

The Lisbon European Council of March 2000 placed labour market reform at the heart of the EU agenda, recognising its importance for economic growth and social justice. In the past four years, many Member States have launched ambitious reforms to assist and encourage people back into work – partly as a result of which, six million more people are in work today than in 1999. Yet despite these successes, progress in delivering reform remains too slow, and the Union as a whole faces an uphill challenge if it is to meet the targets for employment endorsed by EU leaders at Lisbon. As Europe approaches the halfway point in the Lisbon timetable, the Member States and the Community must therefore reinvigorate their commitment to reform, with action to advance flexibility and fairness in Europe, through:

- **improvements to the regulatory environment**, with new legislation assessed to ensure both decent minimum standards in the workplace and the flexibility needed to encourage job creation and to facilitate flexible working patterns;
- **active labour market policies to help the unemployed and inactive**, particularly those among disadvantaged groups, find and remain in work;
- **reforms to tax and benefit systems to improve incentives to work** and advance flexibility and fairness together; and
- **action to create a skilled and adaptable workforce** that can respond rapidly to changing economic conditions, with lifelong opportunities for individuals to refresh and update their skills.

INTRODUCTION

3.1 A well functioning labour market is a key determinant of economic success. High levels of employment make a positive contribution to potential growth in an economy, improving overall competitiveness. Full employment is also the best route to social justice, ensuring that all citizens can share in the benefits of rising prosperity. Raising employment is therefore at the heart of the Lisbon agenda.

3.2 Developments in the global economy, the imminent enlargement of the European Union and an ageing population place a premium on the need for labour market reform in Europe. Increasing global competition and new sources of comparative advantage mean that individuals and firms must have the flexibility to adapt their skills and working practices if they are to remain competitive. Labour market flexibility is central to ensuring greater economic strength and prosperity in Europe.

3.3 As a sign of their commitment to reform, Europe's leaders have committed themselves to a series of targets for increasing employment in Europe and for raising levels of skills in the EU economy. These targets are rightly challenging. However, the reality is that Europe is not on track to meet them, and will not be without a renewed commitment to reform. As Europe approaches the halfway point in the Lisbon timetable, now is the time for further action, with a comprehensive programme of reform that recognises:

- first, that the cause of disappointing employment growth is essentially structural and that cyclical growth alone cannot deliver the job creation that Europe needs;
- second, that an ageing population means a rising dependency ratio, requiring active labour market policies to increase the effective age of retirement; and
- third, the Lisbon targets can be met only if both unemployment and inactivity are addressed, through active labour market policies and policies designed to make work pay.

Box 3.1 The Employment Taskforce

In March 2003, in recognition of the challenges facing European labour markets, EU leaders established a European Employment Taskforce, headed by Wim Kok, former Prime Minister of the Netherlands, to identify the practical reform measures needed to improve Europe's labour market performance and achieve the Lisbon targets.

The Taskforce published its report, *Jobs, Jobs, Jobs: Creating More Employment in Europe*, on 26 November 2003. The report concluded that:

- *“three years into this ten-year programme of change ... it is clear that insufficient progress has been made”;*
- *“policies to promote employment growth must be backed up by structural reforms to make labour markets more flexible and work more attractive, to extend working life and develop human resources”;*
- *“reducing unemployment and boosting employment are political, economic and social necessities”;* and
- *“the high-minded words, expressed at Lisbon more than three years ago, must be followed by deeds ... Europe stands a fair chance of meeting its objectives of economic growth, more and better jobs and greater social cohesion if it acts decisively now.”*

The Government strongly endorses the conclusions of the Taskforce report, and in particular its focus on the need for structural reform to promote job creation. It welcomes the strong recommendations for action delivered to individual Member States, and is committed to pursuing the further reforms necessary to deliver employment opportunity for all in the UK. Above all, the Government believes that the report represents a vital opportunity to reinvigorate labour market reform throughout the EU, and calls on all Member States to demonstrate the will to implement the changes needed to ensure that Europe as a whole can achieve the Lisbon goals.

PROGRESS TOWARDS THE LISBON AND STOCKHOLM TARGETS

3.4 As described in Chapter 2, the Lisbon and Stockholm European Councils set new targets to increase the number of people in work. These targets comprise:

- a total employment rate of 67 per cent by 2005, and 70 per cent by 2010;
- a female employment rate of 57 per cent by 2005, and 60 per cent by 2010; and
- an employment rate for older workers, aged 55-64, of 50 per cent by 2010.

3.5 The Lisbon European Council also agreed new targets for raising levels of skills throughout the European workforce, including that the Union should reduce, by 50 per cent, the number of 18 to 24 year olds with only a basic secondary education by 2010; and should take further steps to foster a culture of lifelong learning.

3.6 This section reviews progress towards meeting these ambitious but essential targets. In doing so, it demonstrates the urgent need for further reform by Member States to realise Europe's goals.

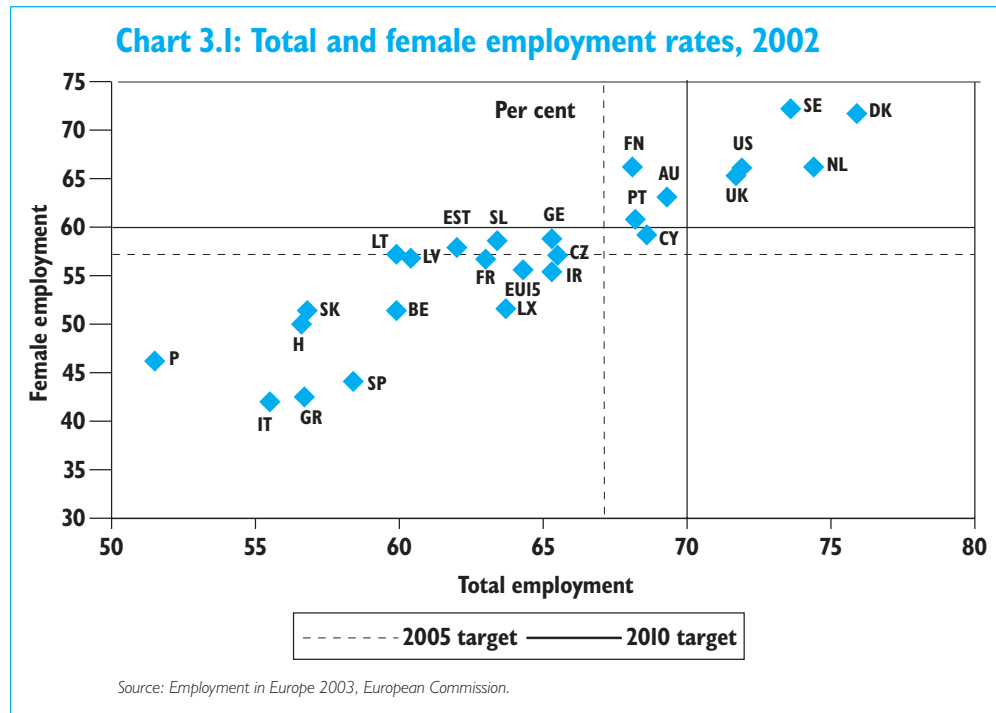
Getting Europe working

Employment 3.7 Employment in the European Union has risen considerably in recent years. In 1999, just prior to the launch of the Lisbon strategy, EU employment stood at 154.9 million, or 62.5 per cent of the working age population. In 2002, this figure had risen to 161.0 million – an increase of around six million people in jobs – resulting in an overall employment rate of 64.3 per cent for the existing Member States.

3.8 While this represents considerable progress towards the Lisbon goals, it also highlights the scale of the challenge ahead if Europe is to meet its 70 per cent target by 2010. Moreover, the increase also masks considerable divergence in the performance of individual Member States. Of the existing Union members, just four – Denmark, the Netherlands, Sweden and the UK – currently meet the 70 per cent target, while three more – Austria, Portugal and Finland – appear on track to do so, having already met the interim target of 67 per cent employment by 2005.

3.9 The scale of the challenge is intensified by enlargement. In 2002, the average employment rate among the new Member States stood at just 55.9 per cent, bringing the overall rate for an enlarged European Union down to 62.9 per cent – far below the 2005 and 2010 targets. Indeed, none of the new Member States exceed the 70 per cent employment target, and only Cyprus appears on track to do so by 2010, having met the 67 per cent interim target ahead of time.

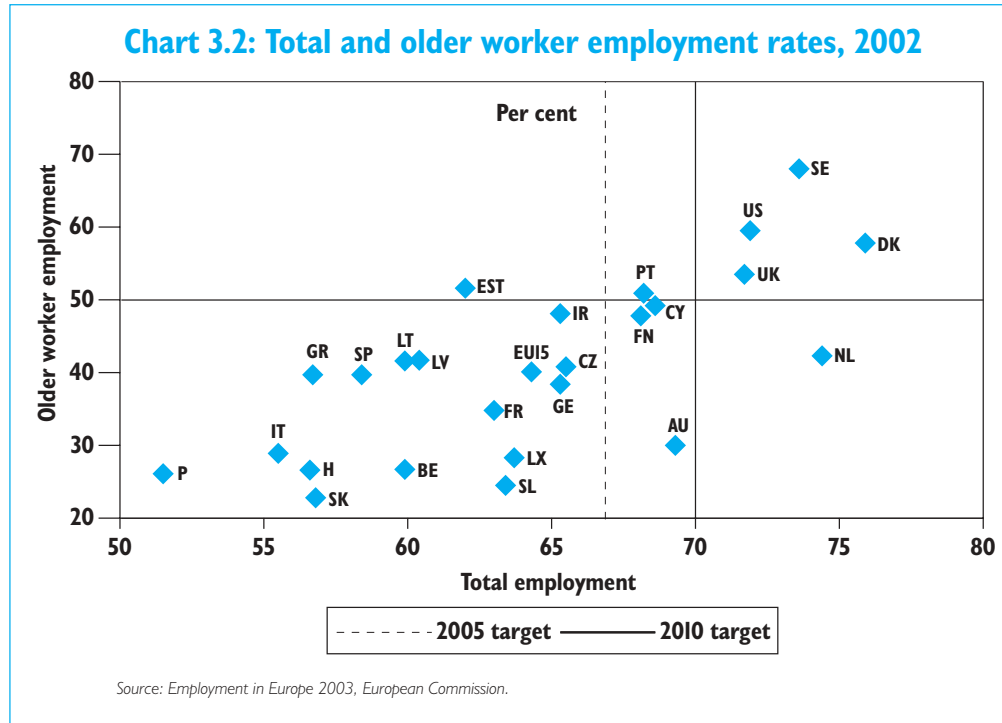
Female employment 3.10 The labour market position of women in Europe is particularly weak. Chart 3.1 shows both total and female employment rates for the new and existing Member States, and for the US. While some Member States – including Sweden, Denmark, the Netherlands, Finland, the UK, Austria and Portugal – have relatively high rates of female employment, in excess of the Lisbon target, the performance of the existing EU as a whole is disappointing, averaging just 55.6 per cent in 2002.



3.11 The picture in the new Member States is also mixed. While six of the ten new Member States had female employment rates above the existing EU average in 2002, the average female employment rate across all of the new Member States stands at just 50.2 per cent, some way below the existing EU average and bringing that for an enlarged Union down to 54.7 per cent. As in the case of total employment, the gap between reality and aspiration is marked.

Employment among older workers

3.12 By far the biggest challenge facing Europe's labour markets, however, is the need to raise employment rates among older workers aged between 55 and 64. Chart 3.2 plots total employment rates against those for older workers. In 2002, the average employment rate among older workers in the existing Union stood at just 40.1 per cent – far below the Lisbon target of 50 per cent by 2010. In an enlarged Union, this figure will fall further to just 38.7 per cent; in the new Member States less than one third of those aged between 55 and 64 are in work. Overall, only five new and existing Member States currently meet the Lisbon target – Sweden, Denmark, the UK, Portugal, and Estonia – with Cyprus, Ireland and Finland hovering just below.



3.13 Employment rates decline sharply in the years leading to statutory retirement age. Research carried out by the OECD¹ suggests that the average effective retirement age in many EU countries has fallen over recent decades, along with the employment rate of older workers. In 2000, the average effective EU retirement age stood at 60.1 years for men and 59.8 years for women – significantly below those in the US which stood at 62.4 years for men and 63 years for women. Indeed, research shows that the average effective retirement age in the US has edged upwards in the past thirty years. Against a backdrop of ageing populations, contracting workforces and pressure on pensions and healthcare systems, a number of Member States have introduced reforms aimed at increasing the length of time Europe’s citizens spend in work, but the pace of reform is small compared with the scale of the problem.

Jobs needed to meet the targets in an enlarged EU

3.14 Meeting the Lisbon and Stockholm targets will require the creation of many more new jobs in an enlarged European Union. Using United Nations population projections, Table 3.1 estimates the number of new jobs required, including for women and older members of the working age population. The conclusions highlight the scale of the challenge. If the 25 Member States of the EU are to succeed in their ambitions for 2010, they must, between 2003 and the end of the decade, create:

- a further 21.5 million jobs – over three million new jobs every year, equivalent to average annual employment growth of around 1.5 per cent; and
- eight million new jobs for women, and nearly six million new jobs for older workers, within this overall total.

¹ See, for example, *Increasing employment: The role of later retirement*, OECD Economic Outlook, December 2002; *Coping with ageing: A dynamic approach to quantify the impact of alternative policy options on future labour supply in OECD countries*, OECD Economics Department, Working Paper 371; and OECD Labour Force Statistics, 2001.

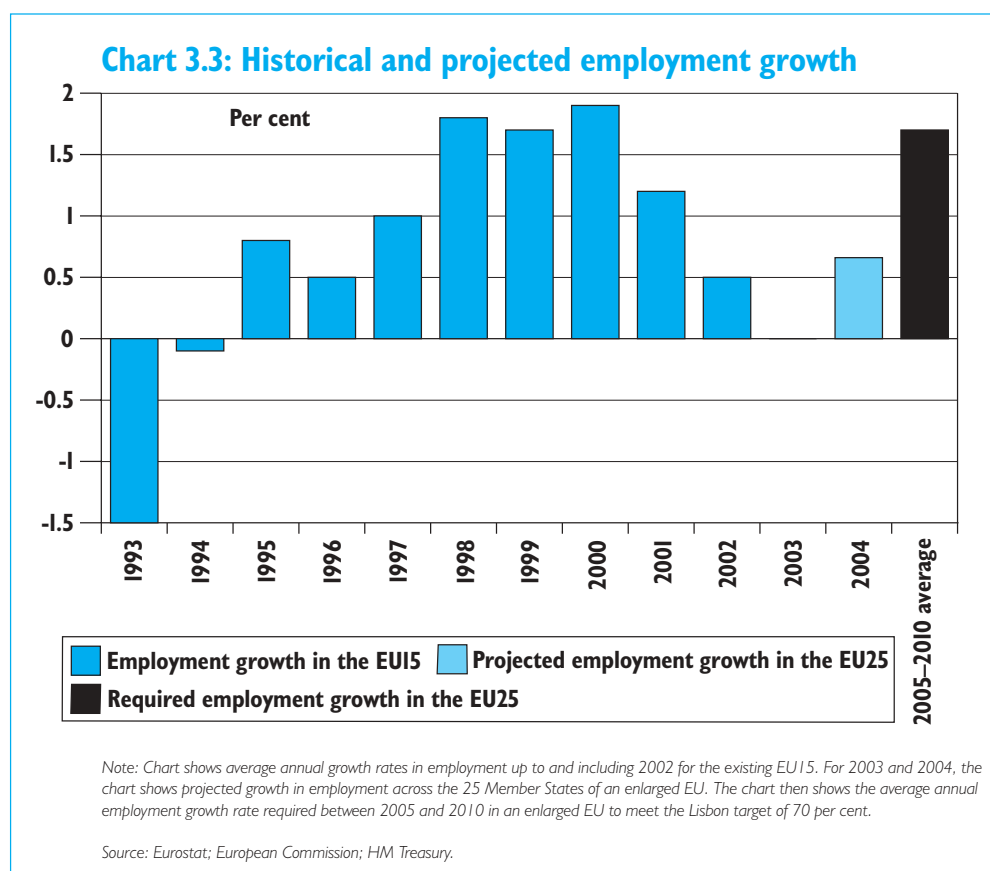
Table 3.1: Required job creation to meet Europe's targets

	1999 employment rate (per cent)	2002 employment rate (per cent)	Jobs created 1999-2002 (million)	2010 target (per cent)	Jobs required 2002-2010 (million)
Total	61.9	62.9	4.9	70.0	21.5
Female	52.9	54.7	3.4	60.0	8.0
Older workers	36.2	38.7	1.5	50.0	5.8

Note: All figures are shown for an enlarged EU of 25 Member States.

Source: *Employment in Europe 2003*, European Commission.

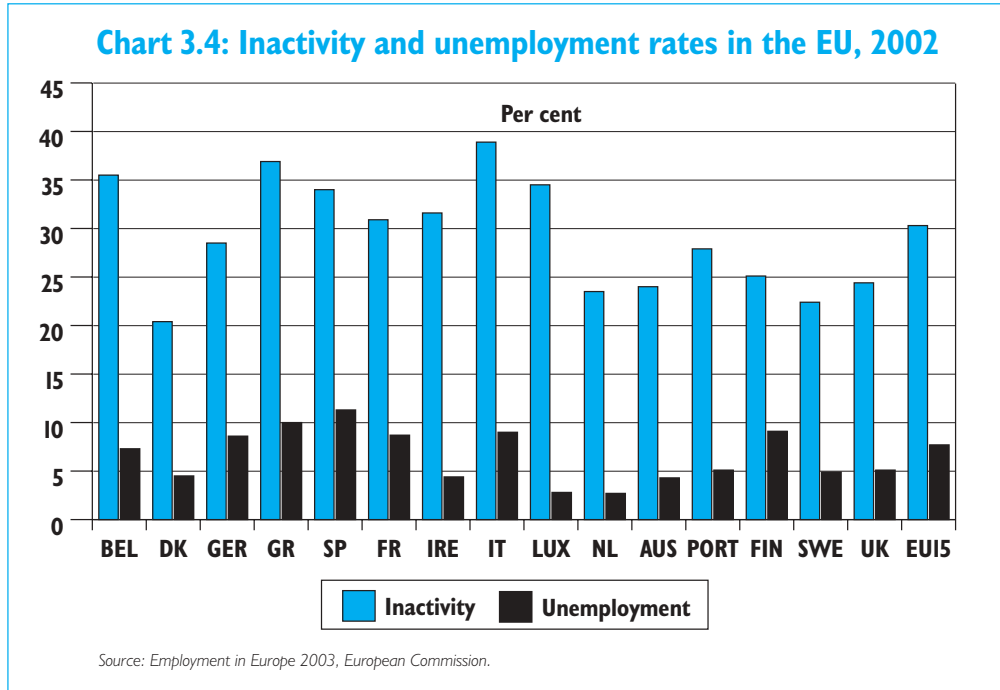
3.15 Recent trends in EU employment growth highlight the scale of this challenge. Chart 3.3 shows that existing EU employment growth has exceeded 1.5 per cent in just three out of the past ten years, and these when the economy was at the peak of the cycle. According to the Commission, employment growth among the 25 Member States is expected to be flat in 2003, rising to just 0.66 per cent in 2004⁴. Were these predictions to materialise, employment in the enlarged Union would then need to grow by an average of 1.7 per cent a year between 2005 and the end of the decade for the enlarged EU to meet its 70 per cent target for 2010.



