



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21.2.2002
COM(2002) 93 final

REPORT FROM THE COMMISSION

on the implementation of the 2001 Broad Economic Policy Guidelines

REPORT FROM THE COMMISSION

on the implementation of the 2001 Broad Economic Policy Guidelines

TABLE OF CONTENTS

Executive Summary	3
1. Introduction	7
2. Overview of key policy areas.....	8
2.1. Ensure growth and stability-oriented macroeconomic policies	8
2.2. Improve the quality and sustainability of public finances	17
2.3. Invigorate labour markets	19
2.4. Ensure efficient product (goods and services) markets.....	23
2.5. Promote the efficiency and integration of the EU financial services market	25
2.6. Encourage entrepreneurship.....	27
2.7. Foster the knowledge-based economy.....	29
2.8. Enhance environmental sustainability.....	32
3. Summary assessments of implementation by the Member States	34
3.1. Belgium.....	34
3.2. Denmark.....	34
3.3. Germany.....	35
3.4. Greece	36
3.5. Spain	37
3.6. France	38
3.7. Ireland.....	39
3.8. Italy.....	39
3.9. Luxembourg.....	40
3.10. The Netherlands	41
3.11. Austria.....	41
3.12. Portugal.....	42
3.13. Finland	43
3.14. Sweden.....	44
3.15. United Kingdom.....	44

EXECUTIVE SUMMARY

The 2001 BEPGs confirmed and extended the comprehensive economic policy strategy

The 2001 Broad Economic Policy Guidelines (BEPGs) confirmed the policy strategy aimed at fulfilling the Lisbon agenda, while extending it in the light of the March 2001 Stockholm European Council, which stressed that the promotion of sustainable development should be integrated in the BEPGs. Sound macroeconomic policies and comprehensive economic reforms on labour, product and capital markets should help maintain growth in the short term and strengthen the basis for future growth in the medium term and for coping with longer-term structural and sustainability challenges. This report offers an overall assessment of the implementation of the policy recommendations set in the 2001 BEPGs. It is accompanied by a report of the Commission services that evaluates the implementation of the recommendations on a country-by-country basis.

The following key messages emerge from the report.

Macroeconomic performance worsened under the impact of adverse economic shocks

The macroeconomic environment deteriorated considerably in 2001. Already suffering under the continuing effects of adverse economic shocks, the economic outlook further darkened by the terrorist attacks of 11th September. Growth decelerated throughout the year and came to a standstill towards the end of the year. Job creation slowed down but still exceeded the number of job losses thereby allowing for a further small drop in the unemployment rate. Having been temporarily higher in the early months of 2001, inflation has subsequently engaged on a clear downward path.

Macroeconomic policies passed the stress test

Monetary authorities took advantage of leeway provided by diminishing risks to price stability by cutting official interest rates on several occasions. Budgetary authorities maintained a broadly neutral fiscal stance by making use of regained budgetary margins to allow for some deterioration in budget balances as a result of the operation of the automatic stabilisers. Wage developments remained broadly compatible with price stability and job creation.

Budgetary policies - actual budget balances worsened as a result of the slowdown

As actual budget positions in the EU generally deteriorated under the impact of the economic slowdown (through the play of automatic stabilisers) and tax reforms, structural budget positions did generally not worsen. Several Member States are not yet fulfilling the “close to balance or in surplus” requirement of the Stability and Growth Pact.

Quality and

A growing number of Member States have introduced institutional

***sustainability of public
finances - progress
underway***

reforms to budgetary rules and procedures to improve efficiency and spending controls. Several made progress in improving the long-term sustainability of public finances through reform of pension systems and the creation of reserve funds. However, in several cases, long-term sustainability seems not yet ensured and would require additional measures. Following the November 2000 Council agreement on the tax package, the Commission has presented an amended proposal for a Directive to ensure effective taxation of cross-border interest payments.

***Labour markets -
efforts are being
undertaken but need to
be stepped up***

Overall, there has been progress in invigorating labour markets, through the implementation of the kind of reforms recommended in last year's Broad Economic Policy Guidelines and in the Employment Guidelines and as recently reported in the Joint Employment Report 2001. While the progress achieved in former years has become visible in more employment-intensive growth, inter alia, due to wage moderation, more flexible contracts and tax reductions targeted to the low end of the wage distribution, the pace of labour market reforms seems to have slowed down in 2001. Progress in reforming tax and benefit systems to make them more employment friendly has been limited in 2001, especially when it comes to undertaking comprehensive reforms on the benefit side and taking account of the interactions between tax and benefit systems. Also in line with the Employment Guidelines, most Member States are pursuing comprehensive strategies for lifelong learning to enhance employability and promote the adaptability of the labour force to structural change and thus fostering occupational mobility. Barriers to geographical mobility have, however, hardly been addressed. In the past year, only some Member States have taken measures to better target and improve the efficiency of active labour market policies.

***Product markets -
goods market
integration further
increased, but slow
progress on the
Internal Market for
services***

European product market functioning improved in 2001 thanks to progress in transposing Internal Market Directives, in opening up public procurement and in reducing State aid but problems remain. Following transposition of Internal Market Directives into national legislation, attention should focus on ensuring effective implementation. Barriers to cross-border trade in services are particularly persistent. Notwithstanding progress made in opening up public procurement markets, a large share of public procurement markets is still not yet open to competition across the Union. Competition was enhanced by ongoing reforms and liberalisation in some network industries, but market shares of incumbents remain very high. Similarly, effective competition is likely to benefit from

steps taken by several Member States to increase powers and the operating capacity of their competition authorities and a more intense co-operation between competition and regulatory authorities. Overall State aid as a share of GDP has continued to decrease in the vast majority of Member States, but it remains relatively high in some Member States.

Capital markets - progress in various areas underway, but the implementation of the FSAP needs new impetus

The recommendations of the Committee of Wise Men have been widely endorsed and are progressively carried out. While encouraging progress has been made in 2001 on a number of individual dossiers, the overall progress in implementing the Financial Services Action Plan (FSAP) has been rather slow. A new impetus and mobilisation of all EU institutions is needed to implement the FSAP by the deadlines of 2003 for securities markets and 2005 for the financial markets in general. Member States have undertaken a number of reforms to promote the risk capital market, notably by easing some of the legal/regulatory constraints on institutional investment and by intruding tax changes that foster, among other things, the risk capital market. On the other hand, little has been done to address the disincentive effects of bankruptcy and insolvency procedures. While several Member States have undertaken a reform of their supervisory arrangements, different models are being followed. Enhanced cross-border and cross-sector co-operation will be necessary.

Entrepreneurship - reduction in the regulatory burden and facilitation of access to finance for SMEs, but fiscal barriers continue to create distortions within the Internal Market

Many Member States introduced measures aimed at reducing the regulatory burden and at promoting start-ups and small and medium-sized enterprises, but there are still big differences between Member States in the time and cost needed to establish new businesses. Similarly, measures have been taken to increase the efficiency of public administration and initiatives were launched to decrease corporate tax complexity and reduce the tax burden on business. However, taxation of cross-border activities and the still large differences in effective rates of company taxation continue to create distortions within the Internal Market. Measures have also been taken to ease access to finance for small and medium-sized enterprises.

The knowledge-based economy - progress continued on several accounts, but setbacks occurred in delivering the Community patent and the unbundling of the local loop remains slow

Several Member States took steps to strengthen incentives and funding for R&D, and to improve science-industry co-operation. The deadline for agreeing by the end of 2001 on how to deliver the Community patent was, however, missed. The access to ICT has continued to improve over 2001. Internet access prices dropped, and governments took measures to promote internet access at schools. Despite progress in unbundling the 'local loop', it is still slow. Partly as a result of the global downturn in ICT markets, the rate of increase in ICT take-up has slowed down and the e-commerce is developing more slowly than earlier expected. Most Member States have taken measures to enhance human resources in R&D and to promote ICT skills.

Environmental sustainability - various market-based instruments introduced

Member States have implemented a variety of measures that contribute to environmental sustainability, notably by leading to a better reflection of environmental costs in prices. Limited progress has been made in agreeing upon a framework for energy taxation at Community level in 2001.

1. INTRODUCTION

The European Union has a well-defined economic policy strategy consisting of the pursuit of sound macroeconomic policies and comprehensive structural reforms, as articulated in the Broad Economic Policy Guidelines (BEPGs). This strategy allows policies to respond flexibly to changing economic conditions in the short run whilst strengthening the productive capacity of the economy over the medium run.

The economic policy strategy has gradually evolved. The Lisbon European Council provided a key impulse two years ago. As part of a comprehensive strategy aimed at improving Europe's dynamism and competitiveness, an ambitious economic reform programme was set in motion. The Lisbon strategy was confirmed by the Stockholm European Council last year and extended by the Gothenburg European Council to integrate sustainable development in the economic policy strategy.

The 2001 BEPGs reiterate and update the existing policy strategy. Emphasis is placed on structural reform to strengthen the EU's growth potential, integrating the Lisbon and Stockholm strategy and giving operational content to its ambitious targets. In addition, the 2001 BEPGs identify the broad policy priorities for growth- and stability-oriented macroeconomic policies and sound public finances. These should not only assist weathering the current economic downturn but also help preparing for the longer-term challenge of an ageing population.

This report evaluates the progress made in implementing the policy recommendations formulated in the 2001 BEPGs. In so doing it contributes to the multilateral surveillance of the economic policies of the Member States and the Union as envisaged by Article 99(3) of the Treaty. Moreover, its assessment provides valuable input to the elaboration of the forthcoming BEPGs.

Mirroring the structure of the BEPGs, this report is complemented by a working document of the Commission services that examines in-depth the implementation of the recommendations on a country-by-country basis. The evaluation integrates the findings of other co-ordination processes and makes use of the structural indicators developed to monitor progress on the Lisbon strategy.

Nevertheless, the conclusions presented should be interpreted with caution. Most of the data employed is of a provisional nature.¹ Moreover, the BEPGs include recommendations of a medium- and long-term nature, which cannot be assessed in a conclusive way at this stage. This is particularly true for structural reforms, where the outcome of policy action takes a relatively long time to materialise.

¹ The report is based on data available on 8 February 2002.

The BEPGs policy strategy

1. Ensure growth and stability-oriented macroeconomic policies.
 2. Improve the quality and sustainability of public finances.
 3. Invigorate labour markets.
 4. Ensure efficient product (goods and services) markets.
 5. Promote the efficiency and integration of the EU financial services market.
 6. Encourage entrepreneurship.
 7. Foster the knowledge-based economy.
 8. Enhance environmental sustainability.
-
-

2. OVERVIEW OF KEY POLICY AREAS

2.1. Ensure growth and stability-oriented macroeconomic policies

2.1.1. Economic situation

In a context of slowing growth ...

While following the very good growth performance in 2000, the 2001 BEPGs reckoned with a mild downturn, the slowdown in growth turned out to be much stronger with economic activity reaching a standstill in the second half of the year. Growth in 2001 came out just above 1½%, i.e. more than a percentage point lower than expected. The unexpectedly sharp slowdown was caused by a number of adverse economic shocks in combination with a less than expected resilience in domestic demand. The slowdown in the economy was compounded by the dramatic events of 11 September, which dealt a further blow to the economy and the chances of an early recovery.

Labour market developments typically reflect the economic situation with a lag and the impact has come to be felt more clearly only during the year. Employment growth, although decelerating, continued well into the year while job losses as a result of company downsizing and closures have only gradually increased, as companies have been hesitant to lay off workers especially where labour markets were still relatively tight. While unemployment rates have started to rise in some countries towards the end of the year, the unemployment rate in the EU and the euro area is expected to show a further decline in 2001. The main labour market impact of the slowdown is expected to show up with some delay in 2002, when unemployment in the EU is expected to increase for the first time since 1994.

Consumer price inflation showed a 'hiccup' pattern in 2001, caused by hikes in oil prices and food prices, and the subsequent reversal in oil prices. Headline HICP

inflation peaked at 3.4% in May 2001, and subsequently declined to 2% by the end of the year. Core inflation, defined as HICP excluding energy and unprocessed food, increased throughout most of 2001 as a result of the pass-through of indirect and second-round effects of the energy and food price hikes, but may have peaked in October 2001.

