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# Ideas Matter

## Dear Reader,

Welcome to the first 2005 edition of the European Enterprise Journal. We have chosen a smaller format of the journal to make it more reader-friendly. At the same time we have slightly altered the name to better suggest the journal's anchoring with the European Enterprise Institute.

In spite of these new developments, the EEJ contents will remain, we hope, equally relevant and informative. The European Enterprise Journal will continue to explore new perspectives on the debates at hand, acting as a platform for academics, politicians, analysts and business to raise the level of policy debates by providing solid arguments and pertinent insights.

A big part of the answer to Europe's ailing economy is increased competition, not least the competition of ideas. A major current of recent debate rightly focuses on the benefits of tax competition in Europe, and a growing number of countries and regions are adopting new, efficient and competitive tax regimes. Were such a tax revolution to spread it would undoubtedly increase European competitiveness. The EEI considers this debate vital and will always lend support to those voices calling for increased competition in Europe.

In this edition we have chosen to focus on two topics that are likely to stay at the forefront of the European debates in upcoming years. We have asked writers to reconsider the so-called Lisbon process, to think freely and suggest bold new ways to make the European economies the most competitive in the world by 2010. We are particularly grateful for the contribution of the newly appointed European Commission President, Jost Manuel Barroso. Bold objectives calls for bold measures, and we wish him and the new Commission a lot of success in tackling the difficult challenges ahead.

Perhaps closer to immediate agenda of the European institutions is the REACH-directive, which considering its far-reaching implications for European producers, retailers and consumers, surely merits its choice as the second main topic of this current edition. The European Parliament has only just kicked off the second leg of the debate with its January tri-committee hearings. We hope the interventions provided here can provide some additional perspective on this important piece of legislation.

In this issue we also have contributions by Scott Marcus, Senior Technological Advisor at The Federal

Communications Commission in the United States, analysing the cause of the unusually high mobile termination fees in Europe; and by Barbara Rapp providing a legal analysis of the way forward in establishing a common European defence procurement policy.

We hope that you will enjoy reading this journal and look forward to sharing with you the months of debate ahead. Should this journal make its way to your bookshelf for future reference in the debates ahead, our mission will have been already partly accomplished.

*Sincerely,*

**Peter Jungen**

*President EEI*

**Jacob Lund Nielsen**

**and Marcus Stober**

*Editors*

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# Why is Lisbon an essential priority for the Union?

► By José Manuel Barroso



**Mr. José Manuel Barroso** is the President of the European Commission. He has previously served as Prime

Minister of Portugal.

Mr. Barroso is a graduate in Law from the University of Lisbon and has an MSc in Economic and Social Sciences from the University of Geneva in Switzerland.

The Union is faced with major challenges, the consequences of which the call for urgent action. This shows that:

- ◆ international competition has increased since 2000. Our trading partners in other parts of the world have developed more rapidly than us (e.g. China in the industrial sector, India in services), while the U.S. and Japanese economies have recovered more quickly.
- ◆ the effects of the ageing of the population on our employment market, healthcare budget and pension systems are already evident, and are threatening to undermine our social model.
- ◆ the Union's growth potential is running out of steam due to the slowdown in our productivity and low levels of investment.

◆ enlargement poses a major challenge in terms of the cohesion and convergence of our economies. Only coherent action and a collective effort can enable the Union to maximise its potential.

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Faced with such challenges, we must act quickly. The consequences are real and are becoming more serious, while our competitors are rapidly outstripping us. We must lose no time in modernising our economy in order to enable the Union to maintain its model, while continuing to progress and develop.

The Lisbon strategy provides the right responses to these challenges.

It offers a European response to the challenges facing Europe (without either importing the American model or joining the deregulation race in order to compete with China and India). But current competition should make us face facts and adapt accordingly.

In the face of these challenges, Lisbon rightly emphasises the need for growth and employment through greater competitiveness, convinced that both of these are essential if the Union is to hold and improve its position.

Lisbon proposes intelligent and innovative action to boost growth and employment. The proposed synergies (for example, education and research, environment and innovative industries) and the central role of knowledge are keys to our development. (We should note that the Chinese, Brazilians and Russians are in the process of adopting similar strategies.)

Finally, I can confirm the basic mix of policies that underpins the Lisbon priorities: to reinforce research and innovation in order to open up new markets, keep and attract more researchers, encourage trade, develop services, facilitate access to all employment markets and improve social cohesion.

**And yet the results achieved are not satisfactory. What must we improve?**

We must face facts squarely: most of the targets set in Lisbon have almost slipped out of reach, with the possible exception of the target

for female employment rate. Our productivity remains insufficient and our level of investment is not strong enough to support innovation.

I am aware of - and to some extent share - criticisms of the "Lisbon" method: it is too complex, there are too many objectives, there is a lack of clear direction, there is insufficient action in the Member States to implement the measures, the method is too centred on Brussels, there are inherent weaknesses in the focus on co-ordination and benchmarking (the so-called "open method of co-ordination"), etc.

However, realism is not the same as pessimism: on the contrary, we must roll up our sleeves and redouble our efforts. We should not lower our sights, not out of some fanatical belief in Lisbon, but because these objectives are still the right ones to follow if we want to maintain and renew our social model. And we should not lose sight of our capacity to achieve ambitious goals, for example, the single market and the euro!

Moreover, much has already been achieved at all levels: 6 million jobs have been created despite the economic downturn; the environment for business and success has been reinforced by more than 100 directives, regulations and programmes in a wide range of Lisbon-related areas, actively supported by the European Parliament; major structural reforms have been launched in most Member States (labour markets, pensions, healthcare systems, education, etc.).

Of course it takes time to implement all these measures and gauge their effects on the ground.

I therefore believe we must build on the work already begun, but with a new sense of urgency and clear priorities. Mr Kok has proposed a number of highly relevant ideas concerning what those priorities should be in terms of policy and method, particularly as regards ownership by the Member States and the institutions. I will now discuss these with my Commissioners with a view to presenting proposals early in 2005.

***"We must also secure the support of the social partners, other institutions, national parliaments and citizens for this agenda for growth and employment"***

However, I am already fully aware that if we are to succeed we must focus on the key factors that will bring growth and employment. This is the guiding principle that I intend to apply, with the support of Vice-President Verheugen.

#### **What can we do collectively?**

My first discussions with the other members of the European Council, the Commissioners and the representatives of the European Parliament have allowed me to identify a number of key targets for the Lisbon mid-term review.

Nothing can be achieved without greater political will and stronger commitment by the Member States, since Lisbon covers many areas which are national responsibilities. We must therefore drive home the

message that Lisbon is useful for the Member States and that collective action is needed.

We must have the courage to carry out the necessary reforms because they are in the general interest of the Union and of future generations. This reform agenda is essential. Failure to act now can only have even worse consequences for Europeans. I know that carrying out reforms is difficult and often unpopular, but there is no alternative.

A number of ideas have already been put forward on how to attract support in the Member States (e.g. financial perspectives, national action plans, bilateral dialogues with the Commission in order to concentrate on specific questions). We must discuss these further with the Member States in order to explore each of these avenues.

It is not enough to convince governments: we must also secure the support of the social partners, other institutions, national parliaments and citizens for this agenda for growth and employment. All those involved must make a firm commitment to defining the new direction to be taken.

For its part, my Commission will direct all its energies to achieving an objective of growth and jobs and to rallying support for the efforts involved.

The Commission will reflect along these lines and present its proposals early in 2005. The debate can then be continued thanks to Parliament's contributions and those of the Member States with a view to the European Council in the spring.

# The Challenge of Telephone Call Termination Fees

► by J. Scott Marcus<sup>1</sup>



**Mr. J. Scott Marcus** is the Senior Advisor for Internet Technology for the FCC. Previously, he served as Chief Technology Officer (CTO)

of Genuity, Inc. (GTE Internetworking). From February through June of 2004, he worked in Brussels under a GMF grant as a Transatlantic Fellow of the German Marshall Fund of the United States in order to study the new European Union regulatory framework for electronic communications.

European consumers are very much aware of the fees that they pay for fixed and mobile telephone service; however, they have no inherent way of knowing whether these prices could be viewed as being fair or economically efficient. These *retail* prices are strongly but subtly influenced by intercarrier payments at the *wholesale* level. *Call termination* fees – wholesale payments from the carrier of the party that receives, or *terminates* a phone call, to the carrier of the party that places, or *originates*, the call – dramatically affect retail pricing.

How might European consumers react if they were to learn that market inefficiencies caused their cell phone use to cost about twice as much per minute<sup>2</sup> as it might in a less distorted free market system? And that these higher prices tend in turn to dramatically deter cell phone usage?<sup>3</sup>

These claims might seem to be sensational, but comparative benchmarking with other developed economies strongly suggests that they are true. Countries with low effective retail rates per minute (including the U.S.A., Canada, South Korea and Hong Kong) enjoy high mobile phone usage, while countries with high effective retail rates (as is the European norm) experience low mobile phone usage.

In the United States, where the effective price of a minute of cell phone use is about \$0.10 U.S. per minute, the average consumer uses his or her cell phone *more than seven times as much* as a corresponding German consumer, where the average effective price is about \$0.33 per minute.<sup>4</sup>

Thus, irrationalities in the wholesale system have arguably had a negative impact on the welfare of European consumers.<sup>5</sup> European institutions are well aware of the problem,

and are taking mighty – but little understood – steps to correct these market imbalances. These rather heavy-handed regulatory measures are appropriate, because the problem that they seek to correct is substantial; at the same time, it will be important in the long term to try to evolve to a subtler and less intrusive regulatory regime once rates have been brought down to more rational levels.

Call termination fees tend not to be constrained by the competitive economic forces that constrain many other prices due to an effect known as the terminating monopoly. In a typical competitive market, a provider cannot increase its price with impunity, first because of the risk of loss of business to competitors, and second because of the likelihood that customers will respond by consuming less of the supplier's services (demand elasticity). Unfortunately, neither of these factors provides an efficient

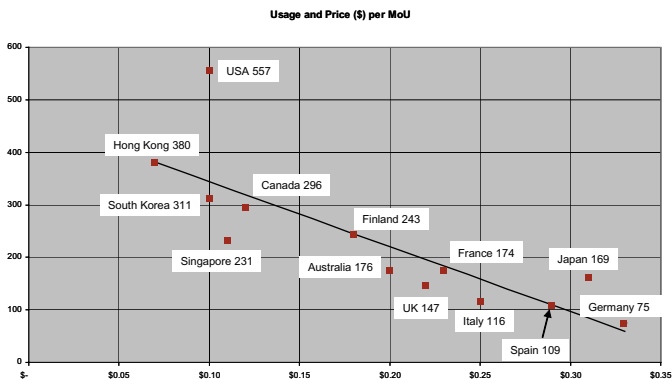


Figure 1. Minutes of use (MoUs) per month as a function of effective price per MoU.

