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PART III

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN COUNCIL

Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)

Companion document

TABLE OF CONTENTS

INTRODUCTION

In March 2005, the Lisbon strategy was re-launched placing growth and jobs at the top of European political priorities. This focus stemmed from the recognition that economic growth in Europe had been disappointing relative to the most dynamic economies in the world, and that the Union faced major challenges in coping with globalisation and ageing populations. Euro area countries faced the additional challenge of improving the capacity of their economies to adjust to economic shocks in the absence of national monetary or exchange rate policies.

The re-launched Lisbon strategy provides a comprehensive framework for reform efforts to raise growth and jobs potential, encompassing measures which promote macroeconomic stability, increase labour utilisation and enhance labour productivity: The Lisbon strategy places considerable emphasis innovation and promoting a knowledge-based economy, through policies which enhance market entry and flexibility, plus higher investment in education, training and R&D.

The end of the revised strategy's first-three year cycle is an appropriate moment to draw some conclusions about how well it is succeeding. Europe's economic situation has improved considerably since the Lisbon Strategy was re-launched in 2005, although recent months have witnessed growing downside risks. Average annual real GDP growth since 2005 has been 2.6%. Growth has been increasingly driven by domestic demand, leaving Europe better placed to cope with adverse external shocks. Budget deficits have been reduced from 2.5% of GDP in 2005 to a forecasted 1.1% in 2007, whilst public debt has declined from 62.7% in 2005 to just below 60% in 2007. Almost 6.5 million extra jobs have been created in EU27 in the last two years, with 5 million more projected to be created by 2009. Unemployment is expected to fall below 7%, the lowest level since the mid-80s. For the first time in a decade, robust employment increases have gone hand in hand with robust productivity growth. In some Member States, improving growth conditions have been accompanied by a gradual build-up of imbalances with signs of overheating, as witnessed by large current account deficits, a loss of competitiveness, increasing household indebtedness and rapidly increasing house prices.

The business environment has benefited from a series of structural reforms. The EU's better regulation agenda is gradually being put into place, although many Member States still need to implement the necessary instruments, including impact assessments and methods to measure and reduce administrative burdens. It is now much easier and cheaper to start a business in almost all Member States. Europe, as a whole, however does not yet have a dynamic, entrepreneurial culture. Too often, efforts to improve the business environment are made in a piecemeal way as opposed to being part of an integrated approach geared towards the growth of SMEs. Whilst Member States have set targets committing themselves to significantly increasing R&D investments which would help the EU approach its 3% of GDP target by 2010, the evidence does not yet reflect this ambition. The EU has made the first steps towards transforming itself into a low carbon society. There is progress in meeting the overall EU Kyoto target and at the Spring 2007 European Council the EU committed itself to ambitious targets for greenhouse gas reduction and increasing the share of renewable energies by 2020.

In some countries, unfortunately, reform seems to be slowing down. However, it is imperative that reforms continue. Most Member States still lag behind leading economies, for example in labour utilisation and labour productivity, and the challenges of globalisation and population ageing will continue into the next decades. Moreover, structural reforms will not only help enhance growth and jobs potential over the medium-run, they also play an essential role helping economies adjust and cope with the shocks and pressures that sparked the recent financial turmoil and heightened economic uncertainty.

A crucial question on the threshold of a new three-year Lisbon cycle is what part structural reforms played in the improved economic performance. Commission analysis has found evidence of structural improvement in the functioning of labour markets. In particular, sustained increases in the employment rates of women and older workers seem partially due to previously enacted policy reforms. The trend decline in productivity growth that entrenched itself in the early 1990s seems to have halted in recent years; since mid-2005, labour productivity growth has accelerated.

This Companion Document accompanies the Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new three-year-cycle. It aims at providing further detail on the underlying rationale for carrying out coordinated policy reforms. It also takes stock of the main developments in policy reform since the re-launch of the Lisbon strategy in 2005.

The paper is divided in five sections. The first, second, and third sections take stock of the main progress, in terms of policy reforms, in the macroeconomic, microeconomic and employment pillars of the Lisbon strategy. The fourth section outlines the Commission's methodology in assessing structural reforms and the Implementation Reports. The fifth provides a mid-term evaluation of the European Growth Initiative.

I. MACRO-ECONOMIC PART

Summary and conclusions

Overall, over the period 2005-2007, there has been some progress with macro economic reforms, although the pace has slowed in the last 12 months.

Consolidation of public finances has advanced, though it remains a challenge in several Member States. The nominal EU27 budget deficit was 2.5 % of GDP in 2005 and it is forecast to drop to 1.1 % in 2007. This mainly reflects reduced government expenditures (as a share of GDP), although revenues (as a share of GDP) have increased. At the start of 2006, twelve countries were in excessive deficit, but only six by end-2007. However, fiscal adjustment seems to have slowed somewhat in the last year; the opportunity to use relatively strong growth conditions to reduce structural deficits by the 0.5% of GDP benchmark in the Stability and Growth Pact (applicable to euro area and ERM II countries) has not been fully taken in all Member States. Indeed, most countries still have some way to go to achieve medium-term budgetary positions that would allow the budget to fully play its stabilising role.

Stability-oriented policies have made some positive contributions. Headline inflation in the EU27 has hovered just above 2% over the last 3 years and is expected to remain at this level. However, in some Member States, improving economic growth has been coupled with a gradual build-up of imbalances with large current account deficits and signs of overheating: poor competitiveness developments, increasing household indebtedness and rising house prices. There is therefore a strong case for macro-economic policies to restrain demand in several Member States as well as further reforms to improve adjustment capacity to shocks and the functioning of the supply side of the economy.

The significant challenge in most countries of keeping intact the long-term sustainability of public finances and the urgency takeoff taking additional measures has increased. At the same time, better budgetary positions and several important pension and health care reforms in some countries have improved the situation in the last few years. The EU27 debt/GDP ratio has declined, from 63 % of GDP in 2005 to just below 60 % in 2007. Pressing ahead with ambitious reform plans and avoiding damaging policy reversals is important.

A primary EU policy objective is to bring more of the working age population into work. Policies need to support wages developing in line with productivity so as to achieve high employment and contain inflation. In the aggregate, wage moderation has continued to support price stability over the period 2005-2007, including the last 12 months, despite a tightening labour market and the closing of output gaps. However, the situation varies across countries. Within countries, across sectors and regions only partial progress has been made to make wage dispersion reflect productivity differentials.

It is important to continue with policies that improve incentives to become employed. Several Member States have indeed taken measures to improve incentives to work, from reforms in the benefit system (both levels of benefits and availability criteria) to labour taxation. However, less has been done to relax employment protection legislation. While many countries have taken measures that go in the right direction, the overall impact is relatively limited in many cases and thus there is a need to further pursue such strategies along the principles of flexicurity. A challenge is how to lower labour taxes without endangering fiscal consolidation.

This part of the annex focuses on the Integrated Guidelines package that addresses policies to ensure a stable and sustainable macroeconomic environment. A first section takes a closer look at economic developments during the three years of the 1st Lisbon cycle (2005 to 2008). It examines whether the economic upturn is cyclical (transitory) or structural (potentially due to the positive impact of past structural reforms) in nature. It also considers the reform agenda facing the EU for the next three year cycle (2008-2010) in the face of challenges resulting from globalisation and ageing populations, as well as the urgent need to address climate change. A second part of the annex reviews progress with structural reforms in several key macroeconomic domains, with a particular emphasis placed on reform efforts over the past year.

1. ECONOMIC PERFORMANCE DURING THE 1ST LISBON CYCLE (2005-07) AND PROSPECTS FOR THE 2ND CYCLE (2008-10)

Economic performance has improved since 2005

Economic performances have improved considerably since the re-launch of the Lisbon Strategy in 2005. Economic growth was 3.0% in the EU27 in 2006 compared with 1.8% in 2005, and is forecast to remain at 2.9% and 2.4% in 2007 and 2008. Thirteen million jobs have been created since 2000, and more than half of that after 2005, and unemployment has fallen steeply from 8.6% to 6.9% over the 2005-2007 period. An especially welcome development is that for the first time since 1997, job creation and productivity improvements have occurred simultaneously[1]. As a result of the improved growth performance, the Commission estimates the output gap is merely -0.1 p.p. % in 2007 compared with 1 p.p. negative gap in 2005. Moreover, the gap in GDP per capita with the US has closed slightly, from 65.4% of the US-level for EU-27 and 72.1% in the euro area in 2005 to 67.1% and 73.5% respectively in 2007. Although it is difficult to disentangle the impact of cyclical and structural factors on growth, it is an encouraging sign that the Commission's calculations suggest that potential GDP growth, i.e. net of cyclical factors, has improved from 2.3% in 2005 to 2.5% in 2007 for the EU-27, and from 2.0 to 2.2% for the euro area. The three Baltic states, Slovakia, Slovenia and the Czech Republic have experienced an especially rapid convergence. The recovery has also spread to EU15 countries, most remarkably to Germany, which seems to have overcome its role as growth laggard in the EU.

In addition to higher growth rates, the composition of growth has become more favourable to domestic drivers over time, which bodes well for increased resilience to adverse external factors. As shown in Table 1, the contribution to growth of fixed capital investment had been particularly weak in the first half of the decade. Since 2005, it has strengthened, returning to growth rates comparable to the ones observed in the late 1990s which raise hopes that firms' higher investment, through the diffusion of technological progress, translates into higher productivity growth. Though private consumption contributed less to growth in 2005-2007 than in the late 1990s, an upward shift in the contribution of private consumption spending is now clearly evident from the data on consumer expenditures as well as from the recovery in consumer confidence underpinned by the declining rates of unemployment. Moreover, as can be seen from a more detailed breakdown of the growth performance (Graph 1) productivity gains accounted for more than half of the average economic growth recorded in EU27 2005-2007, with labour inputs accounting for the remaining part. Labour inputs benefited from net migration, and to a lower extent an increasing native population, while the rise in participation rates, especially of women and older workers, was partly offset by the decline in average hours worked per person employed and the decline in youth participation. As regards

[1] A recent Commission publication entitled Moving Europe's productivity frontier reviews different explanations of the trade-off between productivity and employment growth and provides an empirical assessment of the size of this trade-off and of how it has been changing over time, see the EU Economy 2007 Review: http://ec.europa.eu/economy_finance/publications/european_economy/2007/the_eu_economy_review2007_en.htm

labour productivity, technical progress appears to have been a stronger driving force than capital accumulation and rise of labour initial education. Compared to the 2000-2004 period a key difference is the positive contribution to growth from the reduction in unemployment rates, which should be partly attributed to the cyclical recovery.

Due to sound economic fundaments, most Member States are in a good position to withstand the strains from the financial turbulence witnessed in summer 2007. According to the autumn 2007 forecast of the European Commission[2], growth in the EU-27 is predicted to be 2.9% in 2007 and 2.4% in 2008. For a few Member States (LV, LT, EE), however, accumulated macroeconomic imbalances such as high inflation, large current account deficits and excess housing price increases bear important risks in the current juncture. Also in BG and RO, external deficits are large and inflation high. In other countries such as EL, ES and PT deteriorating economic growth is likely to jeopardise the sustainability of competitiveness, foreign debt or households' indebtedness. Such countries need to closely survey financial stability and, in case of a further widening of the external deficit, vigorous structural reforms to restore cost competitiveness.

Table 1. Economic developments 2000-2009, key figures, EU27

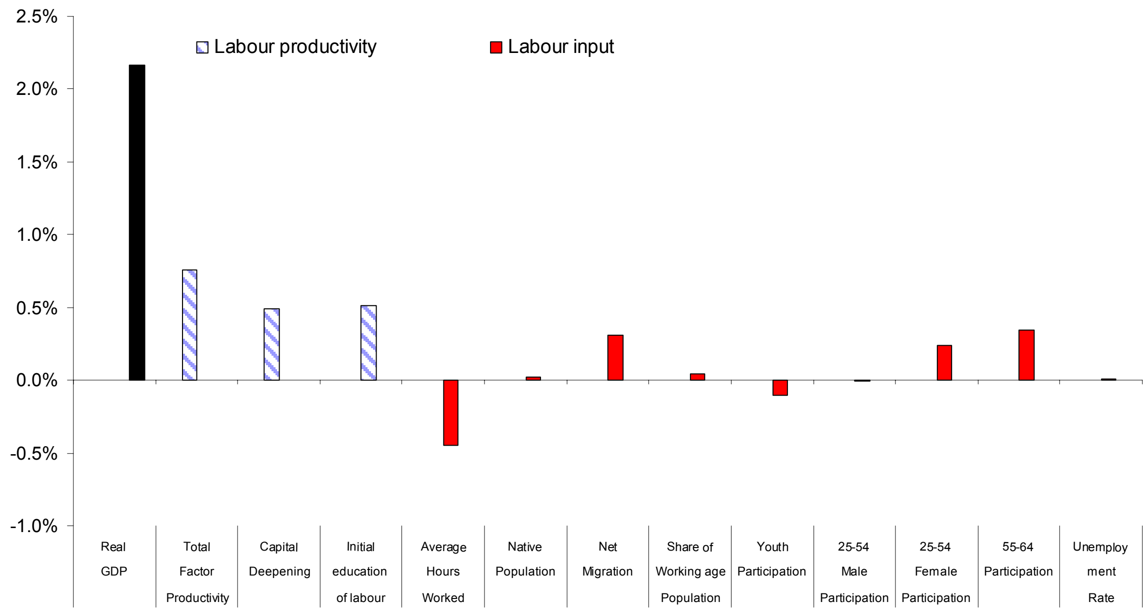
	2000-04	**2005-2007**	**2007**	**2008-09**
GDP growth	2.2	2.6	2.9	2.4
Consumption growth	2.2	2.0	2.2	2.2
Investment growth	1.6	4.8	5.6	3.4
Employment growth	0.9	1.4	1.6	1.0
Unemployment rate (% labour force)	8.8	8.1	7.1	6.7
Inflation rate	2.7	2.3	2.3	2.3
Government balance (% of GDP)	-1.8	-1.7	-1.1	-1.1
Government debt (% of GDP)	61.5	61.4	59.7	57.8
Current Account (% of GDP)	0.0	-0.6	-0.8	-0.9

Source: Commission Autumn Forecast

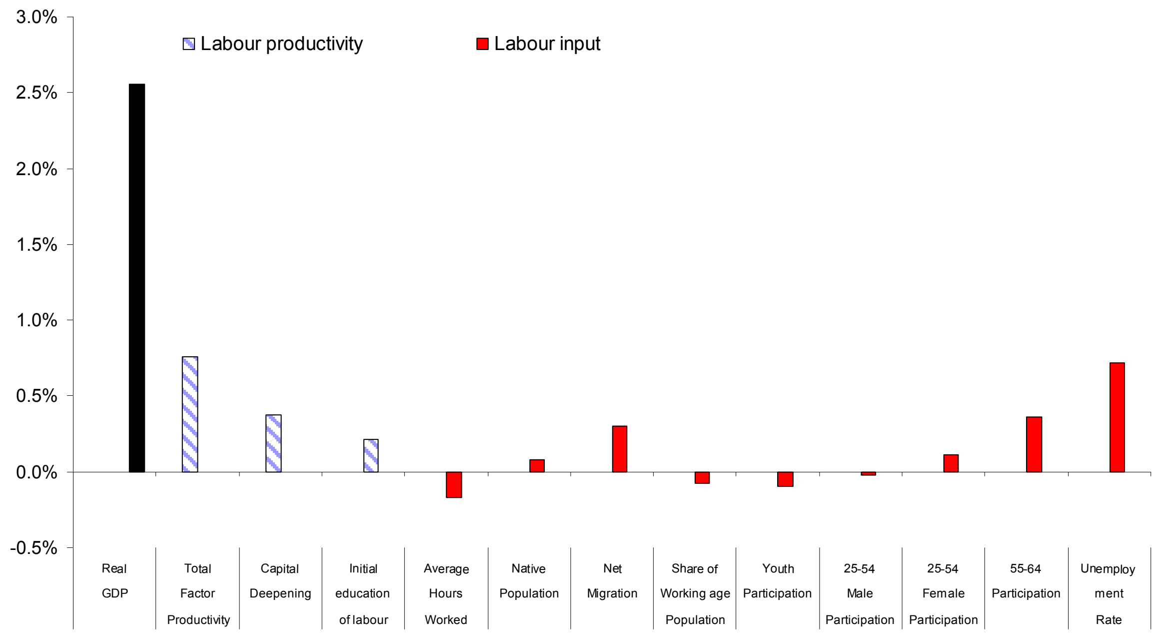
2 See the 2007 Autumn Economic Forecast of the European Commission, http://ec.europa.eu/economy_finance/publications/european_economy/forecasts_en.htm

Graph 1. Real GDP growth and its components in EU27, 2000-2004 and 2005-2007

EU-27 , 2000-2004



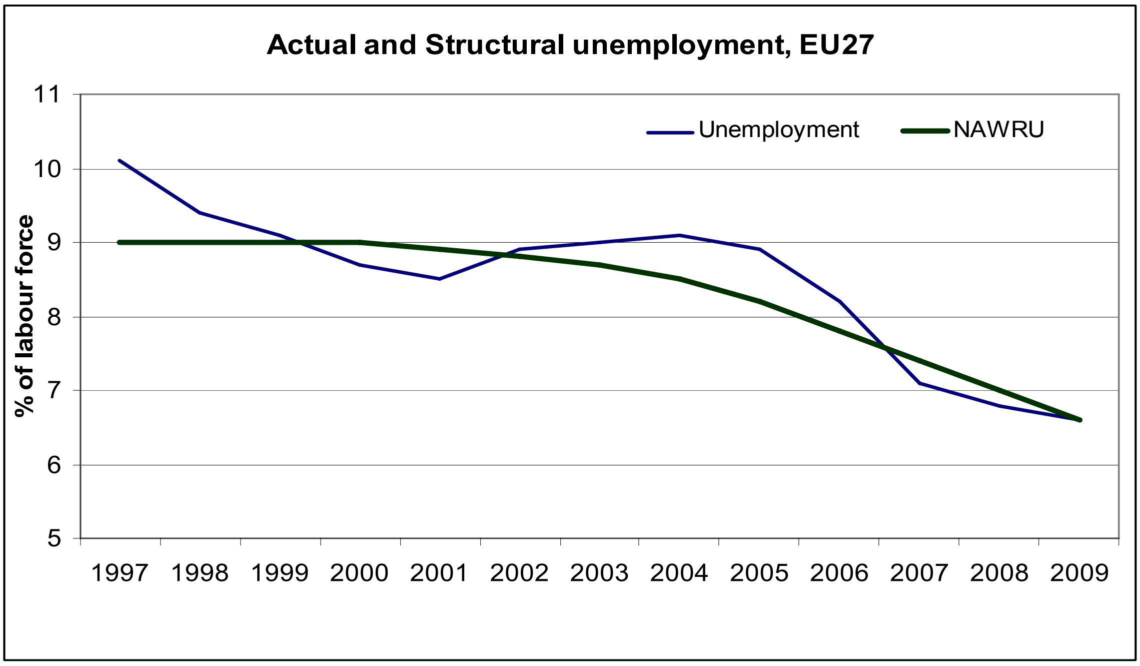
EU-27 , 2005-2007



Are past reforms starting to pay dividends?

One of most important questions as the EU enters a new three-year Lisbon cycle is whether the improved economic performance is in part due to the effects of structural reforms. Establishing a causal link between the progresses made in the Lisbon agenda and economic performance is not straightforward. This is because the observed changes in economic variables can be due to several factors, some of which are beyond the direct or immediate influence of government policies, e.g. the economic cycle, globalisation, technological developments and demographic changes. Also, analysis suggests that reforms need a considerable time before their benefits become visible in growth numbers, and thus relevant reforms may pre-date the revision of the Lisbon strategy. Moreover, it is difficult to establish the extent the new Lisbon governance structures have contributed to overcome reform resistance in individual Member States, as many reforms have a clear domestic rationale and governments may have undertaken them independently of co-ordination efforts at EU level.