⁴ *Employment in Europe 2003*, European Commission.

Unemployment and inactivity

3.16 If the number of new jobs required to meet the Lisbon and Stockholm targets is large, Europe’s untapped pool of labour is even greater. Chart 3.4 depicts rates of unemployment and economic inactivity within the existing Member States. In 2002, some 18.6 million people were unemployed across the enlarged Union – too few to close the existing gap with the 70 per cent employment target. Even if everyone in Europe who is looking for work were to find a job, the EU would still not meet the 2010 Lisbon targets. Action to improve Europe’s labour market performance must therefore also focus on reintroducing the economically inactive to the labour market. At 93.3 million people, the stock of inactive people dwarfs the number of unemployed jobseekers in Europe.



Raising Europe’s skills

3.17 Many of Europe’s economically inactive may have become discouraged from seeking work and distanced from today’s labour market. For this group, acquiring the skills needed to compete for jobs may be an important priority. More generally, a highly-skilled workforce is essential to ensure that people can move quickly between jobs during periods of economic change and are productive when in employment.

Early school leavers

3.18 Despite the importance of skills in the modern labour market, continued effort is required to achieve the Lisbon target to halve the number of early school leavers by 2010. According to Eurostat, within the existing Union, the proportion of 18 to 24 year olds with at most a lower secondary education and not in further education or training stood at 18.5 per cent in 2002, below the 1999 rate of 20.5 per cent. However, the new Member States tend to perform better in this area. On average, in 2002, just 8.4 per cent of 18 to 24 year olds in these countries were not in education or training, bringing the average for an enlarged Union down to 16.5 per cent. While this represents important progress, further reforms are needed to increase the incentives and opportunities for young people to improve their skills.

Lifelong learning 3.19 Europe's efforts to promote a culture of lifelong learning similarly fall short of what is required. According to Eurostat survey evidence,⁵ just 8.5 per cent of workers aged 25 to 64 in the existing Union received training in 2002, little higher than the 8.2 per cent recorded in 1999. Moreover, there is considerable variation between Member States. Commission data for 2002 suggests that employees in the UK are most likely to participate in training – 22 per cent having done so – while in other Member States the proportion falls to as little as 1-3 per cent. In the new Member States, an average of 5 per cent of workers engaged in education or training in 2002.

MEETING THE LISBON CHALLENGE

3.20 The evidence presented in the previous section makes clear that this is a critical time for European labour market reform. Employment rates remain low in comparison with Europe's major international competitors and with the stretching targets established at the Lisbon and Stockholm European Councils. As the Employment Task Force concluded in its recent report: *"Unless the Member States step up their efforts, it is looking increasingly unlikely that the overarching goal for 2010, and the employment objectives, will be attainable."*

Labour market flexibility

3.21 Labour market flexibility is the key to ensuring faster progress towards the Lisbon goals. Flexible labour markets adjust quickly and efficiently to changes in economic conditions, such as those arising from globalisation or the enlargement of the European Union. In doing so, they ensure that high levels of employment and low levels of unemployment are maintained. Supported by policies that equip people to adapt to change and support those not in employment, they are central to delivering an economy that is both more productive and competitive and which enjoys high levels of social inclusion. The characteristics of flexible labour markets are that:

- wages can adjust to maintain balance between labour demand and supply;
- the labour force is equipped with transferable skills;
- firms do not find it too costly to create or vary jobs when they need to;
- workers are able to move easily to take up jobs in different areas;
- working patterns meet the needs of both employers and employees; and
- the institutional environment is supportive of each of these characteristics.

Priorities 3.22 As Europe approaches the halfway point in the Lisbon process, the Member States must revitalise their commitment to reform and to the flexible labour markets needed to advance fairness and the Lisbon goals. Though the precise methods chosen may differ, the challenge remains one for all Member States – Europe will not achieve its goals unless each country takes action to raise employment among all groups in society. Moreover, the objectives of reform are common to all. These are:

- the establishment of a regulatory environment that encourages job creation, and removes barriers to higher employment and activity rates;
- the setting in place of strategies, policies and services which move people from welfare to work, and ensure that work pays; and
- support for the creation of a skilled and adaptable workforce.

⁵ Data records the percentage of the population aged 25 to 64 participating in education and training over the four weeks prior to the survey.

3.23 These priorities are consistent with the four key requirements identified by the Employment Taskforce, namely that Europe should take steps to increase the adaptability of workers and enterprises; attract more people to the labour market; invest more, and more effectively, in human capital; and ensure the effective implementation of reforms through better governance.

The regulatory environment

3.24 The regulatory environment is key to the operation of Europe's labour markets. **Member States and the Community must therefore work together to ensure that regulation designed to protect workers does not inadvertently destroy jobs.** As the Employment Taskforce concluded *“the creation of new businesses must be fostered and job creation maximised by reducing administrative and regulatory obstacles.”* The joint initiative of the next 4 EU Presidencies, including the UK, to promote regulatory reform is described in the next chapter.

3.25 Minimum standards in the workplace, that are sensitive to business conditions, are essential in a modern labour market, helping to boost commitment and productivity while protecting workers against unfair treatment. The UK supports the comprehensive framework of decent minimum standards the EU has developed to safeguard the core rights of employees. However, given the *acquis* that now exists at the national and the EU level, new proposals for legislation must be rigorously assessed.

3.26 Poorly designed regulation can introduce damaging inflexibilities into labour markets, particularly if it:

- unduly constrains employers' ability to organise working practices that respond effectively to changes in economic circumstances. This may encourage the substitution of capital for labour, reducing the level of employment; and
- increases the risks to firms of hiring new or inexperienced staff, and thereby contributing directly to unemployment.

3.27 Much employment protection developed when unemployment was low and when industrial structures were very different from today. Traditional heavy industries have declined, while the service sector has grown rapidly and is now the main source of employment. New competitive challenges from outside the EU, higher consumer expectations and rapid technological development are increasing the pressure on firms to react quickly to change. Economies that cannot switch resources to new areas of growth will stagnate. Restructuring is a necessary response to changing economic conditions and employment levels will be damaged if companies cannot adapt quickly.

Flexible working 3.28 Patterns of work, and in some cases the nature of work, are changing radically. More people want to work flexible hours in order to combine work with family responsibilities, or to avoid a cliff-edge into retirement. Employment growth in the EU is strongly influenced by the ability of businesses to organise work in flexible patterns and for people to work at the time and for the hours that they want. The 2002 Joint Report on Increasing Labour Market Participation and Promoting Active Ageing observed a *“massive demand for part-time work among women returnees”* and went on to note that *“increased flexibility of employment, as measured by the availability of flexible working arrangements such as homework or tele-work, would generally increase both older people's labour force participation and retirement age”*. The problem therefore is not one of demand for part-time and flexible work, but one of supply.

3.29 Europe must ensure that the opportunities for expanding employment through more flexible working are not constrained by out-of-date legislation which places unnecessary burdens on business. The challenge is to encourage the growth of part-time working opportunities. Regulation to make flexible working more attractive to workers could, if poorly targeted, have the opposite effect, adding to employers' costs.

Women and young people

3.30 While there is little evidence that overall job turnover, or employment rates, particularly among prime age males, are influenced by employment protection laws, strict employment laws can be strongly associated with lower employment rates for women and young people.⁶ As the Employment Taskforce concluded: *“Employers must be able to adapt the size of their workforces by interrupting contracts without excessive delays or costs when other measures, such as working time flexibility or re-training of workers, have reached their limits. Overly protective terms and conditions under standard employment contracts can deter employers from hiring in economic upturns or encourage them to resort to other forms of contracts, which can have a negative impact on the ability of less advantaged workers – notably young people, women and the long-term unemployed – to access jobs.”* The Taskforce therefore suggested that Member States should assess and where necessary alter the level of flexibility provided in standard contracts in areas such as periods of notice and costs and procedures for individual or collective dismissals.

Box 3.2: A principled approach to labour market intervention

Policy intervention, at both Community and Member State level, must avoid distorting labour market decisions and harming employment levels. This means:

- **intervention only where there is a recognised and significant problem requiring a government response;**
- **full consideration of policy alternatives, to keep distortions and regulatory burdens to a minimum;**
- **assessment of the consequences for small firms in particular, and consideration of small firms' exemption where appropriate;**
- **testing for the impact on labour flexibility and employment opportunities, especially among disadvantaged or vulnerable groups;**
- **testing for the impact on productivity and growth;**
- **intervention will be subject to cost-benefit analysis and, for regulation, Regulatory Impact Assessment and proper consultation;**
- **information and support for firms and flexibility in implementation timetables, to allow for fully adequate consultation by Member States before implementation; and**
- **where EU regulation might affect competitiveness, evaluation by the Competitiveness Council prior to a decision being taken.**

⁶ *Employment patterns in OECD countries*, Nickell and Nunziata.

Support and incentives for the unemployed and inactive

Active labour market policies **3.31** One of the most important achievements of the European Employment Strategy has been to encourage Member States to establish comprehensive and effective measures to help unemployed people find and retain jobs. **Active labour market policies have an essential role to play, though they can be expensive and need to be well targeted.** Several examples of good practice can be seen in the Union of today:

- in the Netherlands, Centres for Work and Income provide a single gateway for benefit administration and labour market reintegration, providing advice on benefit entitlements and job search activities;
- in Ireland, the FÁS (Foras Áiseanna Saothair) provides a range of services to help people find work, and, alongside a back-to-work scheme, improves incentives for people to return to work by allowing them to keep some or all of their benefit entitlement for up to three years;
- in Sweden, the award-winning e-Government Labour Market Administration uses active job search to match people and vacancies and provides advice and training to improve employability; and
- in the UK, the New Deal for young people offers intensive support for the long-term unemployed aged between 18 and 24, and has helped more than 460,000 jobseekers into work since its launch in 1998.

Employment opportunity for disabled people **3.32** A particular challenge is to address the low level of labour market participation among disabled people – on average, employment rates among disabled people in the EU are around 60 per cent of those for non-disabled people. In the UK and internationally there is much less experience in the field of helping those with health conditions or disabilities than there is in helping many other disadvantaged groups. Indeed, as the OECD has recently noted: *“no single country ... can be said to have a particularly successful policy for disabled people”*.⁷

3.33 To improve the labour market position of disabled people, the OECD makes a number of recommendations, including that work and benefit packages should be individually designed and include rehabilitation, vocational training and work experience; early intervention is needed to guard against long-term benefit dependency; claimants should be required to participate in work-focussed activities in return for benefits; benefit systems should be restructured to remove disincentives to work; and employers should be involved in the process. A number of Member States have already developed strategies that are consistent with these recommendations – for example, in Denmark, Austria and Sweden, claimants of disability benefits are required to participate in vocational rehabilitation schemes. Moreover, in the UK, Pathways to Work pilots are testing new forms of tailored and intensive support for recipients of incapacity-related benefits, including additional work-focused interviews, rehabilitation programmes, improved financial incentives, and the involvement of a wider group of stakeholders such as employers and General Practitioners. The Government believes that **Member States should continue to work together to share experience about what works best in helping disabled people into work.**

⁷ *Transforming disability into ability*, OECD, 2003.

Making work pay 3.34 Active labour market policies are likely to be more effective when part of a wider strategy for making work pay. **Member States therefore need to ensure that their welfare systems, which support the unemployed and inactive, work with, and not against, their active employment policies.** Flexibility and fairness in the labour market requires work incentives that make it worthwhile for people to participate. In many Member States it does not pay to take a job, either because the welfare system undermines work incentives or because there is very little link to associated responsibilities – a life on benefit should not be an option for those who can work.

3.35 Measures to ensure that tax and benefit systems combine to make work more financially attractive than welfare are key. As the Employment Taskforce concluded: *“To ensure that people enter the labour market, Member States must seek to end unemployment, inactivity and low pay traps by adjusting the balance between taxes and benefits, focusing on the low paid.”* The UK approach to making work pay is described in Box 3.3. Many other Member States have taken similar steps. For example:

- most Member States have a statutory minimum wage, or collective agreement which effectively provides for one;
- in the Netherlands and France, tax credits are improving work incentives for people in low paid employment;
- in Austria, the Pact for Older People provides financial incentives for part-time work and training;
- in Belgium, people returning to work from early retirement are permitted to retain supplementary benefits;
- in Germany, the Agenda 2010 programme includes measures to reduce unemployment traps, while Job-AQTIV introduces greater conditionality to the benefit system; and
- in Ireland, a minimum wage, reductions in income tax, and family income support all seek to improve work incentives for the low paid.

Box 3.3: Making work pay in the UK

UK policy to make work pay is underpinned by a National Minimum Wage. The level of the minimum wage is set on the basis of a recommendation by an independent commission, involving employers, employees and academics, to ensure that it does not harm employment prospects. In combination with this, tax and benefit reform has played a key role in improving work incentives, through:

- the introduction of a 10 per cent starting rate of income tax;
- reforms to national insurance contributions (NICs) to remove the unfair “entry fee” and raise the point at which employees start paying NICs, while leaving entitlement to contributory benefits protected;
- a Working Tax Credit, which provides in-work support to those on low incomes, and incorporates both a return to work element for the over 50s and an element to provide assistance with the costs of childcare; and
- a Child Tax Credit, which provides financial support to families, gives parents greater choice over how to structure work and caring responsibilities, and facilitates the take-up of flexible forms of working.

The UK’s reforms are designed to advance flexibility and fairness together, providing people with incentives to adapt to change while tackling the insecurities that surround it. The National Minimum Wage and the Child and Working Tax Credits guarantee a minimum income from work, helping to tackle the unemployment trap and ensuring that work pays more than benefits. The interaction of the minimum wage and the tax credit system also helps the labour market respond more flexibly to shocks, while preserving a degree of stability in workers’ incomes. As a result of these reforms, the number of low income households now facing marginal deduction rates in excess of 70 per cent fell from 750,000 in 1997 to 185,000 in 2003-04, improving fairness and extending employment

3.36 The need to combine active labour market policies with reforms to make work pay is key to raising the employment rates of vulnerable groups, and especially those of women and lone parents. In the UK, the New Deal for lone parents provides tailored information and advice on job-search activities while support provided through the Child and Working Tax Credits, including to meet the costs of childcare provision, improves work incentives and allows parents to adopt flexible working arrangements without losing out financially. As recognised by the Barcelona European Council of March 2002, access to good quality and affordable childcare is particularly important in raising female employment rates, and further action is needed in many Member States to ensure that childcare is available for 90 per cent of pre-school children aged three and over, and for one third of those under three, by 2010. While some Member States, notably the Nordic countries, perform well against this target, many more remain adrift. Recent reforms, including the introduction in Spain of a new childcare allowance for working women with children under three, and additional investment in the UK to increase the supply of childcare places and provide assistance with the costs of childcare, are an important step in the right direction.

Creating a skilled and adaptable workforce

3.37 A dynamic economy is built on skills. Skilled workers adapt faster and more effectively to change. Those who become unemployed are often able to return to employment more rapidly, promoting employment, productivity and social inclusion. As the report of the Employment Taskforce states: *“Too many people do not enter the labour market because of a lack of skills, or due to skills mismatches ... Workers, if they are to remain and progress in work, need to accumulate and renew skills regularly.”*

3.38 Member States need to ensure that employers have the skilled labour they need to support business success and that individuals have the skills they need to remain employable. Action is needed on both the demand and supply side. Education and training systems must become more responsive to the needs of employers and learners. Employers must ensure that current workforce skills are deployed effectively and that opportunities for workplace training are available. Individuals need encouragement to seek out lifelong learning opportunities, and support to overcome the financial barriers involved. The costs of training and skills development must be shared between government, employers and individuals.

3.39 In seeking to promote the concept of a learning society, Europe must also pay particular attention to workplace training, which will ensure a closer link between the skills provided and the requirements of the labour market. Many Member States have already recognised the importance of action in this area and have begun to implement important reforms. For example:

- in Austria, employers receive a tax credit allowing them to deduct 120 per cent of training costs from profits as an operating cost;
- in the Netherlands, a new tax incentive is encouraging firms to train previously unemployed people; and
- in the UK, Employer Training Pilots offer a package of support to improve access to workplace training among the low skilled, with employers who offer their staff paid time-off to train receiving compensation for wage costs.

3.40 Finally, Member States must encourage the use of innovative and flexible ways of delivering effective and appropriate training, which harness the potential of new technologies to ensure that training opportunities are accessible to everyone, including older workers, disabled people and other disadvantaged groups. Distance learning, e-learning, and community and family-based learning can be a more suitable route for some individuals to update their skills.

THE WAY AHEAD

3.41 The diversity of national labour markets means that there is no single blueprint for success. Different countries will need to pursue different approaches which reflect the underlying strengths and weaknesses in their labour markets, as well as their own cultures, traditions and institutions. Europe does not face a hard choice between liberalisation and regulation. The reality is that a Europe composed of a variety of models must find its own route towards flexible labour markets, with employment opportunity for all a central driver of social justice. The right policy mix for one Member State may not be appropriate for another.

The open method of coordination

3.42 The open method of coordination, and the European Employment Strategy, offer the best route to success. With shared objectives defined at the European level, and national policies tailored to suit national circumstances, the Employment Strategy has, over the past six years, proved an important vehicle for monitoring and evaluating reform through a systematic process of peer review and the exchange of best practice. Following the recommendations of the Employment Taskforce, the newly revised and streamlined Strategy should have job creation as its highest priority.

The Employment Taskforce: pledging to deliver 3.43 The report of the Employment Taskforce provides an important opportunity for Member States to demonstrate a high level of political commitment to reform. The strong recommendations for action delivered to each Member State must be matched by an equally strong commitment to act and to reinvigorate national employment strategies. The Government believes that the best guarantee of effective follow up is provided by the continued and direct involvement of the spring European Council. It believes that **the forthcoming European Council in March 2004 should launch a series of national pledges and commitments to take action to implement the further reforms necessary to increase the flexibility of Europe's labour markets, on the basis of the specific messages set out in the Taskforce report.** This does not demand the invention of new processes. Rather, the existing European Employment Strategy can be used to ensure effective follow up to the recommendations of the Taskforce, culminating in an appraisal of progress at the spring European Council in 2005.

Wider responsibility 3.44 More generally, at the Community level, Europe must ensure that the fulfilment of its wider responsibilities support Member States' national efforts to reform their labour markets. As described earlier in this chapter, this means ensuring that regulation designed to protect workers or to strengthen the Single Market does not inadvertently restrict job creation or prevent firms and individuals from adapting to change. It also requires the effective implementation and coordination of macroeconomic policy to deliver the stability which is a precondition of economic and social success.