“brake” to termination prices.<sup>6</sup> First, no one can compete with a provider to terminate calls to that provider’s customers, in general. Second, the demand elasticity effects are muted because the wholesale charges are borne, not by the provider’s customers, but rather by those of other providers.<sup>7</sup> The effects may be spread over multiple providers, and consumers will tend to have little or no visibility into these prices.

Economic theory tells us that the European system will tend to high termination rates in the absence of regulation, and this is precisely what we have historically seen. These high prices may seem normal to consumers, because all providers charge them. It is also worth noting that the problem is not limited to incumbents – small providers will be motivated to set their prices (even) higher than large ones<sup>8</sup>. This is the opposite of normal monopoly behavior.

The European Commission has responded by taking steps that recognize the effects of the terminating monopoly.<sup>9</sup> In effect, National Regulatory Authorities (NRAs) in most Member States will be obliged to impose remedies – typically including the imposition of cost accounting and cost-based termination fees – on most operators, including many operators that historically were not subject to significant regulation.

This is an intrusive remedy, but it is not disproportionate to the magnitude of the problem. Indeed, things seem to be moving in the right direction, if slowly – the Commission reports a distinct downward trend in termination rates.<sup>10</sup>

At the same time, the European regulatory framework was intended to achieve deregulation over time. The real problem with the current

European approach is that there is no exit strategy.

As previously noted, competition alone does not cure the terminating monopoly problem. How, then, might Europe eventually move beyond cost-based termination fees set by the NRAs?

A number of recent papers<sup>11</sup> have suggested that the U.S. system contains valuable clues. The U.S. system of call termination has problems of its own, to be sure, but it has generated low call termination rates (zero in many cases) without

**“Competition alone  
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the terminating  
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requiring regulators to explicitly set termination rates for all carriers.

In the U.S., only wired incumbent providers are restricted to cost-based termination rates. Rates of other providers are generally restricted by a complex system of symmetry and parity with the wired incumbents, but without explicit regulatory setting of termination rates. In effect, the costs of the wired incumbent are taken as a proxy for the costs of other carriers, absent evidence to the contrary. Many rates – including mobile-to-mobile, in general – are established by means of voluntary negotiation, and are often set to zero (“bill and keep”).

In consequence, call termination rates for most calls in the U.S. are less than one U.S. cent per minute.<sup>12</sup> These low termination fees, have resulted in low marginal cost for domestic U.S. calls, which in turn has fostered a migration to zero marginal retail price. Starting in 1998, wireless operators began offering nationwide “buckets of minutes” plans with no roaming or long distance charges. More recently, the U.S. is witnessing

a similar evolution among wired local telephony operators.

One promising development that bears watching is the termination rate scheme recently notified by the Swedish NRA.<sup>13</sup> The NRA required the largest incumbent to implement a full system of cost accounting and cost-oriented termination rates. Two other operators were required to provide cost accounting, but instead of being constrained to cost-oriented termination rates were instead permitted to charge “reasonable and fair prices”, presumably no higher than those of the incumbent.

The remaining small operators must charge reasonable and fair prices, but were obliged to provide cost accounting data only upon the regulator’s request.<sup>14</sup> Thus, the incumbent’s costs are used as a proxy for the costs of the smaller operators. U.S. experience suggests that systems of this type can contribute to the achievement of regulatory goals while burdening only a few operators with full cost accounting and cost orientation. That the European Commission accepted this approach suggests that the Directives that comprise the new European regulatory framework may already provide sufficient flexibility.

In sum, it is indeed important to ensure that call termination rates move to lower and more rational levels over time, and it is heartening that these rates are beginning to move in the right direction. At the same time, it will be important to explore approaches to reduce the regulatory burdens associated with driving these rates down, possibly borrowing selectively from best practices in other developed countries.

Call termination is a complex issue, and it is likely to be with us for a long time. Yet it is in some sense

merely the tip of the iceberg. High roaming charges (the surcharges that a customer pays when using her mobile phone outside the service area of her own provider) among mobile operators represent a comparably serious problem, but one that is in some senses even more difficult to address in the European context.<sup>15</sup>

Like call termination, these charges are largely unconstrained because they impact another provider's customers (and in this case possibly another national regulator's constituents). The increasing significance of Voice over IP (VoIP) places further strains on the call termination system, making it difficult to determine what charges should be imposed, or on whom.

Ultimately, it may well be that call termination fees are unsustainable altogether – that the idea of requiring one provider to compensate another for its costs is unworkable in a technologically converged world. The long term evolutionary path may well be to a world in which each provider must recover its costs and make its profits based solely on charges to its own customers, and not on charges to the customer of some other provider.<sup>16</sup>

*firm – the historic monopolist – has been obliged by the regulator to offer access to its network for the purposes of interconnection or call termination at prices which have usually been set by the regulator to equal cost, including a reasonable return on capital employed: either a direct estimate of network costs or a benchmark based on 'best practice' abroad. Other fixed networks typically have to set interconnection charges at the same level as that determined by the regulator for the dominant network."*

<sup>4</sup> See figure 1, based on Michel Morin and Linda Mutschler, *Global Wireless Matrix 4Q03*, Merrill Lynch Global Securities Research (2004), as cited in the FCC's 9<sup>th</sup> CMRS Competition Report (2004).

<sup>5</sup> Bomsel, Cave, Le Blanc and Neuman (2003) argue that the current system also distorts the market by generating irrational subsidies to mobile operators from consumers of fixed telephone service. They also refute an often-heard claim that high termination subsidies are effectively returned to European consumers through subsidized handset prices.

<sup>6</sup> This has been widely recognized. Cf. Cion, 10<sup>th</sup> Implementation Report (2004): "In the mobile sector ... concerns have been expressed for some time that in many cases mobile termination rates bear no relation to costs."

<sup>7</sup> Note, too, that those providers may also be competitors. A provider has no incentive to minimize a competitor's costs.

<sup>8</sup> Cf. Jean-Jacques Laffont and Jean Tirole, *Competition in Telecommunications*, MIT Press (2000). See also Haucap and Dewenter (2004). This is consistent with the 10<sup>th</sup> Implementation Report, which shows higher termination fees for non-SMP operators than for SMP operators (Annex 3, page 36).

<sup>9</sup> Specifically, they have defined markets 9 (Call termination on individual public telephone networks provided at a fixed location) and 16 (Call termination on individual mobile networks) to reflect

termination for the customers of an individual network operator, thus creating a strong presumption (unless rebutted by facts to the contrary) that the provider has significant market power (SMP). See the Commission Recommendation of 11 February 2003 on relevant product and service markets.

<sup>10</sup> "The average fixed-to-mobile termination rate for SMP operators in the EU 15 fell by 14% between July 2003 and July 2004." Cion, 10<sup>th</sup> Implementation Report (December 2004)

<sup>11</sup> See Crandall and Sidak (2003); Littlechild (2004); and Marcus (2004). This is often expressed as a desire to move toward a U.S.-style "Mobile Party Pays" or "Receiving Party Pays" regime.

<sup>12</sup> There are many exceptions, notably including access charges for rural wired incumbents. By contrast, mobile termination rates in Europe average more than 13 eurocents (Cion, 10<sup>th</sup> Implementation Report).

<sup>13</sup> See "Case SE/2004/0050: Call termination on individual public telephone networks provided at a fixed location in Sweden".

<sup>14</sup> The proposed approach of the Irish NRA is somewhat similar. See "Consultation on Remedies – Wholesale voice call termination on individual mobile networks", document 04/62b, 8 June 2004. See also the UK approach in case UK/2003/0003.

<sup>15</sup> This is a particularly difficult market to analyze. Cion, 10<sup>th</sup> Implementation Report: "To date, there has been at least one notification on each of the markets identified in the Recommendation on relevant markets except one, namely the wholesale national market for international roaming on public mobile networks."

<sup>16</sup> This is already largely the case in the Internet, and in the U.S. mobile industry. See DeGraba (2000); and Atkinson and Banekev (2000).

<sup>1</sup> This article reflects research that the author conducted as a Transatlantic Fellow of the German Marshall Fund of the United States. The author has had affiliations with both the FCC and with the European Commission, but the opinions expressed here do not necessarily reflect the views of either commission.

<sup>2</sup> For purposes of comparison, it is appropriate to count both incoming and outgoing minutes.

<sup>3</sup> These problems could in principle manifest themselves in fixed telephony as well, but tend not to in Europe. See Bomsel, Cave, Le Blanc and Neuman (2003): "In fixed networks, the dominant

# Innovation in Europe

## ideas for growth

► by Jean-Michel Houry and Mark Spelman



**Mr. Jean-Michel Houry** is the Chairman of the European American Industry Council and Managing Director, at Brink's, which

is one of the world's oldest and largest transportation and security company.



**Mr. Mark Spelman** is Vice Chairman of the European American Industry Council and Global Director for Growth and Strategy at Accenture.

To many observers Europe's recent economic performance makes depressing reading. Despite progress on some fronts, the EU as a whole has failed to close the gap with the US and other economies on key indicators such as economic growth, productivity and employment creation. And Europe appears ill-equipped to deal with some of the longer-term trends confronting it such as demographic change and increased globalization of production and investment.

Yet there are grounds for optimism. The high-level Group chaired by Wim Kok has produced a report, which hopefully will give renewed impetus to the stagnating Lisbon Agenda. The report identifies five priority areas to

achieve competitiveness and growth in Europe – the knowledge society, the internal market, business climate, labour market and environmental sustainability.

The Wim Kok recommendations are certainly a valuable contribution. But there are many ways to look at the problem and articulate the ways forward. The European American Industry Council (EAIC) – a cross-sectoral grouping of senior executives leading European operations of US-based multinational companies – recently carried out a major 2-part survey of senior business leaders on

***“Europe appears ill-equipped to deal with some of the longer-term trends confronting it such as demographic change and increased globalization of production and investment”***

European competitiveness, as well as analyzing a range of other sources of evidence. Our findings highlight key areas for reform and point to a practical strategy to advance competitiveness within the EU. It is perhaps unsurprising that these are entirely consistent with Wim Kok's findings. But one perspective which

emerged particularly strongly from the EAIC survey was the need for Europe to strengthen its capacity for innovation.

