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**ANNEX TO THE
COMMUNICATION FROM THE COMMISSION TO THE SPRING EUROPEAN
COUNCIL**

TIME TO MOVE UP A GEAR

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Introduction

This annex complements the communication from the Commission to the 2006 Spring European Council “Time to move up a gear” presented after the renewal of the Lisbon Strategy. It draws on the Commission’s assessment of the national reform programmes (NRP) drafted by Member States on the basis of the new integrated guidelines for growth and jobs endorsed by the European Council in June 2005¹. It also takes into account action taken at the European level, particularly, in the framework of the Community Lisbon programme².

While the key findings of the Commission’s analysis are presented in the communication “Time to move up a gear”, this annex, an integral part of the communication, provides a more detailed picture within the three broad strands of the integrated guidelines: macroeconomic, microeconomic and employment. The latter section constitutes at the same time the draft joint employment report 2005/2006 of the Commission, in accordance with article 128 of the Treaty. A more detailed assessment of the individual national reform programmes can be found in Part II of the communication “Time to move up a gear” containing country chapters as well as a chapter on the euro area.

¹ Brussels European Council, Presidency Conclusions, point 10
(http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ec/85349.pdf).

² Common Actions for Growth and Employment: The Community Lisbon Programme, COM(2005) 330 of 20.7.2005.

Part I

Macroeconomic part

1. SUMMARY AND CONCLUSIONS

This part of the Annex assesses the progress made towards achieving the Lisbon growth and job objectives, and it evaluates the macroeconomic policy strategies of the Member States as set out in their National Reform Programmes (NRPs).

During the first five years of the Lisbon strategy over 6.5 million new jobs were created in the Union. Nevertheless, the 70% Lisbon employment rate target is not expected to be reached by 2010. Labour productivity growth in the EU has been below that of the US, which explains why – in spite of the substantial number of new jobs created – EU GDP per capita has failed to catch up with that of the US.

The EU economy has started to recover following the global downturn at the beginning of the decade. In spite of this, the average EU budget deficit is expected to remain at 2.7% of GDP up until 2007.

An investigation of the NRPs shows that budgetary discipline stands out as the most important macroeconomic challenge identified by Member States. It is typically formulated in terms of public finance sustainability, including pension, health and labour market reforms as well as short-term budgetary consolidation as tools to ensure the long-term sustainability of public finances in an ageing society. However, the specific measures to achieve short-term budgetary consolidation are not spelled out in enough detail in several countries, particularly within the euro area.

Most Member States express the intention to improve the quality of public finances by increasing the efficiency of the public administration and by setting aside public resources for strengthening infrastructure, human capital and R&D investment. However, few NRPs are explicit about the budgetary implications of proposed measures.

Over the coming decades, ageing populations in Europe will put increasing pressure on public finances. Member States appear to recognise that a thorough overhaul of retirement and pension systems is an essential prerequisite for ensuring public finance sustainability. However, in most countries the measures already taken or envisaged are insufficient to negate to the effects of ageing populations.

The majority of Member States have put forward NRPs which show broad coherence between macroeconomic, microeconomic and employment policies, even if synergies between policy actions in different domains could be further developed.

2. MACROECONOMIC DEVELOPMENTS IN THE EU

2.1. Macroeconomic conditions

EU growth performance since 2000

Since the launch of the Lisbon strategy in 2000, the annual growth rate for the EU-15 has averaged 1.9% per year compared to 2.8% on average for the period 1995-2000. In comparison, the US grew at a rate of 2.7% between 2000 and 2005. In per capita terms, EU-15 growth (1.4%) has been only slightly below that in the US (1.7%). Growth in the recently-acceded Member States has been considerably more dynamic (around 4.6%), although their small economic weight means that this is not apparent in the 1.9% growth rate observed in the EU as a whole.

The pattern of EU growth reflects a combination of cyclical and structural factors, which led to a sluggish and protracted recovery following the global downturn at the beginning of the decade. The potential growth rate of the European economy is currently estimated to be around 2.0%. GDP grew by 1.5% on average in the EU in 2005, encompassing a rebound of economic activity in the second half of the year.

Structural factors have become the main force behind the relative growth performance of the euro-area countries: those with a strong/weak growth performance in recent years have by and large maintained this position since the 1990s. On the other hand, growth differences linked to different positions in the cycle have diminished in the last decade.

In 2005, GDP growth in the EU accelerated from a quarterly rate of 0.3% (q-o-q) in the first quarter to 0.6% in the third quarter. This coincided with a similar acceleration in final domestic demand. The contribution of private consumption to domestic demand growth was subdued, since consumer confidence remained weak. This is mainly due to pessimism about employment prospects and a limited rise in the purchasing power of households. On the other hand, the pick-up in investment in the second and third quarters of 2005 reflected improvements in profits and corporate balance-sheets. Net exports – supported by a healthy external environment and by a depreciation of the nominal effective exchange rate of the euro – made a positive but small contribution to GDP growth.

Growth prospects for 2006 and 2007

In line with the positive signals from business survey indicators, it is anticipated that growth will be close to potential during 2006, at 2.1%, and will accelerate further, to 2.4%, in 2007. The recovery expected in 2006-2007 is underpinned by a further strengthening of domestic demand. Investment, in particular, is projected to pick up considerably, followed by a more gradual recovery of private consumption.

Labour market conditions are also set to improve, with an expected 6 million new jobs in the EU in 2005-2007 resulting from the projected rise in economic growth. It is also expected that the unemployment rate will diminish from 8.7% in 2005 to 8.1% in 2007.

2.2. Budgetary policy developments

Budgetary positions

Since 2000, the situation in public finances in the euro area and the Union as a whole has deteriorated, reflecting to a large extent the impact of the economic cycle. In several Member States, part of the deterioration also stemmed from a discretionary

loosening of fiscal policy. Despite a slight improvement in the budgetary position of the euro area and the EU in 2004, budgetary consolidation did not advance any further. Due to the lacklustre growth, net borrowing in 2005 is expected to increase slightly to 2.9% of GDP in the euro area and 2.7% of GDP in the EU.

Excessive deficits

The Commission's autumn 2005 economic forecasts project that the average EU budget deficit will remain at 2.7% of GDP in 2006-2007. For the euro area, a marginal decline in the general government deficit in 2006 and 2007 is anticipated, in the context of a moderate economic recovery. However, current policies are expected to be insufficient to bring the deficit below the 3% reference value by 2007 in any of the euro-area Member States currently under excessive deficit procedure (DE, EL, FR, IT and PT).

Outside the euro area, the fiscal outlook across countries is relatively heterogeneous. The budget deficit in three of the six non-euro-area countries currently under excessive deficit procedure (CZ, HU and PL) is expected to stay above 3% of GDP. The same is true for the UK. Cyprus, Malta and Slovakia, on the other hand, are projected to correct their excessive deficits.

Debt ratios

The deterioration in budgetary positions since 2000 has led to an increase in gross debt within both the euro area and the EU as a whole. Debt ratios in 2005 were well above the 60% of GDP threshold in Belgium, Germany, Greece, France, Italy, Austria, Portugal, Cyprus and Malta.

Budgetary impact of ageing populations

Over the coming decades, ageing populations in Europe will put increasing pressure on public finances. The old-age dependency ratio, that is, the number of people aged 65 years and above relative to those in the 15 to 64 age group, is projected to double, reaching 51% in 2050. This sharp increase is expected to result in a substantial burden of public spending on age-related items, in particular on pensions, health care and long-term care. The 2005 Council Opinions on the Stability and Convergence Programmes identified serious risks to the long-term sustainability of public finances in ten countries (BE, CZ, DE, EL, FR, IT, CY, HU, MT and SI). Seven countries (DK, IE, LU, AT, FI, SE and ES) appear to face relatively limited risks associated with population ageing, while the remaining EU Member States are somewhere in between.

Quality of public finances

While the current EU economic policy framework considers budgetary discipline and fiscal sustainability to be essential elements of a sound and growth-supportive economic environment, the quality of public finances has gradually been gaining importance in the policy debate. An investigation of the composition of public expenditures in the Member States shows that many of the countries that benefited from large decreases in interest payments since the late 1990s used this room for manoeuvre to raise government consumption and current transfers, rather than

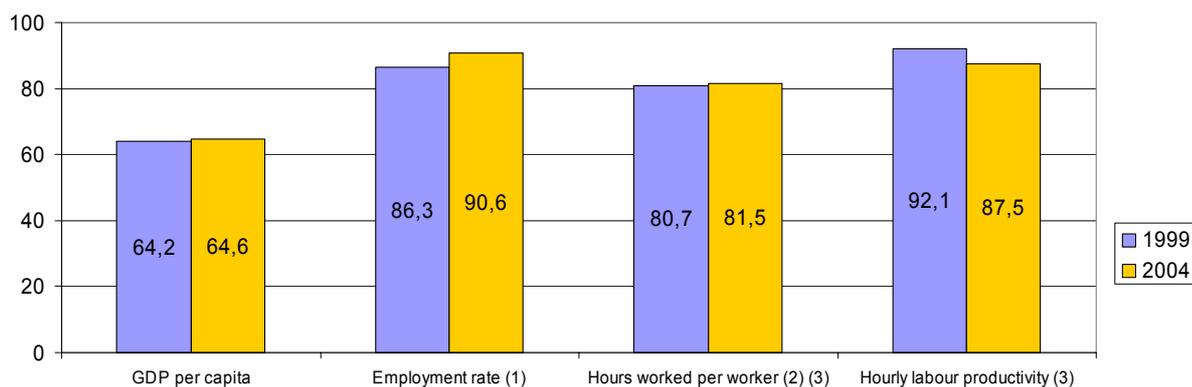
consolidating their public finances. Other Member States, however, have managed to reallocate public resources more effectively towards longer-term targets such as knowledge and innovation, while maintaining fiscal discipline. Denmark and Sweden, for example, have been able to redirect public spending by introducing national expenditure rules and performance budgeting schemes within a medium-term framework.

3. PATH TOWARDS ACHIEVING THE MAIN LISBON OBJECTIVES

Change in GDP per capita

Considering the enlarged EU of 25 Member States, GDP per capita stands at around 65% of the US level with no significant improvement since the launch of the Lisbon strategy. In the first half of the decade, it has not been possible to complement the relatively positive developments in terms of employment creation with the required acceleration of productivity growth (see graph 1).

Graph 1: European Union performance 1999-2004 (US=100) ⁽⁴⁾



- 1) Calculated - Employment rate = $100 * (\text{GDP per capita} / \text{Labour productivity per person employed})$
 2) Calculated - Hours worked per worker = $100 * (\text{Labour productivity per person employed} / \text{Hourly labour productivity})$
 3) EU15 values for Hours worked per worker and Hourly labour productivity
 4) 2004: forecasts

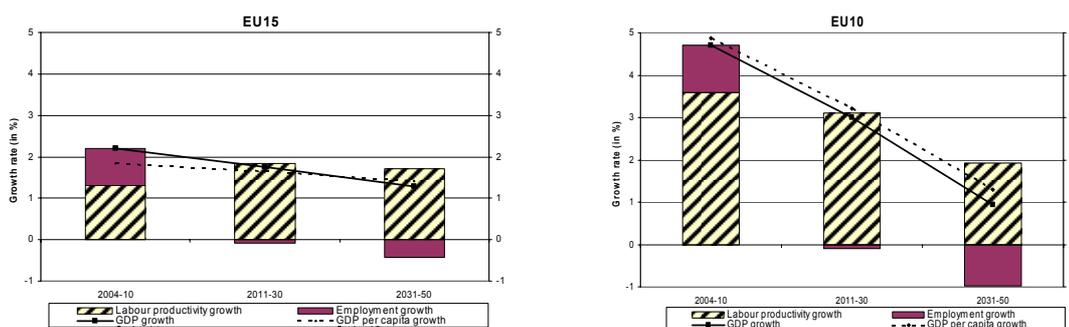
Labour productivity growth

The Commission's analysis indicates that the deteriorating labour productivity performance can be attributed to lower investment per employee and a slowdown in the rate of technological progress. More recently, however, EU labour productivity growth appears to be accelerating. This may be due to the upturn in the business cycle but it is also likely to be attributable to more structural factors such as the delayed impact of investments in ICT and possibly outsourcing, which has been shown to provide a productivity boost if the outsourced activities are well integrated in international networks (as is the case in the German motor vehicle industry, for example). Productivity increases, combined with wage moderation, should help to maintain the EU's competitive position in an increasingly integrated world economy.

