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REPORT FROM THE COMMISSION

on the implementation of the 1999 Broad Economic Policy Guidelines

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EXECUTIVE SUMMARY

The 1999 BEPGs were the first to be adopted after the launch of the euro. They recommended a balanced and mutually-reinforcing three-pillar strategy conducive to the achievement of sustained growth, increased living standards, high employment and social inclusion.

The present report offers an in-depth, overall assessment of the implementation of policy orientations set in the 1999 BEPGs. It contributes to the on-going multilateral surveillance of the economic policies of the Member States and the Union in conformity with Article 99(3) of the Treaty. Furthermore, the appraisal of the achievements made under the 1999 BEPGs will form a key input in the preparation of the forthcoming BEPGs. Indeed, this report together with the assessment of the macroeconomic environment as contained in the Commission services' Spring 2000 Economic Forecasts and the new policy developments and challenges identified in recent reports under the various co-ordination processes as well as in the Commission's contribution to the Lisbon Summit ("An agenda for economic and social renewal for Europe) and its Communication "Strategic objectives 2000-2005", will form the basis for the formulation of the 2000 BEPGs. Amongst the key challenges identified in the documentation for the Lisbon Summit are the transition to an inclusive, knowledge-based economy while aiming at full employment as the core objective of economic and social policy.

The report draws on and synthesises the key findings and conclusions of the monitoring and peer review in the different co-ordination processes at the Union level whilst adding an integrated appraisal.[1] It is accompanied by a working document of the Commission services which presents a detailed examination of the implementation of the country-specific recommendations.

The following key messages emerge from the report.

Improved macroeconomic environment

The externally-induced slowdown, that interrupted the solid recovery of 1997-98, gave way to an accelerating upswing in the course of 1999. The recovery has spread recently to all Member States and is close to maturity in those countries which are in the vanguard. Prospects are for sustained output growth above the potential rate in the years ahead. Job creation has continued at a strong pace as growth has become richer in employment. Unemployment has thus edged down steadily over the last two years and could approach in the near future a level not seen since the early 1990s. Low inflation was secured throughout 1999. Whilst the inflation outlook remains favourable, it has become somewhat less benign under the combined impact of a surge in oil prices and the depreciation of the euro.

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[1] The present report subsumes the information and findings of the various documents and reports prepared under the different co-ordination processes, including: the updated stability and convergence programmes, their assessment by the Commission and the Council opinions; the National Action Plans for employment and the Joint Employment Report 1999; Member States' progress reports on product, services and capital markets, the Commission's second report on "Economic reform: Report on the functioning of Community product and capital markets, 1999" and the EPC's "Annual Report on Structural Reforms, 2000".

Sound macroeconomic policy mix

The 1999 BEPGs stressed the need for a macroeconomic policy mix in the euro area that encourage growth and employment, and in conjunction with continued structural reforms, make it sustainable, i.e. non-inflationary. The combination of brightened growth prospects, falling unemployment and low inflation reflects favourably on euro-area wide macroeconomic policies. The appropriate management of macroeconomic policies mitigated the size and duration of the downturn and contributed to the current upswing. In the context of low and decelerating inflation, the judicious easing of monetary policy provided an adequate support to domestic demand and economic activity. At the same time, Member-State governments maintained – and in some cases enhanced – budgetary discipline despite the economic slowdown. Wage growth remained moderate. Notwithstanding the decisions by the ECB in recent months to raise its key interest rates, prevailing monetary conditions are growth supportive. The pre-emptive moves to address the possible build-up of inflationary pressure in the strengthening euro-area economy augment the chances of achieving a lasting, sustained, non-inflationary recovery. With a view to bringing the economy on a sustained high growth and employment path whilst preserving price stability, the task ahead is to maintain strict budgetary discipline, to encourage the social partners to exercise continued restraint in wage settlements and to implement the necessary structural reforms.

Progress towards more efficient public finances; sustainability finally started to be addressed

The quality and sustainability of public finances is an issue that, now that sound budgetary positions are progressively being achieved, is becoming increasingly important. The composition of public finances, the distortions created by taxation and the long-term sustainability need to be addressed.

- Most Member States have started to reform their *tax system*. Some Member States have lowered taxes on labour, some have shifted the burden towards energy and environmental taxes and some tax reforms have made venture capital more attractive. In the area of VAT, in 1999 an agreement was reached on the possibility to reduce VAT on labour-intensive services. The size and impact of these adjustments are, however, often not sufficient. Since the overall tax burden and, in particular, the tax burden on labour remain high in many Member States, more substantial measures are called for whilst respecting the need for further fiscal consolidation. Although co-ordination is required in certain areas, especially for taxes on certain mobile categories of capital income, in general this does not seem to be forthcoming.

- The long-term *sustainability* of pension systems requires considerable reforms in most Member States. The fact that reorganisations are now taking place is a first step in the right direction, but more are needed in order to cope with the problem of an ageing population. The heightened awareness of the problem is certainly a major step forward. Many Member States have plans for reforms, but they generally tend to postpone their implementation.

Well integrated product markets, but scope for further improvement

As a result of structural reforms in the past decade, product markets within the European Union are relatively well integrated and market competition has been increasing. However, price dispersion within the EU is still high, in particular in comparison with the United States, and the process of price convergence has slowed down in comparison with the early nineties. Therefore, room remains for improvement, especially in certain services sectors, construction and public procurement.

- The degree of implementation of the *Single Market* legislation has improved over the last year. Some Member States are markedly lagging behind, however, and in some areas (veterinary checks and transport) progress has been slow. Similarly, progress has been made with *public procurement*, whilst there are remaining problems, to judge by a number of indicators, such as directives not yet transposed, number of reasoned opinions and a low value of calls for tender published in the Official Journal.

- National *competition policy* has been tightened up and brought in line with Community legislation in many Member States. In a majority of Member States, the national competition authorities now have powers to enforce Articles 81 and 82 of the EU Treaty which deal with agreements between enterprises and abuse of dominant positions. In several other countries, progress has been made in that direction. The focus should now shift towards increasing transparency and improving monitoring and enforcement.

- *State aid* has fallen in recent years and they have become more generic and less specific. However, the level of State aid is generally still too high. It should be reduced.

- The *regulatory framework* has improved in a number of industries, leading to more intense competition and to a better price/quality ratio, the telecommunication industry being perhaps the most striking example (but even there problems remain with the incumbent operator often occupying a dominant position, and regulatory bodies lacking power or transparency). Progress can be speeded up in a number of industries, particularly the railways, water and postal services sectors, where progress has been slow, as well as in the gas and electricity sectors.

- Improving the efficiency of the *distribution sector* is essential for the good functioning of product markets, leading to a broader variety of products offered to consumers and lower prices. Land-use planning, limits on opening hours and specific restrictions on large-scale retail outlets continue to limit competition in this sector. While these issues are being tackled by some Member States, most could benefit from further liberalisations in this area.

- Many Member States have undertaken programmes and measures to improve the *regulatory environment of business* (obstacles to business start-ups, such as complex administrative procedures, inadequate financing possibilities, and limited information) and have lightened tax burdens on SMEs. The regulatory regime is still business unfriendly in many Member States, however, and needs to be reformed further.

Innovation – a key source of dynamism

On aggregate, the EU lags behind the United States in terms of *innovative capacity*. All Member States are pursuing policies to promote R&D and innovation. Nevertheless, large differences between Member States persist and the Union's efforts suffer from fragmentation and compartmentalisation.

- This points to the need for the EU to increase and improve its effort in R&D and to *increase the production and diffusion of ICT*.

- Most Member States would benefit from better *education and training* enabling them to seize the job potential of the information society which is still impeded by a huge skill gap. Additional benefits would be derived from a more *adequate financial backing* for R&D and innovation, an *appropriate regulatory framework* for the information and telecommunication industries and increased *competition* in these markets.

- A number of Member States have undertaken steps to encourage innovation by strengthening the *links between research centres and enterprises* but a true "European research area" to enhance scientific and technological activities in the Union, while fully taking advantage of the high potential of the Member States, is still lacking.

- A more business-friendly *patent system* would stimulate R&D and innovation. A reform of the European patent system would be helpful.

Capital markets - full integration not yet realised, but the euro helps

The introduction of the euro has had significant effects across the spectrum of European financial markets, contributing to the creation of deep, broad and liquid markets. However, obstacles remain to the achievement of fully integrated financial markets.

- The removal in a number of Member States of some of the *quantitative constraints* on investment by institutional investors is contributing to the deepening of financial markets. The Commission has issued a Communication on Funded Pension Schemes and is preparing a draft directive on the prudential supervision of pension funds.

- Some Member States have introduced the *distinction between professional and retail investors* into their legislation. This distinction should be applied more widely and more uniformly. The Commission is currently preparing a Communication on this issue.

- The issue of *risk capital* has been addressed to varying degrees in all Member States. Nevertheless, the availability and allocation of risk capital remains sub-optimal. In this context, the Commission has issued a Communication setting out concrete proposals for speeding up the implementation of the Risk Capital Action Plan.

Considerable progress in active labour market policies, but modest progress in labour market reforms

In spite of the steady gains in employment of the last years, unemployment is still at an unacceptably high level and the participation rate is low in the EU on average. As documented in the Joint Employment Report 1999, there is now a clear move towards a preventive approach in combating youth and adult long-term unemployment in line with the employment guidelines. However, some Member States are more advanced than others. While some reforms have been undertaken, progress on policies to improve the functioning of labour markets has on the whole been modest, especially when compared to the reforms in product and capital markets.

- Many Member States have made significant progress in implementing a preventive approach to tackling youth and long-term unemployment, based on *active labour market programmes (ALMPs).* Some Member States have also taken important steps towards combining active policies with an assessment of benefit duration and eligibility criteria. For others, however, much progress is still required to meet the medium-term deadline for the quantified targets for preventive measures set out in the employment guidelines. For all Member States it is important to ensure the efficiency of these measures, in particular by targeting those with most difficulties in integrating into the labour market.

- A majority of Member States have enacted or will enact reforms to reduce *income taxes and social security contributions* for labour, with reductions often targeted at the lower end of the wage scale. These efforts have been underway since the mid-90s and have resulted in a modest fall in the direct tax burden on labour. This reduction in the direct tax burden on labour has been financed mainly by shifting the burden to indirect taxes, such as VAT or energy and environmental taxes. These changes are welcome and need to be continued.

- A few countries have started a systematic review of their *benefit systems* and have started to undertake major reforms, particularly with regard to eligibility conditions. Apart from these Member States – where reform efforts have paid off in contributing to important reductions in structural unemployment – reform efforts in the area of benefit systems have so far been often very modest and piecemeal. More efforts are needed in this area.

- Some progress has been made in modernising *work organisation*. A number of Member States have taken measures to facilitate part-time work. Limited progress was achieved in some Member States in the areas of flexible and annualised working time. Progress in these areas is also important from the perspective of promoting gender equality. In addition, some Member States have made efforts to facilitate female labour-market participation, for example by improving child-care facilities, although further progress is needed. Very little has been done to address the problems of rigidities, which tend to discourage the recruitment of new permanent staff. The failure of labour costs to adjust to significant regional productivity differentials in certain Member States is indicative of a general lack of labour market flexibility. With a few exceptions, the social partners have not been active enough in modernising the organisation of work.

Conclusion

The overall implementation of the 1999 BEPGs is encouraging. Virtually all Member States met or surpassed their budgetary targets in 1999 and there are prospects for further improvements in budgetary positions in the years ahead. The quality and sustainability of public finances, in particularly the reform of tax and pension systems, have finally come to the fore as issues of concern. As regards economic reforms of product markets, progress has been most visible in the implementation of Single Market legislation and the liberalisation of telecommunications and electricity markets. Some, but insufficient, progress has been made in disciplining State aids. In addition to tax reform, facilitating part-time work and implementing a preventative approach to tackling youth and long-term unemployment have been the most notable areas of progress in labour markets. On the other hand, little progress has been made in implementing and enforcing public procurement rules, liberalising the railway, water, gas and postal sectors, deregulating retail outlets, promoting R&D and innovation, developing risk capital markets, reforming benefit systems, and modernising work organisation. The degree of implementation varies across Member States. Overall, it appears that Member States that have pursued a comprehensive strategy in line with the BEPGs have achieved the best results in terms of economic performance.

0. INTRODUCTION

The 1999 Broad Economic Policy Guidelines (BEPGs) were the first to be adopted after the launch of the euro. They set out a comprehensive strategy designed to achieve strong, sustainable growth and employment. The policy recommendations of the strategy can be regrouped under three main headings: sound macroeconomic policies, actions to improve the functioning of labour markets and economic reforms to enhance the efficiency and flexibility of goods, services and capital markets. The 1999 BEPGs were the first in which the general guidelines, applicable to all Member States, were supplemented with a full set of country-specific guidelines which identified economic policy priorities for each Member State, taking account of their particular circumstances.

For the economic policy strategy to work, it is crucial to secure effective implementation by means of an adequate and regular surveillance. The present report serves a twofold purpose. First, it constitutes a valid test of the degree of commitment by the Member States to the shared policy strategy. Second, it presents the necessary information and analysis for the preparation and adoption of a new set of guidelines. Indeed, this report together with the assessment of the macroeconomic environment as contained in the Commission services' Spring 2000 Economic Forecasts and the new policy developments and challenges identified in recent reports under the various co-ordination processes as well as in the Commission's contribution to the Lisbon Summit ("An agenda for economic and social renewal for Europe) and its Communication "Strategic objectives 2000-2005", will form the basis for the formulation of the 2000 BEPGs. Amongst the key challenges identified in the documentation for the Lisbon Summit are the transition to an inclusive, knowledge-based economy while aiming at full employment as the core objective of economic and social policy.

The present assessment draws together and synthesises the key findings and conclusions of these various processes whilst adding an integrated appraisal. It should be noted from the onset that the present report must be viewed as an interim assessment and as part of an on-going surveillance process.

The structure builds largely on the main lines of the 1999 BEPGs. Section 1 presents a concise overview of the economic situation in the EU. Section 2 reviews the macroeconomic policy mix. Section 3 reviews the progress towards sound and efficient public finances whilst Section 4 assesses wage developments. Finally, Sections 5 to 7 report the main results from the assessment of the progress made with structural reforms in the product, capital and labour markets, respectively.

1. THE ECONOMIC SITUATION IN THE EU

• Mild and temporary slowdown gave way to a robust growth recovery

The 1999 BEPGs were adopted against the background of a marked growth slowdown in the wake of the 1997-98 financial crises. The annual rate of real GDP growth in the Union decelerated to a mere 1½ per cent in the first half of 1999 from about 3 per cent in the first half of 1998. Exports decelerated noticeably and the weakness in external demand combined with less favourable growth prospects led to an important downward adjustment in stocks. Investment in equipment also decelerated, but to a lesser extent than initially feared. Since early summer 1999, the Union has experienced a progressive, broadly-based strengthening of economic activity. Output growth accelerated significantly in the second half. As a result, real GDP is estimated to have expanded at 2.2 per cent in 1999 (see Graph 1 and Table 1).

Domestic demand was the driving force of economic growth in 1999. It proved even more resilient than anticipated. Private consumption remained strong under the combined impact of strong employment growth, a steady expansion of credits facilitated by low interest rates, low inflation and buoyant stock markets. Ongoing improvements on the labour market coupled with steady gains in real per capita incomes boosted consumer confidence to a historical high. Investment was surprisingly resistant, reflecting in part good profitability. Capital spending was increasingly underpinned by brightening demand prospects and a strengthening of business confidence. With the effects of the crisis in emerging markets waning and the US economy continuing on a brisk expansion path, exports rebounded strongly in the second half. As a result, for the year 1999 as the whole, the growth of exports decelerated somewhat less than projected in the spring of last year.

Differences in growth performance among Member States continued in 1999. They reflect the impact of essentially three factors: the different exposure to the crisis-hit emerging market economies, the delayed impact of the policy adjustment in the run-up to Stage 3 of EMU and disparities in potential growth rates. Growth remained very brisk in Ireland and also Luxembourg, showed continued buoyancy in Spain, the Netherlands, Portugal and Finland, and was strong in Sweden. Activity in Germany and Italy was still lagging, but clearly accelerated in the course of 1999.

Short-term prospects are for a further strengthening of the recovery. The external side of the economy will continue to benefit from the global upswing, that is gathering momentum, and improved competitiveness following the depreciation of the euro. Domestic demand is expected to remain the backbone of robust growth. Private consumption will be underpinned by high consumer confidence and continuous improvements on the labour market coupled with steady gains in real per capita incomes. Improving demand prospects, rising business confidence and high profitability bode well for investment. Moreover, growth differences among Member States are set to narrow as the uneven impact of the crises in emerging markets wanes and the lagged effects of different adjustments in the macroeconomic policy mix in the run-up to Stage 3 of EMU are petering out.

- **Employment has become more responsive and unemployment is declining**

The employment performance in the EU has become increasingly encouraging over recent years as growth has become richer in employment. With GDP growth falling temporarily to slightly above 2 per cent, indications are that employment gains were nevertheless of the order of 1¼ per cent. This suggests that employers perceived the slowdown as temporary. But it also reflects, over and above any purely cyclical influences, the effects of several years of wage moderation and of structural reform to enhance both employability and adaptability and to strengthen the effective labour supply. This also bodes well for the future, when job creation will benefit from a strengthening of growth and a continued shift towards the more labour intense services sectors. The improving employment situation has increasingly been reflected in declining unemployment rates. Having reached historical highs in 1997 in many member countries, unemployment fell gradually to 9.2 per cent in 1999 in the EU as a whole (see Graph 2).

Employment gains remained particularly brisk in the rapidly growing economies of Ireland and Luxembourg while they were still subdued in Germany and Italy in 1999. Job creation was also strong in Finland and Spain. In the latter country the fall in unemployment continued at a rapid pace while Luxembourg again recorded the lowest unemployment rate in the EU.

- **Absence of inflationary pressure**

In 1999, the EU economy continued to enjoy a high degree of price stability. Inflation (measured by the harmonised index of consumer prices, HICP) bottomed out in early 1999 at 1 per cent. It has since crept up to 1.8 per cent in January 2000 owing to the sharp reversal of energy and raw material prices, particularly crude oil, and the weakening of the euro. The energy component added directly 0.9 percentage points to the January headline figure. On the other hand, internal demand and supply conditions have been conducive to lower underlying inflation in the EU economy. Wage increases continued to be moderate and deregulation and increased competition in certain utility markets (notably telecommunications and electricity) exerted downward pressure on prices. As a result, core inflation (i.e. excluding energy prices and food) fell to a record low of about 1 per cent in 1999 (see Graph 3 and Table 2).

Another feature of 1999 was a widening of inflation differentials between Member States. In early 1999, inflation fell rapidly to very low levels in a number of countries (Germany, France, Austria) and accelerated in some others (Spain, Ireland, the Netherlands, Portugal). The dispersion in inflation rates tended to narrow gradually since then. The inflation differentials largely reflected structural differences and short-term cyclical disparities in the euro area. In countries like Spain and Ireland, the price increases were indicative of overheating risks and required policy adjustment in terms of demand restraint by budgetary policy.

As regards future trends, following a further rise in oil prices and a weakening in the external value of the euro in the past months, the inflation outlook has become somewhat more uncertain and less benign. It cannot be excluded that headline inflation may slightly but temporarily exceed the 2 per cent mark in the euro area in early 2000. Future trends will importantly depend both on the extent to which the depreciation of the euro will be passed through to import and consumer prices and on future wage developments.

2. GROWTH AND STABILITY-ORIENTED MACROECONOMIC POLICIES

2.1 The macroeconomic policy mix in the euro area

The 1999 BEPGs recommended *a policy mix conducive to growth, employment and stability that should consist of a monetary policy aimed at maintaining price stability in accordance with the Treaty, sustained efforts to bring budgets securely to close to balance or surplus over the medium term, wage developments consistent with price stability and job creation and commitment to economic reform*.

1999, with the successful launch of the euro, was the first year to test in practice the macroeconomic management in the single currency zone. The test result was positive.