4

DYNAMIC GROWTH: COMPETITION, REGULATION AND THE SINGLE MARKET

Flexible product markets are an essential feature of a modern, dynamic economy, providing a competitive environment which rewards efficiency and ensures that firms have strong incentives to deliver quality and choice to their consumers. The Single Market has made an important contribution to competition and flexibility in the European economy, delivering substantial benefits to EU businesses and consumers. The Lisbon strategy has taken this further, broadening and deepening the Single Market, by opening up markets that were previously subject to national monopolies or other constraints. But there is a need to go further if the Lisbon goals are to be realised. As Europe moves into the next phase of the Single Market, the challenge is to build on past successes with a new approach aimed at promoting dynamism and enhanced economic flexibility throughout the European Union. This requires:

- **a comprehensive programme of regulatory reform**, building on the joint initiative of the next 4 EU Presidencies, to promote flexibility and economic performance through better controls on the quality of new regulation, reforms to reduce the burden of existing legislation and active consideration of alternatives to regulation;
- **concrete action to open up markets**, such as that for energy, ensuring that agreements lead to genuine market opening and that deadlines are met;
- **action to extend to the Single Market to services** – the majority of the EU economy but just 20 per cent of intra-EU trade – to deliver wider benefits to EU consumers;
- **a more pro-active approach to competition policy**, so that markets which are not working properly can be investigated and addressed; and
- **further reform of the state aid guidelines**, to tackle the most distortive aids while ensuring that Member States have the flexibility to tackle market failures effectively.

INTRODUCTION

4.1 Flexible product markets are an essential feature of a modern, dynamic economy, providing a competitive environment which rewards efficiency, discourages waste and ensures that firms have strong incentives to deliver quality and choice to their consumers. In a flexible product market, barriers to market entry are low and the regulatory environment promotes efficiency without imposing unnecessary burdens on the economy. This chapter examines the contribution of the Single Market, and the tools used to ensure its effective operation – regulation, competition and state aid – to enhancing competition and flexibility in the European economy. Enterprise and innovation, two further important components of product market flexibility, are discussed in Chapter 5.

4.2 The Single Market is one of the great success stories of the European Union. In the ten years since its completion, the integration of European markets has delivered significant benefits to the European economy. The Commission's own analysis¹ suggests that, as a result of the Single Market:

- GDP has increased in Europe, with an annual contribution estimated at 1.8 percentage points, or €164.5 billion in 2002 alone;
- around 2.5 million jobs have been created since 1992; and
- extra prosperity to the value of around €875 billion has been created over ten years – equivalent to €5,700 per household.

4.3 These benefits have accrued for two principal reasons:

- by removing barriers to cross-border market entry, the Single Market has helped to increase competitive pressures within the EU economy. Competition is a key driver of productivity, flexibility and growth, creating incentives for innovation and helping to ensure that resources are reallocated swiftly towards relatively more productive firms; and
- a larger, and more integrated, Single Market has allowed for greater economies of scale and for a better allocation of resources – for instance, through making better use of capital.

4.4 The Lisbon strategy has sought to broaden and deepen the Single Market, opening up markets which have previously been subject to national monopolies or other constraints. Building on the achievements of the Single Market Programme, important progress has been made on a number of legislative dossiers, including:

- legislation to open up all European energy markets;
- a telecoms package to provide coordination and integration across the EU;
- an agreed roadmap for opening up postal service markets;
- significant progress in agreeing the legislative measures of the Financial Services Action Plan to integrate EU financial services markets;
- modernisation of the competition rules to create common standards across the Union and to provide for better coordinated enforcement; and
- agreement on revised merger rules based on simpler and more economically-grounded principles.

4.5 The impact of this progress is already beginning to be felt. But there is a need to go further if the Lisbon goals are to be realised. As Europe moves into the next phase of the Single Market, the challenge is to build on past successes, promoting dynamism and enhanced economic flexibility by:

- **taking concrete action to open up markets**, such as that for energy, ensuring that European agreements result in real market opening and that deadlines for change are met;
- **extending the Single Market to services** – the majority of the European economy – to deliver wider benefits to European consumers;
- **ensuring that the regulatory environment promotes flexibility** and improved economic performance. Well-targeted regulation has an important role, not just in preserving the integrity of the Single Market, but in correcting for wider market failures and in promoting fairness and opportunity for all. Poorly

¹ *The internal market – ten years without frontiers*, European Commission, 2003.

designed or inappropriate regulation on the other hand can inhibit the functioning of open markets, damaging flexibility and productivity; and

- **using a wider range of policy instruments**, such as strengthened competition policy and a reformed state aid regime, to ensure that the benefits of open markets are translated into improved economic performance.

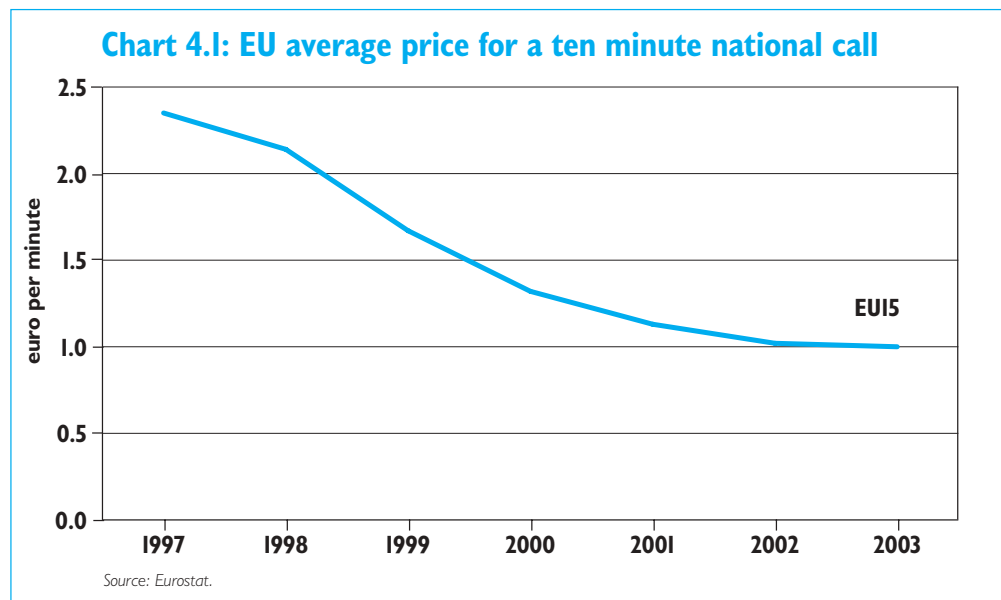
4.6 Improving the functioning of product markets, through stronger competition and regulatory reform, is likely to be of particular importance to the new Member States. Many of the new Member States have succeeded in delivering strong economic growth through reforms implemented during transition. However, to ensure that growth and productivity rewards are maintained, they will, like the existing Member States and the Union as a whole, need to take further steps to improve the dynamism and openness of their markets.

IMPROVING COMPETITION IN PARTICULAR MARKETS

4.7 Since the launch of the Lisbon strategy, significant emphasis has been placed on improving competition in particular markets. Important agreements have been reached to realise market opening in a number of markets and sectors, including financial services and network markets such as transport, energy, postal services and telecommunications. The challenge now is to turn these commitments into concrete action on the ground, and to extend the benefits of liberalisation to markets and sectors where no such agreements have yet been reached.

Progress to date

Communications 4.8 The communications sector stands as a good example of how liberalisation can provide better results for consumers through greater choice, lower prices and improvements in quality. Since 1 January 1998, national telecommunications markets have been open to competition, leading to an increase in the number of operators in EU markets and falling prices for consumers. As shown in Chart 4.1, since that time consumers have benefited from considerably lower prices. The prices charged by the old national monopolies for domestic calls have fallen, on average, by around 50 per cent, and those for international calls by around 40 per cent.



Postal services 4.9 Significant progress has also been made in liberalising the market for postal services. While the foundations for liberalisation in European postal services were established by the 1997 Postal Services Directive, since the launch of the Lisbon strategy further important steps have been taken to reduce thresholds for competition to:

- 100 grams, or three times the basic weight tariff, by 2003;
- 50 grams, or 2.5 times the basic weight tariff, by 2006; and
- zero by 2009, subject to further agreement by Member States following a review by the Commission of the impact on the universal service.

4.10 The Government is committed to the phased opening of postal markets as a spur to competition. Evidence suggests that in postal services, as elsewhere, effective competition can increase efficiency, productivity and innovation. In particular, research² commissioned by the UK postal services regulator, concludes that, in two countries where full liberalisation has taken place – Sweden and New Zealand – “*the introduction of liberalisation had a significant impact on efficiency... the experience of both countries so far is that the incumbents have managed to maintain a profitable operation with no deterioration in the quality of service.*” Under the market-opening programme of the postal services regulator, all restrictions on UK market entry will be removed by April 2007 – ahead of the timetable for market opening set out in EU agreements.

Energy 4.11 The energy sector makes an important contribution to the EU economy, accounting for 3-4 per cent of GDP and providing a key input to many other industries. In November 2002, Member States agreed a package of measures to deliver full market opening by 2007, legal separation of transmission and distribution from production and supply, non-discriminatory access to grid and pipeline infrastructure, and the establishment of independent regulatory bodies. These measures are essential to the proper functioning of the internal market and have the potential to bring significant benefits to consumers in terms of prices, efficiency, choice and levels of services.

4.12 The Government believes that full and timely implementation of this agreement is an essential part of the Lisbon strategy. It particularly welcomes the fact that several of the new Member States have, in advance of their joining the EU, already made steady progress in liberalising their energy markets.

Aviation 4.13 The Commission has also been consulting stakeholders with a view to revising the Third Package of legislation liberalising the air transport industry. The Government welcomes the review as an opportunity for further deregulation of the European single aviation market, increasing competition and reducing government intervention. The Commission is also currently analysing options for introducing market-based systems for the allocation of airport slots. The Government hopes that this will lead to the introduction of a transparent slot market in the near future. This would yield significant benefits for consumers by encouraging competition and greater efficiency in the use of scarce and extremely valuable airport capacity.

Financial services 4.14 The Financial Services Action Plan (FSAP), adopted by the European Commission in May 1999, is a package of policy objectives and specific measures designed to improve the Single Market for financial services. It focuses on the delivery of three strategic objectives: a single market for wholesale financial services; open and secure retail markets; and state-of-the-art prudential rules and supervision. The Government is convinced that financial services integration, pursued as part of a wider strategy of economic reform, holds huge potential, hence its firm support for the objectives of the FSAP and its efforts to work closely with stakeholders to secure economically beneficial outcomes³. It welcomes the significant progress

² *The impact of liberalisation on efficiency: a survey*, Frontier Economics, 2002.

³ A recent report by London Economics for the European Commission calculated that the creation of a single EU financial services market would, by itself, reduce the real cost of capital by 50 basis points for EU businesses, and result in a one-off 1.1 per cent increase in GDP over ten years for the EU as a whole.

that has been made in implementing the FSAP – with 36 of 42 measures now adopted – and attaches high priority to the completion of outstanding measures, provided this does not entail rushing through inadequate or ill designed legislation. Box 4.2, later in this chapter, sets out the Government's future priorities in the area of financial services, once legislation under the FSAP is completed.

Box 4.1: Corporate governance

The EU Action Plan on Company Law and Corporate Governance was published by the European Commission on 21 May 2003. It contains 24 specific proposals across the full range of company law and corporate governance issues, with varying degrees of priority. The Action Plan is intended to be completed over approximately ten years. The Plan – particularly the corporate governance elements – is partly a response to the Enron crisis but is also the result of a longer-term initiative started by the Commission in September 2001 when it appointed the High Level Group of Company Law Experts to examine ways of improving and modernising EU Company Law.

The Plan's approach to corporate governance shares common elements with that taken in the UK, particularly where it adopts a non-prescriptive or voluntary approach. It includes measures to enhance disclosure of corporate governance arrangements, facilitate cross-border shareholder participation by improving communications and the opportunity to take part in meetings and vote, foster an appropriate regime for directors' remuneration and strengthen the role of independent directors. Looking further ahead, the Plan contemplates increasing disclosure of institutional shareholder voting records, and calls for a European corporate governance forum to coordinate the efforts of Member States - for example, by sharing best practice and encouraging convergence. The Government believes that the Plan should assist integration in financial markets by enhancing investor confidence, but believes that implementation should not be overly prescriptive, so that national markets retain flexibility.

Improving competition in EU procurement

4.15 Public authorities can have a significant impact on many markets through their procurement decisions. The public procurement market accounts for some 16 per cent of EU GDP. Effective competition in public procurement is therefore essential to the proper functioning of the Single Market, and the rules governing procurement must be implemented properly. The Government strongly supports fair and open procurement markets and welcomes the revised European procurement rules. To help ensure that these rules are translated into practice, it has **initiated an independent review of public procurement practices in the EU, headed by Alan Wood of Siemens plc**. The review, which is expected to report in summer 2004, will recommend areas for raising capabilities, spreading best practice, and tackling non-compliance to make procurement markets more effective across the Union. The Government also expects the review to identify issues that UK firms should be aware of in seeking to improve their ability to compete effectively for public procurement contracts in Europe.

Extending the Single Market to services

4.16 In contrast to the Single Market for manufactured goods, that for services has seen little obvious change in the last ten years. The services sector covers a wide range of diverse markets, such as retailing, legal services, construction, hotels and management consultancy. While services account for the majority of the European economy, they constitute only twenty per cent of intra-EU trade.

4.17 Extending the Single Market to services has the potential to deliver significant economic benefits to Europe and its citizens, helping to achieve the Lisbon goals:

- Commission analysis at the time of the Single Market Project⁴ provided estimates of the static benefits of liberalisation for the EU in several service sectors – as much as €3.5 billion per year in business services alone⁷. A genuinely integrated single market for services therefore has the potential to contribute billions of euro to EU prosperity; and
- increased competition is likely to lead to dynamic gains through greater efficiency and innovation. Many analysts⁵ attribute much of the superior recent productivity performance of the US to higher levels of innovation in a few sectors, including services sectors such as retail and wholesale. Tackling barriers to competition in services could therefore be an important step towards helping the EU economy to match the dynamism that has characterised recent US economic performance.

4.18 In January 2004, the Commission published proposals for a directive on services in the internal market⁶. The proposals are designed to liberalise substantially the market for trade in services by simplifying the administrative requirements on service providers and dismantling the range of barriers to cross-border service provision. They are based around:

- administrative simplification – with Member States committed to remove regulatory barriers to the establishment of service providers incompatible with the Single Market by 2007 on the basis of principles including non-discrimination and proportionality;
- the country of origin principle – that the cross-border provision of services should be regulated by the home state of the provider, not the customer; and
- improved administrative cooperation to underpin cooperation between Member States.

4.19 **The Government strongly supports the market opening aim of the Commission's proposals and shares its objective to see the Internal Market become a reality for services as well as goods.** It looks forward to working closely with the Commission and other Member States to this end.

REGULATORY REFORM

4.20 From an economic perspective, regulation can be useful for pursuing both greater efficiency and equity. The regulatory framework can correct for market failures and improve economic performance – for instance, through dealing with monopolies that can arise through economies of scale. Regulation can also structure the operation of markets to achieve greater fairness – for example, by protecting the health and safety of workers. However, disproportionate or poorly designed regulation can also have a serious negative impact on economic performance, stifling firms' ability to operate and innovate and preventing resources from being moved efficiently and flexibly to where they can be used most productively.

4.21 A sub-optimal regulatory framework can impede economic activity through three main routes. Each of these, by placing compliance costs on firms and individuals, imposes a deadweight loss and can produce barriers to entry which reduce competition. These costs are shaped by the absolute level or strictness of regulation, by unnecessary complexity in the

⁴ *The economics of 1992*, European Economy no.35, European Commission, 1988.

⁵ See, for example, *Productivity in the United States*, McKinsey Global Institute, 2001.

⁶ *Proposal for a directive of the European Parliament and of the Council on services in the internal market*, Brussels, 2004.

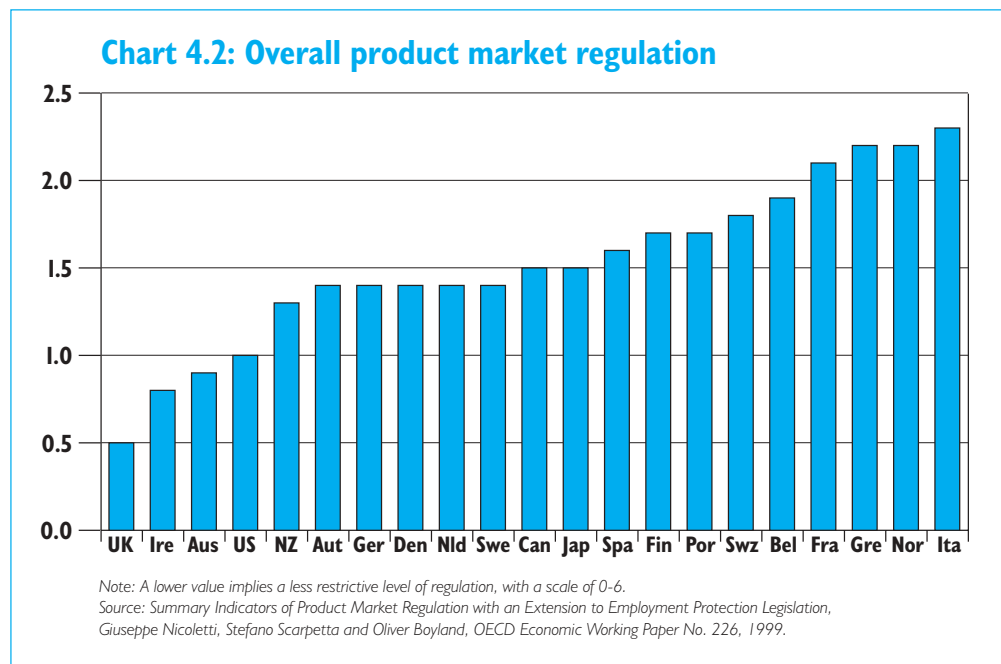
⁷ Subsequent growth in the sector would be likely to make these benefits significantly greater today.

rules or in the processes followed to enforce them, or by instability or frequent change in the framework that requires firms and individuals to bear one-off costs associated with adapting to a new system.

4.22 Empirical evidence supports this approach. For example, an OECD summary of the economic literature⁸ found that:

- reform of product market regulation has a significant and positive effect on levels and growth in GDP, while inappropriately strict regulation inhibits growth; and
- product market reforms have a positive effect or neutral effect on employment when labour market regulation is kept constant.

4.23 More recent work by the OECD⁹ and by the IMF¹⁰ has assessed the regulatory framework in Europe. Both conclude that the current regulatory arrangements are inhibiting the performance of EU economies. The IMF, in particular, conclude that improvements in the EU regulatory framework could deliver a 7 per cent increase in EU GDP and a 3 per cent increase in productivity in the longer term. Alongside this, the Commission recently concluded that regulation is one of the principal factors preventing Europe from achieving the Lisbon goal¹¹, and that “a favourable regulatory environment is... essential if competitiveness is to increase.”¹² As shown in Chart 4.2, levels of product market regulation vary in Europe and in other major economies, but most EU countries are more heavily regulated than the US.