Job creation and the effects of ageing populations

Despite some progress in job creation (see draft Joint Employment Report), the Lisbon employment targets will be difficult to reach. During the first five years of the Lisbon strategy, over 6.5 million new jobs were created in the Union, bringing the employment rate up from 61.9% in 1999 to 63.3% in 2004. Recent work by the Economic Policy Committee and the European Commission (see graph 2) projects a further rise in the overall employment rate to 67% in 2010, with the 70% Lisbon employment rate target being reached in 2020. Meeting the Lisbon employment target, albeit with a delay, will cushion the economic effects of ageing. However, after 2017, total employment will start to contract as a result of the decline of the working age population. This means that, all things being equal, the contribution of employment to growth will turn significantly negative and that Europe's economic growth will increasingly depend on productivity increases in the longer run.

Graph 2: Projected (annual average) potential growth rates in the EU15 and EU10 and their determinants (employment/productivity)



Source: EPC and European Commission (2005), "The 2005 EPC projections of age-related expenditure (2004-2050) for the EU25 Member States: underlying assumptions and projection methodologies" in European Economy Reports and Studies, No. 4, Brussels (http://europa.eu.int/comm/economy_finance/publications/european_economy/reportsandstudies0405_en.htm)

4. MACROECONOMIC POLICY CHALLENGES

4.1. Challenges from a EU-wide perspective

Macroeconomic policy challenges

Europe faces the twin challenges of raising the level of potential growth and of fully realising its growth potential through well-balanced economic expansion. Sound macroeconomic policies are essential to meet these challenges. They are vital for establishing framework conditions that will promote adequate levels of savings and investment, together with a stronger focus of the latter on knowledge and innovation. Securing a sound budgetary position will allow full and symmetric operation of the automatic budgetary stabilisers over the cycle with a view to stabilising output around a higher and sustainable growth trend. On the other hand, structural reforms may widen the room for manoeuvre for macroeconomic policy-makers. Better functioning product and labour markets, for example, will help limit inflationary pressures in the event of a positive demand shock. This illustrates the importance of developing a coherent overall strategy, which takes full account of the interrelationships between macroeconomic, microeconomic and employment policies (see Section 5).

Budgetary policy challenges

The weakening of policies aimed at budgetary consolidation is an issue for concern, because it will limit the margin for manoeuvre at times when the economy requires a true stimulus. Moreover, the deterioration of budgetary positions has led to an increase in debt levels, which is not good news from a longer-term perspective, especially in the light of Europe's ageing population. With the projected increase of age-related expenditures, such as health, social security and pensions, it will be increasingly challenging for the Member States to safeguard the long-term sustainability of public finances, while ensuring the social adequacy of social protection systems. Finally, meeting the needs for increased spending on education and research within a tighter budgetary environment requires a greater effort to improve the overall quality of public spending.

4.2. Challenges identified by the Member States

Most Member States identify the stimulation of (potential) economic growth as an overarching challenge. The other challenges, including the more specific macroeconomic challenges, are seen as tools for achieving this single challenge. Broadly speaking, there is a convergence of views between Member States and the Commission on the macroeconomic challenges identified.

Macroeconomic policy challenges

All but three National Reform Programmes have identified macroeconomic policy challenges. Two of the three exceptions, namely, Netherlands and Sweden, outline in their Programmes broad strategies that appear adequate to maintain the current overall satisfactory macroeconomic stance. Italy's Programme, by contrast, makes reference to other government policy documents, notably the annual Economic and Financial Planning Document, which typically provides the basis for the update of the Stability and Convergence Programme and which, according to the Italian authorities, should be seen as an integral part of the National Reform Programme. The macroeconomic policy challenges identified in the Programmes are broadly in line with those highlighted by the Commission in its contributions to multilateral surveillance.

Budgetary policy challenges

According to the Programmes, by far the most important macroeconomic challenge facing the EU Member States concerns the achievement and/or maintenance of budgetary discipline, the latter being typically formulated in terms of public finance sustainability. Only three countries (EL, ES and LV) have identified short-term budgetary consolidation as a separate challenge, and this despite the fact that no less than eleven countries (not including ES and LV) are currently in a situation of excessive deficit. The related challenge of improving the quality of public finances, which is mostly formulated in terms of increasing the efficiency of the public administration, is considered to be important in seven Programmes.

The identification of fiscal discipline as the key national macroeconomic policy priority reflects widespread recognition of its advantages in terms of maintaining macroeconomic stability and promoting long-term growth, as well as creating the capacity to respond to future fiscal policy challenges, such as those stemming from population ageing. This recognition is strongly embodied in the EMU policy framework, where fiscal rules are seen as necessary to ensure the smooth co-existence of a common monetary policy geared to price stability with the maintenance of fiscal policy in the hands of national governments.

External balances and inflation convergence

Challenges identified in the Programmes, other than those related to public finances, are more difficult to categorise. The external account deficit is explicitly recognised as a challenge – in the context of the broader goal of securing a stable macroeconomic environment – only in one case (EE), although in the view of the Commission other countries (LV, LT, PT) may face challenges on this front. In taking a relatively sanguine view of external imbalances, national authorities presumably reason that current account deficits are the result of investment and saving decisions by rational economic agents and, hence, are consistent with economic fundamentals and likely to have a welfare and growth-enhancing effect, for example by supporting an economic catching-up process. By otherwise emphasising the challenge of fiscal discipline, the national authorities may still recognise that budgetary policy has a role to play in addressing external imbalances, through its impact on savings and, more generally, on the confidence of investors.

Inflation convergence is considered a challenge in a number of countries (LV, LT, SI) in connection with their plans to join the euro area.

Interestingly, neither external imbalances nor inflation divergence seem to be considered as significant challenges by any country in the euro area, with the exception of Ireland, which recognises moderating inflation as part of a broader challenge of maintaining macroeconomic stability. However, it may also betray an excessively benign view of the eventual unwinding of external imbalances in these countries.

5. ASSESSMENT OF MEMBER STATES' STRATEGIES IN RESPONSE TO MACROECONOMIC POLICY CHALLENGES

By and large, the priorities identified in the National Reform Programmes are in line with the principles underlying the recent revision of the Stability and Growth Pact, one aspect of which is the increasing weight assigned to considerations of durability of the correction of fiscal imbalances and long-term sustainability of public finances. The key Treaty provisions on fiscal discipline and their detailed implementation by the Stability and Growth Pact are explicitly indicated in a number of Programmes as providing the framework for the conduct of fiscal policy.

Fiscal consolidation strategies

The fiscal consolidation strategies highlighted in the Programmes are typically expenditure-based (the German Programme is an exception in this respect) and embedded in the broader structural reform plan. Measures to achieve short-term budgetary consolidation are insufficiently explicit in several countries, including FR, IT and PT. Another potential weakness of the Programmes is that the budgetary implications of the actions envisaged in other policy areas, such as employment and social policies, are seldom spelled out.

Only the German Programme envisages increases in taxation, although improvements in revenue collection are explicitly mentioned in some other cases. By contrast, tax cuts are envisaged by several Programmes; in some cases, notably Hungary, even in the presence of significant budgetary imbalances. Measures include tax incentives for enterprises to invest more in R&D and training, the introduction of new energy and/or environmental taxes and measures to reduce the tax burden on labour. While many specific measures seem appropriate, a more systematic approach to reviewing the impact of tax systems on growth and jobs often seems to be missing.

Budgetary consequences of an ageing population

In response to the projected increase in age-related public expenditure, further pension and/or health care reforms figure prominently in the public finance agenda of several Member States. In fact, about half of the Programmes highlight reform measures in these two areas. Coping with the budgetary consequences of ageing is seen as a key challenge also in countries such as DK, IE, LU and FI, which from a cross-country perspective are generally seen to carry a low risk in terms of public finance sustainability. Although not necessarily involving changes in the pension or health care system, the policy responses to ageing in these countries take into account the need to increase the efficiency of public services as well as, in some cases, to guard against the possible erosion of tax bases.

At the opposite end of the spectrum, EL, PT and, among the recently-acceded Member States, CZ - where the need for a thorough overhaul of the pension system has been highlighted as a pre-requisite for ensuring public finance sustainability - generally recognise the need for such a reform. Nevertheless, the comprehensiveness and the concreteness of the measures envisaged remain somewhat limited.

Countries where the projected increase in age-related public expenditure is contained by already-enacted pension reforms may, nevertheless, find themselves at serious

risk through failure to achieve a lasting correction of the present budgetary imbalances, especially if these are coupled with relatively high debt levels. This is the case for most of the countries currently subject to the excessive deficit procedure, including IT and FR and, among the recently-acceded Member States, HU and PL. In general, the need to consolidate quickly is recognised in these cases, although there is a notable lack of clarity in the measures envisaged in the case of Hungary, while Italy, as already noted, does not directly address macroeconomic policy issues, including fiscal consolidation, in its Programme.

Quality of public finances

Concerning policies for improving the quality of public finances, Programmes typically refer to national strategies for strengthening infrastructure, human capital and R&D investment. In addition, some Programmes single out across-the-board improvements in public sector productivity, inter alia, through administrative reform, as an objective on its own. The quality of public finances seems more likely to be recognised as a challenge in its own right by countries experiencing better-than-average growth performance (for example, IE, FI, UK and, among the recently-acceded Member States, EE).

6. PROMOTING COHERENT MACROECONOMIC, STRUCTURAL AND EMPLOYMENT POLICIES

In addition to Member States putting in place macroeconomic policies that can provide conditions conducive to job creation and growth, alongside structural reforms more directly aimed at raising productivity and employment, it is important for the overall reform strategy to be coherent, with reforms in one area supporting those in another. For example, labour market reforms such as those which increase incentives to work through changes in the tax and benefit system can increase the adaptability of the EU economy, particularly in the light of increasing globalisation, and thus allow a more supportive role for macroeconomic policies. Similarly, without policies to safeguard macroeconomic stability, the lower cost and price pressures from structural reforms will not translate into permanently lower prices. The National Reform Programmes also provide the opportunity for Member States to consider the most advantageous way of sequencing reforms. Liberalising product markets early on in the reform process, for example, may help to spur labour market reform, given that in a more competitive product market there will be less excess profit to distribute between employers and workers, thus increasing the incentives for labour market reform.

Coherence of the National Reform Programmes

The majority of Member States have put forward National Reform Programmes which show broad coherence between macroeconomic, microeconomic and employment policies. Only a small minority of Programmes appear to be the result of a departmental rather than a strategic approach (HU and, to a lesser extent, IT). Most National Reform Programmes also avoid having a large number of macroeconomic priorities, allowing the focus to be on key structural challenges (PT, SI and FI being notable exceptions). In some cases (notably EE and, to a lesser extent, ES and LV), the Programmes make cross-references between the different policy areas and

elaborate upon the synergies resulting from such policy links. However, for the majority of Member States, this is an area in which National Reform Programmes could be further developed. Future National Reform Programmes could also provide more indication of how consideration has been given to the appropriate sequencing of reforms.

