SEPTEMBER 2009 Policy Brief

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Economic Survey of the European Union, 2009

How can Europe return to sustainable growth?

What is being done to improve financial regulation?

How can innovation policy be strengthened?

How can competitive pressures be enhanced?

Is the transition to a low-carbon economy occurring in a cost-effective way?

Will energy market reform deliver a single, secure energy market?

What can be done to enhance foreign access to European markets?

How can agricultural policy be improved?

Summary

The European Union is facing severe challenges from the financial crisis and the worst global recession in the past fifty years. The Community has responded to the crisis proactively, consistent with the broad framework for policy actions provided by the European Economic Recovery Plan. Actions have been taken to stabilise financial markets and support the economy. An ambitious agenda for financial services reform is underway to improve macro- and micro-prudential regulation and supervision, and the ECB has cut its policy rate significantly.

It is essential that policy actions to support economic activity during the crisis do not imperil the prospects for recovery or endanger the single market and, where necessary, some measures must be withdrawn once the economy recovers. Fiscal measures should ideally offer dual benefits: mitigating the impact of the recession on output and jobs as well as providing longer term benefits. Structural reforms must be accelerated in the years ahead to help prevent future financial crises, enhance resilience to adverse economic shocks and improve both longer term growth prospects and the long-term sustainability of the public finances.

Strengthening innovation. Despite numerous policy initiatives, research and innovation in Europe still lag behind that in the United States and Japan. An integrated labour market for researchers, a Community patent and a Unified Patent Litigation System would help to stimulate innovation. Tackling obstacles to the funding of innovation and encouraging research co-operation would improve the practical use of research results and accelerate their diffusion. New measures of innovation outputs should be developed to sharpen policy design and evaluation in this area, including education.

Deepening the single market. The single market programme has already brought long-term benefits, but more can be done to enhance competitive pressures. The Services Directive needs to be implemented in a timely and effective manner and actions should be taken to ensure proper implementation of single market rules. Competition in financial services, energy markets and network industries can be raised further, and continued efforts are needed to simplify regulations and improve assessments of policy proposals.

Implementing energy policy and the transition to a low-carbon economy. Europe is taking important steps towards becoming a low-carbon economy. Policies to reduce greenhouse gas emissions, promote low-emission technologies and reduce energy consumption should focus on correcting genuine market failures and be flexible to cope with future economic and technological changes. Faster

This Policy Brief presents the assessment and recommendations of the 2009 OECD Economic Survey of European Union. The Economic and Development Review Committee, which is made up of the 30 member countries and the European Commission, reviewed this Survey. The starting point for the Survey is a draft prepared by the Economics Department which is then modified following the Committee's discussions, and issued under the responsibility of the Committee.

Observer oecd

liberalisation of EU electricity and gas markets is necessary to increase competition, improve energy security, and send clearer price signals through the EU Emission Trading Scheme. Regarding external energy policy, it is important that the Union speaks with a single voice.

Further improving external access to European markets. The EU must continue to resist the rise in protectionist sentiment and continue to push for global trade liberalisation. Reductions in tariffs would send a powerful free trade message to the rest of the world and improve consumer welfare. The rules of origin in the EU's preferential trade agreements could be further simplified and thresholds for domestic content lowered, particularly for developing countries, and it should be ensured that they are fully consistent with both the EU's trade and development goals. Recent reforms have reduced distortions in the Common Agricultural Policy. Support could be further decoupled from production and payments better targeted to achieve income support objectives and encourage the provision of public goods such as improving the rural environment. ■

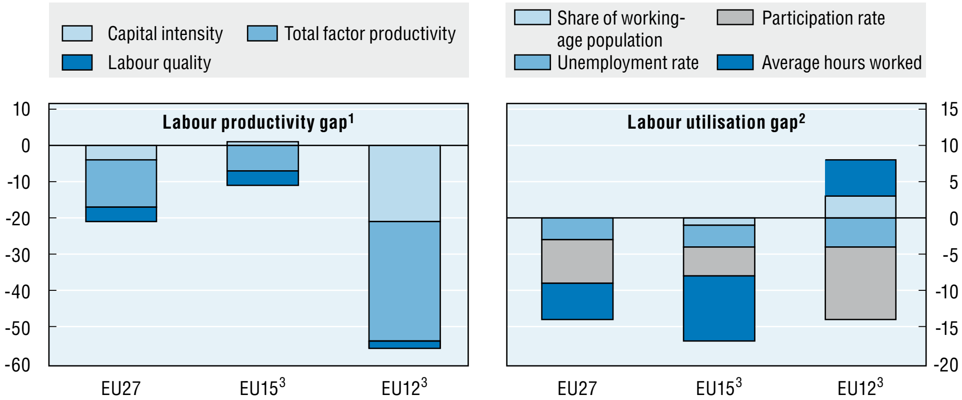
How can Europe return to sustainable growth?