Graph 2: Employment and labour productivity growth, actual and structural, 1997-2009



Notwithstanding the caveats mentioned above, analysis by the Commission suggests that, there is a structural component linked to past structural reforms enacted by EU Member States and in a number of policy areas there are a visible EU level dimension which is expressed through common targets and actions.

There is evidence of structural improvement in the functioning of labour markets[3]. As regards labour utilisation, employment grew by more than 1% each year since 2005, leading to almost 6.5 million new jobs in the EU by 2007. Although sustained efforts will be required to bring the employment rate of 70% by 2010 closer, female employment rates have increased from 54% in 2000 to 56% in 2005 to about 58%[4] in 2007, and the Lisbon employment target of 60% is within reach. There has also been a substantive increase in the employment rates of older workers (aged 55 to 64) from 37% in 2000 to 42% in 2005 and 44%[4] in 2007. Moreover, the effective retirement age has increase by 1 year between 2001 and 2005, which is welcome reversal of long standing historical trends. Analysis suggests that part of this is due to lagged effects of pension reforms: preliminary econometric estimates[5] suggest that the participation rates of older workers (55-64) increased by about 1.5 percentage point after 5 years that a pension reform has been enacted.

Employment has not increased on average in the group of low-skilled workers, with the employment rate being around 55% over the 2000-2006 period. Given the fact that this labour market segment performs rather badly in comparison to other skill groups (employment rates of medium- and highly-skilled workers stand at around 73% and 84% respectively) many Member States have nevertheless focused their policies in this direction. In particular, there has been a general trend towards reducing the tax burden for low skilled workers. As a result, there has been a drop in the total tax wedge (including social security contributions by employees and employers) for the low-skilled workers of almost 4 percent over the period 2000 to 2006[6].

Further evidence of ongoing structural improvements in the functioning of labour markets emerges from an analysis of unemployment rates. The rate of unemployment declined from 8.7% in 2005 to 6.9 % in 2007. This is in stark contrast to previous economic cycles when unemployment rates increased sharply and took a long time to decline: it not only contributes to economic growth, but is equally important for equity and welfare considerations as having a job is the single most important factor in avoiding poverty and social exclusion. When only cyclical forces are at work, the reduction in unemployment typically leaves a clear trace in higher wage growth. In the current upturn, wage growth has hardly accelerated, implying also reduction in the structural rate of unemployment. Structural unemployment, captured as the non-accelerating wage rate of unemployment, NAWRU, is estimated to have been reduced from 8.2% in 2005 to 7.4% in 2007. Similar calculations suggest that the reforms between 2001 and 2006 that aimed at increasing the employability of marginally attached people increased employment rates by 0.8 percentage points one year after the reforms were enacted.

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3 For an encompassing description on EU labour market and wage developments See report "Labour market and wage development in 2006", European Economy no.4, 2007, http://ec.europa.eu/economy_finance/publications/european_economy/labour_mkt_wage2007_en.htm

4 2007 estimate based on the average of data for the first two quarters.

5 Arpaia, A.F. Pierini and P. Braila "Tracking labour market reforms in the European union using the LABREF database" paper presented at the IZA-Fondazione Rodolfo Debenedetti Workshop "Measurement of Labour Market Institutions".

6 Based on EuroStat data on single earner without children (EU27 minus CY, EE, MT, LV, SI, BG, RO) and OECD Working paper (2004-5) on 2004 distribution on family types and earning levels for selected countries.

Positively, since mid-2005 productivity growth in the EU has picked up. Labour productivity growth is estimated at 1.4% in EU-27 in 2007, slightly lower than the 1.5% in 2006 but better than the 1.0% recorded in 2005. An additional positive feature of this is that in 2006, rising employment took place in an environment of accelerating productivity growth: this was the first time since 1997 that both employment and labour productivity accelerated in tandem. Indeed, a central policy goal of the Lisbon strategy is higher structural labour productivity growth given the need to close the gap in the productivity performance vis-à-vis the USA that emerged since mid 1990s. For now, however, it is early to assess whether the welcome acceleration in productivity growth is not only due to cyclical factors, but also linked to structural improvements. .

Aggregated data suggest that the trend decline in productivity growth, which has become entrenched since the early 1990s, has come to a halt in the last years. While statistical tests broadly confirm the bottoming out of the decline in trend productivity growth at the start of this decade, evidence of a turning point beyond that date indicating a recent pick-up in trend productivity growth remain weak.

The challenges for the 2nd Lisbon cycle, 2008-10

The Lisbon strategy is now entering a new three year cycle to cover the period 2008 to 2010. Notwithstanding the progress made since 2005, the diagnosis of the underlying structural challenges facing the Union as regards growth and jobs remains valid. As illustrated in Graph 4, large income per-capita gaps remain across countries. In 2007, based on the Commission Autumn forecast figures, the average per capita GDP of the EU27 was 10% below that of EU15 (and 33% below that of the US). For EU15 and euro area countries, the gap is mainly due to lower labour utilisation (i.e. the numbers of hours worked in the economy), whereas lower labour productivity (measured in terms of output per hour) is the main explanatory factor for Member States which joined in 2004 and 2007. The final column in Graph 3 indicates that over the 2005-2007 period, EU10 countries in particular have further narrowed the income gap benefiting from the process of real convergence. However, progress has been mixed, with some larger euro area countries doing less well.

These challenges may indeed become even more pertinent in the coming years as short- and long-term pressures become more explicit. In the short term, based on the Commission autumn forecast, the outlook for 2008-2009 indicates (see Table 1) a slow-down in growth albeit moderate, towards potential rates at around 2.5% per year. The projected slowdown mainly finds its roots in a slower forecasted pace of investment growth, while employment growth is also forecasted to decelerate (even though unemployment rates will continue to decline somewhat). In the longer term, pressures both from demographics and increased international competition are set to strengthen:

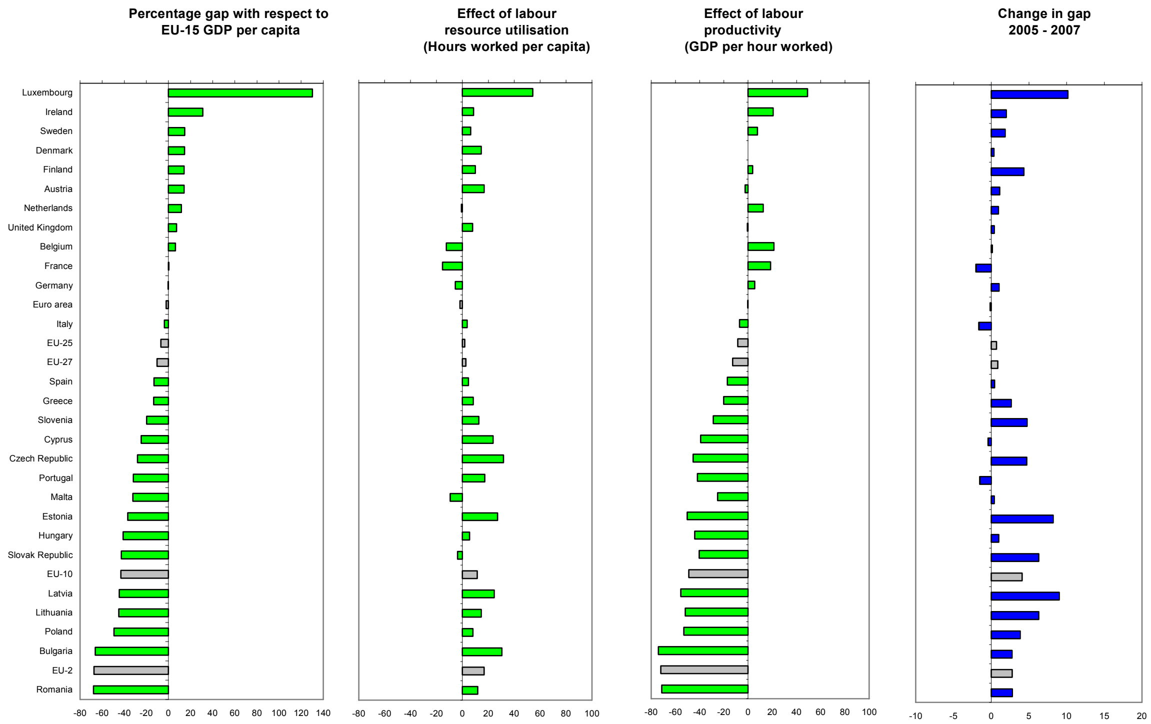
- projections indicate that in the coming decades potential GDP growth rates is set to gradually decline and to reach, by 2050, levels of about half of today's[7]. This

[7] See "Long-term labour productivity and GDP projections for the EU25 Member States: a production function framework", European Economy, Economic Papers, No 253, June 2006, http://ec.europa.eu/economy_finance/publications/economic_papers/2006/economicpapers253_en.htm

downward trend results from the future negative contributions to growth from the working age population due to demographic factors, leaving labour productivity as the key growth driver. The implication is that reform efforts contributing to an increase in labour productivity rates will become increasingly important over time;

- the trend towards increased competition through globalisation is set to continue. While deeper international trade links is expected to be beneficial for growth and employment in the aggregate, it will nevertheless risk in the short term to increase pressures on certain groups of the labour force and thus require a high degree of adaptability for a successful response[8].

Graph 3: Overview of the income gap in the EU25 Member States



***Note**: the gap is measures relative to the average of EU15 Member States*

2. ASSESSING PROGRESS WITH REFORMS THAT CONTRIBUTE TO MACROECONOMIC STABILITY

2.1. Securing economic stability for sustainable growth

Macroeconomic stability is a key framework condition for sustainable growth as expressed in Integrated Guideline N°1. Macroeconomic stability is secured by a

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8 For an extensive analysis of globalisations by the Commission, see 'Rising international economic integration: opportunities and challenges', in the EU Economy: 2005 Review", http://ec.europa.eu/economy_finance/publications/european_economy/the_eu_economy_review2005_en.htm

sound mix of stability-oriented macro-economic measures and well designed structural reforms in product and factor markets. Monetary policy contributes by pursuing price stability. Sound budgetary positions allow the full and symmetric play of the budgetary stabilisers over the cycle. Fiscal restraint, effective financial supervision and the promotion of competitiveness help to contain external and internal imbalances. Moreover, budgetary and wage restraint limit the risk of domestic demand causing persistently higher inflation, potentially causing swings in real exchange rates and a protracted loss of competitiveness. Against this background, to assess how countries fare, and have made progress, in terms of macro-economic stability and budgetary policies, it is useful to look at budgetary positions, the fiscal stance and the extent to which medium-term budgetary positions provide enough safety margins to allow automatic stabilisers to play freely. Similarly, when looking at possible emerging macroeconomic imbalances it is relevant to examine external balances of countries together with domestic inflationary pressures, wage and labour market developments as well as asset price developments.

Over the 2005-2007 period, the consolidation of public finances has moved forward, even if further consolidation remains a challenge in several countries. The EU27 nominal budget deficit has been reduced from 2.5 % of GDP in 2005 to 1.1 % in 2007. According to the Commission forecast, on a "no policy change assumption", it is expected to remain at this level over the coming two years. The same trend is also reflected in structural budget positions which for 2007 are estimated to be -1.1% of GDP in EU27 and -0.7% of GDP in the euro area. This improvement is mainly driven by a reduction in government expenditures to GDP, although revenues as a share of GDP have also increased. At the start of 2006 twelve countries found themselves in a position of excessive deficit while at the end of 2007 only six countries are still there (CZ, HU, IT, PL, PT, SK). However, the pace of fiscal adjustment seems to have been reduced somewhat in the last year, and the opportunity to use the relatively strong growth conditions to reduce structural deficits by the 0.5% of GDP benchmark in the Stability and Growth Pact have not been fully taken in all Member States (applicable to euro area and ERM II countries). Moreover, a majority of countries still have some way to go to achieve medium-term budgetary positions that allows the budget to play fully its stabilising role[9].

Headline inflation in EU-27 has hovered just above 2% over the 2005-2007 period. In 2007, favourable energy-price base effects have contributed to reduce inflation. However, core inflation has continued to drift upwards and reached in 2007 levels close to 2%. This confirms on the one hand that a more mature cyclical position of the economy has been reached but on the other hand it also reflects some administrative measures (such as the VAT increase in DE) and strong increases in commodity prices. Service inflation continues to run at a relatively high rate. In the euro area, inflation in 2007 stood at 2%, somewhat lower than in 2006. The inflation differential between the three countries with highest inflation (IE, EL, SI) in the euro area and the three with lowest inflation (F, MT, FI) was 1.7%-points, similar to 2006.

[9] See the report "Public Finances in EMU-2007", European Economy No 3, 2007.

In 2007, five countries are projected to record an external deficit of at least 10% of GDP (LV, LT, EE, BG, RO). These countries display signs of overheating, characterised by excess aggregate demand evidenced by labour shortages, rapid increases in household borrowing, inflationary pressures and very high external imbalances. Among other Member States, EL, ES and PT have in 2007 external deficits between 8 and 10% of GDP; their external deficits owe mainly to structurally poor competitiveness, although robust growth in Greece and Spain is also a factor. In two other countries, HU and SK, the current account deficit was of a similar magnitude in recent years but has been on a declining trend, with the deficit expected to reach between 3 and 4% of GDP in 2007. It should be noted that in a catching-up country, even a widening external deficit need not be a cause for concern if there is a concomitant rise in productive potential in tradable goods and services and thus in the future export earnings generating capacity sufficient to service the external debt. However, to the extent that the widening external deficit reflects unrealistically optimistic expectations regarding future growth reflected in an excessively rapid increase in expenditure relative to income, an attitude of caution is warranted.

2.2. Safe-guarding economic and fiscal sustainability

Europe's ageing population poses a serious challenge to the long-term financial sustainability in EU countries, which is recognised in Integrated Guideline N°2. In the absence of appropriate reforms, this could lead to increasing debt burdens, lower potential output per capita due to the reduction in the working age population, and pressure for significant increases in public spending on pensions and health care. The economic, budgetary and social implications of ageing populations can be addressed by pursuing a three-pronged strategy, that encompasses an appropriate mix of policies to reduce debt at a fast pace, to raise employment rates especially amongst older workers (so that working lives are extended), and to reform pension and health care systems. Reforms to social protection need to be well designed so as to ensure that they are financially viable in the face of the population ageing and uncertain economic developments, while ensuring that social protection systems fulfil their goals in terms of access and adequacy.

In this context, when assessing how Member State's fare and have made progress in this regard it is relevant to look at debt and deficit developments and to what extent there has been consolidation efforts bringing medium-term budgetary positions in line with the medium-term budgetary objectives (MTO) within the Stability and Growth Pact. This should also take into account the projections of age related expenditures, carried out or planned reforms to pension and health care systems and how these are integrated in an overall assessment of budgetary sustainability.

In the EU over the 2005-2007 Lisbon cycle, some progress has been made to ensure sustainable public finances, although progress has been mixed across countries. The debt/GDP ratio has declined in EU27 over the 2005-2007 period, from 63 % of GDP in 2005 to just below 60 % in 2007. In the euro area, the debt ratio has been reduced from 70.4 % of GDP to 66.7% over the same period. The debt ratio both in Greece and Italy remains above 100% of GDP and in Belgium debt is close to 85% of GDP. Taking into account also projections of age related expenditures, a number of countries remains at what can be called high risk (CZ, EL, CY, HU, PT, SI). A number of countries progressed with the implementation of pension reforms. Rather comprehensive measures to reform the pension system have been conducted in recent years in some countries, in particular MT and PT.

Recently, additional measures, albeit at a lower scale, was introduced in some countries including progressing with on-going reforms (BE, DE, PL, UK). In other countries, where reforms are most needed, progress have been limited (EL, IT, CY, HU, SI). Health care measures were on the policy agenda in a number of countries (DE, CY, MT, LV, RO). In particular, in 2005 and 2006 progress has been shown in terms of increasing the participation rates for older workers which had increased by more than 3% over 2005-2006 in several countries (DE, EE, IE, CY, LV, AT, SI, SK, FI).

Overall, budgetary positions have improved since 2005, and there have been reforms to pension and health care systems in some countries. Nonetheless, important risks to the sustainability of public finances remain in many countries, and there is a need to press ahead with reform efforts, not least the effects of ageing on the size of the working-age population will become more pronounced in the next three-year Lisbon cycle.

2.3. Ensuring that wage developments contribute to stability and growth.

Appropriate wage developments contribute to macro-economic stability and growth, highlighted in Integrated Guideline N°4. Provided that real wage increases are in line with the underlying rate of productivity growth over the medium term, they contribute to stable macroeconomic conditions and an employment friendly policy mix[10]. Variation in productivity caused by cyclical factors, or one off changes in the headline rate, should not cause an unsustainable shift in wage growth. In addition, relative wage developments that reflect local or sectoral labour market conditions help adaptability and counteract regional disparities. In this area, when assessing how countries fare and have made progress, it is necessary to examine wages and productivity developments, i.e. what this implies in terms of nominal unit labour costs (NULC) and to assess whether the latter are in line with price stability and competitiveness. It is also useful to look at real unit labour costs (RULC) and how these relate to labour market developments. Moreover, to the extent that regional unemployment is a serious problem, wage developments and measures that improve the adaptability to local conditions is relevant. Overall, the absence of wage pressure in the euro area and EU27 during the economic rebound has been a positive feature over the last few years. Wage moderation in the euro area and EU27 as seen in nominal and real unit labour costs has generally continued to support price stability over the 2005-2007 period, including the last 12 months, despite a tightening labour market and the closing of output gaps. In 2007, the annual growth rate in compensation per employee is forecast at 3.0% in EU27 and 2.5% in the euro area while the increase in labour productivity is 1.4% and 1.1% respectively. This implies that nominal unit labour costs increase by 1.7% in EU27 and 1.4% in the euro area which is somewhat higher than in 2005-2006 but in the aggregate remains in line with price stability objectives. More evidence of wage restraint in the face of stronger international competition is that real unit labour cost decreased by roughly 1% in 2006 and 2007, both in the euro area and in the EU as a whole. However, this may also reflect other structural factors, such as a gradual reallocation of value added towards sectors with a lower share of labour.

However, this overall assessment of favourable aggregate behaviour conceals sizeable differences between countries, with fairly divergent growth rates in nominal unit labour costs contributing to differing patterns in competitiveness and widening current account imbalances among EU members. At Member State level, two aspects warrant further attention:

- The catch-up process has triggered very high nominal wage growth, in excess of relatively high labour productivity, which has lead to deteriorating price competitiveness. This is particularly notable in EE, LT, LV, RO and BG (see also see section 3 on macro-economic stability where this is put in the context of external imbalances). Also, real unit labour costs have increased markedly over the last few years in EE, LV, RO and in 2007 in BG. Nevertheless, this has been coupled with above average employment growth and falling unemployment.

[10] Provided that they are also consistent with a rate of profitability allowing for productivity, capacity and employment-enhancing investments.

However, in HU increasing unit labour costs have been coupled with weak labour market developments.