... macro-economic policies have supported growth by making judicious use of the room for manoeuvre

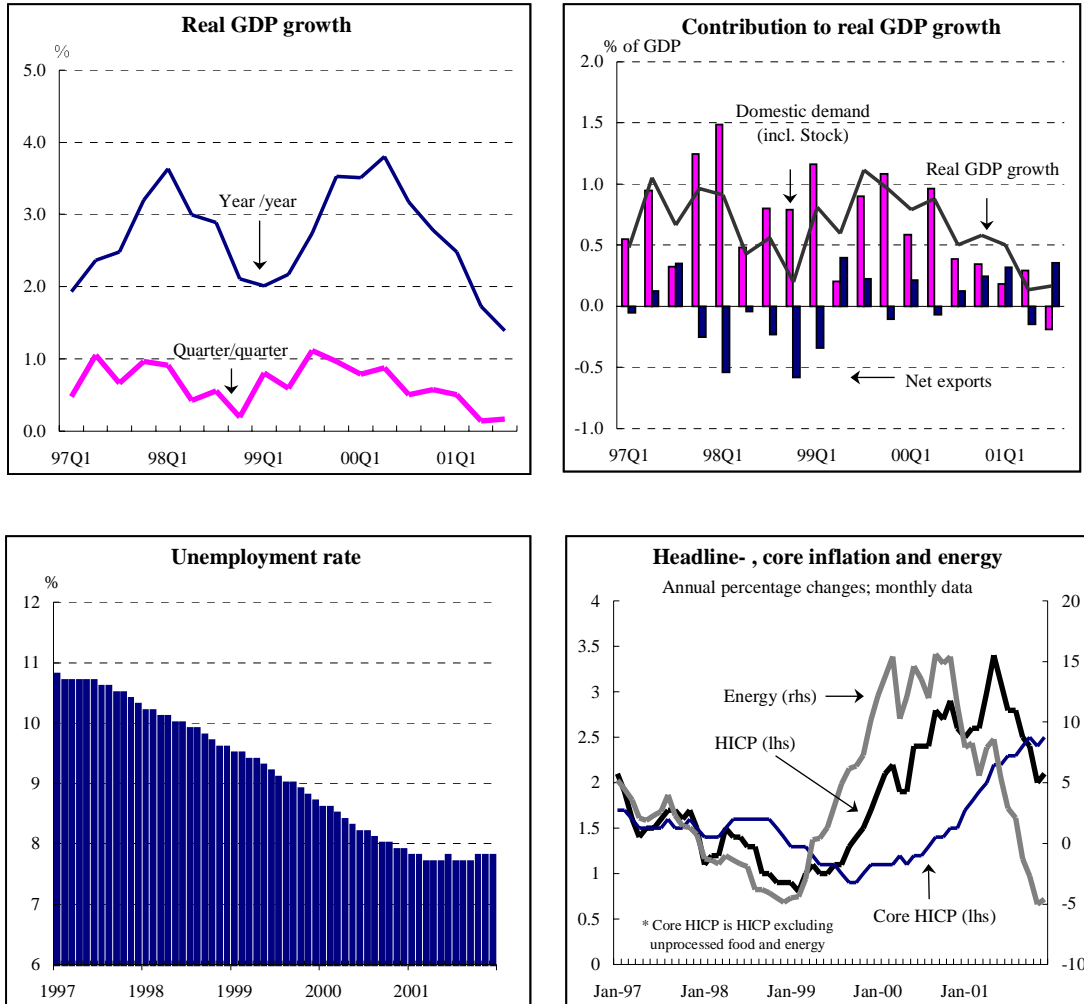
The 2001 BEPGs noted that an appropriate and tension-free economic policy approach consists of: *monetary policy in pursuit of maintaining price stability and, without prejudice to its primary objective, in support of general economic policies; fiscal policies that are geared to sound budgetary positions and avoid pro-cyclical stances. They also underscored the importance of wage developments being consistent with price stability and job creation.*

Making judicious use of possible margins of manoeuvre without compromising the stability-oriented framework, macroeconomic policies have adapted appropriately to the largely symmetric nature of the shocks and the generalised deceleration in growth.

On the back of growing evidence on the extent of deceleration in economic activity and of a gradually improving balance of risks to price stability, the ECB has made use of the emerging leeway by cutting its key interest rate in four steps from 4.75% to 3.25%. Central banks of Denmark, Sweden and the UK also cut rates. These moves were reflected in short and longer-term market interest rates and, particularly towards the end of the year, in an easing of monetary conditions. During 2001 the euro exchange rate strengthened in nominal effective terms, mainly as a result of strengthening against the Japanese yen. Against the dollar, having lost ground over much of 1999 and 2000, the euro stabilised around 0.90 USD in the second half of 2001.

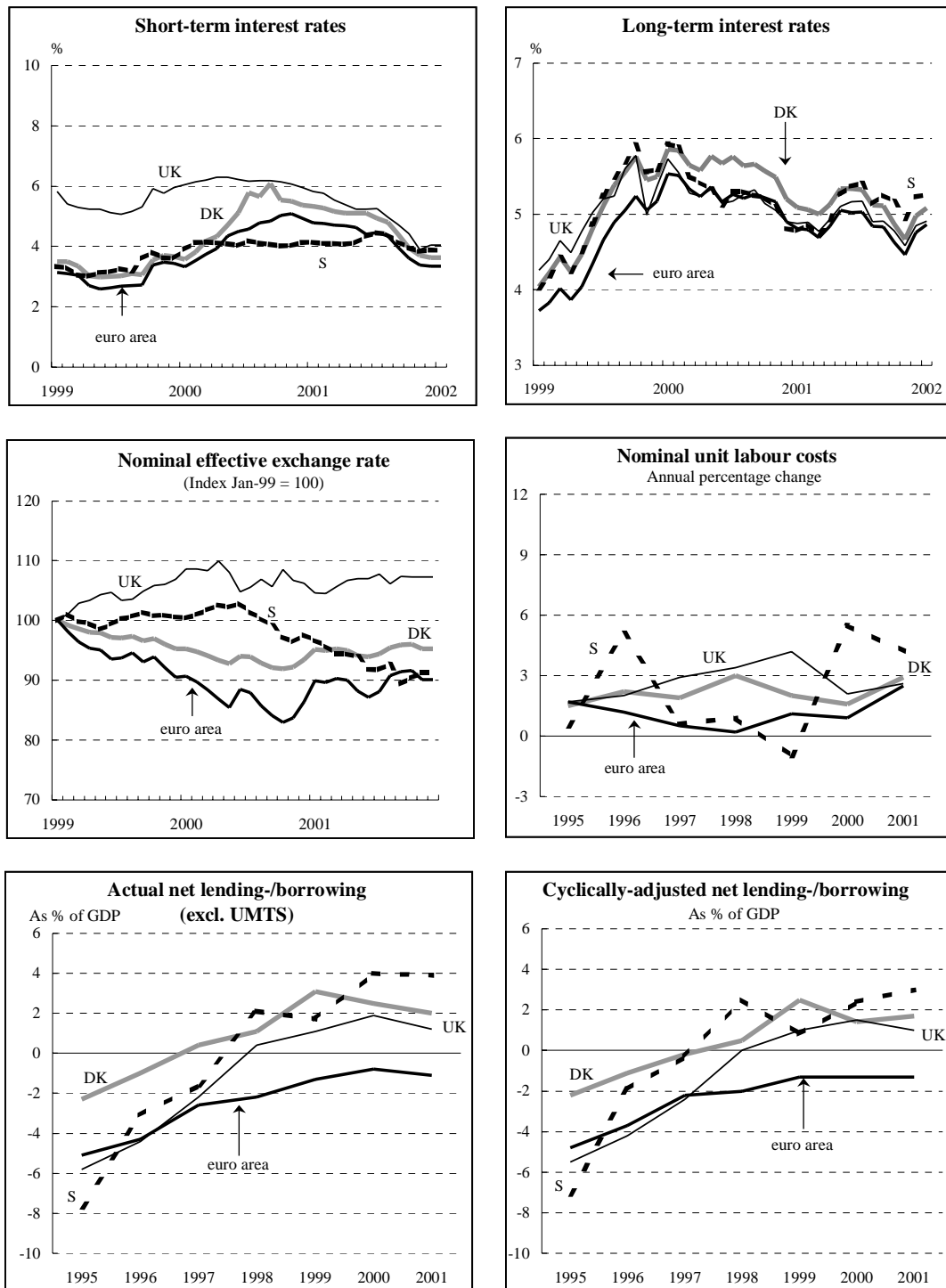
The fiscal stance was broadly neutral while the operation of automatic stabilisers implied some worsening in budget balances. By and large, wage developments continued to be moderate and consistent with price stability and job creation.

Graph 1: Economic developments in the EU



Source: Commission services.

Graph 2: Policy mix in the euro area



Source: Commission services.

2.1.2. *Budgetary policies and the respect of the Stability and Growth Pact*

The 2001 BEPGs recommended Member States to: (i) *meet, as a rule, budgetary positions of close to balance or in surplus in 2001*; (ii) *prepare budgets for 2002 in keeping with the need to achieve or preserve budgetary positions close to balance or in surplus and avoid pro-cyclical fiscal policies*; and (iii) *tighten policy in case of overheating risks*.

Budgetary developments in 2001

As indicated in the 2001 BEPGs, the budgetary recommendations were based on the national stability or convergence programmes, their underlying economic assumptions and the Council Opinions thereon. In the event, growth in 2001 came out considerably lower than assumed in the 2001 BEPGs. The working of the automatic stabilisers implied a considerable deterioration in budget positions in addition to the impact of tax reforms in some countries. As a result, actual budget balances in the EU deteriorated in 2001 as compared to 2000. The EU-wide budget deficit increased to 0.5% of GDP from 0.1% of GDP in 2000 (net of UMTS receipts). This was the first deterioration in the deficit since 1993. Likewise, the euro-area budget deficit increased to 1.1.% of GDP from 0.8% of GDP in 2000. Structural budget positions did generally not worsen.

On a country basis and compared to 2000, budget balances deteriorated sharply in 2001 in Germany, Ireland, Luxembourg, Finland and to a lesser extent in Denmark, Belgium, France, Netherlands, Sweden and the UK. However, in Greece, Spain, Italy and particularly in Austria, outcomes were better than in 2000. Compared to the nominal budget targets for 2001 set in the Autumn 2000 updates on stability and convergence programmes, shortfalls occurred in particular in Denmark, Germany, Greece, France, Ireland and Portugal and to a lesser extent Belgium and Italy. However, targets were met or overachieved in Spain, Luxembourg, the Netherlands, Austria, Finland and Sweden. Deficits are still relatively large in actual and structural terms in Germany, France, Italy and Portugal and consequently these countries are not yet fulfilling the “close to balance or in surplus” requirement of the Stability and Growth Pact (SGP).

Budgets for 2002

In framing their budgets for 2002, Member States, and in particular those with still large deficits, had to strike a balance between the need for further consolidation efforts and the need to avoid a pro-cyclical tightening. Budget plans for 2002 reflect the subdued growth outlook. According to the new set of stability and convergence programmes most countries plan to keep or improve actual budget positions compared to 2001. This would imply a small tightening of the fiscal stance in some countries while for most countries the fiscal stance would be broadly neutral.

Table 1: Evolution in estimates of government budgets for 2001*

	Stability/ Convergence Programme* ¹⁾		Estimated outturn ²⁾		Difference	
	Real GDP growth (% change)	Budget balance (% GDP)	Real GDP growth (% change)	Budget balance (% GDP)	Real GDP growth (% change)	Budget balance (% GDP)
B	2.5	0.2	1.1*	0.0*	-1.4	-0.2
D	2.75	-1.5	0.6	-2.6*	-2.2	-1.1
EL	5.0	0.5	4.1	-0.4	-0.9	-0.9
E	3.6	0.0	2.7	0.1	-0.9	0.1
F	3.3	-1.0	2.0	-1.6	-1.3	-0.6
IRL	8.8	4.3	6.5	1.7*	-2.3	-2.6
I	2.9	-0.8	1.8	-1.2	-1.1	-0.4
L	5.2	2.6	5.1*	4.1*	-0.1	1.5
NL	4.0	0.7	1.5	0.7*	-2.5	0.0
A	2.8	-0.75	1.1	-0.2	-1.7	0.6
P	3.3	-1.1	1.7	-2.2*	-1.6	-1.1
FIN	4.2	4.7	0.5	4.8	-3.7	0.1
Euro area	3.2	-0.6	(1.6)	(-1.1)	(-1.6)	(-0.5)
DK	1.8	2.8	1.3	2.0	-0.5	-0.8
S	3.5	3.5	1.4	3.9*	-2.1	0.4
UK	2.25 ³⁾	0.6 ³⁾	2.3	1.2	0.05 ⁴⁾	0.6 ⁴⁾
EU-15	3.0	-0.2	(1.7)	(-0.5)	(-1.3)	(-0.3)

* Excluding UMTS proceeds.

