

# **European economic reform: Meeting the challenge**

**HM Treasury  
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## FOREWORD

Europe has set itself a great challenge: to become the most competitive, dynamic and socially inclusive knowledge based economy in the world by the end of this decade. And as the US economy slows down, the world is looking to Europe to discharge a greater responsibility than before in the promotion of sustainable global economic growth.

I believe that we can do so most effectively, to the benefit of Europe and the global economy in two ways. First our macroeconomic policies must entrench stability, low inflation and sustainable public finances, while recognizing the importance of public investment. Secondly we must promote economic reform in product, capital and labour markets and encourage more open trade. Together these policies should put the objective of full employment agreed at the Lisbon European Council last year within our grasp.

Reform, while underway within the EU, must move forward with speed. The high public sector deficits of the mid-1990s have been brought under control. There is increasing focus on the sustainability of pensions in the light of demographic change, and several Member States have introduced or are contemplating major reforms. Previously monopolised markets have been liberalised. Several Member States are implementing tax reforms to strengthen investment and enterprise. And national labour markets have become more flexible as a result in part of tax and benefit reforms. 2½million new jobs within the EU in the last year is a big step in the right direction.

Last year's Lisbon Summit was a new way of doing things in Europe. Building on the work of previous Presidencies since 1997, the European Council agreed an ambitious agenda of economic and social reform. Lisbon was a major breakthrough.

- It demonstrated a clear acceptance that on key areas of economic performance the EU has to catch up with the best in the world.
- It brought a strong commitment from Europe's leaders to a comprehensive agenda of reform, combining market opening with action to promote innovation, as well as higher employment rates and greater social inclusion.
- It established concrete indicators of progress to judge how we are doing and a new system of peer review to keep ourselves up to the mark.
- It promised a systematic annual review of Europe's progress towards the Lisbon goal.

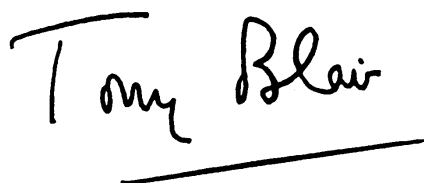
This must now all be delivered. The Stockholm European Council of 23 and 24 March is the first annual review of this new way of working. Stockholm must take forward the Lisbon modernising agenda and achieve concrete

results. We need a higher rate of sustainable growth and to close the performance gap with the US. This calls for further reform in priority areas.

- We must strengthen the single market. In 1988 it was estimated that the single market would add 1.8 million jobs and increase output by 4<sup>1</sup>/<sub>2</sub>%. So far we have seen only half the extra jobs and one third of the expected output gains. Key priority areas for action are strengthening liberalisation in utilities, financial markets and transport.
- Research and innovation remains weak. While some EU countries are ahead of the US and Japan on R&D spending, on average Europe is behind by at least 1 % of GDP. We need to focus spending from the EU research budget and ensure there are fewer barriers to innovation for example by reforming patents.
- To meet the Lisbon target of 70% employment in the EU, we must learn from each other in promoting active labour market policies, making work pay and raising labour market participation - particularly amongst older workers. Further action is also required to strengthen skills in Europe.
- And success in the global economy also requires leadership in trade. Europe accounts for 16% of world trade, more than the US. We must use this position to press for further trade liberalisation.

There is also a wider policy context. This economic reform strategy supports and contributes to the EU's policies on sustainable development, which aim at the maintenance of high and stable levels of economic growth and employment, social progress which recognises the needs of everyone, effective protection of the environment, and prudent use of natural resources. The next summit, at Gothenburg in June, will discuss this wider picture.

This paper sets out why these issues matter and why a positive outcome from Stockholm is so important for the prosperity and opportunity of the British people and indeed of all the peoples of Europe.

A handwritten signature in black ink that reads "Tony Blair". The signature is written in a cursive style and is underlined with a single horizontal line.

**Tony Blair**

## EXECUTIVE SUMMARY

At the Lisbon European Council last year, Europe's leaders committed themselves to an ambitious ten-year strategy for economic reform. The vision agreed at Lisbon is of a dynamic job-creating Europe, of a Europe that delivers on both economic and social objectives to become the leading knowledge based economy in the world.

Making this vision a reality is a major challenge: to raise the EU's employment and productivity performance beyond that of the US by 2010. Matching US performance on both measures would raise Europe's output by forty per cent – equivalent to around five thousand pounds per person per year. Meeting this challenge, and in particular restoring full employment in Europe, is at the heart of creating a just and fair society.

This paper sets out the background of this challenge and looks forward to the next major milestone, the Stockholm European Council of 23 and 24 March 2001. It is structured in six Chapters.

The first two chapters set the scene. **Chapter 1** presents the challenges for the EU's employment and productivity performance and outlines the benefits to Britain and to Europe's citizens of economic reform.

**Chapter 2** looks back at the milestones over the past four years in developing a new approach to economic and social policy-making, defined at Lisbon. This new policy framework, overseen by the European Council, embodies a decisive shift in European economic thinking – away from heavy-handed intervention and regulation, towards an agenda based on enterprise, innovation and competition. It also makes much greater use than before of peer review and benchmarking of national performance, rather than seeking to standardise and harmonise policies at a European level.

**Chapter 3** describes this new policy framework for economic reform. European economic reform is about modernising Europe's economic policies and also the institutional framework through which these policies are implemented. The new economic policy framework is being delivered through a new process involving closer cooperation between governments, learning from each other, led by Member States in the European Council. The new economic policy framework is founded on two core principles:

- Providing a **stable macroeconomic environment** with low inflation, stable growth and sustainable public finances; and
- Making **markets work better** through carefully directed and designed micro-economic reforms to capital, product and labour markets.

This new economic policy framework is complemented by a new social policy agenda – with a strong emphasis on the central role of employment in delivering social policy objectives. These economic and social policies support and contribute to the EU's strategy for sustainable development.

**Chapter 4** describes the productivity challenge facing the EU. It highlights three key areas for reform.

- **Closing the R&D gap with the US and Japan.** In 1998, the EU spent 1.8% of its GDP on Research and Development: a much lower proportion than the US (2.7%) or Japan (3.1%). Reforms at national and EU level are required to close this gap.
- **Reinvigorating the single market.** Following the Cecchini report in 1988, the EU made important steps toward completing the single market, creating an estimated 1 million extra jobs and increasing Europe's output by nearly 1.5%. The challenge today is to extend the single market further into areas such as financial services, energy and aviation.
- **eEurope and the new economy.** Cheap and easy access to the Internet in the US has allowed businesses and consumers to take full advantage of Information and Communications Technology. The EU has yet to experience fully these benefits. To close this gap, the EU is implementing the eEurope action plan, a series of reforms, based around three themes: a cheaper, faster Internet, investing in people and skills and stimulating use of the Internet.

**Chapter 5** discusses the employment challenge facing Europe. The Lisbon Council committed the EU to generating an extra 20 million jobs, by raising the employment rate from 61% to 70% by 2010 and increasing the female employment rate from an average of 51% to more than 60% by the same date. Meeting these ambitious targets requires tackling the structural problems in Europe's labour markets. This calls for continued reform, mainly by national governments, in five key areas:

- Reform of labour market regulation
- Active labour market policies
- Reform of tax-benefit systems
- Provision of childcare
- Labour mobility

Employment is at the heart of Europe's new approach to tackling social exclusion. European social policy is moving away from an old agenda of regulation and centralisation towards one based on national actions to encourage employment, lifelong learning and enterprise for all.

**Chapter 6** takes a forward look to the Stockholm Council. In order to build on the achievements of the past four years, Europe's leaders will need to continue along the path agreed at Lisbon. This requires:

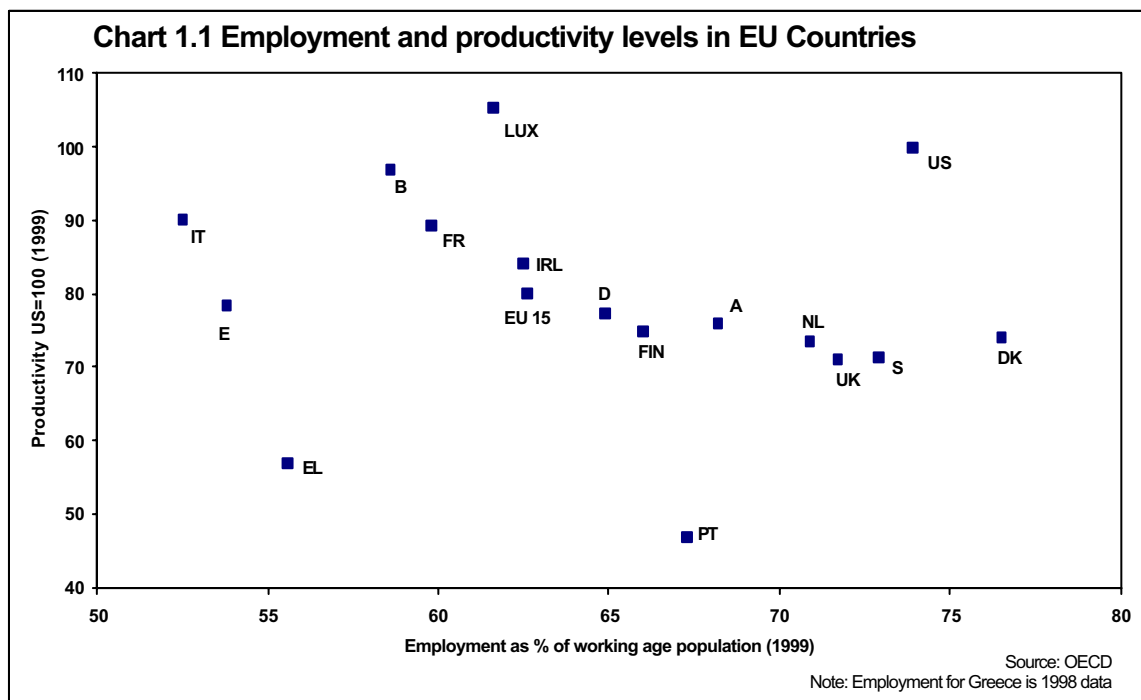
- Further reforms mainly at **national** level to deliver a full employment Europe and close the research and innovation gap, with national measures strengthened and improved as a result of EU coordination through benchmarking and peer review.

- Further reforms are also needed **at EU level** to strengthen the Single Market and sharpen the focus on innovation, enterprise and employment in all EU activities.
- The EU to show **global** leadership by calling for a new trade round.

# 1. THE CHALLENGE OF EUROPEAN ECONOMIC REFORM

*“The Union has today set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustaining economic growth with more and better jobs and greater social cohesion” (Lisbon European Council, 23/24 March 2000)*

- 1.1 At the Lisbon summit last year, Europe’s leaders committed themselves to an ambitious ten-year strategy for economic reform. The vision agreed at Lisbon is of a dynamic, job-creating Europe, of a Europe that delivers on both economic and social objectives.



- 1.2 Making this vision a reality amounts to a major economic challenge: to raise the EU's employment and productivity performance beyond that of the US by 2010. No country in the EU is currently able to match the US on both measures. Matching US performance on employment and productivity would raise Europe’s output by forty per cent – equivalent to around five thousand pounds per person.