4.24 For many years, European regulation, to establish the Single Market and to achieve other important goals such as employment protection and environmental sustainability, has delivered important benefits for businesses and consumers. But the economic evidence increasingly points to a range of unintended consequences flowing from the regulatory

⁸ The implementation and the effects of regulatory reform: Past experience and current issues, Göneng, Maher and Nicoletti, 2001.

⁹ The sources of growth in OECD countries, OECD, 2003.

¹⁰ When leaner isn't meaner: Measuring benefits and spillovers of greater competition in Europe, IMF, 2003.

¹¹ The EU economy: 2003 review, European Commission.

¹² Delivering Lisbon: reforms for the enlarged Union, Report from the Commission to the spring European Council, January 2004.

approach – consequences which have the potential to set back Europe’s economic performance over the longer term and to damage its ability to compete effectively in the modern global economy. **The Government therefore believes that further action is needed to review and reform the regulatory framework in Europe, with action at both Member State and Community levels.** As the October 2003 European Council concluded: “*EU legislation should not be a handicap to EU competitiveness compared with that of other major economic areas ... more effective regulation ... is of the utmost importance*”.

The Better Regulation Action Plan 4.25 In 2002, the European Commission published a Better Regulation Action Plan¹³ designed to deliver faster progress towards a new approach to European regulation. This Action Plan contained three main strands:

- a system of impact assessments, with extended assessments for all significant proposals setting out the consequences for the economy, for social cohesion and for the environment;
- a minimum consultation period of eight weeks; and
- commitment to simplify existing legislation, by looking to remove unused or outdated laws and to remove unnecessary complexity.

Going further 4.26 The Government strongly welcomes the provisions in the Action Plan and looks forward to their full and effective implementation over time. It recognises the progress that has already been made in this area, including the publication of a number of regulatory impact assessments and the conclusion of an inter-institutional agreement on better lawmaking. Nonetheless, it considers that, in several areas, there is an urgent need to go further and to prioritise progress in regulatory reform. To this end, **the Finance Ministers of Ireland, the Netherlands, Luxembourg and the UK – the next four EU Presidencies – have agreed a joint plan of action to boost regulatory reform in Europe, building on existing work to implement the Better Regulation Action Plan**¹⁴. If the Union is to make rapid progress towards achieving the Lisbon goals, action must be taken to:

- review, simplify and improve the regulatory framework already in place;
- improve further the quality of new regulation, with strengthened tests to ensure that new proposals do not adversely affect Europe’s ability to compete in global markets; and
- give greater consideration to the use of alternative policy instruments.

Simplifying the regulatory framework

4.27 While the proposals in the Better Regulation Action Plan for simplifying the regulatory burden are an important step in the right direction, **further action is needed to deliver genuine improvements in the stock of regulation.** This requires:

- **a targeted process to simplify EU regulation during 2004 and 2005**, including in the environmental and social areas. The Government believes that the Council and the Commission should establish a timetable for such a process, which should focus on those areas in which the impact on business and competitiveness is greatest;

¹³ Building on the final report of the “Mandelkern” Group: *Final Report*, Mandelkern Group on Better Regulation, November 2001.

¹⁴ *Joint initiative on regulatory reform*, letter to ECOFIN, available at <http://www.hm-treasury.gov.uk/>

- that Member States provide examples of legislation that their companies find particularly burdensome in order that the Commission may consider these issues in its simplification programme; and
- implementation of the inter-institutional agreement on better lawmaking, including agreement by the Council and the European Parliament to modify their working methods with a view to introducing ad hoc structures with the specific task of simplifying legislation.

4.28 As part of the UK's contribution to this effort, the Better Regulation Task Force is working to identify an area of European legislation to investigate further.

Improving the quality of new regulation

Regulatory Impact Assessments **4.29** The Commission's Better Regulation Action Plan introduced a new system of regulatory impact assessments at the European level, designed to ensure that new proposals for legislation are carefully assessed for their economic, environmental and social impacts. Alongside this, proposals are now subject to a minimum consultation requirement of eight weeks, and extended impact assessments must be completed for all new proposals judged likely to have a significant impact before a proposal is accepted by the Commission and put forward to the Council and the Parliament.

Next steps **4.30** The Government welcomes these steps, which go some way towards replicating the UK's domestic approach to regulatory reform. However, it believes that further action is needed to support this process, at both the Community and Member State level.

4.31 While all Member States endorsed the principle of impact assessment in approving the EU's inter-institutional agreement on better regulation, progress towards introducing national systems varies between Member States. Though some have already introduced systems of impact assessment, others have yet to do so. The Government urges greater progress in this area and believes that **all Member States should commit to ongoing national regulatory reform initiatives, including the introduction of effective systems for impact assessment, building on the best practice available across Europe.**

4.32 The Government also believes that further action is needed to enhance the credibility of impact assessment at the European level. To this end:

- **the Council should agree which Commission proposals should be subject to an extended impact assessment each year.** More formal quality control should also be exercised over extended impact assessments in advance of their publication by the Commission;
- **impact assessments should be used to competitiveness-proof** all Commission proposals for their impact on the EU economy;
- **greater use should be made of imaginative approaches to regulation.** For example, the use of mutual recognition can, in many areas, allow for greater progress in delivering shared objectives; and
- **the Commission should make greater use of review clauses in legislation,** to provide triggers for evaluating the impact of regulation over time.

Alternatives to regulation

4.33 The most effective interventions, at Member State or Community level, will be made where the full range of possibilities has been considered, including different forms of regulation and the many non-regulatory routes through which policy objectives can be delivered. **The Government believes that active consideration should be given to the use of alternatives to regulation wherever possible.** Such alternatives include:

- strengthening and aligning the incentives for economic actors to act in accordance with the public good – for instance, through introducing systems of tradable permits for pollution, or, as described below, the pro-active use of competition policy or the effective operation of the state aid rules;
- self-regulation or co-regulation, which allows those nearest to particular problems to assess the most effective and efficient solutions;
- information provision – either by public authorities or by participants in the market – especially to ensure that consumers can make active choices; or
- at the European level, structures for mutual recognition and cooperation, including the open method of coordination.

Box 4.2: Looking beyond the Financial Services Action Plan

As described earlier in this chapter, the Financial Services Action Plan sets out 42 measures to complete an integrated European market. Substantial progress has been made, with 36 of these measures now agreed. Looking forward:

- as the process of implementation and enforcement gathers pace, the Government is keen to see the Commission progress its work on “indicators of success” and to develop a more quantitative assessment of the costs and benefits of the FSAP. This should help to reveal specific market failures – for example, caused by barriers to new entrants – to be tackled as a priority. Where Community action is necessary, the Commission should use all the policy tools at its disposal and avoid legislation wherever possible;
- the Commission should make more pro-active use of its competition powers to investigate and intervene in financial services markets that appear uncompetitive – for example, those that visibly lack intra-market rivalry or show direct evidence of weak competition;
- the consistency of Member States’ implementation of EC legislation should be improved. It is therefore important that the Lamfalussy¹ level 2 and 3 committees work well;
- Codes of Conduct should be encouraged, be they industry codes, guidance notes, self-regulation, ethical professional standards, industry investment in infrastructure solutions, commercial services or dissemination of information on a pan-European basis. Such an approach should help to minimise the regulatory burden on the financial services industry; and
- other non-legislative options should be considered, including alternative dispute resolution procedures and cross-border ombudsman schemes – for example, FIN-NET.

¹ The “Lamfalussy” arrangements establish a new institutional framework for the regulation of EU financial services, which distinguishes between core principles and practical implementing measures, thus fostering a faster and more flexible system. It is based on a four-level approach: legislative acts (level 1); detailed technical implementing measures (level 2 committees); measures to improve the common implementation of legislation in the Member States (level 3 committees); better enforcement of EU law (level 4).

Institutional leadership and support

4.34 These steps – simplification of existing regulation, improvements in the quality of new regulatory proposals, and the use of alternatives to regulation – provide a clear framework for concerted action and have the potential to deliver important gains to the European economy. **The Government intends to work closely with its European partners to give renewed impetus to regulatory reform**, and looks forward to strong institutional leadership and support for this process. To ensure that progress can be effectively monitored and that momentum is maintained, it believes that:

- **the Commission should propose indicators to measure regulatory quality** and reform, at the European and Member State level, and in consultation with the Council, for activation through the open method of coordination and for application in impact assessments;
- **an EU Better Regulation Working Group should be established** to support implementation of the Better Regulation Action Plan and work by the Commission to improve further the quality of extended impact assessments;
- **Member States should continue to work together** to promote and monitor progress and to share experience and best practice. In this context, the Government welcomes the commitments given by the Irish EU Presidency and by the forthcoming Dutch Presidency to convene conferences on the theme of better regulation; and
- **the Commission should identify future priorities and actions** in relation to better regulation in its 2004 Annual Report, and review progress to date. This should include updated targets as appropriate, and contribute to the mid-term review of the Lisbon strategy in 2005.

COMPETITION POLICY AND STATE AID

4.35 Alongside initiatives in specific markets and sectors, significant reforms have also been introduced to the wider framework for the Single Market, particularly in the areas of competition policy and the control of state aid.

4.36 Competition policy and the state aid rules have a crucial role to play in delivering the benefits which should, in principle, follow from opening up markets to greater competition and integration. Since liberalisation is intended to deliver improved performance principally through increased competition, it is essential to ensure that impediments to competition are effectively tackled. Competition and state aid policy can also provide an alternative to regulation – helping to promote competition across the Single Market without the need for harmonising standards or potentially burdensome legislation.

Competition policy

4.37 Improving competition in European markets is a key objective of the Single Market and an essential driver of the productivity gains needed to achieve the Lisbon goals. Competition policy can help to enforce the key tenets of the Single Market framework, levelling the playing field for trade across borders and providing a focus for Community action which avoids the potential pitfalls of regulatory solutions.

4.38 The Commission and national competition authorities work together to enforce competition law across Europe. As Table 4.1 illustrates, evidence suggests that the overall European regime is rated highly, and behind only those in the United States, the UK and Germany. The evidence also points to significant variation in the performance assessment of national competition authorities, including within Europe.

Table 4.1: Global Competition Review rankings of competition authorities

Peer review points	Authority
4.5	US
4.25	UK, Germany
4	European Union , Australia, New Zealand
3.75	Canada, France, Italy, Japan, Netherlands, Sweden
3.5	Denmark, Finland, Ireland, Spain
3	Korea, Norway, Switzerland
2.75	Israel, South Africa
2.5	Austria
2.25	Brazil, Mexico
2	Greece
1.5	Argentina

Source: Global Competition Review.

Recent reforms **4.39** In recent years, a number of important steps have been taken to modernise the EU competition policy framework. The Government welcomes these steps, and, in particular, the modernisation of antitrust rules, which has:

- improved the role of national competition authorities in enforcing European law, enhancing overall capacity, levelling-up standards across the single market, and positioning the Commission to take a more strategic role; and
- abolished the burdensome arrangements for notification of agreements.

4.40 Following this package of reform, a revised EU merger regulation was also agreed in December 2003. This introduces further improvements to the merger regime, changing the test which mergers must pass to one based on the concept of a “*significant impediment to effective competition*”. This moves the EU system closer to that operated in the UK and the US. The Government greatly welcomes this development and believes it provides a simpler and more economically grounded basis for assessment.

Investigating markets **4.41** As new markets are opened, and as technology develops new industries and sectors, the role of competition policy becomes increasingly important in delivering a productive and dynamic economy. While competition authorities will always have an important role in responding to individual cases, **they should also have a remit to pro-actively review and assess the functioning of particular markets, so that interventions can be targeted more effectively at driving up competition.** As European leaders agreed in March 2003: “*markets which are not working must be investigated and effectively addressed*”.

4.42 The Commission’s powers under the Treaty and under European antitrust laws allow for such a role, looking across markets to identify the full range of market failures which may lead to inhibited, weak or distorted competition. In the last six months, the Commission has taken a number of important steps towards developing its role in this area:

- examining the market for liberal professional services in the EU. The Government believes that the removal of unnecessary barriers to competition is as essential in these markets as elsewhere, to provide consumers with the

benefits of choice, lower prices, and the potential for increased quality. It welcomes the Commission's use of competition policy tools to address the long-running issues in this market and hopes that the investigation can form the basis for more work of this type in the future;

- launching a formal inquiry into the sale of sports rights to Internet and third-generation mobile telephone operators – the first time that the Commission have used their formal market investigation powers in a number of years. The Government supports this approach, which it believes can play an important role in a pro-active and strategic competition regime; and
- setting in train work to examine indicators of competition, which will help to identify those markets where competition is inhibited or restricted and where further investigation might be merited.

4.43 The Government strongly supports the Commission's ongoing work to develop a more pro-active role for competition policy, with market investigations an important tool. It looks forward to the further development of this important work, and believes that **the Commission should be able to build on the results of its work on indicators of competition to set out a framework for investigating markets.**

State aid policy

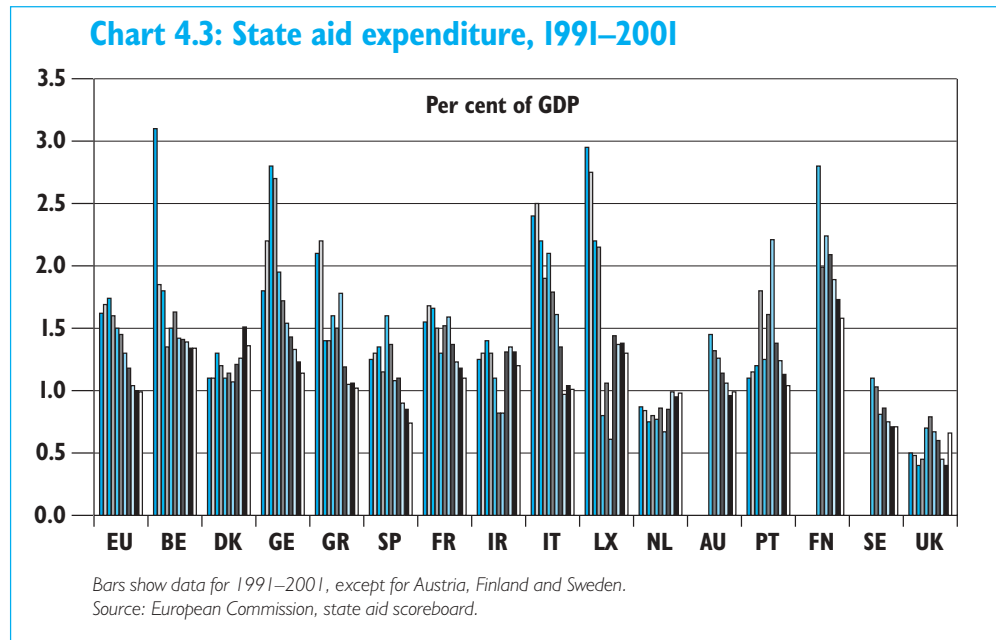
4.44 State aid can play a positive role in supporting economic development where it is used to help tackle market failures. It can be used to compensate firms for the benefits which society gains from R&D or from training, where these benefits accrue not only to the firms concerned. It can also be used to compensate for information failures, such as in the provision of finance to small- and medium-sized enterprises (SMEs).

4.45 However, state aid can also distort competition between firms and impede the effective operation of the Single Market. It can generate unintended competition between governments or regional administrations seeking to attract business investment, with the risk that subsidy auctions lead to over-compensation of firms. Where state aid does not correct for market failure, it will deliver benefits to the recipient firms, but at a cost to taxpayers and consumers.

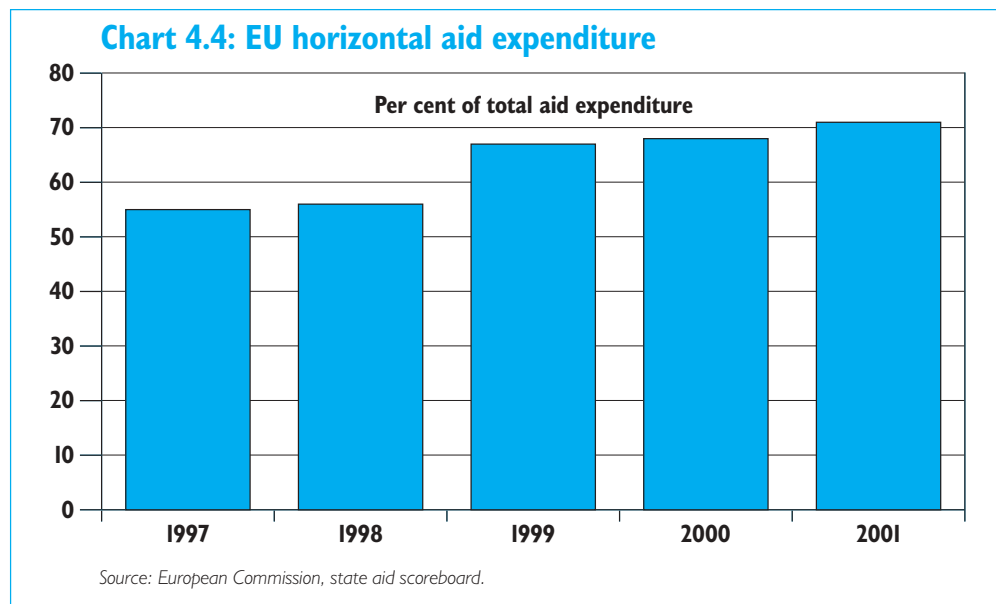
4.46 Competition can therefore be improved by eliminating the most distortive state aid, and by ensuring that, where it is used, state aid is used effectively to tackle market failures. The EU state aid regime helps to achieve this, limiting competition between public authorities to provide business support, while allowing aid for cross-sectoral, or horizontal, measures which more effectively ensure that aid targets specific market failures – for example, in the provision of training, in research and development, and in support for SMEs.

Trends in state aid

4.47 State aid remains a substantial part of the EU economy, accounting for around one per cent of EU GDP, or €86 billion, in 2001. As shown in Chart 4.3, levels of state aid in the EU fell between 1991 and 2001. However, they remain high by international standards – in 2000, the EU average was nearly double the level in Japan, and four times that in the US. While the new Member States have also achieved considerable reductions in state aid expenditure, in 2000 state aid still amounted to around 1.3 per cent of their GDP – above the average for the EU as a whole. However, much of this takes the form of tax exemptions to manufacturing companies, which will be gradually phased out over time



4.48 In March 2003, EU leaders called for a further reduction in state aid and a reorientation in its implementation towards horizontal objectives that support the Lisbon goals. As shown in Chart 4.4, the share of horizontal aid in total aid has increased from 55 per cent of all state aid in 1997, to 71 per cent in 2001.



State aid reform 4.49 Recent reforms to the state aid regime have made it easier for Member States to use aid more efficiently to tackle market failures that hold back progress towards the Lisbon goals. These reforms include the introduction of training and employment aid block exemptions to enable state aid to be used to tackle labour market failures, and risk capital guidelines to address failures in capital markets. The Commission has also introduced a new block exemption to enable research and development aid to be paid to SMEs with greater ease. And controls on distortive aids will be tightened as a result of the new Multisectoral Framework for large regional aid which applies from January 2004, and which introduces new constraints on large investment aids.