1) Second round of updates of late 2000.

2) Commission services Autumn 2001 Economic Forecasts and where available provisional outturn data are indicated with an asterisk.

3) Financial year.

4) Indicative, since comparison between financial year and calendar year figures.

Source: Commission services.

Table 2: Change in actual and cyclically-adjusted budget balances in 2001 *
(% of GDP)

	Actual balance 2001	Change in balance 00/01	Change in balance due to:			Change in balance due to:		Change in CAB due to:	
			Change revenues	Change primary exp.	Change interest exp.	Change cyclical comp.	Change CAB	Change interest exp.	Change primary CAB
	1 **	2 = 3 - 4 - 5 = 6 + 7	3	4	5	6	7 = 9-5	5	9
B	-0.2 (0.0)	-0.3	-0.4	0.2	-0.3	-0.6	0.3	-0.3	0.0
D	-2.5 (-2.6)	-1.2	-1.0	0.3	-0.1	-0.5	-0.7	-0.1	-0.8
EL	-0.4	0.7	0.1	0.1	-0.6	0.3	0.4	-0.6	-0.2
E	0.1	0.5	0.1	-0.3	-0.1	-0.2	0.7	-0.1	0.6
F	-1.6	-0.2	-0.3	0.0	-0.1	-0.1	-0.1	-0.1	-0.2
IRL	2.4 (1.7)	-2.1	-2.0	0.4	-0.3	-0.3	-1.8	-0.3	-2.1
I	-1.2	0.3	0.2	0.1	-0.2	-0.1	0.4	-0.2	0.2
L	4.4 (4.1)	-1.7	-1.5	0.2	0.0	-0.7	-0.9	0.0	-1.0
NL	1.3 (0.7)	-0.2	-1.6	-0.9	-0.6	-0.9	0.7	-0.6	0.1
A	-0.2	1.3	1.6	0.4	-0.1	-0.3	1.6	-0.1	1.5
P	-2.0 (-2.2)	-0.2	0.0	0.2	0.0	-0.3	0.1	0.0	0.1
FIN	4.8	-2.1	-2.3	0.4	-0.6	-1.8	-0.3	-0.6	-0.9
Euro Area	-1.1	-0.3	-0.5	0.0	-0.2	-0.3	0.0	-0.2	-0.2
DK	2.0	-0.5	-0.8	0.1	-0.4	-0.8	0.3	-0.4	-0.1
S	3.8 (3.9)	-0.2	-0.9	0.1	-0.8	-0.8	0.6	-0.8	-0.2
UK	1.2	-0.6	0.1	1.1	-0.3	-0.1	-0.5	-0.4	-0.9
EU-15	-0.5	-0.4	-0.5	0.2	-0.2	-0.3	-0.1	-0.2	-0.3

* Excluding UMTS. ** Commission services Autumn 2001 Economic Forecasts and where available provisional outturn data are given within brackets.

1) Estimated outturn: Commission services Autumn 2001 Economic Forecasts.

Source: Commission services.

Table 3: Projections for general government surplus(+)/deficit(-)
(% of GDP)

	Date ¹⁾	2000 ²⁾	2001 ²⁾	2002	2003	2004	2005
Stability programmes							
B	SP 12/-00	-0.1	0.2	0.3	0.5	0.6	0.7
	UD 12/-01	0.1	0.0	0.0	0.5	0.6	0.7
D	SP 10/-00	1½ (-1)	-1½	-1	-½	0	
	UD 12/-01	1.2(-1.3)	-2½	-2	-1	-0	-0
EL	CP 12/-00	-0.8	0.5	1.5	2.0	2.0	
	SP 12/-01	-1.1	0.1	0.8	1.0	1.2	
E	SP 01/-01	-0.3	0.0	0.2	0.3	0.3	
	UD 12/-01	-0.3	0.0	0.0	0.0	0.1	0.2
F	SP 12/-00	-1.4	0.1(-1.0)	-0.6	-0.4	0.3(0.2) ³⁾	
	UD 12/-01	-1.4	-1.4	-1.4	-1.3/-1.0	-0.5/0.0	0.0/0.3
IRL	SP 12/-00	4.7	4.3	3.8	4.6		
	UD 12/-01	4.5	1.4	0.7	-0.5	-0.6	
I	SP 12/-00	-1.3	-0.8	-0.5	0.0	0.3	
	UD 11/-01	(-1.5)	-1.1	-0.5	0.0	0.0	0.2
L	SP 12/-00	3.0	2.6	2.5	2.5		
	UD 11/-01	6.2	4.1	2.8	3.1	3.4	
NL	SP 09/-00	1.7(1.0)	0.7	0.6 ⁴⁾	1.1 ⁴⁾	1.9 ⁴⁾	
	UD 10/-01	2.2(1.5)	0.7	0.4	0.2	0.5	
A	SP 12/-00	-1.4	-0.75	0.0	0.0	0.0	
	UD 11/-01	-1.1	0.0	0.0	0.0	0.2	0.5
P	SP 01/-01	-1.5	-1.1	-0.7	-0.3	0.0	
	UD 12/-01	-1.5	-2.2	-1.8	-1.0	0.0	0.4
FIN	SP 09/-00	4.5	4.7	4.4	4.5	4.9	
	UD 11/-01	6.9	4.7	2.6	2.1	2.6	
Euro area	SP -00	-0.7	-0.6	-0.3	0.1	0.5	
	UD -01	-0.8	-1.1	-0.9	-0.5	0.0	0.1
Convergence programmes							
DK	CP 12/-00	2.7	2.8	2.6	2.6	2.7	2.9
	UD 01/-02	2.5	1.9	1.9	2.1	2.1	2.1
S	CP 11/-00	3.4	3.5	2.0	2.0		
	UD 11/-01	4.1	4.6	2.1	2.2	2.3	
UK	CP 12/-00 ⁵⁾	1.1	0.6	-0.1	-0.9	-1.0	-1.1
	UD 12/-01 ⁵⁾	2.0	-0.2	-1.1	-1.3	-1.1	-1.0 ⁶⁾
EU-15	C/SP -00	-0.2	-0.2	-0.1	0.1	0.3	
	UD -01	-0.1	-0.8	-0.9	-0.6	-0.1	-0.1

CP = convergence programme; SP = stability programme; UD = updated stability/convergence programme; 1) Dates of adoption by Member States government of updated stability or convergence programme and date of most recent Commission forecasts. 2) Government balances in 2000 or 2001 are affected by receipts from the sale of UMTS licences in several countries. Where relevant and where information is available, two figures are shown: the first includes the proceeds from UMTS licences and the second (in brackets) excludes these proceeds. 3) Government deficit of 0.5% of GDP in 2004 projected in more prudent growth scenario. 4) Favourable scenario, with margin available used for debt reduction; in the cautious scenario, with margin available used for debt reduction, the government surplus is projected to be 0.3% of GDP in 2002 and in 2003 and 0.6% in 2004. 5) Financial years. 6) Government deficit of 1.0% of GDP also projected for 2006-07.

Source: Commission services.

2.1.3. *Wage developments*

The 2001 BEPGs recommended: (i) *that the increase in nominal wages be consistent with price stability; (ii) that the increase in real wages not exceed labour productivity growth; and (iii) to encourage wage formation processes that take account of productivity differences.*

Aggregate wage developments

Overall, wage trends remained moderate in 2001, even though the rise in compensation per employee in the euro area is estimated to have accelerated by half a percentage point to about 3 per cent. While labour market conditions tightened until early 2001, the response in wage settlements to the temporary rise in headline inflation remained muted. Wage increases were relatively strong in Spain, Ireland, Luxembourg, the Netherlands, Portugal and Finland, chiefly countries with comparatively tight labour markets. In France, the rise in hourly costs has been gradually declining as the mechanical effect of the shift to the 35-hour working week is fading.

Whilst the trend in nominal compensation remained overall moderate in 2001, the slowing of the euro-area economy and the implied cyclical set back to labour productivity growth resulted in a clear acceleration in nominal unit labour costs to 2½ per cent. Also real unit labour costs accelerated and the increase in real wages slightly exceeded labour productivity growth. Nevertheless, real unit labour costs remained relatively contained and continued to be broadly compatible with job creation.

Wage differentiation

Moves to achieve wage structures that better reflect productivity differences were limited in 2001. In some countries (Belgium, Germany, Austria) steps were taken that allow, under certain conditions, for deviations from the wage norms fixed in collective agreements at sectoral level.

Table 4: **Wage developments in 2001**
(Annual percentage change)

	Nominal compensation per employee	Real wages ¹⁾	Labour productivity	NULC ²⁾	RULC ³⁾
B	3.2	1.1	0.1	3.1	1.0
D	1.6	0.3	0.4	1.2	-0.1
EL	5.5	2.2	3.0	2.5	-0.8
E	3.9	0.2	0.4	3.5	-0.3
F	2.2	0.7	-0.2	2.4	0.9
IRL	9.5	4.5	4.1	5.2	0.4
I	3.2	0.6	0.3	2.9	0.3
L	4.4	1.4	-1.4	5.9	2.8
NL	5.0	-0.7	-0.4	5.5	-0.3
A	2.4	1.0	1.1	1.3	-0.1
P	6.4	2.4	0.2	6.2	2.2
FIN	4.4	2.0	-0.8	5.3	2.8
Euro area	2.8	0.5	0.3	2.5	0.2
DK	3.8	0.8	0.9	2.9	-0.1
S	3.8	1.9	-0.4	4.2	2.3
UK	4.3	1.9	1.6	2.6	0.2
EU-15	3.1	0.8	0.5	2.6	0.3

1) Nominal compensation adjusted by the GDP deflator.

2) Nominal unit labour costs.

3) Real unit labour costs.

Source: Commission services.

2.2. Improve the quality and sustainability of public finances

The 2001 BEPGs recommended Member States to: (i) *make tax and benefit systems more employment friendly*; (ii) *promote the quality of public expenditure*; (iii) *enhance the efficiency of public spending by institutional and structural reforms, in particular to control spending*; (iv) *improve the long-term sustainability of public finances*; and (v) *pursue tax-co-ordination further and implement the Council agreement of November 2000 on the tax package*.

Tax and benefit systems

Some progress has been made in making tax and benefit systems more employment friendly (see under section 2.3).

Quality and redirection of public expenditure

Besides the contribution given by a non distortionary benefits system, public expenditures can also enhance growth and employment by reducing the interest burden and in general non-productive expenditures; and through the accumulation of productive factors, i.e. investment in physical capital (public investments in infrastructures), human capital (education but to a certain extent also health) and knowledge (R&D and innovation). In this direction, some progress has been made in 2001 with a reduction in interest payments, and, to a lesser extent, in social transfers, which resulted in a decrease in the share of total government expenditure in GDP in many Member States, while public investment remained stable as a proportion of GDP.

Public expenditure

A growing number of Member States have introduced institutional reforms to the budgetary rules and procedures to improve efficiency and controls. These take various forms, and include mechanisms to set and control expenditures, multi-annual budgetary programmes and agreements between different levels of government. The strengthening of budgetary procedures and control is welcomed. However, the degree to which various budgetary procedures, and particular expenditure guidelines, are binding is variable. In particular, the mechanisms to control expenditures on health care need to be strengthened.

Long-term sustainability

The need to improve the sustainability of public finances in light of ageing populations was underlined in a report by the Economic Policy Committee which projected increased public spending of between 4% and 8% of GDP by 2040 in most Member States on pensions, health care and care for the elderly. Progress towards safeguarding the effectiveness and financial sustainability of pension systems, so as to meet their social aims, has been mixed. Several Member States have achieved or sustained sound budgetary position with large primary surpluses, thus leading to a fast reduction in public debt levels. However, the delay in reaching the “close to balance or in surplus” requirement of the Stability and Growth Pact in several Member States (Germany, France, Italy and Portugal) could have long-term consequences as there is only a limited window of opportunity to prepare prior to the impact of demographic changes taking hold.