Budgetary implications of reform measures proposed

A number of Member States have presented reform measures which will, at least in the short term, increase public expenditure. The budgetary implications of such measures need to be considered in the light of their impact on macroeconomic policy. While some National Reform Programmes provide information on the budgetary implications of reform proposals (e.g. CY, MT, LV), this information is missing from most Programmes. Moreover, it is not always clear how high public investment can be reconciled with budgetary consolidation (e.g. in the case of BE).

Similarly, information on the intended use and expected growth and employment impact of structural and cohesion funds is often missing. While a small number of countries (LV, NL and FI) are relatively explicit regarding their planned use of structural funds, the majority of countries (particularly EE, ES, IE, IT, LT, PT, SI, SK and UK) provide less detail.

Part II

Microeconomic part

1. SUMMARY AND CONCLUSIONS

This part of the Annex assesses the microeconomic policy reforms reported by Member States in their National Reform Programmes (NRPs) and links them to the action at Community level.

The main themes of the microeconomic part of the revised Lisbon strategy – knowledge and innovation, and making Europe a more attractive place to invest and work in – are clearly reflected in the NRPs. Microeconomic reforms take the largest share in the reform efforts in the Member States; most of the key challenges identified in the Member States' programmes fall into the microeconomic area. For example, all Member States address research and innovation policies as one of their key priorities. Most Member States also identify the business environment, entrepreneurship, sustainable development and selected competition issues among the key challenges to be tackled.

While the choice of priorities is in general appropriate to the current situation in the Member States, competition issues will require further attention. Often the beneficial effect of competition for European citizens is not sufficiently anchored in the NRPs. In particular, ensuring competition in services – especially professional and financial services – and in network industries is often not addressed to the extent that the situation on those markets would require. Liberalisation of the energy markets is advancing but will take a long time to complete, especially for gas. Postal and railway services are often not considered priorities.

In the field of research and innovation, the main challenge for the Member States is to put in place the right framework conditions, instruments and incentives. While the commitments taken on by Member States imply significant progress towards the R&D target, it remains unlikely that the 3% objective for total R&D spending will be reached by 2010. Further action by Member States will be needed, such as defining national R&D targets to bring the Union closer to the 3% objective and building better coordinated innovation strategies aiming at entrepreneurial innovation.

The goal of promoting a stronger entrepreneurial culture and creating a supportive environment for SMEs is being pursued by increased R&D investment, intensified competition and better regulation. A proactive strategy to foster entrepreneurial mindsets through education is still missing in most countries.

While the large potential benefits for consumers and entrepreneurs from extending and deepening the Internal Market are recognised, particularly in the areas of services and network industries and in Member States with weak transposition and implementation records at present, few Member States have put forward specific action to reduce the transposition backlog or to improve enforcement. Substantial positive potential could also be unlocked in the area of public procurement.

Expansion and improvement of European infrastructure should contribute to improving the business environment and enhancing competition. Most NRPs focus on transport and ICT (e.g. broadband availability) infrastructure; cross-border links are addressed less frequently. Many Member States are taking measures to use ICT to modernise public services.

Most Member States seek to exploit the synergies between economic growth and environmental protection; measures to support environmental technologies as well as energy efficiency and renewable energy or the introduction of environmental tax reform, for instance, can yield both economic and environmental benefits.

The integrated microeconomic guidelines constitute an interdependent set of goals to strengthen the European knowledge economy. The gains from progress on one objective depend on progress on the others. For instance, the gains from increased investment in R&D will be higher when new technologies are swiftly adopted by the market, which in turn depends on the competitive situation on the markets. During the implementation phase, attention needs to be paid to the synergies between extending and deepening the Internal Market, greater competition, enhancing infrastructure, and the business environment.

The governance reforms introduced in the revised Lisbon strategy included a streamlining of existing reporting requirements. The March 2005 European Council concluded that the reports on the follow-up to the Lisbon strategy sent to the Commission by Member States each year, including the application of the open method of coordination, would be combined in a single document. Subsequently, the Commission invited the Member States to cover in their NRPs the measures taken to implement four processes: the European Charter for Small Enterprises; the Environmental Technologies Action Plan; eEurope/i2010; and the 3% investment in R&D Action Plan. Such reporting would replace separate reports on each of the four processes. Four Member States (CZ, EE, FI, MT) have presented such information in a separate annex to the NRP, while others often provide relevant information in the main text of the programme. The degree of detail in reporting varies across the NRPs.

The following sections give more detail on the reform measures, following the structure of the microeconomic guidelines. While the emphasis is on overall trends, individual measures are frequently singled out as interesting examples.

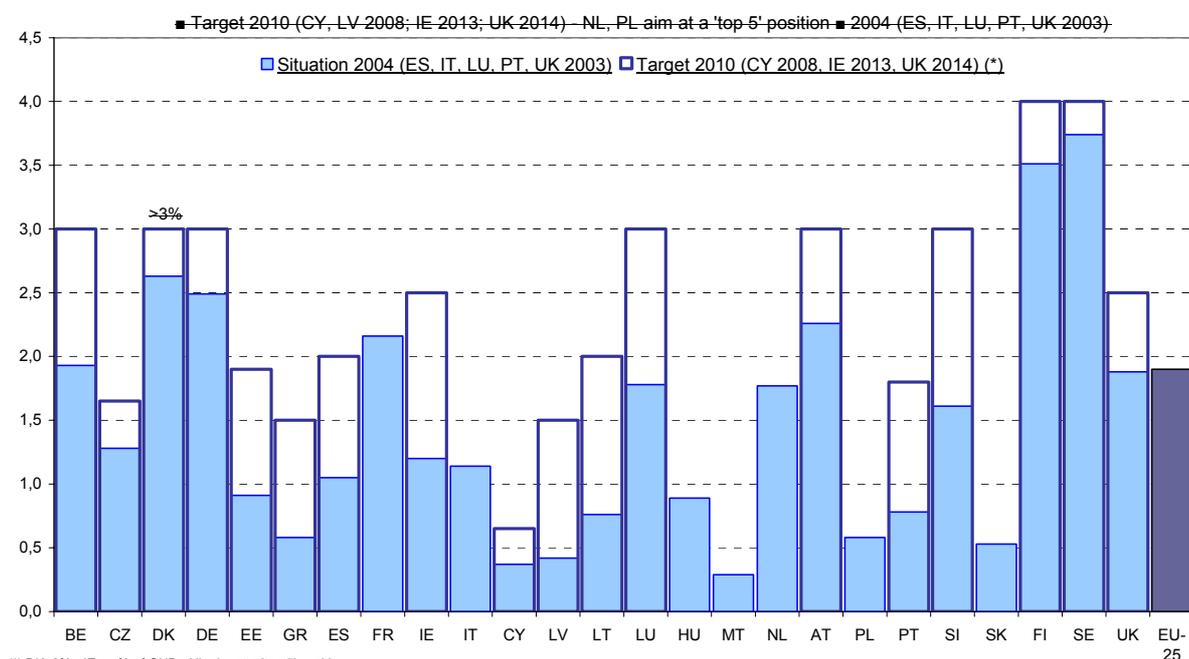
2. KNOWLEDGE AND INNOVATION — ENGINES OF SUSTAINABLE GROWTH

2.1. Research

Relatively low levels of private R&D investment in the EU are an impediment to knowledge accumulation and long-run growth. In 2004 the EU spent 1.9% of its GDP on R&D, of which 55% was financed by business. Twelve Member States reported explicit R&D spending targets for 2010 in their NRPs, and six Member States provided sub-targets or targets for a different year. Seven Member States provided no target at all. Assuming that all the R&D expenditure targets which 18 Member States provided in their NRPs were met, R&D expenditure in these 18 Member States would increase significantly to an approximate average of 2.6% of

GDP in 2010³. Despite the expected increase, the EU-25 would however remain substantially below the 3% target in 2010.

Graph 3: Gross domestic expenditure on R&D (GERD) as % of GDP*



(*) DK > 3% - IE as % of GNP - NL aim at a 'top 5' position
 Source: Eurostat, Structural Indicators, Innovation & Research - OECD

** The Irish target is 2.5% of GNP (not GDP)

Increasing the leverage effect of public R&D investment on private R&D investment is key to increase private R&D investment. Several Member States (ES, LV, AT, FI) have taken specific action to increase public expenditure on R&D. In order to make public R&D expenditure more effective, a number of Member States (SK, ES, FR) plan to introduce systems for monitoring and evaluating public R&D. About half of the Member States already use fiscal measures to leverage private R&D and several others are considering such measures. Spain is planning to introduce a scheme that would reduce wage taxes for firms which invest in R&D, similar to the scheme in the Netherlands. Hungary has decided to simplify its tax allowance scheme for R&D. In France the “Crédit d’Impôt de Recherche” tax break is set to triple in volume by 2010.

Developing and strengthening centres of excellence in educational and research institutions, promoting public-private partnerships and improving cooperation and transfer of knowledge between public research institutes and private enterprises are keys to competitiveness in all Member States. Several Member States plan to reform or improve the mechanisms for transferring knowledge. Germany intends to introduce a “grace period” to allow researchers to publish their research results without losing the possibility to patent them. Spain will include knowledge transfer

³ The R&D intensity for 2010 was calculated on the basis of the estimated GDP weightings for 2007 for Member States having presented targets for 2010. Targets were not available for FR, IT, HU, MT, NL, PL and SK.

aspects in the career appraisal and incentive structures for public research staff and will transform large public research organisations into public agencies to increase their autonomy.

Most Member States see a need to ensure a sufficient supply of qualified researchers. In Spain the Torres Quevedo programme aims at quadrupling the number of PhD holders taken on by enterprises, by co-financing contracts. In Denmark the industrial PhD programme has proved to be successful in placing researchers in enterprises and will be stepped up. Estonia aims to increase R&D staff in enterprises by more than 50% between 2003 and 2008.

In conclusion, Member States have generally presented a well-founded analysis of the strengths and weaknesses of their R&D systems and put forward a variety of measures to address them. Overall the NRPs reflect a greater awareness of the need to have a coherent policy mix to support R&D. However, a stronger commitment from those Member States that have set no R&D spending target for 2010 combined with a determined emphasis on implementation and mutual learning by all Member States would lead to a quantum leap in R&D. The Commission believes that there is a real opportunity for a break-through in this area.

2.2. Innovation

A far-reaching reform of Europe's innovation system is needed. The innovation gap between the European Union and its main competitors, the United States and Japan, persists, mainly in the number of patent applications, the share of the population with tertiary education and ICT investment⁴. Big differences remain between the new Member States and leading countries with world-class innovation systems such as Sweden, Finland or Germany.

A majority of Member States have identified innovation as a key priority in their NRPs. Most Member States address the strategic importance of innovation poles, networks and incubators bringing together universities, research institutions and enterprises at regional and local level in order to bridge the technology gap between regions. Action is mainly focusing on high-tech sectors, while other sectors which might also hold considerable innovation potential often seem neglected.

France has identified 67 promising "Pôles de compétitivité" which will receive strong public support. A recent law in Greece established "regional innovation poles", with the aim of promoting regional development by creating centres of technological skill and excellence in peripheral areas. Italy is aiming at further developing, consolidating and linking the 24 existing technological districts. Ireland is working on developing applied research centres in universities and has established new incubation and innovation centres.

Measures to encourage cross-border knowledge transfer are included in a small number of NRPs. For example, in Sweden the "Visanu" initiative is aiming at increasing international awareness of the competitiveness of regions and attracting foreign investors. Very few Member States present plans to use public procurement

⁴ The 2005 European Innovation Scoreboard is available at <http://www.trendchart.org/scoreboards/scoreboard2005/index.cfm>

to promote innovation; Portugal, for instance, plans to allocate 20% of large public contracts to R&D and innovation projects.