Euro-area monetary conditions were generally growth-supportive in 1999, against a background of an economic slowdown and sustained price stability. With the balance of inflation risks seen to be on the downside, the ECB lowered its key policy rate by 50 basis points to 2.5 per cent in April and left its rates unchanged until November. The fall in money-market rates in response to the ECB action was accompanied by a substantial depreciation in the nominal effective exchange rate of the euro. The implied easing in monetary conditions was offset to some extent by a substantial rise in euro-area bond yields which, despite the absence of internal inflation pressures, were pulled higher by developments in the United States (see Graph 4 and 5).

With a brightening growth outlook in the euro area, the prospect of higher capacity utilisation and tightening labour markets, the ECB has considered that the risk of inflation has shifted to the upside, reversed its prior move in November and raised policy rates by a further 25 basis points in early February.

The conduct of monetary policy was facilitated by the resolve of Member States' governments to abide by their 1999 budgetary targets, despite on average lower growth than expected at the time when the plans were made. Indeed, virtually all euro-area Member States met or even overachieved these targets. Several factors contributed to this positive outcome, including a further decline in the debt service burden (see Section 3). As a result, general government net borrowing in the euro area as a whole fell to about 1¼ per cent of GDP in 1999. Last year also saw a notable improvement in the cyclically-adjusted balance of ¾ of a per cent of GDP in the euro area. The cyclically-adjusted primary balance posted a moderate improvement of a ¼ of a percentage point to close to 3½ per cent of GDP. The 1999 results also imply that more Member States than hitherto anticipated achieved a sound underlying budgetary position in line with the Stability and Growth Pact.

Wage developments in the euro area continued to be consistent with price stability in 1999. On average, settlements remained moderate, resulting in an increase of nominal compensation per employee of about 2¼ per cent. This implied, after taking into account productivity growth, an increase in unit labour costs of approximately 1¼ per cent, which did not give rise to inflation concerns. Moreover, real wages advanced approximately in line with labour productivity, thereby maintaining the rate of return on investment at a level which should be conducive to investment, growth and employment creation as demands strengthens further (see also Section 4).

All in all, the judicious conduct of monetary policy, budgetary policies that remained on a steady course and appropriate wage trends resulted in an adequate policy mix in view of the prevailing economic situation. The euro-area economy has passed its first test of macroeconomic management. Moreover, continued moves to enhance vitality and responsiveness of the economy through an EU wide process of structural reform have underpinned confidence of economic agents and thereby supported activity (see Sections 5 to 7).

2.2 The macroeconomic policy mix in the member states outside the euro area

Noting that *Member States not participating in the euro area retain national responsibility for monetary and exchange rate policy*, the 1999 BEPGs recommended *to maintain stability-oriented macroeconomic polices. For the two Member States participating in the ERM II, the main focus must be to maintain sound monetary and budgetary policies in order to respect exchange rate commitments. For the two Member States with a direct inflation target, it is important that the conduct of monetary and fiscal policy be consistent with the achievement of that target, thus creating the conditions for exchange rate stability.*

Denmark is relatively advanced in the economic cycle and some inflation pressure has emerged as labour-market conditions have tightened. The Danish National Bank is committed to keep the krone within the narrow fluctuation band of the ERM II and the exchange rate has remained very steady at slightly above the central rate since the inception of the mechanism as the Central Bank has closely shadowed euro rates (see Graph 6). With a view to securing the basis for sustainable growth while respecting the commitment to a fixed exchange rate against the euro, budgetary measures to calm domestic demand were implemented in 1999, in line with the 1998 "Whitsun" package. While the measures have temporarily slowed growth they should help to arrest competitiveness losses notably against the euro area. Moreover, the discretionary move has further improved public finances which are now in surplus and comfortably meet the requirements of the Stability and Growth Pact.

Greece has advanced in the process of real catching up while making further progress in nominal convergence in 1999. The inflation differential with the euro area has narrowed considerably, and key interest rates were lowered progressively towards year end while the drachma remained above its ERM II central rate, within the standard 15 per cent fluctuation band. In view of a closing output gap, budgetary policy succeeded in scaling further back the deficit, implying also an improvement in the underlying position. In recognition of the progress already achieved in 1998, the Ecofin Council, on a recommendation from the Commission, abrogated the decision on the existence of an excessive deficit last November. In January, the drachma's central rate vis-à-vis the euro was revalued by 3½ per cent which should support the authorities in their efforts to keep the economy on a path of sustainable growth with price stability.

Sweden enjoyed a strong and broadly based upswing in 1999 as the economy seems to have entered a virtuous circle against a background of good fundamentals. Inflation (as measured against the HICP index) is among the lowest in the EU, the current account in surplus and public finance in a much better shape than only a few years ago. The stance of budgetary policy was eased in 1999. The surplus continues to meet the requirements of the Stability and Growth Pact and the scaling back of taxation is to be welcomed in view of the high tax burden. Nevertheless, some care might be warranted in adopting a pro-cyclical budgetary stance as the output gap is closing and is expected to turn positive in the coming years. This holds even more as the commitment of the Swedish Riksbank to price stability as an objective has been further underlined by new legislation that came into force in 1999. The Riksbank has an explicit inflation target of 2 per cent with a tolerance interval of +/-1 percentage point. Inflation is still low, albeit edging higher and short-term rates have already been channelled up over recent months.

The UK economy weathered relatively well the emerging markets' crises and growth has gained momentum in the course of 1999. Following major improvements in earlier years, budgetary policy turned more steady while still making some progress in reaching a budget surplus of close to 1 per cent of GDP in 1999. This favourable development reflects the Government's commitment to conduct budgetary policy in a manner consistent with safeguarding macroeconomic stability. Inflation has remained contained and fell even below the euro-area average in the second half of last year in terms of the HICP. However, there are upside inflation risks as the economy is operating at close to capacity. The Bank of England's monetary policy committee reversed a steady downward trend in policy rates in September 1999. This and the moves since are to ensure that the inflation target of 2½ per cent, in terms of the retail price index excluding mortgage interest payments, continues to be met.

3. Sound and efficient public finances

In 1999, budgetary policy in the EU was conducted for the first time in the framework of the Stability and Growth Pact. The 1999 BEPGs recommended that Member States *(i) achieve budgetary positions of close to balance or in surplus no later than by the end of 2002, in conformity with the stability and convergence programmes;* (*ii) meet fully their 1999 budgetary targets; and (iii) improve simultaneously the quality and sustainability of public finances* (see Box 1 for the country-specific recommendations). Below are first addressed developments in 1999 and then the short term outlook and medium-term plans as presented in the recent updates of the stability and convergence programmes.

3.1 1999 budgetary targets met despite growth slowdown

When Member State governments prepared their budget plans for 1999 in the second half of 1998, the extent of the slowdown in economic activity then under way in many EU countries was not yet apparent. This holds generally also for the first round of stability and convergence programmes as these were typically based on the budget plans (see Tables 3 and 5). In about half of the Member States, GDP growth turned out lower than projected in the programmes. The slowdown was especially noticeable in Germany, Italy and Austria while in Belgium, Greece and Spain growth almost matched initial expectations. However, in other countries growth was actually higher than projected, e.g. in France, Ireland, the Netherlands, Sweden and the United Kingdom.

Nevertheless, regardless of the varying growth performances, the 1999 budgetary targets were generally met or even overachieved. Seven out of the fifteen Member States recorded a budgetary surplus. The group of countries in surplus consists of the Nordic countries, Ireland, Luxembourg, the Netherlands and the United Kingdom. Four countries had a deficit between 1 and 1.5 per cent of GDP while the deficit in France, Italy, Austria and Portugal was still close to or above 2 per cent of GDP (see Table 3). Government debt ratios also came down faster than expected.

Some Member States with stronger growth than anticipated also overachieved initial budgetary targets. Notable outcomes in this respect were obtained by the Netherlands, Sweden and the United Kingdom. Maybe more noteworthy is the budgetary performance in those countries that experienced a marked slowdown. This holds in particular for Germany where the budget balance came out appreciably better than targeted. In Italy, where the deficit objective had been adjusted upward in the course of the year in view of the slowdown, the deficit outcome posted a marginal improvement on the initial 2 per cent of GDP deficit target. Only Ireland and Austria appear to have undershot their 1999 budgetary targets.

Several factors contributed the better than expected 1999 budgetary figures, although they are sometimes difficult to quantify in any precise way. The main factors were:[2] the budget results for 1998 were better than expected and thus improved the starting position; sustained efforts to tightly control expenditures; unexpectedly buoyant tax receipts, which moreover benefited from the tax friendly composition of growth underpinned by domestic demand; and finally a tendency for Member States to build in contingency reserves in their budgetary targets, especially, as it seems, regarding interest payments. All in all, the 1999 budget deficit in the EU as a whole fell to ¾ of a per cent of GDP and the underlying position also improved (see Table 4).

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[2] The changeover of the reference economic accounting system from ESA79 to ESA95 (the budget targets were set on an ESA79 basis while outcomes are ESA95 based) also played a role. The ESA changeover had a small impact on 1999 budget balance figures on average, but was notable in Portugal and Sweden.

Most of the improvement in budget balances in 1999 can be attributed to an increase in the ratio of revenues to GDP. The ratio of total expenditures to GDP decreased marginally, but this was entirely due to the fact that the lower interest burden offset an increase in primary expenditures. The decline in the government investment to GDP ratio was arrested. In the EU as a whole this ratio improved slightly to 2.3 per cent, but is still well below the levels reached in the early 1990s (see Graph 7). While in most countries the investment ratio was stable, it increased visibly in Ireland and Italy. Furthermore, many Member States have undertaken efforts to increase investment in human capital.

The higher tax and primary expenditure ratios may be seen as a less positive feature of the overall budgetary adjustment in 1999 given the general acknowledgement that a high quality budgetary adjustment strategy should be led by expenditure restraint which then also allows for a lowering of tax burdens. However, it should be noted that the on-going tax reforms in Member States generally envisage cutting tax rates together with a broadening of tax bases. In the short term, while economic agents adapt, this may lead to fluctuations in tax intakes. Moreover, to the extent that the collection of taxes has been made more efficient - a precondition in some cases for lowering tax rates - this should also lead to higher tax revenue. On the expenditure side, beyond the somewhat higher investment ratio, the working of the automatic stabilisers contributed also to increase expenditures. In fact, according to the presented medium term budgetary plans it is likely that both revenue and primary expenditure ratios peaked in 1999.

3.2 Budget plans for 2000 and beyond

Regarding the short-term prospects for public finances in 2000, in most Member States no major consolidation efforts seem to be incorporated in current plans. Judging from the budgetary targets presented so far for 2000, budget balances on average will nevertheless continue to improve somewhat due to cyclical reasons and lower interest expenditures. Cyclically-adjusted primary balances are probably set to deteriorate slightly should the nominal targets just be met. Whilst the targets are not very ambitious, it should be noted, however, that most budgets are based on deliberately prudent economic assumptions. As a consequence, with the brightened economic prospects for 2000, there is a good chance that the budgetary targets for this year can again be bettered.

Since last September, all but one of the Member States have submitted updated stability and convergence programmes. Only Austria has not yet submitted its update, because of the delays in the formation of a new government and of the subsequent absence of a budget for 2000. The new Austrian government is expected to submit its updated stability programme before the end of March.

The updated programmes stick to or strengthen the medium targets of the original programmes, often making use of the additional year at the end of the programme to make further progress in deficit reduction (see Table 5). These updates indicate that the fourteen Member States either fulfil or will fulfil by 2002 at the latest the requirement of achieving the minimum benchmark position, which allows the automatic stabilisers to work without risk of the deficit breaching the 3 per cent of GDP reference value. By 2002 or 2003, eight of the Member States aim for a budget surplus and a further five expect a deficit of no more than half a per cent of GDP.

These updates are generally based on cautious assumptions about growth and interest rates. Consistent with the 1999 BEPGs, Member States would be expected to hasten the adjustment process and the reduction in the still high debt ratios if the improved economic outlook were to materialise. A more ambitious strategy might have been more appropriate for those Member States which were called upon to create additional safety margins or those where very high government debts still are a matter of concern. An additional consideration in this context is the cyclical position. Countries where economic growth has remained strong and where the economy recovery is at a mature stage, a stronger and front-loaded adjustment would help diminish overheating risks.

The composition of the planned budgetary adjustment outlined in the updates generally seems to be beneficial in the sense that total revenue and total expenditure ratios stabilise and start declining gradually over the medium-term, while remaining on historically high levels. As regards expenditure, government investment is expected to remain broadly constant. Furthermore, many Member States explicitly or implicitly adopt a budgetary strategy built on primary expenditure control to create room for an easing of the tax burden.

Government debt to GDP ratios are set to continue their downward trend towards more sustainable levels. All Member States which have submitted updates so far, project debt to GDP ratios lower than in last year's programmes. In fact, most Member States will already in 2001 have debt ratios below the 60 per cent of GDP threshold. The remaining high debt countries, Belgium, Greece and Italy, continue to reduce their debt burdens and approach the 100 per cent to GDP level in 2002/2003 (see Table 6).

3.3 Quality and sustainability of public finances

- **Pension reform**

Given the very long-term consequences of changes to pensions and health care systems, it is important that reforms are well thought through and achieve a broad consensus in society. Hence, it would be inappropriate to assess the implementation of the BEPGs solely on the basis of measures enacted in one year, without taking into account proposals for reforms and consultations with social partners.

There is a great deal of diversity in the public pension systems amongst the Member States, and countries are at different stages in the reform process. Nonetheless, it is clear that the issue of long-term budgetary sustainability, in particular as regards public pension systems, was high on the political agenda in almost all Member States (see Box 2). Overall, a number of common trends can be identified in the reforms underway: (i) steps are being taken to curb early retirement and increase participation rates amongst the elderly; (ii) a better balance is being sought between contributions and expenditures; (iii) there is a shift towards more funding public pensions: and (iv) a better balance is being sought in the pension systems via the strengthening of funded second and third pillar pension schemes.

Concrete measures were enacted or past reform entered into force in several countries, notably Denmark, Ireland, Netherlands, Finland, Sweden and the United Kingdom. In Germany agreement was reached to reduce the contribution rates of employers and employees which will be financed via higher energy taxes.

The year 2000 could mark a major milestone in the reform of public pensions in Europe, with the possibility of significant reforms in Belgium, Germany, Greece, Spain, France and Portugal. Further reform of the public pension system is also possible, indeed desirable, in Italy and Austria. It is vital that such reforms address the issue of long-term sustainability of public pension systems in a comprehensive manner, taking into account the need to make them more employment-friendly and to ensure a fair distribution both within and between generations.

In several Member States, reforms to public pensions have been suspended by incoming governments following elections. In recent years, this has occurred in Germany and France. While it is important that governments achieve a broad consensus in society of pension reform, it is vital that hard decisions are not repeatedly postponed. There is a short window of opportunity to address the challenge before the retirement of the baby-boom generation around 2010.

Overall, the BEPGs as regards sustainability have been respected even though many Member States are in a consultation phase. However, compliance in the year 2000 should be judged on the basis of the extent to which proposals and consultations will have turned into concrete action.

During 1999, a working group was established in the Economic Policy Committee (EPC) to provide comparable estimates of the long-term budgetary implications of ageing populations. This work should be completed in 2000. It is vital that consistent and comparable estimates are available to improve policy making at EU level. Moreover, the emphasis until now has been on public pensions. More work is required on the impact of ageing populations on public health care expenditure and tax revenues. The work of the EPC will provide essential input to that of the High-Level Working Party set up by the Portuguese Presidency, which will assess the long-term sustainability of social protection schemes, in particular pensions.

- **Tax reform**

Reducing the overall tax burden

Most Member States have taken or plan tax reforms affecting social security contributions, personal income taxes, corporate taxes, and, to a much lesser extent, indirect taxation (see Box 3). Such reforms, because of their coverage and degree of ambition, so far seem to have had a limited effect on government receipts in many cases. However, over the period 2000-2003, the tax burden (as measured by the ratio of total government receipts to GDP) is expected to fall in most Member States, particularly in Denmark, Germany, France, Ireland, Luxembourg, the Netherlands, Finland and Sweden.

Reducing the tax wedge on labour on the lower paid and tax shifting

A majority of Member States (Belgium, Germany, Greece, Spain, France, Italy, the Netherlands, Finland and the United Kingdom) have undertaken measures to reduce non-wage labour costs. They are targeted at the lower paid (Belgium, France, Italy, the Netherlands and the United Kingdom), as well as at improving incentives for new and permanent labour contracts (Greece, Spain and Italy). Furthermore, a number of Member States are reforming personal income taxes to reduce the total burden on labour income. In Germany, Spain, Ireland, the Netherlands, Finland and Sweden, general reductions of marginal and standard rates have been planned or applied. Targeted reforms (Denmark, Greece, Italy, Austria and the United Kingdom), consisting of tax cuts at the bottom of the income distribution and of increasing minimum exempted incomes, aim at making work pay. In the UK (within the so-called welfare to work programme), the minimum guaranteed income (Working Families Tax Credit) has been raised as well.

The reforms of personal income taxes seem to be inducing modest reductions in the direct tax burden borne by labour.[3] The reduction of non-wage labour costs has started moderately (see Table 7).[4] Overall, reduction of social security contributions might have a negligible impact on non-wage labour costs.[5] This is not surprising since most of the measures are targeted (new jobs, low end of the wage scale) and might be affecting just a small fraction of the tax base.

Reforms of indirect taxation are rather limited. Only in Denmark, Germany, France, Finland and the United Kingdom have energy and environmental taxes risen. In some cases they aim at shifting the tax burden away from labour. In Germany and the United Kingdom additional revenues are meant to finance cuts in non-wage labour costs. In France ecological taxes will contribute to finance the budgetary impact of the reduction in working time. In addition, nine Member States (Belgium, Greece, Spain, France, Italy, Luxembourg, the Netherlands, Portugal and the United Kingdom, only for the Isle of Man) plan to apply reduced VAT rates to labour-intensive service sectors with a view to enhancing the demand for labour in such activities.

Improving the efficiency of taxation systems

Although making tax systems more employment-friendly seems to be a major goal of tax policy in Member States, improving their efficiency is also behind certain tax policies. In some countries, the reform of the personal income tax has consisted of an across-the-board reduction of marginal tax rates. In addition, targeted tax cuts will reduce certain distortionary effects of taxes such as unemployment traps. Nevertheless, cases of evasion and fraud suggest that further efforts are needed to increase efficiency and effectiveness in administration and enforcement. Furthermore, tax cuts at the bottom, as well as the rise of the minimum exempted income, may cause discontinuities in marginal tax rates and enhance progressivity of personal taxes at the lower half of the income distribution.

Reforms of capital and corporate taxes do not seem to respond to potential tax competition pressures. They aim at improving the functioning of capital markets (Denmark, Germany, France and Italy) and at creating incentives for venture and intangible capital (Greece, Spain, France, Ireland and Italy). In Germany and Finland the reforms are more general. Corporate rates will be reduced in the former country, while in Finland rates will be raised by 1 percentage point.

Where the overall capital income is concerned, current levels and evolution of effective tax rates on capital seem to support the view that reforms of corporate and other capital taxes are not introducing fundamental changes in the tax burden on capital.[6] It rather seems that reforms of the

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3 This direct tax burden on labour consists of social security contributions, plus taxes on payroll and workforce and the part of personal income taxes attributable to labour income. It is usually expressed in percentage points of gross wages.

4 Table 7 also shows the so-called effective tax rates of labour. Whilst conceptually broadly similar to the implicit tax rates published by Eurostat, there are some methodological differences. Largely based on macroeconomic data, they allow, however, to be updated in line with the Commission services' economic forecasts, thus enabling an assessment on the basis of the most recent information.

5 These are calculated as the ratio of social security contributions and taxes on payroll and workforce to gross wages.

6 The effective taxation on capital comprises personal taxes on capital income, property and corporate income taxes expressed in percentage points of the operating surplus.

personal income tax, which also tax capital income, are reducing the tax burden on both labour and capital income. A lowering of the capital effective tax rate is expected over the period 2000-2001.