- 1.3 Meeting this challenge could not be more important. At a time of a US economic slowdown, the world is looking to Europe to take on a greater responsibility than before in the promotion of stability and global economic growth. Continued reform will help Europe respond to demographic change – the ratio of over 65s to working age population in the EU is expected to rise from 27% today to 53% in 2050. To forestall future problems, Europe must continue to develop and implement the strategy of economic reform agreed at Lisbon.
- 1.4 Economic reform and social justice go hand-in-hand. Restoring full employment in Europe is the key to tackling social exclusion and eradicating poverty. To do this requires a modernised approach to social policy, focussed on helping people find jobs, equal opportunities, lifelong learning and combating social exclusion. Economic and social reforms also contribute to the long-term goal of sustainable development: to ensure a better quality of life for everyone, now and for generations to come.
- 1.5 European economic reform to implement the Lisbon strategy will bring important benefits to Europe's citizens:
- **Improving the supply of finance to Europe's entrepreneurs** – in 1999, venture capital investment accounted for less than 0.15% of EU GDP compared with 0.54% of GDP in the US.
  - **Delivering a real single market in retail financial services** - the average cost of financing credit card debt can differ by a factor of three between Member States.
  - **Lower electricity and gas bills through market opening** – between 1996 and 2000, prices to small electricity users in the UK domestic market fell by 11.9% as competition was introduced into this sector.
  - **Faster and cheaper Internet access** - through telecoms liberalisation and the rest of the eEurope initiative.
  - **Tackling youth unemployment** - in 1999, EU unemployment rate among 15-24 year olds was 17.2%.
  - **Increasing participation among older workers** - labour market participation among 55-64 year olds is over 40 percentage points lower than for people aged 25-54.
- 1.6 European economic reform is strongly in the UK's national interest. The UK has much to gain from a strong and vibrant European economy. Eight of the UK's top ten trading partners are in Europe and, in 1999, 59% of UK trade in goods was with the EU. The single market benefits UK companies through greater opportunity to win business abroad – for example 30-40% of UK small and medium sized enterprises now trade in the EU. There is much that the UK can learn from other EU economies as well as from other major competitors. There are also areas where our experience of tackling these challenges can help other Member States.

- 1.7 This paper describes the new framework for economic policy that underpins the Lisbon strategy; outlines some of the progress made so far in meeting the productivity and employment challenges and looks forward to the next steps for reform, starting at Stockholm. The Government will follow up this paper by publishing a White Paper on economic reform in Europe for the Spanish presidency.

## **2. THE DEVELOPMENT OF EUROPEAN ECONOMIC REFORM**

- 2.1 The Lisbon summit marked a major change in economic policy making in Europe. It was the result of three years of work to establish a new economic and social policy framework that will deliver the higher levels of growth, productivity, and employment needed in the EU.
- 2.2 This new policy framework, overseen by the European Council, embodies a decisive shift in European economic thinking – away from heavy-handed intervention and regulation, towards a new strategy based on enterprise, innovation and competition. It also makes much greater use than before of peer review and benchmarking of national performance, rather than seeking to standardise and harmonise policies at a European level.
- 2.3 Recognising our interdependence with other EU economies - and in close cooperation with our European partners - the UK Government has been at the forefront of developing this new policy framework.
- 2.4 The first important step towards European economic reform was taken during Luxembourg's Presidency of the EU. In November 1997, at a special meeting of the European Council, aimed at 'getting Europe back to work', Europe's leaders launched a process - known as the 'Luxembourg process' - of labour market reform.
- 2.5 Economic reform was one of the main themes of the UK Presidency of the EU in 1998. The Cardiff European Council endorsed a light-touch procedure in which Member States and the European Commission each produce short end-year reports about reforms to product and capital markets. Further important steps were taken under the Austrian, German and Finnish Presidencies in 1998 and 1999.

### **Box 2.1 Peer review and the Luxembourg and Cardiff processes**

The Luxembourg and Cardiff processes have introduced to the EU a new way of doing business, based on peer review and the exchange of information, ideas and evidence on national policies.

In labour markets, the Luxembourg process is based on agreed Employment Guidelines and National Employment Action Plans, which outline the steps being taken by each country to meet these guidelines. These are then subject to peer assessment by other Member States and also by the Commission in the Joint Employment Report. The other component of the Luxembourg process is the recommendations to Member States on implementation of their employment policies.

The Cardiff process is a means by which EU Member States exchange examples of good practice and review each other's supply side performance. Each country produces an annual report in November on the progress of product and capital market reforms. This report feeds in to a multilateral review and assessment early in the following year. These country reviews take a comprehensive look at the whole reform process, provide comparisons between countries and highlight good practice. The conclusions of the examinations are presented in an annual report on economic reform, which helps the European Council to identify priority areas for future action.

These processes of peer review are characterised by an open method of coordination: sharing best practice examples and evaluating national policies and performance against agreed indicators.

- 2.6 The Lisbon summit in March 2000 was devoted to economic reform. Lisbon agreed a strategic goal for the next decade – “to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion” – backed up by specific proposals to reform in the areas of innovation, the single market, employment and social policy.
- 2.7 Following Lisbon, economic reform is now an established part of the EU landscape, with annual meetings of the European Council to discuss progress in achieving this strategy and to decide what further needs to be done. The next such meeting is at Stockholm on 23 and 24 March 2001.

**Table 2.1 What Lisbon agreed**

Innovation	Economic Reform for Single Market	Employment	Modern Social Agenda
<ul style="list-style-type: none"> <li>• Legal framework for E-commerce in 2000</li> <li>• Fully liberalised and competitive telecoms market in 2001</li> <li>• Internet access for all schools in 2001</li> <li>• Community-wide patent in 2001</li> <li>• Government procurement and access to basic public services on-line by 2003</li> </ul>	<ul style="list-style-type: none"> <li>• Faster liberalisation in gas, electricity, transport</li> <li>• EIB to channel EUR 1bn of venture capital support to SMEs</li> <li>• Reduction in state aids</li> <li>• Financial Services Action Plan implemented by 2005</li> <li>• Risk Capital Action Plan implemented by 2003</li> <li>• Small Firms charter by 2000</li> <li>• Strategy for removal of barriers to services in 2000</li> </ul>	<ul style="list-style-type: none"> <li>• Increase EU employment rate to 70% overall and 60% for women by 2010</li> <li>• Europe-wide data base on jobs and training</li> <li>• Benchmark provision of lifelong learning</li> <li>• Award for companies that invest in employees</li> <li>• More effective Employment Guidelines (Luxembourg process)</li> <li>• Increase per capita investments in human resources</li> </ul>	<ul style="list-style-type: none"> <li>• National action plans to combat social exclusion</li> <li>• Halve by 2010 18-24 year olds excluded from labour market</li> <li>• Report on sustainability of pensions in EU</li> <li>• Set up benchmark for improved childcare</li> </ul>

2.8 The Nice European Council was the first opportunity to reassess Europe's approach to social policy in the light of the new strategic goal agreed at Lisbon. Nice set out a new European approach to social policy, with a much greater emphasis on the central role of employment and economic reform in delivering social objectives.

### **3. THE NEW POLICY FRAMEWORK**

- 3.1 European economic reform is about modernising economic and social policies in Europe. It is also about modernising the framework for European economic policy, based on the institutions set out in the EC Treaty, in order to maximise the effectiveness of government policy.

#### **Maximising the capabilities of government**

- 3.2 This new policy framework is being delivered through a new policy process, led by Member States in the European Council and implemented by the Council of Ministers, the European Commission and the European Parliament. This works in the following way.
- 3.3 Each Spring, the European Council has a special meeting in which Heads of Government and Finance Ministers meet to review performance and set priorities for the next year. The first such meeting was the Lisbon summit of March 2000. This meeting draws on contributions from the European Commission and the Council of Ministers as well as from each Member State.
- 3.4 The conclusions of this meeting are taken forward through two main channels. The traditional route in European policy making is for EU legislation, with the Commission proposing legislation, which is then adopted by the Council of Ministers and European Parliament. This is often the best approach for reforms necessary to complete the single market.
- 3.5 In other areas, national reforms are more appropriate. These reforms are coordinated by ECOFIN - the Economics and Finance Council of the EU - through the Broad Economic Policy Guidelines. These guidelines bring together Member States' experiences of best practice. They are supported by analysis of agreed performance indicators and by more detailed processes of peer review – some of which are carried out by other Councils such as the Employment and Social Policy Council.
- 3.6 Avoiding unnecessary centralisation of decision-making underlies the UK's approach to EU economic reform. For example, in areas such as labour market reform, policy is determined mainly at a national level, with Member States exchanging information about best practice. Allowing fair policy competition between Member States - for example by applying the principle of mutual recognition – permits innovation in policy making so that governments can learn about the different ways to tackle similar problems.

### **Box 3.1 Mutual recognition**

The principle of mutual recognition has become a cornerstone of the single market. Mutual recognition permits the free movement of goods, services, capital and people between Member States, while respecting different national traditions and avoiding unnecessary harmonisation. The application of this principle has evolved through case law along with specific decisions and Directives on how to interpret the relevant part of the EC Treaty (Article 28).

For goods, services and capital it means that no Member State has the right to forbid the sale on its territory of any product that has been lawfully produced or marketed in another Member State, even if that product has been produced according to different technical or quality standards from those applied to its own products. For workers, mutual recognition means that individuals qualified in one Member State should in principle be treated as qualified in another Member State without having to requalify from the beginning.

Member States may waive the principle only under very strict conditions of general public importance: public morality; law and order; public security; and protection of health and life of persons and animals.

- 3.7 Efficient and accountable institutions are key to delivering good policies. That is why the UK Government strongly supports the proposals for Commission reform to introduce a better system for setting priorities, to overhaul financial management and to modernise personnel policy. Likewise the UK Government fully supports the work by the current Swedish presidency of the EU to increase the transparency of the European Council.
- 3.8 Increasing emphasis is being placed on ensuring that policies are evidence-based. The EU has developed a series of structural performance indicators to monitor economic performance against the goals agreed at Lisbon. These bring economic evidence into the heart of EU decision-making.

### **Box 3.2 EU structural indicators**

The Lisbon European Council called for the development of structural performance indicators to take stock of progress towards the goals set at Lisbon. A set of 35 such indicators was agreed the Nice European Council in December 2000. The indicators cover the four priority areas identified at Lisbon: employment, innovation, economic reform and social cohesion. The UK strongly supports the use and further development of agreed indicators.

Structural indicators – as used in this document - can help focus attention on the crucial areas where reform and specific action plans are needed.

They are a powerful tool for:

- Focussing on economic outcomes as well as necessary processes
- Taking a critical look at policy and learning from each other
- Shaping the agenda for Stockholm and future European Councils
- Evaluating the cost-effectiveness of public policies

## **The economic policy framework**

3.9 The Lisbon summit was an important step in developing a new framework for European economic policy to meet the employment and productivity challenges. This new economic policy framework is founded on two basic principles:

- **providing a stable macroeconomic environment** with low inflation, stable growth and sustainable public finances. That is, an environment in which firms can make critical long-term decisions with greater certainty and at lower cost; and
- **making markets work** better through carefully directed and designed microeconomic reforms.

### *Providing a stable macroeconomic environment*

3.10 Economic stability is essential for high and stable levels of growth and employment. The macroeconomic policy framework, which this Government has introduced in the UK, is designed to deliver stability and avoid a return to the cycles of boom and bust.