Several Member States are seeking to improve access to finance by reforming the rules on venture capital and foreign direct investment or by establishing funds to this effect. Member States are generally focusing on start-up companies, while paying less attention to financing conditions for more mature innovative enterprises. For example, Spain has established a risk-capital fund for seed and start-up capital and has expanded the participative loans scheme for innovative and high-tech companies. Sweden's "Innovation bridge" initiative establishes a regional structure providing seed capital at seven university locations for commercialising research results. In Hungary a reform of the law should increase the availability of venture capital, while Lithuania is planning to set up an Innovation Foundation aimed at specifying measures to promote private capital investment.

Italy is addressing shortcomings in the area of intellectual property rights (IPR) through a set of measures aimed at improving companies' patenting capabilities and protection, e.g. reduction of patenting costs. In Germany the patent exploitation agencies will be further developed and expanded. In Belgium the federal government, the European Patent Office, the Patlib-centres, research centres and universities are collaborating in an initiative to support SMEs in using the IPR system. Latvia has developed a public support programme to protect and enforce IPR and raise awareness, in the business community, of their importance.

In conclusion, Member States have generally presented a coherent analysis of the strengths and weaknesses of their innovation system. Many of the measures proposed in the NRPs would, however, need to be strengthened in order to make a substantial contribution to bolstering national innovation systems. Several Member States would in particular benefit from a better coordinated national innovation strategy that builds on identified strengths and improves entrepreneurial innovation.

2.3. Information society

Production and use of ICT have a significant impact on productivity growth of modern economies. However, the share of the ICT industry in the economy as a whole is smaller in the EU than, for example, in the United States. Europe is also lagging behind several of its competitors in terms of investment in ICT and in ICT R&D.

ICT issues are declared as challenges in many NRPs (most prominently by CY, EE, ES, FI, PT). The main tools proposed to achieve the goals of the NRP are legislation and public funding. Other instruments, such as creation of new institutional frameworks, cooperation networks between ICT players or promotion of standardisation efforts, are also considered. NRPs most commonly address the issues of e-government, broadband and e-skills/e-literacy. Uptake by firms and households, implementation of the electronic communications regulatory framework and network security are addressed in around half of the NRPs. Most do not address promotion of the ICT industry, except as far as the regulatory framework is concerned.

Many NRPs present e-government as a way to cut red tape, reorganise the public administration and improve its efficiency (CZ, DK, LT, LV, PL, SI, ES, IE, EE, PT,

FR, SK, MT). A number of countries have made facilitation of companies' access to government services a priority (NL, FI, FR, CY, EE, LV). Other measures put forward include: communication with society; e-procurement; e-signature; e-health; and the introduction of innovative electronic means of identification.

Finland is one of the leading countries in terms of availability of online public services. Nonetheless, a major reorganisation of the public administration's information management system is envisaged. The use of government online services will be stimulated through investment in identification methods. Meanwhile, electronic ID cards and PIN codes issued by banks may be used to access public services. Requirements for e-administration are taken into account in the Act on Electronic Signature and the Act on Electronic Services. Promotion of electronic public procurement facilitates electronic exchanges of information with businesses. In health care, progress is being made with the introduction of electronic patient records.

Issues of broadband coverage and take up have been addressed by all NRPs. Competition is considered the primary driver of broadband developments. However, in the less developed areas of the Union, public support is used to accelerate deployment. Significant broadband programmes have been put forward in several NRPs (AT, IE, EE, FI, FR, HU, IT, LU, LT, PT, SI, ES). France for example is aiming at making broadband available to 80% of households in every municipality by 2007. Small municipalities will be equipped with at least two public internet access points. The main industrial areas will benefit from affordable high-speed offers (around 100 MBps). The objectives will be achieved through upgrades of the existing infrastructure by commercial operators, while local authorities may stimulate broadband roll-out in under-served areas from national and structural funds. Deployment will be further stimulated by support to emerging broadband technologies.

e-literacy and e-skills programmes are proposed in many NRPs to improve human capital (AT, BE, CY CZ, IT, LT, LU, SK, IE, EL, EE, ES, UK, FR, PT, PL). The topical issues in this area include the introduction of ICT knowledge into school curricula, provision of on-line libraries and on-line knowledge resources, and addressing the digital divide, in particular between better and less educated and between urban and rural residents.

In conclusion, all NRPs are addressing ICT, and in some of them ICTs play a prominent role. The main areas for action are e-government, broadband and digital literacy. Many NRPs refer to the EU i2010 framework, therefore recognising common objectives.

2.4. Industry

European industrial performance varies from high growth sectors such as ICT and automobiles to negative growth sectors such as textiles, clothing and footwear⁵. Competitiveness is hampered by Europe's relatively low specialisation in high

⁵ Implementing the Community Lisbon Programme: A policy framework to strengthen EU manufacturing - towards a more integrated approach for industrial policy, SEC(2005) 1215 of 5.10.2005.

technology sectors. The share of high-tech industries in manufacturing value-added in EU-25 in 2002 was 16.0%, whereas it stood at 23.3% in the US⁶. In the context of mounting competition from countries such as China, there is a need to look carefully at sectoral competitiveness.

A large number of Member States (FR, IE, LT, LV, MT, NL, PT, SL, SK, SE) propose to monitor the competitiveness of sectors and to promote high value-added sectors. Technology policy measures include the promotion of technological upgrading in SMEs (AT, CY), support to European industrial research projects (FI, NL) or promotion of private-public partnerships. Most NRPs stress the need to support clusters (in particular BE, FR, FI, LT).

To reap the benefits of internationalisation, many Member States propose measures to support exports (AT, BE, EE, EL, ES, FR, LT, PT, SL, SK) or to attract foreign direct investment (FDI) (BE, CY, ES, HU, IE, LT, LV, MA, PT, SL). Cyprus plans to set up an agency to promote the country as an industrial base and to attract FDI. Spain and Portugal presented programmes to support the internationalisation of businesses.

Many Member States display regional specialisation in sectors at risk of being hit by international competition. This is the case, for example, with the southern European countries with their strong specialisation in fashion industries (textile, clothing, footwear, leather, furniture). Six Member States (CY, EL, HU, IE, LT and PT) explicitly mention the need to foster structural changes. The Portuguese NRP proposes a programme to accelerate the industrial transition and restructuring processes. New Member States are generally aiming at reorienting their economies towards high value-added activities.

In conclusion, many NRPs address ways to strengthen the industrial base. The approaches range from horizontal policies to sectoral measures. Many NRPs propose measures to foster the internationalisation of business, but measures to facilitate structural change are seldom discussed.

One promising development in many Member States is the formation of clusters and innovation poles aimed at furthering innovation, strengthening the industrial fabric and facilitating the setting-up and subsequent growth of SMEs. Cluster development therefore brings together several important strands of the microeconomic guidelines. Public support for such clusters is justified since they typically generate significantly wider benefits for society, through technology spill-overs, the opening of new markets, and the possibility to upgrade the value chain and to improve the way the market works. However, the approach taken varies considerably across Member States and thereby hampers the potential exploitation of synergies that are so crucial for clusters. This makes the case for a cluster policy at the European level, aiming at complementing and supporting national and regional clusters policies and the development of trans-national cooperation.

⁶ Report on European Technology Platforms and Joint Technology Initiatives: Fostering public-private R&D partnerships to boost Europe's industrial competitiveness, SEC(2005) 800 of 10.6.2005.

2.5. Sustainable use of resources

The EU economy consumes a relatively high level of resources: its material intensity is slightly better than that of the US, but twice as high as Japan's. The integrated guidelines invite Member States to encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth. Growth should be decoupled from environmental degradation and as far as possible environment policy should be designed in a way that supports growth and job creation.

Environmental sustainability is addressed in all NRPs and many Member States have chosen to include environmental sustainability issues among their key priorities or key challenges.

All of the NRPs address the promotion of renewable energy sources. Wind energy seems to have the greatest support, but several Member States are also increasing the promotion of biofuels (AT, CY, DE, ES, IE, LV, LT, MT, SE). Measures to promote energy saving and energy efficiency in buildings are included in several programmes, with varying levels of detail.

The vast majority of the Member States (AT, BE, CY, CZ, DE, DK, ES, FI, FR, GR, IE, IT, LV, LT, LU, MT, NL, PT, SK, SI, SE, UK) refer to climate change or the Kyoto protocol and have either already started implementing climate change programmes or plan to do so. Measures that are being considered to contribute to combating climate change include: promotion of climate-friendly technologies (e.g. AT), environmental taxes on cars (e.g. SE, CY, FR) use of biofuels and capture of methane from waste disposal and treatment (e.g. MT, LV).

The majority of Member States have highlighted the importance of strengthening the synergies between environmental protection and growth, as environmental investments can generate jobs, reduce resource dependence and also increase competitiveness, provided they are cost-effective. Most Member States (AT, CY, CZ, DE, DK, EE, FI, GR, LU, NL, PT, SK, SI, ES, SE, UK) report that they have taken or will take steps towards internalising external environmental costs via economic instruments – notably in the area of transport and energy taxation. Some plan to achieve the Lisbon goals by shifting the tax burden away from labour towards resource use and pollution (e.g. EE, SI, CZ).

Environmental technologies play an important role in e.g. Austria, where support will be given to improve the market conditions for environmental technologies via green public procurement and an export initiative geared to SMEs in particular. In the Czech Republic environmental technologies are supported through environment-friendly public contracts. Malta will develop green criteria for inclusion in public purchasing procedures. Cyprus proposes greening the public procurement process by making energy performance one of the selection criteria.

Two thirds of the Member States (BE, CY, DK, EE, FR, GR, IE, LV, LT, LU, MT, NL, PT, SK, SI, SE, UK) refer to biodiversity or nature protection in their NRPs. Some of them consider biodiversity a particularly crucial resource due to the important economic contribution from nature tourism, notably in Cyprus, Malta, Slovenia and the three Baltic countries.

In conclusion, the issues of resource pressures and global problems like climate change and biodiversity loss are recognised by most Member States which attach high importance to protecting the environment in their NRPs. Most Member States want to foster growth and at the same time preserve a high-quality environment. This is leading them to try to harness the synergies between the economy and the environment, notably through measures to stimulate the development and uptake of eco-innovations (e.g. research and the Environmental Technologies Action Plan) and by advancing the use of economic instruments.

3. MAKING EUROPE A MORE ATTRACTIVE PLACE TO INVEST AND WORK

3.1. Internal Market

Internal Market policy is by nature a Community responsibility. Correct transposition, implementation and enforcement of Community law in all related policy areas is, however, the responsibility of individual Member States. In 2005 the transposition record of Member States improved considerably. The average transposition backlog stood at 1.9 percent in 2005 compared to 7.1 percent in 2004. This significant improvement is due in good part to the accession of the ten new Member States. Further progress has been made since the re-launch of the Lisbon strategy.

Many NRPs recognise the importance of a competitive marketplace and while many Member States concede that their national goods, services and energy markets are not yet fully competitive, only a few have identified extending and deepening the Internal Market as a key challenge at national level.

Although many NRPs mention the importance of transposition of Internal Market legislation, they only rarely suggest concrete operational improvements. Improving the transposition record is particularly important for those Member States which are lagging behind. The Latvian and Irish NRPs are good examples of how to speed up the transposition of Internal Market Directives. The Latvian NRP combines a political commitment to improving implementation of EU law with firm targets and a timetable for transposition of the Internal Market Directives. The Irish NRP provides detailed information on how the internal mechanisms and procedures for monitoring the transposition of Directives have been reviewed and strengthened.

Most Member States recognise the importance of the completion of the Internal Market in services. Measures such as the simplification of the regulatory environment and the increased use of information technology also contribute to this aim. To further integrate the financial services markets, the implementation and enforcement of the related Directives are addressed as key issues in the Financial Services Policy paper for 2005-2010.

