II

(Acts whose publication is not obligatory)

COUNCIL

COUNCIL RECOMMENDATION

of 19 June 2000

on the broad guidelines of the economic policies of the Member States and the Community

(2000/517/EC)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99(2) thereof,

Having regard to the recommendation from the Commission,

Having regard to the discussion by the European Council on 19 June in Santa Maria da Feira;

Whereas a resolution on the recommendation from the Commission was adopted by the European Parliament,

RECOMMENDS:

I. GENERAL ECONOMIC POLICY GUIDELINES

1. INTRODUCTION

Globalisation and the prospect of a new knowledge-driven economy present major opportunities for the European Union and its citizens. To take advantage of these opportunities, there is a need to accelerate the ongoing transformation of the European economy. To this end, these broad economic policy guidelines (BEPGs) build on and extend the existing strategy and give operational content to the conclusions of the Lisbon Summit. In particular, they focus on the medium and long-term implications of structural policies and on reforms aimed at promoting economic growth potential, employment and social cohesion, as well as on the transition towards a knowledge-driven economy. The Cardiff and Luxembourg processes will deal with their respective subjects matters in more detail.

The broad economic policy guidelines

The Treaty requires Member States to conduct their economic policies with a view to contributing to the achievement of the objectives of the Union and in the context of the broad economic policy guidelines (BEPGs) (Article 98). It also requires Member States to regard their economic policies as a matter of common concern and to coordinate them within the Council (Article 99). To this end, since the start of Stage 2 of economic and monetary union, the Council, on a recommendation of the Commission, has adopted each year the BEPGs. At the centre of the economic policy coordination process, they provide the framework for the definition of the overall policy objectives and orientations for the Member States and the Union. The BEPGs, acquire an increased significance in view of the Council report entitled 'Economic policy coordination' endorsed by the Helsinki European Council, and the Lisbon special European Council on employment, economic reform and social cohesion, in which the European Council decided that it will hold an annual spring meeting devoted to economic and social questions.

In order to allow the European Council to give effective political guidance in a timely manner at its annual spring meeting and to ensure that the Ecofin Council is able to draw on the work of other Council formations, the organisation of the preparation of the BEPGs will be modified.

From this year on, the BEPGs will be forwarded to other relevant Council formations for them to assume responsibility for implementation in their respective areas. At the same time, these Council formations will be invited to pursue work with a view to the formulation of the BEPGs for the coming year, and to make their contributions available by the end of January of the following year.

The Commission, in the light of this work and drawing, *inter alia*, on the stability and convergence programmes, the joint employment report and the Cardiff reports, as well as its own assessment of the implementation of the BEPGs, will prepare the orientation debate at the Ecofin Council meeting which precedes the annual spring meeting of the European Council.

The Ecofin Council will draw up, on this basis, a paper setting out the key issues on which the European Council will be invited to focus its discussion in the part of the annual spring meeting which has a direct bearing on the BEPGs.

The Ecofin Council, acting on a recommendation by the Commission, and in the light of the priorities established by the European Council in the annual spring meeting as well as possible comments by other Council formations on the Commission's recommendation, will draw up a draft for the BEPGs on the basis of which the June meeting of the European Council will discuss its conclusion. The Ecofin Council will subsequently adopt the BEPGs as provided for in the Treaty.

Member States face broadly the same challenges and policy needs. Hence the general recommendations set out in Section 3 apply to all of them. At the same time, Member States differ in terms of economic performance and prospects as well as structures and institutions. This means that within the overall strategy, policy priorities differ somewhat across Member States. These are addressed in Part II which identifies country-specific economic guidelines. It should be noted that the country-specific guidelines, in so far as labour market issues are concerned, complement the 2000 employment guidelines and underpin the implementation of the revised national action plans. The latter have just been submitted by the Member States and will be further assessed in the joint employment report in the context of the next employment package.

Participation in the euro area implies the need for enhanced policy coordination. To this end, the Ministers of the euro-area Member States will continue to meet informally in the Euro-11 Group, without prejudice to the role of the Ecofin Council at the centre of the economic policy coordination and decision-making process. The Euro-11 Group is deepening its discussion of issues of common concern, in line with the conclusions of the Luxembourg European Council. In doing so, they pay attention, *inter alia*, to issues such as euro exchange-rate developments, current account positions, capital market developments, and cyclical positions and budgetary stances of participating Member States.

The Euro-11 Group will continue, and where appropriate strengthen, the continuous surveillance of budgetary developments and policies of the Member States participating in the euro area. This continuous surveillance will foster debates aimed at keeping fiscal policies in line with the BEPGs or with the criteria mentioned in the Treaty. On external issues relevant to its competence, the Euro-11 Group will continue to formulate common euro-area positions in international forums. It also attaches particular importance to the productive dialogue with the European Central Bank, which is regularly represented at meetings. Building on the experience gained over the past two years, the Group continues to develop and strengthen a common language, where appropriate, prepared by the Econcomic and Financial Committee, and agreed positions among themselves, so as to ensure coherent expressions of views on subjects of common concern.

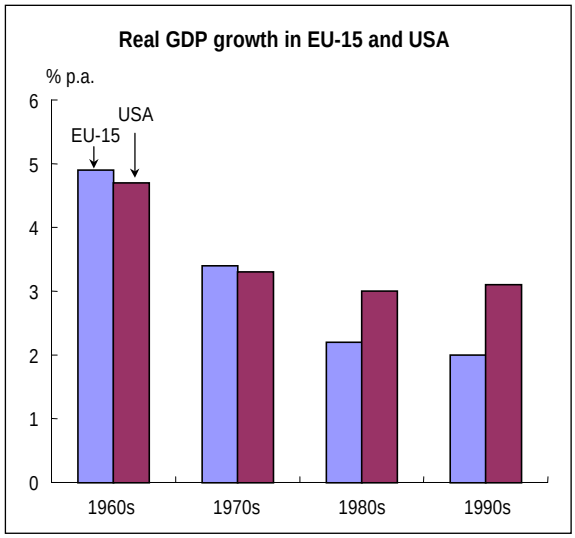
2. MAIN PRIORITIES AND POLICY REQUIREMENTS

2.1. *The EU economy at the start of the new millennium*

The background for the 2000 BEPGs is the economic situation and outlook as outlined in the Commission services' spring 2000 economic forecasts. Moreover, the Council has drawn on the findings and conclusions of the Commission's implementation report on the 1999 BEPGs. The report concluded that the overall implementation of the 1999 BEPGs is encouraging. Taken as a whole, macroeconomic policies were appropriate. But progress with the reform of labour markets is mixed: while policies towards activation and prevention where implemented in many Member States, employment disincentives in tax and benefit systems have been tackled in only a few. Moreover, excessively rigid employment protection legislation should be reassessed more actively in order to identify means to foster job creation. With respect to economic reforms, progress has been most visible in the implementation of internal market legislation and the liberalisation of telecommunications and electricity markets. In this respect, the structural performance indicators agreed in the Lisbon summit, that will be ready by the end of this year, will contribute to accelerate the economic reforms for a more competitive European economy. A certain improvement, but not enough, has been made in disciplining State aid and the development of risk capital markets. Little progress has been made in a number of other areas, including the enforcement of public procurement rules, and the promotion of R & D and innovation.

The heritage of the 1990s — Over the last decade, the European Union has significantly fostered economic integration and has created a solid framework for the conduct of economic policies. The functioning of the internal market has been further improved and some previously over-regulated industries are being liberalised and exposed to the forces of competition. A stability-oriented monetary policy, supported by improving budgetary policies and appropriate wage developments, has been put in place. The euro has been successfully introduced. A comprehensive framework for the coordination of economic policies has been established, to which the European Employment Pact was added last year which includes a macroeconomic dialogue.

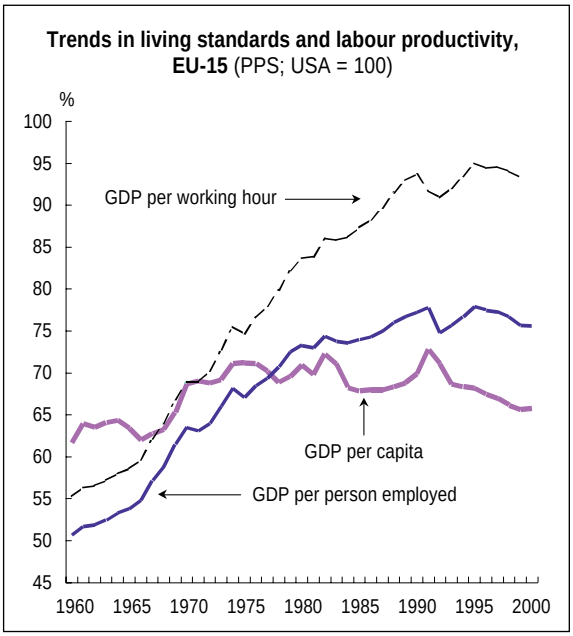
In spite of these achievements, the European Union's economic performance in the 1990s was disappointing, both in comparison with the past and with the United States of America.



Source: Commission services.

Economic growth was relatively weak, no net gains in employment were made and the current unemployment rate is still higher than the start of the decade. Living standards in the EU are on average about 35 % lower than in the United States despite the near convergence of output per hour worked to US levels after four decades of catching up. The large gap in per capita income can in part be ascribed to low and stagnating participation and employment rates. Furthermore, real investment in the EU hardly rose in the 1990s leading to a further fall in the investment-to-GDP ratio while real investment in the United States nearly doubled.

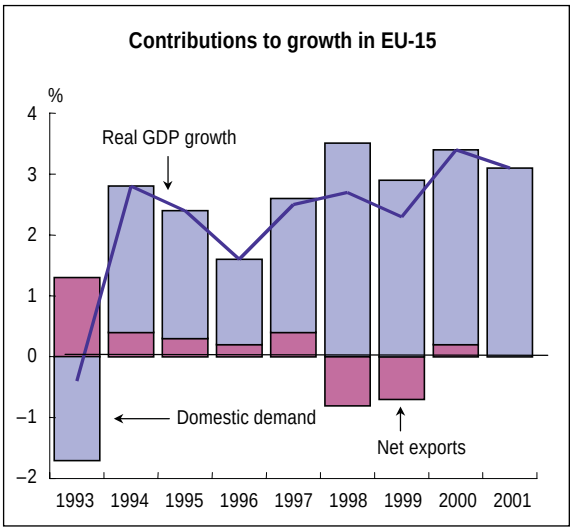
The fact that the improvements in the framework conditions are not reflected in a stronger economic performance is indicative of the severity of the macroeconomic imbalances and structural rigidities prevalent at the start of the previous decade. In part, it also reflects the late start to economic reforms in many Member States and the time it takes before an appropriate policy mix starts to bear fruit. In this context, it should be noted that some Member States experienced an impressive economic performance over the last decade. Although they were also affected by the recession in the early 1990s, they subsequently enjoyed strong recoveries that reduced unemployment significantly, in some cases to levels not seen since the early 1970s. While country-specific factors placed a role, these countries have in common that a swift macroeconomic adjustment went hand in hand with a comprehensive structural reform package and that this mutually-reinforcing strategy was implemented with resolve.



Source: Commission services.

Favourable growth prospects — Since early summer 1999, when the latest BEPGs were adopted, an increasingly robust and broadly-based economic recovery has taken hold in the Union. It reflects in part the influence of a favourable environment. More importantly, though, it is the result of sound macroeconomic policies, increasingly underpinned by the structural measures taken by Member States. This process has to be continued forcefully. Under these conditions, and if, as expected, wage developments continue to be appropriate, an annual rate of non-inflationary growth of around 3 % for the EU as a whole should be a realistic prospect for the coming years. However, risks to price stability need to be closely monitored.

Growth has become richer in employment largely because of shifts in demand towards the more labour-intensive services sectors and efforts to enhance effective labour supply. Thanks to favourable macroeconomic conditions and structural measures taken in the labour markets, employment growth is expected to continue at a strong pace, leading to a further reduction in unemployment.

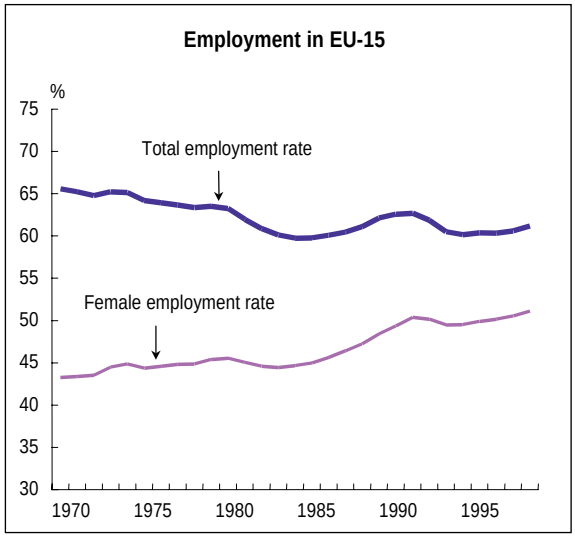


Source: Commission services.