3.11 Likewise, the EU has set out a programme of reform to create the macroeconomic conditions which will foster high and stable levels of growth and employment. The EU strategy has focussed on creating a stability-orientated monetary policy - culminating in Economic and Monetary Union - alongside a sustained effort to strengthen public finances. New procedures and institutions have been set up at EU level to monitor and coordinate the fiscal policies of Member States.

The focus of these reforms is on macroeconomic stability, sound public finances and price stability – just as in the UK.

### *Making markets work*

- 3.12 Building on these stable foundations, Europe's governments are now embarking on economic reforms to product, labour and capital markets.
- 3.13 Well functioning **labour markets** are essential to delivering consistently high levels of employment and ensuring that workers have the skills to adapt to the demands of a changing economy. Efficient **product markets** deliver low prices to consumers and stimulate innovation among firms. Effective **capital markets** are an essential source of funding for businesses and allow investors to earn good returns on their savings.
- 3.14 Competitive markets provide the best means of ensuring that the economy's resources are put to their best use. Where markets work well, they provide strong incentives for good performance – rewarding efficient and innovative firms with growth and profits, and rewarding workers for their endeavours with wages that reflect their productivity.
- 3.15 But markets can and do fail. Governments at all levels have an important role to play when this happens. The key to a successful framework for government policy is to focus on market failure. This means only intervening where there is a clearly identified need and ensuring that interventions are targeted on the problem. Economics identifies four major causes of market failure:
- **Externalities** – where an activity has benefits or costs to society not included in its market value. For example, the benefits of research and development can spill over to consumers or producers other than the firm who carries it out.
  - **Market power** - where competition is not strong enough to keep prices down or to keep firms efficient. For example, many utilities companies enjoy market power as a result of a combination of natural and statutory monopolies.
  - **Information failures** – where customers or suppliers do not have good enough information to make the best decisions. For example, many customers of credit cards are unaware of basic details of how their products work.
  - **Poor regulation** - where government policy itself is a cause of market failure. For example, over recent years EU governments including the UK have been addressing problems in making work pay for low-income workers, caused by the way in which tax and benefit systems interact.

**Table 3.1 Examples of policies to improve the microeconomic environment**

	<b>Product markets</b>	<b>Capital markets</b>	<b>Labour markets</b>
<b>Externalities</b>	EU Community patent	Venture capital – EU Risk Capital Action Plan	National skills and training policies
<b>Market power</b>	EU utilities liberalisation	Single market in financial services	National minimum wages
<b>Information</b>	Consumer confidence in e-commerce	Retail financial services regulation	Improving information on job vacancies
<b>Regulation / taxation</b>	Better regulation	German corporate capital gains reforms	National tax-benefit reforms

3.16 Box 3.3 shows the headings of the 2000 Broad Economic Policy Guidelines. It demonstrates the way in which they embody the new economic framework - moving from macroeconomic stability through to the microeconomic reforms needed to raise employment and productivity.

**Box 3.3 The 2000 Broad Economic Policy Guidelines**

- Ensure growth and stability
- Speed up fiscal consolidation
- Improve the quality and sustainability of public finances
- Promote appropriate wage developments
- Foster a knowledge-driven economy
- Ensure efficient product markets
- Promote capital markets through further integration and deepening
- Invigorate labour markets
- Enhance sustainable development

**The social policy framework**

3.17 The new economic framework is complemented by a new social policy framework. This is based on the European social agenda agreed at Nice. This agenda set specific priorities for action around the following six headings:

- More and better jobs
- Anticipating and capitalising on change in the working environment by creating a new balance between flexibility and security
- Fighting poverty and all forms of exclusion and discrimination in order to promote social integration
- Modernising social protection

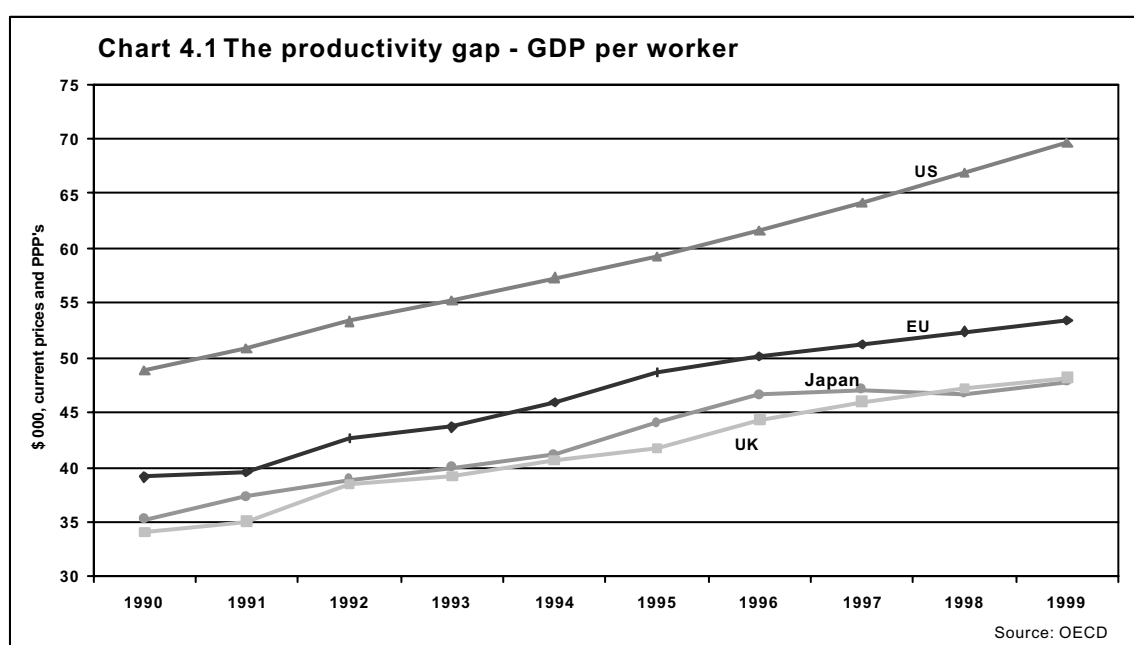
- Promoting gender equality
  - Strengthening the social policy aspects of enlargement and the EU's external relations
- 3.18 A key component of the European social agenda is the creation of new national action plans for combating poverty and social exclusion. They allow for the diversity of national policies and enable Member States to learn from each other through peer review and sharing best practice.

## **Sustainable development**

- 3.19 At the Helsinki European Council in 1999 Heads of State committed themselves to adopting a first sustainable development strategy for the EU. The strategy would aim to dovetail policies for economically, socially and ecologically sustainable development. The European Commission has been invited to submit its proposal to the Gothenburg European Council in June.
- 3.20 The focus of the strategy is expected to be on the steps which will need to be taken in the EU in order to tackle the key unsustainable trends facing Europe over the longer term. These are likely to include climate change, the depletion of natural resources, public health, social exclusion, ageing and transport and land-use pressures. All of these have strong links to social and economic policy in the EU and, in effect, many of the reforms launched since Lisbon will make a major and direct contribution to sustainable development. In recognition of this, the 2000 Broad Economic Policy Guidelines already include a section on sustainable development.
- 3.21 The next two Chapters look at the way in which this new policy framework is being applied to meet the productivity and employment challenges facing Europe.

## 4. THE PRODUCTIVITY CHALLENGE – RAISING EUROPE’S GAME

- 4.1 Productivity is a major concern of the UK Government. The UK’s productivity performance has been poor for a long time compared with other leading economies. As a result, the UK now has a productivity gap that is substantial on all measures in comparison to the US, Germany and France.
- 4.2 But Europe as a whole also faces a productivity challenge, if Europe’s economies are to match the overall performance of the United States. Under any measure, Europe’s performance falls short of the US. The gap is largest when looking at output per worker.

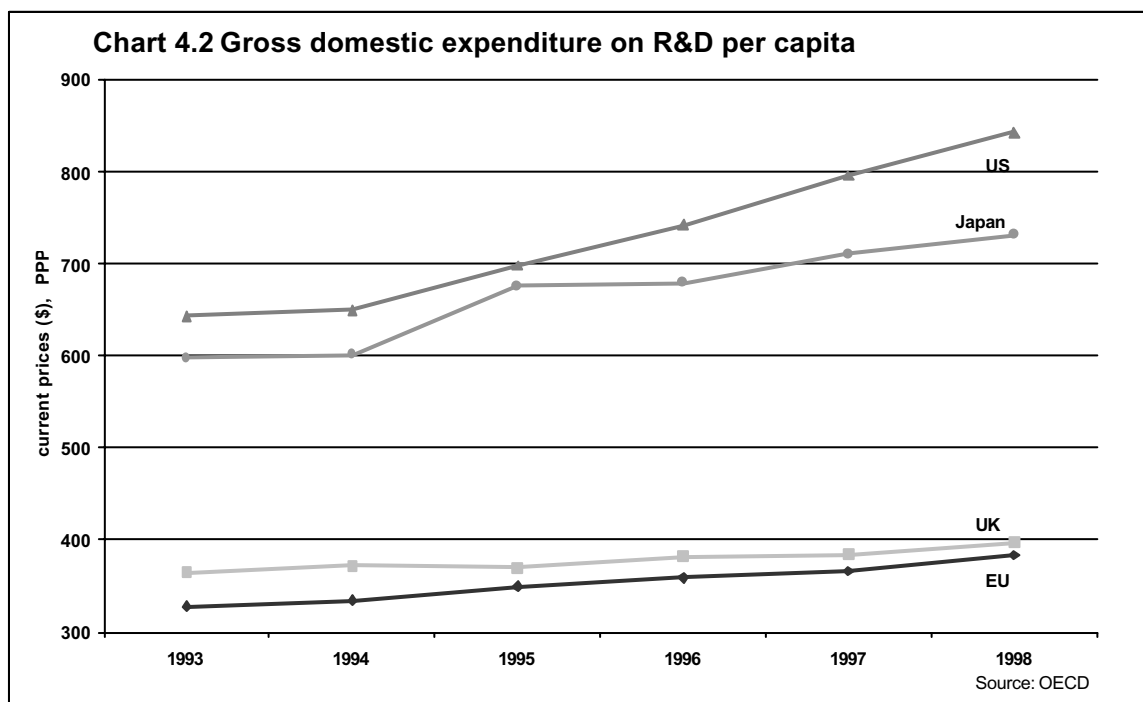


- 4.3 Meeting the productivity challenge calls for widespread reforms across product, capital and labour markets. Each Member State of the EU has its own priorities for reform. The UK Government’s priorities for raising productivity were set out in a recent report by HM Treasury – “Productivity in the UK: the Evidence and the Government’s approach”.
- 4.4 This chapter focuses on three key areas, in which there is clear room for improvement in Europe’s performance and where further reform will bring substantial benefits to Europe’s citizens. These are:
- Closing the R&D gap
  - Reinvigorating the single market; and
  - eEurope and the new economy

