CENTRE FOR EUROPEAN REFORM
policy brief

The Barcelona European Council

By Edward Bannerman

The EU's ten-year plan to transform itself into "the most competitive and dynamic knowledge-based economy in the world by 2010" is running out of steam. The forthcoming summit in Barcelona on March 15th and 16th needs to re-energise Europe's faltering commitment to the 'Lisbon agenda' of economic reform.

Many Europeans like to think of their continent as a global economic superpower. But when compared to the US over the last decade or so, Europe looks like a laggard. From 1990 to 2000, the EU achieved only one year of economic growth above 3 per cent. In contrast, the US economy experienced just one year in which its economy grew by *less* than 3 per cent. The gap between GDP per capita in Europe and America is now at its highest level since the early 1960s.

To tackle this under-performance, EU leaders, meeting in March 2000 in Lisbon, agreed on an ambitious ten-year programme that was designed to raise Europe's GDP by around 40 per cent and create 20 million new jobs. But the EU has made only limited headway, with many deadlines already missed. Spain, a strong advocate of structural reform and current holder of the rotating EU presidency, will host this crucial gathering of EU leaders to review progress. British Prime Minster Tony Blair has even described the Barcelona summit as "make or break" for the EU's economic reform agenda.

However, the current political and economic environment continues to present a number of obstacles to progress. The effect of the global downturn has made many member-states reluctant to embark on the kinds of bold economic restructuring that may result in short-term job losses. Elections later this year in France and Germany have further muted discussion of radical reforms and the hard choices that Europe faces.

CER experts will be in Barcelona to provide commentary on the forthcoming European Council meeting. The CER will also publish its comprehensive, annual assessment of progress in implementing the Lisbon agenda shortly after the summit. "*The Barcelona Scorecard: the status of economic reform in the EU-25*" will also include a review of performance by EU candidate countries. Please see the CER website (www.cer.org.uk) for more information or contact:

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Benchmarking progress at Barcelona

The CER's assessment of the Lisbon programme of economic and social policy reforms is summarised below.

INNOVATION

The EU cannot compete in a global economy on the basis of low-skilled production in traditional sectors. Europe's record on generating new ideas is strong, but it has had less success in commercialising innovation for the international markets. European businesses still invest too little in new products. The US alone currently outspends the EU on R&D by €76 billion every year – almost 20 times the value of the EU's new flagship research initiative, the sixth framework programme.

Even when European businesses do create new products, the dismal failure of the EU to launch the Community patent on schedule potentially jeopardises intellectual property rights. Member-states continue to argue over how many languages will be acceptable in patent applications. Their failure to meet the end-2001 deadline undermines both the EU's economic competitiveness and its political credibility.

At the heart of the knowledge-based economy must be the creation and dissemination of information, for which the use of new technology is essential. Around 90 per cent of EU schools are now connected to the world wide web, but the end-2001 deadline for 100% access was missed. Overall, growth in internet connections has leveled off in the EU, particularly for high-speed broadband connections, which are used by less than 2 per cent of households. Business investment in information technology continues to lag behind US levels.

LIBERALISATION

The supposed completion of the EU's single market in December 1992 left much unfinished business. Many barriers to the free movement of goods, services, people and capital remain intact, largely due to the deeply entrenched interests of member-states. Back in 1999, the EU announced a strategy to complete the internal market, but one-third of the target actions it set are now overdue. The Commission has launched a staggering 1500 infringement cases against member-states for their failure to implement the single market properly. These shortcomings explain why the economic gains of integration have been much lower than foreseen.

In 2001, the EU did introduce new measures to open up telecoms markets to increased competition, but overall telephony prices remain high, at around three times the US level. Some member-states, notably France, continue to block other liberalisation initiatives in energy or transport. A deal on opening energy markets for commercial users is the minimum the summit needs to claim any sort of success. But the French are likely to demand further commitments on social policy in return.