Some progress was recorded in several Member States as regards reform of pension systems, although in some cases (Germany, Austria, Portugal) additional measures may be required in the future to secure their financial sustainability. Reforms planned by several Member States (Belgium, Spain, France, Italy) needs to proceed as a matter of urgency, especially in those countries where reforms have been subject to delays and deferrals. Reserve funds have been created in a number of Member States (Belgium, Spain, Ireland and France), although their limited size means that they will only make a limited contribution to meeting the additional spending on pensions in some countries.

Tax package

Following the conclusions reached at the Ecofin meeting in November 2000, the Commission has presented an amended proposal for a Directive² to ensure effective taxation of cross-border interest payments to individuals within the European Union. In the meantime, Member States pursue their peer-review on the standstill and the rollback of the 66 business tax measures that have been identified as harmful in the November 1999 report of the Code of Conduct Group. Finally, the proposal for a Directive to eliminate withholding taxes on interest and royalty payments between associated companies has been discussed in the Council since 1998. The Commission and the Member States are working intensively to meet the December 2002 deadline for agreement on these three elements constituting the "tax package".

2.3. Invigorate labour markets

The 2001 Broad Economic Policy Guidelines recommended to: *(i) promote increased participation in the labour market; (ii) ensure that tax and benefit systems make work pay; (iii) bring down obstacles to labour mobility within and between Member States; (iv) facilitate occupational labour mobility; (v) further improve the efficiency of active labour market policies; (vi) promote more flexible work organisation; and (vii) pursue policy aiming to reduce gender pay differences due to de facto discrimination.*

In 2001, the labour market suffered from the cyclical slowdown, and the very positive developments of the preceding year could not be repeated. Employment growth decelerated to 1.1%; and the unemployment rate decreased only slightly, to 7.8% at the end of the year. Still, the average unemployment rate of 7.7% was 0.5 percentage points below the 2000 average. Progress towards the Lisbon employment goals was also more moderate than in 2000. The overall employment rate increased by 0.7 percentage points to 63.9%, those for women reached 54.7%, 0.7 percentage points above the level in 2000. The employment rate of older workers (55-64 years) increased in 2001 by 0.5 percentage points to 38.3%. The labour market performance of Member States remained, however, quite diverse, both in terms of employment and unemployment levels and in terms of improvements. The decline in the momentum of structural reform is especially worrying in the context of the current cyclical slowdown and the still insufficient growth potential.

Tax and benefit systems

Unemployment and poverty traps, under which individuals face disincentives to take up and stay in employment or to increase their number of hours worked, remain a serious problem for labour market participation in most Member States. These traps may affect, essentially, those at the lower end of the wage scale or those with low working skills. Many Member States have started or pursued tax reforms which

²

Com (2001) 400. The final adoption of the Directive is subject to the adoption of equivalent measures to those applying in the Member States by a number of third countries and the adoption of the same measures as those applying in the Member States by associated and dependent territories of Member States.

reduce the tax burden on labour, in particular for low wage earners. In 2001, the average tax burden on low wage earners in the EU has, according to preliminary data, decreased by more than $\frac{3}{4}$ of a percentage point, to under 39 percent.

Where work incentives are concerned, although some Member States (Spain, France, Ireland, the Netherlands and Finland) achieved significant progress in strengthening the incentives associated with both taxes and benefits in former years, overall efforts in 2001 were rather scattered. There seems to be some reluctance to complement tax reforms with comprehensive reforms of benefit systems in order to make sure that work pays. In 2001, most Member States have opted only for a partial approach, e.g. by addressing benefit schemes for specific target groups. Current reforms are not targeted sufficiently towards enhancing work incentives and activation.

Table 5: Tax wedge on low wage earners
(single person on 67% of average production worker wage level)

	1997	2000	2001*	Change 2000-01
B	49.5	49.9	49.1	-0.8
DK	41.7	41.2	41.1	-0.1
D	47.7	46.5	45.4	-1.1
EL	35.0	34.3	34.3	0.0
E	34.8	32.8	33.3	0.5
F	41.6	39.6	38.4	-1.2
IRL	24.9	18.1	17.3	-0.8
I	48.8	43.3	42.9	-0.4
L	29.7	30.4	28.8	-1.6
NL	38.8	40.6	36.8	-3.8
A	41.1	40.1	39.9	-0.2
P	30.8	30.4	29.6	-0.8
FIN	44.2	42.4	40.9	-1.5
S	49.2	47.9	47.0	-0.9
UK	28.4	25.3	24.8	-0.5
EU-15	40.8	38.6	37.8	-0.8

* 2001 figures are preliminary.

Source: OECD/Commission services, DG TAXUD.

Geographical and occupational mobility

In many Member States, the mismatch between skills offered and demanded is a major obstacle to more employment. Mismatch problems and bottlenecks are present in a number of Member States for different reasons, namely tight labour markets (Denmark, Ireland, Luxembourg, the Netherlands, Austria, Portugal), strong regional unemployment disparities (Belgium, Germany, Spain, Italy and the United Kingdom) and high structural unemployment (Greece, Spain, France, Italy and Finland). Most Member States are pursuing comprehensive strategies for life long learning in order to enhance the adaptability of the labour force to structural change. Some have taken measures to reform the educational system in general (e.g. Spain, Greece and Portugal). Barriers to geographical mobility, be they within Member States or between

them, have hardly been addressed, with insufficient attention paid to the potential of the European labour market as a whole.

Active labour market policies

While good progress was made in recent years in the field of early activation of the unemployed, it appears that some programmes seem to work better than others and for some groups of the labour force more than others. However, in most Member States targeting the programmes and monitoring their efficiency remain problematic, as assessed in the Joint Employment Report 2001. Only some Member States have recently undertaken (Finland, Sweden, United Kingdom) or announced (Germany) evaluation-based measures to enhance the efficiency of active labour market policies (ALMPs).

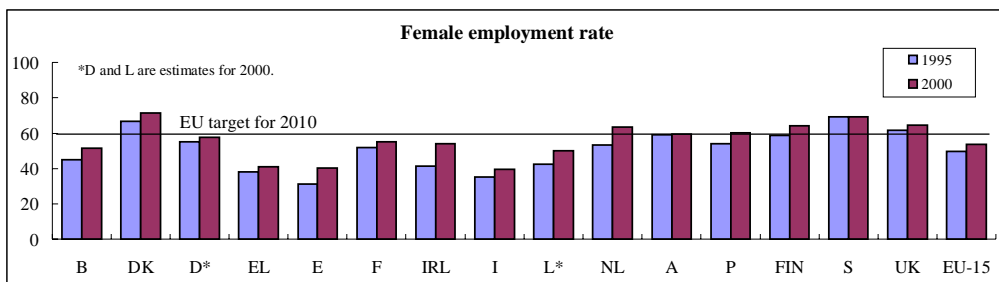
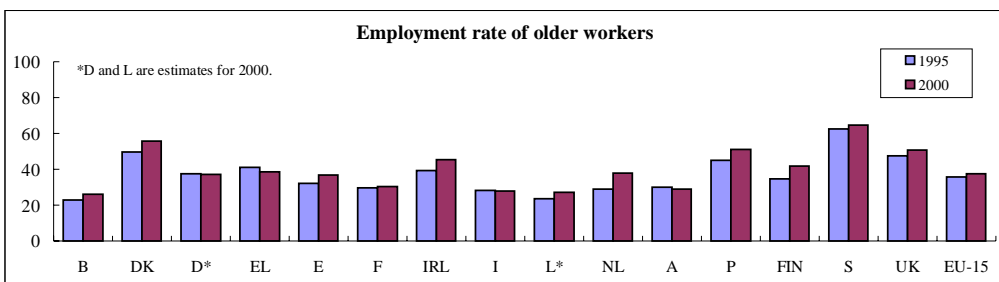
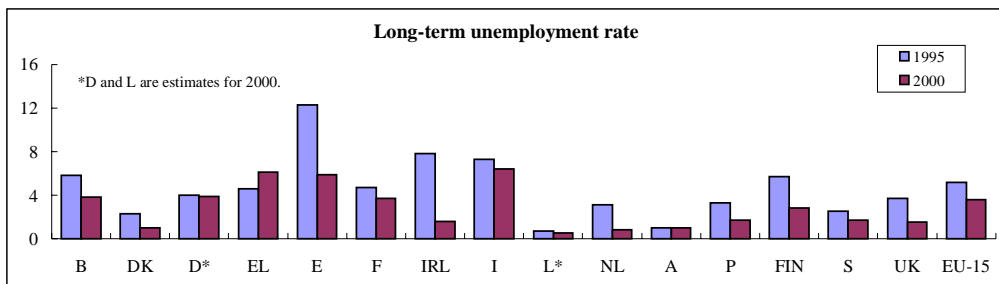
Flexibility and modernisation

The organisation of working time has become more flexible in some Member States and flexible forms of work – e.g. part-time work, fixed-term contracts, temporary agency work and, to a lesser extent, teleworking – are among Member States' and social partners' priorities for the modernisation of work organisation. Meeting the implications of demographic changes and shortage of skilled labour is expected to become important over the next few years. Several Member States (Germany, Spain, France, Italy, Portugal) need to go further in reforming the existing regulatory framework with a view to combining greater flexibility with security in order to reduce structural unemployment and labour market segmentation. Only Spain has taken significant steps to increase flexibility during the past year.

Discriminatory gender pay differences

On average, women earn less than men. According to the results of the European Community Household Panel for 1997, women's average net hourly earnings (employees at work for 15 hours or more) were around 86% of men's (no data available for Sweden). This fact is due to both differences in labour market characteristics (the age structure of the labour force, occupation, work experience and educational attainment) and pay differences. The goal of greater gender equality in the labour market is on the policy agenda of most Member States. The Commission will launch an overall assessment in 2002 on the reasons why differences leading to a gender gap, including in pay levels, exist.

Graph 3: Labour market situation in the EU



Source: Commission services

2.4. Ensure efficient product (goods and services) markets

The 2001 BEPGs recommended Member States to: *(i) fully implement the Internal Market (cut internal market legislation transposition deficits, eliminate technical barriers to trade, create an effectively functioning internal market in services and further open up the public procurement market); and (ii) reinforce competition (liberalisation of the network industries, effective competition and regulatory authorities, State aid).*

Progress towards creating a fully integrated and efficient internal market has been mixed. EU markets for goods are becoming increasingly integrated, even if differences in standards and regulations continue to hinder cross-border activities. The creation of an internal market for services, however, has advanced only slowly. On the other hand, progress has been made in transposing Internal Market directives into national legislation, in opening up public procurement, in reinforcing the powers of the competition authorities, and in reducing State aid. The liberalisation of the telecommunication and electricity markets has started to result in price reductions, but prospects for further price reductions are likely to be affected by physical bottlenecks and inadequate domestic de-regulation and the high market shares of incumbents in these sectors. Market opening in rail transport and postal services is less advanced.

Completion of the Internal Market

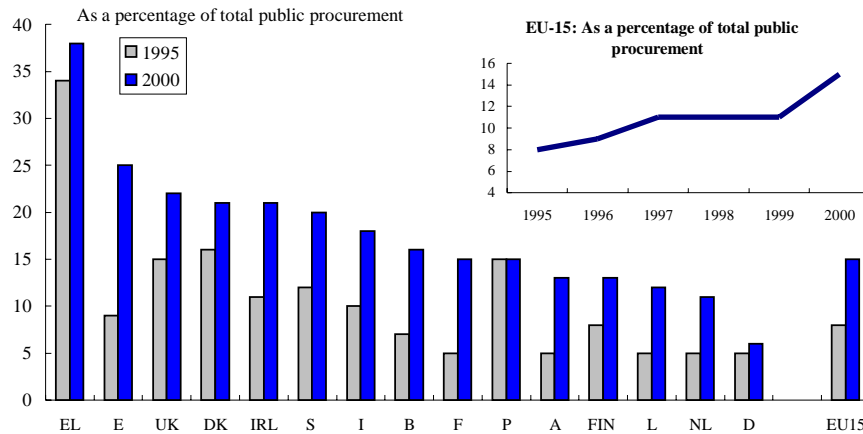
The growth of trade and investment flows between Member States is indicative of a continuing process of economic integration in the EU, even if the convergence of price levels between Member States appears to have slowed down. The percentage of Internal Market directives not yet transposed into national legislation was reduced to 2% on average in October 2001, a 1 percentage point decline compared with the year before. But in Greece, France, Austria, the United Kingdom and Germany, it remained more than 1 percentage point above the target of 1.5% set for the 2002 spring European Council. Attention is shifting now from transposition to effective implementation of the directives: France and Italy account for nearly 30% of alleged breaches of Internal Market law.