4.50 The Government welcomes these important steps which have delivered genuine improvements in the operation of the state aid system. Nonetheless, it believes that further reform is needed to achieve the Lisbon goal of less and better state aid, balancing the need for effective competition within the Single Market with the need to tackle market failures where they exist. In particular, further steps are needed to:

- streamline the state aid system, with a simplified economic framework for ensuring that insignificant aids can be approved and implemented more quickly;
- develop further the framework of horizontal guidelines so that state aid can be used more effectively to address the root causes of market failure; and
- strengthen controls on the most distortive aids which undermine competition in the Single Market.

Insignificant state aid **4.51** The Commission has recently published proposals for a simplified economic framework to ensure that aid which is likely to have a low impact on trade and competition, and which pursues clear Community objectives, can be approved more quickly. If approved, this framework would release resources within the Commission and Member States, allowing greater scrutiny to be applied to the most distortive aids. It would also facilitate the introduction of minor measures by Member States to address market failures and advance the Lisbon goals. **The Government welcomes these proposals and looks forward to continuing its work with the Commission and other Member States to develop the detail of the new framework with a view to ensuring its swift implementation.**

Targeting market failures **4.52** The Government believes that the state aid rules must provide Member States with the flexibility they need to tackle market failures, in a proportionate manner, wherever they occur. It welcomes the considerable progress that has already been made in this area, but believes that some areas are still not adequately provided for. **Further reform of the horizontal guidelines for state aid is therefore needed to help advance the Lisbon goals.** These reforms should include:

- the introduction of more effective rules governing Member State intervention to tackle the land and property market failures which inhibit regeneration. The Government believes that this could be achieved through a new regeneration state aid framework, drawing on the experience of regeneration schemes which have already been approved in the UK, including a relief from stamp duty for property transactions in deprived areas, and a derelict land remediation scheme;
- as described in Chapter 5, improved guidelines on state aid for risk capital, to ensure that Member States can effectively address the particular barriers faced by business start-ups and expanding SMEs, and revision of the R&D guidelines to better address the market failures which inhibit innovation; and
- as described in Chapter 6, the review and potential revision of the state aid guidelines for environmental protection to ensure that Member States are able to provide effective support to environmental schemes, while respecting the need to promote competition within the Single Market.

Regional state aid **4.53** The current regional aid guidelines allow Member States to grant aid in support of business investment in eligible areas defined on a regional aid map, and permit higher levels of aid under many of the cross-sectoral horizontal guidelines in the same areas.

4.54 In May 2003, the Commission launched a review of the guidelines for regional state aid. **The Government believes that this review provides an important opportunity to reform the regional aid guidelines with a view to improving the focus of the overall state aid framework on specific market failures, while bearing down on the most distortive aids.** In particular, it considers that the review should:

- ensure there are tight and effective controls on the most distortive and significant aids which have the potential to lead to inefficient investment decisions and to undermine competition;
- examine the relative merits of investment aid granted to compensate for regional economic under-performance, and of alternative measures targeted directly at the causes of such under-performance, including through the horizontal guidelines; and
- consider carefully how to ensure that regional aid can be targeted more effectively on problems at the local level. Existing eligible areas are defined at a level of aggregation which is often too large to tackle local market failures. A revised targeting regime would improve the ability of Member States to intervene at the points where markets are weakest, and where public support will have the greatest added value.

4.55 Reform of the regional state aid framework must also ensure that Member States have the flexibility they need to pursue EU regional policy objectives, whether through domestic means or through the channelling of EU budget support. The Government's proposals for a new, devolved framework for EU regional policy were described in Chapter 2.

To compete effectively in an integrated and competitive global economy, Europe needs to improve its capacity to innovate and to foster an entrepreneurial culture. By helping to generate economic prosperity and employment in deprived areas, enterprising firms and individuals can also make a positive contribution to Europe's social goals. While important steps have been taken to identify and address the barriers to enterprise and innovation in Europe, the EU as a whole continues to under-perform relative to a number of its major international competitors. It is only by learning from the best, within Europe and beyond, that the Union will realise the full potential of enterprise and innovation in creating the most dynamic, knowledge-based economy in the world. Further action is needed to:

- **adopt and implement an Entrepreneurship Action Plan**, drawing on the joint initiative of the UK, France and Germany, to identify the range of actions needed to promote enterprise in Europe, including new European Centres of Enterprise – local centres of excellence in enterprise policy;
- **develop and implement an effective Action Plan for Innovation** to help tackle the barriers to innovation in Europe;
- **support research and innovation through the Action for Growth initiative**, ensuring a focus on the most economically and financially viable projects and leveraging in private investment in research and new technologies;
- **promote enterprise in the Community's most disadvantaged areas**, including through a more flexible and innovative approach to EIB financing in these areas;
- **review and reform Community instruments for research funding**, ensuring that assistance provided under Framework Programmes delivers value for money and the greatest possible impact on research and innovation;
- **further reform the state aid guidelines** to give Member States the flexibility they need to address market failures inhibiting both innovation and access to finance by businesses; and
- **implement swiftly the Community Patent** in a way that effectively addresses the needs of businesses.

INTRODUCTION

5.1 Enterprise and innovation are crucial drivers of progress towards the Lisbon goals, enhancing economic flexibility and productivity within an economy. By helping to generate economic prosperity and employment in deprived areas, enterprising firms and individuals can also make a positive contribution to Europe's social goals.

5.2 To compete effectively in an integrated and competitive global economy, Europe needs to improve its capacity to innovate and to foster an entrepreneurial culture. While some Member States stand out as examples of strong performers, the EU as a whole continues to under-perform relative to a number of its major international competitors. It is only by learning from the best, within Europe and beyond, that the Union will realise the full potential of enterprise and innovation in creating the most dynamic, knowledge-based economy in the world.

Enterprise and innovation in a flexible economy

5.3 As described in Chapter 2, to achieve the Lisbon goals, Europe's economies must become more flexible and dynamic. Reforms to stimulate enterprise and innovation are central to the creation of a flexible economy.

5.4 Measures to encourage innovation, by enabling firms to develop and implement new processes and products ahead of their competitors, are an important driver of flexibility in product markets. Low barriers to market entry, which make it easier for new firms to challenge incumbents, can also increase the incentives for innovation and efficiency and improve the flexibility of the economy. A competitive market environment, and proportionate regulation, act as a spur to both. Likewise, flexible capital markets, which ensure that entrepreneurs and innovators have ready access to the funds they require to develop their ideas provide a further, vital underpinning.

5.5 Enterprise and innovation are also important drivers of productivity. A thriving and dynamic small business sector can make an important contribution to productivity growth across the Single Market, driving competition within the European economy and providing continual incentives for investment, innovation, efficiency and quality improvements.

5.6 Evidence also points to a significant effect from research and innovation¹. Innovation involves the development of new ideas and their economic application. It provides opportunities for productivity growth through the development of more valuable products and services, or of new processes that increase efficiency. It may also drive improvements in people's lives by changing for the better the environment in which they live and work. While estimates of private rates of return from research and development (R&D) vary from 10 to 15 per cent², spillover effects can lead to much larger benefits to the wider economy.

5.7 Finally, successful small businesses may also form part of the bedrock of their local communities, contributing not just to economic prosperity but to social cohesion too. Smaller businesses can generate local wealth – by employing people from within their local communities, obtaining goods and services from local suppliers, adding to the local skills base, and reinvesting their profits locally. Entrepreneurs may also therefore make a positive contribution to the Lisbon goal of social cohesion.

THE EU PERFORMANCE GAP

5.8 Over the course of the past year, several Member States have taken important steps to tackle the barriers to enterprise and innovation in their economies. Nonetheless, despite the importance of enterprise and innovation to growth and productivity, Europe as a whole has much still to do in order to realise the full potential they have to deliver. This section assesses the overall state of EU performance.

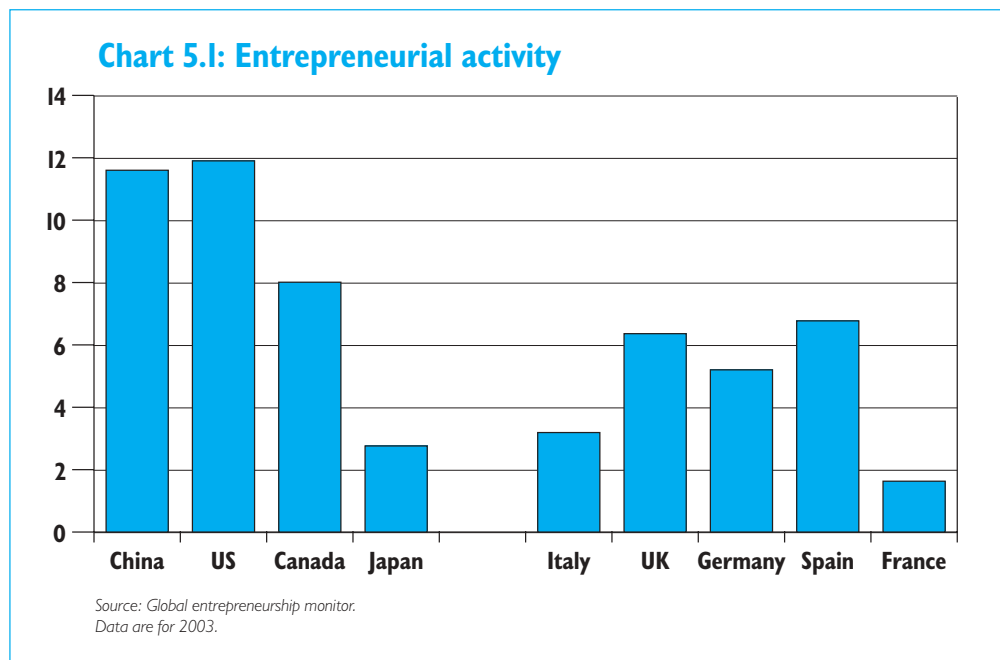
¹ See, for example, *Knowledge technology and economic growth: recent evidence from OECD countries*, OECD, 2000; *R&D and productivity growth: a panel data analysis of 16 OECD countries*, OECD, 2001.

² See, for example, Hall (1996), *The private and social returns to research and development*, in [eds] B Smith and C Barfield, *Technology, R&D and the economy*, Brooking Institution and American Enterprise Institute.

The enterprise gap

5.9 There are presently around 20 million small and medium-sized enterprises (SMEs) in the European Union, the vast majority of which employ substantially fewer than 250 people. SMEs account for around two thirds of total EU employment, providing jobs to almost 80 million people³. Around six million SMEs are also active in the new Member States, providing employment to a further 30 million people – around 70 per cent of total employment in these countries⁴.

5.10 However, while successful small businesses provide clear economic and social benefits, evidence suggests that much of Europe’s entrepreneurial potential remains untapped. As shown in Chart 5.1, in 2003, the proportion of working-age adults engaged in starting a new business or running a young firm⁵ in Europe was only moderate by international standards, with rates of entrepreneurship substantially higher in Canada and China and up to twice as high in the US.



5.11 Moreover, many groups, such as women, people from disadvantaged communities, some ethnic minorities and disabled people continue to be significantly under-represented in the entrepreneurial community. According to the Observatory of European SMEs, only one in five SMEs in the EU is run by a woman.

5.12 The Eurobarometer⁶ survey offers further useful indicators of attitudes to and levels of enterprise in the EU and makes comparisons with the US. The findings of the survey indicate that, on average, many more people in the US would prefer to be self-employed, and have considered starting their own business, than in the EU. Europeans also appear to be more risk averse than their US counterparts. According to the survey, nearly half of all Europeans would not start a business if there was a risk of failure, compared with just a quarter of Americans.

³ SMEs in Europe, Observatory of European SMEs 2002 – No.2, European Commission.

⁴ SMEs in focus, Observatory of European SMEs 2002, European Commission.

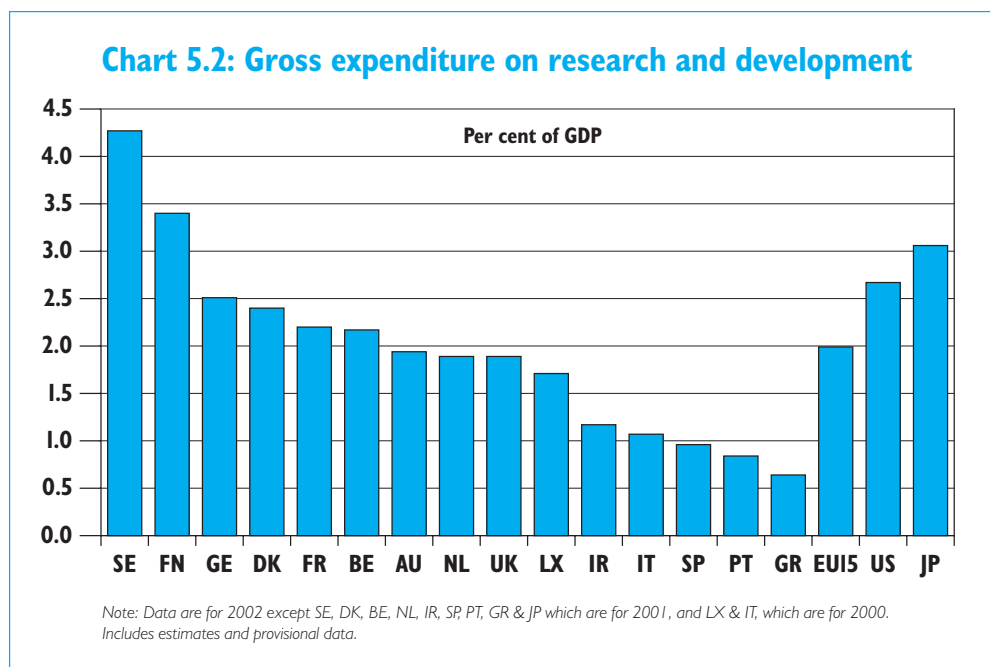
⁵ The proportion of 18-64 year olds involved in starting a new business, or who own or manage a business that is less than 42 months old.

⁶ Flash Eurobarometer 134, Entrepreneurship, Gallup Europe, November 2002.

The innovation gap

The Innovation Scoreboard 5.13 The innovation performance of the Union remains relatively poor in comparison with other countries such as the US or Japan. The Commission's latest Innovation Scoreboard⁷ shows that the US leads the EU on ten of the eleven performance indicators available for both. US leadership is particularly marked in the areas of patenting, the provision of early stage venture capital, tertiary education and business investment in R&D. Moreover, while a process of catch up is observable in the areas of high-tech manufacturing and ICT expenditure, the EU only outperforms the US in terms of the numbers of science and engineering graduates, aged 20-29, it produces, and even here the EU lead is declining.

Investment in R&D 5.14 One way of measuring an economy's commitment to innovation is to examine the inputs it makes to the innovation process, including through investment in the knowledge economy, and particularly in R&D. While R&D is only one part of the innovation process, work carried out by the OECD and others has demonstrated that R&D conducted by universities and businesses across different sectors has a large impact on productivity⁸. Chart 5.2 compares the overall levels of public and private investment in R&D made by existing Member States with those in the US. Taken as whole, average EU expenditure on R&D amounts to just 2 per cent of GDP, compared with 2.7 per cent in the US and 3.1 per cent in Japan. Moreover, despite considerable variation in the performance of Member States, only two – Sweden and Finland – invest more than the US or Japan.

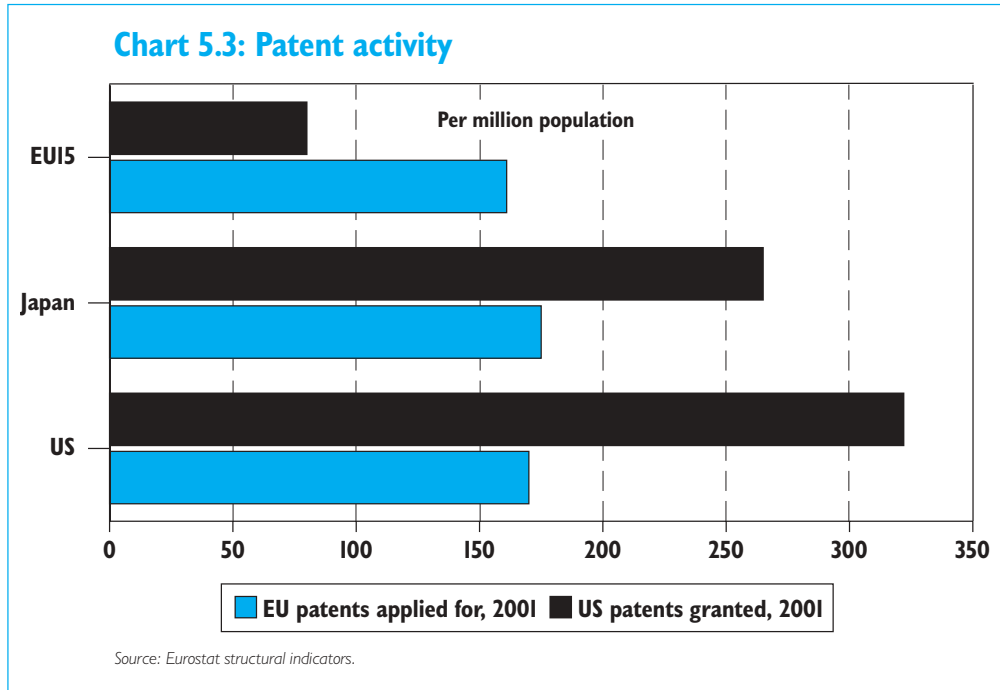


5.15 The performance of new Member States is weaker still. Despite concerted efforts to develop stronger knowledge-based economies, gross expenditure on R&D remains below the EU average in each of the new Member States, and just 0.8 per cent on average. To meet the goal set at the Barcelona European Council to increase overall expenditure on R&D with the aim of approaching 3 per cent of GDP by 2010 substantial efforts must therefore be made across the enlarged EU to increase investment in R&D, particularly by industry.

⁷ Commission Staff Working Paper, SEC(2003) 1255, November 2003.

⁸ See, for example, *Knowledge technology and economic growth: recent evidence from OECD countries*, OECD, 2000; *R&D and productivity growth: a panel data analysis of 16 OECD countries*, OECD, 2001.

Patenting 5.16 By focusing on an input to innovation – total expenditure on R&D – EU leaders hoped to generate increased output. One indicator of innovation output is the amount of patent activity generated by an economy. Chart 5.3 compares patent activity in 2001 by EU, US and Japanese businesses at the European and US patent offices. The data shows that EU businesses significantly under-perform their major international competitors on this measure of innovative activity.



Closing the enterprise and innovation gaps

5.17 The economic evidence points to the need for renewed effort to close the enterprise and innovation gaps that exist between the EU and its major international competitors, and to ensure that Europe can compete effectively in the global economy.