On a more positive note, EU member-states made some headway on postal liberalisation last year. The Financial Services Action Plan is almost back on track, following the European Parliament's adoption of the Lamfalussy report. This should help speed through new regulatory measures to create a single European capital market by 2005. And that should benefit both EU businesses seeking fresh investment, and European workers who want to save for their retirement through funded pension schemes.

ENTERPRISE

New firms are the key to new jobs and innovation. Crucially, Europe lacks a dynamic, entrepreneurial culture in which success is rewarded and failure accommodated. The process of starting a new business in the EU is slow and expensive, costing on average €830. Once established, European businesses face a daunting burden of red tape, which adds to compliance costs and stifles innovation. Regulation in Europe, by common consensus, needs to be speeded up, slimmed down and subjected to rigorous impact assessments.

Two reports, both published in 2001, offer some hope for the future. The high-level Mandelkern Group on regulatory reform concluded that the EU should jettison two-fifths of its 80,000-page rule book by June 2004. The European Commission's own White Paper on Governance suggested a new willingness to consider using 'lighter touch' forms of regulation, working in tandem with industry.

Stronger competition within the EU can help to spur international competitiveness and growth, but protected and subsidised national champions become inefficient and unsustainable. Under the vigilant watch of Commissioner Mario Monti, state-aids in the EU have continued to decline and are now below 1 per cent of EU GDP. But government aid continues to distort competition in 'sunset' industries like coal, steel and shipbuilding.

SOCIAL INCLUSION

Lisbon established a new approach to the European social model, declaring that jobs were the key to social inclusion and to sustainable public finances. The focus is therefore on increasing employment levels in the EU – and these are slowly rising, with 5 million new jobs created since March 2000. But much greater participation by women and particularly older (55-64) workers will be needed, in order to reach the overall target of 70 per cent of the workforce.

Europe must also do more to improve the quality as well as the quantity of its workers. Around 150 million Europeans have not completed their basic secondary education, and only 10 per cent of the workforce is in recognised training schemes. The EU needs to increase investment in skills across all levels of the labour market, promote the mobility of job-seekers, and ensure that the social safety net does not become a poverty trap. The Commission's recent policy paper on skills and mobility sets out the steps needed to remove all such obstacles to employment by 2005. The summiteers are likely to endorse many of these measures.

Marginal tax rates for lower paid workers, averaging 38 per cent across the EU, are another significant barrier to employment and they perpetuate welfare dependency. Economic growth and active labour market policies have helped reduce long-term unemployment in the EU. Welfare reform is now on the agenda but many member-states still need to do much more to make their pension systems sustainable.

SUSTAINABLE DEVELOPMENT

The EU added an environmental dimension to economic and social policy at its Göteborg Council in June 2001. A competitive and cohesive Europe need not come at the expense of future generations. The EU recently demonstrated this commitment by its formal adoption of the Kyoto protocol, and is already half-way towards achieving the target of an 8 per cent reduction in greenhouse gas emissions. Further investments in 'clean' technologies could produce real economic gains. However, in other areas such as energy taxes, some tough trade-offs will need to be made because of the potential impact on competitiveness.

The impact of enlargement

Over the longer term, the planned enlargement of the EU is likely to have a profound impact on the Union's economic performance. The EU has pledged to include candidate countries in the Lisbon processes of benchmarking and exchange of best practice from 2003, even before they become full members of the Union. It is essential these countries are not left behind in the structural transformation of Europe, otherwise the political 'iron curtain' that divided Europe for so long may be replaced by an economic one.

There are some compelling reasons why enlargement should be good news for the Lisbon strategy. Candidate countries tend to have fast-growing, dynamic economies. Real GDP growth in these countries is roughly double the EU-15. The labour force is typically low-cost but highly skilled, while their governments have extensively liberalised their economies in recent years, attracting high levels of inward investment.

Furthermore, new opportunities for exchanging policy ideas will present themselves after enlargement. Candidate countries are much more used to objective benchmarking as part of the accession negotiations. This is a key aspect of the Lisbon process, which relies on peer pressure to encourage reforms among the slower-moving member-states.

