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Implementation of the Lisbon Strategy Structural Reforms in the context of the European Economic Recovery Plan – a more detailed overview of progress across the EU in the specific macro- and micro-economic as well as the employment areas

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This document traces progress with the implementation of the Lisbon strategy up to the end of 2008.

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1. THE MACROECONOMIC OUTLOOK: PREPARING FOR DIFFICULT TIMES

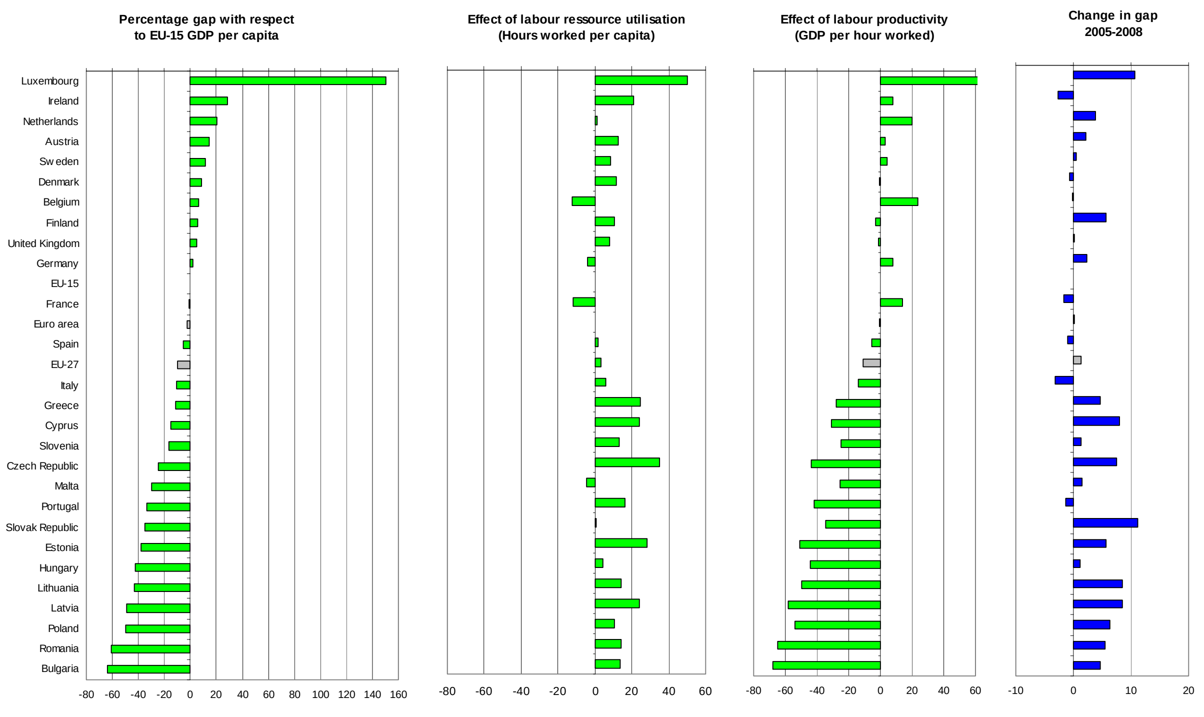
1.1 The medium-term challenges facing the Union

The Lisbon strategy in the period 2008-2010

The Lisbon strategy has entered a new three year cycle to cover the period 2008 to 2010. Notwithstanding the progress made since 2005 and the weak outlook given the financial crises, the diagnosis of the underlying structural challenges facing the Union as regards growth and jobs remains valid. As illustrated in graph 1, large income per-capita gaps remain across countries and the gap between most EU Member States and the best performing Member States is still large. For instance, in 2008 the average per capita GDP of the EU as a whole was still 34% below that of the five best EU performers. Moreover, over the last three-year period (see final column in Graph 1), while some impressive income catch-up has been achieved by the 12 Member States which joined in 2004 and 2007 (newly acceded Member States), the per-capita GDP gap has widened in some former EU15 Member States.

Overall, both the underutilisation of labour resources (i.e. total hours worked over total population) and the relatively weak hourly labour productivity explain this income gap. In particular, weak productivity is a key concern in many EU15 Member States (DK, EL, ES, FI, IT, PT, UK) and in the newly acceded Member States while lower labour input (i.e. hours worked per capita) is the cause of relatively low per capita GDP only in four Euro Area countries, namely FR, DE, BE and MT.

<u>Graph 1</u>: Income per capita differentials in the EU (2008)



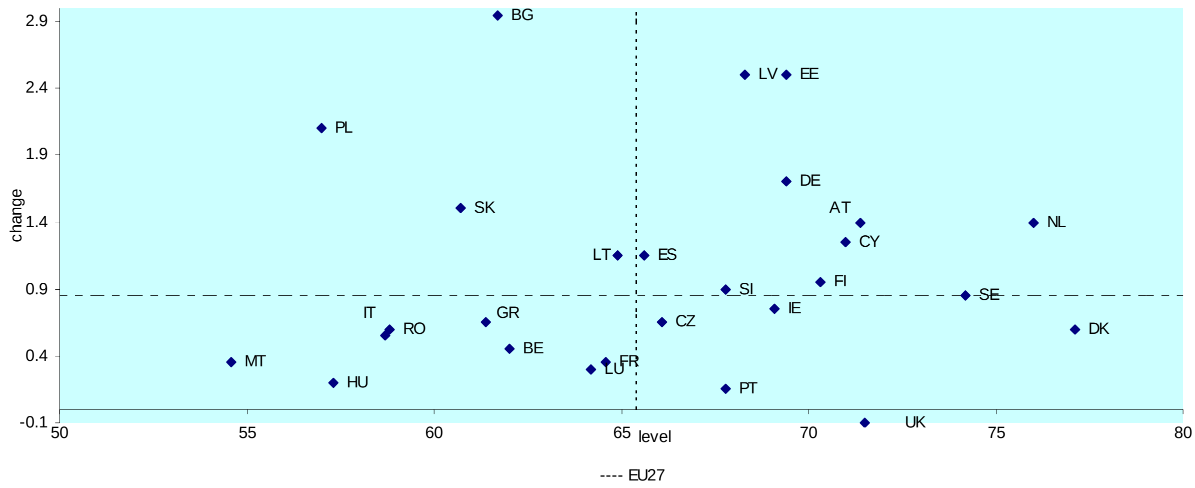
Source: Commission services

The three policy areas of the Lisbon Strategy influence macroeconomic performance

The EU economy as a whole depends on progress in all three policy areas of the Growth and Jobs strategy. A broad overview of the major developments in these areas therefore has to be an element of any assessment of the macroeconomic performance of the EU economy. While there has been significant progress with the implementation of Europe's medium-term structural reform agenda since the re-launch of the Lisbon Strategy for Growth and Jobs in 2005, the performance across Member States and across the policy areas of the strategy has varied considerably. The Statistical annex to this section documents this in greater detail. Progress with the consolidation of public finances has been considerable in the period 2005-2007, with deficits being reduced considerably in virtually all Member States and debt to GDP ratios declining. Clearly, however, a large part of the improvement was due to cyclical factors and a number of Member States continue to have significant challenges with regard to the long-term sustainability of public finances as evidenced by Table 1 below. Clearly, deficits are increasing as a result of the present economic slowdown which will reverse much of the progress achieved over the past years. It will, therefore, be of crucial importance that Member States revert to fiscal consolidation when the crisis ends.

Most progress has been made in recent years in the employment policy area. Unemployment has come down considerably, and the overall employment rate has been growing strongly, on average by about 1 percent per year since 2005. Analysis by the Commission suggests that, there is evidence of structural improvement in the functioning of labour markets. These developments can be seen as a major success of the Lisbon strategy to date. They also reflect significant structural improvements in European labour markets that are contributing to the resilience of the European economy although conditions are set to deteriorate as the economic slowdown takes hold Graph 2 below shows Member States' performance level (2007) and recent progress in terms of the overall employment rate (2005-2007). While the employment rate has risen in each Member State, the graph shows clearly that progress has been limited in a number of Member States even where the level is well below the EU average. Thus, while the overall picture is rather positive, there remains considerable scope for improvement in some Member States.

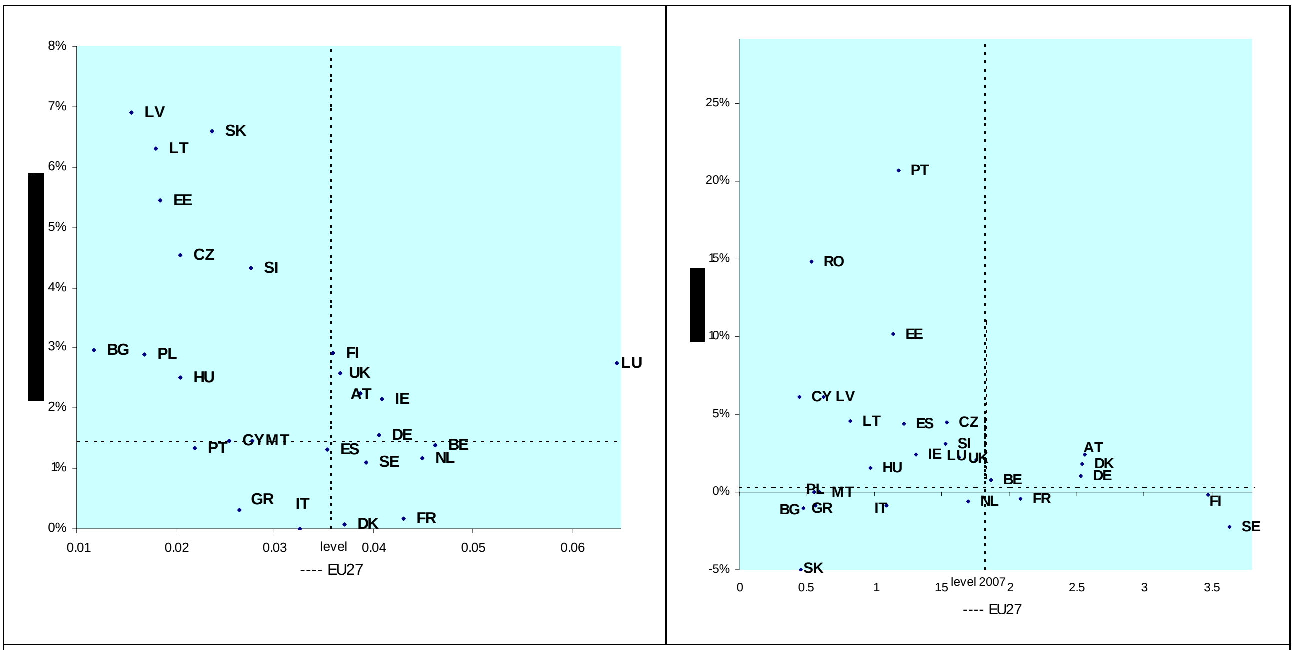
Graph 2: Employments rates in EU Member States, performance (2007) and average annual change **(2005-2007)**



Source: Commission Services

Productivity growth, one of the key objectives of the Lisbon strategy has improved somewhat in the recent period, although no structural narrowing of the gap with the USA can be observed. Unsurprisingly, productivity growth is highest in the newly acceded Member States which are catching up with the rest of the EU (see Graph 3). Overall, compared to the progress in the macroeconomic and employment policy areas, developments in the microeconomic area raise a number of concerns. For example, the continued slow growth in R&D expenditure is leading to a situation where the R&D expenditure rate at 1.83 % of GDP has hardly changed compared to 2005 and the 2010 target is in jeopardy. The evidence relating to these two important objectives under the Lisbon strategy shows that much needs to be done in terms of improving the framework conditions necessary to raise productivity growth in Europe, above all enhanced competition and the improved functioning of the internal market. Productivity growth remains clearly the EU's key long-term competitiveness challenge.

Graph 3: Member States' performance and progress in terms of Labour productivity (per hour worked)	**Graph 4: Member States' performance and progress in terms of R&D spending**



Source: Commission Services

1.2 The rapidly deteriorating economic situation

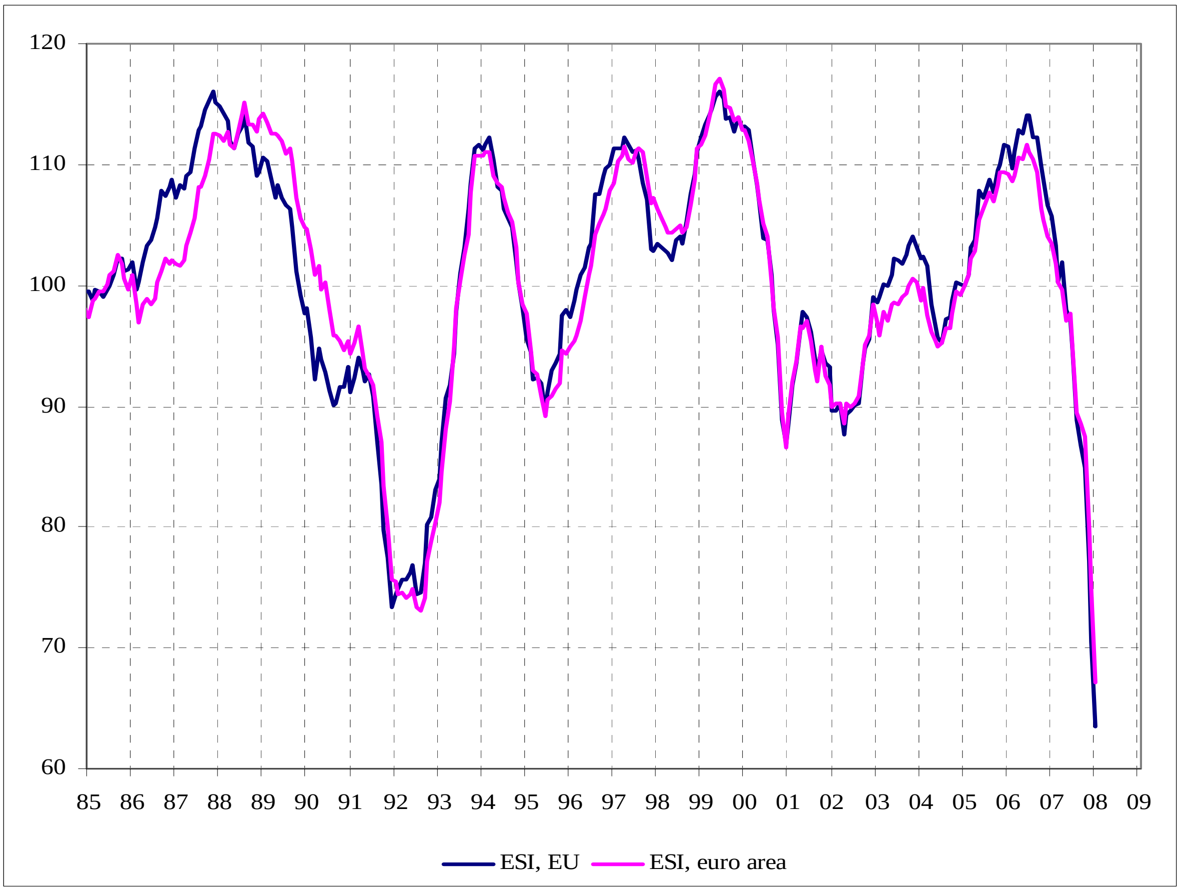
After several years of favourable growth, and in particular a good performance in terms of employment creation, economic conditions deteriorated rapidly in recent months. The deterioration is mainly due to the impact of the financial crisis which comes on top of a correction in house prices in many economies. In its 19 January 2009 forecast, the Commission predicts a strong contraction of GDP of 1.9% and 1.8% for the euro area and the EU as a whole respectively. The slowdown in economic activity is broad-based with the number of Member States registering negative growth rising from five in 2008 to 18 in 2009. Countries with particular exposure to the effects of housing and financial market corrections and those facing challenges in terms of external competitiveness are seen performing comparatively poorly. Looking at the GDP breakdown, investment, which was a key driving force in the previous upturn, is set to slump in 2009, reflecting the impact of multiple shocks: a weakening in demand and a marked drop in investor confidence, tighter financing conditions and a reduction in credit availability.

Confidence is at historical lows

Confidence amongst households and firms has slumped at end 2008 (see graph 5) which points to a further weakening of the underlying growth momentum in the EU and the euro area in coming months. Confidence data have fallen almost uninterruptedly since May 2007 and are now well below their long-term averages. In December, the Commission's Economic Sentiment Indicator declined to its lowest level in both the EU and the euro area since the current series was launched in January 1985. . The latest flash PMI readings for the euro area also showed record-low values for both manufacturing and services. Business confidence being at such a low levels, especially in manufacturing, may suggest that the downturn in global manufacturing cycle is deeper than initially expected. Faced with falling demand globally, as both developed and developing countries are facing a poor outlook, and therefore poor prospects for profits, firms are sharply curtailing investment, while households in the face of risks to employment and the need to rebuilding savings are curtailing consumption, especially of durable items. Car sales in the EU have plummeted leading to temporary closures of car manufacturing plants.

Graph 5: Survey indicators point to further weakening ahead

Economic sentiment indicator (s.a.) until December 2008

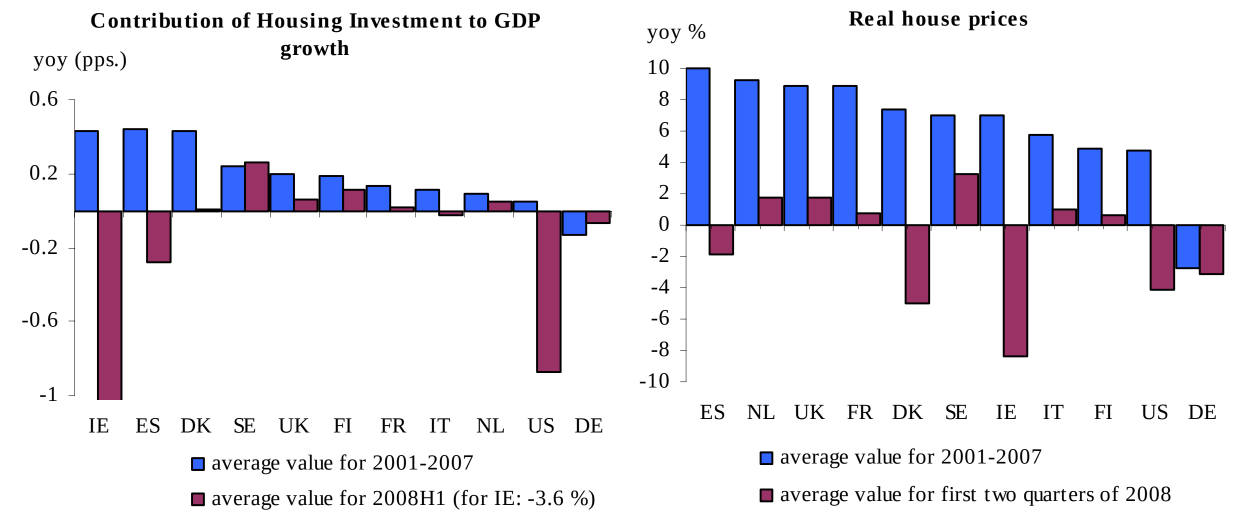


Source: Commission services

Ongoing correction in the housing markets of some Member States

In some Member States, the ongoing correction in the housing market – which in and off itself is necessary - is severely aggravating the already difficult economic situation, see graph 2. This occurs through a negative wealth effect where house price corrections dampen consumer spending and further undermine the balance sheets of financial institutions, as well as through employment losses in residential construction. Evidence from the past 30 years suggests that during housing market slumps, prices fall in the order of 25-30% and that this is associated with a decline in GDP growth of 1% to 3%: it is worth noting, however, that the most recent housing boom far exceeds the historical average in scale and duration.

Graph 6: Housing investment - contribution to GDP & House price developments

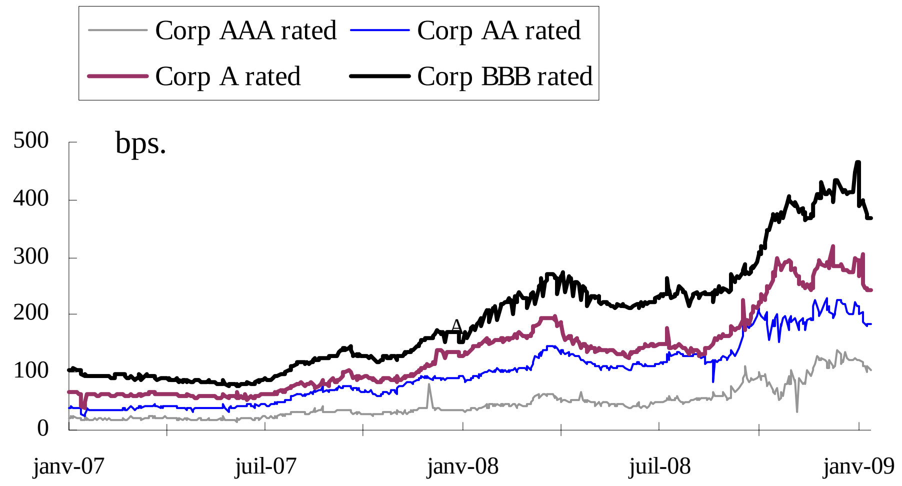


Source: *Commission services*

Prolonged financial markets distress remains the main downside risk

Financial market developments pose the main downside risks to the economic outlook, and the financial system remains in a highly fragile state. Measures taken by governments and central banks in October seem to be gradually taking effect in credit markets. The fear of financial meltdown has receded, as reflected in a moderate but sustained improvement in a range of indicators of market stress. For example, market indicators of default expectations in the banking sector have also improved modestly. However, functioning of wholesale credit markets is still far from normal. Euribor and Libor rates remain high in relation to central bank refinancing rates, as well as expected policy rates. The spread on 10-year BBB-corporate bonds is currently around 370 bps, whereas the spread on A-corporate bonds is nearly 300 bps and thus only slightly below the record highs in mid-October and far above levels seen before the outbreak of the financial turmoil in July 2007 (Graph 3). Banks remain highly reluctant to lend to each other and, with indicators of bank default risk still well above pre-crisis levels, it is clear that the sector remains vulnerable to adverse shocks.

Graph 7: Corporate bond spreads, euro area (in bps (1/100 of 1 %)), 1 Jan 2007 to 26 Nov 2008)



Source: Ecowin.

Meanwhile, the effects of the financial crisis are increasingly being transmitted to the real economy. Risk aversion is pervasive. Bank-lending standards continue to tighten and there is growing evidence that tighter standards are now translating into lower lending volumes. The Composite Financing Cost Indicator (CFCI) compiled by the Commission services shows that non-financial corporation funding costs were 160 bps higher in October 2008 (most recent available estimate), than in July 2007. The rise was comparatively smaller for households at 47 bps. Growth in euro-area bank lending to the corporate sector has been decelerating since April, while the growth rate in lending to households is now in low single-digits. Direct financing conditions have also deteriorated, as negative sentiment in equity markets and corporate bond markets is driven by the deteriorating outlook for the global economy.

Overall, while recent measures seem to have prevented a meltdown of the financial systems, the situation is still very precarious. The financial stress could still intensify, last longer or have a more pronounced impact on the real economy, fuelling a negative feedback loop. This would, in turn, reinforce the ongoing correction of some housing markets, putting balance sheets under strain, which could both hamper the necessary deleveraging process in the financial sector and, via negative wealth and confidence effects, reduce private consumption. The priority is to rapidly and consistently implement the announced packages, with a particular focus on restoring confidence in the functioning of the interbank market, and to monitor carefully possible market distortions.

The labour market: greater resilience but unemployment set to rise

The labour market, which has performed exceptionally well in recent years, will clearly be affected by the economic slowdown albeit with a lag. After slowing in 2008, employment is forecast to contract by more than 1.5% in both in the euro area and in the EU in 2009. The pace of decline is expected to slow in 2010. As a result the unemployment rate is forecast to increase by close to 3 percentage points from the lows of early 2008. So far, the greatest increases in the unemployment rate have been recorded in Spain, Estonia, Ireland and Latvia, all affected by severe housing market downturns.

