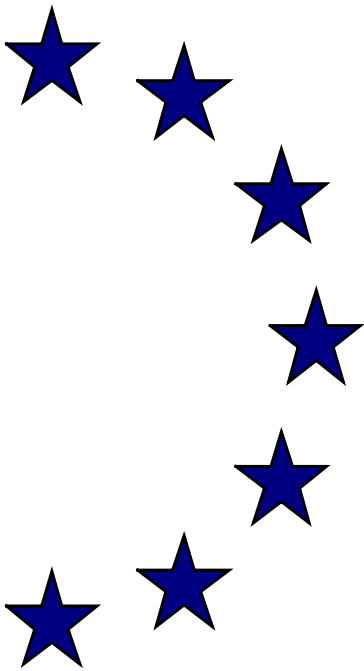


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**Annual Report on Structural Reforms
2002**

by Economic Policy Committee (EPC)



ECONOMIC POLICY COMMITTEE

Annual Report on Structural Reforms 2002

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Preface

The present report is the fourth report on structural reforms prepared by the Economic Policy Committee. It summarises the results of an annual country by country examination of economic policies, which the Committee is asked to carry out according to its statutes.¹

The country examinations are a peer review exercise focussing on progress made in the structural reform of product, capital and labour markets and long-term aspects of public finance sustainability. The examinations take a comprehensive look at the whole reform process, provide "benchmarking" comparisons between countries and evaluate to what extent Member States have implemented the country specific recommendations addressed to them in the Broad Economic Policy Guidelines (BEPGs).

The peer review exercise incorporates the "Cardiff process", launched by the Council in 1998, for monitoring economic reform in Member States in order to improve the functioning of product and capital markets in the Community. The national reports on structural reform and the Commission's Cardiff report² are therefore an essential basis for the examinations.

The country examinations also assess the performance of Member States' labour market policies, which are an essential part of the overall economic policy framework. The examinations build on the joint analysis prepared in the framework of the Luxembourg process and reflected in the Joint Employment Report and the Employment Guidelines and focus inter alia on reforms of tax benefit systems, in view of the importance hereof for other areas of economic policy.

As in previous exercises, the Committee has paid particular attention to a number of priority subjects. The special topics chosen this year reflect the strategic objectives agreed by the Heads of State and/or Government at the special European Council in Lisbon as well as priorities set by the European Council in Gothenburg. The Committee has focused on policies to support long-term sustainability of public finances in the light of ageing, policies to reform and liberalise public utilities and network industries and policies to integrate economic and environment policies. Separate annexes are devoted to these priority subjects.

This year, the report has been reorganised and reports only horizontal details for the special priority subjects examined in order to reduce overlap to documents prepared by the Commission. Instead a separate short chapter has been included for each Member State summarizing the examination of that Member State.

By looking at a wide range of economic policy areas and by evaluating the implementation of the BEPGs, the examinations and the present report contribute to the preparation of the multilateral surveillance by the Council according to Article 99 (3) of the Treaty. The conclusions of the examinations as reflected in this report will support the Commission and the Council in the preparation and the adoption in Sevilla of new BEPGs, which form the centre of economic policy coordination within the European Union.

The peer review was carried out in a working group of the EPC under the Chairmanship of Per Callesen. It involved the 15 Member States, the European Central Bank and the European Commission, which provided substantial analytical input and support for the working group. The present report is the key output of the examinations. It was adopted by the EPC on 22 February 2002 and submitted to the ECOFIN Council for transmission to the Heads of State or Government for their Barcelona meeting.

¹ See Council Decision of 29 September 2000 on the composition and the statutes of the Economic Policy Committee (2000/604/EC); OJ L 257, 11.10.2000, p. 28

² The national reports and the Commission Cardiff report can be found on the website of the Economic Policy Committee: http://europa.eu.int/comm/economy_finance/epc/index_en.htm

1. Key messages

Executive summary

The 4th annual country review by the Economic Policy Committee shows that Member States made further progress in 2001 on structural reform in product, capital and labour markets. Over the last several years this process has contributed towards the improved economic performance of the EU area, including supporting significant, non-inflationary employment growth and stable macro-economic fundamentals. Compared to the larger initiatives taken in previous years, however, few significant reforms were launched in 2001.