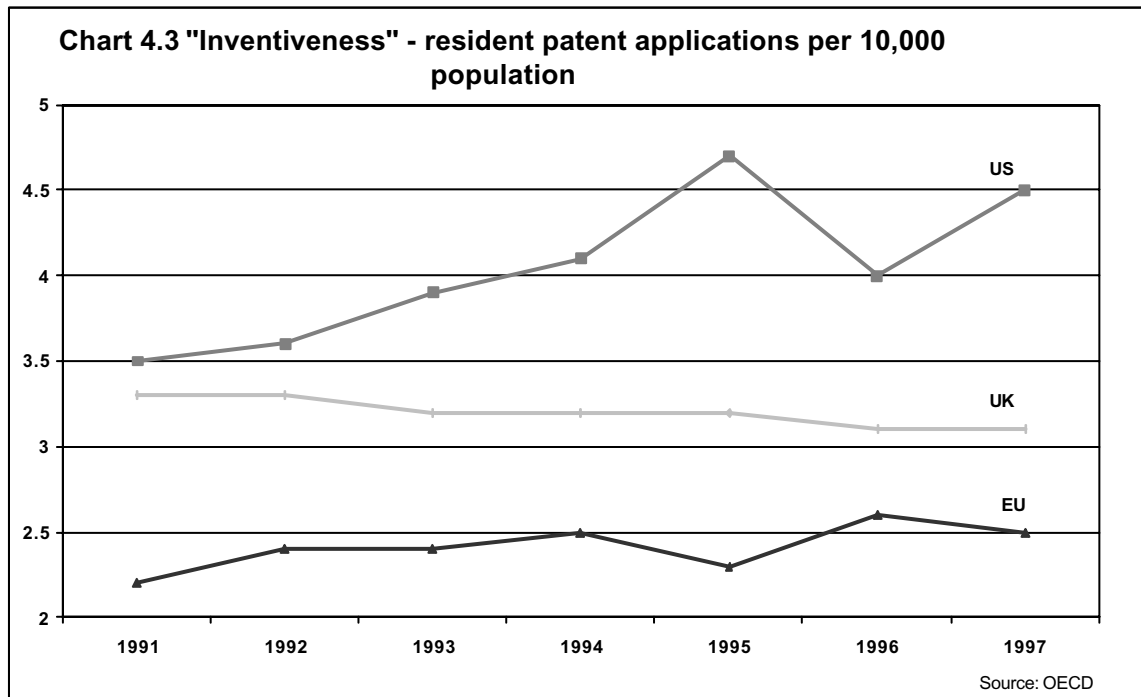
## Closing the R&D gap

4.5 Greater innovation, and particularly more R&D, is clearly associated with higher growth and productivity. Productivity growth relies on a continual stream of inventions and innovations both of new technologies and improved working practices. This is an area where there is clear evidence of market failure – the social returns to R&D have been estimated at about 1.5 times the private return.

4.6 The EU invests considerably less than both the US and Japan in R&D. In 1998, the EU invested 1.8% of GDP in R&D, considerably behind the US (2.7%) and Japan (3.1%).



4.7 This shortfall in R&D expenditure is also reflected in lower levels of innovation, as measured by the “inventiveness coefficient”, which compares patent applications with population. The EU has some world-class researchers working in its universities and research institutes, but has often lagged behind its rivals in disseminating this basic research, and ensuring the right environment is in place for business to turn new ideas into marketable products.



- 4.8 This need to improve R&D performance to match the world's best is increasingly being recognised by EU leaders both in their national policies and at the Lisbon summit last year. Policies are being developed to close this gap, combining national and EU reforms to create the right climate for innovation.
- 4.9 At a national level, fiscal incentives are an important way of supporting the innovation process, alongside investing in the science base and contributing to the creation of a stable framework within which innovation can occur.
- 4.10 R&D tax incentives, that act to promote R&D by businesses through lowering the post-tax cost of R&D, are in use in a number of countries, and evidence<sup>1</sup> suggests that such tax incentives can have a significant impact on levels of R&D and innovation. Box 4.1 sets out details of the UK Government's approach and highlights schemes in operation in four other member states: France, Italy, Spain and The Netherlands.

<sup>1</sup> For example, Bloom, Griffith and Van Reenen, "Do R&D tax credits work? Evidence from an international panel of countries, 1979-1994". IFS Working Paper, No 99/8

#### **Box 4.1 R & D Tax Credits**

Alongside the March 2001 Budget, the UK Government published a consultation document, *Increasing Innovation*, which sets out proposals for a new R&D tax credit for large companies. The new measure would complement the R&D tax credit for small companies that was introduced in April 2000.

Italy also has an R&D tax incentive that is focused on small and medium sized companies.

Under a scheme in operation in France, companies are given a tax credit proportional to the increase in their R&D spending above the average of their last two years - thus directly incentivising firms to increase their R&D spending above current levels.

Companies in Spain can benefit under a two-stage scheme which gives a tax credit in proportion to the total amount of R&D undertaken, but which also has a higher rate for any additional R&D that a company carries out above their average of the last two years.

A scheme in operation in the Netherlands acts to stimulate R&D through reducing the labour costs component of R&D. The relief is calculated with reference to the salaries of those employed on R&D activities.

- 4.11 Improving the links between universities and enterprises to commercialise and disseminate research, and increasing the investment in the science base is another area in which the UK and others have carried out recent reforms.

#### **Box 4.2 University-Business Links**

In Germany the Government has launched the "EXIST Programme – Start-Up Entrepreneurs from Universities" as part of a package of measures to assist the transfer of innovation and technology and to foster innovative business start-ups. EXIST began as a competition aimed at universities working together with external partners from business and research in their region. More than 200 universities took part and in many cases this competition was the starting point for regional networking.

- 4.12 Policies have also focussed on improving the supply of finance for innovation. EU venture capital investment per head is only a quarter of that in the US. The Risk Capital Action Plan set out a package of national and EU reforms to address, by 2003, market failures in the supply of venture capital.
- 4.13 In carrying out these national reforms, Member States are using methods of peer review such as the Cardiff process to share best

practice and compare performance. This is vital to highlight strengths and weaknesses and to encourage improvement.

- 4.14 At EU level, Lisbon agreed to deliver a single EU patent by the end of 2001. Compared to Japan and the US, the current EU system of patenting is both slow and expensive: it takes on average 46 months to have a patent granted for all 15 Member States by the European Patent Office, almost twice the time it takes in the US and, on the Commission's estimates, at five times the cost. This is a significant barrier to innovation, and discourages research.

## **Reinvigorating the single market**

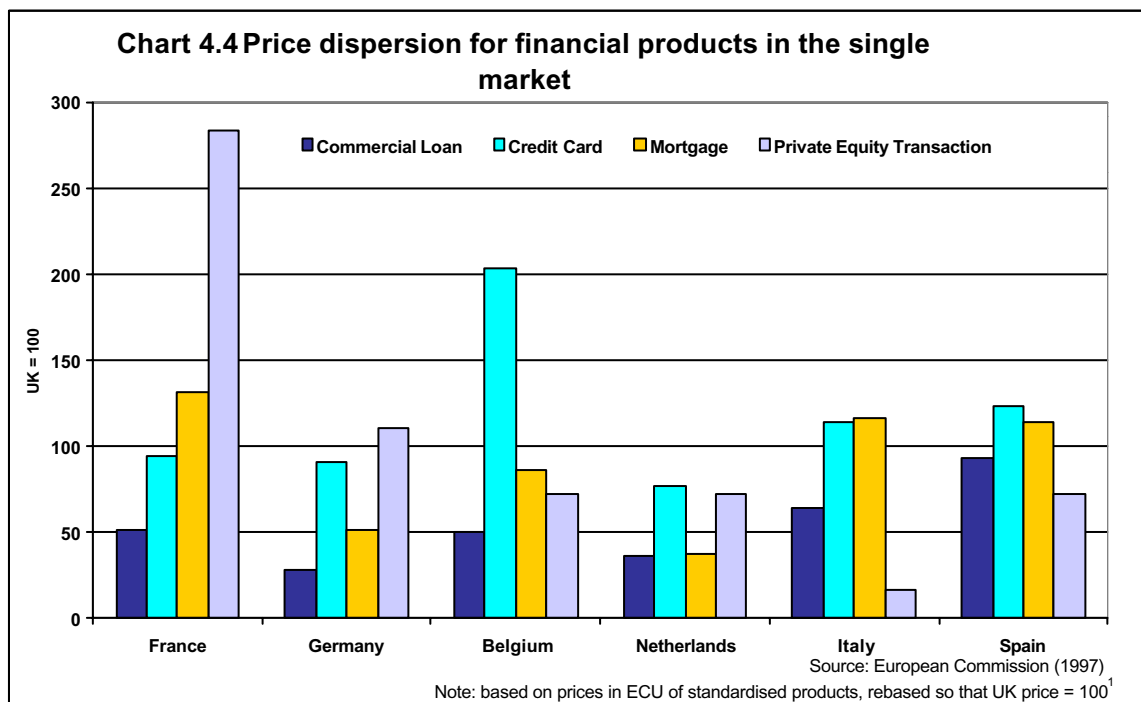
- 4.15 The single market is at the heart of the EU. The progress made so far in completing the single market is one of the EU's major achievements: A market of 375 million people and potentially 100 million more, as effective in some areas as the US single market.
- 4.16 The Cecchini report of 1988 suggested that further market integration in the EU would, over the medium term, add an extra 4.5 % to Europe's GDP, along with substantial reductions in costs and consumer prices and a boost to employment of up to 1.8 million jobs.
- 4.17 Energised by the Cecchini report, and making good use of mutual recognition, the '1992' project allowed some of these gains to be realised. A 1996 study found that a million extra jobs had come and output had risen by nearly 1.5 %. The challenge today is not to restrict the single market, or retreat from it, but to extend the single market. To extend it in areas where it is still incomplete, such as financial services energy and aviation, with clear timetables and action plans for reform. An increasing focus needs to be placed on results – lower prices and greater choice for consumers – as well as the necessary legislative processes.

### *Financial services*

- 4.18 Developing a dynamic single market in financial services will make a major contribution to raising Europe's growth, employment and productivity. Broader and deeper capital markets will reduce the cost of capital and increase the efficiency of allocation of capital across the EU. This will help all businesses, including start-ups and SMEs. Consumers and investors will also benefit from a greater choice of more competitive and innovative financial services and products.
- 4.19 The EU still has a long way to go to match the integrated, dynamic capital market of the US. For example, the EU's equity market capitalisation in 1999 is only 106.7% of GDP compared with 181.1% in the US. Restrictions remain on pensions investment – for example,

rules in one member state mean that only 30% of pension funds may be invested in foreign equities with a ceiling of 50% on foreign assets. This lack of a truly effective single market shows up in returns to investors. Over the period 1984 to 1998, the average real return on pension funds was 10.5% in the US, compared with 6.3% in EU countries where funds faced investment restrictions.

4.20 Further development is also needed in the retail financial services sector. Financial services should be ideally suited to international trade but the barriers that remain mean that the single market is less well developed in this area, than in many markets for physical goods. For example, when customers buy a holiday over the Internet from another European country, they are often prevented by national regulations from buying the travel insurance to go with it. The European Commission's analysis shown below shows a lack of price convergence in this area. For example, the average cost of financing credit card debt can vary by a factor of three between Member States.



