Opinion of the European Economic and Social Committee on 'The EU Economy: 2007 Review — Moving Europe’s productivity frontier'

(2009/C 77/28)

On 17 January 2008 the European Economic and Social Committee decided, under Rule 29(2) of its Rules of Procedure, to draw up an own-initiative opinion on "The EU Economy: 2007 Review — Moving Europe’s productivity frontier."

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee’s work on the subject, adopted its opinion on 3 June 2008. The rapporteur was Mr Morgan.

At its 447th plenary session, held on 17 and 18 September 2008 (meeting of 18 September 2008), the European Economic and Social Committee adopted the following opinion by 108 votes to 4 with 5 abstentions.

1. Conclusions and recommendations

1.1 This opinion is the latest in the series prepared by the EESC dealing with issues of economic governance in the EU. It is based on the Communication from the Commission COM(2007) 721 final entitled "The EU Economy: 2007 Review — Moving Europe’s Productivity Frontier."

1.2 The 2007 Review starts from the fact that while the European Union is one of the most advanced and productive economies in the world, a sizeable gap still exists in living standards, as measured by GDP, between the EU and the most advanced economy in the world — the United States. The root cause lies in a divergence in productivity developments in various industry sectors and Member States.

1.3 While data on the USA provide a useful yardstick by which to measure relative Member State performance, the focus of the opinion is on inter country comparisons in the EU. Factors such as social models, working hours and workplace participation rates affect transatlantic comparisons, but those issues are not the point of this opinion. This opinion is simply about why some EU countries create more wealth and more jobs than others.

1.4 The central idea of the Commission Report is that implementation of the Lisbon agenda will at the same time help Member States to increase both employment and wealth. A number of key policies can make an important contribution. These must aim at:

— Promoting an integrated approach to enhance both security and flexibility in the labour market (whereby the EESC would point out that this approach must be negotiated by the social partners),

— Improving the quality of public finances.

1.5 These policies become even more relevant in the light of the changes to the global economy which have emerged since the Lisbon EU Council in 2000. The new challenges include not only the present financial crisis but the supply-demand balance for fossil fuels, the evidence of climate change, the growing shortages of food and the soaring demand for commodities generally. These issues make R&D investment and world-class research even more vital. They highlight the need for a competitive Single Market underpinned by effective flexicurity provisions in the labour market and high-quality public finances.

1.6 Macroeconomic factors on both the demand and supply side were discussed in depth in the earlier EESC opinions on EU economic governance detailed in the Introduction in which the Committee stressed that supply-side measures to improve competitiveness must be accompanied by a macroeconomic policy mix that promotes incomes, demand and jobs. The focus of this opinion is to show that, demand factors notwithstanding, there is a significant correlation between the supply side reforms in the Lisbon agenda and GDP growth.

1.7 In the recently published Lisbon Scorecard for 2007 (1) the top seven countries were, in order, Denmark*, Sweden*, Austria*, Netherlands*, Finland*, Ireland* and the UK* followed by Germany and France (2). The leading New Member States were Slovenia* and Estonia*. The lowest ranked of the EU 15 were Spain, Greece, Portugal and Italy. Overall, Netherlands,....

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(2) Member States denoted with an asterisk form part of a ‘Watch List’ of best-performing countries as explained in point 4.9.
Austria and Estonia were awarded the accolade for the most effective Lisbon implementation. Greece and Italy were judged to be the least effective. How does leadership in implementing the Lisbon programme affect productivity and employment?

1.8 Although there are many other relevant factors, the conclusion to be drawn from the analysis in this opinion is that there is indeed a close correlation between the Lisbon implementation and progress in the growth of employment and GDP per capita. In general, the reverse is also true, with countries failing to implement the Lisbon reforms tending to underperform. On the basis of this conclusion, the EESC encourages Member States to implement the full Lisbon programme as soon as possible.

1.9 The importance of each element in the programme must be emphasised. The Committee is particularly anxious to see greater investment in knowledge, education and R&D. There is no doubt that competition stimulates innovation, so EU economies need to face competition to meet the challenges of globalisation. The redeployment of the factors of production from failing industries and sectors to emerging and thriving industries and sectors is required in order to maximise the productivity of Member States’ economies. In turn, this means a Member State commitment of resources to flexicurity. Finally, it is clear that Member States’ economic performance is heavily dependent on the good management of public finances.

