EUROPEAN POLICY CENTRE

EPC WORKING PAPER N° 18

An agenda for Sustainable Growth in Europe

Final Report

EPC Growth Task Force

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March 2005

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GROWTH AND JOBS

EUROPEAN POLICY CENTRE

EPC WORKING PAPER

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Preface

Economic growth is not an end in itself. Rather, economic growth is there to serve a greater ambition: the creation and maintenance of a vibrant, socially inclusive and environmentally sustainable European society. Economic growth is a means to achieve these wider ends.

The challenge, then, of boosting the growth rates of the European Union is part and parcel of the challenge of creating the necessary balance between economic prosperity, social justice, the development of intellectual capital and respect for our shared environment. Without higher growth rates in the European Union, none of these aspirations will be realised. Much, therefore, is at stake.

In this, the final report of the EPC's Task Force on the European Growth Initiative, we underline that there is much that the European Union should be proud of. We reject the pessimism which often governs the public discussion in the European Union.

Yet, the successes of the European economy cannot disguise persistent shortcomings. The total employment rate in the EU still lags almost 10% behind that of the US labour market. The EU would have to employ almost 17 million additional people to close this gap. Productivity in the EU has stagnated in recent years, now at almost 20% lower[1] per employed person than in the US. These are the main reasons why, today, GDP per capita is more than 30% higher[2] in the US than in the EU. Add to this the low fertility rates in the EU, and the impending explosion in the number of pensioners Europe, and the reasons why urgent action is required to boost EU economic growth becomes self evident.

The EU is not starting from scratch, given the already successful launch of the internal market, the introduction of the euro and the most recent enlargement. Both the Lisbon Agenda and the Sustainable Development strategy are important tools which set out the route towards stronger, sustainable growth. But far more political commitment is needed to turn the potential for strong EU recovery into reality.

This report is addressed to all decision makers in the European Union. The intention is not to provide yet another exhaustive analysis of the policy remedies required. Rather, our initial list of 10 points is designed to highlight some of the most crucial aspects of the process of economic reform in the European Union. The 10 points are followed by a closer examination of two areas that, in the opinion of the group, deserved a more detailed analysis: labour market reforms and innovation and entrepreneurship in Europe.

In drafting this report, we based our analysis on a number of underlying assertions:

- That a careful balance must be maintained between the role of the European Union itself and the duties and responsibilities of the Member States. Failure to implement commitments made at EU level by Member States is a persistent shortcoming in the pursuit of greater economic growth and competitiveness. On the other hand, the freedom of Member States to compete and exploit national advantages must not be threatened by excessive harmonization at EU level.

- That, in an enlarged EU with greater political and commercial diversity, new EU regulation must be ever more intelligently crafted in order to be effective. This is especially so in view of the EU's recent enlargement to twenty-five members. Regulation which provides incentives for individuals and companies alike to operate on a level playing field is most likely to succeed.

- That raising productivity and increasing job creation should go hand in hand. At present, high productivity levels are often accompanied by low employment rates, and higher employment rates by low productivity. Such a choice is not inevitable, and there are good examples in the EU of economies that possess both high levels of employment and impressive productivity levels. A relentless emphasis on innovation, intellectual capital and the fostering of dynamic, new economic sectors is needed.

- That job security and labour market flexibility must also go hand-in-hand. The assumption that one opposes the other is false. Job security for those employed cannot be guaranteed on the back of Europe's unemployed. Lowering barriers for those wishing to enter the labour market does not necessitate the lowering of generous social security support, as long as that support does not act as a disincentive to seeking employment.

The detailed section on labour market reforms (*Reform at Work: Jobs as the Centrepiece of Growth in Europe*, page 37) covers much familiar analytical territory concerning the lack of employment-intensive economic growth in large parts of the EU, and sub-optimal labour productivity.

However, the key assertion made in this section is that labour market regulations which protect those in work - at the cost of those seeking employment - have the perverse effect of increasing overall insecurity in the labour market rather than enhancing the security of employment. High barriers to enter and exit the labour market increase the time required for those out of work to find new employment. Thus, levels of employability are reduced in the workforce as a whole. Empirical evidence shows that the longer it takes to find new work, the higher the general feelings of insecurity in the labour market.

The key ingredients for a dynamic, successful labour market, then, are limited regulations governing the creation and cutting of jobs, combined with generous, targeted welfare benefits and active employment policies (training, job search facilities, etc.) which encourage and assist those who seek work to do so as rapidly as possible. This combination of light labour market regulation and well-funded benefit and employment policies, producing both flexibility and security ("flexicurity"), already exists in some Member States, notably in the Nordic countries. The section concludes with an analysis of the transferability of this best practice to other parts of the EU. While there are significant public expenditure costs in following the "Scandinavian model," these are not out of reach of a number of Member States who are, at present, simply devoting resources to policies which are failing to create either jobs or enhance feelings of job security.

The section on innovation and entrepreneurship (*Towards a More Innovative and Entrepreneurial EU*, page 59) restates the urgent need for the EU to continue to raise the levels of public and private investment in research and development. More importantly, it shows that even with increased funding, too much R&D is spread across too many locations within the EU. The tendency for Member States and regions to create their own plethora of R&D "clusters" simply risks squandering the EU's collective potential. A concerted attempt must be made to concentrate the bulk of the EU's R&D efforts in a limited number of centres of excellence, even if that means that some areas of the EU will be left without their own flagship initiatives.

Scale is also identified as a key problem in the analysis of the restraints on the growth of competitive high-growth enterprises in the EU. While the obstacles to business start-ups are familiar, the wider challenge is to provide conditions in which the sustained growth of innovative companies is fostered, so that they can grow in size over time. This includes everything from the streamlining the regulatory environment to easing access to capital. The section concludes with a consideration of various fiscal incentives (e.g. exemptions from social contributions or non-profit related taxes) which could be employed to help high-growth companies develop their potential during the crucial stages of their early development.

The principal purpose of this final report is to act as a wake up call to policy makers everywhere, especially in light of the mid-term review of the Lisbon Strategy in March 2005. The members of the EPC Task Force are drawn not only from the corporate world, but also from labour and environmental organisations. The claim, therefore, that this group represents an important spread of opinion from both the private sector and civil society is fully borne out in the findings represented in this report.

In the meantime, we hope that this paper provokes discussion, and helps foster an environment in which active policy reform can take place throughout the European Union.

Nick Clegg
Chairman, European Growth Task Force

1. Recommendations: 10 Do's and Don'ts on Growth and Jobs

1. ***Do take the EU growth challenge seriously*** *and restore momentum to the Lisbon Strategy. Growth is not an end in itself but the means to maintain the quality of life all Europeans deserve. Our continent's well-being depends on it. The objective of transforming the EU into the world's most competitive knowledge-based economy remains a valid goal.*

2. ***Don't give in to pessimism.*** *The EU is a global leader in sustainable development, has great economic strengths, is a magnet for foreign investment, a powerhouse of intellectual capital, a catalyst for global trade, and an unrivalled trans-national single market. But the re-establishment of sustainable economic growth is a complex process, which requires tough choices.*

3. ***Do foster a better and more dynamic climate for innovation, entrepreneurship and investment.*** *The development of sustainable entrepreneurial initiatives and the achievement of technological leadership, the adoption of Information and Communication Technologies, easier access to capital, and labour mobility and flexibility must enjoy full political support and necessitate a smart use of the available resources. Risk-taking must be encouraged and rewarded.*

4. ***Don't let EU Member States off the hook.*** *Future prosperity cannot be invented in Brussels, especially in view of the EU's dramatic recent enlargement. Most of the measures to establish economic growth, social progress and environmental sustainability need to be taken at a national (or regional) level, but there is great scope to learn from each other and to coordinate policy measures more effectively than at present.*

5. ***Do remember the fundamental value of the European Social Model****. Lowering all social protection is not the answer. The most competitive members of the EU have economies with high employment rates and progressive welfare policies, which can serve as examples for others. The trick is to provide social support, which encourages - rather than discourages - employment.*

6. ***Don't always assume the best remedy is additional EU regulation.*** *Be selective in creating additional EU regulation in order to create value-added at European level. Better regulation, subject to transparent and rigorous scrutiny, is vital. Concentrate on implementing what has already been agreed, notably in completing the Internal Market, as much as on something new.*

7. ***Do everything possible to invest in education and boost research capabilities in Europe.*** *Europe's human capital is its most valuable asset. Europe needs to improve the relevant framework conditions to stop the "brain drain" and provide incentives to link up universities with the private sector.*

8. ***Don't believe that European citizens are not willing to work****. Long-term unemployment, especially amongst elderly workers, is a scar on European society, not a choice. Over-regulated labour markets and high labour-related taxes and fees can act to protect those in work whilst deterring the creation of new jobs.*

9. ***Do remember the public****. So far, a large part of the Lisbon process has been a debate between national governments. The public must be involved and so should local and regional governments; there is no reason why citizens should accept their governments' failings when remedies are available. Communication is key.*

10. ***Don't forget the bigger picture****. Innovation and sustainability are the key to improve Europe's international competitiveness. Future prosperity depends on a carefully balanced blend of growth, environmental sustainability and social inclusion. Social cohesion and environmental protection are not impediments to economic growth, but necessary conditions for all dynamic and sustainable economies.*

1. Do take the EU growth challenge seriously

Low growth and high unemployment continue to be a European disease. There are some early signs of economic recovery but not enough to inspire confidence. A breakdown of GDP factors illustrates weak outcomes, especially in the area of investment.

EU-GDP growth components (annual % changes)

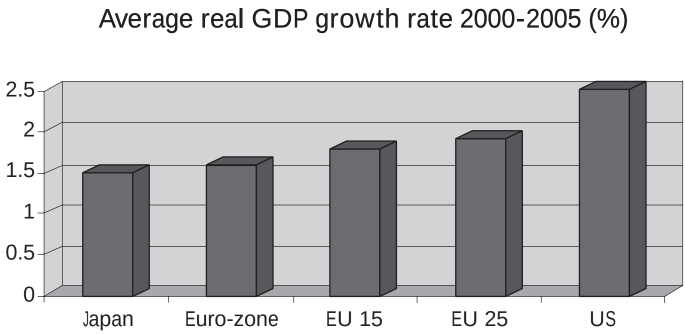
	EU-15				
	1991-2000	2001	2002	2003	2004
GDP	2.1	1.7	1.1	0.8	2
Private Consumption	2	2	1.2	1.5	1.8
Government Consumption	1.7	2.3	2.7	2	1.4
Investment (GDCF)	2	0.6	-1.9	-0.4	2.7
Exports	6.9	2.7	1.2	0.3	5.3
Imports	6.3	1.3	0.6	1.7	5.2

Source: Statistical Annex of European Economy

Why is higher productivity important?

It is generally agreed that approximately two thirds of the growth difference between the EU and the US is linked to lower labour utilisation, higher unemployment, more leisure time, shorter working hours, etc., but the rest can be ascribed to lower labour productivity in Europe.

If Europe is to return to strong and sustainable economic growth, more and better jobs are needed. Boosting employment is not enough. The spread and application of knowledge that can lead to jobs which generate higher productivity is vital. Otherwise, the EU will fall into a downward spiral of low productivity, low income, low consumption and, ultimately, low growth.



Source: Structural Indicators, EUROSTAT

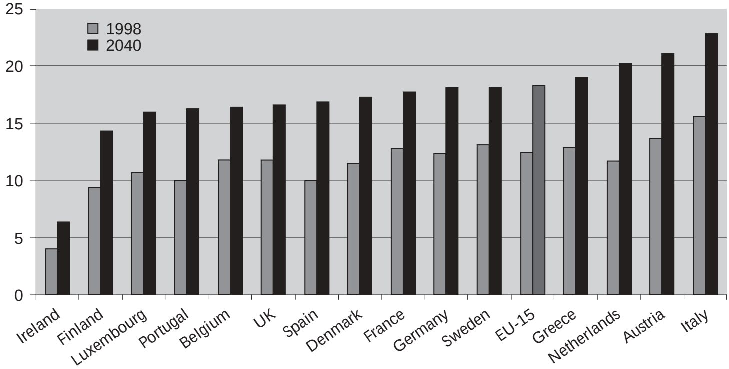
The demographic challenge

The EU faces an additional pressing problem, which does not occur in other parts of the world: European countries have low birth rates, ageing populations and still harbours distrust towards immigrants.

Projections show that by 2050 there will be one pensioner to every working person, reducing growth to less than 1%, with severe cuts in GDP per capita and general welfare. Migration is a defining characteristic of today's world and represents a moral challenge for Europe. Yet, it can also be a useful tool in combating the problems that arise from demographic change. It could help reduce labour shortages in key sectors, such as ICT or health care, as well as low-skilled occupations. It could also spread the effects of the economic transition over a longer timescale, thus limiting the immediate impact of demographic change.

There are not many options. If Europeans want to maintain their high standards of living, serious reforms need to be launched urgently in order to address the problems of an ageing and under-performing continent.

The challenge of population ageing in Europe
Pensions as percentage of GDP



Source: OFCE, Paris

2. Don't give in to pessimism

The EU is a global leader in many areas, but has not been successful in conveying this message to the rest of the world. All too frequently it is seen – even by Europeans – as a historical and cultural paradise rather than a truly innovative venture.

But it is also a fact that some members of the EU are persistently the best performing countries in the world, whether it is with regard to competitiveness, innovation or human development. Learning from their experience would be a good starting point. Europe is already a global leader in different fields – telecommunications, environment, optics, tourism, etc. – including the means toward building an inclusive society. It also plays the role of 'standards setter' at the global level in different fields such as in environment or financial provisions. Furthermore, Europe is a global leader in sustainable development. This is an area of major comparative advantage and the EU should become the global reference point, creating new markets and jobs, becoming more energy-efficient, demonstrating the link between environment and welfare, exporting our knowledge and creating a new culture of sustainable development.

The Lisbon Strategy

The strategy for developing Europe's model already exists. The Lisbon Strategy is a comprehensive plan designed to equip Europe with means to meet current and future challenges. Implementing the Strategy would result in higher living standards that could be sustained through stronger economic growth, social inclusion, investment in human capital and the information society as well as the protection of the environment.

Yet, the general view is that implementation has been poor and that a strong push is needed in many areas. Despite the negative perceptions in the media and elsewhere, some significant advances in the economic reform process have, in fact, been achieved:

- The adoption of a substantial body of legislation, actions and measures aimed at achieving the Lisbon targets;

- The creation of more than 6 million jobs since 1999;

- The full or partial completion of certain networks (telecommunication, rail, freight and gas); and

- Concrete progress towards a knowledge-based society, with a significant increase in broadband and mobile users as well as eGovernment services.

However, many important challenges still remain. It is now time for **implementation** rather than for the planning of new strategies or initiatives. In addition:

- The complete transition towards a **knowledge-based society** is a top priority and further efforts are urgently needed.

- The role of **legislation** and the **division of powers**, between national and EU institutions and between the EU institutions themselves, need simplifying.

- Greater policy **coherence must be achieved** so that policies support, rather than contradict each other.