Our view of innovation is that it is the application of ideas to create value, whether this is through new products and services, new ways of working, new commercial arrangements, business models or ways of getting the best out of people and resources. Innovation is therefore not just about R&D – although that is an important part of it and the generally low levels of R&D investment in Europe are certainly a concerning factor. Nor is innovation simply about someone sitting on their own coming up with a great idea. According to our detailed research, it is much more likely to be a collaborative effort, bringing together people from a range of disciplines, organizations and geographic regions across networks of established businesses, venture capital providers, academia and government. Of course there is a great deal of logic and pragmatism underpinning this type of collaboration – it is about splitting costs, spreading risk and sharing expertise.

So where does this leave Europe? First and foremost, Europe has the potential to be much more innovative - it has some world-class universities and research institutes, leading



edge research capabilities, and an educated and skilled workforce. But Europe is failing to commercialize many of its ideas because of a number of barriers. New approaches to innovation should therefore aim to improve the flow of people, money and ideas and reduce policy inhibitors. Specifically, we believe innovation within the EU can be strengthened through:

1. **Improving the flow of talent between industry and academia.** This is increasingly happening elsewhere. For example, a new centre at Stanford University in the US has opened for experts in IT, biotechnology and material sciences to share ideas and look for commercial applications<sup>1</sup>. Significantly 10 per cent of the spaces are reserved for external visitors and private industry. There are many other possibilities. As a starting point, Europe could establish business internships for academics and students and proactively hold up entrepreneurial role models and examples of success.
2. **Realigning academic incentives to support both quality research and the commercialisation of ideas.** We need to create the incentives for researchers

and academics to collaborate with business, for example by making business secondments for academics a positive step in the promotion process, and by measuring and rewarding academic performance on the basis of collaboration and commercial application of research as well as academic quality of research. Effective collaboration also means

***“But Europe is failing to commercialize many of its ideas”***

ensuring that the costs and benefits of developing intellectual property are distributed equitably between different stakeholders involved in innovation.

3. **Promoting the commercialisation of more publicly funded research, and encouraging more experimentation in the use of EU public funding for research.** In practical terms, this means rewarding projects and partners who demonstrate success in research, business acumen and results, and it means establishing a quicker, less bureaucratic application process. In the US this is taken a step further through the Bayh-Dole Act and other

related legislation, which requires federal agencies, and recipients of federal funds to promote the commercialization of publicly funded research.

Innovation is not a new concept but it is likely to become an increasingly important one for Europe. And it aligns extremely well with Wim Kok's recent report. In particular, improving the knowledge society will be essential to boosting innovation; creating the right climate for entrepreneurs in Europe is an absolutely fundamental viewpoint arising from our survey; encouraging strategies for lifelong learning could feed directly into a reinvigorated innovation economy; and working towards an environmentally sustainable future will almost certainly require innovative solutions.

In short, innovation has become the key weapon for securing competitive advantage and economic growth in today's global economy. And strengthening Europe's capacity for innovation requires a more collaborative approach between all the key players - business, governments, and academia.

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<sup>1</sup> *Business Week*, “The Innovation Economy – Global Hot Spots”, 11 October 2004

# A more ambitious Lisbon strategy

► by Karin Riis-Jørgensen MEP



**Mrs. Karin Riis-Jørgensen** is the Vice-Chair of the Liberal Group in the European Parliament and member of

the Committee on Economic and Monetary Affairs. Before being elected to the European Parliament Mrs. Riis-Jørgensen achieved professional recognition as the head of department at Coopers & Lybrand (Price Waterhouse Coopers), from the European Commissions special branch for Small and medium sized enterprises and as the head of the International branch of the Danish Federation of Small and Medium-Sized Enterprises in Brussels.

Globalisation means Europe will have to face up to enormous economic and structural challenges. We cannot face up to these challenges without first increasing our economic strength. The U.S. has remained the driving force of the global economy since WW2, but the economic centre of gravity will likely shift in the future towards Asian economies such as India and China. Should this happen Europe's relative share of the world economy will almost certainly lessen and our political weight will diminish accordingly.

Five years has passed since the Lisbon strategy was launched.

The purpose was to make Europe the most competitive knowledge based economy in the world by 2010; half way through, the time has now come to evaluate the midterm results and put additional speed to our efforts to secure a competitive Europe.

The first we lesson to draw is that the Lisbon Strategy has become much to complex. We must focus on the areas where we can make a real difference. I see five crucial points for improvement:

**“But the economic centre of gravity will likely shift in the future towards Asian economies such as India and China”**

First, I believe that we should focus on real structural reforms in the economically dominating countries of the EU. The EU must become better at debating the benefits of more flexible labour markets, a better control of public expenses, lower taxes on labour. The EU should see to it that investments on education and longer participation in the work-force pay off.

These proposals perhaps exceed the EU's existing competencies but improvements in these fields will likely determine Europe's

**“The Lisbon Strategy has become much too complex”**

economic future and the EU has therefore an important role to play also in these areas. Take the example of public finances. It is remarkable how silent the Commission has been regarding the budget deficit in France and Germany. It is essential that the trust and respect for the common budget rules are re-established, and furthermore it is of highest importance that the independence of the European Central Bank is not contested. In this area the Commission should play an important role.

Secondly, the EU should prioritise investments in research and development. This also includes EU's own budget where too much money is spent on subsidies instead of on R&D. Nano- and biotechnology are vital priorities for the future. The EU has to strengthen basic research and create European super universities

which should be among the best in the world. Finally, we should create an internal market for knowledge. It should be possible for researchers

***“The EU should see to it that investments on education and longer participation in the work-force pay off”***

to move more easily from member state to member state and we must see to it that mutual recognition of diplomas is implemented as soon as possible.

The third point I would stress is that European competitiveness requires that we take a step further in developing the internal market. The service sector amounts 2/3 of the European economies and we have yet to create a single market for services. It would be an enormous advantage to create such a single market for and so it is essential to have a constructive and fruitful debate about the services directive and for legislators to follow the process closely. A single market for services will provide better, cheaper and more professional

service for the citizens of Europe as well as increasing the conditions for European businesses.

The fourth point is that in order to strengthen the internal market we must urge member states to comply with European rules and regulation. It should be possible to give member states fines if they do not comply with or rightfully implement the ‘acquis communautaire’. When all

***“It is remarkable how silent the Commission has been regarding the budget deficit in France and Germany.”***

member states does not comply with European regulation is has a negative effect on export between them.

Fifth and last, we must ensure better regulation. The EU’s increasing influence should carry a greater responsibility to ensure quality in European regulation. Therefore, it would be wise if all European regulation is examined for negative consequences for citizens, trade and industry. An

idea is to establish an independent control unit within the Union, which only purpose should be analysing common legislation.

To conclude, it is necessary that the EU increasingly focus on domains where it’s possible to make a real and sincere difference for the European citizens. The EU has been a great success because it has created more welfare for all through economic liberalisation and mutual integration within the member states. We must never forget these main competencies. The EU must therefore concentrate on creating fair competition throughout all European markets. The EU must create minimum standards for protection of the environment and consumers while

***“A single market for services will provide better, cheaper and more professional services for the citizens of Europe”***

avoiding introducing mutual social standards or tax levels which would be detrimental for overall economic competitiveness.

# SMEs on their way to Lisbon

► by Dr. Paul Rübzig MEP



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The Small and Medium Sized Enterprises (SMEs) are the backbone of the European economy: they represent 99 % of all enterprises in the EU and provide around 65 million jobs. Contrary to large undertakings, they are more flexible to adapt to economic market changes. That makes them socially and economically important and an essential source for entrepreneurial spirit and innovation. One has always to bear in mind that the European small and medium enterprises with less than 250 employees are the employers of two thirds of the work-force, that they contribute to 50% of the GDP and pay 80% of the taxes; for all of these reasons they must be given the best

framework conditions for adapting to a globalised world.

In order to encourage people to set up SMEs, the current framework conditions must be improved. And in order to reach the ambitious goals of Lisbon, these statements hold more truth than ever before.

SMEs are the main source of welfare, innovation and job creation in Europe. Creating the right economic conditions for enterprise development and a culture of entrepreneurship are the prerequisite for continued economic growth and the development of family businesses both in the EU and the Accession Countries. Priorities on entrepreneurship are now more than ever: Reducing the administrative and regulatory obstacles to the setting up and management of businesses; reinforcing a culture of entrepreneurship, from school level to higher education, including access to vocational training; improving the balance between "risk" and "reward" of entrepreneurship; facilitating access to finance and the setting of an appropriate framework for SMEs in the context of Basel II; simplifying the administrative environment, cutting down red tape and undertaking systematic comparable

business impact assessment on each new piece of legislation; and taking all the relevant measures to facilitate access to and training on the use of information and communication technologies.

Other measures that have to be taken include releasing the job-creation potential of SMEs and start-ups through encouraging the reform of personal and corporate tax systems on a national level, by drawing on experience which has worked for SMEs and start-ups elsewhere; and the reform of the tax systems in such a way that it allows also SMEs to build up long-term savings deposits which are not taken away by a rigid tax system, to ease their better capacity to access to capital by removing discriminatory tax regimes.

I strongly support the Commission's efforts to create a more entrepreneur-friendly environment by conducting entrepreneurship awareness campaigns, fostering the creation of more fast-growing enterprises (gazelles), promoting entrepreneurship in social sectors, enabling micro-enterprises to recruit by reducing the complexity of regulations and facilitating

SMEs access to public markets, and reducing costs and efforts to start businesses.

Investments in innovation as well as in research and development bear a lot of potential for the positive development of the European economy. Although investments in R&D have increased considerably since the beginning of the Lisbon process, still not enough has been done in this area to achieve the objectives set, as e.g. «the Barcelona target» of 3% investments in R&D until 2010.

Services are a key driver for creating a “knowledge society” with high productivity levels. In the U.S. the emergence and adoption of ICT technology has been identified as the single most important factor in increasing productivity. In concrete terms Europe’s R&D spending is still done to 95% at national level and is reserved for national recipients. A target to increase competition in this area would certainly increase the efficiency of spending.

Taking into account the direct consequences of an enhanced investment rate on economic growth in Europe, initiatives which

improve conditions for public and private investments in knowledge have to be encouraged, as they are particularly important for pushing forward the entire Lisbon process.

***“Services  
are a key driver  
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productivity levels.”***

In order to maintain and enhance European competitiveness, investments in new technologies and infrastructure are essential. Particular attention must be paid to Transport Trans-European Networks to assure easy access to all member states, especially the new ones. Against this background, sufficient funds for Transport TENs have to be provided.