- Wages adjust slowly over time to changing cyclical conditions, especially in some countries of the euro area, which means a long-lasting impact of shocks on economic activity. Indeed, the experience with adjustment to shocks in the early years of the euro area calls for flexibility despite a general background of marked wage moderation[11]. While wage moderation has been supportive of price stability in the aggregate, the continuously high-rates of long-term unemployment and the persistence of regional differences in employment performance suggest that there may be some lack of wage differentiation in some Member States (BE, DE, IT). Progress in terms of wage dispersion that reflects productivity differentials across sectors and regions has only been partial even though in some countries wage bargaining outcomes that better reflect local conditions can be observed. Additional flexibility seems however to have been achieved as regards working time organisation and greater opt-outs from collective agreements (AT, FR, DE, IE, NL, ES).

[11] See the "EU Economic review: 2006" which investigates how adjustment has been proceeding in the euro area and how the efficiency of adjustment could be improved. European Economy No 6, 2006.

2.4. Policies to make work pay

Policies to improve the financial incentives to work are largely recognised as being a key element of that comprehensive set of measures (macro, micro and employment), which is most needed to raise labour utilisation, and therefore contribute to the general objectives of the Growth and Jobs strategy (see in particular Integrated Guideline N°5). Improving the adaptability and adjustment capacity of economies helps respond to changes in both cyclical economic conditions and longer term trends such as globalisation and technology. In this regard, policies to "make-work pay" are particularly pertinent as they aim to attract more people into the labour market and to make the underlying incentive structure in the tax and benefit systems supportive to employment. This implies modernising tax (direct taxation on labour income and social security contributions paid by employers and employees) and benefit systems (unemployment insurance, in-work benefits, disability and sickness schemes, means-tested benefits and other forms of social assistance), so that they reduce benefit dependency and provide effective incentives to take up jobs, and remain in work, by making work economically attractive and rewarding relative to staying on benefits. Moreover, providing the right incentives to increase employment and hours worked is particularly important to improve labour utilisation, also in the light of budgetary challenges stemming from ageing populations.

Against this background, when assessing how Member States fare and have made progress in this regard, it is useful to look at performance indicators such as labour participation, employment and unemployment rates. Moreover, it is also important to take policy outcomes into account, measured by different tax wedges and marginal effective tax rates that give an indication of the size of unemployment, inactivity and low-wage traps.

In those Member States where employment and participation rates are relatively low (BE, BG, EL, MT, IT, PL, RO), or in those where labour market participation is higher but where generous welfare systems require extensive financing (SE, DK, NL), it is particularly challenging to improve incentives to work and hours worked. In other countries, the incentives to work embedded in their tax and benefit systems appear to be significantly low, as also results from their labour market situation (BE, PL). However, it can be observed that in several Member States a fair wealth of measures has been taken to improve the incentives to work, both as regards reforms in the benefit system, and in particular labour taxation, while in general much less has been done in the field of employment protection legislation.

In the area of unemployment and welfare-related benefits, some countries passed major reforms over the years of this Lisbon cycle (CZ, SE in 2007; BG, FR, SI in 2006; HU, NL in 2005; DE in 2004). In other Member States, policy action has been taken to promote labour market transition from unemployment and inactivity to work through stricter work availability criteria, the use of sanctions for non-compliance with rules, the strengthening of control mechanisms and streamlining the financing for labour market subsidies and income support (GR, NL, PT, SI in 2007). Many reforms that do not appear to directly target the financial incentives to work, such as strengthening the enforcement of rules and tightening up eligibility and work-availability requirements, may in fact well improve the overall incentive structure of the benefit system. However, risks remain of low-wage, unemployment and inactivity traps for the unskilled and low income earners in a consistent number of Member States.

As regards labour taxes, many Member States have lowered the level of taxation on labour in recent years, either through general tax reductions, mainly focused on cutting the tax-wedge on low income groups (AT, FR, HU, SI, CZ, IT, MT, LT, SE), or by a straight reduction of the tax burden on low incomes (DK, FI, GR,NL, SL), there including extensions of the tax-free range of income or tax credits for low-income earners (LV, SE, FR, GR, IRL, NL, SK). In 2007, measures to this end was taken in FI, SI, BG, IT, CY, GR, LT, LV, IR, MT, NL and the UK. Also, a general trend towards reducing social security contributions for both employers and employees was recorded over recent years, often aimed at boosting labour demand and creating incentives to hire specific target groups (see for instance BE, SE, MT in 2007). Some convergence therefore appears to have taken place, as countries with highest tax rates in 2001 are those that have reduced most over the last years. Nonetheless, tax wedges on low wages remain high in a number of Member States (see in particular BE, DE, FR, AT, SE, HU, PL).

To favour labour attractiveness especially for the lowest earners, i.e. to prevent people from being discouraged to accept work because it could adversely affect their income, a consistent number of Member States have also introduced over recent years various sorts of in-work benefits schemes (BE, FR, PL, AT, CZ, SK, DK, UK). Other countries have taken actions to reduce the use of benefit schemes – either unemployment or disability schemes – as an alternative route for early retirement (see HU in 2007 and UK in 2006). The sickness system was also largely reformed in CZ and SE in 2007 and in the NL in 2006.

Overall, many countries have taken measures that go in the right direction, but the overall impact remains limited in many cases and thus there is a need to further pursue "making work pay" strategies along the principles of flexicurity. A further challenge in this respect is how to lower labour taxes further without endangering fiscal consolidation.

Table 2. Overview of situation in EU Member States on securing economic stability

	Performance				Areas where CSR have been proposed				
	Budget balance	Fiscal stance	Infla-tion rate	External balance,	2005 NRP	March 2007 Council		Dec. 2007 Comm. Prop.	
	2007	2005-07	2007	2005-07	Key chall-enge	CSR	PTW	CSR	PTW
BE	-0.3	-0.2	1.7	3.1					
BG	3.0	1.1	6.7	-14.3	X			X	
CZ	-3.4	-1.9	3.0	-2.7	X				
DK	4.0	-1.3	1.7	2.4					
DE	0.1	2.4	2.2	5.3		X			X
EE	3.0	1.7	6.2	-11.2					X
IE	0.9	0.2	2.7	-4.0			X		X
EL	-2.9	2.4	2.8	-8.8	X	X		X	X
ES	1.8	0.6	2.6	-7.8			X		X
FR	-2.6	1.0	1.4	-2.0	X	X		X	
IT	-2.3	2.0	1.9	-1.5	X	X		X	
CY	-1.0	2.1	1.8	-5.9*					
LV	0.9	0.6	9.5	-17.8	X	X		X	
LT	-0.9	-0.4	5.7	-9.2	X		X		X
LU	1.2	0.6	2.4	10.9*	X				
HU	-6.4	2.9	7.6	-5.2	X	X		X	
MT	-1.8	0.8	0.7	-3.4					
NL	-0.4	-1.0	1.6	6.9					
AT	-0.8	-0.1	1.9	3.6			X		X
PL	-2.7	1.1	2.3	-2.0	X	X		X	
PT	-3.0	2.8	2.4	-8.3	X	X		X	
RO	-2.7	-1.7	4.5	-10.3	X			X	
SI	-0.7	-0.3	3.4	-2.6					
SK	-2.7	-1.9	1.6	-6.7					
FI	4.6	0.7	1.5	5.4					
SE	3.0	0.6	1.6	6.4					
UK	-2.8	0.5	2.4	2.8	X		X		X

Note: CAB: cyclically-adjusted budget balance; Fiscal stance: measured as the change in the structural budget balance over 2005-2007 (a positive figure implies tightness, a negative looseness); CSR: country-specific recommendation; PTW: point to watch

Table 3. Overview of situation in EU Member States on securing long-term sustainability.

	Policy Performance				Areas where CSRs have been proposed				
	Debt ratio	Sustainability gap	Sustaina-bility risk class-ification	Empl. rate older worker	2005 NRP	March 2007 Council		Dec. 2007 Comm. Prop.	
	2007	2007	2007	2006	Key Chall-enge	CSR	PTW	CSR	PTW
BE	85	2.7	Medium	32	X		X		X
BG	19	n.a.	-	-	X				X
CZ	30	8.0	High	45	X	X		X	
DK	25	0.3	Low	61	X				
DE	65	3.3	Medium	48	X	X			X
EE	3	-3.2	Low	59					
IE	25	2.4	Medium	53			X		X
EL	94	1.3	High	42	X	X		X	
ES	36	2.8	Medium	44			X		X
FR	64	3.2	Medium	38	X	X		X	
IT	104	3.0	Medium	33	X	X		X	
CY	61	7.0	High	54	X	X		X	
LV	10.	1.2	Low	53					
LT	18	2.4	Low	50					
LU	7	9.3	Medium	33			X		X
HU	66	12.3	High	34	X	X		X	
MT	63	-0.1	Medium	30	X		X		X
NL	47	2.4	Low	48					
AT	60	-0.1	Low	36	X				
PL	47	-1.4	Low	28					
PT	64	8.3	High	50	X				
RO	13	n.a.	-	-					X
SI	26	7.0	High	33		X		X	
SK	31	4.1	Medium	33					
FI	36	-0.7	Low	55	X				
SE	41	-1.5	Low	70					
UK	45	4.2	Medium	57	X		X		

Note: the S2 indicator measures the budget adjustment necessary to ensure sustainability given government debt and projections of age related expenditures. The sustainability risk class takes the S2 indicator into account as well as additional information: ource: Public Finances in EMU 2007, European Economy N°. 3, 2007. CSR: country-specific recommendation; PTW: point to watch.

Table 4. Overview of situation in Member States on wage developments and bargaining systems

	Policy Performance			Areas where CSRs have been proposed				
	Nominal Unit Labour Cost 2007	Real Unit Labour Cost 2007	Diversity of regional unem-ployment	2005 NRP Key Chall-enge	March 2007 Council CSR	March 2007 Council PTW	Dec. 2007 Comm. Prop. CSR	Dec. 2007 Comm. Prop. PTW
BE	1.1	-1.0	47	*	*		*	
BG	10.5	2.8	47				X	
CZ	2.2	0.1	47	*		*		*
DK	4.4	2.0	20					
DE	0.8	-1.0	45					
EE	12.7	3.7	34					
IE	3.6	1.5	17					
EL	2.6	-0.4	30					
ES	2.0	-1.0	33					
FR	2.1	0.2	36					
IT	1.3	-1.3	63	*	*		*	
CY	1.1	-1.4	n.a.					
LV	21.0	4.6	23				X	
LT	7.9	0.1	21					
LU	3.3	-0.3	n.a.					
HU	3.0	-2.8	30			*	*	
MT	1.1	-1.4	n.a.					
NL	1.8	0.4	26	X				
AT	0.8	-1.4	41					
PL	4.2	1.3	22	*				
PT	1.1	-1.7	30					
RO	10.2	2.3	42				X	
SI	2.3	-0.5	31					
SK	0.4	-2.1	42	*				
FI	0.8	-1.2	29	X		X		
SE	2.8	0.4	16					
UK	1.7	-1.4	34					

Note: Diversity of regional unemployment is measured by the coefficient of variation of 2005 regional unemployment (source Eurostat). as a benchmark, 44% equals the EU average plus one standard deviation. CSR: country-specific recommendation; PTW: point to watch.* in "policy orientations" column refers to a policy orientation dealing with regional unemployment disparities rather than directly mentioning wages *per se*.

Table 5. Overview of situation in Member States regarding policies for "making work pay".

	Policy Performance				Areas where CSRs have been proposed				
	Partici-pation rate	Unempl oyment trap	Inact-ivity trap	Tax wedge	2005 NRP	March 2007 Council		Dec. 2007 Comm. Prop.	
	2006	2005	2005	2006	Key Chall-enge	CSR	PTW	CSR	PTW
BE	66.5	85	65	49	X	X	X	X	X
BG	64.5	74	n.a.	31					
CZ	70.0	66	56	40	X	X			
DK	80.6	90	88	39	X		X		X
DE	75.0	75	67	47	X	X		X	
EE	72.4	65	48	40*					
IE	71.8	74	74	16	X		X		X
EL	67.0	62	16	35	X	X		X	
ES	70.9	80	43	36	X				
FR	69.4	82	62	44	X		X		X
IT	63.0	72	23	41	X				X
CY	73.0	63	63	19*					
LV	71.3	87	61	42	X				
LT	67.4	80	39	41					
LU	66.6	88	69	31	X				
HU	62.0	55	44	43		X			X
MT	59.2	59	59	18*	X	X		X	
NL	77.4	83	83	41	X	X		X	
AT	73.7	67	65	44	X	X		X	
PL	63.0	81	58	42	X	X		X	
PT	73.9	81	38	32					
RO	64.1	61	n.a.	42	X				
SI	70.9	93	60	36	X	X		X	
SK	75.0	75	67	36					
FI	75.6	77	74	39	X				
SE	78.8	87	78	46	X		X		X
UK	75.5	68	68	30					

Note: Unemployment and Inactivity traps are calculated on the basis of marginal effective tax rates The "tax wedge" is the difference between the costs of a worker earning 67% of the average wage and the amount of net earnings received (* =2005 figure): sources: Eurostat CSR: country-specific recommendation; PTW: point to watch

II. MICRO-ECONOMIC PART

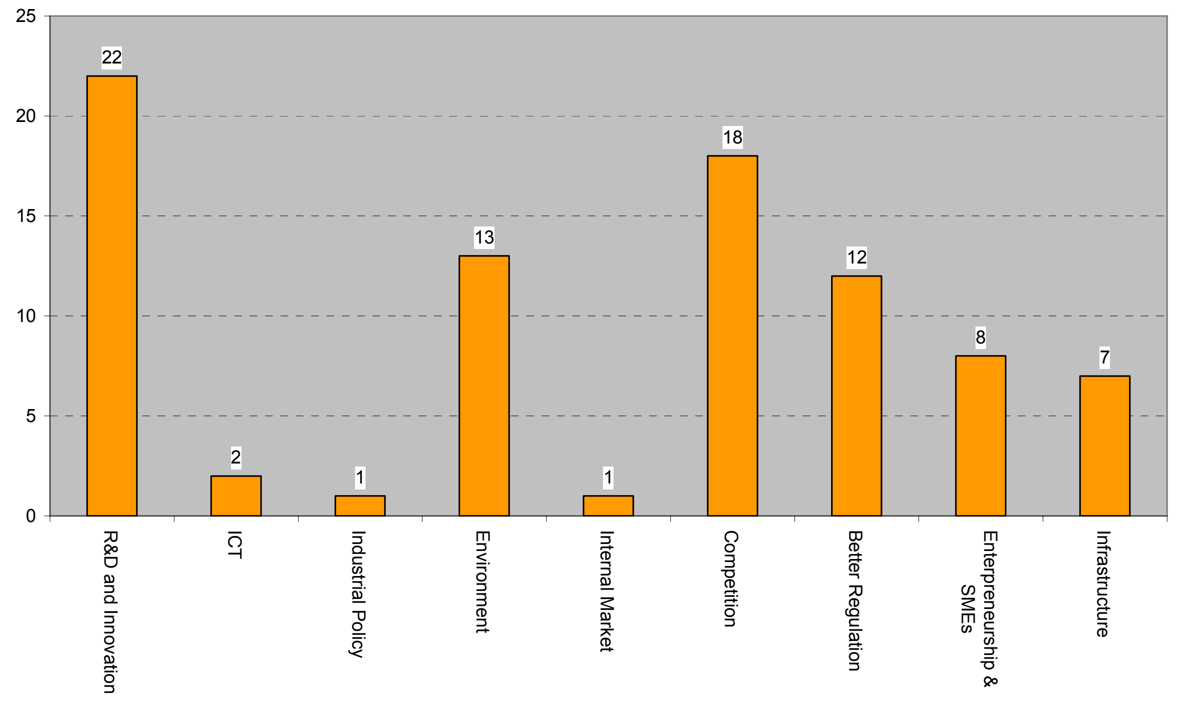
Summary and conclusions

Micro-economic reforms are the heart of the reform efforts of the Member States under the revised Growth and Jobs Strategy. Half of the main challenges, as identified by the Member States themselves in their National Reform Programmes for 2005-2008, are in the micro-economic area. Nearly half of the country specific recommendations and 'points to watch' which the Commission proposed and which the Council adopted in spring 2007, relate to micro-economic reforms (Graph 2).

The key challenges and country specific recommendations in the micro-economic area are strongly concentrated on research and innovation; competition; the regulatory environment and entrepreneurship/SMEs. Despite the focus on several micro-pillar issues, it is important to keep in mind that they form part of an integrated strategy: microeconomic reforms will be deprived of much of their effectiveness if complementary measures are not taken within the macroeconomic and employment pillars.

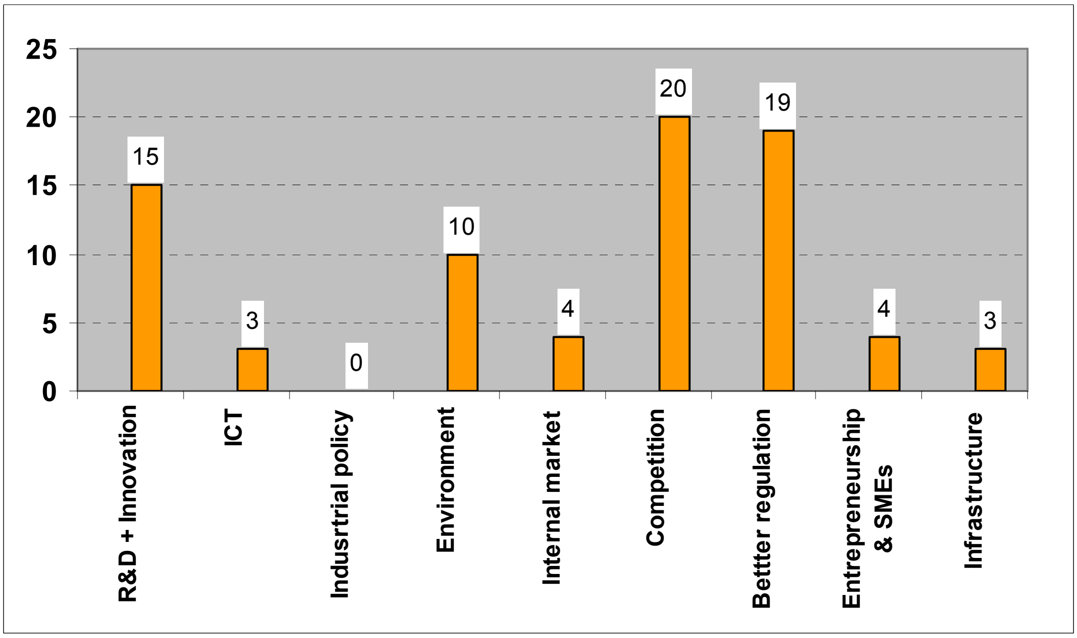
This chapter takes stock of the reform efforts under the microeconomic pillar of the Growth and Jobs strategy. Section 1 presents some of the theoretical and empirical evidence in support these efforts and Section 3 overviews progress achieved so far in the various policy areas. Section 4 draws some forward looking conclusions. This section shows that significant progress has been made in a number of areas with the implementation of the microeconomic reform agenda. Around half of all Member States have shown a strong policy response in the areas of R&D and ICT, and most others have at least made some progress in these areas. Regarding the aim to unlock the business potential, particularly of SMEs, where concrete objectives have been targeted for end-2007, a clear majority of Member States have shown at least a fairly good or strong policy response. About a third of Member States show a strong policy response with regard to energy and climate change. However, the uneven implementation record across Member States implies that progress overall could still be better. This stock-taking exercise concludes that measures in different policy areas call for a higher degree of policy coordination and integration, in order to maximise positive externalities. This does not apply only to the micro-pillar policies – where an integrated approach to the ‘knowledge triangle’ of research, innovation and education policies is called for – but also to the reform design across the three pillars of the renewed Lisbon strategy.

Graph 1. Number of key challenges in the microeconomic pillar in the National Reform Programmes of the Member States



Note: Number of EU27 Member States having identified the issue as a key challenge.

