CENTRE FOR EUROPEAN REFORM
working paper

THE LISBON SCORECARD

The status of economic reform in Europe

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FOREWORD

The European economy is strong and is now growing faster than the US. Earlier reforms in both the public and private sector are starting to bear fruit and many European firms are benefiting from new growth opportunities in the knowledge economy. For much of the continent, the euro is a reality and is heightening both competition and competitiveness.

In the UK, the debate has often been dominated by a false impression that the rest of Europe is stuck in "old-style thinking" about economic policy. The Lisbon Summit in March 2000 showed that new ideas are permeating all the EU capitals, and KPMG fully supports that reform agenda. One year on, we need an honest and independent assessment of where things stand. This CER Working Paper highlights that, while much remains to be done, Europe is clearly heading in the right direction.

This philosophical convergence is just as important as economic convergence. At the Stockholm summit, Europe's leaders must underline the new consensus and build on the progress already made. They will find that businesses across the continent share their vision and are ready to play their part in realising Europe's potential.

Mike Rake
European Chairman of KPMG

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I. Introduction

It will be left to future historians to appreciate fully the significance of the Lisbon Summit of March 2000 in the economic evolution of Europe. But it is already possible to argue that its impact could be even more far-reaching than that of the euro. Essentially, how Europe creates its wealth is more important than how Europe chooses to denominate it.

At Lisbon, Europe's leaders decided that sustained economic growth should be a central aim of the EU. They recognised that this would require not only short-term political initiatives, but also medium-term economic restructuring and even long-term cultural change. The Lisbon conclusions set out an ambitious ten-year agenda to make the EU "the most competitive and dynamic knowledge-based economy in the world by 2010, capable of sustainable economic growth, with more and better jobs and greater social cohesion". Such wordy declarations in themselves are not new. But the Lisbon summit did bring together the work programmes of many different parts of the European policy-making establishment in support of one over-arching vision, and that was a real breakthrough.

EU leaders decided at Lisbon that what has been termed the "open method of co-ordination" should be a key mechanism for achieving economic reform. This gives member-states considerable latitude as to how they should fulfill commonly agreed policy goals. In return, they must submit themselves to review by their peers. The EU was, in effect, creating a "single market for policy", in which the Commission would take on a new role as a secretariat to facilitate the benchmarking and exchange of best practice. However, other parts of the Lisbon agenda will require traditional directives, which involve proposals by the Commission which are passed by the Council of Ministers and the European Parliament, and then implemented by member-states.

The Lisbon summit agreed that future spring summits should focus on issues identified as crucial to long-term competitiveness. With the Swedish EU presidency now under way, the Stockholm Summit at the end of March 2001 will provide the first formal review of progress since Lisbon. It is therefore an appropriate time to consider what the EU and its member-states have achieved, even if many of the reforms are barely underway and have yet to bear fruit.

This paper asks whether the EU is genuinely committed to the reform process, and whether it is prepared to do what is required to achieve its objectives – even if in the short term this results in political or economic pain. We have assembled evidence from a wide range of sources to highlight the challenges facing the EU and to look for signs of progress in the key areas. The Commission has itself published a commendably frank assessment, and it has put together a set of "structural indicators", which will over time provide useful measures of progress. We do not seek to duplicate that work. Instead, our scorecard will focus on the politics underpinning economic reform, and our judgements will inevitably be partly subjective.

For example, in most areas of policy there are "heroes" of reform who are either beacons of best practice or who have begun significant new initiatives since Lisbon. There are also "villains" who either lag badly or who have made little apparent effort to improve. In the spirit of the "open method" we have sought to highlight both of these groups in this paper. The overall score for each issue reflects our assessment of the current position, one year on from the Lisbon summit.

Sweden is a promising place to start the review. The country was prematurely written off in the 1990s as a lost case of euro-sclerotic social democracy. Now the Swedes enjoy vigorous growth, low unemployment and are at the forefront of the "new economy" – thanks to their strength in key knowledge-based industries such as IT and biotechnology. The Swedes appear fully committed to the economic reform process and have made employment a centre-piece of their presidency. This is a clear step forward from the French presidency, which was distracted by the power-politicking that came to a head at the Nice summit in December 2000. Many in the French government also retain some instinctive scepticism about the merits of the Lisbon agenda.

Nevertheless, the EU's creation of the Lisbon process per se, in which Portugal, UK and Spain were all instrumental, deserves credit, even before we consider the actual results. Lisbon has established some mechanisms to bring about the long term structural changes that Europe desperately needs. The EU's traditionally lofty rhetoric is – at last – being matched by a transparent process of setting objectives and measuring performance. This is the basis for our first score:

The Lisbon Process	B+
Heroes	Portugal, UK, Spain, Sweden, European Commission
Villains	France

II. The Lisbon Agenda

The Lisbon summit's comprehensive and joined-up approach to economic and social policy was welcome and long overdue. However, the very breadth of the Lisbon conclusions perhaps explains why their significance was largely lost on the public at large. Many disparate initiatives were brought together into a single package. For the purposes of this scorecard we have grouped the Lisbon targets under four broad headings or "pillars":

A. INNOVATION

Europe cannot compete in a global economy on the basis of low-cost, low-skilled production in traditional sectors. Increasingly, knowledge is becoming the major factor in wealth generation. But knowledge by its very nature is difficult to harness or tie to any geographical area. Europe's record on generating ideas is strong, but the continent has often fallen down when it comes to turning ideas into products and services for the global markets. At the heart of the knowledge-economy must be the creation and dissemination of information. While Europe was slow to exploit the internet, it has established strong positions in mobile telephones and biotechnology. Creating, protecting and exploiting intellectual property will be the key to future economic success.

