorsed the conclusion of the Mandelkern committee of independent experts on better regulation, including a proposal for a 40 per cent reduction in the quantity of EU legislation by 2005. The Commission issued a paper on better regulation in June 2002, which included promises to consult more widely and introduce regulatory impact assessments on major pieces of legislation. In February 2003 the Commission presented a further proposal on updating and simplifying the acquis, suggesting it would cut the EU’s rulebook by at least one-third. The Commission is also in the midst of an effort to codify and simplify European law, so that it becomes far easier for businesses and citizens to understand and apply.

Therefore recent calls from the member-states for cutting EU red tape and for the wider use of impact assessments are probably more about appeasing domestic businesses than providing substantive fresh proposals. German industry, for example, is unhappy with the Commission’s proposal for a new chemicals licensing procedure, which it regards as costly and complex. British business is opposed to a raft of Brussels legislation, including a directive which could increase the rights of temporary workers. Although it is ultimately the member-states that decide on EU rules, they are often quick to blame the Commission for burdensome and poorly drafted laws.

The blame is not entirely undeserved. The Commission has admitted to teething problems in its conduct of impact assessments on legislation. In 2003 only 17 per cent of legislative proposals were subjected to a rigorous impact assessment, and only half of these were completed on time. The Commission is short of expertise and has had difficulties quantifying the results of its impact assessments.

Similarly, the Commission describes its first attempts at simplifying EU legislation as yielding “mixed” results. It has so far removed only 30 obsolete acts from the EU’s rulebook, while another 600 are under review for abolition in the second phase of the simplification process.
On the whole, however, the Commission’s approach to ensuring better regulation is as well developed, if not more so, than that of the EU member-states. EU governments are only just beginning to conduct widespread impact assessments of national laws. Sweden and the UK, for example, are aiming to submit all business relevant legislation to an impact assessment by 2006.

Meanwhile, most member-states have not lived up to their commitment to implement EU legislation in a timely and efficient manner. Businesses cannot take full advantage of the single market if key legislation is not properly implemented throughout the Union. The member-states’ record of implementing Lisbon-related legislation is particularly poor. By the end of 2003 they had only fully implemented seven out of 70 pieces of legislation adopted under the Lisbon strategy.

The member-states have long promised to do a better job of legislating at national level for laws that have been passed at EU level (‘transposition’ in EU jargon). The Lisbon target was to narrow the implementation gap to less than 1.5 per cent of all laws by March 2002. Nearly two years later just five out of the 15 existing member-states had met this target: Denmark, Spain, Finland, Ireland and the UK. Ireland’s performance is especially impressive as it succeeded in reducing the quantity of outstanding legislation by half in less than a year. Denmark, Finland and Portugal also met a supplementary target of ensuring that all EU legislation more than two years old is implemented. Belgium, France and Germany have the worst implementation records. In addition, France and Italy together account for nearly 30 per cent of all internal market infringement cases.
C3. State aid and competition policy

★ Promote competition and reduce subsidies to industry

★ Overhaul public procurement rules and make them accessible to SMEs

All member-states have publicly stated their commitment to reducing industrial subsidies. Yet in 2001 (the last year for which figures are available) the amount of state aid governments paid out increased.\(^{31}\) That year the EU-15 provided subsidies worth €86 billion, or 0.99 per cent of EU GDP, compared with €82 billion in 2000. The UK was responsible for the bulk of this increase, as it bailed out its struggling rail track operator. Despite this increase, the UK remains the country which provides the lowest level of subsidies overall, at 0.66 per cent of GDP in 2002. Finland continues to spend the most on state aid, 1.58 per cent of GDP, primarily because the Finnish government provides large-scale financial support to uneconomic agriculture in northern regions.

To form a better picture of market-distorting aid in manufacturing, the Commission has constructed an indicator that strips out aid to the heavily subsidised agricultural, fisheries and transport sectors. On this measure, Portugal and Denmark pay proportionately the most aid, while Luxembourg, the Netherlands and the UK pay the least.

Denmark has recently completed a comprehensive review of its state aid policies, which should result in a 10 per cent cut in aid levels from 2003.\(^{32}\) The World Economic Forum also includes a measure of government subsidies as part of its growth and competitiveness index. It ranks Germany as by far the worst offender among all developed countries for the payment of distorting subsidies.

Mario Monti, the competition commissioner, demonstrated his determination to crack down on state aid with a high profile ruling against Electricité de France (EdF), the state owned energy giant, in December 2003. The Commission ruled that EdF must return €1.2 billion of aid to the French government – the largest ever repayment. Just as importantly, the Commission also secured a commitment from the French government to remove its guarantee from EdF’s debt, which effectively protected the company from bankruptcy and enabled it to borrow more cheaply than its rivals.