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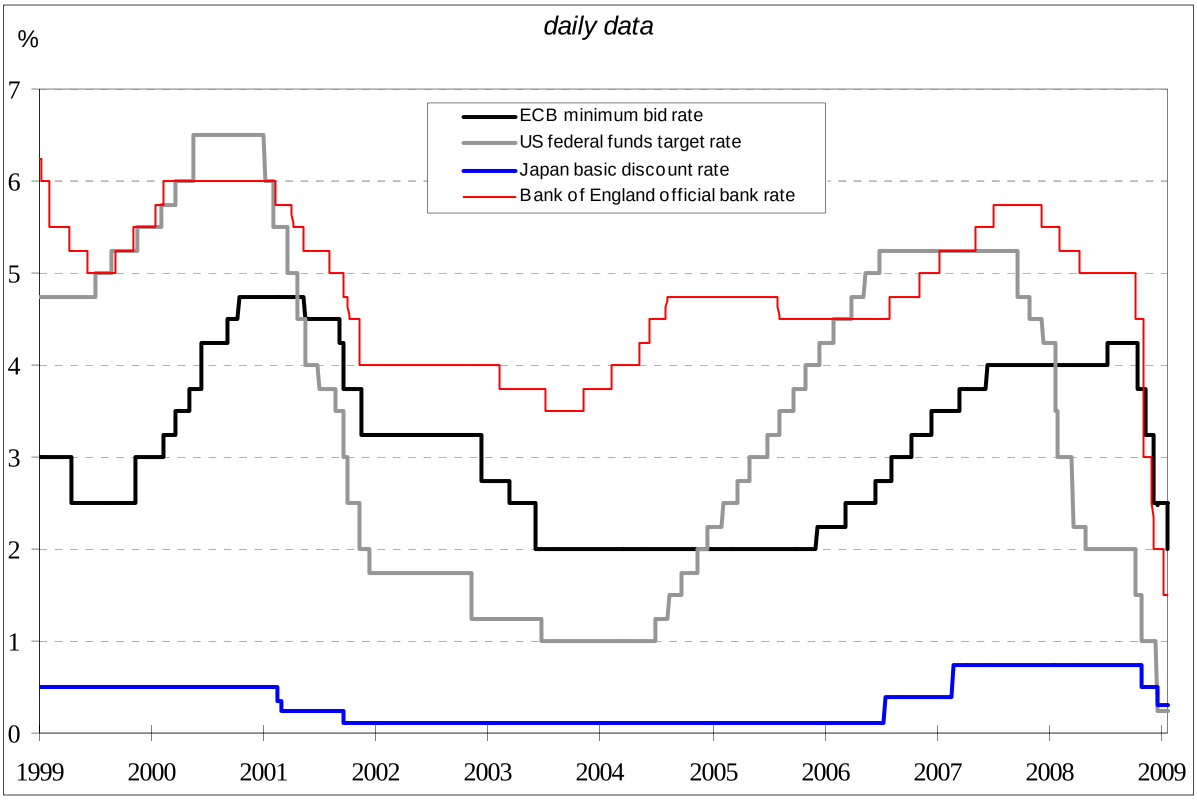
Inflation and monetary developments

Monetary policy has played an important role in containing the financial crisis and keeping the financial system afloat since the outbreak of the turmoil in 2007 through swift liquidity injections to keep the financial markets from freezing up and through globally concerted interest rate cuts by all major central banks. Inflation in the EU is expected to peak in 2008 and to fall rapidly in 2009. The recent strong decline in commodity prices, together with a marked weakening of the growth outlook and a related easing of the labour-market situation, reduces markedly the risk of second-round effects.

<u>Graph 8</u>: Evolution of policy rates of major central banks – ECB, FED, BoJ, BoE



<u>Source</u>: Commission services

While monetary authorities have been acting deftly to address the crisis, the broad-based deterioration in financial market conditions has negatively affected the transmission mechanism of monetary policy to output and inflation, implying more difficult financing conditions for firms and households. The financial turmoil has had a negative influence on the pass-through from policy rates to other interest rates, such as short- and long-term bank rates and capital market rates. In normal periods, there exists no significant difference between overnight rate and term rates, such as the 3-month rate. Hence, by controlling the overnight rate with short-term (i.e. weekly) refinancing operations, central banks usually control longer-term money market rates as well. This mechanism has been hampered. Uncertainty about banks' own future liquidity needs and about counterparty risk exacerbated by extreme risk aversion has led to a very low willingness to lend and high risk premia in unsecured money markets.

1.3 Diverging situations and trends across Member States

The worsened outlook will have a substantial negative impact on public finances, with the deficit in general government balances increasing from less than 1% of GDP in 2007 in the EU to 2.0% in 2008 and to 4.4% in 2009. Most countries will be affected although with significant differences, given their fiscal positions and competitiveness situation going into the crisis. The precise fiscal implications of the financial rescue packages remains unclear: real fiscal costs will be incurred to the extent that public guarantees are called and bank capital losses cannot be recovered. Already now measures taken to recapitalise banks are showing up in higher debt levels. Together with the evidence of an ongoing structural deterioration in budget balances, this may have implications for assessments on the risks to the long-term sustainability of public finances, especially in the most exposed countries, and in the light of the impending costs of ageing.

- **Table 1. Indicators on fiscal positions and competitiveness**

	Fiscal space				**Competitiveness**			
	Government budget balance, % of GDP (2008)	**Structural budget balance (2008)**	**Government debt to GDP ratio (2008)**	**Sustainability risk classification (2008*)**	**Current Account balance, % of GDP (2008)**	**Nominal Unit Labour Cost (2008)**	**Real Unit Labour Cost (2008)**	**Real Effective exchange rate** (2008-2005)**
BE	-0.9	-1.7	88.3	Medium	-0.7	4	1.9	2.8
BG	3.2	2.2	13.8	n.a.	-24.7	15.4	4.8	12.6
CZ	-1.2	-2.4	27.9	High	-0.9	4.8	0.9	13.5
DK	3.1	3.2	30.3	Low	1.5	4.9	0.9	3.8
DE	-0.1	-1.3	65.6	Medium	7.1	2.6	0.8	1.1
EE	-2	-2.6	4.3	Low	-10.1	16.6	7.5	12.7
IE	-6.3	-6.3	40.8	Medium	-5.7	4.7	5.1	5.9
EL	-3.4	-4.7	94	High	-13.4	5.4	1.1	3.3
ES	-3.4	-3.7	39.8	Medium	-9.4	3.1	-0.2	1.9
FR	-3.2	-3.7	67.1	Medium	-3.8	2.7	0.3	1.6
IT	-2.8	-2.9	105.7	Medium	-2.2	5.1	2	3.8
CY	1	0.2	48.1	High	-13.4	3.9	-0.5	2.8
LV	-3.5	-5.4	16	Low	-14.9	24.1	9.8	19.8
LT	-2.9	-4.6	17.1	Low	-12.6	12.2	0.1	7.9

LU	3	2.4	14.4	Medium	8	6.6	6.6	:
HU	-3.3	-4.3	71.9	High	-7.2	7	1.6	4
MT	-3.5	-4	63.3	Medium	-6.5	1.8	-0.9	1.3
NL	1.1	0	57.3	Medium	8.4	3.4	0.9	2.2
AT	-0.6	-1.6	59.4	Low	3.1	2.8	0.3	0.3
PL	-2.5	-3.4	45.5	Low	-5.6	6.1	2.4	11.6
PT	-2.2	-2.3	64.6	Medium	-11.8	3.7	1.7	2.5
RO	-5.2	-7.4	15.2	n.a.	-12.9	15	1.3	1.6
SI	-0.9	-2.2	22.1	High	-6	6.2	1.3	2.9
SK	-2.2	-3.9	28.6	Medium	-6	4	0.1	8.7
FI	4.5	3.6	32.8	Low	4.2	5.6	2.3	4.1
SE	2.3	1.9	34.8	Low	6.2	3.7	0.9	-1.3
UK	-4.6	-5.2	50.1	Medium	-2.3	2.5	0.1	-13.4
*******								
E.A.	-1.7	-2.4	68.7		-0.4	3.5	0.9	4.4
EU27	-2	-2.7	60.6	n.a.	-1	3.7	0.7	2.6

* Classification made in the 2008 Public Finance Report (for Bulgaria and Romania no risk classification was made (however 2008 general government gross debt is 14% of GDP in both countries)).

** Real effective exchange rates, change 2007-08, based on GDP deflator - Performance relative to the rest of 35 industrial countries; double export weights

*** Averages un-weighted.

Growing macroeconomic imbalances

Member States' situations with regard to their fiscal and competitiveness positions varied considerably in 2008 before any fiscal impact of the crisis had occurred. As Table 1 shows, Member States' ***fiscal space*** which relates to the size of the deficits and other risks to sustainability, stemming from the level of debt and other liabilities bearing on public finances (ageing, financial sector) shows a considerable variance. In several cases, the fiscal space is restricted both by weak nominal and structural budget balances as well as sustainability concerns mirrored by high debts and future budgetary pressures from the ageing of populations. It is clear that already for 2008 a majority of countries (20 out of 27) have estimated structural budget positions in deficit, which implies that significant corrections will be needed once expansionary fiscal policy are reversed after the end of the crisis.

In terms of polices, Member States with less fiscal space need a more prudent fiscal policy, as sustainability risks undermine household's confidence and increase risk premia on sovereign debt. Any budgetary deterioration therefore would need to be accompanied by reforms aimed at enhancing sustainability and strengthening national budgetary frameworks and institutions.

Member States' circumstances also vary considerably with regard to the size of other macroeconomic and structural imbalances. In the wake of the crisis, two Member States (HU, LV) had to turn to international institutional financing to address balance-of-payments problems. The indicators in Table 1 relate to both current account positions and developments in price competitiveness. An increasing number of countries now have very large current account deficits by historical standards. Although catching up processes may play a role, current account deficits may eventually become a cause for concern, in particular when they are combined with a loss of relative price competitiveness over a number of years as seen by the relative change in real effective exchange rate (REER) and in labour costs growing faster than labour productivity (NULCs). As financing conditions become more difficult, this is a particular concern in the present juncture, as reflected by the widening of sovereign bond spreads. It is clear that overall the challenges in this area have sharpened as the downturn has taken hold. This is reflected in the policy recommendations issued under the Lisbon strategy as regards macroeconomic stability.

In terms of policies, countries with large domestic and external imbalances, a poor competitive position, large current account deficits, sectoral imbalances (e.g. oversized construction, financial sector) and poor productivity (growth) need to take into account what this implies for the conduct of their fiscal policies. They have less of an option of financing expenditure by issuing additional debt and need to base their policy plans on particularly cautious medium-term assumptions for revenue growth. At a juncture of lower fiscal receipts, Member States in such a situation need to reset their priorities for public spending. Policies that facilitate inter-sector adjustment may also contribute to economic recovery in the medium-run. The hard choices necessary in terms of spending should be guided by Member States' structural reform priorities with the aim of enhancing potential growth. Strengthening national budgetary institutions may also contribute to enhancing the efficiency and effectiveness of public finances. If limited fiscal space co-exists with high risks to long-term sustainability, pension system reforms should be pursued. Country specific reform needs should be addressed. Budgetary deterioration needs to be limited and accompanied by decisive reform implementation to improve compliance with budgetary targets.

- Of course, more scope exists in Member States with fiscal space and a favourable competitive position and few domestic imbalances. These countries can let the automatic stabiliser play fully and in addition implement more ambitious targeted discretionary measures, underpinning economic growth, while at the same time pursuing ambitious implementation of the reform agenda. They should ensure that measures are easy to implement and timely, so that they can have an effect at the trough of the slowdown. These policies should be targeted to the objective in order to ensure effective and efficient use of resources.

2. THE EUROPEAN ECONOMIC RECOVERY PLAN AS THE EU'S RESPONSE TO THE MACROECONOMIC CHALLENGES

2.1 Overview

The European Economic Recovery Plan is the EU's response to the economic and financial market crisis. To tackle the crisis effectively, the European Economic Recovery Plan is a comprehensive, coherent and co-ordinated response to the slowdown that will help mitigate the impact of the financial market crisis on the real economy. It calls for fiscal stimulus and encompasses structural reforms at both Member States and EU level.

The EERP consists of two pillars: The first pillar is a major budgetary impulse amounting to €200 billion, or 1.5% of EU GDP to boost demand fully respecting the Stability and Growth Pact. It is made up of a budgetary expansion by Member States of at least €170 bn and EU funding in support of immediate actions in the order of €30 bn. The second pillar outlines a number of short-term actions designed to provide short-term support that is consistent with countries' long-term challenges, notably to accelerate the transformation of the EU into a low-carbon, knowledge-intensive economy as well as the sustainability of public finances, grounded in the Lisbon strategy for growth and jobs.

Through close co-ordination at EU level, the Recovery Plan will help to enhance the effectiveness and scale of the impact achieved by measures taken at the level of Member States. The importance of policy co-ordination can hardly be overstated. The benefits of the co-ordinated approach proposed by the Recovery Plan are particularly important in the euro area, as the positive spillovers of the fiscal stimulus will be strong in this context. Conversely, insufficient policy co-ordination of the crisis response would lead to potentially very high costs in terms of the likely aggravation of existing imbalances within the euro area, which would complicate adjustment and constrain future policy options. Apart from ensuring co-ordination, the approach proposed by European Economic Recovery Plan recognises that Member States' starting positions, are different and takes account of the ambition of structural reform agendas. The close link between macroeconomic stimulus and on key structural reforms with medium- to long-term effects on the sustainability of public finances, growth potential, and competitiveness is a critical feature of the Recovery Plan. This link enhances the credibility and effectiveness of actions taken at the level of Member States as well as of the package as a whole.

2.2 Fiscal stimulus package

The role of fiscal policy in the current juncture

Government budgets are set to deteriorate considerably in the next years reflecting not only the normal operation of automatic stabilisers but also unfavourable revenue developments that are linked to the ongoing unwinding of imbalances and therefore likely of more permanent nature. Ensuring that fiscal policy remains on a sustainable course is key to anchoring expectations of an orderly resolution of the crisis and enabling monetary policy to play its supportive role.

In responding to the current crisis and averting the risk of a full-blown credit crunch and a downward spiral, all available policy levers (monetary and fiscal policies as well as structural reforms) must be used. As has been shown in section 1, the swift action taken since the outbreak of the financial market crisis to avert a breakdown of the financial system has not fully succeeded in ending the distress in financial markets. This is having increasing repercussions on the real economy. Under these circumstances the need for macroeconomic policies to prop up faltering demand to avoid a vicious self-reinforcing cycle is evident. Both monetary and fiscal policies must make a contribution to this that is in line with the scope for and the likely effectiveness of their respective tools. As the effectiveness of the monetary transmission channel is somewhat impaired in the current situation, fiscal policy has to assume a particularly important role.

The conduct of fiscal policy needs to balance short-term stabilisation requirements with the need to preserve sustainable public finances. The Stability and Growth Pact provides the adequate policy framework ensuring that sustainable fiscal positions are maintained while allowing for adequate flexibility over the timing and the profile of adjustment (see Box 1).

Ensuring the effectiveness of fiscal stimulus packages

In the choice of stimulus, governments have a variety of instruments at their disposal, both on the revenue and expenditure side. In general, discretionary public spending will have a stronger positive impact on demand in the short-run compared with measures on the tax side (see Box 1 for possible stimuli measures). However, the choice of fiscal stimulus packages needs to take into account country-specific circumstances and institutional settings, as well as political economy considerations, which may influence the design of measures in terms of being timely, temporary and targeted. Below are examples of possible measures which could be considered in EU fiscal stimulus packages.

However, it must be recalled that to be effective any discretionary fiscal stimulus needs to be well designed. Past experience shows that fiscal stimulus packages often failed in this respect due to poor design and implementation. It is therefore essential that measures included in Member States' fiscal stimulus packages are:

– *timely* so that they quickly support to economic activity during the period of low demand, as delays in implementation could mean that the fiscal impulse only comes when the recovery is underway;

– *temporary* so that as to avoid a permanent deterioration in fiscal positions which would undermine sustainability and eventually require financing through sustained future tax increases;

– *targeted* towards the source of the economic challenge (increasing unemployment, credit constrained firms/households etc..) as this maximises the stabilisation impact of limited fiscal resources;

– *coordinated so that they multiply the positive impact and ensure long-term budgetary sustainability.*

Box 1: Possible measures in a fiscal stimulus package

Below are examples of possible measures which could be considered in EU fiscal stimulus packages.

Public investment expenditure and capital transfer to private sector for investment have a strong impact on demand in the short term, can boost potential growth over the long-run and is temporary as spending tails off when projects are completed. It could include spending on investments to meet long-term public policy goals, such as improving infrastructure endowments and tackling climate change. The main challenge for public investment is to be timely in the face of long planning/implementation horizons: to this end, priority should be given to accelerating projects which are already planned, e.g. bringing forward the implementation on of projects supported by the EU, e.g. via Structural Funds or R&D budget*s* C*apital transfer to the private sector for investment* offers the advantage of being effective in periods of credit constraints, and moreover are likely to be efficient as investment decisions are driven by the expected returns and self-selection in such an environment is strong. Examples would possibly include investment tax credits.

Public consumption also has an impact on demand in the short-term. Measures can be introduced quickly and targeted at households which are especially hard hit by the slowdown are likely to feed through almost directly to consumption. The main challenge is to ensure that measures do not become permanent, as this would weaken incentives to work and impact the sustainability of public finances. Examples include could consist of temporarily increased transfers to the unemployed or low income households, or a temporary lengthening of the duration of unemployment benefit.

Guarantees and loan subsidies to compensate for the unusually high risk premium can be particularly effective in an environment where credit is generally constrained, e.g. to SMEs. They are likely to be efficient as investment decisions are driven by the expected returns. Moreover, they can help bridge lack of short-term of working capital which is a problem for many companies at the present time. Examples include planned increase in EIB support for lending targeted in particular at SMEs. Many member states also operate such funds.

Indirect tax reductions can be introduced relatively quickly and, when targeted and timely, provide a strong fiscal impulse to support consumption. To maximise effectiveness, reductions should be temporary so as to provide incentives to bring forward consumption. They should also be well targeted towards specific goods or services where demand has slumped. Previous experience with pass through where these conditions have not been met suggests that benefits to consumers can be limited. Limited access to credit and unemployment fears may moreover reduce the effectiveness of this instrument in the current environment. Naturally, it is crucial to ensure that measures of this type do not undermine the level playing field of the internal market and implications for tax administration should also be carefully considered. Possible examples of effective measures include targeted registration and circulation tax reductions for cars and VAT reductions for labour intensive services. Co-ordination at EU level of such measures is needed for Internal Market reasons.

Lower taxes on labour particularly when targeted on low-wage earners can have a positive impact on employment and are particularly well suited for Member States with high labour costs and facing problems of external competitiveness. However, their impact is likely limited if they are temporary.

Fiscal policy and the SGP

Fiscal policy should be conducted within the SGP, so as to provide a common and credible framework for policy. The 2005 revision of the Pact allows better taking into account cyclical conditions while strengthening the medium and long-term fiscal discipline. The resulting framework is more demanding in good times, it affords more flexibility in bad times.

Against the background of a deepening slowdown and revenue shortfalls, fiscal positions will deteriorate. Depending on the starting position and the gravity of the slowdown, this will imply not only a departure from medium-term objectives but also for some countries a breach of the 3% of GDP deficit threshold. The revised SGP allows for a graduated flexibility in dealing with the occurrence of fiscal deficits.

The examination of stability and convergence programmes, including the updates that Member States will produce to account for additional counter-cyclical measures, will provide the opportunity to assess the overall fiscal strategy.

In the case of breach of the 3% deficit threshold the Commission has to prepare report, in which it assesses whether the situation is 'exceptional' and, importantly, whether the double overarching condition of 'close and temporary' is fulfilled.

In case an Excessive Deficit Procedure is opened, the extraordinary nature of the current crisis can be accommodated. Specifically:

– 'relevant factors' can be called upon to depart from the normal one-year deadline for the correction of the excessive deficit;

– in the subsequent stage of the procedure, if the excessive deficit has not been corrected within the initial deadline, extensions are possible if the failure to correct it is due to unexpected adverse economic events.

In the current extraordinary circumstances the application of the SGP rules and procedures need to continue ensuring the goal of anchoring medium-term expectations of fiscal sustainability. In line with this goal, the examination of stability and convergence programmes and the recommendations under the excessive deficit procedure should pursue the following objectives:

– ensure the reversibility of measures increasing deficits in the short term;

– improve fiscal policy-making in the medium-term, through a strengthening of the relevant budgetary frameworks and rules;

– ensure long-term sustainability of public finances, through reforms curbing the rise in age-related expenditure, where the trends point to unsustainable trends.

The degree of fiscal flexibility applied would also take account of the level of ambition of the structural reform agenda paying attention especially to those reforms strengthening resilience and enhancing long-term fiscal sustainability.

2.3 Structural reforms under the European Economic Recovery Plan

The role for structural reforms in recovery programmes

Structural reforms have a crucial role to play in the European Economic Recovery Plan for a number of reasons and in a number of ways: Firstly, structural reforms can help ensure that the short-term response to the crisis is consistent with Europe's the medium- to long-term reform agenda under the Lisbon strategy for growth and jobs. Pursuing the European Economic Recovery Plan, which is rooted in the Growth and Jobs Strategy, should therefore tackle the immediate challenges of the crisis and at the same time render the European Union stronger vis-à-vis its long-term challenges.

Secondly, through ensuring the time-consistency of the overall effort made under the Recovery Plan structural reforms can also lend credibility to the stimulus package and enhancing confidence of economic agents that it will be effective. This is particularly important where the necessary fiscal expansion is pursued in Member States with relatively limited fiscal space and/or significant external imbalances. In such cases, credible commitments to structural reforms that guarantee the long-term sustainability of public finances, bolster external competitiveness, and raise growth potential are necessary to ensure the effectiveness of the overall package. In the absence of appropriate structural reforms of this kind fiscal expansion could be associated with higher sovereign bond spreads for those countries with limited fiscal space and external imbalances. This could, over time, limit the intended positive effects of the expansion. More generally, without such structural reforms, the effectiveness of the package in terms of generating additional demand in the short term may be undermined, as consumers and firms would expect that the current fiscal expansion would be followed by a commensurate fiscal contraction in the following period. Setting the right signals through strong commitments to structural reform is therefore an important condition for the success of the Recovery Plan.

Thirdly, certain types of structural reforms offer the opportunity to bolster aggregate demand in the near term without additional public spending. Within the existing priorities of the Lisbon strategy, it is thus possible to identify types of reform measures that support aggregate demand and strengthen the resilience of economies and thus help tackle the crisis in the short run, while preparing to shift towards low carbon economies.

Finally, structural reforms can contribute to the resilience of Europe's economies by reinforcing their adjustment capacity. This can be accomplished mainly through improvements in the functioning of product, services, and labour markets.

Structural reforms that can support aggregate demand in the short term

A resilient, flexible economy helps mitigate the adverse impact of an economic crisis. Appropriately tailored, Lisbon strategy structural reforms could be an appropriate short-term policy response to the crisis as they strengthen economic resilience and flexibility. The following types of reforms are well suited to deliver the objectives set out above:

– <u>*Direct support of aggregate demand*</u>: such actions could include frontloading public investment on projects which support long-term public policy goals such as improving infrastructure endowments or tackling climate change, perhaps by making use of Structural funds and enhanced support from the EIB.

– *Support consumer purchasing power through improved market functioning*: policies that improve the functioning of key markets can help sustain demand by helping bring down core inflation, thus supporting the purchasing power of households. In general, accelerating national implementation of the Services Directive could help bring down inflation and increase households' purchasing power. Such measures are relevant to all countries.

– *Address immediate competitiveness problems*. Countries with inflation and competitiveness problems urgently need to take measures more closely to align wage growth to productivity increases. These measures are particularly relevant to countries with competitiveness problems.

– *Support employment and facilitate labour market transitions*: today's prime labour market challenges are to avoid redundancies in basically healthy firms/industries temporarily affected by short-term demand disturbances, but ensure efficient essential labour re-allocation across sectors. To that end various measures to facilitate labour market transitions and supporting employment are required. These include strengthened activation policies and better matching through effective employment services, flexibility in working time arrangements and where appropriate, lower social charges for employers and employees, especially for low-pay jobs and an adequate income safety net for workers made redundant. Such policies are relevant to all countries, although starting positions will need to be taken into account with regard to the size of budgetary outlays.

– *Strengthen the efficiency of public policy implementation*. This particularly relates to national budgetary rules and medium-term frameworks, whose robustness and credibility is crucial to the confidence of international investors. Potentially relevant to all countries, such policies would be particularly important to countries with limited fiscal space.

– *Reduce administrative burdens on businesses*. Such reforms help increase productivity, helping to contain inflation and strengthen competitiveness. Measures that can be implemented rapidly include continuing efforts to reduce the time to start up a business. This is important for all Member States.

Obviously, priority should be given to measures that can be implemented rapidly. Reforms covered by the Member States' National Reform Programmes are an obvious starting point as they should be at a more advanced state of preparation.

2.4 The EU-level contribution to the EERP

The European Economic Recovery Plan comprises actions at Member State- and at EU-level. This concerns the fiscal stimulus, where the contribution of the EU-level to the Recovery Plan consists of an impulse of about € 30bn. This impulse is brought about by increased financing, especially from the EIB and accelerated EU spending on structural and cohesion funds. The EU-level contribution also comprises some structural reforms, such as regulatory measures at EU-level which reduce the administrative burden and improve the business environment will also have a significant impact.

Apart from the actions taken at EU-level, the exercise of the co-ordination of measures taken under the European Economic Recovery Plan at national level by itself is of utmost importance (see section 2.5 below) for the effectiveness of the plan itself. Without close co-ordination the benefits of the Recovery Plan would be diminished by potential negative side effects. This is particularly significant in the context of the euro area, where the benefits of co-ordination are large.