The European Union is facing severe challenges from the financial crisis and the deep recession. The European economy has been heavily affected by ongoing financial turmoil and the associated deep and synchronised recession in the global economy, reflecting the strong commercial and financial linkages between European economies and between Europe and the rest of the world. Output is projected to decline by around 4% this year, making this Europe's worst post-war recession. The actions taken by central banks, member state governments, the Commission and other EU institutions have stabilised financial markets and supported the economy. It is important that these policy actions do not imperil the prospects for subsequent recovery or endanger the single market. The recession itself will result in a considerable loss of capacity in the European economy, adding to the pressures on long-term growth prospects that will come from population ageing, and has disrupted the progress that was being made towards achieving the objectives of the renewed Lisbon Strategy for Growth and Jobs.

Reforms undertaken through the Lisbon Strategy since 2005 have helped the EU to improve the resilience of its economy. These results can be attributed to the

THE SOURCES OF DIFFERENCES IN GDP PER CAPITA

Difference to the US in percentage points



1. GDP per hour worked.
2. Total hours worked per capita.
3. EU15 refers to member states who joined the Union before 2004. EU12 refers to the new member states who have joined the Union since 2004.

Source: Mourre, G. (2009), "What Explains the Differences in Income and Labour Utilisation and Drives Labour and Economic Growth in Europe? – A GDP Accounting Perspective", *European Economy, Economic Papers* 354, January.

overhaul of the Strategy in 2005 marked by the introduction of clear "governance" mechanisms. There have also been improvements in the fiscal position in many countries that allowed for a co-ordinated fiscal impulse to support demand and boost confidence as part of the EU's recovery plan. The speed and depth of reforms, however, still vary among member states. This can be remedied by further improving governance which would bring more ownership and a substantial policy response of the member states to these policy recommendations. Tackling these "delivery disparities" should be a key objective for the upcoming revision of the Lisbon Strategy for the period after 2010. Structural reforms remain essential for the European economy, and the Lisbon Strategy will need to ensure that reforms are accelerated and deepened, thereby limiting the medium-term effects of the crisis on potential output.

This Survey reviews recent developments and the measures introduced in response to the economic and financial crisis. It then identifies some of the key structural policy challenges that the European economy will face in the coming years. These include strengthening innovation performance, deepening the single market, making the transition to a low-carbon economy and further opening European markets to the rest of the world.

The crisis presents substantial challenges to European policymakers, with prompt action needed to revive financial markets and cushion the impact of the recession on demand and employment. EU-level actions have also been needed to provide additional financial support to some of the member states that have faced considerable economic and financial headwinds since the onset of the financial crisis. The short-term challenges to European policymakers are magnified by the need to press ahead with the implementation of structural reforms that will help to prevent future financial crises, enhance resilience to adverse economic shocks and improve both longer term growth prospects and the long-term sustainability of the public finances, in the context of ageing populations.

The Commission has a central role in monitoring and co-ordinating the actions taken by member states in response to the economic crisis and ensuring they are implemented effectively. The European Economic Recovery Plan (EERP), which combined short-term measures with an acceleration of structural reforms as set out in the Lisbon Strategy country specific recommendations was a welcome answer to the crisis. Total support to demand from member states and EU-level authorities will amount to around 5% of EU GDP in 2009 and 2010. Discretionary fiscal measures in these two years amount to a total of 1.8% of GDP, augmenting the significant stimulus coming from the relatively large automatic stabilisers in the EU. Past structural reforms and, in particular, fiscal consolidation in good times, have allowed most member states to launch fiscal stimuli within the framework of the EERP. Measures taken to underpin the financial sector and direct assistance from the Commission and other European bodies are also supporting activity. Further measures may be announced by member states that have sufficient budgetary scope. However, taking into account the contingent liabilities linked to the financial sector rescue operation and the implicit liabilities related to ageing, the fiscal space has been narrowing across the EU. In some member states, fiscal space has been virtually exhausted owing to already high budget deficit and public debt levels, which are reflected in rising interest rate spreads on government bonds. It is vital that the Commission and the Council, through the Stability and Growth Pact, ensure that clear and credible plans for fiscal consolidation are implemented by the member states.