The Commission’s state aid and competition policies are likely to come under increasing scrutiny over the coming year. The EU’s new anti-trust and mergers rules, which give greater responsibility to national competition authorities, come into effect in May 2004. Businesses frequently complain that competition rules are not applied evenly across the EU – a problem that will worsen after eastward enlargement. Moreover, some member-states are pressurising the Commission to soften its stance towards politically sensitive companies, such as Volkswagen which is protected from takeover by the state of Lower Saxony’s cap on share ownership. For example, Britain, France and Germany agreed at their trilateral meeting in February 2004 to put pressure on the Commission to take “more account of the characteristics of international competition and the necessary industrial development of Europe” when taking competition decisions. In other words, the big three want the Commission to stop taking tough action against national champions, such as EdF and Volkswagen.

The Commission is also under pressure to draft a framework directive to exempt ‘services of general interest’ – such as health, education or postal services – from normal EU competition rules. The French government insisted on a clarification of these state aid rules in exchange for agreeing to energy liberalisation at the Barcelona summit in March 2002. Jacques Chirac even got Tony Blair and Gerhard Schröder to draft a joint letter calling on the Commission to respect the ‘special nature’ of services of general interest.

The EU has made good progress in recent years in the liberalisation of public tenders for goods and services. A competitive market for

\(^{31}\) There are no updated figures for the accession countries, making it impossible to assess their performance since the last scorecard.

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

After eight years of steady employment growth, the EU experienced a decline in jobs in 2003. Unemployment increased from 7.7 per cent to 8.0 per cent in the EU-15, and from 8.8 per cent to 9.0 in the EU-25. The 12 eurozone countries suffered a net loss of 300,000 jobs in 2003, the first decline since 1994.

The EU has rightly focused its efforts on increasing employment rates, rather than on reducing headline unemployment numbers. Although some EU countries have seen a sharp decrease in unemployment in recent years, in some cases this was a result of people opting out of the labour force and into sickness benefits or early retirement. The EU can only boost its economic growth rates and ensure the long-term sustainability of its pension systems if it manages to bring more people into the workforce.

Although full 2003 employment data were not available at the time of writing, the 2002 figures indicate how the economic slowdown has held back job creation. The EU-15 employment rate stood at 64.3 per cent in 2002, only marginally higher than the 64.1 per cent recorded in 2001. Even though the economic slowdown also affected job creation in the US, the US employment rate, at 71.9 per cent in 2002, remained well above Europe’s.
The Commission warns that with such slow rates of job creation the EU risks missing its 70 per cent employment target in 2010, as well as its intermediate target of 67 per cent in 2005. The OECD is more explicit, saying that the EU is now highly unlikely to achieve its employment goals. The OECD predicts that the EU employment rate will have risen to a mere 65.5 per cent in 2010. Even if the EU’s growth rate rose to US levels, employment would still only rise to 66.5 per cent by 2010, the OECD predicts. The EU-15 would need to create 15 million extra jobs, and the EU-25 a total of 22 million, to meet the Lisbon employment target by 2010.

Employment performance differs considerably across the Union. Four of the current EU countries – Denmark, the Netherlands, Sweden and the UK – have already exceeded the 70 per cent target. Three other member-states – Finland, Portugal and Austria – have met the interim target of 67 per cent. But the economic slowdown has affected even these strong performers. The Netherlands is the only country to have recorded employment growth in 2002, with its overall level rising to 74.4 per cent, from 74.1 per cent the previous year. Denmark had the highest employment rate in the EU in 2002, at 75.9 per cent, down from 76.2 per cent in 2001.

Italy is at the other end of the spectrum, with only 55.5 per cent of all people of working age having a job in 2002. The other Mediterranean countries have similarly low employment figures, but at least they have recorded strong job growth in recent years. Greece enjoyed fast employment growth in 2002, lifting its overall employment level to 56.7 per cent. The Spanish rate rose to 58.4 per cent that year, compared with just 49.4 per cent five years previously.

The employment situation is even bleaker in the accession countries of Central and Eastern Europe. Average unemployment stands at 15 per cent, nearly twice the level in the existing member-states. High unemployment is matched by low employment rates. Barely 50 per cent of the working-age population has a job in Bulgaria and Poland, where the employment rate slipped by almost 2 percentage points in 2001-2002 alone. Romania fared even worse, with job losses shaving nearly 5 percentage points off the employment rate, which fell to 57.6 per cent in 2002. On the other hand, the Czech Republic and the three Baltic states (Estonia, Latvia, and Lithuania) all recorded a rise in the employment rate in 2002. The Czech Republic boasts the highest employment rate among the East European countries, at 65.4 per cent, above the EU average. Cyprus almost reached the 70 per cent target with an employment rate of 69.4 per cent in 2002.

While the EU looks set to miss its overall employment target, it is making steady progress towards at least one of its supplementary targets. In 2002, the female employment rate for the EU-15 rose to 55.6 per cent, putting the interim 2005 target of 57 per cent within reach. In seven member-states, the female employment rate already exceeds the ultimate target of 60 per cent for 2010. Sweden had the highest rate, at 72.2 per cent, while Italy had the lowest, at only 42 per cent. In the accession countries, female employment – almost universal during communism – declined sharply in the 1990s. Recently, however, the female employment rate appears to have stabilised, with an average for the accession countries of 50.1 per cent in 2002. Malta has the lowest rate in the EU-25, with 33.6 per cent.