Reforms in **product markets** should be speeded up. In particular with respect to liberalisation and promotion of stronger competition in network industries as well as in a significant number of other domestic service sectors, increasing the efficiency of public procurement and public services, and reducing the backlog of implementation of Community legislation. In **capital markets**, further action must be taken at the Community level to ensure better integration and competition.

Strong efforts in education are needed to enhance productivity and reap the full benefits of the **knowledge-based society**. An improved innovation climate is crucial in this respect. Policy efforts should be geared towards improving general framework conditions (including stronger competition, healthy fiscal and regulatory environments and flexible labour markets conducive to worker mobility), better innovation institutions (including intellectual property protection), enhancing private R&D, promoting the effectiveness of public R&D and facilitating networking.

In **labour markets** the recent tax cuts need to be followed up by improvement of the incentives to employ and, in particular, supply labour embedded in protection and benefit systems. Measures targeted at improved inclusion of older workers, women and the long-term unemployed are strongly needed.

Pension systems need to be adjusted to reward later retirement and take consistently account of increasing life expectancy. The general consolidation of public finances must be speeded up in many Member States in order to ensure the sustainability of public finances and pension systems in view of the future demographic pressure on public expenditures for pensions, health and long-term care.

Environmental policy should be made more cost-effective through the use of market-based instruments in addition to regulation. Further efforts at the Community level are required in order to facilitate the use and efficiency of, e.g., taxes and marketable emission permits.

The process of structural reform needs to be revived in order to meet the targets set by the European Council in the context of the Lisbon growth strategy with respect to productivity, employment and the sustainability of public finances, social protection systems and the environment.

Until 2000 employment grew strongly, but further improvement is necessary, in particular with respect to reducing high structural unemployment in many Member States. Labour supply in all Member States is insufficient if the Lisbon and Stockholm employment objectives and national employment aspirations are to be met. Overall productivity growth, and hence the increase in living standards, has been relatively weak in recent years, although partly reflecting large employment increases among the low skilled. No further convergence in productivity levels or decreases in the dispersion of prices of tradable products has been achieved. Capital markets have been further integrated, but the process is hampered by delayed action at the Community level. Pension systems and budget balances are in most cases not sufficiently prepared for the challenge of ageing populations.

Therefore the political commitment to structural reform needs to be translated into further direct and specific action if the ambitious Lisbon targets with respect to employment and living standards as well as the sustainability of budgets, the environment and social systems are to be met. Action is needed both in individual Member States and at the Community level. Economic fundamentals are basically sound, and weaker cyclical conditions should not diminish the determination to pursue the Lisbon strategy. Continued structural reforms – interacting with growth- and stability-oriented macro-economic policies – are a key element of a speedy recovery and sustained growth.

In the following, the conclusions with respect to previous implementation of reforms and challenges ahead are summarised. This includes the three special topics covered by the 2002 country review, i.e. a) **network industries**, b) **ageing, pensions and fiscal sustainability** and c) **market-based instruments to protect the environment**. Overall, Member States made progress with respect to implementing the 2001 specific Broad Economic Policy Guidelines.

Product markets

In product (goods and services) markets, Member States have continued efforts towards completing the Single Market as well as regulatory reforms. Most measures have been of a gradual nature, but in the right direction, in broad terms following the progress of previous years:

- Some further progress was made towards **compliance with Single Market directives** in almost all Member States. However, some Member States have substantial implementation backlogs, and only 5 Member States currently fulfil the Stockholm target of reducing the transposition deficit to less than 1.5 per cent. Rapid progress is therefore needed to reduce the transposition deficit.
- Some overall reductions in **State aid** took place, and aid is also increasingly directed away from sector-specific aid and *ad hoc* aid to declining industries toward horizontal measures. This needs to be continued. The transparency of State aid policies has improved with the wider dissemination of State aid data. Care should be taken that the present cyclical conditions do not lead to a reversion of previous efforts made in this area.
- The efficiency of **public procurement** is addressed through increasing transparency and competition through EU-wide public tendering, although only a relatively small share of public procurement is covered so far. This process needs to be intensified. Also, Member States increasingly make use of Internet portals, and some have moved

towards co-ordinating the procurement policies of local and central levels of governments.