Past experience shows that growth-enhancing structural reforms are often initiated at times of economic crisis. But careful thought is necessary in designing such reforms to ensure that they offer long-term benefits rather than just a short-term palliative. The EERP rightly combines short-term measures with structural reforms in order to meet the Union's medium-term objectives. In particular, it is essential that policies to support local jobs and businesses do not endanger the European single market or hamper external access to the European Economic Area. The Commission has already intervened promptly against measures that favour selected subgroups of companies and violate single market principles and must continue to do so. The Commission also needs to stand ready to ensure time-limited state aid and other fiscal supports are withdrawn promptly at the appropriate juncture as the economy recovers.

Nonetheless, the fiscal easing underway in many European economies has provided an opportunity to facilitate some worthwhile structural reforms. Well-founded investments in infrastructure, including broadband and new low-emission technologies will offer long-term supply-side and environmental benefits as well as a short-run boost to activity. The activation of labour market programmes, development and better matching skills with the market needs, reductions in social security contributions and support for low-income households will dampen the impact of the recession on labour markets and the necessary adjustments that will arise from other structural reforms. Maintaining, and even increasing, investment in education and training is a lever for helping to get through, and overcome, the challenges of the recession, thus helping to ensure that the workforce holds on to and upgrades its skills, and that people are equipped for opportunities that will arise once the crisis is over. The Commission needs to continue to monitor the effectiveness of these measures, provide guidance on policy design and facilitate the exchange of information about policy experiences. ■

What is being done to improve financial regulation?

While most financial market segments have become well integrated, financial supervision has remained predominantly national in scope. This may hinder the single market for financial services and increase the chances that financial risks related to the EU-wide activities of systemically important cross-border institutions will not be detected and acted upon. It also complicates financial crisis management and resolution, as the financial crisis has revealed. In early 2009, the de Larosière Group made proposals on how the European financial supervisory system could be improved, including: *i)* measures to establish a European System Risk Council (ESRC) to oversee the stability of the financial system as a whole, and *ii)* for the supervision of individual financial institutions, a European System of Financial Supervisors (ESFS), consisting of three European Supervisory Authorities (ESA), replacing the existing three Level 3 committees and working in tandem with the national financial supervisors. The ESRC would pool and analyse all information relevant for financial stability, and a macro-prudential risk warning system would be put in place. The ESFS would represent an evolutionary reform. The ESAs would have, in cases clearly specified in Community legislation, the means to ensure coherent application of Community legislation, including the power to resolve disputes between national supervisors. They would also be given the responsibility for the authorisation and supervision of certain entities with pan-European reach, such as credit rating agencies. This should better balance the interests of home and host supervisors and better take into account the EU-wide impact of cross-border activities. The ESRC should make it more likely that systemic risks are quickly recognised and acted upon. In May 2009, the Commission published a Communication fleshing out the recommendations put forward by the de Larosière Group. The intention of the Commission is to present all necessary legislative proposals in the course of autumn 2009. It is essential that the proposed powers and independence of the new authorities are retained in the legislative proposals.

The Commission has announced further measures to counteract the financial crisis and has set out an ambitious agenda for financial services reform. Based on earlier roadmaps, many measures have been adopted, including a Regulation on Credit Rating Agencies and a review of the Capital Requirements Directive (CRD). Furthermore, the Commission has indicated how it intends to apply state aid rules to state support schemes and individual assistance for financial institutions; has provided guidance on the treatment of asset relief and impaired assets; and has presented proposals for establishing regulatory and supervisory standards for alternative investment fund managers. Further revisions to the CRD will be proposed in October 2009. As regulatory changes are made it will be important to remember that unnecessary or badly-designed regulation could impair the functioning of financial markets and increase instability. In the shorter term, concerns that the scale of impaired assets has not been fully recognised and that banks may be insufficiently capitalised to deal with a further deterioration in economic conditions need to be addressed. ■

How can innovation policy be strengthened?

In 2000, the Lisbon agenda included a commitment to make Europe the most dynamic and competitive knowledge-based economy in the world. Enhancing investment in knowledge and innovation is now one of the four priority areas of the renewed Lisbon Strategy. The Commission set out a broad-based innovation strategy in 2006 and member states have committed to achieving an integrated European Research Area (ERA) by 2020. Increasing attention is now being given to the concept of "creativity", although this concept has not yet been clearly defined or measured.