But there are also dangers to the reform process that could result from enlargement, if the EU becomes even more unwieldy in its policy-making. Twenty-five member-states will find it much harder to agree shared positions on key subjects. If debates after accession focus principally on the distribution of regional aid and revisions to the Common Agricultural Policy, the EU risks losing sight of the key, over-riding objectives of structural economic reform.

Barcelona or bust?

Two years after Lisbon, the EU's headline goal of becoming the world's most competitive economy does not seem any closer. While the global slowdown is partly to blame, Europe seems unable to spur its own growth and remains embarrassingly dependent on the US economic cycle. The EU economy grew only 1.6 per cent in 2001. Growth for the whole of 2002 is unlikely to be any higher.

The European Commission's pre-summit synthesis report has highlighted the 'delivery gap' between what was promised at Lisbon and what has been achieved. Speaking to MEPs at the beginning of this year, President Romano Prodi put it starkly: "We need to catch up, and catch up fast". European companies, not always natural allies of the Commission, would certainly endorse that urgency. The UNICE employers' federation told the EU recently that "the credibility of the whole [Lisbon] process is now at stake; the Barcelona summit must therefore be a real step forward".

Whether the EU makes any further headway depends largely on the member-states, who must take – and implement – the key decisions. British Prime Minister Tony Blair said last summer that the Barcelona summit would be "a real test of our collective European leadership". The EU is perilously close to failing that test. Progress may accelerate after the elections in France and Germany later this year, but this is far from certain. Moreover, the urgency of reform is, if anything, greater in the current economic downturn.

The stakes in Barcelona are therefore extremely high. The citizens of the member-states, European companies and global financial markets will deliver an appropriately damning verdict if the EU fails to restructure fundamentally for the demographic and economic challenges ahead.

The <u>draft</u> CER Barcelona Scorecard

Issue	**2002 (*2001*)**	**Heroes**	**Villains**
The Lisbon process	C- (*B+*)	Sweden, Spain, UK, Netherlands	France, Germany, Poland.
Innovation			
Information society	C+ (*B+*)	Netherlands, Sweden, Denmark, Slovenia	France, Germany, Romania, Bulgaria.
Research & development	C+ (*B-*)	Sweden, Finland, Germany, Hungary, Slovenia	Italy, Spain, Greece, Portugal, Poland
Liberalisation			
Telecoms	B- (*B+*)	Commission, Finland, Poland, Estonia	Germany, UK, Austria
Other utilities and services	D- (*D*)	Commission, UK, Finl., Denmark, Sweden, NL, Hungary, Estonia	France, Germany, Greece
Financial services	B- (*C+*)	UK, Spain, Hungary	Germany
Enterprise			
Business start-up environment	D (*D*)	Denmark, UK, Ireland, Hungary	Austria, Italy, Belgium
Business regulation	C- (*D+*)	Finland, Estonia, Poland	Italy, France
State-aid and competition policy	B- (*B-*)	UK, Germany, Czech Republic	Finland, Portugal, Slovakia
Social Inclusion			
Bringing people into workforce	B- (*B-*)	Sweden, Spain, Ireland, UK, Denmark, NL	Italy, Poland, Greece, Austria
Upgrading skills	C- (*D*)	Sweden, Denmark, Finland, UK, Czech Republic	France, Germany, Greece, Portugal, Luxembourg
Modernising social protection	C+ (*C+*)	UK, Germany, Poland	Spain, Italy, Belgium
Sustainable Development			
Climate change	C (*N/A*)	Sweden, UK, Germany	Ireland, Portugal, Spain
Natural environment	C+ (*N/A*)	Nordics (TBC)	Italy, Greece, UK, Ireland, Spain
Conclusion			
Overall assessment	C- (*C+*)		

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

NOTE: Final Scorecard may be revised on the basis of summit outcomes.