Harmonisation of VAT and other indirect taxes

Indirect taxation is the field where the EU has progressed most in the past. However, further progress is needed to ensure a smooth functioning of the Single Market. Where statutory and effective VAT rates are concerned, large differences still exist across Member States, not to mention differences in exemptions and special treatment of goods and services. In addition, technology is changing the nature of consumption taxes. E-commerce might have large influence in the operation of tax systems in the EU since a third of government receipts come from indirect taxes. Electronic transactions make final consumption highly mobile and expose VAT to potential tax avoidance. They can also radically change basic concepts of tax administration and enforcement. These challenges call for renewed and further harmonisation efforts in VAT and other indirect taxes.[7]

Pursuing tax co-ordination and avoiding harmful tax competition

Tax competition has important positive consequences: it is a means of benefiting citizens, of imposing downward pressure on government spending and of ensuring that tax policies take account of the European Union's global competitiveness. At the same time, however, the erosion of certain national tax bases through unrestrained tax competition for mobile activities represents a threat to the tax revenues of the Member States and might lead to shift in the balance of the tax burden towards less mobile bases, namely labour. Such harmful tax competition also undermines the very basis of the Single Market, namely a level playing field in terms of fair competition between companies.

The package of measures to tackle harmful tax competition, including the Code of Conduct for business taxation, is based on the principle that a co-ordination (rather than a harmonisation) of certain direct tax policies is necessary. It provides a means of developing co-ordinated solutions to problems which the Member States are unable to resolve by acting individually. In this context, in line with progress in the Code of Conduct, further co-ordination efforts between Member States are needed, especially in taxes on certain mobile categories of capital income.[8]

4. APPROPRIATE WAGE DEVELOPMENTS

The 1999 BEPGs maintained that: *(i) nominal wage increases must be consistent with price stability; (ii) real wage increases in relation to labour productivity should take into account the need to strengthen, where necessary, and subsequently maintain the profitability of investment; (iii) wage agreements should better take into account differentials according to qualifications, skills and geographical areas; and (iv) wage imitation should be avoided and labour cost differences between Member States should continue to reflect discrepancies in labour productivity.*

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[7] Following a proposal by the Commission in November 1998 for a Directive on certain legal aspects of electronic commerce in the Internal Market, the Council reached agreement on a common position in December 1999.

[8] While the 1999 BEPGs stated that the Council awaited the outcome of the ongoing discussion on the taxation of the interest on savings in line with the conclusions of the European Council held in Vienna in December 1998, no agreement has been reached yet.

Compensation per employee, i.e. including employer's social security contributions, rose by close to 3 per cent in the EU in 1999, in line with the trend observed over recent years.[9] The increase in nominal unit labour costs accelerated to about 2 per cent, in part due to a cyclically-induced dip in labour productivity (see Table 8). This situation is still perfectly compatible with price stability, but can carry inflationary risks when other factors put additional pressure on prices. Unit labour costs rose at rates close to or above 3 per cent in some of the cyclically advanced Member States, such as Denmark and Ireland. In Portugal, the pace of unit labour costs accelerated to 4 per cent and continued to exceed 4 per cent in the United Kingdom. Such rates, if sustained, would put price stability and competitiveness at risk.

Real wage increases (nominal compensation adjusted by the GDP deflator), which rose at a pace well below the growth of labour productivity since the mid-1980s and thereby allowed a remarkable improvement in the profitability of investment, accelerated somewhat in 1999 and slightly exceeded productivity gains. This lead to a temporary halt in the rise in profitability in the EU as a whole. Real unit labour costs rose rapidly in particular in Sweden and the United Kingdom. While both countries have in fact enjoyed levels of profitability above the EU average, a further marked acceleration in wage settlements not matched by a corresponding quickening in labour productivity would threaten to erode competitiveness.

Some countries have taken or plan steps to ensure that wage cost differentials better reflect productivity differences between different qualifications, skill levels or geographical areas. A targeted reduction in non-wage labour costs was implemented in Spain, France and in Italy in 1999, and further reductions are planned in Belgium. In Greece, territorial employment pacts offer in principle an opt-out from sectoral wage agreements in high unemployment regions and in Italy, the "Social Pact for Development and Employment" allows for area contracts to deviate from national standards of wage setting.

Especially within the euro area it is important that wage trends in the participating countries stay tuned to productivity. While the 1999 developments do in general not signal problems in this respect, unit labour costs in Portugal rose clearly faster than in the single currency area as a whole, which, if continued unabatedly, risks impairing Portuguese price competitiveness. In contrast, the level of the minimum wage in Ireland will need to be carefully monitored to ensure that low-productivity workers are not priced out of the labour market.

5. More efficient product (goods and services) markets

The 1999 BEPGs asserted that: *(i) the Single Market and competition policy should be strictly applied and closely monitored; (ii) Member States need to exercise self-discipline with respect to State aids and the Commission needs to control these; (iii) regulatory reforms should be pursued and speeded up in telecommunications, transport and energy; (iv) further progress should be made with improving the quality of the legal and regulatory environment, especially for SMEs and business start-ups; (v) VAT should be further revised and simplified; (vi) further progress should be made to avoid harmful tax competition; and (vii) Member States should also put more emphasis on the environmental dimension of economic policy* (see Box 4 for the country-specific recommendations).

[9] Compensation per employee rose by 2.4 per cent in 1998. This figure however includes the effect of the Italian tax reform, which reduced employers' social security contributions. Without this one-off effect, compensation for the EU as a whole would have risen to a similar extent as in 1999.

Product markets within the European Union are relatively well integrated and competition in the markets is increasing. The exposure of domestic product markets to international competition, as measured by the degree of trade openness, the importance of foreign direct investment and cross-border mergers and acquisitions, still varies between Member States (see Table 9). For instance, countries like Belgium, Ireland, Luxembourg, the Netherlands and the United Kingdom are relatively more exposed to the pressures of external competition while this is less the case in the other Member States. In the latter countries, the regulatory reforms undertaken are therefore even more important to raise the level of competition in the product markets as well as to cope with future competitive pressure.

Despite the significant advancement in European integration and intense trade linkages, price dispersion within the EU is still high, in particular in comparison with the United States.[10] Moreover, the process of price convergence has slowed down in recent years in comparison with the early nineties. Significant differences in price levels persist between Member States (see Box 5).

There remains considerable room for improvement in the functioning of the Internal Market, especially in certain services sectors, construction and public procurement. Sectors not covered by Single Market legislation would also benefit from stronger competition. To overcome these problems and tackle structural impediments, in recent years the Member States have undertaken a significant number of reforms in the product markets.

5.1 Single Market - established legal framework must be properly implemented

The degree of implementation of the *Single Market legislation* has increased further. The legal framework for the Single Market has now been largely established in almost all the Member States. As indicated in the last Scoreboard, 10 out of the 15 Member States have a transposition deficit below 4 per cent (see Table 10). Similar efforts are now required by the 5 Member States (Greece, France, Ireland, Luxembourg and Portugal) whose transposition deficit continues to be above 4 per cent. Progress has been relatively slow in veterinary checks and transport.

As transposition increases, the focus must now shift to the correct implementation of the Single Market directives. In this respect, reasoned opinions are a useful indicator because they signal that a breach of Community law has occurred. Four countries (Belgium, Greece, France and Italy) together account for more than half of the reasoned opinions issued between September 1998 and August 1999.

Given its economic importance, *public procurement* is a key area of the Internal Market where the legal framework needs to be properly implemented and enforced. Published public procurement contracts have a value of a little less than 2 per cent of GDP whereas public procurement markets (including those of the Ministries of Defence) amount to 14 per cent of EU GDP. Several indicators (directives not yet transposed, number of reasoned opinions, low value of calls for tenders published in the Official Journal) point to remaining problems in this area in a few Member States (Germany, Italy, the Netherlands and Austria).[11] The New Approach to *technical standardisation*, i.e. the legislative harmonisation of essential product requirements, has gradually grown in importance for the elimination of the remaining technical barriers to trade in the Union.

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10 Caution is required when comparing price dispersion in the EU with that in the United States.

11 See also the second Commission report under the Cardiff process, "Economic reform: Report on the functioning of Community product and capital markets", COM (2000) of 26.01.2000.

5.2 Competition policy - modernised legislation and some progress regarding State aid

Competition policy has an important role to play in safeguarding and enhancing the flexibility and the efficiency of product markets. In this area, a majority of the Member States have made an important effort to modernise their competition legislation and to reduce State aids. In the United Kingdom, the new Competition Act, strengthening the powers and independence of the competition agencies, comes into force on 1 March 2000 and in six other Member States (Belgium, Germany, Spain, France, the Netherlands and Austria) the competition law was tightened up or simplified in 1999. However, a number of Member States still lack a fully independent competition authority.

In nine Member States, the national competition authorities now have powers to enforce Articles 81 and 82 of the EU Treaty, dealing with agreements between enterprises and abuse of dominant positions. This is not yet the case in Denmark, Ireland, Luxembourg, Austria, Finland and Sweden. However, in Sweden, the government is examining the possibility of giving power to the national authority to enforce Articles 81 and 82 and it has presented a bill to simplify merger control. It is foreseen that appropriate measures will be taken by April 2000. In Austria, the new Cartel Act was adopted in July 1999, extending the scope of the prohibition of cartels. Finally, in Denmark, it is expected that Parliament will this year adopt a new Law to give the Competition Council powers to control mergers and to fine companies for infringements.

Regarding *State aid*, its relatively high levels demonstrate the need for continued strict control and rigorous application of the Community rules. However, there have been some positive developments over the recent years. In particular, the declining trend observed since the beginning of the nineties appears to be continuing. State aid levels (excluding agricultural aids) as a percentage of GDP are still relatively high in Germany, Italy and Portugal.

The composition of State aid, not just its total volume, influences its impact on competition in the Internal Market. The share of ad hoc and sector-specific aid should be reduced. In this respect, another encouraging evolution is the decline in the share of ad hoc aid in almost all Member States with the notable exception of France, where this type of aid still accounts for almost a quarter of its total aid, the highest proportion in the Union. A substantial decline has been observed in Germany where ad hoc aid has been halved. Sector-specific aid is still relatively high in Belgium (railways), Germany (coal, railways but again declining in absolute terms), Greece (railways and airlines, where a large reduction is now seen), Spain (railways, coal, shipbuilding) and France (railways and financial services) and Ireland (financial services). In Italy, a positive development is the reduction in the share of sector-specific aid. Regarding the structure of State aid, the share of regional aid has increased at the expense of other horizontal objectives. Horizontal aid clearly predominates in countries such as Denmark, the Netherlands, Austria and Finland.

5.3 Public utilities - progress in the telecommunications and the electricity sector

The efficiency of certain key utilities is crucial in order to ensure a supportive business environment and to increase the potential for economic growth. It is vital to continue efforts to increase competition and improve the regulatory framework in sectors such as public utilities, distribution and financial services. In the public utilities, liberalisation is under way but at a speed which differs between sectors and Member States. Progress has been faster in telecommunications and the introduction of competition has progressed in electricity as well. On the other hand, the liberalisation of gas, railways, water and postal services has been slower.

During the last decade, the *telecommunications* sector has been opened up to competition in all the Member States. New entrants have penetrated the market, reducing the market share of incumbents, and, as a result, a substantial reduction in prices was observed in most Member States. For example, according to the Fifth Report on the Implementation of the Telecommunications Regulatory Package, the prices of long-distance national and international telephone calls in the European Union fell by an average of 27 per cent and 38 per cent respectively over the period 1997-1999 (see Table 11). The decline in prices was very significant for national calls in Ireland (54 per cent), Austria (41 per cent) and Sweden (39 per cent) and for international calls, in the Netherlands (89 per cent), Germany (67 per cent) and Luxembourg (63 per cent). Despite this progress, the incumbent operators still have a dominant position in most Member States, particularly in the local access market. In some Member States (Belgium, Spain and France), the lack of powers of the regulatory authority or of transparency is a cause for concern.

The introduction of competition in *electricity and gas* markets has progressed as well. The Community Electricity Directive providing for a progressive opening of national markets to competition has been transposed in all the Member States (see Box 6). Most Member States have set themselves ambitious liberalisation targets in terms of market shares and segments open to competition, and price reductions have already been reported in some countries. The deadline for the implementation of the Gas Directive is August 2000. Greece and Portugal, where the use of natural gas is in its infancy, have received a ten-year derogation period for the liberalisation of this sector. Important measures to open up the gas market have been taken in the United Kingdom (where all consumers can now choose their suppliers) and Spain (where 46 per cent of the market was opened up in 1998). This year, Austria will open up its markets completely while Ireland plans to implement legislation to open up 75 per cent of its gas market. The Netherlands and Belgium will open up 45 per cent and 47 per cent, respectively.

In the *railways, water and postal sectors*, the liberalisation process has progressed at a slower pace. However, some measures have been taken to increase competition. In the railways sector, there has been a trend toward the separation of the management of infrastructure from the operation of services. The extent to which this has been carried out varies from the creation of internal divisions to legally separate companies. Steps in this direction have been taken in Belgium, Denmark, Germany, Spain, France, Italy, Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom. All Member States have now formally separated the accounts of infrastructure management and rail operations as required by Directive 91/440. In the postal sector, a Community Directive has been adopted opening up the sector to competition. However, it still awaits transposition in several Member States.

Competition in or for the provision of services provides a spur to encourage improvement in this area. With regard to management of the infrastructure, new challenges are emerging, such as the need to improve the regulatory oversight of the railways so as to provide adequate incentives for investment and efficiency while protecting consumer interests. This issue has been particularly acute in the United Kingdom. This balance between safeguarding the interests of producers and consumers is crucial for all the network industries (see Box 7).

5.4 Distribution - further liberalisation is necessary

Improving the efficiency of the *distribution sector* is essential for the good functioning of product markets. An efficient distribution sector could widen the variety of products offered to consumers and lead to lower prices. The greater transparency of prices associated with the advent of the euro could stimulate the development of arbitrage operations and, in this respect, the distributors will have a crucial role to play in the process of downward convergence of price levels.

However, land-use planning (in the Netherlands and Sweden), limits on shop-opening hours (Belgium, Denmark, Germany and Austria) and specific restrictions on large-scale retail outlets (Spain and Portugal) continue to limit competition in this sector. In some of these countries (Denmark, Germany and Sweden), the impact of these regulations is being investigated. In Italy, a significant process of liberalisation of the retail distribution sector started in 1998, leading to a deregulation of shop-opening hours and a simplification of start-up procedures. The retail distribution sector is highly concentrated in several Member States, most notably in Finland and Sweden, and this can contribute to the relatively higher price levels in these countries. In France, the government, which is concerned about the risk of abuse of a dominant position in the relations between producers and retailers, will submit a draft law in 2000 to regulate these relationships.

5.5 Public administration - increasing efficiency and avoiding unfair competition

A modern public administration is crucial for the good functioning of an economy. This is particularly true in the EU due to the relatively large size of government in most Member States. Therefore, measures to improve the efficiency of public administration, such as the use of new management and communication (e-commerce, internet) techniques, are welcome and more particularly so in those Member States, such as the Nordic countries where the share of the public sector is higher than the EU on average. In this respect, Finland has made a specific effort to promote the use of market-oriented procedures for the provision of public services. In general, and particularly in those countries, it is essential to avoid unfair competition being imposed on private companies by the public sector.

Some Member States (notably Belgium, Ireland, the Netherlands, Finland, Sweden and the United Kingdom) have chosen to promote Public-Private Partnerships in order to bring in private sector management and expertise and efficient risk sharing to public sector services. These initiatives can contribute to increasing efficiency in public services by introducing market mechanisms into their provision. However, attention should be directed to avoiding a lack of transparency in the relationships between the public and the private sectors which could distort competition or indicate a State aid to the private partner.

5.6 Other regulatory reforms - reducing the regulatory burden of starting new businesses

In recent years, governments have been increasingly aware of obstacles to business start-ups, such as complex administrative procedures, inadequate financing possibilities and limited information. Administrative procedures were particularly heavy in Germany, Greece, Spain and Italy, and lower in the Nordic countries, Luxembourg and the United Kingdom.

Many Member States have now undertaken programmes and measures to improve the regulatory environment of business. These measures include the establishment of one-stop shops for small companies (Spain, France, Italy, Portugal and the United Kingdom), the simplification of bureaucracy in order to reduce business set-up times (Belgium, France, Ireland, the Netherlands, Portugal, Finland and Sweden) and the reduction of the costs of registering a company (France and Austria). In addition, some Member States have reduced tax burdens on SMEs (Germany, Greece, Austria, Portugal and the United Kingdom). Further effort to improve the business environment could be made in Greece, Spain and Italy.

5.7 Innovation - reforms to improve the technological performance are necessary

Innovation is a driving force behind competitiveness and employment. Europe lags behind the United States in terms of innovative capacity and this gap seems to have increased since the mid-1990s. In 1998, R&D expenditures accounted for 1.8 per cent of GDP in the European Union against 2.8 per cent in the United States. R&D expenditures show quite a large dispersion between the Member States: they range between 0.5 per cent of GDP in Greece and 3.9 per cent in Sweden (see Table 12). On the one hand, one finds Portugal, Spain and Italy, with percentages of R&D expenditures around or below 1 per cent and on the other, Germany, France, the Netherlands and Finland with percentages between 2 and 3 per cent. Austria has set a target of raising R&D spending to 2.5 per cent of GDP by the year 2005 (up from 1.6 per cent of GDP in 1998). Furthermore, the Union's research efforts suffer from fragmentation and compartmentalisation. The regulatory and administrative frameworks and the reference systems for research show wide variations and there is hardly a real "internal market" for scientific knowledge and technology.

Europe also lags behind the United States in the production and diffusion of Information & Communication Technologies (ICT) with great variation across Member States. Two countries, Germany and the United Kingdom, are responsible for almost half of the total EU production of ICT goods. In terms of ICT penetration, the Nordic countries are in the lead. The diffusion of ICT in the Benelux countries, Germany, France and the United Kingdom is at an intermediate level while the lowest ICT penetration rates are found in Southern Europe.

This comparison with the United States points to the need for the European Union to increase and improve its effort in R&D and to increase the production and diffusion of ICT. Many Member States have started to undertake reforms to that end. In Ireland, where the level of government R&D expenditure is particularly low, additional budgetary resources have been allocated for the period 2000-2006. Regarding innovation, initiatives have been taken to encourage a better collaboration between research institutes and industry (Denmark, Germany, Greece, France, the Netherlands, Portugal, Finland and Sweden), since the major handicap of Europe is its difficulty in converting scientific research into commercial results. Other measures include the funding of R&D projects (Ireland) and tax incentives to stimulate R&D spending (Spain, Austria and United Kingdom).

The importance of the diffusion of ICT has been recognised by Community policies and several Member States. This issue was taken up in the evaluation process of the national Action Plans for Employment. In the Employment Guidelines 2000, Member States have agreed to provide access to Internet and other PC facilities in schools by the end of 2002. Furthermore, several Member States (Belgium, Germany, France, Portugal and the United Kingdom) have taken measures encouraging the use of the Internet and PCs.

But in order to reduce the fragmentation of the Union's research effort, a true «European research area» must be created. This would enhance scientific and technological activities in the Union, while fully taking advantage of the high potential already existing in the Member States.

Finally, serious skill shortages are a further barrier to fully exploit the innovation potential of the information society, and thus of growth and employment in the Union. While the skill gap at the expert level is estimated to be important, the information society changes skill requirements outside the ICT sector. This requires an improvement in human capital formation and, in particular, demands basic ICT literacy across the economy.

6. MORE INTEGRATED AND DEEPER CAPITAL MARKETS

The 1999 BEPGs urged Member States to: *(i) co-ordinate their efforts for reducing differences in national regulations and tax regimes, while preserving the consistency with prudential and fiscal national requirements; (ii) ensure, where appropriate, that additional host country requirements only apply to financial services offered to retail customers and not to professionals; (iii) ensure that existing national "general good" rules, which aim at ensuring consumer protection and promoting cross-border business, are applied in a transparent and proportionate manner; and (iv) promote risk taking and innovation in the Union* (see Box 8 for the country-specific recommendations).

The 1999 BEPGs stressed the need to eliminate the differences in national regulatory and fiscal regimes which continue to fragment the EU financial markets, and to develop deeper and better functioning risk capital markets. Particular consideration was to be given to the rules applying to institutional investors, to the pursuit of a policy distinguishing between professional and individual consumers when imposing additional host country requirements, to increasing transparency in the application of national "general good" rules aimed at consumer protection, and to the facilitation of access to risk capital for SMEs and to R&D financing for all enterprises.