Despite the wide range of policy initiatives, progress to date has been slow, with research and innovation still lagging behind the United States and Japan. The target of raising research and development (R&D) expenditure to 3% of GDP by 2010 will not be met in the EU as a whole and appears unlikely to be achieved anytime soon. While the target is an aggregate level benchmark that has encouraged policy action during the past decade, it is less clear that it should be retained as such, because it depends largely on private sector actions, and tends to emphasize innovation inputs rather than outputs and the use of innovations. EU member states have already set themselves their own specific targets within the framework of the National Reform programmes. The understanding of the innovation process is also changing, with non-technological innovations and open innovations (such as open-source software) becoming more important and research efforts more likely to involve co-operation across national borders. These all change the link between national R&D efforts and innovation outcomes. The Commission is taking steps to improve the statistical information available about innovative and creative activities in order to make greater use of output-based measures, allowing innovation policies to be developed from a more appropriate knowledge base. Support for R&D by the EU member states should be at least maintained during the current recession.

Improvement in measurement would also be an important step towards better evaluation of the effectiveness of the innovation policies pursued by the Commission. The Commission has been commendably prompt in introducing policy support for innovation. The policy initiatives are tied together by the vision of the future European Research Area and a broad-based innovation strategy. But there is a need for priority setting amongst the initiatives and better quantification of the importance of each in accounting for differences in innovation across countries. The policies adopted reflect the perceived need for favourable framework conditions such as well-functioning product and financial markets and an adequate supply of human resources for science and technology. Without these, the effectiveness of specific innovation-related initiatives and attempts to foster demand for innovations may be constrained. Better measurement of innovation outcomes would aid the evaluation of Commission-funded research programmes. The Commission should also take further steps to improve the development and use of common evaluation methodologies and techniques for all innovation programmes.

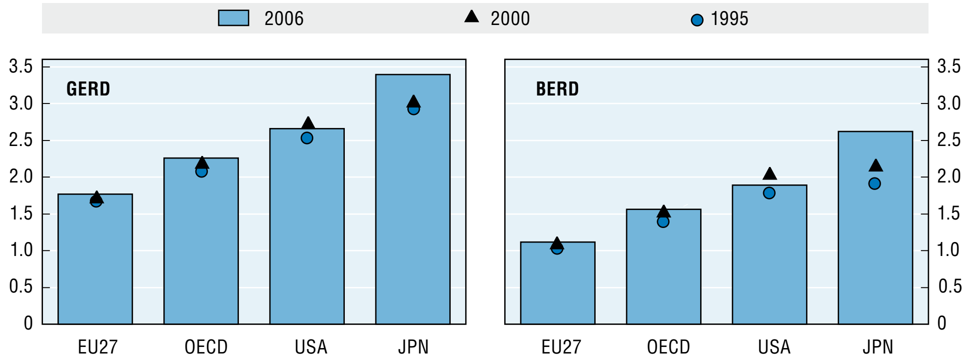
Improvements in the framework conditions for innovation and progress towards an integrated research area will underpin the free movement of knowledge across national borders (the so-called "fifth freedom"). Achieving a fully integrated labour market for researchers, a Community patent and a Unified Patent Litigation System will be important. The Commission is already taking actions to improve education and training policies to raise the long-term supply of human resources for science and technology. But such resources remain smaller in the EU than elsewhere and a significant share of university graduates, doctorate recipients and postdoctoral students graduating in Europe migrate to work elsewhere. The international orientation of European researchers should, in principle, enhance knowledge flows to the EU economy. However, steps need to be taken to enhance the circulation of EU and non-EU researchers. The Commission has launched the European Partnership for Researchers and should ensure that the priority actions are implemented on schedule by end-2010. Some of these are a matter for member states, but the Commission can ensure that publicly-funded research positions and research grants are open to qualified nationals of all member states and that researchers have the freedom to take research grants across national borders when changing jobs. Obstacles to short-term mobility in national pension and social security schemes should be removed. A Blue Card scheme is also to be introduced to encourage inflows of highly-skilled migrants by simplifying application procedures, provided that they have sufficient experience and a job offer with a salary above a certain threshold. The scheme is a welcome step forward, but the immediate benefits of it may not be large, especially since the Card will not grant rights to permanent residency and member states retain the right to set quotas that limit the numbers of cards issued. It will be important to monitor the impact of the scheme and explore possible extensions to the rights granted to Card holders to further promote mobility.

The European patent system, and hence the cross-border markets for technology and knowledge, is currently fragmented. Patent protection can be obtained in multiple European countries by receiving a "European patent" from the European Patent Office. But such patents require validation by national patent offices, which often requires translation into another language. Furthermore, the "European patent" is subject to litigation in the national courts. The costs of validating and maintaining a patent in many European countries are thus much higher than in either the United States or Japan, with the burden being especially high for small and medium-sized enterprises. Therefore, to reduce such costs, a simplified system, with a single "Community patent" that would be valid automatically in all member states and a centralised Patent Litigation Court for both European and "Community patents" should be implemented.