- The focus should be on **innovation** rather than imitation.

- Available funds must be used intelligently. **Financial resources**, both at national and EU level, must be put in place to accomplish agreed objectives.

- The exchange of **best practice** needs greater emphasis.

- There should be a greater focus on those areas in which Europe potentially enjoys **comparative advantage**.

- **Social cohesion** and **environmental sustainability** should not be seen as trade-offs, but as contributors to the EU's long-term competitiveness.

- The **Stability and Growth Pact (SGP)** needs much closer interaction with Lisbon's goals and the Internal Market needs urgent completion and updating.

- It is high time for a **public debate.** Lack of public awareness results in a lack of bottom-up pressure to achieve the Lisbon goals.

The Lisbon Strategy also has a strong, but often forgotten, external dimension.

The EU must also:

- Respond to the challenges posed by **international trade and labour** competition by "re-skilling" and developing new areas of competitive advantage.

- Find new approaches to the **management of globalisation** and to reconcile the opportunities it creates with the difficulties that go with it.

- Develop proactive **international partnership** with other leading economies to promote liberalisation of trade in goods and services in the framework of the Doha Development Agenda.

- Accept that globalised **international competition** and greater **capital mobility** may erode the capability of European economies to maintain the fiscal basis of their social models.

- Promote the idea of a more **socially inclusive** and **secure world,** as is demanded by very different fora. Europe has the answer and must become the reference point at international level.

3. Do foster a better and more dynamic climate for innovation, entrepreneurship and investment

Europe must give priority to the creation of an environment that gives confidence to existing enterprises, is attractive for investments and stimulates the development of global leadership in major industrial and technological areas.

For this to happen the EU must send strong signals, by providing an improved climate for entrepreneurship and the implementation of structural reforms that enable innovation and competition. The completion of the Single Market, overcoming inefficient regulation, increasing labour flexibility, the provision of risk capital, usage of new technologies, and investment in education and R&D are vital steps.

The list of basic requirements for a more innovative and entrepreneurial Europe includes:

- Improving the financial environment. This is still an under-exploited area and further measures, such as micro-credits and programmes for seed capital (initial investment funds for a project or start-up company) need rapid development.

- Promoting the creation of new companies through networks and services that promote closer contact between the different relevant inputs: policy making, research facilities, financial services, etc.

- Providing SMEs with proper attention and support according to their relative importance to the European economy.

- Ensuring sufficient R&D funding and promoting closer contacts between science and industry so that research findings are translated more effectively into new products and services.

- Establishing a regulatory environment that fosters investment and encourages the development of innovative business models.

- Improving training and education provisions in order to build up an innovative business culture.

- Accelerating the adoption and use of new technologies, especially in the information and communications technology field, a key driver for enhanced competitiveness not only in the private sector but also by public authorities.

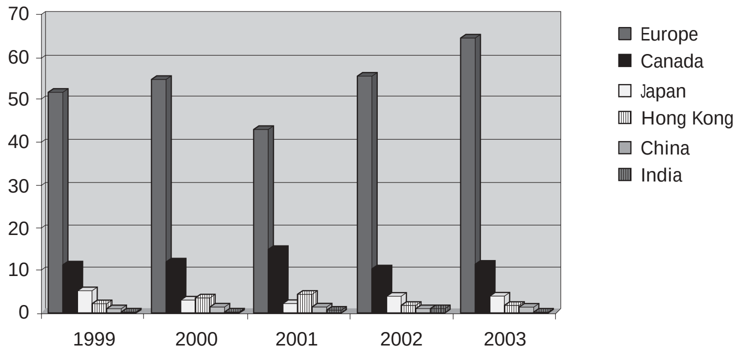
The good news is that initial steps have been taken towards the creation of a better environment for business and first positive signs are becoming visible. A recent study[3] analysing business conditions around the world singles out the EU as the busiest reformer. It includes indicators which measure the simplicity of starting a company, enforcing contracts, obtaining finance, protecting investors, etc. Although there is still a long way to go, it conveys a real change of mood in the EU.

The EU as a recipient of Foreign Direct Investment

Much has been said about the EU as an increasingly unattractive place in which to invest. Mounting regulation and slow growth are the most common complaints. Nevertheless, statistics contradict these comments and highlight rather positive and even puzzling trends.

Europe is obliged to retain current levels of investment and significantly increase its competitiveness. An EU Pact for Investment, with a coherent and integrated approach, could prove to be useful and timely and would send a clear signal to the rest of the world.

US Foreign Direct Investment (%)



Source: US Dep. of Commerce

4. Don't let the EU Member States off the hook

"The European Council agrees that the critical issue now is the need for better implementation of commitments already made. The credibility of the process requires stepping up the pace of reform at Member State level. Enhanced monitoring of national performance is needed, including information exchange on best practice. There must be speedier translation of agreements and policy making at EU level into concrete measures. The European Council underlines the need to address the unacceptably high deficits in transposing agreed measures into national law, and to complete the legislative programme arising from the Lisbon Agenda."

Presidency Conclusions, Brussels European Council
25/26 March 2004.

The responsibility for implementing the Lisbon Strategy does not lie with the EU institutions alone. Many of the reforms required to boost EU growth are the exclusive competence of the Member States who have the overriding responsibility to put a common framework in place that will provide prosperity and high living standards for future generations. This was the aim of the Lisbon Strategy from the outset.

The different levels of government within the Member States have a vital role to play. It is crucial to involve regions and local authorities and other stakeholders, such as civil society and business. They are frequently the motors of best practice and the source of positive peer-pressure within and across borders. Regional policy plays a fundamental role in this regard and in easing the transition towards achieving the Lisbon objectives.

Completing the Single Market

Since the internal borders were removed more than ten years ago, the internal market has proven to be a driving force for the EU. It has increased economic growth by approximately 1.8%, and has fostered the creation of 2.5 million new jobs, but it is still not a full-fledged reality.

The internal market needs to be optimised quickly, as it is the basic foundation on the path toward turning the EU into a global leader. The Internal Market Strategy 2003-2006 provides a good basis for action.

Areas requiring urgent action:

- The Community Patent.
- The Directive on Recognition of Professional Qualifications.
- The Financial Services Action Plan's investment services and transparency Directives.
- The Directive on Services.
- The Trans-European Transport network (which must be driven forward, particularly after the Union's enlargement).

5. Do remember the fundamental values of the European Social Model

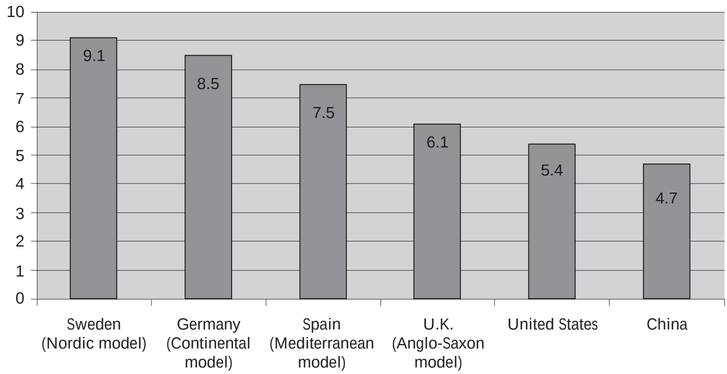
The European economic and social model is a generic definition of how Europeans choose to organise their societies and their life choices according to different sub-models that share essential characteristics. It is not, however, set in stone, and changing circumstances mean that the model needs to be updated.

Employment is a major issue and it is essential that the model helps to reduce unemployment, instead of promoting it. It must provide a catalyst for rejuvenating the labour market by combining and fostering higher levels of flexibility and mobility without harming social protection.

Contrary to widespread belief, maintaining social protection and achieving high levels of competitiveness are not contradictory aims. On the contrary: the most competitive economies in Europe enjoy highly developed social security models with large public sectors. In these countries, the public sector has been able to "reinvent" itself, changing from a slow-moving bureaucracy to an active driver and a reliable partner towards increased growth and innovation.

Most importantly, fiscal and regulatory burdens on employment (non-wage labour costs, rules for dismissal, etc.) are light, while social security provision for those genuinely unable to find work remain generous.

Different social models, different levels of poverty
Income share held by lowest 20% (2001)



Source: World Bank

The role of the public sector

Citizens evaluate the effectiveness of the social model on the basis of their own experience: "getting value for their money." The public service sector has traditionally been in charge of the management of different aspects, such as security, education and health. One of the biggest challenges in updating and reforming the social model is to make it live up to the aspirations of a changing society while simultaneously making it responsive to citizen's needs.

Innovation plays a key role. The public sector accounts for approximately half of the Member States' economies. It should, therefore, become a driver towards achieving competitiveness, by transforming itself into a modern and innovative administration, focussing on the needs of citizens and businesses.

As such, it should concentrate on:

- Providing better and more efficient services to citizens. From education to environment there is a wide range of opportunities to invest in society and contribute to growth and competitiveness.

- Finding better means of allocating public expenditures. Many Member States could improve the environment in which businesses prosper, while maintaining high quality social services.

- Improving cooperation and coordination across Member States and implementing pan-European eGovernment services

Modernising the European social model can be a decisive tool for achieving high levels of competitiveness and a major factor for advancing sustainability. Its success depends on the ability to innovate and re-structure itself in response to new challenges, by allocating adequate resources to growth-creating measures and quality services. In other words, we need to identify the critical aspects that will provide welfare and prosperity to society as a whole.

Public goods

At the same time, there is a need for a public debate on the definition of public services that ensure the provision of high-quality and affordable services of general interest to all citizens and enterprises in the EU, as a fundamental element of the European social model.

What should be done about the social model?

- Rethink the benefits of micromanaging the economy. Is excessive intervention in labour and product markets always a positive for the economy?

- Emphasise the importance of key areas such as R&D, ICT, education and the environment to achieve excellence.

- Transform the culture of governance into real public management, capable of designing a coherent and sustainable strategy for the future.

- Implement better management and better regulation (human resources, financial, budgeting, etc).

- Design a coherent and approach to combine working and family life.

6. Don't always assume the best remedy is more EU regulation

Regulation at the EU level seeks to strike a balance between minimal economic disturbance and market efficiency on the one hand, and social, environmental and consumer protection concerns on the other hand. Therefore, EU regulatory activities are not in themselves obstacles to the attainment of the Lisbon objectives. On the contrary, they are driven by the aspiration of creating a competitive and sustainable Europe – the same key principles as those anchored in the Lisbon Strategy.

However, regulation can stifle economic development and deter investment because of compliance costs, administrative burdens and cumulative effects. This can be a large barrier for entrepreneurs, small firms and growth companies that are key to innovation. This is particularly true for increasingly competitive markets where conditions should foster investment and the development of new products and services, rather than apply past regulatory concepts.

The reform of EU regulatory procedures is vital in light of the Lisbon Strategy. EU and national regulations impact directly or indirectly on economic activity, international and European competition and innovation. Reforming regulatory procedures could have a major impact on the Lisbon Strategy. Reforms like the one set out in the "better regulation" framework are a good example of that change in regulatory culture.

The EU level must:

- Rethink the concept of subsidiarity. Clarify the roles and responsibilities of the EU institutions and national governments in this regard.

- Develop a coherent Risk Communication Policy. The EU institutions should establish a formal and binding policy statement for effective risk communication, which would apply to all phases of the regulatory process.

- Provide MEPs and members of the Council with a set of comprehensive guidelines on regulatory quality requirements.

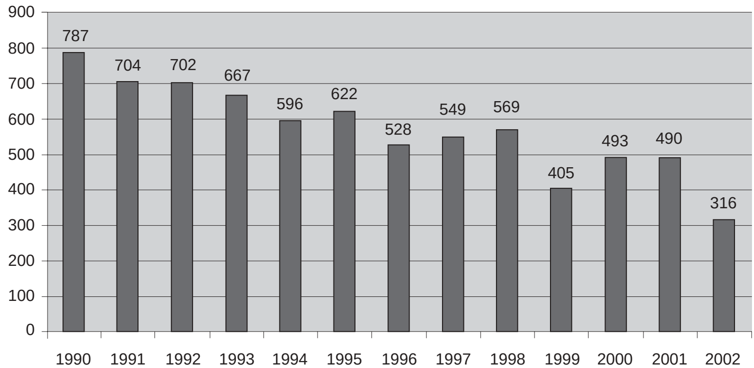
On better regulation

- Publish a formal and binding policy statement on Better Regulation.
- Enhance the role of the SME Envoy. SMEs should be fully informed about proposals that potentially affect their activity and be able to formulate recommendations.
- Upgrade the structure of the Council and the EP, and creating internal organisations responsible for improving inter-institutional coordination and carrying out impact assessments on any major amendments they submit.

At international level

- Intensify international cooperation on regulation, which implies following-up on the agreements reached with the US and Canada and further negotiation with other major economies, such as Japan or China.

An overall reduction of EU legislative acts in the last decade
Number of Commission proposals



Source: European Commission

7. Do everything possible to invest in education and boost research capabilities in Europe

Human capital is a necessity and a guarantor of a modern economy. Measuring competitiveness is measuring the development of human capital in a given society. The present “brain drain” of eminent European researchers shows the risk of loosing parts of this important asset for future developments in Europe.

Human capital should become Europe’s major comparative advantage, bearing in mind the traditional strong public expenditure in education. Human capital leadership requires more than financial efforts. Member States must accelerate the reforms undertaken.

The private sector must also play a more active role and the European Commission should promote and ensure a closer interaction between policy making, companies, universities and research centres and financial bodies.

What we need:

- Private investment in education and training. Increased partnerships between firms and universities would lead to higher private investment in education. These could be rewarded through fiscal incentives and stimulus allowing for a future commercialisation of R&D results.

- Promotion of science and technology to raise greater public awareness of the career prospects in these fields, with a strong focus on the female population.

- Better access to lifelong learning in order to achieve high employment rates and higher labour productivity.

- Facilitation of educational and professional mobility.

- Regeneration of teaching staff. By 2015, over a million primary and secondary school teachers will have to be recruited. A shortage of teaching staff would considerably slow down the emergence of Europe as a leading knowledge-based society.

Research and Development and Innovation

R&D is a major source of knowledge creation in today's world. Both public and private expenditure in the EU remains far below the commitments made at the Barcelona European Council in 2002 of achieving 3% of GDP by 2010.

One of the basic differences between the US and EU economies is the level of investment in R&D and the consequent effects this has on productivity growth and economic growth.