2.2. ***Key challenges***

On these sound foundations, European policy makers face new challenges and opportunities in the coming years and beyond. The key challenges consist of the return to full employment, the transition to a knowledge-driven economy, the impact of a rapidly ageing population and the improvement of social cohesion. All Member States are confronted with these challenges, but there are marked differences both in the extent to which countries are exposed to them and in the degree to which they have already prepared themselves.

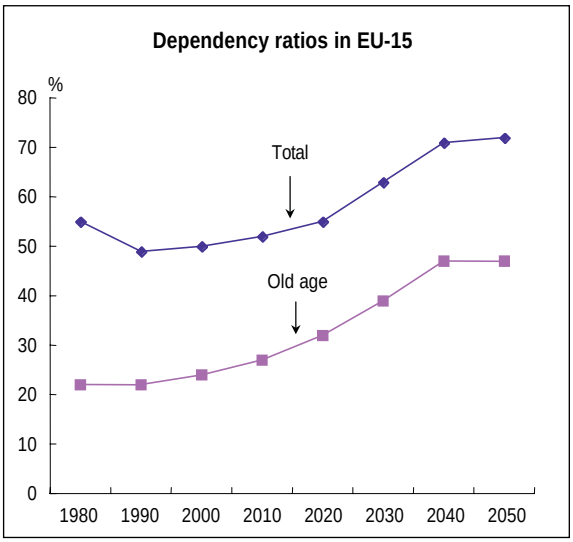
Restoring full employment — Unemployment remains too high. Although it has edged down gradually, it is still around 9 % of the Union labour force with an important gender gap remaining in most Member States. Moreover, the Union's employment and participation rates are low, in particular those of women and older workers in a large number of countries. The present degree of non-employment is the source of large economic and social costs. Addressing these problems implies in particular the creation of jobs in the services sector, an increase in the rate of female employment and a greater participation of older workers. As emphasised by the Lisbon Special European Council, the overall aim is to raise the employment rate from an average of 61 % today to as close as possible to 70 % by 2010 and to increase the number of women in employment from an average of 51 % today to more than 60 % by 2010, for the EU as a whole. In addition, the Lisbon Special European Council encouraged Member States to consider setting national targets for an increased employment rate. The realisation of these objectives over the medium to long term would not only help to bring the EU economy onto a durably higher growth path, it would also considerably alleviate Member States' public finances and social security systems and help fight effectively against social exclusion.



Source: Commission services.

Promoting a knowledge-driven economy — Innovation and accumulation of knowledge are increasingly becoming key drivers for competitiveness, productivity, economic growth, employment and standards of living. Yet, the Union needs to catch up with the United States both in terms of innovation capacity, and in the production and diffusion of information and communication technologies (ICT). Furthermore, there are serious skill shortages, in particular within the sciences and engineering, and there is a lack of basic ICT literacy for many workers and of expert skills needed in the information society. Meeting these challenges will therefore require more public and private investment in human resources, a modernisation of the capital stock, further liberalisation and structural reforms that will lead to the adaptation of economic structures, more competitive markets, the increased flexibility in allocation of resources among sectors, firms and occupations as well as an improvement in the match between skills and jobs.

Preparing for population ageing — On the basis of current demographic trends, the EU is expected to witness a substantial increase in the proportion of people in older, non-active age groups after 2010 and a decrease in the size of the labour force. Apart from the potentially important effects on the level of aggregate savings, other things equal, a rising dependency ratio will have considerable consequences for the contribution of labour to economic growth and for the sustainability of public finances. A rising dependency ratio will result in lower economic growth unless it is offset by an increased employment rate and sustained improvements in factor productivity growth. Regarding the budgetary impact of ageing populations, unchanged policies are expected to lead to large increases in expenditures on public pensions and health-care systems. To tackle this issue, Member States will need to develop comprehensive strategies, including measures to ensure the sustainability of public finances, the reform of pension and health-care systems and action to stimulate higher labour force participation, especially for older workers. Recognising this challenge, the Lisbon European Council has called for stronger cooperation between Member States, notably on the future evolution of social protection giving particular attention to the sustainability of pension systems from a longer-term perspective.



Note: Total dependency ratio = the ratio of the number of people in age groups 0-14 and 65+ divided by the population in the working age group 15-64 years old.
Old age dependency ratio = the ratio of the number of people in age group 65+ divided by the population in the working age group 15-64 years old.
Source: Commission services.

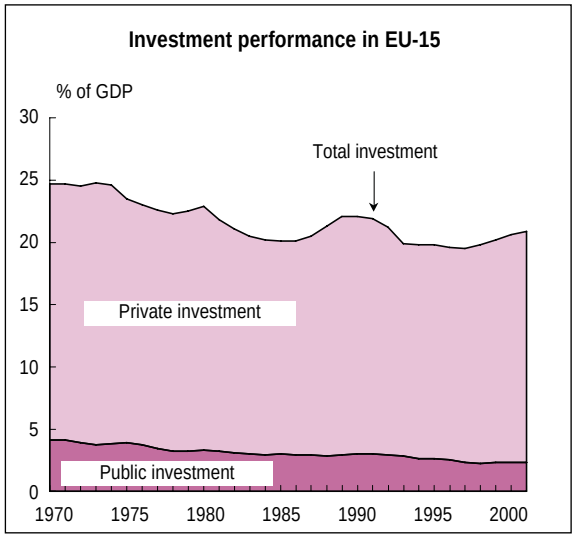
Improving social cohesion — Although Union citizens enjoy, on average, high living standards and high social protection levels, social exclusion still abounds. Unemployment remains the prime cause of social exclusion in the EU. Exclusion is especially due to the high proportion of long-term unemployment and the highly concentrated nature of unemployment — in particular regions of communities, and among special social groups or categories of workers. Although social inclusion goes beyond labour-market issues, the best safeguard against social exclusion is a job. Creating better framework conditions for high employment and low unemployment is therefore the strongest contribution economic policies can make to social inclusion.

Pursuing reforms within the international context — In an increasingly integrated world economy it is not enough for the European Union to consider its own economic reforms in isolation — they should be benchmarked not just within the EU, but held up against the world's best performing economies. If Member States are to reap the benefits from an improved framework for economic policy-making, appropriate external policies must be pursued. The Union should therefore continue to adopt a common

commercial policy which favours open, competitive markets to maximise growth, prosperity and stability. There is a very strong correlation between openness to international trade and investment, and growth. As one of the largest single markets in the world, the Union stands to gain greatly from further liberalisation and is willing to contribute itself to this process in the framework of the WTO negotiations.

2.3. *Moving forward the strategy: strengthening the EU economy's potential for growth*

The challenges of restoring full employment, creating a knowledge-driven economy, preparing for population ageing and safeguarding social cohesion are interlinked, also internationally, and will need to be addressed by a coherent and comprehensive economic policy strategy for the medium to long term. Although important progress in meeting the key challenges can be expected in the context of the current cyclical upturn, a rise in the potential output of the Union's economy would be an important ingredient for maintaining the pace of non-inflationary growth over the medium term. This requires, together with macroeconomic stability and sound, sustainable public finances, the building of efficient, integrated and competitive markets. Efficient markets greatly reinforce the ability to invest in the human and physical capital needed for growth and they are the fundamental source of innovation and dynamism.



Source: Commission services.

This policy strategy should be pursued with resolve by all policy actors, to achieve a balanced and comprehensive mix of policies which mutually reinforce conditions for investment, growth and job creation, for the capacity to innovate and accumulate knowledge and for greater social inclusion: The main planks, as described in the next section, are:

(i) ensure growth- and stability-oriented macroeconomic policies;

(ii) speed up the ongoing process of fiscal consolidation;

(iii) improve the quality and sustainability of public finances;

(iv) promote appropriate wage developments;

(v) foster a knowledge-driven economy;

(vi) ensure efficient product (goods and services) markets;

(vii) promote capital markets through further integration and deepening;

(viii) invigorate labour markets;

(ix) enhance sustainable development.

3. POLICY RECOMMENDATIONS

3.1. ***Ensure growth- and stability-oriented macroeconomic policies***

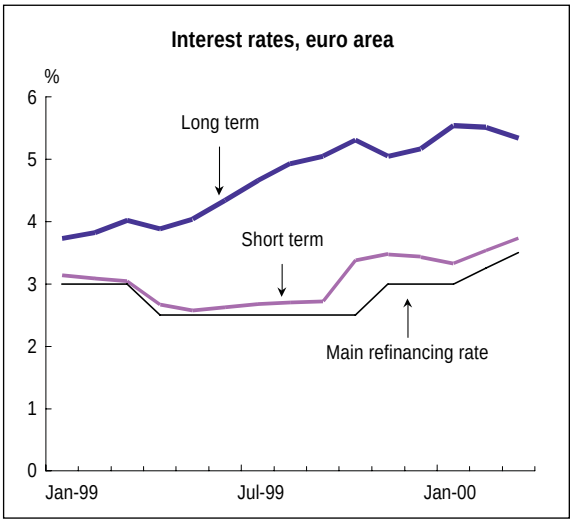
The overall approach to macroeconomic policy plays a key role in promoting growth and employment and in preserving price stability. Over the short term, it should ensure the continuation of the ongoing recovery and the full realisation of the current growth potential. Over the medium-term, it should contribute to the establishment of the framework conditions ensuring adequate levels of saving and investment so as to position the economy on a sustained, higher, non-inflationary, growth and employment path.

In the euro area, economic conditions and prospects have improved considerably as the recovery has broadened and strengthened. Now, the key policy challenge is to ensure that the ongoing recovery develops into a long-lasting period of vigorous economic growth and rising employment. An appropriate and tension-free economic policy approach consists of:

(i) monetary policy committed to maintain price stability in accordance with the Treaty;

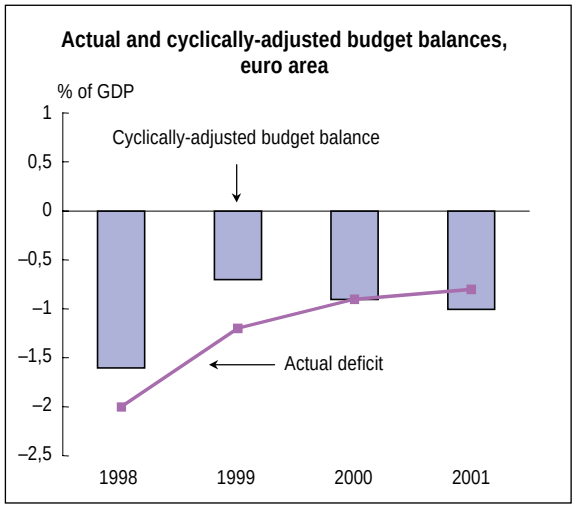
(ii) sustained efforts by Member States to speed up the ongoing fiscal consolidation, to achieve, as rapidly as possible, and maintain, over the medium-term, budgetary positions close to balance or in surplus and to lower public debt;

(iii) a continuation of responsible behaviour on the part of the social partners that supports wage developments that are consistent with price stability and job creation.



Source: Commission services.

The Member States *outside the euro area* should also maintain sound monetary and budgetary policies in order to respect the exchange-rate commitments, for the two Member States participating in ERM 2 (Denmark and Greece), or to achieve the inflation target, thus creating the conditions for exchange-rate stability, for the other two Member States (Sweden and the United Kingdom).



Source: Commission services.

3.2. ***Speed up the ongoing process of fiscal consolidation***

Sound budgetary positions, in line with the Stability and Growth Pact, will create the necessary scope for the full working of the automatic stabilisers without the risk of breaching the budget deficit threshold of 3 % of GDP. It will also have a favourable effect on interest rates and contribute to the crowding-in of private investment, to the further reduction in the government debt to GDP ratio and, by increasing the credibility of the budgetary framework of EMU, to a strengthening of investors' confidence. Given expected output growth above the potential rate, a pro-cyclical stance of budgetary policy should be avoided. With budgetary prospects indicating no improvement in underlying positions for the EU as a whole, there is an agreement for speeding up fiscal consolidation. Since economic and budgetary situations differ across Member States, the scope, timing and speed of further adjustment will need to be tailored to national circumstances. In general, however, Member States shall:

(i) take advantage of fiscal improvements due to the better than expected economic growth to achieve budgetary positions in 2000 better than the objectives set in the updated stability and convergence programmes; this is in conformity with last year's recommendation to front-load the budgetary adjustment as of the year 2000 and should be possible in most Member States given the better than planned outcomes in 1999;

(ii) as growth remains strong, meet a budgetary position of close to balance or in surplus earlier than envisaged in the updated stability and convergence programmes and, as a rule, in the year 2001 so as to achieve a sufficient margin to cope with the impact of adverse cyclical fluctuations;

(iii) pursue, where appropriate, further fiscal consolidation beyond the minimum to comply with the requirements of the Stability and Growth Pact so as to create additional room for manoeuvre for cyclical stabilisation, to cope with unexpected budgetary developments, to put the debt on a more rapidly descending trajectory and to prepare for the budgetary challenges associated with population ageing.