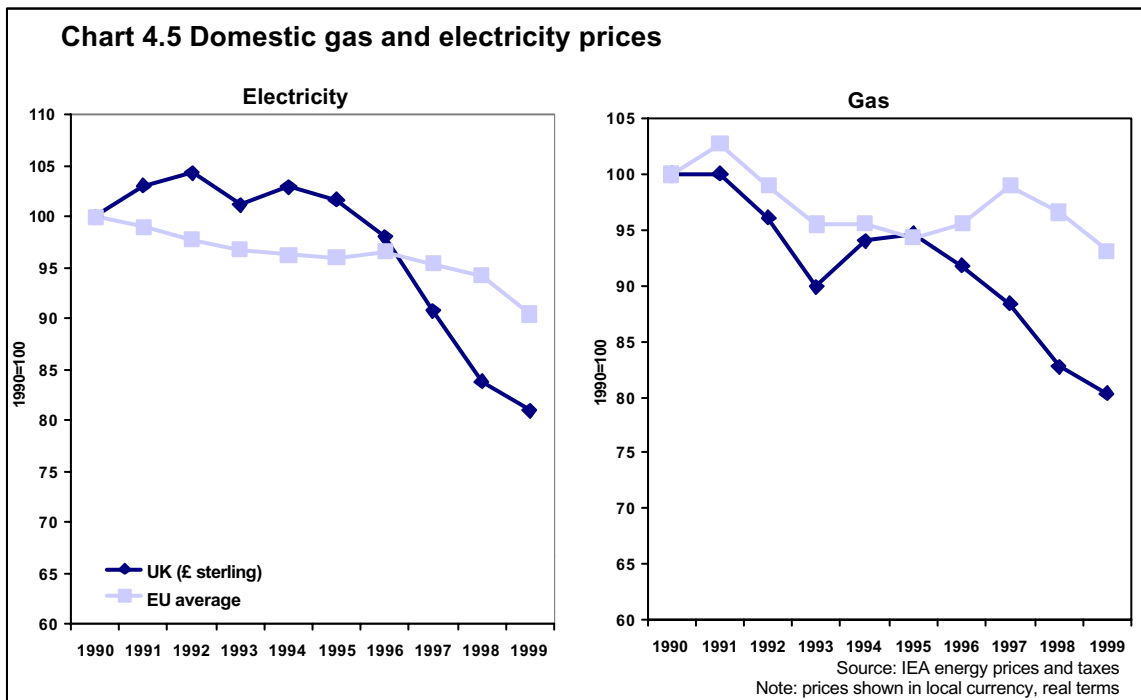
4.21 It was against this background that at the Cardiff summit in 1998, the European Council launched the Financial Services Action Plan, containing the measures needed to complete the single market by 2005.

<sup>1</sup> Product definitions are; (1) Commercial loan: cost (including commissions and charges) to a medium-size firm of a commercial loan of 250,000 ECU; (2) Credit Card: annual cost assuming 500 ECU debit; (3) Mortgage: annual cost of home loan of 25,000 ECU; (4) Private Equity Transition: commission costs of cash bargain of 1.440 ECU. All prices are in ECU.

- 4.22 Last July, the UK Government published a paper setting out ideas for prioritising the measures in the Financial Services Action Plan to bring forward completion to 2004. A major priority is the removal of barriers to the single market for pensions, to encourage the portability and cross border membership that are important for labour and capital mobility. The paper also called for the development of clear indicators and measures of success.
- 4.23 The UK paper set out an approach to completing the single market for financial services, based on mutual recognition and core standards. To make mutual recognition work in this sector requires:
- "Home state" regulation combined with mutual recognition of national rules
  - Agreement where necessary on a framework of core standards for conduct of business and consumer protection rules
  - Effective mechanisms for consumer redress across borders
  - Better-informed consumers
- 4.24 This would mean that financial service providers face lower costs and greater certainty when marketing and selling their services across the EU. It is also the only practical approach if the EU is to embrace e-commerce and new technology – and is fully consistent with high levels of consumer satisfaction.
- 4.25 The Lamfalussy Committee on the regulation of European Securities Markets was mandated by ECOFIN - the Economics and Finance Council of the EU - to examine ways of accelerating the completion of the single market in financial services. It issued its final report on February 15 2001 and its recommendations were welcomed by market participants and member states. The Committee's analysis of the problems caused by the absence of a single market in securities suggests that the EU lags far behind the US in terms of investment and returns on investment.
- 4.26 Like the UK Government's July 2000 report, the Committee suggests prioritising the measures on the Financial Services Action Plan and bringing forward the deadline for the completion of the single market to 2003/4. The Committee also recommended a speedier and more flexible process for producing and implementing securities legislation - to ensure the laws don't lag behind the market – as well as better co-operation, overarching principles of good regulation and a Cecchini-style report on financial services and indicators of output. The Government is hopeful that discussion at ECOFIN and Stockholm will lead to a mutually acceptable implementation of the bulk of the Committee's proposals.

## Energy markets

- 4.27 One of the next big challenges is to open up Europe's energy markets. The Feira Council of June 2000, called on the European Commission to present a report by March 2001 on "the evolution of energy markets according to the Lisbon strategy".
- 4.28 The UK gas and electricity markets are already fully liberalised, with all types of customer able to choose their own supplier. As at October 2000 over 19% and 29% of domestic electricity and gas customers respectively have switched supplier. This represents some 6m electricity and 6m gas customers. Competition in the UK has benefited consumers. Since the UK gas market was opened to competition - during 1997 and 1998 – prices to all consumers have fallen. New gas suppliers have been offering savings of around £50 on an average gas bill of £315. Similarly domestic electricity prices have fallen as markets have opened up: between 1996 and 2000, prices to small domestic electricity users in the UK fell by 11.9% as competition was introduced into this sector – the third largest price fall in the EU.



- 4.29 Other Member States, such as Sweden, have also achieved full liberalisation. A model of regulatory 'best practice' has developed in Europe's energy markets. The main elements of this are the separation of transmission activities from production and supply, regulated third party access to grids and pipelines and the appointment of independent regulators. This model allows appropriate safeguards to be put in place to ensure security of supply and is fully consistent

measures to promote the take-up of renewable energy and greater resource efficiency and with policies to tackle fuel poverty.

### *Aviation*

- 4.30 The EU has already made a lot of progress towards completing the single market in aviation. The European Commission's 1999 report 'The European airline industry: from single market to worldwide challenges' showed that as a result of deregulation:
- **Air travel prices have fallen significantly.** Looking at the period 1993-1998 business fares were on average 10% lower than before deregulation; full economy fares were down 17% and promotional fares had fallen by 24%
  - **Competition between airlines has increased.** The number of routes with more than two operators trebled over the same period.
  - **New competitors have entered the market.** In 1998 there were 164 carriers compared with 132 in 1993. As a result of liberalisation firms such as easyJet, to take just one example, have rapidly established a market presence.
- 4.31 The challenge to Europe is to go one step further on the road to reform. The existing rules for allocating take off and landing spaces at airports (known as 'slots') are inhibiting competition at Europe's busiest airports, such as Heathrow. The UK Government is committed to working towards a revised European Regulation that introduces market mechanisms to allocate scarce capacity.
- 4.32 The European initiative to tackle increasing air transport delays - the Single European Sky - will reduce air delay and congestion in Europe. A 25% reduction in delays could save Europe air transport industry and the public around £1.4 bn a year. This initiative will also reduce fuel burn with significant environmental benefits, and help provide the infrastructure to meet the expected growth in passenger traffic.

## **eEurope and the new economy**

- 4.33 Substantial investment in Information and Communications Technology (ICT) has been a major feature of recent rapid growth in output and productivity in the US. There is a lively academic debate about the extent to which ICT and the Internet have contributed to a permanent increase in the US growth rate. What is clear is that cheap and easy access to the Internet in the USA has allowed businesses and consumers to take advantage of the new technology, with benefits in terms of lower search costs allowing easier access to suppliers and customers, greater choice and lower prices.

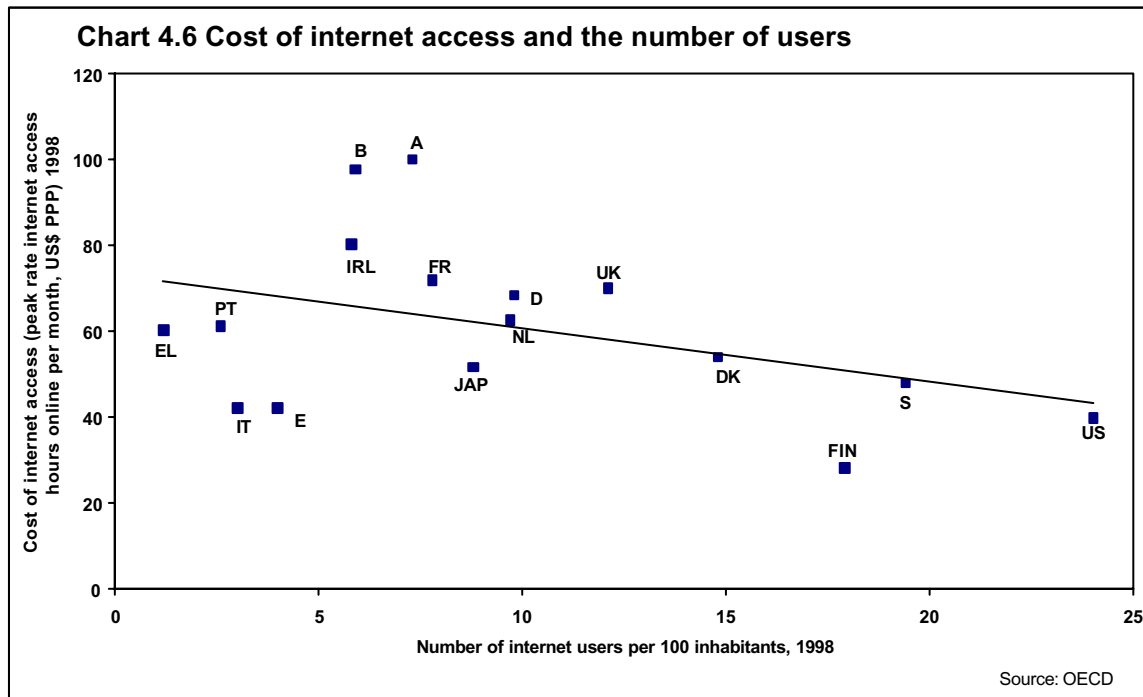
4.34 The EU has yet to experience fully these benefits. The following facts help reveal the extent of the gap between the EU and the US:

- In US, the ICT sector accounts for 7.6% of GDP compared to 5% in EU and 6.4% in UK
- US Internet penetration was 55.8% by population in November 2000 - far above the UK at 33.6%.
- In the US, Internet start-ups accounted for 2.3 million direct jobs in January 2000 - up from 1.6 million in 1998.
- In Europe there has been slow take-up of electronic commerce by SMEs – only 66% of SMEs have access to the Internet compared to 76% of large companies. But only 6% of SMEs can carry out e-commerce.
- In IT skills, although almost half the EU working population uses computers at work, less than 22% of the workforce have had any formal computer training.
- According to one study, demand for IT experience and skills in the EU is expected to grow from 10 million in 2001 to 13 million by 2003 producing a skills shortage equivalent to 1.7 million jobs.

4.35 To close this gap, in June 2000, the Feira European Council adopted the eEurope 2002 Action Plan and set out an ambitious series of deadlines – from 2000 to 2002 – for effective delivery of this transition. The objectives of this plan revolve around three core themes:

- A cheaper, faster Internet
- Investing in people and skills
- Stimulating use of the Internet

4.36 Liberalisation of Europe's telecommunications systems is at the heart of delivering a cheaper, faster Internet. Cheap and efficient telecommunications systems are the engine of the new economy. There is a strong relationship between the low cost of Internet access and high levels of Internet penetration in countries such as the US, Sweden and Finland.



