

BUSINESSEUROPE



EUROPEAN REFORM BAROMETER SPRING 2007

BUSINESS ASSESSMENT
OF REFORMS FOR GROWTH
AND JOBS IN EUROPE

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■ EXECUTIVE SUMMARY

BUSINESSEUROPE WARNS OF REFORM COMPLACENCY

The BUSINESSEUROPE spring 2007 survey among national business federations indicates that the current pace and scale of reforms is not sufficient to improve competitiveness and raise the growth potential in Europe. Despite the current economic upturn, the downward trend in productivity growth has not yet been reversed.

Nevertheless, policy efforts are moving in the right direction. Initiatives to implement reforms for more growth and jobs are taking shape in virtually all Member States, but too many reforms are still not fully implemented or have not fulfilled companies' expectations. It is vital for the future of the European economy to keep up the reform momentum.

MORE MEMBER STATES ARE PERFORMING WELL, BUT SOME HEAVYWEIGHTS ARE STILL LAGGING BEHIND

The Nordic countries and Ireland continue to foster world-class economic structures which rank them among the world's most competitive. Others have recently implemented wide-ranging reforms, such as Austria and the Netherlands as well as several new Member States.

However, other countries and especially the large continental Member States are still struggling to adapt their economic structures to the challenges of increased global competition and population ageing. These Member States must redouble their reform efforts in order to lift the whole EU to a level of competitiveness which will allow for self-sustaining growth and job creation.

PROGRESS IS SATISFACTORY IN RESEARCH POLICIES, BUT REMAINS MIXED IN OTHER AREAS

Policies which aim at advancing the knowledge economy have received the most favourable assessment by national business federations: measures to improve the research environment and, to a lesser extent, those to provide better framework conditions for innovation.

Business equally attests to reform progress in improving the business environment and public finances; however, for most companies in Europe an overall reduction of fiscal and regulatory burdens has not yet become a reality. Mixed progress has also been achieved in completing the Internal Market with big challenges remaining in the energy and services sectors.

Remarkable progress has been made on integrating more people in the labour market. However, improvements in labour flexibility have been limited, especially for regular employment contracts. Moreover, the matching of people's skills with labour market needs remains a major weakness in Europe.

■ WHAT IS THE EUROPEAN REFORM BAROMETER?

At the Spring European Council 2005 all EU Member States recommitted to the “Lisbon” Strategy for Growth and Jobs, a detailed agenda for economic reform whose goals were defined as:

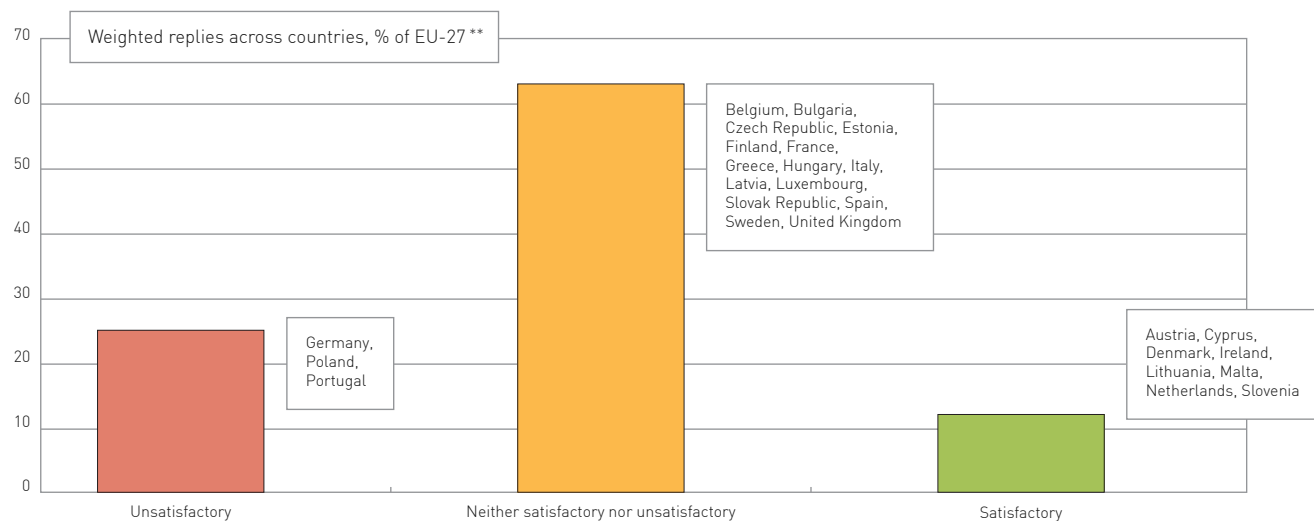
- Renewing Europe’s competitiveness, increasing its growth potential and productivity and strengthening social cohesion,
- Placing the main emphasis on knowledge, innovation and the optimisation of human capital.