Progress towards the other supplementary target – to increase employment among older workers – has been much less impressive. The Commission estimates that the EU would have to get seven million older workers into jobs to meet its target of a 50 per cent employment rate for 55-64 year-olds by 2010. In 2002, the employment rate for older workers stood at only 40.1 per cent. In Belgium, Italy, Luxembourg and Austria, fewer than 1 in 3 older workers is employed. In contrast, 68 per cent of older workers in Sweden have jobs. The employment rate for older workers is even worse in the accession countries where early retirement schemes are still widely used to tackle unemployment problems. Less than a
quarter of 55-64 year-olds are in work in Slovenia and Slovakia. Cyprus and Estonia, on the other hand, already meet the EU’s 50 per cent target.

Faced with such discouraging data and forecasts, the member-states have pledged to step up their efforts to raise employment levels. They set up a special employment taskforce, chaired by the former Dutch Prime Minister Wim Kok, which made a series of practical and country-specific recommendations in November 2003. The expert group called on EU governments to make labour market regulations simpler and more flexible; to re-design social security systems to make working worthwhile; and to reduce payroll taxes, especially for low wage earners.

In some of these areas, member-states have already made progress over the last year. France, for example, has introduced more flexibility into the 35-hour working week, while Portugal has passed a new labour law to encourage worker mobility. But the Commission still chides Germany, Greece, Spain and Italy for overly restrictive rules in its Joint Employment Report.

Many member-states have also reformed their tax and benefit systems to encourage people back into work. But with public finances stretched in many of the larger member-states, governments are finding it harder to cut taxes. According to the European Commission, the tax burden on low-wage earners in the EU-15 increased slightly in 2002, to 37.8 per cent, although this was mainly due to the economic slowdown. In the US, by comparison, low-wage jobs were taxed at 27.3 per cent in 2002, and in Japan at 23.2 per cent. Among the EU-15, Belgium fares worst, with a tax burden on low-wage earners of 48.9 per cent in 2002, although this represents a decline from 51 per cent in 1999. Ireland imposed the smallest burden on low earners in the EU-15, at 16.6 per cent.

In the East European accession countries, payroll taxes are generally much higher than in the EU-15. The tax burden for low-paid workers is above 40 per cent in seven of the accession countries, including Poland, Hungary and the Czech Republic. High payroll taxes discourage job creation and drive workers into the black economy. In Poland, one-quarter of unskilled and low-skilled workers do not have a job, and in Slovakia that figure is 40 per cent. Moreover, although estimates of unofficial employment are by necessity unreliable, there is no doubt about the huge scale of the black and grey economies in Eastern Europe. In Hungary, for example, one in three workers is thought to get at least part of his or her income from unofficial employment.

The ‘structural’ level of unemployment – the rate to which unemployment could fall without sparking higher inflation – provides a rough and ready measure of an economy’s capacity to generate high levels of employment. The OECD estimates that several member-states have succeeded in reducing the level of structural unemployment over the last decade. Ireland leads the way, having cut the level from 14.1 per cent in 1991 to 6.4 per cent in 2001. However, the OECD estimates that the structural unemployment rate has increased in Germany, Greece and Finland.

For the acceding countries, such estimates are hard to come by. But very high rates of long-term and youth unemployment indicate that labour market problems are structural, rather than cyclical. In the Baltic states and Poland, 7-9 per cent of the labour force has been out of job for more than year. In Slovakia and Bulgaria, the figures are even higher.

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D2. Upgrading skills

★ Halve the number of 18 to 24 year-olds with only a basic secondary education by 2010

★ Foster a culture of lifelong learning, with support from social partners

Better education is vital to raising the EU’s productivity and employment levels. The Commission estimates that if the average length of education was extended by one year, productivity levels would rise by 4-9 percentage points. Furthermore, education is the best insurance against unemployment. According to Commission figures for the EU-15, the employment rate among workers with basic secondary education was 49.4 per cent, compared to 82.8 per cent among those who had completed tertiary education.

To monitor progress in education reform, the member-states have established common targets for five basic indicators, namely the number of graduates in maths, science and technology; the share of young people who have fully completed secondary education; improvement in the literacy rates of 15 year-olds; and the level of participation in lifelong learning among the adult working population. So far, the EU falls well short of its self-imposed targets. For example, the EU wants at least 85 per cent of all 20-24 year-olds to have fully completed their secondary education by 2010. But in 2003 the share was only 74 per cent. Just three EU countries – Austria, Finland and Sweden – have so far met the 85 per cent target. In Portugal less than 50 per cent of students complete their secondary education. Not surprisingly, the Commission has warned that “if reform proceeds at the current rate, the Union will be unable to attain its objectives in education and training”.

The East European countries generally score well on basic indicators of education and skill levels. The accession countries as a group already meet the EU target for secondary education, with 88.3 per cent of all 20-24 year-olds having fully completed secondary education. In three countries – the Czech Republic, Slovenia and Slovakia – the proportion is more than 90 per cent. The newcomers also have very high literacy rates, and their level of education spending (as a percentage of GDP) is on par with the EU-15. Nevertheless, there are concerns about the quality of educational outputs. Curricula in the new member-states are often too rigid, overloaded and out of date. As a result, East European education systems struggle to equip people with the skills needed in a market economy.