4.37 Competition is the key to low prices and high levels of innovation in telecoms markets. This reflects the complex relationship between different aspects of productivity – completing the single market in telecoms can, in turn, boost research and innovation. The opening up of EU telecoms markets began in 1990, and competition has been introduced in all Member States. These reforms have benefited consumers through lower prices: the cost of a 3-minute call between the UK and Italy halved between 1989 and 1999. To take another example, prices for UK mobile phone users have fallen by 20% in 18 months from the beginning of 1999.

4.38 However, in the late 1990s concerns remained that, in certain segments of the market, the removal of effective monopolies was not happening quickly enough. For this reason - together with the growing convergence between broadcasting, telecoms and IT - the European Commission launched in 1999 a major review of the single market in telecoms. The Lisbon European Council called for the resulting package of legislation to be agreed as soon as possible in 2001.

4.39 The eEurope Action Plan also provided a range of measures to ensure that the European information society is inclusive. To create an information society for all, Member States are asked to share best practice and to make financial resources available to include young people and schools, working people and the disabled.

4.40 The IT skills gap in the EU workforce is widening, where the estimated 800,000 current job vacancies for IT professionals are expected to grow to 1.7 million by 2003 unless action is taken. And the wider need for increased digital literacy is even more pressing. This challenge is to be met by education and training, such as through providing life-long

learning opportunities for all in IT by the end of 2002, and through establishing a European diploma for basic IT skills by the end of 2001.

- 4.41 In the UK, skills are being improved with a target of over 75% of 14 year olds having basic computer skills, backed by a £1bn investment programme in ICT for schools over the next three years. Across the EU, all schools are to have access to the Internet by end of 2001; by the end of 2002, all teachers are to be skilled in using the Internet and all pupils will be able to leave school digitally literate.
- 4.42 The EU must also stimulate the use of the Internet to increase penetration to US levels. One way of doing this is to raise consumer confidence in e-commerce by, for example, making cost-effective smart card solutions available by 2002. There are also a number of innovative national policies, which aim at increasing use of ICT and the Internet.

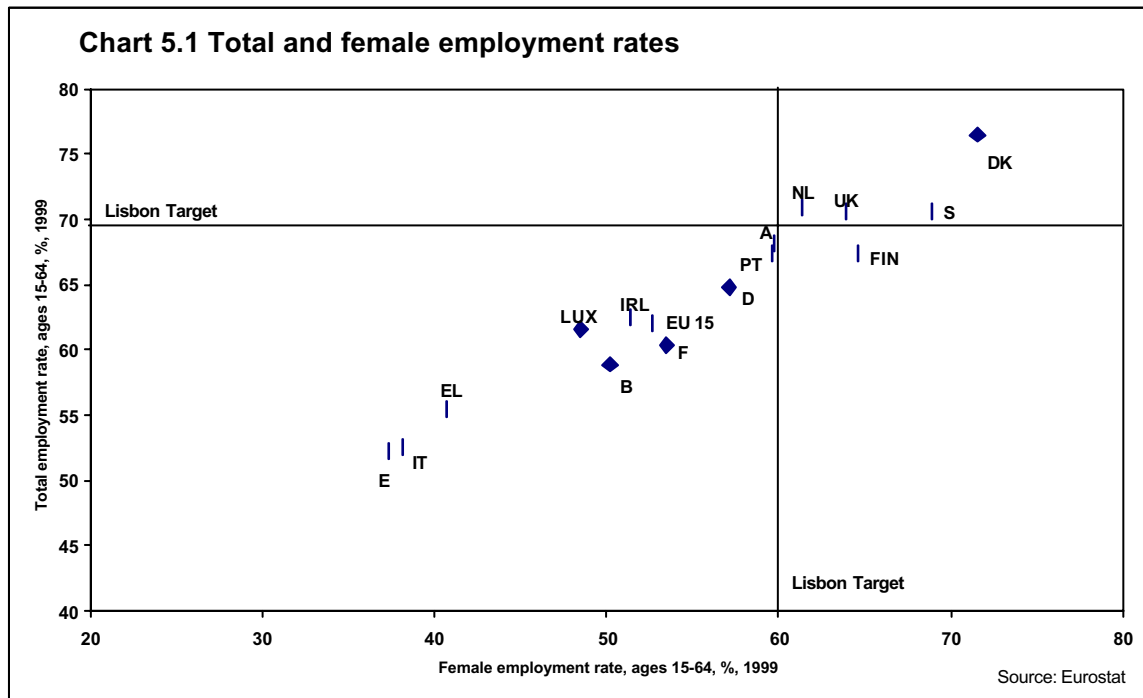
**Box 4.3 Swedish home-PC initiative**

Sweden gives tax incentives for employees to rent a PC for work at home. This involves giving employees the possibility of receiving or loaning a PC for use at home as a tax-free benefit. This benefit is available to the entire permanent workforce and also, if the employer chooses, temporary staff. In practice, most employers offer a PC in combination with a reduction in gross pay, which then gives the employee a lower taxable income. Over 1998 and 1999 767,500 home PCs were acquired under the project – part of the reason why Swedish PC penetration rate was 60% by mid-2000.

- 4.43 The eEurope Action Plan stressed the importance of bringing government online. It requires that Member States are to ensure generalised access to main basic public services by the end of 2003. Indeed, the UK Government is allocating £1bn over three years towards its aim to get all Government services on-line by 2005 (42% are already on-line), and for tendering for all Government contracts to be done electronically by 2002 to realise the potential efficiencies from these forms of doing business.

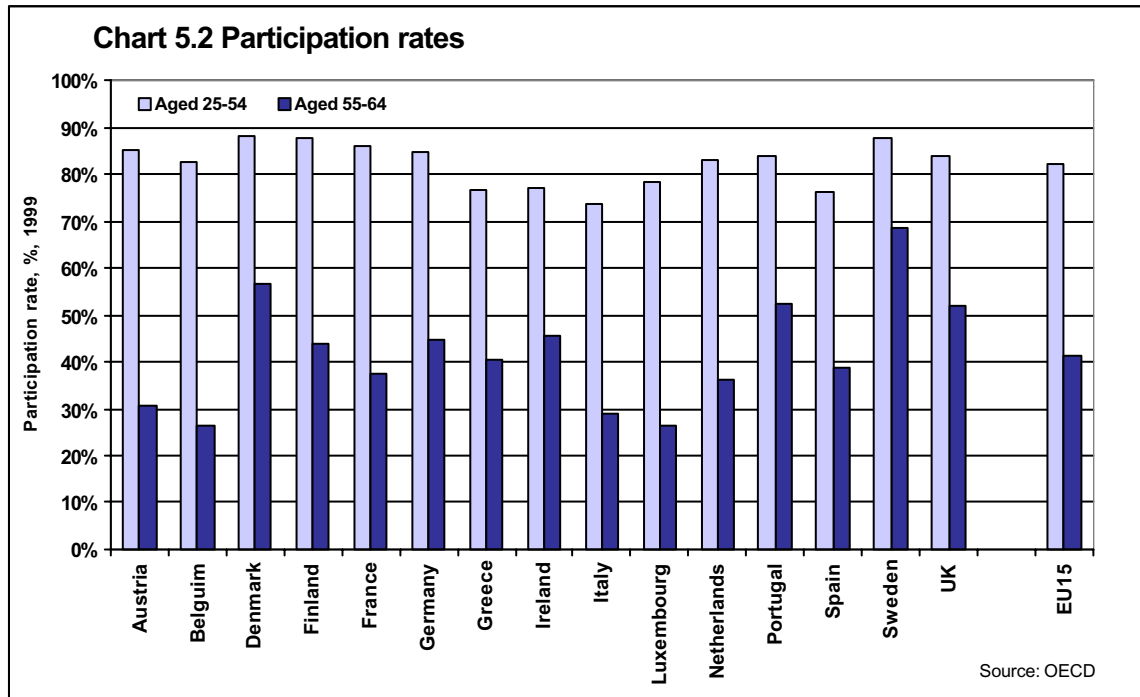
## 5. THE EMPLOYMENT CHALLENGE – DELIVERING SOCIAL INCLUSION

- 5.1 The Lisbon Council committed the EU to raising the employment rate from an average of 61% to 70% in 2010 and to increasing the female employment rate from an average of 51% to more than 60% by the same date. The UK's employment ambition is to deliver high and stable levels of employment, taking account of the economic cycle, so that at least three quarters of the working age population are in work by the end of the decade.
- 5.2 Restoring high levels of employment to the EU is essential to creating an inclusive and fair society. As the Lisbon Council recognised, a job is the best safeguard against social exclusion. The UK believes there is no conflict between reforming Europe's economies and delivering on social objectives.

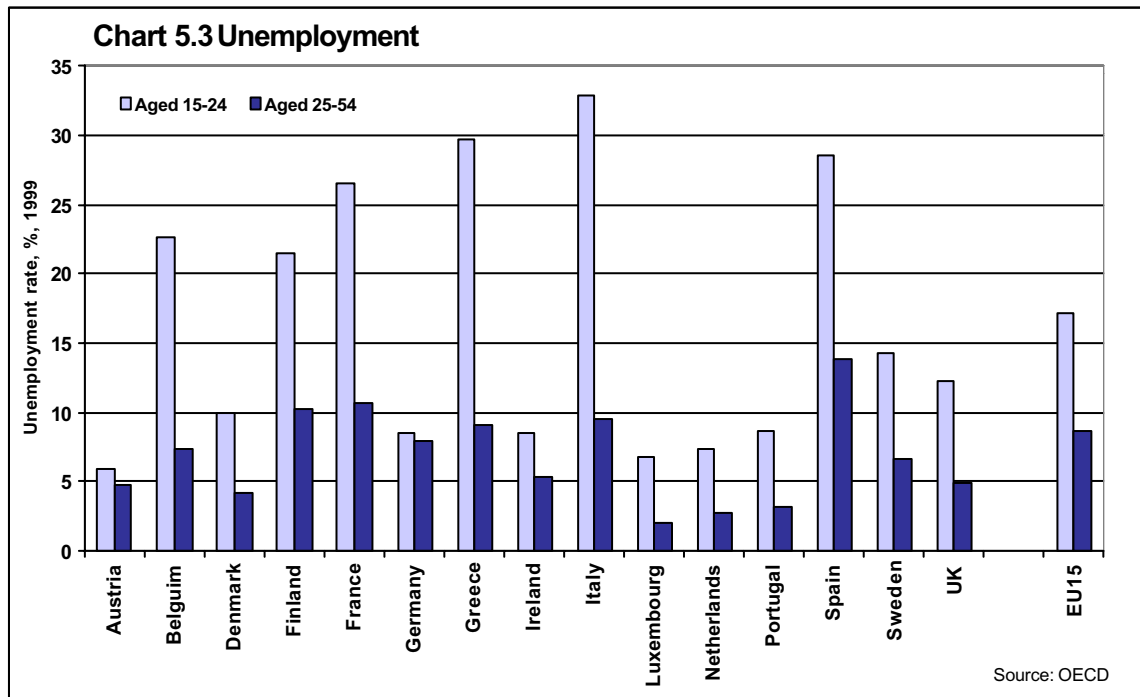


- 5.3 Meeting the Lisbon targets means tackling the structural problems in Europe's labour markets. National conditions differ, but overall unemployment rates – especially for young people - remain high, and participation rates among women and older workers are both low.
- 5.4 Employment and participation rates are lower for **women** than for men in all Member States. However the scale of differential varies greatly. Thus while in five Member States – Greece, Ireland, Italy, Luxembourg and Spain – these differentials are greater than 20%, in both Finland and Sweden these differentials are 5% or under.