BUSINESSEUROPE has asked its national member federations, for the second consecutive year, to assess progress achieved in their countries on the economic reform agenda.

This document aggregates the assessments from national federations and draws general conclusions for the European economy. The assessment of overall national reform progress, compiled in the table below, shows that progress has been made but that this progress **does not satisfy business expectations**. Only in eight, mostly smaller, EU Member States does business assess overall reform progress as satisfactory.

Chart 1 Assessment of overall progress in national reforms for growth and jobs*

Source: BUSINESSEUROPE members survey spring 2007



* National federations could give five possible replies to assess reform progress in their countries: - excellent, - satisfactory, - neither satisfactory nor unsatisfactory, - unsatisfactory, - deteriorating. No federation assessed overall reform progress as - excellent or as - deteriorating.

** The graphs in this document show the weighted share of national business federations’ replies, i.e. the share of federations for each answer weighted according to their country’s GDP relative to EU GDP (in Purchasing Power Parity).

Individual assessments by national business federations are available on the website www.buinessurope.eu/growthandjobs

■ EUROPE'S PERSISTENT PRODUCTIVITY PROBLEM

The falling trend in EU productivity growth has not yet been reversed. Without higher productivity, Europe will not be able to sustain higher growth rates, especially in view of falling labour availability due to population ageing.

The present economic upsurge therefore risks being short-lived if it is not underpinned by further structural reform to make Europe more productive.

	1983 - 1987	1994 - 1998	2004 - 2008
Average real EU GDP growth	2.5	2.6	2.2
Contribution from hourly labour productivity	2.6	2.0	1.4
Contribution from labour utilisation	-0.1	0.5	0.8
• Employment rate	-0.3	0.5	0.6
• Hours worked per person	-0.5	-0.3	-0.2
• Active age population	0.7	0.3	0.4

Sources: BUSINESSEUROPE based on Eurostat, Groningen Growth and Development Centre, OECD.
Forecasts for 2006 and 2007 are from BUSINESSEUROPE's spring 2007 Economic Outlook (www.busesseurope.eu/economicoutlook)

The table above divides average GDP growth in the current recovery into its contributions from productivity and labour utilisation growth. As a point of comparison, similar breakdowns are provided for the mid-1980s and mid-1990s upturns. Two fundamental characteristics of the current upturn become apparent:

- On the one hand, labour utilisation is a much more important contributor to growth today than it was in the past. The total volume of hours worked is rising more rapidly due to increasing employment rates, slower declines in average hours worked per person and still dynamic active age population