2.5 Quantifying the impact of the EERP

Quantifying the impact of a coordinated policy response

The ERRP calls for a coordinated fiscal expansion of some 1.5% of EU27 GDP as well as proceeding with the structural reform agenda set down in the Lisbon Strategy. Using its macroeconomic model (QUEST III), the Commission services have evaluated the potential impact of the EERP for the short (2 years) and long-term (10 years),[1] paying particular attention to the effects on GDP, employment, public debt and current account balances. The modelling exercise is calibrated to assess the impact of a fiscal expansion for the EU27 of 1.5% of GDP in both 2009 and 2010 and where Member States introduce ambitious structural reforms under the Lisbon strategy. It has been configured to caters for the fact that an unusually large share of households and firms are facing credit constraints, and that risk aversion prevails leading to higher risk premium on government debt in countries where there are perceived risks to the sustainability of public finances. Clearly, the usual caveats apply when interpreting the results, which should be seen as illustrative and not point estimates.[2]

The outcome of model simulations is presented in **Table 2** which shows the result of a co-ordinated approach across Member States (assuming some differentiation on the basis of fiscal space). It underlines the potential for large and immediate benefits for all countries of a package combining strong fiscal stimulus with ambitious structural reforms. Moreover, the following main insights can be drawn on basic features of policy responses to the economic crisis at hand:

– fiscal policy is a powerful policy instrument in supporting short-run economic activity in a credit-constrained environment;

– the design of the fiscal stimulus matters. In particular, it is of critical importance that the stimulus is perceived as "credibly temporary". In fact, half of the potential impact of the stimulus on output in the short term would be lost if households/firms perceive that the measures will turn out to be permanent;

– the choice of appropriate fiscal measures matters as some are more powerful than others. In general, expenditure measures are a more powerful stabilisation instrument compared with measures on the revenue side which depend on the response of the private sector (e.g. tax reductions can partially end up in precautionary savings). Government investment and investment tax credits have a particularly strong impact in the short-run and they also boost GDP in the long-run;

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1 Ratto Marco, Werner Roeger and Jan in 't Veld (2008): "QUEST III: an estimated DSGE model of the euro area with fiscal and monetary policy", *European Economy, Economic Papers*. July N°353. European Commission. Brussels.

2 In the baseline setting it is assumed that 20% of all households are liquidity constrained, 60% are credit constrained and 20% are not financially constrained. The simulations assume risk premia on government debt of 50 bp for the "intermediate risk" countries and 100bp for the "high risk" countries. Furthermore, small additional country risk premia have been added for the "high risk" countries reflecting their precarious competititevenss positions. The fiscal expansion raises government debt by 2% of GDP and (lump-sum) taxes are adjusted in the long run to keep the debt-GDP ratio at this level.

– the model simulations also show the benefits of including structural reforms in an integrated response to the economic slowdown. While structural policies usually act on the supply-side and only deliver their full benefits in the medium- to long-run, some reforms can generate tangible benefits in the short-run and thus cushion the effects of the slowdown. For example, measures aiming at cutting the red tape raise GDP rather significantly shortly after their implementation;

– there are merits in tailoring recovery programmes to starting conditions at Member State level. Such a tailored approach allows to lower current account deficits and debt levels in high risk countries while boosting employment and GDP.

Table 2: The estimated effects of coordinated implementation of the EERP

		After 2 years				After 10 years			
		GDP	Employment	Debt	Current account	GDP	Employment	Debt	Current account
Low-risk	€ area	3.5	2.6	0.0	-0.9	2.3	0.9	0.6	-0.4
Intermediate-risk	€ area	2.1	1.3	0.1	0.2	2.0	0.9	0.3	0.4
	non- € area	2.2	1.4	-0.2	-0.0	2.0	0.9	-0.4	0.1
High-risk	€ area	2.0	1.4	0.3	0.4	2.8	1.9	-0.6	0.5
	non- € area	2.5	1.9	-0.4	0.2	2.8	2.0	-1.8	0.1

Notes:

1) The simulations were carried out in December 2008 based on macroeconomic data available at that time. They do not reflect the Commission's forecast of 19 January 2009.

2) The overall fiscal stimulus modelled accounts for 1% of EU27 GDP assuming varying sizes for different groups of countries. Of the total impulse, 0.2% comes from increased EIB lending, the remaining 0.8% from a temporary increase in government investment. All countries are also assumed to proceed with ambitious structural reforms leading to: a 1 pp reduction in mark-ups in the final goods market; a 10 % reduction in firms' administrative burden (overhead labour); and a 3% reduction in the wage mark-up (6% for "high-risk" countries).

3) Low-risk countries (large fiscal space + good competitiveness): AT, NL, FI, DE, DK, SW

4) Intermediate-risk countries (small fiscal space + good competitiveness): euro area - BE, FR, IE, SK; non-euro area - UK, CZ, PL

5) High-risk countries (small fiscal space + poor competitiveness): euro area: EL, IT, PT, ES, CY, SI, MT; non-euro area: HU, LT, LV, RO, EE, BG

Quantifying the EU-level contribution

The EERP combines actions at EU and national level, both as regards the fiscal stimulus and structural reforms. A tentative qualitative assessment of the short-term (after 2 years) and long-term (after 20 years) effects of some EU level measures was undertaken with the QUEST III model.[3] Given data and other usual limitations, some of the estimations are based on stylised shocks, and the results for individual reform measures should generally be treated as upper bounds, indicating orders of magnitude of potential impact rather than precise effect.

Overall, the measures at EU level complement actions taken at the national level in providing a stimulus to the economy. The measures with important short-run effects to be implemented by the EU are estimated to increase the level of GDP by 0.3% to 0.5% in the next two years., and the long-run effects are estimated to raise GDP by around 0.7%. The estimated short-run effect of the additional funds made available by the EIB (and EBRD) on the level of GDP is approximately 0.1% to 0.2%. However, the effects slowly diminish over time as the accumulated capital depreciates. The short-run effects of frontloading of EU structural and

[3] The results report level changes in GDP, i.e. percentage deviations from the baseline. Note that these are not growth rates (to get an approximate average growth rate for the first two years the reported number should be divided by 2). While the short-term impact mostly corresponds to the macroeconomic effect after 2 years to assess the capacity of measures to help cushion the economic slowdown, the real effects may materialise with some additional delay owing to the implementation lags. Finally, the simulations do not always take into account the short-run costs of reforms which may reduce the estimated impact of reform.

cohesion funds could be in the order of 0.1 % of GDP. As the net EU spending over time is unchanged, the effect of the financial impulse would disappear rather quickly. On the other hand, the reprogramming of ESF could have a favourable impact on the skill composition of the workforce which would have a long lasting effect on the level of GDP. The estimates show that the assessed regulatory measures could increase GDP by relatively meagre 0.05% of GDP in the short-run, and reach 0.5% of GDP in the long run. Some of the gains of regulatory measures could be reaped relatively rapidly although short-run adjustment costs exist in certain cases.

In addition, the EERP proposed measures that could significantly contribute to cushioning the effects of the economic crisis but which need to be implemented at national level within the context of an EU-wide framework. These measures comprise targeted tax cuts aimed at boosting demand for low-skilled labour (e.g. through reducing VAT rates for labour-intensive services[4]) . The results show that these measures could have a significant short-run effect on GDP of 0.1% to 0.2%. The size of the shock would depend on whether the measures would be considered as temporary as well as on the financing of the measures.[5]

3. CONCLUSIONS

The EU economy is facing the biggest global economic downturn since the Second World War. This will invariably have significant impacts on households, people in (self-) employment, businesses and public finances throughout the Union. The next years will be difficult indeed.

However, there are several strengths on which the EU can draw in facing up to this slowdown. The Lisbon strategy has strengthened the economic fundamentals, notably in the labour markets, and further modernisation of European labour markets through vigorously implementing the EU Common Principles of Flexicurity remains a priority. The euro has been acting as a strong stabilising factor in the current crisis and the decline in oil and other commodity prices and the resulting decline in inflation will by itself be supportive going forward. Moreover, progress with the consolidation of public finances implies that the starting positions are better now than they have been in a decade. Building on these successes, there clearly is a need to press on with structural reforms and the strengthening of fiscal frameworks and rules. The difficult economic circumstances imply that there is a need for an accelerated implementation of the Lisbon structural reforms. There is no room for complacency. The analysis in this document shows that there is ample scope for improvement and that progress varies significantly across the Member States.

By endorsing the European Economic Recovery Plan proposed by the Commission, Heads of States and Government have equipped the Union with a strong tool to cushion the blow to growth and jobs in the next years. If fully implemented, the ERRP will help the EU economy to return to a growth path rapidly. This requires, strong co-ordination, however, both of fiscal and structural policies. Full account will need to be taken of Member States' different starting

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4 Note that this measure is just an extension of already an existing temporary measure and there would be no additional effects. Therefore, the estimated effects should be seen as opportunity cost of not making the VAT reduction permanent. This result is not included in the overall effect of tax measures.

5 With the exception of reductions in tax burden on low incomes, the measures are assumed to be financed through public deficit and increase in public debt. The loss in tax revenues from a cut in taxes on low incomes is assumed to be financed through a shift of tax burden to high-skilled labour or VAT. The effect depends on the option selected with the shift to consumption taxation delivering higher results as the distortions in the economy are reduced.

positions. The fiscal expansion will need to be reversed as conditions improve to avoid undermining the long run sustainability of public finances in the Union.

STATISTICAL ANNEX ON PROGRESS ACHIEVED WITH THE IMPLEMENTATION OF THE LISBON STRATEGY FOR GROWTH AND JOBS 2005-2007

Annex Table 1: *Indicators on overall progress with the Lisbon Strategy for Growth and Jobs*

	1		2		3		4		5		6		7		8		9		10		11		12		
	GDP per capita		General Government Gross Debt		Primary balance		Labour productivity		R&D spending EU target = 3%		Broadband penetration		Total greenhouse gas emissions		Employment rate EU target = 70%		Older worker employment rate EU target = 50%		Activation		Long term unemployment rate		Participation in LLL		
	At current prices (unit: 1000 PPS)		%GDP		% GDP (Net lending excluding interest, general government)		GDP at current market prices per hour worked (unit: 1000 PPS)		GERD in % of GDP		# broadband lines as % of the population		Index of greenhouse gas emissions (Kyoto base year = 100)		Employed persons aged 15-64 as % of total population aged 15-64		aged 55-64		number of participants in LMP measures divided by the number of persons wanting to work		Long term unemployed population (12 months or more) as % of total active population		% population aged 25-64 participating in education and training over the four weeks prior the survey		
	07	05-07	07	05-07	07	05-07	07	05-07	07	05-07	07	05-07	06	04-06	07	05-07	07	05-07	06	04-06	07	05-07	07	05-07	
	Level	% annual change	Level	annual change p.p.	Level	annual change p.p.	Level	% annual change	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	
AT	31.6	3%	59.5	-2.1	2.3	0.5	0.04	2.3%	2.6	0.06	18.4	3.4	115.2	-0.4	71.4	1.4	38.6	3.4	24.5	3.3	1.2	-0.1	12.8	0.0	AT
BE	29.7	2%	83.9	-4.1	3.5	1.0	0.05	1.4%	1.9	0.02	23.9	3.3	94.0	-3.2	62.0	0.4	34.4	1.3	61.9	-1.2	3.8	-0.3	7.2	-0.6	BE
BG	9.5	6%	18.2	-5.5	1.1	-1.2	0.01	3.0%	0.5	-0.01	5.7	n.a	53.8	0.3	61.7	3.0	42.6	4.0	14.8	1.6	4.1	-1.0	1.3	0.0	BG
CY	23.2	2%	59.5	-4.8	6.5	2.7	0.03	1.5%	0.5	0.03	11.1	4.2	n.a	n.a	71.0	1.3	55.9	2.7	n.a	n.a	0.7	-0.3	8.4	1.3	CY
CZ	20.2	6%	28.9	-0.4	0.2	1.3	0.02	4.5%	1.5	0.07	12.2	4.0	76.3	0.4	66.1	0.6	46.0	0.8	9.4	1.2	2.8	-0.7	5.7	0.1	CZ
DE	28.1	3%	65.1	-1.4	2.6	1.6	0.04	1.5%	2.5	0.02	21.1	5.5	81.5	-0.9	69.4	1.7	51.5	3.1	37.4	3.2	4.7	-0.5	7.8	0.0	DE
DK	30.5	2%	26.2	-5.1	6.0	-0.5	0.04	0.1%	2.5	0.04	37.2	7.6	101.7	1.9	77.1	0.6	58.6	-0.4	47.3	n.a	0.6	-0.3	29.2	0.9	DK
EE	17.6	9%	3.5	-0.5	2.9	0.6	0.02	5.4%	1.1	0.10	20.0	4.5	44.3	-1.4	69.4	2.5	60.0	2.0	2.0	n.a	2.3	-1.0	7.0	0.6	EE
ES	26.5	2%	36.2	-3.4	3.8	0.5	0.04	1.3%	1.2	0.05	16.8	3.4	149.5	1.3	65.6	1.2	44.6	0.8	94.5	21.4	1.7	-0.3	10.4	0.0	ES
FI	29.0	4%	35.1	-3.1	6.8	1.2	0.04	2.9%	3.5	0.00	28.8	5.1	113.1	-0.4	70.3	0.9	55.0	1.2	22.3	0.8	1.6	-0.3	23.4	0.4	FI
FR	27.6	2%	63.9	-1.2	0.1	0.2	0.04	0.2%	2.1	-0.01	22.3	4.2	96.0	-1.0	64.6	0.3	38.3	-0.2	45.6	0.7	3.3	-0.3	7.4	0.2	FR
GR	24.2	4%	94.8	-2.0	0.6	0.7	0.03	0.3%	0.6	-0.01	6.8	3.0	124.4	-0.3	61.4	0.6	42.4	0.4	n.a	n.a	4.1	-0.5	2.1	0.1	GR
HU	15.8	3%	65.8	2.0	-0.9	1.4	0.02	2.5%	1.0	0.02	11.6	3.6	68.1	-0.4	57.3	0.2	33.1	0.1	10.7	-1.5	3.4	0.1	3.6	-0.2	HU
IE	37.1	3%	24.8	-1.2	1.2	-0.8	0.04	2.1%	1.3	0.03	15.5	5.6	125.5	1.0	69.1	0.8	53.8	1.1	32.0	-3.1	1.4	-0.1	7.6	0.1	IE
IT	25.2	1%	104.1	-0.9	3.4	1.6	0.03	0.0%	1.1	-0.01	15.9	3.2	109.9	-1.0	58.7	0.6	33.8	1.2	25.6	-0.1	2.9	-0.5	6.2	0.2	IT
LT	15.2	9%	17.0	-0.7	-0.5	-0.4	0.02	6.3%	0.8	0.04	12.7	3.9	47.0	1.5	64.9	1.2	53.4	2.1	10.9	3.0	1.4	-1.5	5.3	-0.4	LT
LU	68.9	4%	7.0	0.5	3.5	1.7	0.06	2.7%	1.6	0.03	24.6	6.5	101.2	-0.3	64.2	0.3	32.0	0.2	79.6	5.1	1.2	0.0	7.0	-0.8	LU
LV	14.4	12%	9.5	-1.4	0.5	0.2	0.02	6.9%	0.6	0.04	11.6	4.0	44.9	1.5	68.3	2.5	57.7	4.1	3.4	0.9	1.6	-1.3	7.1	-0.4	LV
MT	19.2	3%	62.2	-3.8	1.6	0.3	0.03	1.5%	0.6	0.00	13.9	1.8	n.a	n.a	54.6	0.4	28.5	-1.2	n.a	n.a	2.7	-0.4	6.0	0.4	MT
NL	32.9	3%	45.7	-3.1	2.6	0.2	0.04	1.2%	1.7	-0.01	33.1	5.4	97.4	-2.4	76.0	1.4	50.9	2.4	45.6	-1.5	1.3	-0.3	16.6	0.4	NL
PL	13.3	6%	45.2	-0.9	0.5	1.0	0.02	2.9%	0.6	0.00	6.8	2.5	71.1	1.4	57.0	2.1	29.7	1.3	9.8	n.a	4.9	-2.7	5.1	0.1	PL
PT	18.6	1%	63.6	0.0	0.2	1.9	0.02	1.3%	1.2	0.19	14.8	2.4	138.3	-1.5	67.8	0.1	50.9	0.2	30.7	-4.8	3.8	0.0	4.4	0.2	PT
RO	10.1	7%	12.9	-1.5	-1.8	-0.8	n.a	n.a	0.5	0.07	6.6	n.a	56.3	-0.4	58.8	0.6	41.4	1.0	6.8	0.1	3.2	-0.4	1.3	-0.2	RO
SE	31.3	3%	40.4	-5.2	5.4	0.7	0.04	1.1%	3.6	-0.09	28.3	5.6	91.1	-2.7	74.2	0.9	70.0	0.3	32.0	n.a	0.9	-0.3	32.4	-0.5	SE
SI	22.6	6%	23.4	-1.8	1.8	0.8	0.03	4.3%	1.5	0.05	15.3	3.8	101.2	1.2	67.8	0.9	33.5	1.4	14.3	n.a	2.2	-0.5	14.8	-0.3	SI
SK	17.0	9%	29.4	-2.4	-0.6	0.3	0.02	6.6%	0.5	-0.03	6.9	2.7	67.9	-0.8	60.7	1.5	35.6	2.7	31.2	5.3	8.3	-1.7	3.9	-0.4	SK
UK	29.1	2%	44.2	1.0	-0.6	0.4	0.04	2.6%	1.8	0.04	23.8	5.2	84.0	-0.3	71.5	-0.1	57.4	0.3	2.3	-0.4	1.3	0.2	20.0	-3.8	UK
EU27 (unweighted avg.)	24.7	4.4%	43.3	-2.0	2.0	0.6	0.03	2.6%	1.4	0.03	17.2	4.1	90.1	-26.7%	66.0	1.0	45.5	1.3	28.9	1.8	2.6	-0.5	9.8	-0.1	
EU27 (weighted avg.)	24.9	2.8%	58.7	-1.4	1.8	0.8	0.04	1.4%	1.8	0.02	18.2	4.3	96.9	-56.6%	65.4	0.9	44.7	1.2	33.8	2.5	3.1	-0.4	9.5	-0.5	

Annex Table 2: *Indicators on overall progress with the Lisbon Strategy for Growth and Jobs*

	1		2		3		4		5		6	
	Consumer prices inflation		**Labour utilisation**		**Trade balance**		**Science and technology graduates**		**Patent applications to the EPO**		**Starting a business - Time**	
	Annual average of change in HICP		Unit: 1 hour worked per person		at current prices in % of GDP		per 1000 of population aged 20-29		Number of applications per million inhabitants		in days	
	07	05-07	07	05-07	07	05-07	06	04-06	05	03-05	08	06-08
	Level	annual change p.p.	Level	% annual change	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	absolute annual change
AT	2.2	0.1	815.9	0.4%	5.9	1.0	10.8	0.8	183.1	10.6	28.0	0.0
BE	1.8	-0.4	641.0	0.8%	3.0	-0.4	10.6	0.0	129.1	2.43	4.0	-11.5
BG	7.6	0.8	801.6	3.3%	-22.1	-3.0	8.5	0.1	1.4	-0.68	49.0	8.5
CY	2.2	0.1	910.6	1.0%	-5.6	-1.5	4.3	0.0	17.0	3.83	n.a	n.a
CZ	3.0	0.7	983.8	1.3%	5.0	0.9	10.0	0.9	7.3	-2.00	15.0	-4.5
DE	2.3	0.2	692.9	1.3%	7.1	0.9	10.7	0.6	275.0	6.64	18.0	-3.0
DK	1.7	0.0	822.1	2.3%	1.3	-1.8	13.8	1.1	174.6	-5.76	6.0	0.0
EE	6.7	1.3	955.0	2.9%	-10.9	-2.3	11.2	1.7	5.6	-1.16	7.0	-14.0
ES	2.8	-0.3	751.3	0.7%	-6.8	-0.7	11.5	-0.4	29.3	3.52	47.0	0.0
FI	1.6	0.4	806.0	1.3%	5.1	0.3	17.9	0.2	267.6	13.58	14.0	0.0
FR	1.6	-0.2	640.8	1.4%	-1.9	-0.5	20.7	0.3	119.2	-3.37	7.0	0.0
GR	3.0	-0.3	914.6	3.6%	-10.5	-0.8	10.1	2.1	6.5	-0.67	19.0	-9.5
HU	7.9	2.2	770.5	0.2%	1.5	1.7	5.8	0.2	7.8	-2.29	5.0	-16.5
IE	2.9	0.4	909.4	1.1%	10.7	-0.7	21.4	0.2	64.1	4.36	13.0	0.0
IT	2.0	-0.1	773.2	1.0%	-0.3	-0.1	9.1	1.7	76.1	0.57	10.0	-1.5
LT	5.8	1.6	841.5	2.5%	-13.4	-3.2	19.5	1.3	1.3	-1.25	26.0	0.0
LU	2.7	-0.6	1067.5	1.4%	32.2	3.3	n.a	n.a	194.9	-1.25	26.0	n.a
LV	10.1	1.6	924.7	4.6%	-20.3	-2.9	8.9	0.6	5.7	1.05	16.0	0.0
MT	0.7	-0.9	692.1	1.2%	-2.8	1.3	5.0	-0.1	21.6	4.07	n.a	n.a
NL	1.6	0.1	733.4	2.0%	8.6	0.0	9.0	0.7	173.3	-18.62	10.0	0.0
PL	2.6	0.2	790.1	3.5%	-2.7	-1.0	13.3	1.1	3.0	0.05	31.0	0.0
PT	2.4	0.2	847.3	0.0%	-7.4	0.7	12.6	1.9	7.4	0.77	6.0	-1.0
RO	4.9	-2.1	n.a	n.a	-14.3	-2.0	10.5	0.5	0.7	-0.03	10.0	-0.5
SE	1.7	0.5	798.3	1.6%	7.6	-0.1	15.1	0.3	184.8	-16.55	15.0	0.0
SI	3.8	0.7	821.4	1.5%	-1.3	-0.4	9.5	0.6	32.2	-3.01	19.0	-20.5
SK	1.9	-0.5	717.1	2.6%	-1.0	1.8	10.3	0.9	5.8	0.06	16.0	-4.5
UK	2.3	0.1	795.9	-0.1%	-3.4	0.0	17.8	-1.3	91.4	0.77	13.0	0.0
EU27 (unweighted avg.)	3.3	0.2	816.1	1.7%	-1.4	-0.4	11.8	0.6	77.2	-0.16	17.2	-3.3
EU27 (weighted avg.)	2.3	0.0	737.1	1.1%	0.5	-0.1	13.4	0.4	105.7	0.49	16.6	-1.6