One problem faced by old and new EU members alike is a looming shortage of teachers. This makes it hard for them to achieve their educational targets at primary and secondary levels. One-third of all secondary school teachers and 27 per cent of primary school teachers in the EU-15 are over 50. The Commission estimates that existing member-states will need to recruit one million new teachers by 2015 to plug this gap. Meanwhile many current teachers do not receive enough training to keep them motivated and abreast of the latest developments in their subject area. In the accession countries, teachers’ salaries are sometimes so low that they have to take on a second job to survive.

While EU countries need more teachers, they should not necessarily spend more public money on education. Rather, they need to raise the efficiency of educational spending. In 2000, the average EU-15 country spent 4.93 per cent of GDP on education, in line with the 4.79 per cent spent by the US but greater than Japan’s 3.59 per cent. However, Japan consistently outscores the vast majority of EU member-states and the US in international education evaluations, such as the OECD’s programme for international student assessment (PISA).

The EU is committed to encouraging more private sector spending on education, rather than raising overall expenditure levels. High
levels of private spending are closely associated with high-quality adult training and research, especially in science and technology. OECD data show that private sector education spending in the US amounts to 2.2 per cent of GDP – more than twice as much as in Germany, the EU country with the largest private sector share. Private sector involvement has raised total US spending on tertiary education to double the EU level. Well-equipped US universities attract a growing number of overseas students, including from the EU. More than twice as many EU students now attend US universities than vice versa, according to the Commission.

Even a top-class university degree may not suffice to equip workers with the skills they require in a fast-changing economy. The Kok report (see previous section) therefore stresses the importance of adult training for raising employment levels. The report commends Sweden, Denmark and Finland for combining good levels of initial educational attainment with wide access to university and high levels of adult training. Sweden has just begun a new vocational training scheme, which has sharply increased the number adults in education. According to the EU’s labour force survey, some 34 per cent of Swedes aged between 25 and 64 undertook some training in the month prior to the survey, the highest level in the EU. The average of the EU-15 was 9.6 per cent in 2003, up on the 8.5 per cent recorded in 2002, but still below the EU’s target rate of 12.5 per cent by 2010.

However, some EU countries, in particular Portugal and Greece, are lagging far behind in professional training. The same holds true for most of the accession countries, where training is all the more important, given the weaknesses of basic education sectors and the fast pace of economic change. The traditional company-based apprenticeship and training model broke down with the privatisation of state-owned industries. New training methods have not yet caught on widely. On average only 5.6 per cent of workers in the new member-states received training in 2003. In Bulgaria and Romania barely 1 per cent of workers had any training.

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<td>Villains</td>
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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’s demography is set to change radically over the next 50 years as a result of rising life expectancy and falling birth rates. The United Nations forecasts that, on present trends, the population of the EU-15 will decline by around 40 million to 340 million in 2050. The number of people over the age of 65 will increase from 60 million to 100 million in 2050. Although the average age in the new member-states is lower than in the EU-15 at present, most of the East European countries will age even faster than the EU-15. The United Nations predicts that the population of Estonia could halve by 2050, while the Czech Republic, Hungary and Slovenia could all see their populations fall by a fifth.

When Europe’s pension systems were first established, the difference between retirement age and life expectancy was typically only a few years. Today, most people can expect to live 20 years or more after retirement, putting a considerable burden on classic pay-as-you-go (PAYG) pension systems. For example, Belgians now live in retirement for an average of 22 years. By 2030, Belgian women are expected to enjoy an average of 32.5 years in retirement, the highest rate in Europe. The diminishing ratio of pensioners to workers, together with improvements in life expectancy, will put publicly funded pension systems under serious financial strain in the near future.

Government spending on pensions, and other age-related services such as nursing homes, already accounts for between 21 per cent (in the Mediterranean countries) to 29 per cent of GDP (in the Nordic countries). The EU has estimated that unless member-states reform their pension systems, they will face additional age-related spending amounting to between 3 and 7 per cent over the next five decades. Member-states could help curb rising pension costs by meeting the Lisbon target of raising the retirement age by five years. In 2002 the average retirement age for the EU-15 stood at 60.8, up slightly from 60.4 in 2001. Belgians still retire earliest, at an average age of 58.5 in 2002, which – although an improvement on the 2001 average of 56.8 – is far below the EU target of 65. Swedes currently work longest, retiring at 62.3 on average. None of the accession countries comes close to the EU target. Poles, for example, typically stop working at 56.9 while Slovaks retire at 57.5.

Many EU countries have embarked on wide-ranging reforms to put their public pension systems on a more sustainable footing. Several passed pension reform packages, often accompanied by widespread public protests and strikes, in 2003. In France, the number of working years needed to qualify for a full state pension will rise from 37.5 years now to 41.75 in 2020. Moreover, the government has reduced incentives for early retirement and capped future pension rises by linking them to price rather than wage inflation. Similarly, Austria is gradually raising contribution periods, and abolishing incentives for early retirement. It has even offered a bonus for those who choose to stay in work past the normal retirement age.