- **Administrative** and compliance **burdens** have been reduced to some extent by, e.g., simplification of business registration and reporting procedures and the use of electronic communication with government agencies. The variation between Member States is still substantial and efficiency needs to be further improved in all Member States.
- Steps have been taken towards strengthening national **competition authorities**, including moving towards more independent regulatory bodies and the consolidation of sector-oriented into horizontal agencies. However, several countries need to pursue further reforms along these lines in order to make the regulatory framework more effective.
- In many sectors, there is scope for more active and targeted **enforcement of competition**. In some sectors – including professional services – care should be taken that measures to safeguard consumer protection and quality do not hamper economic efficiency, transparency and competition. Several Member States are examining these issues, and efforts at the Community level to create an internal market in services should be intensified.
- In some Member States, lack of effective competition in construction and building materials is evident, although progress has been made for some materials. Stronger efforts at the Community level to **harmonize technical standards** and/or strengthen **mutual recognition** are needed. Cross-border competition should also be encouraged.

Network industries

Reforms of utilities in telecommunications and – to a more limited extent – energy and transportation have succeeded in creating new markets, delivering higher-quality services and lowering costs. There is no evidence so far of conflict between deregulation – and hence free choice and cost-effectiveness – and universal service obligations. In some cases, the consumer price of network services has declined by less than production cost because of, e.g., reduced cross-subsidisation or higher taxes. However, this does not imply that the gains to society are lower, but rather that they alleviate the burden of other taxes or prices.

The experience in network liberalisation also indicates the need to pay attention to the management of the transition process and making sure the intended results are produced. In this regard better information to consumers about the timeframe of the transition and the intended improvements with respect to, e.g., quality and cost is crucial.

A liberalised framework is well established in many Member States and proceeding according to a specific timetable in others. However, this process needs to be speeded up by advancing deadlines already set and introducing deadlines where they do not currently exist. Further action is warranted in most Member States to ensure effective competition and thus lower prices in already liberalised network industries:

- Competition in telecommunications is developing favourably in most market segments, but remains weak at the local loop of fixed networks. Efforts have been taken by several Member States to allow entry by third parties. In energy markets, liberalisation has proceeded in 2001. However, the pace of market opening and the regulation of net-

work tariffs vary greatly between Member States. At the end of 2001, agreement was finally reached to speed up liberalisation of postal services at the Community level. A relatively slow and gradual process is envisaged, which Member States could speed up ahead of the agreed timetable. A number of Member States have taken the first steps in opening up passenger railways to competition. However, a detailed assessment of the experience with railway liberalisation is necessary to determine which model of deregulation and competition provides the best outcome.

- Typically, concentration has declined markedly along with deregulation in mobile telephony and long-distance telecommunications. However, **incumbent domination** in some recently deregulated utilities should be monitored as it may indicate barriers to competition. Also, Member States should improve price transparency, and hence facilitate consumer choice, and effective competition including true contestability of markets.
- The inefficient use and scarcity of **inter-connections** of national electricity and natural gas networks is an obstacle to competition in some Member States. Ongoing efforts to eliminate these problems should be intensified.
- There is substantial scope for productivity improvements through deregulation and competition in **postal services** and **transportation**.
- Problems due to the potential tension between the **dual role of government** as regulator and owner need to be reduced, including addressing issues such as the participation of government-controlled or -owned firms in public tenders and cross-border competition. In many cases privatisation, combined with measures ensuring contestable markets, can contribute to a more transparent and efficient regulatory framework.