General government net lending (+)/borrowing (−) in the updated stability and convergence programmes

(% of GDP)

	Date (1)	1999 (2)	2000 (*)	2001	2002	2003
Stability programmes						
B	12/99	− 0,9	− 0,7	− 0,5	0,0	0,2
D	12/99 (3)	− 1,1	− 1,1	− 1,5	− 1,0	− 0,5
E	01/00	− 1,1	− 0,8	− 0,4	0,1	0,2
F (4)	01/00	− 1,8	− 1,5	− 1,2	− 0,7	− 0,3
IRL	12/99	2,0	1,6	2,5	2,6	n.a.
I	01/00	− 1,9	− 1,5	− 1,0	− 0,6	− 0,1
L	02/00	2,4	2,5	2,6	2,9	3,1
NL (5)	11/99	0,5	0,4	− 1,3/− 0,5	− 1,1/0,0	n.a.
A	03/00	− 2,0	− 1,7	− 1,5	− 1,4	− 1,3
P	02/00	− 2,0	− 1,5	− 1,1	− 0,7	− 0,3
FIN	09/99	2,3	3,7	4,2	4,6	4,7
Euro-11		− 1,2	− 1,1	− 1,0	− 0,6	− 0,2
Convergence programmes						
DK	12/99	3,0	2,2	2,2	2,3	2,5
EL	12/99	− 1,6	− 1,2	− 0,2	0,2	n.a.
S	11/99	1,9	2,2	2,0	2,0	n.a.
UK (6)	12/99	1,2	0,2	0,2	− 0,1	− 0,4
EU-15		− 0,6	− 0,7	− 0,6	− 0,3	− 0,2

(*) March 2000 EDP notifications from Member States.
(1) Date of adoption.
(2) Out-turn.
(3) Addendum to the updated stability programme of February 2000.
(4) Favourable scenario; cautious scenario projections: − 1,3, − 0,9 and − 0,5 % of GDP, respectively, in the years 2001 to 2003.
(5) Figures for 2001 and 2002 based on a cautious scenario and favourable scenario respectively; both scenarios are based on the Budget Memorandum 2000, published in September 1999, since which actual developments have been more favourable.
(6) 1999 Out-turn for calendar year. Programme data for financial years.

Source: Commission services.

3.3. *Improve the quality and sustainability of public finances*

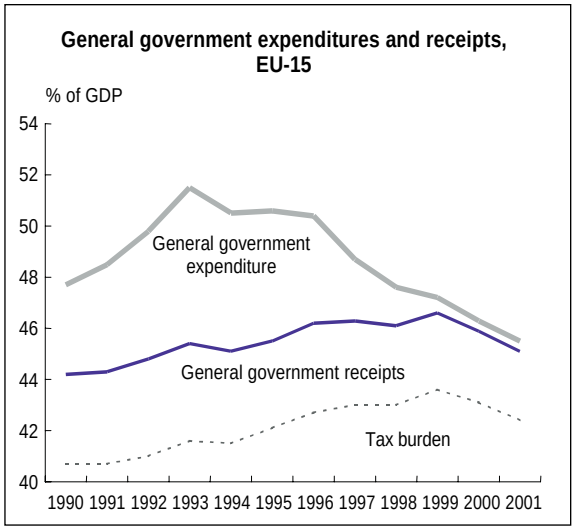
The current favourable economic prospects provide the opportunity to introduce comprehensive reforms involving expenditure restructuring and reductions in the tax burden, while enhancing fiscal consolidation. The composition and quality of budgetary, consolidation is instrumental in enhancing employment and guaranteeing a smooth functioning of EMU. Public expenditure needs be restructured in order to support investment in tangible and intangible capital and so to enhance the growth potential of the economy; tax reforms aimed at lowering tax burdens and removing tax distortions will play an essential role in increasing the growth and employment potential. Furthermore, tax

systems have to cope with the challenges brought about by economic integration and technical change, including the need to fight harmful tax competition. Welfare systems must underpin economic transformation and need to be adapted to ensure that work pays, disincentives to work are removed and quality services are provided in an efficient manner. At the same time, the modernisation of the welfare state must ensure that structural change does not compound the existing social problems, such as unemployment, social exclusion and poverty. There is a need to ensure the sustainability of public finances in the medium and long term while taking account of demographic and other long-run structural developments. Member States should:

(i) improve the sustainability of their public finances principally through expenditure restraint rather than through tax increases;

(ii) introduce or enhance the mechanisms and institutions that help control spending, in this context, the introduction of ceilings for expenditure could be considered;

(iii) redirect government spending to give greater relative importance to investment in physical and human capital, R & D, innovation and information technologies so as to ensure a substantial annual increase in per capita investment in human resources;



Source: Commission services.

(iv) review benefit systems, in order to make work pay;

(v) reduce the tax burden, especially on low-wage labour, to favour employment within continued fiscal consolidation;

(vi) promptly review pension and health-care systems in view of the budgetary challenges of an ageing population;

(vii) improve the efficiency and transparency of tax systems, especially through widening the tax base, reducing tax rates and ensuring appropriate enforcement procedures;

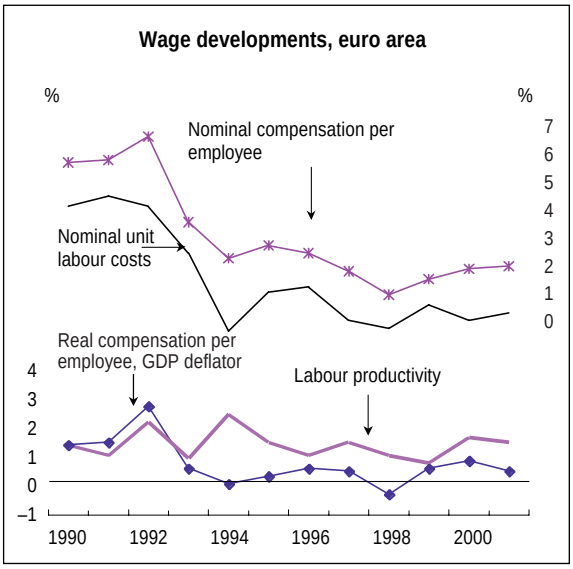
(viii) engage in reforms of the VAT system aiming at greater simplification and modernisation of existing rules, more uniform application of existing provisions and the re-enforcing of administrative cooperation; conclude the ongoing discussions on taxation of e-commerce, which is instrumental to guaranteeing a smooth functioning of the internal market;

(ix) pursue tax coordination further so as to avoid harmful tax competition; reach an agreement on the tax package in line with the conclusions of the European Council held in Helsinki in December 1999.

Just like the Member States, the Community should respect the principle of budgetary discipline. This must be applied to all categories of the financial perspectives, as agreed at the 1999 Berlin European Council, while respecting the Interinstitutional Agreement on budget discipline and the improvement of the budget procedure; within the financial perspectives and respecting the Interinstitutional Agreement, a better allocation of Community resources should be exploited in order to enhance the economic impact of the EU budget.

3.4. ***Promote appropriate wage developments***

Wage developments in Member States should be allowed to reflect different economic and employment situations. Governments can create the right framework conditions which facilitate the negotiations of social partners. For wage developments to contribute to an employment-friendly policy mix, the social partners should continue to pursue a responsible course and conclude wage agreements in Member States in line with the general principles set out in the broad economic policy guidelines. It is necessary to:



Source: Commission services.

(i) insist that nominal wage increases be consistent with price stability. This implies, that in the euro area, aggregate wage increases will be consistent with keeping price increases within the price stability objective of the ECB;

(ii) stress the importance of real wage developments for strong employment growth; encourage real wages to increase in relation to labour productivity growth while taking into account the need to strengthen, where necessary, and subsequently maintain, the profitability of capacity-enhancing and employment-creating investment. This implies that in countries where overall labour productivity growth is slowing down, the scope for real wage increases will be reduced. More specifically, a reduction in working time should not lead to an increase in real unit labour costs. For improved profitability to result in higher investment in the Union, it is essential to forge an investment-supportive environment in terms of demand developments, labour-market conditions, taxation and the regulatory framework;

(iii) ensure that collective bargaining systems take account of productivity differences (whether according to skill, qualification or geographical area) when determining wage levels;

(iv) pursue policy aiming to reduce gender pay differences due to *de facto* discrimination.

3.5. ***Foster a knowledge-driven economy***

The European Union needs to improve its innovative capacity as an essential element in its strategy to increase growth and employment. But the impact of innovation and technology diffusion will be modest unless they are part of a broader reform process in the area of product, capital and labour markets. Higher levels of competition in product and capital markets and well-functioning financial markets are essential conditions for increased innovation and better diffusion of technology. Member States should:

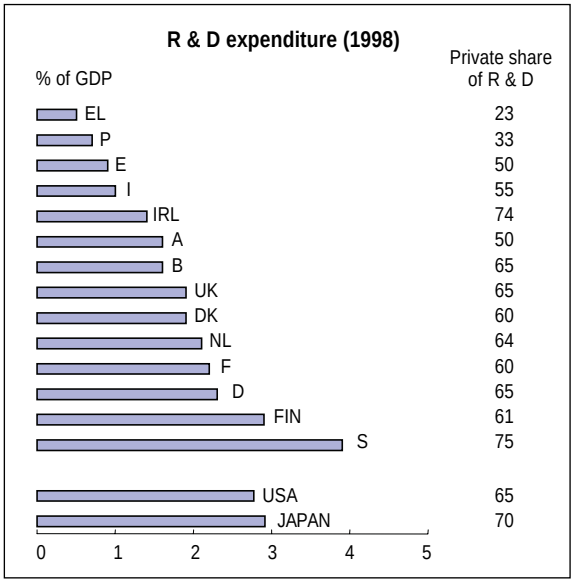
(i) provide adequate framework conditions to increase the involvement of the private sector in the financing of R & D expenditures, R & D partnerships and high technology start-ups, for example by using tax policies and by improving the functioning of risk capital markets;

(ii) stimulate competition in product and capital markets, in particular, by removing entry and exit barriers, with a view to strengthening incentives for firms to innovate and to promote the diffusion of technology and information;

(iii) ensure efficient and adequate public support for the funding of basic research, the creation of centres of excellence and the provision of incentives for the establishment of better links between research institutes and business and ensure the dissemination of information; EC State aid rules must be strictly applied;

(iv) ensure availability of low-cost, high-speed Internet access

(v) take measures to reduce the fragmentation and compartmentalisation of the R & D effort and to intensify cooperation at the EU level so as to establish a European area of research and innovation; improve the networking of research centres by 2001 and take steps to remove obstacles to the mobility of researchers by 2002; ensure, on the basis of a Commission proposal, the establishment of an EU patent system by the end of 2001;



Note: The data refer to the share of R & D performed by the private sector.
Source: Commission services and OECD.

(vi) strengthen education and training efforts, both private and public, in order to raise the adaptability of the labour force and to avoid the emergence of unemployment and social exclusion due to a lack of skills; promote lifelong learning of information society skills; encourage companies, workers and educational institutions to participate in lifelong learning; halve by 2010 the number of 18 to 24 year

olds with only lower-secondary education who are not in further education and training; increase the number of researchers and engineers; guarantee the availability of Internet and multimedia resources to all schools by the end of 2001 and the required teacher skills by the end of 2002; use information technology on a wider scale in schools.