The introduction of the euro has had significant effects across the spectrum of European financial markets, contributing to the creation of deep, broad and liquid markets. However, as identified in the 1999 BEPGs, obstacles remain to the achievement of fully integrated financial markets. Progress has been made during 1999 both on the basis of initiatives taken at the EU level and as a result of the reforms introduced by Member States.

At the EU level, implementation of the Financial Services Action Plan is progressing on the basis of the work of the Financial Services Policy Group and of five groups of market experts. A progress report was issued in November 1999. Within this framework measures corresponding to the 1999 BEPGs recommendations have been taken: the Commission has issued a Communication on Funded Pension Schemes and is actively preparing a draft directive on the prudential supervision of pension funds. A draft Communication on the distinction between "sophisticated" investors and retail investors is under preparation in close co-operation with FESCO.[12] The Commission is preparing, with the assistance of a group of market experts, a Communication codifying clear and comprehensible information for purchasers of retail financial products and services. Finally, the Commission has issued a Communication setting out concrete proposals for moving forward with the implementation of the Risk Capital Action Plan, based on a review of developments on risk capital markets and of measures already taken.

At the level of the Member States, the issue of risk capital has been addressed by all Member States and various measures have been taken which have contributed to the growth of these markets. However, despite these efforts, the European venture capital market remains significantly smaller than in the US and insufficiently oriented towards young and innovative companies. Measures of particular interest have been taken in Denmark, France, Ireland, Italy, the Netherlands, Finland and the United Kingdom mainly in the form of financial assistance programs to innovative SMEs, tax relief schemes, employee ownership schemes and stock options, relaxation of quantitative investment controls on pension funds and insurance companies. Measures to provide financial support need of course to comply with State aid rules to ensure they do not distort competition.

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12 The Forum of European Securities Commissions.

Other initiatives such as the reform of the legislation on insolvency and bankruptcy have been considered crucial by many Member States, but up to now have only been implemented by few of them.

Beyond the issue of risk capital, information on other reforms introduced by the Member States to increase the integration and the efficiency of their capital markets, information is less systematic and an overall assessment is difficult to make. Some Member States have undertaken reforms to reduce specific quantitative constraints on investment rules for pension funds (in Belgium for example), insurance companies (in Sweden) or investment funds (Spain and France). A law allowing the creation of pension funds have been introduced in Luxembourg and the reforms of pension systems underway in Germany and Sweden should have an impact on the deepening and widening of the financial markets. The notion of 'qualified investor' has been introduced in French law, while in the UK an exemption from investment promotion rules will enable companies to communicate directly with sophisticated investors. In a large number of Member States, legislative changes introduced or being considered to improve corporate governance will increase transparency.

A revision of the financial services sector supervisory framework has been launched in several Member States with the aim of setting up a single authority to supervise all financial institutions (as in Ireland) or to improve supervision of financial groups (as in Denmark).

Disengagement of the State from the financial sector has continued in Greece, France and Italy, and is starting in Ireland. The banking sector is in general undergoing a major restructuring and consolidation process. This has been particularly noticeable in Belgium, the Netherlands and in Spain, giving rise to new concerns in terms of competition and of supervision of the new entities.

Finally there have also been important developments among market institutions with the creation of links and alliances among national stock exchanges and markets, and the creation, in several Members States, of stock markets for young and growing companies. These new markets which offer high-growth companies a new source of financing, have grown strongly and, by the end of 1999, some 750 companies were listed on the Euro.NM network (consisting of the Paris, Frankfurt, Amsterdam, Brussels and Milan new markets), EASDAQ and AIM.

7. BETTER FUNCTIONING LABOUR MARKETS

The 1999 BEPGs recommended *that the integrated four-pillar strategy set out in the employment guidelines should be fully implemented and in a prompt and transparent manner.* In particular, it insisted on *(i) policies that acted on both the demand for and supply of labour by applying the preventive approach of the employment guidelines and (ii) reviewing and adapting, where appropriate, the tax and benefit systems to ensure that they actively support employability and job creation* and encouraged *the social partners to modernise the organisation of work and to prevent any overall reduction of working time from increasing unit labour costs whilst taking future needs in terms of increased labour supply into account* (see Box 9 for the country-specific recommendations).

7.1 Overall trends

In the EU as a whole, labour market performance improved during 1999 as the economy picked up. Unemployment fell to 8.8 per cent s.a. in January 2000, the lowest level since June 1992, and employment growth is forecast to remain robust over the next two years. The job-content of growth in the 1990s appears to be high by historical standards, with GDP growth in the expansion phase of the present decade being comparable to that achieved in the 1980s, but with employment now growing at a faster pace. As a result, apparent labour productivity growth seems to have experienced a slowdown.

It must be stressed that the picture among and even within the various Member States is highly diverse (see Graphs 8 and 9). Some – Denmark, Luxembourg and the Netherlands – have matched or surpassed the US in achieving robust employment growth and low unemployment. In Denmark, Spain, Ireland, the Netherlands, Finland and the United Kingdom, the particularly sharp fall in unemployment in recent years strongly suggests a fall in structural unemployment, given the relatively moderate wage growth at this point in the economic cycle. Thus, while the improved employment performance is partly due to the favourable macroeconomic environment, the policies pursued in some Member States have played an important part – in particular, structural reforms of labour markets, including a shift in focus from benefit dependency to the preventive approach based on active labour market measures. The benefits of comprehensive reforms are most evident in the cases of Denmark, the Netherlands and the United Kingdom.

However, there also remain considerable grounds for concern. The low employment rate is constricting the EU's growth potential and undermining the long-term sustainability of public finances. Moreover, as cyclical unemployment has fallen, wage pressures have begun to emerge in a number of Member States, although in general these remain moderate to date. Structural unemployment is still unacceptably high, particularly in the large euro-area countries. Moreover, it is highly concentrated – in deprived communities, among women, young people and the low-skilled. There are very wide regional disparities in unemployment within several Member States, particularly Belgium, Spain, Italy and Germany. Finally, around half of total unemployment is still long-term, which is symptomatic of the structural nature of the problem (see Graph 10). The proportion is at 50 per cent on average in the euro area, and much higher in several Member States that experience particular structural problems in the labour market. Much remains to be done, in particular, in Belgium, Germany, Greece, Spain and Italy.[13]

Progress on policies to improve the functioning of labour markets has on the whole been modest, when compared with structural reforms in product and capital markets and the consolidation of public finances. It is therefore important to underline the important role of structural reforms and active measures in raising the employment rate and in bringing down structural unemployment. Significant progress here would make an important contribution to raising the EU's longer-term growth potential as well as fostering social inclusion.

7.2 Active labour market programmes - considerable progress realised

Many Member States, as documented in the Joint Employment Report 1999[14], have made significant progress in implementing a preventive approach to tackling youth and long-term unemployment, based on active labour market programmes (ALMPs) in line with the employment guidelines. Such policies, by improving skills and employability, and by keeping people in touch with the labour market, can make an important contribution to reducing structural unemployment. Of course, they can also involve displacement and administrative costs, and programmes need to focus on those with most difficulties in integrating into the labour market. In the case of Sweden, where active labour market programmes have been an important component of economic policies for decades, the scope of ALMPs grew rapidly as unemployment rose in the early 1990s. More recently, the coverage has been reduced to 3 per cent of the labour force and the composition has been changed in favour of labour market training, an alteration designed to improve the efficiency of these programmes. In France, where the 'New services – jobs for young people' scheme had created 200,000 jobs by June 1999, there may be a risk of high displacement and dead-weight costs, especially as economic growth is picking up.

Some Member States have also taken important steps towards combining active policies with an assessment of benefit duration and eligibility criteria, and towards increasing the efficiency of active measures through targeting programmes to individual needs. Recent reforms in Spain and the United Kingdom provide examples of this shift from passive to active measures. In Denmark and the Netherlands, activation measures are clearly targeted according to an assessment of individual needs. In Finland, the quality of the employment services has been improved, as have results in terms of activation of young and long-term unemployed people.

Other countries, however, still have important progress to make if they are to meet the quantified medium-term targets for active measures set out in the employment guidelines. In Belgium, Greece and Italy there are concerns regarding delays in implementing preventive measures on youth and long-term unemployment, while concrete progress is somewhat lacking in Germany. In Portugal, an adequate benefit system is still needed to support active measures.

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13 In the case of Ireland, figures on long-term unemployment are only available up to 1997. However, national estimates suggest that long-term unemployment as a percentage of total unemployment fell considerably during 1998.

14 The "Joint Employment Report 1999" presents a detailed assessment of the implementation of the employment guidelines. Its findings led to the issuance of country-specific recommendations which were adopted by the Council in late 1999. The present report supplements this assessment and focuses on the recommendations made in the 1999 BEPGs.

7.3 The tax burden on labour - many reforms to reduce labour taxes

A majority of Member States have reduced income taxes and social security contributions for labour, with reductions often targeted at the lower end of the wage scale. These efforts have been underway since the mid-1990s and have resulted in a modest fall in the direct tax burden on labour (shown in Table 7 as the labour effective tax rate). A number of Member States have adopted or announced additional reductions in this area. Measures to reduce the tax burden on labour have recently been taken or announced in Germany, Ireland, Italy, Austria, Finland and Sweden and in addition, reductions have been targeted at the lower end of the wage scale in Belgium, Denmark, Greece, Spain, France, Italy, the Netherlands and the United Kingdom. In many Member States, tax/benefit systems hamper female labour supply. In several Member States, tax systems create a disincentive to women's participation in the labour market by imposing high marginal tax rates on second incomes, for example.

This overall reduction in the direct tax burden on labour has been financed mainly by shifting the burden to indirect taxes such as VAT or energy and environmental taxes. Over the next few years, in line with further tax reforms already announced, even the tax wedge on labour is forecast to fall.

7.4 Benefit systems - little overall progress despite good results in some countries

High levels of unemployment benefits, if combined with long duration and lax eligibility rules and administration of benefit systems, tend to undermine incentives to search for a job or to participate in active labour market programmes (see Table 13). Thus, in some Member States, there is a risk of keeping people dependent on benefit schemes for longer than appropriate. On top of this, other benefit systems – early retirement or disability schemes – are frequently used instead of unemployment benefits with similar if not worse results in terms of discouraging engagement with the labour market and reducing effective labour supply. A high proportion of the population is in long-term benefit dependency in a number of Member States, including some of those with very low official unemployment rates such as Denmark and the Netherlands.

A few countries have started a systematic review of their benefit systems and have begun to undertake major reforms. Common themes on the reform agenda include addressing the combined incentive effects of the tax and benefit system, tightening eligibility criteria and job availability requirements while linking receipt of benefits more closely to active labour market programmes to improve employability, and introducing employment-contingent benefits and tax credits. The United Kingdom's labour market reforms have gone a long way in these areas, and the Netherlands too plans to introduce tax credits for working people on low incomes, although it is too early for a full evaluation of these schemes. Denmark stands out as a positive example where job availability criteria for unemployment benefits and social assistance have been tightened up significantly, in combination with better education and training opportunities.

Apart from these few countries – where reform efforts have paid off by contributing to important reductions in structural unemployment – reforms in the area of benefit systems have so far been often very modest and piecemeal. There have been no substantial reforms as of yet in Germany or in Belgium (where unemployment insurance is still of indefinite duration for some types of worker, although the government is reviewing this). Reforms are under consideration in Italy, but this is proving politically and financially difficult. In Finland, since the measures taken to recover from the last recession, efforts to reform benefits have been weak.

7.5 Work organisation and flexibility - some but insufficient progress

Some progress has been made on modernising work organisation. A number of Member States have taken measures to facilitate part-time work while limited progress was made in some member States in the areas of flexible and annualised working time. Progress in these areas is also important from the perspective of promoting gender equality. In addition, some Member States have made efforts to facilitate female labour-market participation, for example by improving child-care facilities, although further progress is needed. Very little has been done to address the problems of rigid employment protection legislation (EPL) and excessive dismissal costs in some Member States, which tend to discourage the recruitment of new permanent staff. The failure of labour costs to adjust to significant regional productivity differentials in certain Member States, particularly Belgium, Germany, Spain and Italy, is indicative of a general lack of labour market flexibility. There is little evidence to suggest that the social partners have taken initiatives to the extent required in response to the invitation in the 1999 BEPGs and the employment guidelines to negotiate at all appropriate levels agreements to modernise the organisation of work.

There have been no substantial reforms of EPL in Belgium, Germany or Italy and, in France, it has been tightened slightly, if anything. In Spain, the share of temporary contracts is still high, and further reductions in the costs of dismissals are needed. In Portugal, there is also some concern over the share of temporary contracts, as well as the lack of progress on flexibility and dismissal costs. In Greece, new legislation on part-time work, informal working hours and working time is in place, but not fully implemented. In Austria, there has been no substantial modernisation of work organisatin.

Box 1: 1999 country-specific recommendations for budgetary policies

Belgium: (1) Meet the 1999 budget target of 1.3% of GDP in 1999. (2) Ensure that the real annual growth of primary expenditure rate is contained within the 1½% limit set in the stability programme. (3) In future years, maintain the primary surplus at 6% of GDP. (4) Renew the "co-operation" agreement between the Federal government, the Regions and Communities.

Denmark: (1) Seek to maintain a strong government surplus in 1999, in line with the planned surplus of 2.5% of GDP. (2) In the medium term, maintain the reduction of distortions in the tax system (included in the "Whitsun package").

Germany: (1) Respect the target for the government deficit of 2% of GDP in 1999. (2) Make faster progress with the medium-term objective of the deficit if the strengthening of the economy in 2000 is stronger than foreseen. (3) The tax reform, implying a cut in tax rates and a simultaneous widening of the tax base, should also result in an effective simplification of the tax code.

Greece: (1) Achieve the target for a government deficit in 1999 of 1.9% of GDP. (2) Aim for a further decline in the budget deficit for 2000, helped by a reduction in the primary current expenditure ratio to GDP. (3) Increase further the efficiency of the tax system by combating tax avoidance and evasion. (4) Reform the public sector.

Spain: (1) Meet the target for the government deficit of 1.6% of GDP. (2) Reaffirm in the budget for 2000 a deficit of 1.0% of GDP; adopt a tighter fiscal stance, if evidence of overheating emerges. (3) Reinforce control of government expenditure; monitor closely and respect fully the existing internal stability pact between the regions and the State.

France: (1) Respect the target for the government deficit of 2.3% of GDP. (2) Control government expenditure in 1999 and subsequent years. (3) Use the expected strengthening of economic activity in 2000 and beyond to make progress towards the medium-term objective for the deficit projected in the favourable scenario of the stability programme.

Ireland: (1) Restrain the economy by appropriately using budgetary policy if there evidence of wage inflation that continues to gather pace. (2) Restrain the growth in government consumption from the estimated 5% volume increase in 1998 to 2% in 2001.

Italy: (1) Avoid any significant slippage from the target for the primary surplus and limit any weakening in the primary surplus to no more than due to the operation of the automatic stabilisers; respect the target for the total deficit of 2% of GDP, helped by savings in interest payments. (2) Aim to re-establish the primary surplus of 5.5% of GDP with the budget of 2000. (3) Tightly control government current primary expenditure in 1999 and subsequent years. (4) Re-assess the reform of the pension system.

Luxembourg: (1) Monitor closely public expenditure. (2) Pursue the necessary long-term reforms, especially in the field of social security.

Netherlands: (1) Respect the target for the government deficit of 1.3% of GDP. (2) Pursue as a minimum objective the very limited reduction in the deficit to 1.1% of GDP in 2002 as set out in the cautious scenario of the stability programme.

Austria: (1) Meet the target of 2% of GDP for the government deficit in 1999 through tight control of government expenditures. (2) Overachieve the budgetary targets set in the stability programme and ensure that the general government debt ratio is kept firmly on a downward path. (3) Realise significant savings on the expenditure side.

Portugal: (1) Ensure the target for the government deficit of 2% of GDP. (2) Pay close attention to primary current expenditure, especially health expenditure and the government's wage bill. (3) Implement swiftly the structural reforms with a direct impact on the budget outlined in the stability programme. (4) Introduce private-public partnerships in healthcare systems and review eligibility criteria of pensions.

Finland: (1) Increase the government surplus further so as to cope with the rapidly ageing population and the pressure that this will impose on the social accounts. (2) Give priority to the reduction in central government deficit. (3) Base further fiscal consolidation on a reduction in government expenditure. (4) Firmly respect the stability programme's annual ceilings on central government expenditure for the years 2000 to 2002.

Sweden: (1) Adhere to the announced policies since these are expected to achieve the government's budgetary targets of a rising government surplus. (2) Ensure the maintenance of the tight expenditure control on which its budgetary outlook is heavily reliant. (3) Seek ways of reducing the tax burden further.

United Kingdom: (1) Adhere strictly to expenditure plans so that the government's fiscal rules can be respected and the medium-term objective of public finances broadly in balance by 1999/2000. (2) Take promptly corrective action if the government balance deteriorates unexplainable by the economic cycle.

	Box 2: Recent developments as regards public pensions
B	Building on important reforms introduced in 1997 for private sector employees, the new government together with social partners is reflecting upon further reforms to cover for public sector employees and the self employed. Consideration is also being given to promote private funded pensions.
DK	The transformation a largely unfunded system to one with a much higher degree of funding has been underway for some years. 1999 saw a temporary contribution to the ATP (Labour market supplementary pension) amounting to 1% of the average wage made permanent and a tightening up of early retirement rules.
D	Pension reform was very high on political agenda. A tax reform package was agreed enabling increased revenues from energy taxes to partially offset a reduction in the contribution rate to pensions by employees and employers. Changes were also agreed for 2000/2001 linking increases in public pensions to inflation rather than the evolution of net wages. However, important reforms agreed in 1998 and due to come into force in 1999 were suspended by the new Government for two years, pending important reforms due to be announced in 2000.
EL	A two phase reform strategy was announced in 1998. The first phase was largely organisational, involving for example the introduction of single social security number. The second phase requires a major overhaul of public pensions, and could involve the consolidation of retirement ages in different pension regimes, adjusting contribution and eligibility rates to sustainable levels, and the introduction of compulsory occupational pension scheme. Announcements on the second phase are still being awaited.
E	Important reforms were introduced in 1997 (based on the 1995 Pacto de Toledo) which placed public pensions on a more sustainable footing. Further reforms are scheduled for 2000. They will need to address measures to increase the effective retirement age and discourage early retirement, and special pension regimes (e.g. covering self-employed, agricultural workers). In 2000, minimum pensions will increase by between 5.4 and 16 per cent depending on the type of pension, though on average by only slightly above 5.4 per cent. In 2000 a Social Security fund reserve has been created to address the problem of the ageing population . The initial fund amounts to 0.1% of GDP and there is a commitment in the updated Spanish Stability Programme to further increase this fund reserve.
F	After postponing reforms adopted in 1997, a report was presented in 1999 to serve as a basis for dialogue between authorities and social partners which is now taking place. Reforms are scheduled for 2000 and could include measures to raise the effective retirement age, whether special pension regimes need to be brought in line with the 'general regime', and possible strengthening of a Social Security reserve fund which was established in the 1998 budget.
IRL	In May 1998, the Government outlined its plans for creating a fully developed pension system. As part of the 1999 budget, an annual provision of 1% of GDP will be made to pre-fund future public pension costs. This fund was supplemented with part of the proceeds from the privatisation of the State telecom company. Part of the proceeds were also use to buy-out the State's future pension liabilities to pre-privatisation staff.
I	A series of reforms in the 1990s, the last one in 1997, have contributed to stabilise the ratio of pension expenditure to GDP in the medium term, but it remains high. The main weaknesses of past reforms are excessively long transition periods, 'excessive' generosity, and uncertainty about future reforms. No reforms were undertaken in 1999.
L	Reforms were introduced in 1998 to align the pension regime for new public servants with that applying to the private sector.
NL	With a large proportion of pensions already funded, the impact of ageing populations is being addressed via the reduction of public debt and measures to increase employment rates.