	7		8		9		10		11		12		
	Starting a business - Cost		**Venture capital investment**		**Transposition deficit of Single market directives**		**Summary innovation index**		**Electricity generated from renewable sources**		**Energy efficiency**		
	% of income per capita		% of GDP		% of internal market directives not yet comunicated as having been transposed, in relation to the total number of		Composite indicator		% of gross electricity consumption		GDP (at constant prices, 1995=100) divided by gross inland consumption of energy - Euro per kgoe (kilogram of oil equivalent)		
	08	06-08	07	05-07	07	05-07	07	05-07	06	04-06	06	04-06	
	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	
AT	5.1	-0.3	0.1	0.0	0.9	-0.3	0.5	0.00	56.6	-1.1	6.7	0.0	**AT**
BE	5.2	-0.3	0.3	0.1	1.2	-0.3	0.5	-0.01	3.9	0.9	4.4	0.1	**BE**
BG	2.0	-2.95	0.2	n.a	0.8	n.a	0.2	0.01	11.2	1.2	0.6	0.0	**BG**
CY	n.a	n.a	n.a	n.a	1.2	0.0	0.3	0.01	0.0	0.0	4.1	0.3	**CY**
CZ	9.6	0.35	0.1	0.0	3.4	0.5	0.4	0.01	4.9	0.5	1.2	0.1	**CZ**
DE	5.6	0.25	0.3	0.1	0.9	-0.2	0.6	0.00	12.0	1.3	6.3	0.1	**DE**
DK	0.0	0	0.5	0.0	0.6	-0.1	0.6	-0.02	29.0	0.4	8.7	0.4	**DK**
EE	1.7	-1.7	0.1	n.a	1.0	-0.2	0.4	0.01	1.4	0.4	1.0	0.1	**EE**
ES	14.9	-0.65	0.3	0.0	1.0	-0.3	0.3	0.00	20.0	2.5	4.5	0.0	**ES**
FI	1.0	-0.05	0.6	0.2	1.2	0.2	0.6	0.00	24.0	-2.2	4.1	0.3	**FI**
FR	1.0	-0.05	0.7	0.1	1.1	-0.3	0.5	0.00	13.3	1.0	5.4	0.1	**FR**
GR	10.2	-4.8	0.2	0.1	1.7	-1.0	0.3	0.00	12.1	1.3	4.7	0.1	**GR**
HU	8.4	-6.25	0.0	0.0	1.2	0.3	0.3	0.01	3.7	0.7	1.8	0.0	**HU**
IE	0.3	0	0.2	0.0	1.2	-0.3	0.5	0.00	9.3	1.3	7.0	0.3	**IE**
IT	18.5	-0.75	0.1	0.0	1.3	-0.9	0.3	0.00	13.7	-0.2	5.3	0.0	**IT**
LT	2.7	-0.05	0.1	n.a	0.6	0.1	0.3	0.02	4.6	0.4	1.1	0.1	**LT**
LU	6.5	n.a	0.2	n.a	2.8	-0.8	0.5	0.00	3.4	0.1	5.4	0.0	**LU**
LV	2.3	-0.6	0.1	n.a	0.6	-0.3	0.2	0.01	37.7	-4.7	1.6	0.1	**LV**
MT	n.a	n.a	n.a	n.a	0.9	-0.2	0.3	0.00	0.0	0.0	3.8	-0.1	**MT**
NL	5.9	-0.65	0.7	0.1	0.7	-0.3	0.5	0.00	7.6	0.0	5.0	0.1	**NL**
PL	18.8	-1.3	0.2	0.1	1.7	0.4	0.2	0.01	2.9	0.4	1.7	0.1	**PL**
PT	2.9	-0.7	0.1	0.0	2.3	-0.4	0.2	0.01	29.4	2.5	4.1	-0.1	**PT**
RO	3.6	-0.4	0.2	0.1	0.8	n.a	0.2	0.01	31.4	0.8	0.9	0.1	**RO**
SE	0.6	-0.05	1.3	0.1	1.0	0.1	0.7	-0.02	52.1	-1.1	5.0	0.1	**SE**
SI	0.1	-4.65	0.0	n.a	0.7	-0.3	0.4	0.01	24.4	-2.4	3.2	0.0	**SI**
SK	3.3	-0.75	0.0	0.0	0.6	-0.4	0.2	0.01	16.6	0.0	1.2	0.1	**SK**
UK	0.8	0.05	1.7	0.2	1.0	-0.2	0.6	0.01	5.1	0.4	4.9	0.1	**UK**
EU27 (unweighted avg.)	5.2	-1	0.3	0.1	1.2	-0.2	0.4	0.00	15.9	0.2	3.8	0.1	
EU27 (weighted avg.)	6.9	-0.43	0.6	0.1	1.1	-0.3	0.5	0.00	14.6	0.7	4.8	0.1	

Annex Table 3: *Indicators on overall progress with the Lisbon Strategy for Growth and Jobs*

	1		2		3		4		5		6		7		8		9		10		11		12		
	Female employment rate EU target = 60%		**At-risk-of-poverty rate after social transfers**		**Early school-leavers**		**Tax wedge on labour cost**		**Youth education attainment level**		**Dispersion of regional employment rates**		**Average exit age from labour force**		**Gender pay gap in undajusted form**		**Vacancies per unemployed**		**Involuntary part-time and fixed-term employment**		**Childcare (0-2 years)**		**Childcare (3 years to compulsory school age)**		
	Female in employment 15-64 aged as a % of total female 15-64 aged population		Share of persons (%) with an equivalised disposable income below the risk-of-poverty threshold (i.e. 60%)		% of population aged 18-24 with at most lower secondary education		Tax rate on low wage earners (single earner)		% of the population aged 20-24 having completed at least upper secondary education		Coefficient of variation of employment rates (of the age group 15-64) across regions (NUTS 2 level) within countries		The average age of withdrawal from the labour market		Difference between men's and women's average gross hourly earnings as a percentage of men's average gross hourly		Ratio of job vacancies to the number of unemployed		% of total employees		for 30 hours and more		for 30 hours and more		
	07	05-07	06	04-06	07	05-07	06	04-06	07	05-07	07	05-07	07	05-07	06	04-06	07	05-07	07	05-07	06	05-06	06	05-06	
	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	% annual change	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	Level	annual change p.p.	
AT	64.4	1.2	13.0	0.0	10.9	1.0	43.5	-0.2	84.1	-0.90	3.80	-0.15	60.9	0.8	20.0	1.0	n.a	n.a	4.0	0.7	1.0	0.5	16.0	0.0	AT
BE	55.3	0.8	15.0	0.0	12.3	-0.4	49.2	0.2	82.6	0.40	8.60	0.10	61.6	0.8	7.0	0.5	n.a	n.a	8.0	-0.4	23.0	2.0	62.0	7.0	BE
BG	57.6	3.0	14.0	-0.5	16.6	-1.7	31.1	-2.4	83.3	3.40	7.10	-0.05	64.1	2.8	14.0	-1.0	100.9	18.8	3.6	-0.5	n.a	n.a	n.a	n.a	BG
CY	62.4	2.0	16.0	n.a	12.6	-2.8	11.9	-3.4	85.8	2.70	n.a	n.a	63.5	n.a	24.0	-0.5	170.1	n.a	12.6	-0.6	18.0	3.0	37.0	-3.0	CY
CZ	57.3	0.5	10.0	n.a	5.5	-0.3	40.1	-0.9	91.8	0.30	4.60	-0.45	60.7	0.1	18.0	-0.5	436.9	150.5	5.6	-0.3	1.0	0.5	39.0	-0.5	CZ
DE	64.0	1.7	13.0	n.a	12.7	-0.6	47.4	-0.2	72.5	0.50	4.80	-0.40	62.0	n.a	22.0	-0.5	354.0	56.1	7.7	0.4	7.0	-0.5	27.0	0.5	DE
DK	73.2	0.6	12.0	0.5	12.4	2.0	39.3	0.0	70.8	-3.15	n.a	n.a	60.6	-0.3	17.0	0.0	n.a	n.a	5.7	-1.0	66.0	3.0	80.0	0.5	DK
EE	65.9	1.9	18.0	-1.0	14.3	0.2	38.4	-0.3	80.9	-0.85	n.a	n.a	62.5	0.6	25.0	0.5	617.2	182.3	1.8	-0.3	12.0	1.5	78.0	4.5	EE
ES	54.7	1.8	20.0	0.0	31.0	0.1	35.9	0.3	61.1	-0.35	7.50	-0.40	62.1	-0.2	13.0	-1.0	56.6	4.2	23.0	9.3	19.0	2.5	44.0	2.0	ES
FI	68.5	1.0	13.0	1.0	7.9	-0.7	38.9	-0.3	86.5	1.55	5.60	0.05	61.6	-0.1	20.0	0.0	288.0	50.7	12.8	-0.7	21.0	1.0	56.0	2.5	FI
FR	60.0	0.8	13.0	0.0	12.7	0.4	44.5	1.1	82.4	-0.50	6.60	-0.30	59.4	0.3	11.0	-0.5	n.a	n.a	11.6	0.0	17.0	0.5	42.0	1.5	FR
GR	47.9	0.9	21.0	0.5	14.7	0.7	35.4	0.3	82.1	-1.00	3.50	-0.40	61.0	-0.6	10.0	0.0	109.6	30.2	9.4	-0.3	8.0	2.0	20.0	-7.0	GR
HU	50.9	-0.1	16.0	n.a	10.9	-0.7	42.9	-0.9	84.0	0.30	9.70	-0.10	59.8	-1.5	11.0	-1.5	121.5	n.a	5.3	0.6	6.0	0.5	58.0	2.0	HU
IE	60.6	1.2	18.0	-1.5	11.5	-0.4	16.3	-1.9	86.7	0.45	n.a	n.a	64.1	1.0	9.0	-1.0	n.a	n.a	0.6	0.0	5.0	-0.5	13.0	-0.5	IE
IT	46.6	0.7	20.0	0.5	19.3	-1.3	41.5	0.1	76.3	1.35	16.30	0.15	60.4	0.6	9.0	2.0	n.a	n.a	12.9	0.5	16.0	0.0	66.0	-2.0	IT
LT	62.2	1.4	20.0	n.a	8.7	-0.3	40.6	-0.5	89.0	0.60	n.a	n.a	59.9	-0.7	16.0	0.0	387.7	164.0	3.6	-1.5	4.0	-2.5	47.0	0.5	LT
LU	56.1	1.2	14.0	1.0	15.1	0.9	30.6	0.5	70.9	-0.10	n.a	n.a	59.4	1.7	14.0	0.0	281.6	74.8	3.4	-0.5	17.0	4.5	16.0	2.0	LU
LV	64.4	2.6	23.0	n.a	16.0	2.1	41.8	-0.1	80.2	0.15	n.a	n.a	63.3	1.0	16.0	1.0	283.7	81.2	3.2	-0.9	14.0	-1.0	56.0	-2.0	LV
MT	35.7	1.0	14.0	n.a	37.3	-2.0	18.4	0.4	55.5	0.90	n.a	n.a	58.5	0.4	3.0	-0.5	n.a	n.a	4.1	0.1	3.0	1.5	25.0	1.0	MT
NL	69.6	1.6	10.0	n.a	12.0	-0.8	40.6	-0.1	76.2	0.30	2.20	0.10	63.9	1.9	18.0	0.0	857.1	236.5	6.4	0.2	4.0	0.0	7.0	0.0	NL
PL	50.6	1.9	19.0	n.a	5.0	-0.3	42.5	0.1	91.6	0.25	4.50	-0.55	59.3	-0.2	12.0	1.0	n.a	n.a	21.4	3.6	2.0	0.0	21.0	-0.5	PL
PT	61.9	0.1	18.0	-1.0	36.3	-1.2	31.7	-0.4	53.4	2.20	3.30	0.00	62.6	-0.4	8.0	1.5	32.8	-1.7	19.7	2.1	32.0	3.0	66.0	5.5	PT
RO	52.8	0.6	19.0	0.5	19.2	-0.8	42.2	-0.3	77.4	0.70	4.60	0.05	64.3	4.0	10.0	-2.0	149.7	22.8	1.4	-0.3	n.a	n.a	n.a	n.a	RO
SE	71.8	0.7	12.0	0.5	8.6	-1.6	46.0	-0.6	87.2	-0.15	2.40	-0.30	63.9	0.2	16.0	-0.5	184.3	31.4	14.2	0.2	27.0	-2.0	58.0	3.0	SE
SI	62.6	0.7	12.0	n.a	4.3	0.0	41.2	0.7	91.5	0.50	n.a	n.a	59.8	1.1	8.0	0.0	177.8	34.2	9.9	1.0	26.0	2.0	66.0	-0.5	SI
SK	53.0	1.1	12.0	n.a	7.2	0.7	35.6	-2.0	91.3	-0.25	8.30	-0.75	58.7	-0.4	22.0	-1.0	74.1	20.8	3.7	0.0	4.0	0.5	63.0	3.0	SK
UK	65.5	-0.1	19.0	n.a	17.0	1.5	30.4	0.2	78.1	0.00	5.40	-0.15	62.6	0.0	21.0	-0.5	404.1	-16.7	3.7	0.3	5.0	0.0	24.0	-2.0	UK
EU27 (unweighted avg.)	59.1	1.1	15.7	0.0	14.5	-0.2	37.0	-0.4	79.7	0.34	6.0	-0.20	61.5	1	14.6	-0.1	267.8	67.1	8.1	0.4	14.3	0.9	43.5	0.7	
EU27 (weighted avg.)	58.3	1.0	16.0	0.1	15.2	-0.1	40.1	0.1	78.1	0.21	11.40	-0.20	61.2	0.3	15.0	-0.1	164.0	25.1	10.2	1.2	12.0	0.4	37.4	0.2	

II. Micro-economic part

1. INTRODUCTION

Europe's main challenge over the long term is to maintain per capita income growth with a declining labour force and scarcer physical inputs, so that living standards continue to progress for all. This implies maintaining and even rising productivity growth and increasing (resource) efficiency. Moreover, there is a large consensus that the most important source of future growth will be total factor productivity (TFP). This is the part of productivity growth generated by intangible factors such as technical progress or organisational innovation instead of increased use of inputs, such as capital. Measures of total factor productivity are therefore the most comprehensive account of the efficiency of an economy and of its technological capabilities. Differences in TFP largely explain the persistence of the labour productivity gap of the EU in comparison to the US[6].

Among the policies most relevant to total factor productivity growth are those designed to foster technological progress, innovation and R&D, the use of ICT, education and training, competition and product market reform. These policies are at the heart of the microeconomic pillar of the Lisbon strategy, suggesting that the ongoing reform process can contribute significantly to boosting total factor productivity and economic growth. They can also improve the adjustment capacity of European economies and make them more resilient in the long run.

The political importance of structural reform is also reflected in the fact that half of the main challenges, as identified by the Member States themselves in their National Reform Programmes (NRPs) are in the micro-economic area. Also, nearly half of the country specific recommendations and 'points to watch' which the Commission proposed and which the Council adopted in spring 2008, relate to micro-economic reforms. The launch of the second tri-annual cycle of NRPs this year did not change this distribution.

This chapter takes stock of the reform efforts under the microeconomic pillar of the Growth and Jobs strategy. Section 2 provides an overview of developments regarding key microeconomic policy priorities since 2005. Section 3 overviews progress achieved so far in the various policy areas and Section 4 explores evidence about whether reform efforts have any tangible effect on European economies and Section 5 concludes.

2. MICROECONOMIC REFORMS IN 2008 AND THE ONSET OF THE ECONOMIC CRISIS

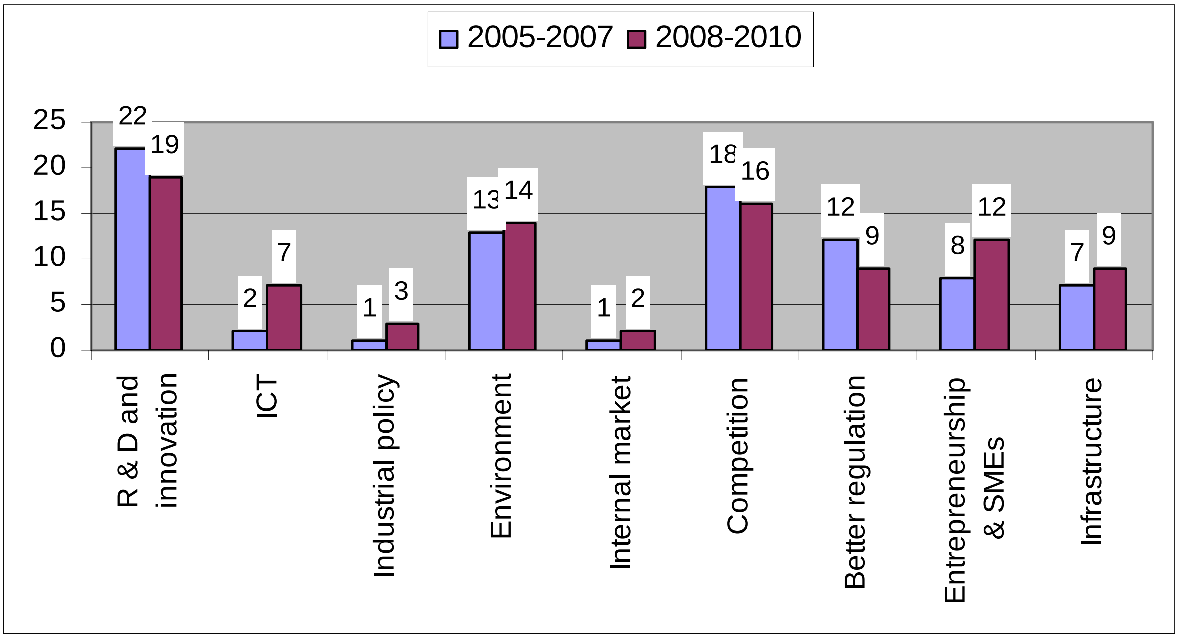
2.1 The Lisbon strategy since 2005

The EU's reform agenda of 2005 has put emphasis on the reforms needed to substantially improve the European competitiveness and ensure sustainable growth and job creation. Moreover, at the launching of the new cycle the main challenges facing the European economies over the medium to long term had not changed significantly since 2005. Consequently, only minor adjustments were made to the integrated framework of economic and employment policy guidelines. This stance was confirmed by the overall stable pattern of challenges addressed by Member States in their new National Reform Programmes.

[6] Ref. European Competitiveness Report 2008, document SEC(2008)2853 of 28.11.2008.

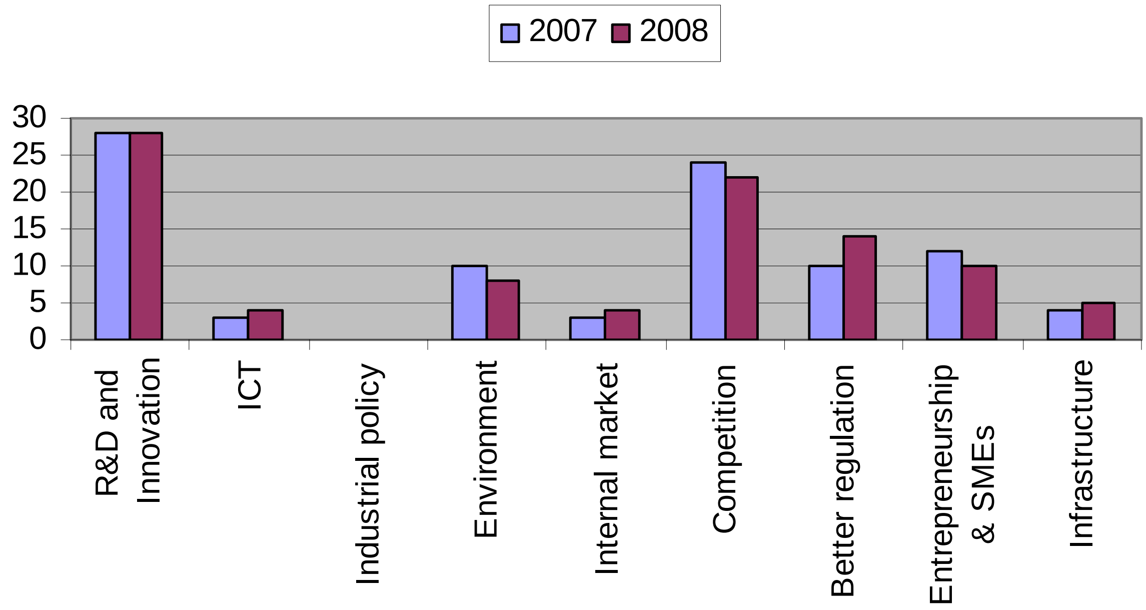
The key challenges and country specific recommendations in the micro-economic area are strongly concentrated on research and innovation; competition; climate change and other environment issues; the regulatory environment and entrepreneurship/SMEs. When comparing the national microeconomic priorities as expressed in the 2005-2007 and 2008-2010 NRPs the most notable change is a higher emphasis on ICT and entrepreneurship and SME related policy objectives (see Graph 1). The pattern of country specific recommendations and 'points to watch' remained overall stable between 2007 and 2008, with the exception of an increase of those related to Better Regulation (Graph 2) and a corresponding decrease of those related to SMEs, as actions related to the business regulatory environment are described more operationally in better regulation policy terms. The graphs are misleading as concerns the priority attached to industrial policy as most actions addressing industrial (and service sector) competitiveness are classified under other headings such as innovation or competition.

Graph 1. Number of key challenges in the microeconomic pillar in the National Reform Programmes of the Member States in 2005-2007 and 2008-2010



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' in 2007 and 2008. Bulgaria and Romania were not assessed yet and are not included in the 2007 data.

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.

2.2 Microeconomic reforms and the economic crisis

In general, the NRPs make little reference to the current economic crisis and this applies even more with regard to their microeconomic policy areas. This is due to their medium to long term focus but also to the fact that, in most cases, at the time of their preparation the real economy had not yet been affected. Nevertheless, it is important that when adjusting their economic policies to the crisis - through recovery plans and stimulus packages - Member States do not sacrifice their long-term objectives.

In this context, the first signs from the measures that the Member States are taking or announcing, mainly in the context of their next year's budgets, with the aim of addressing the effects of the financial crisis on the real economy that are linked to microeconomic policies are encouraging. Most measures (see corresponding sections for details) aim at facilitating the access of SMEs to the credit markets or to bring forward or increase public investment in infrastructures. Some have also announced increased support for R&D and a small group of countries measures to increase competition, as a way to increase consumers' purchasing power.

The European Commission presented a European Economic Recovery in November, designed also to present a number of short term priority actions, in the micro-economic field, aimed at sustaining economic growth and at adapting our economies to long term challenges that will require important efforts from Member States to implement. These fall under the four priority areas of the Lisbon strategy and cover entrepreneurship, access to finance, reduction of administrative burdens, research and innovation and eco-innovation.

Microeconomic policies aim at increasing economic efficiency, either by inducing productivity growth –through innovation or through reducing costs related to regulation- or by assuring a better resource allocation through product market reform. By boosting the growth potential and the ability to adjust of the economies and by assisting to seize the opportunities offered by the low carbon, low resource use economy they will help them emerge from the crisis faster and stronger than before and will contribute to preserve and strengthen their international competiveness.

3. AT THE START OF A NEW CYCLE IN THE REFORM AGENDA: AN ASSESSMENT OF PROGRESS BY POLICY AREA

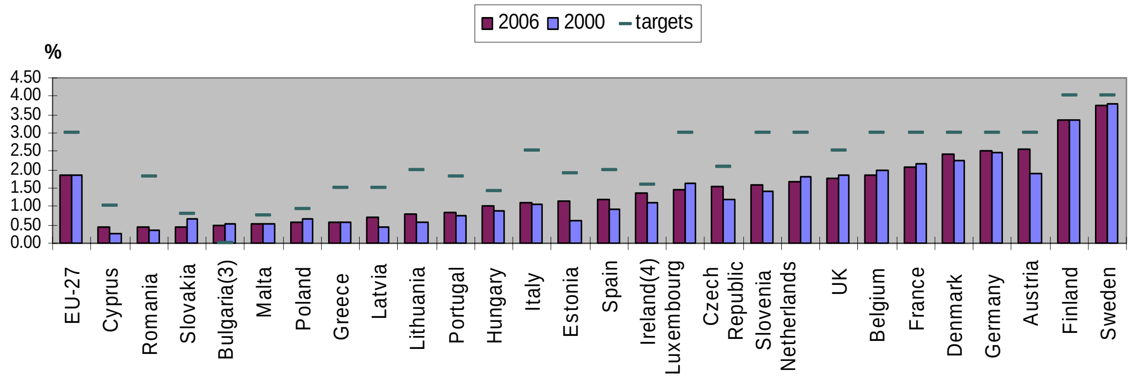
3.1 Knowledge and innovation

3.1.1 Research

There are clear risks that the current economic downturn could lead to a weakening of investments in R&D, and notably those of the business sector, through a reduction or postponement of projects in the pipeline. In this situation, it is vital that immediate priority is given to measures which enhance productivity and which continue strengthening the European research system, including through raising public R&D investment, as has also been called for in the European Economic Recovery Programme, but more importantly, also through action across the full spectrum of Lisbon related policies and notably those developing attractive conditions for business R&D investment and innovation. It is only by improving its attractiveness for research and other investments that Europe will be able to fully reap the benefits of the next economic upturn.

In this respect, steady progress towards the 3 % objective remains vital. Progressing towards a higher level of R&D investment will reflect Europe's success in building a society that thrives on knowledge. The EU's **R&D intensity** in 2006 stood at 1.84 % GDP, with little or no progress since 2000. The picture at Member State level (see graph 3) is more dynamic and contrasted. In 17 Member States, R&D intensity increased between 2000 and 2006, although the rates of growth have varied considerably between Member States. Increases have been particularly high in many of the less R&D intensive Member States (Malta, Estonia, Cyprus, Latvia, Lithuania, Spain, Hungary, Romania, Ireland, Czech Republic, Slovenia, and Portugal). Among the more R&D intensive EU Member States, only Austria has managed to progress significantly. The stagnation at EU-27 level concerns both public and private R&D investments and is largely explained by the fact that R&D intensity in terms of GDP has stagnated in the four largest countries (Germany, the United Kingdom, France, and Italy).

Graph 3. R&D intensity targets and situation in 2000(1) and 2006(2)



Source: Eurostat, Member States

Notes (1) EL : 2001; FR, HU, MT : 2004; SE : 2005

(2) IT: 2005; IE, AT, SK, FI: 2007.

(3) BG has not set an R&D intensity target

(4) The 2010 R&D intensity target for IE was estimated by DG Research.

There is evidence that many Member States have prioritized public R&D investments within their national budgets. In 20 Member States, the share of R&D in total government budget increased between 2000 and 2007. However, the overall intensity of government funding of R&D at EU-27 level has remained stable, in particular due to the stagnation and decline in Member States with a high share of GDP.