Graph 2. Number of country-specific recommendations and points to watch in the policy areas of the microeconomic micro-pillar



Note: Number of Member States for which the Council made a specific recommendation or raised a 'point to watch'.

1. ECONOMIC EFFECTS OF MICROECONOMIC REFORMS

Raising the long-term economic potential by increasing productivity growth is one of the fundamental objectives of the renewed Lisbon strategy. A large part of the reforms, in pursuit of this objective, are being undertaken in the microeconomic policy pillar of the strategy.

Given what is known about the relationship between microeconomic structural reforms and productivity growth, the present section undertakes a broad assessment of whether the types of reforms engaged by Member States since 2005 are likely to have the desired effects on growth in total factor productivity[12]. Some estimates of the size of these effects are presented in a separate staff working paper on spillovers and complementarities in the context of the Lisbon Strategy[13]. However, as the results of productivity-enhancing structural reforms can rarely be captured in the short term and since the measurement of their effects is complex and fraught with both methodological and empirical problems, a note of caution is in order.

Europe's success in achieving sustained economic growth during the post WWII era is associated mainly with capital accumulation and the imitation or adaptation of innovations made elsewhere. Once the catching up process was complete by the 1980s, this strategy was no longer sufficient to boost growth; increasing home-grown innovation had become a necessity. The required transition can be described as moving from the investment-driven phase of economic development to the innovation-driven phase. Which policies are likely to support this transition?

The adoption and use of ICTs are regarded as salient among the factors determining productivity growth. Against this background, detailed analyses have attributed the widening of the gap in productivity growth between the United States and Europe since the mid-1990s mainly to innovations in the ICT sector and their rapid spread across all sectors of the economy. Contrary to the United States, Europe has failed to keep up with regard to both the production and the use of ICT. ICT investment, in order to bring the desired productivity gains, needs to be accompanied by organisational change and the retraining of the workforce.

Many economic studies indicate that there is a significant relationship between market structure, and hence competition, and innovation. In general, competition is found to have a positive effect on innovation[14].

The design of growth-enhancing policies may need to change once countries move closer to the technological frontier. For instance, stringent protection of intellectual property can be more important for productivity growth in countries close to the frontier which are more heavily engaged in innovation rather than imitation.

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12 This section draws on the analysis developed in Chapter 2 of the European Competitiveness Report 2007 - SEC(2007) 1444, 31.10.2007.

13 Spillovers and complementarities in the context of the Lisbon Growth and Jobs Strategy including economic effects of the Community Lisbon Programme - SEC(2007) 1689.

14 See OECD - Economic Policy Reforms: “Going for Growth”; of 9th February 2006; by Jean Philippe Cotis; at http://www.oecdwash.org/PDFILES/gfg2006_cotis_washington.pdf#search=%22OECD%202006%20Going%20for%20Growth%22

Most empirical evidence suggests a negative relationship between the intensity of regulation and indicators of economic performance such as innovation or productivity. Reducing administrative burdens can boost GDP by freeing resources for more productive uses. This also underlines the importance of structural reforms in the labour market to facilitate the reallocation of production factors.

Studies on the links between regulation and productivity suggest that labour productivity has accelerated since the mid-1990s in lightly-regulated economies while it either grew more slowly or declined in highly-regulated countries. In addition, lower barriers to trade and less regulation appear to have increased the level and rate of productivity growth by stimulating business investment and promoting innovation. Studies on the impact of product market reforms on innovation in the EU find that intensifying competition tends to increase R&D investment, but mainly through increased innovative activity by incumbents rather than by new entrants.

Policy synergies

Claims that labour market reforms and product market reforms are complementary have been corroborated by simulations which indicate clear synergies between product and labour market policies. As an example, increasing skills and R&D raises real wages, which in turn is expected to lead to an increase in participation rates. The reduction of administrative burdens, through lower mark-ups, has synergies with the employment target due to a reduction in equilibrium unemployment. There are also clear synergies between the skills policy and R&D policies: without a sufficient supply of graduates in mathematics, science and technology, additional R&D expenditures will increase wages for these workers but will not impact output substantially.

2. THREE YEARS IN THE NEW REFORM AGENDA: AN ASSESSMENT OF PROGRESS BY POLICY AREA

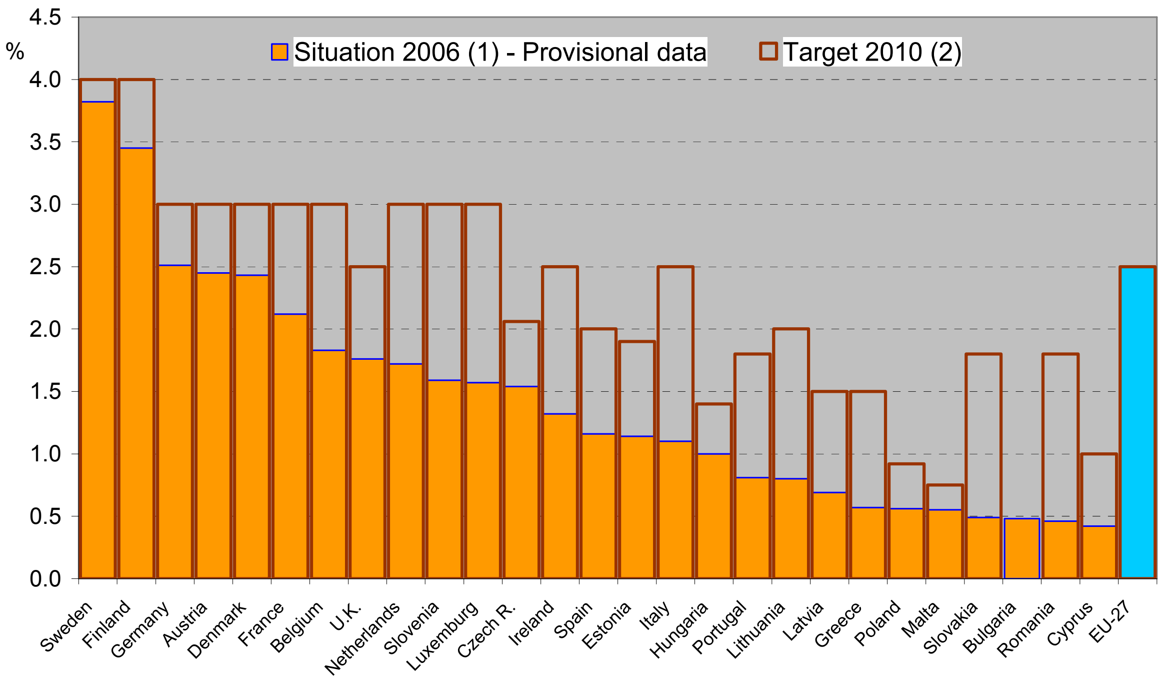
2.1. Knowledge and innovation

2.1.1. Research and innovation

Investment in knowledge (R&D and education) is the basis of innovation and technological progress. Raising the level and effectiveness of expenditure on knowledge is crucial for the EU to make the shift towards a knowledge based society. Following the re-launch of the Lisbon strategy in 2005, all Member States except BG have set national targets for R&D intensity and most of them have developed ambitious R&D and innovation strategies and accompanying measures to increase R&D intensity and the innovative capacity of their economy.

However, progress as concerns EU R&D intensity has so far been unsatisfactory, standing in 2006 at 1.84% GDP, a considerable way off the 3 % R&D target (see graph 3). Moreover, in 2007, France and Greece postponed their 2010 targets whereas Hungary, the Slovak Republic and Poland revised their targets towards lower levels of ambition. Should all Member States achieve their national targets, EU R&D expenditure is now forecasted to be 2.5% of GDP by 2010.

Graph 3: Gross domestic expenditure on R&D (GERD) as % of GDP – 2006 levels[1] (provisional data) & targets



Notes:

(1) IT, LU, PT, UK: 2005.

(2) EL: 2015; FI: 2011; FR: 2012; IE: 2013-GNP; SK: 2015; UK: 2014; EU27 = DG RTD est. for EU26

(3) Member States have been ranked according to the current level of R&D intensity from left to right.

Source: Eurostat, Member States

In general, Member States have followed up on their commitments by announcing increases in government budgets for R&D in nominal terms; however, concurring increases in GDP have led to budgets remaining either stable for many Member States or even slowly decreasing (FR, IT, NL, SK) in % GDP terms. On the other hand, public R&D spending has significantly increased in several Member States (CZ, EE, IE, ES, LT, SL, RO, LU, PT), showing that progress can be made when effectively prioritising R&D investment. Business R&D remains low in the EU and has seen no positive evolution since 2000, clearly indicating that improving the framework conditions for private R&D investments and the leverage of public R&D policy should remain policy priorities.

Tax incentives continue to be a major instrument for governments to stimulate private R&D investment. Over the past years, a clear EU wide shift has taken place in the direction of strengthened fiscal incentives. This trend continued throughout 2007 with a number of Member States (NL, UK, BE, FR, CZ, IE, PT, AT, RO, IT) further developing their incentive systems while others undertook to evaluate their effectiveness.

In this context, the increasing role of Cohesion Policy in financing R&D can be clearly noticed, especially in some of the new Member States. The effective use of Structural Funds earmarked for research is an important opportunity for many countries that still have a low level of funding.

Assuring adequate levels of human resources will be a critical factor in raising R&D expenditure and is being addressed through measures such as increasing the number of scholarships or making researchers' career prospects more attractive. A recent trend has seen the setting up of programmes aimed at stimulating the recruitment and re-integration of excellent expatriate and foreign researchers. The planned Structural Funds interventions should provide an important contribution to develop the European human potential for research and innovation.

Reforms in R&D policies have up to now been designed almost exclusively from a national perspective. As R&D systems are, however, increasingly interconnected, it is important that national policy makers take explicit account of the European perspective in their national policies, in order to maximise the benefits from synergies and spillovers. This would increase the effectiveness of national systems and would, in the context of the European Research Area initiative, make a significant contribution towards developing the EU's research system as a whole to be a competitive player on the global scene.

However, increasing investments in research is not enough for bolstering the innovative capacity of the economy as around half of innovative firms in the EU do not conduct any formal R&D. At national level, improving science-industry linkages continues to receive significant policy attention. Setting up public-private partnerships to stimulate innovation is the most prominent approach. Measures range from improving the legal framework governing science-industry interaction, to networking, the establishment of technology transfer mechanisms, or the promotion of inter-sector mobility of researchers. Policy focus has recently shifted from traditional 'technology push' -type measures towards a more systemic approach to build innovation support mechanism. However, Member States still give a low priority to demand side issues, such as public procurement, faster commercialisation of innovative ideas and faster growth of innovative start-ups. In particular, better access to domestic and international finance by innovative SMEs remains an important challenge in most EU Member States.

There has been some progress in the EU's innovation strategy. In 2006, the Commission outlined an innovation strategy[15] for the years 2006 to 2008. This strategy is broad-based in that it brings together policies and measures from several different areas, and is complementary to regional and national measures foreseen in the context of the National Reform Programmes of the Lisbon process. On this basis, the December 2006 Competitiveness Council adopted nine strategic priorities for innovation action at EU level. Initiatives so far have covered areas of Intellectual

[15] Commission communication “Putting knowledge into practice: A broad-based innovation strategy for Europe” - COM(2006) 502.

Property Rights, standardisation in support of innovation,, public procurement in support of innovation. Joint Technology Initiatives, lead markets, the European Institute of Technology (EIT), clusters, innovation in services and risk capital markets**.**

2.1.2. Information Society

Throughout the first three years of the revised Lisbon agenda, there has been an increasing focus on mainstreaming ICT policies. The most frequent initiatives in the Implementation Reports relate to the spread of eGovernment, broadband and digital skills in education.

Member States have seen e-Government and the use of ICT in administrations as instrumental in improving government efficiency and service delivery. Online public services in the EU are moving rapidly towards the stage where a whole process can be conducted on-line.

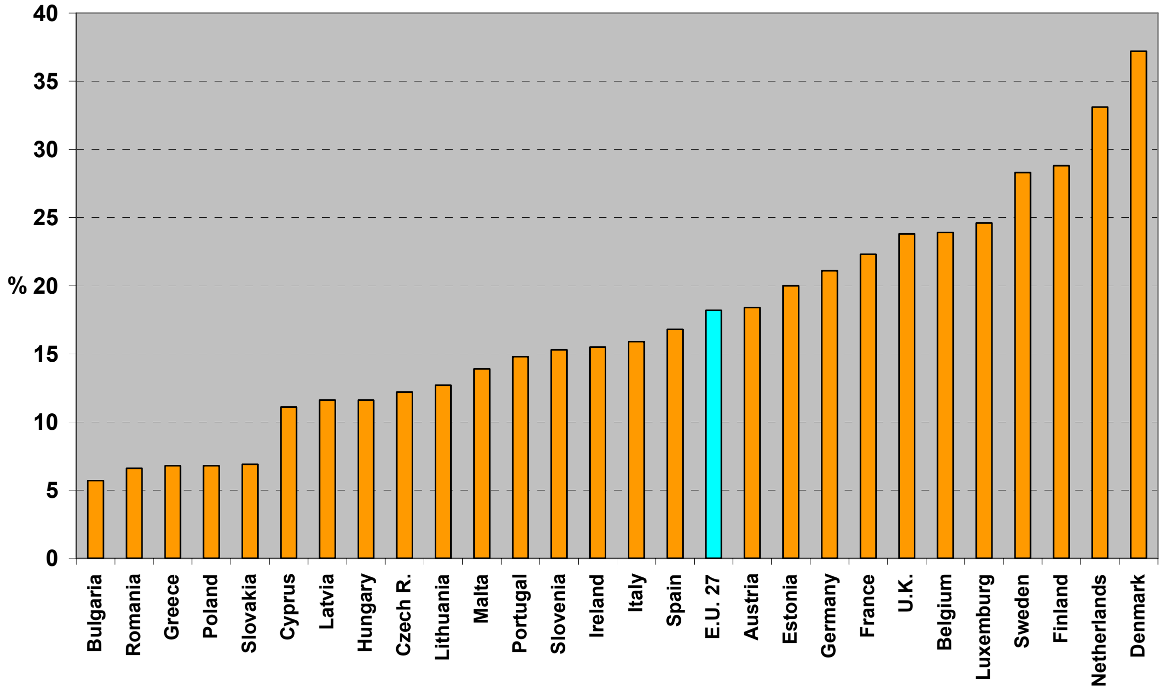
Austria has been leading the online public service league. Other top performers are Malta and Slovenia, while Portugal has made major progress since 2006. Businesses are still being better served than citizens, although the gap between the two is closing. In general, Implementation Reports show continued commitment to the development of e-government policy, with increasing attention devoted to one-stop shop government portals in all countries, digital signature, electronic identity cards, and the use of e-government for back-office re-organisation with a view to the modernisation of the public sector. The trend is very strong in the new Member States but also in large countries like Italy which need to catch up with the most advanced Member States.

In the area of **broadband**, take-up is progressing fast. The average penetration rate (number of subscribers per population) has increased from 10.5% in July 2005 (EU25) to 18.2% in July 2007 (EU27) (see graph 4 below). Although some European countries are world leaders in terms of broadband access, there is a growing gap between the best and worst performers. The main reasons for this are the lack of infrastructures in some Member States and the need for a more consistent and effective implementation of the existing e-communications regulatory framework.

Most Member States are stimulating take-up through the implementation of the regulatory framework and are extending broadband coverage in rural areas. The most significant gaps can be found in the rural areas of PL, EL, LV, SK but also in IT and DE. Actions in these areas are mostly funded through Cohesion policy programmes (mostly in the new Member States) and the European Agricultural Fund for Rural Development[16] (EAFRD).

[16] About one-third of the Rural Development Programs 2007–2013 take on board broadband initiatives.

Graph 4: EU Broadband penetration rate (July 2007)



Source: Communications Committee

In general, there is a need to bring forward more concrete and innovative policies, speeding up action on the interoperability of cross-border eGovernment services, stimulating business take-up and including e-skills strategies in life-long learning and skills policies.

2.1.3. Industrial competitiveness

The industrial competitiveness of Europe depends to a great extent on setting the appropriate framework conditions for the entire economy. Therefore, actions undertaken in other policy areas, such as R&D and innovation, reinforce industrial competitiveness in Europe. Yet, industrial competitiveness can require industry specific horizontal and sectoral initiatives.

The majority of Member States addressed industrial competitiveness over the period, notably through measures to increase the technological content of industry, to address the sustainability of industry, to promote sectoral competitiveness and to favour the internationalisation of companies by supporting exports or attracting foreign investments. In 2007 more emphasis was put on investment in environmental technologies.

2.2. Energy and climate change

The Lisbon strategy aims at strengthening the link between sustainable use of resources, environmental protection, climate and energy policies and growth. Many Member States have included environmental sustainability among their key priorities or challenges and report important new policy measures. However, recent analysis shows that tackling climate change, improving resource and energy efficiency, and halting biodiversity loss will remain key challenges for the period until 2011 and more efforts will be needed. Recognising this, new cohesion policy programmes plan a total investment of €50.6 billion under the heading of environmental protection and risk prevention. Further investment of €9.6 billion is planned in the area of energy.

Energy efficiency and conservation is a key issue in reducing greenhouse gas emissions and curbing energy demand. A majority of Member States is reporting progress in this area and outline a number of policy measures already implemented or in the planning stage. In addition, the EU average energy intensity had decreased at 0.4% annually from 2002 to 2005. While the data suggest general room for improvement in this area, notably through gains in energy generation or in buildings, a direct comparison of performance between Members States is hindered by the unique structure of the economy in each Member State. Improvements of performance against sectoral benchmarks are a key requirement for the future.

Renewable energy has an important role in reducing CO_2 missions, improving sustainability and the security of energy supply as well as creating new job opportunities, in particular in rural areas. According to the most recent data, nine Member States (DE, DK, ES, FI, HU, IE, LU, NL, SE) are on track to meet existing indicative targets for renewable electricity in 2010[17]. As a result of support schemes, including feed-in tariffs, the share of wind power and biomass in electricity production has increased significantly in some Member States. The corresponding industries have become world-class, allowing not only an improvement of the energy situation inside the EU but also exporting equipment and know-how.

Also promotion of **eco-innovations and environmental technologies** could have received more attention in the implementation reports. Most of the Member States reporting new, specific measures have already a strong competitive edge in the development and application of environmental technologies such as Sweden, Denmark, Austria, or Finland. Some Member States also report measures under consideration, for example, the expansion of the Environmental Fund in Slovenia for financing high risk investments in environmental technologies. Further promotion of environmental technologies would increase competitiveness in one of the fastest growing markets and has the potential to promote efficiency across all industries and generate new employment.

Some Member States report on measures to halt **biodiversity loss**, taking into account environmental and economic role of ecosystems. These measures include adoption and implementation of national biodiversity strategies, completion of

[17] Directive 2001/77/EC.

Natura 2000 network, providing economic incentives to biodiversity protection and rural development policies.

Efforts to break existing trends in **resource use and unsustainable consumption patterns** have generally not been highlighted in the Member States reports. However, some Member States report progress in implementation on green public procurement and resource management (e.g. waste, water and forestry) as well as on internalising the environmental costs through market-based instruments. Nevertheless, the average policy response on internalisation appears weak and slow, with a number of countries lagging behind expectations. Even when internalisation and the "polluter pays" principle are mentioned by Member States as policy priorities, concrete measures are missing in terms of environmental reform initiatives. Positive examples in this area include the environmental tax and fee systems of Denmark, Luxembourg, Netherlands and UK as well as a new environmental tax in Belgium partially offsetting the tax reduction on labour. An environmental tax reform shifting the tax burden from welfare-negative taxes (e.g. on labour) to welfare-positive taxes (e.g. on environmentally damaging activities) can be a win-win option to address both environmental and employment issues, and could be explored further by all Member States. Tax exemptions to promote biofuels, incentives for low emission vehicles, road charging reforms, use of market-based instruments, traffic management and shifts to more environmentally friendly modes of transport by several countries will help reduce external costs from the transport system.