3.6. *Ensure efficient product (goods and services) markets*

Well-functioning product markets are essential to enable the EU countries to take full advantage of the opportunities provided by the introduction of the euro, globalisation and the new technologies and play an important role in tackling employment challenges. In this area, significant progress has already been achieved, in particular as a result of structural reforms implemented in Member States and the impulse given by the Cardiff process. In services, progress has been slowest, however. By the end of 2000, a strategy for the removal of barriers to trade in services is needed. Member States should:

(i) implement the international market legislation fully and effectively, especially in the area of public procurement and technical standards; take measures to ensure availability of both government procurement and basic public services on-line by 2003; reduce the volume of national technical regulation to the strict minimum necessary; improve the functioning of the mutual recognition principle;

(ii) ensure the independence of competition authorities; empower competition authorities to enforce Articles 81 (cartels) and 82 (abuse of dominant positions) of the EC Treaty with transparent and effective instruments;

(iii) reduce State aid, in particular ad hoc aid, and redirect it towards horizontal goals; improve the monitoring of State aid and the assessment of its efficiency;

(iv) complete the liberalisation of the telecommunications market by the end of 2001 and, in particular, work towards strengthening competition in local access networks before the end of 2000;

(v) speed up the liberalisation of the energy (electricity and gas), postal services and transport sectors aiming at a truly internal market in these areas; fully implement the Community directives that open markets for public utilities; make certain that the benefits of lower prices and high quality of services are also transmitted without delay to consumers and industrial users via adequate regulation and taking account of public service obligations; systematic assessment of reforms in network industries is needed after they have been implemented;

(vi) reinforce competition in services sectors, especially in the financial services, the distribution sector and business services; on the basis of a Commission proposal, agree on a strategy for the removal of barriers to services by the end of 2000 and undertake measures to enable electronic commerce to develop fully its potential;

(vii) reduce regulatory burdens on business, in order to create a more friendly environment for innovative business, especially the set up and the running of SMEs, and set out a strategy for further coordinated action to simplify the regulatory environment by 2001;

(viii) develop a systematic approach to the regulatory framework for services which could aim at identifying areas where market elements could be used in the provision of public services; develop measures to improve the efficiency of public administration by promoting the use of new management and communication (e-commerce, Internet, public procurement on line) techniques and by stimulating transparent public-private partnerships;

(ix) monitor the effective implementation of the many regulatory reforms in order to obtain concrete results in terms of economic efficiency and consumer benefits.

3.7. ***Promote capital markets through further integration and deepening***

Efficient, integrated financial markets improve the allocation of capital and reduce its cost. They facilitate the process of structural reform and play an essential role in supporting an entrepreneurial culture. This could assist in raising the profitability and investment ratio. Sound financial systems also contribute to macroeconomic stability. Since the introduction of the euro, encouraging progress in the integration of financial markets has been made, not the least by the on-going implementation of the action plans for financial services and risk capital. This work is a key political priority, where action should be taken as quickly as possible; the Lisbon Special European Council has asked full implementation of the action plans by 2005 and 2003 respectively. In addition, the plans and their implementation should take into consideration actual market developments, so that integration is as much as possible market driven. It is necessary:

(i) to facilitate the widest possible access to investment capital on an EU-wide basis, including for SMEs, by means of a 'single passport for issuers';

(ii) to facilitate participation of all investors in an integrated market by eliminating barriers to investments in and by pension funds, by ensuring adequate investor protection, by clarifying the distinction between sophisticated and retail investors, by reviewing conduct of business rules and by improving the framework for the investment activities of institutional investors;

(iii) to promote further integration of government bond markets through greater consultation and transparency on debt issuing techniques and instruments, and improved functioning of cross-border sale and repurchase (repo) markets;

(iv) to improve the efficiency of securities clearing and settlement systems, with the aim of facilitating and promoting sound cross-border activities;

(v) to enhance the efficiency of cross-border retail payment services through improving the procedures for processing cross-border payments and communications with customers;

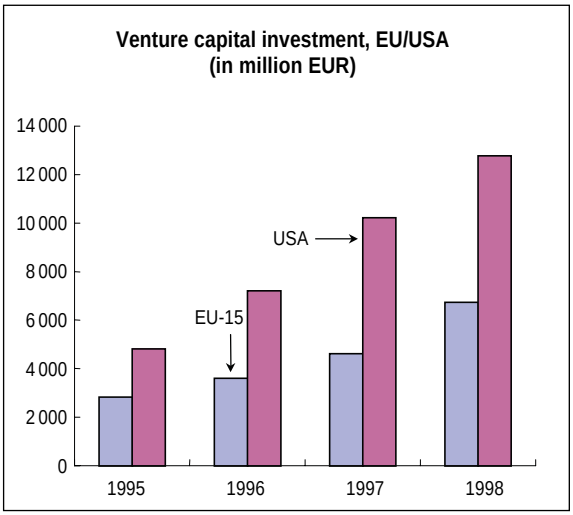
(vi) to enhance the comparability of financial statements of companies which need access to an integrated financial market and allow the EU to respond quickly to developments under way in the international accounting field;

(vii) to speed up fiscal actions to promote the development of new firms and investment in venture capital, changes in bankruptcy legislation to give entrepreneurs a second chance, and actions to promote employee ownership schemes;

(viii) to ensure more intensive cooperation between EU financial market regulators and supervisors;

(ix) to follow-up on the EU provisions on takeover bids and on the restructuring and winding-up of credit institutions and insurance companies.

The Union should contribute to international financial stability by engaging in an effective dialogue with its main trading partners, and by helping to ensure the strengthening of the international financial architecture. It should continue to work for the conclusion of a multilateral framework of investment rules in the next WTO trade round, to improve the predictability and stability of the international investment environment.



Source: EVCA, Venture one.

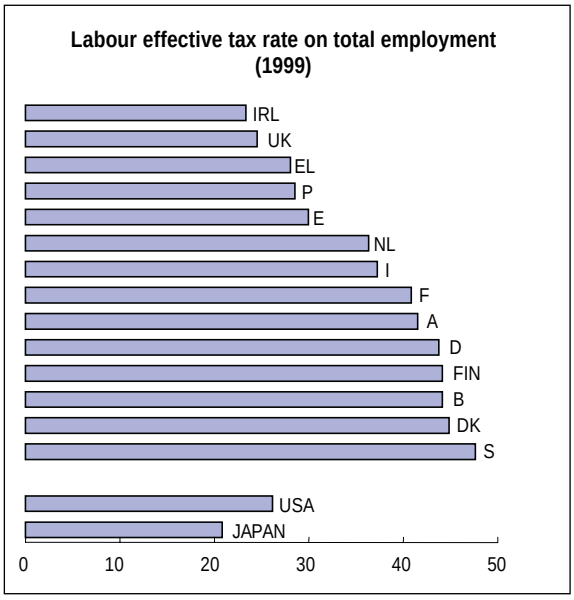
3.8. ***Invigorate labour markets***

The Lisbon European Council set out Europe's strategy for full employment through stepping up the process of structural reform and preparing the transition to a knowledge-based economy; modernising the European social model, investing in people and combating social exclusion; and applying an appropriate macroeconomic mix. Labour-market performance is improving but differs widely among the Member States, partly owing to the uneven progress made in implementing structural reforms and active measures designed to improve employability and adaptability. The countries that have most progress, while pursuing sound macroeconomic policies, are reaping the rewards in the form of higher employment and reduced structural unemployment. However, considerable problems remain: unemployment is still unacceptably high and concentrated among certain groups and regions; and the long-term unemployed form a high proportion. The low employment rate, particularly among women and older working-age people, is constricting the EU's growth potential. Furthermore, the demographic evolution in the EU will see stagnation in the growth of the working-age population. To tackle these problems and fully grasp the benefits of the knowledge-based economy, the integrated four-pillar strategy set out in the employment guidelines should be implemented and in a prompt and transparent manner. The emphasis on investing in people is a key reinforcement of the European social model. Member States should:

(i) promote the transition from passive to active measures and implement a comprehensive preventive strategy against long-term and youth unemployment, in line with the employment guidelines; in particular, raise the employability of individuals through a lowering of taxes and social security contributions, especially on low-paid workers; facilitate access to labour-market training, education and lifelong learning, and aim at reintegrating the unemployed through well-focused active programmes; involve the social partners with the public authorities in the efforts to improve education, training and opportunities for lifelong learning;

(ii) review and reform, where appropriate, tax and benefit systems to ensure effective incentives and rewards for participation in an active working life; assess passive income support and compliance with eligibility criteria in benefit systems and reform where appropriate; avoid the transfer of people from unemployment benefit schemes to other expensive, passive systems outside the labour market and develop active labour-market measures to avoid long-term unemployment support by purely passive systems;

(iii) enhance labour mobility, *inter alia*, through mutual recognition of qualifications and by improving the portability of pension entitlements in order to sustain labour mobility across sectors and regions in the EU;



Note: Labour effective tax rate on total employment is the ratio of social security contributions plus personal income taxes on labour income to gross wages. While conceptually broady 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.

Source: Commission services.

(iv) modernise work organisation in cooperation with the social partners, including flexible working time arrangements, measures to facilitate part-time work and an assessment of tight job protection legislation and high severance payments; accompany any reductions in overall working time, whether by legislation or social agreements, by efforts to prevent increases in unit labour costs and take future labour supply needs into account;

(v) strengthen efforts on equal opportunities policy for women and men, *inter alia*, by improving incentives in tax and benefits systems and by promoting policies to reconcile work and family life;

(vi) strengthen efforts to agree on steps to secure a more inclusive labour market by the end of 2000.

3.9. ***Enhance sustainable development***

The promotion of environmentally-friendly technologies, products and behaviour could contribute to a more sustainable development. A sound environmental policy that tries to exploit the efficiency gains embodied in market-based instruments would also bring benefits in terms of more efficient economic structures, hence contributing to higher growth and employment. Member States should:

(i) introduce or strengthen market-based policies like taxation, user charges, insurance/liability schemes and tradable permits, which put a price on scarce resources; help achieving the EU objectives under the Kyoto protocol; and contribute to break the link between environmental pressure and economic growth;

(ii) reassess sectoral subsidies and tax exemptions and other existing measures which have a negative environmental impact while taking full account of other relevant economic and social factors;

(iii) work to agree on an appropriate framework for energy taxation at the European level.

II. COUNTRY-SPECIFIC ECONOMIC POLICY GUIDELINES

1. BELGIUM

After a slowdown in 1999, acceleration in economic activity is expected in 2000, supported by domestic demand, notably private consumption and investment, and a continuing positive contribution from net exports. Employment creation is expected to continue in 2000 and to strengthen further in 2001 as the reduction in labour taxes takes effect.

Budgetary policy

Belgium has made further progress towards budgetary adjustment in 1999, as the general government budget deficit fell to 0,9 % of GDP, which is blow the target set in the stability programme, and government debt to 114,4 % of GDP. According to the updated stability programme 2000 to 2003, Belgium will continue its fiscal consolidation effort based on high primary surpluses, aiming at a situation of budgetary balance in 2002 and a dept ratio close to 100 % of GDP in 2003. In view of the above, budgetary policy should aim:

(i) to achieve better budgetary results in 2000 than the 1 % of GDP deficit target set in the budget and in the updated stability programme, in the light of the better budgetary results in 1999 and higher GDP growth prospects for 2000 than projected in the budget;

(ii) to contain the real annual growth rate of primary expenditure within the 1,5 % figure implicitly derived from the commitments under the updated stability programme, thus allowing a reduction in the tax burden, notably on labour, while preserving the achievement of a lower government deficit target;

(iii) to maintain the primary surplus at levels somewhat above 6 % of GDP in order to ensure a continuous reduction in the general government deficit and to allow a fast reduction in government debt ratio;

(iv) to allocate the proceeds of privatisations or other sales of assets owned by the State to the reduction of government debt.

Product markets

Belgium is very well integrated into the European economy. The openness of the Belgian economy creates competition, especially in the goods markets. However, problems persist in selected services sectors. While significant progress has been made in transposing internal market legislation, implementation should be speeded up. The Belgian Government has expressed its commitment to reduce the administrative burden for enterprises by 25 % by the end of its term. Despite recent efforts, the ratio of R & D spending to GDP is below EU average. Efforts to stimulate the growth of the below average ICT penetration rate have to be pursued. In view of the above, Belgium should give high priority to the following:

(i) addressing the problem of a lack of competition in services, which contributes to high prices and poor productivity performances in sectors such as energy, telecommunications, rail transport and business services;

(ii) speeding up the liberalisation of the electricity and gas sectors and strengthening the powers of the regulatory authorities responsible for energy and telecommunications;

(iii) implementing without delay and monitoring closely the various measures envisaged to reduce the administrative burden for business;

(iv) increasing the transparency of the relationships between the public and private sectors, particularly within the public-private partnerships in order to avoid distortions of competition.

Capital markets

Several reforms have been undertaken to improve market efficiency in an increasingly competitive environment. Venture capital is largely dominated by the public sector and characterised by a high percentage of early-stage and high-tech investments. Although the concentration of efforts on early-stage operations is in general positive, the shortage of private venture capital, and of bridging finance in particular, may in the longer run restrict the growth of the venture capital market. In view of the above, Belgium should give high priority to the following:

(i) making further efforts to encourage private, as opposed to public, venture capital through an improvement of the fiscal environment; giving consideration, in particular, to restructuring the corporate tax system, through reducing the tax rates and widening the tax base.