A	Large reform packages were adopted in 1993 and more recently in 1998. The latter reform addressed incentives for early retirement, tightened up eligibility for disability pensions, and aligned the pension system for civil servants to the general system. Also an annual adjustment formula was introduced making an adjustment for the financial impact of increased life expectancy. This was, however, suspended in 1998 and 1999 and must be addressed in 2000.
P	A new framework law was presented by the new Government in late 1999 in response to a White Paper presented in 1999. Reforms are therefore expected to be adopted in 2000. Inter alia, it will need to address the creation of a compulsory second pillar contributory based scheme, and tackling early retirement.
FIN	During 1999, agreement was reached between labour market organisations on measures to postpone early retirement and extend active participation. Together with a large primary balance, this will make it easier to meet increased age-related expenditures in coming years. However, questions remain about the long-term sustainability of existing public pension schemes, and further reforms are likely to be required to tackle imbalances at source.
S	Reforms adopted 1998 are currently being phased in. They are increasing the degree of funding pensions. They also establish a closer link between contribution paid and benefits received, and indexation clauses were adjusted.
UK	Projections released in 1999 show a broadly sustainable long-term position for the UK's public finances. Extensive reforms were proposed in late 1998 and adopted in 1999. They provide for a 'minimum income guarantee' and a replacement of SERPS (state earnings related pension scheme) with a second flat rate pension.

Box 3: Tax reforms in EU countries					
	Social security contributions	**Personal income taxes**	**Corporate and capital taxes**	**Consumption taxes**	**Others (Energy, environment)**
B	Lowering of SSC, specially for the low-paid.			Lowering of VAT on labour-intensive services.	
DK[1)]	The temporary contribution to the supplementary pension systems is made permanent.	Reduction of marginal tax rates for low incomes.	Simplification of tax-rules on sharehold-ings for individuals. A 5% tax on stock-return to pension funds has been intro-duced. Gradual reduction in tax deductions for interest payments on mortgages (1999-2001).		Increase energy taxes.
D[2)]	Reduction of SSC to the pension system by 0.8 pps.	Across-the board reduction of income taxes. Minimum marginal rate from 25.9% 19.9%; maximum from 53% to 48.5%. Minimum exempted income will be raised.	Corporate tax rate cut to 25% (from 40% and 30% for non-distributed and distributed profits, resp. No taxes on capital gains when hol-dings are sold between com-panies.		Ecological taxes have been introduced in 1999 and will gradually increase to finance reductions in SSC.
EL	Reduction of employers' SSC (50%) on new staff.	Tax cuts for low incomes.	Tax relief for venture capital.		
E	Targeted SSC cuts for permanent contracts (0.2 pps employers, 0.05 employees (2000).	Reduction (8 pps) of marginal rates at the top. Increasing of exempted income (1999).	No withholding tax on securities. Tax incentives for venture capital.		
F	Employers' SSC cuts at the lower end of the wage scale.		Tax incentives for young innovative companies.	Reduced VAT rates on households repairs and services.	Rise in ecological taxes to finance reduction in working time
IRL		Reduction of the top rate (46 to 44%) and of the standard rate (24 to	Tax relief and reduce rates for capital gains for venture capital.	Increase in indirect taxes on tobacco.	

		22%). Increase of the minimum exempted income.			
I	SSC rebates for new jobs, as well as at the lower end of the wage scale.	Tax rate of the 2nd break down 1 pp (from 27 to 26%).	More incentives to capitalisation of profits. Incentives for risk capital.	Reduced VAT rates on labour-intensive services.	
L				Reduced VAT rates on some labour-intensive services.	
NL[3)]	Reduction of SSC at the lower end of the wage scale.	Increasing the minimum exempted income. Reduction direct taxes on labour income (2001).		Reduced VAT rates on some labour-intensive services. Increase of VAT (1.5pps – 2001).	
P	Harmonisation of SSC for the self-employed and the employed.				
A		Increase of family allowances. Reduction of rates at the bottom and the middle.			
FIN[4)]	Reduction in SSC	Rates reduced by 1.5 pps sin 1997-99. New reductions planned for 2000-2003.	Rates increased from 28 to 29% in 2000.		Increase of energy and environmental taxes in 1999.
S		Lowering of income taxes in 1999 and 2000. Further reductions planned for 2000-2001.	Corporate taxes to be reduced in 2000. Tax reliefs 2000-01. Coupon tax on dividends to foreign companies partly abolished.		Increase in energy taxes in 2000.

UK	Reduction of SSC at the bottom. Reduction of employers SSC by 0.3% (2001).	Increasing the minimum exempted income when working and guaranteeing a minimum income (Working Families Tax Credit).			Climate change levy to finance SSC cuts.

1) This refers to the 1998 tax reform, named the "Whitsun package", which was adopted in June 1998 and is being gradually implemented between 1999 - 2002.

2) Tax Relief Act 1999/2000/2002. A further reduction in the tax burden is planned for 2003, with a reduction in the basic rate to 17% and in the top rate to 45%. Basic allowances will also be raised.

3) The Dutch stability programme (update 1999) foresees the review of the tax system by 2001.

4) The reductions in personal income taxes are meant to be partially financed by higher capital, corporate, energy and environmental taxes.

Source: Commission services.

Box 4: 1999 country-specific recommendations for structural reforms in product markets

Belgium: (1) Improve the record on implementing Single Market directives, especially in telecoms and transport. (2) Open up further the network industries: telecommunications, post, energy and transport.

Denmark: (1) Strengthen and apply more vigorously the existing competition regulations. (2) Introduce competitive tendering in the provision of public services. (3) Implement reforms in the electricity sector without delay. (4) Further review liberalisation of shop-opening hours.

Germany: (1) Improve implementation of Single Market measures in public procurement. (2) Continue to decrease State aids. (3) Increase efforts in liberalising services, including in retail distribution. (4) Further accelerate business registration procedures for creating SMEs.

Greece: (1) Improve transposition record on implementing Single Market legislation, particularly for public procurement. (2) Sustain efforts to privatise state-owned enterprises. (3) Reduce further administrative burdens for registering a new company. (4) Stimulate business R&D expenditure.

Spain: (1) Improve further the transposition of Single Market legislation, particularly for transport. (2) Reduce sector-specific state aids. (3) Deregulate retail distribution. (4) Reduce the number of procedures and time taken for company registration. (5) Continue efforts to promote industrial innovation. (6) Reinforce competition policy.

France: (1) Improve implementation of Single Market Directives, particularly in telecommunications. (2) Reduce rescue and restructuring State aids and increase emphasis on horizontal measures. (3) Realise faster progress in liberalisation of network industries, particularly in the energy sector. (4) Monitor closely measures to simplify formalities and encourage innovation.

Ireland: (1) Accelerate the reduction of its transposition deficit on Single Market legislation especially in transport. (2) Give power to the Competition Authority to enforce Articles 81 and 82 of the EC Treaty. (3) Consider initiatives to promote competition in telecommunications, electricity and gas supply, and domestic and international transport sectors. (4) Encourage venture capital, local R&D, and government participation to improve R&D performance.

Italy: (1) Make further progress in the transposition of the Single Market legislation, especially in areas such as transport and public procurement. (2) Reduce non-agricultural State aids and improve its overall composition of aids. (3) Intensify transport liberalisation. (4) Reduce the number of procedures and the time spent on registering a company.

Luxembourg: (1) Speed up implementation of Single Market regulations, particularly for telecommunications and transport. (2) Evaluate the necessity and effectiveness of regional aids. (3) Consider abolishing the price regulation system and shift to a more active competition policy.

Netherlands: (1) Speed up transposition of Single Market regulations, particularly in transport. (2) Monitor strictly the implementation of measures to strengthen competition and remove regulatory obstacles to business start-ups. (3) Speed up liberalisation of public transport. (4) Review the impact of spatial planning regulations on the efficiency of the retail sector.

Austria: (1) Accelerate transposition of Single Market Directives in transport and public procurement. (2) Speed up the reform of the 1988 cartel law and the creation of an independent Cartel Office. (3) Continue to reform public services and accelerate deregulating process of utilities. (4) Consider liberalising shop-opening hours further. (5) Continue and expand initiatives to simplify procedures to start new businesses. (6) Reach the objective of raising R&D expenditure.

Portugal: (1) Accelerate transposition of Single Market regulations, especially in public procurement, telecommunications and transport. (2) Reduce restructuring aids and aids to specific sectors. (3) Bring anti-trust legislation in line with EU legislation. (4) Pursue further liberalisation of network industries. (5) Review the law restricting licensing of large retail outlets. (6) Reduce administrative burdens on creating businesses. (7) Improve innovative activity.

Finland: (1) Give power to national authorities to enforce articles 81 and 82 of the EC treaty. (2) Monitor closely areas where public and private enterprise compete, and continue efforts to create a competitive environment in these areas.

Sweden: (1) Give the Swedish competition authority the powers to enforce Articles 81 and 82 of the EC treaty. (2) Improve the efficiency of the public sector. (3) Take further measures to increase competition, avoid market dominance, and promote new entry in the utilities sectors. (4) Review regulation that limits competition in retail distribution.

United Kingdom: (1) Improve the record of Single Market legislation, particularly in the area of transport. (2) Apply strictly new legislation that strengthens the powers of the Office of Fair Trading. (3) Adjust the tax structure in favour of SMEs.

Box 5: Differences in price levels between EU Member States

Price dispersion between Member States (as measured by the coefficient of price variation) declined in the run-up to the completion of the Single Market, from 20.1% in 1985 to 16.2% in 1993. In the period 1993-1997, this process of price convergence slowed down, which may be attributed in part to exchange rate fluctuations. In 1997, price dispersion equalled 14.8%. This figure is based on relative price levels including value added and excise taxes. The corresponding figure based on relative price levels excluding indirect taxes equalled 13.7%, which is above the 11% price dispersion reported for the United States.

In 1997, price levels were generally high in the Nordic countries, Germany, France and Luxembourg, but relatively low in the southern countries (see table below). Macroeconomic factors such as exchange rate developments, standards of living and indirect taxation levels may help explain these differences in price levels. However, other more microeconomic factors such as the opening up to international competition and an early liberalisation of public utilities may play a role as well. In order to eliminate the influence of some of the macroeconomic factors, the graph below presents a regression analysis of the pre-tax 1997 price levels on GDP per capita in Member States. Countries located above the estimated regression line had pre-tax price levels above what one would expect given their standard of living. This is the case most evidently in Sweden and Finland. The opposite is true for countries located below the regression line.

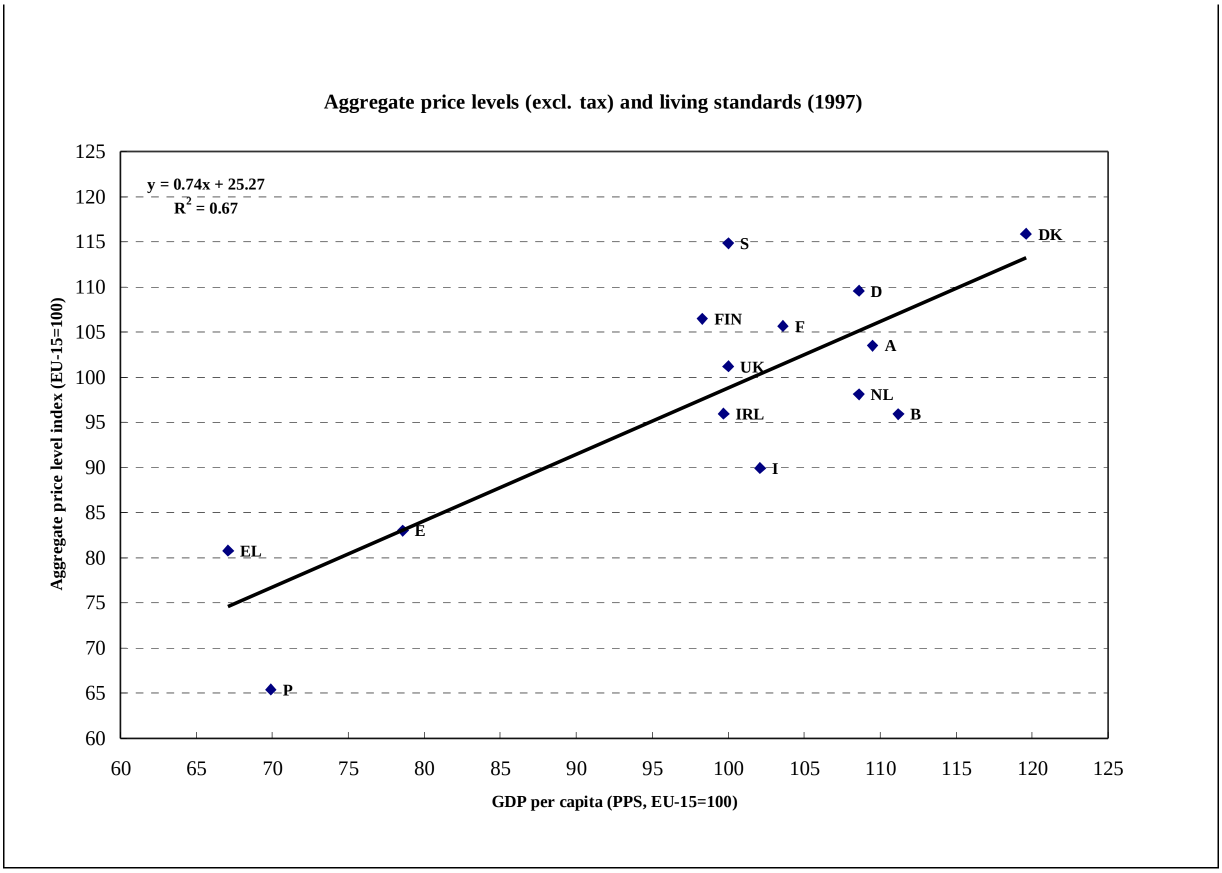
Relative price levels in the EU Member States

(1997, EU-15=100)

	Aggregate price levels incl. tax	Aggregate price levels excl. tax	GDP per capita at current market prices (PPS)
B	98	96	111
DK	121	116	120
D	108	110	109
E	81	83	79
EL	80	81	67
F	108	106	104
IRL	96	96	100
I	90	90	102
L	108	111	168
NL	98	98	109
A	104	104	110
P	65	65	70
FIN	109	106	98
S	120	115	100
UK	100	101	100
EU-15 price dispersion [1]	14.8%	13.7%	n.a.

[1] As measured by the coefficient of variation of the price level indices.

Source: Commission services.


Aggregate price levels (excl. tax) and living standards (1997)
y = 0.74x + 25.27
R2 = 0.67
Aggregate price level index (EU-15=100)
GDP per capita (PPS, EU-15=100)
DK
S
D
FIN
F
A
UK
NL
IRL
B
I
E
EL
P
60
65
70
75
80
85
90
95
100
105
110
115
120
125

Box 6: Electricity market liberalisation

The electricity industry in the Community generates about 2% of GDP, accounts for one-fifth of final energy demand (close to half if the transport sector is excluded), and has a turnover of € 165 billion.

Liberalisation of the Community's electricity market under the terms of Directive 96/92 got underway in February 1999. Greece has a two year derogation; two Member States – Belgium and Ireland – received a one-year derogation, so that they have now started opening their markets. As a consequence of delays in transposing the Directive into national law, both France and Luxembourg enjoyed a *de facto* derogation.

The Directive requires that an increasing share of domestic electricity consumption be gradually opened up to competition, from approximately 26% in 1999 to 30% in 2000 and will be about 35% by 2003; the Commission will review the situation in the coming years, and may propose further liberalisation to take effect from 2006. In practice, many Member States are already going beyond the minimum provisions of the directive: in Germany, Finland, Sweden and the United Kingdom, all customers are free to choose their electricity supplier. In the latter three countries, liberalisation preceded Community legislation.

Liberalisation of the Community's electricity market has taken place against a background of several years of falling prices, linked to declining energy costs and technological improvements in generation. The downward trend in electricity prices continued during the first half of 1999, notwithstanding a recovery in oil prices: in most Member States, median prices charged to industry fell by at least 3% compared with twelve months previously. Although it is too early to make a definitive judgement on the impact of liberalisation on prices to consumers, some indication of what may be expected may be gleaned from experience in the United Kingdom: when full market liberalisation took effect in 1999, <u>all</u> distributors cut their prices in an effort to attract new customers.

Experience in the United Kingdom also suggests that fears that cheaper electricity will lead to higher levels of pollution may be unfounded. Emissions of carbon dioxide fell sharply as new gas-fired power stations entered the market and displaced older, dirtier coal-fired generation capacity. Indeed, it is not liberalisation, but rather government intervention to protect the remnants of the domestic coal industry which has been bad for the environment. Nevertheless, the Commission continues to monitor the environmental implications of liberalisation, and has launched a study to examine the likely effects, including the impact of enlargement of the Community.

Further progress on the setting of transmission tariffs, in particular for cross-border electricity flows, remains to be made before a truly pan-European electricity market can emerge. The Commission continues to work with national electricity regulators and operators within the framework of the Florence European Regulatory Forum in order to reach a satisfactory agreement on this issue.

Box 7: Transport

Even when one neglects the large volume of transport that is undertaken on the own account of companies and private individuals, the annual turnover of the transport sector in the EU is well over 500 bn (see Table). This indicates a large untapped potential of economic efficiency improvements, as much of the sector remains tightly regulated. Nevertheless, liberalisation and improvements in the functioning of the internal market continue to occur in small steps.

The *road haulage industry* can be considered to be broadly liberalised with a high degree of competition also across borders since the last restrictions on cabotage have been abolished. In Greece, Italy, and Spain however, price constraints for intra-country transport limits the degree of competition. Furthermore, the ever increasing importance of cross-border haulage makes it more pressing to reduce potentially harmful tax competition through differing diesel charges, as was foreseen in the Commission Energy tax proposal. This was witnessed by the UK abandoning its fuel escalator in the face of complaints from the road haulage industry. The degree to which working hour regulations and taxes on trucking require closer harmonisation also needs to be examined.

Turnover by mode of transport 1995 (€ billion)

	Railways	Other land transport	Water transport	Air transport	Auxiliary transport	Total transport
B	1.54	8.49	1.60	2.46	12.59	26.68
DK	1.05	2.98	4.42	1.37	3.71	13.53
D	10.20	35.80	3.78	7.78	49.42	106.98
E	2.40	14.00	2.00	6.00	13.00	37.40
EL	0.10	4.41	4.15	1.53	3.13	13.32
F	8.00	30.30	3.24	9.96	24.22	75.72
IRL	0.50	1.50	0.20	0.40	0.32	2.92
I	6.40	22.70	3.46	9.37	23.48	65.31
L	0.08	0.40	0.04	0.50	0.25	1.27
NL	2.36	8.91	4.05	5.04	7.67	28.03
A	1.52	6.02	0.22	1.41	8.15	17.32
P	0.29	2.37	1.30	1.63	4.93	10.52
FIN	0.54	3.30	1.69	1.15	3.00	9.68
S	1.30	7.56	2.72	2.04	9.59	23.21
UK	9.07	24.57	4.44	15.06	32.09	85.23
EU-15	45.35	173.31	37.31	65.60	195.55	517.12

Source: Commission services.

In *urban public transport,* local authorities resort increasingly to tendering procedures for the operation of their transport networks. This has allowed for substantial cost savings and reductions in subsidies, for instance in the UK and Denmark (see Table). In some instances, however, a narrow focus on budget constraints has lead to higher fares and reduced passenger-trips.