1.10 In the opinion submitted by the EESC to the Lisbon Council in March 2000 (1), we said: ‘It is our conviction that in Europe we do have the necessary innovation, creativity, knowledge and enterprise to excel in the new paradigm (i.e. the information society). But we must release these capabilities. Obstacles must be replaced by opportunities. Penalties must be replaced by incentives. The last decade saw the liberalisation of European industries. Now we have to liberate the energies of European men and women’. In 2008 there is still a great deal left to do, but the Lisbon agenda is the way forward.

2. Introduction

2.1 This opinion is the latest in the series prepared by the EESC related dealing with issues of economic governance in the EU. It has been prepared in response to the Communication from the Commission COM(2007) 721 final entitled ‘The EU Economy: 2007 Review — Moving Europe’s Productivity Frontier’. The previous opinion, in September 2007, dealt with the 2006 Review — ‘Strengthening the Euro Area: Key Policy Priorities.’

2.2 In this present opinion the EESC sought to relate Member State employment growth and GDP per capita to the various policy recommendations contained in the Communication from the Commission. In this respect it is rather different from the conclusions of the previous opinion on the 2006 Review which explained the domestic socio-economic circumstances and divergent political objectives which govern Member State actions.

2.3 Earlier opinions, October 2006 (2) and February 2006 (3), dealt with the Broad Economic Policy Guidelines (BEPG) 2005-2008, while in March 2004 we gave our opinion on The Broad Economic Policy Guidelines 2003-2005 (4). Although the EESC has received the Commission recommendation for BEPG 2008-2010, it notes that they are unchanged from those for 2005-2008. In view of its previous work on the BEPG, the EESC has decided to use the Review of the EU Economy in 2007 as the basis for this present opinion.

2.4 In October 2006 the EESC examined the rules which affect the overarching objectives of price stability, growth and employment. In this opinion we concentrate on the policies rather than the rules. In February 2006 the EESC published its opinion on the 2005-2008 BEPG. Although this opinion was wide ranging in its scope, it generally endorsed the same policy agenda for growth of employment and productivity that forms the basis of the present opinion. In both of these opinions the EESC considered the economic factors affecting demand. In this opinion we deal with the Commission’s proposals for supply side reforms.

2.5 Even so, the Committee stresses that supply-side measures to improve competitiveness must be accompanied by a macroeconomic policy mix that promotes incomes, demand and jobs. The Committee addressed the question of an appropriate policy mix in its still-topical March 2004 opinion.

2.6 The Commission document ‘European Economy’ No 8/2007 includes the Communication ‘Moving Europe’s Productivity Frontier’ together with four chapters amounting to 149 pages in all:

1. Productivity trends in Europe: finally turning the corner?

2. Assessing productivity at the industry level.


(2) Opinion of the Economic and Social Committee on The Broad economic policy guidelines and economic governance — The conditions for more coherence in economic policy-making in Europe, OJ C 324 of 30.12.2006, p. 49.


(4) Opinion of the Economic and Social Committee on The Broad Economic Policy Guidelines (2003-2005), OJ C 80, 30.3.2004, p.120.
3. Is there a trade off between productivity and employment?

4. Policies in pursuit of higher productivity: another look.

The Committee regrets that the Commission’s recommendations for bolstering competitiveness are confined to the supply side and flexibility in the labour market (whereby the EESC would point out that this approach must be negotiated by the social partners)

This opinion evaluates the policies advocated in chapter 4.

3. Gist of the Communication from the Commission

3.1 The 2007 review starts from the fact that while the European Union is one of the most advanced and productive economies in the world, a sizeable gap still exists in living standards, as measured by GDP between the EU and the most advanced economy in the world — the United States — remains. The root cause lies in a divergence in productivity developments in various industry sectors and Member States.

3.2 By adopting the Lisbon Strategy in 2000, the EU attributed the highest importance to improving its productivity performance along with achieving robust employment growth. The main elements of this strategy were building knowledge, strengthening competitive forces and enhancing flexibility.

3.3 Knowledge building requires more and better investment in R&D and human capital. The effectiveness and cost-efficiency of education needs to be secured throughout the European Union.