B. LIBERALISATION

The formal completion of the single market in December 1992 was a long way from being the end of the story. Many barriers to the free movement of goods, services, people and capital remain intact, largely due to deeply entrenched interests protected by member-states. Europe must create a fully functioning single market in order to raise its overall levels of competitiveness. With the WTO negotiations stalled, and enlargement imminent, the EU's calls for others to open their markets will have a hollow ring until it puts its own house in order.

C. ENTERPRISE

It is now widely recognised that new firms are the key to new jobs. Crucially, Europe lacks a dynamic, entrepreneurial culture in which success is rewarded and failure accommodated. Many of Europe's finest minds are now running start-up ventures in the US, where they believe they have more flexibility and more reward. Regulation in Europe, by common consensus, needs to be speeded up, slimmed down and subjected to rigorous impact assessments. New approaches such as self-regulation and co-regulation should be explored with European businesses and social partners. State aids must be reduced and protected national champions exposed to real competition.

D. SOCIAL INCLUSION

Lisbon recognised that Europe is not America and should not aspire to be. Improved opportunities for firms should also mean new opportunities for individuals, and will require a new approach to the European social model. Jobs are the key to social inclusion and to sustainable public finances. The focus should therefore be on increasing employment levels in the EU. Strong economic growth is generating demand for new staff, but Europe must do more to improve the quality as well as quantity of its supply of workers. Investing in skills across all levels of the workforce, increasing the mobility of job-seekers and ensuring that the social safety net does not become a poverty trap are all important objectives.

The EU needs to maintain a balance across all four pillars, for the overall construct – a competitive and cohesive Europe – depends on all of them. For example, if restrictions on pension fund investments were liberalised, to release more venture capital for high-tech start-up firms, Europe would start to see increased innovation and enterprise. In time, the returns on those investments will support sustainable pensions and foster social inclusion. Good economic policy is good social policy. And vice versa.

III. The Scorecard

A. INNOVATION

A.1 Information Society

TARGETS

Connection of all schools to the internet by the end of 2001, with training of teachers in the new technologies by 2002 and a new curriculum with a strong IT focus by 2003
On-line access to main public services by 2003
Adoption of a legal framework for e-commerce by end -2000

At the time, media reports described Lisbon as "the dot.com Summit". That was March 2000, just as the NASDAQ stock market in New York reached its peak. The subsequent collapse of hi-tech stock prices does not diminish the overall importance of the internet to the long-term competitiveness of Europe. By January 2001, access to the internet in Europe had risen to 28 per cent of all households, up from only 18 per cent at the time of Lisbon. This makes the EU about one and a half years behind the US in terms of market maturity. However, the internet sector in Europe is now developing at a faster pace than the US, and it is finding its own niches in areas such as mobile wireless and interactive television. The closely-watched IDC/ World Times index on the development of the Information Society recently placed Sweden and Finland as first and third in the world, with Norway second and the US now in fourth place.

Much of what the EU is trying to achieve is encompassed in the package of measures known as the e-Europe programme. At Lisbon, governments not only endorsed this programme but also declared it to be a top priority. The e-Europe programme includes a mixture of traditional directives, such as those on key technical standards, and new "open method" approaches, for instance on IT skills, and the wiring up of schools. In every EU country (with the exception of Greece), more than 80 per cent of secondary schools are now connected to the internet. However, the number of computers per pupil in Europe is still too low to make IT a core part of most schools' curriculums.

The "digital divide" between those fully participating in the information society and those at the margins can also be seen within member-states, between rich and poor and between men and women. Some governments provide access to the web through local post offices or libraries, while privately-run internet cafes can be found across Europe. However, although around half of the European workforce uses a computer only about a fifth are classified by the Commission as IT-literate. The Lisbon teacher training target of 2002 will also be hard to meet without a significant additional effort by many member-states. While around half of Europe's small- and medium-sized enterprises (SMEs) have access to the internet, only a very small proportion can undertake full e-commerce transactions. German SMEs are more advanced in internet take-up than their French or British counterparts.

The e-Commerce Directive, adopted during the Portuguese presidency, is intended to provide a legal framework for new economy. The recently passed e-Money Directive will support buying and selling on-line and the Copyright Directive, which is likely to be approved soon, appears to be a sensible compromise on intellectual property rights after three years of negotiation. The new regulation on jurisdiction and enforcement begins to provide a legal basis for resolving e-commerce disputes, which will be essential if the practice is to gain public confidence.