Creating more favourable framework conditions for private R&D investment and the growth of research intensive sectors remain key objectives in building a knowledge-based economy. This should lead to a shift of the industrial structure towards sectors with higher knowledge content. With an increasing globalisation of R&D investments, the attractiveness of local conditions is ever more important for retaining and gaining private investments in R&D. Each Member State should, in this respect, adopt a policy approach that is in line with its R&D investment target, building on comparative advantages. In some cases, policies are still too much based on simple copying without taking into account country-specific situations and needs. For example, for some Member States that are still catching up and need to modernise their research systems, it is essential to ensure that the public research base can deliver adequately trained researchers especially in the field of applied research and to encourage project-based competitive funding of public research, which can contribute to stimulate private R&D investment. For other Member States with a well developed public research base, more sophisticated policy mixes combining e.g. measures to further the excellence of the public research base, tax incentives, public-private partnerships or cluster approaches may be needed. Still others may want to look beyond traditional R&D policy measures and develop cross-government approaches to achieve further progress. In most of the cases, more openness of the research and innovation system to other sources of R&D worldwide (e.g. by enhanced international collaboration or by an intensified exchange of researchers) can also increase overall efficiency and effectiveness of the system and further encourage private investment in high and medium tech sectors.

Intensifying efforts to accelerate the realisation of the **European Research Area** is crucial to increase the efficiency of European research systems and better address common economic and societal challenges. Realising the Fifth Freedom, the freedom of movement of knowledge, will allow increasing cross-border spill-overs and building synergies across national borders and across policy levels.

New Member States typically perceive the ERA as an opportunity driving them to catch up and develop their research policies and systems to higher levels of effectiveness and efficiency. There are some, however, where ERA is partially perceived as a challenge, as a more open European research system may drain some of their human resources away. The more developed Member States typically see ERA as an external resource (in terms of budgets, networks and ideas) that can strengthen their system in complement to their own resources.

The Framework Programme is still seen as the major instrument for building the ERA and stimulating national researchers to participate in it is an objective of most Member States. Some of the ERA initiatives have stimulated or contributed to discussions on issues such as the career prospects of researchers or research infrastructures. New Member States in particular actively seek inspiration in the policies of the Community or those of other Member States to shape their own.

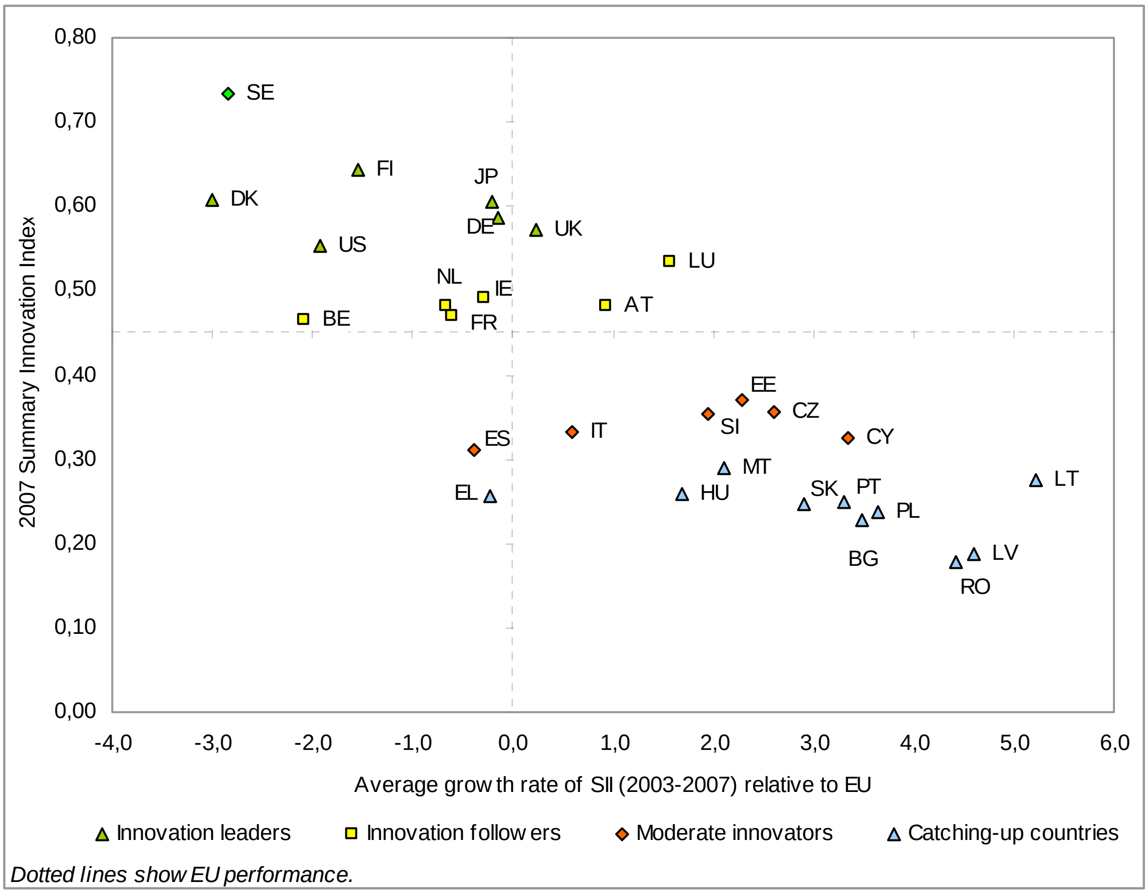
What is common throughout all Member States is that a purely national perspective still dominates national policy making. Considerations on how to align national policy with that of other Member States or that of the Community with a view to creating a stronger Europe together are only slowly gaining recognition. Discussions on furthering the opening up of national programmes, an efficient division of labour between national programmes and the Framework Programme or how to develop cooperative policy approaches to create world class excellence in Europe in key scientific and technological domains are examples of elements where further impetus could be given to the development of the ERA. There is still large potential here for increasing the effectiveness of national policies and making a significant contribution towards developing a multi-level European research system as a more competitive player on the global scene.

The current economic downturn should not make Member States lose their focus on the longer term importance of knowledge related investments and structural reforms. It is particularly noteworthy that in this context, some Member States (BG, ES, LT, LU and SI) have announced new measures in support of R&D, also as contributions towards re-launching their economies.

3.1.2 Innovation

In terms of innovation performance, there is evidence from the European Innovation Scoreboard that most EU countries are converging to the EU-27 average in terms of their innovation performance (see Graph 4). This is a typical catch-up phenomenon, with countries with a low performance at level terms improving faster their performance than those with a high absolute performance.

Graph 4 Current innovation performance and progress in last 5years



Source: European Commission, European Innovation Scoreboard 2007

Note: Innovation performance as captured by the Summary Innovation Index(SII)which is a composite index of 25 indicators

The innovation gap between the EU and its two main competitors, the US and Japan, is significant but keeps narrowing down. A comparison over time shows that the EU is experiencing an increasing lead over the US in S&E graduates, employment in medium-high and high-tech manufacturing and Community trademarks, and a stable lead in Community designs. The EU is experiencing a declining gap with the US in broadband penetration, early-stage venture capital, ICT expenditures and triad patents. But the gap with the US is increasing in public R&D expenditures and high-tech exports. The forthcoming 2008 European Innovation Scoreboard will analyse further improvements in the EU's innovation performance in comparison with the US as well as differences in Member States' innovation performance, both in terms of level and trends.

The shift in the innovation policy focus to complement the science and technology push approach with more systemic and non R&D-based policies has continued. A number of Member States have, for instance, been paying more importance to the services sectors in their innovation policies and strategies (for instance, the “People - Economy – Environment” and the “Innovations in social and healthcare system” strategies of TEKES in Finland). Policies in support of non-technological innovation, user-driven and user-oriented innovation, such as design innovation, are also becoming increasingly important in some of Europe’s leading innovation nations. There is also more emphasis on demand side measures, such as the potential of public procurement to stimulate innovative products and services (UK Innovation White Paper, VINNOVA in Sweden) and tax incentives for consumers to stimulate the uptake of innovative products (e.g. incentives for hybrid fuel-saving cars).

Improvements in the design of policy formulation, from timely involvement of stakeholders to a more evidence-based approach have been noticeable in many Member States. For instance, in the UK, most government departments have been asked by the Government Chief Scientific Adviser to produce Science and Innovation and Evidence and Innovation Strategies[7].On the other hand, some deficiencies in the coordination of government bodies in charge of innovation policy do persist in some Member States.

In most of the new Member States, the Operational Programmes under the Structural Funds are one of the main vehicles to implement innovation related policies, from cluster policies to access to finance or human resources (such as the Operational Programmes “Enterprise and Innovation” and “Education for Competiveness” 2007-2013 in the Czech Republic). These are making good use of the range of possibilities under the State Aid framework for research and development and innovation.

A common trend to most EU Member States in terms of their innovation policy governance is the separation between policy design and policy implementation, with a proliferation of government agencies in charge of delivering policies and managing funding programmes, such as the newly announced Technology Agency in the Czech Republic, the Polish Agency for Enterprise Development (PAED) or the recent regrouping of OSEO in France. On the other hand, there is some evidence that governance systems with fewer but stronger players tend to display superior results in terms of policy delivery.

A persistent challenge to innovation systems in many EU Member States is the relative lack of high-growth enterprises, which are known to make a proportionally higher contribution to job generation and economic growth. This may be related to the relative fragmentation of venture capital markets in Europe or the relative lack of propensity to internationalisation of many European SMEs. Furthermore, improving science-industry linkages remains prevalent in the innovation strategies of most Member States.

In the face of the current credit crisis and negative economic outlook, Member States should remain firm in their policy responses to the identified challenges to their national innovation systems. Only a steady flow of investment in research and innovation will ensure that companies can take full advantage of the economic upturn at the end of the current crisis. To support innovation in manufacturing, in particular in the construction industry and the automobile sector which have recently seen demand plummet as a result of the crisis and which also face significant challenges in the transition to the green economy, the Commission proposes to launch 3 major partnerships between the public and private sectors: In the automobile sector, a 'European green cars initiative' involving research on a broad range of technologies and smart energy infrastructures essential to achieve a breakthrough in the use of renewable and non-polluting energy sources, safety and traffic fluidity; In the construction sector, a 'European energy-efficient buildings' initiative, to promote green technologies and the development of energy-efficient systems and materials in new and renovated buildings with a view to reducing radically their energy consumption and CO_2 emissions[8]; to increase the use of technology in manufacturing, "a factories of the future initiative": the objective is to

7 See http://www.berr.gov.uk/files/file40538.pdf

8 Buildings currently account for 40% of energy consumption.

help EU manufacturers across sectors, in particular SMEs, to adapt to global competitive pressures by increasing the technological base of EU manufacturing through the development and integration the enabling technologies of the future, such as engineering technologies for adaptable machines and industrial processes, ICT, and advanced materials.

3.1.3 Information Society

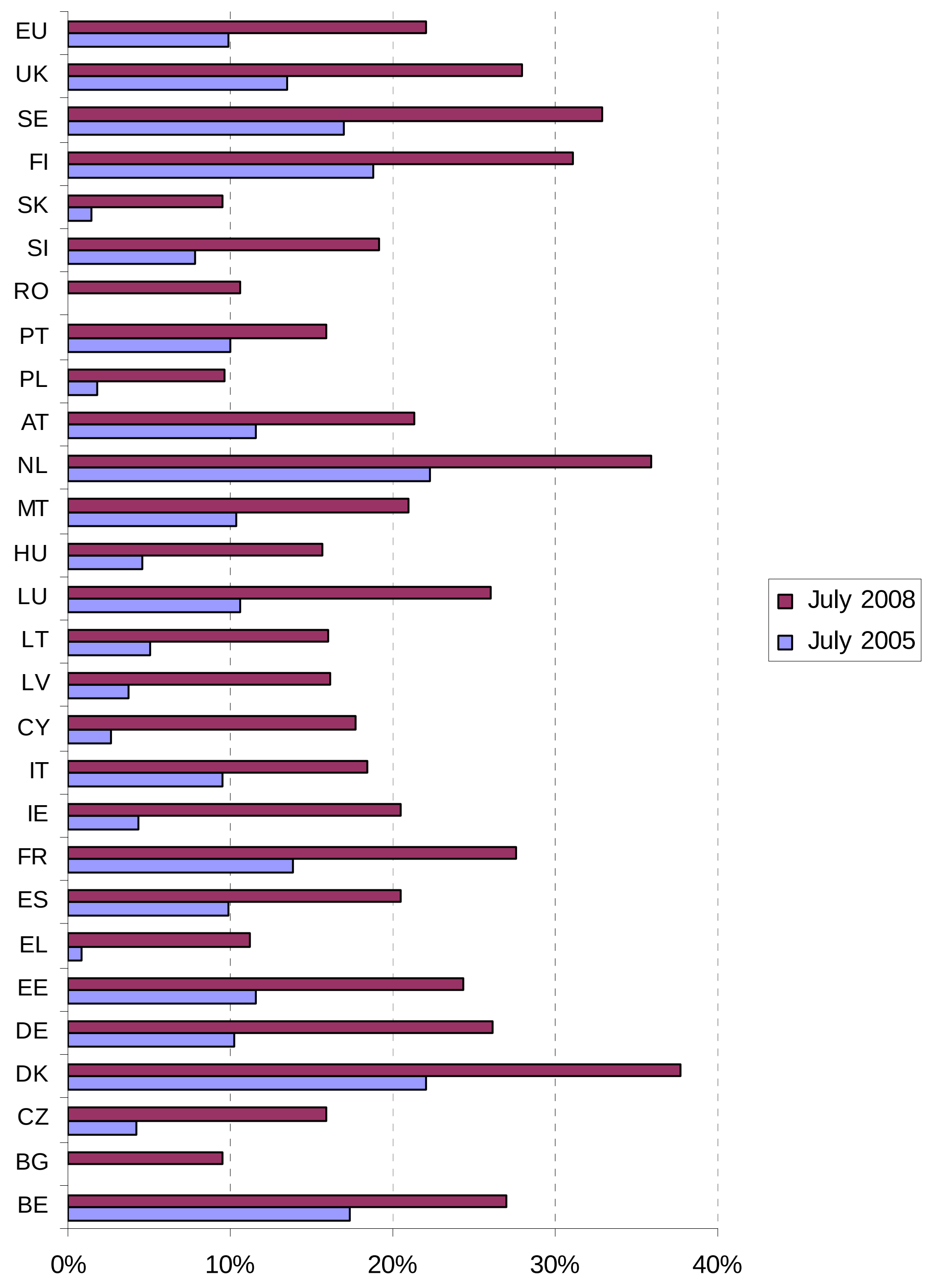
Almost half of the EU productivity gains in the past decade can be traced back to investments in information and communication technology (ICT). This is an area of intense innovation activity that results in efficiency gains in the entire economy, including the public sector, and new economic activities in high growth areas.

Since 2005, Member States have been mainstreaming ICT policies, reflecting increasing confidence in the promotion of the information society as a way to improve economic performance and the efficiency of the public administration, while strengthening citizens' quality of life. Countries increasingly recognise the importance of greater cooperation within and among government organisations. The most frequent initiatives undertaken by Member States focus on the spread of eGovernment, broadband and digital skills in education. National plans have been increasingly addressing a variety of ICT areas, often with dedicated strategies along the lines of the EU i2010 initiative and through the use of Structural Funds, but commitments are uneven across the European Union and ICT development remains fragmented.

The geographic pattern of information society developments has remained largely unchanged in recent years: more advanced in the Nordic countries plus the Netherlands and the UK and lagging in many of the countries of eastern and central Europe and the Mediterranean. Overall, it can be said that with regard to ICT diffusion both performance and policy response are stronger than in other microeconomic policy areas.

In the area of broadband, despite fast growth in take up (Graph 5), the 2008 Spring European Council invited Member States to *"make high-speed internet available to all schools by 2010 and to set ambitious national targets for household access as part of their National Reform Programmes"*. However, beside some general declaration on progress, no target has been set in this year's programs. The EU's economic recovery plan called for an even more ambitious objective to reach 100% coverage of high speed internet by 2010 across the EU's territory. Although far from these objectives, progress on the ground has been remarkable, with the number of fixed broadband access lines more than doubling between July 2005 and July 2008 across the EU (graph 5). In addition, and also with a view to upgrading the performance of existing networks, Member States should promote competitive investments in fibre networks and endorse the Commission's proposals to free up spectrum for wireless broadband.

Graph 5: Fixed broadband access lines in the EU (July 2005 – July 2008)



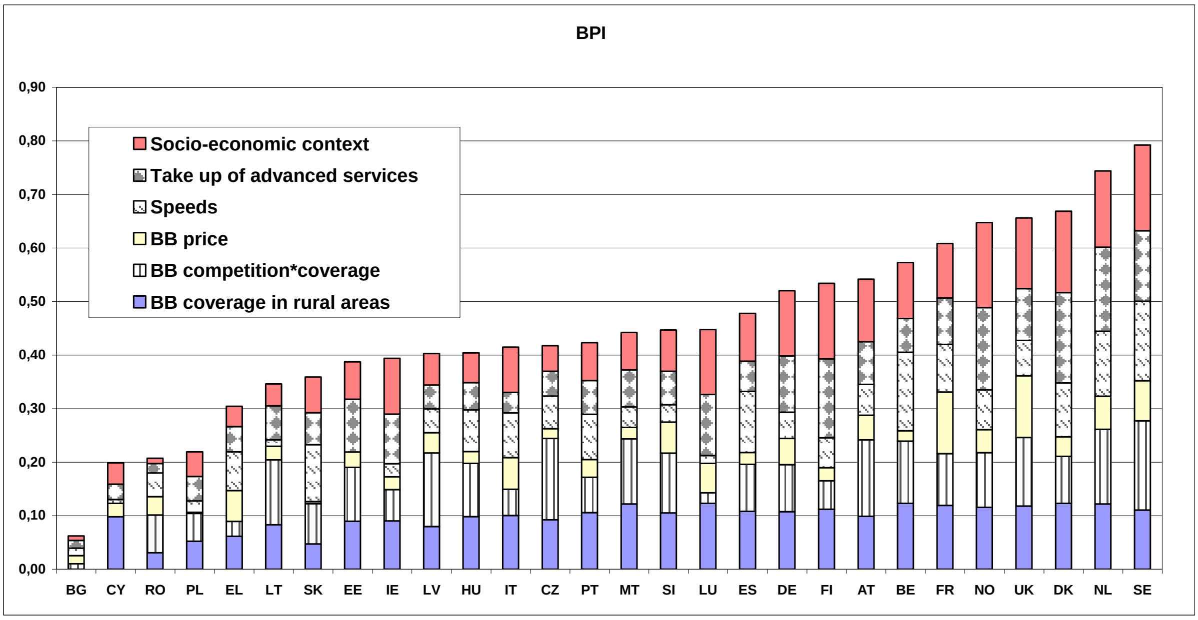
Source: Communications Committee

Note: Number of lines expressed as a percentage of population.

In 2008 the European Commission has analysed the underlying conditions in the Member States so as to assess the EU readiness to progress in the development of broadband, in particular in the migration to high-capacity broadband[9]. Different factors may impact on the take-up of broadband services and result in increasing gaps between Member States. Differences are visible not only in terms of penetration rates but also in coverage, speeds, prices and level of usage, as a result of competition and other socio-economic factors. The new Broadband Performance Index benchmarks the overall performance of the Member States on a range of factors (Graph 6).

This composite index[10] is very useful in illustrating elements that are not immediately apparent from a mere analysis of the penetration rates illustrated by graph 5. Even in some of the leading countries, the results highlight weaknesses (in particular prices and speeds), apparently due to a weak competitive environment. Elsewhere, competition has translated into low prices and high speeds, but users are not so willing to take up advanced services. In several Member States, the socio-economic context, resulting in low skills and a correspondingly low interest in advanced services, appears to be an important barrier to further developments.

Graph 6. Broadband performance index



Source: European Commission, DG INFSO

As highlighted one year ago, there is a need to bring forward more innovative policies, speeding up action on the interoperability of cross-border eGovernment services, stimulating business take-up and including e-skills strategies within lifelong learning and skills policies. But measures should also take into account the important challenges ahead. Investment in next-generation networks is expected to characterise the next decade of the information society, with a rise in the use of wireless and mobile technologies. Cloud computing and ICT services are becoming accessible from anywhere to the benefits of SMEs. Most of all,

9 SEC(2008) 2507

10 For the methodological note, see Section 1.3 in SEC(2008) 2507.

Member States need to be wary of not reducing ICT spending in response to upcoming economic difficulties, as ICT programmes and strategies have consistently demonstrated the way in which ICT can transform services and create efficiency gains across the economy.

3.1.4 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 aiming at increasing the technological content of industry, addressing the sustainability of industry, favouring the internationalisation of companies by supporting exports or attracting foreign investments and promoting sectoral competitiveness.

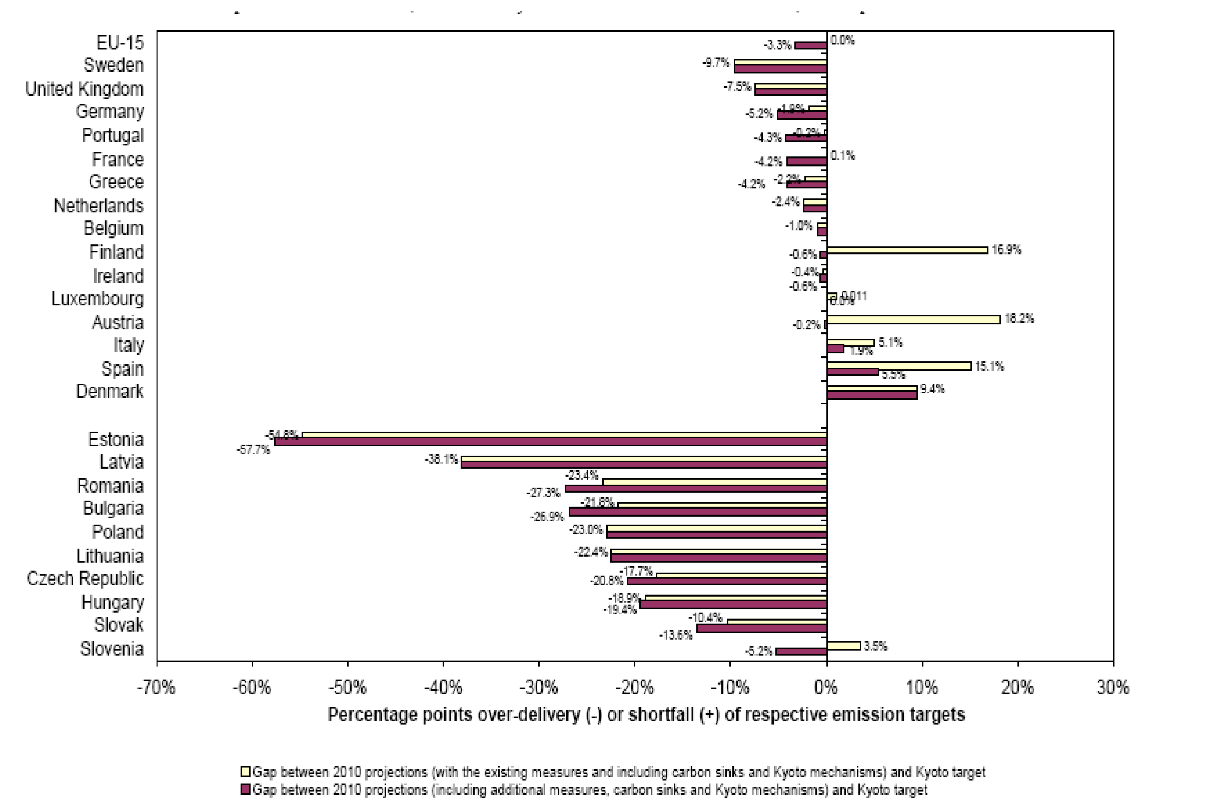
In light of the current economic challenges, Member States are invited to take important actions in the automobile sector with a "European green cars initiative", in the construction sector in order to stimulate energy-efficient buildings and to increase the use of technology in manufacturing via a "factories of the future" initiative (section 3.1.2 above).

3.2. Energy, climate change and sustainable use of resources

Keeping a strong European industry means successfully managing structural reforms toward a low-carbon and low resource-use economy, which can have an important impact on European competitiveness. It will be beneficial for the European economy if it increases its energy and resource efficiency. Encouraging technological innovation and the development of new economic activities will also create lead market opportunities. The Climate and Energy package, the Sustainable Consumption and Production action plan, the 2008 Health check of the CAP and the 2nd Strategic European Energy Review will complement the increasing number of measures Member States are taking in this area. The progress in some policy areas however still has to translate into tangible results for some Member States.

With regard to **climate change**, the EU as a whole is on track to reach its Kyoto target. The most recent projections indicate that by 2010 total EU-27 GHG emissions will be about 10.1% below base-year levels. Based on the latest available data for 2006, total greenhouse gas (GHG) emissions in the EU-15 were 2.7% below base year emissions. The most important reductions in emissions took place among the new Central and Eastern European Member states as well as in Sweden and the UK. However, some of the Member states are lagging behind. Five Member States (Austria, Finland, France, Luxembourg and Slovenia) are projected to reach their targets only when also taking into account additional policies and measures planned. Given the existing uncertainties and the EU's ambitious reduction target of 20% by 2020, it is important that Member States not only ensure the implementation of existing policies but also accelerate the development and full implementation of their planned policies and measures. By sector emission trends indicate decreases in the energy sector, industrial processes, agriculture and waste, while significant increase has taken place in the transport sector.