Labour markets

Belgian labour markets have performed relatively well in terms of employment growth. Starting from a low overall employment rate, especially for women and older workers, labour supply rose steadily. The increase in employment therefore did not translate into much lower unemployment. The unemployment rate continues to be one of the highest among the smaller Member States, and regional differences are pronounced. Shared responsibilities between federal government, regions and language communities require substantial coordination. In view of the above, Belgium should give high priority to the following:

(i) reinforcing measures to promote labour mobility between and within regions and encouraging social partners to further allow wage negotiations, within the frame of the federal wage norm, to better reflect local labour market conditions and/or the financial situation of the enterprises, given the pronounced geographical differences in unemployment. Social partners and public authorities should also, in their respective areas or responsibility, pay more attention to upgrading skills and improving educational attainments of the labour force;

(ii) reinforcing active labour-market policies in order to create incentives to participate in active measures and to take up new job offers; the active policy measures should be combined with a review of potential disincentive effects of tax and benefit systems, including availability and benefit conditions, on employment, in particular of low skilled, older workers and women.

2. DENMARK

Economic growth should recover in 2000 since domestic demand, and in particular private consumption, should regain strength in parallel with the brighter outlook for export markets. Unemployment, which at 4,5 % of the labour force at the end of 1999 reached its lowest level since the 1970s, is likely to edge up over the year.

Budgetary policy

Government finances in Denmark improved strongly in 1999, with the general government surplus reaching 3 % of GDP, half a percentage point higher than expected at the adoption of the budget bill. For 2000, the general government surplus is expected to amount to 2,2 % of GDP and, according to the updated Danish convergence programme, to increase thereafter gradually to some 3 % of GDP by 2005. Expenditure overruns have regularly occurred at the level of local governments. In view of the above, budgetary policy should aim:

(i) to adhere to the government's aim to restrict real growth in government consumption to 1,2 % in the budget for 2000; for this, exercise vigilance at the level of local governments; consider stronger institutional arrangements, respecting the autonomy of local governments, if there is a risk that this target will not be met;

(ii) to pursue the decline of both the tax and expenditure ratios as foreseen in the updated convergence programme, given the healthy situation of government finances, as this would increase economic incentives and contribute to a more favourable medium-term outlook for growth and employment.

Product markets

Denmark is among those countries that have gone the furthest in product market reform, in particular in the area of the network industries. However, there is scope for improvements in price levels and productivity in the Danish economy if the problem of inadequate competition in certain sectors, such as food and beverages, building materials, and retail distribution, is resolved. The Danish commercial R & D track record compares unfavourably with that of the other Nordic countries. In view of the above, Denmark should give high priority to:

(i) continue to take policy action to strengthen competition policy and make sure that it is enforced in full; given the Competition Council powers to enforce Articles 81 and 82 EC;

(ii) continue the effort to improve the efficiency of the comparatively large public sector, for example by using public tendering more systematically;

(iii) increase the effort to raise technology transfers from research institutes to business and to induce entrepreneurship in high-tech sectors.

Capital markets

Major reforms have been taken to increase market efficiency and to develop risk capital. However, the equity market remains relatively small, especially compared to the bond market. A market for high-growth companies was created in 1998, but relatively few companies are listed. Despite the reforms undertaken, the venture capital market also remains small. In view of the above, Denmark should give high priority to:

(i) increase the sources of funds for venture capital investments by further reducing the quantitative constraints on pension funds investment; this process should take into account the need for risk diversification;

(ii) give particular attention to the examples of good practice but forward in the October 1999 Risk Capital Communication in the areas of taxation of investments in venture capital, legislation on bankruptcy, and promotion of innovative employee ownership schemes, including stock-options.

Labour markets

The labour market situation has improved substantially in Denmark in recent years, partly as a result of the comprehensive structural reforms implemented since the mid-1990s. However, given a high employment rate and a low unemployment rate, it might prove very difficult to ensure an adequate labour force in the longer term. Demographic developments will not help in the coming years, nor will the announced introduction of a sixth holiday week. Despite the recent changes in tax rules, the taxation of labour remains high and benefit schemes are large and generous. In view of the above, Denmark should give high priority to:

(i) implement the reforms so as to reduce the overall fiscal pressure on labour, in particular the marginal tax rate on low incomes, and to increase incentives to take up or remain in jobs; monitor closely the reform of early retirement and leave schemes in the light of the need to increase labour supply.

3. GERMANY

Economic activity clearly accelerated in the second half of 1999, with the external contribution turning positive again for the first time since mid-1998. With the external environment expected to retain its vigour and domestic demand supported by the expected decline in unemployment, the current year should see clearly higher GDP growth than in 1999.

Budgetary policy

The consolidation of government finances in Germany continued in 1999, with the general government deficit declining to 1,1 % of GDP compared to a target in the original stability programme of 2 %. According to the updated stability programme of 1 February 2000, the deficit is expected to decrease to 1 % of GDP in 2000. This modest decline in the deficit ratio, despite an ambitious savings package at the federal level, is due, *inter alia*, to a slight deterioration of finances at the regional level and a replenishment of reserves in the social security sector. In 2001, the planned reforms of income and corporate taxes will lead to a deterioration of the general government deficit to an estimated 1,5 % of GDP. In view of the above budgetary policy should aim:

(i) to use the fiscal gains in the event of higher growth than expected to reduce the deficit in 2000 below the targeted level;

(ii) to implement the reforms of income and corporate taxation in 2001 with greatest caution in order to limit the renewed increase in the government deficit and to minimise the risk of a lasting deterioration of the structural deficit;

(iii) to elaborate structural reforms of the social security system (especially pension and health) as they are key to sustainable finances in the medium term;

(iv) to make sure that the debt ratio is put on a downward trend by fully respecting the envisaged deficit targets and pursuing available privatisation opportunities at all levels of government. Furthermore, one off revenues should be used fully for debt reduction.

Product markets

Germany is well integrated in the European product markets. However, German price levels remain relatively high mostly due to higher per-capita income levels. Several reforms have recently proved successful in improving the functioning of German product markets, in particular in the area of competition policy and the liberalisation of network industries. Nevertheless, there is scope for further improvement. In view of the above, Germany should give high priority to:

(i) ensure an increased opening-up of public procurement; promote electronic access to public tenders;

(ii) liberalise the advertising regulations according to European standards (i.e. eliminate the restrictions on discounts and free gifts), taking into account the requirements of the new e-commerce Directive;

(iii) improve competitive structures and efficiency by exploiting the possibilities of privatisation;

(iv) continue to reduce State aid, including ad hoc aid and sector-specific aid;

(v) review the new agreement on electricity payments, which lasts until the end of 2001, in the light of experience gained, so as to capture the full benefits of the liberalisation of the electricity sector;

(vi) undertake further efforts to reduce restrictions and administrative burdens on SMEs, in particular for business services and craft firms.

Capital markets

The German financial market has developed dynamically over the last five years, especially in 1999. Particularly successful has been the development of the Neuer Markt, the stock market for high-growth, high-tech companies. As a result of strong public support, as well as of recent market developments, the German venture capital market is growing strongly with, moreover, a substantial amount invested in the early stage. In view of the above, Germany should give high priority to:

(i) giving consideration to the examples of good practices given in the October 1999 Risk Capital Communication in the field of taxation, bankruptcy laws and support to stock option schemes.

Labour markets

The German labour-market situation improved moderately in 1999, but this was mainly concentrated on the western part of the country. The 'Alliance for jobs' has set the framework for recent wage moderation, including increased opportunities for part-time work for elderly people, to be implemented by the social partners. A far-reaching tax reform, shifting taxation away from labour to eco-taxes, has already been implemented, and there are plans to bring forward further steps of the reform. Pension increases will be slowed which should help to keep pension contributions stable. In view of the above, Germany should give high priority to:

(i) critically reassessing its policy towards the eastern part of the country, where labour-market problems are still, 10 years after unification, especially severe. This assessment should cover, in particular, the efficiency of transfers, and also how social partners could encourage job creation by means of increased labour-market flexibility and adequate wage structures;

(ii) continue and monitor efforts to bring down gradually the fiscal pressure on labour by reducing taxes and social security contributions. Labour costs should be reduced further over the whole wage scale and in particular at the lowest end, while respecting the need for fiscal consolidation. The policy strategy of shifting taxation from labour to eco-taxes, which has already contributed to a decline of pension contribution rates of about 5 %, should be continued in line with the envisaged further steps of the reform;

(iii) reducing disincentives within the tax and benefit system which discourage labour-market participation of all groups, especially of older workers, considering the policy choice most appropriate to avoid the early withdrawal of workers form the labour market and to promote employment of older workers.

4. GREECE

The recovery in economic activity initiated in 1994 continues at a strong pace; in 1999, real GDP growth in Greece exceeded the EU average for the fourth consecutive year, despite a slight deceleration related to external developments. The consolidation of the growth phase is expected to affect the labour market positively in coming years.

Budgetary policy

Greece made further progress in 1999 in improving its budgetary situation, as the general government deficit fell to 1,6 % of GDP, below the target set in the convergence programme, and the government debt fell to 104,4 % of GDP. The faster reduction in the deficit was due to much higher budget revenues than expected which resulted in more than offsetting a slight overrun in expenditure. The updated convergence programme provides for a further reduction in the government deficit in 2000 and 2001. Fiscal consolidation is supported by a high primary surplus, part of which is generated by the social security system following the reforms of the 1990s; mainly because of population ageing, further reform of the sector is foreseen. In view of the above, budgetary policy should aim:

(i) to consider as an upper limit the target set in the budget for the general government deficit in 2000 at 1,2 % of GDP; a better outcome on the revenue side should be reflected in a lower general government deficit; to tighten the budgetary policy further in 2001 if inflation pressures emerge;

(ii) to secure expenditure control through clear and binding norms with the aim of reducing the primary current expenditure ratio;

(iii) to pursue the reform of the social security sector with a view to ensuring long-term viability in the system; in addition, to improve the asset management by social security funds combined with the continuation of the rationalisation and control of expenditure;

(iv) to implement the privatisations schedule for 2000 and in subsequent years with a view to securing a faster reduction in the debt ratio.

Product markets

Partly because of its geographical location, the Greek economy is less integrated in the European product markets than other Member States. Price levels are relatively high for several categories of prices. Greek labour productivity growth rates have improved, the levels of productivity, however, are lower than those in other Member States. Despite significant progress made in privatising public companies and a few measures taken to promote entrepreneurship and innovation, the process of reforms in product markets is rather slow. In view of the above, Greece should give high priority to:

(i) improve the transposition record and the implementation of internal market legislation;

(ii) speed up the process of liberalisation in the telecommunications, electricity and gas sectors;

(iii) take concrete measures to promote business start-ups;

(iv) take further measures to increase R & D and ICT diffusion and stimulate private sector involvement in R & D financing.

Capital markets

On the basis of on-going liberalisation, the Greek capital market is increasingly open to competition. The stock market has benefited from reforms introduced in the field of corporate governance and listing conditions, and from the dematerialisation of securities. Furthermore, the shares of small and medium-sized dynamic companies are expected to be listed shortly in the newly formed stock market for these companies modelled after the European New Market. Venture capital investments, however, remain the lowest in the EU. This restricts significantly the source of finance available to young high-growth companies. Incentives provided through tax relief and a financial support programme were introduced only recently, therefore their results cannot yet be evaluated. In view of the above, Greece should give high priority to:

(i) speed up the implementation of the actions put forward in the 1998 risk capital action plan, and give particular consideration to the examples of good practice provided in the October 1999 communication.

Labour markets

Greek labour market performance in the 1990s was characterised, on the one hand, by an increase in the participation rate and employment while, on the other hand, unemployment increased. Although the full-time equivalent employment rate is now close to the EU-average, considerable structural problems remain, including a low employment rate, low part-time and female employment, and high long-term unemployment. Steps have been taken towards structural reforms of the labour market and the implementation of a preventive approach to tackling youth and long-term unemployment. The tax burden on labour has been reduced. Efforts to increase part-time employment which in Greece is lower than the EU average, have started producing results in 1999. In view of the above, Greece should give high priority to:

(i) take decisive, coherent and measurable action to prevent young and adult unemployed people from drifting into long-term unemployment; to make, in particular, strengthened efforts to complete the reform of employments services, to implement preventive policies in compliance with employment guidelines 1 and 2; pursue efforts to reform training and education systems in line with the needs of the productive systems;

(ii) ensure full and effective implementation of the labour market reforms agreed in 1998, in particular regarding the extension of part-time work and more flexible working time;

(iii) review wage formation systems with the social partners, with a view to adapting wage developments to productivity differentials at geographical, sectoral and company level, ensuring in particular that opting out of sectoral agreements (respecting, however, the minimum level set by the general collective bargaining agreement) under the territorial employment pacts becomes a practical possibility.

5. SPAIN

In 1999 GDP growth kept its previous robust pace along with job creation. Prospects for 2000 remain favourable based on a more moderate development of domestic demand and on a recovery of Spanish exports. However price developments have been worse than expected since the second half of 1999 but are likely to decelerate in the course of 2000 provided wage settlements remain moderate.