Air transport continues to grow rapidly. Prices have been pushed down somewhat due to the still ongoing adjustments to the completion of the single market for aviation of April 1997. However, air transport services towards third countries are still ruled by bilateral agreements which weaken the benefits of the single market. In particular, the bargaining situation of the EU with respect to getting access to the important US market is extremely weak because Member States have preferred to negotiate bilaterally with the US. These "open sky" agreements distort internal competition among Community carriers and endanger a proper functioning of the internal market. Moreover they normally give no right to operate flights within the other country, but give unlimited rights to operate between the other country and third countries. Because of extremely differing shares of intra-country and foreign flights, the overall result of the open sky agreements is disadvantageous: Americans get access to roughly 80 % of the European market, while Europeans can enter only 20 % of the American market. The Commission referred cases against eight Member States to the ECJ for concluding such aviation agreements in violation of EU competition law. Furthermore, air traffic management is not yet integrated and is responsible for increasing delays. At last, despite paying for its own infrastructure, air transport clearly enjoys a preferential tax treatment vis-à-vis other modes as it is largely exempted from transport specific or environmentally motivated charges (such as fuel taxes) or from general taxation (such as VAT). The discriminatory tax treatment in some Member States between domestic and intra-community flights in the context of value added taxation also remains questionable. However, a first step towards harmonisation was made with the abolition of duty free shopping, which acted as an indirect subsidy to air transport.

The development of the *railway sector* continues to lag that of other transport sectors and it continues to lose market share. There is evidence of substantial inefficiency, slow take up of new technology, and services are still almost entirely planned and operated on a national basis. Member States are attempting to make railway operations more business oriented and to reduce subsidies and this is noticeable in particular in cost-cutting efforts involving a substantial reduction in personnel. Nevertheless, with the exception of the UK, railways continue to be state owned.

An important step was made at the December 1999 transport Council, where Member States agreed to a package of measures relating to the rail sector. This addresses some of the issues relating to the regulation of rail infrastructure and includes an extension of access rights to allow undertakings from other countries to operate international rail freight services on a Trans-European Rail freight Network including the use of infrastructure for access to the final customer.

Box 8: 1999 country-specific recommendations for structural reforms in capital markets

Greece: Help the creation of new firms by further developing venture capital markets and expanding the stock market.

Ireland: Continue to be take measures to create incentives encouraging venture capital and local R&D.

Austria: Take measures to develop and facilitate access to venture capital.

Portugal: Develop venture capital market and improve innovative activity.

United Kingdom: Adjust the tax structure in favour of SMEs and alter of laws on insolvency and bankruptcy, to ensure that a greater share of venture capital goes to early-stage business.

Box 9: 1999 country-specific recommendations for structural reforms in labour markets

Belgium: (1) Focus more on activation of unemployed adults. (2) Review benefit duration and the availability requirements. (3) Rethink strict employment protection legislation for white collar workers. (4) Facilitate regional opening clauses in wage agreements.

Denmark: (1) Increase labour supply, e.g. via benefit reforms. (2) Evaluate tax reform with a view to reducing high tax wedge. (3) Reconsider leave schemes.

Germany: (1) Review benefit and assistance schemes. (2) Continue income-tax and non-wage-labour costs cuts, especially at the lower end of the wage scale. (3) Assess employment protection legislation for SMEs.

Greece: (1) Reinforce preventive approach and reform education and training system. (2) Encourage the use of new part-time contracts and more flexible working hours.

Spain: (1) Shift from passive to active labour market policies with particular emphasis on training and education. (2) Continue efforts to reduce the tax wedge on labour and discourage early retirement. (3) Reinforce recent agreements to reduce the cost of dismissal. (4) Adapt wage developments to reflect productivity differentials.

France: (1) Review the unemployment benefit schemes and employment protection legislation. (2) Continue the policy of tax cuts at the lower end of the wage scale and promote jobs in the service sector. (3) Monitor the introduction of the 35 hour working week.

Ireland: (1) Pursue a balanced approach involving preventive as well as active measures, increase the participation rate of the long-term unemployed and low-skilled in education and training programmes. (2) Ensure continued wage moderation through adherence to the social pact. (3) Avoid potential negative effects from setting the minimum wage level too high.

Italy: (1) Increase the coverage of active labour market measures. (2) Continue efforts to shift the tax burden away from labour. (3) Reform benefit schemes to reduce the numbers being transferred to pensions and other schemes. (4) Encourage early activation and adequate unemployment benefits to ensure an increased labour supply and greater labour mobility. (5) Review employment protection legislation. (6) Encourage tripartite local agreements in the South which introduce wage flexibility in line with labour productivity.

Luxembourg: Focus reform on the low employment rate of women and older workers by, inter alia, increasing on-the-job-training in firms and the creation of additional childcare facilities.

Netherlands: (1) Continue efforts to reduce the overall tax burden on labour, especially for low-wage earners. (2) Make further efforts to ensure that there are sufficient incentives in benefit and assistance schemes to encourage the take-up of job offers.

Austria: (1) Review early retirement conditions, improve incentives to work and modernise organisation of work. (2) Pay special attention to low-skilled and low-wage workers.

Portugal: (1) Reform the benefit system to ensure appropriate incentives to take up job offers and to participate in active measures. (2) Pursue further recent policies to enhance labour market flexibility.

Finland: (1) Reduce the overall tax burden on labour. (2) Increase job availability, make job search more effective and increase the incentives to take up job offers in the benefit system. (3) Review early retirement conditions.

Sweden: (1) Reduce the overall number of participants and focus the ALMPs more precisely, while increasing the share in labour market training. (2) Implement further reduction of taxes on labour, with a priority for low and medium-paid workers. (3) Review further benefit and assistance schemes.

United Kingdom: (1) Continue efforts to lower marginal effective tax rates on low-paid workers. (2) Deal with regional unemployment differences and address the issue of social inclusion.

REPORT FROM THE COMMISSION

on the implementation of the 1999 Broad Economic Policy Guidelines

STATISTICAL ANNEX

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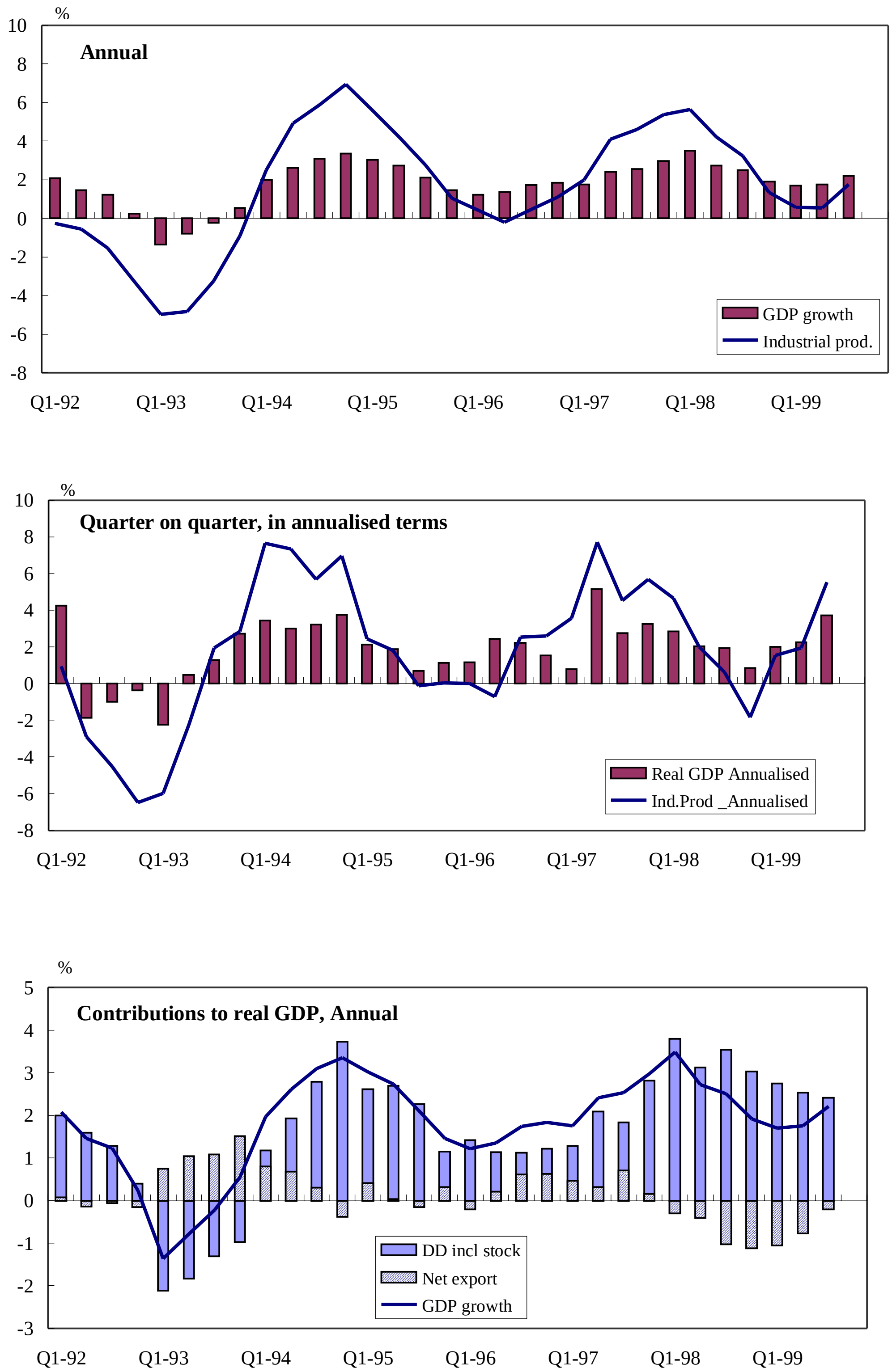
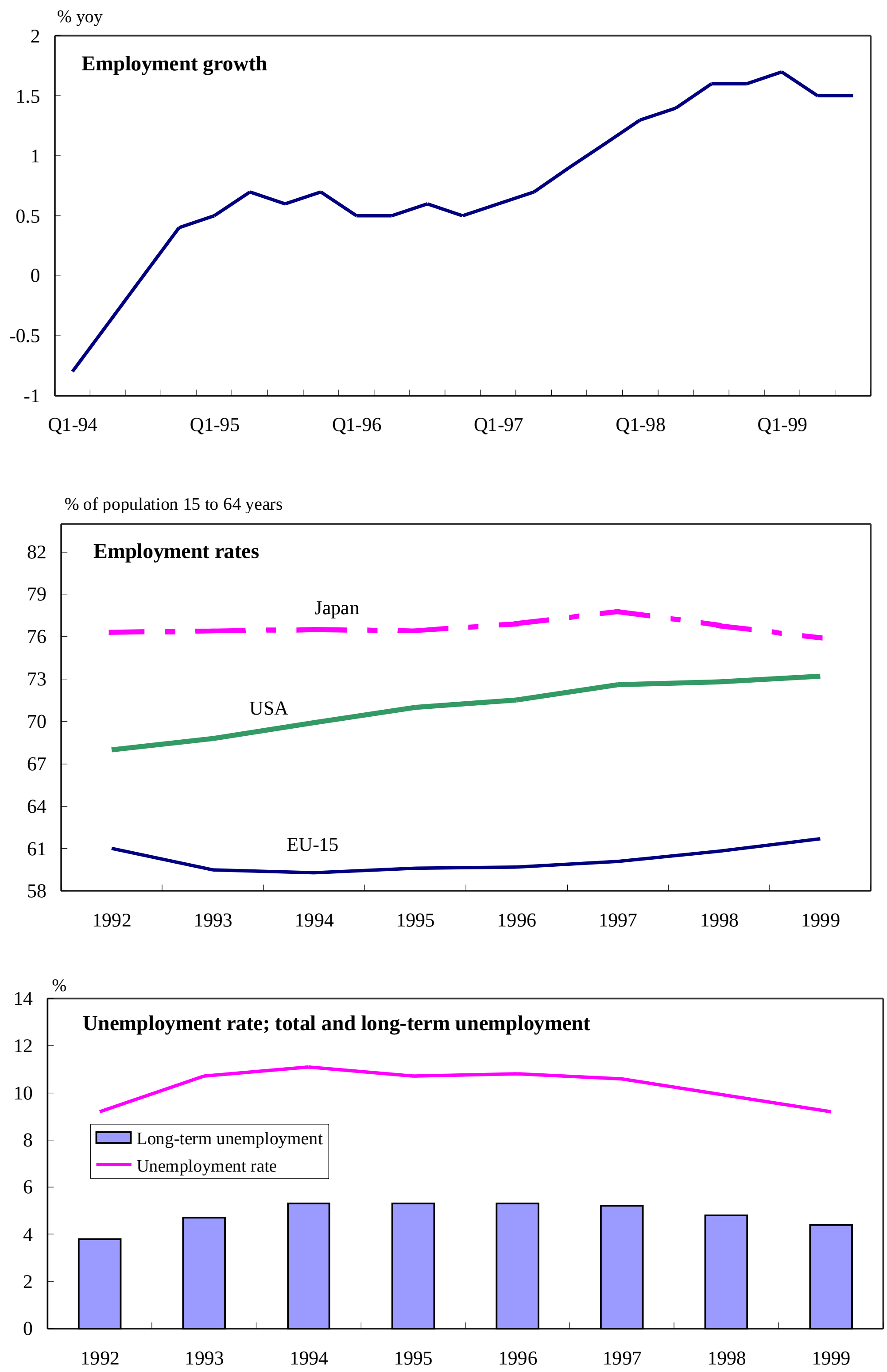


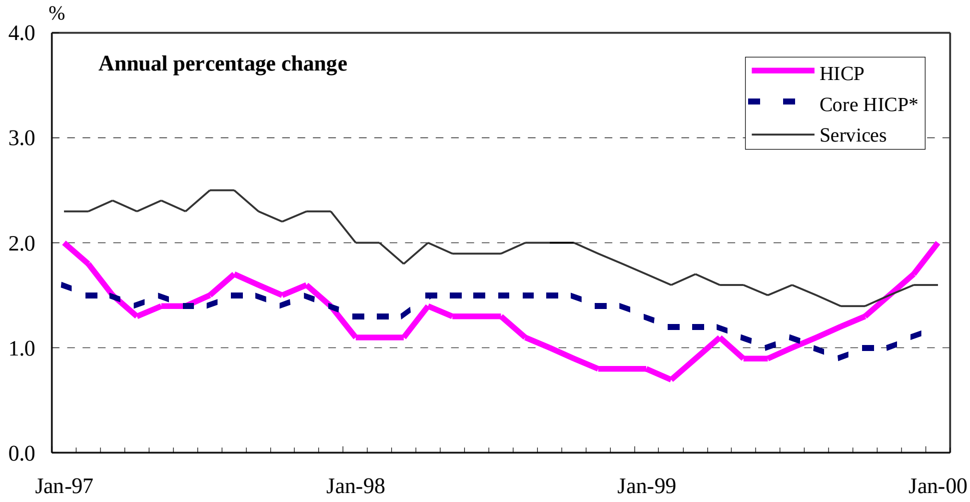
Source: Commission services.

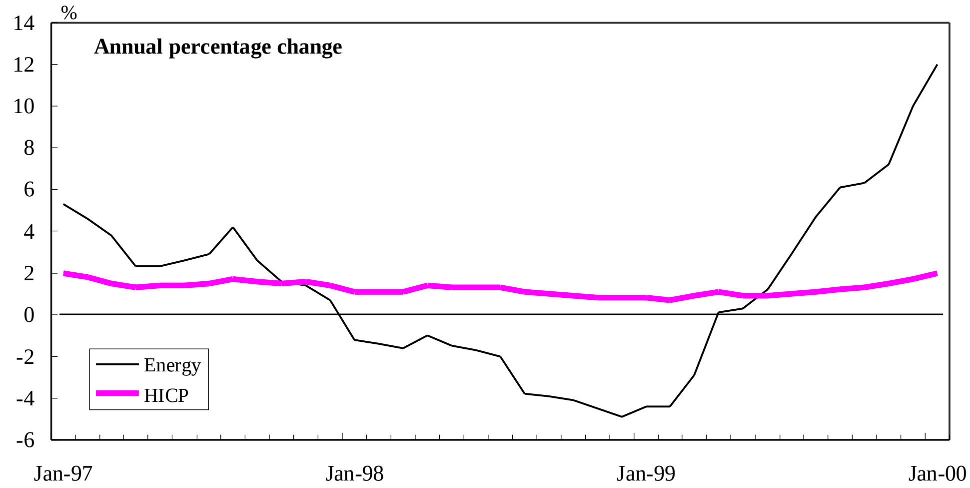
Graph 2: **Employment and unemployment, EU-15**

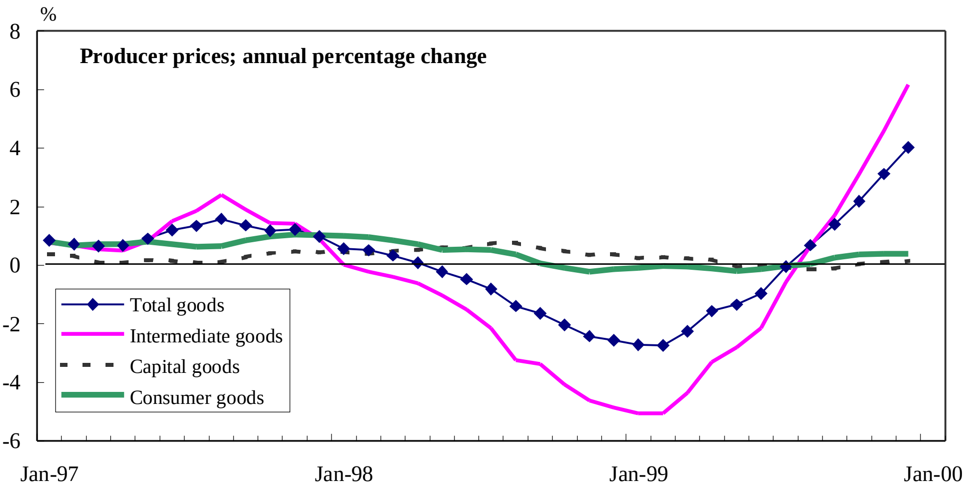


Source: Commission services.

Graph 3: **Inflation trends, euro area**



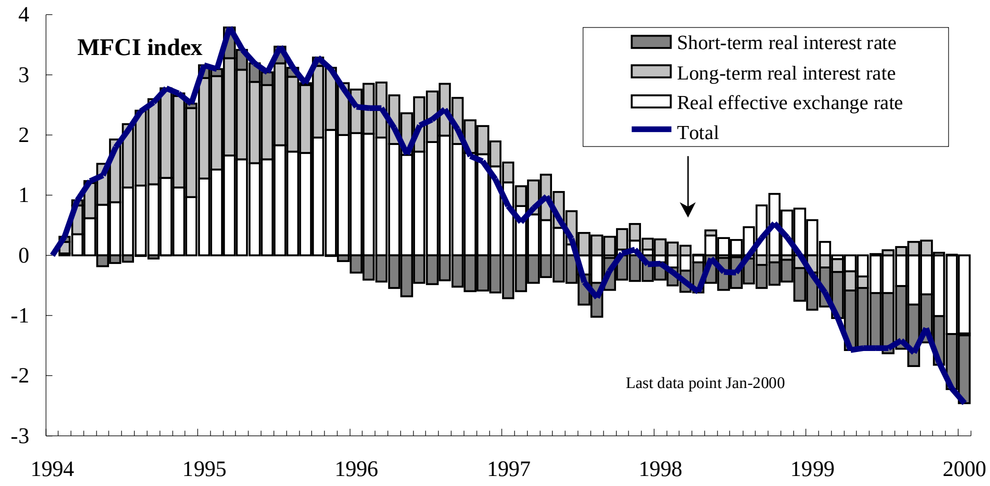


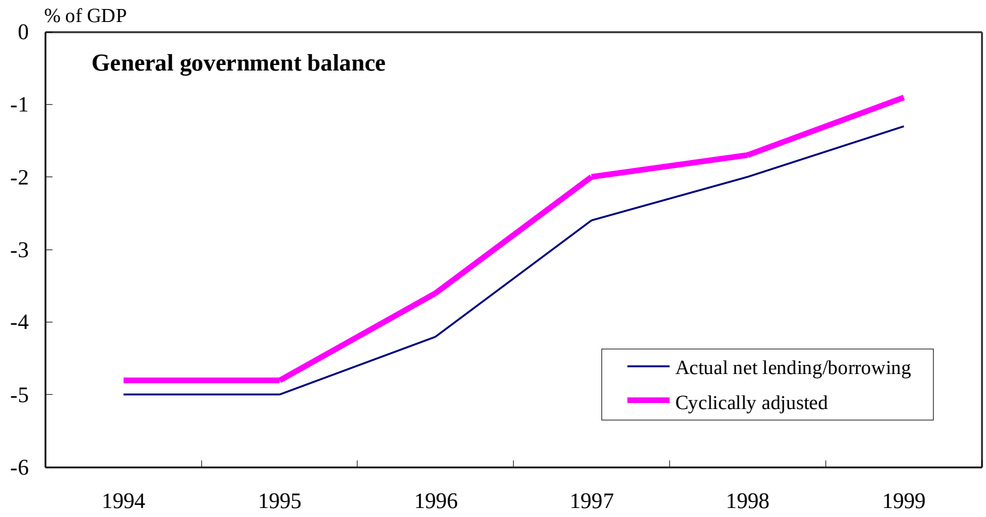


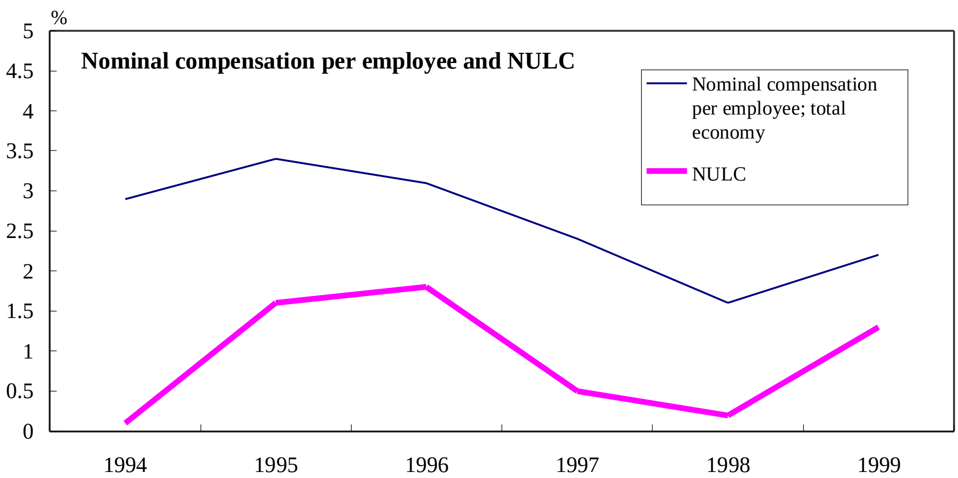
* HICP excluding unprocessed food and energy.