Capital markets

Modernisation and consolidation has taken place in the financial sector, notably banking, within and between Member States, including cross-border mergers and acquisitions. This has led to a strengthening of the financial sector, thereby contributing to the effectiveness of capital markets and the allocation of financial resources provided competition is effective.

Member States have continued to reform capital markets, with special emphasis on strengthening supervision and prudential regulation. Following last year's recommendations, progress has been achieved in developing risk capital markets, thereby providing easier access to risk capital for new and innovative companies.

- Member States have generally moved towards more independent **financial supervisory authorities**, including the provision of discretionary powers to initiate investigations. Regulators in banking, insurance and other financial services have been combined in some Member States, thus improving the coherence of the regulatory framework.
- In a number of Member States **consolidation in the banking sector** has led to an increase in market concentration. Continued close attention by national supervisory authorities and central banks – including increased cross-border co-operation – is warranted to ensure the exploitation of economies of scale without increasing systemic risk or hampering effective competition.

- In a number of Member States, **access to risk capital** constitutes a challenge for new and innovative companies, notably in the start up phase of business development. However, in response to the recommendations of the Broad Economic Policy Guidelines, many Member States continued to improve the framework for venture capital, including revisions of bankruptcy law. Also, some Member States have taken steps towards improving the fiscal framework affecting small and medium-sized firms.
- At the Community level, action must be taken to speed up the **implementation of the Financial Sector Action Plan and the Risk Capital Action Plan** and foster the development of integrated and effective capital markets. Also, it is vital that the Lamfalussy group recommendations on a new approach to EU **regulation of securities markets** are swiftly implemented.

Knowledge-based economy

Some progress has been made towards achieving the “knowledge-based society”. However, large differences between Member States remain, and present efforts need to be accelerated in order to meet the Lisbon targets, including improving the quality of labour supply:

- The overall **education level** remains insufficient in many Member States and only limited progress has been made with respect to reducing the substantial backlog in some Member States. Enrolment in secondary education has increased somewhat, but remains too low in many countries. Furthermore, quality problems and high dropout rates persist. In general, sustained employment growth has revealed labour shortages in many sectors and occupations. Some progress has been made with respect to reducing the shortage of specialists in ICT, science and engineering, but continued efforts are needed.
- Efforts to increase **R&D** and innovation are continuing, but public R&D has decreased in some Member States and commercial use remains insufficient. Private sector R&D remains low in many Member States and needs to be promoted by better framework conditions. Better interaction between public and private sector activities needs to be developed. Better functioning and more competitive product and capital markets will stimulate private sector R&D and innovation, as will increased mobility of researchers and the extension of networks between the different institutions involved in R&D and innovation. In particular the educational system has only in some Member States successfully increased the supply of potential researchers. An increased supply of knowledge workers remains a central aim in order to expand R&D activities substantially. The creation of a cost-efficient Community patent would improve the incentives of private firms investing in R&D. While direct public support, including tax credits, for private R&D has been introduced in some Member States, it is too early to assess the overall benefits and costs of these measures. Member States could look to build on the current variety of direct and indirect support for private R&D.
- **The structure of publicly funded R&D**, innovation and tertiary education are being reviewed and reformed in a number of Member States. Improvements are needed with respect to management, networking, cross-border interaction and efficient use of the knowledge being created.
- Most Member States are promoting **Internet use** in both government and private sectors. Internet and ICT use is increasing rapidly, but still lags behind in some Member States, where average educational attainment may impede the diffusion of ICT. A fur-

ther obstacle may be high Internet charges due to inadequate competition in telecommunications.

Labour markets and tax-benefit systems

The rate of unemployment has become low in a number of Member States and decreased in most others reflecting both cyclical and structural factors. However, significant structural unemployment remains in many Member States and the Community at large, and substantial variation between regions, age, gender and skills persists. Furthermore, a large number of persons remain outside the labour market.

In most Member States, labour supply is insufficient if the Lisbon and Stockholm targets as well as national ambitions are to be met. Major problems remain unsolved with respect to employment and participation rates of older workers in most Member States, although large differences between countries exist. Female participation rates are low in many countries. New measures in 2001 have focused on further tax reductions in line with previous years and, to some extent, education and training, whereas efforts in other areas have been limited.