Surveys suggest that businesses are increasingly satisfied with the operation of the Internal Market. However, technical barriers to cross-border trade still cause concern. The situation is worst for technically complex products or products where risks to health are a major concern (e.g. food products). While agreement on standards have been achieved in some areas (e.g. construction products), problems remain and the use of the mutual recognition principle is still considered as being too risky and time-consuming.

In a survey on business service providers, 40% of respondents believed that eliminating barriers to cross-border trade would increase their sales by up to 20%, a clear illustration of the importance of creating an effectively functioning internal market in services. However, little progress has been made on this issue and in 2002, the Commission will set a precise timetable for Member States to dismantle specific barriers, present non-legislative supporting measures and may propose harmonised

rules for some services. A mechanism to ensure that Member States apply the principle of mutual recognition on service provision will also be proposed.

Graph 4: Public procurement openly advertised



Progress has been made in opening up public procurement markets: public procurement advertised in the Official Journal as a share of the total value of public procurement almost doubled in the second half of the 1990s (see Graph 4). Between 1999 and 2000, this ratio increased by more than one third in Austria, the Netherlands, Denmark, Spain, the UK, Sweden and Italy. However, only 15% of total public procurement was actually published in the Official Journal. Only Portugal, Finland, Sweden and the UK have two-way interactive on-line procurement systems at present, but several more Member States are developing them.

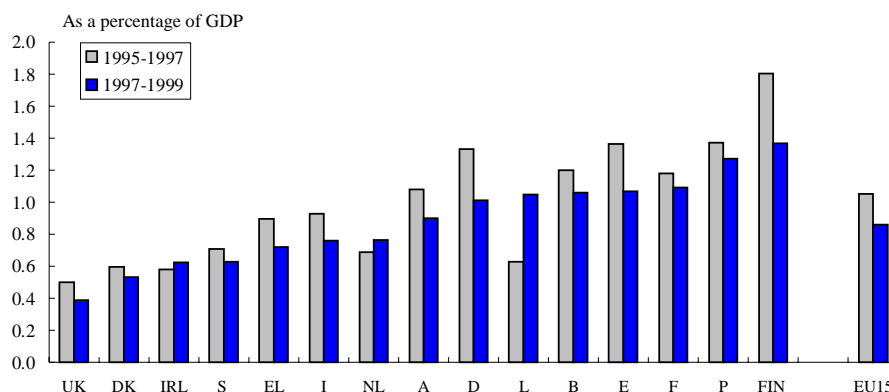
Reinforcement of competition

Reforms have continued in the network industries and have started to pay off in terms of price reductions. Even if price declines for local calls have been smaller in size, telecommunications services have become more affordable to Europeans of all income levels. Electricity prices fell in most EU Member States for both industry and household users between 1997 and 2001. However, prices remain relatively high in Belgium, Germany, Italy and Portugal. Moreover, conditions for effective competition are not met in certain Member States, because the degree of market opening reaches only the legally required level (Greece, France, Ireland and Portugal) or because of the continued high market share of the incumbents (Greece, France and Ireland). Finally, even in the liberalised section of the market, the switching between producers remains below 5% amongst large industrial users in Spain, Italy and Portugal and amongst small users in Germany. In other network industries such as railways and postal services, the liberalization process is less advanced.

A number of Member States, including Greece, France, Ireland and the UK, took steps to increase the powers and the operating capacity of their competition authorities. Cooperation between competition and regulatory authorities is more and more frequent. Less progress was achieved in improving the institutional framework so as to

give more effective independence to competition authorities, in order to avoid the risk that decisions may be based on criteria other than competition criteria. In Ireland, Luxembourg, Austria, Finland and the UK, the competition authorities are not yet empowered to apply EC competition law.

Graph 5: Sectoral and ad hoc State aid as a percentage of GDP



Source: Commission Services.

While data on State aid is available only with a certain time lag, figures for 1997-1999 indicate that overall State aid as a share of GDP has continued to decrease in the vast majority of Member States. The EU average declined from 1.4% of GDP in 1995-97 to 1.2% in 1997-99. During that same period, sectoral and ad hoc State aid declined from 1.1% to 0.9% of GDP. However, such aid remains relatively high in Belgium, Germany, France, Finland, Spain, Luxembourg and Portugal³ (see Graph 5). The transparency of Member States' State aid policies has improved thanks to, on the one hand, the publication of State aid data by some Member States and, on the other, the creation of a public State aid Register on the internet and the publication of the State aid Scoreboard by the European Commission. The Scoreboard also offers a forum for Member States to exchange information on their support policies and their assessment of aid granted.

2.5. Promote the efficiency and integration of the EU financial services market

The 2001 BEPGs recommended to: (i) ensure bringing into play the recommendations of the Committee of Wise Men on the Regulation of European Securities Markets; (ii) ensure full implementation of the FSAP by 2005 at the latest and by 2003 for the priorities set out in the report of the Committee of Wise Men; (iii) speed up the

³

The high amount of such aid in Portugal is largely due to a single regional aid scheme for Madeira, which has many characteristics of a sectoral scheme. Since January 2001, this aid scheme is closed for new applications and its possible renewal is examined by the Commission. The Portuguese authorities have also commissioned a study to evaluate the cost-effectiveness of the scheme.

implementation of the RCAP, in particular with regard to quantitative constraints on institutional investment, bankruptcy laws and taxation; (iv) further improve cross-border and cross-sector co-operation among supervisory and other relevant authorities.

Regulation of European Securities Markets

As the structure of the EU financial system changes rapidly, the procedures for its regulation need to keep pace and be in tune with market developments. In the middle of 2000, the Committee of Wise Men, chaired by Mr Lamfalussy, was asked to assess the EU mechanism for regulation of the securities markets and make some proposals for improvement. In early 2001, the Committee proposed a four-level approach distinguishing between (i) framework legislation embodying main principles, (ii) implementing legislation embodying more detailed measures, (iii) transposition of EU legislation into national law, and (iv) enforcement. The Stockholm European Council (23-24 March 2001) welcomed the report and called for implementation of the proposed four-level approach. The two committees proposed by the Wise Men to assist the European Commission in formulating and implementing legislation (the EU Securities Committee (ESC) and the Committee of EU regulators (CESR)) have now been established, in an advisory capacity only. Regulatory powers will be granted to the two Committees when two directives (on prospectuses and on market abuse) are adopted. The European Parliament's agreement on the four-level approach in early February 2002 has removed the last obstacle to the full implementation of the Wise Men's recommendations.

Implementation of the Financial Services Action Plan (FSAP)

The 42 measures contained in the FSAP are designed both to complete the legislative framework for the single market in financial services and to ensure that it is appropriate to markets, which are constantly changing. Significant progress in implementing the FSAP has been made in 2001, and 25 of the 42 original measures have now been finalised. However, as was stressed by the 5th progress report⁴ on the FSAP, serious concerns remain about the pace of implementation. Several important Directives or Regulations (in particular on pension funds, on prospectuses, on financial conglomerates, on International Accounting Standards) are now on the table for adoption in the Council and the European Parliament and will need to be adopted soon if the deadline of 2005 for full implementation of the FSAP is to be respected.

Implementation of the Risk Capital Action Plan (RCAP)

Progress in setting up a proper regulatory framework for the development of the risk capital market has continued. In addition to those actions under the FSAP that are relevant to the implementation of the Risk Capital Action Plan (RCAP - measures taken at Community level), Member States have undertaken a number of reforms at the national level. Regarding the key area of legal/regulatory constraints on

⁴

“Financial Services; Europe Must Deliver on Time”, COM (2001) 712.

institutional investment, some constraints have been (or are to be) eased in Belgium, Austria, Italy and Denmark. However, quantitative constraints remain in most Member States (except in Ireland, the Netherlands, Finland and the United Kingdom which have no such constraint beyond a general requirement for prudence). With respect to the fiscal framework, several Member States have introduced specific or general tax measures that foster, among other things, the risk capital market. In so doing, Member States should fully respect Treaty obligations, notably those concerning State Aid, as well as other commitments taken in the EU tax area. For instance Portugal introduced several reforms aimed at avoiding double taxation of venture capital investors, fostering savings and stimulating R&D investments. Italy and Spain have increased tax incentives to private retirement savings, while the UK launched stakeholder pensions. Spain has also granted favourable tax treatment to risk capital companies and funds and has even increased tax benefits. Belgium is planning a partial tax exemption on reinvested profits. On the other hand, little has been done to address the disincentive effects of bankruptcy and insolvency procedures, with proposed reforms postponed (e.g. Italy), or still in a preliminary elaboration/discussion stage (e.g. Belgium, Sweden, UK).

Safeguarding financial stability

In order to assess the adequacy of institutional arrangements in the EU in the context of likely developments in financial markets, the Economic and Financial Committee prepared reports on financial stability (April 2000) and financial crisis management (April 2001). The reports concluded that the existing institutional arrangements are appropriate, but that further enhancement of their functioning was needed, in particular through closer cross-sector as well as cross-border co-operation among the authorities (supervisors, central banks and Ministries). Several Member States have been reforming (or are to reform) their supervisory arrangements (Portugal, Belgium, France, Germany, Ireland, Austria). The Member States are following different models of consolidated financial supervision, with the choice of different models explained by specific national characteristics. This choice of different models is likely to increase the need for enhanced cross-border co-operation. However, progress is also being made in this area; e.g.: further to the integration of the Brussels, Paris and Amsterdam's stock exchanges into Euronext, the three financial supervisory authorities agreed to co-ordinate their respective competencies.

2.6. Encourage entrepreneurship

The 2001 BEPGs recommended Member States to: *(i) create a business-friendly environment (reduce administrative burdens and barriers, increase efficiency of public services, simplify VAT systems); and (ii) encourage risk-taking through improving access to finance especially for SMEs in their early stages.*

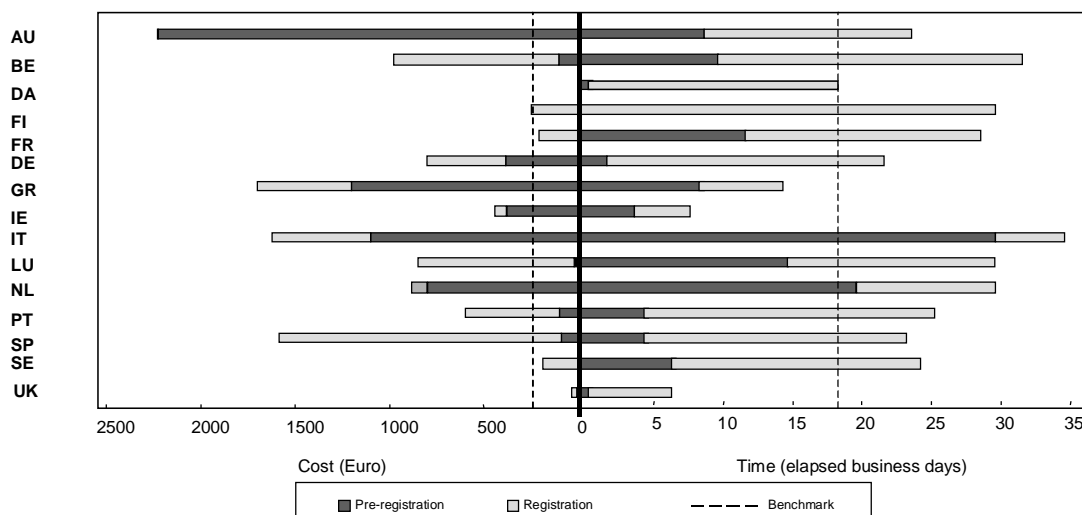
A great variety of measures has been taken to reduce the regulatory burden on business, to stimulate business creation, and to ease access to finance for SMEs. In spite of an increased use of the benchmarking tool, differences in business conditions between Member States remain important. This is true in particular in the area of taxation.

Business environment

Reducing the regulatory burden on business is increasingly recognised as an important economic policy objective. A recent survey suggests that better-designed legislation would save EU companies up to 15% on compliance costs. Almost all Member States introduced measures aimed at reducing the regulatory burden but, in spite of this, business remains particularly dissatisfied with the regulatory environment in Germany, France and Greece.

Belgium, Denmark, Greece, Spain, France, Italy, the Netherlands, Austria, Sweden, Finland and the UK took new measures in 2001 to promote start-ups and small and medium size companies. In spite of significant progress made, the registration of a new private limited company is still very time-consuming in Belgium, Italy, Luxembourg, the Netherlands and Finland, and very costly in Greece, Spain, Italy and Austria (see Graph 6).