The consequences and advantages for the US include:

- better growth performance in R&D sectors
- larger weight in R&D intensive sectors
- higher R&D intensity in most sectors
- better Intellectual Property Rights (IPR) protection

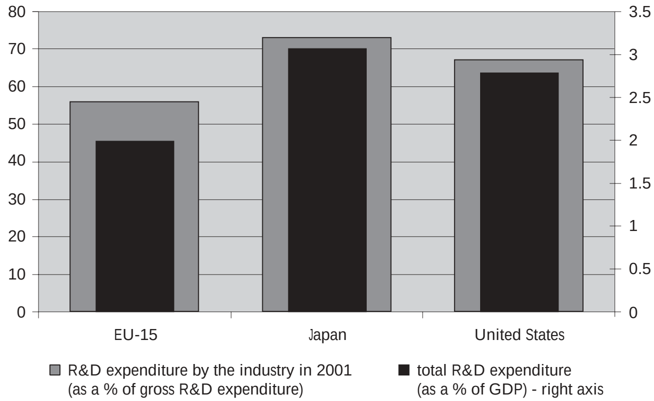
In general it can be said that US growth is more linked to R&D, while in the EU there is a large growth in capital-intensive industries (metals, paper, etc.).

At the same time, the right balance between the Union level and national measures must be found. Some other important measures would include:

- engagement of the private sector in R&D.
- proposal of a relevant number of priorities and themes that would mix theoretical breakthroughs and applied research.
- creation of a more attractive European Research Area for scientists and researchers.
- improvement of the IPR regime, allowing for easier cooperation between private and public research institutions and for smoother knowledge transfer to permit commercial product development.
- establishment of a clear link between R&D programmes and entrepreneurship.

- opening of the EU's Research Area to the rest of the world.
- determination of strategic priorities for future European technology leadership.

Insufficient private investment in R&D



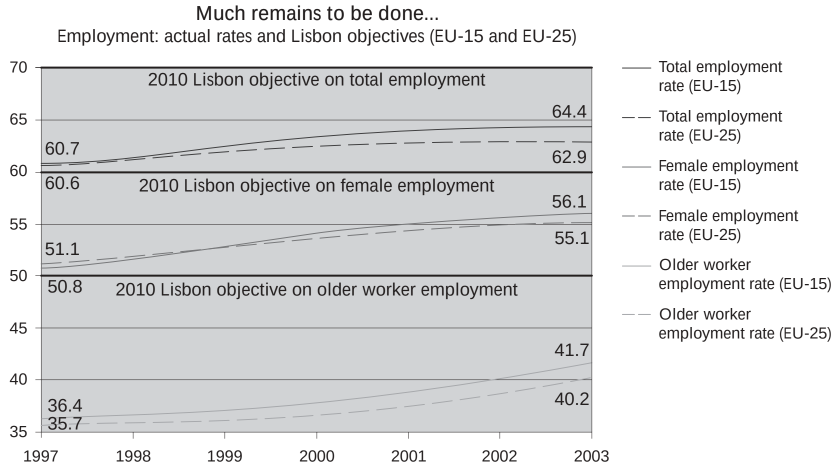
Source: Eurostat, structural indicators

Building a European Area of Knowledge

The EU should aim at the eventual creation of a European Area of Knowledge, which would favour a better climate for higher education, R&D and innovation. To reach these goals, many measures have still to be put in place. Better and more efficient coordination between the Member States, sufficient financial security, real involvement of business, etc., are some of the core elements needed to guide this objective. Needless to say, investing in innovation has an evident effect on higher productivity, economic growth and efforts to improve social welfare.

8. Don't believe that European citizens are not willing to work

Attaining the 2010 target of a 70% overall employment rate is becoming increasingly unlikely, with unemployment the scourge of European society for the last thirty years. In too many Member States, high levels of protection for those employed has been achieved at the cost of excluding large numbers of people from the labour market. Increasing employment-rich growth is a prerequisite for tackling the challenge of an ageing population.



Source: Eurostat, structural indicators.

Employment must become a real possibility for all. All different actors should contribute to a collective effort of promoting employment, easing the transition and integration of unemployed people into the labour market and finding better means of matching the unemployed with work and training opportunities.

A knowledge-based economy demands new and continuously updated skills. Investing in people and skills to generate greater human capital is a necessity.

Three areas require serious attention:

- **Education and Training:** The reform of the education system and the needs of the labour market must be reconciled, while improving the EU-wide recognition of qualifications.

- **Mobility:** Measures must be devised and implemented to release the full potential offered by the internal market.

- **Information:** General knowledge about the EU-wide labour market must be enhanced through more targeted information, to encourage people to make appropriate career choices, based on the most complete information possible.

There is a long list of measures that need urgent implementation to affect change and improve the functioning of labour markets within the EU.

These include:

a. A regulatory culture promoting markets, helping them to work better.

- Making labour markets more flexible
- Providing better fiscal incentives
- Creating an employment friendly tax environment

b. A job creation agenda based on productivity growth.

- Reinforcing the link between entrepreneurship and job creation
- Promoting new forms of work organization

c. A set of policies and regulatory mechanisms to enhance labour market flexibility and security.

- Increasing participation rates (not only disadvantaged)
- Consolidating active labour market policies (ALMP)
- Fostering life long learning
- Balancing work and family

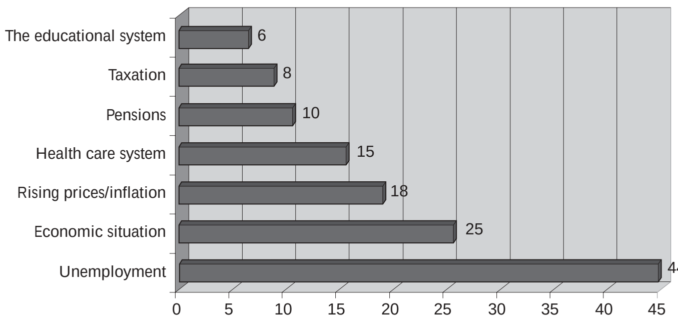
Europe needs to fulfil its economic potential, to lay the groundwork for a sustainable employment strategy with higher levels of productivity and enhanced confidence in the medium and long term.

Both the European Employment Strategy and the different commitments made by the Member States in this area have failed to achieve the desired results. With high employment a prerequisite for sustainable growth, it may be useful to study ways to strengthen and simplify the Open Method of Coordination (OMC) for employment at European level. Streamlining the instruments (the Broad Economic Policy Guidelines, the Employment Strategy and Action Plans) into a single coherent framework - an employment pact – might be a more useful way to achieve an Active Labour Market Strategy that Member States could support.

9. Do remember the public

The Lisbon Strategy was partly built on a bottom-up approach. The application of the Open Method of Coordination, was to at once create a basis for comparison between Member States and highlight the areas in which progress was insufficient to the public. The potential positive effect of bottom-up pressure is still amiss, however, despite the fact that the Lisbon Agenda actually addresses matters relevant to businesses and citizens as well as organisations representing a broad spectrum of societal interests.

Lisbon-covered issues of major interest to the EU cities
The most important issues our country is facing at the moment (EU-15) in %



Source: Eurobarometer, Spring Report 2004.

It is important to realize that the success of the Lisbon Strategy requires a change in mentality - not only for Member State governments. All social actors must be both informed and ready to play their part, as members of political institutions, business leaders, NGO representatives, university students, union members, consumers, etc. It is hard to understand why a strategy that targets some of the most basic interests of European citizens - from employment to health - should remain an enigma to the public at large.

In this, the European media also has a much stronger role to play in fostering the wider debate. While debates on employment, social, environmental and welfare reform rage on the Member State level, these are forever seen through the national lens. What is needed is more inclusive coverage, comparative coverage on these issues that all European governments are struggling to resolve simultaneously. Better information on best practices through independent sources will generate the type of peer pressure among various actors to the benefit of economic and social reform throughout Europe.

What is missing:

- Clear and strong leadership at European level.

- Better communication of the Lisbon process goals through all possible channels.

- Public debate to exert bottom-up pressure to achieve the Lisbon goals.

- National parliamentary debates on the Lisbon goals and national achievements based on the Spring Report.

- Full involvement of the social partners and civil society groups.

- An inclusive, Europe-wide debate on Lisbon through the media to foster positively competitive peer-pressure.

10. Don't forget the bigger picture

Sustainability is a crucial concept, and should not be relegated to buzzword status. It is the central pillar, the final defining characteristic of the European Model. Achieving sustainability must be the goal of all policies under the Lisbon umbrella, encouraging and demanding their coherence.

Achieving a balance between economic development and the natural environment is a key part of the sustainability concept, but factors such as social cohesion and financing developments also play a role.

Europe, in contrast with the United States, has a positive financial balance sheet with respect to its development. Both the external (balance of payments) and internal balances (public finances) are good – the latter primarily thanks to the strict rules enforced through the Stability and Growth Pact. While the US, in contrast, has recorded higher economic growth in recent years, its growth has come at the cost of financial sustainability. The external and internal economic balances in the US are clearly in the red and show no sings of stabilising. This gap between accelerated growth and the lack of financial basis for this development will have to be addressed at some point. Undoubtedly, a rebalancing cannot be achieved without an decisive effect on economic growth

With respect to environmental sustainability, several issues should be highlighted:

> The Sustainable Development Strategy is the overarching long-term objective. It primarily addresses Europeans' quality of life. However, "long-term" should not be misinterpreted and the measures outlined in the Strategy regarded with complacency. The implementation of these reform measures are as urgent as the rest of the policies highlighted in the Lisbon Agenda.

> Climate change is not a distant phenomenon of the future - it is a reality today and as such it needs clear responses. Complying with the targets set out in the Kyoto Protocol is a necessary first step (gas emissions, generation of waste, tax energy, phasing out of fossil fuel production and consumption, increased energy efficiency, new alternative fuels, etc.), but the European Union should also commit itself to becoming the global leader on sustainable economic and social development.

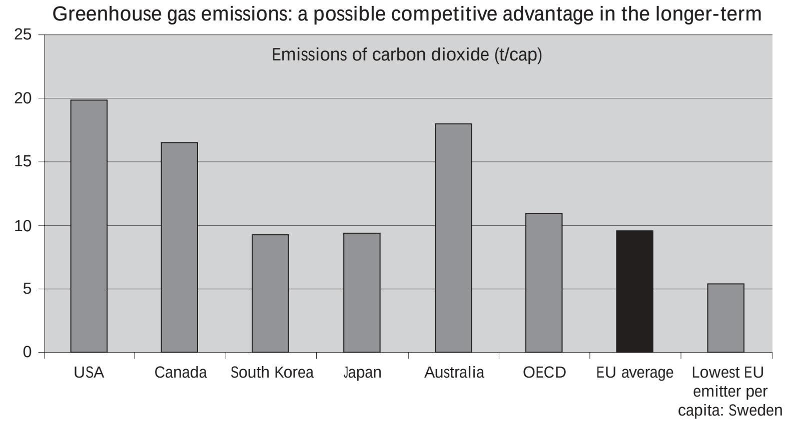
> Investment in knowledge and technological progress is vital. Little tangible progress can be made without this type of investment, as the coupling of knowledge and technology drives fundamental issues such means toward reducing pollution; a more sensible use of natural resources and improving public health. Overall, technology is directly linked to improved living standards across all sectors and has a great impact in lowering costs and increasing healthy competition.

> Sustainable Development as a concept is too broad. Intuitively, people may understand it but there is a large gap between theory and practice. Educating people about the protection of the environment and on the benefits of Sustainable Development would make a noticeable difference (including a better understanding of threats to public health, means to prevent diseases, ensure food safety, etc.)

> Serious improvement must be made in making policy more transparent and in regaining citizen's trust. Disaffection for public institutions and political leaders is a well-known current trend. Creating public ownership of the Sustainable Development Agenda is a must that will unquestionably have a positive multiplier effect.

> Policy coherence is a problem in the European Union. There are too many overlapping interests and policies in the EU. It is crucial to regain perspective and formulate a clear vision. A comprehensive plan that cuts across all policy areas will lead to much needed coherence and convergence towards achieving sustainability.

The EU is ideally placed to serve as the global leader in sustainable development. Europe cannot afford to miss this opportunity. The EU has more experience than any other part of the world in combining economic growth with social cohesion and concern for the environment. Turning this into our defining strength can only result into a "life insurance" for future generations.



Source: OECD

Having agreed on the 10 Do-s and Don't-s, the European Growth Initiative focussed on two additional areas crucial to the process of economic and social reform in Europe: labour markets and the innovation and entrepreneurship climate in the Union. Both of these areas are mutually reinforcing and are hampered by a number of structural problems. With millions of long-term unemployed in some of the largest European economies, an in-depth, comparative reflection on the functionality of new Active Labour Market Policies in EU Member States serves as a valuable tool for concrete recommendations for the future.

The European Commission recently stressed that even if the EU employment rates show signs of increasing, they are still far from achieving the 2010 Lisbon targets. Member States are still finding it hard to overcome certain dysfunctions that prevent the European economy from unleashing its full potential. Over the past thirty years, the business and market environment has changed radically and these changes have often not been fully anticipated by governments and institutions. Retaining talent and promoting the adoption of new skills in a constantly changing environment demands that both the private and the public sector adapt quickly to these new circumstances. At the same time, this state of flux creates dilemmas for policy-makers, such as the apparent trade-off between the flexibility demanded by companies and the levels of job and social security requested by workers. Developments like "flexicurity" or the activation of labour market policies arise as antidotes to cope with these stresses, while serving as a means to update our labour markets to contemporary demand.

The following analysis approaches employment as a central issue of public concern, but also centres it within a more complex but also more realistic nexus of macroeconomic relations and the European social model. It opens by outlining a number of policy prescriptions aimed at contributing to the general debate on economic and social reform in the EU and, more particularly, the functioning of the labour markets and the European social model. The second part underlines that competitiveness today requires the construction of a strongly networked and cohesive society, ready to invest in the future and establishes a solid ground for growth and innovation. In doing so, it uses a series of relevant indicators, trends and comparisons that illustrate examples of best practices in a number of Member States.

2. Reform at Work: jobs as the centrepiece of European Growth

Policy Recommendations

1. ***Economic growth is key for job creation and will determine the outcome of any labour market reform.*** *The need for reform in a changing environment must be acknowledged and thus driven by a more dynamic policy approach that promotes the creation of new markets, industries and business. In addition, greater coherence is needed between the Broad Economic Policy Guidelines (BEPGs), the Lisbon Strategy objectives and the European Employment Guidelines. An integrated approach is needed between these different strands and their governance structures at EU level.*

2. ***Building more comprehensive patterns to measure the success of European labour markets.*** *In their assessment of the progress made in the employment sector, the Lisbon partners (Commission, Presidency and Member States) should focus on the rise achieved in percentage terms every year, rather than on the differences between certain national employment figures and the common Lisbon target. This type of assessment will help in identifying reasons for low economic growth. Functional proposals to reinvigorate economic activity in the countries concerned can then be formulated on that basis.*

3. ***Employment policy should address the dual challenge: more and better jobs.*** *The European Social Model is an important asset to ensuring future global competitiveness. However, it should not guarantee the protection of those that have jobs to the detriment of those that are unemployed, thus aggravating the gap between "insiders" and "outsiders" in the labour market. Employment policy should foster an inclusive and dynamic labour market, which promotes increasing levels of participation. At the same time, a clear agenda for high quality jobs must be set.*

4. ***Investing more in human resources.*** *Global competitiveness can broadly be defined as the best application of knowledge and resources to value-added sectors. Investing more in lifelong learning and education is a fundamental first step toward achieving greater competitiveness. This also increases the employability and flexibility of the workforce. Fiscal incentives should be granted to foster training*

for the usually disadvantaged groups, namely those engaged in temporary or seasonal work, part-time employment, or the older workers.