However, the EU states must do more than reform PAYG pension systems if they want to meet the challenge of ageing societies. They will also have to encourage more private saving for retirement, to reduce the future burden on public finances. Most EU countries are only just starting this process, not least since the transition from a publicly funded to a (partially) private system...
puts a significant burden on public finances. The German government is currently considering more generous tax incentives for workers to save part of their income in a private pension, because take-up of existing pension packages has been disappointingly slow. Germany is also planning to enact curbs on generous civil service pensions – a step that the French government has so far shied away from.

Many of the accession countries have already gone further in introducing private pensions than the current EU member-states. Bulgaria, Estonia, Hungary, Latvia and Poland have all added compulsory, privately financed ‘second pillars’ to their PAYG systems. Slovakia and Lithuania are planning to follow suit. Poland and Latvia have followed Sweden in linking pension payouts from the PAYG systems more closely to lifetime contributions. In the Czech Republic, more than half of the workforce had opened private pension accounts by late 2003.

Even in those countries, such as Britain, which have pushed through reforms to their pension systems, the long-term fiscal position may not be as healthy as it first appears. Official figures suggest public expenditure on pensions in Britain is less than half of that of most other EU members. However, these figures greatly underestimate the true level of public sector spending on pensioners. Since state pensions are small, many pensioners are also eligible for other state benefits, such as income and housing support. One recent estimate suggested that on current trends more than 80 per cent of British pensioners would qualify for government assistance in addition to their state pensions by 2050. The official data also underestimate the importance of private retirement savings in continental Europe. In countries such as Germany and France, people tend to save through life insurance and other savings vehicles that are not usually counted as retirement savings.

As part of the Lisbon agenda, the EU has also set some general targets for the reduction of poverty and the risk of social exclusion. Member-states agree that one of the best ways to reduce the risk of poverty is to create more and better employment opportunities. People who live in jobless households are at a far greater risk of poverty than those from households in which at least one member is working. However, there is no clear correlation between high levels of employment and low poverty rates. The UK has one of the highest employment rates in the EU. Yet some 10.9 per cent of the working age population live in jobless households. Even more worryingly, some 17 per cent of children in the UK live in jobless households, the highest rate in the EU-25. In Belgium, 14.2 per cent of the adult population live in jobless households, which suggests the existence of widespread pockets of deprivation. Poland has the highest rate of jobless households in the enlarged EU, at 14.8 per cent, reflecting the country’s huge unemployment problem.

The Commission estimates that around 55 million people, or 15 per cent of the EU-15 population, were at risk of poverty in 2001. Among the member-states, Ireland – surprisingly – has the highest proportion of the population at risk of poverty. This suggests that the economic gains of recent years have not spread throughout the population. Some 21 per cent of the population is at risk of poverty, higher than in Greece or Portugal. The Swedes do best, with only one in ten of them at risk of poverty.

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42 Tom Clark and Carl Emmerson, ‘The tax and benefit system and the decision to invest in a stakeholder pension’, Institute for Fiscal Studies, Briefing Note no 28, August 2002.
E. Sustainable development

E1. Climate change

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

★ 22 per cent of electricity to derive from renewable sources by 2010

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

The EU aspires to global leadership on the issue of climate change. The EU-15 are committed to meeting the Kyoto target of an 8 per cent reduction in greenhouse gas emissions by 2010. Heads of government made this goal, along with a number of other environmental targets, an explicit part of the Lisbon agenda at the Göteborg summit in June 2001. However, the United States and Russia have so far refused to ratify the protocol, which leaves its long-term significance in doubt.

The European Environment Agency (EEA) calculates that the EU reduced greenhouse gas emissions by 2.3 per cent between 1990 and 2001.44 But the downward trend was reversed in the last year of this period, when emissions increased by 1 per cent. The Commission warns that member-states are not making enough progress for the EU to meet its Kyoto targets by 2010.45

Ten of the 15 existing member-states are not on course to meet their individual commitments. In particular, Austria and Ireland recorded large emissions increases between 2000 and 2001 and have moved further away from their
2010 targets. At the end of 2001, France, Sweden and Luxembourg were the only EU members to have met their Kyoto targets.

All the accession countries – with the exception of Slovenia – can expect to meet their Kyoto commitments. Emissions in the twelve accession countries declined by 36 per cent between 1990 and 2001, as Eastern Europe underwent a period of economic decline and large-scale industrial restructuring. Latvia and Lithuania, for example, halved their greenhouse gas emissions between 1991 and 2001.