Promoting enterprise 5.18 Cultural factors may well be a contributory factor in explaining Europe’s relative under-performance on indicators of enterprise. While such factors may take many years to address, the effort must start now. It is only by tackling the wider structural barriers to enterprise in Europe that Member States can best overcome these constraints and create an enterprising culture throughout the Union. This means:

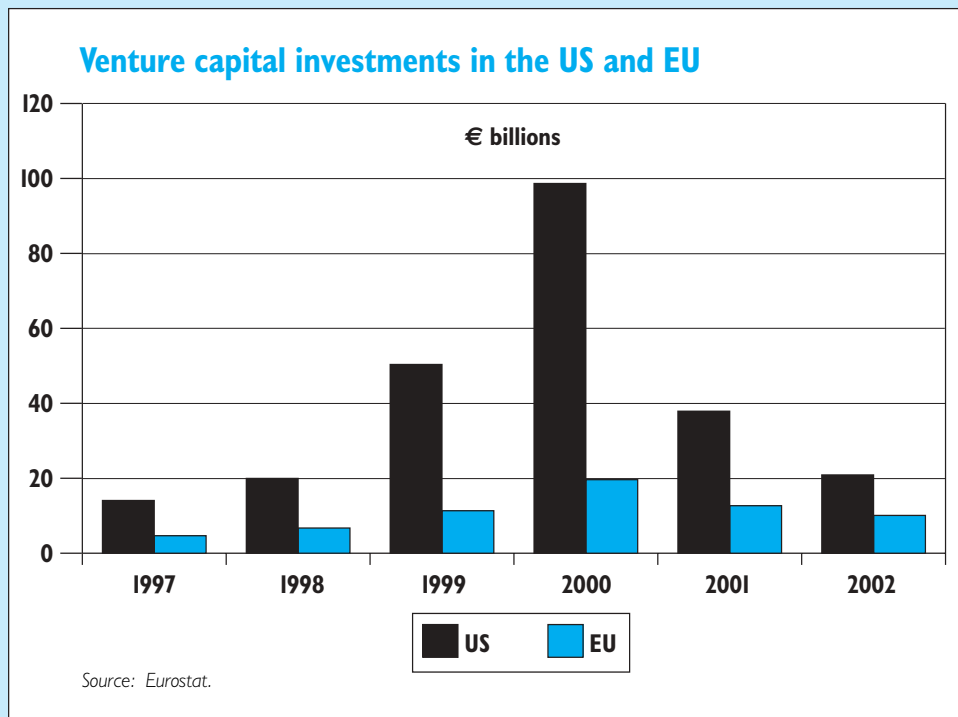
- improving access to finance to stimulate business start-ups and provide further help for new and innovative firms seeking to grow, especially those operating in disadvantaged communities;
- increasing levels of enterprise education and skills to encourage more people to create their own businesses and ensure a steady supply of highly skilled staff for existing SMEs; and
- removing the regulatory barriers that discourage enterprise and unduly impact upon small businesses.

Box 5.1: Access to capital in the EU and US

The availability of capital is key to both enterprise and innovation. Efficient risk capital markets are vital if the EU's high growth small firms are to reach their potential and generate new jobs and growth.

Risk capital markets provide equity financing to small and medium-sized enterprises and high-growth companies, play a crucial role in business start-ups and their further development, and are vital to promoting entrepreneurship and job creation within the EU. A broader, deeper, more liquid and integrated capital market across the EU would deliver substantial benefits, in particular for new and innovative firms, by increasing the availability and reducing the cost of capital.

The chart below shows levels of venture capital investment in the EU and US. In the most recent year for which data is available – 2002 – the amount of venture capital investment in the US, at €20 billion, was twice that in the EU, at €10 billion.



As the chart shows, while the recent global economic downturn has led to a contraction in venture capital investment in both the EU and the US, this contraction has been much less severe in Europe than in the US, resulting in a significant narrowing of the investment gap. Nonetheless, further action is clearly needed to tackle the remaining obstacles to an integrated risk capital market in Europe and to improve the availability of finance to businesses, entrepreneurs and innovators.

Promoting innovation **5.19** While further public investment in R&D can help to deliver a stronger innovation performance, Europe cannot rely on this alone. To successfully promote innovation, Member States and the Community must take further action to create the framework conditions needed to deliver an endogenous increase in research spending. They must also implement the structural reforms needed to address the many specific barriers to innovation performance across the EU. This means:

- improving the effectiveness of intellectual property regimes, including through the implementation of an affordable EU patent;
- strengthening the links between science and industry, to foster greater commercialisation of research and overcome existing information barriers;
- improving the supply of risk capital to enable innovative firms to fund new projects;
- increasing the effectiveness of public research spending, including from the Community budget; and
- improving regulation to reduce the administrative burden for high-tech start-ups and reduce the punitive impact of bankruptcy laws.

5.20 Having identified the key barriers which limit the levels of enterprise and innovation in Europe, further effort is needed to reduce and eliminate these barriers through appropriate interventions at the Community, Member State and regional levels.

TOWARDS AN ENTERPRISING, MORE INNOVATIVE EUROPE

5.21 A number of steps have been taken to address the structural factors inhibiting business growth and the development and utilisation of new technologies across Europe. These steps make an important contribution to the achievement of the Lisbon goals. But Europe must still do more if it is to achieve its aim of becoming the most competitive, dynamic knowledge-based economy in the world by 2010. This section reviews progress and next steps.

A framework for action

5.22 A shared political commitment to reform, based on a common framework of objectives, but with the freedom for Member States to tailor policy responses to suit national circumstances, is key to advancing the Lisbon goals.

R&D Action Plan **5.23** In April 2003, EU leaders endorsed a new Action Plan designed to support progress towards the Union's aim to raise public and private expenditure on R&D to approaching 3 per cent of GDP by 2010, with two-thirds of this new investment coming from the private sector. The Plan sets out the range of actions required at the Member State and Community level to create a stronger public research base in Europe and to stimulate private investment in research and innovation. It includes actions to:

- improve public support for research and technological innovation – for example, by improving the careers of researchers, strengthening the links between public research and industry, and exploiting fully the potential of European and national financial instruments;
- increase the levels of public funding for research – for instance, by encouraging and monitoring the redirection of public budgets, and by making effective use of the state aid and public procurement rules; and

- improve the framework conditions for private investment in research, particularly in the areas of intellectual property protection, the regulation of product markets, competition rules, financial markets and the fiscal environment.

5.24 The Government welcomes the Action Plan as an important contribution to the Lisbon strategy and looks forward to participating fully in future work to implement the Plan and to share best practice in national policy approaches. Box 5.2 describes the action the Government has taken, consistent with the recommendations of the Plan. However, the Government also believes that action to promote investment in R&D should take account of the scope for external collaboration. While Europe currently supports R&D collaboration within and outside its borders, there remain obstacles to the implementation of external science and technology agreements. Steps should therefore be taken to improve opportunities for external collaboration, through further opening of EU funding to third-country partners and greater joint planning of national programmes.

Box 5.2: Implementing the R&D Action Plan in the UK

UK policy to promote research and development is driven by an output-focused Public Service Agreement target to improve the relative international performance of the UK's science and engineering base, the exploitation of the science base, and the overall innovation performance of the UK economy. In seeking to meet this target, the UK Government has taken a number of steps that will contribute to the overall achievement of the Lisbon goals. These include:

- **action to ensure an adequate supply of research and skills.** Recent years have seen the largest sustained increase in the UK science budget for more than a decade, with an additional £1.25 billion by 2005-06 – a 10 per cent annual real increase. This investment, which includes substantial increases in funding for science, research and infrastructure, has been accompanied by action to improve the supply of scientists and engineers, through the recruitment of additional school science teachers, and higher PhD stipends and postdoctoral salaries;
- **steps to promote knowledge transfer and support business innovation.** The UK operates a variety of schemes to promote knowledge transfer from research institutions to businesses, including the Higher Education Innovation Fund, which will invest £187 million between 2004 and 2006 to help universities translate their research more effectively into innovation with commercial potential and to promote entrepreneurship. In addition, the Department of Trade and Industry are refocusing their investments in support of collaborative business R&D and knowledge transfer in a new £150 million National Technology Strategy; and
- **action to stimulate business R&D.** In the UK, a volume-based tax credit acts to stimulate commercial R&D, by increasing the value of the tax deduction for current expenditure on R&D to 125 per cent for large companies and to 150 per cent for SMEs. Loss-making SMEs can also claim repayment of the credit at 24 per cent. Take up of the credit among SMEs has been significant, with more than 8,000 claims since its inception, generating £500 million of support for innovative companies.

Entrepreneurship Action Plan 5.25 Building on the success of the R&D Action Plan, the Commission is also due to publish a draft Action Plan to promote entrepreneurship in Europe. The Government strongly supports the need for a new Action Plan in this area, and broadly endorses the priority actions already identified by the Commission, including those to:

- foster entrepreneurial mindsets among young people;
- reduce the stigma of business failure;
- facilitate business transfers;
- review social security schemes for entrepreneurs;
- provide tailor-made support for women and ethnic minorities;
- support businesses in developing knowledge-based activities;
- create more equity and stronger balance sheets in firms; and
- listen to the views and concerns of SMEs.

5.26 The Commission have also identified the need to reduce the complexity of complying with tax laws. The Government agrees that business tax systems can play an important role in promoting enterprise, but believes that taxation is a matter for Member States, in keeping with the principle of subsidiarity. Fair tax competition allows governments to reflect national preferences concerning the role, structure and aims of taxation.

5.27 **The Government looks forward to working closely with the Commission and other Member States to develop the content of the Entrepreneurship Action Plan, drawing on the recommendations set out in the recent joint paper submitted by the UK, France and Germany, *Towards an enterprising Europe*.** It hopes that rapid progress can be made, during the Irish Presidency of the EU, to adopt and implement the Action Plan, including through the open method of coordination.

European Centres of Enterprise 5.28 In taking forward action to promote enterprise in Europe, **the Government also proposes the launch of a new Europe-wide competition to identify European Centres of Enterprise** – local centres of excellence in enterprise policy. Selected from national nominations on the basis of agreed criteria, including the effectiveness of local policy interventions, European Centres of Enterprise would spotlight and champion best practice in policy-making and implementation across Europe, highlighting its contribution to business development, employment, regeneration, social inclusion and education. The sense of competition generated by the scheme would also serve to strengthen the incentives on localities across Europe to take action to promote enterprise. The Government looks forward to discussing this proposal with other Member States and the Commission.

Box 5.3: Towards an enterprising Europe

In January 2004, on the occasion of the *Advancing Enterprise* conference, hosted by the Chancellor of the Exchequer, the Finance and Industry Ministers of France, Germany and the UK submitted a joint paper, *Towards an enterprising Europe*¹, to the Commissioners for enterprise and the information society, and for economic and monetary affairs.

Drawing on joint work between the three countries, the paper identifies a wide range of policy actions, at the national and Community level, to help unblock Europe's entrepreneurial potential and deliver higher employment and productivity growth over the longer term. It concludes that action is needed to reduce regulatory barriers to enterprise, overcome social and cultural barriers to enterprise, and improve access to finance for new businesses and for all businesses seeking to develop and grow. The paper also draws attention to a range of recent reforms in France, Germany and the UK designed to tackle the barriers to enterprise in each country. For example :

- in France, the July 2003 *Loi pour l'Initiative Economique* introduces new measures designed to increase the rate of business creation to 200,000 new firms per year and to speed up the development of new firms by facilitating access to finance. These reforms include measures to simplify the environment for business creation by reducing the risks and costs associated with starting a business, encourage employees to create their own businesses, improve access to finance, reduce the personal risks involved in entrepreneurship, and facilitate the purchase and transfer of businesses. Recent figures suggest that business creation in France in 2003 was 12 per cent higher than in 2002;
- in Germany, reforms introduced in 2003 seek to facilitate the start up process and improve the conditions for existing enterprises, by improving the legal framework for entrepreneurs, with reforms to the tax and social security system and to the registration process for new firms; improving the business environment, through the provision of information, steps to facilitate business transfer and action to promote vocational training; improving access to finance for small firms, with additional resources and the creation of innovative financing instruments; and reducing the administrative and bureaucratic burden on small businesses; and
- in the UK, the Government intends to launch Enterprise Capital Funds (ECFs), subject to state aid approval. ECFs will be private sector, commercially-managed entities that adapt the US Small Business Investment Company model by investing a mix of public and private sector capital in small high-growth businesses. The first ECFs will be allowed to invest in funding rounds of up to £2 million and will put the private sector on the same risk basis as public sector capital. The Government has also introduced a series of reforms to ease the tax and regulatory burden on small businesses and has taken steps to tackle the social and cultural constraints to enterprise, funding Enterprise Advisers in schools and launching a national campaign to raise enterprise awareness.

The Government believes there is much Member States can learn from one another in seeking to promote enterprise throughout Europe, and hopes that the conclusions set out in *Towards an enterprising Europe* can be reflected in ongoing Commission work in this area.

¹ The report is available on the HM Treasury website.

Innovation Action Plan 5.29 An Innovation Action Plan, to complement and reinforce that already adopted for R&D, could play a crucial role in helping Member States to improve their innovation performance.

5.30 The Government welcomes the Commission's intention to prepare an Action Plan early in 2004. It believes that the Plan must address the general framework conditions needed to encourage innovation, including the environment for business and the supply of skills, as well as the specific reforms needed to encourage innovative practice. In this context, the Government believes that Member States should concentrate their policy responses on the following priorities:

- ensuring that the skills needs of high-tech innovative businesses are given a high priority in national education and training strategies;
- strengthening the links between research communities and businesses in order to promote knowledge transfer and collaboration;
- raising awareness of intellectual property (IP) among the business and academic communities, ensuring that national systems deliver a range of IP information, registration and enforcement services responsive to the needs of business;
- improving the innovation impact of public procurement systems and public research spending, giving particular consideration to SMEs, while continuing to protect open and fair competition within the internal market; and
- where appropriate, targeting support on key cross-sectoral technology areas, especially those which will have a structuring impact, such as micro- and nano-technologies, making full use of the European Action for Growth initiative and the EIB's Innovation 2010 Initiative funding stream, described below.

5.31 The Government believes that any Action Plan must also consider the steps that can be taken at the Community level to promote innovation, including:

- as described later in this chapter, a review of the state aid framework to ensure that the R&D and venture capital guidelines are properly targeted on the key market failures that inhibit innovation and are sufficiently flexible to enable Member States to design and implement appropriate policies;
- as described in Chapter 4, improvements in the regulatory process to reduce the administrative burden on innovative firms;
- as described in Chapter 4, steps to ensure strong and effective competition throughout the EU, with competition policy combined effectively with other interventions to target market failures, and action to ensure that the application of competition policy does not inadvertently inhibit the dissemination of innovative ideas through intellectual property-sharing agreements between companies;
- steps to build better cross-country university-business networks, such as international partnerships, and to improve the mobility of researchers, including, as described later in this chapter, through the use of Framework Programmes;
- as described below, rapid implementation of the Community Patent, and other relevant directives, ensuring that the outcomes strike the right balance between the needs of businesses and consumers; and
- the prospects for more specialised financing instruments to support particular modes of research exploitation, such as proof-of-concept funding, utilising opportunities within the European Action for Growth initiative and the EIB's Innovation 2010 Initiative funding stream.

Box 5.4: Promoting innovation and business-university links: the UK experience

The UK Government is currently considering the conclusions of two recent reviews, commissioned to identify the range of potential policy responses needed to stimulate innovation by businesses and better collaboration between businesses and university research departments.

The Innovation Report

A wide-ranging review of business innovation and its contribution to productivity growth was launched in November 2002. The review reported in December 2003 on the steps needed to ensure a coordinated approach by government across a range of policy areas, including procurement and regulation, to improve the UK's innovation performance.

An increasingly important element of the Government's strategy is investment in the development and diffusion of new or emerging technologies with the potential to have pervasive impacts and to disrupt traditional businesses and markets, including biotechnology, genomics, micro- and nano-technologies and e-science. Following the Innovation Report, the Government intends to develop a new Technology Strategy to guide future public support for science and innovation over the medium to long term in key technologies and markets.

Review of Business-University Collaboration

In December 2003, the Government received an independent review into business-university collaboration, outlining the steps needed to help businesses better exploit the technologies and skills in the university sector.

The Review concluded that further collaboration could bring significant additional benefits to the university sector, to businesses and to the economy as a whole. It made a number of recommendations for improving the degree of collaboration between businesses and universities in the UK, including a new funding stream for business-relevant research, increased and improved funding for knowledge transfer, an increased role for the Regional Development Agencies in facilitating knowledge transfer, and the development of model contracts and a protocol for intellectual property to speed up intellectual property negotiations.

Risk Capital Action Plan 5.32 Risk capital markets provide equity financing to small and medium-sized enterprises and high-growth companies, play a crucial role in business start-ups and their further development, and are an important driver of enterprise and job creation. As shown earlier, in Box 5.1, comparisons with the US suggest that risk-capital markets remain significantly underdeveloped in the European Union.

5.33 Launched at the Cardiff European Council in June 1998, the Risk Capital Action Plan has, over the past five years, sought to dismantle regulatory and administrative barriers to the development of a single risk capital market in Europe. The Government welcomes the steps that have been taken to implement the provisions of the Action Plan. However, further action is needed to create a wider, deeper and more liquid risk capital market in Europe and to raise levels of risk capital investment in the EU to match those in the US, improving access to finance for small firms. With the deadline for implementation of the Risk Capital Action Plan now passed, this will require further action by Member States, including through the development and implementation of EU Action Plans for entrepreneurship and innovation, as described above. Member States should also work together, through the Financial Services Committee, to identify the remaining market and regulatory barriers to risk capital investment in Europe, and to evaluate and benchmark examples of best practice, including in the use of innovative funding vehicles.

Promoting enterprise and innovation

5.34 The establishment of common frameworks for action is a vital first step towards tackling the performance gap between Europe and its major international competitors. But it is important that these are translated into effective action. This will require additional reform to tackle market failures and help new and innovative firms start up, develop and grow. While Community funding instruments can play an important role, Member States must share the responsibility for action and be granted the flexibility and support they need to develop and implement national policy solutions.

European Action for Growth

5.35 The European Action for Growth initiative was endorsed by EU leaders at the December 2003 European Council. The initiative is intended to mobilise investment in trans-European network infrastructure, including transport, telecommunications and energy, and in the areas of R&D and innovation. On the latter, the initiative will:

- strengthen the Union's capacity to generate and use knowledge through specific action to boost investment in leading edge technologies;
- mobilise an additional €40 billion from 2003 to 2010 from the European Investment Bank's Innovation 2010 Initiative, offering greater support and a broader range of instruments to support innovation; and
- deliver a €500 million increase in the provision of venture capital to innovative SMEs through the European Investment Fund, and step up the Fund's guarantee and advisory activities.

5.36 To accelerate progress, the first group of projects will be part of a Quick Start Programme, embracing ready-to-launch projects that will have an impact on growth and innovation and where work and investment can be under way within three years. Five research areas have so far been identified at a total cost of around €10 billion to 2015. These projects focus on technology sectors that are likely to be key to Europe's longer-term competitiveness, including nano-electronics, next generation lasers, the use of hydrogen as a source of energy and electricity, and the use of new technologies to deliver broadband connections.