3.4 Stimulating competition is crucial for both the level and growth rate of productivity. Empirical research confirms that opening markets to competition not only has a positive effect on productivity and growth, but also on employment.

3.5 Enhanced flexibility is needed to smoothly adjust production structures towards further specialisation and diversification into new areas of relative comparative advantage. Measures have been taken by Member States over recent years to facilitate firm and labour mobility, but more and broader action is warranted.

3.6 The conclusions are that a change in ‘mindset’ is called for. A number of key policies can make an important contribution. These must aim at:

— Promoting higher levels of R&D investment

— Developing world-class research and educational establishments working in close partnership with industry

— Establishing a fully functioning open and competitive single market

— Promoting an integrated approach to enhance both security and flexibility in the labour market (whereby the EESC would point out that this approach must be negotiated by the social partners)

— Improving the quality of public finances.

3.7 Many widely held beliefs have been discredited: not only large countries and large companies can be technology leaders, trade is not the main vehicle for technology diffusion; small countries can lead in specialised fields; small companies often introduce innovative new technologies; international mobility of workers and financial capital are the main vehicles for technology diffusion.

3.8 A broad consensus is now emerging on what is constraining productivity growth and the measures needed to increase it. Restrictions concerning labour and product markets, lack of openness to foreign direct investment and barriers to access or the creation of new technologies and their diffusion can act as key impediments to productivity growth over longer periods of time.

3.9 Since the realisation of productivity gain is influenced by the exit of the least productive entities from the market, policies that foster resource reallocation are important. If productivity gains lead to higher income, consumer demand can be expected to shift towards services. While many service industries have high added value and productivity, the economy can then also afford to create new jobs in sectors with genuinely low productivity.

4. Productivity and Employment

4.1 GDP per Capita depends on more than the Lisbon agenda. GDP depends on factors such as the development of emerging markets, Eastern Europe and Russia, trends in energy and commodity prices and markets, technological change and globalisation generally. Domestic demand is influenced by wage and employment levels as well as purchasing power. Control of demand is very much a function of fiscal and monetary policy while credit to fuel both business and consumer demand depends ultimately on central banks. While financial markets remain in crisis, credit is likely to be in short supply, demand will suffer and GDP will be affected.

4.2 Macroeconomic factors were discussed in depth in the earlier EESC opinions on EU economic governance detailed in the Introduction. The focus of this opinion is to show that, demand factors not withstanding, there is a significant correlation between the supply side reforms in the Lisbon agenda and GDP growth.

4.3 Relative GDP per Capita data is provided in Table 1. Two time periods have been chosen: 1999, the year that the euro was introduced, and 2007. For the New Member States (NMS) this period brackets their accession to the EU. During the period the USA has declined from 161.8 % to 150.9 % relative to EU27. Even so, the so-called old Member States have been unable to take advantage of this relative decline in the USA, with EU15 declining from 115.3 to 111.7 and the Eurozone declining from 114.5 to 109.8 relative to EU27.
Given this GDP data, what do the employment statistics tell us? Table 2 shows employment data for the years 1998 (the year that the first accession negotiations were started with the NMS) to 2006 (the last available data). Unemployment data is shown for the period to 2007. Employment in the USA declined from 73.8 % to 72 % of the workforce in this period while unemployment rose from 4.5 % to 4.6 %. At the same time the Eurozone started to catch up with employment rising from 59.2 % to 64.8 % and unemployment falling from 10.1 % to 7.4 %. Data for the EU15 is slightly better than the Eurozone while for the EU25 it is slightly worse.

In the recently published Lisbon Scorecard for 2007 the top seven countries were Denmark*, Sweden*, Austria*, Netherlands*, Finland*, Ireland* and the UK* followed by Germany and France. The leading NMS were Slovenia* and Estonia*. The lowest ranked of the EU 15 were Spain, Greece, Portugal and Italy. Overall, Netherlands, Austria and Estonia were awarded the accolade for the most effective Lisbon implementation. Greece and Italy were judged to be the least effective. How does leadership in implementing the Lisbon programme affect productivity and employment?

In relative GDP per Capita, Luxemburg and Norway are ahead of the USA. Countries within 20 % of the USA are Ireland* (outstanding), Netherlands*, Austria*, Sweden*, Denmark*, Belgium and (just) UK* and Finland*. Outside of the EU, Iceland, Switzerland and Japan are all within 20 % of the USA. Amongst the NMS, Cyprus and Slovenia* are closest to the EU27 average, while Estonia* has made the most dramatic progress, followed by Latvia, Lithuania, Hungary and Slovakia.