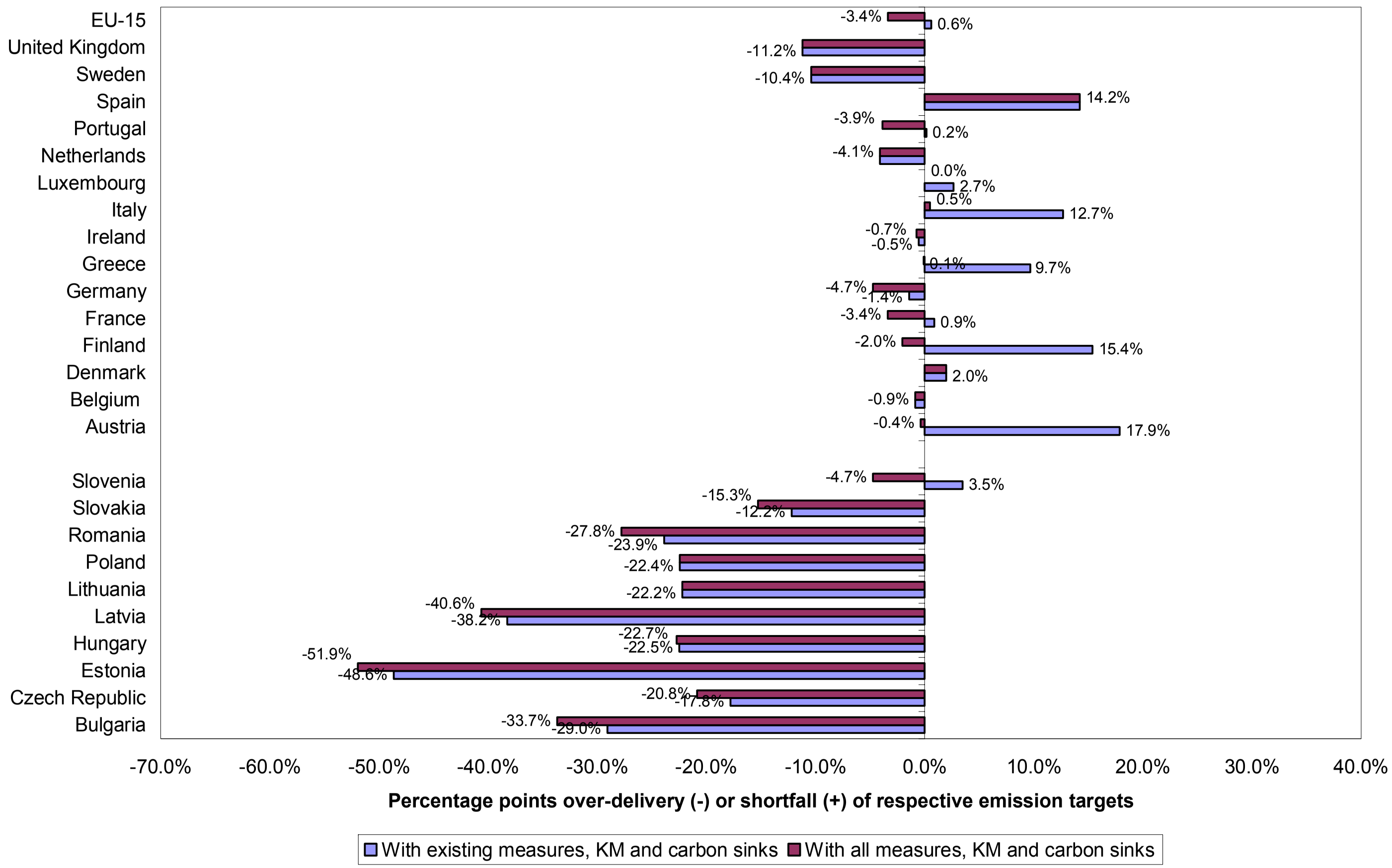
The issue of **climate change** represents a long-term challenge which, if left unaddressed, would bring about major economic costs for the European Union. According to the Stern Report[18] the overall costs and risks of climate change could be as much as 5-20% of global GDP, with the costs of strong and early action to reduce greenhouse gas emissions to avoid the worst impacts of climate change estimated at 1% of global GDP.

The EU has committed itself early to lead the global combat against climate change. Under the Kyoto Protocol, the European Community (EC) has agreed to reduce its greenhouse gas emissions by 8% by 2008–12, from base year levels. Through the burden sharing agreement this joint target has been distributed to individual Kyoto targets for the EU 15 Member States. All new EU Member States, except for Cyprus and Malta, also have agreed on targets for reducing greenhouse gases. While the EU overall has made progress in reaching the targets set the fight for climate change continues to be a real challenge, involving significant investments and potentially structural changes.

Progress in the implementation of measures against climate change so far is mixed. Several Member States will have to implement additional policies to comply with Kyoto targets (Austria, Finland, France, Greece, Luxembourg, Portugal and Slovenia), while most recent projections indicate that Italy, Spain and Denmark may not meet their targets even with additional policies (Graph 5).

[18] Stern (2006).

Graph 5: Relative distance between GHG projections for 2010 and the respective 2010 targets based on 'existing' and 'additional' domestic policies and measures, the use of Kyoto mechanisms and carbon sinks



Note: A negative sign (-) indicates an overachievement of the Kyoto target while a positive sign (+) a shortfall
Source: Draft Kyoto progress report 2007 pg. 9 Fig. 5

Several EU-wide common and coordinated policies and measures have been implemented, most notably the EU Emissions Trading Scheme (ETS), the RES-E directive, the directives on the energy performance of buildings and on biofuels, the promotion of co-generation (combined heat and power), and energy taxation. On average 10,800 installations participated in the first two years of the trading scheme (2005 and 2006) emitting approximately 2,020 Mt CO_2/yr. Two thirds of all installations are classified as combustion installations and are responsible for 72% of overall emissions. The assessment process for the second National Allocation Plans (NAP) started in 2006. On average, the proposed caps were reduced by 7% compared to the 2005/2006 verified emissions, which should bring an estimated emission reduction of 2.4% for the EU-27 compared to base year.

For the future, tackling climate change needs a long-term view. The European Council has set ambitious targets for 2020 to reduce greenhouse gas emissions by at least 20% and to increase the share of renewables in energy consumption to 20%. In addition, energy efficiency is to increase by 20% compared to the base trend and the share of biofuels in overall transport petrol and diesel consumption is to reach to 10%. This confirms the EU leadership in internalising the adverse effects of CO_2 emission at the global level. It is essential to reach these targets in a cost-effective way to maintain the competitiveness of the EU economy. Furthermore early action on adaptation to climate change will minimize risks to economic development, health, property, and infrastructure. If managed well, the challenge can create additional opportunities for innovative EU businesses that lead in developing new technologies and strategies.

2.3. Making Europe a more attractive place to invest and work

2.3.1. Internal Market and Competition

Internal Market and competition are complementary policies: the former focuses on the regulatory framework of the Internal Market and its effective implementation while the latter aims to ensure open and competitive markets, thereby enhancing consumer welfare. Since 2005, the policy attention given to these two areas has varied widely across the Member States.

As regards the Internal Market, the Member States in general have not identified concrete policy actions in their National Reform Programmes. Nonetheless, the transposition deficit of Internal Market legislation has improved considerably over the last period in a number of Member States.

As regards competition, the measures were often general in scope and rarely linked to quantitative indicators; often (in particular as regards network industries) references were simply made to the implementation of the existing *acquis*. The second most frequent measures – after network industries – were reforms relating to the enforcement of competition policy.

2.3.1.1. Progress on particular internal market and competition issues

- **Transposition of internal market directives** is mentioned as a specific issue in a number of NRPs but in the majority of cases it is not being dealt with in an operational way. There is however a considerable improvement in a number of

Member States of the transposition deficit over the last two years; but at the same time the number of infringements is increasing, indicating a deteriorating quality of transposition. As a follow up to the 2007 Spring Council conclusions the Member States concerned will need to address the question of how they intend to reduce their deficit to 1% by 2009 at the latest. There is also a need for a more qualitative approach, including by reinforcing the problem solving capacity of Member States in addressing incorrect application of internal market law.

- In spite of their economic importance, only very few NRPs address at present the issue of better functioning of **public procurement** markets. The key challenge is to make sure that Member States comprehensively transpose and implement the new public procurement framework adopted in 2004 in a correct, timely and coherent way.

- Experience so far is largely positive in the field of **competition policy enforcement**. Several Member States have taken measures contained in their NRPs strengthening national enforcement regimes (e.g. extending the powers and resources of national competition authorities) in line with the Modernisation of EC competition law in 2004[19]. Also, most if not all Member States and their national competition authorities are engaged in the screening of markets with the aim of removing obstacles to competition (a fact which is reflected in several NRPs). DK has a particularly advanced system in this respect. Rather large divergences in terms of ambition seem to exist. Less emphasis seems to have been put on the actual removal of obstacles identified.

Looking forward, ensuring convergence and uniformity in the application of EC competition rules through the European Competition Network (ECN)[20] remains a challenge. In programmes foreseeing immunity from or reduction in fines for undertakings revealing cartels (leniency) convergence is of key importance[21]. The role of national courts in ensuring convergent enforcement of EC competition law should be stressed. Further efforts should be undertaken to accelerate judicial proceedings in competition cases. Member States could in line with the existing case law of the Court[22] be encouraged to undertake procedural reforms facilitating antitrust damages actions.

- In its APRs the Commission has attached particular importance to the need for national action to remove unnecessary and disproportionate restrictions on competition in **professional services**. While some Member States are taking positive steps to remove restrictions, in some cases yielding rapid positive effects (IT), significant reforms are still needed on the part of other Member States (reflected in a number of country specific recommendations and points to watch).

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19 Regulation No 1/2003.

20 Comprising the Commission and the national competition authorities of the EU Member States.

21 See e.g. the ECN Model Leniency Programme. The OECD (see "Hard Core Cartels – Third Report on the Implementation of the 1998 Recommendation") refers to recent research estimating that the average overcharge is somewhere in the 20-30% range (with higher overcharges for international cartels).

22 The case law of the Court of Justice already today obliges Member States to guarantee effective procedures for obtaining damages in case of an antitrust infringement (see e.g. C-295/04 to C-298/04, Manfredi, paragraph 62).

The reforms should focus on the most severe restrictions (e.g. price regulation and unjustified barriers to entry).

- The persistence of barriers to competition combined with the economic significance of this sector justify that professional services remains a priority for the upcoming Lisbon cycle. Indeed, roughly one fifth of cases concerning infringements of competition results reported within the framework of the European Competition Network has related to professional services. Moreover, the Services Directive will oblige Member States to review and to assess the proportionality of their national legislation on requirements affecting inter alia professional service activities (e.g. fixed tariffs, multidisciplinary partnerships, numerus clausus) in addition to ongoing screening by national competition authorities of existing regulation and practices.

- Some NRP contain measures aimed mainly at removing public barriers to market entry and expansion in the **retail sector** (e.g. opening hours). Some measures have already produced positive effects in terms of prices in this area (IE). Given the economic importance of the retail sector (not least as a productivity driver) there would seem to be more scope for action (e.g. zoning laws, planning restrictions). Improving entry to and competition at the retail and distribution levels would also be helpful in ensuring that trade liberalisation agreed to by the EU feeds through to end consumers[23].

- Generally speaking Member States are making progress in shifting **state aid** to horizontal purposes (e.g. environment, R & D) ("better aid") while efforts to reduce the overall aid level has stagnated in recent years ("less aid"). As far as the NRPs are concerned, only a few Member States have included specific measures to reduce State aid or have reported on progress in reducing overall levels and shifting aid towards horizontal objectives[24]. Important complementary Community level measures under the State Aid Action Plan has been undertaken to promote better aid while reducing burdens on companies and Member States.

- The main challenge ahead is the timely and consistent implementation of the Services Directive, which will contribute to achieving a genuine **Internal Market in services.** By removing legal and administrative barriers to the development of services activities, it will facilitate the freedom of establishment and the freedom to provide cross-border services. The implementation process is a complex and challenging task both for the Member States and the Commission. Close cooperation is required, and the Commission has taken the commitment to provide guidance and to coordinate Member States' efforts until the December 2009 implementation deadline. To ensure that the necessary legislative measures can be adopted in 2009, Member States should aim at completing the screening and assessment of national legislation before end 2008. In parallel, the setting up of

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23 See '4. Conclusion – lessons to be drawn from the Irish experience of globalisation. European Economy No 6.

24 The overall level of State aid less agriculture, fisheries and transport stood at € 45 billion for the EU in 2005. There is a slight downwards trend from an annual average of € 52 billion in the period 2001-2003 to an annual average of € 47 billion in the period 2003-2005. There is a clear move towards "better targeted aid" with more than half of Member States now awarding more than 90% of their aid to horizontal objectives.

points of single contact, procedures by electronic means and of an effective system of administrative cooperation will require Member States to make a number of decisions and preparations in 2008.

- The importance of integration of **financial markets** is underlined in a number of NRPs; however in most of the cases without setting out concrete actions. Nevertheless, the transposition of the Financial Services Action Plan measures is well under way, even if the process should be accelerated in some Member States. As explained in the post-FSAP White Paper, the focus has now to be put from adopting new regulation to ensuring correct implementation and effective enforcement of existing measures and to removing remaining barriers to the further integration of financial markets.

2.3.1.2. Network industries

While many Member States address competition in network industries, notably in gas and electricity and electronic communications, from a growth and jobs perspective greater efforts (going beyond existing legal commitments) are needed in many countries in respect of issues such as unbundling (notably in the gas, electricity and rail sectors) as well as the need for clearly mandated and independent regulatory authorities with adequate levels of resources.

The focus on improving the functioning of network industry markets should be sharpened. The importance of network industries from a competitiveness perspective as well as from the point of view of citizens/consumers extends well beyond their 6-8% share of EU value added).

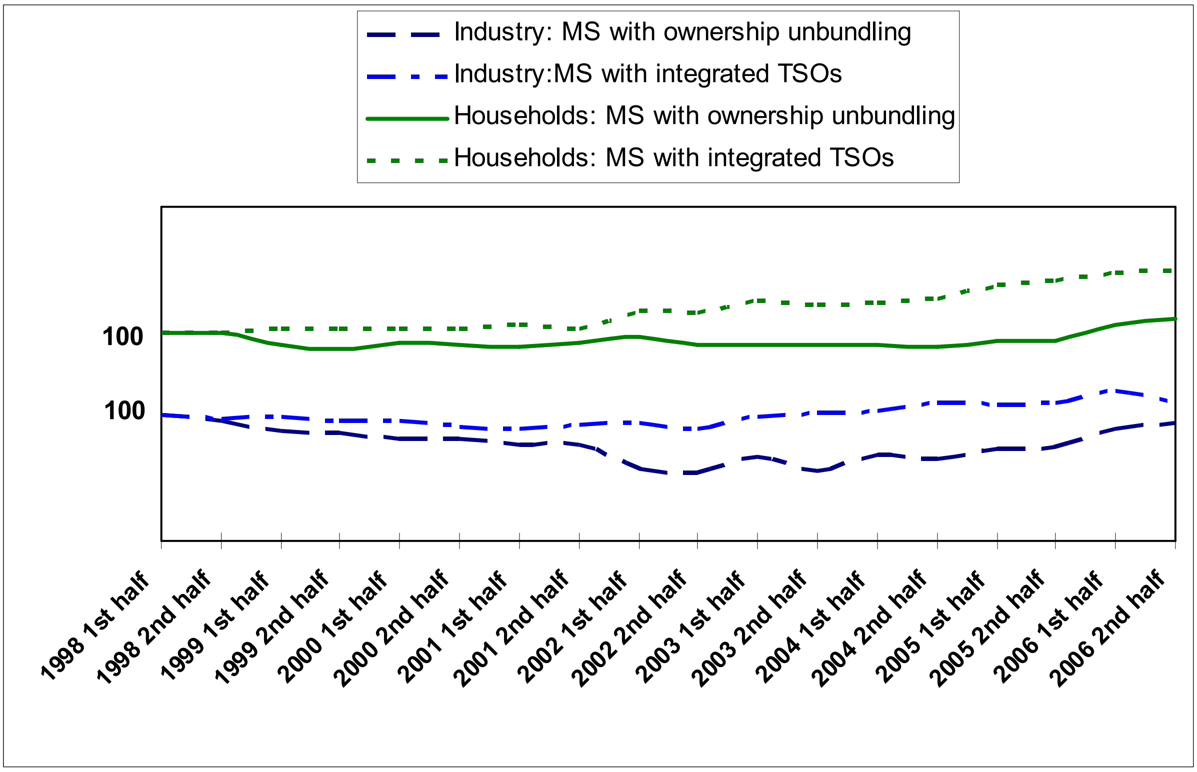
A common key challenge (in particular for gas, electricity, rail and electronic communications) is the need to ensure independent, clearly mandated and well resourced regulators (as well as intensified cooperation between the regulators themselves and with the Commission.

Continuous efforts should be made at finding the optimal balance between sector-specific regulation on the one hand, and general competition and internal market policy principles on the other hand. To the extent that competition intensifies, regulation may be progressively lifted.

Developments in the various network industries are as follows:

- Promoting competition in gas and electricity markets remains a key challenge and concern for most Member States. While it is undeniable some progress in opening up gas and electricity markets has been made in recent years, it is also true that in many Member States a real competitive European market for electricity and gas still needs to develop. Yet, the benefits to consumers and users of an effective liberalisation are clear (see a comparison of price developments between unbundled and integrated transmission system operators (TSOs) in graph 6). High levels of market concentration, vertical foreclosure and lack of transparency continue to characterise gas and electricity markets.

Graph 6: Electricity price evolution in EU-27 for the period 1998-2006 according to ownership structure of TSO



Source: Eurostat, European Commission calculations

The key problems to be addressed are well known (vertical integration and the need for more effective unbundling (preferably ownership unbundling). A particular problem is a tendency for Member States to maintain or impose price regulation.

- Competition in **electronic communications markets** is governed by the regulatory framework adopted in 2002. This is an innovative construction involving harmonisation legislation based on competition policy principles. The experience with the regulatory framework during its first three years of operation is positive. More competition has led to innovation and investment by both new entrants and incumbent operators as well as to significant retail price declines, for example, of around 40% for local fixed telephony costs on average. The independence of the national regulatory authorities both from ownership interests in the sector and from undue political interference, and transposition issues (in particular secondary legislation and amendments of existing laws) remain an issue.

- While competition in the **rail sector** is addressed in some National Reform Programmes, few Member States envisage concrete measures to tackle the key problems limiting competition (such as the insufficient separation between the infrastructure manager and the incumbent rail operator) and to ensure that the rail regulators are independent and adequately endowed with resources. The major event in terms of Internal Market and competition regulation in the railway sector was the complete market opening for all kinds of rail freight services on the EU railway network on 1 January 2007 according to Directive 2004/51/EC of 30 April 2004 (part of the second railway package). The legal possibility of open access traffic has led to new market entry and the development of competition in rail freight services in a number of Member States. The number of new entrants and their market share has risen, for instance, in Poland, Romania, the Czech Republic and France. Strengthening the power of institutions on which the organisation of the sector depends, i.e. the rail infrastructure manager, the rail regulatory body and the safety authority, will be of crucial importance. On 23 October 2007, the European Parliament and the European Council adopted the 3rd railway package, which includes Community law on market opening for international rail passenger services by 2010, passenger rights in rail transportation and on the certification of train drivers.