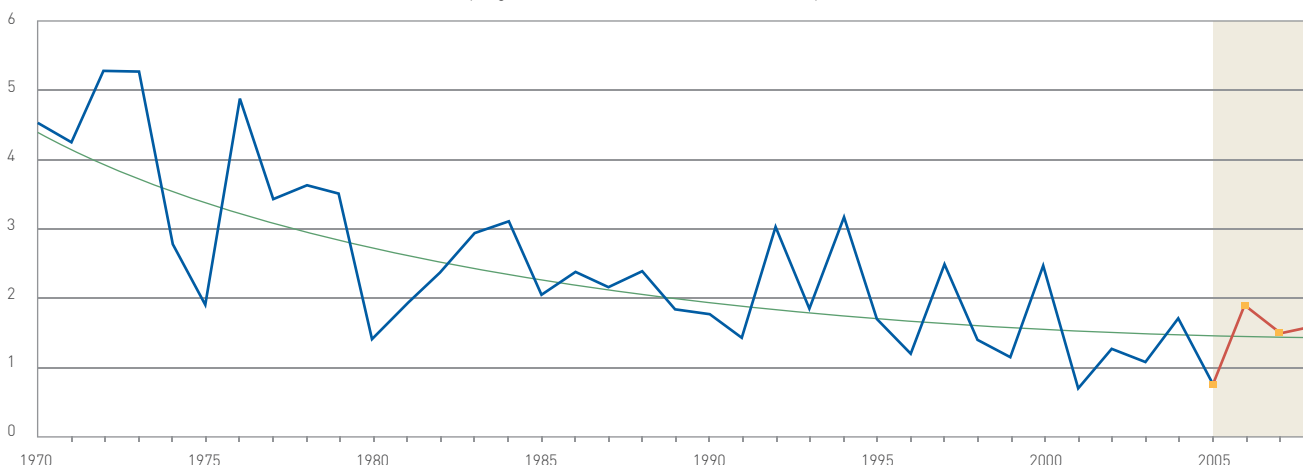
growth. Reforms are going in the right direction in terms of easing unemployment and integrating more people in the labour market.

- On the other hand, BUSINESSEUROPE forecasts productivity growth to remain at only around 1.5% this year and next. This significant underperformance compared with past recoveries not only reflects the short-term substitution effect of rising labour utilisation (notably through the reintegration of lower skilled workers in the labour market), but also reveals structural impediments to stronger productivity growth.

Chart 2 Productivity growth in EU15

Source: BUSINESSEUROPE based on Groningen Growth and Development Centre.

Forecasts for 2006 to 2008 are from BUSINESSEUROPE's Spring 2007 Economic Outlook (www.busesseurope.eu/economicoutlook)



ASSESSMENT OF POLICY AREAS

SUSTAINABLE PUBLIC FINANCES

Without policy changes, public debt levels in EU-15 are projected to explode by 2050 to 180% of GDP, in the new Member States to as much as 280%. (Standard & Poor's 2006)

Above all, social security systems must be made financially viable by raising the pension age, introducing more competition between insurance providers, strengthening private funding, and decoupling social security contributions from labour cost.

BUSINESS ASSESSMENT OF REFORM PROGRESS:

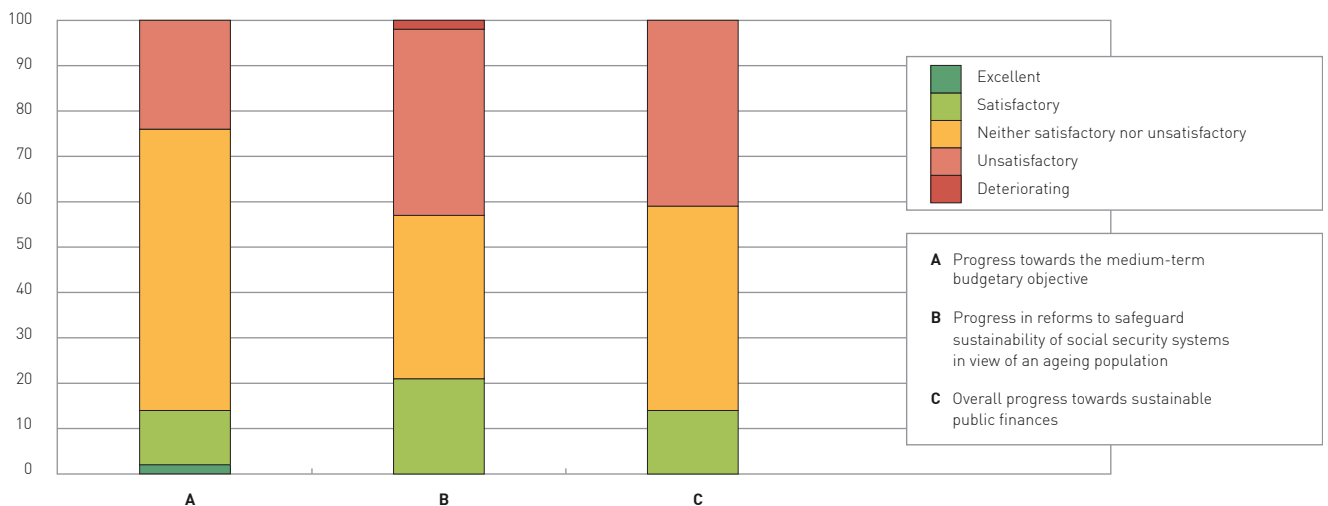
- Policy-makers are not taking full advantage of the recovery to adapt public finances to population ageing.