Budgetary policy

In 1999, fiscal consolidation made clear progress: the general government deficit was reduced to 1,1 % of GDP, half a percentage point below the target set in the original stability programme. According to the updated stability programme the general government deficit is expected to be further reduced in 2000 and 2001 and it would turn into a surplus in 2002 and 2003, which would be achieved mainly through restraint of primary current expenditure. This would also permit a reduction in the tax burden. With a view to addressing the problem of the ageing population, a pension reserve fund has been created. In view of the above, budgetary policy should aim to:

(i) achieve and possibly improve upon the budgetary targets set in the updated stability programme, given the better than expected outturn in 1999; be prepared, already in 2000, to tighten fiscal policy further to counterbalance any possible overheating risk;

(ii) implement the pending reform of the National Budget Law in the year 2000 with a view to improving the control of primary current expenditure, which is central to the strategy of fiscal consolidation; this should allow non-budgeted expenditures to be limited mainly to unforeseeable contingencies;

(iii) gradually increase the pension fund reserve created in the 2000 Budget Law to cope with the long-term problem of the ageing population; take additional steps in the new round of talks about reform of the pension system between the Government and the social partners which have to take place in 2000 within the 1995 Pacto de Toledo framework; and

(iv) continue and respect fully the existing internal stability pact between regions and the State, as territorial governments have an increasing role in many fields of expenditure.

Product markets

Spain is moderately well integrated in the European product markets. Various measures have been taken to improve competition on product markets: improved transposition of internal market legislation; progress in the liberalisation of telecommunications; reinforcement of the competition law and creation of one-stop shops for SMEs. The new plan for science and technology targets a major increase in the ratio of R & D spending to GDP. In view of the above, Spain should give high priority to the following:

(i) continue the implementation of the 1999 reform of the competition law; within this reform, give particular attention to reinforcing the capacity and the resources of the independent competition authority to investigate cases;

(ii) continue to reduce sector-specific (railways, coal, shipbuilding) aid;

(iii) take measures to reinforce the competition framework in sectors such as electricity, gas and retail distribution, to remove restrictions on land supply and to bring the price of water closer to its real cost; and

(iv) continue the measures to reduce administrative burdens, especially for SMEs given the high share of SMEs in business employment, and expand the geographical coverage of the one-stop shops for businesses.

Capital markets

The capital market is developing rapidly as a result of reforms introduced to support business access and to facilitate investment in unlisted securities, and as a result of the privatisation process and growing household share ownership. However, the venture capital market remains small. In view of the above, Spain should give high priority to the following:

(i) make further efforts to develop venture capital markets and in particular to increase early-stage investments; give consideration to the examples of good practice put forward in the October 1999 Risk Capital Communication in the areas of legislation on bankruptcy, promotion of innovative employee ownership schemes and promotion of stock markets for small and medium-sized businesses.

Labour markets

Spanish labour market performance has improved markedly in recent years, with a remarkable fall in unemployment and strong employment growth. Efforts have been made to shift from passive to active labour market policies, including a reinforcement of the preventive approach to tackling youth and long-term unemployment. The tax burden on labour has been reduced, particularly at the lower end of the wage scale. However, unemployment is still the highest in the EU, and considerable structural problems remain, including the duality of the labour-market between permanent and temporary contracts, low rates of female participation and employment, and wide regional disparities. There is also some risk of wage pressures developing. In view of the above, Spain should give high priority to the following:

(i) review, together with the social partners, the wage formation system and the regional-local enforcement of the welfare system and take action to improve the functioning of the housing market in order to promote labour mobility and tackle regional disparities in unemployment;

(ii) pursue efforts to improve the efficiency of active labour-market policies and to enhance their coordination with passive labour-market policies to reduce inflows into long-term unemployment and combine this with a review of tax and benefit systems to improve incentives to hire, to take up work and to participate in active labour-market programmes; review the quality and efficiency of technical training in schools; and

(iii) review further, together with the social partners, tight job-protection legislation for employees on permanent contracts and lower barriers to dismissal in order to reduce the weight of temporary contracts and enhance the flexibility of the labour market.

6. FRANCE

Economic activity strengthened in the middle of 1999 and the expansion seems to be well established at present: growth should continue to be healthy in 2000 allowing strong job creation, all the more so as the employment content of growth has increased in recent years. Despite above potential growth, inflationary pressures are excepted to remain subdued as a result of increased competition and moderate wage increases.

Budgetary policy

France made visible progress in the improvement of its budgetary position in 1999, as the general government deficit fell to 1,8 % of GDP, half a percentage point below the target set in the original stability programme. According to the updated stability programme, further reductions of the deficit ratio are to be pursued in 2000 and beyond. This would be the result of a tight control of expenditure, which would also allow a reduction in the tax burden. In the medium term, the French public finance, specially the pension system and sickness insurance, will face an increasing burden resulting from the ageing of population. As a first answer to this problem, a pension reserve fund has been created in 1999. In view of the above, budgetary policy should aim to:

(i) reduce the government deficit in 2000 to a level clearly below the one set in the updated stability programme, given the better than planned outcome for the government deficit in 1999 and the strong growth prospects;

(ii) take prompt corrective measures in the event of any significant slippage from the expenditure targets in specific sectors, which have been established by the updated stability programme; whenever possible, implement such corrective measures within the same year or, at the latest, in the following year;

(iii) take the opportunity to reduce the deficit more quickly in case of a wider budgetary room for manoeuvre so as to fulfil the Stability and Growth Pact objectives even in 2000 or in 2001 with a more comfortable margin; and

(iv) orient the reform of the pension system, which is intended to begin in 2000, towards long-term sustainability of government finances, taking into account considerations of equity — including between generations.

Product markets

France is relatively well integrated in the European product markets. Over the recent period, the pace of structural reforms has speeded up, leading to an improvement in the competitive environment and to a reduction of red tape for business. The present more favourable macroeconomic situation offers France a window of opportunity for additional reforms. In view of the above, France should give high priority to the following:

(i) improve its record in transposing internal market directives which is relatively poor and has deteriorated recently; resolve problems in the application of internal market rules; and continue efforts to introduce greater transparency in public procurement procedures;

(ii) avoid granting large ad hoc aid such as those that were granted in the recent past;

(iii) widen the liberalisation, already initiated, of network industries, particularly in the energy sector; and

(iv) continue efforts to simplify formalities for business and to encourage innovation.

Capital markets

The French capital market is mature and efficient. The stock market developed dynamically in the 1990s following modernisation of technologies, the creation of a market for high-growth companies, privatisation, and the introduction of fiscal measures to support equity investments. Various measures have been taken to stimulate the development of risk capital. However, the risk capital market, in spite of its recent growth, needs further development. In view of the above, France should give high priority to the following:

(i) further facilitate investment by institutional investors in stock markets and in venture capital; and

(ii) give particular attention to the actions put forward in the October 1999 Risk Capital Communication, as examples of good practice to improve the taxation framework, enhance enforcement of bankruptcy legislation and to promote the further development of employee ownership schemes.

Labour markets

The labour market situation has improved markedly in France, even if the unemployment rate of 10,6 % of the labour force at the end of 1999 remains one of the highest in the Union. The fall in the youth unemployment rate has been even more pronounced as new, substantial measures gradually come into effect. Nominal wage growth has remained subdued, despite the recent improvement in demand for labour. The forthcoming wage developments must be watched closely, as they will continue to incorporate effects of the gradual introduction of the 35-hour working week. The effective taxation on labour is relatively high, the net replacement rate relatively generous and the regulatory environment could be made lighter. In view of the above, France should give high priority to the following:

(i) pursue and evaluate policy measures designed to reduce the fiscal pressure on labour, particularly those addressing unskilled and low-paid workers, and, in this context, review benefit schemes in order to avoid poverty traps;

(ii) review employment protection legislation in order to assess its impact on employment; and

(iii) monitor the negotiation of the 35-hour working week reform closely so as to avoid adverse effects on wage costs, labour supply and work organisation in the medium term.

7. IRELAND

GDP again grew exceptionally well in 1999 and strong, albeit lower, growth is expected in 2000 as final demand growth will remain high. Some of the current acceleration in inflation is attributable to one-off factors and underlying inflation may be contained, but there are signs of over-heating especially in the labour market. Supply constraints may, therefore, threaten both inflation and growth in the short term.

Budgetary policy

In 1999, the government finances, again, recorded a strong surplus put at 2 % of GDP. In the stability programme, surpluses are foreseen to continue in the coming years. There are now firm signs of upward pressure on inflation in the economy and the emergence of supply constraints both physical, including infrastructure, and in the labour market. In view of the above, budgetary policy should aim to:

(i) be ready, already in 2000, to use budgetary policy to ensure economic stability given the extent of overheating in the economy; gear the budget for 2001 to this objective;

(ii) restrain the growth in real public consumption from the 4,3 % estimated in 1999 to 2,7 % in 2002 as shown in the updated stability programme; and

(iii) ensure that the objectives of the national development plan are accorded high priority, given the necessity of meeting the infrastructural needs of a strongly growing economy, while at the same time achieving the stability objectives of fiscal policy.

Product markets

Ireland's economy is very well integrated with the rest of the EU, with relatively low prices, in spite of the recently rapid rise in prices of housing and some services, and high productivity. A number of product market reforms have been carried out in recent years. Progress has been made in developing competition in the telecommunication sector, the electricity and gas markets are to be progressively opened to competition and the government has begun to use public-private partnerships to improve the efficiency of public services. Government research expenditure is rather low, but the budgetary resources allocated to R & D are to be increased substantially. In view of the above, Ireland should give high priority to the following:

(i) give the competition authority the power to enforce Articles 81 and 82 of the EC Treaty; permit a real strengthening of competition policy in the reform of competition law to be drawn up this year and do not restrict it to procedural matters; and

(ii) take measures to liberalise further the transport sector; in particular, introduce competition into urban bus transport and into the railways, e.g. by franchising.

Capital markets

Capital markets are developing well and stock market capitalisation as a percentage of GDP has doubled over the last five years. However, the number of companies listed has remained small. Several measures have been taken to encourage venture capital, and there has been a positive move of funding away from government-sponsored to private investors. Investments, which were traditionally focused on the latter stage (expansion), have increasingly been directed to the early stages. However the overall level of investments remains low. In view of the above, Ireland should give high priority to the following:

(i) make further efforts in particular to develop start-up and early-stage venture capital.

Labour markets

Strong employment growth and unemployment rates approaching historically low levels are the main features of the current Irish labour market. The employment rate matches the rate for the euro area, female participation in the labour force is increasing and recent trends show a major decline in the long-term unemployment rate. While demographic forces will continue to increase the size of the labour force, the overall situation raises the concern that a tightening labour market could restrict economic growth. In view of the above, Ireland should give high priority to the following:

(i) monitor wage developments so as to ensure that they are at most consistent with the recently concluded national pay and partnership agreement, the programme for prosperity and fairness, as the minimum necessary basis for the maintenance of employment growth; and

(ii) adopt a comprehensive strategy to increase the participation of women in the labour market, including the removal of tax-benefit disincentives, and put in place measures which facilitate the reconciliation of work and family life; pursue, in particular, flexible leave schemes and a sustained effort to increase the supply of care for children and other dependants.

8. ITALY

From the second half of last year, economic growth in Italy has shown a marked acceleration, and prospects are expected to remain robust in 2000-2001. Growth is fuelled by domestic demand and net exports are improving. Despite improvement in labour market flexibility, unemployment remains high.

Budgetary policy

In 1999, Italy reduced the general government deficit to 1,9 % of GDP, slightly better than the original target of 2,0 %. However, the primary surplus was lower than expected (4,9 % of GDP instead of 5,5 %) and the debt remained at the high level of 114,9 % of GDP. The updated stability programme foresees a further reduction of the deficit ratio to 0,1 % in 2003. The reduction in the deficit would be the result of tight control of expenditure, which will also permit a reduction in the tax burden. Over the medium term, the Italian public finances, specially the pension system, will face an increasing burden as a consequence of population ageing. In view of the above, budgetary policy should aim to:

(i) achieve better budgetary outcomes than planned should growth turn out stronger than projected in the programme and thus accelerate the reduction in the still high debt/GDP ratio towards the 60 % reference value;

(ii) as a minimum, achieve a primary surplus of 5,0 % of GDP in 2000 and 2001 projected in the updated stability programme, namely through tight control of current primary expenditure;

(iii) contain in the medium term the expected increase in the ratio of pension expenditure to GDP; to this end, begin as soon as possible a reassessment of the pension system and take further steps to reform the pension system, including promoting the expansion of funded pension provisions; and

(iv) carry out the planned privatisation programme with vigour and continue to use privatisation receipts to reduce government debt further.