- While all Member States have transposed the current directives, only a number of Member States have addressed **postal services** in their National Reform Programmes. Liberalisation has progressed well. Member States have embraced liberalisation as agreed thus far and most of them have taken steps to prepare their postal services sectors for further liberalisation. The actual level of competition in the sector however remains low. Looking ahead, the Commission proposal for liberalisation is expected to be adopted by EP and Council first semester of 2008. Objectives of the proposed action are to achieve an internal market for postal services through the removal of exclusive and special rights in the postal sector, safeguard a common level of universal services for all users in all EU countries and set harmonised principles for the regulation of postal services in an open market environment, with the aim of reducing other obstacles to the functioning of the internal market. The transposition and effective implementation of the directive will be an important challenge.

2.3.2. *Better Regulation*

In general, Member States have expressed their commitment to the key Better Regulations objectives in their National Reform Programmes, while implementation in the daily policy making processes has stalled. Moreover, Better Regulation has been treated as a reform measure rather than as an underlying principle of efficient public administration delivering effective, coherent and less burdensome legislation[25]. So far, action at national level has been limited to the eventual setting up of better regulation tools, without a real change in regulatory conditions and with limited impact on the business environment. The lack of specific targets, compliance incentives and monitoring and enforcement mechanisms has taken its toll in slowing down the implementation of announced measures as well as the process of cultural change in policy making.

The European Council has invited Member States to set their own national **administrative burdens** reduction targets by 2008 of comparable ambition to the

[25] BG and RO have not been included in the analysis, as they are at the very beginning of developing their approach to Better Regulation.

target set by the Commission, i.e. a 25% reduction. To this date, ten Member States (AT, DE, DK, EL, ES, IT, NL, SE, SK, UK) have set a 25% national reduction target, while another two Member States (CZ, FR) set a target of 20%. In comparison with last year this is considerable progress as the number of Member States with a quantitative target has doubled. However, there is still a considerable effort to be done in this regard by the end of next year.

The Commission and Member States will be entering a crucial phase next year when first results from the measurement will provide indications of how administrative burdens can actually be reduced. The key step was taken when most Member States opted for the same measurement methodology (standard cost model). Four Member States have so far carried out baseline measurement of administrative burdens (CZ, DK, NL, and UK); while another four are currently conducting them (AT, DE, FR, SE).

However, reduction of administrative burdens is only one of the **regulatory simplification** elements. Despite initial progress in developing systematic simplification programmes, the pace has slowed down with only two Member States advancing in this area in the course of last year (PL and LU). It is worth mentioning that in fourteen Member States (BE, CZ, CY, DK, IE, LU, MT, NL, PL, PT, SE, SI, SK and UK), stakeholders are involved in setting regulatory simplification priorities under existing programmes or ad-hoc measures.

Limited progress has been made in implementing **impact assessment** systems. Rigorous impact assessments analysing economic, social and environmental impacts of new legislative proposals are being carried out by a handful of Member States, (AT, DK, DE, IE, NL and UK). Moreover, only two out of these six Member States make their impact assessments publicly available (DK and UK). Overall, impact assessment quality among Member States varies widely and there is room for substantial improvement. Rather worrying remains the fact that very few institutional structures which would allow for a rigorous implementation of the impact assessment system and its quality control have been created (DE, IE and UK), while promising steps in this direction are being taken (EL, LT and LV).

Regular **consultation of stakeholders** remains the least developed Better Regulation tool in Member States. Even for those Member States which report on a formal obligation incorporated in their law making procedures (AT, BE, CZ, DE, DK, FI, IE, LT, LU, PL, SE, SI and UK), there is still scope for further improvement towards a systematic implementation of clear, consistent and transparent consultation rules across the board. Moreover, the understanding of the contribution that stakeholders could bring into the policy making process substantially differs across the Member States, as evidenced by the differences with regard to the stage in the law making process at which the stakeholders become involved and with regard to the methods used to reach them.

Lastly, progress in developing **Better Regulation strategies** has decelerated, with only one Member State (CZ) developing a strategy in 2007. Some of the originally promising plans have not yet resulted in explicit Better Regulation programmes which would ensure a coherent approach to policy making. This stalemate, in conjunction with the above mentioned lack of progress in the area of impact assessments and legislative simplification, holds back progress in increasing the efficiency of public administration and in creating favourable regulatory conditions for businesses.

2.3.3. *Entrepreneurship and SMEs*

Overall, the measures and initiatives in the area of SME policies undertaken by Member States since the re-launch of the Lisbon partnership for growth and jobs in 2005 are going in the right direction. Progress has been particularly visible in improving the start-up procedures but also in the integration of the "think small first" principle into the policy-making process. In the area of entrepreneurship education, SME access to public procurement and recruitment of the first employee, policy actions have been initiated in almost all Member States while their results have not yet materialised. Most of the priorities set at the Spring European Council 2006 – start-ups, recruiting the first employee, entrepreneurship education, think small first – need to be seen in a long term perspective, and related policy actions need to be intensified.

Average time and cost to **start up** a private limited company is 12 days and cost is € 485 (see Table 1). This is substantially lower than the 24 days and € 830 for an equivalent company in 2002. Many Member States have established a one-stop-shop or equivalent arrangement even though in some cases they do not cover all types of companies: only 2 out of 3 one stop shop systems offer the possibility to register a private limited company. Member States that fully comply with all three objectives (one-stop-shop, time and cost) are BE, DK, EE, FR, HU, PT, RO, SI and UK. In general registration times have improved and in 13 Member States, it is now possible to register a company within one week. It should be noted, however, that this analysis only looks at the steps to get a company registered. In many countries there are further administrative steps and more time is required before a new SME can start its business operations[26].

Table 1: Results of the objectives set by the Spring 2006 Spring Council conclusions - One stop shop to start-up a company (1)

	Name	Fully operational	Time required to start-up a company	Cost to start-up a company**
Belgium	Guichet agreé d'entreprises	YES	1,5	€ 517
Bulgaria		NO*	12-30	€ 155
Czech Republic	Central Registration Offices (CRO)	NO*	42-56	€ 345 €
Denmark	Danish Commerce and Companies Agency (DCCA)	YES	3	€ 0
Germany	Starter-Center	NO*	6,5	€ 783
Estonia	Notaries	YES	2	€ 190
Ireland	Companies Registration Office (CRO)	NO*	2-5	€ 50
Greece	Directorate of Development at the prefectures (KYE)	NO*	30	**€ 1.366**
Spain	Ventanilla Única Empresarial (VUE) + PAIT for Ltd.	YES	30-40	€ 617

26 In this context, the timely implementation of the points of single contact foreseen in the Services Directive, to be implemented by end 2009, will also be an important task for Member States.

France	Centres de formalités des entreprises (CFE)	YES	4	€ 84
Italy	"Sportello unico"	YES	4	**€ 2.673**
Cyprus	OSS at Ministry of Commerce, Industry and Tourism	YES	7	€ 265
Latvia	Register of Enterprises	NO*	4	€ 205
Lithuania	Centre of Registers	YES	6	€ 130-€ 289
Luxembourg	Guichet unique d'entreprises	YES	14	**€ 1000**
Hungary	County Courts	YES	2-3	€ 392
Malta	Registrar of Companies – Malta Financial Services Authority (MFSA)	NO*	7-10	€ 450
Netherlands	Chambers of Commerce	NO*	3	**€ 1.040**
Austria	WKO Gründerservice	YES	7-30	€ 400
Poland	Tax Offices	NO*	30	€ 735
Portugal	Enterprise Formality Centres (CFE)	YES	1	€ 300-€ 360
Romania	Counties Trade Registers	YES	3	€ 100-€ 125
Slovenia	VEM	YES	3	€ 250
Slovakia	Trade licence offices, companies register	NO*	14	€ 330
Finland	Trade Register	YES	14	€ 330
Sweden	Företagsregistrering	YES	21	€ 222
United Kingdom	Companies House & Business Link	YES	1	€ 54
AVERAGE			12 days	€ 485

Notes
(1) All figures on cost and time based on information provided by Member States which have not been fully validated. Calculation methods as described in Commission Staff Working Document SEC(2007)129.
*NO means that the services offered by the one-stop-shop are not sufficient to consider it a fully functional one-stop-shop.
**Cost: numbers in bold for countries with cost above the threshold.

Member States are increasingly integrating the **"think small first"** principle into the policy-making process. While only few have set up a specific body to represent SMEs interests, almost all of them consult SMEs representatives. A number of Member States (for example BE, DK, ET, MT, NL, SE, FI, UK) evaluates or is planning to evaluate the impact of new legislation on SMEs. Examples of specific provisions to alleviate the administrative burden on SMEs go from the simplified conditions for accessing subsidised finance (FR) to longer payment time for VAT (DK) or development of dedicated electronic services (FI). However, further national efforts are needed in the application of this principle in order to meet the specific needs of micro and small enterprises but also to maximise its positive contribution to the target of reducing by 25%, at EU level, the administrative burden by 2012.

Awareness of the need to enhance **entrepreneurship education** at school is constantly increasing in the Member States and in the last couple of years new plans and individual initiatives have been flourishing in this area. However reforms planned in a number of countries are sometimes described in rather generic terms and their implementation in practice will have to be monitored. In a few Member States, entrepreneurship is already a recognised objective of the education systems and is embedded explicitly in national framework curricula (ES, FI, IE, CY, PL, UK) but implementing means (teacher training, teaching materials) still need to be stepped up.

In some cases, elements of entrepreneurship are found horizontally throughout the curriculum, or entrepreneurship forms part of economic subjects (LV). Other Member States are starting to implement or are planning reforms in the same direction. However, Member States where entrepreneurship is well established in the curricula are still a small minority.

Almost all Member States have already taken or are currently introducing measures to raise SMEs' awareness on public tenders and to provide them with easy access to tender information (single electronic access points or electronic procurement, training and counselling, etc.). However, only a handful of Member States report on more specific measures to help SMEs' to participate in **<u>public procuremen</u>**t (use of prior information notices, dividing contracts into small lots) and only very few have put in place a strategy or specific measures to help SMEs to participate in public procurement (e.g. UK, IT, FR). A study published by the Commission in November 2007[27] showed that 42% of the value of public procurement contracts above the EU Directives' thresholds goes to SMEs. This share is smaller than the economic importance of SMEs in the EU, but above the SME quota for federal public procurement in the US (23%).

Since 2005, some limited progress has taken place in the simplification of procedures for recruiting a first employee. Overall, the average number of mandatory external contacts (social security organisations, tax offices, labour offices, etc.) has been reduced from 3 to 2.5 and the average number of procedures (filing forms, etc.) from 3.5 to 3. However, the target of having no more than one public administration point in that process is still far and the situation varies significantly from a Member State to another. Only three Member States (e.g. ES, MT, and PT) have a special one-stop-shop system for recruitment of first employee or one-stop-shops for start-ups that can also take care of recruitment. Several other Member States have procedures that are so simple that only one contact with a public administration is required (e.g. BG, FR, IE, LV, LT, SE). In others, at least the social security registration is organised as a one-stop-shop or one-window-system, i.e. one branch of the social security collects the registration and distributes the information to the other branches (e.g. DE, SK or the UK). BE is a special case where "social secretariats" take care of all employment related procedures for businesses, including the registration of new employees etc. but have to be paid by businesses.

2.3.4. *European infrastructures in the transport sector*

In 2007 the rate of progress towards the key objective of completing the Trans-European transport network has been high. The measures taken jointly by the Member States and the Community in support of the TEN-T and the 30 priority projects in particular, have resulted in an annual investment (EU 27) of € 40 billion, with approximately € 20 billion of this going to priority projects. PP 4, the High-speed railway axis east (section Paris-Bodrecourt) and PP6, the dedicated rail freight Betewe line, were completed during 2007, and PP 2 the High-speed railway axis - Paris-Brussels-Cologne-Amsterdam-London is now almost complete, while

[27] *Evaluation of SME Access to Public Procurement Markets in the EU,* Final Report by GHK and Technopolis, available at: http://ec.europa.eu/enterprise/entrepreneurship/public_procurement.htm

substantial progress has been made on other projects including PP 3 the High-speed railway axis of south-west Europe - Madrid-Barcelona, Madrid-Valladolid.

Looking to the future, the Community institutions support the introduction of a higher Community co-financing rate, in particular for cross-border projects, for those having a transit function, or those involving the crossing of natural barriers. The Multi-annual Programme will allocate between 80 and 85 % of the TEN-T financial reference amount of € 8,013 million for the period 2007-2013 to projects presenting the highest value to the Community (in particular cross-border projects), to the deployment of the European rail signalling system ERMTS/ETCS and to the development of Intelligent Transportation Systems. In the same period, new cohesion policy programmes plan to invest for the development of railways more than EUR 22 billion and more than EUR 17 billion for the development of TEN-T motorways.

3. IMPLEMENTING PRIORITIES FOR ACTION

The potential contribution of microeconomic structural reforms to the European Union's long-term economic performance through achieving stronger productivity growth is well established in the theoretical and empirical literature. An important part of the task to enhance total factor productivity growth consists of bringing about more propitious framework conditions. Well functioning markets and competition are a key condition for higher R&D spending to translate into innovation and better results in terms of productivity.

The previous section summarises the evidence on the implementation of micro-economic reforms since 2005, drawing on Member States' implementation reports throughout the first cycle of the strategy for Growth and Jobs. It shows that the types of reforms engaged by Member States in the last years have the potential to strengthen Europe's productivity performance and thereby make a key contribution to the objectives of the growth and jobs strategy. Full implementation of the reforms in the microeconomic area remains the most important condition for realising their potential in terms of productivity growth.

The analysis shows that significant progress has been made in a number of areas with the implementation of the microeconomic reform agenda. Around half of all Member States have shown a strong policy response in the areas of R&D and ICT, and most others have at least made some progress in these areas. Regarding the aim to unlock the business potential, particularly of SMEs, where concrete objectives have been targeted for end-2007, a clear majority of Member States have shown at least a fairly good or strong policy response. About a third of Member States show a strong policy response with regard to energy and climate change. However, the uneven implementation record across Member States implies that progress overall could still be better.

There are also important policy areas where overall progress across Member States has been not satisfactory and where significant implementation deficits remain despite the strong performance of some Member States. In the area of R&D, current efforts will probably not be sufficient to reach the established target. In the area of competition policy only few Member States have registered a good policy response, while overall progress has been limited. At the start of a new cycle these implementation deficits give rise to concern. Member States commitment to the full implementation of their National Reform Programmes is important for the credibility of the strategy overall. It will be important to take any implementation deficits from the first cycle into account when defining the ambition of the National Reform Programmes for the new three-year cycle.

- In the area of R&D, innovation and industrial policy, Member States have given a high priority to the measures to enhance research and innovation. While all Member States have set a target for research spending and despite progress made in many Member States, important implementation gaps remain overall. The slight decline in R&D expenditure in 2006 after broadly stagnating levels in the years before is a sore reminder that one of the flagship objectives of the renewed Lisbon strategy—the 3% R&D expenditure target—may not be reached by 2010. More than insufficient public spending on R&D, this outcome reflects weaknesses in the existing framework conditions and in policy design. Going forward it will therefore be crucial to set up coherent R&D and innovation strategies where they are not yet in place and to address issues such as innovation in services organisational innovation, intellectual property rights, ensuring the availability of qualified researchers, and overcoming skills shortages.

- Regarding ICT, implementation gaps remain regarding the availability of digital content and related policies (IPRs), digital skills requirements, standardisation, next generation networks, and security of electronic payments, privacy, and interoperability.

- The implementation record in the areas of functioning markets and competition policy has been mixed across the Member States. While there is clear progress with transposition of internal market legislation, more attention to the quality of transposition, implementation and enforcement of internal market legislation is needed. More also needs to be done to ensure the good functioning of public procurement markets and, at the Community level, the development of a well balanced framework for intellectual property rights. The integration of financial markets, in particular in the area of retail financial services, has so far remained inadequate.

- State aid and competition in professional services have not been prominent on the Member States' reform agenda. Particular implementation deficits remain in the area of external openness, professional services and some network industries, in particular gas, electricity, and rail. It is telling that the more country-specific recommendations and points to watch have been proposed in the field of competition policy than in any other micro-economic area. This shows that this policy area constitutes a key challenge for most Member States also for the new three-year cycle.

- In the area of Better Regulation, the main progress has been reaching consensus on prioritising this policy area and in creating the necessary tools to serve it. However, implementation has been slow and the objective of embedding Better Regulation in every-day policy making is far from secured. Despite the recent progress, there is a need for more action to achieve the SME start-up targets set by the 2006 Spring European Council. Improving SMEs' access to finance and mainstreaming of SME issues into other policy areas deserve more attention.

- Implementation of policies to address climate change and sustainable use of resources has been insufficient. Also, more action is needed to improve the interconnections of national energy networks and to integrate the energy markets. In the area of transport policy, interoperability and interconnection of the national networks remain priorities, while not enough has been done to promote the efficient use of infrastructure.

A general conclusion of this stock-taking exercise is the recognition that policy measures in the different policy areas need to be better integrated, so as to maximise their positive externalities. This does not apply only to the micro-pillar policies – where an integrated approach to the 'knowledge triangle' of research, innovation and education policies is called for – but also to the reform design across the three pillars of the renewed Lisbon strategy, i.e. the macro-economic, micro-economic and employment policy areas.

In order to ensure continued progress toward bringing about a better productivity performance in the European Union, it will be important that Member States in their National Reform Programmes for the new three-year cycle of the strategy take account of the microeconomic implementation deficits of the first cycle that have been outlined here. R&D and innovation policies as well as enhancing competition, market functioning and sustainable use of resources will remain key challenges in the period ahead both for both most Member States and the European Union as a whole. A sustained effort will be needed to narrow the EU's productivity gap vis-à-vis the global top performers.

III. THE COMMISSION DRAFT OF THE JOINT EMPLOYMENT REPORT 2007/8

Summary and conclusions

The favourable economic environment has left positive traces on the European labour markets. 2006 saw employment–intensive growth for the first time in almost a decade. The laast two year have seen the creation of almost 6.5 million new jobs and unemployment has reached the lowest levels in years. Part of this is cyclical but there are good reasons to believe that the European Employment Strategy and the integrated Lisbon strategy are showing results and that structural reform are starting to pay off. One of the most obvious sign of this is the recent decline in structural unemployment.

Despite the relatively favourable labour market outlook a number of serious concerns persist The most pressing is youth unemployment that continues to be a severe problem in many Member States. Young people have not benefited proportionately from the economic upswing; in 2006 they still remained exposed to unemployment more than twice as much as the overall work force. Today nearly one in six young people in the EU, or almost 7 million, still leave the education system prematurely and there has been virtually no increase in levels of educational attainment.

Further efforts are needed to reach the European employment targets. Moreover, the responsiveness of European labour markets to the challenges of globalisation and ageing remains insufficient. Structural unemployment still remains too high and more needs to be done within comprehensive flexicurity approaches to improve the functioning of European labour markets and to facilitate transitions with the aim of eliminating barriers to employment.

It is very encouraging that about half of the Member States have now developed or are developing comprehensive flexicurity approaches but the performance within the various underlying components is less positive. Labour market segmentation remains a significant problem in many Member States and the focus of the policy response still tends to be more on easing labour market regulation for new entrants and facilitating more contractual diversity than on reforming existing mainstream labour legislation. Reforms of social security systems have tended to be limited to pension reforms. Active labour market policies, although becoming more personalised, have been subject to a decline in expenditures since 2000 both as a share of GDP and per worker. Finally, participation in lifelong learning in the EU barely increased between 2005 and 2006, while it has actually decreased in half of the Member States, and adult training remains unevenly distributed. These figures are disappointing and worrying for the future. A substantial rise in the investments in human capital better targeted towards labour market needs is essential to close the productivity gap with our key global competitors.