- The weighted majority of national business federations attests to progress towards the medium-term objective but judges that more could have been done in view of the ongoing recovery. Progress in public finances is often due more to increased tax revenues rather than to a real improvement in the structure of public finances.

- Initiatives to reform social security systems are starting to gain ground in many Member States. However, especially in the bigger Member States the measures have not gone far enough or are stuck in political discussions, so that their final outcome is still unclear. At the other end of the scale Member States like Ireland are building up pension reserve funds due to the excellent state of public finances.

Chart 3 Sustainable public finances

Source: BUSINESSEUROPE survey spring 2007



ASSESSMENT OF POLICY AREAS

BUSINESS ENVIRONMENT

The annual cost of administrative burdens in Europe is as high as 3.5% of GDP or 470 billion Euros, 30% of which originates at EU level, 70% at the national level. (European Commission 2006)

BUSINESS ASSESSMENT OF REFORM PROGRESS:

- Better regulation initiatives are promising, but have resulted in little real alleviation for companies so far.
- Company creation is becoming easier, but company growth is held back by fiscal burdens.

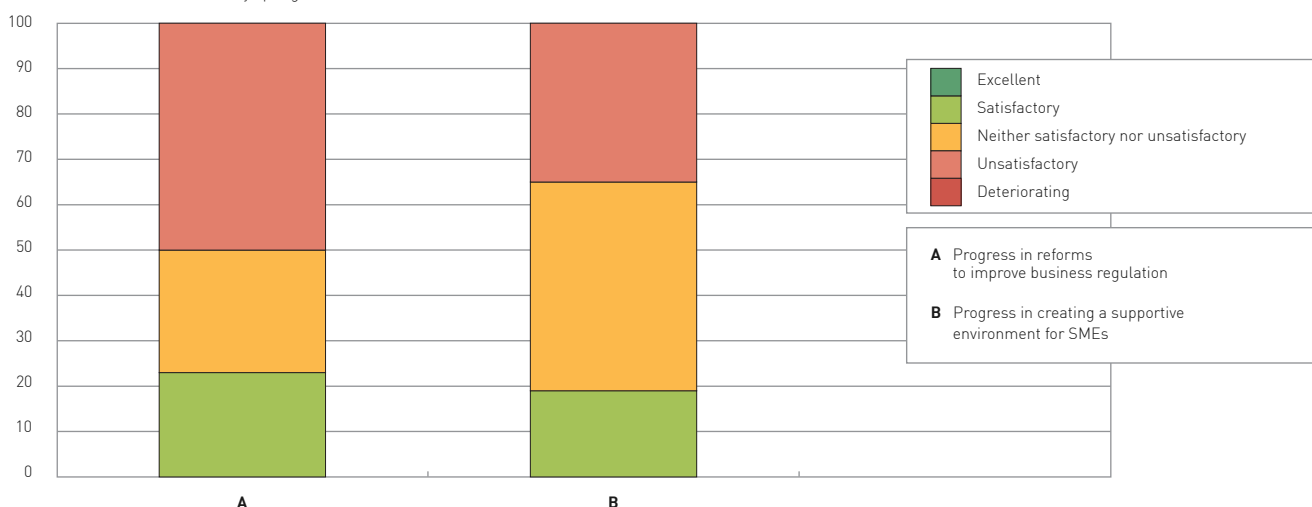
- For business federations throughout Europe, better regulation is a priority. Over recent years and not least thanks to the exchange of best practice in the framework of the EU Growth and Jobs Strategy, at least 16 Member States have now started using a common methodology to measure and eventually reduce administrative costs. The practice of assessing the impact of legislative proposals is also spreading.
- Last year's BUSINESSEUROPE survey revealed a moderate optimism from national business federations regarding better regulation initiatives. In contrast, this year's assessment is markedly more reserved. Better regulation initiatives in Europe have not yet led to substantial alleviations for companies on the ground. In addition, they are sometimes