Liberalisation of the railways has been driven largely by European initiatives and developments differ widely across Member States. Not all the Member States have transposed the railway *acquis* that aims at opening and technically de-fragmenting rail markets. NRPs rarely refer to opening the rail market even though a common European rail market, especially in freight, would contribute to a smoother flow of goods in intra-Community and international trade. It will also be important to press

ahead with reforms in the postal sector, in preparation for the further opening of the market targeted for 2009 in the Directive; a small number of NRPs address the liberalisation of this sector.

Few NRPs take up the issue of public procurement rules. Any action envisaged in that area tends to be limited and can be regarded only as first steps. The deadline for implementation of the legislative package on public procurement is 31 January 2006. In conclusion, considerable progress has been made in 2005 and since the relaunch of the Lisbon strategy both on the transposition record of Member States and on several legislative proposals. However, the potential benefits consumers and entrepreneurs could reap from additional improvements in operation of the market remain very large, particularly in the areas of services and network industries and in those Member States with a weak transposition and/or implementation record. Many NRPs recognise this positive potential and concede that markets are not yet fully competitive.

3.2. Competitive markets

The open global economy offers opportunities for stimulating growth and competitiveness in the EU economies. Competition policy is crucial in ensuring a level playing field for firms in the EU and can be instrumental in creating the conditions for firms to compete effectively. A regulatory framework that facilitates market entry is an effective tool for enhancing competition and can bring dynamic efficiency gains by improving incentives for innovation. Implementation of the measures already agreed to open up network industries to competition should help ensure lower prices and greater choice. Increased competition in the services sector in general would also have the same effect.

A majority of the Member States have acknowledged the need to do more in the area of competition and, to varying degrees, proposed measures to address these issues. Around half the NRPs envisage strengthening the powers of national competition authorities and several NRPs provide for selective screening of markets and regulation by competition and regulatory authorities. For example, Estonia proposes implementation of a pro-active competition policy through sector analysis and raising awareness of competition law.

Implementation of the Community legislation on liberalisation of network industries varies significantly across Member States. Though most NRPs note the importance of opening the electricity and gas markets, often presenting the on-going national measures, progress is still generally relatively slow, especially for gas. Among the NRPs from the Member States, Slovakia plans to identify barriers preventing the opening of the power supply market and measures to remove them. Detailed measures to improve competition in financial services will also be identified.

At Community level, the first market enquiry launched under the Community's Lisbon programme confirmed a number of serious malfunctions in the Internal Market for electricity and gas. The initial findings confirm long-standing concerns about competition on electricity and gas markets: market concentration, vertical foreclosure, lack of market integration, lack of transparency and price issues. An inquiry concerning financial services is also under way.

A competitive telecommunication sector is a major factor in enhancing competitiveness and fostering adoption of ICT. Nevertheless, competition on and liberalisation of the telecommunications markets are not covered well by many of the NRPs.

Most NRPs make no mention of reform and promotion of competition in professional services, although in many Member States these are highly regulated, including price regulation, bans on advertising or restrictions on business structure and inter-professional cooperation. The UK will implement recommendations to promote competition made in a review of the regulatory framework for legal services.

Member States have largely re-oriented or intend to re-orient their State aid measures towards horizontal objectives (particularly aid for R&D, innovation, SMEs, environmental purposes and energy saving) and some Member States have reduced sectoral aid. Some Member States intend to focus State aid on areas where market failures exist and intend to conduct ex ante and ex post evaluations and monitoring. Nonetheless, the trend in the total amount of aid granted over the past five years has been static⁷. Though a large majority of Member States still envisage measures favouring horizontal objectives, most NRPs included no concrete proposals aimed at reducing the overall volume of State aid.

Cyprus proposes an interim evaluation of all existing State aid schemes by the implementing authorities and an ex ante evaluation for all proposed State aid measures to identify whether there is a market failure in the area to be supported. Finland envisages a review and assessment of government subsidy policy as a whole aiming at reducing the overall volume of subsidies and at ensuring that aid does not distort competition.

In conclusion, while several Member States include competition as a challenge to be addressed, more urgent and concrete action is needed, in particular to remove barriers hindering competition and to open up services and network industries to competition.

3.3. Business environment and better regulation

Better regulation plays an important role in achieving the Lisbon objectives and creating a more competitive business environment, as it leads to better quality legislation, creates greater incentives for business, cuts unnecessary costs and removes obstacles to adaptability and innovation. However, action at EU level alone is not sufficient, as a large proportion of the administrative costs arise because of the way in which EU law is implemented by the Member States and national legislation is drafted. Better regulation does not disrupt the decision-making process in Member States but changes the culture and conditions under which decisions are made.

All countries acknowledge the role of better regulation in improving the business environment and reducing the administrative costs borne by businesses. The majority of Member States consider the business environment to be a key priority.

⁷ State Aid Scoreboard, COM(2005) 624 of 9.12.2005.

Eight Member States (DK, DE, EL, HU, IE, NL, SE, UK) have provided information on a systematic approach to better regulation but only two others (FI, LT) have indicated any such plans for the future. Most of the Member States with a strategy for better regulation have an institutional body to implement it..

Six Member States (AT, DK, IE, NL, PL, UK) already require impact assessments and another five Member States (BE, CZ, EE, DE, SI) presented plans to introduce obligatory impact assessments. Only four Member States (AT, DK, FI, SK) explicitly acknowledge a need for a fully integrated assessment of the economic, social and environmental impacts. Little information was provided on the institutional arrangements for operating an impact assessment system.

Twelve Member States (AT, BE, CY, DK, FR, DE, LT, LU, NL, PT, SI, UK) have created, or expressed an intent to create, institutional structures to manage or to support analysis of the administrative costs, while ten (CZ, EE, DK, FR, IT, DE, HU, PL, NL, UK) intend to base their system on the standard cost model and one (LU) is considering the EU standard cost model. Five countries (CZ, DK, NL, SE, UK) specified quantitative targets for reducing administrative costs (e.g. 20 or 25% by 2010). The legislation indicated as primary targets for this exercise already exists but the focus has shifted towards legislation in preparation. Some of the efforts identified to support this exercise relate to e-government, one-stop shops and central registration offices, all of which should simplify registration and administrative procedures for businesses.

Eight Member States (AT, EE, DE, IT, PL, SI, ES, UK) are planning to launch simplification programmes, in addition to the four Member States (DK, IE, LU, SE) which have already done so. They are targeting on legislation on tax, reporting, fiscal measures, setting up business, insolvency, labour and consumer protection.

Only the United Kingdom currently imposes obligatory consultation of stakeholders but four Member States (DK, DE, IE, IT) are planning new moves in this area.

In parallel to these efforts at Member State level, significant progress in the area of better regulation was also made at Community level during 2005: the guidelines for impact assessments⁸ were revised, a common methodology for assessing administrative costs⁹ was agreed, pending legislation was screened¹⁰ and a strategy for simplification of the regulatory environment¹¹ was launched.

In conclusion, given the varying degrees to which better regulation is already implemented in the Member States, the Commission identifies three stages of progress. The first one is characterised by developing better regulation awareness, strategy and tools. At this stage it is essential to raise better regulation awareness, put

⁸ Impact Assessment Guidelines, SEC(2005) 791 of 15.6.2005.

⁹ Communication from the Commission on an EU common methodology for assessing administrative costs imposed by legislation, COM(2005) 518 of 21.10.2005.

¹⁰ Communication from the Commission to the Council and the European Parliament – Outcome of the screening of legislative proposals pending before the Legislator, COM(2005) 462 of 27.9.2005.

¹¹ Communication of the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Implementing the Community Lisbon programme: a strategy for the simplification of the regulatory environment, COM(2005) 535 of 25.10.2005.

in place tools for stakeholder consultation, and to develop an integrated better regulation strategy and institutional structure.

The second stage includes those Member States which are advanced in using some better regulation tools, however with scattered and an insufficiently coordinated approach. Key challenges are the implementation of the announced strategy and focus on all integral better regulation tools: integrated assessment of economic (incl. administrative costs), social and environmental impacts, consultation and simplification.

The most advanced stage has full better regulation awareness and an integrated better regulation system, so for those countries the challenge is to stay focused. This will require monitoring progress, evaluating the results of existing programmes together with stakeholders, exchanging best practices with other Member States as well as launching new initiatives when and where this might be appropriate.

3.4. Entrepreneurship and SMEs

Small and medium-sized enterprises are a key source of growth and jobs, a breeding ground for business ideas and a powerful driver for entrepreneurship and innovation. Yet the EU is not fully harnessing its entrepreneurial potential and not enough people want to become entrepreneurs. More than half of the Member States have recognised SME and entrepreneurship policies as a priority in their NRPs.

Entrepreneurial mindsets can be fostered through education. Several Member States have already included (AT, ES, FI, IE, PL, UK), or plan to include (EE, MT, PT, SK), entrepreneurship as an objective of secondary school curricula. Other Member States are planning to adopt supportive measures in this field (LT, SE). For example, as of September 2005 the United Kingdom is providing five days of enterprise teaching to all pupils aged 14 to 16. Estonia is planning to introduce business studies into the general and secondary vocational education curricula and to develop complementary entrepreneurship training. Lithuania will organise campaigns to promote entrepreneurship and publicise examples of successful businesses in order to promote the image of entrepreneurship among the general public.

Little is said in the NRPs about measures to address the stigma of failure. One interesting example, however, is Spain where the new national curricula will teach students at all levels not only about the business environment, but also about the value of entrepreneurship and business failure.

Several Member States are gearing their efforts to providing funds to innovative companies (CZ, IE, LU, MT, NL, SE). One good example of this form of activity is the new KAPITAL programme in the Czech Republic which includes both private and State funds. Such private-public partnerships can efficiently stimulate further private-sector interests to invest. The introduction of venture capital instruments is the most common financial measure, with one third of the Member States planning to launch initiatives (DK, EE, GR, IE, LT, LV, LU, SI, SE). A number of countries are also setting up loan guarantees (CY, GR, LT, LV, MT).

Several Member States are simplifying their tax systems or reducing their corporate tax rate (ES, FI, FR, GR, HU, SI, UK). Some are also introducing tax relief for SMEs

(DK, MT, UK). For example, Denmark plans to introduce tax relief for growth entrepreneurs. It would start when the entrepreneur generates profits for the first time and be granted for three years.

A number of Member States are improving their business support services (AT, FI, IE, IT, LT, MT, SK). For example, Italy has introduced the “manual of e-government” and guidelines for on-line public services. SMEs, especially the smallest ones, will benefit from this reform. The improvements include a big reduction in the number of paper certificates, increased use of e-mails since they will have legal force, standardisation and increased availability of databases and electronic archives, and improvement of the services offered by one-stop shops. The situation with regard to improving business support for SMEs varies, with some countries taking measures actively and others not addressing the issue at all.

Some Member States plan to take measures to facilitate business start-ups (BE, CZ, ES, GR). By contrast, few measures are in the pipeline to help the transfer of businesses (SE). Approximately one third of the NRPs include plans to reform the national insolvency legislation (CY, EL, HU, IT, LT, LU, LV, PL, SI, SK). For instance Luxembourg and the Netherlands are in the process of analysing how substantially to improve their bankruptcy laws. Several Member States have recently reviewed their bankruptcy legislation, amongst other things to promote the continuity rather than liquidation of viable enterprises and to speed up proceedings.

In conclusion, all the NRPs address entrepreneurship and SMEs, although the emphasis of the measures varies significantly between countries. Issues that, in general, have received little attention in most NRPs include women entrepreneurship, transfer of businesses and the stigma of failure.

3.5. European infrastructure

Completion of the trans-European transport network is indispensable for creating a sustainable transport system in Europe. Of particular importance are the trans-border projects, both for transport and energy networks. New physical infrastructure is often a pre-condition for achieving effective competition in network industries. For example, electricity interconnection capacity remains lower than needed for efficient integration of electricity markets.