The EU has made some progress towards a supplementary target of supplying 22 per cent of its electricity from renewable sources, such as hydro-electricity and wind, by 2010. However, the European Environment Agency calculates that the EU would need to double the current rate of growth of the use of renewables to meet this target. The EU generated 15.2 per cent of its electricity from renewable sources in 2001, compared with 13 per cent a decade earlier. Sweden is heading towards hitting its individual target of generating 60 per cent of its electricity from renewables by 2010, increasing the amount from 45 in 1991 to 54 per cent in 2001. However, Greece, Finland, Ireland and Luxembourg all produce less electricity from renewable sources than they did a decade earlier. Among the acceding countries, Latvia produced 46 per cent of electricity from renewables in 2001, close to its target of 49 per cent in 2010. Slovenia, on the other hand, is now producing less electricity from renewable sources than a decade ago.

The EU intends to introduce further measures to cut down on emissions over the next few years. Under an emissions trading scheme, EU-based companies will be able to buy and sell permits to emit greenhouse gases from January 1st 2005. However, the EEA concludes that this scheme, while symbolically important, will only make a “limited contribution” to the Kyoto targets. EU members also reached agreement in October 2003 on an energy tax directive, which sets minimum rates of taxation for coal, gas and electricity. The Commission estimates that the tax will reduce emissions in the EU-15 by 0.5 per cent. The new member-states have secured an extended transition period, which means that many of them will not apply the new rules until 2010.

The EEA blames a “runaway increase in emissions from transport, especially road transport” for the EU-15’s worsening performance. The EU has made little headway towards its stated aim of breaking the link between economic growth and the volume of road transport, a process known as ‘decoupling’. EU transport emissions increased by 21 per cent between 1990 and 2001, and the EEA predicts a total increase of 34 per cent for the entire 1990-2010 period.

The share of goods carried by road continues to rise year after year. It stood at 79 per cent of all transported goods in 2002, compared with 74 per cent a decade before. In six member-states, more than 90 per cent of freight is carried by road. In Greece and Ireland, the shares are 98 and 97 per cent respectively. In contrast, just 62 per cent of freight in the Netherlands and 66 per cent in Austria and Sweden goes on road.

Traditionally, East European countries have relied heavily on railways, a legacy of central planning and the concentration of heavy industries. Although the importance of rail transport has decreased since the onset of transition, it continues to play a bigger role than in the EU-15. In Estonia and Latvia, for example, barely one-third of freight is carried by road. Some East European businesses claim that the reliance on old-fashioned and inflexible railway links causes them problems. But the region’s poorly developed road infrastructure impedes a more rapid shift towards road freight.

Meanwhile, the accession countries are recording rapid growth in passenger road transport. Car ownership in the region has leapt by three-quarters since 1990. In the Czech Republic 79 per cent of passenger journeys were by car in 2000, compared with 69 per cent in 1992. In Slovakia, the share of car journeys rose from 59 per cent to 68 per cent between 1996 and 2000. In the EU-15, car passenger...
volumes have remained relatively static over the last five years, standing at 84 per cent in 2000 of all journeys, compared with 84.1 per cent in 1995. The UK is the EU’s most car-dependent country: 88 per cent of all passenger journeys are made by car. In 2004 the Commission is due to publish a 25-year strategy to curb the future growth of road transport.

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### E2. Natural environment

- Reduce exposure to particulates and ozone emissions
- Improve management of natural resources and stop the depletion of biological diversity

The EU’s agricultural and fisheries policies have exacted a heavy toll upon Europe’s rural environment. Recent research showed that Europe’s population of farmland birds has declined by nearly one-third since 1980, owing to the intensive farming techniques encouraged by the common agricultural policy (CAP).\(^6\) Three formerly common species – the corncrake, red-backed shrike and great bustard – are virtually extinct in North-western Europe. They remain relatively common in the Central and Eastern European countries that do not yet form part of the CAP. The EU also has a poor record of enforcing long-standing laws, such as the bird habitats directive, which are designed to protect wildlife. The Commission estimates that nearly one-third of all infringement cases relate to environmental issues. Italy, Spain and Ireland are the worst offenders.

The EU recently approved a major reform of the CAP, which should help to reduce its negative environmental impact. In particular, the EU is committed to phasing out farm production subsidies that encourage intensive farming and over-production. Instead, the EU will increasingly pay income support directly to farmers. Moreover, farmers will have to meet exacting environmental and animal welfare standards to claim aid. However, the opposition of a number of member-states, most notably France and Spain, to wholesale CAP reform means that certain sectors, such as cereals, will continue to receive subsidies that are tied to production.

The EU hopes the reforms will encourage more farmers to adopt environmentally friendly agricultural techniques such as organic farming. The amount of land given over to organic farming has
grown steadily over recent years. At the end of 2002, 2.6 per cent of land in the EU was farmed organically, compared with 1.74 per cent in 2000.47 In Austria 11.6 of farmland is given over to organic farming, as is 8 per cent in Italy. But organic farming has not yet taken off in Ireland (0.7 per cent), Poland (0.36 per cent) or Lithuania (0.25 per cent).

The EU has also made some progress over the last year in reforming its fisheries policies. Over-fishing has left many fish stocks close to extinction. The International Council for Exploration of the Sea (ICES) estimates that nearly two-thirds of catches of fish such as salmon and cod were outside safe biological limits in 2001, meaning these fish stocks are in danger of becoming depleted.