5. ***Public expenditure should be targeted more efficiently to encourage people to actively seek employment and re-enter the labour market.*** *This expenditure acts as an investment in human capital and will generate future gains for the economy in the form of higher productivity rates or lower unemployment. For this reason, active labour market policies should focus on devising effective training programmes for the unemployed, providing better job services and counselling, and measures to foster youth employment. The examination of the size and composition of government expenditures shows that the costs of active labour market policies (ALMPs) are not a sufficiently convincing argument to prevent the adoption of proven successful activation measures to those countries in with the greatest amount of structural-related unemployment.*

6. ***Better regulation tests should also be applied to labour market policies.*** *Regulation should not prevent turnover in the labour markets. Best practices in different areas, including lifelong learning, ALMPs and general regulatory measures exist in Europe and should be identified and promoted.*

The diversity of the 25 Member State labour markets, complicates the process of formulating EU-wide recommendations, such as the "employment" provisions in the Lisbon Strategy and the Employment Guidelines. It also explains why these recommendations sometimes lack a certain sense of clarity or seem irrelevant for several Member States. The International Labour Organization (ILO) defines labour market institutions as the combination of the following elements: employment protection legislation, unemployment benefit systems and active labour market policies, trade unions and wage bargaining, as well as taxes on labour. A brief look at one of these elements – wage bargaining - is enough to illustrate the wide array of different institutional structures at play in the EU-25's labour markets.

In addition, structural rigidities within Member States further complicate the process of responding adequately to changing economic realities. Characterized by different geometries with respect to product, labour and capital markets, many Member State systems seem to be in a semi-permanent state of metamorphosis. This raises questions regarding the real functioning of the internal market and disturbs European economic performance. Different institutional arrangements in the Member States further add to the complex reality of identifying best practices or the feasibility of defining an optimal model.

Unemployment is Europe's most stubborn *malaise*. As will be shown below, employment rates are on the rise, but that this rise is nevertheless likely to fall well short of the rates set out as the 2010 goals, following a hypothesis of constant linear growth. This applies across the board to the entire active population, women, and/or older workers. The more these goalposts seem unrealistic, the more we might become wary of the rationale behind setting employment targets as an absolute objective - one that must be fulfilled at any price, regardless of the macroeconomic environment, its social impact or the capacity of the different Member States to adapt these to their own characteristics. Beyond the importance of setting targets, it is time for Europe to design a more balanced strategy that can promote high quality jobs while creating new opportunities for those excluded from the labour market.

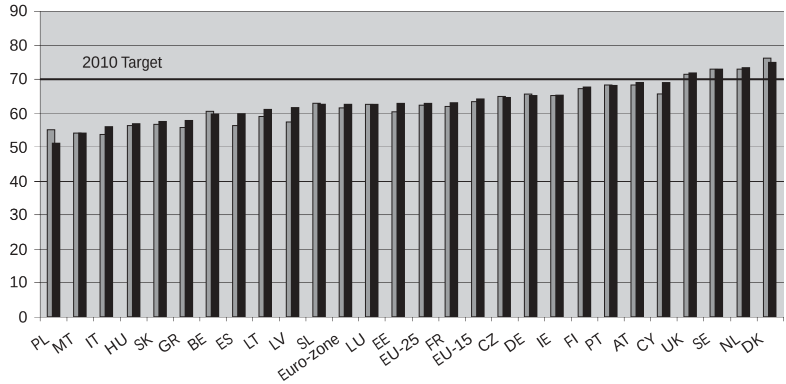
1. Assessing employment trends in Europe

Employment rates are going up, but too slowly to match the Lisbon targets

In its EU Economy 2004 Review, the European Commission stresses that EU employment rates are following a positive trend, but that this rise will not be rapid enough to meet the 2010 Lisbon targets. This insufficient progress is attributed to limited reforms, which fail to address the persistent problems of "priority areas," such as tax and benefit reforms, wage bargaining, early retirement and labour market regulation.

A broader view would acknowledge the fact that unemployment – regardless of the last signs of improvement - remains a structural problem in the EU. It has developed into the European *malaise* over the past thirty years; one that has spread and reached heights that will make it intolerable in the near future as it creates poor economic performance, social tensions, excessive burden on public budgets, etc.

Total employment rates (persons aged 15 to 64):
2000 (grey) compared to 2003 (black)

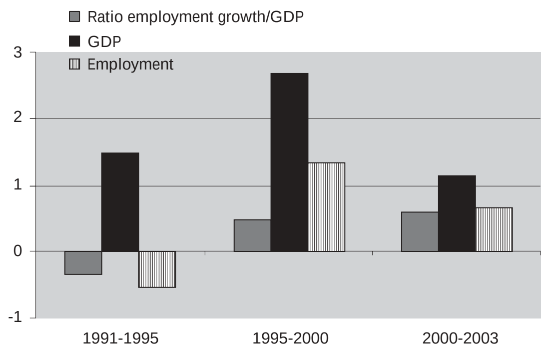


Source: Eurostat, structural indicators

As is depicted in the figure, **most Member States are not yet on the right path toward reaching the 70% threshold by 2010**. The "priority areas" mentioned above are, indeed, important; however, tackling these will likely be insufficient in reaching unattained employment targets or establishing the perfect environment in which to foster employment and economic growth. As this is common knowledge, we should look beyond these accepted realities to investigate why this is the case and how best to foster a more ambitious reform agenda. Beyond the importance of "structural reforms" (tax and benefit systems, retirement schemes, etc.), reforms must be underpinned by **a more dynamic and coherent policy approach that seriously pursues economic restructuring**. EU Member States should practice what they preach before criticising the lack of progress on the Lisbon Strategy. Unfortunately so far, not many have truly committed to a comprehensive reform agenda embracing key elements raised in our ten do-s and don't-s (including greater investment in education and training, an inclusive labour market, means to create new markets and industries, and a re-thinking of the macro-economic setting that would allow labour supply to meet labour demand).

Learning lessons from the past

Comparisons between employment rates are often misleading, as they do not distil the performance factors out of the labour market per se. The employment rate is affected by a wide range of variables, comprising the labour market's determinants but also the economic growth rate. For this reason and in order to focus on the labour market's performance and compare national or periodical employment rates on an equal basis, it is necessary to neutralise the impact of the growth rate differential. This is best done by calculating the job content of a percentage point of growth for each economy/period. Bearing this in mind, we can still draw some conclusions from the following graph, taken from the Commission's EU economy 2004 review. It shows the increased employment content of growth in the period 2000-2003, compared to 1991-1995 and 1995-2000.



The comparison of 2000-2003 to the first half of the nineties is particularly striking. Despite higher growth than in the years 2000-2003, the first half of the nineties was characterised by a drop in employment, whereas the first three years following the agreement of the Lisbon Strategy saw at least a small rise. As emphasised above, this rise is still insufficient in light of the 2010 target, but the comparison of the different periods in terms of growth content – as illustrated by the ratio employment growth/GDP growth- may indicate at least one valuable change: **Europe has done away with the "zero-sum game fallacy."** This view prevailed in the period 1990-1995: encouraging less productive groups (especially older workers) to pull out of the labour market – through early retirement schemes for instance - thereby "making room" for those unemployed. A less static and deterministic vision of economic growth, as well as an increased awareness of the challenges to the pension system caused by extended longevity of European workers have shaped the Lisbon Strategy and the employment reforms that result from it. Thus, we have more job-intensive economic growth today, which bodes well for employment if accelerated growth can be achieved in the years to come.

Why productivity matters

Economic growth is a process in constant transformation and, therefore, the manner in which labour markets evolve has a clear impact on it. Overall, productivity growth is a good measure of both the contribution of the different sectors of the economy to economic growth but also of how the employment structure changes over time. These days, knowledge is seen as an essential element of the production process. The EU – in contrast to the US - has been slower in adapting to these new realities. As a result, skills are unevenly spread throughout the economy and are thus a rather disappointing contributor to growth in the European Union.

If the EU's aim is to build a sustainable and innovative economy, it needs to **not only create more jobs, but also to create 'better' ones. Setting this type of goal will have a positive effect on the use of higher education and increased training in the economy, resulting in higher levels of common welfare**. Employment is not an end in itself. On the contrary, it is a means of basic human development and an essential element of private and societal welfare. The persistent emphasis on employment rates in Lisbon Agenda fails to take into account the role of employment in a wider societal perspective: the labour market acts as a powerful motor of social integration. In addition, it brings self-fulfilment and enrichment at the individual level. Thus, the worryingly high level of unemployment in many Member States must be urgently remedied, not least to put a halt to the negative social consequences of these developments. In tackling these problems, the Union and its Member States have to avoid being misled by an over-zealous and narrow-minded focus on common employment targets or specific labour market problems. What is needed is a holistic approach.

Increasing the quality of the labour force implies a greater reflection on how best to invest in skills, improve working conditions and the regulatory climate, strengthen social cohesion and combine flexibility in the labour market with job security. All this needs to be coupled with plans toward increasing productivity levels. These are essential ingredients of a competitive economy, which is able to provide its citizens with the best possible standard of living with sustainable, quality jobs.

The most recent figures on productivity confirm the impression that Europe is trying too hard to focus solely on price competitiveness, cutting down expenditures on both human and capital investment. This narrow-minded approach has the propensity of creating a vicious circle where productivity gains are low. This, in turn, creates a downward pressure on wage raises, aggravating the problem of dormant internal demand. In the end this leads to stagnant, not increased economic growth. Ultimately, this strategy of low productivity might also undermine Europe's competitiveness and therefore, the external demand. The relationship between labour productivity growth to economic growth in Europe has been in a steady decline over the last decades. From an annual average rate of 4.6% in the 1960s it dropped to 2.8% in the 1970s, 1.8% in the 1980s and 1.5% in the 1990s. It is perhaps important to highlight that performance was even worse in the late 1990s, amounting to around 1.0%.

Is there a contradiction between increasing employment and productivity growth?

Jobs are a basic engine for economic growth. However, that engine cannot generate the capability to turn simple economic growth into *sustainable* economic growth on its own. At this stage additional measures must be put into place. To achieve both sustainable development and productivity growth, governments must commit to setting up **a much more proactive climate for investments in leading industries and human capital in the medium and long term. Governments must also actively create opportunities in emerging areas of the economy**. Once effective policy choices are made by government, they should be guaranteed a strong degree of continuity over time and changing national administrations.

Ireland and Finland both provide a very good example of strong commitment to these key issues and the results this can achieve. The increase of labour productivity in those two countries has outperformed the other EU Member States. Bearing in mind the particular characteristics of each country as well as the strategies pursued, they share interesting similarities. During the last decade, both countries have launched measures toward profound industrial restructuring and fostered the creation of new sectors. Over the past ten years both countries have had a relatively strong performance in employment creation. This was supported by conscious policy choices. First, a permanent emphasis on improving productivity, by investing more in education of human resources, promoting the application of new technologies and improving the quality and efficiency of industrial equipment. Second, both countries chose to boost the investment rate in research and develop or assure better access to it through business innovation. Thirdly, a strong commitment to social dialogue, played a key role in ensuring the support of social partners and an appropriate labour market response.

Reconciling quantity and quality

In heterogeneous societies policy measures must address needs at different levels. Targeting only employment rates may prove to be as short-sighted as betting only for productivity growth. Quantity and quality can be two sides of the same coin. Promoting 'high road' strategies does not necessarily imply the protection of good jobs at the expense of the unemployed or those otherwise excluded from the labour market. Nor does it entail the creation of a largely unproductive workforce. A higher employment rate is clearly a fundamental objective of employment policies, and all economic and social actors should actively participate in achieving it. But the quality of the jobs in a given economy - defined in terms of duration, content, conditions and wages of these positions - constitutes an important element that must be taken into account in pursuing the wider objective of greater employment. The key variables listed here have a strong impact on internal demand and are the decisive factors for delivering competitiveness and boosting economic growth both in the short and longer term. For this reason, the **measures aimed at raising employment rates must be combined with measures aimed at maintaining a certain level of job quality**.

2. From employment rates to policy choices

Following the Spring European Council in 2004, Member States were urged to pay attention to four particular structural challenges: **adaptability, attracting more people into the labour market, improving the quality of employment and investing in human capital.**[4] Now, with only days to the Lisbon Agenda mid-term review at the European Council on 22/23 March, the issue of **adaptability** looks likely to be a key issue for critique by the Commission, given the lack of delivery at national level. The Commission has repeatedly called for more flexible wage-setting systems, which would make wages more dependent on productivity. These national wage-setting systems have remained largely unchanged since 2000. **Improving the quality of employment** is a broad objective, which sometimes conflicts with the issue of adaptability, when understood as “flexible forms of work.” Still, both of these elements are crucial towards creating a knowledge-based economy. They are best understood in the context of the debate on how to combine flexibility and security given new and changing economic circumstances. The other two objectives have a more pragmatic appeal and Member States are focussing the bulk of their efforts on these, namely **attracting more people into the labour market** and **investing in human capital**. The diffusion of the so-called “active” labour market policies (ALMPs) across Europe has been positive in both regards. Labour market expenditure is usually positively related to the evolution of the unemployment rate over time. In addition to this correlation, as the Commission notes in its study on the key determinants of labour market performance,[5] there has been a general shift of expenditure to the advantage of ALMPs in the last years, most markedly in Ireland, Italy, France and Spain.

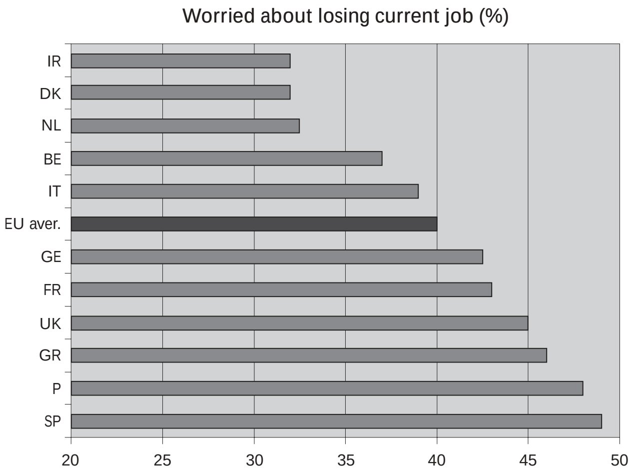
The case for ‘flexicurity’

> 3. ADDRESS CHANGE AND PROMOTE ADAPTABILITY AND MOBILITY IN THE LABOUR MARKET
> Member States will facilitate the adaptability of workers and firms to change, taking account of the need for both flexibility and security and emphasizing the key role of the social partners in this respect.
>
> *European Employment Guidelines, European Council Decision, 22 July 2003*

In the transition towards a knowledge-based economy, striking the right balance between flexibility and job security seems to be a first step in the right direction. Regardless of the uncertainties that this concept might raise, its logic arises from the realization that, under the current changing patterns, both can be achieved simultaneously. Making European labour markets more efficient through combining flexibility and security could help to unleash the currently insufficiently tapped resource of human capital in Europe.