Overall, the legislative and regulatory response since Lisbon has been impressively brisk. But as e-commerce leads to a rise in the volume of cross-border trade, there is bound to be tension between the rights of businesses and consumers in the various countries. A transparent, consistent and responsive legal framework will remain essential.

As another way of encouraging greater European take-up of the internet, EU leaders have committed 150 million euros to improving the available content for non-anglophone users. But they will need to do more to increase the availability and utility of on-line public services. A recent survey of EU countries on the extent of internet access to public services showed that general information is readily available, but that the degree to which key transactions can be carried out on-line by citizens or businesses is much more limited.

Europe's established strengths in mobile telephones may be the key to greater access to on-line public services. Take-up of mobiles is actually higher in the EU than in the US and is quite consistent across all member-states, suggesting that mobile phones may offer a more socially inclusive means of accessing information than, for example, PC-based systems. In many respects, Europe can be proud of its progress towards becoming an information society.

Information Society	B+
Heroes	Commission, Sweden, Finland, Germany
Villains	Greece

A.2 Research and Development

TARGETS

Establishment of an EU Patent by end-2001
Mapping of R&D centres of excellence, and an Innovation Scorecard by June 2001
Creation of High-speed TransEuropean Networks for scientific research by 2001

The establishment of an EU patent required a treaty change at Nice to support a new intellectual property regime. After much lobbying by industry, EU leaders have signed up to the new regime but there remains much to be done before the EU patent becomes a useable alternative to existing national arrangements. The creation of a specialised and effective court to resolve intellectual property disputes will be crucial, but discussions on this issue appear bogged down. National patent offices are still grumbling about the potential loss of revenue. For their part, business users are unhappy with onerous language requirements. Spain is insisting on its full language rights for European patents and this could hold up progress on a vital policy initiative.

The Stockholm Summit must underline the urgency of the EU patent initiative for Europe's long term competitiveness, and set a clear deadline and process for resolving the outstanding issues. The economic importance of creating an EU patent regime is underlined by the current frenetic patent activity being undertaken by the American firms on everything from human genes to "business processes". In 2000, the number of patents granted worldwide jumped by over a quarter from the previous year. The EU will not be able to negotiate at the global level to protect its intellectual property unless it has its own legal infrastructure in place.

October 2000 saw the launch of the "European Research Area", which will bring together researchers across the EU using new TransEuropean Networks (TENs) of high speed data cables. A report will be made at Stockholm highlighting the significant progress that has been made. However, Lisbon is only just starting to have an impact on the Commission's research programme. This is the third largest Commission programme in budgetary terms, and one that has sometimes been criticised as the scientific equivalent of the

much-maligned Common Agricultural Policy. In the past, many of the Commission's big-ticket programmes have lacked relevance to European industrial competitiveness and may even have "crowded out" private sector activity.

The Commission launched the Sixth Framework Programme in February 2001, pledging greater emphasis on larger-scale projects and increased co-ordination. However, the mapping of centres of excellence has taken longer than expected and the link with the Lisbon process remains unclear. The delayed and over-budget Galileo satellite project, which seeks to create a European rival to the American Global Positioning System, is a good example. The EU should not commit further resources to this project unless there is much greater clarity on how the private sector will contribute to – and benefit from – this venture.

The benchmarking of member-states against each other, and against other leading economies, should start to provide some pointers on how Europe can make the most of its impressive knowledge base. The Commission has put together a draft "Innovation Scoreboard" of key R&D performance measures in each member-state. This is a useful first step although the authors acknowledge the limitations of currently available data and qualify their findings accordingly. Nevertheless, on the 16 indicators proposed, Sweden comes out well ahead with 12 scores that were more than 20% above the EU average results. This puts Sweden on a par with – or even ahead of – the US. The Swedes are followed by Finland (8 scores more than 20% above the average), then Denmark and Germany, both with 7. The Germans deserve particular credit since they score very well for knowledge creation, and some of the indicators used will favour smaller countries, as the Commission notes. The low performance of Greece and Portugal will not be turned around quickly.

The challenge now is to both refine the quantitative indicators and – more importantly – to focus on the sharing of best practice that will enable the EU to improve its overall score. The member-states need to do more. Opening up national research programmes to other EU researchers will also do much to enhance overall co-ordination and make the European Research Area a reality.

Research and Development	B-
Heroes	Sweden, Finland, Germany
Villains	Commission, Spain, Greece, Portugal

B. LIBERALISATION

B.1 Telecoms

TARGET

Liberalisation of telecoms market by 2001, including competition in the local loop to reduce internet access costs

In so far as the information society runs on anything it is phone lines, used for the electronic transmission of data. Thus the high cost of telecoms in Europe, relative to the US, is a major barrier to the development of e-commerce. It also heightens the "digital divide" between those that have access to the new technologies and those that do not.