Graph 7	Relative gaps between GHG projections and the respective 2010 targets



Source: European Commission[11]

Note: Relative gaps (over-delivery or shortfall) 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, and in part the effect of the EU ETS.

Progress in **energy efficiency** has been reported by the majority of Member States. All EU Member States have already adopted their National Energy Efficiency Action Plans and most have already started implementing them. Nevertheless, total energy consumption in the EU-27 continues to grow with an annual rate of just over 0.8 % between 1990 and 2005 (a total of 12%), compared to an average increase of 2.1 % in Gross Domestic Product (GDP) at constant prices grew during the same period. As a result, total energy intensity in the EU-27 fell at an average rate of -1.3 % per year because of improvements in energy efficiency and structural changes within the economy. The latter included a shift from industry to services, which are typically less energy intensive, and a shift within industry from energy intensive to higher value-added, less energy-intensive industries. Furthermore, improvements in power generation (i.e. less energy input to produce the same energy output) as well as in the intensity of some end-use sectors (industry and services) contributed to the reduced overall energy intensity. There are significant differences in total energy intensity within the EU-27, with the highest 'economic' intensities (i.e. intensities in terms of GDP) in Bulgaria, Estonia and

[11] Communication from the Commission "Progress towards achieving the Kyoto objectives," 16.10.2008, COM (2008) 651

Slovakia and the lowest in Ireland, Italy and Denmark (when compared at Purchasing Power Standards).

Renewable energy has an important role in reducing CO_2 emissions, improving sustainability and the security of energy supply as well as creating new job opportunities, in particular in rural areas. Since the introduction of a European legislative framework for renewable energy, several Member States have made great strides in removing administrative barriers and introducing micro-economic reforms in the renewable energy sector to encourage its growth. The result is that the sector will generate almost 20% of Europe's electricity by 2010, and European companies are world leaders in a range of renewable energy technologies, notably wind and biomass. The future benefits of renewable energy have been acknowledged by the Community with the agreement to more than double the share of total renewable energy used by 2020. The new directive will establish legally-binding, national renewable energy targets requiring Member States to reform their administrative and regulatory practices. Member States must truly liberalise their energy markets and facilitate market entry of new, competitive SMEs generating renewable energy. In this manner Europe will reduce its emissions, reduce its use of imported fossil fuels, and build up a competitive hi-tech sector generating jobs and wealth.

The use of **renewable energy** has also generally increased over the last years and the annual reports indicate that Member States are continuously fine-tuning policy measures in this area. However, the policy response of some Member States should be accelerated (for example, the share of electricity from renewable sources in total electricity consumption stands at 0% in Cyprus and Malta).

Progress in the implementation of policy measures to halt the **loss of biodiversity** is mixed – some Member States such as Poland still had very low sufficiency levels in establishing Natura 2000 network as of June 2008. The preliminary results of the report "Economics of Ecosystems and Biodiversity" demonstrate the high dependency of human society upon ecosystem services, and suggested that a "business-as-usual" scenario could lead to substantial economic losses. In the first years of 2000-2050, the annual loss of ecosystem world-wide services is estimated equivalent to € 50 billion. By 2050, the cumulated welfare losses were estimated equivalent to 7% of GDP. It emphasizes the urgency with which Member States need to incorporate the value of ecosystem services into policy measures.

The ongoing crisis in the financial markets and the volatile resource prices have highlighted the importance of the policy initiatives aiming at achieving a more sustainable use of resources – they would encourage the necessary synergies between different policy objectives e.g. through significant increases in efficiency, a decreased environmental burden, a positive effect on security of energy supply and facilitate the transition to a low carbon economy. The EU's economic recovery plan calls on the Commission to propose the reduced VAT rates for green products and services, and on Member States to set demanding targets for ensuring that public buildings and both private and social housing meet the highest European **energy-efficiency** standards and consider introducing a reduction of property tax for energy-performing buildings. In addition, Member States should promote the rapid take-up of "green" products by using the full range of incentives to promote their demand and rapidly implementing environmental performance requirements (notably, promoting "green" cars, requirements for external power supplies, stand-by and off-mode electric power consumption, set-top boxes and fluorescent lamps). In this line, some Member States (BG, DE, HU, UK) stepped up measures in the area of energy efficiency in the context of providing an additional stimulus to their economies.

Member states should also focus on fostering green public procurement to ensure a rapid take-up of "green" products and services. One of the forerunners in this area is the Netherlands setting the target of 100% green procurement for central government, 75% for communes, and 50% for provinces and water management entities by 2010."

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

3.3.1 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.

In general, the policy response of the Member States is weaker in Internal Market and, more particularly in Competition, than in other microeconomic policy areas. Yet further progress in this area will increase the capacity of the economies to adjust to and sustain adverse shocks.

As regards the Internal Market, 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 category of measures – after network industries – was reforms relating to the enforcement of competition policy.

3.3.1.1. Progress on particular internal market and competition issues

Member States have stepped up their efforts considerably to ensure timely **transposition of Internal Market legislation**. Only one year after the European Heads of State and Government agreed on the future deficit target of 1%, 18 out of 27 Member States are already in line with this target. In addition, 4 Member States meet the 1.5% target. That leaves only 5 Member States to have a transposition deficit above 1.5% (Czech Republic, Portugal, Poland, Luxembourg and Cyprus). The recent progress achieved by Luxembourg and the Czech Republic shows that significant results can be achieved within a short period of time if the political will is there and the authorities give it sufficient priority. These two Member States are encouraged to build upon the current momentum to reach the 1% target next year. Important efforts are also required from Member States which have increased their transposition deficit since the last Scoreboard.

As the timeliness of transposition improves, the spotlight will turn to correct implementation of Internal Market rules. Member States will need to pay more attention to the quality of the transposition as well as the correct application of the rules on the ground, including Treaty rules governing the four freedoms in the Internal Market. Incorrect transposition and application of Internal Market rules remains a problem and EU citizens and businesses pay a high price whenever this arises.

- With regard to **competition policy enforcement**, Many Member States continue further re-organisation and reinforcement of the Competition Authority and of market monitoring. However, the political will to act on the findings and recommendations resulting from the screening of markets seems to be missing. There is scope for further enhancing the overall deterrent effect of fines, for instance in the Nordic countries where the level of fines has remained very low. The implementation and revision of leniency programs, which provide an incentive for voluntary disclosure of cartels, has progressed smoothly, with 25 Member States having such a program today. Whilst the efficiency of leniency programs depends on various factors (e.g. the system of sanctions, role and strength of the competition authority, size of the economy and cultural factors), Member States are making efforts to increase the transparency and predictability of their leniency programs by aligning them with the ECN Model Leniency Program.

- The current situation shows that a regulation of **professional services** is still rather restrictive in a number of Member States. The professions of lawyers, architects and engineers, (e.g. BE, CY, EE, FI, IT) are relatively highly regulated, hampering competition. The progress made in implementation of professional services reforms is relatively slow or not sufficient although some positive developments have already taken place concerning investigations of professional services (CY, BG, IE). In most of the cases a proactive approach and consistent action of competition authorities and governments is needed to open up highly regulated professions and activities. Positive actions in relaxing restrictive rules in the area of professional services are taken in the context of Service Directive by adopting new competition laws (BG, EE), improving transposition (IE, LU) and screening of norms (DE). Significant reforms are still needed in this area in order to improve the overall performance level of Member States.

The implementation of the **Services Directive** will bring about a major development in this area and many NRPs refer to national preparations to this respect. By removing legal and administrative barriers to the development of services activities, such as fixed tariffs or *numerus clausus* restrictions, it will facilitate the freedom of establishment and the freedom to provide cross-border services. The implementation process is a complex and challenging task. It is now crucial that sustained and consistent efforts are made by all Member States to meet the December 2009 implementation deadline. Efforts need to be stepped up in particular to finalise the review and simplification of national legislation and to adopt necessary legislative measures to remove barriers to trade in services and to set up fully functional "points of single contact", through which businesses can get all information and easily complete all administrative procedures, including by electronic means and across borders. The allocation of adequate resources and strong political backing at national level are crucial to achieve this aim. Since there are **professions not covered by the Services Directive** that continue to have restrictive regulation (e.g. notary profession)[12], Member States are encouraged to look at all professional services regulation and consider whether it remains proportional to consumer benefit.

The Financial Services Action Plan (FSAP) 1999-2005 has set out a framework for creating the EU **single financial market**. Many NRPs refer to the transposition of the FSAP directives, which, overall, is almost complete. However, in most cases a forward looking dimension, i.e. setting out concrete actions and giving indications of plans for the future, is missing. Financial integration has progressed although the speed and scope has not been the same across all market segments. In particular, retail markets remain fragmented. The financial turmoil that started as a US sub-prime mortgage crisis has revealed structural weaknesses that need to be urgently addressed. Much has to be done concerning the review of the adequacy of the regulation, the oversight, and the transparency of all financial actors and

[12] The Commission published a study of regulation in the notary profession in January 2008, concluding that high levels of regulation generally go hand in hand with high prices whilst not resulting in higher levels of quality, http://ec.europa.eu/comm/competition/sectors/professional_services/studies/studies.html

all significant capital market investors – including hedge funds and private equity – leading to measures to plug any gaps identified.

The inflationary pressures that manifested themselves throughout the EU in 2007-2008 have lead to a new focus on competition in the **retail sector**. In order to address potential malfunctioning and increase competition in the retail sector a number of Member States have taken actions by adopting and implementing specific actions For example, Poland abolished regulations which limited investments in retail or wholesale markets. In countries where heterogeneous local and regional regulation (e.g. ES) creates problems, the implementation of the Services Directive could be a key element to remove unnecessary barriers in the sector. Also, some NRPs contain measures aimed at removing public barriers to market entry by new operators and expansion of existing ones. National Competition Authorities in some Member States (such as FR, IT, AT, IE, SI) advocate for increasing competition in retailing, notably by reducing impediments to market entry.

In spite of their economic importance, few NRPs address the issue of better functioning of **public procurement** markets. However, the challenge is now to make sure that Member States not only implement correctly the public procurement Directives adopted in 2004 but also transpose the new Directive on remedies in a correct, timely and coherent way. In addition, some Member States (such as SE) have granted specific powers to their national competition authorities to asses competition problems related to public procurement also covering issues not covered by the public procurement directives. Public procurement is an area where the complementary use of internal market and competition tools can be effective in line with the approach set out in the framework of the Single Market Review.

3.3.1.2. 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 (implementing and 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.

A common 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).

- 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. High levels of market concentration, vertical foreclosure and lack of transparency continue to characterise gas and electricity markets. 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. Additionally, cross-border issues with an impact on competition, such as the lack of interconnection capacity or important cross-border mergers, remain problematic.

- Competition in **electronic communications markets** is governed by the regulatory framework adopted in 2002 which created a level playing field across market segments and technologies. By fostering competition, it led to innovation, increased infrastructure investment and to significant retail price declines. However, in many Member States (notably in LV, LT, HU, MT, SI and SK) the position of the incumbent on fixed local calls remains predominant. 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 issues that demand attention.

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 market entry and 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. On 26 June 2008, the Commission opened infringement procedures against 24 Member States for incorrect implementation of key provisions of the 1st railway package, which defines the basic regulatory and institutional framework for market access. Principal grievances raised by the Commission are lacking independence of the execution of essential functions for non-discriminatory access to the rail network from (e.g. allocation of capacity, setting of track access charges) from the provision of rail transport services, insufficient management independence of the incumbent railway undertaking, insufficient powers and independence of the regulatory body as well as incorrect implementation of basic infrastructure charging principles. The nature and number of grievances vary, however, strongly from Member States to Member State. The complete market opening for rail freight services in the EU on 1 January 2007 has lead to new entry and to an increase of the market share of non-incumbents in a number of countries such as France, Poland, Romania, Estonia, Italy, Germany and the Netherlands. The experience shows that competition and market development depend strongly on the administrative capacity and proactive behaviour in favour of market access of key institutions in the sector, i.e. the rail infrastructure manager, the rail regulatory body and the safety authority.

3.3.2 Better Regulation

Better Regulation continues to be high on the reform agenda of Member States and the European Union. In the current economic downturn, with growing pressure on businesses and on households, improving the business environment by leaner more efficient and well thought-of legislation can be a rapid and cost-effective means to give some impetus to growth. The Spring Council 2008 called upon Member States to step up their efforts on reducing administrative burdens arising from EU legislation by 25% by 2012, in line with the European Council Conclusions of March 2007. However, although Member States have remained committed to the key Better Regulation objectives, in most of them progress has been slow. While better regulation tools have been set up in most Member States, their use in actual policy making is variable. Political support is missing in some Member States as well as adequate institutional structures and sufficient financial and human resources. This translates in a limited positive impact on the business environment. . Moreover, specific targets, awareness of Better Regulation principles (policies, institutions and tools) among government officials, monitoring and evaluation mechanisms are needed to improve the regulatory culture.

To this date, 17 Member States (AT, DE, DK, EL, ES, FR, HU, IE, IT, LV, NL, PT, RO, SE, SI, SK, UK) have set a 25% or higher national reduction target, while another two Member States (CY, CZ) set a target of 20%. PL and MT have set 25% reduction targets but applied to selected priority areas. In comparison with last year this is a considerable progress. Three Member States announced their intention to set a reduction target before the end of 2008 (BG, FI, LT). The remaining three Member States are still encouraged to follow the Spring Council recommendation. The measurement of **administrative burdens** is an important process ongoing at EU level and in a number of Member States. It follows in most cases the same methodology (the standard cost model). Seven Member States have so far carried out baseline measurement of administrative burdens (AT, CZ, DE, DK, NL, SE and UK). Partial measurements have been or are being carried out by another 16 Member States (BE, BG, EE, ES, FI, FR, HU, IE, IT, LV, LT, MT, PL, PT, RO and SI). A number of Member States who set a national target at an early stage have already enacted major changes in the implementation or transposition of EC legislation in their country and in their purely national legislation. Efforts are currently being directed, by way of a close cooperation between the Commission and national authorities which transpose EU legislation, to the dissemination of good practices that allow administrative burdens to be reduced quickly.

The reduction of administrative burdens should be accelerated by adopting ad hoc fast track actions, for example, by removing the requirement on **micro-enterprises** to prepare annual accounts (the estimated savings for these companies are € 7bn per year) and limit the capital requirements of the European private company to one euro. Simplifying and reducing the fees for patent application and maintenance by up to 75% can also contribute considerably.

However, reduction of administrative burdens is only one Better Regulation element. There has been progress in developing administrative **simplification** programmes with 22 Member States now having a simplification strategy or action plan in place (AT, BG, BE, CY, DE, DK, EE, EL, ES, FR, HU, IE, IT, LU, MT, NL, PL, PT, RO, SE, SI, UK). In a number of Member States, stakeholders are involved in setting regulatory simplification priorities under existing programmes or ad-hoc measures. The kinds of legislation targeted in simplification measures cover taxation, reporting requirements, licensing, fiscal measures, business start-ups, insolvency rules, insurance and consumer protection.

Progress in developing and implementing **impact assessment** systems remained limited. Impact assessments for new legislative proposals are mandatory in a number of Member States; however, often they are only partial and superficial assessments whereas full blown impact assessments, where possible with a cost-benefit analysis, should be carried out for all major new pieces of legislation. . Overall, impact assessments often tend to be rather checklists than comprehensive analytical documents. In a number of Member States, quantification is limited to budget implications. Member States are further encouraged to refine their impact assessment systems so that they analyse all significant economic, social and environmental impacts. Moreover, transparency could be improved by making all impact assessments publicly available, which currently occurs only in four Member States (CZ, DK, RO and UK).

A formal requirement to **consult stakeholders** exists in a number of Member States (AT, BE, CZ, DE, DK, FI, EL, IE, LT, LU, NL, PL, RO, SE, SI, SK and UK). For consultation to have a significant impact on the quality of new legislation, early involvement of stakeholders remains crucial. Ideally stakeholders should be involved at the stage of preparation of legal proposals and their feedback should be used to inform the impact assessment process. Guidelines on consultation do not exist in all Member States and often there are different approaches between different Ministries in one Member State. The adoption of guidelines would lead to more consistency and transparency. Member States still not consulting on a regular basis would gain from introducing minimum consultation requirements for major policy proposals.

Lastly, progress in developing **Better Regulation strategies** was limited. Additional strategies or action plans have been adopted in four Member States (BG, LT, LU, RO) in the course of the last year. However, some Member States still have no explicit Better Regulation strategy in place and this is a reflection of lack of political support. While some progress on

Better Regulation has thus been achieved, substantial further efforts should be undertaken in integrating Better Regulation tools. An evaluation of the actual impact that the existing Better Regulation strategies and tools have on businesses could help identify areas with additional potential for improvement.

There is considerable variation across Member States as concerns the take up of the various Better Regulation tools. Graph 8 displays the extent to which two subsets of Member States have developed and implemented specific Better Regulation tools. The subsets cover a group of – on the one hand – most advanced Member States that have most Better Regulation tools in place and – on the other hand – the remaining Member States that are yet to implement the full range of comprehensive Better Regulation tools and use them in actual policy making.

Graph 8 Development of Better Regulation

Source: European Commission, DG ENTR, 2008.

The purpose of Better Regulation policies is to create a more competitive business environment and encourage private initiative. It follows that they are necessary but not sufficient in achieving these broad objectives. For instance, the institutional framework and the efficiency of public administration play a very important part in determining the business environment along with other factors that are covered explicitly by the micro-economic pillar of the Lisbon strategy. The reform of public administration is high on the agenda of many Member States (BG, EL, HU, PT, RO) for which structural weaknesses in this area constitute an impediment in addressing other economic development challenges.

3.3.3 Entrepreneurship and SMEs

In its Communication[13] the Small Business Act for Europe (SBA) the Commission invited Member States to take advantage of the update of the Lisbon cycle planned by the end of 2008 to take account of the SBA in their National Reform Programmes and in their annual implementation reports. Mainly for timing reasons, only a few Member States actually reflected the commitments of the SBA in their updated or revised NRP's for the period 2008-2010 and in their annual implementation reports (i.e. AT and FR). However, several Member States (i.e. DE and SE) have already started separate SBA monitoring exercise and other countries are expected to follow in the coming months. Given these circumstances, 2008 has

[13] COM(2008)394 - http://ec.europa.eu/enterprise/entrepreneurship/sba_en.htm of 26.06.2008

to be considered as a transition year and reporting on developments in the Member States has been focused on the SME priorities set at the 2006 Spring European Council.

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. However, compared to 2007, progress has been somewhat limited in most of the priorities set at the Spring European Council 2006 – application of the think small first principle, start-ups, entrepreneurship education, access to finance and to public procurement and recruiting the first employee – as described in the paragraphs below.

Notwithstanding the limited number of measures taken in 2007, on a longer term perspective, Member States are increasingly integrating the **"Think Small First"** principle in policy-making. Almost all of them consult SMEs representatives including in the framework of SME councils or forums (ES, EE and IE). In some cases specific bodies to promote SME interests have been established such as SME agencies (PT and BG). A number of Member States 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 on-line submission for investment projects (PT) to the simplifications/exemptions for statistical reporting (UK) to the one-stop shops to carry out tax registration and notifications to the public administration (CZ). 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% the administrative burden by 2012.

In 2008, average time and cost to **start up** a private limited company is 9 calendar days (12 days in 2007) and cost is € 466 (€ 485 in 2007). The time reduction is due to two factors: a recalculation of times required in each country and simplifications introduced in 2 countries (time in EL drops from 30 calendar days to 15 and ES from 30-40 calendar days to 17.5). The cost reduction is due to some fee reductions in EL (which drop the total cost from € 1,366 in 2007 to €1,101 in 2008) and in SI where starting a company is now completely free (a reduction of cost from €250 to €0). Despite these positive changes, the number of compliant Member States in terms of existence of an operational One-Stop-Shop (17), times (13) and cost (23) remain unchanged and are exactly the same as in 2007. 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. It should be noted, however, that this analysis only look at the steps to get a company registered. In all countries there are further administrative steps and more time is required before a new SME can start its business operations. The economic recovery plan asks Member States to ensure that **starting up** a business anywhere in the EU can be done within three days at zero costs and that formalities for the hiring of the first employee can be fulfilled via a single access point.

Table 1: 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	Registry Agency	NO*	10-20	€ 155
Czech Republic	Central Registration Offices (CRO)	NO*	30-40	€ 345 €
Denmark	Danish Commerce and Companies Agency (DCCA)	YES	3	€ 0
Germany		NO*	6.5	**€ 783**
Estonia	Notaries	YES	2	€ 185
Ireland	Companies Registration	NO*	2-5	€ 50

	Office (CRO)			
Greece	Directorate of Development at the prefectures (KYE)	NO*	15	**€ 1,101**
Spain	Ventanilla Única Empresarial (VUE) + PAIT for Ltd.	YES	17.5	**€ 617**
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	Register of Legal Entities	YES	6	€ 130-€ 289
Luxembourg	Guichet unique d'entreprises	YES	14	**€ 1,000**
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	8-23	€ 400
Poland		NO*	30	**€ 735**
Portugal	Enterprise Formality Centres (CFE)	YES	1	€ 300-€ 360
Romania	Counties Trade Registers	YES	3	€ 100-€ 125
Slovenia	VEM	YES	3	€ 0
Slovakia	Trade licence offices, companies register	NO*	8	€ 330
Finland	Trade Register	YES	14	€ 330
Sweden	Företagsregistrering	YES	16	€ 222
United Kingdom	Companies House & Business Link	YES	1	€ 54
AVERAGE			9 days	€ 466

Notes
(1) Calculation methods as described in Commission Staff Working Document SEC(2007)129.

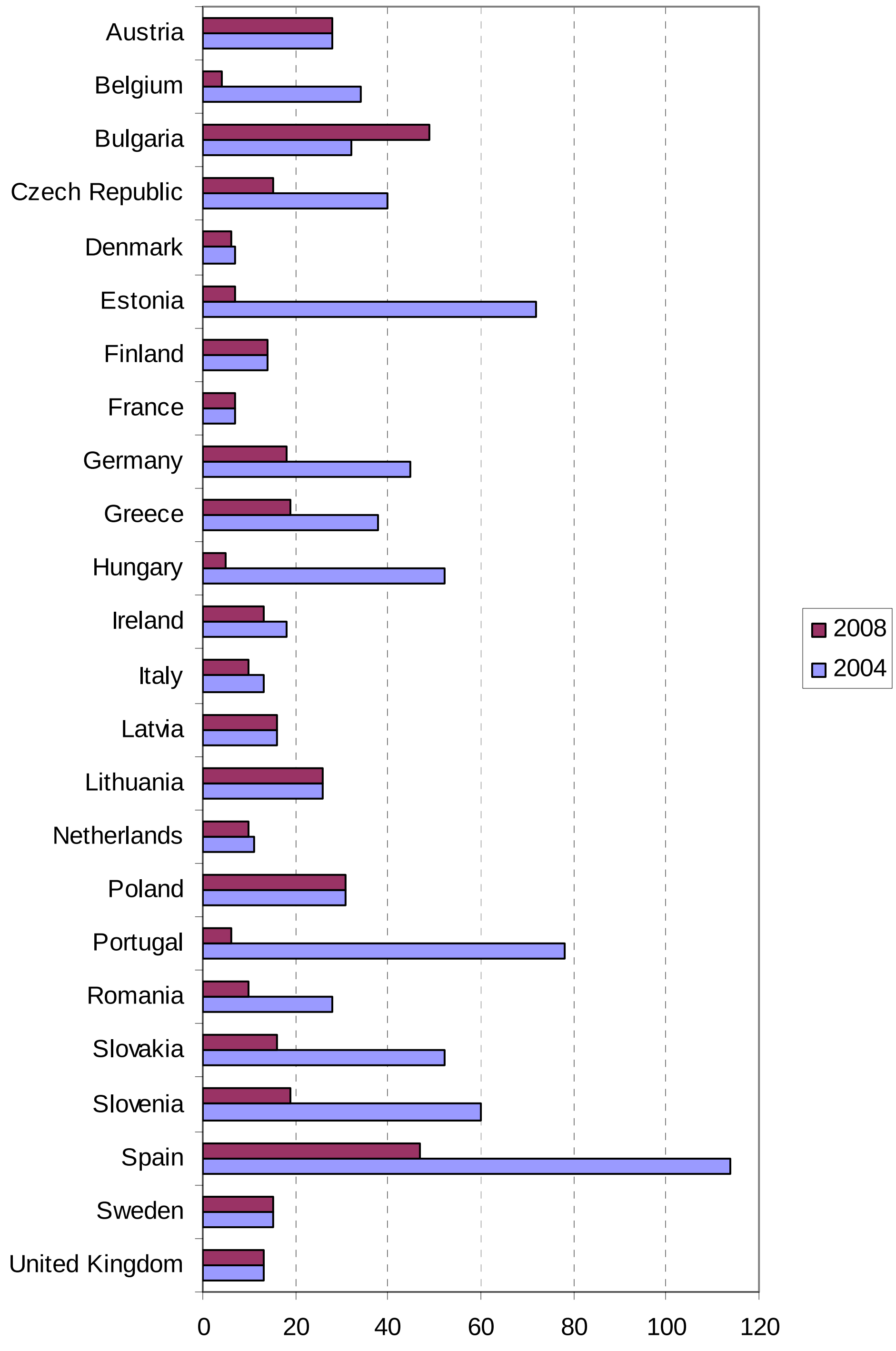
*NO means that the services offered by the one-stop-shop are not sufficient to consider it a fully functional one-stop-shop.