Infrastructure is addressed in around 20 NRPs. In half of them (CZ, EL, ES, IE, IT, CY, LT, HU, AT) infrastructure building is ranked as a first priority. The reasons given are primarily to improve economic integration – within the Single Market, but also globally – and, in second place, to enhance productivity growth by modernising the physical business environment. Building integrated logistic platforms, improving public transport and the regional and intermodal balance, and tackling congestion are other objectives taken into consideration.

Modernising and upgrading transport infrastructure (roads, railways, airports, seaports and canals) comes first in the NRPs which address the infrastructure guideline. Member States usually specify the projects they consider as a priority, in some cases also giving details of the financial envelopes (DK, LV, LT, NL, AT, UK). The *TEN corridors* are well integrated in national planning and are addressed explicitly in 15 NRPs. Among the priority projects identified at EU level, the

Brenner tunnel, the Paris-Brussels-Cologne-Amsterdam-London high-speed rail link, Rail Baltica, the Fehmarn belt railway and motorways of the sea are mentioned in the NRPs.

Some also pay particular attention to energy infrastructure, especially international link-ups (EL, ES, IE, LV, LT, PO, SE). The Nordic electricity network and its southward links, the Iberian network and the Republic of Ireland-Northern Ireland network are all mentioned by the relevant Member States.

ICT infrastructure is addressed by all NRPs as far as broadband availability is concerned (see section 2.3).

Public-private partnerships (PPPs) in the context of transport infrastructure are addressed by EL, ES, FR, LV, NL, PO and the UK. Depending on specific national conditions, issues considered in this context include privatisation, introduction to the stock market, redesign of PPP contracts or introduction of new legislation governing PPPs.

Finally, some Member States address infrastructure pricing in their NRPs. The Netherlands is exploring shifting taxation from vehicle ownership to road use by introducing bottleneck and kilometre levies, Portugal, Belgium, Cyprus, Sweden, and France plan to internalise environmental and infrastructure costs in vehicle taxation and Sweden will experiment with a congestion charge for Stockholm. Infrastructure pricing is also mentioned in the Hungarian and Irish NRPs as an issue for future consideration.

In conclusion, transport infrastructure modernisation, upgrading and cross-border connections for transport and energy feature prominently in many NRPs. They are considered key priorities in a significant number of Member States. Priorities linked to the TEN corridors are well embedded in most NRPs. However, not all the agreed priority projects are addressed. The preferred modes vary significantly between countries, from a clear focus on road in many new Member States to a more balanced approach linking different modes of transport. Public-private partnerships for infrastructure development and infrastructure pricing systems that take into account investment and external costs are discussed in a limited number of NRPs.

Part III

Draft Joint Employment Report 2005/2006

More and Better Jobs : Delivering the Priorities of the European Employment Strategy

1. SUMMARY AND CONCLUSIONS

Reform pays off. This is the lesson learnt from the structural changes Member States have pursued since the mid-1990s and their positive impact on a wide range of labour market characteristics. Reform has helped raise the employment content of growth, provide more employment-friendly wage developments, and lower structural rates of unemployment. However, for the EU as a whole, the scope and the depth of reform has lacked ambition and conviction. Structural progress remains insufficient to fuel more economic and employment growth and a more rapid movement towards the EU employment rate targets¹².

The refocused Lisbon strategy concentrates on this deficiency, in the knowledge that the challenges confronting the EU economy and society will magnify. Demographic ageing is altering the composition of the labour force and will reduce labour supply and ultimately employment. Accelerating economic change caused by globalisation will continue to upset existing balances. The EU and the Member States have the capacity to adjust to this changing environment. The Lisbon Strategy provides the EU with the framework for successfully making this adjustment.

The European Employment Strategy (EES), the employment pillar of the Lisbon Strategy, is based around three objectives: full employment, productivity and quality at work, and social and territorial cohesion. As part of the Guidelines for Growth and Jobs, the Employment Guidelines provide the policy framework to focus action. They highlight three priorities: attracting and retaining more people in employment, increasing labour supply and modernising social protection systems; improving the adaptability of workers and enterprises; and increasing investment in human capital through better education and skills. A comprehensive approach requires building upon the interaction of measures under these priorities. Improving the governance of employment policies is also an integral part of the guidelines.

¹² The employment rate targets are outlined in table 2. For a review of the latest employment trends and structural changes in the EU labour markets, see European Commission, *Employment in Europe 2005*.

Although well-designed employment policies are essential to boost employment and productivity growth, they cannot succeed alone. Sound macro-economic policies and efficient reforms to foster entrepreneurship, research and innovation, and the functioning of goods and services markets are critical for recovering from weak economic growth and raising employment and productivity. The integrated nature of the Lisbon strategy provides the basis for a policy mix that corresponds to the specific challenges of each Member State and for setting in motion a wide partnership for reform.

The analysis of the employment aspects of the National Reform Programmes (NRPs) leads to the conclusion that Member States give most prominence to attracting and retaining more people in employment. The determination to increase employment rates is welcome, as is the fact that a majority of Member States now plan measures with the help of national employment rate targets. However, the effectiveness and sustainability of the policies to deliver this goal is impeded by piecemeal actions, targeting a limited number of specific groups. This should be complemented by a lifecycle approach, including gender mainstreaming, with a view to facilitating employment and career transitions.

The theme of more investment in human capital to improve employment and productivity growth receives widespread attention, although efforts to improve the efficiency of investment receive less attention. To reach the breakthrough required to meet the economy's human capital needs, policies need to overcome the fragmented nature of the measures. Implementing lifelong learning, embracing education, training and adult learning, particularly for the low-skilled, demands a coherent policy linked to the economic and social situation of each Member State. The structure and sources of financial investments need to be reviewed, with a special focus on the incentives governing investment in lifelong learning.

The NRPs neglect the importance of further measures to increase the adaptability of workers and enterprises. The current balance between flexibility and security in many Member States has led to increasingly segmented labour markets, with the risk of augmenting the precariousness of jobs, damaging sustainable integration in employment and limiting human capital accumulation. This neglects the interaction with policies to raise productivity and ensure labour market inclusiveness. Greater attention should therefore be given to establishing efficient conditions of 'flexicurity'. Sufficiently flexible work contracts, coupled with effective active labour market policies to support labour market transitions, a reliable and responsive lifelong learning system, and modern social security systems combining the provision of adequate income support with the need to facilitate labour market mobility are necessary ingredients. More attention should be given to the active involvement of the social partners, who have a significant responsibility in this domain.

The NRPs provide evidence that Member States are committed to reform, notably since they have singled out key challenges and priorities. Whereas the overall direction is appropriate, there is reason for concern that the gap between ambition and realisation cannot be bridged with the actions announced. For instance, whereas there is evidence that government ownership of the strategy at national level is well articulated, there is less indication that the agenda is shared widely across society and is firmly built on social partnerships for reform. Combined with the vagueness about national local and regional administrative capacity and budgetary allocations, including the use of the European structural funds, this gives cause for vigilance. The country-specific challenges outlined in the country chapters of the Commission's communication focus on those areas where individual Member States need to step up efforts¹³.

2. ACHIEVING THE OBJECTIVES

Member States' policies should foster full employment, quality and productivity at work and social and territorial cohesion. These objectives, together with good governance, frame the EES. In the NRPs, most attention is devoted to increasing employment. Few Member States pay attention to improved productivity and quality at work, or social and territorial cohesion, and in particular the synergies between these objectives and increasing employment rates.

Full employment

Sluggish economic growth has held back labour market performance over recent years, and explains much of the slow progress towards the Lisbon and Stockholm employment objectives. Employment growth was limited in 2004 at 0.6%, slightly up from the last year's level (0.3%). As a result, the employment rate for the EU increased to 63.3%. Unemployment remained unchanged compared to 2003 (9.0% - provisional figure 2005 8.7%), although long-term unemployment increased to 4.1%. The rise in the employment rate was again driven by women (0.7 of a percentage point) and older people (0.8 of a pp).

¹³ See the country-specific chapters of the communication.

Table 1: Overall employment rates

Pace of progress since 1997 Rates in 2004 (%)	Low	Close to average	High
> 70		DK, SE, UK, NL	
65-70	AT	CY, DE, PT, FI, SI	IE
< 65	CZ, EE, LT, MT, PL, SK	BE, EL, HU, FR, LU, LV	ES, IT

Explanation: Pace of progress is defined as the percentage point change in the employment rate between 1997 and 2004:

- a) Low progress: the employment rate increased below the EU25 average minus half of the (un-weighted) standard deviation
- b) Close to average: the employment rate increased inside a band of one standard deviation centred on the EU25 average
- c) High progress: the employment rate increased above the EU25 average plus half of the (un-weighted) standard deviation

The employment rate of women continued to rise, reaching 55.7% in 2004. The employment gender gap further narrowed to 15.2 percentage points in 2004 (down from 17.6 in 2000). However, the progress has been slower in full-time equivalents (21.7 pp in 2004 compared to 23.3pp in 2001).

Older people have seen employment rates rise markedly since 2000, with an accumulated increase of 4.4 pp to a rate of 41.0%, accounting for the majority of the increase in employment. In contrast, half of the Member States have seen the labour market situation for the young deteriorate. At 18.7%, youth unemployment is about twice the overall rate. This needs to be addressed through policies to ensure that young people receive a good start to their labour market participation, and throughout the lifecycle.

Despite some progress over the years, the overall employment rate remains 7 pp or some 20 million jobs below the 2010 target, and whilst female and older people's employment rates have risen more rapidly, they still remain 4 and 9 pp below their respective 2010 targets. An increasing number of Member States have set out their ambition through employment rate targets. 18 Member States have set national targets on employment rate, 15 for women and 11 for older workers¹⁴.

Quality and productivity at work

Since the mid-1990s, there has been a relative decline in productivity growth compared with the US. Average labour productivity growth (in terms of GDP per person employed) was 1.9% in 2004, an improvement on the previous three

¹⁴ See tables 2 and 3 for a complete list of employment targets set by Member States.

years, but not a significant improvement on the sluggish performance since the mid-90s. This still compares unfavourably with the US (3.3%) and Japan (2.5%). The disparity is less marked looking at productivity growth in terms of GDP per hour worked, with EU growth at 2.5% in 2004, similar to growth in Japan, although the gap with respect to the US has been growing .

Progress in terms of increased quality at work remains mixed¹⁵. Participation in lifelong learning has risen, as have youth education levels. Nevertheless, further progress is essential in other elements of quality at work, especially both the transitions from temporary to permanent jobs and out of low-paid jobs and labour market segmentation. Few Member States pay attention to the synergies between improved quality and productivity at work and to developing increasing employment.

Social and territorial cohesion

After several years of decline, long-term unemployment again increased slightly in 2004 and the job prospects of vulnerable groups have deteriorated. The NRPs place emphasis on the provision of employment opportunities as the best solution for developing inclusive labour markets. Although such an approach is essential, this should be complemented by policies promoting access to quality employment, training, health care and housing, and an income enabling full participation in society.

Regional employment and unemployment disparities remain widespread, with very high rates of unemployment in many regions. Regions with low levels of employment also tend to be the ones with lower productivity levels. Rises in labour productivity in regions with low overall levels of productivity have not yet been followed by substantial increases in employment.

Governance of employment policies

The drafting of the NRPs marks a new departure for employment policies, building on the experience of the EES since its launch in 1997. The NRPs take over previous national action plans for employment, which helped structure and develop national employment policies. In the majority of cases, the priorities outlined by the Member States are in line with the EU country-specific Employment Recommendations adopted in 2004.