- 5.5 Whilst in many states unemployment rates are no higher for **older workers**, inactivity amongst older workers is a serious problem across the EU. In six Member States – Austria, Belgium, France, Italy, Luxembourg and the Netherlands – participation rates for those aged 55-64 are less than half those for individuals aged 25-54, while in only one Member State – Sweden - is the differential less than a third.



- 5.6 Apart from in Germany unemployment rates for **young people** aged 15-24 are higher across all countries than for those individuals aged 25-54. However again the extent of the problem differs greatly. In five Member States - Austria, Ireland, Luxembourg, Netherlands and Portugal – the differential is below 5 percent whereas in another six - Belgium, Finland, France, Greece, Italy and Spain - the differential is greater than 10 percent.



## Meeting the employment challenge

5.7 So Europe's economies face many common problems. While the extent of these problems varies between countries, no one Member State has managed to overcome them all. To do so, continued structural reform is a must for all, and the pooling of knowledge and experience is key. In particular, meeting the employment challenge calls for:

- Reform of labour market regulation;
- Active labour market policies;
- Reform of tax-benefit systems;
- Provision of childcare;
- Policies to enhance mobility.

### *Reform of labour market regulation*

5.8 Labour market regulation is essential to ensure basic minimum standards in the workplace and social protection for workers. For example, minimum wages remove the worst excesses of low pay by providing a floor for wages; and employment protection legislation is necessary to protect workers against the risk of unfair or arbitrary dismissal. Since 1997, the UK has introduced a series of reforms to ensure greater decency and fairness in the workplace. These include new trade union recognition rights; the National Minimum Wage; new

rights on unfair dismissal; and new family friendly policies such as increased maternity rights and the right to paternal leave.

- 5.9 However labour market regulation must strike a balance - ensuring effective social protection without being so strict it hurts those it is meant to help. For example, if minimum wages are set at too high a level then some unskilled workers, particularly the young may be priced out of employment. And overly strict employment protection laws may discourage employers from hiring workers or reduce job security of employment by encouraging employers to hire workers on temporary rather than permanent contracts. Finally, excessive or ill-designed legislation can insulate labour market 'insiders' from the competition posed by people without a job. This will reduce the effective supply of labour generating higher levels of unemployment.
- 5.10 In such circumstances regulatory reform is needed, so that Member States combine flexible and dynamic labour markets, to promote employment opportunities for all, with a system of effective but realistic social protection.

#### *Active Labour Market Policies*

- 5.11 Implementation of active labour market policies is widespread, though varied, across Member States and many innovative approaches have been pioneered.

#### **Box 5.1 Active Labour Market Policies**

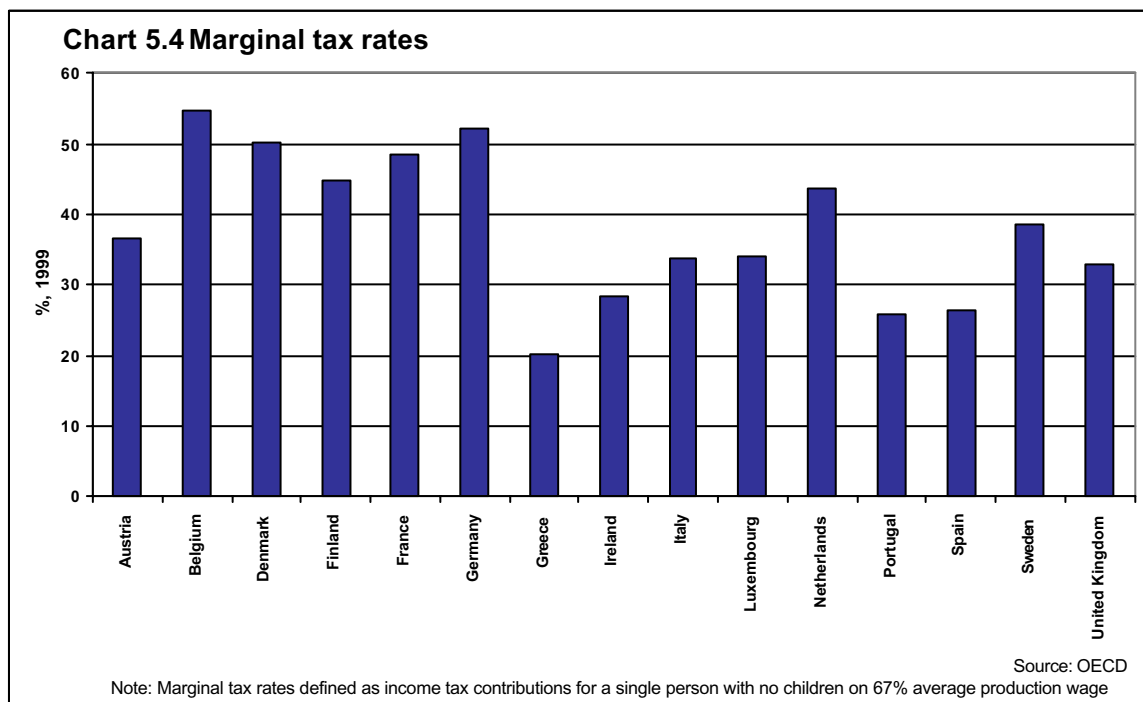
In Sweden enhanced job search is being utilised to eradicate periods of short-term unemployment prior to active measures where people have evident problems in finding work, for example due to obsolete skills, even though they have been recently employed.

- 5.12 Such policies will play a crucial role in meeting the Lisbon targets, through helping people move from welfare into work and focussing on those groups who find it particularly difficult to access the labour market. For example, Germany is committed to ensuring women participate in active measures in proportion to their share in unemployment.
- 5.13 Most Member States have policies specifically in place in order to target youth unemployment - a widely accepted problem and an important area to tackle. In the UK the New Deal for Young People includes a personal adviser service and, for those who need additional help, further provision including wage subsidies, work experience and vocational training. New Deal programmes are also being extended to other groups including long-term unemployed people, lone parents, those aged 50+, disabled people and partners of unemployed people.

5.14 Member States have also taken steps to encourage active ageing and to reintegrate older workers into the labour market. Finland has introduced a package of measures to encourage active ageing, including the promotion of re-training.

*Tax-benefit reforms to make work pay*

5.15 In many Member States, the tax and benefit systems lead to unemployment traps - where financial gains from work are small or non-existent - and poverty traps – where people in employment are discouraged from working longer hours or taking better jobs. Meeting the employment challenge therefore requires tax-benefit reforms to improve work incentives, reduce marginal withdrawal rates and the tax wedge on labour. Reforms are needed to make work pay, in particular for those at the lower end of the wage distribution.



5.16 Many Member States have made progress in making the tax system more employment friendly. For example the UK – through the Working Families Tax Credit (WFTC) – has taken the first step towards integrating its tax and benefit system. Along with other reforms of the tax and benefits system the WFTC guarantees a minimum income above and beyond the level of the National Minimum Wage for families with children. Similarly France has recently announced the introduction of a “Prime pour l’emploi” a tax-credit paid to working people on low incomes, which varies according to household composition. However, whilst there has been some shift from passive to active measures, changes to benefit systems have been less extensive.

## *Childcare*

- 5.17 Lack of good quality, affordable childcare is a major barrier to parental employment, especially for women and lone parents. The level of childcare provision varies greatly between Member States.

### **Box 5.2 Childcare and employment**

Denmark currently has the most comprehensive system of childcare provision and the Danish government ascribes the country's top of the league position on men's and women's activity and employment rates to this factor more than any other.

- 5.18 Member States must therefore act at a national level to ensure adequate childcare provision, thus ensuring that those who want to work can do so. The UK government believes that there are three key principles. First, affordability - childcare can be an expensive cost, especially for lone parents and low-income families. To ensure work pays Governments may therefore have to subsidise childcare costs. Also quality is important. Parents often emphasise that they must have confidence in the childcare facility and trust in the carers who will care for their child. Finally accessibility is often key as childcare is a localised good. Demand is such that childcare must be available in the local area, however disadvantaged areas in particular may suffer from a lack of childcare provision.

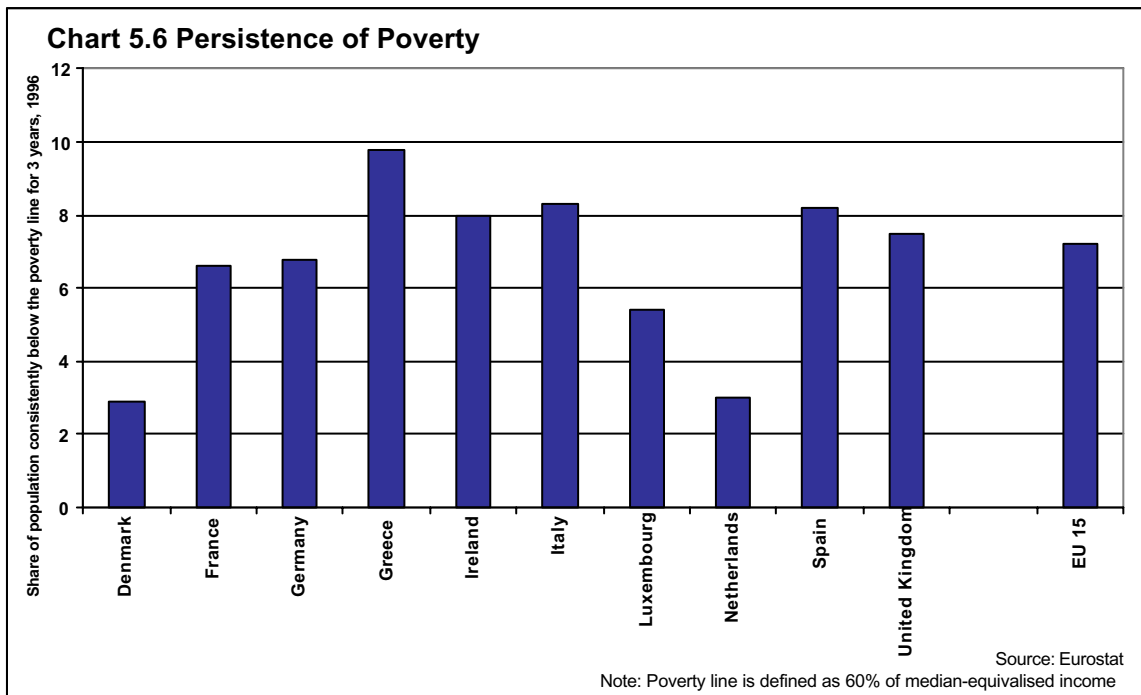
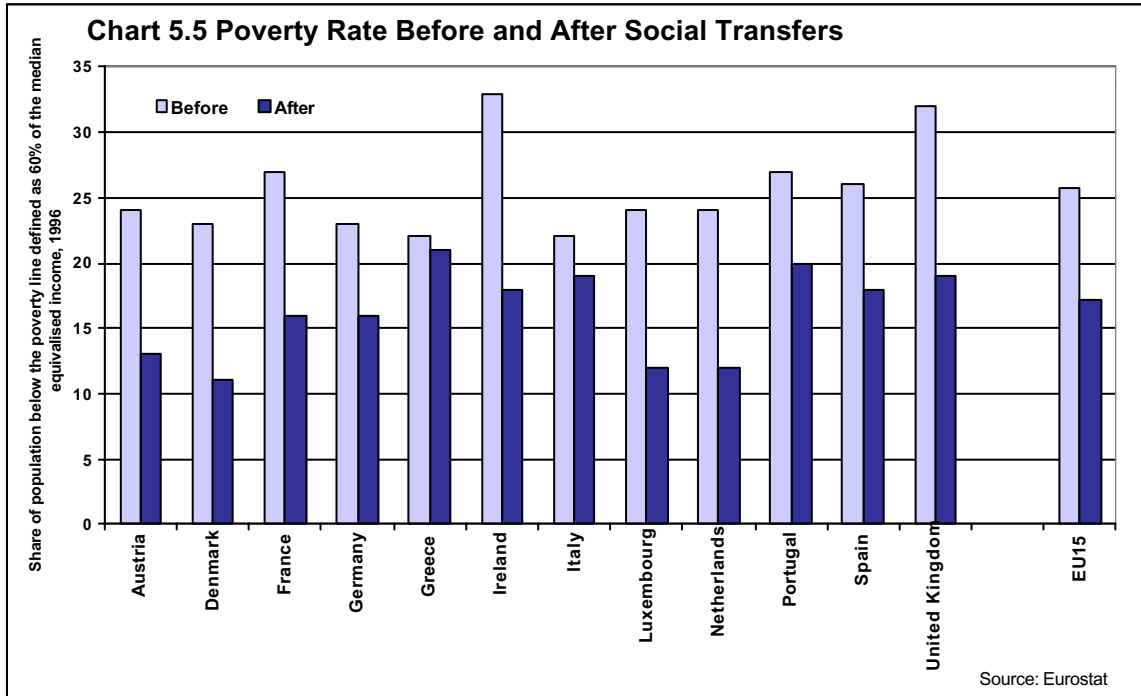
## *Labour mobility*