Given the diversity of labour markets in the EU, there is no single prescription to achieve the 'perfect' balance between the two. In this sense, national employment systems are the first point of reference to analyse how to achieve this equilibrium. The objective here cannot be to replace permanent jobs with increased part-time work or similar schemes, but to use new tools (e.g. new technologies) and possibilities (e.g. new workplace structures) to complement these. A higher level of inclusion in the labour market, regardless of whether this is through permanent or other flexible arrangements, is beneficial to all. **The case for 'flexicurity' is linked to a change in attitudes and expectations. It derives from the fact that the sense of security shifts from staying in the same job to the easiness of moving between jobs.** The desire to change jobs is motivated by a wide variety of preferences that can range from evolving professional interests, income expectations, career choices, work-life balance, etc. The following case illustrates the logic behind this concept and the resulting impact that it has on the functioning of the labour markets in two different Member States.

The following comparison between Greece and Denmark serves as a striking example in this regard. According to a study by the International Labour Office (ILO), Greece has one of the lowest levels of labour market participation (LMP). At the same time, it has one of the highest levels of employment protection, which thus creates an employment system with one of the highest levels of job tenure in Europe. However, this does not imply a stronger sense of security. On the contrary, Greek workers are some of the most concerned about losing their jobs. The polar opposite is true for Denmark: here, confidence in finding a new job is high. At the same time, there is a high level of labour market participation and flexibility. In addition, the Danish system is marked by considerable investment in programmes aimed at helping the unemployed reintegrate. Thus, Denmark reaps the benefits in terms of good labour market performance.



Source: ILO

Active labour market policies

Governments have become increasingly interested in determining the role that active labour market policies play in tackling unemployment and supporting structural change in the work force. In brief, active labour market policies are **programmes designed to minimize the time spent between jobs**. They encourage the unemployed to go back to work and, at the same time, create higher levels of employability. The programmes promoted by these policies provide incentives (sometimes coupled with sanctions and compulsory measures) for the individual to engage in searching for a job and further training. In return, the individual is offered a certain variety of services (for instance counselling, job search assistance, training).

In the "classical" sense, ALMPs constitute all the policies intended to increase the employability of the unemployed in an effort to get them back to work. They contrast with passive labour market policies, which are intended only to compensate for the social costs of unemployment (essentially unemployment benefits). Exemplified best by the Danish model, briefly described above, the new definition of ALMPs emphasises the "incentive" side, i.e. to ensure that an individual will effectively do his utmost to re-enter the labour market. This new definition also includes the possibility for the use of compulsory measures and sanctions. It also gives preference to expenditures on labour market training and employment services, at the expense of subsidised employment. The following table shows the amount allocated to active labour market policies defined in the "classical" sense (comprising expenditure on labour market training, employment services, support of youth employment, support of employment of disabled people, subsidised employment). It also shows the scale of training expenditure in the funds earmarked to ALM expenditure over two key time periods.

	Active Expenditure as % of total labour market expenditure		**Labour market training as % of ALM expenditure**	
	1990-1995	1996-2002	1990-1995	1996-2002
Austria	21	27	31.7	36.5
Belgium	31.1	35.5	19.5	19.3
Denmark	24.2	32.8	34.6	56.6
Spain	19.3	31.4	20.3	25.8
Finland	32.8	33	26.8	31.9
France	36.2	43.3	34.6	22.2
Germany	41.2	36.8	34	28
Greece	45.2	47	33.8	29.1
Ireland	34.2	51.4	18.2	16.4
Italy	58.7	56.7	1.1	8.9
Luxembourg	26.2	30.3	8.9	3.8
Netherlands	33.6	39.4	18	24.4
Portugal	52.8	47.3	27.9	33.3
Sweden	55.9	53.2	29.8	22.3
U. Kingdom	29.1	38.1	26.8	14.5

Source: Commission, DG Employment and Social Affairs

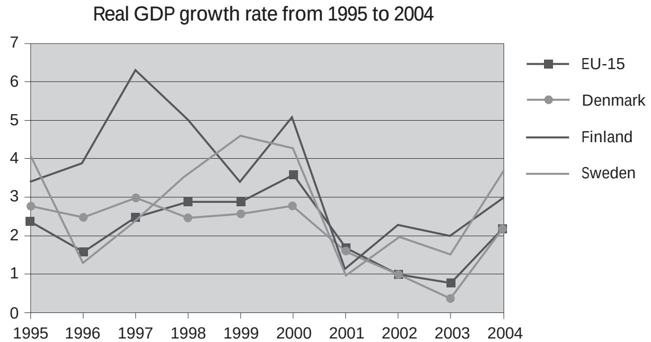
Greece and Italy are striking counter-examples in terms of the implementation of active labour market policies in their newer sense: training expenditure accounts for a small percentage of their overall Active Labour Market package. Both of these countries thus represent examples where the introduction of active labour market programmes has not been sufficiently accompanied by a facilitated access to the services that these should provide in principle. In addition, countries like Belgium, Italy, Spain and Ireland, spent the lion share of the funds earmarked for active labour market expenditures on subsidised employment - also called direct job creation - in the period between 1996 and 2002. The long term effects of this type of employment, with respect to employability and the chances for re-entry into the labour market are doubtful, while it is clear that these programmes are undoubtedly very costly. A reallocation of funds within the overall ALMP envelope towards training, employment services and youth measures, is advisable in these countries. Austria and Denmark stand out as inspirational examples: they are the two only EU countries with a large and steadily increasing share of expenditure attributed to training.

3. Learning lessons from good practices

The success of the Nordic "active" labour market policies

Similar to many other EU Member States, the Nordic economies - Finland, Sweden and Denmark - suffered from the effects of economic slowdown in 2003. Finland and Sweden recorded negative employment growth in 2003, while Denmark's economy underwent another year of employment contraction after 2002. Despite these recent negative developments, the Nordic countries still stand out as the group 'best performers' in terms of employment rates. Denmark and Sweden's employment rates have already surpassed the 2010 EU targets, with 5.1 percentage points (Denmark) and 2.9 percentage points (Sweden) in 2003 - above the 70% threshold for the total employment rate. These two economies perform even better with respect to female employment. Here the employment rate is slightly lower than the total employment rate – 70.5% for Denmark and 71.9% for Sweden in 2003 – but it outperforms the EU-25's rate by far, as this only amounts to 55% in the same year. The situation of older workers in both countries is another case in point: Sweden has already exceeded the 2010 target by 18.6 percentage points, Denmark has done the same by 10.2 percentage points in 2003, yielding an employment rate of 50% for older workers. Finland's employment rates are clearly lagging behind, but the country's economy was faced with a much more daunting challenge after the collapse of the Soviet Union's economy, one of its main trading partners, and the subsequent process of economic restructuring which this transition called for. Compared to Sweden and Denmark, Finland has made greater progress on a relative scale, increasing its total employment rate by more than 7.4 percentage points between 1994 and 2003. Finland's total employment rate was only 2.3% under the 2010 target in 2003, making it likely that the country might exceed the 2010 target of 70%.

The following graph displays a comparison of real GDP growth rates between the EU-15, Denmark, Sweden and Finland, from 1995 to 2004.[6]



Source: Eurostat, key indicators

At least since 1997, Finland and Sweden have experienced substantially higher levels of growth than the rest of the EU. This continued higher growth could explain why these countries have outperformed their peers in terms of employment rates. This phenomenon also confirms the point made earlier on the short-sighted approach behind those policies that focus solely on the employment rate, while ignoring other macro-economic determinants, including internal demand. Denmark is a particular case in point. Its economic growth rates did not differ much from the EU-15's over time, but the country managed to maintain a surprisingly high employment rate. The economic slowdown observed from 2001 to 2003 led to employment contraction but was not enough to undermine Denmark's outstanding performances in terms of employment rates, in all categories. What did the Danish economy do to effectively insulate its employment rate from the ups and downs of the economic cycle? A look at the structure of labour market expenditures provides a first insight into the on the basis of this Danish exceptionalism. Denmark is the one Member State that spends the most on labour market expenditures – 5.2% of GDP over the period 1996-2002. It is also the only Member State which allocates the majority of its active labour market expenditures – 56.6% in the period 1996-2002[7] - to labour market training. However, it would be overly simplistic to believe that Denmark's exceptional positioning results only from more labour market-related spending. This spending is couched in a more complex framework intended to offer the best possible assistance to the unemployed, while encouraging them to make best use of the opportunities created by this personalised assistance.

The box below describes this wider employment policy framework:

Denmark combines a high level of expenditure on ALMPs, especially on policies to get the unemployed back into work, with generous unemployment benefits and moderate employment protection legislation.

- In 1994, the labour market reform left the benefit level unchanged, but it fixed the right to unemployment benefits for a definite period of time (up to 7 years, plus two years of leave), without possibilities of extension via activation or employment schemes. In parallel, this reform enforced the obligation for all unemployed people to participate in employment programmes, comprising private and public job training, training in job search, and targeted education with support from the public employment services.

- Since 1994, each adjustment has increased the incentive/compulsion for the unemployed to engage in active labour market programmes. The timing of the obligation to provide the unemployed with an activation offer was shortened from after 4 years of unemployment in 1995 to after one year after 1999 (six month for young unemployed). Among others, the subsequent adjustments also restricted access to the unemployment benefit system, reduced the total unemployment benefit period from seven to four years, and generally provided for tougher availability assessments.

High levels of benefits, and tailor-made employment programmes and skills enhancement initiatives counterbalanced the strong thrust of “social disciplining” in these measures.

Finally, the peculiarities of the institutional set-up in Denmark must also be born in mind, as this probably facilitated such a drastic shift in social and employment policies from 1994 onwards. Employers and employees are traditionally strongly involved in policy-making in these areas. What is more, the trade unions manage the unemployment insurance schemes.

Source: OECD Policy Brief, Flemming Larsen and Mikkel Mailand[8]

A shift in employment policies from scratch? The French case on ALMPs.

It would be wrong to believe, however, that Denmark is the only country which has made conscious use of the ALMPs, in their revised definition, i.e., in the attempt to link unemployment benefits to the participation in job search, employment and training programmes more closely. Sweden was probably the first European country to innovate in that sense, but France was also a forerunner by introducing a totally new benefit system in 1988 the RMI (*revenu minimum d'insertion*). This universal minimum income was supposed to be granted in return for the signing of a *"contrat d'insertion,"* which laid out a plan with the actions to be taken to enable the recipient to permanently re-enter society, and eventually, also into the labour market. This plan included counselling, training and finally employment. This forerunner of French activation policies was chaotically implemented and despite the recent efforts by the government under Prime Minister Jean-Pierre Raffarin, it never made the attribution of social benefits conditional on an active job search. However, the idea of a contract between the unemployment recipient and society to accelerate his or her re-entry into the labour market was undoubtedly a structural breakthrough that the Danish policy of *aktivering,* launched in 1994, could build upon.

The activation principle is not confined solely to unemployment insurance. It can also apply to other parts of social protection, be it retirement schemes, family-related benefits or taxation. The following table shows the lack of consistency in the pursuit of active labour market policies in France:

Constituent of social protection/potential instrument for activation	Latest developments	In line with the "activation" principle?
RMI-RMA (**universal minimum income** for those who are not eligible for other benefits)	In 2004, a **new variant of the RMI** was introduced, the RMA. After a certain period of eligibility, RMI recipients are transferred to a **new benefit entailing enhanced employment obligations**, and offering **100,000 subsidised contracts**. This reform was met with considerable opposition from various actors and at the end of 2004, **only 500 contracts** were signed.	Given that the results have been so limited (number of contracts), **NO**.
PARE (unemployment insurance)	Introduction of the PARE in 2000 (back-to-work support plan). **Monthly sanctions** pursuant to the lack of individual participation have **substantially increased**: In 2002/2003, there were 35,000 such sanctions for a total of 340,000 leaving the register of the public employment service.	**UNANSWERABLE**: the **"incentive" side** has substantially been **reinforced**, but the **improvement of the "service" side** is still very **doubtful** (no major change in means allocated to ALMPs, and no perceived improvement in the individual assistance offered to the unemployed)
Funding of social protection	Introduction of the **CSG** (generalised social contribution) in 1990 and further extension of the taxation base in the nineties. **This tax is levied on most incomes** (including retirement benefits) and was meant to facilitate the **shift away from social contributions in the funding of social protection**.	**YES**
Early retirement schemes	**Persistence of such schemes** since the industrial restructuring (heavy industry) of the eighties. In 2001, there were still 204,000 participants in various early retirement schemes, while 284,000 older assisted unemployed were allowed to disengage from the job search.	**NO**

Source: Jean-Claude Barbier[9]

While France was a frontrunner in introducing these type of policies in the 1980s, it failed to develop as coherent a framework as Denmark, i.e. to simultaneously emphasise the "incentive" and the "service" sides of the ALMPs, and to actively reshape all elements of its social protection system to re-focus these towards achieving a re-entry of the unemployed into the labour market. In that regard, some of the French social protection system principles contradict one another: On one hand, those receiving unemployment benefits face the threat of sanctions, if they fail to actively engage in job search or employment programmes (given that their reticence to seek employment represents an unfair burden for the society). On the other hand, older workers were still encouraged to withdraw from the labour market early, through various retirement schemes. Contradictions are even apparent within individual sectors of the social protection system: Early retirement schemes are still supported, while the Raffarin government managed to extend the necessary number of years of service to receive full pension benefits for those employed in the public sector for two years (from 38 to 40) in 2003.

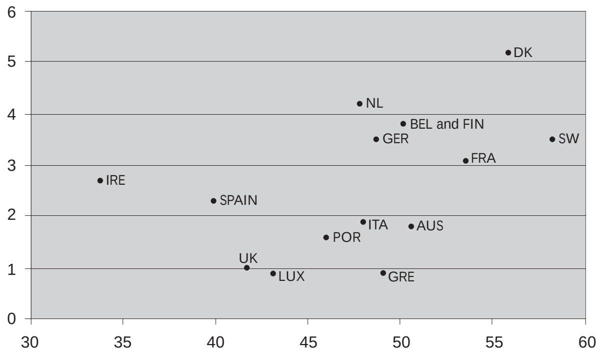
The situation in France is also unfavourable to the implementation of a more coherent and effective set of ALMPs because of two other factors. The first is the state of the employment services and the training on offer. It is both unfair and inefficient to make the granting of the social benefits increasingly conditional on the participation in employment programmes, if these are not markedly overhauled and improved. The second is the macroeconomic environment of the country today. The persistently low rate of employment creation in France makes the "return-to-work" objective very hypothetical for many of the unemployed, unless they accept jobs are below their qualifications and experience or in fact have little to do with these. There is an issue of fairness here, but also one of political costs for the current government. Lest one forget that the macro-economic environment, most importantly, the state of economic growth and employment creation, very much pre-determines the feasibility and success of any initiative inspired by the results of ALMPs in countries like Denmark.