On the employment front there are many parallels to the GDP picture. US employment is just over 70 % of the workforce. In the Table, all the non EU countries, including Japan and all three non Eurozone countries (Denmark*, Sweden*, UK*) have employment levels over 70 %. In the Eurozone only the Netherlands* and Austria* are over 70 %, while Ireland* and Finland* are close. Amongst the NMS, Cyprus and Estonia* lead with totals close to 70 %.

US unemployment is 4.6 %. Ireland*, Netherlands*, Austria*, Denmark*, Cyprus and Lithuania are better than the USA, as is Norway, Luxemburg, UK*, Czech Rep, Estonia* and Sweden* are all within one point of the USA. Sweden*, Latvia and Malta are within two points of the USA.

From the above analysis, it is clear that we should be looking at the policies and trends in the leading countries from the Lisbon Scorecard — Denmark*, Sweden*, Austria*, Netherlands*, Finland*, Ireland* and the UK* — and the leading NMS — Estonia* and Slovenia*. For the purpose of this opinion, these countries will constitute a ‘Watch List’ and are denoted with an asterisk. We will examine the extent to which policies relating to knowledge, competition, innovation, and public finances have contributed to the relative success of these countries. By way of contrast, the policies of Spain, Greece, Portugal and Italy will be monitored as a ‘Control Group’. In addition, policy initiatives in the heavy-weight French and German economies remain very important for the EU. Both countries are characterised by polarised politics which have made reform difficult although, to an extent, the results are now coming through.

The OECD programme for international student assessment is called PISA. Table 3 is a composite taken from the 2006 survey of the reading, mathematics and science competencies of 15-year-old children in OECD and other states.

Apart from Korea, Japan and Switzerland, the countries with straight ‘A’s are Finland* (the clear winner), Netherlands*, Belgium and Estonia*. Countries with two ‘A’s are Czech Rep., Austria*, Slovenia* and Ireland*. Countries with one ‘A’ on the list are Denmark*, Sweden*, the UK*, Germany and Poland. Germany and the UK gain their ‘A’s in science. The UK* has the third highest competency in science at level 6 after Slovenia* and Finland*. All the countries on the watch list achieve ‘A’ grades. The countries in the control group are clustered with the USA at the bottom of the ranking.

Given the considerable correlation between the performance of the education system and the performance of Member State economies, the EESC believes that the Commission is certainly correct to make the quality of education a flagship policy for the EU.

The Jiao Tong University in Shanghai has developed a methodology for ranking universities. There are other methodologies in use to rank universities, but the Jiao Tong is in line with the EU focus on science and research.

The performance of the US School system as measured by PISA is very ordinary. It is in higher education that the USA maintains its competitive edge. Table 4 is extracted from the Jiao Tong rankings. There are 17 American universities in the top 20, two British and one Japanese. The UK, with ten entries in the top 100, is on the watch list. Outside of the EU, Japan (6 entries), Canada (4), Australia (2), Switzerland (3), Norway (1) and Israel (1) also feature. Five of the watch list appear in the top 100: the UK*, the Netherlands* (2), Denmark* (1), Sweden* (4) and Finland* (1). None of the control group appears. It is time for Bologna, Salamanca and Coimbra to regain their former glory. In addition there are 6 entries for Germany and 4 for France.
5.6 Outside the UK, only six Member States are represented in the top 100 universities; twenty EU countries are unrepresented. The policy of the Commission appears to be to fill this gap with an EU Institute of Technology. Despite EESC support for this project, it is difficult to see how it can flourish without weakening the EU presence in the top 100. An alternative strategy would be to review and revise Member State policies for the development of their leading universities. The biggest need is a closer partnership between universities and industry to develop the knowledge and skills to harness 21st century science and technology for wealth creation and employment.