Lisbon stressed that the EU needed to reduce telephone charges as part of the e-Europe "innovation" package focusing on internet access. We have included it under "liberalisation" because the problems – and solutions – have more in common with the traditional issues of ensuring access to protected national markets. The evidence is overwhelming: exposing incumbent monopolies to competition raises quality and reduces charges.

Over the years, the EU has introduced a vast amount of legislation aimed at increasing competition in telecoms. Much of this legislation will hopefully be simplified and consolidated soon. Lisbon tackled one high profile anomaly: the "local-loop" exchanges which are the final part of the European telecoms infrastructure that is not subject to full competition. An EU regulation, which was agreed ahead of schedule in January 2001, opened up the local loop in a process known as "unbundling". The European Commission, European Parliament and member-states all deserve credit for what a leading official described as "one of the fastest bits of legislation ever". This has removed a key political obstacle to liberalisation at the EU level.

The real test, however, will be the extent to which competition increases on the ground and how far prices drop as a result. Even after "unbundling", significant regulatory and commercial issues remain unresolved. Although the UK began the process of liberalisation some 15 years ago, other member-states have now caught up. Indeed, the British government was recently embarrassed by the slow development of broadband lines, which can carry high volumes of internet traffic.

The European Commission publishes an Index of Competitive Development, which measures the degree of telecoms liberalisation achieved and the sophistication of the services available. On the basis of data which predate Lisbon, the leaders were the UK, Finland and Germany which topped the poll (scored out of 100) with scores of 62, 59 and 59 respectively. At the bottom, the laggards were Spain and Belgium, which score 37 and 36 respectively. Since Lisbon, however, Germany has pushed even further forward with liberalisation, as indeed has Spain.

Lisbon called for agreement on a further package of telecoms liberalisation by June 2001, which would set the regulatory environment for access, universal service and inter-connection charges, in support of a "Single Communications Market". In spite of their current financial difficulties, major telecom operators are broadly supportive. Many would like the Commission to be given greater powers to intervene in national markets, if the national regulator fails to discharge its responsibilities. However, other governments, notably France, have been trying to marginalise the Commission. The French government wants to maintain a significant degree of state control through a thoroughly ambiguous approach to ongoing privatisation, and a regulator which is subject to political influence.

Overall, however, tangible progress has been made and there appears to be momentum for further liberalisation under the Swedish presidency.

Telecoms liberalisation	B+
Heroes	European Commission, Germany, Spain, UK (just)
Villains	France, Belgium

B.2 Utilities and Transport

TARGET

Develop a strategy for completing the internal market for all services by end-2000

Lisbon committed the EU and its member-states to make progress in key areas of the internal market, such as utilities liberalisation, which had been left out of the original "1992" programme. Although not at the cutting edge of the new economy, utilities have a crucial impact on Europe's overall competitiveness. Electricity and gas are vital to the production process, while even a traditional service such as mail delivery has taken on a new importance in the age of consumer-orientated e-commerce.

The adoption of the Electricity and Gas Directives has theoretically allowed two-thirds of EU electricity customers and three-quarters of EU gas customers to choose their supplier. Prices have started to fall. The Gas Directive was due to be fully implemented by August 2000. However, a number of member-states, including France and Germany, failed to pass the necessary legislation and obliged the Commission to launch infringement procedures.

Energy commissioner Loyola de Palacio has promised new proposals to address the many enduring barriers with a view to the full liberalisation of energy markets by 2005. These will focus on the unbundling of production and sales, and on facilitating cross-border trade in electricity, which is still only 8 per cent of the total market. The Commission is already investigating gas movements and pricing structures in the cross-Channel pipeline.

In the transport sector, which underpins the effective functioning of the Single Market and is again critical to overall competitiveness, progress has also been slow. The lack of a "Single European Sky" in terms of air traffic control is said to cost users of air transport around 5 billion euros a year through increased delays. The ongoing dispute between the UK and Spain on airspace over Gibraltar appears to put the 2004 deadline for effective liberalisation of air traffic control in serious jeopardy.

The opening of international rail freight markets has been given one of the most distant deadlines of 2008, thanks to concerted opposition from key continental operators, such as those in Belgium, which do not want through-traffic on their lines. Their protectionism imposes costs on EU firms that are seeking to exploit the single market and flies in the face of environmentally-driven attempts to shift more goods from road onto rail.

A proposal to liberalise postal services is stuck in a divided Council, while the European Parliament is also likely to have much to say on the subject. Germany, supported by the Netherlands, has called for full liberalisation by 2003. However, an unusual alliance between the UK and France is resisting anything more than incremental progress.

Opponents of liberalisation in various member-states advance many reasons for protecting any given sector and the issues around each case deserve fuller exposition. The focus here is on the ongoing impact of *not* opening these markets. The knock-on effects on overall competitiveness can be very significant. Effective enforcement of existing rules by the Commission, combined with aggressive lobbying by the consumers of these services, is the key to future liberalisation.