- Many Member States have targeted tax cuts at **indirect wage costs or income taxes for the low paid**, although not on a large scale. These measures have contributed to higher demand for low skilled workers in a number of Member States and provided additional incentives to seek employment. However, budgetary constraints limit the scope for further tax cuts, and such measures are in any case not sufficient to address remaining problems in labour markets.
- With considerable variation across Member States, tax reforms have generally contributed to a reduction of **marginal tax rates**, thus providing stronger incentives to increase work effort. In several Member States cuts in tax rates have been entirely or partly financed by a broadening of the tax base reducing the disincentives implied by a given overall level of taxation. In addition, several Member States have reduced marginal effective tax rates by adjusting social security systems or introducing in-work benefits. Efforts to reduce distortions and make tax systems more transparent should be continued.
- Few steps have been taken to reform **benefit systems**. Eligibility criteria, enforcement of availability requirements and the duration of benefits have changed little. Further efforts to improve work incentives are clearly warranted, while maintaining a proper balance with respect to social protection. Otherwise, replacement rates are generally kept at previous levels, while some recent initiatives contribute to higher replacement rates in some Member States and somewhat lower rates in others.
- The legal framework underpinning the **wage formation** process has largely remained unaffected by labour market reforms. Although responsibility for wage bargaining lies with social partners as well as individual companies and workers, Member States should ensure a framework that facilitates stronger responsiveness of wage differences to labour market conditions, including differences across skills and regions, as labour market institutions continue to contribute to a compressed wage structure. This includes, e.g., adjusting labour market legislation and inviting social partners to participate in an employment promoting wage formation process.

- In a number of Member States temporary employment contracts have become substantially more widespread, contributing to job creation and labour market flexibility. This has especially occurred at the entry level, hence contributing to lower youth unemployment. Very few Member States have addressed dualism in labour markets by reforming **employment protection** in general. In a few Member States employment protection is being partially replaced by extended access to, and generosity of, unemployment benefits. While contributing to higher labour market flexibility and the alleviation of outsider problems, it is crucial that such a shift avoid the creation of unemployment traps and excessive budgetary costs. Furthermore, such measures will probably necessitate more emphasis on the enforcement of availability requirements.
- Efforts have been taken to increase the **participation rate of women**, which has risen substantially in a number of Member States. Several Member States already meet the Lisbon objectives, but large differences persist for the EU as a whole. More remains to be done in order to improve incentives for women to enter the job market or remain active in the labour market when raising children. Further reforms of the tax-benefit system and expansion of childcare facilities may support progress towards this objective. Child-care benefits should be designed to promote the participation of women, i.e. benefits should be employment-conditional or non-means-tested. In some cases more flexible working hours may help increasing female participation rates.
- **Active labour market policies** in most Member States have focused on education and retraining programmes aimed at those at risk of becoming disconnected from the labour market. Furthermore, several countries are moving towards more competition in the provision of employment services. In very few Member States the cost-effectiveness of active labour market programs is systematically reviewed, while effective targeting remains a challenge.
- Some efforts have been made to raise the participation and employment rates of **older workers**. However these rates are still low or very low in almost all Member States, hampered by a combination of tradition, insufficient labour market inclusiveness and in particular a lack of incentives to remain in the labour force. Little progress has been achieved with respect to increasing the employment of older workers, and hence meeting the Stockholm targets. The incentives of this age group to participate in the labour market remain limited in many countries, despite generally improved health conditions and increasing life expectancy. If the Lisbon employment targets and the long-term sustainability of public finances are to be met, it is necessary to reduce early retirement, if unrelated to health status, and the use of, e.g., disability or sickness benefit schemes as passive substitutes for unemployment benefits.