Product markets

Italy is relatively less integrated in the European product markets than other large Member States. The international involvement of Italian companies is below what would be expected from a country of its size. However, price levels in Italy are significantly below the EU average and productivity performances are similar to those of France and Germany. Several reforms have been introduced and have contributed to improve the functioning of the product market, in particular in the area of the privatisation and liberalisation of public utilities and of the reduction of administrative burden on SMEs. In view of the above, Italy should give high priority to the following:

(i) continue current progress in transposing internal market legislation and strengthen efforts to reduce remaining problems in the area of public procurement;

(ii) increase efforts to reduce further the overall level of non-agricultural State aid and to further improve its structure since the level of non-agricultural State aid expressed in percentage of GDP remains among the highest in the EU;

(iii) reinforce efforts to simplify the regulatory environment for companies and to develop one-stop shops; and

(iv) reinforce initiatives to promote R & D and innovation in the light of the very low ratio of R & D expenditure to GDP.

Capital markets

Substantial progress has been made towards the development of deeper and more integrated financial markets and the development of risk capital in Italy. Italian equity markets are growing rapidly thanks also to the extensive ongoing privatisation programme. Venture capital and private equity have also expanded rapidly in recent years, and the creation of the *Nuovo Mercato* will contribute further to these developments. Nevertheless the venture capital market remains underdeveloped. In view of the above, Italy should give high priority to the following:

(i) continue efforts to encourage the development of venture capital, in particular by further improving the taxation framework for risk capital, by facilitating investment of institutional investors in stock markets and venture capital, and by reforming bankruptcy legislation.

Labour markets

Despite some recent improvements, the labour market situation remains difficult, with a low employment rate, high structural unemployment and large regional differences. Segmented labour markets, a large informal economy and unequal unemployment distribution across groups and regions point to structural problems. Many underlying structures are unfavourable for employment, including a high tax burden on labour and loose benefit systems combined with strict employment protection legislation. While there have been significant efforts to reduce taxation on labour, to modernise administration and to introduce new forms of job contracts, these measures have not yet borne full fruit. There is a clear need to complement these efforts by comprehensive structural measures. In view of the above, Italy should give high priority to the following:

(i) combine an improvement of the unemployment benefit system with an increase in the flexibility of employment protection legislation and a tightening of eligibility rules for pension and other benefit schemes, whilst ensuring proper job availability requirements and incentives to participate in active labour market programmes;

(ii) continue to enhance labour market flexibility and, in particular, reinforce efforts towards wage flexibility in line with labour productivity differences in particular across regions, and

(iii) continue efforts to reduce taxation on labour, and monitor developments closely, especially the effect of temporary tax and social security contribution measures targeted at disadvantaged labour market groups and regions.

9. LUXEMBOURG

Real GDP growth was particularly fast in 1999 despite unfavourable external developments and is expected to remain strong. Unemployment remains very low and there are some upward pressures on inflation.

Budgetary policy

Due to fast economic growth and the ensuing buoyancy in fiscal revenues, the Luxembourg government has repeatedly registered comfortable surpluses for several years. In view of the above, budgetary policy should aim to:

(i) monitor closely current government expenditures in order to facilitate the achievement of the budgetary objectives while making room for a reduction in the tax burden as planned in the updated stability programme; and

(ii) combine the implementation of sound public finance policies with reforms, notably in the field of social security, that are needed in order to maintain the long-term viability of the system and prepare for the challenge of an ageing population.

Product markets

While the Luxembourg economy is very well integrated in the European product market and its macroeconomic performance is excellent, structural policies targeted towards better functioning product markets are less well advanced. However, progress is being made. The abolition of most of the price regulation system and the reduction of the coverage of the regional aid systems which should take place in the near future, is particularly welcome. In view of the above, Luxembourg should give high priority to the following:

(i) speed up the transposition of internal market legislation, particularly in transport, motor vehicle, plant-health checks and social affairs;

(ii) adopt a new competition law permitting a more efficient competition policy by the authorities, giving them the power to enforce Articles 81 and 82 EC; and

(iii) create the conditions allowing a continuation of the catching-up to the most recent developments in the information society, in particular given the late start of ICT penetration for a country with a high standard of living.

Labour markets

The labour-market performance of Luxembourg is good, with the lowest unemployment rate and the highest domestic employment rate in the EU, relying heavily on cross-border workers. The national employment rate is not outstanding, with low female and older worker participation rates. While there are no major problems in the functioning of labour markets, some underlying tax and benefit structures are not so favourable for encouraging employment. In view of the above, Luxembourg should give high priority to the following

(i) examine the tax-benefit system with a view to removing disincentives which may discourage the participation in employment, and continue efforts to increase the national employment rate, in particular that of women and older workers.

10. NETHERLANDS

Economic activity hardly decelerated in 1999 with respect to the high growth rate achieved in 1998; as a result, employment kept increasing at a rapid pace and registered unemployment fell to levels not seen since the early 1970s. Growth is likely to accelerate in 2000 following the improvement in the external economic situation. Fast growth and a progressively tightening labour market call for vigilance about the evolution of prices and, even more, of wages, which are now increasing faster than in neighbouring countries.

Budgetary policy

Strong economic growth boosted government revenues in 1999 so that the deficit, which was at the beginning of the year generally expected to rise, eventually turned into a surplus of 0,5 % of GDP. Since the mid-1990s, the Dutch budgetary strategy has consisted of setting growth ceilings for government expenditures in order to reduce the tax burden and simultaneously the government deficit. A major tax reform is planned for 2001 consisting of a reduction of personal taxes and an increase in indirect taxation. In view of the above, budgetary policy should aim to:

(i) strengthen the envisaged budgetary position in 2000 and the following years, taking into account the government surplus already achieved in 1999 and current strong economic growth and possible inflationary pressures; and

(ii) monitor closely public expenditure in 2001 so as to ensure that the deterioration in the budgetary position, resulting from the loss of revenues due to the tax reform, remains limited and temporary.

Product markets

The Netherlands is very well integrated into the European economy and its product markets function relatively well. Structural reforms have been effective, even if there are still some problems related to the transposition and implementation of internal market legislation (in transport). Competition policy should continue to be reinforced as should the liberalisation of postal services, the energy and transport sectors. The private share of R & D funding is relatively low and technology transfer between public and private research still insufficient. In view of the above, the Netherlands should give high priority to the following:

(i) make further progress in enforcing the public procurement directives as the share of the value of calls for tenders published in the Official Journal in total public procurement is amongst the lowest in the EU;

(ii) pursue further the regulatory reform and privatisation process at the basis of the introduction of competition in network industries; in particular safeguard access to the cable network with a view to avoiding abuse of dominant positions of cable companies in broadcasting, telephony and internet services; speed up the transposition of internal market directives in the area of transport; and

(iii) take further measures to raise the involvement of the private sector in R & D and to encourage technology transfer between public and private research.

Capital markets

The Dutch stock market and the venture capital market are mature and competitive. The venture capital market has shown strong growth over recent years as a result, in part, of a favourable taxation environment. However early stage investments remain relatively limited. In view of the above, the Netherlands should give high priority to the following:

(i) concentrate its efforts on encouraging early stage investments; give consideration to the examples of good practices put forward in the October 1999 Risk Capital Communication, in the area of promotion of innovative employee ownership schemes, including stock options.

Labour market

Dutch labour-market performance has been among the best in the EU in recent years, in large part thanks to the comprehensive strategy of structural reforms pursued. Tax and benefit reforms have reduced the tax burden on labour and have improved work incentives. Measures have been taken to increase labour supply among specific groups, including older people and those on disability schemes. Nevertheless, significant structural imbalances remain, with a high proportion of the working-age population in receipt of passive unemployment and disability benefits. In view of the above, the Netherlands should give high priority to the following:

(i) continue efforts to improve the tax-benefit system with a view to removing disincentives which may discourage participation in employment, in particular of women and older workers; pursue resolutely the efforts to reduce the high number of people who remain outside the labour market supported by passive income support schemes.

11. AUSTRIA

Austria is experiencing an acceleration of economic growth due to a well-balanced pick-up of all demand components and in particular robust private consumption. Employment is likely to continue rising and, with labour supply remaining elastic, translating partly into a decrease in unemployment.

Budgetary policy

Austria made some progress in consolidating its government finances in 1999 as the deficit fell to 2,0 % of GDP, the target set in the original stability programme. Against the background of a marked tax relief in the framework of the reform of income taxes, the updated stability programme targets a general government deficit of 1,7 % of GDP in 2000 and further reductions thereafter. However, this will be attained with the help of sizeable one-off measures. To achieve a durable improvement in the government accounts in the medium and longer term, significant structural measures, first and foremost in the pension and health domain, are foreseen in the updated stability programme. In view of the above, budgetary policy should aim to:

(i) as a minimum, achieve a better deficit outcome than projected for 2000, especially if growth should turn higher than expected; this would help to establish a clear downward trend in the debt ratio; realise substantial savings on the expenditure side and exercise strict expenditure control in the budgetary execution in order to meet the cost of the reform of income taxes and family assistance;

(ii) replace the one-off measures taken in 2000 by measures of a permanent nature with a view to putting public finances on a sustainable path; and

(iii) implement the announced pension reform aimed at raising the average retirement age from the end of 2000 onwards and pursue reforms in order to put the predominantly pay-as-you-go pension system on a sounder footing.

Product markets

While Austria is rapidly integrating into the European trading system, its involvement in foreign direct investment and cross-border M & A activity remains below par. Austria has adopted a rather cautious approach to product market reform. Nevertheless, some progress has been made in transposing internal market legislation, in reinforcing competition policy and in liberalising telecommunications. Some initiatives have also been taken to simplify procedures for starting new and handing over businesses and the ambitious target of raising R & D spending to 2,5 % of GDP by the year 2005 (up from 1,6 % of GDP in 1998) has been set. In view of the above, Austria should give high priority to the following:

(i) make further progress in the transposition of the Community's public procurement guidelines, in particular at the provincial level which has been delayed;

(ii) accelerate the process of regulatory reform in the energy and transport sectors in order to ensure effective competition in the market place; and

(iii) take further measures aimed at increasing the involvement of the private sector in R & D and at encouraging technology transfer between public and private research.

Capital markets

The government has undertaken several reforms to stimulate the stock and risk capital markets. However, the stock market remains small, and venture capital investment is also low, though rapidly increasing, and focused on the later stage sector. In view of the above, Austria should give high priority to the following:

(i) upgrade the supervisory framework, improve corporate governance by, *inter alia*, pursuing privatisation, and develop fiscal incentives for equity and risk capital investments; and

(ii) implementing the actions put forward in the 1998 Risk Capital Action Plan, especially concerning taxation of new firms and investment in venture capital, legislation on insolvency and bankruptcy and promotion of stock options.

Labour markets

Austrian labour markets are performing relatively well. Unemployment is low and employment rates are high. However, the employment rate for older workers is below the EU average, due in part to disincentives arising from the early retirement system. Another feature of the Austrian labour market is the smoothly working cooperation of the social partners, which might be seen as a model for many other countries. In view of the above, Austria should give high priority to the following:

(i) rapidly implement the announced reforms on increasing the early retirement age and review benefit systems; accompany the pension reform measures by further measures targeted at older workers in order to avoid a rising incidence of unemployment for this age group; and

(ii) continue efforts to reduce the high tax burden on labour, in particular by focusing on problem groups in the labour market.

12. PORTUGAL

After the slowdown in both domestic and external demand in 1999, exports began to recover in the second half of 1999, pointing to an acceleration of economic activity in 2000. Job creation is expected to remain robust in 2000 but somewhat slower due to a more balanced composition of growth. There is a widening current account imbalance as the indebtedness of the private sector has risen rapidly.

Budgetary policy

In 1999, the general government deficit declined to 2,0 % of GDP, the target set in the original stability programme. According to the updated stability programme, a reduction of the deficit ratio to 1,5 % is to be achieved in 2000 and to continue thereafter. The deficit reduction in 2000 would be the result of a steep rise in tax revenue, resulting from a more efficient collection of taxes, which would more than offset the planned rise in total expenditure. To underpin the process of fiscal consolidation in the medium term, the updated stability programme foresees various reform plans, most notably the introduction of a new basic law for the budget, a new law on social security pensions and measures in the sickness insurance. In view of the above, budgetary policy should aim to:

(i) as a minimum, achieve the 1,5 % of GDP deficit target for 2000, which implies a strict control of current primary expenditure which has risen significantly in recent years; in this context, not use the expenditure amounts frozen in the budget for 2000 if this is required to achieve the deficit target, thus creating a cushion to absorb a possible shortfall in tax revenue;

(ii) ensure that budgetary policy contributes to a more balanced policy mix to correct the major imbalances in the Portuguese economy; achieve a faster decline in the deficit ratio than planned with a view to increasing the safety margin allowing Portugal to let the automatic stabilisers work in the event of a cyclical downturn; and

(iii) approve, before the end of 2000, the new basic law for the budget, putting budget preparations on a multiannual basis in order to identify better the medium-term effects of policy decisions; implement urgently a number of reforms with a budgetary impact, including both the measures announced in the area of health care and a new social security pension law to strengthen the financial position of the social security sector so as to face the ageing problem better.