Utility and transport liberalisation	D
Heroes	Commission
Villains	France and Germany for energy; Spain, UK and Belgium for transport; UK and France for post

B.3 Financial services

TARGETS

Financial Services Action Plan to be implemented by 2005
Risk Capital Action Plan to be implemented by 2003

The cost of capital is a crucial determinant of competitiveness for almost any business. European stock markets are smaller, less liquid and less efficient than their American counterparts. The lack of a developed "equity culture" is one of the key barriers to Europe matching America's recent growth record. The EU's regulatory framework has struggled to keep pace with the rapid evolution of a sector which is responding to the emergence of new communications technologies and global financial services firms. (These challenges are considered in detail in a new CER pamphlet: *The future of European stock markets*.)

The Lamfalussy Committee, which was established in the summer of 2000 and has recently made its final report, sought to develop a proper institutional response. After some initial scepticism from the UK government, the common sense approach of these "Wise Men" seems to have won broad respect. Many in the French government remain suspicious of the power of British and American stockmarkets but their ambitions for a European equivalent of the US Securities and Exchange Commission appear to have been thwarted. Instead, Lamfalussy proposed a new "Securities Committee" of national experts, close to the markets, who would develop legislation within a framework set by political leaders at the EU level. Many other regulatory powers will remain with member-states.

Whether the Council, Commission and European Parliament will be willing to accept the institutional innovation of a Securities Committee will be a good test of the EU's ability to embrace new thinking in governance. The collective response of EU leaders at Stockholm will be critical to ensuring further progress on this issue, much of which will be quite technical in nature. The Commission has brought forward key proposals on pension funds and investment services, and others are expected soon on collateral, market abuse and accounting rules. The omens are encouraging, with Spain, Sweden, Finland and the UK all jostling to bring forward the deadline for implementing the 43 measures set out in the Financial Services Action Plan to 2004 or even 2003.

The problems faced by European companies in raising finance start well before they graduate to the stock market. Improved access to venture capital is a critical step to creating more new, dynamic companies. Although the EU venture capital industry has increased rapidly in the last year or two, it is still only one third of the size of its American equivalent. About half of the European market for venture capital is in the UK although the Dutch have the highest amount as a proportion of GDP. Belgium also scores well on this measure, and is already planning to make venture capital a priority of its presidency in the latter half of 2001.

The EU's Risk Capital Action Plan, which is due to be implemented by 2003, has not attracted as much attention as the broader financial services package but covers many of the same areas. The objective is to create a "single passport" for finance houses, allowing them to invest in businesses across Europe and to compete with established lenders in protected national markets. Pension funds would also be allowed to put much more of their funds into cross-border venture capital, creating more jobs and better returns.

Financial services liberalisation	C+
Heroes	Lamfalussy Committee, UK, Netherlands and Belgium
Villains	France

C. ENTERPRISE

C.1 Business start-up environment

TARGET

Evaluate the business start-up environment in the EU, with indicators on the speed and cost of establishment by end 2000

Europe needs more dynamic new businesses in order to achieve its broader economic objectives. Start-up enterprises create more jobs and are often more innovative than their larger rivals. The overall level of entrepreneurial activity is strongly associated with economic growth. This policy lesson has been taken on board by governments around the world. The London Business School's Global Entrepreneurship Monitor (GEM) supports the widely-held view that Europe lags significantly behind the US in new firm creation. This lack of enterprise is one of the key reasons why overall growth has been lower in recent years, according to GEM.

The GEM data suggest that Europe is, depressingly, still much closer to Japan than the US in terms of its entrepreneurial activity. Italy, with a strong family business tradition, and the UK, are fractionally ahead of the EU average; but for the most part EU countries are bunched together with only Ireland, France and Belgium lagging to any significant extent. Ireland has the excuse of a booming job market and Belgium can at least point to its high degree of international investor activity in mitigation. The lack of French entrepreneurs seems deeply rooted in cultural factors. There has been little significant change to report since Lisbon but in fairness this was always going to be a long term process. GEM researchers detected some signs of increased entrepreneurial activity in response to the dot.com boom last year but these have since waned.

There are some specific things that the EU needs to do in order to spur progress. The Commission has so far failed to deliver its promised study on the establishment and start-up costs for businesses in each member-state. This may be because some member-states fear the possibly unflattering comparisons. The Commission should have the courage of its convictions and press ahead regardless. This is exactly the sort of the issue that the open method of co-ordination was supposed to address. A previous study in 1996 found that establishing a company in the UK took one week and cost 70 euros. In Germany, the process took 16 times longer while in France it cost 20 times as much. European entrepreneurs need to know if anything has changed.

Business Start-up Environment	D
Heroes	UK, Italy
Villains	France

C.2 Regulatory environment

TARGETS

Approval of new European Charter for SMEs
Strategy for simplification of the regulatory environment, including impact assessments, by 2001

EU leaders agreed the European SME charter at Feira in June 2000. This pledges the EU and its member-states to more enterprise-friendly policies, although the specific commitments are very limited and much is left to the discretion of member-states. It does however point the way towards new ideas on governance, based on bottom-up industry agreements rather than top-down directives. Commission officials are looking at ways of codifying and simplifying the sprawling EU regulatory regime but progress has proved difficult. Spain and the UK have proposed a new inter-institutional agreement to set out the rights and responsibilities of the Parliament, Commission and member-states in order to accelerate this process.