Graph 6: The typical Time and Cost of Setting Up a Private Limited Company



Source: Ongoing Best Procedure Benchmarking Exercise on the Administration of Start-ups. **Note:** Benchmark refers to the lower quartile.

The larger the size of the public sector, the greater the gains for the economy from spending public resources efficiently. The Nordic economies are making significant advances in this respect as they progressively expose the public services to competition. Belgium, Italy, and Portugal have also focused their attention on improving the efficiency of their public administration.

Belgium, France, Greece, Ireland, Luxembourg, the Netherlands and Portugal launched initiatives to simplify corporate taxes and reduce the business tax burden. However, taxation of cross-border activities continues to be a source of distortions within the Internal Market, as exemplified by the still large differences in effective rates of company taxation between Member States and the existence of a large number of tax obstacles to such activities. The Commission's recent Communication on

company taxation⁵ proposed a number of possible solutions to these obstacles. In the VAT area, the Commission has proposed a strategy aimed at reducing fiscal barriers to cross-border activities through simplifying and modernising the VAT system.

Access to finance

In many Member States, measures have been taken to ease access to finance for SMEs, which complement the structural reforms on the financial services markets treated in section 2.5. Such measures generally concentrate on sharing the investment risks between public sponsors and private investors and on providing additional funding to small companies. Denmark, Germany, Greece, Spain, France, Ireland, the Netherlands and Portugal have set up or further developed existing publicly-sponsored venture capital schemes with the view to improve access to finance, especially for SMEs in their early stage. However, the availability of early stage venture capital varies significantly across Member States (with Greece, Spain, Austria and Portugal lagging behind) and it is targeted mainly at high-tech and innovative enterprises. Finally, information and support systems to help future entrepreneurs obtain information on access to finance have been set up in several countries, including Italy and the Netherlands.

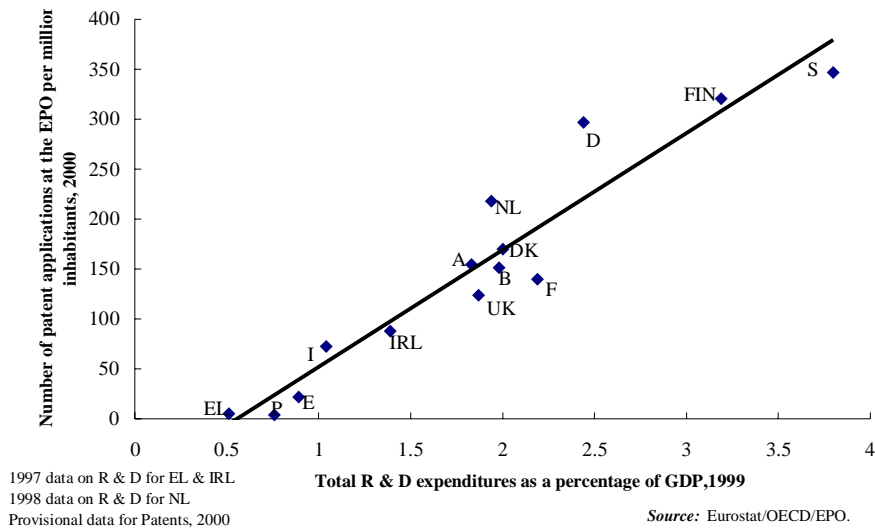
2.7. Foster the knowledge-based economy

The 2001 BEPGs recommended to: *(i) stimulate R&D and innovation (adequate framework conditions, better ties between university and business, enhanced collaboration on research and innovation across Europe, sufficient funding for R&D and clear priorities for public research); (ii) promote access to and use of ICT (unbundling of the “local loop”, use of internet in schools, regulatory framework for e-commerce, internet use in public administrations, ICT security); and (iii) strengthen education and training (ICT skills, education systems capable of responding to changes in skill requirements).*

The European Union's transition to the knowledge-based economy is advancing with the introduction of further incentives for business R&D. However, the large differences between Member States, for instance in terms of R&D expenditures or in terms of the number of patent applications submitted to the European Patent Office (see Graph 7), continue to be a source of concern. Moreover, the EU continues to lag behind the United States in areas such as business spending on R&D, Internet usage and education.

⁵ "Towards an Internal Market without Tax Obstacles: A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities (Com (2001) 582)".

Graph 7: R&D expenditures and patents



Research and development (R&D)

Throughout the 1990s, EU R&D expenditures fluctuated around 1.9% of GDP, which was significantly below the 2.6% figure recorded by the United States, the difference being explained by lower EU business expenditures on R&D. In its Communication to the Spring European Council in Barcelona, the Commission has proposed to set a target of 3% of GDP for total EU spending on R&D by the end of the decade. Within that total, the amount funded by business should rise to around two-thirds against 55% today. To stimulate business R&D, countries such as the UK and Portugal introduced tax incentives for private R&D. Austria launched a new programme giving financial support to R&D, while other Member States created R&D incubators. However, the Community deadline for agreeing by the end of 2001 on how to deliver the Community Patent was missed.

More intense collaboration between science and industry is required to permit the commercialisation of R&D results. Public funding is increasingly targeted at science-industry collaboration. At the same time, in all Member States public research institutions are being encouraged to direct their research efforts to areas of interest to private firms.

In 2001, the European Research Area continued to develop, extending the links between national research communities. In December, agreement was reached on the main action lines of the forthcoming sixth Research Framework Programme.

Adequate funding for basic research is crucial to expanding the knowledge base and increasing the flow of innovations. Several measures were taken and others were expanded upon in 2001, including the creation of a new organisation in Sweden for

funding research. In France, a decision was made to augment the public research workforce.

Information and communication technologies (ICT)

The global downturn in ICT markets meant that the increase of ICT take-up in 2001 was only moderate in comparison with previous years. Moreover, progress in practice in unbundling the local loop was slow, although this was crucial to expand high-speed Internet access. As a result, broadband access is still patchy. On a more positive point, the fall of Internet access prices continued. Also, the share of EU households that had internet access at home kept on rising at a rate of almost 1 percentage point per month. In spite of such progress, ICT take-up within the EU remains below that in the US. While the most advanced EU Member States have Internet access rates on par or even higher than the US, others continue to lag significantly behind.

The share of schools in which pupils have access to the Internet is above 70% in all Member States except Greece (44%), Portugal (52%) and Austria (64%). With this achievement, the next challenge is to further bring down the number of pupils per on-line PC, which is below 10 already in Denmark, Luxembourg, Finland and Sweden. Furthermore, a series of new projects were launched to reduce ICT skills shortages.

Creating a safe, predictable environment for doing e-commerce remains a top priority. E-commerce is developing, but more slowly than expected. The copyright directive will be in force by December 2002, but the proposal on distance marketing of financial services still awaits a Council decision, while the directives on VAT rules for e-commerce and on electronic invoicing are still pending.

National administrations are increasingly extending services to permit online communication with citizens. New technologies are similarly being used on the production side of the public sector. For instance, Denmark has launched a public procurement portal designed to streamline procurement processes and trigger economies of scale.

The Commission has adopted communications on creating a safer information society and on security in electronic networks. It also has launched an e-confidence web site.

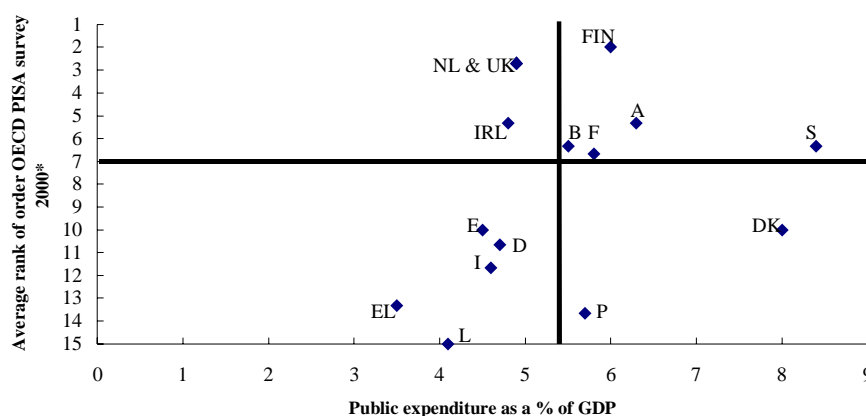
Education and training aspects of the knowledge-based society

The number of researchers per 1000 of the workforce is rising in all Member States, but the rate of increase for the EU as a whole is below that of the United States because of below average increases in the large Member States (Germany, France, Italy, UK). Germany, France, Spain, Finland, Ireland, Sweden and the United Kingdom have put in place schemes to attract foreign students and researchers or to encourage the return of their own scientists, illustrating an increased awareness that human resources may become inadequate for future needs. Most Member States have taken measures to promote ICT skills, often attaching a priority to disadvantaged groups, with Denmark, the Netherlands, Sweden, Finland and the UK generally the most advanced Member States according to the Joint Employment Report. In terms of basic skills 70% of the young EU population (aged 25-34) had attained at least upper

secondary education in 2000 ranging from above 80% in Austria, Denmark, Finland, Germany, Sweden, and the UK to below 60% in Italy, Portugal and Spain.

In terms of inputs, public education expenditure in the EU has remained unchanged at around 5% of GDP between 1995 and 1999. However, the results from a recent OECD survey show that the reading, mathematical and scientific literacy of 15 year-olds are only weakly correlated with education spending (see Graph 8). Member States efforts to increase the efficiency of their education systems are therefore also important. This would seem to be true in particular for Denmark and Portugal, as they combined above average public expenditures on education with below average scores in the OECD survey.

Graph 8: Education expenditure & Schooling outcomes



* The OECD programme for International student assessment (PISA) is a three yearly survey of the knowledge and skills of 15-year-olds. The rank has been elaborated from the year 2000 results on the mean performance on the mathematical, scientific and reading literacy.

Source:
UNESCO/OECD/Eurostat.

2.8. Enhance environmental sustainability

The 2001 BEPGs did not make country-specific recommendations in this area, but contained a number of horizontal recommendations addressed to all Member States: (i) *commit to effectively implement the European Sustainable Development Strategy agreed by the Gothenburg European Council*; (ii) *introduce and strengthen market-based policies like taxation, user and polluter charges, insurance/liability schemes and tradable emission rights*; (iii) *reduce sectoral subsidies and tax exemptions and other measures which have a negative environmental impact*; (iv) *intensify the use of economic instruments to curb greenhouse gas emissions, fulfil the requirements of the Kyoto Protocol and help to de-couple economic growth from a range of environmental pressures*; and (v) *agree on an appropriate framework for energy taxation at the European level and for the creation of a single internal market for energy*.

As regards the implementation of the Sustainable Development Strategy, the Commission has issued several proposals, among the more important of which are a

draft Directive on emissions trading, and a White Paper on the European Transport Policy.⁶

Based on the limited information available to the Commission, in this first year of integration of sustainable development promotion within the BEPGs, progress by Member States included the following:

Preparations to implement climate change policies intensified. The UK's climate change levy took effect from April 1st. The UK and Denmark introduced a system of tradable emission permits, while several other countries, such as Sweden, the Netherlands, Ireland, Finland are examining the possibility of doing so. The Netherlands established a scheme of tradable certificates for electricity from renewable energy sources; similar systems are planned by Austria, Belgium, Denmark, Italy, and the UK.

Taxes or charges were introduced on products such as electrical appliances (Belgium, Portugal) and plastic bags (Ireland). France extended the TGAP to cover phosphates in washing powders, agricultural pesticides and natural mineral aggregates. Ireland introduced a levy on landfill of waste. Finland adopted a new act on water supply management which requires users to pay water charges at least covering costs of water supply and wastewater removal. Spain's National Hydrological Plan has established a "transfer levy" payable by the users of transferred water.

Several measures targeted energy use, in particular in transport. Belgium, Germany and Ireland differentiated fuel excise taxes in favour of low-sulphur fuels, while the UK widened existing differentials. Vehicle excise duties were restructured to take account of environmental criteria in Belgium, France, Ireland, Spain and the UK. Germany and Sweden continued established policies of switching taxes from labour to energy. Denmark phased in new tax increases on domestic and industrial energy consumption, in line with the 1998 tax package. France set guaranteed prices for the next twenty years for electricity from wind. Luxembourg introduced a tax on electricity. However, little or no progress was made by the Council in its discussions on energy taxation, although discussions continue under the current Council Presidency. Discussions on completing the internal energy market also continued.