High benefits, high investment in human capital, high costs: Does the rest of Europe want that?

As was shown earlier, active labour market policies in the Nordic style offer many benefits and a large choice of training opportunities. These features help to maintain a certain level of employability for the unemployed and ensure a better match between labour demand and labour supply, in terms of skills and knowledge. The low probability of long term unemployment generated by these programmes creates a general sense of security, which does not relate to the security experienced by holding on to the same position over time. This positive assessment logically raises the following question: **What is the degree of transferability of these labour market policies to the rest of the European Union?**

There is undoubtedly a "price tag" associated with the Nordic Model. As emphasised above, active and passive measures overall absorb 5% of Danish gross domestic product (GDP). These high costs are acceptable in economies singularised by the EU's highest total general government expenditure. The following scatterplot shows the degree of correlation between total government expenditure and labour market expenditure in the EU-15:

Correlation between total governement expenditure (as % of GDP, 1996-2002, X axis) and labour market expenditure (as % of GDP, in 2002, Y axis)



Source: Eurostat, structural indicators

This scatterplot shows that this model undoubtedly has a cost, but that a number of other EU Member States could assume this cost, as they display similar levels of total government expenditure. Sweden and to a lesser extent, France, are cases in point. However, France is faced with a much less favourable situation in terms of unemployment. In other words, other Member States have the means to conduct the same policies, but their policy prioritisation does not allow for it. The integration of the unemployment variable emphasises the peculiarity of Italy and Greece. Despite high levels of unemployment – 9.7% in Greece and 8.7% in Italy in

2003 – and despite government expenditure levels around the 50% threshold, these two countries stand out with their relatively low level of labour market expenditure. This correlation between government and labour market expenditure shows that Member States other than Denmark could earmark necessary financial means to active true active labour market policies, including improved employment services and training programmes. This change would require the political courage to redefine the priorities of public spending and allocate more funding to the fight against unemployment on various levels. The lack of political courage and leadership in Europe today – more so than their degree of transferability - is increasingly becoming an obstacle to the development of ALMPs.

The second area of study proposed by the European Growth Initiative Task Force was the creation of a more innovative and entrepreneurial Europe. Discussions in the Task Force reflected the wide range of issues including the particular obstacles to the activity of small and medium-sized enterprises (SMEs), the completion of the Single Market, the contribution made by innovation and technology clusters to growth and more and better jobs, the role of education and investment in human capital, the lacking cultural mindset towards entrepreneurship, etc. All this was discussed within the overall conviction of the importance of the Social Model and the stability of our standards of living. All members of the Task Force agreed that the increasing global competitive challenges called on the European abilities to innovate and compete, to ensure economic growth and competitiveness and to maintain the high standards in welfare and social protection. Europe's innovative capacity has to be bolstered and encouraged through appropriate conditions. Europe needs to invest more in value-added activities.

The following third section of this paper highlights a number of policy recommendations aimed at contributing to the current debate on investment, growth and innovation. The first part of the following analysis concentrates on the remaining barriers to creating a more suitable entrepreneurial climate in Europe. The implications that R&D spending has on the level and type of innovation in Europe is considered in the later parts of this next section.

3. Towards a more innovative and entrepreneurial EU

Policy recommendations

1. ***Create the conditions that promote an environment for change, innovation and investment.*** *Entrepreneurship and innovation are basic engines for growth and jobs. Europe needs to be much more proactive in setting up the right structures to enhance market conditions; not only to foster the creation of new companies, but particularly to allow them to grow in a sustainable manner.*

2. ***Create an improved regulatory climate – it is vital to establishing a more favourable environment for innovation.*** *Better regulation should be fully applied to reduce the administrative burden on business.*

3. ***Encourage ways to release the potential of innovation.*** *Possibilities of granting fiscal incentives to favour young innovative companies during the start-up process and early development should be considered. This would stimulate private sector research and multiply the rate of investment in innovative sectors.*

4. ***Complete the internal market.*** *A well functioning internal market is an essential requirement for economic growth and stronger efforts should be made to progress in this regard. The removal of tax obstacles to cross-border economic activity, a better enforcement of competition rules and the reduction of state aids are basic requirements to provide a necessary climate in which business can grow and prosper.*

5. ***Improve the links between research and its commercial application.*** *Contact between universities and Research Centres on the one hand and commercial actors in the economy on the other should be actively fostered and the improvement of the technology transfer promoted. The improvement of commercial applications developed at universities must be facilitated and the incorporation of public and private sources of seed finance enhanced.*

6. ***Use public R&D in an effective and intelligent manner.*** *It could be a useful tool to anticipate global environmental challenges and to use this knowledge for opportunities. Public R&D could enhance sectors in which the EU enjoys a competitive advantage, ensure that the best conditions are set for maintaining that leadership, while persuading other international partners of these EU standards – essentially providing the incentive 'carrot' for others to follow.*

7. ***Enhance coherence and better coordination of the overall R&D expenditure at EU level.*** *The size and potential of the European internal market remains largely unexploited. Both public and private funding sources must be engaged to quantitatively and qualitatively reshape European R&D. Private funding and entrepreneurship in relation to R&D must be furthered, not discouraged. In that context, it is urgent to markedly improve the incentives associated with R&D, so as to tap into the private potential for growth.*

The global competitive pressures Europe faces have changed in character over the last decade. Globalisation used to be associated with the outsourcing of jobs in sectors that had no future in Europe. Today, these global pressures have led to the realisation that Europe must become increasingly engaged in the value-added areas of work, in an effort toward developing the knowledge-based society. Global competition is no longer only about sacrificing jobs in mature sectors. Europe's competitors in the value-added areas are no longer only the United States: China and India – formerly unthreatening developing countries – now challenge European knowledge-based industries.

There is no alternative to the increased development of high value-added activities in the face of changing realities. The pace for developing these must be stepped up, and the innovative capacities in Europe need to improve rapidly. Innovation means being at the cutting edge of technological development and having a strong ability to apply new research to practical solutions that can be brought to the market as products, services or improved production processes. Thus, innovation requires a high-level educational and skills base and an environment that promotes the transformation of ideas into practice.

Europe does not perform uniformly in this respect. Whether performance is measured using the Lisbon criteria or any other competitiveness indicator on the global scale, there are big differences across the continent. Some Member States – generally the best economic performers, as discussed above – have an ability to be innovative and creative. They generally tend to think of globalisation as an opportunity rather than a threat. At the same time, other Member States seemingly have yet to fully realise that the rules of the global game are changing. These tend to be the countries in which globalisation is widely seen as a threat rather than an opportunity.

On the whole, the 25-member European Union remains poorly equipped to face up to this challenge. Establishing first the basic conditions to encourage entrepreneurship is key to creating an innovative Europe. Completing the internal market and alleviating the regulatory burden on companies to foster their creation and growth are just a few of the basic but necessary conditions. In addition, facilitated access to financing, more investment in human capital, a more dynamic role for universities in innovation and knowledge transfer (together with other actors), and better coordination and use of R&D expenditures are needed in the long run.

This chapter identifies the remaining barriers to creating a more suitable climate to encourage entrepreneurship.

1. Entrepreneurship in Europe: a first glance

Many European Member States have made substantial progress in the promotion of small and medium size enterprises (SMEs). The EU, and more particularly, the Lisbon Strategy, has proved consistent in setting up specific instruments and allocating a sizeable part of the funds earmarked for the support of economic activity to SMEs. The adoption of a European Charter for small enterprises, in June 2000, and the creation of an SME Envoy, in December 2001, illustrates the commitment toward creating a more favourable environment for small businesses at EU level. Moreover, most Community policies and programmes have a substantial SME component. From 2000 to 2006, 16 billion euros, or 11% of the Structural Funds, have been granted to SME support projects. In addition, pre-accession assistance has also increasingly been directed toward SMEs. However, creating a large number of small businesses is not the solution in itself. Bearing in mind particular challenges that SMEs face from a globalising economy, due to their particular characteristics, establishing the proper conditions for them to prosper is at once valuable and necessary. However, this approach must be reinforced with an analysis of the most promising sectors in terms of growth prospects. In other words, **the real issue is to facilitate business activity in those sectors with a clear growth perspective** and, thus, an equally clear job creation perspective.

	share of employment, EU-25, 2001, by enterprise size-class			
Sectors	micro (1 to 9p.)	small (10-49p.)	medium (50-249p.)	large (250p. or more)
mining and quarrying	4.6	13.7	13.2	68.5
manufacturing	9.6	20.6	25.2	44.5
electricity, gas and water supply	1.9	5	13.6	79.5
construction	30.4	36	18.3	15.3
distributive trades	39.6	21.2	12.4	26.8
hotels and restaurants	45.7	24.4	10.2	19.7
transport, storage and communication	17	14.4	11.7	56.9
real estate, renting and business activities	31.9	18	16.7	33.4

Source: European business facts and figures, Eurostat.

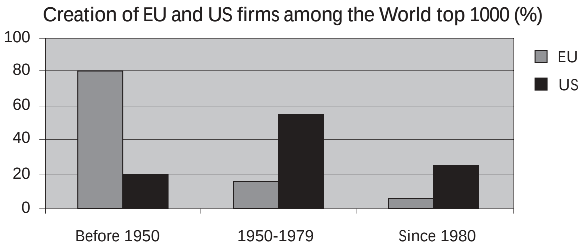
In many sectors of the economy, small businesses create more jobs than large companies. The table above shows the share of employment broken down by enterprise size-class. These figures demonstrate that small and even 'micro' businesses play a major role in employment, in sectors such as construction, distributive trades, hotels and restaurants, real estate, renting and business activities. The only service sector that does not appear to be dominated by employment in micro- or small businesses is "transport, storage and communication." This table confirms that the shift to an increased focus on services in the EU economies will consolidate the role of small-scale businesses play in generating employment.

Creating new business

So far, much focus has been on the cost associated with and the time it takes to create a new businesses. The 2002 Kok expert group report entitled "Jobs, Jobs, Jobs" made the strong case for measures intended to foster the creation of new businesses and consequently, maximise job creation. The report mentioned the removal of administrative and regulatory obstacles to the setting-up and subsequent management of new businesses, the development of advisory services (such as 'one-stop shops') for business start-ups and the improvement of access to finance for start-ups and SMEs as priority areas that would substantially impact on the European job creation capability in the coming years. Improvements have been made in most parts of Europe. Quoted as an inspirational example regarding labour market policies, Denmark once again stands out as the model to imitate. This Member State updated its legislation regarding the business entry in 1996. Only 4 procedures are required today to launch a business and the registration of a private limited-responsibility company is entirely free of charge. As a result, in the World Bank ranking in the report "Doing Business 2004: Understanding regulation." Denmark ranks first on the cost of starting a business and third on the time spent to start a business – two days on average.

One of the main difficulties of launching and even expanding a business is related to the lack of risk capital. Since the second half of 2000 and the burst of the IT bubble, the EU risk capital market has experienced a severe correction. Eurostat figures on the amount of venture capital as a percentage of GDP show that this type of private funding fell abruptly from 2000 to 2003, moving down from 4*10-2 to 1.5*10-2 % of the Eurozone's GDP.[10] Today, DG Enterprise is confident that this phase of restructuring has caused the venture capital industry to mature and become better equipped to bounce back in the case of severe economic downturns. EU institutions have been trying to guide this restructuring process, adopting, among others, a Regulation on the application of International Accounting Standards in 2002. However, some of these initiatives can be considered as quite unfortunate. This holds true especially for the wide support expressed in favour of the provisions of the Basel II agreement.[11] The implementation of this agreement will make the search for external funding more difficult for SMEs, as credit institutions will find it even less attractive to finance small business than today, due to the increased risk ratings of such engagements.

However, are these steps enough? **Experience shows that once all obstacles in the start-up phase have been overcome, the challenge of keeping a business growing in the EU remains daunting**. The poor economic growth performance that plagues Europe today is partly to be blamed for this unfavourable business environment. Entering the market and competing in it remain the key difficulties in Europe, irrespective of the size of the company. A number of obstacles are linked to this situation, including the unfinished internal market, overly restrictive bankruptcy laws, rigid employment legislation, lack of incentives to innovate and a better regulatory environment. The graph below clearly outlines the trend, according to which Europe is proving unable to set the necessary conditions to produce those firms that will be global leaders now and in the future.



Source: The Lisbon Challenge: designing policies that ‘activate’ knowledge, Luc Soete.

Supporting a better environment for business

In broad terms, a number of essential measures still need to be put in place to establish a positive playing field that encourages risk-taking and rewards entrepreneurship. Two basic elements in that respect are the completion of the internal market and a more appropriate regulatory climate.

Regulation supports two main EU objectives. It contributes to boosting competitiveness by providing a safe, stable and predictable economic framework for companies – and it helps preserve a democratic and sustainable "European economic and social model," as it constitutes the fundamental basis for guaranteeing adequate standards for social, environmental and health protection. At the same time, however, poor regulation may create social and individual costs both to economic actors and to consumers.

Any regulatory reform which aims at improving the quality of the regulatory activity should be supported, as it contributes to improving the business and social environment. While the focus of the Lisbon process so far has been on regulation regarding start-ups, emphasis should be put more on the regulatory environment for growing small businesses in the future. Reducing compliance costs and administrative burden is only one but nevertheless an important element in this respect. It is also paramount to develop consistent methodologies for impact assessment and improve consultation procedures. Finally, monitoring and control mechanisms for timely implementation and effective enforcement of regulation should be put in place.

In Europe, regulation plays a particular role also because of the specific character of our society. Europeans are not only increasingly aware of risk, but they also have developed a certain risk-averse attitude. Regulation should therefore continue to protect intellectual property and capital, and secure transactions between economic agents. At the same time, it should allow the diffusion of all relevant information more generally. Regulation should help to make all economic actors more responsible and more aware that any economic activity involves risks.

Regulation should therefore be seen more as a facilitator than as a burden *a priori*. It should guarantee all types of investment and transfers for all business operations. Should existing rules prove to be a constraint on business, the reasons for this effect should be identified. While it must be possible to measure how regulation responds to legitimate social or environmental concerns, it should also be possible to review existing regulation and test its effectiveness in relation to its original objectives. In case a specific piece of regulation proves to no longer be justified, it should be repealed. **Better regulation, therefore, goes beyond mere de-regulation**. The concept should be taken literally to mean higher-quality regulation. Better regulation and less regulation are not necessarily the same. Most importantly, it is crucial to ensure that any regulatory activity meets the classical principles for high-quality regulation: necessity, proportionality, accountability, consistency and transparency.

Although most small businesses operate at a local level, growth companies need to be able to operate across borders within the internal market. This has so far proven to be difficult because of different rules and regulatory cultures. **While there has been a certain degree of "Europeanisation" in some of the regulatory areas, this is not the case for all economic sectors**. Taxation, for instance, plays a key-role in the cross-border establishment of companies and business activities. Recent research by the Commission[12] proves that compliance costs are proportionally higher for SMEs than for larger companies. Moreover, cross-border activities lead to significantly higher compliance costs statistically. The home-state taxation[13] proposal devised by the European Commission would make it easier for growth companies to operate across European borders. However, several Member States are wary of the dynamics of "fiscal dumping" and business reallocations this type of arrangement may create. Fiscal matters are still subject to unanimity voting in the Council, but the Commission should at least breathe new life into the debate on home-state taxation.