The market for high-risk capital, such as private equity and venture capital, plays an important role in the financing of innovation, especially for young, innovative companies, but is underdeveloped in Europe. The Commission and other

GROSS DOMESTIC AND BUSINESS ENTERPRISE EXPENDITURE ON R&D

As a percentage of GDP



Source: OECD (2008), *Main Science and Technology Indicators*, Vol. 2008/2.

Community-level bodies have thus taken steps in the EERP to ensure that financing of such companies is supported during the ongoing recession. Further ahead, the Commission will need to follow through on plans to tackle obstacles to cross-border venture capital provision. It should enhance the effectiveness of innovation policy design and delivery by tackling overlaps between the numerous Community-level programmes that offer funding for innovation, by looking for unexploited synergies and by reducing the presently high cost of research grant applications.

Innovation activities increasingly involve co-operation between different groups. Yet European innovation surveys indicate that public research organisations are a key information source for only a relatively small number of companies. This could mean that there are only a few commercial applications of the basic research undertaken in Europe, but is more likely to indicate that there are obstacles preventing firms from either being aware of the work undertaken in publicly-funded research organisations or from accessing it. The Commission produced guidelines for universities and research institutions to improve their links with European companies in 2007 and is to upgrade the status of the EU Forum for University-Business Dialogue. In 2008 it adopted a Recommendation on the management of intellectual property in knowledge transfer activities and a Code of practice for universities and other public research organisations. The rules for participation in Community-level R&D funding programmes should be extended to ensure that all applicants have to submit plans for dissemination of research findings as part of their research projects. Consideration should also be given to ways in which the European Union might further strengthen research and innovation links with other regions. ■

How can competitive pressures be enhanced?

The single market programme has already delivered many benefits to the European economy and improved longer term growth prospects, by raising competitive pressures. But much more remains to be done, especially in service sectors and some network industries. OECD product market regulation indicators show that such regulations remain relatively stringent and that competitive pressures are lower than they could be. Intra-EU trade in goods and services is growing only modestly and price convergence between member states appears to have stalled, with the exception of the new member states. Some important past reforms are awaiting full implementation by member states. There has been an improvement in the rate of transposition of legislation, but as of the end of 2008 there were 92 single market directives (6% of the total) that had not been transposed fully by all member states by the due date. Some were several years overdue. There are also many cases of directives either being transposed incorrectly or incorrectly applied. In all, over 1 200 infringement cases remained open as of the end of 2008. Assessment of the quantitative importance of such infringements is difficult, but actions should be taken to limit their number. The Commission should press ahead with measures to identify best practices amongst member states, particularly with regard to the application of single market rules and administrative co-operation on single market issues, and continue to pursue infringement proceedings where necessary.

The Services Directive should bring a marked improvement in competition, provided it is implemented in a timely and effective fashion, as intended, by the end of 2009. Implementation is a demanding task for member states as numerous legislative changes are required and new procedures have to be introduced to reduce administrative and regulatory costs. Information on the state of progress is sparse, but there are indications that some member states may find it difficult to meet the deadline. The Commission is already providing advice to member states and has drawn up plans to continue collaboration through a “mutual evaluation exercise” that will take place with member states in 2010. The Commission will need to act decisively in introducing follow-on actions if member states do not meet the transposition deadline. Assessments of the state of transposition could be helped by the development of a centralised website with timely information on measures adopted by member states.

Increasingly, the focus of single market activity appears likely to turn towards monitoring and implementation, but further steps will need to be taken to ensure that obstacles to cross-border retail financial services are tackled and that further liberalisation takes place in EU energy markets. The adoption of the third Postal Directive marks the commitment of EU member states to fully open their postal markets by the end of 2010 (with the possibility for some member states to postpone full market opening by two more years as a maximum, accounting for the remaining 5% of the EU postal market). Previously untouched sectors, such as port services, also have to be tackled. Increasingly, the Commission will need to strengthen the evidence base for single market initiatives and identify the importance of specific barriers for market size and productivity growth. Without these, the impact of past legislation and the need for follow-up measures will be impossible to assess effectively. The Market Monitoring exercises recently begun by the Commission are an important step towards achieving this.

The business environment can be further improved by continuing efforts to simplify the administrative burdens resulting from Community law. Considerable progress has already been made by the implementation of the Better Regulation agenda since 2005, which includes proposals to simplify more than 130 regulations. A programme is now in place to reduce administrative burdens by an estimated 25% by 2012. It is important that this is pursued vigorously, with high quality *ex post* evaluation of the resulting measures being undertaken. More could also be done to improve the quality of *ex ante* impact assessments of new legislative proposals. Impact assessments of Commission proposals are always made, but are rarely revisited after amendments are made by the European Parliament and the European Council. This complicates effective evaluation of the final policies introduced. ■

Is the transition to a low-carbon economy occurring in a cost-effective way?