Europe must continue labour market reforms for more and better jobs. People not working and in precarious work need special attention. An ageing Europe in an intensely competitive world needs more people working more productively.

1. PROGRESS IN ACHIEVING THE OBJECTIVES OF THE EUROPEAN EMPLOYMENT STRATEGY

1.1. Full Employment

Employment targets

Helped by the strong economic expansion employment growth picked up in 2006 and recorded the strongest increase since the nineties with nearly 4 million jobs being created during the year and the overall employment rate climbing to 64.3%. This employment expansion notably took place in an environment of accelerating productivity growth, not seen in a decade. Progress has been widespread but was in particular driven by a handful of Member States. Labour market performance is projected to continue at least next year and should lead to further progress towards reaching the employment targets.

Despite the positive performance in 2006 Europe remains short of the 2010 employment targets. The current employment rate implies that another 20 million jobs will have to be created by 2010 if the target is to be reached. Forecasts already suggest that another 5.5 million new jobs could be created by 2008[28]. With sustained efforts, the 2010 overall target of a 70% employment rate becomes closer.

Older workers still represent one of the largest target groups for raising employment. With a current employment rate of 43.5%, (6.5 pp from the 2010 target), there is still significant untapped potential among older workers and their numbers will continue to grow during the coming decades. Regarding gender, the employment rate for women has increased in almost all Member States reaching 57.2 % in 2006, and stands relatively close to the 2010 target of 60 %. With an employment rate of only 50%, people with disabilities also remain a potentially large untapped resource of additional labour supply.

Unemployment dropped significantly from 8.9% in 2005 to 8.2% in 2006 and almost all Member States contributed to this trend. Both women and men benefited as the unemployment rate fell to respectively 9% and 7.6%. A notable indicator of the robustness of the current labour market performance is that the long-term unemployment rate fell for the second year in a row, from 4% to 3.6%.

Youth unemployment remains a severe problem in many Member States. The overall youth unemployment rate did decrease over the last year but this was mainly attributable to significant reductions in a small number of Member States. The unemployment rate amongst young people has actually increased since 2004 in a number of other Member States. So far young people have not benefited enough from the favourable economic environment; they remain more than twice as exposed to unemployment as the overall work force. Finally, many Member States still fall short of the new activation targets. Despite also being a Lisbon priority since 2006, and given the importance of the young generations in addressing the future demographic challenges, these trends remain disappointing.

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28 European Commission, Economic forecast, Spring 2007.

Structural reforms

There are a number of signs that structural labour market reforms in recent years are having an impact[29]. The strongest evidence however, is the significant reduction in structural unemployment throughout Europe[30]. While the period 1997-2003 was characterised by rather stable and high structural unemployment, it has been reduced by about one third since 2004 and is forecast to drop further in 2007. The level, however, is still significantly higher than that of our principal competitors.

Together this points to the existence of significant barriers to employment. European labour markets are not sufficiently responsive to the challenges of globalisation and ageing. More needs to be done to improve their functioning and to facilitate labour market transitions.

1.2. Quality and productivity at work

Productivity

One of the most striking challenges of globalisation is the enhanced requirements for productivity gains in order to ensure sustainable employment growth. Since the eighties, average labour productivity growth in the EU has been decreasing from around 2% a year in the second half of the 1990s, to around 1% between 2001 and 2003. Over the same time frame the US has sustained productivity growth rates of some 2% on average. Since 2003 however, there has been evidence that the decline in productivity growth in Europe is being reversed.

Table 1. GDP, employment and labour productivity growth (annual averages)

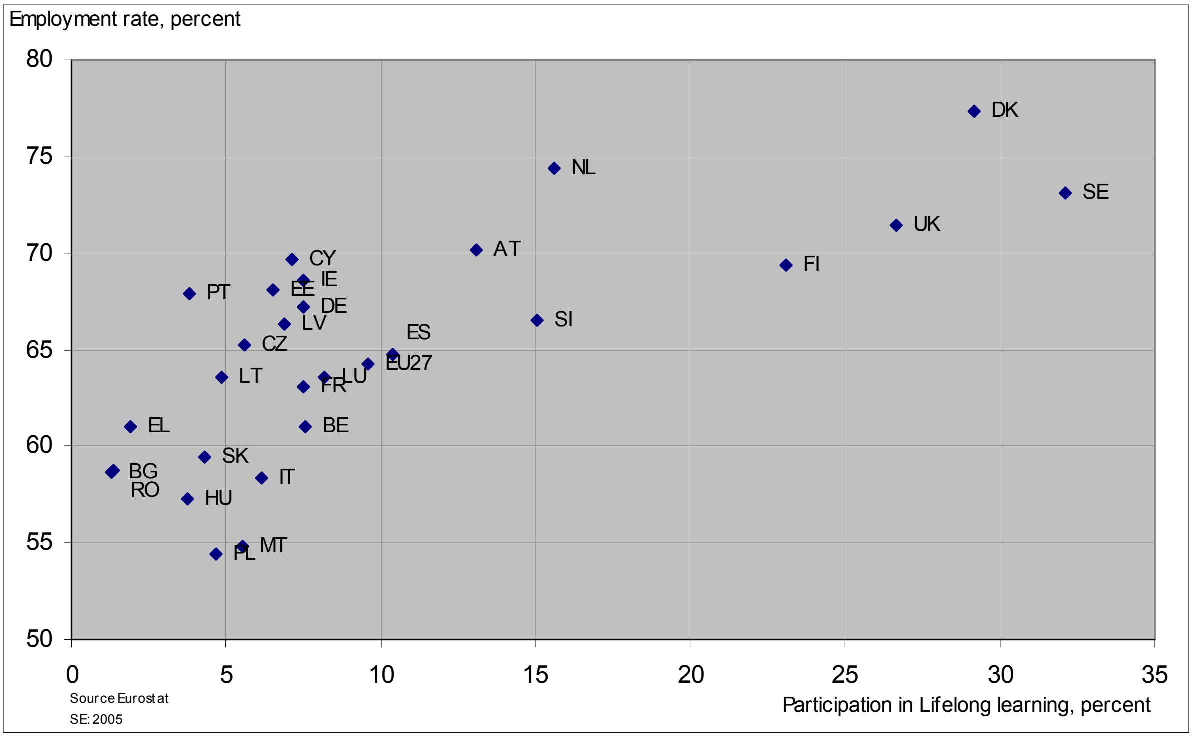
	1997-2000		**2001-2003**		**2004-2006**	
	EU27	**US**	**EU27**	**US**	**EU27**	**US**
1. GDP	3.1	4.2	1.5	1.6	2.4	3.2
2. Employment	1.1	2.1	0.3	0.0	1.1	1.6
3. Labour Productivity (per worker)	2.2	2.1	1.1	2.0	1.5	2.1
4. Hourly Labour Productivity		2.1	1.6	2.7	1.4	2.3

One important means of improving labour productivity is through investment in human capital, in particular by establishing comprehensive strategies for lifelong learning throughout the life cycle. In this regard, Europe is behind schedule.

29 One of them is the development in wages. In the current economic upturn, there has been no significant pressure on wages which has been typical for cyclical driven expansions.

30 European Commission, AMECO database, DG ECFIN.

Graph 2: Employment rates and participation in lifelong learning 2006



The graph indicates that there may be some correlation between employment rates and participation in lifelong learning. The graph might also indicate that to achieve very high employment rates it is necessary to exceed a certain level of participation in lifelong learning.

Clear progress has been made in recent years on reducing early school leaving, but in 2006, almost 7 million young people still left education prematurely. Progress is too slow in increasing youth educational attainment levels; figures have only improved moderately since 2000. The level of adult participation has remained stable or has even decreased in 20 out of 27 Member States since 2004. Participation levels are particularly low in Southern European countries and in most of the new Member States. The lowest participation rates throughout the EU continue to be those of older workers.

It is imperative that Europe steps up its investments in human capital[31]. Adequate incentives and cost sharing mechanisms for enterprises, public authorities and individuals must be developed.

Quality at work

Progress in the quest to increase quality at work again remains mixed[32] and implementation of policies to this aim is limited. In-work poverty still affects 8% of workers in the EU. While 2006 saw some further improvements in youth education

31 Currently US and Japan are for example spending twice as much as the EU on tertiary education.

32 For details of the 10 dimensions of quality at work see: Improving quality in work: a review of recent progress - COM(2003) 728, 26.11.2003.

levels there has been limited progress in other elements of quality at work, including in particular the transitions from insecure to secure jobs, and the issue of reducing labour market segmentation, the level of which is currently on the rise in many Member States. Adult participation in lifelong learning, one of the key indicators for quality at work shows stagnating or even declining trends.

1.3. Social and territorial cohesion

Social cohesion is crucial for sustainable employment growth. In 2007 in the framework of the open method of coordination in social protection and social inclusion, Member States have continued focusing their policies on fighting and preventing child poverty and promoting the active inclusion of people furthest from the labour market through an approach combining income support with activation policies.

In spite of the positive economic environment, in most countries there was no reduction of relative poverty and employment rates increases for vulnerable groups have been more limited than those for the labour force in general. In the EU, the percentage of adults and children living in jobless households has remained unchanged since 2000 at nearly 10%. Social protection reforms should in particular improve, where required, the adequacy of social benefits linked to employment activity. This is a pre-condition for a well functioning flexicurity approach.

The favourable economic environment has had significant impact on the magnitude of regional disparities which continued to narrow in 2006, especially as concerns unemployment. It is still characteristic that regional disparities on unemployment are markedly larger than on employment, but the former has been reduced by one third since 2001. Although this trend is observed in most Member States there is a handful recording a strong negative trend in regional disparities.

2. IMPLEMENTING PRIORITIES FOR ACTION

2.1. Attract and retain more people in employment, increase labour supply and modernise social protection systems

Promote a lifecycle approach to work

Still only very few Member States have a comprehensive lifecycle approach to work.

There has been some recent progress in encouraging active ageing strategies especially through restricting eligibility conditions, while compensating for particularly demanding or hazardous jobs, by increasing incentives to work longer for employees and employees (AT, FR, ES, DK), by enhancing work opportunities for older and particularly disabled workers and by improving working conditions while and providing opportunities for skills upgrading and retraining. The current average exit age from the labour market (60.9) still remains well below the 2010 target.

The progress in the field of gender equality has been mixed. The female employment rate has increased strongly but is still under 50% in 4 Member States (EL, IT, MT and PL). Only some countries (AT, CY, FR, EL, IE, LV, MT, PL, SE, SI) systematically use statistics broken down by sex for reporting on employment. The gender pay gap shows no sign of reduction over the last few years and is still at 15 % overall in the EU. Few countries have taken concrete actions in this field (AT, BE, FI, FR, LU, NL, SE, SK, UK) and no new targets have been set following the Commission Communication on gender pay gap.

Box: Promoting the labour market integration of young people remains a key challenge

Only about half of the Member States have seen an improvement in youth unemployment between 2000 and 2006. There are still 17.5% of young men and 13.2 % of young women leaving school with at most a lower secondary education. Only six Member States have reached the target of no more than 10%.

Despite relatively poor results, increased efforts to fight youth unemployment are reported by many countries. Policy measures are pursued along 4 axes: Firstly, through improved vocational education and training pathways (AT, BE, LU), specific guidance and pathways for at-risk school leavers (BE, FR, DE, LU) and specific contract schemes with a training component (LU). Secondly, through intensified and personalised guidance and job-search support (PT) and creation of employment pathways (MT). Thirdly, through reduction of employers' social security contributions (BE, HU, SE), tax promotion for apprenticeship places (AT, FR), wage support for recruitment of long-term unemployed (DE). Fourthly, through strengthening the conditionality of social or unemployment benefits (CZ) and reduced taxation of students' jobs (FR)

At the 2006 Spring European Council Member States agreed that they should provide a "new start" for the young unemployed within 6 months by 2007 and 4 months by 2010. . According to the most recent EU data, only 15 countries manage to have a timely new start offered to at least two thirds of young unemployed. In a small lead group of countries nearly all young unemployed are offered a new start during their first months of unemployment (AT, FI, SE). Seven countries have reached an 80-90 % coverage (BE, FR, DE, IE, LT, NL, ES) while 4 countries only provide a 70-80% coverage (HU, LV, LU, PT). For the remaining countries no EU data are available.

The issue of reconciliation between work and private life is gaining some impetus in Member States, mostly through the commitment to improve the provision of childcare facilities (AT, DE, EL, LU, NL, PT, UK). However, many Member States are far from reaching the childcare targets and most do not even refer to them in their national strategies.

Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job-seekers, including disadvantaged people, and the inactive

Efforts have increased in integrating people at the margins of the labour market and in an "active inclusion" approach. Low-skilled job seekers are subject to specific activation measures or support for placement from the employment services (UK), while financial incentives are created for employers to hire them (BG, DE) and train them (NL). Some measures aim at providing specific training opportunities, organised either through public employment services or on-the-job (AT, LT, BG, EE, BE). A number of Member States have taken steps to develop and improve the programmes for basic literacy and numeracy of adults (FR, DK).

Specific training measures and language courses are being offered to migrants (SE, CY, DK, ES, AT, BE) and activation measures coupled with support from the employment services (DK, ES, DE, AT, EE, UK) are specifically aimed at this group. Wage subsidy schemes for employment of migrants and their descendents have been introduced in SE and DK. Some Member States are taking steps to better integrate children of immigrants into the educational system (LU, NL), while others with large shares of immigrants are launching specific programmes for geographic areas where migrants are highly concentrated (FR, UK). In a number of countries, immigration is seen as an important element in answering labour market needs (ES, DK, IE), and some Member States are planning to develop plans to attract highly skilled migrants (NL, CY, DK, LT), and to simplify the procedures for work and residence permits in sectors where there are labour shortages (SE, IE, AT, FI, EE, MT, BE, CY, DK, ES, LU, SI).

Some Member States have increased spending and raised the effectiveness of their active labour market policies (AT), notably by tightening eligibility conditions for unemployment benefits (EL), increasing the effectiveness of job-search assistance (BE, SK), providing targeted training for the unemployed (AT) and introducing "in-work" benefits (SE). Some Member States also subsidize self-employment (DE, LT, EL, SK, LV). An increasing focus is on the individual responsibility of job seekers (BE, MT, NL, SI, LU, UK, SE, DK, HU), with increased conditionality of unemployment benefits, increased monitoring of their job searching activities and in some cases their contracts concluded between job seeker and employment service defining rights and mutual obligations. The local or regional dimension of activation is often emphasized, and many Member States aim at improving the internal cooperation between the different agencies serving job seekers (NL, MT, HU, IE, SK). However, Member States rarely report on the "new start" target for unemployed, nor the activation target for long-term unemployed.

Some countries have lowered tax wedges in order to foster participation rates and job creation either through general tax reductions, mainly focused on cutting the tax-wedge on low income groups (AT, FR, HU, SI, CZ, IT, MT, LT, SE), or by a straight reduction of the tax burden on low incomes (DK, FI, GR,NL, SL). Also, a general trend towards reducing social security contributions for both employers and employees was recorded over recent years (BE, SE, MT). .

Financial incentives are being created to increase the readiness of people with a disability to take up work (IE, EE, SK), while subsidies are given to employers to hire disabled people and to adapt their workplace to their needs (NL, SE, PL, IE, SI, AT, BG, LV). Measures are also being taken to establish and develop guaranteed jobs and supported employment opportunities (CZ, DK, ES, SE, SI, DE, LT, SK).

Improve the matching of labour market needs

Adaptation to economic change is stated as a relevant priority for all Member States, although addressed through different tools at the level of the Public Employment Services. Different areas have seen particular investments: training and vocational qualifications (EE, IE, SI); skills upgrades (DK, PT, CY, IE) and involvement of employers (EL, IT, UK); taxation measures to address disadvantaged social groups (FR, FI); targeted services according to age group, education/qualification levels and greater exposure to the risk of exclusion (PT); extension to a personal assistance scheme and reinforcement of services for people with disabilities (SK); work-life balancing (CY); actions for female and senior workers (LT) or young people (PL, SE); public-private partnerships (BE, IT[33]).

However, with very few exceptions (BE, IT in particular), not much progress on trans-national mobility has been achieved across Member States. Conversely, concerning the anticipation of skills needs, several Member States (AT, EL, LT, LV, MT, PT) are building infrastructures to forecast labour market needs and skills shortages.

2.2. Improve the adaptability of workers and enterprises

Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of social partners

Whereas promoting the adaptability of workers and enterprises received little attention in the first year of the new cycle launched in 2005, a careful examination shows that the political prioritisation by the European Council and the wide debate since then on flexicurity has brought about an important turn-around, and increased the awareness of the benefits that flexicurity policies can bring. Flexicurity is now acknowledged throughout the EU as a key approach to make labour markets more responsive to the changes resulting from globalisation, as well as to reduce labour market segmentation.

Box 2: The increasing role of flexicurity

About half of the Member States have now developed or are developing comprehensive flexicurity approaches, and combining efforts on contractual arrangements, lifelong learning, active labour market policies and social security systems. This is a considerable improvement from only a handful in 2006. Various Member States are reporting on their intentions, including initiatives to develop national flexicurity pathways, seeking cooperation with or input from their social partners (for example AT, FI, IE, IT, SI, FR).

On July 23rd 2007, the **Italian** Government signed an agreement with the Social Partners on social protection, employment, competitiveness and sustainable growth. The agreement covers the areas of pensions, social benefits, contractual arrangements, work incentives, labour cost, and training. The agreement includes steps towards a more universal coverage of social protection, independent of the specifics of work contracts. It envisages limiting repetitive fixed term contracts, promoting 'long' part-time contracts and improving protection of workers on on-call contracts.

33 The Italian NRP dedicates a specific section to PES and to the assessment of their reform process over the last 7 years.

Flexicurity measures are being implemented along two lines. On the one hand, measures are being pursued to strengthen flexibility in order to make labour markets more dynamic and responsive to change, both through internal and external flexibility instruments. SI, EL, BG, RO for instance report on how they wish to promote part-time employment. SK, PL, LU, LT, RO introduced tele-working as a new form of work providing more flexibility. In some countries, the regulation of permanent work contracts is allowing for more flexibility. Changes in employment protection legislation (EPL) for workers on open-ended contracts are relatively scarce. In LV, BG, NL, RO, attempts are being made to simplify EPL although political outcomes are sometimes uncertain.

Initiatives are also underway in several countries to extend security. Labour code reviews are quite frequent (AT, BG, CY, CZ, EE, FI, FR, HU, IT, LT, LU, NL, PL, PT, RO, SK, SI, SE) but their character seems to be gradually changing. They are tending to move away from focusing on increased flexibility through the introduction of new types of contracts, and towards a more balanced approach including more security for workers on temporary contracts. MT, SK, HU, NL, CY, IE, IT are improving social protection provisions for workers in part-time or fixed-term contracts. The regulation of temporary agency work is a policy focus in FI, AT, BG. Some countries aim to limit the consecutive use of fixed-term contracts (CZ, FI, IT, NL).

A move from passive to active labour market policies is slowly taking shape (e.g. by increasing job search support, benefit conditionality or by reforming tax and benefit systems to "make work pay"). Transition security for workers on open-ended contracts is not really recognised as an issue. The traditional attitude, concentrating on job security rather than on a broader concept of employment security, is still very much alive though policy efforts are restricted to the management of larger company restructurings. Standardised support for all workers faced with dismissal still remains to be implemented (SE, FI, LU).