⁶ European transport policy for 2010: time to decide (COM(2001) 370 final of 12.09.2001).

3. SUMMARY ASSESSMENTS OF IMPLEMENTATION BY THE MEMBER STATES

3.1. Belgium

In 2001, economic growth decelerated sharply, with real output growing at around 1.1%. The slowdown was driven by a decline in private consumption and investment compounded by a negative contribution of net exports resulting from the deteriorating external environment. The downward trend in unemployment was interrupted in September. Employment grew at a much slower pace than in 2000. As regards inflation, after having peaked in May, HICP inflation moved into a declining trend and averaged 2.4% in 2001.

Altogether, Belgium made some progress in implementing the budgetary recommendations of the 2001 BEPGs. Despite the economic slowdown, public finances were kept under control and, for the second consecutive year, general government accounts were in balance. The debt ratio has been on a downward path since 1993, but remained at 106.9 % of GDP at the end of 2001, considerably above the 60% of GDP reference value.

Some progress was made in implementing the 2001 labour market recommendations. Efforts to reform tax and benefit systems, in order to make work pay, continued. Some measures were agreed to enhance labour market flexibility. Their overall impact on labour supply is unclear. On the one hand, they could reduce the labour supply of those already in work. On the other hand, they could increase the participation rate of those currently inactive, and provide incentives to older workers to remain longer in employment. No major measures were undertaken to promote more wage flexibility, although the latest inter-sectoral agreement allows greater scope for wage differentiation at sectoral level.

Some progress was made in implementing the 2001 product market recommendations. Some steps were taken to liberalise further the energy sector, but effective competition in this sector remains low and prices are still high. The formal links between public and private actors in different sectors of the economy, energy included, still suffer from a lack of transparency. The reforms of the railways, public administration, administrative simplification, personal and corporate taxation started only recently and have yet to produce tangible results.

Good progress was made in implementing the 2001 capital market recommendations. Several reforms were tabled to develop further the risk capital market: removal of some quantitative constraints on pension funds' investment, tax reforms to make the fiscal framework more conducive to investment and entrepreneurship, planned reform of the procedures for insolvency.

3.2. Denmark

Economic activity decelerated to around 1.3% in 2001 as a result of the continuing effects of adverse economic shocks. Following a stabilisation period in 2000,

unemployment fell slightly through 2001. The tightness of the labour market also resulted in high wage increases in the second and third quarter of 2001. Inflation fell continuously during 2001, after having peaked in the middle of 2000, and HICP inflation averaged 2.3% for the whole year.

Altogether, Denmark made good progress in implementing the budgetary recommendations of the 2001 BEPGs. General government finances showed a large surplus, as recommended. The remaining 2001 budgetary recommendations were also met, and public finances appear adequate to meet the medium term challenges.

Limited progress was made in implementing the 2001 labour market recommendation. No new measures have been taken in 2001. However, previous tax reforms will lead to a reduction in the taxation on labour. Similarly, previous reforms of early retirement schemes will lead to a reduced inflow into such schemes.

Some progress was made in implementing the 2001 product market recommendations. Some effort was made to enhance conditions for competition in public procurement and for the provision of public services at the local level, through benchmarking and increased use of public tendering. But considerable scope for further progress remains in this area. Partial measures were taken to strengthen competition in some sectors, such as construction.

Regarding the 2001 capital market recommendations, some progress was made to establish a fiscal framework more conducive to investment and entrepreneurship. However, little was done to adjust bankruptcy laws.

3.3. Germany

The economy slowed down considerably in 2001, with real output growing at 0.6 %. The downturn was due to the loss in purchasing power resulting from the 1999/2000 oil price hike, the worsening international environment, and a significant decline in construction activity. Since January 2001, this has resulted in rising unemployment, which is likely to exceed the 4 million threshold in 2002 and threatens to undo much of the employment gains of the last few years. Average HICP inflation in 2001 was 2.4%; after a peak rate of 3.5% in May it fell to a level of 1.7% in December.

Altogether, Germany made some progress in implementing the budgetary recommendations of the 2001 BEPGs. Budget deficits increased markedly, from 1.3% of GDP in 2000 to 2.6% in 2001, due to the economic downturn and the introduction of tax reforms. With overall growth in 2002 expected to remain at 2001 levels, there is a risk that the 2002 deficit comes very close to the Treaty's 3% reference value.

Some progress was made in implementing the 2001 labour market recommendations. While the "Job Aktiv" bill is a first step in the right direction, a more comprehensive reform of the benefit system is still missing and the inefficiency of large-scale ALMPs has not yet been addressed. Despite some progress, more needs to be done to adapt wage increases to the need to achieve wage structures that better reflect productivity differences. The use of working time accounts, agreed between social partners,

contributed to a more flexible organisation of work, but no progress was achieved in making labour market regulations more flexible. Care should be taken that the reform of works councils does not reduce labour-market flexibility.

Good progress was made in implementing the 2001 product market recommendations. The reform of the higher education system became effective on 1 January 2002 and the shortage of IT personnel declined. State aid continued to decline gradually and entry into the handicraft trades was made easier, but the value of public tenders published in the Official Journal did not increase significantly. While competition authorities carried out numerous investigations on whether the fees charged for the use of electricity distribution networks were justified, significant regional differences in these fees remain. Network access charges seem higher than in most other Member States.

Germany made some progress in implementing the 2001 capital market recommendations. The reform of the taxation of holding transfers will probably benefit also the German risk capital market. The harmonisation of the taxation of venture capital funds will increase investor's certainty about their legal position and thus their planning decisions.

3.4. Greece

Despite the impact of the adverse economic shocks, economic activity was strong in 2001, with real output growing above 4%. Economic resilience was driven by investment in preparation for the 2004 Olympic Games. The increase in employment and the fall in unemployment suggest a mild improvement in the labour market situation, although the unemployment rate still exceeds 10%. Following inflationary pressures until summer 2001, inflation, over the year as a whole and as measured by the HICP, averaged 3.6%.

Altogether, Greece made some progress in implementing the budgetary recommendations of the 2001 BEPGs. The government's budgetary adjustment efforts in recent years resulted in a significant improvement of fiscal imbalances. Indeed, in 2001 the general government accounts were in balance for the first time since the early 1970s. The debt ratio, which has been on a downward path since 1996, fell just below 100% of GDP but remains considerably above the 60% of GDP reference value. Partial privatisation of a wide-range of public companies continued, albeit at a slow pace. The reform of the social security sector, announced in the first stability programme, was not initiated in 2001.

Some progress was made in implementing the 2001 labour market recommendations. Measures taken included numerous changes to the tax and benefit system, and a further package of labour market reforms. Moreover the reform of the educational system continued to be implemented. However, measures taken have not yet gone far enough in tackling the key structural problems on the labour market. Furthermore, past reforms have continued to be dogged by problems in implementation.

Some progress was made in implementing the 2001 product market recommendations. Transposition of Internal Market directives improved markedly, although the transposition deficit remains high and efforts were made to promote ICT diffusion and to reduce the administrative burden on business. However the cost of setting up a new business remains high. The system of corporate taxation continues to discourage firms' growth. R&D and innovation performance is relatively poor, and competition in liberalised network industries is progressing slowly.

Regarding the 2001 capital market recommendations, Greece made some progress. In a bill submitted to Parliament, the government has proposed full "tax transparency" in the tax treatment of risk capital funds, a new legal framework for the creation of venture capital funds and favourable tax treatment for R&D expenditure. However, no efforts to ease quantitative constraints on institutional investment and improve bankruptcy legislation have been reported.

3.5. Spain

Economic activity slowed down in 2001, with real output growing at approximately 2.7%. This was due to the impact from oil and unprocessed food price hikes earlier in the year, and subsequently in response to the international downturn. In this context, job creation lost dynamism although the unemployment rate continued falling to 13%. HICP inflation accelerated slightly to 3.6% on average in 2001, reflecting not only the adverse behaviour of the most volatile components, but also an increase in core inflation.

Altogether, Spain made good progress in implementing the budgetary recommendations of the 2001 BEPGs. Fiscal consolidation made additional progress in 2001. A general government balanced budget, as recommended, is likely to have been met.

Some progress was made in implementing the 2001 labour market recommendations. A reform of employment contracts goes some way towards making permanent and part-time contracts more flexible, although the share of temporary contracts in employment remains very high. The government made initial efforts to encourage the social partners to agree on a reform of collective bargaining; however, the recent agreement between trade unions and employers for moderate wage growth in the current year did not address the wage bargaining system or wage indexation clauses. Limited measures to encourage labour mobility have been taken.

Good progress was made in implementing the 2001 product market recommendations. Initiatives were taken to achieve a greater diffusion of the knowledge-based society and efforts to simplify the regulatory burden for SMEs continued. Implementation of the liberalisation package adopted in June 2000 continued in 2001.

Good progress was made regarding the implementation of the 2001 capital market recommendations. Tax incentives for risk capital funds are foreseen in the draft Finance Law and a new regulated fund type specialised in unlisted securities was

created to channel investment to SMEs. However, no progress on adjusting bankruptcy laws to encourage entrepreneurship has been reported.

3.6. France

Economic activity decelerated in 2001 with real output growing at around 2%. However, resilient domestic private consumption avoided an even more severe downturn as a result of the continuing impact of adverse economic shocks. The slowdown induced slower employment growth and unemployment has increased since the spring. In such a context, inflationary pressures remained very limited. After reaching a peak in May, HICP inflation decreased to an estimated 1.8% by the end of the year.

Altogether, France made some progress in implementing the budgetary recommendations of the 2001 BEPGs. In contrast with the progress made over the period 1996-1999, budgetary adjustment slowed down markedly in 2000 and 2001. Indeed, the general government deficit is projected to decrease by only 0.2 percentage point of GDP over the 1999-2001 period (from 1.6% of GDP in 1999 to 1.5% in 2001).

Some progress was made in implementing the 2001 labour market recommendations. Reforms of the tax and benefit system have been underway for some time, although further action is required, particularly on benefits. Policy-makers continued to monitor the implementation of the reduction of working time and allowed flexibility in application of working-time legislation to SMEs. However, there was no progress in implementing the recommendation on employment protection legislation, which called for a better balance between security and greater adaptability. New legislation was introduced to increase employment protection, but no measures were taken to increase adaptability.

Some progress was made in implementing the 2001 product market recommendations. The transposition deficit of internal market directives was reduced but is still the second worst in the EU. State aid as a percentage of GDP came down towards the EU average. Efforts made in 2000 to reduce the administrative burden were pursued but businesses continue to perceive it as a major constraint. The opening up of the gas and electricity markets was pursued but at a very slow pace.

Some progress was made in implementing the 2001 capital market recommendations. In particular by developing a fiscal framework more conducive to investment and entrepreneurship.

3.7. Ireland

The impact of supply constraints compounded by several exogenous shocks resulted in a pronounced slowdown of the economy from double-digit growth in 2000 to around 6.5% in 2001, most of which represents carry-over effects. The labour market so far has proved remarkably resilient, with strong employment gains in the first three quarters of 2001 and a limited rise in the unemployment rate to a level still close to 4% in December 2001. Annual HICP inflation has moderated since its late-2000 peak to a two-year low of 3.4% in November 2001. However, underlying inflation has risen, pointing to unabated domestically-generated price pressures.

Altogether, Ireland made good progress in implementing the budgetary recommendations of the 2001 BEPGs. Due mainly to the larger-than-expected downturn, taxes were about 8% below the objective, leading to a general government surplus of just 1.7% of GDP, almost 2½ percentage points lower than targeted.

Some progress was made in implementing the 2001 labour market recommendations. Further income tax changes and funding to promote the provision of childcare facilities are among the measures addressing labour supply. Evidence on earnings indicates that wage growth exceeded the revised pay terms of the national agreement in 2001. The challenges of a tight labour market remain in relation to mobilising labour and future wage setting processes.

Good progress was made in implementing the 2001 product market recommendations. Measures were taken to enhance competition in the network industries, taxi services, pharmacies and the sale of alcoholic liquor. However, incumbent firms still have high market shares in the network industries. Appropriate programmes were set up to promote R&D.

Some progress was made in improving access to early-stage financing, for instance through the establishment of a dedicated government-sponsored venture capital scheme.