undermined by the adoption of excessively burdensome legislation, for example the way the anti-discrimination directive was implemented in Germany.

- No clear trend emerges as regards reforms to create a supportive environment for SMEs. Progress is being made on the SME-specific objectives which Member States committed to at the Spring Summit 2006, making it possible to create a company in less than a week. However, the difficulty in many countries is not so much the creation but the growth of SMEs. Few companies in Europe have so far benefited from lower overall corporate taxes and social charges.

Chart 4 Business environment

Source: BUSINESSEUROPE survey spring 2007



■ ASSESSMENT OF POLICY AREAS

RESEARCH AND INNOVATION POLICIES

Absolute levels of research and innovation activities vary immensely across Member States, but average R&D spending in the EU (1.84% of GDP) is significantly lower than in the US (2.67%) or Japan (3.2%). Even more worrisome is the fact that this figure has virtually stagnated in the EU over the last 10 years, whereas it has moderately improved in the US and Japan.

(European Commission 2005)

Research must translate into successful innovation. Here Europe is also lagging behind: out of the 60 globally most R&D-intensive companies created after 1960, 53 are US-American but only 2 are European (Source: UK Department of Trade and Industry 2006).

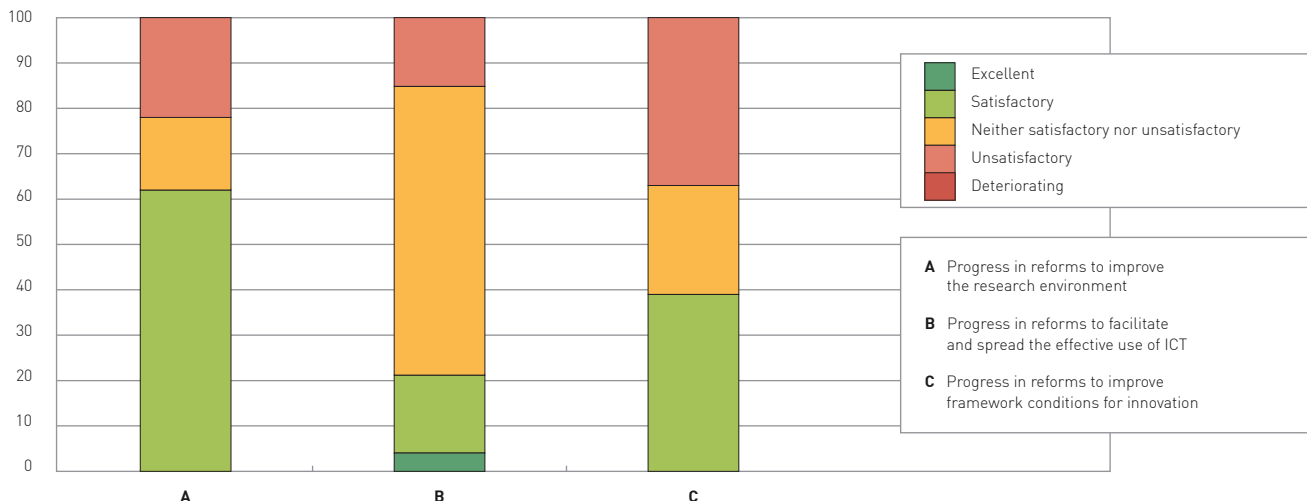
BUSINESS ASSESSMENT OF REFORM PROGRESS:

• Policies to boost research and, to a lesser extent, innovation policies have recently been making satisfactory progress.