Targeting segmentation is also an explicit goal in some countries, with for instance ES creating incentives for employers to transform time-limited contracts into permanent ones. On the whole, however, segmentation of labour markets remains to be addressed, especially for female workers, still affected by low quality jobs and weaker employment and social security. Between 2000 and 2006, the share of workers on temporary contracts in EU27 rose from 12.2% to 14.1%, whereas the share of workers on part time contracts rose from 16.4% to 18.1%. A high level of undeclared labour is another aspect of segmentation (IT, EL, SK, HU, LV, LT, SI, RO, BG). Most countries suffering from high levels of undeclared work are paying attention to this concentrating on reinforcing labour inspectorates or other control or surveillance measures and incentives to legalise labour relations (HU).

Policies aiming to modernise work organisations receive rather little attention in Member States (e.g. FI, IE, SE, LT, and LU). Innovations in working time management are most widespread (DE, LU). Only few countries are developing a comprehensive vision of high quality workplaces, combining greater demands and responsibilities on workers with increased autonomy at work (FI, SE).

Ensure employment-friendly labour cost developments and wage setting mechanisms

Employment-friendly policies should support wage developments in line with productivity in order to achieve high employment and contain inflation. Member States are largely successful in ensuring this balance. Wage flexibility is not widely addressed, although some countries, in cooperation with their social partners, promote wage settlements that reflect productivity differentials at company level. Efforts to reduce non-wage labour costs are widespread, and focus in particular on young people and workers with disabilities.

2.3. Increase investment in human capital through better education and skills

Expand and improve investment in human capital

Investing in human capital to achieve efficient and equitable outcomes is still a challenge in most Member States. Total public expenditure on education as a percentage of GDP increased in the EU between 2000 and 2003 from 4.7% to 5.2%, but then decreased again to 5.1% in 2004. Similarly, progress on private expenditure on educational institutions as a percentage of GDP slowed down in 2004. The European Social Fund (ESF) will invest around 34.3 billion EUR in improving human capital and life-long learning systems in the current programming period.

Most countries have made progress in defining comprehensive lifelong learning strategies covering all systems and levels of education and training. It is essential that those countries that have not yet adopted a lifelong learning strategy do so urgently. All countries have measures addressing the areas for which EU benchmarks have been set: reducing the number of early school leavers, and improving secondary attainment and increasing adult participation in lifelong learning. However, most countries have not set quantitative national targets (BE, DK, EE, EL, ES, FI, FR, HU, IE, LT, LV, MT, NL, PL, PT, RO, SI, SK, RO have) and the modest progress visible since 2000 is not sufficient to reach the EU targets set for 2010.

Every sixth young person (15.3%) aged 18-24 in the EU-27 still leaves school with no more than lower secondary education (male: 17.5%, female: 13.2%) and does not participate in any kind of education and training after this. Progress has so far not been sufficient to reach the EU benchmark of 10% by 2010. Several countries (ES, IT, MT, PT) still had very high levels (above 20%) in 2006 and in some countries performance has actually worsened since 2000 (ES, LU, SE, SK). Similarly, there has been some progress in improving upper secondary attainment levels, but not enough to achieve the objective of at least 85% of 22-years-olds to complete at least upper-secondary education by 2010.

Also adult participation in lifelong learning is no longer on track to achieve the EU benchmark of 12.5% by 2010. In 2006, an average of 9.6% of Europeans aged 25-64 was participating in education and training activities (men: 8.8%, women 10.4%), which is slightly less than in 2005. The participation rate remains lower for inactive and unemployed persons, for older persons, and for persons with low educational attainment. The participation of older workers is still only half of the overall rate and adults with a high level of education are still more than six times as likely to participate in lifelong learning as the low skilled.

A large part of the policy-making is focused on finding ways to encourage employers to invest in training and motivate employees to take part in it. Several Member States also see it as a particular challenge to motivate the less-educated and middle-aged part of the workforce to acquire new skills. Many measures imply financial incentives through tax reduction or grants for employers investing in training (MT, EE, BG, DE, NL, IE, DK, BE, LV), but some countries have also taken initiatives to simplify the conditions for educational leave (AT, LU). The role of agreements among social partners about the implementation of lifelong learning strategies is emphasized and stressed by some Member States (DK, FR, PL, NL).

Adapt education and training systems in response to new competence requirements

There is evidence suggesting that early education is receiving increasing attention in many Member States particularly in establishing the basis for learning throughout life and in facilitating access to education of citizens with a less favourable socio-economic background, and migrants. Some are working on teaching content (DE, DK), quality assessments (ES, LT), building the capacity of pre-primary teachers (CZ) and increasing their numbers (DK, HU, MT, NL, SE, SK, UK). Others are extending compulsory schooling to parts of the pre-primary level (CY, DK, EL, PL). Strengthening pre-primary education is a key measure to improve the efficiency and equity of education and training systems.

National qualifications frameworks in line with the European Qualifications Framework are being developed by the majority of countries (AT, BE, BG, CZ, DE, DK, EE, ES, FI, HR, HU, IT, LT, LU, LV, NL, PT, SI, SK), with a view to facilitating international mobility as well as the transition between different education and training sectors . They are an important means for ensuring flexible learning pathways which are also facilitated by many countries setting up systems for the validation of non-formal and informal learning (AT, BE, CZ, ES, IT, LT, LU, PL, RO, SE, SK, UK). The challenge here is to move from experiment to full application of such systems in national qualifications systems, including in access to higher education

These improvements are running in parallel with a greater focus on learning outcomes in learning programmes and qualifications which increases the relevance of both vocational education and training and higher education for the labour market. Despite renewed emphasis on apprenticeship and work-based learning, further work must be done to improve the quality and attractiveness of vocational education and training.

Little progress is visible in forecasting future skills and qualifications needs, despite the efforts made by some countries to improve their infrastructures (AT, EL, LT, LV, MT, PT). More also needs to be done by Member States to facilitate international mobility. Mobility is still much more widespread in higher education than in vocational education and training.

Given that the quality of teacher education is a prime factor influencing student performance, more attention must also be given to teacher education and training, in particular to continuing teacher training and professional development.

Finally, a number of countries are developing centres of excellence in higher education (DE, EE, EL, FI, UK), but more needs to be done to address education alongside research and knowledge transfer in the context of such initiatives, and to improve university-business cooperation.

IV. THE GENERAL APPROACH USED BY THE EUROPEAN COMMISSION TO ASSESS PROGRESS WITH STRUCTURAL REFORMS

The renewed Lisbon strategy marked a major change in the approach to the co-ordination of structural reforms in the EU. A "partnership approach" between EU and national authorities has been pursued to tackle the implementation gap between reform commitments and concrete actions. Based on 24 Integrated Guidelines, Member States in a bottom up exercise adopted National Reform Programmes covering the period 2005-07 period in which they themselves identified their "key challenges" to raise the growth potential. There is also an annual reporting and peer review process, which led to the adoption of policy recommendations in February 2007 by the Council which pointed to areas where good progress has been made as to areas where reform efforts as lagging. The recommendations were graduated with "country-specific recommendations" (CSRs) addressed to countries on policy areas where little progress was made and "points to watch" on policy areas where only some progress was made.

The main focus of attention within the current Strategic Report is on implementation. While account is taken of overall progress achieved since the re-launch of the Lisbon Strategy in 2005, the assessment mainly considers 2007 with a particular emphasis on tracking Member States' responses to country-specific recommendations (CSRs) or points to watch (PTWs) adopted by the Council in April 2007. The Commission attaches considerable importance is attached to having a robust and transparent framework for assessing progress with structural reforms which is comparable across policy areas and Member States. The main elements of the approach used by the Commission to arrive at its policy recommendations are outlined in the box below.

It should be underlined that given the relatively short period since the re-launch of the Lisbon Strategy, and given the inevitable time lags in adopting reforms and for them to have an impact on the real economy, the assessment essentially remains a tracking exercise which catalogues planned and enacted reform actions. There is only limited scope to evaluate in-depth the significance of reform measures or to quantify their impact on growth and jobs (although this is part achieved via a thematic review exercise on specific policy areas carried out by the Economic Policy Committee and the Employment Committee) Over time, the Commission will strive to enhance the evaluation exercise upgrade so that there are more multi-annual in character, and include a greater reliance on quantitative as well as qualitative analysis that is supported by modelling results.

The Commission services are investing considerable resources in developing robust methodologies for systematically identifying the key policy challenges facing Member States and for evaluating the impact of structural on growth and jobs. Much of this work is being carried out jointly together with national authorities via a Lisbon methodology working group (LIME) attached to the Economic Policy Committee[34]. Progress has already been made which has supported the assessment in the Strategic Report. In particular, most Member States have attached "streamlined reporting tables" to their National Implementation Reports submitted to the Commission in October 2007: these tables systematically report the relevant reform measures that according to the Member State contribute to the Lisbon process, and offer the

[34] See European Economy Research letter No 1., April 2007, http://ec.europa.eu/economy_finance/publications/researchletter_en.htm

potential of greater transparency on structural reform developments in real time. In addition, the Commission has made considerable progress in developing institutional databases that catalogue enacted structural reforms in a comprehensive and comparable manner across Member States. The LABREF database, which records information on enacted labour market reforms, has been backdated to 2000 and is starting to be actively used for analytical and surveillance purposes[35]. The MICREF database collects similar information on reforms falling under the microeconomic pillar of the Integrated Guidelines.

The approach used by the Commission to assess progress with structural reforms in the Strategic Report

In assessing progress with structural reforms, the European Commission took account of all relevant information at its disposal, including the information contained in the National Implementation reports submitted to the European Commission in 2007 along with the streamlined reporting tables. In broad terms, three considerations were taken into account when arriving at policy conclusions, and in particular whether a CSR or PTW should be issued to a Member States to signal the need for more progress in a specific policy area. They are:

- the ***performance of a Member State in different policy areas***: more weight will be attached to countries where the starting level of performance is poor or lagging. In doing so, relevant policy and performance indicators are considered

- the ***adequacy of the policy response***. This is the core element making use of information on structural reforms gathered from Lisbon missions and the National Implementation Reports. In doing so, the *degree of responsiveness* (whether a policy response has been approved and passed all the necessary legislative/administrative procedures to start being implemented) is considered, the *significance of a policy measure* (e.g. do they address core underlying problems, does the reform imply a significant change relative to existing institutional settings, has an adequate allocation of financial and personnel resources been foreseen to implement the policy, are targets/goals realistic), and the *degree of follow-up* (e.g. whether the design of the policy response foresees monitoring mechanisms);

- the ***relative priority of a policy area in terms of its potential contribution to growth and jobs in the country concerned***. The aim is to have a rounded view on the overall economic policy challenges facing a country, and to concentrate on those policy areas where countries are especially lagging behind the best-performer and which can contribute most to raising growth and jobs. In most instances, the priorities are well defined in the key challenges identified by Member States.

Overall, by looking at performance, policy responses and priorities, a robust and transparent assessment is arrived at which is comparable across policy areas and Member States. Naturally, all other relevant qualitative considerations, including wider political issues, are also taken into account.

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35 For access to the LABREF database, follow:
http://ec.europa.eu/economy_finance/indicators/labref_en.htm
The information in LABREF has been used to feed into economic analysis on the impact of labour market reforms, see papers from a Commission conference in March 2007on tracking and evaluating the impact of labour market reforms in Europe
http://ec.europa.eu/economy_finance/events/2007/events_brussels_1403_en.htm .

V. THE EUROPEAN GROWTH INITIATIVE

The European Action for Growth (or European Growth Initiative[36]) is an action plan endorsed by the European Council in December 2003. It aims at stimulating the long-term growth potential and the innovative capacity of the European Union by mobilising investment in transport, energy and electronic communication networks, and in research, development and innovation, with a particular focus on growth-enhancing technological areas.

At the European level, the initiative is supported by non-financial measures to improve the regulatory, administrative and financial environment for investment, as well as Community financial support, lending from the European Investment Bank (EIB) and venture capital from the European Investment Fund (EIF)[37], and innovative financing tools to mobilise private investment. At the Member States' level, it relies on supporting national actions to promote private investment, and on significantly redirecting public funding towards the areas of the initiative with a special emphasis on infrastructure investments.

In order to focus efforts on key investment projects of European interest, the Commission identified a list of TEN infrastructure projects and R&D technological areas, considered as sufficiently mature to be turned into action in the short run. This process was carried out in close collaboration with the EIB and was based on the explicit intentions of the Member States. The selection criteria included, in addition to project maturity, their trans-frontier dimension, the impact on growth and on innovation in an enlarged EU, and benefits for the environment. The "Quick Start programme" was endorsed by the European Council in December 2003. It was foreseen that the list might be updated, in the framework of the annual cycle for reporting to the Spring European Council, if other projects fulfilled the same criteria[38].

The Commission and the EIB were asked to provide a mid-term evaluation of the initiative by the end of 2007, on the basis of the following criteria: (i) effects on growth; (ii) impact on the internal market and cohesion in the enlarged EU; (iii) mobilisation of private sector capital, (iv) acceleration of the implementation of TENs and innovation and R&D projects including environment projects; (v) progress in reducing regulatory barriers; (vi) the impact on the environment and employment."

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[36] This is an extract of the Commission Staff Working Paper "Mid-term review of European Action for Growth - Stocktaking on progress of the implementation of the European Action for Growth" - SEC(2007) 1695, 11.12.2007

[37] The European Investment Fund (EIF) is part of the EIB group

[38] The 31 Quick Start projects in the area of transport and the 17 projects in the area of energy are key sections of the TEN-T and TEN-E priority projects whilst the 8 projects related to electronic communications and knowledge reflect R&D, innovation and eEurope priorities within the Lisbon strategy for Growth and Jobs.

1. THE IMPROVED FRAMEWORK FOR INVESTMENT – PRELIMINARY RESULTS

1.1. Developments at European level

Almost all legislative measures identified by the Growth Initiative as necessary to improve the conditions for investment have been adopted and have entered into force (e.g. the TEN guidelines and financing rules, the Euro-vignette and cross-border mergers directives). They aim at facilitating investment in large-scale or complex cross-border infrastructure projects, and in research and innovation partnerships.

The Growth Initiative has given some initial impetus to set up new instruments and initiatives coordinating better funding from public sources and encouraging private investment in networks and R&D and innovation (e.g. nominating European coordinators for transport and energy priority projects, establishing Joint Technology Initiatives on nano-electronics and hydrogen and fuel cells).

The areas highlighted by the Initiative have benefited from significant funding over 2000-2006 and from increased budgets for the 2007-2013 period via the TEN-T and TEN-E programmes, the Structural and Cohesion funds, the 6th and 7th research framework programmes and the eTEN and Competitiveness and Innovation Programme.

The EIB has been actively engaged in supporting the Growth Initiative as well as the Lisbon reforms through increased lending facilities, the strengthening and development of financial instruments (e.g. the TEN investment facility), and the provision of technical expertise.

The EIB and the Commission have jointly developed new financial instruments, at least in part as a result of the commitments made in the Growth Initiative (e.g. the Loan Guarantee Instrument for TEN-transport LGTT, the Risk Sharing Finance Facility RSFF and the JEREMIE and JASPERS funds). The Member States look forward to using these new instruments to leverage private investments and improve access to risk capital.

1.2. Developments at national level

20 Member States replied to the Commission information request on the Growth Initiative and related infrastructure investments (Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Lithuania, Luxembourg, Poland, Portugal, Slovak Republic, Spain, Sweden, and the UK). The information provided is mostly qualitative but gives an insight on the national investment context onto which the Growth Initiative has developed its effects. As public infrastructure spending is commonly included in long-term strategies, it was difficult to analyse the influence of the Growth Initiative with a limited hindsight.

Public investment in transport infrastructure has accelerated in recent years in most Member States.

Investment in energy infrastructure is mainly market-driven. The need to modernise energy infrastructures and to better integrate national networks into the EU market is prompting investments in most Member States. The promotion of energy efficiency and renewable energies, a new priority in many countries, also steadily necessitates high investment level. Increased demand for mobile communication services enables the private sector to invest in upgrading the networks to provide innovative high speed mobile services.

Investment into ICT networks serving scientific needs presenting important public good characteristics continue to be partly financed by national budget. The Member States have renewed their commitment to develop spatial technologies from which a wealth of applications with commercial or public services purposes will grow. Hydrogen technologies and nanoelectronics have also gained a priority position in the list of projects up for public R&D investment at the national level and national research capacities in these key areas for long term growth and sustainability have been reinforced.

1.3. Progress on the implementation of the Quick Start Projects

The improved enabling framework both at the European and the Member States level including the availability of financing has had significant knock-on effects on the implementation of the Quick Start projects. However, these effects fell significantly short of expectations voiced back in 2003, namely with respect to transport infrastructure projects.

The Quick Start transport projects are sections of the TEN-T large priority projects identified by the TEN Guidelines. They are spread over the entire territory of the EU, including a majority of railway links, some road and waterway links, as well as motorways of the sea, and the Galileo system. Some progress has been made in the implementation of these projects, but the overall picture remains mixed. The new instruments put in place by the TEN-T guidelines and financial regulations have played a role in unlocking some problematic areas. The new financial instruments have just become operational in 2007, so their effects on the implementation of TENs and mobilisation of private investment will be felt in the coming years only.

Progress in completion of electricity connections has remained generally slow, hampering the development of an efficient internal market, as shown in the Commission Communication on the Priority Interconnection Plan adopted in January 2007. This overall assessment applies to the Quick Start projects as well as to other projects of European interest. The main cause for delay is often not the lack of financing but the complexity of coordinating planning and authorisation procedures between several Member States. Conversely, the completion of the Quick Start gas pipelines has proceeded satisfactorily, and none suffers from significant delays.

The substantial financial support mobilised on Quick Start ICT projects from a combination of different sources of funding is one of the actions making tangible the commitment of the EC and the Member States to speed up the delivery and the use of high capacity communication networks. This continued commitment is already living up to its expectations: creating improved access to ICT networks offering new ways of creating and sharing knowledge for work, research and leisure.

For all Quick Start R&D projects, investments decisions proceed according to the initial plans, while a tight integration of funding from different sources is clearly taking place. The support to Nanoelectronics projects is in line with the original targets of the Initiative. Adequate funding has been made available to set up the next generation laser infrastructures key for Europe's research. Funding hydrogen and fuel cell research at European level is playing, as expected, an important role reinforce coordination between various sources of funding. Finally it is at least partly due to the Growth Initiative if the critical mass of public and private resources (both financial and technological) has been quickly and timely assembled to finalise the design of the GMES satellites and to install a new spatial launch site.

2. THE GROWTH INITIATIVE WITHIN THE LISBON STRATEGY FOR GROWTH AND JOBS

The European Growth Initiative operates on an instrumental level but within the Lisbon Strategy's comprehensive approach.

The measures proposed in the European Growth Initiative are now being brought at full speed by the Lisbon Strategy for Growth and Jobs. To name but a few examples, improving the patent system in Europe, as longed for by the European Growth Initiative, was taken over in 2005 as a key policy issue of the Strategy for Growth and Jobs. The i2010 initiative, a European Information Society for Growth and Employment addresses the challenges also mentioned in the European Growth Initiative, but it is fully developed under the Lisbon Strategy. The European Growth Initiative emphasised the need for updating the rules applied to State aid for R&D and innovation to make them more conducive to investments. The new framework on state aid for R&D and innovation has been adopted under the impetus of the Lisbon Strategy where state aid control is a prominent issue. The Growth Initiative hinted at the need for measures on risk capital investment to improve SMEs' access to finance especially for innovation. These measures have actually been launched under the main thrust of the Lisbon Strategy. In future, the instruments and projects of the Growth Initiative will be merged even further in the Lisbon Strategy, with corresponding repercussions for reporting on progress of implementation.