With regards to international trade the European traders have witnessed progress in the WTO/GATT trade negotiations, and benefits of trade liberalization have been transferred to European consumers through improved consumer choice in terms of quality and price. Unfortunately, European trade still remains relatively restricted in a number of areas. This

includes most obviously the traditional enterprises as well as significant tariffs on a number of manufacturing commodities. In addition, non-tariff barriers (such as complex import administration requirements) have risen in importance as tariffs have fallen, as has the recourse to tools of anti-dumping.

In light of the stalled trade talks within the Doha development round, I am concerned that the absence of progress on trade talks will result in a backsliding to protectionism which will threaten the continuation of a rules-based open trading system.

To achieve the goals of the Lisbon strategy in a globalized world, increased competition by the European Union’s trading partners should not be seen as a threat for domestic producers, but as an opportunity to boost competitiveness. To this end, a level playing field for business is needed, preparing the ground for innovation and restructuring. A liberal trade policy is pivotal to achieve this goal. Enhanced competitiveness requires dismantling protectionism - and the sooner the better.

# Growth should be the focus of Lisbon

► by Gunnar Hökmark MEP



**Mr. Gunnar Hökmark** is a Member of the European Parliament where he heads the Swedish Moderate delegation

in the EPP-ED Group. Mr. Hökmark has long career in Swedish politics as a leading proponent for liberalisation of the Swedish economy. Mr. Hökmark is former President of the Swedish Think-Tank, Timbro Idea and currently co-presides the European Enterprise Institute.

The Wim Kok-report is a step forward in order to ensure a competitive Europe but it isn't enough. There are still too many remaining unanswered questions left in the report. We still have to tackle fundamental problems such as why do our economies generate so few new jobs; why are newly generated jobs not better paid and why does not our economies provide enough capacity for new enterprising and generate so few entrepreneurs? The report has bluntly left out dealing with these fundamental questions and avoids discuss what's needed in order to create a competitive Europe.

The Wim Kok-report states that the European model is strong and robust- and must be preserved -But what is the European Model?-

Is it the regional rifts, or the segregation in our cities? The high unemployment and dependence on subsidies? perhaps is it the lack of low growth or that of choice. Isn't there something wrong with a model that feeds unemployment and that prevents new enterprising and new companies?

And what model are we talking about. The Nordic Welfare state, Die Soziale Marktwirtschaft and the civil society? The Anglo-Saxon model of insurance systems, or perhaps is it our own tiger-economies in Central- and Eastern Europe?

The common denominator of those who proclaim high taxes and large public sectors as a model for others (presumably over other EU fast-growing economies), can not however, pride themselves with solid well-fare nor high employment, but only heavy-tax loads and regulated labour-markets.

**“This tax-burden has an undeniable impact on investments in the private sector;”**

The general tax-load of EU-15 is 45% compared to the OECD-area which averages at 35% of

GDP. Should we include into this comparison the Asian economies and the American economy, the difference becomes even more

**“So, let's all focus on what matters and re-shift the Lisbon priority on competition and delivering economic prosperity to the benefit for all Europeans.”**

striking. This tax-burden has an undeniable impact on investments in the private sector; on wage-costs; on profits generated by businesses; on access to risk-capital and on the speed of innovations and entrepreneurship in the European economies.

The Wim Kok-report tries to excuse the Central- and Eastern European countries for lagging behind in certain indicators spelled out in the report, but yet, they pride themselves with higher growth rates. Is it not unfair to criticise countries which have chosen to reduce their tax-load as a way to increase growth and competitiveness when this should be at the very essence of the Lisbon-Process?

In reality, the idea that some countries compete unfairly with lower taxes is recognition that reducing tax-load stimulates

***“Is it not unfair to criticise countries which have chosen to reduce tax-load as a way to increase growth and competitiveness whilst this should be at the very essence of the Lisbon-Process?”***

growth. The critic of fast growing EU members states becomes therefore nothing but an effort to cover the failure of promoting growth through heavy taxation and more public sector.

It might be true that some of the new the new Member States score poorly at some Lisbon indicators but they display good results on the core dimension of the Lisbon process, which is growth. Economic growth has allowed for new companies to be created, higher employment and better environment. Not bad. Scoring badly on certain indicators whilst boosting growth levels provides

better opportunities than having god results in certain indicators combined with low growth rates. So, let's all focus on what matters and re-shift the Lisbon priority on competition and delivering economic prosperity to the benefit for all Europeans.

A problem of focusing too much on the indicators spelled out in the Wim Kok report is that they do not always show progress.

For example, when measuring the share of the population employed in public sector, countries with high growth tend to come behind the countries with low growth. This means that if the larger part of your economy belongs is dedicated to public the public sector, the greater problems you have with the growth. Or, if the bigger share of the work-force is employed in the private sector, higher growth is generated.

The same logic applies for the general tax load. Countries with high growth levels tend to have lower tax loads. This is because lower taxes increase the size of the private sector and thereby give more room for private investments and private enterprises. If people are less dependant on public transfers and experiences the

results of their work the more they'll deliver. This doesn't mean less welfare but more of it allocated to the citizens.

If you combine indicators such as tax on enterprising, company tax on capital dividends and property tax, the pattern becomes even more striking. The more you tax entrepreneurs, the less enterprising you will get and the fewer entrepreneurs will be motivated to make that crucial leap and engage in new businesses, creating new markets and new jobs.

What's true is that the key to growth is less dependence on the public sector and more room for free enterprising and rewarding entrepreneurship and that is what

***“The key to growth is less dependence on the public sector and more room for free enterprising and rewarding entrepreneurship”***

in long-run will determine the strength of the market. Couldn't we therefore have a new motto for the Lisbon process; it's the market economy, stupid!

# Towards a European defence procurement policy

► by Barbara Rapp



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Mrs. Rapp is a Member of the board of the Kangaroo Group and is interested in the legal questions surrounding the creation of the European defence equipment market EDEM.

## Background

Articles 296 EC, concerning the defence sector, lays down the most far reaching derogation to the rules of the EC-Treaty. In essence, the provision stipulates that with regard to the production and trade of arms, munitions and war material, any Member State “*may take such measures as it considers necessary for the protection of the essential interests of its security*” (Article 296 (1) a). Moreover, when a Member State “*considers*” disclosure of information “*contrary to the essential interests of its security*” (Article 296 (1) b), its normal obligations to cooperate with Community institutions are limited. The derogation has far-reaching effects: *de facto* because Member States make an extensive, quasi-systematic use of it, and *de jure* because it applies not only with respect to the rules on the internal market, but with respect to the general Treaty rules altogether, e.g. concerning fundamental freedoms, competition,

and common policies<sup>1</sup>. As a result, the defence sector is so far subject to a plethora of national legal frameworks, strictly fragmented along national lines and deprived from participating in the benefits of the Common Market.

However, the actual quasi-systematic use of the exemption does not properly reflect that legally speaking, the general rules of the EC Treaty do *in principle* apply to the production and trade of defence equipment.<sup>2</sup> That is so because Article 296 EC does not provide for

**“The Commission’s Green Paper Defence Procurement is a significant step towards a common defence procurement policy.”**

a general, automatic exemption for defence equipment but requires Member States to invoke and justify the use of the exemption on a case by case basis<sup>3</sup>, including the necessity of that use<sup>4</sup>. Moreover, as a derogation from the general Treaty rules, the Article has to be interpreted narrowly.<sup>5</sup>

Furthermore, Article 296 EC lays down that measures connected with the production and trade of arms, munitions and war material shall not adversely affect competition in the collateral markets for products “*not intended for specifically military purposes*”. Therefore Article 296 must not be applied so as to affect competition with respect to dual use

equipment or civilian equipment used under military command.

A derogation, which induces Member States *de facto* to withdraw an entire economic sector from the process of European integration, has by its very nature detrimental effects upon the Lisbon process. A fresh look at Article 296 EC is necessary with a view to defining its correct scope in the light of recent advances in the European security and defence policy (ESDP). Action is required in order to strengthen the industrial and technological base of the European defence sector in accordance with the Lisbon objectives.

An efficient public procurement policy is required in line with recent advances of ESDP.

The Commission’s recent Green Paper on defence procurement<sup>6</sup> is a significant step in this direction. The objective of this initiative is to have an appropriate regulatory framework for defence procurement in Europe. The ultimate goals are a better allocation of defence resources, the gradual creation of a European defence equipment market and an increase in the economic efficiency of this sector.

In its Communication “Towards a European Union defence equipment policy” of 11 March 2003<sup>7</sup> the Commission announced this Green Paper jointly with other actions concerning, *inter alia*, common monitoring of defence



related industries, an appropriate legal instrument concerning intra-community transfers of defence equipment and the establishment of a security-related common research agenda. The Green Paper on defence procurement has now been published and gives rise to the following comments:

### The need for Community action

The Commission proposes to pursue the debate on defence procurement on the basis of two alternative instruments:

- ♦ either the adoption of an interpretative Commission Communication clarifying the existing legal framework, in particular the principles defined by the European Court of Justice with regard to Article 296 EC;
- ♦ or a proposal for common procurement rules which specifically address the field of defence and take the special nature of this sector into account.

A Communication clarifying Community law as it stands and explaining how to distinguish contracts subject to the general rules of the Treaty from those covered by the derogation would be very helpful for both the authorities and the suppliers concerned. However, as it is not binding under EU-law, a communication of the Commission has limited effects. All it can do is clarify the scope and limits of Article 296 EC subject to the control of the European Court.

The Commission's Green Paper Defence Procurement is a significant step towards a common defence procurement policy.

Therefore, initial Community action may well include an interpretative instrument but binding measures should follow. A legislative framework especially shaped to the sector's characteristics and needs is required. Taking the security interests of Member States and the European Union properly into account will encourage

Member States not to rely on the derogation of Article 296 EC or to rely on it less frequently. The growing convergence in the field of European foreign, security and defence policy followed by the installation of the European Defence Agency (EDA) by the Council on 12 July 2004<sup>8</sup> must be supported by legislative Community action.

A defence-related Community directive would bring the national defence procurement rules closer together while at the same time contributing to the development of a European defence and safety equipment market. Operators would be in a position to strengthen their independence in relation to their national governments and the restructuring of the sector could be initiated.

### **“Community action should include a Directive specific to defence procurement.”**

The Commission should therefore be encouraged to adopt both an interpretative Communication and a proposal for a defence procurement directive. The Communication would be the appropriate instrument to increase legal certainty in this grey area and bridge the period of time needed up to the implementation of the future Defence Procurement Directive.