- 5.19 In a modern labour market, employment opportunity for all cannot be achieved through jobs for life, but rather by ensuring job opportunities for all throughout their working lives. So high levels of labour market mobility, where a skilled labour force is able to move between jobs in response to changing patterns of economic demand, is essential to ensuring high and sustainable levels of employment. This requires actions to enhance labour mobility, locally, regionally and internationally. It will also demand greater availability of information on the European employment market and developing of skills in national labour markets that are transferable across the EU. Another priority area is for more effective implementation and application of mutual recognition of professional qualifications.

## **New approaches to social exclusion**

- 5.20 The Lisbon Council agreed on the need to modernise social protection and that tackling social exclusion should be a priority. There are many aspects to social exclusion. Two relevant measures are relative income poverty and persistence of poverty. The most recent

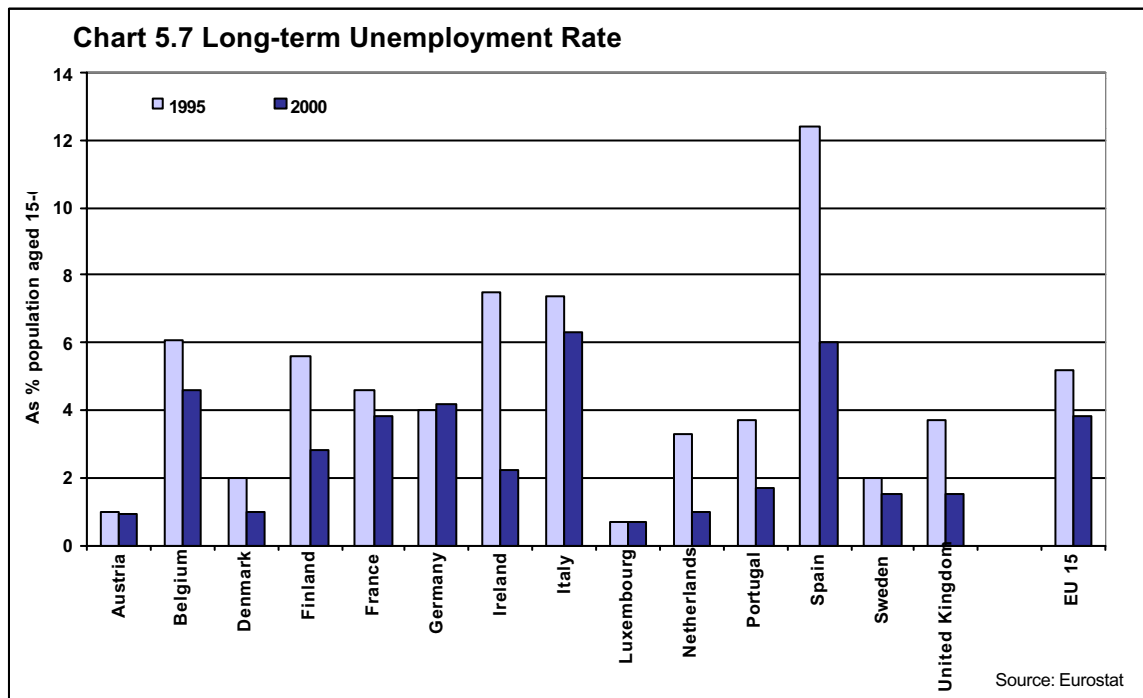
comparative data on both of these areas is from 1996. During this Parliament, the UK has introduced a package of measures to make a significant start in tackling the high levels of poverty and social exclusion that built up over the previous two decades.



5.21 Meeting the employment challenge is central to the new social agenda endorsed at Nice. In this new approach, economic reforms work

together with policies to deliver social inclusion – encouraging employment, giving all citizens the skills to prosper in a modern economy and making enterprise open to all.

5.22 The Lisbon Council rightly recognised that a job is the best safeguard against social exclusion: worklessness is one of the main causes of poverty, and work is the best route out. Evidence from the UK shows that in 80% of cases between 1991 and 1995, finding work meant moving out of the bottom fifth of the income distribution. Policy should address labour market failures that have engrained worklessness and social exclusion in certain sections of society. This means tackling long-term and youth unemployment, targeting those who have lost contact with the labour market and widening employment access to those who are typically under-represented, such as ethnic minorities, older workers and the disabled. It also means making work pay by eliminating unemployment and poverty traps. At the same time, policies should ensure decent support for those who cannot work.



5.23 Education and skills are a major route out of social exclusion. In 1999, the UK unemployment rate for those with no qualifications was 12.4%, compared to 6.5% for those with secondary level education. Policies are required to ensure all have access to the right educational opportunities, that there is equality of access to skills and training throughout working life and that quality of provision and standards of attainment are high. Policies should be implemented to help individuals acquire skills to enable them to return to the labour market, with an emphasis placed on fostering a culture of lifelong learning, so that all citizens have access to, and are able to participate in, the knowledge-based economy.

- 5.24 A strong economy and a strong society belong together. Enterprise and fairness, wealth creation and social inclusion are at the heart of a strong society. Being socially responsible is not only the right thing for companies to do but it also makes good business sense, for small as well as large businesses. Policies are needed to extend opportunities for enterprise to everybody, especially those in disadvantaged areas. Jobs and prosperity are best delivered through business-led growth, with governments playing an active and enabling role by setting the right framework for private investment in high unemployment communities. For example, in the UK, the Social Investment Task Force has recommended a five-point programme of action to increase enterprise and wealth creation in disadvantaged communities. The UK Government is now taking forward these recommendations, including proposals for tax credits to encourage community investment and a venture capital fund aimed at community development.
- 5.25 Measures to reduce poverty and social exclusion should be implemented at the appropriate level, be it national, regional or local, with government agencies working in partnership with the voluntary and community sector. Many examples exist within individual Member States of effective and imaginative policies to tackle social exclusion, to promote regional development and local regeneration and to promote employment. Exchanging information about best practice, for example through the National Action Plans for combating poverty and social inclusion, will enable all Member States to learn from each other, and put in place effective policies.

## 6. THE WAY FORWARD - THE STOCKHOLM COUNCIL

- 6.1 Much progress has been made over the past four years towards meeting Europe's employment and productivity challenges. By developing a new economic and social policy framework, Europe's leaders have taken the vital first steps toward identifying the shared problems facing the EU and carrying out the necessary reforms.
- 6.2 But more needs to be done. The Stockholm European Council of 23 and 24 March is the next major milestone. At Stockholm, Europe needs to continue on the path agreed at Lisbon.
- 6.3 This means reforms mainly at **national** level to deliver a full employment Europe and close the research and innovation gap, with national measures strengthened and improved as a result of EU coordination through benchmarking and peer review. Priorities for national reform include:
- Our macroeconomic policies must entrench stability, low inflation and sustainable public finances, while recognizing the importance of public investment in infrastructure, education, science and innovation, consistent with the Broad Economic Policy Guidelines formulated in line with Article 99 of the Treaty of the European Community.
  - Increased employment participation rates through tax/benefit reforms to make work pay; together with policies to promote equal opportunities, improve adult literacy and access to lifelong learning, and combat social exclusion, within the framework of the EU Employment Guidelines
  - Enterprise policies to promote R&D and venture capital with greater effort in basic research and the arrangement of entrepreneurial spin-offs from universities including the promotion of business "clusters" near centres of research excellence, in line with the proposals for a European Research Area and the Risk Capital Action Plan;
  - Measures to promote the information society in schools and communities, to realise the potential of e-government and tackle info-illiteracy and the risk of the digital divide consistent with the e-Europe Action Plan.
- 6.4 Further reforms are also needed **at EU level** to strengthen the Single Market and sharpen the focus on innovation, enterprise and employment in all EU activities. Priorities here include:
- Reaching early and appropriate agreement to all outstanding EU legislation on telecoms liberalisation and e-commerce, to meet existing targets of 2001 for telecoms liberalisation and 2002 for the e-Europe

## Action Plan;

- Agreeing clear and ambitious timescales for more rapid opening of utilities and transport markets. For example there should be full liberalisation of energy markets by 2003;
- Setting tighter deadlines for the EU's priorities in financial services liberalisation and implementation of the recommendations in the Lamfalussy report – with a target of integrating financial markets by 2004;
- Taking action to reduce air traffic delays by agreeing to the creation of the Single European Sky by 2004;
- Action to reduce unfair state aids which distort the single market while enabling governments to target state aids where they can deliver the greatest benefits;
- In particular to take action to ensure venture capital regional funds are no longer delayed or impeded.
- Acting against unfair tax competition, which amounts to unfair state subsidies, while making clear that fair tax competition, not tax harmonisation, is the best way forward.
- Refocusing the EU research budget on a limited number of frontier technologies and encouraging researcher mobility in order to create cross border networks of excellence;
- To close the gap with leading competitors, carrying out a study into EU R&D and innovation performance, exchanging information on best practice to promote R&D and innovation;
- The preparation of a Biotechnology/Bioscience Action Plan for Europe;
- To have in place the mechanisms to deliver a quick and cheap Community patent by the end of 2001;
- Following up the Charter for Small Firms by improving the representation of small businesses in EU decision-making;
- Inviting the Commission to implement plans for better regulation, including a proper procedure for regulatory impact assessment, full consultation of the business community before new regulations are put forward and guidelines on alternatives to regulation;
- The establishment of an EU business-led taskforce on skills for the new economy with a remit to present proposals by 2002 on what new

skills will be needed by Europe's workforce, and how obstacles to mobility can best be overcome.

6.5 The EU should also show **global leadership** by calling for a new trade round. We should seek agreement with the United States on how the EU and US as Transatlantic partners can secure consensus to open a new trade round at the WTO Summit later this year.