5.37 The Government welcomes the Action for Growth initiative as an important strand of the overall Lisbon reform programme, and as a contribution to the wider drive to improve Europe's long-term growth potential through higher investment in research and new technologies. Going forward, it believes that:

- projects brought forward for support under the initiative must be economically and financially viable and be able to demonstrate a clear impact on the overall aims of innovation and growth;
- the initiative must focus its action on those areas where it can add the most value, including by stimulating venture capital markets that provide access to finance for Europe's most innovative and leading edge firms; and
- the focus must be on leveraging in private sector capital, not displacing it.

Financial support for enterprise in disadvantaged areas

5.38 The Government believes that there is further scope for utilising the support provided by European Investment Bank (EIB), and its subsidiary, the European Investment Fund (EIF), to help overcome the market failures that inhibit the ability of small firms to raise finance. The EIB and EIF play a vital role in supporting investment across Europe, by providing venture capital and guarantee instruments for SMEs. EIF and EIB funds are finite and must be used in the areas where they will generate the most benefit. As a general principle, funding should be targeted to address specific market failures, and in particular to areas where the failures are most acute.

5.39 There is widespread evidence of a continuing finance gap for small firms, driven by informational asymmetries, high transaction costs and lack of collateral. These market failures are especially acute in disadvantaged areas, where economic growth is lower than average, and EIF interventions could therefore secure greater additionality in these areas. To help to address the particular disadvantages facing small firms operating in Europe's poorest areas, **the EIF and EIB, should develop a more innovative approach and greater flexibility in their provision of support to firms in disadvantaged areas.** As a first step, the EIF should review the additionality of the instruments it uses and consider how its finite resources could be used to intervene in the market in the most effective ways possible.

Framework Programmes **5.40** Framework Programmes are the European Union's main instrument for research funding in Europe. The Sixth Framework Programme (FP6) became operational in January 2003 and will run until 2006. Participation is open to all organisations engaged in research, including businesses, research institutes and academia. The Programme has been designed to support the establishment of an European Research Area, with the bulk of funding designated to the promotion of research networks and integrated projects, giving research consortia greater flexibility and autonomy. The overall budget of €17.5 billion will contribute to the Barcelona aspiration to raise overall levels of investment in R&D.

5.41 The Government strongly supports the Framework Programmes as a vehicle for encouraging R&D, strengthening international competitiveness, and supporting wider EU policy objectives. **However, it believes that support provided under Framework Programmes should be subject to continual assessment and appraisal to ensure value for money and to maximise its impact on excellent research and innovation. This should include:**

- measures to improve Programme design and administration in order to reduce complexity and increase the impact on business innovation;
- consideration of the scope for using Framework Programmes to build on existing business-led networks and projects for developing R&D collaboration between Member States;
- consideration of the scope for using Framework Programme support to enhance researcher mobility and business-university collaboration, as well as private sector inter-company mobility; and
- measures to enhance the development and diffusion of new technologies.

5.42 To support and inform this process, and to assess the priorities for the next Framework Programme, due to start in 2007, the Government has commissioned its own external evaluation of existing Framework Programmes.

State aid **5.43** The state aid guidelines have an important role in enabling Member States to tackle the market failures which inhibit innovation and enterprise, while tackling those aids which may distort trade and competition within the Single Market.

5.44 The Government welcomes the Commission's current review of R&D state aid, which will help to determine the effectiveness of public support in leveraging private investment and encouraging innovation. However, it believes **there is a need for a more fundamental review of the state aid guidelines to ensure that aid can be granted to tackle specific market failures across the innovation system.** While permitted aid should remain in proportion to the level of market failure, the state aid guidelines should be reformed to reflect a more systemic approach to innovation and to provide Member States with the flexibility they need to encourage greater diffusion and dissemination of research and innovation.

5.45 State aid can also play a key role in helping to overcome market failures associated with enterprise, particularly those faced by SMEs and innovative businesses. The state aid guidelines on risk capital should enable this, provided Member States are allowed to use them to address all relevant market failures and are not unduly constrained by the ‘safe harbour’ limits set out in the guidelines. The Government also believes that **the Commission should examine whether there is a further role for state aid in addressing the barriers faced by start-ups and high growth firms** – in particular, whether the risk capital guidelines should be extended to cover forms of finance other than equity and whether specific guidance is needed to address forms of support such as incubators for new businesses.

**Community
Patent**

5.46 Intellectual property rights underpin innovation by allowing innovators to make a return on their investments, whether these are based on scientific, technological or artistic creativity. However, patenting across the EU through the European Patent Office is currently five times as expensive as that in the US and twice as slow, with patent rights currently enforced separately in each Member State.

5.47 At the European Council in March 2003, Member States reached agreement on a common political approach to a Community Patent, designed to simplify the patent application process in Europe and substantially reduce costs for inventors. This is an important step forward – according to the Commission, once implemented, the new system will reduce the costs of obtaining a patent by more than 50 per cent. The Government welcomes this agreement and believes that **it is now imperative that the necessary steps are taken to ensure swift implementation of the Community Patent in a way that effectively addresses the needs of businesses.**

In an interconnected global economy, Europe's opportunities, responsibilities and challenges do not stop at its borders. External openness, underpinned by a flexible and dynamic economy, can play an important role in advancing the Lisbon goals of growth, productivity and employment, reinforcing action taken as part of the Single Market programme. As it strives to achieve the Lisbon goals, Europe must also acknowledge its responsibility to pursue the goals of sustainable development, challenging traditional perceptions of growth to ensure that economic and social progress go hand-in-hand with action to protect the environment, and demonstrating global leadership in the fight against global poverty. An outward-looking Europe, committed to the pursuit of sustainable long-term growth and to tackling poverty, at home and abroad, must therefore:

- **adopt a leadership role in multilateral trade negotiations** with the aim of ensuring the most ambitious agreement possible. Europe must commit to deliver further significant improvements in access to all of its markets and offer additional flexibility to developing countries so that they may share in the benefits;
- **take steps to strengthen the transatlantic economic relationship** – the EU's most significant trade and investment relationship – by identifying and then tackling ongoing barriers to trade and investment between the EU and the US, to the benefit of businesses and consumers on both sides of the Atlantic. The Chancellor of the Exchequer and the US Treasury Secretary have announced their support for a new OECD-led study to quantify the potential benefits of closer economic cooperation, which now has the backing of an array of EU Finance Ministers;
- **demonstrate global leadership in the pursuit of sustainable development**, through further steps to encourage innovation in environmental technologies, and a revitalised commitment to make progress towards the Kyoto targets to reduce greenhouse gas emissions and address the problem of climate change; and
- **take further action to help tackle global poverty**, by improving the effectiveness of national and Community financing for development, supporting the establishment of an International Finance Facility to mobilise additional aid resources and continuing reform of the Common Agricultural Policy.

INTRODUCTION

6.1 The European Union is an important part of an increasingly interconnected world economy. A highly open economy, Europe cannot concern itself simply with the economic development of the Member States. It must also recognise both its broader responsibilities as a major player in the global economy and the opportunities that these may bring for Europe itself. Europe's opportunities, responsibilities and challenges do not stop at its borders.

6.2 Globalisation and free trade offer important opportunities for Europe. Openness to trade and investment acts as a spur to growth, employment and productivity within the Union, reinforcing elements of the wider Lisbon strategy. The challenge for Europe is to ensure that its economy is sufficiently flexible to realise the benefits that greater openness could bring. Its responsibility is to become ever more outward-looking in its approach, demonstrating global leadership for open markets and ensuring that the benefits are available to all, including the world's poorest. As the Commission notes¹, *"in the context of the external dimension of the Lisbon Strategy, measures should be taken to ... secure a successful outcome to the Doha process and broadening and strengthening our Positive Economic Agenda with the United States."*

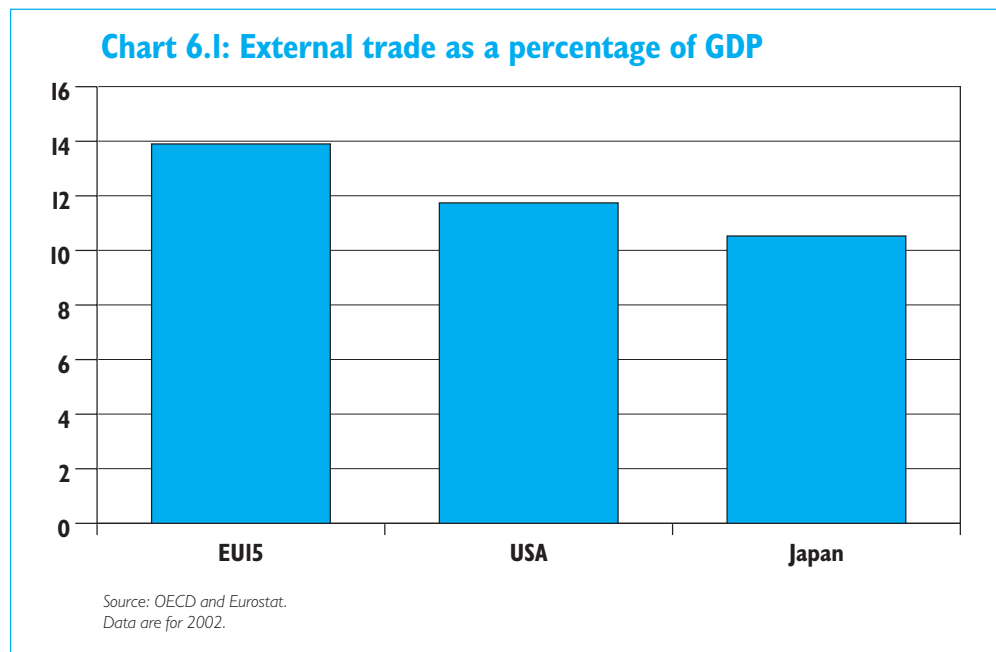
¹ Delivering Lisbon: reforms for the enlarged Union, Report from the Commission to the spring European Council, January 2004

6.3 Europe must also acknowledge its responsibilities to the environment and to the goal of sustainable development. As it strives for increased competitiveness, Europe must continue to challenge and stretch traditional perceptions of economic growth, ensuring that its economic, social and environmental objectives are pursued concurrently and that its global responsibilities to the environment are met. It must also show a lead in the fight against global poverty and in international efforts to meet the Millennium Development Goals.

EXTERNAL OPENNESS AND THE LISBON STRATEGY

6.4 By bringing down the barriers to trade within Europe, the Single Market programme has delivered substantial benefits to the EU economy. Increased openness to external trade offers the prospect of similar, if not greater, reward.

6.5 The European Union is already a highly open economy. As shown in Chart 6.1, as a ratio of GDP, external trade in the EU stood at 13.9 per cent in 2002, some way above that in either the US or Japan. But significant barriers to trade remain – barriers which slow down progress towards the Lisbon goals. Greater external openness is a natural counterpart to the Single Market programme, and would enable Europe to secure more swiftly the improved economic performance it aspires to. Successful economic reform, which increases the flexibility of the European economy, would help to ensure that these gains are realised.



The economic benefits of trade

6.6 The benefits of trade should be seen in the context of an overall goal of higher economic growth. The majority of general cross-country studies suggest that increased trade openness has a positive impact on country income². Overall, these studies suggest that a one per cent increase in the trade-to-GDP ratio will lead to increases in real GDP per capita of at least one third of one percent in the longer term. As it strives to implement the Lisbon strategy, Europe must therefore look seriously at the important role that greater trade and openness could play in raising the Union's long-term growth performance.

²See, for example, Frankel, J.A. and Romer, D. (1996), *Trade and growth: an empirical investigation*, NBER Working Paper No 5476; and Frankel, J.A. And Rose, A.K. (2000), *Estimating the effect of currency unions on trade and output*, NBER Working Paper No 7857.

6.7 In the simplest terms, trade can be seen as the exchange of goods or services between two parties. Increasing the ease with which such transactions take place brings economic benefits, and is a desirable objective. The path to such an objective has two distinct elements: economic integration, or the facilitation of exchanges taking place within customs borders; and trade liberalisation, the facilitation of exchanges across borders. Trade liberalisation is therefore a logical extension of the Single Market.

6.8 As an extension of the Single Market, trade liberalisation has the potential to deliver benefits on a similar scale. As described in Chapter 4, the Single Market programme has yielded substantial economic rewards, enhancing economic activity within Europe, and delivering improvements in efficiency and productivity. Commission research³ suggests that EU GDP has been boosted by around €875 billion – equivalent to €5,700 per household – over the ten years of the internal market, generating 2.5 million additional jobs. In 2002 alone, these benefits amounted to an extra 1.8 per cent, or €164.5 billion, on EU GDP.

6.9 While further benefits on this scale would make an important contribution to the achievement of the Lisbon goals, they require that action is taken to reduce the barriers to external trade. Existing barriers take a number of forms, including tariffs imposed at the border, which have no counterpart in the economic integration agenda, and non-tariff barriers, such as quotas or product standards, which have a much more direct parallel. Box 6.1 gives examples. Taking both types of restriction into account, research⁴ suggests that the total cost to consumers of existing EU protection could represent as much as seven per cent of EU GDP, or around €600-700 billion.

Box 6.1 Barriers to EU external trade

Existing barriers to EU external trade take a variety of forms – some obvious, others less so. For example:

- **tariffs continue to play a key role, both in agriculture and non-agricultural goods, although they are lower for the latter. Tariff peaks on specific products, and tariff escalation are particularly distorting, with the latter occasionally concealing the degree of protection present in final goods;**
- **quotas are still widely used on many goods, including sugar, textiles and clothing;**
- **export subsidies are available for a range of agricultural products, helping to sustain a wide margin between internal market and world prices;**
- **trade-distorting domestic subsidies to support suppliers are available in different countries across a spectrum of agricultural, non-agricultural and services sectors;**
- **product standards cover an important and diverse range of non-tariff barriers. Some are imposed on precautionary grounds – for example, restrictions on GM foods or hormone-treated meat, and limits on low frequency emissions from electrical equipment. Others are practical or cultural – for example, metric labelling and the European content requirement for TV broadcasts. While some may be justified, others serve simply as protectionist measures; and**
- **in services trade, barriers range widely and include the non-recognition of professional qualifications, ownership requirements, and complex and opaque procedures for the establishment of companies or subsidiaries.**

³ *The internal market – ten years without frontiers*, Commission working document, 2002.

⁴ Patrick A Messerlin, *The real cost of European protectionism*, Institut d'Etudes Politiques de Paris and Groups d'Economie Mondiale de Sciences Po (GEM), 2001.

6.10 Reducing anti-competitive product market regulations could also have significant positive effects on non-agricultural employment rates. A recent OECD study⁵ found that, in some countries, regulation of this nature could account for up to three percentage points of the deviation of the employment rate from the OECD average.

Trade and productivity 6.11 Trade openness also has a direct impact on productivity. Economic incentives provided by reduced trade barriers can lead to the re-allocation of resources in an economy to more efficient producers, increasing the productivity of the economy as a whole. Moreover, these changes can occur both between and within major economic sectors, acting as a major catalyst for achievement of the Lisbon goals. Recent economic research confirms the role of international trade as a catalyst for the reallocation of resources towards more productive firms⁶.

Competition 6.12 Increased competition is one of the key channels through which trade may lead to higher productivity⁷. Greater external openness widens the market for the sale and sourcing of intermediate inputs as well as that for products for final consumers. By reducing monopoly rents, increased competition forces firms to become more efficient, driving down margins and the prices of goods and services for consumers. In the context of the Lisbon strategy, increased market competition arising from a reduction in barriers to external trade would complement, and surpass, that achievable through improvements in the EU competition policy framework alone.

Technology transfer 6.13 External openness can also drive productivity improvements by facilitating increased technology transfer across borders. There is now a well-established link between research and development (R&D), innovation and productivity – with productivity exhibiting a strong dependence on domestic levels of R&D. This supports the focus on R&D investment within the wider Lisbon strategy. However, there is also evidence to suggest that cross-border technology spillovers can make a significant contribution to an economy's overall productivity performance. The R&D performance of key trading partners can have a direct impact on domestic productivity, where new technologies, materials, production processes or organisational methods can be replicated domestically. Foreign R&D may also have an indirect impact, through imports of goods and services developed abroad and containing embodied innovation and R&D investment⁸. Greater external openness could therefore deliver improvements in Europe's innovation performance, helping to close the performance gap described in Chapter 5.

Other channels 6.14 While competition and technology transfer appear to be the key channels through which greater external openness could improve Europe's productivity performance, other channels may also be important. For example:

- foreign direct investment (FDI) can lead to spillovers of technology or innovative business processes from the investor to the host economy, both directly, through emulation by domestic firms, or indirectly, when workers transfer their skills between firms⁹;
- trade openness can encourage product market regulatory reforms – particularly those which liberalise entry, and therefore give a spur to investment and economic growth¹⁰; and

⁵ *Product and labour markets interactions in OECD countries*, Nicoletti et al, OECD 2001, ECO/WKP(2001)38.

⁶ See, for example, Marc J Melitz, *The impact of trade on intra-industry reallocations and aggregate industry productivity*, April 2002, NBER working paper 8881.

⁷ See, for example, Joseph F Francois, Felix Eschenbach, *Financial sector competition, services trade, and growth*, Tinbergen Institute 2002, Discussion Paper TI 2002-089/2.

⁸ See, for example, *Report on research and development*, Economic Policy Committee, EPC/ECFIN/01/777-EN Final, 22 January 2002; D.Coe, E Helpman, *International R&D spillovers*, 1993, NBER working paper No 4444; and J. Eaton, S. Kortum, *Engines of growth: domestic and foreign sources of innovation*, 1995, NBER working paper no 5207.

⁹ *Openness and growth*, eds James Proudman and Stephen Redding, Bank of England 1997.

¹⁰ Alesina et al (2003), *Regulation and investment*, OECD Economics Department Working Papers, No. 352.

- to the extent that reduced barriers to external trade make it easier for firms to enter and exit the market, productivity can be enhanced by the entry of new and dynamic firms, and exit of unproductive ones¹¹. Smaller and younger firms may also have a relative advantage in generating and implementing novel ideas, capturing better the productivity potential through innovation¹². And there could be benefits to European SMEs from having additional opportunities to operate internationally.

Trade and flexibility

6.15 The economic benefits arising from increased external openness could be substantial. However, they will only be realised if firms and individuals are able to adapt quickly to change so that resources can be reallocated efficiently to the most productive economic sectors and firms. This underlines the importance of the economic flexibility in the Lisbon agenda, as described in Chapter 2.

6.16 Greater external openness can have an important impact on domestic product markets, leading to changes in trade patterns and industry specialisation. Flexible product markets, in which there is ease of entry and exit for firms, and in which incumbent firms are able quickly to adjust their production patterns, are crucial to ensuring that the benefits of greater openness are realised.

6.17 Labour market flexibility is also essential. Flexible labour markets ensure that changes in the pattern of labour demand can be quickly accommodated with a minimum of social disruption. With greater external openness, they help to ensure both that potential productivity gains are realised, and that any adverse effect on employment is temporary in character and does not negatively impact on employment rates in the longer term¹³. As described in Chapter 4, reforms to improve skills levels are central to labour market flexibility. Skilled workers often adapt faster and more effectively to change, allowing firms to update products and working practices at the rate demanded by rapidly changing markets.