### **Community law as it stands regarding defence procurement**

Community law as it stands does not include a set of rules specific to defence procurement. The general procurement rules apply. These have recently been updated and streamlined; see in particular Directive 2004/18 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts which must be transposed by January 2006 at the latest (“Directive 2004/18”).<sup>9</sup>

Article 10 lays down that this Directive “shall apply to public contracts

awarded by contracting authorities in the field of defence, subject to Article 296 of the Treaty”. Article 14 exempts from the rules of the Directive “secret contracts and contracts requiring special security measures.” According to the interpretation given in consideration 22 of Directive 2004/18, Articles 10 and 14 make provision “for cases where it is possible to refrain from applying the measures for coordinating procedures on grounds relating to State security or secrecy”.

Article 10 of Directive 2004/18 is rightly based on the understanding that the general rules of the Treaty apply in principle to defence equipment, whereas Article 14 mirrors the fact that the common rules do not apply whenever Member States have sufficient reasons to rely on their essential security and secrecy interests.

With regard to the field of application of Directive 2004/18, it appears that the rules of the Directive have a wide scope. They are meant to apply not only to civilian and dual-use goods but also to military equipment and possibly even hard defence goods referred to in the list adopted by the Council on the basis of Article 296 paragraph 2 EC<sup>10</sup>, provided the derogation in Article 296 is either not referred to or the substantive criteria thereof are not met.

Community action should include a Directive specific to defence procurement.

However, those rules have a serious deficit: Directive 2004/18 is of general application to a variety of sectors and accordingly cannot sufficiently take into account the specific features which distinguish defence procurement from other types of public procurement.<sup>11</sup>

The Commission therefore rightly points to Directive 2004/17 of the European Parliament and of the Council

of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors as a “model” for regulating defence procurement<sup>12</sup>. As in the case of those special sectors, a Directive specific to defence procurement should be adopted.

### The legal basis of a Directive for Defence Procurement

Directives 2004/17 and 2004/18 on public procurement are based upon Articles 47 (2), 55, and 95 EC. With respect to the legal basis of the future Defence Procurement Directive, the fact that Directive 2004/18 already covers defence procurement supports the choice of the same legal basis for the new set of rules. Article 296 EC would not prevent recourse to Articles 47 (2), 55, and 95 EC given that it does not provide for a general automatic exemption but must be justified case by case.

### The field of application of the future Directive

In light of Article 296 EC, the field of application must at this stage be limited to those cases “for which the use of the derogation is not justified”<sup>13</sup>. The Green Paper suggests two alternative methods:

- ◆ either define the scope by reference to existing lists of arms, munitions and war material to which Article 296 (1) b EC applied, excluding from the Directive the products so listed;
- ◆ or define the scope on the basis of an abstract general definition of the category of military equipment covered.

As can be seen, the Commission does not suggest defining the scope of the future rules on the basis of a *positive list* enumerating the categories of goods to be effectively caught. A positive list would indeed risk ending up in a “minimalist” solution below the

level of integration already achieved by Directive 2004/18 EC.

The determination of the field of application by reference to a “negative” list excluding the material so listed from the Directive would have the advantage of a simple and transparent solution. For example, the list set up by the Council on the basis of Article 296 (2) EC<sup>14</sup> or the more recent list concerning the Code of Conduct on arms exports<sup>15</sup> could be used in an updated version. On this basis the decision whether a given contract comes under the Directive or under the derogation of Article 296 EC could be taken without difficulty.

**“The field of application should be defined on the basis of an abstract definition completed by a negative list.”**

The field of application should be defined on the basis of an abstract definition completed by a negative list.

*However, in the light of the rapid development of military equipment such a list should not remain the only tool determining the field of application of the future Directive. In addition, an abstract definition is required of the categories of equipment to which the Directive may or may not apply. It would provide additional legal certainty and assist the legislator when updating the list in future.*

### Taking the special nature of defence procurement into account

The future Defence Procurement Directive should not only ensure an appropriate degree of transparency and guarantee the non-discrimination of the bidders but above all should take the specific features of defence procurement into account. To be considered first of all is the dominant role of the State. The government is normally the only

client of its national defence industry (monopsony). It often has a significant influence upon the industry and determines the size of the market.

Further specific features are the needs for secrecy and confidentiality of military equipment and programmes, national security concerns, the sensitive political nature of the award decisions, the need for security of supply, the high-technology nature of the products concerned, the high level of costs, the long duration of many projects as well as the frequent need for speedy solutions.

Procedures and selection criteria should be shaped according to the specific features of defence procurement.

*As the Commission proposes, the procedures to be followed and the criteria to be applied with regard to selection and award have to be defined in accordance with these specifics.<sup>16</sup> As a rule, contracting authorities should use the negotiated procedure with prior publication of a contract notice. The negotiated procedure would enable the authorities to consult the potential bidders and negotiate the contract terms with selected companies. The notice should be published in an EU-wide bulletin in order to allow European defence industries to participate in calls for tender in all Member States.*

As the Commission rightly admits, the negotiated procedure *without* prior publication of a contract notice should also be permitted. In addition to the exemptions from publication laid down in existing directives (e.g. Article 31 Directive 2004/18), no prior publication should be required whenever security interests might thereby be affected. The precise criteria determining those cases will have to be thoroughly considered. They may be embedded in a common definition of the concept of

essential security interests referred to at point 7 below.

The selection criteria should be more flexible than those contained in the Directives currently in force. New criteria aimed at security of supply are necessary in order to ensure supply for the entire duration of an arms programme as well as for emergency situations. Security of supply can no longer be seen from a purely national angle but is an interest that may well be common to several Member States or the Union. Safeguard clauses guaranteeing secrecy, reliability and special supply conditions will be required. A gradual elimination of offsets would require detailed discussion. On the whole, procedures and criteria should allow European-wide reliable relations between suppliers and Member States.

The success of the future Directive will also depend on the establishment of a common licensing system simplifying intra-Community trade in military equipment as well as on the creation of common technical specifications and performance requirements.

#### **A common definition of security interests?**

As mentioned, the application of the future Directive would be limited to those cases where either the Member States do not rely on Article 296 or the criteria of the derogation are not met. The concept of “essential security interests” is therefore of crucial importance for the future Directive, but has been defined nowhere in Community law. The Commission does not suggest a definition, and the European Court of Justice has not yet had the opportunity to give precise indications concerning this concept.

In addition, the creation of a European defence procurement market requires harmonisation of the concept of “essential security interests of Member States” in Article 296 EG.

The European Council of 12 December 2003 has provided the Union with a common canon of a European security strategy “a secure Europe in a better world”. Under the authority of the Council, the first common security institution, the European Defence Agency EDA has been put in place<sup>17</sup>. With its responsibilities in the field of defence capabilities, crisis management, acquisition, and armaments cooperation, EDA should be the first authority to apply the common procurement rules.

### **“In addition, the creation of a European defence procurement market requires harmonisation of the concept of “essential security interests of Member States” in Article 296 EG.”**

In view of these advances of the European security and defence policy and the growing importance of an efficient procurement policy the Commission should be encouraged to go a step further than envisaged in the Green Paper and define a common concept of “essential interests of security”<sup>18</sup>. This concept can no longer be limited to purely national security interests but should be broadened so as to include security interests of the European Union. The more the objective of a common security policy is pursued, the more the national security interests referred to in Article 296 EC become interdependent and coincide with those of the Union<sup>19</sup>. The industrial, social and economic interests at stake here justify an energetic approach to harmonisation in this delicate field.

<sup>17</sup> See former Advocate General Siegbert Alber, “Scope and Limits of Article 296 EC”, paper presented on 12 October 2004 on the occasion of a Legal Forum of the Kangaroo Group chaired by the author. Articles 30, 39 (3), 46 (1), 55, 58 (1) and 64 (1) EC refer to public security.

<sup>2</sup> Green Paper Defence Procurement, 19 July 2004, COM(2004)608 (hereunder “Green Paper”) p. 7 et seq.; Gilsdorf/Brandtner in Von der Groeben Schwarze, Article 296 point 2; critically M. Trybus, “The Limits of European Community Competence for Defence”, *European Foreign Affairs Review*, 2004, vol. 9 no. 2 pp. 189-217(29).

<sup>3</sup> Case C-222/84 Johnston [1986] E.C.R. 1651 at para.26. Case C-414/97 Commission v. Spain [1999] E.C.R. I-5585 at para. 22.

<sup>4</sup> See footnote 3.

<sup>5</sup> Case C-67/74 Bonsignore [1975] ECR 297.

<sup>6</sup> See footnote 3.

<sup>7</sup> European Commission (2003), *European Defence – Industrial and Market Issues: Towards an EU Defence Equipment Policy*, COM(2003)113 final.

<sup>8</sup> Council Joint Action 2004/551/CFSP of 12 July 2004, OJ L 245 of 17 July 2004 p. 17.

<sup>9</sup> Directive 2004/18 of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, OJ L 134/114 of 30 April 2004. Prior to transposition, Directives 92/50, 93/36 and 93/37 continue to apply.

<sup>10</sup> List according to Article 296 (2) and (1) b EC, published in reply to a written question in OJ C 364/85 of 20 December 2001.

<sup>11</sup> See M. Trybus, “Procurement for the armed forces: balancing security and the internal market”, *European Law Review* [2002] 27, 703.

<sup>12</sup> OJ L 134/1 of 30 April 2004; Green Paper, p. 11

<sup>13</sup> Green Paper, p. 11.

<sup>14</sup> See footnote 10.

<sup>15</sup> Annexed to the Council Declaration of 5 June 1998 (8675/2/98, CSFP).

<sup>16</sup> Green Paper, p. 12.

<sup>17</sup> See footnote 8.

<sup>18</sup> In that sense, former Advocate General Alber, footnote 1.

<sup>19</sup> See Karl von Wogau, *Verteidigung als Aufgabe europäischer Politik*, in: *Auf dem Wege zur Europäischen Verteidigung*, 2003; as to national vs. European security interests see Harald Möller, *Terrorism, proliferation: a European threat assessment*, EU-Institute for Security Studies, 2003, p. 14 et seq.

# REACH

## must be properly implemented to succeed

► by Nance Dicciani, Ph.D.



**Mrs. Nance Dicciani** is president and chief executive officer of Honeywell Specialty Materials, a strategic business group of Honeywell

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Mrs. Dicciani has spent her entire career in the chemical field, both as an innovator and a manager. Nance Dicciani currently serves on the Executive and International Committees of the American Chemistry Council and was recently elected to their Chair of the Board Research Committee.

Perhaps no science or industry has played a more significant role in the past 200 years in improving the human condition than chemistry and the chemical industry.