After 30 years of discussion, the recently agreed EU regulation on a European Company Statute may be a step forwards. European businesses will from 2004 be able to register as an SE, *Societas Europaea*, assuming that the appropriate supplementary legislation is passed by the European Parliament. Any company established in more than one member state with capital of at least 120,000 euros will be able to become an SE and operate with a single set of rules and a unified management structure. The social obligations of the new firm, for instance on worker participation, will depend to a large extent on the previously dominant arrangement within the company's operations. If member-state tax authorities can resolve a few outstanding issues, the benefits should be significant: a 1995 study by the Competitiveness Advisory Group estimated the potential savings on company administration at around 30 billion euros. The introductions of the SE should also greatly facilitate the industrial restructuring of Europe through cross-border mergers and acquisitions.

The OECD's Business Freedom index (scored out of 100) is a revealing assessment of the regulatory burden in European countries. Leading the charge for lighter regulation is the UK, with the lowest index score of around 10. Ireland, Denmark and Norway follow in the low 20s. There is then a gradual increase in the burden of red tape until one reaches the levels of Belgium, France and most of all Italy, whose scores are well into the 40s. This probably helps to explain why so many of the small Italian companies fail to become big Italian companies.

The forthcoming Commission White Paper on governance is expected to take on board new approaches to regulation. The Commission is also committed to publishing a co-ordinated strategy on simplifying the regulatory environment, an issue which will be discussed at Stockholm. European business leaders have put regulatory reform at the top of their agenda. The UK and Portugal have held conferences on best practice in regulation. The Dutch and Finns have also pledged support for new thinking. Although the starting point is low, Europe may finally be beginning to move in the right direction and Stockholm must make improving the business environment a priority.

Regulatory environment	D+
Heroes	UK, Ireland, Denmark, Netherlands
Villains	Italy, Belgium, France

C.3 State aids and competition policy

TARGETS

Promote competition and reduce the level of state aids
Strategy for redirection of the European Investment Bank and the European Investment Fund to support SMEs by end 2000

State aids to favoured firms have long distorted competition in the EU. In a joint letter of October 2000 Tony Blair and Jose-Maria Aznar have called for the current level of state aids at 1.1 per cent of EU GDP to be cut to 0.9 per cent by 2003, and to 0.7 per cent by 2005. Governments have stopped granting state aids to the shipbuilding sector, but the EU still needs to go much further. The Commission has an impressive record of vigilance on this issue. It is committed to publishing on-line a state aid register and scoreboard by July 2001. Hostility from disadvantaged competitors should prove an effective catalyst for further reductions in state aid. The early evidence from the Commission is that Spain has made the greatest progress since Lisbon. In Belgium, however, the level of state aids is rising higher.

Europe should not just lower the overall levels of state aid, but also improve the targeting of government assistance. This has been a familiar refrain of EU summits for many years. The Lisbon summit highlighted the need to move away from the "vertical" support of decaying firms, and into "horizontal" investment in the key infrastructure of the knowledge economy. Rather than governments attempting to pick winners, the aid would be channeled through intermediaries, such as regional banks and venture capital houses. These intermediaries should be able to make quicker and better decisions on investments in innovative SMEs. At the heart of this new thinking is the European Investment Bank, which responded to Lisbon by establishing, together with the European Investment Fund, the Innovation 2000 Initiative, predictably abbreviated in internet shorthand to "i2i".

Since May 2000, the EIB has earmarked over 1.4 billion Euros for investment in communication networks and technology training under the i2i budget line. 200 million euros has also been made available in venture capital for SMEs and the EIB will no doubt parade some of the more attractive case studies at Stockholm. In total, the EIB will lend between 12 and 15 billion euros under this programme over the next three years. Although modest in terms of the EIB's overall outlays, this does represent a significant change of emphasis from traditional investments in Mediterranean motorways.

Both free-market purists and the Commission have noted that the distinction between providing "good" financial support for innovative SMEs and "bad" old-fashioned state aids is not always clear cut. British plans for R&D tax credits and regional venture capital funds have raised eyebrows in Brussels, although the Commission recognizes the value of such schemes.

The Commission's ability to enforce a level playing field will not be made easier if the EU hands back some functions of competition policy to the member-states, as currently envisioned. Greater clarity on the principles and process of competition policy is also badly needed.