As there is no chance for widespread European harmonisation on labour and social relations in the Union, these will continue to vary for many years to come. This does not mean, however, that simplification cannot take place. Identifying best practises within Europe and applying them elsewhere is a feasible solution, and the Commission should provide a more detailed benchmarking scheme, taking into account the opinion of the growth companies on the effect of legislation on their activities. Best practices should be implemented across Europe without hesitation. The following table displays the average number of days needed for an entrepreneur to hire a new employee in 2004, and shows the kind of benefits that can be reaped from the exchange of best practices.

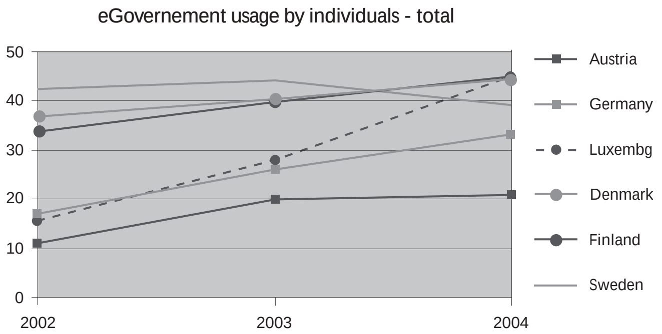
Country	Rank	N° of days	Country	Rank	N° of days
Slovak Rep.	1	0	Portugal	13	33
Austria	1	0	Finland	13	33
Denmark	1	0	Lithuania	13	33
Estonia	4	11	**AVERAGE**		**35**
Poland	4	11	Germany	16	44
U.K.	4	11	Czech Rep.	16	44
Belgium	4	11	Italy	18	61
Hungary	4	11	Spain	19	67
Slovenia	9	28	France	20	78
Sweden	9	28	Greece	20	78
Ireland	9	28	Latvia	20	78
Netherlands	9	28			

Source: Doing Business 2004, World Bank

There seems to be no rational explanation for the variation between the best and the worst performers. The new Member States fare better than their older counterparts. States known for their high degree of regulatory complexity such as Belgium have made substantial progress, but other countries such as France or Greece, despite disappointing employment performances, seem to have done very little to facilitate the recruitment of new employees. Note that small Member States, such as Luxembourg, Malta, and Cyprus, were not included in this study.

eGovernment

More emphasis on eGovernment in relation to small businesses can be an important step toward improving the regulatory environment. As a high number of small businesses across Europe are on-line and have become accustomed to using e-Banking and other online services, important impetus could be provided by establishing ‘one-stop-shops’ for dealing with local and national government, and by effectively phasing out paper versions of licensing applications, social administration, tax, VAT and other regulatory issues. Not only will eGovernment solutions make life easier for small businesses, it will also provide savings for the public sector, and act as an important driver for development of the computer industry that provides solutions and applications. The following graph exhibits the recent increase in the usage of eGovernment services in selected countries:



Source: Eurostat, structural indicators.

In these countries, the habit of dealing with the public authorities via computer is clearly becoming more and more common – in fact, it is almost close to the majority of users. However, there is a bias in the selection of the countries represented here – due to the availability of data. These countries are also characterised by the highest figures of GDP/capita in the EU. It is quite likely that the diffusion of eGovernment services in other and less wealthy Member States is much more limited. For this reason, the phasing - out process with respect to paper forms should be planned over a longer period of time. European Institutions should continue to play a pioneering role in the provision of public electronic services.

2. Towards a more innovative environment

The role of education

Creating a knowledge-based, innovative European society requires high levels of education. This is often regarded as a general condition to achieving the Lisbon targets or as a necessary means to attaining higher levels of competitiveness. While this seems obvious, there is much more to it. The changes that go in parallel with creating this "new society" are slowly wiping out the traditional boundaries of work and leisure, crafting a much more mixed picture. Education and social cohesion thus become even more important as the key elements to a full participation in the public sphere, preventing the dangers of new social divisions.

In many parts of Europe, education has traditionally focussed on merely acquiring knowledge. However, as social and labour market needs change, emphasis should partly and increasingly be placed on learning how to apply knowledge. In other words, Europe's educational culture should focus more on the qualities inherent in applied knowledge. In this sense, there should be a stronger link between education and applied research, so that Europe can meet the challenges from other knowledge centres in the world and avoid a damaging 'brain-drain.'

In 2000, the Lisbon European Council adopted a number of priorities that pointed squarely in this direction: strengthening skills in the transition towards a knowledge-based society. These measures included increasing the investment in human resources, encouraging more students to engage in tertiary education, promoting the adoption of new necessary skills like ICT, creating a spirit of initiative and entrepreneurship, etc. One year later, in Stockholm, the Council agreed on a set of common objectives for education policy. These could largely be grouped under three broad guidelines: raising the quality and effectiveness of European education systems; making education and training a real opportunity for all; and opening it up to the world – through scholarships, exchange programmes but also through regulatory measures. A broad number of measures were associated with these guidelines, ranging from training teachers, adopting ICT skills, attracting more students into sciences and technical studies, fostering social cohesion through education, increasing mobility, etc.

Unfortunately, these laudable initiatives contrast starkly with the realities on the ground: in the period between 1995 and 2001 public expenditure on education (%GDP) in the EU was reduced from 5.19% of GDP to 5.09%. Results following the Council initiatives have thus been mixed, but a general observation shows that **the EU is not tapping into its full potential at the most advanced levels of education, in its desire to create a more innovative society**. Researchers constitute a fundamental element in this regard. They form an important engine for change, for generating new knowledge, developing new methods and applying new systems. They are also a good measure with which to judge a country's efforts with respect to its commitment to investment in innovation. The EU is still far from reaching the optimum in this regard. The figures show that a much stronger emphasis is needed:

- The US employs almost 40% of the researchers in the OECD countries, followed by the EU with 28% and Japan with 19%. In comparative terms, Japan invests most in researchers (in the total number of people employed in the economy).

- Investments in knowledge (investment in R&D, software and higher education) also put the US ahead of the EU and Japan. It invests 6% of GDP in knowledge, while Japan spends 4.5% of its GDP, and the EU is a further percentage behind at 3.5% of its GDP.[14]

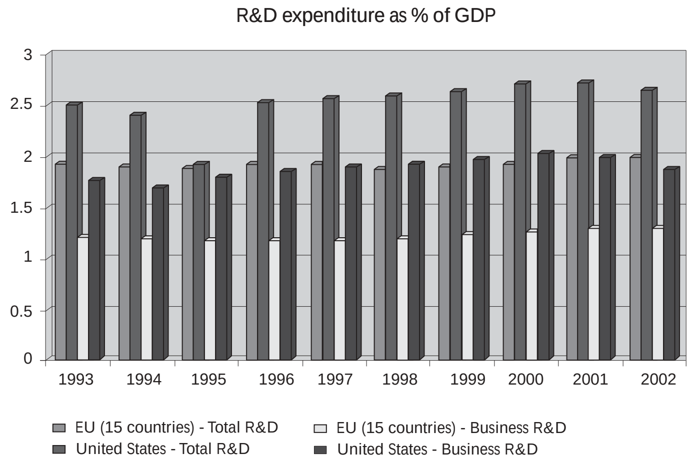
- American universities remain much more attractive for students. The number of European students in US universities is double that of the number of American students in European tertiary education. In addition, half of all Europeans that acquire their PhD in the US, prefer to remain there afterward.[15]

- An additional factor is how connected researchers and business are. In general terms, in the US four out of five researches work for the private sector, while only one out of two does the same in the EU.

These figures underline the large differences between the EU and US. But crucial differences also exist within Europe, where Sweden and Finland score at the top of the OECD comparative figures terms of the number of researchers, R&D expenditure and the existence of business researchers in industry.

More and better R&D

In the post-war period, European countries began to catch up in terms of public and private expenditure in R&D, to the point of almost equalling the levels of private investment in the US by the end of the seventies. However, this took place under very different structural circumstances to US developments. In Europe, investment in R&D was led by a few multinationals, supported by and connected to research structures that also involved the public sector, with a very strong national character. It is important to underline that the overall level of public investment in R&D in Europe has been more or less similar to that of the US. The key difference lies in the fact that much of the European investment in R&D comes not from 'big business' but from public actors. Nevertheless, those European companies heavily engaged in investing in R&D were forced to diversify their investments following increasing international competition. As a result, the traditional direct connection between companies and national research institutions was severed.



Source: Eurostat

Total investment in R&D has increased steadily among the main global economies and continues to do so. Nevertheless, key differences among these economies remain. R&D expenditure in the US is higher than in the rest of the countries, at 44% of the total OECD expenditure in 2001, followed by the EU (28%) and Japan (17%).

In the view of the OECD,[16] if the EU were to achieve the 3% target agreed in Barcelona, the consequences for the economy would be very promising. Firstly, it would lead to an increase of GDP by 1.7% (annually of 0.24%). Productivity would rise by more than 0.8% by 2010 and employment rates would increase by 1.7%. Ultimately, there would be a positive effect on income levels, which would increase by 3%. This Barcelona target is still the absolute minimum of what is to be achieved by 2010. Still, one cannot merely set a basic threshold and expect the job to be done. The response to the European innovation question is more complicated: both the qualitative and quantitative dimension must be considered. As underlined above, the problem of distribution between R&D expenditures in the public and private sector remains to be solved. In any case, the right balance between basic research and the applied product and service development must be established.

<u>Promoting innovative sectors</u>

The high tech sector must clearly be associated with any reflection on the wider development of innovation and entrepreneurship. A the same time, innovation is not limited to these type of industries and can also have a significant impact in integration of products and services, in management methods, in marketing and in developing traditional sectors other than manufacturing.

Industrial policy should not favour specific industries. Still, the rationale for public R&D funding is to provide a strategic direction for economic growth. In this, the identification of specific sectors and business activities that are bound to grow exponentially within the next decades is particularly useful.

The need for a change of attitude

Regardless of the targets agreed by the Council in Barcelona in 2002 and persistent calls to meet these at all costs, the EU may still be lacking a consistent and coherent approach and a proactive mentality in tackling these goals. The focused quantitative targets established in Barcelona should have been proposed with the full understanding that certain structural conditions also need to be changed in order to devise a proper innovation policy.

Some relevant issues worth bearing in mind are:

- **A lack of clarity on what to finance:** Innovation must be mainstreamed into all European policy areas to avoid conflicting measures. An increased commitment to innovation should be reflected in the EU Budget.

- **An educational gap:** European universities remain less attractive than their American counterparts. The objective of fostering a renewed scientific culture that would attract researchers to this day remains wishful thinking. The absence of this in part explains the lack of clear and strong linkages between the university and the private sector and between public research and the market.

- **The role of Intellectual Property Rights (IPR):** IPRs should play an enhancing role in the processes of technology transfer and the sharing of knowledge, as well as for patenting and licensing for of R&D results.

- **A lack of entrepreneurial culture in education:** In comparison to the US, the role of the European entrepreneur has never held the same social significance. A shift in cultural attitudes should be encouraged, to foster a more entrepreneurial-friendly mindset.

- **A lack of coherence with the macroeconomic environment:** The contradiction between the Growth and Stability Pact, which encourages cuts to public spending, (including R&D expenditure), and a Lisbon Strategy that calls for more investment (both private and public), into these activities must be erased.

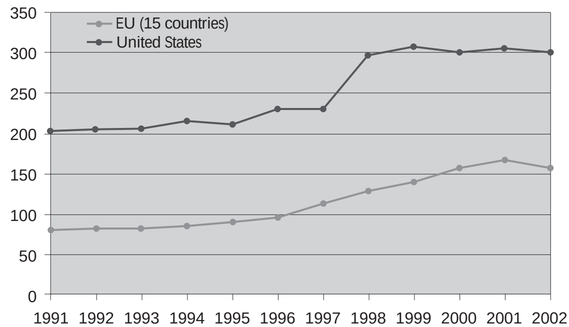
From research to the market: building innovative capabilities

As noted above, the successes of the American model in stimulating entrepreneurship derives largely from the close linkages between research institutions and the market. For the European case, this implies a more focused approach on how to bridge the gap between research and the market, aside from the obvious need to step up efficient investments in knowledge and R&D infrastructure. Europe must be capable of formulating pro-active strategies, rather than continually focusing just on how to catch-up to the American competition.

As discussed above, productivity for productivities sake cannot be the road ahead for Europe. As the services sector gains increasing importance and the application of new technologies to traditional products changes the market, it also has an impact on the future of economic growth in Europe. To remain competitive – in fact, to lead the global economy in these areas – European companies must focus more intently on producing those products which generate more value-added and are thus more immune to price competition on the global scale.

Stating the obvious differences does not, however, solve the problem. The structures – specifically the relationships between research and market – are proving inefficient in transforming Europe into a knowledge-based society. As mentioned above, many indicators highlight the fact that Europe is an 'R&D underachiever,' especially in comparison with the United States. The graph below demonstrates that the IT shock between 1997 and 2001 did not reduce gap between the US and Europe, in terms of the number of patents registered. Europe had a lead in a few sectors, such as mobile phone technologies, but this fragmented leadership did not suffice to make Europe more innovative in terms of patents[17] over that period of time.

Evolution of the number of patents - by million of inhabitants



Source: Eurostat, structural indicators

This is not to advocate the imitation of American model for Europe, but it does imply a serious debate about learning from best practices and adapting to a more up-to-date model that fits within the European system.

The traditional European manufacturing sector is the most volatile to global competition. Only if innovation can be applied to marketing and distribution, the integration of new technologies and development of added services and integration of mainstream trends, (i.e., environmental considerations), will these industries stay in Europe. Making better use of innovation in the manufacturing sector not only requires a determined effort by the companies themselves, but also necessitates a supportive environment, including a well- functioning internal market in Europe. Positive examples do exist: the creation of economies of scale via the Airbus model or pan-European mergers can be cited in this context.

One of the key 'missing links' for the EU to make greater use of innovation are the difficulties encountered in the process of **technology transfer**. In theory, this should ease the transition from research centres to businesses for commercial use. Technology transfer could become much more professional. Further efforts are needed to attract attention to this vital part of the process, in an effort to explain the reasoning behind its use and the need and applicability of new products and services to the market. Greater business interest, public and private resources need to be attracted and, ultimately, the trend towards increased research capabilities and more investment in human capital must be reinforced.

European institutions have a chance of proving their commitment to increasing the importance of research and development in their negotiations surrounding the 7th Framework programme for R&D. Although the means provided by this programme are small compared with the needs, it sets important priorities. By focussing the programme on emerging needs, creating contract rules that facilitate the transfer of knowledge to business, and promoting pan-European research and development cooperation, European institutions will send important signals. If they engage in the usual horse-trading in order to promote national priorities, they will fail.