- As in last year's BUSINESSEUROPE survey, the policies most positively assessed by national business federations are those to improve the research environment. A raft of different measures is being implemented, such as fiscal incentives to promote private R&D activities, encouragement of public-private partnerships, or stimulation of competition between research institutes. In view of the strong global competition in this area from the US and Japan but also increasingly from emerging economies, these measures come just in time.
- Although still moderately upbeat, national business federations are more hesitant to give a positive assessment to innovation policies which involve a complex set of measures from various policy areas. European business is worried about people's attitudes towards new technologies, e.g. hostility towards genetically modified products.
- Moderate progress continues to be achieved in e-government and the use of broadband, while the level of ICT usage in Europe is already quite high. However, business urges accelerated usage of ICT in the public sector, and especially in the educational field, in order for Europe to keep up with international standards.

Chart 5 Research and innovation policies

Source: BUSINESSEUROPE survey spring 2007



ASSESSMENT OF POLICY AREAS

IMPLEMENTATION OF INTERNAL MARKET RULES

It is good news that the average rate of Internal Market directives transposed into national law has increased in recent years and even reached the 98.5% target set by the European Council. Transposition, however, is not sufficient. The number of infringement cases against Member States for not correctly applying Community legislation rose by 6% in 2006 to 1,246 cases [European Commission 2007].

BUSINESS ASSESSMENT OF REFORM PROGRESS:

- Mixed progress has been achieved in the overall implementation of Internal Market legislation.
- Competition in the European energy market is inadequate.

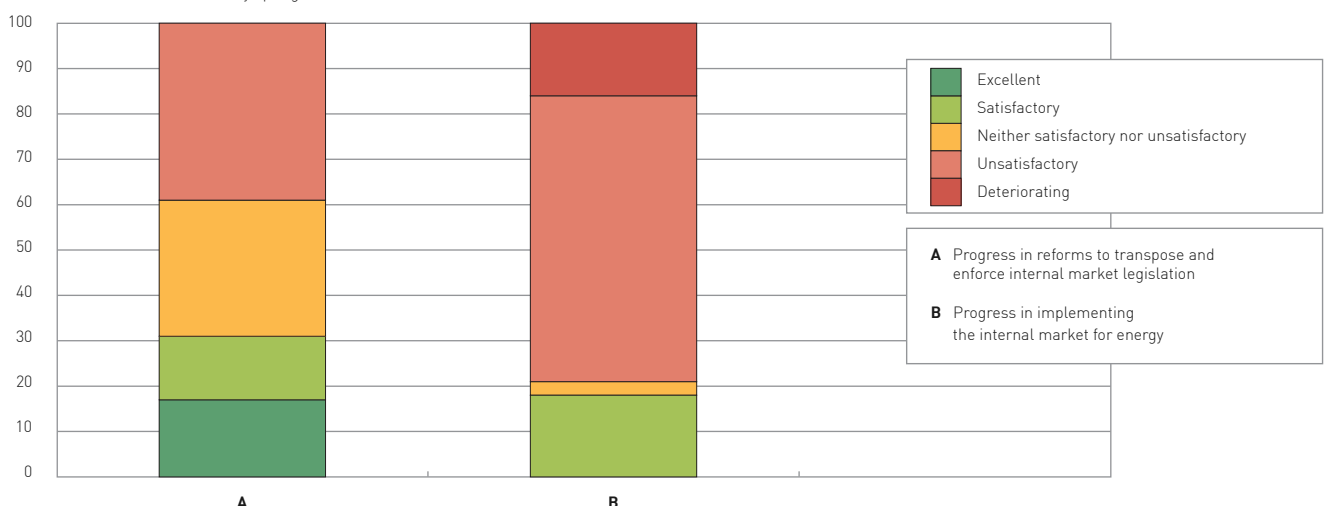
- According to national business federations, there was mixed progress in 2006 on transposing and enforcing Internal Market legislation. Business hopes for a new impetus at the national level in the wake of the European Commission's current Single Market Review.
- Making the Internal Market work is an ongoing process: constantly evolving Internal Market legislation must be properly transposed into national law; a landmark challenge for Member States will arise with implementation of the newly adopted services directive. The Community text of this directive unfortunately leaves Member States with options to protect their services markets from cross-border competition. It is therefore all the more important