Source: Commission services.

Graph 4: **Policy mix, euro area**

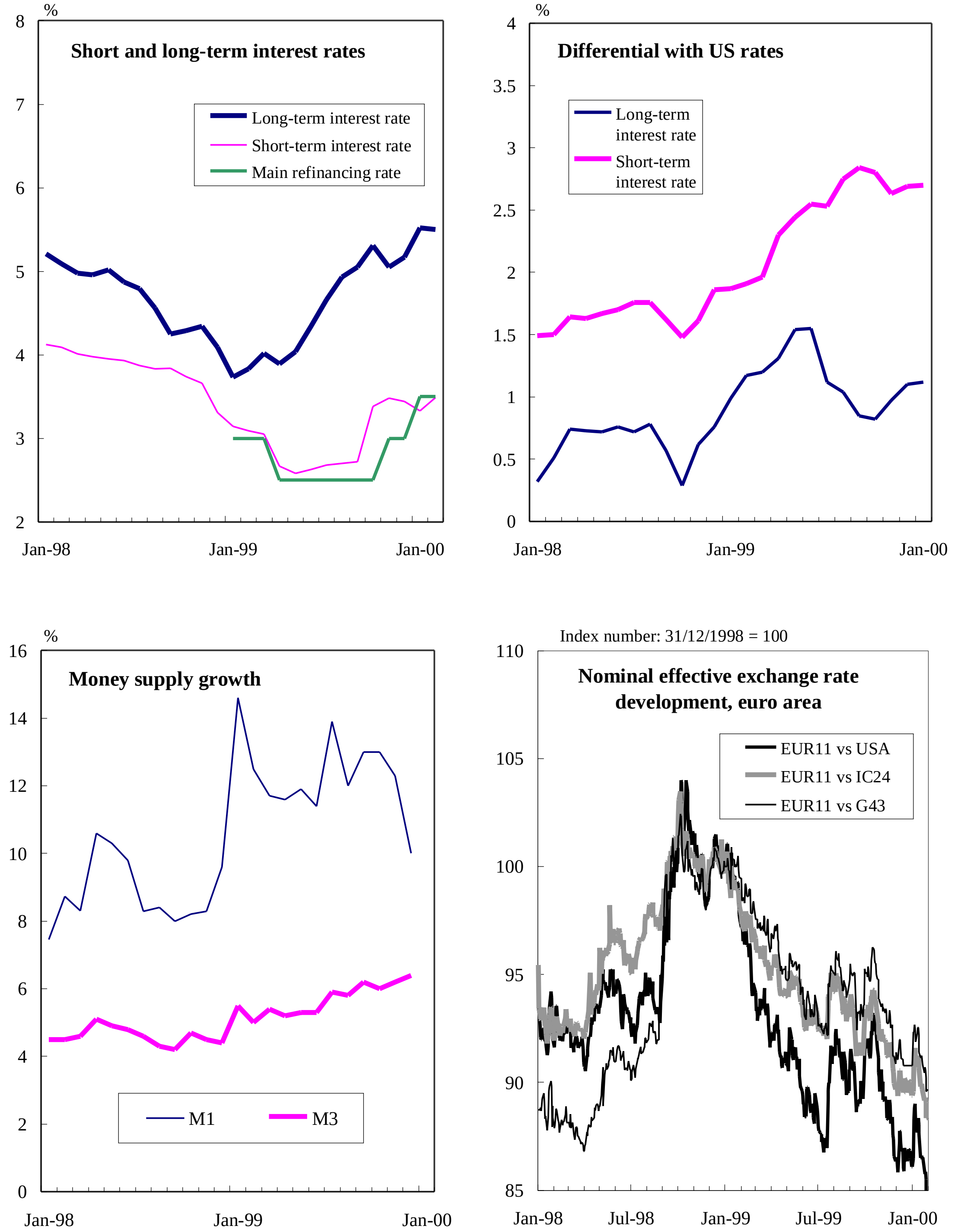






Source: Commission services.

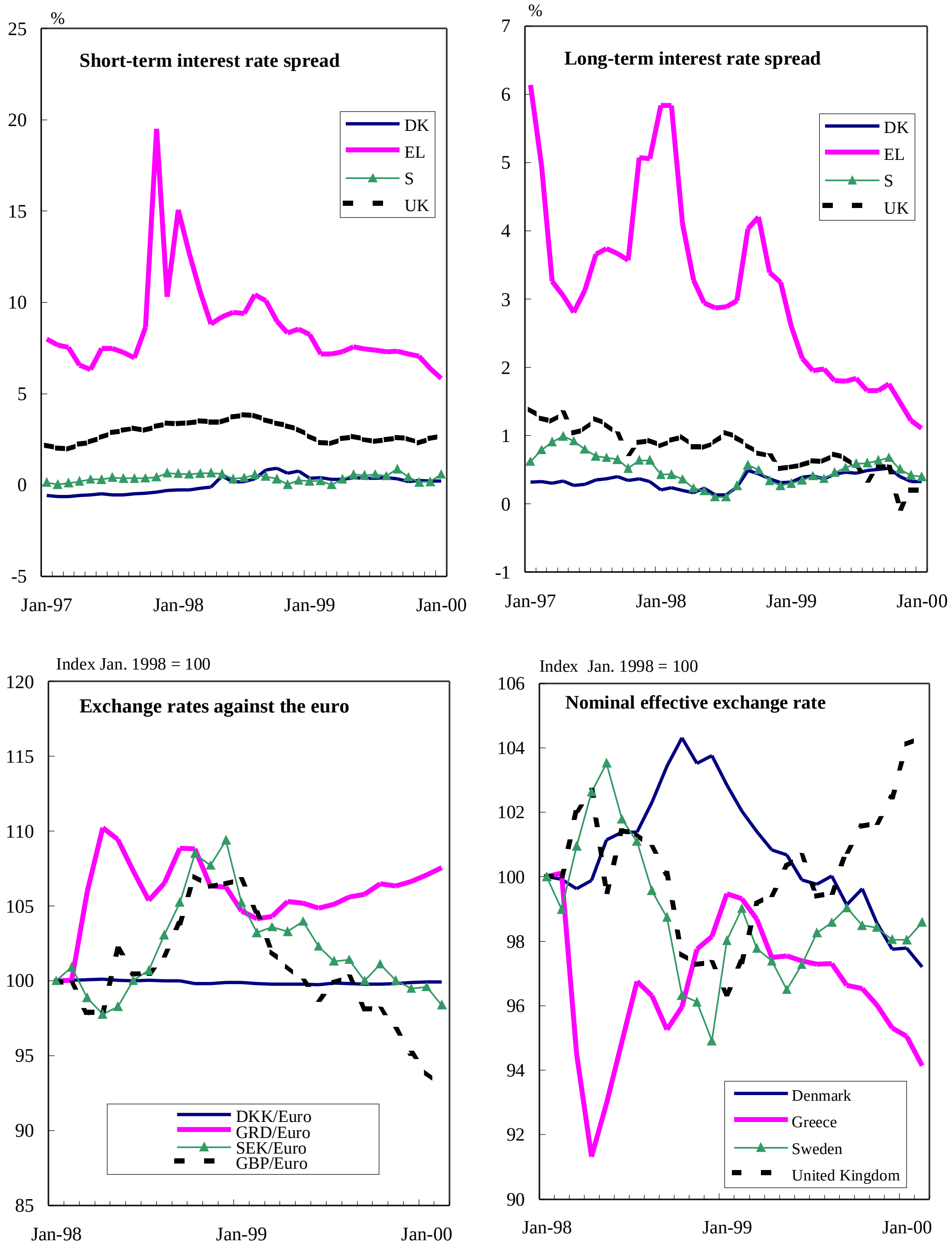
Graph 5: **Monetary and financial indicators, euro area**



Source: Commission services.

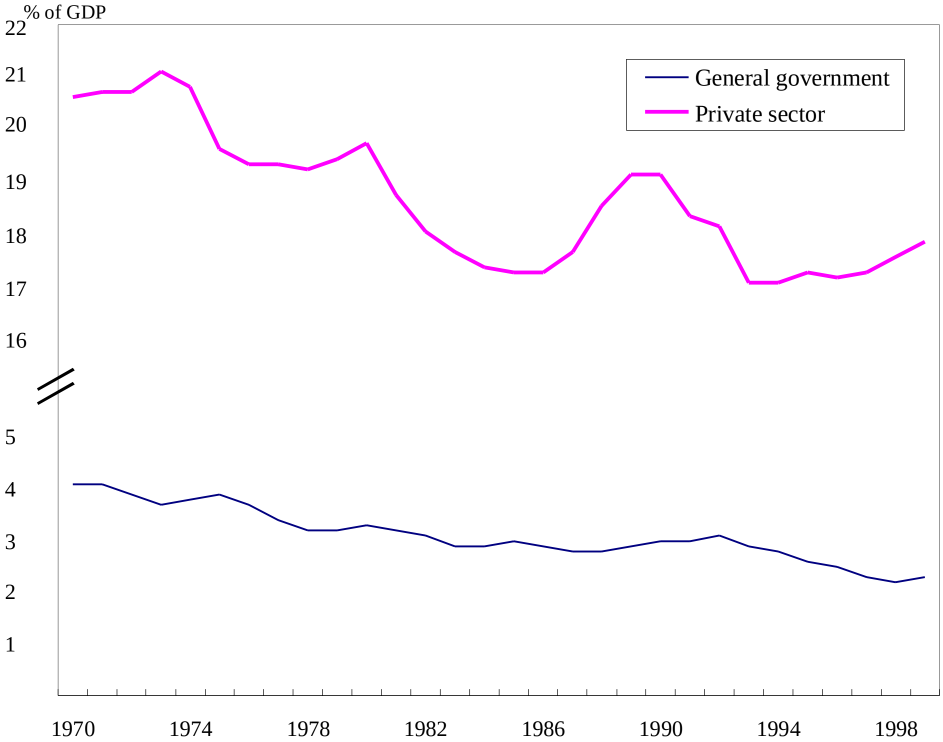
Graph 6: **Monetary and financial indicators**

("pre-in" countries in comparison with the euro area)



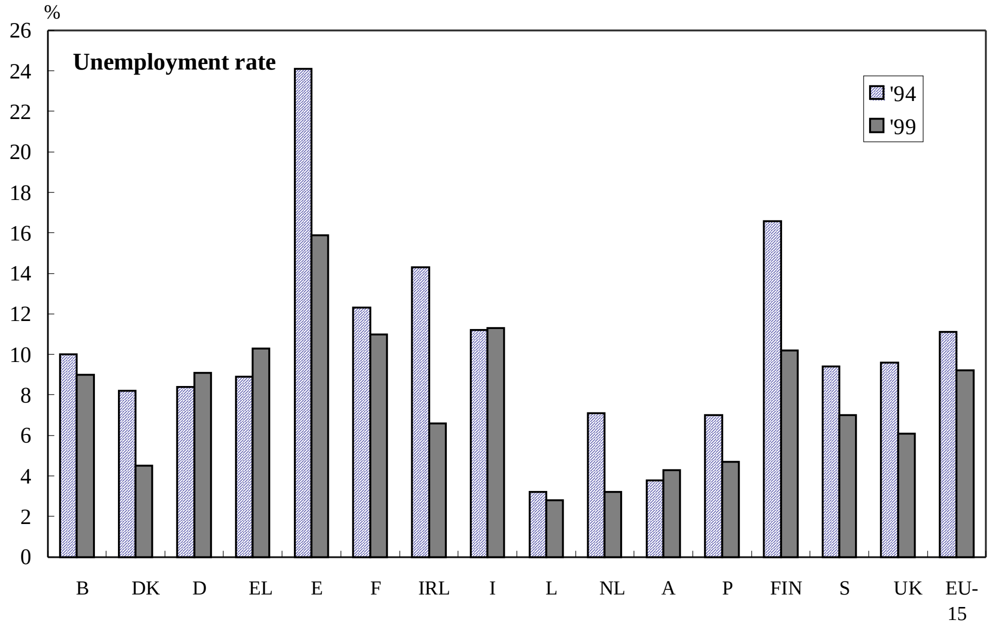
Source: Commission services.

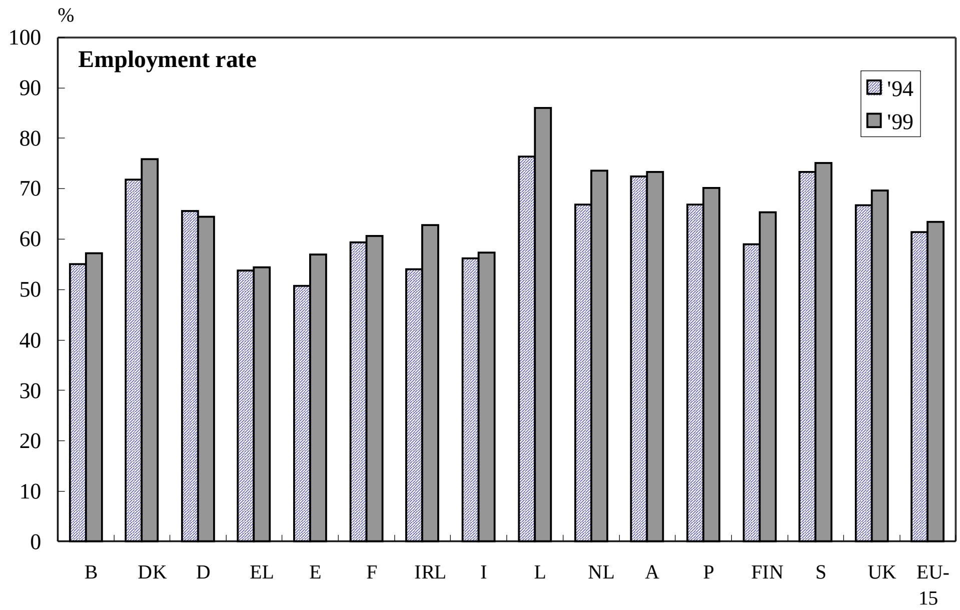
Graph 7: **Investment performance, EU-15**



Source: Commission services.

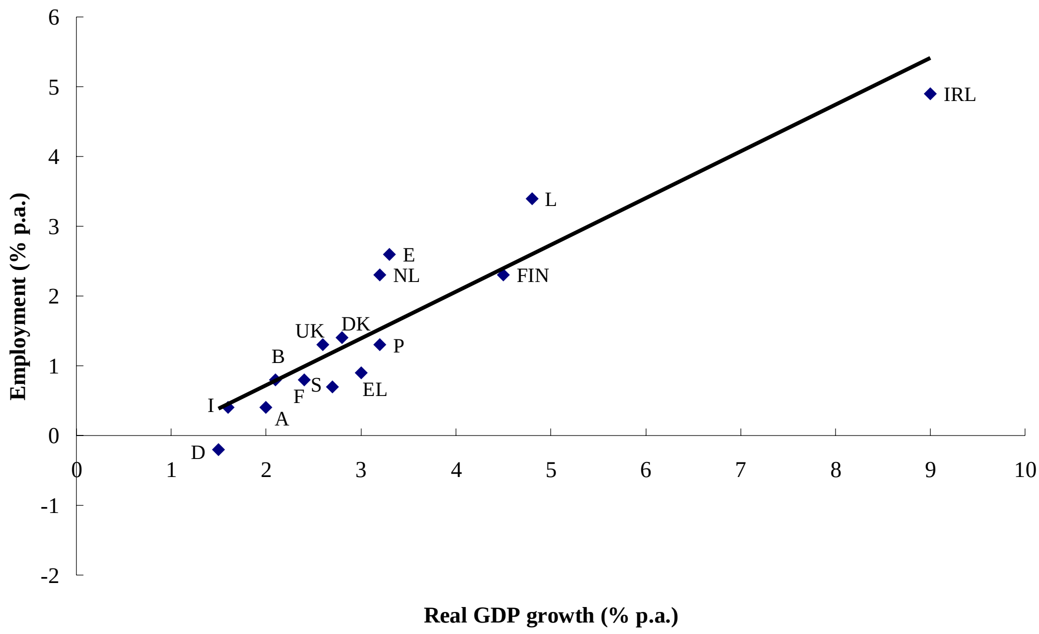
Graph 8: **Unemployment- and employment rate in the Member States**





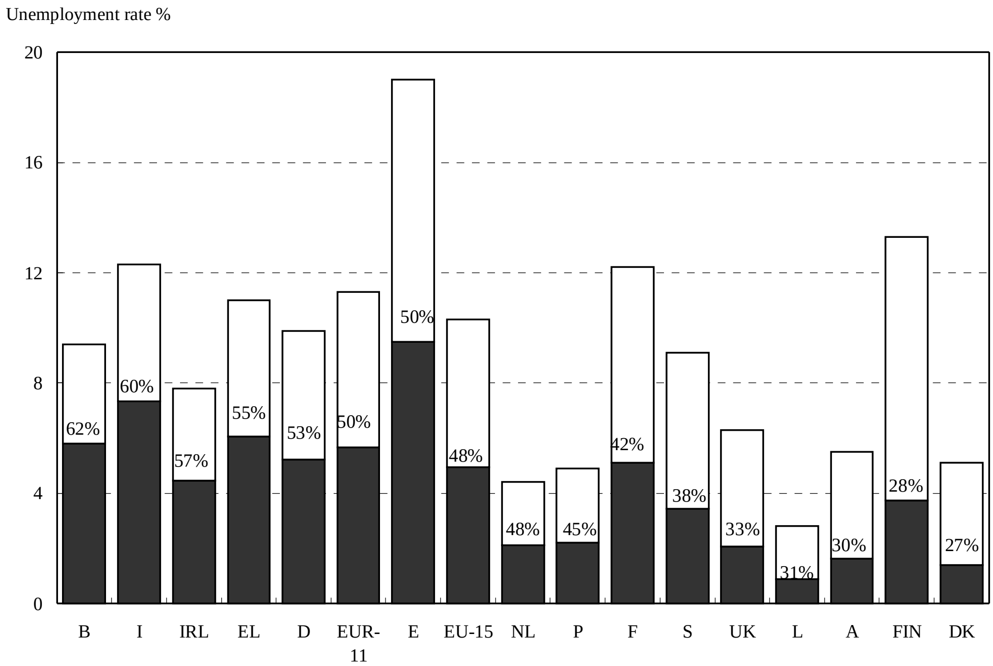
Source: Commission services.