In October 2003 EU governments finally agreed to limit catches of some of the most threatened sea-fish, including cod, hake and plaice, for the next ten years. This is the first time member-states have agreed on a long-term recovery programme, rather than rely on an acrimonious annual round of quota negotiations. But the deal does allow fishermen to increase their catches of other less threatened species, such as haddock and prawns. Moreover, the ICES is not convinced that the cuts are sufficient to ensure the recovery of cod stocks. It is campaigning for a complete moratorium on fishing in areas such as the North and Irish seas until stocks have fully recovered.

The EU is also struggling to meet its other Lisbon environmental goals, such as the reduction of pollution and waste. For example, the EU is committed to reducing the amount of waste it disposes of in landfill sites. But most member-states remain highly reliant on dumping waste in such sites, which still account for around 90 per cent of waste disposal in the EU.

Commission data show that in the EU-15 the annual volume of waste dumped in landfill sites has declined only marginally since 2000. In 2002, the amount dumped fell by 1.7 per cent compared with the previous year. Ireland and the UK fare worst on a per capita basis. Ireland dumped over 500 kilos of waste per person in 2001. Belgium has the lowest rate, disposing of just 22 kilos of waste per person in landfill sites that year.

Air pollution is also a growing problem in many EU countries. The Commission claims that around 60,000 deaths each year are linked to high levels of air pollution. Across the EU, one child in seven now suffers from asthma. The Mediterranean countries, in particular, record high levels of air pollution (which are partly linked to weather patterns). In Greece and Italy, virtually the whole population was exposed to excessive (ground) ozone and particulate levels in 2001. The Commission is currently preparing an action plan designed to tackle environmental problems that constitute a human health hazard.

Most of the accession countries, including Hungary, Poland, Slovenia and Slovakia, also suffer from high levels of pollution. The new member-states will find that meeting environmental standards is one of the most demanding aspects of joining the EU. The Commission, in its environment policy review, estimates that Central and East European countries will need to spend up to €80 billion on implementing the EU’s environmental acquis. The implementation of the EU’s waste water directive alone will cost around €15 billion.

<table>
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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

Four years into the Lisbon reform agenda, it has become clear that the EU stands little chance of achieving its overall goal of becoming “the world’s most competitive and dynamic knowledge-based economy by 2010”. Rather than catching up with the US, the EU economy is slipping further behind on indicators such as GDP per head. According to Commission data, the average US citizen was nearly 39 per cent richer than the average EU inhabitant in 2003, compared with 37.5 per cent in 2002. And the Commission forecasts that this gap will grow to 41 per cent by 2005. The EU economy has grown by an average of 1.75 per cent a year since 2000, compared with its goal of 3 per cent.

EU workers are on average around 20 per cent less productive than their US counterparts. The Commission estimates that productivity growth (per person employed) is running at half the levels in the US. The Commission has therefore had to conclude in its spring report on the Lisbon agenda that the EU will not match US GDP by 2010.

However, the fourth CER scorecard also demonstrates that the EU has made good progress in some specific areas of the Lisbon agenda. The EU has created six million jobs since 1999. Long-term unemployment has declined from 4 to 3 per cent of the total
Any attempt to dilute the Lisbon agenda would be a mistake. Whatever its flaws, nobody has thought of a better tool for promoting economic reform in the EU. That said, the EU should use the mid-term review to refine the agenda:

★ Maintain focus on employment and growth

All parts of the Lisbon programme are important. But in the short term some are more important than others. The overall goal is to increase the EU’s growth and employment rate. The EU should focus on those measures most likely to achieve this ambition.

The EU pays lip service to focus and clarity, but in practice the Lisbon agenda has increased in scope every year since its inception in 2000. For example, the Commission said in January 2004 that it intends to pursue only a limited number of economic reform goals over the next year, including increased investment in the knowledge economy and better regulation. Yet it also suggested in its report to the spring European Council that the EU should consider adding the modernisation of healthcare systems to the Lisbon strategy from 2005.

Once the EU adds a new issue to the agenda it is hard to remove it. Environment ministers strongly resisted a Commission recommendation in the autumn of 2003 that they should drop the Lisbon agenda. The EU should resist the temptation to add extra clutter to an already demanding economic reform agenda.

★ Don’t change the targets

The mid-term review will provide an opportunity for the EU to change some of the Lisbon targets. The member-states could justify such a move as required to take account of the inclusion of the new member-states, and also to refocus governments on
working towards more ‘realistic’ goals. Thus the employment rate for the EU-25 is 62.9 per cent, compared with 64.3 per cent in the EU-15. Enlargement will make it even less likely that the EU as a whole will meet the key Lisbon target of raising employment levels to 70 per cent by 2010.

However, the member-states should resist the temptation to downgrade targets – even those they are likely to miss – for two reasons. First, clear and consistent targets are an essential part of the Lisbon programme. The EU is employing a system of benchmarking and peer pressure to encourage member-states to undertake economic reform. If the EU changes its targets halfway through the process, it would become much harder to assess its performance. Second, any softening of the targets would imply that the EU lacked ambition for its economic reform agenda. Individual countries can and should aspire to meeting the headline goals, even if the EU as a whole will not meet them by the end of the decade.