Europe is taking important steps towards a successful transition to a low-carbon economy and making an effective contribution to the world's efforts to mitigate climate change. The goal of reducing Europe's carbon footprint is underpinned by concrete targets for reducing greenhouse gas emissions by 20% by 2020, raising the share of renewable energy consumption to 20% by 2020 and reducing energy consumption by 20% by 2020. In addition to addressing the wedge between the social and private cost of greenhouse gas emissions, policy has to overcome other market failures, including, for instance, capital market imperfections, monitoring and enforcement costs or incentives for free-riding. It is essential that the instruments that are chosen are efficient, correct genuine market failures and are flexible to cope with future economic and technological changes. Policies that unnecessarily raise the cost of carbon abatement need to be avoided. For the most part the EU is doing this, but, there are ways to improve the current policy mix. It is widely acknowledged that Emission Trading Schemes (ETS) are more efficient and equitable if they cover as many sectors of the economy as can be done cost-effectively, and that allocating free emission allowances to installations should occur when the cost of such allowances cannot be passed on and when auctioning could therefore lead to an increase in greenhouse gas emissions in third countries where installations would not be subject to a comparable carbon constraint. In principle, incentives for abatement should be aligned across all sectors of the economy. The EU should seriously consider including all transport sectors in the ETS when practical and appropriate. The EU plans to improve the way that emission allowances are allocated partly by auctioning. However, only sectors rigorously identified as being at a significant risk of carbon leakage should continue to receive free allowances until 2020. Thresholds for determining which trade-exposed sectors should receive free allowances were determined without an impact assessment. However, the risk of carbon leakage is being assessed on the basis of quantitative and qualitative criteria laid down in the

Directive and there will be a review following a comprehensive global agreement on future climate action.

Although additional support for the research, development and deployment of low-emission technologies may be necessary to counteract market failures, many member states already offer generous subsidies to the renewable energy sector. Such policies are likely to increase the overall cost of greenhouse gas abatement, particularly in the short run. There are a number of ways to ensure that the 20% renewable energy target is met in the most cost effective way, including the options implemented with the new Directive on Renewable Energy Sources. In the longer term, restrictions on importing renewable energy should be abolished and a single, harmonised European low-emission energy support mechanism should be considered when practical. It should be ensured that the development of renewable energy in the transport sector is achieved as sustainably and cost-effectively as possible, through a combination of European production and greater use of imported biofuels. Given the high cost of biofuel technologies, it will be important to ensure that the 10% renewable transport fuel target efficiently achieves its objectives of reducing greenhouse gas emissions, ensuring sustainability and increasing security of supply. At the very least, tariffs on imported biofuels should be reduced significantly. Funding for low-emission technology R&D should be stepped up as current levels of Community support are likely to fall short of what is necessary, particularly in an economic environment where firms are cutting back on non-essential investment. Moreover, it is essential that the social benefits of policies to reduce energy consumption exceed the costs. Mandatory labelling standards are an effective way of overcoming information failures, but mandatory performance standards need to be carefully designed so that they focus on performance rather than specific technologies and are re-assessed to ensure ongoing incentives for innovation. ■

Will energy market reform deliver a single, secure energy market?

Further liberalisation of EU electricity and gas markets is necessary to deliver efficient retail electricity and gas prices, increase incentives to innovate and invest in new generation and transmission capacity and improve energy security. A fully competitive single market for gas and electricity has been a long-time goal but liberalisation has progressed unsatisfactorily. The EU’s third liberalisation package forces more effective unbundling through the creation of independent Transmission System Operators (TSOs). They can remain part of vertically-integrated companies, but there will be detailed rules governing the autonomy, independence and investment of TSOs. Full ownership unbundling is also an option, even though voluntary. Another option is the creation of an independent system operator where the ownership of the TSO assets remains with the vertically-integrated company, but the system operation is effectively separated from the assets. It is important that the review of the independent TSO option that the Commission intends to undertake does take place as planned, and that if the expected improvement in competition does not occur, full ownership unbundling is required.