**Cost: numbers in bold for countries with cost above the threshold.

Taking a longer view with an alternative source of data[14] one can visualise better the progress achieved in this area. Overall, the average number of days necessary to start a company in the EU has dropped from 96 to 35 and the dispersion of values decreased by almost 60% (graph 9).

14 Word Bank, Doing Business project, see http://www.doingbusiness.org/

Graph 9. Number of days necessary to start a business in 2004 and 2008



Source: World Bank, Doing Business project, 2009 and 2005 reports

At policy level, awareness of the need to enhance **entrepreneurship education** is steadily increasing in the Member States, and new initiatives have been launched. However, only in a small minority of Member States entrepreneurship is already a recognized objective of the education systems, and is embedded explicitly in national framework curricula (ES, FI, IE, CY, PL, UK). Some more Member States are starting to implement or are planning reforms in the same direction (CZ, EE, LT). In a couple of MS a national strategy has been recently adopted in order to promote entrepreneurship through education (SI, SE). Another form of promoting this objective is the provision of grants from the government to schools and universities that implement entrepreneurship education (NL, UK). In general, more efforts are needed to embed entrepreneurship into established curricula, and to build a critical mass of educators who have received a specific training on entrepreneurship.

– Awareness of the need to enhance **access to finance** for SMEs is steadily increasing in a majority of the EU Member States and as the current financial crisis is progressively impacting the real economy through a severe credit crunch this issue has become even more urgent. Indeed, a majority of Member States have already taken or are currently introducing measures facilitating SME financing, mainly through extending schemes guaranteeing SME loans, interest rate subsidisation for SMEs and increasing credit availability earmarked for SMEs. Access to finance in practice nevertheless still remains problematic, fragmented and incommensurate with the current need for finance, in particular in the more basic market segments, such as for enterprises or individuals that need start-up capital and small loans (micro credit). In the current exceptional circumstances, the Commission will develop temporary guidelines allowing state support for loans. The Commission will put in place a simplification package, notably to speed up its State aid decision-making and to temporarily authorise Member States to ease access to finance for companies through subsidised guarantees and loan subsidies for investments in products going beyond EU environmental standards. Member States should also ensure that public authorities **pay invoices**, including to SMEs, for supplies and services within one month to ease liquidity constraints and accept e-invoicing as equivalent to paper invoicing; any arrears owed by public bodies should also be settled.

In the overwhelming majority of Member States, **SMEs' access to public procurement** is not subject to a specific strategy or policy. The most widespread SME friendly measures remain cutting tenders into lots and facilitating access to information through centralised websites, interactive web-pages, and other e-Procurement developments. This is probably due to the fact that this particular policy area has received so far less attention than others, such as for instance easier start-up. It is hoped that the SBA and its Code of Best Practices on SME friendly procurement techniques will help in spreading practices such as setting proportionate qualification levels and financial requirements, the use of prior information notices or defining the technical specifications in terms of performance or functional requirements.

Compared to the situation in 2005 when data on procedures for the **recruitment of a first employee** were collected by the European Commission for the project "Obstacles to Growth – Recruiting the First Employee" some progress has been made. Yet, on average there are still on average 2.5 mandatory contacts and almost 3 procedures required for the recruitment of a (first) employee. In 2005 an average number of 3 contacts and 4 procedures were necessary[15]. However, the average figures do not fully reflect the considerable simplifications for employers that have taken place in some countries (FR, LV, MT, NL). Only few countries (ES, MT) have a special one-stop-shop system for recruitments or one-stop-shops for start-ups that can also take care of recruitments. Some few countries have procedures that are so simple that only one contact with a public administration is required (FR, IE, LV, SE). In Belgium

[15] Please note that these figures are not exactly comparable since the current sample contains more countries than the 2005 data set. For the countries that participated in the 2005 project the improvement is somewhat better, i.e. to 2 ¼ mandatory contacts and 2 ¾ mandatory procedures.

there is the special situation that the relatively comprehensive procedures are taken care of by specialised agencies that the employer has to pay however.

3.3.4. European infrastructures in the transport sector

2008 saw the opening of several important parts of the Trans-European Transport (TEN-T) network, including the dedicated rail freight, "Betuwe" line and the Madrid-Barcelona high-speed rail link. The Via Egnatia and the Salonika-Domokos and Tithorea-Athens rail links in Greece were completed as were the Vuosaari harbour line, the missing section of E18 motorway in the Nordic Triangle and the second part of Gdansk-Grudziadz motorway in Poland. Rail capacity bottlenecks were also removed between Verona and Bologna and Bologna and Milan. 2008 also saw good progress with preparatory studies for other projects, such as the Brenner Basis Tunnel, as well as many political, as well as administrative obstacles, being removed, not least due to the efforts of the European Coordinators nominated by the Commission to support the most challenging priority projects.

2008 also saw the launch of two important initiatives to further facilitate private sector involvement in delivering TEN-T projects. In January, the Commission and the EIB jointly launched a new Loan Guarantee instrument for TEN-T PPP projects, and in September, the Commission, EIB and some Member States inaugurated the European PPP Expertise Centre.

In the course of 2008 individual financing decisions were issued to projects following Multi-annual and Annual calls for proposals. Given the higher rate of support and stronger focus on priority projects enabled by the new TEN Financial Regulation, Community financial aid will trigger or accelerate certain important European projects. No less important in 2008 were the actions launched by Member States on interoperability and traffic management (such as the European Rail Traffic Management System, Intelligent Transport Systems or Single European Sky Air-traffic control Research), which are vital elements of the TEN-T programme and supported by the TEN-T budget.

The calls for proposals made it also clear that the funding requirements of the TEN-T projects strongly exceed the resources available on the Community level.

In May 2008, at the informal transport Council, an in-depth report on progress implementing priority projects was prepared jointly with the Member States. Compared to 2004, a 16.8% increase in the total cost of the land-borne priority projects was reported. The total cost of the priority projects is now €397 billion; €126 billion was already invested before 2007, a further €150 billion is expected before 2014 and the remaining €120 billion after that date. Not only did the report paint a positive picture of the progress already achieved and took stock of further funding challenges but it also confirmed the strong commitment of Member States and Community institutions to accelerating the delivery of the key European transport infrastructure. It is important that this momentum is maintained throughout the coming years. To this end and to take us closer to the Community goal of a sustainable and competitive transport network fit for the 21st Century, an important TEN-T policy review exercises was launched in 2008 and will continue in 2009 with the Green Paper and subsequent stakeholder consultation.

As a response to the crisis, and in order to provide an additional stimulus to their economy, several Member States (e.g. AT, BG, EE, FI, FR, DE, LT, LU, RO, SL, SW, UK) announced that they would bring forward or increase infrastructure investment. Most will target transports in particular (AT, EE, FR, DE, SL) and Finland the energy sector. On the contrary, Lithuania announced cutting down on a planned increase in road investment.

4. EVIDENCE ON THE EFFECTIVENESS OF REFORMS

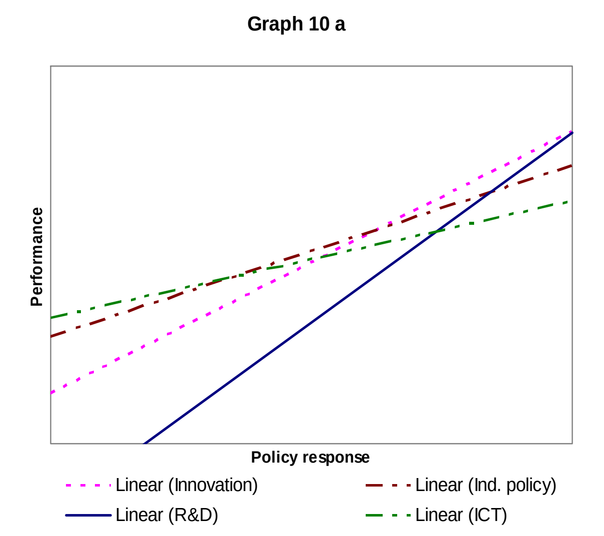
The limited time span since launching the renewed Lisbon strategy makes it very difficult to assess objectively whether microeconomic reforms adopted in the period had any tangible effects. In many policy areas adequate quantitative indicators are missing and where they exist data are often outdated. At a more macroeconomic level, the influence of specific reforms is difficult to disentangle from the multitude of other factors in play, including the business cycle.

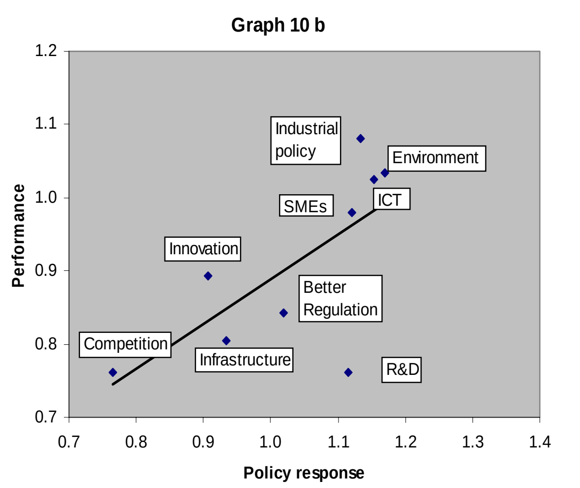
At policy area level, the relationship between performance, as depicted by available quantitative indicators, and policy response, as appreciated on the basis of existing information in NRPs and other available sources, is invariably positive across Member States for the various policy areas (see graph 10a for knowledge linked policies) as well as at the EU average level (see graph 10b) across policy areas. However, this should not be over-interpreted: in the current assessment framework performance data are backwards looking and often old while the assessment of policy response refers mainly to the last twelve months and is essentially forward looking, also covering measures still not fully implemented. A possible explanation of this positive correlation would be the existence of an evaluator bias i.e. that objectively (evidence-based) good performance induces a positive policy response evaluation. Another interpretation would be that where key structural weaknesses exist it is hard to design and implement in a short time a policy that is really up to the challenges.

The hypothesis that Member States would "build on success", i.e. that they would tend to focus on areas where their performance is already good is not born out by the facts, at least at EU level. Data from the MICREF database of microeconomic reform measures indicate that, progressively, reform activity in the EU, as measured by the number of individual reform measures, tends to fit the distribution of key challenges (graph 11a). Obviously the distribution change from 2004 to 2005 is driven by the fact that Member States submitted their first NRP with key challenges in 2005. Still it is encouraging to see that reforms activity increasingly takes place where it needs to.

A positive relationship can also be discerned between key challenges and reform activity, at least as far as micro key challenges are concerned (Graph 11b). Thus Member States with more micro key challenges tend to undertake more reforms in this area as well.

Graphs 10. Performance and policy response, by policy across Member States (10a) and across policies at EU level (10b)

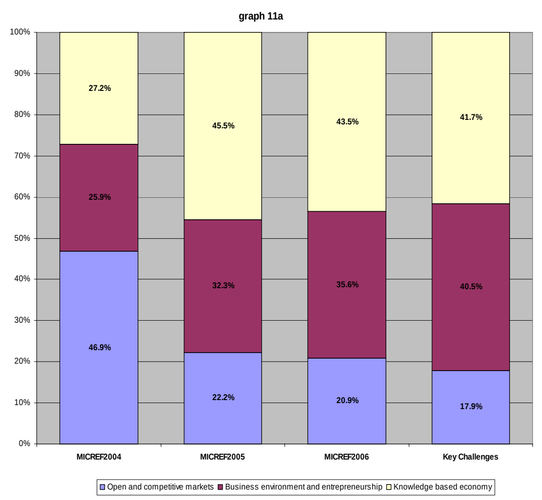


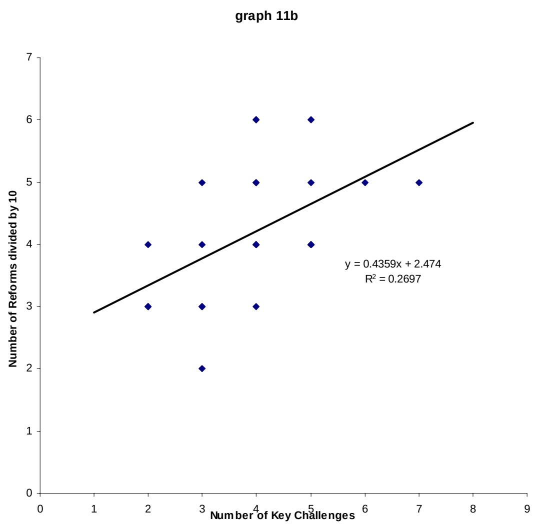


<u>Source</u>: European Commission

<u>Note</u>: Graph 10a represents linear trend lines across scatter plots (non-displayed) of points representing average policy response and performance for each policy area.

Graphs 11. Reform activity and key challenges in the microeconomic pillar





<u>Source</u>: European Commission

<u>Notes</u>: MICREF data cover until 2006.

As MICREF does not record infrastructure measures, nor measures that can be immediately related to sustainable development/environment, these two categories are left out.

The data above do not permit to assess the effectiveness of reforms undertaken so far. Nevertheless, one can get some indications on the overall effect of reforms from the data gathered in the main international competitiveness comparison projects. In this line, taking the EU as a region[16] reveals that the latter improved its overall score slightly and progressed from rank 14 to 11 between 2004/2005 and 2008/2009 in the WEF Global Competitiveness Report[17]. However, this result is not confirmed in the IMD World Competitiveness Yearbook[18] where the EU stagnated at rank 14 between 2004 and 2008. Similarly, the data gathered by the World Bank Doing Business project[19] which focuses on the regulatory environment for businesses –thus ignoring other factors such as macroeconomic stability, infrastructure endowments or skills, show that the EU as a region has not progressed in terms of ranking among the countries reviewed between January 2005 and January 2008. As in the IMD case, this does not mean that there was no progress in absolute but that, in relative terms, this progress was not sufficient to upgrade the ranking of the EU average.

These data highlight the diversity of the EU. The WEF Global Competitiveness index ranking ranges between 3 and 4 (Denmark and Sweden) to 67 and 68 (Greece and Romania) while the World Bank business regulatory environment ranges between ranks 5, 6 and 7 (Denmark, the UK and Ireland) to ranks 75, 76 and 96 (the Czech Republic, Poland and Greece). In total 11 Member States are among the 30 best performers in the WEF report (in 2005 as in 2008) and 12 in the Doing Business.

Making Europe an attractive place to invest and work was one of the main themes of the renewed Lisbon strategy in 2005 and there is evidence that EU attractiveness improved. The Ernst and Young European Attractiveness Survey (EAS) has surveyed the attitudes of major international companies towards foreign direct investment in the EU[20] over recent years. The results of the survey since 2005 show that the envisaged relocation of investment by these companies to outside Europe has halved from 32 % in 2005 to 16% in 2008. Conversely, the proportion of international businesses not looking to relocate investment outside Europe has risen from 62% in 2005 to 74% in 2008 (graph 12a).

The European Attractiveness Survey also gives specific information on the opinions of global business decision makers about the three most important criteria for enhancing Europe's attractiveness for investment. The results show that significant progress has been made on three important criteria: concerns about making innovation easier and supporting R&D, simplifying EU and national regulations, and making labour markets more flexible. The summarised results as shown in graph 12b below demonstrate that in each of these areas, the

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16 The EU score is calculated as the weighted average (by GDP) of the scores of individual Member States.

17 The World Economic Forum (WEF) bases its competitiveness analysis on the Global Competitiveness Index (GCI), a weighted average of a set of components reflecting the various aspects of competitiveness, grouped into 12 pillars of economic competitiveness (institutions, infrastructure, macroeconomic stability etc). Indicators used are based either on hard (statistical) or soft (perceptions survey) data. More information can be found in http://www.weforum.org/en/index.htm

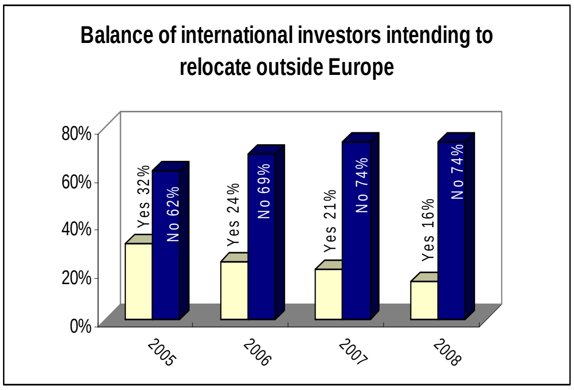
18 IMD assesses the national environment in which enterprises operate along four dimensions: economic performance, government efficiency, business efficiency and infrastructures. Indicators used are based either on hard (statistical) or soft (perceptions survey) data. More information can be found in http://www.imd.ch/

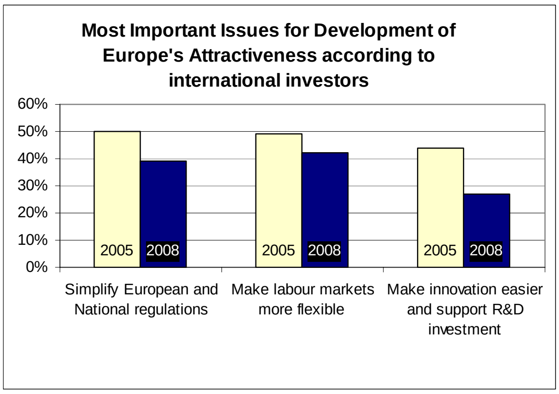
19 *Op.cit.* footnote 9

20 Ernst & Young European Attractiveness Surveys for 2005, 2006, 2007 and 2008. These surveys are carried out by an independent market research company by contacting international business decision makers. The sample size changes in the range of 700 to 1000 depending on the year. More than 50% of the samples are from European companies and main sectors are covered. The term Europe is used geographically and is thus wider than the EU.

Lisbon goals to a certain extent met the expectations of EU investors. Over the period 2005-2008, the importance of each of these criteria diminished, with international investors becoming most concerned about issues such as human capital investments, infrastructures, and sustainable development.

Graphs 12a and 12b International investors attitudes towards Europe





<u>Source</u>: Ernst & Young European Attractiveness Survey

In conclusion, the evidence about the real effects of the reforms for the EU as a whole is rather mixed, ranging from stagnation to real improvements on the ground. This should not come as a surprise as reforms take time to implement and to produce effects that are visible at macroscopic level. This result may also be interpreted as indicating that so far, although going in the right direction, reforms were not ambitious enough.

5. MAIN CONCLUSIONS

The 2008-2010 National Reforms Programmes of the Member States focused on medium to long term policy objectives. Measures to address the effects of the financial crisis on the real economy are being announced or taken in the framework of recovery plans and/or in next year's budgets. In the microeconomic sphere, they are concentrated around two targets, to facilitate access to credit for SMEs and to bring forward or increase public investment in infrastructures. Also, it is encouraging that in their additional economic stimulus packages many Member States have included investments in R&D and energy efficiency.

Concerning the medium to long term, microeconomic reforms remain high on the agenda. By boosting productivity they are crucial for the future growth and the competitiveness of European economies and for increasing their resilience to negative shocks. From assessing the progress so far with their implementation but also evidence about their concrete outcomes on the ground, the main message is that reform activity is increasingly targeting the structural weaknesses of European economies but still a lot remains to be done. This is also reflected in the overall stability as regards key challenges and priorities that the new national reform programmes display as well as the recommendations that the Council addresses to the Member States from one year to another.

Pursuing the microeconomic objectives contributes to addressing the effects of the crisis. Investments in knowledge, in energy efficiency and in infrastructures yield a double dividend, they provide a welcome addition to demand on the short term while also improving the long term prospects of the economy while measures in the area of better regulation, competition and other market reforms contribute to lower costs for businesses and consumers and increase external competitiveness.

III: Draft Joint Employment Report

1. EXECUTIVE SUMMARY: DETERIORATING LABOUR MARKET PROSPECTS

The economic outlook has changed markedly over the last half year, owing to the financial, bank and credit crises. Despite the emerging economic downturn, the impacts on EU labour markets have been limited so far at least in part due to greater adaptability of the labour markets coming from recent years' structural reforms. With the exception of a small group of Member States where employment fell, in all other Member States employment continued to grow in 2008.

Although the effects of the downturn on EU labour markets remain very uncertain, most evidence suggests that the situation is expected to deteriorate sharply in 2009. Business surveys in late 2008 pointed to a considerable weakening of employment prospects across sectors. The economic climate indicator registered the largest decline in its history and consumer confidence is at its lowest in 20 years.

The postponement in investment and consumer purchasing decisions may create a vicious cycle of further falling demand, downsized business plans, reduced innovation activities and labour shedding. The expected increase in unemployment in 2009 demands additional measures as called for by the European Economic Recovery Plan. Some Member States will need to take actions that go beyond their plans laid out in the National Reform Programmes, especially to ensure that vulnerable groups are not being hit too hard by the economic contraction and to allow social protection to play its full role as an automatic stabiliser. Rapid, relevant and coordinated action is essential to minimise the effects of the economic downturn on people's jobs, purchasing power and prosperity and to restore confidence.

The current economic downturn has first of all underlined the need to reinforce certain efforts within two key policy areas: implementing integrated flexicurity pathways and ensuring better skills matching and upgrading. Flexicurity is essential in ease and secure employment transitions. The right skills are an important element in getting the unemployed into jobs and improving employment security. Through the European Social Fund (ESF) and the European Globalisation adjustment Fund (EGF) the EU already possesses two effective financial tools to support these priorities now to be made better suited to confront the economic downturn.

Although there is a clear necessity for short term measures to alleviate the economic downturn it is crucial not to loose sight of the structural problems which still persist and which are causing European labour markets to perform unevenly. The structural reforms initiated and implemented in recent years must be pursued. They have been successful and contributed to more resilient labour markets and they will underpin economic recovery when it occurs. The European Employment Strategy and the Lisbon process are more relevant than ever.

2. THE EU EMPLOYMENT ACHIEVEMENTS AND CHALLENGES

Recent developments and outlook

Most Member States labour markets have so far not been very affected by the recent slowdown; in 2007-2008 the EU saw more than 6 million new jobs being created and unemployment moved just below 7%, the lowest in decades. Employment rates continued to rise in the EU attaining 65.5% on average, 58.3% for women and 44.7% for older workers and thereby bringing the EU closer to the Lisbon targets. The increase in participation rates amid deterioration in consumer confidence and employment expectations can be regarded as a positive development.

Structural unemployment continued to decrease to 7.6% in 2008 and now stands significantly lower than in 2000. This further confirms the positive structural impact of the Lisbon reforms implemented in recent years, which demonstrably has facilitated the transitions on the European labour markets and removed barriers to create employment. For the same reasons higher unemployment is expected to be of a transitory nature and relatively quickly revert towards the lower levels of last years when the real economy recovers.

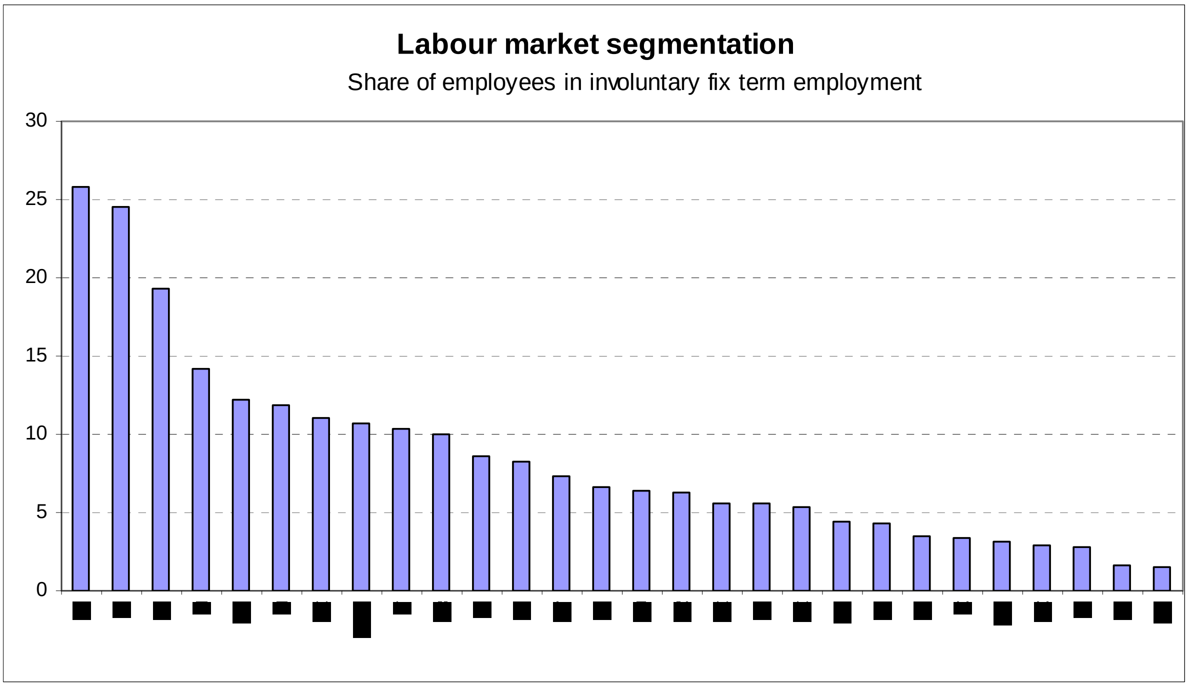
At least some Member States are already clearly in recession and the slowdown has started to affect their labour markets. EU employment growth has eased gradually and is estimated to have grown by only 0.9% in 2008 while unemployment appears to have started rising. With the current economic contraction and projections of negative employment growth in 2009, the 2010 targets now remain definitely out of reach.