Medicines, born from our ever-expanding knowledge of chemical interaction, have given us healthier, longer lives. Chemical science has fuelled the semiconductor revolution, sparking global economic prosperity and scientific advancements in all fields. Indeed, chemistry has time and again earned the title of “enabling science.”

Europe is arguably the birthplace of the chemical revolution and has long been a leader in innovation

in this industry. More than half the recipients of the Nobel Prize for Chemistry have been Europeans since the first award in 1901. Today, chemicals are one of the European Union’s most global, competitive and successful industries.

But Europe has also become the focal point of debate on the regulation of chemicals, sparked by the proposed REACH (Registration, Evaluation and Authorization of Chemicals) regulations under consideration by the EU.

**“REACH will place heavy cost burdens on the chemical industry and downstream users, increase regulatory confusion and stifle innovation in this crucial European industry.”**

Honeywell, like many others in the chemical industry, supports the basic goals of the proposed regulation.

REACH could, if effectively and correctly implemented, deliver human health benefits while at the same time spurring innovation and growth by removing trade barriers, reducing or avoiding unnecessary costs, and streamlining the regulatory landscape.

But in its latest form – naturally the proposal has changed as the debate around it has ensued – REACH will place heavy cost burdens on the chemical industry and downstream users, increase regulatory confusion and stifle innovation in this crucial European industry.

To ensure Europe achieves the best result from this regulation, some key revisions are necessary.

- ◆ **Use a risk-based methodology to prioritize substances for registration and evaluation.** REACH attempts to define a “safe” product as something that has no inherent intrinsic hazard. This is a difficult proposition, given that even common table salt is hazardous under certain conditions. Focusing on hazard alone could mean that products safely used now would disappear or become restricted in use.

Clearly, the intent of REACH is to ensure public and environmental safety, but to accomplish this the regulation must focus on risk rather than hazard. An emphasis on risk allows regulators to assess a chemical’s safety for the use it is intended, thereby allowing them to identify and concentrate on those chemicals and usage levels that pose the greatest risk to health. It is vital

that resources be directed where both severity of effect and chance of impact on human and environmental health are high.

The EU should examine and adopt the best practices and experiences from other countries, such as the Canada and the U.S., where risk-based modeling, based on scientific methodology, is being used today to focus resources on those substances that pose the greatest risk.

I would also note here that the chemical industry is doing its part to ensure that the body of risk-related research continues to grow. The American Chemistry Council, through the Long-Range Research Initiative, has invested more than \$100 million over the past five years to fund independent risk based research in cooperation with government bodies, leading research centers and universities. The industry is also providing safety information on high production volume chemicals to the public under voluntary programs with government and non-government organizations.

♦ **Make full use of existing information.** Hazard information already exists for most substances. Collecting existing information should be the first step in REACH. This information

could then be evaluated to determine if it is sufficient for risk management decisions.

Using existing information would help alleviate some burdensome costs for both the chemical industry and EU authorities and avoid unnecessary animal testing.

♦ **Empower the Chemicals Agency with full responsibility for managing the system.** Spreading responsibilities for various aspects of REACH among

***“Focusing on hazard alone could mean that products safely used now would disappear or become restricted in use”***

the Chemicals Agency, Member States, or other authorities adds unnecessary complexity and cost to the regulatory system.

A central agency with complete authority, including mechanisms for proper oversight and a robust appeals process, will ensure a consistent implementation and interpretation of the regulation. This central regulatory environment reduces uncertainty in the economic environment.

♦ **Protect the chemical industry from unnecessary disclosure.**

Drafts of the regulation have required the disclosure of detailed information about various applications of chemicals to governments, customers, suppliers, and the public. However, the details of those specific applications often are proprietary and competitively sensitive information for companies. REACH should not force companies into disclosures that would undermine competitive advantage. Ensuring the safe use of chemicals need not compromise confidential business information.

In summary, the EU should be commended for its deliberate and measured pace in evaluating the proposed REACH regulation and for providing a forum to hear all sides in the debate over its adoption. The EU should continue this diligence by carefully measuring the effects of each part of the initiative. This will ensure not only that any new regulation provides the protection the EU seeks, but also that EU citizens reap the benefits of ongoing chemical innovation and a strong European Chemical industry.

# The REACH Challenge

► by Edit Herczog MEP



**Mrs. Edit Herczog** is a member of the European Parliament where she is active in the Committees on Internal

Market and Consumer Protection; on Industry, Research and Energy; and on the Committee on Budgetary Control. Mrs. Herczog sits on a mandate from the Hungarian Socialist Party.

Mrs. Herczog has thorough knowledge of the Chemical industry in Managing positions with National Starch and Chemical and as an assistant lector with the University of horticultural and food sciences in Budapest.

The proposed REACH directive is a regulation that, if adopted in its current form, will have great impact on the producers and users of chemicals. The scope of the legislation does not only restricts itself to chemical producers but to all users and consumers of products made of chemicals, that is nearly everything. If introduced, producers, importers, traders and users of all quantities will all have to learn the REACH lesson.

So, in my opinion what are the opportunities and challenges that European legislators need to tackle in order to secure a competitive European chemical industry, while

protecting the environment and the health of consumers?

## **REACH has increased awareness for industry concerns:**

It is a positive outcome that the REACH debate has increased the interest by European legislators for the challenges that is facing the chemical industry. This will hopefully lead to policies that will enforce competitiveness of the industry in the European region. Such growth would grandly help deliver the Lisbon Agenda.

Another consequence of the current focus on REACH is the common acceptance for its underlying goals. The ambition of the Directive is widely agreed upon amongst all players, such as companies, NGOs, institutions and European citizens, which all share the concern that we need to protect human health and environment while promoting competitiveness. Of course, there are differences as regarding the means of achieving these targets, but the debate has the potential of highlighting problems industry will have to face up to once REACH gets implemented.

Additionally, let's not forget that as a continent-scaled project REACH will be nothing less than an European

tool for global chemical policy shaping. Such a strategic European leadership will not only promote the EU to become a global locomotive but will also ensure that European industry takes the lead on world-wide

***“The ambition of the Directive is widely agreed upon amongst all players”***

industry standards. If these are some of the positive aspects of REACH let's now focus on some of the problems related to proposed legislation.

## **Weaknesses:**

If you want to understand some of the challenges facing the chemical industry you only have to look at the billionaires' CVs and year-by-year statistics and you will find out that richness is today is rarely created from chemicals, or even, from the broader production industry. The industry is generally less profitable than other services such as it-or finance industries.

What is significant in the chemical industry is that with its longer and lower return on investments it remains a fairly bad investment compared to other business opportunities. So, any further administrative, bureaucratic, scientific and financial burden on

the industry's shoulders will not improve its strength nor will it help support jobs in the sector. We must therefore be careful to keep REACH at a reasonable level of workability. If REACH becomes unworkable stakeholders will put their assets into more valuable investments.

Another problem occurred by REACH is the costly process of registration of chemicals. This is especially true for smaller companies that are less able to cope with imposed workloads with its limited personal and financial

***“We must therefore  
be careful  
to keep REACH  
at a reasonable  
level of workability”***

resources. If we want European chemical industry to carry on with its diversity, richness and continental spread and if we want make use of the potential of European SME's, we must also allow REACH also to be workable for the smallest companies.

Yet, this is only one of the threats to deal with.

#### **Threats facing industry:**

If we impose too excessive requirements on SMEs they might be forced out of business. If this happens, the market will

be concentrated to a few large companies. With SMEs losing their competitiveness, jobs would

***“Substances and  
products tend to evolve,  
even without  
legislation,  
into new substances  
and products  
with added value”***

certainly be lost, and expectably not just a few ones. The work would still be done, but in third countries under unknown conditions. This shifting of production to low-costs nations with hazardous production methods to, what some would call, conditions of modern slavery is for sure not compatible with our European values and goals.

Loss of innovation is another aspect of REACH that is a concern for industry. The authorisation scheme of REACH aims to enforce substitution of hazardous substances by new innovative and safer ones. But, if resources are dedicated only to fulfilling new administrative requirements for already existing substances, costs risk crowding out investments in research and development. Unless we reduce the administrative costs of REACH, it might inhibit innovation.

One way to make REACH workable would be to attach a support structure to the Agency which could provide helpdesk services to reduce administrative costs for industry.

The last but not the least threat that REACH poses is often mentioned by the chemical industry and downstream users in the debate. This is the fear that legislation will force producers to re-design, re-test and the re-formulate certain substances with increased costs as consequence. This concern is understandable, but must not be over-stressed. Substances and products tend to evolve, even without legislation, into new substances and products with added value and this is the real opportunity of REACH.

#### **The Opportunity of REACH:**

Finally, if we are able to manage this added value it will not only push innovation forward but it will also boost profit. Here lies one of the greatest, if not THE greatest opportunity of REACH: Better awareness by consumers and recognition for industry efforts are key elements to increase industry competitiveness while protecting environment and consumers.

What remains to be done is only to agree on the means of achieving this.

# REACH - threatens jobs

► by Roger Helmer MEP



**Mr. Roger Helmer** was first elected to the European Parliament in 1999 as a Conservative member representing East

Midlands in England. During the course of his long business career he spent a total of twelve years running businesses in East and South East Asia in various leading positions in companies such as Procter & Gamble in Newcastle-upon-Tyne, Readers Digest, National Semiconductor, Coats Viyella and the whisky firm United Distillers.

I recently visited a medium-sized company, Elementis Pigments, in the delightful rural town of Market Harborough in the British East Midlands, the region which I represent in the European Parliament. Elementis are in the chemicals business, and they're worried about the EU's new "REACH" proposal on the testing of chemicals. REACH stands for (wait for it) "Registration, Evaluation, Authorisation and Restriction of Chemicals".

This proposal is being considered by several committees in the European Parliament, including the Environment Committee on which I sit. It has the noblest of objectives. It aims to test a wide range of

chemicals, which could have possible adverse environmental effects, and to control any dangerous ones appropriately.

***"Instead of prioritizing, and focussing on the high-risk areas first, they're aiming to test tens of thousands of chemicals, one at a time"***

I have had rather a lot of letters from concerned voters, about (for example) the fact that chemicals called "endocrine disrupters" have been found in human breast milk. Green campaigners are calling for tighter controls. The British "Women's Institute", famous for its commitment to marmalade and Middle England, and immortalized in the film "Calendar Girls", has undertaken a letter-writing campaign to parliamentarians to promote the legislation.