A well-functioning internal energy market also requires effective institutions for overseeing cross-border co-operation between national supervisors and managing cross-border investments. The EU proposal for an Agency for the Co-operation of Regulators (ACER) is welcome. ACER will have decision-making powers in specific cross-border matters in order to achieve a single, competitive market. In any case, it is essential that the strengthened national regulators co-operate within a harmonised European regulatory framework. ACER will also need to be adequately staffed, while the Commission should have binding oversight over the certification procedures for TSOs. Increasing investment in cross-border transmission networks is also critical; without sufficient interconnection capacity foreign suppliers cannot exert competitive pressure on national incumbents. The earlier approach of leaving member states to voluntarily develop joint schemes for congestion management has delivered insufficient progress. Under the third liberalisation package, operators of the main gas and electricity transportation networks will be obliged to co-operate and co-ordinate the operation of their networks through the European Networks of Transmission System Operators. The Commission will need to monitor cross-border investment and be prepared to take measures should investment be inadequate.

Security of supply is a key component of the Lisbon Strategy and a key objective of the EU integrated energy and climate change policy. The EU's "20-20-20 by 2020" objectives and energy market liberalisation policies will improve security of supply by diversifying energy supply and increasing internal trade. The EU's Energy Security and Solidarity Action Plan provides complementary measures focusing on: infrastructure needs and the diversification of energy supplies; external energy relations; oil and gas stocks and crisis response mechanisms; energy efficiency; and making the best use of the EU's own energy sources. Increasing investment in gas pipelines and other energy infrastructure to diversify supply is critical, as illustrated by the recent stand-off between the Federation of Russia and Ukraine. Additional investment will help reduce countries' exposure to energy supply shocks from individual supplier countries. A number of projects have been identified under the Trans-European Networks-Energy Programme. However, as of 2008 only a small proportion of projects with a European interest have been finalised, in part because incentives for investors to guarantee security of supply are not always sufficient. Consequently, for implementation of such projects, obligatory minimum security of supply standards for gas and a fast implementation of the third internal market package, which will ensure greater independence of transmission and trading interests, are important. The Ukraine/Federation of Russia stand-off also highlighted the need for improved procedures for dealing with gas emergencies, and in particular, for co-ordinating emergency policies amongst member states. Regarding external energy policy it is essential that EU member states speak with a single voice. Although diversifying EU energy supply is an important policy goal, it is important that policies to achieve this do not unnecessarily raise the cost of energy inputs. ■

What can be done to enhance foreign access to European markets?

These are testing times for European and global trade policy. Progress on the Doha round of world trade negotiations stalled, global trade has collapsed and the economic crisis is creating political pressure to raise protection for domestic firms. As the world's largest trading power, the EU has a significant interest in resisting protectionist pressures and securing further trade liberalisation. While the successful completion of Doha is not assured, there is much that the EU and other OECD countries can do to promote freer trade. Although average non-agricultural most-favoured-nation (MFN) tariffs are low, at around 4%, average MFN agricultural tariffs are considerably higher, at just under 15%. The EU remains committed to its offer to undertake a significant reduction of the border protection of its agricultural sector as part of a comprehensive multilateral trade agreement. As is the case with other OECD countries, further trade liberalisation by the EU would send a powerful free trade message to the rest of the world. In addition to its efforts in the multilateral sphere, the EU also pursues its trade policy objectives through reciprocal bilateral and regional preferential trade agreements (PTAs). Although the limited available evidence suggests that the EU's web of PTAs has been welfare enhancing overall, more can be done to raise trade creation. Further simplification of rules of origin requirements and, where appropriate to enhance development, lowering of the thresholds for the necessary value added in partner countries should be actively considered. The argument has been made that Europe's trade defence instruments, such as anti-dumping policies, should be updated to reflect the increasingly global supply chain of European firms. However, there is no consensus among the member states about whether or how such a reform should be carried out. ■

How can agricultural policy be improved?