Reducing state aid and promoting competition	B-
Heroes	Commission, UK, Spain
Villains	Belgium

D. SOCIAL INCLUSION

D.1 Bringing people into the workforce

TARGET

Employment Action Plans to raise overall workforce participation rates to 70 per cent, and for women to 60 per cent, by 2010

Lisbon represented a major change in EU thinking, away from prescriptive remedies towards the deceptively simple notion that participation in the workforce is the best remedy for social exclusion. In other words, jobs have both economic and social benefits. According to the Commission's Stockholm report, 2.5 million new jobs were created in the EU during 2000, and two-thirds of these went to women. Overall employment rates have risen from 60.7 per cent a year ago to 62.1 per cent now. Sweden, the Netherlands, the UK and Denmark have already reached the EU's 70 per cent target rate. Ireland has the fastest job creation rate in Europe and from a low starting point, Spain has made excellent progress. Amid some fanfare, France has recently passed the landmark of a million new jobs created since the Jospin administration took office.

This is, of course, to some extent a cyclical phenomenon. Despite the headline figures there are significant variations in performance. Around 14 million people remain out of work in the EU and many of them lack the most basic education and training. Older people are particularly vulnerable to marginalisation. Of the 55-64 age group, only 37 per cent remain in the workforce but the variations between member-states are striking: in Sweden, almost two-thirds of this age group are in work while in two of Europe's largest economies, Italy and France, the figure is less than 30 per cent. With an ageing population in Europe, this is simply unsustainable in terms of welfare and health provision. New targets must be set at Stockholm to address this.

In terms of female participation, Denmark and Sweden are the top performers, while the Mediterranean countries lag but are gradually improving. New technology is also providing many women with increased opportunities for home-working, while a new generation of female entrepreneurs is beginning to emerge. Childcare issues will need to be addressed if the EU is not to suffer an acute labour shortage due to long term demographic change. Overall however, there are encouraging signs that Europe is slowly moving towards the levels of employment that have been the norm in US and Japan for many years.

Bringing people into the workforce	B-
Heroes	Sweden, Denmark, Ireland, Spain and France (for its overall level of job creation)
Villains	Italy, France (for its older people)

D.2 Upgrading skills

TARGET

A 50 per cent reduction in the number of 18-24s who possess only a basic secondary education by 2010

Importantly, the EU's focus on job creation should not just be on quantity but quality. The economic benefits of these new jobs will depend on the skills and training of the workforce. Again, a hugely diverse picture emerges across the EU. While unemployment is below 5 per cent in Portugal, thanks to several years of strong growth, almost half of the 18-24 year old workforce has only the most basic secondary education

and is not receiving any further training. This proportion has actually risen in recent years. Portugal has clearly benefitted from EU membership, partly thanks to its low labour costs. But without further improvements to its skills base it risks creating a generation of burger-flippers.

If the European workforce is going to be competitive in knowledge-based industries, older workers will also need continuous training and updating of skills. The principle of life-long learning has been part of the European Employment Strategy since 1997. But the member-states have a long way to go in implementing this principle at national level. Some of them have not yet set appropriate targets. According to Eurostat, around one quarter of the Swedish workforce is receiving regular training and this proportion is rising. France has only three per cent of workers in regular training, and this miserable share has actually fallen in recent years.

If the EU does not take serious steps to improve skills and raise employability, individual citizens and overall European competitiveness will suffer. One in five British adults are functionally illiterate, according to UN figures, which puts it among the worst of all European countries. Under the open method of co-ordination, member-states are sharing new ideas on how to address these long-standing and deeply entrenched problems. The development of appropriately challenging targets is crucial. However, progress to date has been poor, as the Commission noted in its own Stockholm report.

Upgrading skills	D
Heroes	Sweden
Villains	Portugal, France, UK

D.3 Modernising social protection

TARGETS

Agreement of the social agenda at Nice
Creation of high-level working party on social protection

The Lisbon conclusions noted that as well as creating "more and better jobs", Europe needed to modernise its systems of social protection in order to underpin the transformation to the knowledge economy. The French presidency secured agreement on a new social agenda at Nice, building on the Commission's communication of the summer and contributions from both the Parliament and the Economic and Social Committee in the autumn. This agreement sets a framework for the next five years which will shape the social aspects of the Lisbon agenda.

The "open method" has allowed social exclusion back on the EU agenda in the context of the broader competitiveness agenda. The Commission will play a vital role in providing a platform and secretariat for discussion. Member-states agreed on the broad objectives for tackling social exclusions at Feira, but there remains a danger of backsliding over indicators and data collection. The EU has introduced measures to promote equal opportunities and to counter discrimination which will be particularly important as the demography of Europe changes in the years ahead. Leaders have postponed more contentious proposals, such as the Information and Consultation Directive, at least until after the UK election. A number of other member-states (such as Denmark and Ireland) also continue to have significant reservations about this directive.

At both Lisbon and Feira, EU leaders highlighted the growing importance of corporate social responsibility. Many companies and member-states are anxious to find an alternative to the more prescriptive, legislative approach that is associated with the social agenda. The Council made a "special appeal" to business at Nice and a further communication is expected from the Commission in the summer. Denmark, particularly, has championed this issue and will be hosting a conference on corporate social responsibility later in the year.