that national policy-makers transpose the directive not only to the letter but also in spirit to create real cross-border competition in services throughout Europe.

- This year's BUSINESSEUROPE survey contained a specific question on how national business perceives the functioning of the Internal Market for energy. A considerable number of national federations perceive progress in liberalising electricity and gas markets as downright unsatisfactory. A well functioning energy market with globally competitive energy prices is crucial for European companies. Solutions for the unbundling of energy supply and energy distribution as well as for future market regulation and better cross-border connectivity must be found in 2007.

Chart 6 Internal market rules

Source: BUSINESSEUROPE survey spring 2007



ASSESSMENT OF POLICY AREAS

LABOUR MARKET AND EDUCATION

Good news from the labour market: 8 ½ million jobs are expected to be created from 2006-2008. Already in 2005 the EU employment rate increased to 63.8% which, however, is still a long way from the 70% target set by the EU Growth and Jobs Strategy, as well as the employment rate in the US (71.5%) and Japan (69.3%) (Eurostat 2005).

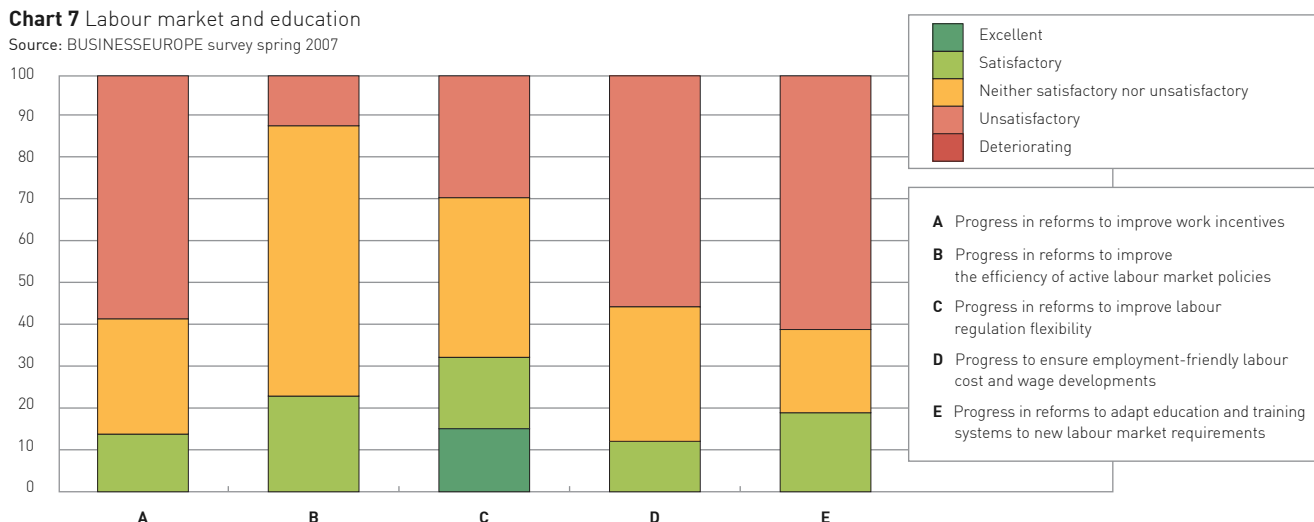
At the same time labour flexibility and labour costs in many European countries still pose a problem. With 44.3% in 2005 the tax wedge in the EU was still far higher than in the US (29.1%) or Japan (27.7%) (OECD 2005).