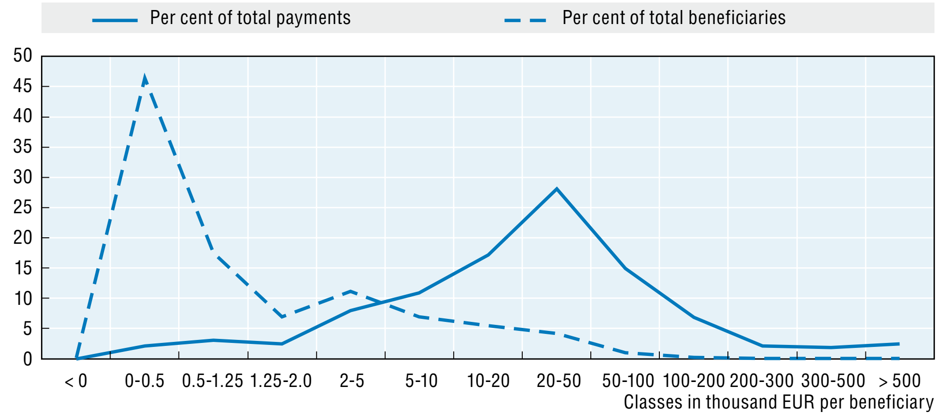
The Common Agricultural Policy (CAP) represents around 40% of the total EU budget (the total support estimate – encompassing price support and budgetary transfers – is estimated at 0.9% of GDP), and just over a quarter of gross farm receipts. A series of important reforms, including the 2008 Health Check, have significantly reduced distortions where the linkages between payments and production have been cut. The use of market price support measures has also been scaled back for many agricultural commodities. Moreover, the CAP has also become marginally more equitable as payments for landowners receiving more than EUR 5 000 under the Single Payment Scheme have been further reduced and the savings generated transferred to the Rural Development Plan. Nevertheless, there is further scope to improve the CAP. Full decoupling should be extended to the livestock meat production sector, if adverse social and environmental impacts can be addressed through more targeted support measures. Payments across agricultural producers should be flattened further, in line with the Health Check recommendations. Despite the increase in modulation following the Health Check, the CAP could better target those farmers in need of income support. In part, the unequal distribution of CAP payments is due to the way that farmland and past production patterns were distributed in Europe. But, this is exacerbated by the loose definition of income support and stabilisation objectives, the poor measurement of farm households' profitability and wealth, and the failure to separately quantify the magnitude of payments that are necessary to correct market failures relating to public goods and externalities. The Commission should consider moving to a more effective mechanism for providing income support, whether that be through subsidised private insurance targeted at farmers exposed to significant income variability, or a system of income-contingent loans. Most importantly, payments for the provision of public goods should be separated from payments to support incomes to the extent that it is possible to measure public goods produced, taking into account transaction costs. ■

For further information

For further information regarding this *Policy Brief*, please contact:

Mr. Peter Hoeller, e-mail: peter.hoeller@oecd.org, tel: +33 1 45 24 87 82; or
Mr. Nigel Pain, e-mail: nigel.pain@oecd.org, tel: +33 1 45 24 91 54; or
Mr. Jeremy Lawson, e-mail: jeremy.lawson@oecd.org, tel: +33 1 45 24 87 62.

DISTRIBUTION OF AVERAGE DIRECT PAYMENT PER BENEFICIARY IN EU25

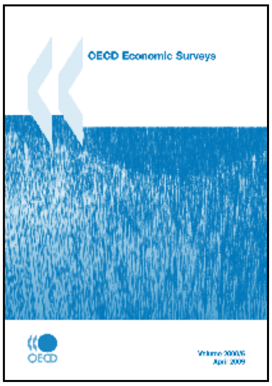


Source: European Commission, DG Agriculture.

The OECD Policy Briefs are available on the OECD's Internet site:
www.oecd.org/publications/Policybriefs

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

For further reading



OECD Economic Surveys: *Economic Surveys* review the economies of member countries and, from time to time, selected non-members. Approximately 18 Surveys are published each year. They are available individually or by subscription. For more information, consult the Periodicals section of the OECD online Bookshop at *www.oecd.org/bookshop*.

Additional Information: More information about the work of the OECD Economics Department, including information about other publications, data products and Working Papers available for downloading, can be found on the Department's website at *www.oecd.org/eco*.

Economic Outlook No. 85, June 2009.
More information about this publication can be found on the OECD's website at *www.oecd.org/eco/Economic_Outlook*.

Economic Policy Reforms: Going for Growth, 2009 edition.
More information about this publication can be found on the OECD's website at *www.oecd.org/economics/goingforgrowth*.

OECD publications can be purchased from our online bookshop:
www.oecd.org/bookshop

OECD publications and statistical databases are also available via our online library:
www.SourceOECD.org

Where to contact us?

OECD HEADQUARTERS
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: *www.oecd.org*

GERMANY
OECD Berlin Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail: berlin.centre@oecd.org
Internet: *www.oecd.org/berlin*

JAPAN
OECD Tokyo Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: *www.oecdtokyo.org*

MEXICO
OECD Mexico Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560 MEXICO, D.F.
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail: mexico.contact@oecd.org
Internet: *www.oecd.org/centrodemexico*

UNITED STATES
OECD Washington Center
2001 L Street N.W., Suite 650
WASHINGTON DC. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail: washington.contact@oecd.org
Internet: *www.oecdwash.org*
Toll free: (1-800) 456 6323

10 2009 13 1 P4

The OECD Policy Briefs are prepared by the Public Affairs Division, Public Affairs and Communications Directorate. They are published under the responsibility of the Secretary-General.