6.18 In summary, while greater external openness has the potential to advance the Lisbon goals, implementation of the wider Lisbon reform programme is key to capturing the full rewards. With flexibility in product and labour markets, greater openness could deliver substantial improvements in growth, productivity and employment over the longer term, delivering benefits for all of Europe's citizens.

REALISING THE BENEFITS OF EXTERNAL OPENNESS

6.19 The economic benefits of increased openness, to Europe and to the developing world, are substantial. **Europe must therefore ensure that the goals of structural reform and more open global markets are pursued vigorously and in tandem.** This entails a leadership role in the current multilateral trade negotiations, as well as further action to strengthen the transatlantic economic relationship by reducing the barriers to trade and investment between the EU and the US.

¹¹ See, for example, *Enterprise Britain: a modern approach to meeting the enterprise challenge*, HM Treasury, 2002.

¹² Cosh, A., Hughes, A., & Wood, E., *Innovation in UK SMEs*, 1999, in Acs, Z., Carlsson, B. & Karlsson, C. (eds): *Entrepreneurship, small and medium-sized enterprises and the macro-economy*, Cambridge University Press.

¹³ See, for example, *UK membership of the single currency: An assessment of the five economic tests*, HM Treasury, 2003.

Multilateral trade liberalisation: a European priority

6.20 Multilateral liberalisation through the World Trade Organisation (WTO) provides by far the best opportunity for Europe to increase substantially its openness to trade in near term. This is because:

- multilateral trade negotiations provide the greatest opportunity to reduce trade barriers across the board, reducing the persistence of tariff peaks and other barriers in sensitive areas;
- the multilateral reduction of trade barriers ensures that trade flows increase and are not simply diverted due to false advantages created by bilateral or regional agreements; and
- the multilateral approach offers to developing countries a stronger voice in negotiation and a better opportunity to secure improved market access in areas where they enjoy comparative advantage.

6.21 Research¹⁴ suggests that the annual welfare gain from a 50 per cent reduction in global trade protection across all agricultural, industrial and services sectors and a one per cent reduction in transaction costs, through improved trade facilitation, could amount to almost \$100 billion in the EU. According to the World Bank¹⁵ global welfare gains of more than \$500 billion are at stake.

The Doha Development Agenda

6.22 The WTO Doha Development Agenda (DDA) negotiations were launched in November 2001 with a deadline for completion of 1 January 2005. All WTO members committed to place developing countries' needs and interests at the heart of the negotiations. The negotiating agenda included:

- a fair and market-oriented trading system in agriculture with substantial improvements in market access, and substantial reductions in export subsidies and trade-distorting domestic support;
- liberalisation in the service sector, including on movement of natural persons;
- reduced tariffs, including tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers in manufactured goods – particularly those of export interest to developing countries;
- better access to patented medicines for developing countries without pharmaceutical manufacturing capacity, through the Trade-Related Intellectual Property (TRIPS) and public health agreement; and
- decision, by explicit consensus, on the modalities to negotiate the, so-called, Singapore Issues of investment, competition, transparency in government procurement and trade facilitation.

Progress to date 6.23 A major stumbling block to the negotiations was resolved in late August 2003 when WTO members finally reached agreement on TRIPS and public health. This agreement will enable developing countries without manufacturing capacity to issue compulsory licenses to import essential medicines at lower prices in times of public health crisis, helping to keep pharmaceutical prices low after 2005, when tighter intellectual property rules come into effect.

¹⁴Nagarajan, Nigel (1999): *The Millennium Round: An economic appraisal*, Economic Papers NI 39, European Commission.

¹⁵World Bank (2003) *Global Economic Prospects 2004: Realising the Development Promise of the Doha Agenda*.

6.24 However, despite this important step, progress towards resolving the other main areas for negotiation, particularly agriculture, has been unacceptably slow. The collapse of the Fifth WTO Ministerial Session at Cancún represents a serious set-back to the DDA, with deadlock on the Singapore issues the immediate cause of failure. It will now be very challenging to meet the January 2005 deadline for concluding the DDA.

Box 6.2: Reforming EU agriculture

Key to success in the DDA is EU and US flexibility over agricultural support.

In June 2003, the Union agreed reforms to the Common Agricultural Policy that have the potential to reduce trade-distorting support. These reforms break the link between the bulk of subsidies and production, make subsidies dependent on minimum environmental standards, and trigger reduced subsidies when expenditure on the CAP looks in danger of exceeding agreed ceilings. These are welcome measures. Taken together, they should reduce the trade-distorting impact of the CAP, improve resource allocation and market focus, and lead to productivity increases in the agricultural sector. They should also help to mitigate environmental damage stemming from agricultural production, and will begin to protect taxpayers from significant real increases in future agricultural spending.

Nonetheless, further reform is urgently needed. In particular, the decoupling of subsidies and production – and, over time, the reduction of subsidies – must be extended to the remaining supported sectors as soon as possible. Reforming the sugar and cotton sectors would be of real benefit both to the EU economy and to the economic positions of developing countries. It would also signal to the wider world, the strength of the EU's commitment to create a sustainable agricultural sector in Europe compatible with the WTO objective to correct and prevent restrictions and distortions in world agricultural markets.

EU leadership 6.25 The DDA represents a unique opportunity for the EU to increase its openness to trade, driving efficiency and productivity improvements in the European economy. The successful completion of negotiations would also foster long-term economic growth among developing countries, lifting millions of people out of poverty and advancing the international community's Millennium Development Goals.

6.26 **The Government considers it vital that the EU adopts a leadership role in future DDA negotiations with the aim of securing the most ambitious agreement possible.** Europe must demonstrate clearly a commitment to deliver further significant improvements in access to all of its markets, and be prepared to offer additional flexibility to developing countries, so that they may sequence properly the necessary trade reforms. The EU should also lend its support for substantial improvements in aid for trade-capacity building, to give developing countries the support they need to improve the supply-side capacity and infrastructure of their economies and take full advantage of the new opportunities to trade. The Government urges the Commission and other Member States to take a similarly positive approach to the DDA process as the best means of achieving stronger economic growth in Europe, the developing world and beyond.

Strengthening the transatlantic economic relationship

6.27 A successful conclusion to the Doha Development round must remain one of Europe's uppermost priorities. However, the size and importance of the economic relationship between the EU and the US means that it cannot be ignored in efforts to deliver more open global markets.

The EU-US economic relationship **6.28** The US is by far the EU's most significant bilateral trade and investment partner. Data from the Commission reveals that, in 2002, around 17 per cent of EU goods imports were sourced from the US, while 24 per cent of exports were destined there. Roughly 40 per cent of all EU trade in services was conducted with the US.

6.29 Moreover, it is in the investment relationship that the economic interdependence between the EU and the US is at its most evident. For example:

- around half of all US FDI during the 1990s went to Europe;
- at \$1.4 trillion, the sales of US affiliates in Europe in 2000 accounted for more than half of all US foreign affiliate sales, and were double the comparable figures for the Asia-Pacific region; and
- EU businesses account for nearly 75 per cent of all FDI into the US during the same period, and \$1.4 trillion of affiliate sales in the US.

6.30 The US and Europe are therefore major sources of growth and income for one another. Indeed, research suggests that the transatlantic economic relationship may account for up to \$2.5 trillion of commercial transactions each year, including foreign trade to the value of \$500 billion, and provides employment to over 12 million people on both sides of the Atlantic¹⁶.

The benefits of closer cooperation **6.31** The potential benefits from closer bilateral economic cooperation between the EU and the US are substantial. In May 2003, HM Treasury, and the Dutch Ministry of Finance commissioned two studies by the Centre for Economic Policy Research (CEPR) and the European University Institute (EUI) on the nature and benefits of closer economic cooperation between the EU and the US¹⁷.

6.32 Drawing on earlier empirical work, the CEPR conclude that full liberalisation of transatlantic trade could lead to an annual income gain of up to 2 per cent of GDP in the EU and of up to 1 per cent of GDP in the US. The additional gains to the EU arise from the positive impact that openness to US competition would have on economic reform in Europe. The greater segmentation of EU markets relative to those in the US, means that further transatlantic integration would have a relatively larger competitive impact on the Single Market and therefore, as described earlier in this chapter, a greater impact on growth and productivity.

6.33 The studies also point to a series of obstacles to closer integration, highlighting regulatory differences, rather than tariffs, as being of growing importance. Although low, tariff barriers between the EU and US do remain and should be reduced further in the Doha round of multilateral trade negotiations. However, regulatory differences, though often a reflection of legitimate domestic concerns, can in practice erect new barriers to transatlantic commerce and to the realisation of additional economic gains. The EUI therefore concluded that the EU and the US should work together to improve understanding of the sources of transatlantic regulatory barriers and disputes, with a view to strengthening cooperation over regulatory issues in the future.

Moving ahead **6.34** The Government strongly endorses this conclusion. Closer economic integration could deliver significant benefits to businesses and consumers on both sides of the Atlantic and further work is needed to tackle the barriers that remain. **In November 2003, the**

¹⁶ *Drifting apart or growing together? The primacy of the transatlantic economy*, Center for Transatlantic Relations, Johns Hopkins University, 2003.

¹⁷ See, *The political economy of the transatlantic partnership*, compiled by the European University Institute, and *Enhancing economic cooperation between the EU and the Americas: An economic assessment*, compiled by the Centre for Economic Policy Research, both published by HM Treasury, May 2003.

Chancellor of the Exchequer and the US Treasury Secretary therefore announced their support for a new study, led by the OECD, to quantify the potential benefits of closer economic cooperation between the EU and the US. The study will assess the potential gains stemming from the removal of tariff and non-tariff barriers and seek to identify priority sectors in which enhanced cooperation would yield the most immediate economic benefits to both the EU and the US, complementing and reinforcing the established Positive Economic Agenda, agreed by the European Commission and the US administration in May 2002. The proposed study has already received enthusiastic support from the OECD Secretary General, from the EU Chair of the Transatlantic Business Dialogue and from an array of EU Finance Ministers. The Government urges other EU Member States to offer their full and constructive support for this work.

6.35 Looking ahead, the promotion of financial services integration should be a priority. More efficient financial markets should lead to higher investment, growth and welfare and reduced costs to benefit consumers, producers and economies on both sides of the Atlantic. The Government therefore believes that the EU and US should commission an expert study into the benefits of a single transatlantic capital market, as recommended by the Transatlantic Business Dialogue in November 2002, and that the existing regulatory dialogue should be expanded to consider a broader range of issues, with wider participation and a more forward-looking agenda.

6.36 Further steps are also needed to establish an Open Aviation Area between the EU and the US. The 2003 EU-US Summit in Washington agreed to work towards a comprehensive agreement on transatlantic air services. The Commission's mandate envisages a comprehensive and fully liberalised agreement under which airlines owned and controlled by nationals of EU Member States and the US would be able to fly on whichever routes, and at whatever frequency, they wished. The Government supports this approach, which has the potential to bring significant benefits for consumers and airlines in Europe and the US.

MEETING THE CHALLENGE OF SUSTAINABLE DEVELOPMENT

6.37 Europe's responsibilities in the global economy extend beyond its role in promoting open markets and free trade. Europe must also acknowledge its wider international responsibilities to pursue the goals of sustainable development, with economic growth that ensures fairness between generations. As it strives to achieve the Lisbon goals, the EU must continue to challenge and stretch traditional perceptions of growth, ensuring that progress is made on three fronts – economic development, environmental protection and social cohesion. It must also continue to play a leading role in international efforts to tackle global poverty and advance the international community's Millennium Development Goals.

EU leadership 6.38 The World Summit on Sustainable Development (WSSD) in 2002 called for a step change in the international community's approach to sustainable development. The EU Sustainable Development Strategy (SDS) is the vehicle through which Europe can, and must, continue to demonstrate global leadership in the pursuit of these objectives. **The EU must now commit itself to the further action needed to implement international commitments arising from the WSSD** – for example, the ten-year programme for sustainable consumption and production – making full use of the 2004 review of the SDS and establishing new mechanisms to ensure effective and regular monitoring of progress in delivering them.

Protecting the environment

Supporting environmental technology 6.39 Environmental technologies can play a vital role in meeting the challenge of sustainable development. Support for the development and deployment of new technologies can help to deliver important environmental benefits while maintaining Europe's competitiveness and promoting long-term growth. To ensure that Europe can remain

competitive in this field, **the Government believes that more must be done both to encourage innovation in environmental technologies and, critically, to support the commercialisation of new technologies.** This will require further action at the Member State and Community level, including to:

- consider how support provided under the Research Framework Programme – described in Chapter 5 – could be improved to increase its impact on the development of environmental technologies and speed up the process through which research outputs are taken through to demonstration projects;
- strengthen and extend the existing voluntary agreements between the Commission and industry to reduce vehicle emissions, to provide further incentives for the development of cutting edge vehicle technologies;
- review and revise the state aid guidelines for environmental protection to ensure that they provide sufficient flexibility for Member States to provide effective support to environmental schemes, while respecting the need to promote competition within the Single Market; and
- rapidly develop new means to support environmental technologies, possibly through the European Investment Bank.

Climate change 6.40 Climate change is among the greatest challenges to continuing global prosperity. Without fundamental changes in the way in which countries generate and use energy to power their economies, the pace of climate change is likely to accelerate in the next 50 years, with those worst affected often the least able to afford adaptation measures. As it works to advance the Lisbon goals, Europe must therefore continue to give leadership to international action to address climate change.

6.41 The Kyoto Protocol commits the EU to reduce greenhouse gas emissions by 8 per cent below 1990 levels between 2008 and 2012. The Government strongly supports this commitment. The UK's own national goal is to move towards reducing carbon dioxide emissions by 20 per cent by 2010. Beyond this, the Government aims to put the UK on a path towards reducing carbon dioxide emissions by 60 per cent by 2050.

6.42 However, more must be done if Europe is to fulfil its commitments under the Kyoto Protocol. According to the latest EU emissions projections¹⁸, existing measures may only deliver a 0.5 per cent reduction in emissions by 2010 – far below what it is required under the terms of the Kyoto Protocol. Moreover, while the implementation of additional planned measures would allow for further progress – possibly producing a 7.2 per cent reduction in emissions – realisation of these gains will require over-achievement by several Member States. **The Government therefore believes that further action is needed, building on the momentum already established to deliver faster progress towards the Kyoto targets.** In particular:

- progress made in implementing the EU Climate Change Programme should be thoroughly reviewed in 2004, to inform proposals for additional action needed to ensure successful delivery of the Kyoto targets; and
- Member States should consider the need to establish longer term greenhouse gas emissions reduction targets, perhaps with a view to such targets being established at the European level in 2005.

Emissions trading 6.43 An EU-wide Emissions Trading Scheme (ETS) will begin on 1 January 2005. Emissions trading will encourage emission abatement where it costs the least and will help all EU Member States to meet and, potentially, go beyond their Kyoto targets. The UK has already made emission trading a central plank in its emissions reduction strategy, having introduced the world's first economy wide emission trading scheme in 2002.

¹⁸Fourth annual progress report on greenhouse gas emissions under Council Decision 93/389/EEC as amended, European Commission.

6.44 The Government welcomes the ETS as a flexible and imaginative approach to tackling environmental challenges. By creating a value for carbon emissions, the trading scheme will create financial incentives for abatement, reducing emissions and providing a spur for the innovation needed to deliver the larger reductions necessary to stabilise levels of carbon dioxide in the atmosphere in the longer term. Emissions trading should also allow for cost-effective abatement, promoting business development and competitiveness consistent with environmental protection.

Tackling global poverty

6.45 In seeking to meet the challenge of sustainable development, Europe must also acknowledge its wider responsibilities in the fight against global poverty. The EU endorses the international community's Millennium Development Goals (MDGs) – global targets for 2015 to halve the proportion of people living in extreme poverty, reduce child and maternal mortality, and reverse the spread of HIV/AIDS, malaria and other killer diseases. **Europe must now play a leading role in international efforts to achieve the MDGs, advancing a new global compact built on trade liberalisation and additional financing for development.**

EU aid to developing countries

6.46 As described earlier in this chapter, the potential impact of trade liberalisation on poverty reduction is very significant indeed. However, if they are to realise the full benefits, low-income countries need to sequence carefully their own trade reforms within their development strategies and to build their capacity to take advantage of new trading conditions. Progress will only be made with additional action to enhance and improve aid flows to developing countries. Additional aid is essential to raise investment in poverty reduction, health and education, and to provide funding for public investment in human, social and physical infrastructure. It is the natural counterpart to trade liberalisation, helping to ensure that developing countries have the capacity to benefit fully from increased market access.

6.47 According to the World Bank, to maintain current average rates of world economic growth, growth in developing countries must rise significantly in the future with their share of global GDP doubling to 40 per cent by 2050. This reality imposes a pressing need for EU Member States, as a major part of the international community, to deliver additional financing for development and further improvements in the effectiveness of both bilateral and Community assistance, so that no country genuinely committed to poverty reduction should be denied the chance of achieving its goals through lack of resources or opportunities for growth.

6.48 The EU has already taken some positive steps. The Member States have jointly agreed to increase the total volume of their official development assistance to 0.39 per cent of EU gross national income by 2006. And many Member States have made poverty eradication the principal aim of their development efforts. But much more needs to be done, particularly in the case of the Community budget, to ensure that grant assistance is focussed on the world's poorest countries and used to fund activities that have the largest impact on poverty reduction. **The UK Government has therefore put forward proposals to improve the effectiveness of the Community's external assistance budget, which build on the Commission's ongoing management reforms and Europe's pledge to harmonise development policies and procedures and to untie aid at all levels.** The UK proposals are designed to deliver a step change in Community aid effectiveness and provide the basis for a refocusing of grant assistance on low income countries, where it can have the greatest impact, for the duration of the next Financial Perspective and beyond. Progress towards improved aid effectiveness will be an important test of the Union's continuing and genuine commitment to meeting its development responsibilities.

An International Finance Facility 6.49 Even assuming Europe improves its aid effectiveness and delivers on its international commitments, the best available evidence suggests that an additional \$50 billion of global development assistance is needed if the MDGs are to be met. Despite additional pledges of a further \$16 billion a year by 2006 there is still a significant funding gap. To close this gap, **the UK Government has proposed a new International Finance Facility (IFF), designed to deliver the additional resources needed to meet the MDGs by frontloading aid through the international capital markets.** The IFF has the potential to improve aid effectiveness, delivering predictable aid flows targeted at the poorest countries by locking in long-term commitments from donor countries, including the EU. Funds would then be leveraged from these commitments and disbursed mainly in the form of grants and additional debt relief. The IFF has the potential to deliver at least an additional \$50 billion a year, including \$25 billion a year to Africa. In September 2003, EU Finance Ministers agreed to support further work on financing for development, including the IFF. Moreover, at the 2003 Dubai Annual Meetings, the World Bank and the IMF were called upon to make an interim report on these issues at the 2004 Spring Meetings and to deliver a full report at the autumn 2004 Annual Meetings, in order that the substantial additional resources needed can be mobilised urgently, including through an IFF.

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