BUSINESS ASSESSMENT OF REFORM PROGRESS:

- Policies to integrate more people in the labour market have been successful, but this has left reforms of regular work contracts relatively unaffected.
- (Indirect) labour cost is far too high in global comparison.
- The adaptability of the workforce to new labour market requirements remains a serious concern.
- Active labour market policies are assessed as moderately successful, as more people and especially disadvantaged groups have been integrated in the labour market. In addition to the Member States with an already satisfying level of labour market flexibility such as Denmark or the UK, some Member States have recently adopted measures to improve labour regulation flexibility, however not across the board but only for temporary labour contracts, whereas regular contracts have remained relatively unaffected. This bears the risk of creating a dual labour market situation.
- The still high average tax wedge in Europe ties in with businesses' dissatisfaction concerning reforms to improve work incentives and to ensure employment-friendly labour costs. In addition wage moderation seems to be wearing off, spurred by the modest recovery.
- Reforms to adapt education and training systems to new labour market requirements are assessed very negatively. Companies are worried about the persistent mismatch between skills required and skills obtained by the European workforce.

Chart 7 Labour market and education

Source: BUSINESSEUROPE survey spring 2007



■ CONCLUSION: KEEP UP THE REFORM MOMENTUM

In its December 2006 “Annual Progress Report” the **European Commission** carried out a detailed analysis of Member States’ reform progress and finds that 18 Member States have made good or very good progress (see table below). The analysis includes important country-specific recommendations for the policies on which Member States should focus in 2007.

Business federations agree with the European Commission that remarkable reform progress has recently been achieved in EU Member States. However, the European Reform Barometer shows that praise is premature in most countries and policy areas. Reform progress remains insufficient if measured against Europe’s needs in order to get back on a path of sustained growth.

Assessment of overall reform progress in Member States, spring 2007




Commission Assessment	Very Good Progress			Luxembourg Estonia Finland Sweden	Ireland Denmark	
	Good Progress		Germany Portugal	Spain UK France Belgium	Netherlands, Austria, Slovenia, Cyprus, Lithuania, Malta	
	Progress			Italy Latvia Slovakia		
	Limited Progress		Poland	Greece Czech Republic Hungary		
	No Progress					
			Deteriorating	Unsatisfactory	Neither satisfactory nor unsatisfactory	Satisfactory
Evaluation by national business federations						

BUSINESSEUROPE calls on all Member States to keep up the reform momentum in 2007, concentrating in particular on the European Commission’s country-specific recommendations and taking into account the assessment by their national business federation. There is no time for complacency.

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MEMBERS ARE 39 LEADING NATIONAL BUSINESS FEDERATIONS IN 33 EUROPEAN COUNTRIES

 Austria	 Belgium	 Cyprus	 Czech Republic	 Denmark	 Denmark
 Estonia	 Finland	 France	 Germany	 Germany	 Greece
 Hungary	 Iceland	 Iceland	 Ireland	 Italy	 Lithuania
 Luxembourg	 Malta	 Norway	 Poland	 Portugal	 Portugal
 Slovenia	 Spain	 Sweden	 Switzerland	 Switzerland	 The Netherlands
 Turkey	 Turkey	 United Kingdom			
 Bulgaria	 Croatia	 Latvia	 Rep. of San Marino	 Romania	 Slovak Republic

THE EUROPEAN REFORM BAROMETER AGGREGATES THE ASSESSMENTS MADE BY BUSINESSEUROPE'S MEMBERS ON NATIONAL REFORM PROGRESS. INDIVIDUAL COUNTRY ASSESSMENTS ARE AVAILABLE ON THE WEBSITE:

WWW.BUSINESSEUROPE.EU/GROWTHANDJOBS

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