5.7 A further measure of Member State university education is the Eurostat data on the number of tertiary graduates in science and technology per thousand of population in the 20-29 age bracket. The figure for the USA is 10.6. Member States within a percentage point of the USA are Belgium, Germany, Greece, Italy, Latvia, Austria*, Poland, Romania, Slovenia* and Slovakia. Member States with a much greater output are Denmark* (14.7), Ireland* (24.5), France (22.5), Lithuania (18.9), Finland* (17.7), Sweden* (14.4) and UK* (18.4). All countries flagged with an asterisk (*) are on the watch list. Italy and Greece are the control group countries which qualify here. Developing graduates in science and technology must be a focus for Member State secondary and tertiary education systems.

5.8 One of the goals of the Lisbon project is to raise EU R&D spending to 3 % of GDP. Of this 2 % should come from the private sector. Two of the watch list, Sweden* and Finland*, spend more than 3 %. Two more, Denmark* and Austria* spend between 2 % and 3 %, as do Germany and France. Those spending between 1 % and 2 % are Belgium, Czech Rep., Estonia*, Ireland*, Netherlands* Slovenia*, Spain and the UK*, most of which are on the watch list. All other Member States spend less than 1 % with the exception of Hungary and Italy, both at 1 %, Italy and Spain feature in the control group. To close the gap it does not seem unreasonable to expect governments to contribute a full 1 % of GDP to R&D. Ideally, this would be channelled into universities and research institutes to help build their reputations and presence in the global scientific community. At the moment EU15 governments spend in the range 0.30 % to 0.40 % while NMS governments spend in the range 0.30 % to 0.60 %. More could and should be done, not least to develop the science needed to tackle climate change and pollution.

5.9 With regard to tax relief for private sector R&D, the EESC has already presented its Opinion to the Commission (7). In the view of the EESC, all Member States should adopt best practice and introduce tax incentives to encourage more private sector R&D investment, especially by SMEs.

5.10 There is a circular relationship between education, research, innovation, technical knowledge and employment trends. In a virtuous circle, the national knowledge and skill base attracts inward investment, knowledge transfer and immigration. Without that base, skilled people are tempted to look for a knowledge environment where their skills are at a premium. This can lead to a vicious circle of emigration and a brain-drain.

5.11 The policy conclusions for research and education are that many Member State secondary and tertiary education systems need to be overhauled and that Governments should increase their spending on R&D. There is clearly a correlation between effectiveness of policies and employment and productivity, as has been demonstrated by the record of both the watch list and the control group.

6. Competition and Innovation

6.1 The Communication from the Commission outlines three policies to foster competition. These are the liberalisation and regulation of network industries, competition policy and gains from the positive effects of the Internal Market.

6.2 The Internal Market benefits include the stimulus to innovate which results from exposure to foreign competition, the economies of scale in production, distribution and marketing which are available in the larger market and the technology transfers which follow from openness to foreign investment.

6.3 EU Member States have not been uniformly attractive to and open to FDI (Foreign Direct Investment). In terms of technology transfer, management methods, market presence and capital investment this will have been a handicap for those Member States which have not benefited from FDI. Ernst & Young data on FDI show that for the period 1997-2006 the top 10 FDI recipients in Europe by number of projects were:

<table>
<thead>
<tr>
<th>Country</th>
<th>Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>5 539</td>
</tr>
<tr>
<td>Germany</td>
<td>1 818</td>
</tr>
<tr>
<td>Spain</td>
<td>1 315</td>
</tr>
<tr>
<td>Belgium</td>
<td>1 190</td>
</tr>
<tr>
<td>Poland</td>
<td>1 046</td>
</tr>
<tr>
<td>Hungary</td>
<td>1 026</td>
</tr>
<tr>
<td>Ireland</td>
<td>884</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>849</td>
</tr>
<tr>
<td>Russia</td>
<td>843</td>
</tr>
</tbody>
</table>

6.4 FDI has been of great importance for the economic growth of the NMS. As competition for FDI grows from countries all over the world, including India and China, the NMS are going to have to embrace the knowledge economy to guarantee growth and jobs. Asian countries excel in the PISA competency tests and hundreds of thousands of graduates with ordinary and master’s degrees in science and technology are graduating from their universities.