The timing and novelty of the process partly constrained the consultation process in 2005. The involvement of national parliaments was very limited. Few played a role in the approval procedure. This should improve with fewer timing constraints. Social partners were consulted to a varying degree by almost all

¹⁵ For details of the 10 dimensions of quality at work see: Improving quality in work: a review of recent progress, COM (2003) 728 of 26.11.2003.

Member States, but the NRPs generally remain government documents. In Member States where tripartite bodies exist, these have not always been closely involved and the preparation of the NRPs did not sufficiently include social partnership commitments. Again, this should improve in the next phases.

Implementation structures are referred to by Member States in their NRPs, but there is much less detail on the precise delivery and monitoring mechanisms that need to be put in place at national, regional and local level.

The guidelines call for reforms to be backed by adequate financial means and effective use of public funds, with transparent information about the expected outputs and timetables of the main measures. There is too little information in the programmes to illustrate whether this is the case. The role of the European Social Fund (ESF) is often highlighted but reporting is uneven.

3. IMPLEMENTING THE PRIORITIES FOR ACTION

In order to achieve EU employment objectives and targets, the Employment Guidelines are built around three priorities for action. The NRPs give prominence to attracting and retaining more people in employment and more and better investment in human capital. They tend to neglect the importance of further measures to increase the adaptability of workers and enterprises. Employment policy often appears fragmented and unbalanced in this area. More attention should be given to establishing conditions of 'flexicurity', by combining sufficiently flexible work contracts with effective policies to support labour market transitions, lifelong learning for all, and adequate social insurance.

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

Promote a lifecycle approach to work

Member States generally do not explicitly develop an integrated lifecycle approach (LV, NL and the UK do). Many pay attention to most of its components but not in a systematic manner. The emphasis is on young jobseekers and on closing down exit routes for older workers. Policies to support female employment and bring about gender equality are somewhat underdeveloped.

Most Member States pay considerable attention to young people, although the approach tends to be piecemeal. A majority include measures for building employment pathways combining work/apprenticeship with education and training. Many aim to increase apprenticeships, but with little emphasis on increasing offers of employment. Greater integration of policies on education, training, mobility, employment and social inclusion, with specific targets and objectives, would lead to effective strategies for young people. Member States

respond to the ambition to offer a new start to every young jobseeker within 6 months by presenting measures to offer individual action plans containing support such as career consultancy, vocational (re)training, job search assistance and apprenticeships.

The European Youth Pact

The Heads of State and Government at the European Council of March 2005 adopted the European Youth Pact as one of the instruments to achieve the Lisbon objectives of growth and jobs. The Youth Pact aims to improve the education, training, mobility, employment and social inclusion of young people, and to facilitate the reconciliation of working life and family life. The response to the Youth Pact in most Member States has been encouraging, although its full potential remains to be realised. A number refer explicitly to it (AT, BE, DE, ES, FI, FR, IE, NL, PT, SI, SE, UK), although not always in depth, and several have integrated measures consistent with the Pact without giving it visibility. As foreseen by the European Council, involvement of youth organisations should be strengthened – only SE has consulted young people in preparing the NRP.

Most Member States recognise the need to raise the employment rates of older workers but measures are often ad hoc. Wide-ranging initiatives aim at reviewing incentives to discourage early retirement, creating more flexible pathways to retirement, and increasing retirement age. The EU objective to raise the effective average exit age by five years by 2010 (now 61.0 compared to 59.9 in 2001), will not be met unless policies are implemented with greater urgency. Only seven Member States set explicit targets in this area. Pension reform continues in many Member States, in an effort to lengthen working lives, but this should be better accompanied by measures to ensure job opportunities for older workers. Measures to fight unemployment of older workers and improve their position within companies are not widespread.

The potential contribution of women to raising employment rates is not strongly emphasised. Measures concentrate on improving the availability and affordability of care for children and other dependants. Seven Member States set targets for extra care places. However, the Barcelona childcare targets are far from being reached. Reconciliation of work and private life are often considered to be a women's issue, and the need to strengthen the role of men in care and parental leave is not stressed. Commitments to closing employment and unemployment gender gaps are rare. The issue of gender pay gaps is discussed more widely, but only a few propose concrete actions (DK, FR, NL, and SE). Others are in the stage of drafting possible steps or general commitments to reinforce equal pay legislation and reduce labour market segmentation.

Most Member States are putting efforts into modernising social protection systems, reinforcing the incentives to take up a job and remain in work longer, as well as offering personalised support to those furthest away from the labour market. Many Member States are faced with the substitution effect between benefit schemes used as exit routes, placing emphasis on reducing the particularly high numbers of people who are inactive for reasons of ill-health or disability, where often eligibility criteria are less stringent for older workers (FI, NL, PL, SE, and UK are facing particular sustainability challenges in this context). A small number of Member States (DE, NL, PT, UK) undertake a systematic reassessment of several branches of social protection systems to tackle this substitution effect.

Synergies with EU Social inclusion and protection objectives

There is broad consistency between the NRPs and Member State commitments at EU level in terms of social policies through the open method of coordination for social inclusion, pensions and health. The NRPs recognise that the exclusion of people and groups from participation in society and the labour market is a waste of resources which should be addressed for economic and social justice reasons. Pension reforms aimed at strengthening sustainability are improving the incentives for working longer. The adequacy of pensions now depends on opening labour markets for older people and fighting segmentation. Some NRPs (especially in new Member States) stress the importance of health issues as a precondition for raising the quantity and quality of labour.

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

The effectiveness of Member States' efforts to increase work incentives in social protection systems will depend on their ability to help people find employment through active labour market policies. Policies to strengthen work incentives in tax-benefit systems include reductions in taxes or social contributions for (low-paid) work, in-work benefits, benefit levels, and eligibility criteria and their enforcement. Most Member States adopt the EU target that every unemployed person is offered a new start in the form of e.g. training, work practice, or a job before reaching 6 months (young people) or 12 months (adults) of unemployment. However, only eight Member States are close to meeting it. The target that 25% of long-term unemployed should participate in active measures is met by eleven Member States, although the NRPs generally do not set targets.

Member States' plans to improve efforts to support the inclusion of those furthest away from the labour market focus on the young and jobseekers with disabilities. Other groups such as non-EU nationals or minorities often receive insufficient attention. Combating inactivity, encouraging active participation, and greater promotion of policies to increase job retention rates are essential, in

view of the number of working-age people who become disabled and do not return to work.

Improve the matching of labour market needs

Several countries are making important organisational changes in their public employment services (PES) to meet demands for labour market integration. Closer cooperation or a merger between the PES, social security authorities, and unemployment benefit organisations is ongoing in several countries (BE, CZ, DE, DK, EE, FI, FR, NL, UK), aiming to improve work with people furthest away from the labour market. Cooperation between public and private employment services is developing (CZ, ES, FR, NL). Early identification of jobseekers' labour market opportunities is an established practice in a number of countries (DK, FI, MT, NL, SE, SK, UK) and being developed in others (EE, HU). Most Member States have already joined the EURES vacancies platform to ensure that job seekers are able to consult PES job vacancies throughout the EU.

Member States rarely address the contribution occupational and geographic mobility, better management of economic migration and better anticipation of skill needs can make to the functioning of the labour market.

3.2. Improve the adaptability of workers and enterprises

The policy components of this priority received less attention in the response from Member States, despite being a major issue for a number. This is worrying given the increasingly segmented nature of labour markets. Measures to improve the functioning of the labour market, better anticipate restructuring and deliver employment-friendly labour costs are often vague. The core of adaptability lies in finding the right combination of flexibility and security to reduce labour market segmentation. Many Member States approach this priority by emphasising flexibility for the employer.

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

Many Member States, including some large ones, give little attention to steps to address labour market segmentation. Although essential for employment, as well as productivity and quality at work, the modernisation of labour law and improvements in work organisation, including working time issues and working conditions, are rarely mentioned. The promotion of non-standard forms of employment is rarely elaborated upon despite varied use of flexible forms of contracts across Member States. A number illustrate specific measures to amend employment legislation (making labour contracts more flexible in DE, EE, FR, NL). Self-employment is also seen as a way to cope with restructuring needs (AT, SK, LV). Sweden and the Netherlands undertake efforts to increase total hours worked.

Health and safety at work is an important aspect of this priority (with DK, EE, ES, FR setting targets to reduce accidents at work). However, it is insufficiently covered in many Member States. Only a few pay attention to tackling undeclared work (AT, EE, HU, MT, LV, LT SE, SK). The extent of the problems is not recognised by most Member States.

Although the issue of relocation is often highlighted, creating the right conditions for positive anticipation and management of economic restructuring is not sufficiently seen as a priority (it is discussed by BE, LT, PT and SI). Portugal and Slovakia tackle the issue with incentives for self-employment and reform of labour relations. Slovakia is also targeting measures at those at risk of large-scale layoffs by introducing a special guarantee fund. . Beyond managing sectoral and/or company-level restructuring, a more favourable business environment is obviously crucial to sustain economic development in the longer run.

A Globalisation Adjustment Fund: The success of the Lisbon strategy depends on confidence in Europe's ability to achieve prosperity and solidarity. A European shock absorber, taking the form of a Globalisation Adjustment Fund, responding to sudden redundancies shall offer an additional EU level mechanism to help affected workers adjust to the consequences of restructuring through one-off, time-limited individualised support, covering training, relocation and outplacement services.

The concept of 'flexicurity' is a response to the needs of both employers and workers in a rapidly changing labour market aimed at providing adequate bridges during periods of labour market transition. In some countries, conditions for a good combination of flexibility and security exist, notably in Denmark and the Netherlands. The Danish approach provides actors with a maximum of freedom to shape their employment relationship in combination with good access to unemployment benefits and measures supporting employability. The Dutch approach relies on the availability of different contractual forms, balancing rights and obligations for each individual contract form, while providing for active measures for the unemployed.

Each Member State starts from a different position. Four ingredients are essential in achieving a good balance between flexibility and security without increasing the risk of labour market segmentation.

Firstly, the availability of contractual arrangements, providing adequate flexibility for both workers and employers to shape the relationship according to their needs. A proliferation of different forms of contracts should be avoided and sufficient homogeneity between these forms of contracts preserved to facilitate transitions between them.

Secondly, active labour market policies should effectively support transitions between jobs, as well as from unemployment and inactivity to jobs (e.g. AT's *Arbeitsstiftungen* serve as transition agencies to support job-to-job placement in cases of threatened mass dismissal; in Sweden social partners actively negotiate off-the-job placement). This highlights the importance of achieving the activation targets of the Employment Guidelines (see 3.1 above).

Thirdly, credible lifelong learning systems should enable workers to remain employable throughout their career (see 3.3 below).

Fourthly, modern social security systems should be in place to ensure that all workers are adequately supported during absences from the labour market and to facilitate labour market mobility and transition.

Moving from any initial situation towards such a balanced framework requires broad partnerships and consensus.

Ensure employment-friendly labour cost developments and wage setting mechanisms

The importance of labour costs for job creation is given little attention in the NRPs. The EU has witnessed moderate wage developments, with real unit labour costs declining in most Member States as well as for the EU25 and the euro area. Wage moderation is seen as a priority for some (e.g. NL). In line with social partner agreements (BE, NL), the commitment to wage moderation is often combined with changes in social protection arrangements. It is to be noted that the contribution of wage developments to job creation is seldom addressed as such, rather being dealt with in the macro sections (BE, EE, DE) or under the 'wage moderation' theme (AT, ES, NL). The need to review wage-bargaining systems is hardly addressed.