Ageing, pensions and fiscal sustainability

The long-term fiscal consequences of population ageing is a common challenge in all Member States, but differs considerably across countries, as does the current fiscal position. Key elements in a sustainable budget and pension strategy involve the continued consolidation of government finances, the promotion of later retirement and reforms of pension systems aimed at containing the long-run budgetary cost of population ageing. Very few changes have been made with respect to income replacement rates in pension systems.

- Although starting positions differ among Member States, very few have carried out or prepared comprehensive **pension reform**, e.g., including consistently accounting for increasing life expectancy, which is necessary to make pension systems more robust.

There is a strong need to assess the effects of measures already taken – including the impact on government finances and labour force participation among the elderly.

- Several Member States have implemented or are planning changes in **retirement benefit provisions** or various tax measures, including in a few cases an increase in the statutory retirement age, which may contribute to a higher effective retirement age. The impact of these measures on retirement incentives and government finances has yet to be assessed. But it is unlikely that the measures undertaken so far along these lines will substantially reduce the future increase in pension expenditures. Member States taking a gradual approach to reducing incentives for early retirement should be encouraged to speed up such efforts.
- In many Member States, the current rate of **fiscal consolidation** is far from sufficient to prepare for the expected long-term increase in public pension expenditures and the cost of government financed health care. Efforts should therefore be taken to speed up the reduction of government debt and adopt appropriate measures to address future expenditure growth (e.g., pre-funding).
- **Second and third pillar pension systems** are becoming more widespread as a supplement to public pensions. This may contribute to improved allocation of saving over the lifetime, the effective functioning of capital markets and may serve important priorities with respect to the future living standards of retired citizens. While potentially reducing dependency on social benefits, and hence future demands for an expansion of public pension programmes, increases in second and third pillar pensions can not substitute for reforms of public pension systems. A sound regulatory environment for second and third pillar systems should also be developed taking into account the need to ensure the sustainability of public finances.

Market-based instruments to protect the environment

Among Member States, there is an increasing awareness that making environmental policies cost-effective implies relying more on market-based instruments in addition to regulatory measures. However, further efforts at the Community level are required in order to pursue these objectives without negative effects on competitiveness.

- Several Member States have implemented or planned **higher fuel and other energy taxes**, although these efforts slowed down significantly in the wake of the oil price increase in 1999. In a number of Member States charges for or taxes on the extraction and use of natural resources should generally be better aligned with total costs, including those associated with environmental damage.
- There is a broad tendency to **exempt energy intensive sectors** in industry and transportation from energy taxes due to concerns about international competitiveness of such sectors. This increases the costs of fulfilling environmental targets. Real progress on this issue – and hence a more cost-effective way of achieving environmental improvements – would be facilitated by action at the Community level on, e.g., minimum charges.
- Subsidies or tax credits promoting investment in, and the use of, **environmentally friendly technologies**, such as the use of renewable energy and energy conservation, are becoming increasingly widespread. While contributing to positive substitution effects between, e.g., energy sources, care should be taken that the implied cost reduction

does not increase overall use of energy and other natural resources by reducing the price of energy-intensive products. Further action should also be taken to phase out subsidies to fossil fuel production and consumption.

- A few Member States are introducing **tradable emission permits** to combat greenhouse gas emissions. The scope and efficiency of this concept needs to be developed further, potentially through the adoption of a Community-wide emissions trading scheme as suggested by the Commission.
- **Existing taxes and excise duties**, as well as certain public sector charges, should be made more compatible with environmental concerns.

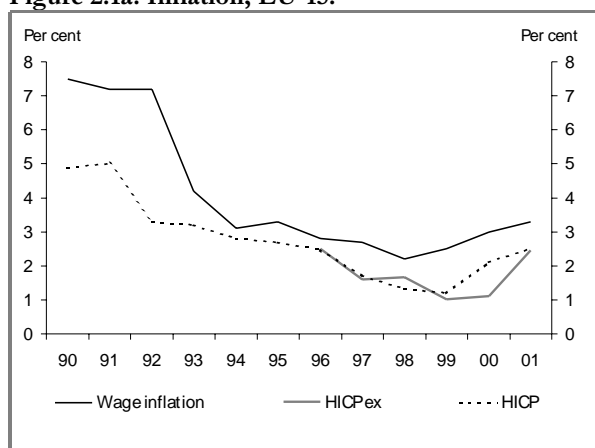
2. Structural reform in a macroeconomic perspective

2.1. Recent developments and the need for further structural reform

A sharp cyclical downturn has unfolded over the course of 2001 following a fairly long period of sustained economic growth and strong employment gains since the mid 1990s. The slowdown was initiated by international events but was exacerbated by weak domestic demand in most EU Member States. The macroeconomic fundamentals of the Union remain sound.