6.5 Liberalisation and regulation of network industries has considerable potential to reduce costs and improve productivity throughout the economy. There are three phases to this policy: First privatisation, then regulation to allow new entrants to challenge incumbents and finally an ownership split between networks and network services. In its Report on progress in creating the internal gas and electricity market (8) the Commission used switching by customers between suppliers as a measure of effective competition. The following table is illustrative:

<table>
<thead>
<tr>
<th></th>
<th>Electricity</th>
<th>Gas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big Business</td>
<td>41 (*)</td>
<td></td>
</tr>
<tr>
<td>SMEs</td>
<td>7 (*)</td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>5 (*)</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big Business</td>
<td>15</td>
<td>14</td>
</tr>
<tr>
<td>Households</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big Business</td>
<td>25</td>
<td>60</td>
</tr>
<tr>
<td>SMEs</td>
<td>22</td>
<td>60</td>
</tr>
<tr>
<td>Households</td>
<td>19</td>
<td>2</td>
</tr>
<tr>
<td>UK</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big Business</td>
<td>50+</td>
<td>85+</td>
</tr>
<tr>
<td>SMEs</td>
<td>50+</td>
<td>75+</td>
</tr>
<tr>
<td>Households</td>
<td>48</td>
<td>47</td>
</tr>
</tbody>
</table>

(*) Data on the gas market is not available from Germany.

6.6 The implementation of Competition Policy is designed to favour efficiency and productivity where the consumer benefits. This policy is very much in line with the balance the EESC seeks to maintain between the interests of its component constituencies.

6.7 The Communication concludes that competition is crucial for both the level and growth rate of productivity. It is striking that the watch list economies are the most open in the EU. They have the highest productivity, the highest levels of employment and the greatest capacity to absorb migrant workers. It is a mistake for Member State governments to try to put barriers around their economies out of fear of competition.

7. Reallocation Policies

7.1 By Reallocation the Commission means the redeployment of the factors of production from failing industries and sectors to emerging and thriving industries and sectors.

7.2 The core thesis of the Communication is that to the extent that economic growth is driven by an expansion of the technology frontier, the economy will be exposed to structural change. New high technology sectors may gain market share at the expense of shrinking sectors. New firms may become important players and well established firms may be forced to adapt or disappear.

7.3 Since the economy will anyway be exposed to structural change, the adjustment capacity of the economy is crucial to ensure that maximum benefit is derived from technological change and knowledge mobility. However, the Commission feels that Member States have limited capacity to make the necessary adjustments due to the limited flexibility allowed for by labour market institutions and rule books.

7.4 The Communication proposes four key policy measures to improve resource reallocation: facilitating market entry, reducing the administrative burden, labour market regulation and financial market integration.

7.5 Policies to facilitate market entry include a number on which the EESC has already written Opinions. These involve reductions of the administrative burden associated with company formation, a variety of support schemes for new SMEs and changes to the laws governing bankruptcy. Access to finance and a competition policy to ensure contestable markets are important elements in any strategy for reallocation via new company formation.


Competition is generally most advanced in some of the watch list countries although Italy and Spain have also made progress.
7.6 While big and small firms alike may face administrative costs, the burden is much greater for smaller firms, given their smaller size. The reduction of administrative burden is one of the five most important goals on the EU agenda but as the Communication acknowledges, the reduction of regulation and administrative costs is difficult because most of the measures were introduced for specific reasons. They serve to correct market failures, to protect market participants, or to provide policy makers with information. Many EU constituencies would argue that the social protection underpinned by these regulations is a key element of the acquis. Even so, the cumulative impact of such regulation imposes substantial economic costs.

7.7 The UK-based Better Regulation Task Force, corroborated by work of the Dutch Central Planning Bureau (CPB), suggests that the costs could be 3-4 % of GDP. It has been estimated that a 25 % reduction in the administrative cost burden in the EU would initially result in a 1 % increase in real GDP. The long run effects would be even larger. Reduction of this cost burden is highly desirable, but there has been no evidence to suggest that anything will come of this initiative. Since the EU is institutionally pre-occupied with the possibility of market failure, such improvements are unlikely to be achieved. Furthermore the EESC, with its concern to provide every protection to market participants, is unlikely to support any significant reduction of the administrative burden.

7.8 Labour market structures have an important impact on labour redeployment. The impact of market reforms on productivity and employment is greater when labour markets are flexible. While there are no reliable studies of labour market flexibility, the employment levels of the watch list countries is certainly a measure of the capacity of their employment laws to accommodate change.