More emphasis is given to reducing the (high) tax burden on low-wage earners by focusing on income taxation or employers' social contributions in order to achieve an overall reduction in the tax wedge (BE, CZ, EE, FI, LT, LV, PL and SK). Measures to reduce non-wage labour costs would support the recent trend of wage moderation. A declining trend is noticeable in some Member States with a high tax wedge (AT, BE, DE, DK, FR), but not in some other Member States where an increase is observed in 2004 (IT, PL, LV, SE). The idea of targeting reductions of non-wage labour-costs at specific labour market groups (e.g. subsidies for the employment of older workers in FI) is gaining prominence, but evaluation of the impact of past measures is often lacking. A coherent approach to reducing labour costs should take account of the need to consolidate public finances and include the wider considerations of minimum wage provisions and a review of the impact of the tax system on employment. For a number of countries, reforms to reduce the tax burden on labour imply substantial modification to the tax base, including the creation of alternative sources of public revenues.

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

This priority receives widespread attention, with Member States acknowledging the crucial importance of developing the skills needed in knowledge-based economies. The policy response to the objective of investing more in education and training concentrates on qualitative reforms in education systems. Reforms to stimulate adult learning, particularly for the low-skilled, and to improve the governance of the systems to ensure comprehensive lifelong learning strategies are less visible. Replies to the call for better investment responsive to changing needs are also less ambitious. The focus here is placed on improving quality standards in education and training, better access and improving the definition and transparency of qualifications. The majority of NRPs are shown to be consistent with the implementation of the Education and Training 2010 work programme. Clear objective-setting with respect to the EU targets and reference to the use of European instruments in national policies can be found in few NRPs.

Expand and improve investment in human capital

The three EU human capital targets set out in the Employment Guidelines have been addressed by the majority of countries but with varying degrees of ambition. Despite a decreasing trend in the average proportion of early school leavers over recent years (2000: 17.7%, 2005: 14.9%) a major policy effort is still essential to reduce early school leaving to 10% in line with the EU target (especially in CY, ES, FR, IT, LU, MT, PT, and UK).

The EU average rate for completing upper secondary education has stagnated at around 77% since 2000. Half of the Member States achieve the benchmark, a further six are nestled around the EU average, while in seven countries (DE, ES, IT, LU, MT, NL, PT) greater efforts are necessary to catch up.

The performance divide across countries in lifelong learning participation is wider, illustrating the lack of a comprehensive approach in a number of countries. The good performance of a few Member States (DK, FI, NL, SK, SI, UK) significantly contributes to the average EU level of 10.8% in 2005 (2004: 10.3%). A slight upward trend can be noted in a majority of countries. However, the culture of learning needs to be improved and the systems modernised in the majority of countries if the EU is to achieve the 12.5% benchmark.

Some Member States have adopted targets and benchmarks linked to those at EU level. However, more needs to be done to raise participation in lifelong learning and the skill and competence levels of the population, especially among the less-advantaged. Legislative measures have been introduced in some countries, while others follow a strategy with legislative and non-legislative components. Progress in establishing lifelong learning systems is noted in countries which previously had little experience of lifelong learning. Ensuring a truly comprehensive approach embracing education, training, adult learning

(particularly for the low-skilled) and the involvement of all stakeholders remains a considerable challenge for many.

Education & Training 2010 work programme

The EU Education & Training 2010 Work Programme is a comprehensive agenda for Member States' cooperation in improving education and training systems in Europe. It therefore supports the economic and social objectives of the Lisbon Strategy, making a key contribution towards implementing the integrated guidelines for jobs and growth, in particular those on human capital development. There is a good deal of coherence between Member States approaches reported under this work programme and in the NRPs. Member States are making a range of in-depth reforms to support more effective lifelong learning. However, the development of truly coherent and comprehensive lifelong learning strategies by 2006 remains a challenge for many countries.

Despite a commitment by Member States to improve investment in human capital, there is little evidence of actual or planned increases in public and private investment. Few provide information on levels of public spending or touch upon increasing private investment. Budgetary information on specific measures is rare. However, since 2000, an encouraging upward trend in public expenditure on education (as a % of GDP) in the EU is notable. There is little evidence of an increase in the contribution from the private sector or in employer investment in continuing training. The role of the Structural Funds in supporting national policy is highlighted in a number of NRPs, but specific details are lacking. The financing of learning in terms of fair and transparent sharing of costs and responsibilities between actors is addressed in few NRPs. A number of countries focus on the quality and efficiency of investment in education and training, which tends to be a major theme for reform.

The European Social Fund (ESF) and the European Employment Strategy

The Structural Funds have a crucial role to play in supporting the delivery of NRP priorities. It is fundamental to ensure that ESF support underpins the implementation of reforms needed in the context of the EES. In defining the national Strategic Reference Frameworks for the period 2007-13, Member States and the Commission must give particular attention to the commitment to increase EU support for investment in human capital, increasing labour market adaptability, and support for improved administrative capacity, especially under the convergence objective.

To increase investment in human capital, to achieve a significant breakthrough in establishing a lifelong learning culture, and thus help deliver the EU economic and social needs, it is necessary to review the incentives for

households, enterprises and public authorities to invest in people. More emphasis needs to be placed on the importance of improving the efficiency of investment in human capital in the public sector, particularly in the cohesion countries.

This investment can significantly influence overall economic performance via a direct impact on overall output and productivity as a result of its size and efficiency.

Adapt education and training systems in response to new competence requirements

Many of the reforms outlined in the previous guideline also have implications for this guideline. The responsiveness of training to changing economic and labour market needs is acknowledged as an important aspect of modernising education and training systems. It is reflected in curricula reforms and the extension of vocational training opportunities. Progress is also noted in the development of systems for the validation of non-formal and informal learning. A stronger response would clearly go hand in hand with further development of comprehensive lifelong learning strategies, including a strengthening of the quality and attractiveness of vocational training and the modernisation of higher education. Regarding the updating of skills of the workforce, policies focus mainly on specific groups of the population (young people, women) and in particular on active labour market measures for unemployed people and groups underrepresented in the labour market.

Table 2: Employment rate targets set by Member States for 2010^{16*}

Country	Employment rates: Total	Female workers	Older workers
EU targets	70%	At least 60%	50%
BE	70% as soon as possible	60% as soon as possible	50% as soon as possible. Activity rate ↑ 1.5 times faster than EU15
CY	71 %	63 %	53 %
CZ	66.4% (2008)	57.6% (2008)	47.5% (2008)
DK	50,000-60,000 extra jobs	-	-
DE	-	-	-
EE	65.8% (2008); 67.2% (2010)**	63.3% (2008)65% (2010)**	54.8% (2008)**
EL	64.1 % **	51%**	-
ES	66%	57%	-
FI	70% (2007); 75% (2011)	-	-
FR	-	-	-
HU	63%	57%	37%
IE	-	-	-
IT	-	-	-
LT	68.8 %	61 %	50 %
LU	-	-	-
LV	65% (2008); 67% (2010)	62%	50%
MT	57%	41%	35%
NL	-	65% working ≥ 12 hrs a week	40% working ≥ 12 hrs a week 2007
AT	-	Align with overall employment rate	-
PL	-	-	-
PT	69% (2008); 70% (2010)	63% (2008)	50%
SE	80% (aged 20-64)	-	-
SI	67% (2008)	2008 - At least 2 pp above EU15 average	35% (2008)
SK	Annual ↑ of 1-2 pp.	-	-
UK	80 % (national definition, no date)	-	-

*Targets are for 2010 unless mentioned otherwise**Presented as projections

¹⁶ For a full list of targets under the European Employment Strategy, see: Council Decision of 12 July 2005 on Guidelines for the employment policies of the Member States (2005/600/EC).

Table 3: Other employment targets set by Member States for 2010*

	Raising effective exit age	Childcare provision	New start	Long term unemployed in active measures	Early school leavers	Upper secondary education	Participation in life-long learning	Other targets
EU	+5 yrs (from 59.9** in 2001)	Coverage: 33% (children <3 yrs old) and 90% (children 3 years -school age)	Offer active support after 6 months (young) and 12 months (adults)	25% participating in an active measure	No more than 10%	At least 85% of 22 yr olds to complete	Participation rate of 12.5% of working age population	
BE	Min age for pre-pension systems 58 to 60 in 2008	33% of < 3yr olds; 13.000 extra places in 2009	Personalised pathway for all within 6 months	-	Under 10%	85%	12.5% of employees per month and 50 % of employees/year	--
CY	↑ retirement age to 63	-	-	-	-	-	-	
CZ	-	-	-	-	-	-	-	25,000 more jobs for refugees and immigrants 2005: 50% of university students to end studies with bachelor degree; 2006 50% adults basic IT literacy
DK	↑ by 6 months	-	-	-	-	95% by 2015	-	
DE	-	230,000 extra places for < 3 yr olds.	Offer new start for <25 yrs old within 3 months	-	-	-	-	40% of an age group to start tertiary education; 2004-2007 per yr 30.000 new apprenticeship and 25.000 new traineeship places
EE	-	-	-	35% in 2007	< 10% in 2014	85%	10% by 2008	Disabled ↑ to 30% in 2008 ↑ until 2008 by 8% participation rate in vocational training
EL	-	-	-	-	-	-	-	Unemployment rate ↓7.3% ↑ public expend on education to 5% GDP
ES	-	-	-	-	Halve the rate	80%	12.5%	↓ youth unemployment to 18.6%; ↓ work accidents by 15%
FI	↑ by 3 years in the long run	-	-	↑ by 50% in 2008	-	-	60 % by 2008	96% of those completing basic education to move on to further education by 2008
FR	-	-	-	-	-	-	-	500,000 apprenticeship places by 2010
HU	-	-	-	-	-	-	-	employment rate for men: 69%
IE	-	13,000extra places	-	-	-	-	-	--
IT	-	-	-	-	-	-	-	--
LT	↑ to 64.5	30% for < 3 yr.ols.; 90% for 3 - school age	Meet EU target	25%	9 %	No	10%	50,000 new jobs by 2008; ↓ youth unemployment by 15%; LTU by 3.5%; unemployment down to 8%; Unemployment rate in all regions below 135% of national average. 45% of pupils to study under technological profile and VET programmes (ISCED level 3)
LU	-	X2 the number of places by end of 2007	-	-	-	-	-	--
LV	-	-	-	-	-	-	-	Labour productivity 53% of EU average; LTU 3.8%

	Raising effective exit age	Childcare provision	New start	LTU in active measures	Early school leavers	Upper secondary education	Participation in life-long learning	Other targets
MT	-	-	-	-	35%	65%	7%	--
NL	-	-	-	-	8%	85%	20%	--
AT	-	-	-	-	-	-	-	Further ↓ school drop-out rates; 4.200 new study places at universities
PL	-	-	-	-	-	-	-	Unemployment 14.6% in 2008
PT	-	100% for 5 y.o.; 90% for 3-5 y.o.; 35% < 3y.o.	Meet EU target. For unemployed <23 yrs and not completed yr 12 of schooling this is brought forward to 3months.	25%	Halve the rate	65%	12.5%	qualify 1 million through training & recognition of qualifications; 25.000 young people in VET per year by 2009; To raise n° of new graduates in scientific and technological areas, to attain 12 per 1000 in the population with ages between 20 and 29; to raise n° of new doctorates in scientific and technological areas, to attain 0,45 per 1000 in the population with ages between 25 and 34 years.
SE	-	-	-	-	-	-	-	Unemployment ↓ to 4%; Halve sick leave 50% of 25yr olds to have started Higher Education
SI	Gradual rise from 58 to 65	-	young graduates to be offered a first job within 6 months	-	-	-	-	Unemployment 5.5% in 2008
SK	Raise by 9 months a year to 62	-	-	-	-	-	-	--
UK	-	sufficient childcare for 3-14 y.o.	-	-	↑ proportion of 19yr olds with upper secondary by 5% 2004-2008	90% by 2015	-	50% participation rate of 18-30yr old in Higher Educ by 2010; improve basic skills of 2.25 Mio. Adults in 2001-2010; reduce by 40% number of workers with only basic skills by 2010

*If no target year mentioned: 2010. ** subsequently revised upwards to 60.3 year.