★ Appoint a ‘Lisbon’ commissioner

The British, French and German governments agreed at their trilateral summit in February 2004 to press for the appointment of a senior commissioner to oversee the Lisbon agenda. The CER has long supported the creation of such a post, for the Commission has sometimes failed to give sufficient focus to economic reform. The new Lisbon commissioner would work in tandem with the chairs of the Ecofin and competitiveness councils, which oversee the EU’s work on economic reform, to help the EU to meet its targets. The Lisbon commissioner would monitor the progress of the various Commission directorates-general (DGs) in meeting their legislative goals. In particular, the commissioner could ensure that the directives produced by various DGs, especially those for the environment and social affairs, are fully compatible with the economic reform agenda.

However, the member-states should not use the creation of a Lisbon commissioner as an excuse to ignore their own responsibilities. It is the member-states, not the Commission, which will have to undertake most of the outstanding reforms that are needed for the fulfilment of the Lisbon goals. A Lisbon commissioner may encourage and sometimes even cajole governments to embrace reform, but he or she cannot force them.

★ Improve national reporting of the Lisbon process

The Commission conducts an annual review of the Lisbon process in its spring report to the European Council. It increasingly tries to hold member-states to account for their performance, highlighting strengths and weaknesses. Other papers, including this scorecard, provide independent assessments of the EU’s progress towards meeting its Lisbon goals. But in an EU of 25 countries, such reports can only ever provide a snapshot of progress in individual member-states. Member-states submit a plethora of progress reports on individual aspects of the Lisbon process to the Commission. But governments are not obliged to provide a coherent overview of how they intend to meet the Lisbon targets.

The Commission should require less reporting on individual items of the Lisbon agenda from the member-states. But each member-state should prepare an annual report that reviews its overall progress towards the Lisbon goals. This should state what action the government intends to take to address any weaknesses. Each government should present this report to its national parliament during the winter, so that parliamentarians – alongside journalists and independent experts – have a chance to quiz ministers on their record prior to the spring economic summit.
Take account of the specific needs of the new member-states when integrating them into the Lisbon process

This scorecard has shown that many of the new member-states perform well on a wide range of Lisbon measures. However, most of them will remain well below the EU average for the foreseeable future.

The EU Economic Policy Committee, which advises Ecofin, has concluded that the challenges facing new member-states are not fundamentally different from those in the present member-states. That assessment is correct – up to a point. But the EU needs to take account of the fact that the new members face economic challenges of a different magnitude. At the same time the new members should have higher ambitions. Many of the Lisbon goals will – if pursued vigorously – help the new member-states to grow faster, in particular those targets concerning education, market liberalisation and entrepreneurship. However, Central and East European countries will need to focus their reform efforts even more tightly than the existing members, given their overstretched national budgets and limited administrative resources.

Job creation must be the top priority in the new member-states. But the EU should think very carefully about whether its existing employment guidelines are suitable for the new members.

The EU has sought to deal with its unemployment problems by cutting back labour market regulations, revamping tax and benefit systems to create work incentives, and improving so-called active labour market policies, for example job search assistance programmes.

Such measures are unlikely to do Eastern Europe much harm. But they could be beside the point. The real problem of East European labour markets is a double mismatch: one geographical, one skills-related. Unemployment stands at 30 per cent in many declining industrial heartlands and rural areas, but workers do not move. Governments need to tackle poor transport links and inflexible housing markets. They also need to equip workers with the skills necessary to work in high-tech manufacturing and services industries, where most new jobs are created. Therefore the new member-states need to make a priority of increasing labour mobility, attracting investment to declining regions and upgrading their education and training systems.

Overall assessment of results: C
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<td>Cyprus, Czech Republic, Netherlands, Sweden</td>
<td>Belgium, Italy, Poland</td>
</tr>
<tr>
<td>Upgrading skills</td>
<td>C+</td>
<td>B-</td>
<td>Czech Republic, Finland, Slovakia, Slovenia, Sweden</td>
<td>Greece, Portugal</td>
</tr>
<tr>
<td>Modernising social protection</td>
<td>B-</td>
<td>C+</td>
<td>Austria, France, Sweden</td>
<td>Belgium, Ireland and UK (for social exclusion)</td>
</tr>
<tr>
<td><strong>E. Sustainable development</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Climate change</td>
<td>C-</td>
<td>C+</td>
<td>France, Sweden</td>
<td>Austria, Ireland</td>
</tr>
<tr>
<td>Natural environment</td>
<td>C+</td>
<td>C</td>
<td>Austria, Belgium, European Commission</td>
<td>Ireland, Spain</td>
</tr>
<tr>
<td><strong>Conclusion</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Lisbon process</td>
<td>C</td>
<td>C+</td>
<td>Ireland, Sweden</td>
<td>Italy</td>
</tr>
<tr>
<td>Overall assessment of results</td>
<td>C</td>
<td>C+</td>
<td></td>
<td></td>
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