No-one, surely, will disagree with the objective, or with protecting the public and the environment from dangerous chemicals. But the objective is not the problem. It's the way they're proposing to go about it. Instead of prioritizing, and focussing on the high-risk areas

first, they're aiming to test tens of thousands of chemicals, one at a time. It could take more than a decade. It will cost a fortune. And some dangerous chemicals might not be tested for years.

Worse yet, it imposes an obligation on businesses to prove the absence of risk, which as any philosopher will tell you is spectacularly difficult, and in many cases will prove spectacularly expensive.

Elementis Pigments offers a good example. The Market Harborough plant supplies colouring materials to the building trade, for mixing with cement to make coloured tiles

***"Chemicals industry, spokesmen are predicting job cuts, bankruptcies and the loss of useful low-volume chemical products which are harmless, but cannot support the costs of testing"***

or patio paving stones. And their main ingredient is iron oxide, or (to use a four-letter word!), RUST.

Now rust has been around, in close contact with people, since at least



the start of the Iron Age about 3000 years ago. It is well known. Its chemical properties are in school text-books. It's safe. And in any case, it will be locked into concrete

***“As it stands,  
sixty million  
rats and rabbits  
could be subjected,  
at enormous expense,  
to pointless  
experiments”***

tiles and paving stones where it can do no harm.

You could probably eat a rust sandwich without doing yourself a great deal of harm. It might even cure anaemia. Yet the EU wants Elementis to spend a million euros on testing it.

Elementis has a further three operating companies – Chromium, Specialty Chemicals and Specialty Rubber -- and across the whole of Elementis' business, the costs of testing under this new directive will amount to about a year's profit. That's money that could have gone in wages or investment or research.

Across the chemicals industry, spokesmen are predicting job cuts, bankruptcies and the loss

of useful low-volume chemical products which are harmless, but cannot support the costs of testing. And just to prove that the lunatics are running the asylum, the controls on chemicals will not apply to imports. So a Taiwanese manufacturer (say) could produce a refrigerator using a chemical that would be illegal in the EU -- and export the fridge to any EU country! Like so many EU directives before it, this one will directly result in the export of manufacturing and jobs to third countries outside the EU.

It gets worse. For most of the chemicals involved, animal tests will be required. As it stands, sixty million rats and rabbits could be subjected, at enormous expense, to pointless experiments. In fact I have had as many letters from animal welfare campaigners, horrified by the threatened holocaust of laboratory animals, as I have had from environmentalists. This is the first time in my experience when animal rights lobbyists have joined forces with industry lobbyists to oppose an EU proposal.

So what is the alternative? The UK's Royal Commission on the Environment has set out a vastly preferable alternative. Four points

emerge. First, we should prioritize by risk, not sales volume, and test chemicals with known risks first. Second, we can use the fact that families of chemicals have similar properties to speed the work and limit the testing. Third, we can use work already done elsewhere - in the US or Japan, for example - rather than re-inventing the wheel.

And fourthly, we can use 21st-century computer modelling techniques to predict chemical properties and risk factors, rather than relying excessively on 19th-century animal testing methods.

The industry, the Royal Commission, and many MEPs have been pressing the European Commission to adopt a more sensible approach. It has made some changes to its proposal,

***“We should  
prioritize by risk,  
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risks first”***

but nothing like enough. We shall keep bashing away, and we'll try to get a result that protects the environment without damaging jobs and prosperity.

# REACH:

## Does it Really Exist in America, and Will it Really Work in Europe?

► by Robert D. McArver



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*Manufacturers' Association, located in Washington DC) where he leads government relations efforts, including both legislative and regulatory initiatives to benefit and protect the batch and custom chemical industry.*

*Mr. McArver is the primary liaison to U.S. Congress and coordinates SOCMA efforts on environmental, health, safety and security priorities.*

The debate over the REACH chemicals directive being considered by the European Union provides an opportunity for the global community to revisit chemicals management policies. Is REACH workable? Toward that end, claims of varying specificity have been made that a REACH-like law already exists, without problem, in the United States. This is not remotely true.

A fundamental component of the REACH debate is whether it represents a workable approach to managing chemicals in commerce. Nothing like the REACH approach has been tried anywhere, notwithstanding direct and indirect claims made by REACH's workability and claims. One oft-cited example is the Toxic Use Reduction Act

(TURA) in the state of Massachusetts.<sup>1</sup> While TURA may have REACH-like impacts (i.e., manufacturers leaving Massachusetts), in substance it bears little resemblance to the system proposed in Europe. Before moving forward with the REACH proposal, Europe should consider its potential impact on the European economy and on international trade.

### Level playing field

The Commerce Clause of the U.S. Constitution prohibits states from developing regulatory schemes that could disrupt interstate commerce. This prohibition bars Massachusetts or any other state from implementing chemicals management regulations markedly different from those of the federal government. Standardizing chemicals management across the states allows for the free flow of commerce and levels the playing field in the national marketplace. Impeding production in a global market, on the other hand, does not.

That is to say, Massachusetts is not legally capable of imposing a REACH-like law. Unlike the U.S.'s Toxic Substances Control Act (TSCA) or even REACH, TURA is not a chemicals management policy. Instead, the law requires companies using certain chemicals above threshold quantities to report on uses and waste generation

and then evaluate and consider alternative chemicals, to encourage companies to reduce the use of toxic chemicals. This represents only one element of chemicals management. Taken at face value, this may sound like a reasonable approach. In practice, however, the requirements have proved burdensome and have only resulted in moderate net reductions of toxic chemical use similar to those achieved in states that rely on voluntary approaches and on partnerships between states and industry. The modest reductions in Massachusetts were remarkably similar to that in other states, but at far greater cost and even costly business relocation. In fact, reductions may be more attributable to companies leaving the state than to actual toxic use reduction in manufacturing processes.

The experimental TURA and other stringent measures in Massachusetts have combined to create a hostile regulatory environment, resulting in the construction of few new manufacturing facilities and an exodus of existing operations. The only substantive way that TURA resembles REACH, one could argue, is that both create hostile regulatory environments that erect barriers to market entry and make it more likely for existing players to leave. It is telling that in the fifteen years since TURA was signed into law no

other state has chosen to follow the Massachusetts example.

### REACH in America?

Despite its limited scope and the narrow stage on which TURA has played out, TURA is cited as an example of how REACH is already being implemented in the U.S. This is clearly a misinterpretation or misportrayal of the facts. This distortion is made worse by the suggestion that

**“TURA is not REACH, nor is it even close.”**

TURA is achieving toxic use reduction without imposing the costs that many predict REACH will incur.

Rather than mandating extensive and costly testing and risk assessments as REACH does, the Massachusetts law merely establishes limited reporting requirements. TURA's use reporting and direction to covered entities to consider ways to reduce their use of toxic substances does not compare with REACH' a proposed which mandates testing without regard to exposure and use data. TURA by contrast has no testing requirement and requires no exposure data. In addition, REACH applies both to European manufacturers and to importers, whereas TURA applies only to those using chemicals in their processes within Massachusetts. Finished articles are not covered by TURA like they are in REACH.

The obligations that would be imposed on manufacturers by REACH do not resemble, and in fact far exceed those of Massachusetts to which REACH is analogized. To suggest otherwise is simply wrong.

Staunch advocates of TURA (and of REACH) at the University of Massachusetts at Lowell explain the law as follows:

*“Passed in 1989, the Massachusetts Toxics Use Reduction Act encourages firms to identify ways to reduce their reliance on listed toxic substances rather than calculate acceptable emissions levels. Manufacturing firms using more than 10,000 pounds per year of toxic substances are required to annually calculate their toxic materials use and waste generation. They must then develop plans and thoroughly examine options to reduce their waste and use of toxic substances and measure progress. Summaries of these plans and materials accounting data are publicly available. Fees on chemicals use funds the regulatory program as well as voluntary technical assistance to industry, and a research and training program that assists firms and communities in seeking safer chemicals, processes, and products.*

*The success of the Act makes it an impressive model... The toxics use reduction program, however, only applies to manufacturing firms in Massachusetts and has thus not included chemicals in products produced outside of the state...”<sup>2</sup>*

**“The REACH proposal and discussions leading up to it go far beyond any comparable U.S. initiative, which has resulted in a reluctance of some government and industry officials to support its adoption in this country.”**

Clearly, even TURA proponents do not suggest that it represents a significant evolution in chemicals management or that it serves as a model that other states are likely to follow. Even more to the point, they do not suggest that

TURA can be equated to REACH. Supporters and opponents of TURA can argue over whether it has been successful in pursuing its modest objectives, but even this assessment by REACH/TURA supporters critically notes that “the REACH proposal and discussions leading up to it go far beyond any comparable U.S. initiative, which has resulted in a reluctance of some government and industry officials to support its adoption in this country.”<sup>3</sup>

Where TURA is a relatively modest effort by a state with a limited manufacturing base and a history of burdensome regulations, REACH is a massive undertaking across national borders that could cripple a critical component of the European economy. As a more burdensome proposal than any existing regulatory structure and could result in severe economic consequences and the loss of thousands of jobs.

American producers recognize that Europe desires a harmonized chemicals management policy and what emerges will likely be called REACH. The EU needs to remember, however, that as with TURA in Massachusetts there will be unintended economic consequences when introducing an untested, far-reaching regulatory concept. Europe should proceed cautiously before introducing a policy that significantly differs from systems that have been shown to work elsewhere.

### The Nordic Report and MEPs' Mistaken Impression

According to published documents, one source of confusion on the question of whether there is an American equivalent of REACH is

"The True Costs of REACH," a report prepared for the Nordic Council of Ministers (The True Costs of REACH, <http://www.norden.org/pub/miljo/miljo/sk/TN2004557temp.pdf>). This document, which is referred to as "the Nordic Report," was written by Frank Ackerman and Rachel Massey with the Global Development and Environmental Institute at Tufts University in Boston, Massachusetts. The Nordic Report is privately cited by influential staff within the European Parliament as having persuaded relevant MEPs on the presumably pro-competitiveness EPP side that REACH is in place in the States and working fine.

In fairness, the Nordic Report does not make such a demonstrably untrue claim. It does, however, fail to directly acknowledge the largely voluntary nature of the Massachusetts law. It also fails to note that TURA, unlike REACH, does not abandon traditional risk assessment in favor of the zero-risk "precautionary principle." In the context of analyzing REACH's impact, to reference TURA but omit such clarification of the differences between the two programs allows for significant misunderstanding. This omission has contributed significantly to the perception in Brussels that REACH exists and is working in America.