Product markets

The Portuguese economy is moderately well integrated in European product markets. The international involvement of Portuguese companies is relatively weak. Progress has been made in transposing internal market legislation and in liberalising the telecommunications and energy sectors. However, productivity and R & D levels remain amongst the lowest in the EU. In view of the above, Portugal should give high priority to the following:

(i) continue efforts to improve the record in transposing internal market legislation, especially in transport, because, despite progress made, the transposition record remains poor;

(ii) reduce State aid and take action to bring competition law more in line with European Union legislation and to reinforce the independence of the competition authority;

(iii) monitor closely the effectiveness of the various measures taken to simplify administrative procedures and to reduce further their costs in light of the high share of SMEs in business employment; and

(iv) undertake further efforts to promote R & D and ICT diffusion, in particular create incentives to increase private sector involvement in R & D.

Capital markets

The combination of an extensive privatisation process, the introduction of the euro, and the shift to all-electronic trading have increased the maturity, depth and efficiency of the Portuguese stock market. Progress has also been made in the implementation of EC financial services directives. Despite the initiative taken to improve the legal framework for venture capital, venture capital investment remains low and highly dependent on the support of public funds. In view of the above, Portugal should give high priority to the following:

(i) make further efforts to develop venture capital and in particular give consideration to a revision of the tax framework in order to reduce the relative cost of risk capital as compared to other financial instruments.

Labour markets

Portuguese labour markets are performing better than in many other Member States. The full-time equivalent of the employment rate is among the highest in the EU. One of the most serious problems related to the further catching up of the Portuguese economy is the low level of educational attainment of the workforce. Although younger workers' educational level has improved substantially compared to previous generations, it still lags far behind other Member States. Employment protection legislation is considered to be relatively strict in Portugal. In view of the above, Portugal should give high priority to the following:

(i) improve education and training, including technological courses and greater coverage of pre-primary schooling, in order to increase the employability and adaptability of the labour force, and accompany this by an adequate benefit system so as to ensure appropriate incentives to participate in active labour market measures and to take up job offers; and

(ii) pursue the policy further of implementing a number of laws aimed at improving the performance of the labour market, including the easing of dismissal and job assignment rules and the introduction of higher working time flexibility, with a view to enhancing labour-market flexibility;

(iii) encourage partnership among social partners in order to modernise the labour market.

13. FINLAND

Rapid economic growth in recent years has been led by buoyant exports centred on high-technology products; domestic demand has recovered from the earlier recession and employment is expanding, though unemployment, mainly structural, remains high. Strong growth together with firm budgetary expenditure control has resulted in highly successful budgetary consolidation. Given an outlook of continuing strong growth, however, overheating has emerged as a significant risk.

Budgetary policy

The general government surplus rose to 2,3 % of GDP in 1999 from 1,3 % in 1998. According to the updated stability programme, the surplus should remain above 4 % of GDP throughout the period 2000 to 2003, with the main contribution to change being the central government surplus. The actual surplus profile will depend on the timing of reductions in taxes and charges on labour which the government aims to cut by 1,5 % of GDP by 2003. Surpluses are justified by the need to prepare for a rapidly ageing population. In view of the above, budgetary policy should aim to:

(i) maintain the tight fiscal stance represented in the 2000 budget, given the increasing overheating risks, and stand ready, already in 2000, to tighten further if the risks materialise more clearly;

(ii) continue to increase the government surplus through a reduction in government expenditure relative to GDP; to this end, respect firmly the central government expenditure guidelines for the years 2001 to 2004 announced in March 2000; and

(iii) continue the reductions in the high burden of taxation on labour as in 1999 and 2000 and as part of a restructuring of the tax system with the aim of supporting job creation.

Product markets

Integration of the Finnish economy in European product markets has improved since the country joined the EU. Significant and fast progress has been achieved in the transposition of internal market legislation and in the liberalisation of telecommunications and electricity sectors. The already important R & D effort has been further increased since the mid-1990s. However, there is scope for improvements in price levels and productivity in the Finnish economy if the problem of inadequate competition in certain sectors is resolved. In view of the above, Finland should give high priority to the following:

(i) take further measures to strengthen competition in a range of sectors, most notably the distribution sector; consider reforming the competition law to give national competition authorities more powers in line with the Commission White Paper on modernising competition policy, and

(ii) further open up markets for public services, which should lead to lower costs and higher quality.

Capital markets

The Finnish stock market has grown strongly in recent years, both in terms of capitalisation and of number of companies listed. The venture capital market is active and the recent creation of a market for high-growth companies will further favour the development of risk capital. However, further efforts should be made to support the development of risk capital. In view of the above, Finland should give high priority to the following:

(i) give particular attention to the examples of good practice put forward in the October 1999 Risk Capital Communication in the areas of legislation on bankruptcy and promotion of innovative employee ownership schemes; and

(ii) continue with measures to encourage investment by institutional investors in equity markets.

Labour markets

The labour-market situation improved considerably in 1999, including a relative substantive reduction in long-term unemployment. However, the unemployment rate still remains above the EU average, and is, more importantly, almost completely structural. Other main problems include a high benefit dependency among the working-age population, high taxation on labour and a compressed wage distribution. There have been significant efforts to reduce the tax burden on labour and to improve the quality of and intensify active labour market measures. These efforts need to be balanced by reforms of the benefit system so that the latter actively supports the activation programmes and makes the underlying structures more supportive of employment. In view of the above, Finland should give high priority to the following:

(i) review the overall benefit system with the aim of increasing job availability, making job search more effective, and ensuring sufficient incentives to take up a job offer and to stay in the labour force; and

(ii) pursue recent policy orientations to reduce the tax burden on labour, and in particular, reduce the marginal effective tax rates on low wages.

14. SWEDEN

The Swedish economy is expected to continue to grow strongly above trend in 2000, driven both by continued strong domestic demand growth and strong exports. With buoyant demand, in combination with low inflationary pressure, further employment growth and lower unemployment can be expected over the year. However, in some sectors, supply constraints could emerge that will put upward pressure on prices, not least with respect to the tightening of the labour market.

Budgetary policy

In 1999, the general government surplus remained at 1,9 % of GDP, the same as in 1998. According to the updated convergence programme, continued surpluses of at least 2 % of GDP are to be aimed for in 2000 it and beyond. This would be the result of continued tight expenditure control, which would also allow a reduction in the revenue-to-GDP ratio. In view of the above, budgetary policy should aim to:

(i) tighten the stance of budgetary policy, since the stance followed since 1999 could become too expansionary in the current high-growth environment;

(ii) maintain tight expenditure control this year and next, on which the budgetary outlook is heavily reliant, thereby leading to a further decline in the ratio of government expenditure to GDP; and

(iii) reduce further the tax burden which remains high despite the tax reductions in 2000. The scope and pace of further tax reductions should be governed by the overall aim to maintain sustainability in the public finances and a well-balanced macroeconomic policy mix.

Product markets

Sweden is increasingly integrated in Community markets and has an excellent record in transposing internal market legislation. State aid is low; R & D spending is the highest amongst the EU-15 Member States; and a great effort has been made to deregulate the network industries. However, there is scope for improvements in price levels and productivity in the Swedish economy if the problem of inadequate competition in certain sectors is resolved. In view of the above, Sweden should give high priority to the following:

(i) continue efforts to remove regulation that hinders or limits competition in retail distribution, construction and pharmaceuticals while taking into account that it is inherently difficult to achieve full-scale competition in a country with a large number of sparsely populated regions; give, as currently envisaged by the government, the Competition authority the power to enforce Articles 81 and 82 of the EC Treaty;

(ii) continue efforts to improve competition in railways and air transport; and

(iii) pursue vigorously initiatives that have been launched to enhance efficiency in public procurement and the provision of public services.

Capital markets

The Swedish capital market has been characterised by rapid globalisation, technological change and growth in venture capital investments. The venture capital market is active. It has evolved from having a handful of mostly government players to having a substantial number of private players. However, enterprises in their very early stages and enterprises outside the 'growth-sectors' still have difficulties in raising capital. In view of the above, Sweden should give high priority to the following:

(i) make further efforts to facilitate access to risk capital in particular for small companies outside the high-tech industry; give consideration to the examples of good practice put forward in the October 1999 Risk Capital Communication in the areas of taxation, and promotion of innovative employee ownership schemes.

Labour markets

The labour-market situation started to improve more markedly in 1999 and the employment rate, in particular the female employment rate, is one of the highest within the Union. Despite the measures already taken, taxation of labour remains very high and the benefit schemes generous. The Swedish government appropriately focuses its labour-market policy on improving human capital. The current streamlining of ALMPs is expected to improve their efficiency, while it is important to continue to target the programmes closely to actual and potential long-term unemployed as well as to the demands of the labour market. In view of the above, Sweden should give high priority to the following:

(i) take additional measures to reduce the high tax burden on labour income, in particular for those with a low take-home pay from work; and

(ii) further adapt the benefit and assistance schemes in order to clarify eligibility criteria, limit the benefit duration by activation policy, strengthen the administration and ensure efficient incentives to take up a job.

15. UNITED KINGDOM

Growth in the United Kingdom in 1999 exceeded expectations and even stronger, above-trend growth is expected in 2000 but no major resurgence of inflation is expected. The labour market is expected to remain strong and while wage earnings are showing some sign of acceleration, government measures already taken to promote employment opportunity and improve the attractiveness of work should limit the risks of growth translating into greater pressures on the labour market.

Budgetary policy

Government finances registered a surplus of 1,2 % of GDP in 1999. The authorities now expect the surplus to be 1,3 per cent of GDP in financial year 1999/2000 compared to the 0,3 % of GDP projected in the updated convergence programme. The budget announced in March raised expenditure in certain areas; there are also plans for raising, further than previously announced, the share of government investment in GDP, from its current low levels. Nevertheless the finances are expected to remain in comfortable surplus in 2000/2001. In view of the above, budgetary policy should aim to:

(i) keep the underlying position of the government finances broadly unchanged as shown in the convergence programme, taking account of cyclical developments in the economy; make sure that any new expenditure or tax initiatives are consistent with this goal; and

(ii) pursue the policy of substantially raising the ratio of government fixed investment to GDP within the context of firm control of total government expenditure.

Product markets

The economy of the United Kingdom is very much exposed to international competition. The liberalisation of goods and services markets in the United Kingdom is in many respects further advanced than in the other Member States. However, problems still remain, most notably in transport. Despite significant reforms to improve the functioning of product markets, the United Kingdom faces a serious problem of low productivity. Declining R & D expenditure and innovation intensity may play a part in this. The ability of SMEs to sustain growth and skill shortages also gives cause for concern. In view of the above, the United Kingdom should give high priority to the following:

(i) monitor and, if necessary, reinforce the effectiveness of measures which have been taken or announced to tackle the problems of declining R & D efforts, low innovation intensity, skill shortages and the high failure rate of SMEs; and

(ii) develop a long-term plan for transport in order to tackle the problems of road congestion, inadequate investment in the railways and poor service quality in public transport.

Capital markets

The British capital market is mature and competitive, and a range of initiatives are underway to develop venture capital markets. Nevertheless, venture capital investment in early-stage businesses remains low compared to investment in management buy-outs/buy-ins. Furthermore, although pension funds are not prevented from investing in venture capital by quantitative prudential regulations, their investment in this field remains low. In view of the above, the United Kingdom should give high priority to the following:

(i) analyse the reasons which, notwithstanding the absence of quantitative prudential restrictions, prevent pension funds from investing in venture capital, and take actions to stimulate this investment. This will be one of the areas that the Myners review of institutional investors will examine.

Labour markets

British labour-market performance has been among the best in the EU in recent years. Recent reforms have intensified and extended the 'welfare to work' approach. Tax and benefit reforms have lowered marginal tax rates for low-paid workers while providing in-work benefits to families and disabled persons. A strategy for improving childcare provision has been established. Various measures have been taken to target localities and regions with high unemployment. However, in the context of a good overall performance, the problem of concentrated areas of unemployment, much of it long term, stands out. In view of the above, the United Kingdom should give high priority to the following:

(i) pursue efforts to address the problem of concentrated unemployment in deprived areas and communities, aiming at reducing the proportion of households with no-one at work; and reinforce the preventive strategy against long-term unemployment, with the aim of providing a fresh start within 12 months for unemployed adults in line with the employment guidelines.

Done at Santa Maria da Feira, 19 June 2000.

For the Council

The President

J. PINA MOURA