European policymakers are grappling with proposals to support the flexibility and mobility of workers which is vital to relieving bottlenecks in the labour markets. The OECD has repeatedly been highly critical of rigid arrangements in the German labour market. At a European level, only 0.4 per cent of the EU's population move between member states in any one year, although almost three-quarters say they would like this opportunity. Most member-states appear to favour increased mutual recognition of qualifications rather than the more standardising approach of a "Euro-CV", created to a specified common format.

EU leaders must commit themselves to further work on labour market reform at Stockholm. Portable pensions and social security benefits would help enormously and, if the political will is there, a sensible compromise could be reached. A number of countries, notably Italy and Germany, are only just beginning to grasp the nettle of pensions reform. Bold and far-sighted thinking is desperately needed but leaders in these countries have all too easily succumbed to short-term political pressures. Co-operation and the sharing of best practice at the EU level should help bolster the momentum for reform in all member-states.

Modernising social protection	C+
Heroes	France, Denmark
Villains	Italy, Germany

IV. Conclusions

OVERALL TARGETS

World's most competitive and dynamic knowledge-based economy by 2010
Average economic growth of 3 per cent, leading to the creation of 20 million jobs by 2010

So where is the EU in terms of its overall objective? With economic growth well on target, the EU looks set to be the leading motor of the world economy in 2001. Unemployment continues to drop towards 8 per cent and the most recent edition of the closely-watched World Competitiveness Yearbook (published by the Swiss-based Institute for Management Development) implied that most European countries were strengthening their competitive position. However, there is absolutely no room for complacency. Even with its current economic hiccup, the US rate of unemployment is still half the EU average. Both the US and Japan have 75 per cent of their workforce in employment, compared to Europe's 62 per cent. While there has been significant progress in beginning reform, there is still a long way to go.

It is to the EU's credit that the member-states are beginning to submit themselves to objective benchmarking. Over time, performance league tables should spur real improvements. The all-important "structural indicators", which were finally agreed just in time for Stockholm, will be the key indicators of progress over the next nine years. Europe can expect vigorous debate within and between member-states as to the lessons to be learned from their relative standing – good or bad. Many will contest the appropriateness or value of these indicators, and no doubt refinements will have to be made over time. But the Lisbon genie is well and truly out of the bottle.

The twin dangers of complacency when times are good, or, political cowardice during downturns, will never be far away. Potential "losers" of the reform process will mount well-organised resistance in support of their particular vested interests. The far larger number of potential "winners" often lack both cohesion and voice. In order to strengthen the reformers, the UK and Germany have proposed a comprehensive study to assess the real and significant benefits for businesses and consumers across the EU. The Lisbon conclusions noted that "achieving the new strategic goal will rely primarily on the private sector". This is true not just economically but politically as well. In terms of keeping up the momentum for reform, many in the European business community have rallied around the Lisbon banner, and they must continue to do so.

During its presidency Sweden is highlighting "sustainability", which has both environmental and demographic dimensions. This is undoubtedly an important issue with which Europe must grapple. But Lisbon must not become a Christmas tree on which every interest group can hang its bauble. The focus must continue to be on driving economic growth in Europe. Success – or failure – will have a huge impact on Europe's single currency, its ability to absorb successfully the new members of central and eastern Europe and its role in vital future WTO negotiations.

Our overall assessment may appear ungenerous but we are only one year into a ten year programme. Many member-states have recently undertaken a number of important economic reforms, not all of which directly relate to Lisbon. But they will have a significantly positive impact on overall competitiveness. French moves to cut the social costs of employment, and the German tax reforms (which will make it easier for companies to be taken over), are just the most high profile examples. The European supertanker has now turned itself around to face in the right direction. We are confident that by the time of the Barcelona summit in the spring of 2002, a similar report would conclude that it is steaming steadily ahead.

Overall Score	C+

THE CER LISBON SCORECARD

Issue	Score	Heroes	Villains
The Lisbon process	B+	Portugal, UK, Spain, Sweden, Commission	France
Innovation			
Information society	B+	Commission, Sweden, Finland, Germany	Greece
Research and Development	B-	Sweden, Finland, Germany	Commission, Spain, Greece, Portugal
Liberalisation			
Telecoms	B+	Commission, Germany, Spain, UK	France, Belgium
Utilities and Transport	D	Commission	France, Germany, Belgium, UK, Spain
Financial services	C+	Lamfalussy, UK, Netherlands, Belgium	France
Enterprise			
Business start-up environment	D	UK, Italy	France
Regulatory Environment	D+	UK, Ireland, Denmark, Netherlands	Italy, Belgium, France
State aid and competition policy	B-	Commission, UK, Spain	Belgium
Social Inclusion			
Bringing people into the workforce	B-	Sweden, Denmark, Ireland, Spain, France	Italy, France
Upgrading skills	D	Sweden	Portugal, France, UK
Modernising social protection	C+	France, Denmark	Italy, Germany
Conclusion			
Overall assessment	C+		

KEY: A = very good; B = good; C = satisfactory; D = poor; E = very poor