Showcases

There are a number of technological showcases within Europe to draw lessons from. Strong clusters of innovative behaviour can be found in Europe. The table below displays the characteristics of two of the most successful clusters in Europe today, Munich, Germany and Cambridge, UK. The comparison with American competitors shows that even Europe's most successful clusters suffer from a lack of scale, be it in terms of staffing, output or the number of biotech companies present in the area.

	Cluster size			
	Cambridge	Munich	Boston	Bay Area
Researchers	9,200	6,300	23,550	N/A
Publications	15,000	10,000	38,000	29,500
Number of public companies	>11	>4	>38	>44
Number of biotech companies	>110	>60	>200	>190

Source: EIF

There is a common position among the stakeholders in EU research policy that these type of technological clusters lack critical mass to emerge as global leaders in R&D and provide European firms with an initial competitive advantage. There is a tendency to promote the development of local clusters, meant to act as drivers for the economic development of their region where they are located, both at the EU and at the Member State level. This results in scattered and small-scale R&D facilities, which do not reach the above mentioned critical mass in terms of financing, staffing or business presence, to generate significant innovations. These local or regional clusters are surely valuable initiatives but there should be a debate as to what would be the most efficient type of clustering, generating most value-added at EU level. Would it not be more efficient to concentrate EU funding on a few clusters - such as Cambridge, Munich, or Sofia Antipolis - to turn them into global leaders, while complementing their activity with a virtual pan-European network of laboratories? This way EU clusters could operate in niches that would of interest both for the business and the research community.

Aside from the problems that arise from the size of R&D centres in Europe, finding a sufficient source of financing still remains a challenge which hampers the realisation of many promising projects. As a result, initiators are often unable to "sell" their projects and ideas, or are limited in the means to obtain financing when projects are considered as 'too risky' to be worthy of any external investment. The European Investment Fund has set up a project on Tech Transfer Accelerators, commissioning experts to investigate best practices to finance the seed stage both in Europe and on a global scale. One of the key findings was that there is a key lack of financing for research projects that range in cost from 100.000 to 2 million euros. Tech Transfer Offices run by universities could represent a solution for meeting these financing needs. This strategy was first adopted in the US but is progressively being used in UK universities. These offices can help the initiator of a research project overcome the information asymmetry that exists between him/her and potential investors. Here, drawing on alumni networks can be particularly useful. Information asymmetry acts as an even greater constraint on small-scale projects or projects conducted by small firms. In that case, the entity carrying out research has no collateral to offer to the lender, which would allow him to recuperate a part of his investment expenses, should the project prove unsuccessful.[18] Introducing new sources of funding could be complemented with the creation of fiscal incentives. A viable option, therefore, is to establish "tax credit" schemes, similar to the R&D tax credits applied in the UK, or the CIR in France.

Crédit Impôt Recherche (Research Tax Credit) in France

This fiscal incentive was created in 1983 and its continuation was officially confirmed last year. The CIR is a type of public support aimed at ameliorating the enterprises' competitiveness through assistance in R&D. This mechanism of tax credit is composed of two elements:

TC = (45/100 * (R&D spending surplus of last year – average R&D spending over the two years before)) + (5/100 * last year's R&D spending in volume)

In other words, the amount of tax credit is equal to 5% of last year's R&D spending (1st component) plus 45% of the surplus of last year's R&D spending, compared to the average spending over the two years before (2nd component).

The calculated tax credit is discounted from the amount to be paid to the tax authorities. This tax credit is subject to a ceiling of 8.000.000 euros. The constituents of R&D spending are the usual human and material costs associated with research. They also comprise patenting costs and costs created by technological monitoring. In 2001, this tax credit amounted to 520 million euros and 2800 enterprises benefited from it.

Source: French Ministry for Research, C.A.E.

The problem is that this type of tax incentive requires the beneficiaries to make taxable profits, which is a difficult condition to fulfil for start-ups exploring new sectors or processes. In other words, these tax incentives will not necessarily target the most innovative businesses; they will benefit those that have already reached a certain phase of maturity, i.e., profitability. For this reason, exemptions from social contributions or non-profit related taxes, for all those activities related to R&D seems the most feasible way forward. France can serve as a model in this regard: SMEs, that have fewer than 250 employees and are less than 8 years old can benefit from local tax and social contribution exemptions, amounting up to 35% of all R&D-related spending, provided that they can demonstrate the existence of R&D projects and are willing to report to the tax authorities on these every year. However, for these tax incentives to be fully effective on private R&D expenditure, it must be ensured that these type of exemptions do not run the risk of being considered “state aids” by the Commission. The EU’s executive arm should take a clear stance on this. More generally, these tax incentives should not lead to a “zero-sum game,” which implies that the net loss caused by tax or social contribution exemptions does not push public authorities to reduce public funding for R&D.

Concluding remarks

The Lisbon Process has been declared dead by many and too often is seen as a symbol of the ailing, 'old Europe' unable to meet the challenges of global competition. As this paper has shown, the EPC Task Force has taken a different view. Not only is the Lisbon Strategy as relevant now as it was in 2000, but this report also highlights a number of areas in which Europe has achieved impressive global competitiveness. Europe is home to nearly half a billion people with high income levels and strong social welfare programmes and yet Europe remains a strong magnet for investment. The truth is that Europe has strong economic and social foundations which should be built on - not weakened or destroyed.

The Task Force acknowledges the areas in which Member States have failed to deliver on the Lisbon goals in different parts of Europe as well as the continuing need for serious reforms. But the fact remains: some parts of Europe actually deliver world class competitiveness, while others have fallen behind. The Nordic model seems – more so than most – to be able to deliver economic growth, relatively low unemployment, decent social standards and a commitment to both environmental sustainability and fiscal stability simultaneously. The 'Lisbon success stories' include those who have managed to keep state intervention minimal in the development of product, service and labour markets. Larger continental European countries are still struggling to reform these markets. Moreover, a number of Southern and Eastern European countries are laggards in creating sustainable economic growth – not so much in terms of immediate economic growth prospects but in terms of the structural modernisation of their economies which is essential if they are to stay competitive over the longer term.

The EPC Task Force has taken a view of competitiveness that is broader than the narrow economic growth criteria emphasised by others. Given global competition and the rapidly changing world economic environment, Europe's only chance of staying competitive will be to invest substantially more in knowledge-based industries and services. Competing on the level of narrow production or labour costs is not a sustainable way forward for Europe. Inevitably we will lose jobs in sectors that are dominated by price competition. As has been shown above, this is why the development of knowledge-based economies are crucial for Europe's future – as also strongly emphasised in the Lisbon Strategy. But this only underlines the serious concern we share that our economies are simply not investing enough in expanding the knowledge base. This increased focus on the importance of knowledge-based industries does not imply that Europe should give up its industrial base. On the contrary, it means that the industrial base needs to be subject to constant modernization, through the integration of research, development and new technologies existing industries.

Only through the creation of a long term potential for growth can Europe sustain its economic and social model. The great majority of European citizens want to uphold the benefits of this model. The most compelling reason for creating improved economic growth is not just to participate in an international race for the highest short term growth rates. Rather it is to lay the basis for sustainable growth. This is why the Lisbon Process must continue to embrace both social cohesion and environmental sustainability. These may be viewed as factors that add costs to the economy. But they also promise great advantages, including a largely untapped entrepreneurial opportunity to sell Europe's social and environmental expertise, products and services in a rapidly industrialising world market.

The Task Force has identified two areas where reforms in Europe are urgently needed: labour markets and welfare systems on the one hand, and the development of a more innovative and entrepreneurial Europe on the other.

Rigidities in the European labour market do create problems. In our rapidly changing economies nobody can expect skills and jobs to remain frozen in aspic for decades. We must all be expected to constantly upgrade our skills in order to adapt to changes in working world. Greater investment in human resources is consequentially a key recommendation of this report. A good education and a willingness to constantly upgrade one's skills is thus the best (eventually the only) way to remain employable. This implies a qualitatively higher degree of flexibility in the labour market as a whole.

Welfare systems also need to be adapted to the changing economic environment. They should not be designed to guarantee the protection of those that have jobs if this is to the detriment of those that are unemployed or seeking work. Secondly, budgets for social and labour market support should be directed towards Active Labour Market Policies to address the structural deficiencies in unemployment policies. Resources should be devoted to helping people back into work rather than funding long term unemployment.

The demand for knowledge-based growth also points to another European weakness: the unfortunate tendency fall behind the global competition in terms of innovation and entrepreneurship. With the rapidly changing environment, life cycles for products and services are becoming shorter and shorter. Thus, even the largest companies are forced to constantly reinvent themselves to stay at the cutting-edge of competition. This requires a high degree of innovative behaviour, which can only be achieved if the regulatory and market environment is favourable. Europe has a range of sectors in which it has established itself as a global leader. These sectors need further development. At the same time, market access should be improved by a series of efforts to implement and update the EU's internal market. This would also allow European companies to collaborate and operate increasingly across European borders, and follow the successful examples in the creation of economies of scale within Europe.

The Lisbon Agenda's target of reaching a quantitative level of 3% of GDP is relevant, but it is also important to ensure that the funds for research and development are spent in a forward-looking manner. Aside from merely reaching the quantitative target, qualitative concerns remain. Europe must develop its scientific and research base to avoid a 'brain drain' to other parts of the world. Thus, the best brains need to be given the opportunities and challenges that will tempt them into staying in Europe. This requires an improved relationship between research facilities and universities and the markets.

Small and medium sized businesses are key for employment creation and for the development of innovation. There has been much focus on the costs and duration of starting a new business, this report has highlighted a crucial additional point, namely the how to overcome the existing obstacles for the development and growth of small businesses so that they might become the winners of tomorrow. Europe, in this regard, suffers from a lack of entrepreneurial culture, often unnecessary 'red tape,' a lack of risk capital and proper market conditions for SMEs to prosper. Public support can help, but this type of investment cannot be the main driver for company growth. Europe has many examples of excellent practices. The focus on regional strengths and the development of entrepreneurship in partnerships between SMEs, research institutions and public authorities can be cited in this context. Many of these 'best practices' could be transferred from one area to the next, and a maximum of efforts should be made – across Europe – toward facilitating this process.

In conclusion, Europe needs better growth performance. It needs growth to stem those pressures threatening the European model, which derive both from global competition and the demographic changes of ageing affecting Europe. We already have many examples of good practice in Europe, and it is crucial to start learning from these best practices and get down to implementation of these reforms. Only by doing so can we ensure that Europe will be a region of economic growth and opportunity with an innovative knowledge-base, a high degree of social cohesion and a sustainable environment for the next generation. Surely such a cause merits the direct support and involvement not only of European institutions and national governments, the European and national Parliaments but also of regional authorities and organisations representing businesses, trade unions and civil society at large.

Hans Martens
Chief Executive, European Policy Centre

1 EU15, Source: Structural Indicators, European Commission.

2 EU15, Source: Structural Indicators, European Commission.

3 The World Bank and International Finance Corporation. Doing Business in 2005: Removing Obstacles to Growth, Washington: World Bank, International Financial Corporation and Oxford University Press, 2004.

4 Presidency Conclusions European Council. Brussels: 25/26 march 2004.

5 European Commission, DG Employment and Social Affairs. Employment in Europe 2004. chapter 2. Luxembourg: European Communities 2004.

6 The real GDP growth rate for 2004 is a forecasted value.

7 These two figures are contained in the report Employment in Europe 2004 Review, chapter 2

8 Larsen, Flemming and Mailand, Mikkel. Danish activation policy - the role of the normative foundation, the institutional set-up and other drivers. Danish contribution to the ETUI activation regime project. Brussels: February 7, 2005.

9 Barbier, Jean-Claude. Normative and regulatory frameworks influencing flexibility, security, quality and precariousness of jobs in France, Germany, Italy, Spain and the United Kingdom. ESOPE project report, Fifth framework project, December 2002. See also Barbier, Jean-Claude, La stratégie européenne pour l'emploi: genèse, coordination communautaire et diversité nationale. Rapport pour la DARES (ministère du travail), CEE, Noisy le Grand, 2004.

10 These figures reflect venture capital investments at an early stage. Venture capital investment is defined as private equity raised for investment in companies; management buyouts, management buy-ins and venture purchase of quoted shares are excluded. The category of "early stage" investments refers to the funding needed to start up and seed a business.

11 Released in June 2004, the new capital adequacy framework commonly known as Basel II was the result of an effort by international banking supervisors to update the original international bank capital accord (Basel I), which has been in effect since 1988. The Basel II Framework sets out the details for adopting more risk-sensitive minimum capital requirements for banking organisations. The new framework reinforces these risk-sensitive requirements by laying out principles for banks to assess the adequacy of their capital and for supervisors to review such assessments to ensure banks have adequate capital to support their risks. It also seeks to strengthen market discipline by enhancing transparency in banks' financial reporting. Like the EU's shape after the Maastricht Treaty, the Framework rests on three pillars:

_"Pillar 1" of the new capital framework revises the 1988 Accord's guidelines by aligning the minimum capital requirements more closely to each bank's actual risk of economic loss

_"Pillar 2" of the new capital framework recognises the necessity of exercising effective supervisory review of banks' internal assessments of their overall risks to ensure that bank management is exercising sound judgement and has set aside adequate capital for these risks.

_"Pillar 3" leverages the ability of market discipline to motivate prudent management by enhancing the degree of transparency in banks' public reporting. It sets out the public disclosures that banks must make that lend greater insight into the adequacy of their capitalisation.

12 European Commission. Taxation Paper n°3 - European Commission Staff Working Paper. Brussels, 12 January 2005.

13 The profits of a group of companies active in more than one Member State would be calculated according to the rules of one company tax system only, the system of the home state of the parent company or head office of the group. Participating companies would self-assess, report and pay the local tax but the calculation of the combined profits of the group would only be filed by the parent company in the home state.

14 OECD figures for 2001.

15 Rodrigues, Maria Joao. From European Policies for a knowledge economy. Edward Elgar Publishing Limited, 2003, 55.

16 OECD. Science, Technology and Industry (STI) OECD Outlook 2004. OECD.

17 The graph below provides an insight into the national patenting activities through patent applications to the European Patent Office (EPO), granted patents by the United States Patent and Trademark Office (USPTO) and the triadic patent families i.e. patents that at the same time are filed at the EPO and the Japanese Patent office (JPO) and granted by the USPTO. Besides total number of applications (EPO) , patents granted (USPTO) and triadic patent families (EPO-USPTO -JPO) this figures are also related to million inhabitants and million labour force at the country level.

18 Betbèze, Jean-Paul. Financer la R&D. Rapport du Conseil d'Analyse Economique n°54, Paris 2005.

Mission Statement

The European Policy Centre (EPC) is an independent, not-for-profit think-tank, committed to making European integration work. The EPC works at the 'cutting edge' of European and global policy-making providing its members and the wider public with rapid, high-quality information and analysis on the EU and global policy agenda. It aims to promote a balanced dialogue between the different constituencies of its membership, spanning all aspects of economic and social life.

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