Graph 9: **Growth and labour market performance, 1995-1999**



Source: Commission services.

Graph 10: Share of long-term unemployment in total unemployment, 1998



Source: Labour Force Survey 1998, except Ireland which is 1997.

Table 1: **Macroeconomic developments in the EU**
(annual percentage change unless otherwise stated)

	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999** Spring 1999 forecast	**1999** Provisional Outturn*
Real economy								
GDP growth	-0.4	2.8	2.4	1.6	2.5	2.6	2.1	2.2
Private consumption	-0.4	1.7	1.8	1.9	2.0	3.0	2.6	2.7
Public consumption	1.1	1.0	0.6	1.8	0.3	1.3	1.7	1.6
Investment	-5.9	2.6	3.3	1.9	3.2	5.6	3.7	4.8
- construction	-3.1	1.9	0.1	-0.7	0.8	1.8	3.5	3.7
- equipment	-10.7	3.8	8.1	4.8	6.2	10.0	3.8	5.9
Stockbuilding	-0.4	0.2	0.5	0.0	0.3	0.7	1.0	0.5
Exports (G & S)	1.4	9.0	8.3	4.8	9.6	5.6	3.5	3.9
Imports (G & S)	-3.1	7.8	7.3	4.1	9.0	8.6	4.7	5.5
Growth contributions								
Domestic demand [1)]	-1.7	2.4	2.1	1.3	2.2	3.5	2.4	2.8
Net exports	1.3	0.4	0.3	0.3	0.3	-0.8	-0.4	-0.5
Labour market								
Employment	-1.7	0.0	0.7	0.4	0.8	1.3	0.8	1.3
Employment rate (%)[2)]	59.5	59.3	59.6	59.7	60.1	60.8	61.3	61.7
Employment rate (%)[3)]	57.1	55.8	55.4	55.4	55.2	55.3	n.a.	n.a.
Unemployment rate (%)	10.7	11.1	10.7	10.8	10.6	9.9	9.6	9.2
Labour productivity	1.6	2.8	1.7	1.3	1.8	1.3	1.3	1.0
RULC [4)]	-0.7	-2.3	-1.4	-0.5	-0.9	-1.0	-0.1	0.3
Inflation trends								
HICP[5)]	3.4	2.8	2.8	2.4	1.7	1.3	1.2	1.2
GDP deflator	3.5	2.7	3.0	2.5	2.0	2.0	1.7	1.5
Compensation per employee	4.3	3.1	3.4	3.3	2.9	2.4	2.9	2.8
NULC[6)]	2.7	0.3	1.6	2.0	1.0	1.0	1.6	1.8

* Based on the Commission service's provisional Spring 2000 forecast.
1) Domestic demand including stockbuilding.
2) Benchmark series.
3) Full time equivalent.
4) RULC = Real unit labour costs.
5) CPI until 1996.
6) NUCL = Nominal unit labour costs.
Source: Commission services.

Table 2: **Inflation (HICP)**
(annual percentage change)

	Headline inflation		**Core inflation**[1)]	
	1998	1999	1998	1999
B	0.9	1.1	1.2	1.1
D	0.6	0.6	1.1	0.4
E	1.8	2.2	2.1	2.4
F	0.7	0.6	0.9	0.7
IRL	2.1	2.5	2.4	2.3
I	2.0	1.7	2.3	1.8
L	1.0	1.0	1.3	0.9
NL	1.8	2.0	1.9	1.9
A	0.8	0.5	1.2	0.7
P	2.2	2.2	1.5	2.5
FIN	1.4	1.4	1.5	1.4
EUR-11	1.1	1.1	1.4	1.1
DK	1.3	2.1	1.4	1.6
EL	4.5	2.3	5.3	2.7
S	1.0	0.6	1.1	0.5
UK	1.6	1.3	1.9	1.2
EU-15	1.3	1.2	1.6	1.2
		Dispersion in euro area		
Min	0.6	0.5	0.9	0.4
Max	2.2	2.5	2.4	2.5
Range	1.6	2.0	1.5	2.1
Standard deviation	0.61	0.73	0.51	0.76

1) HICP excluding unprocessed food and energy.
Source: Commission services.

Table 3: **Evolution in estimates of government budgets for 1999**
(general government net lending/borrowing)

	Initial stability/ convergence programme*		**Provisional outturn****		**Difference**	
	Real GDP growth (% change)	Budget balance (% GDP)	Real GDP growth (% change)	Budget balance (% GDP)	Real GDP growth (% change)	Budget balance (% GDP)
B	2.4	-1.3	2.3	-0.9	-0.1	0.4
D	2.0	-2.0	1.4	-1.2	-0.6	0.8
E	3.8	-1.6	3.7	-1.1	-0.1	0.5
F	2.4	-2.3	2.8	-1.8	0.4	0.5
IRL	6.7	1.7	8.3	1.4	1.6	-0.3
I	2.5	-2.0	1.4	-1.9	-1.1	-0.1
L	3.4	1.1	5.0	n.a.	1.6	n.a
NL	2.3	-1.3	3.3	0.5	1.0	1.8
A	2.8	-2.0	2.1	-2.2	-0.7	-0.2
P	3.5	-2.0	3.0	-2.0	-0.5	0.0
FIN	4.0	2.4	3.6	2.6	-0.4	0.2
EUR-11	2.6	-1.8	2.2	-1.3	-0.4	0.5
DK	1.7	2.5	1.4	3.1	-0.3	0.6
EL	3.7	-2.1	3.5	-1.5	-0.2	0.6
S	2.2	0.3	3.7	1.9	1.5	1.6
UK	1-1½	-0.3 1)	1.9	1.2	0.8	1.5 2)
EU-15	2.4	-1.4	2.2	-0.7	-0.2	0.7

* ESA79 basis.
** ESA95 basis.
1) Financial year.
2) Indicative, since comparison between financial year and calendar year figures.
Source: Commission services.

Table 4: **Change in actual and cyclically adjusted budget balances in 1999**
(% of GDP)

	Actual deficit	Change in deficit 98/99	Change in deficit due to:			Change in deficit due to:		Change in CAB due to:	
			Change revenues	Change primary exp.	Change interest exp.	Change cyclical comp.	Change CAB	Change interest exp.	Change primary CAB
	1	2 = 3-4-5 = 6+7	3	4	5	6	7 = -5+9	5	9
B	-0.9	+0.1	-0.1	+0.2	-0.4	-0.2	+0.4	-0.4	-0.1
D	-1.2	+0.5	+0.7	+0.2	-0.1	-0.3	+0.8	-0.1	+0.7
E	-1.1	+1.5	+0.4	-0.4	-0.7	+0.2	+1.3	-0.7	+0.6
F	-1.8	1.0	+0.8	0.0	-0.2	+0.2	+0.8	-0.2	+0.6
IRL	1.4	-0.6	+0.7	+1.6	-0.3	+0.3	-0.9	-0.3	-1.2
I	-1.9	+0.9	+0.4	+0.7	-1.3	-0.1	+1.0	-1.3	-0.3
L	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
NL	0.5	+1.2	+1.0	+0.1	-0.4	0.0	+1.2	-0.4	+0.8
A	-2.2	+0.2	+0.3	+0.4	-0.3	-0.1	+0.3	-0.3	0.0
P	-2.0	-0.5	+3.0	+3.0	-0.2	0.0	-0.5	-0.2	-0.6
FIN	2.6	+1.3	+0.5	-0.6	-0.3	-0.1	+1.4	-0.3	+1.1
EUR-11	-1.3	+0.6	+0.5	+0.3	-0.4	-0.1	+0.7	-0.4	+0.3
DK	3.1	+2.2	+0.6	-0.6	-0.6	-0.9	+3.1	-0.6	+2.5
EL	-1.5	+1.0	+0.7	+0.1	-0.4	+0.2	+0.8	-0.4	+0.4
S	1.9	-0.4	-1.1	-0.3	-0.5	+0.9	-1.3	-0.5	-1.8
UK	1.2	+0.9	+0.3	-0.2	-0.4	-0.3	+1.2	-0.4	+0.8
EU-15	-0.7	+0.7	+0.5	+0.1	-0.4	-0.1	+0.8	-0.4	+0.3

Source: Commission services.

Table 5: **Projections for general government surplus(+)/deficit(-)**
(% of GDP)

		1999	2000	2001	2002	2003
		Stability programmes				
B	SP98	-1.3	-1.0	-0.7	-0.3	
	UD99	-1.1	-1.0	-0.5	0.0	0.2
D	SP98	-2.0	-2.0	-1.5	-1.0	
	UD99	-1.2	-1.0	-1.5	-1.0	-0.5
E	SP98	-1.6	-1.0	-0.4	0.1	
	UD99	-1.3	-0.8	-0.4	0.1	0.2
F	SP98	-2.3	-2.0	-1.6	-1.2	
	UD99 1)	-2.1	-1.7	-1.3	-0.9	-0.5
IRL	SP98	1.7	1.4	1.6		
	UD99	1.4	1.2	2.5	2.6	
I	SP98	-2.0	-1.5	-1.0		
	UD99	-2.0	-1.5	-1.0	-0.6	-0.1
L	SP98	1.1	1.2	1.3	1.7	
	UD99	2.3	2.5	2.6	2.9	3.1
NL	SP98	-1.3			-1.1	
	UD99 1)	-0.6	-0.6	-1.3	-1.1	
A	SP98	-2.0	-1.7	-1.5	-1.4	
	COM	-2.2	-2.6	-2.4		
P	SP98	-2.0	-1.5	-1.2	-0.8	
	UD99	-2.0	-1.5	-1.1	-0.7	-0.3
FIN	SP98	2.4	2.2	2.1	2.3	
	UD99	3.1	4.7	4.2	4.6	4.7
EUR-11	SP98	-1.8	-1.6	-1.1	-0.8	
	UD99	-1.4	-1.1	-1.0	-0.6	-0.3
		Convergence programmes				
DK	CP98	2.5	2.8	2.6		
	UD99	2.9	2.1	2.2	2.3	2.5
EL	CP98	-2.1	-1.7	-0.8		
	UD99	-1.5	-1.2	-0.2	0.2	
S	CP98	0.3	1.6	2.5		
	UD99	1.7	2.1	2.0	2.0	
UK 2)	CP98	-0.3	-0.3	-0.1	0.2	
	UD99	0.3	0.2	0.2	-0.1	-0.4
EU-15	SP98	-1.4	-1.2	-0.8	-0.5	
	UD99	-0.9	-0.7	-0.7	-0.4	-0.1

CP = convergence programme; SP = stability programme; UD = updated stability/convergence programme; COM = Commission 1999 autumn forecasts.
1) Based on the cautious scenario for growth.
2) On a financial year basis, 1999 = FY 1999/2000.
Source: National stability and convergence programmes and Commission services.

Table 6: **Government debt in the updates of the stability and convergence programmes**

(% of GDP)

	1999	**2000**	**2001**	**2002**	**2003**	**2002** [1]
B	114.9	112.4	108.8	105.0	101.3	106.8
D	61.0	61.0	60.5	59.5	58.5	59.5
E	63.5	62.8	60.6	58.1	55.8	59.3
F	60.3	59.4	59.0	58.4	57.7	58.3
IRL	52.0	46.0	40.0	36.0	n.a.	43.0 (2001)
I	114.7	111.7	108.5	104.3	100.0	107.0 (2001)
L	4.3	n.a.	n.a.	n.a.	n.a.	n.a.
NL	64.3	62.3	61.8	61.0	n.a.	64.5
A	n.a.	n.a.	n.a.	n.a.	n.a.	60.0
P	n.a.	57.1	55.2	53.3	51.0	53.2
FIN	46.6	42.9	40.7	38.0	35.2	43.2
EUR-11	72.4	71.1	69.7	67.9	66.0	68.3
DK	52.8	50.1	47.5	44.6	41.6	49.0 (2001)
EL	104.2	103.3	99.5	98.0	n.a.	99.8 (2001)
S	66.1	58.8	54.1	52.0	n.a.	58.0 (2001)
UK [2]	44.9	43.1	41.3	39.9	38.8	42.0
EU-15	67.7	65.9	64.2	62.5	60.6	63.5

1) 2002 target in last year's SP/CP.
2) Financial years.
Source: Commission services.

Table 7: **Non-wage labour costs and tax burden on labour**

	Non-wage labour costs[1] (% of gross wages)			**Labour effective tax rate on total employment**[2]		
	1995	**1999**	**Change**	**1995**	**1999**	**Change**
B	26.3	27.0	0.7	42.7	44.1	1.4
DK	4.5	5.6	1.1	43.7	44.8	1.1
D	30.5	31.7	1.2	42.4	43.7	1.3
EL	21.1	22.0	0.9	26.2	28.0	1.8
E	21.0	22.0	1.0	29.6	29.9	0.3
F	34.8	31.6	-3.2	41.0	40.8	-0.2
IRL	11.9	11.3	-0.6	24.3	23.3	-1.0
I	25.4	23.5	-1.9	38.3	37.2	-1.1
L	n.a.	19.0	n.a.	n.a.	n.a.	n.a.
NL	28.3	27.8	-0.5	38.8	36.3	-2.5
A	25.7	26.3	0.6	38.8	41.5	2.7
P	17.9	20.9	3.0	25.2	28.5	3.3
FIN	25.8	23.7	-2.1	46.2	44.1	-2.1
S	23.8	22.0	-1.8	46.4	47.6	1.2
UK	12.0	11.9	-0.1	24.3	24.5	0.2
EU-15	26.0	24.7	-1.3	37.7	37.2	-0.5

1) Non-wage labour costs is the ratio of total social contributions to total labour costs.

2) Labour effective tax rate on total employment is the ratio of social security contributions plus personal income taxes on labour income to gross wages.

Source: Commission services and OECD.

Table 8: **Wage developments in 1999**
(Provisional outturn)

	Nominal compensation per employee	**Real wages[1)]**	**Labour productivity**	**NULC[2)]**	**RULC[3)]**
B	2.4	1.6	1.2	1.1	0.3
D	1.9	0.9	1.1	0.8	-0.1
E	2.4	-0.3	0.4	2.0	-0.6
F	1.9	1.5	1.4	0.5	0.0
IRL	7.0	3.3	4.0	2.9	-0.7
I	1.8	0.2	0.4	1.3	-0.2
L	1.9	0.9	0.5	1.4	0.3
NL	3.7	2.0	1.1	2.6	1.0
A	2.8	1.8	1.1	1.7	0.7
P	5.4	2.4	1.2	4.1	1.2
FIN	2.9	1.9	0.3	2.6	1.6
EUR-11	2.2	0.9	1.0	1.3	0.0
DK	4.6	1.9	0.8	3.7	1.1
EL	4.8	1.4	2.2	2.5	-0.8
S	3.5	2.8	1.5	2.0	1.3
UK	5.0	2.3	0.8	4.1	1.4
EU-15	2.8	1.3	1.0	1.8	0.3

1) Nominal compensation adjusted by the GDP deflator.
2) Nominal unit labour costs.
3) Real unit labour costs.
Source: Commission services.

Table 9: **Exposure to international competition, 1993-1998**

	Average of imports+exports as a % of GDP	Total FDI inflows as a % of GDP	Total cross border M&As as a % of GDP
B	n.a.	n.a.	2.6
BLEU	59.0	5.2	n.a.
DK	26.7	1.7	0.8
D	20.8	0.6	0.6
E	18.7	1.2	0.3
EL	16.1	n.a.	0.1
F	19.4	1.0	1.1
IRL	57.7	n.a.	1.9
I	18.6	0.6	0.4
L	n.a.	n.a.	6.8
NL	46.1	5.0	2.0
A	27.9	n.a.	0.3
P	27.1	1.5	0.3
FIN	28.0	2.2	3.0
S	29.3	4.2	2.5
UK	21.9	2.8	1.4
Large MS average	20.1	1.1	0.8
Small MS average	37.6	3.4	1.7
EU-15 average	23.7	1.6	1.0

Source: Commission services.

Table 10: **Transposition and implementation of Single Market directives**

	Transposition deficit Nov. 1999	**Number of reasoned opinions** Sep. 1998-Aug. 1999	**Tenders published in the OJ as a % of total public procurement 1998**
B	3.5	27	27.3
DK	1.3	2	15.1
D	2.9	24	7.6
E	2.2	23	13.9
EL	6.2	26	44.7
F	5.6	43	18.8
IRL	4.4	10	18.9
I	3.9	33	12.3
L	5.7	7	22.7
NL	2.8	8	10.0
A	3.7	6	8.4
P	4.9	13	15.5
FIN	1.7	4	11.3
S	2.1	3	15.3
UK	2.8	9	13.8
EU-15 1)	12.6	238	13.1

1) For EU-15, percentage rate of Internal Market Directives not yet transposed across the whole of the Union.

Source: Commission services.

Table 11: **Telecommunications - market structure and price evolution**

	Long distance calls (200 km; 10’)		International calls to US (10’)		Digital mobile market
	Number of operators 1999	Total % price variation 1997-1999	Number of operators 1999	Total % price variation 1997-1999	Number of operators 1999
B	10	-23	9	-21	4
DK	11	-36	11	-30	3
D	47	-36	47	-67	4
E	10	-18	10	-27	4
EL	1 [1)]	-25	1 [1)]	-16	3
F	31	-29	31	-55	3
IRL	6	-54	8	-37	3
I	12	-28	12	-50	4
L	6	n.a.	7	-63	4
NL	24	-33	24	-89	2
A	20	-41	20	-34	2
P	1 [2]	-34	1 [2)]	-49	5
FIN	19	3	14	-32	3
S	22	-39	22	0	4
UK	26	-10	66	0	4
EU-15 [1)]	n.a.	-27	n.a.	-38	n.a

1) Greece has been granted a derogation until 2001 for the introduction of competition in the national market.
2) In Portugal 4 licenses for the public network have been issued to date, but operators were not able to start commercial activity until 1 January 2000, owing to Portugal’s derogation for the introduction of competition in the national market.

Source: Commission services.

Table 12: **R & D expenditures and internet hosts**

	Gross expenditure on R&D as a % of GDP 1998 [1)]	**Internet hosts per 1000 inhabitants July 1999**
B	1.6	36.6
DK	1.9	73.9
D	2.3	25.6
E	0.9	16.2
EL	0.5	8.1
F	2.2	22.8
IRL	1.4	29.9
I	1.0	12.7
L	n.a	39.0
NL	2.1	57.2
A	1.6	35.5
P	0.7	8.1
FIN	2.9	123.2
S	3.9	96.5
UK	1.9	44.1
EU-15	1.8	42.0

1) 1998 or latest year available.

Source: Commission services and OECD.

Table 13: **Benefit duration and job availability requirements**

	Unemployment insurance 1997	**Unemployment assistance 1997**	**Job availability requirement**
	months [1)]	**months** [1)]	**index** [4)]
B	no limit [2)]		3.2
DK	60		2.8
D	12 [3)]	no limit	2.6
EL	12 [2)]	no limit	..
E	24 [2)]	6	..
F	60 [2) 3)]	no limit	2.8
IRL	15	no limit	1.8
I	12		..
L	12		4
NL	60 [2) 3)]	24	3.7
A	12 [3)]	no limit	2.3
P	30 [3)]	10	2.9
FIN	23 [3)]	no limit	2.8
S	10 [3)]	5	3.8
UK	6	no limit	2.6

1) For a 40 year old single worker with a long employment history.
2) Depends on the length of the employment history.
3) Depends on the age of the worker becoming unemployed.
4) The index is a weighted average of points from 1 to 5 dedicated to 8 categories of job availability criteria. 5 points are given to the maximum strictness.
***Sources*:** OECD (1999) and Ministry of Finance, Denmark (1998).