3.8. Italy

Economic activity decelerated in 2001, with real output growth averaging 1.8%. The slowdown is the result of weakened exports and contracting private investment expenditure. While weakening, the performance of the labour market remained positive, with the rate of unemployment declining by more than a full percentage point compared to 2000. However, unemployment remains relatively high at 9.5% of the labour force, with large regional disparities and significant segmentations by age and gender. HICP inflation for 2001 ended at 2.7%, mainly reflecting inflationary pressures at the beginning of the year.

Altogether, Italy made some progress in implementing the budgetary recommendations of the 2001 BEPGs. Budgetary consolidation continued in 2001. The actual budget deficit is now officially estimated at 1.1% of GDP in 2001. The departure from the original objective of 0.8% of GDP is largely explained by lower-

than-expected economic growth. The debt ratio has been on a downward path since 1995, but remains at around 108 % of GDP, considerably above the 60% of GDP reference value. Although the government has confirmed the strategy of fiscal consolidation, concerns remain about the long-term sustainability of public finances, particularly with respect to pressures from an ageing population.

Some progress was made in implementing the 2001 labour market recommendations. Although only minor measures were actually implemented during 2001, a broad set of labour markets reforms was proposed, which appear to be going some way towards addressing the main structural problems. Due to the budgetary impact of the recent slowdown, the planned overall reform of the tax system has been postponed to 2003.

Some progress was made in implementing the 2001 product market recommendations. Measures were taken to promote the knowledge-based economy and further reduce red tape and regulatory constraints. Progress was also achieved in increasing competition in the energy sector and in the provision of local public services. However, no concrete measures were taken to increase competition in professional services.

Some progress was made in implementing the 2001 capital market recommendations. Some of the quantitative constraints on institutional investment were removed. The government is to propose a new reform of bankruptcy laws early 2002.

3.9. Luxembourg

Economic activity decelerated somewhat in 2001, following record growth rates in 1999 and 2000. Nevertheless, growth probably amounted to around 5%, remaining significantly more dynamic than its neighbouring countries, due to continued strong growth in private and public consumption, as well as in gross fixed capital formation. Employment kept growing at a rapid pace, while decelerating slightly. Consequently, unemployment began to rise moderately once again. Inflation decelerated significantly since the beginning of 2001, the annual rise in the HICP slowing down to 2.4% in 2001. Nevertheless, wages continued to increase rapidly and underlying inflation continued to accelerate.

Altogether, Luxembourg made some progress in implementing the budgetary recommendations of the 2001 BEPGs. While remaining comfortable, the general government surplus declined from the record level reached in 2000.

Some progress was made in implementing the 2001 labour market recommendation. The government sent a bill to the Parliament concerning a revision of the definition of eligibility for a disability pension, but without any modification of the pension level. Earlier efforts to increase female participation produced noticeable results in the second half of the 1990s.

Thanks to the openness of the economy, Luxembourg's product markets are contestable. Nevertheless, the legal framework presents inadequacies and limited progress was made in implementing the 2001 product market recommendations. The

abolition of fixed and monitored prices, the empowering of the competition authority, and a single legislative framework for public procurement are three reforms whose delay may limit the degree of competition.

3.10. The Netherlands

Seven years of strong economic growth ended at the beginning of 2001, as a result of weaker domestic demand, caused by receding private investment and sluggish private consumption, and the deterioration in external trade. Altogether, real output grew above 1% in 2001. However, employment kept increasing rather fast, and unemployment, which reached record lows in the course of the year, has not yet started to rise. Wages, which had accelerated significantly over recent years, kept increasing at a rapid pace. Inflation jumped to 4½%-5% since the beginning of 2001, the annual rise in HICP inflation reaching 5% as a result of mounting tensions on the labour and good markets, but also due to a rise in indirect taxation.

Altogether, the Netherlands made good progress in implementing the budgetary recommendations of the 2001 BEPGs. The general government surplus decreased moderately.

Some progress was made in implementing the 2001 labour market recommendations. New financial incentives to encourage the labour market activity of benefit recipients, older workers and low wage earners were introduced, but discussion on a reform of the disability scheme has not yet led to tangible results.

Good progress was made in implementing the 2001 product market recommendations. The value of public tenders published in the Official Journal has increased and the liberalisation of the energy and transport markets is advancing. Measures were taken to encourage ICT use and reduce the shortage of ICT experts. In spite of efforts made to stimulate research and innovation, business expenditures on R&D as a percentage of GDP have fallen further behind the EU average, and this has contributed to a relatively slow labour productivity growth.

Some progress was made in implementing the 2001 capital markets recommendations. The taxation of stock option has been reformed to help alleviate the negative effects of their taxation at grant and a reform of bankruptcy laws is considered.

3.11. Austria

Economic activity decelerated considerably in 2001, with real output growing at approximately 1%. This was due to the loss in purchasing power and the slower growth in construction activity which depressed domestic demand, while exports suffered from slow growth in main trading partners' economies. The falling trend in unemployment has reversed since the beginning of the year. Inflation started to decline from the summer onwards, with HICP inflation estimated to average 2.3% in 2001.

Altogether, Austria made good progress in implementing the budgetary recommendations of the 2001 BEPGs. Expenditure restraint in combination with significant revenue side measures, essentially broadening tax bases, led to a marked improvement in government finances, which reached balance in 2001.

Some progress was made in implementing the 2001 labour market recommendations. Measures aimed at older workers' labour force participation continue to be implemented, and the inflow into early retirement has started to decrease. However, research by the IHS suggests that disincentives to working longer than the minimum retirement age are still strong, in particular for low-wage earners, and that invalidity pensions could be used to side-track the restricted early retirement scheme.

Some progress was made in implementing the 2001 product market recommendations. While federal and regional legislation on public procurement have still not been harmonised, public procurement seems to have been advertised more openly and the establishment of a federal procurement company is a first step towards a more unified framework. Efforts have been made to strengthen R&D at different levels and to favour the spread of ICT and the supply of ICT experts.

Good progress was made in implementing the 2001 capital market recommendation. Pension funds are now allowed to invest up to 5% in assets not listed in the catalogue of permissible investments; Austria has abolished the registration fee for start-ups and foresees an extension of tax incentives for "new" start-ups to acquisitions of existing "start-up" companies.

3.12. Portugal

Economic activity decelerated from the strong growth rates registered in 1999-2000 to around 1¾% in 2001. This reflects a slowdown in the growth contribution of domestic demand, due mainly to efforts of private sector agents to reduce their indebtedness. This was only partly counterbalanced by an improvement of exports. Labour market developments remained positive, with unemployment remaining below 4½%, and total employment rising by approximately 1½%. Wages per head accelerated, reflecting the tightness in the labour market and strong public sector wage increases. HICP inflation rose to 4.4% in 2001.

Altogether, Portugal made some progress in implementing the budgetary recommendations of the 2001 BEPGs. Fiscal consolidation faltered in 2001, mainly due to lower-than-expected tax revenues. The latter was mainly the consequence of the slowdown in economic activity and unexpected shortfalls following the implementation of the tax reform. Some progress was made in addressing the budgetary consequences of an ageing population, in particular by changing the formula used to calculate pension benefits, but reform efforts need to be sustained.

Some progress was made in implementing the 2001 labour market recommendations. Measures were taken to improve the effectiveness of the education and training systems, but attainment and literacy levels remain significantly below most other

Member States. No major initiative was undertaken to ease the strict employment protection legislation.

Good progress was made in implementing the 2001 product market recommendations. Several measures were enacted to increase the R&D and innovation base of the economy and to promote ICT take-up. Transposition of Internal Market directives improved markedly, and further efforts were devoted to improving the business environment. On the other hand, competition in key utilities is being introduced relatively slowly, with incumbents remaining very influential and prices relatively high. Ad hoc sector specific aid is among the highest in the EU as a share of GDP and are only decreasing slowly. Several fiscal reforms were implemented to stimulate investment and entrepreneurship.

Some progress was made in implementing the 2001 capital market recommendations. Several fiscal reforms were implemented to stimulate investment and entrepreneurship. However, no real progress was made regarding quantitative constraints on institutional investment or adjustment of bankruptcy laws.

3.13. Finland

Economic growth slowed down sharply in 2001, with real output growing less than 1%, thus ending seven years of buoyant economic activity. This was mainly due to sharp decline in exports, especially in the ICT sector, but also of a weakened domestic demand, triggered by construction investment and, to a lesser extent, private consumption. Nevertheless, employment expanded favourably for most of the year and unemployment continued to decline, although at noticeably decelerating pace ending at 9.1% in December. HICP inflation eased markedly towards the end of the year, after having peaked at 3.3% in May, averaging 2.7% in 2001.

Altogether, Finland made some progress in implementing the budgetary recommendations of the 2001 BEPGs. The budgetary position remained sound, although in the absence of the exceptional tax revenues of 2000, the general government surplus declined from its record levels.

Good progress was made in implementing the 2001 labour market recommendations. Efforts were aimed at reducing the high level of structural unemployment and at increasing incentives for older workers to remain longer in the labour force. While the tax reductions on labour increased incentives to work in general, they have done little in reducing high marginal tax rates for low-wage earners. The targeting and tailoring of ALMPs is improving and efforts to prevent exclusion from the labour market have been increased. However, measures are scheduled for 2002 that will increase the level of unemployment benefits.

Some progress was made in implementing the 2001 product market recommendations. Some measures were taken to enhance competition in the distribution and construction sectors. Some measures were implemented to increase competition in public procurement and to improve the transparency in the provision of public services but the rate of public procurement advertising is relatively low.

Some progress was made regarding the implementation of the 2001 capital market recommendations. Finland developed capital guarantees provided by the Finnish Export and Guarantee Credit Agency to safeguard investors against losses on venture capital investments, and launched reforms in the field of capital, income and corporate taxation.

3.14. Sweden

The economy performed weakly in 2001, with real GDP growth decelerating to less than 1.5 per cent. This was mostly due to the continuing effects of adverse economic shocks, and particularly related to the global slump in the telecom sector. In 2001, unemployment, which has been falling since 1997, was relatively low at 5.2 per cent of the labour force. HICP inflation averaged 2.7% in 2001. It rose sharply in spring and has remained relatively high since then, partly due to temporary factors.

Altogether, Sweden made good progress in implementing the budgetary recommendations of the 2001 BEPGs. Available evidence indicates that the recommendations were met. Public finances have been in surplus in each year since 1998, aided by tight expenditure control, and are expected to continue to be so in the coming years.

Good progress was made in implementing the 2001 labour market recommendations. The scope and mix of ALMPs were adapted and the tax burden on income was reduced. However, the tax burden still remains the highest in the EU, and the many measures undertaken do not appear to be targeted at the low end of the wage scale.

Limited progress was made in implementing the 2001 product market recommendations. The government introduced a number of measures to simplify regulations on public procurement. However, no new measures were taken to increase competition in air transport and pharmaceuticals.

Sweden made some progress on the implementation of the 2001 capital market recommendations. Bankruptcy legislation was improved to encourage reconstruction of failing companies and proposals to further reduce corporate taxation aim at stimulating growth and investments.

3.15. United Kingdom

While the economy decelerated in 2001, in association with the global slowdown, growth remained respectable above 2% - supported by strong household expenditure. Unemployment fell to around 5% by the end of the year. HICP inflation, at 1.0% in December, was close to the lowest in the EU.

Altogether, the United Kingdom made some progress in implementing the budgetary recommendations of the 2001 BEPGs. The government finances revealed a surplus of around 1% of GDP in 2001 and the recommendations concerning the government balance relating to financial years 2001-02 appear to have been fulfilled. While government investment is growing strongly, as recommended, a 1% of GDP deficit

emerges in 2002/3 and persists in the medium term in the latest Convergence Programme, also as a result of the use of a very cautious trend growth assumption.

Good progress was made in implementing the 2001 labour market recommendations. The UK Government continued its efforts to tackle concentrated and long-term unemployment and inactivity through its range of active labour market measures, which have been reinforced in some respects, though it remains to be seen whether the overall strategy is sufficient. A reform of the delivery of sickness and disability benefits is in progress.

Some progress was made in implementing the 2001 product market recommendations. The UK Government has taken or is considering several measures to raise productivity such as promoting competition in certain sectors of the economy including retail banking, car retailing and postal services. However, events over the last year have caused the UK Government difficulties in implementing its 10-year plan for transport in the railways sector.

Some progress was made in implementing the 2001 capital market recommendations as the UK Government has already taken on board or is actively considering the recommendations of the Myners Review on institutional investment.