The relevant passage on TURA in the Nordic Report consists of an offhand comparison of disclosure requirements between the Massachusetts law and REACH. An accompanying footnote cites the law's mandatory use and waste reporting requirements (at much higher thresholds than REACH) and the voluntary reduction and substitution elements. There is no explanation that neither Massachusetts nor any other

state or the federal government enacts the hallmark of REACH-abandonment of risk-based science through the precautionary principle.

On its face, it is not clear how the limited reference to TURA and the offending footnote can be read to imply that a REACH-like regime "REACH-plus" is already in place in the U.S.

Consider the references to the Massachusetts law. The Nordic Report asserts that "[fears of such disclosures [of confidential business information] may be exaggerated in general [in addition to being "based on a misreading of the [REACH] regulations"]. In the United States, the state of Massachusetts has a Toxics Use Reduction Act, in effect for more than 10 years, that requires disclosure of more information about industry's chemical use than REACH. N. 34".<sup>4</sup> Given that registration dossiers required under REACH must include relevant information and data on all identified uses, suggesting the limited obligations under TURA are more comprehensive is a stretch.

The accompanying footnote makes no claim that TURA resembles REACH's objectionable provisions, and does make clear that the law is primarily a reporting vehicle recommending consideration of ways to achieve toxic use reduction.

*"Under the Toxics Use Reduction Act (TURA), Massachusetts firms that use more than a certain amount of specified toxic chemicals must (a) examine their toxics use and evaluate alternatives, and (b) report the quantities of toxic chemicals used or generated...Companies' data on toxic chemical use and generation are open to the public, with exceptions*

*for companies that file a special confidentiality request."*

An unbiased reading of this section of the Nordic Report should find that after suggesting that the TURA reporting requirements are greater than those proposed in REACH, it then corrects itself in a footnote. It is not reasonable to interpret this as evidence that a workable REACH (let alone ("REACH-plus") exists in the U.S.

In furtherance of this internal contradiction, the report then asserts that "a state agency uses the information [generated by TURA] to help small and medium-sized enterprises develop plans for reducing their use of toxic chemicals, a program that has won wide acceptance and praise in the business community."<sup>5</sup> Well, yes and no.

If the report is suggesting that the agency has been effective in helping SMEs reduce their use of toxic chemicals and been praised for that, this is reasonably accurate. If, however, it is suggesting as a result the law itself has been accepted and praised by the business community, then this statement is demonstrably wrong. In fact, other than those found in the anti-chemical activist community, TURA has few admirers. The benefits that companies have realized as a result of the law are almost always offset by the real-world costs.

In sum, TURA includes no specific obligations to reduce use, and its burdens are in no way comparable to those proposed under REACH. The most troubling elements of REACH-costly testing triggered by volume levels rather than use and exposure data, and shifting of the burden of persuasion while also requiring companies to prove a

negative-are not part of TURA. TURA's direction that covered entities examine options to reduce waste bears little resemblance to the mandatory testing and authorization requirements that REACH would impose. Any suggestion that TURA's use reporting requirement is stronger than that of REACH is not defensible, and any suggestion that TURA is REACH-plus is absurd.

### Real Trade Impacts

REACH proponents insist it will have no impact on trade, but when pressed they typically fall back on the claim that the U.S. will ultimately be forced to go along with REACH on its own and therefore there will be no trade impacts. Not only does this assertion completely dodge any substantive analysis, but it effectively makes the case it intends to rebut. If not because of the significant and adverse impacts on commerce, what would force the U.S. to follow the European example that it already rejects?

Compared with the Massachusetts law, the trade impacts of REACH will be vastly more significant. If a single U.S. state's modest reporting law has adversely impacted the economy of that state, when producers can relatively easily move across the state line, imagine what a vastly more onerous, continent-wide scheme could do to the European economy.

If REACH was imposed in a protected system at a "steady state," its impact might be limited since all of the costs would simply be transferred downstream. This is not the case in the chemical industry. The price of a chemical product tends to be similar world wide. If the costs in a particular region get out of line, the market adapts and other regions simply

ship the same material or finished articles into the high cost area.

If REACH is adopted as proposed, the EU will surely face an immediate loss of significant basic production. These losses will then spread upstream, as upgraded articles are supplied into Europe and they lose the ability to amortize these costs over a large production base. None of this is in the best interest of other western producers. The primary beneficiaries will be in low cost production areas, primarily in the Far East.

### ***"Sudden, wide-scale change in chemicals management is a dangerous regulatory experiment."***

The requirements on reporting outlined in REACH means that it will be very difficult for non-EU based companies to understand these new requirements. This fact alone is a barrier to trade, especially for small and medium sized companies. Many suppliers of fine chemicals do not know the actual use of many of the materials they sell. If REACH requires that this information be disclosed, purchasers may limit the number of suppliers they use to better protect intellectual property rights.

Fine chemical production is already leaving the EU for the Far East, especially India and China. REACH will accelerate this process. All of the major companies are expending a great deal of new capital to build facilities in this emerging region, especially for research and development. Given that trade follows capital, this does not bode well for American or European manufacturers. Adding the REACH requirements on top of current

pressures could be a fatal blow to the chemical industry in Europe, which would have a significant impact on the overall European economy.

### A Better Path Forward

While it is clear that the Massachusetts Toxic Use Reduction Act is in no way REACH-plus, the larger and more important question is whether REACH as currently constructed is the right way for Europe to revise its chemicals management policy. Rather than leap into the unknown with a sweeping and questionable regulatory experiment, Europeans will be better served if the EU first establishes centralized management and decision-making for chemicals through a single entity. From that point, the central chemicals bureau can consider changes to existing directives in a step-wise fashion, allowing for more careful evaluation of costs and benefits after each stage of implementation.

Sudden, wide-scale change in chemicals management is a dangerous regulatory experiment. The ultimate question is whether the EU would prefer to risk the economic well-being of the European chemical industry and the economy it supports or take a more deliberate and balanced approach to revising its chemicals management policy.

<sup>1</sup> *Massachusetts Toxics Use Reduction Act (TURA)*, MASS. GEN. L. ch. 211 Sec. 2 (1989): <http://www.environmentalleague.org/Issues/Toxics/TURA.html>

<sup>2</sup> *Integrated Chemicals Policy*, Lowell Center for Sustainable Production, p. 13 <http://chemicalspolicy.org/downloads/ChemPolicyBrochure.pdf>

<sup>3</sup> *Id.*, p. 15

<sup>4</sup> *Nordic Report*, p. 48

<sup>5</sup> *Id.*

# Is Europe becoming the World's Playground?

► by Stefan Lorentzson



**Mr. Stefan**

**Lorentzson** is the Vice President of AB Volvo and Head of Volvo Group Representation, EU, based in Brussels.

He has held previous positions within Volvo Bus, Volvobil (market company), Volvo Trucks, Volvo Global Trucks (incorporating the Volvo, Renault and Mack truck brands), the AB Volvo head office and at the Swedish Enterprise Confederation. Mr. Lorentzson is a Board member of Renault Trucks Legal Board, the SNS (Centre of Business & Policy Studies) Board and The French Chamber of Commerce.

As the EU approaches the "Mid term Review" of the Lisbon agenda, namely the ambitious objective set in March 2000, "to become the most competitive and dynamic knowledge-based economy in the world by 2010". We must ask ourselves, how exactly does the EU plan to become more competitive than the economic powerhouses like the United States and the fast developing economies in Asia?

Whilst the emergence of a common and bigger market has raised new opportunities for industry, the conditions in which it operates have also become more stringent, making Europe a less attractive place to invest and do business. Despite promises

made, improved conditions for business competitiveness - the path to higher growth and more and better jobs – are simply not being delivered.

*The automotive industry is a case to bear in mind, in recent years we have experienced more and more competitive pressure, from the United States and Asia. Ensuring a competitive European automotive industry, and any other sector for that matter, must involve better regulation, leadership, focused R&D spending and a balanced approach to sustainable development.*

Better regulation is the cornerstone of a competitive Europe. There is no point in creating a single European market when the basic regulatory framework is either not workable or just not adhered to. In Europe today, we are caught in a vicious circle, on the one hand, there are too many regulations, on the other there is a lack of pan-European or even global regulation. Smart regulation needs to be developed which doesn't contradict existing legislation. Both new and old should be subject to strict scrutiny regarding cost effectiveness, simplification, clarity and transparency. Existing global standards should also be factored into the consultation process at an early stage.

Why not look at the Nordic example? In Denmark, Sweden and Finland, there is plenty of regulation and yet these countries are ranking highest in terms of implementing EU regulation. At the same time, these markets are among the most competitive in Europe. The difference is that it is smart regulation, applied with effective governance. The initiative of the successive EU Presidencies: Ireland, Netherlands, Luxembourg and the UK, to launch a regulatory reform process, appears to be a step in the right direction.

Increased R&D expenditure is also vital to innovation. Right now, Europe lies at the bottom of the heap. The number of researchers in the EU accounts for only 5.7 per 1,000 of the workforce, while the corresponding figures are 8.1 for the US and 9.1 for Japan. 40% of all EU researchers choose to carry out research in US institutions and companies rather than in the EU. There must be more focus on investment in human capital and measures to curtail this brain drain. However it has never been easy to marry academic research with business needs. I hope the new Commissioner Janez Potocnik who is expected to receive a doubled research budget of Euro 10 billion for 2007-2013, will focus on initiatives aimed at boosting industry and in-house research.

When it comes to sustainable development we need global solutions. Consensus and implementation of global standards proposed at multilateral level would speed up the necessary measures to secure a safe environment for future generations. The automotive industry is a good case in point. As environment legislation stands now, we are obliged to manufacture several types of engines, partially defeating the purpose of reducing environmental impact. We look forward to achieving globally harmonized test methods and emission standards, as well as a global breakthrough on low-sulphur fuels. In my view, sustainable development is a trade off between staying profitable and competitive without restricting opportunities for future generations.

We also need to be more realistic about the contribution transport plays to overall European growth. Existing political initiatives, which promote the de-coupling of transport and growth and favoring

**“Sustainable development is a trade off between staying profitable and competitive without restricting opportunities for future generations.”**

alternative modes of transport, are just pie in the sky thinking. We are facing an increase in transport demand by up to 50% in 2010. Without efficient transport, the

European Union and especially the new members will be curtailed from establishing a growth economy.

We need leadership and direction from the highest level. We need to cut out the rhetoric and get moving on concrete actions. We are already late, political will and execution are the key triggers at EU and national level. It is heartening, that the new Commission President Mr Barroso, will personally Chair the Group of Commissioners on the Lisbon Strategy. But if the EU is to become the most competitive, knowledge based economy by 2010, it is vital that all the respective high level groups take realistic decisions to tackle the barriers constraining European business.



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