7.9 Employment protection legislation in the EU is understandably controversial. Rather than amend the protection given in permanent contracts, many Member States have introduced temporary contracts in parallel. It is these temporary contracts which have accounted for much of the increase in employment discussed in point 4 above. While the data does not give the actual full-time employment measure, the scale of employment growth is encouraging and structural unemployment is reducing.

7.10 It is, of course, necessary to mitigate the disruption caused when labour regulations are sufficiently flexible to optimise reallocation. Therefore Member States are urged to introduce flanking policies in parallel. Flexicurity is critical in this process. Resources need to be made available so that life-long learning can reinforce adaptability and employability, social security systems can provide incentives to participate in the labour force and facilitate redeployment while labour market policies should help people to deal with change and the unemployment involved in the transition to new, secure employment. Such policies are indispensable when employment protection is relaxed.

7.11 Financial market integration is the last of the reallocation policies. In general, the degree of fragmentation in the financial system in the EU could be seen as an impediment to productivity and employment especially in respect of start-up companies. These shortcomings are being addressed by the Financial Services Directives. In parallel with this Opinion the EESC is preparing an Opinion on cross-border venture capital activity. The role of an efficient financial system in structural change is most evident in the financing of start-up companies.

8. Improving Public Finances

8.1 Table 5 contains Eurostat data on Member State finances. The average government debt of the Eurozone 12 at 68.8 % of GDP exceeds both the EMU convergence goal of 60 % and the averages for EU15 (63.0) and the EU25 (61.9). In general, government debt in the watch list states is below 50 % of GDP and, in many cases, far below. The exception is Austria (61.7 %). Furthermore, all the watch list states have reduced government debt over the period 1999 to 2006. The reduction in Ireland, Netherlands and Sweden has been particularly dramatic. Of the control group, only Spain has government debt at under 50 % of GDP, following a dramatic reduction during the period. Italy (106.8 %) and Greece (95.3) are at the bottom of the league.

8.2 In the EU 15, Belgium, Ireland, Spain, Luxemburg, Netherlands, Finland, Denmark and Sweden had positive budget balances. The remaining countries had negative balances of less than 3 % except for Italy (−4.4 %) and Portugal (−3.9 %). Amongst the NMS, Bulgaria and Estonia have positive balances while Hungary, Poland and Slovakia are more than 3 % negative. At only 1.2 % negative, Cyprus and Slovenia stand out. Amongst the watch list the UK, at 2.7 % negative, has lost its way. It failed to balance its budget in years of favourable economic activity so that its position amongst the leaders is now in jeopardy. In the control group, the Spanish performance stands out while Italy and Portugal confirm their generally low standing in the league.

(11) Removing obstacles to cross-border investments by venture capital funds. (INT/404).
8.3 In its annual Opinions on the EU economy the EESC has argued for sound public finances. The relative record of the countries on the watch list and the control group shows that sound public finances are an important component of employment and productivity performance in Member States.

8.4 In examining the relative performance of the watch list and the control group a question arose about the impact of taxes. The Eurostat report on EU tax in 2005 shows that the average tax rate as a % of GDP in the EU 27 was 39.6%. This is about thirteen percentage points more than the rates for the USA and Japan. Amongst all the non-EU OECD countries, only New Zealand has an effective tax rate greater than 35%. After an attempt by Member States to reduce the burden of tax, the trend has been reversed and the average tax rate is now back to the 1995 level.

8.5 In terms of tax burden, Sweden*, Denmark* and Finland* are in the top 5, together with Belgium and France. Austria* and Slovenia* are in the next 5, together with Italy. The Netherlands* and UK* stand at 12th and 13th respectively. Only Estonia* (22nd) and Ireland* (23rd), numbers 22 and 23, enjoy a significantly low level of tax. In the control group, the Italian tax burden is lower than or equal to five of the watch list countries. Spain, Portugal and Greece have tax burdens lower than all the watch list except for Ireland and Estonia. There is no prima facie argument that the control group countries are over taxed.

8.6 The EU is more highly taxed than competitor regions. Specific Member State tax regimes are heavily influenced by the amount of money spent on social protection. Taking a purely EU view, it is difficult to make the case for tax reductions while the leading EU economies have the highest tax rates. However, taking a global view, competitor regions have lower tax levels and it is likely that this contributes to their high levels of innovation and enterprise.


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