It is expected that many Member States will be faced in 2009 with a decline in the employment rate and an increase in unemployment. The January Interim Economic forecast by the Commission suggests that employment is expected to decrease by about 2% in the EU in 2009-2010 while unemployment is currently expected to increase by as much as 2.5 percentage points in the next two years, to reach up to 9.5% in the EU by 2010. Furthermore, available forecasts suggest that the impacts are likely to hit Member States differently: some expect serious impacts; others anticipate only moderate downturns to the labour market.

Structural problems remain

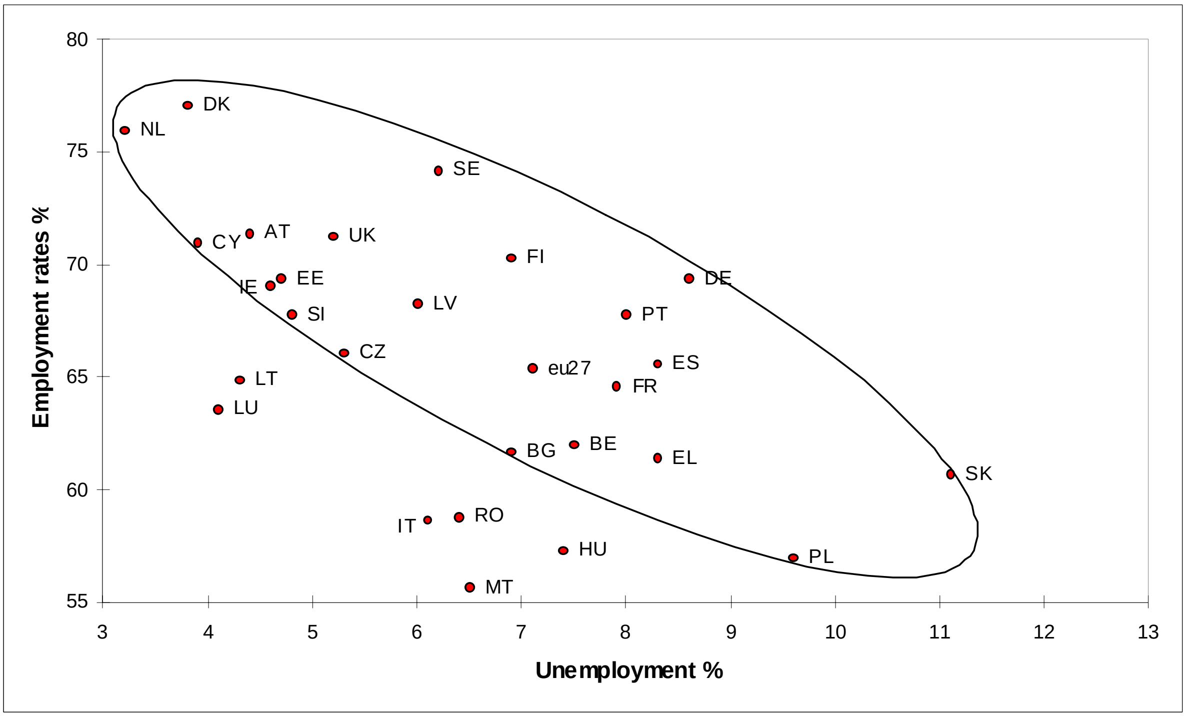
A number of structural problems identified in recent years persist. Evidence shows that European labour markets remain segmented (see graph 1 below) and perform unevenly. There is still a relatively large gap between the best performing and less well performing labour markets.

Graph 1: Labour market segmentation



Those labour markets that cannot prevent high unemployment are also those labour markets which cannot ensure high participation and activity rates. The highly segmented labour markets are also generally those performing low on employment and unemployment.

Graph 2: Employment versus Unemployment



Two illustrations of the continued structural problems are youth unemployment and relatively low participation in lifelong learning. Despite the significant reduction in youth unemployment in 2007 in most countries, young people remain more than twice as exposed to unemployment as the overall work force. Many Member States fall short of the new EU-wide activation targets. Despite an increased focus in Member States, the levels of adult participation in lifelong learning have barely increased between 2006 and 2007 and follow a worrying declining trend in some Member States. These figures are a worrying sign for the future since a substantial rise in investments in human capital better targeted towards labour market needs is essential to close the productivity gap with our key global competitors.

Priorities for employment policies

In the current climate of uncertainty and economic contraction, but also in view of the need to continue with structural reforms in the medium term, employment policy should focus on two priorities: implementing integrated flexicurity pathways and better skills matching and upgrading. This requires an open and constructive dialogue with social partners and other stakeholders as well as carefully considering the interplay between monetary, budgetary, fiscal, employment and social protection policies.

For flexicurity the focus should be to ease and secure job transitions with adequate safety nets and minimum income schemes and on strengthening the Public Employment Services and active labour market policies. In the short term, flexicurity policies are helpful in alleviating the fears of unemployment and reduced income leading to inhibited consumer spending through a focus on supporting and facilitating labour market transitions

Skills upgrading is critically important for growth and productivity as it strengthens labour force capacity to adapt to rapid technological change and continued innovation while improving employment security. In the context of rising unemployment, ensuring a better match between the supply of skills of job seekers and labour market demand is crucial.

The current ESF programmes offer considerable scope for supporting flexicurity policies and policies easing transition periods by providing training combined with personalised job counselling, in-company training, apprenticeship, subsidised employment as well as grants for self-employment and business start-ups. Member States should consider re-programming, where necessary, ESF expenditures in order to strengthen these priorities.

3. IMPLEMENTING INTEGRATED FLEXICURITY APPROACHES

The awareness of the benefits that flexicurity policies can bring has been strengthened by the European Council's endorsement of the common principles of flexicurity, the supportive common position of the European social partners and the wide range of debates including the so-called "Mission on Flexicurity" (ref). Flexicurity is now acknowledged as a key approach to make labour markets more responsive to the changes resulting from globalisation, as well as to reduce labour market segmentation. The analysis of the recent National Reform Programmes shows that several Member States are putting in place flexicurity strategies, but also that the overall efforts are still insufficient and must be strengthened, particularly in view of the economic downturn.

The current economic context reinforces the need for efficient and effective, but especially integrated, flexicurity approaches in all Member States. People at the margin of the labour market will be first and hardest hit. Active inclusion policies and activation policies including labour market training will become more essential to avoid long term and persistent unemployment that may otherwise follow. Intervention should therefore focus on high-risk groups; the vulnerable, low skilled and other disadvantaged people. Public employment services will be at the forefront of confronting rising unemployment and need to be better equipped to do so. Adequate social protection systems that at the same time provide incentives to work are necessary to smooth transitions and keep up consumer demand.

The following actions are of particular importance in the short and medium term:

- **Contractual arrangements**: Reduce segmentation, harmonise temporary and permanent contracts and rapidly implement the provisions of the directive on temporary agency workers.
- **Active labour market policies**: Prioritise job subsidies and equivalent measures leading to rapid integration of the workless into a job.
- **Effective lifelong learning systems**: Focus on short-term skills upgrading, and enhance matching of the skills of the unemployed with the available jobs, looking particularly to sectors currently facing labour shortages (also a role for ALMPs).
- **Modernise social security systems**: Reduce high marginal effective tax rates on the low paid, boosting demand in the economy and reducing unemployment/inactivity traps.

– With respect to implementation, a number of Member States (IE, EE, FR, LV) undertook or announced reforms to develop flexible and reliable contractual arrangements, while improving the protection of employees engaged in more flexible forms (e.g. IE, AT, FR) or revise Labour Codes (CZ, PL, PT).

– Among the flexicurity components, Member States devote most of their attention to lifelong learning although this has had no impact on the participation in lifelong learning so far. Skills upgrading is increasingly seen as an important tool to ensure the continual adaptability and employability of workers and thus maintain and increase employment security. On-the-job and adult training is encouraged and supported in DK, FI, FR, EE, IE, NL, UK, AT, MT, BG, EL, PL, LV and in the form of training leave in BE, LU and AT. Reform of the vocational training system took place or is planned in the majority of the Member States in order to improve quality and better meet labour market needs.

– Active labour market policies are increasingly oriented towards prevention and early interventions with a higher emphasis on training. Job-to-job transitions of redundant employees are supported in NL, DE, LU, FI, and EE. Some countries have focused on a better integration of active and passive labour market policies by a possible merger of the public administration delivering placement services for jobseekers (PES) and the national authority responsible for unemployment benefits and other welfare schemes (FR, EE, NL, UK). Innovative actions to promote professional mobility especially for youth took place in a number of Member States (BE, DE, SE, EE, PT, SI, DK, CZ).

– Several Member States undertook a reform of their benefit systems with a view to encouraging work. Conditionality was strengthened and eligibility tightened in BG, HU, CZ, DK, LT, LV, NL and SE.

– The involvement of social partners in designing and implementing flexicurity policies varies across the Member States. There is a considerable involvement in DK, IE, ES, LU, IT, AT, FR, NL, LV, FI and SE.

4. THE CHALLENGES OF SKILLS MATCHING AND UPGRADING

The next decade will see an increasing demand for a high-qualified and adaptable workforce and more skills-dependent jobs with the proportion of jobs requiring high level of educational attainment expected to rise from around 25% to more than 30%[21]. Skills upgrading is critically important for Europe's future growth and productivity, for its jobs and its capacity to adapt to change and for equity and social cohesion. But ensuring a better match between the supply of skills and labour market demand is just as necessary. In response to the European Council mandate[22], the Commission has published a first assessment of future skills requirements up to 2020.

Improving employability is one of the key priorities to address the expected impacts of the current economic downturn and put Europe on the road to recovery. The education, training and employment policies of the Member States must focus on increasing and adapting skills and providing more learning opportunities at all levels. To maintain and update skills of those loosing jobs is crucial in avoiding that cyclical evolvements in unemployment become longer lasting.

Measures to develop the continued vocational training are particularly important in this context. Evidence shows that especially low-skilled and older workers are lagging behind when it comes to participation in lifelong learning and measures targeting these groups should be given priority within companies and by the PES among job seekers. The PES need to reinforce their awareness of where demand for labour is and the skills needed. They should focus on equipping the newly unemployed and other job seekers with these skills. It is encouraging that almost all Member States have focused on raising the quality of vocational education and training, including apprenticeships.

Some Member States have recently taken measures to promote financial aid to employers promoting training (BE, BG, DK, EL, IE, UK, EE, DE, MT, HU, NL, LU, PL, PT, LV), improve the conditions for special training leaves (AT, BE, LU) or specific programmes for training of people who are inactive, have a lower level of attainment or have other disadvantages (BG, CY, CZ, DE, DK, EE, FI, IE, LV, LT, NL, PL, RO, SI, SE, UK). Some Member States also foresee specific actions for facilitating migrants' access to the labour market: funding of adult education to activate participation (FI), language courses (CY, FI, PT, SE) facilitating participation in basic vocational training or upper secondary education (DE, FI, MT, PT, SI), programmes for community integration (CY, EE, IE, DE, SI) and validating competences and qualifications (FI, IE, PT, SE, LU).

Table 1. Share of workers participating in lifelong learning

	Total (25-64 year)	Unemployed (25-64)	Inactive (25-64)	Older 55-64 year	Low skilled (25-64)
Share participating in Lifelong learning	9.7	8.4	7.1	4.7	3.9

Source: Eurostat

[21] CEDEFOB estimates

[22] The European Council stressed in March 2008 that investing in people and modernising labour markets is one of the four priority areas of the Lisbon strategy, and invited the Commission *"to present a comprehensive assessment of the future skills requirements in Europe up to 2020, taking account of the impacts of technological change and ageing populations and to propose steps to anticipate future needs"*

In the medium and longer run ensuring a better match between the supply of skills and labour market demand is crucial. This can be achieved through establishing a better link between education, training and employment systems and better anticipation and forecasting for skills needs.

Several Member States (SI, FI, LT, EE) are developing new forecasting methods for skill needs and specific research programmes while others have already developed instruments (FR, UK, NL, IE, FI) or are at the early stages of introducing such systems (LV).

Several Member States have undertaken educational reforms to strengthen entrepreneurship or increase the relevance of education and training in matching labour market needs (CZ, DE, SI, LV, SE, HU, LU, SK) while some are at very early stages (BG, LT, SK).

The modernisation process of PES is ongoing in several Member States. In some, the focus is on a better integration of active and passive labour market policies (FR, EE); while in others the reform process is mainly driven by the need of ensuring a more efficient coordination of regional offices with the central level (SE). Others have more generally modernized the PES (BG, CY, IT, FR, ES, LU) by offering training for disadvantaged groups such as older workers (AT, IE, LV), immigrants (LU), migrants and low-skilled (IE). Some initiatives concern the involvement of employers (AT, HU, UK), state financing (DE) and ESF (CZ, CY, HU, IE, SK, SI).

5. IMPLEMENTING STRUCTURAL REFORMS

Structural labour market reforms across all the employment guidelines should be pursued. The EU and individual Member States have their particular strengths and weaknesses with the latter needing to be addressed with renewed vigour.

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

Promote a lifecycle approach to work

Few Member States have a comprehensive lifecycle approach to work. However, there has been some progress in recruiting and retaining older people in the labour market. To sustain progress it is essential to avoid using early retirement schemes to regulate supply as in past downturns. In particular by improving working conditions in the workplace through projects to ensure age-appropriate arrangements and fostering good working environments (SE) as well as awareness raising through age positive campaigns (UK, MT, LU).

Most countries have implemented pension reforms strengthening the incentives to work longer and closing early exit routes. Several have developed new strategies (FR, IE, PL, LT,) and undergone pension reforms to encourage and retain older people in work (CZ, DK, EL, FR, AT, FI, PT, UK, RO, PL, MT). ESF has been specifically targeted to the expansion of labour market policy for older people (AT, SI), but despite efforts the current average exit age from the labour market still remains well below the 2010 target.

Progress in the field of gender equality has continued to be mixed. The female employment rate has further increased (58.3%) and is close to the 60% 2010 target. Despite 15 Member States already reaching this target, in three it remains below 50% (EL, IT, MT). Most countries are still far from adopting a full gender mainstreaming approach to employment policies, notably through systematic gender impact assessment of policy measures.

The issue of reconciliation between work and private life is gaining some impetus, mostly through the commitment to improve the provision of childcare and pre school facilities. However, only five Member States have met the childcare target of 33% coverage rate for the lower age-group from 0 to 3 years (DK, NL, SE, BE, ES), while five (PT, UK, FR, LU, SI) are approaching it. For children between 3 years old and the mandatory school age, eight (BE, DK, FR, DE, IE, SE, ES, IT) have surpassed the 90% coverage rate while three others (UK, NL, CY) are approaching it. Moreover, in many countries a high proportion of childcare facilities for children in this age-group operate on a part-time basis only. For example, the coverage rate for full-time attendance is below 50% in more than half of the countries and not even 30% in a third of them. In many facilities are too costly or the opening hours are not compatible with full-time work or jobs with atypical hours. However, several countries took new initiatives in this field, mainly for younger children (AT, BE, ES, HU, IE, PT) but also for pre-school children (ES, PL).

A positive development is that initiatives are no longer limited to the availability of child care. They also concern: encouragement of more flexible working arrangements (MT, UK); tax credits for women returning to work (MT, IT, NL, EL); flexibility of childcare allowances (AT, DE); better replacement income during leaves (FI, LV); parental leave regulation (CZ, MT, NL); better protection against dismissal for women on maternity leave (ES); support services to encourage re-entrance into the labour market for women who have taken career break to rise a family and creating family flexible environments (DE, HU, SE). Several Member States took measures in order to improve the right or to increase the take up of leave by fathers (AT, EL, FI, SE). Involvement of companies through non-legislative initiatives is also used (FR, IT, LU).

Two thirds of Member States have seen an improvement in youth unemployment and increased efforts to fight youth unemployment are reported by many. Policy measures include improved vocational education and training schemes to ensure a better match with the labour market (DE, FI, LU, SI, PT) and specific entrepreneurship programmes (LT). Some are providing personalised learning, guidance and support (AT, FI, LU). Others are seeing reductions in employers' social security contributions (HU, SE), or allocations of subsidies for companies recruiting young people (AT, FI, SK), reforms of social assistance or unemployment benefits (FI, NL).

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

Efforts have continued to integrate those furthest from the labour market into work through an "active inclusion approach" although results are mixed.

There are still some groups with large shares outside the labour market, such as people with disabilities, ethnic minorities including Roma, immigrants, and low skilled. Whereas the employment rate for people with disabilities improved in some countries (AT, DE, DK, EE) it worsened in others (PL, SE, SK). Some groups are even more underrepresented in employment such as women with disabilities (ALL MS) and those with mental disabilities (DE, HU, UK). Supported employment to get people with disabilities into the open labour market should be encouraged, as some Member States have a rather strong focus on sheltered employment (DE, HU, SI). In others support measures concentrate on people with severe disabilities and exclude those with minor disabilities (AT, DE).

Integration of the Roma is an emerging issue (CZ, RO, HU, ES, SK, BG). Measures to encourage access and integration to the labour market include anti-discrimination policies for example in the form of legal proceedings combating school segregation and refusal to hire Roma (BG, HU). Labour market policies also include subsidised employment programmes (BG), pre-employment training, career guidance and supervision to help Roma integrate into the labour market (ES), focus on PES to increase motivation of Roma to start working (SK) and appointment of mediators assisting their job search (BG).

Differences in employment and unemployment rates between people with a migrant background and the rest of the population is still significant in many countries. Some are facilitating access by offering tailored language lessons (DE, FI, LU), supplementary training (FI), social assistance and starting allowances (DK, FI, SE) but few have designed integrated strategy and action plans for the integration of migrants (IE, NL).

Measures adopted to make work pay seem to get less focus. Some have tightening eligibility conditions for unemployment benefits (CZ, NL) or introducing "in-work" benefits that top-up low wages (SE, UK).

5.2 Improve the adaptability of workers and enterprises

Anticipating economic restructuring and improve work organisations

Design and dissemination of innovative and more productive ways of organising work is foreseen in CY with ESF assistance. In IE, the Workplace Innovation Fund was established to encourage the development of new ways of working, through partnership, aimed at increasing flexibility and improving performance in the workplace. A number of Member States (DK, EE, AT, MT, LT, LV, PT and SI) introduced or announced measures to improve health and safety at work.

Undeclared work is an important aspect of segmentation. BG, EL, HU, LV, MT, PT, RO, SI report on measures to tackle the issue, mainly through strengthening labour inspectorates or other control and surveillance measures or incentives to legalise labour relations.

Regional mobility is being promoted, *inter alia* by planning to or already contributing to the costs of commuting (FI, AT, LT, LV, RO, BG, SK), enhanced cooperation between the regional PES and language training (BE), while SK foresees supporting housing costs.

Ensure employment-friendly labour cost developments and wage setting mechanisms

Publication of annual pay statistics by gender are still only produced by some countries (AT, CY, DK, FR, EL, IE, LV, MT, PL, SE, SI), however the gender pay gap still remains large. Several countries have emphasized the gender pay gap in their National Reform Programmes but very few announced some new initiatives as targets (FI, UK), legislation (SK) or other policies (FI, LU).

Efforts to ease the tax wedge and reduce non-wage labour costs took place in many countries (BE, CY, DK, DE, ES, FR, FI, RO, SI, AT, EE, LV, LT, SE, PL, MT, NL) with a particular focus on young people, older workers and disadvantaged groups. The minimum wage is reviewed or increased in FR, UK, LV, PT and IE and sector specific ones introduced in AT, DE.

5.3 Increase investment in human capital through better education and skills

Expand and improve investment in human capital

There are still no signs that investment in human capital is on the rise following the 2003-2005 period where total public expenditure on education as a percentage of GDP decreased from 5.2% to 5.0%. There are still important divergences between Member States ranging from around 8% in DK to below 4% in RO.

Some have recently adopted new coherent life long learning strategies (CZ, DE, LV, BG, LT), or skills upgrading strategies even involving PES (UK) while others are still lacking strategic and coherent lifelong learning strategies (AT, MT, PL, HU, RO).

The education targets within the Lisbon Strategy are not likely to be reached. In 2007, the rate of early school leavers stood at 14.8% (benchmark for 2010: 10%) and is more severe among males and young people with migrant backgrounds. The upper-secondary attainment rate of the population aged 20-24 was at 78.1% in 2007 (benchmark for 2010: 85%) and the percentage of adult participating in lifelong learning at 9.7% (benchmark for 2010: 12.5 %).

Following the March 2008 European Council call, Member States have taken action to address early school leaving. The measures combine preventive approaches with facilitating the return to education for those who have dropped out of school (AT, NL, IE, LT, LV, LU, PT, SI). They include financial incentives addressed either directly to individuals at risk or to schools and other professionals working at the local level (ES, NL, UK), boarding school programmes for children from low-income families (EE), improved guidance (CY, CZ, EE, FR, LU, UK) extra-curricular activities (FR) and better transition between different school types (LU).

Virtually all countries are now focusing on strengthening pre-primary education, which is considered to improve the prospects to succeed in lifelong learning especially for children from disadvantaged groups. Reforms undertaken on primary education include, language screening and language teaching for children with migrant background (AT, DE, DK, EE, FI, IE, NL, LU), and efforts to ensure the quality of primary education, for example through the development of framework curricula (CZ, LU). At the same time, the entry age to primary education are lowered (BE, SE and PL) and measures targeted at improving reading literacy also focus on identifying and supporting students with weaknesses already during the early years of education (DK, MT, SE).

Little progress has been made in targeting the low skilled. Activation measures that are identified include explicit national strategies (IE) and training from employment services (DE, FI), while financial incentives are created in the form of income tax-credit (NL, DE) and lower tax wedge for low-skilled employees (BE) and other measures include raising the compulsory participation age in education (UK).

Many indicators highlight the poor quality of education received by Roma children with segregation as a pervasive problem and high drop out rates. Member States are combating this through provision of free text books and scholarship assistance (BU), special Roma reserved places in both high school and universities (RO, HU) and grant schemes for scholarships (SK). SK adopted a White paper on education of Roma children and pupils including the development of secondary school and university education. BG has created a lifelong learning strategy to target group for literacy measures and courses. ESF is used to support Roma marginalised communities (CZ, ES, SK).

Moreover, and especially in the light of the current situation it will also be important that entrepreneurship training does not only target schools (EE, LT, PL, UK, SE, SI, SK and UK), but that also any packages supporting the setting up of new businesses, for example in support of unemployed persons, include education/training elements which will help new entrepreneurs to succeed and to better deal with, for example, accounting or other administrative tasks.

Adapt education and training systems in response to new competence requirements

Access to education and training, flexible learning pathways, and mobility between sectors are also being promoted by the good progress made in implementing the European Qualifications Framework. Some Member States (FR, IE, MT, and UK), are developing or have committed themselves to develop an overarching national qualifications framework covering all education and training sectors. As all other, they are committed to develop a qualifications framework for higher education. In most countries the development of national qualifications frameworks goes along with efforts to improve the validation of non-formal and informal learning, for example to facilitate access to higher education (CZ, DE, EE, FI, LT, MT, PT, NL, PL, SI, UK).

In addition to measures aimed at facilitating access to higher education and to increase the share of people completing tertiary education, including the extension of financial support schemes (CY, EL, DE, PT, SK), more needs to be done to improve university-business cooperation. Some (CZ, DE, EE, EL, FI, LT, LU, SI, SK, UK) are allocating funds to contact points and networks facilitating joint projects and knowledge transfer between academic institutions and businesses. Further efforts are needed to increase the relevance of higher education for labour market needs, to support innovation and to strengthen universities' role in lifelong learning.