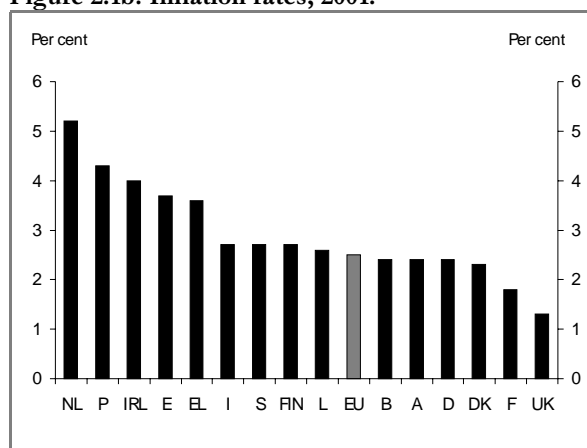
Compared to previous experience the recovery came to a halt in early 2001 within a framework of substantially improved financial balances and much lower inflation, *cf. figure 2.1a*. Structural improvements in labour and capital markets, fiscal consolidation, moderate wage developments and the stability provided by the introduction of the euro have paved the way for a more favourable position of EU economies. As a result, and against the background of monetary easing, the slowdown should also be seen as a temporary setback unless the international political and economic environment deteriorates significantly again.

Figure 2.1a. Inflation, EU-15.



Note: HICP ex is HICP excl. energy and unprocessed food.
Source: Commission Services, Eurostat.

Figure 2.1b. Inflation rates, 2001.



Neither the cyclical downturn nor the prospects of an impending recovery should distract attention from the need for further structural reform, which is strongly indicated by a number of factors:

- Even if the slowdown in 2001 was mainly triggered by international developments, skill shortages, general labour market pressures and capacity constraints were emerging in most Member States before the turnaround. Also, the underlying inflationary pressures were somewhat stronger than in previous years. Slower growth in a number of Member States would have been necessary in any case.
- Unemployment rates are still high and to a significant extent structural in a number of Member States and regions. Furthermore, most Member States struggle with low participation and employment rates among older workers and women.
- Compared to the USA, and in view of the opportunities provided by new technologies and globalisation, overall productivity growth has been disappointing.
- The long-term challenge of ageing populations reinforces the need to reduce structural unemployment, promote later retirement, ensure sound public finances and reform public pension and health care systems.

The structural reform efforts of Member States must be seen in the context of the ambitious targets with respect to performance in areas such as knowledge, employment, social inclusion and the environment that were introduced at the special Lisbon Council two years ago and confirmed and extended in Gothenburg and Stockholm. Whereas some progress towards achieving these targets has been made, much remains to be done.

The continuation and acceleration of the structural reform process – interacting with growth- and stability-oriented macroeconomic policies – is necessary in order to facilitate economic recovery as well as further improvements in the economic performance of Member States along the patterns experienced during the second half of the 1990s.

2.2. Gains in overall performance 1995-2001

EU-15 GDP growth averaged 2,4 per cent over the period 1995-2001, fairly evenly split between employment growth and increased productivity (GDP per person employed), *cf. table 2.1.*

Table 2.1. Contributions to growth, 1996-2001. EU-15 and USA.

	EU-15							US
	1996	1997	1998	1999	2000	2001 ²	96-01 ²	96-01 ²
Productivity ¹	1,4	1,5	1,3	1,1	1,6	0,6	1,3	2,2
Employment	0,3	1,0	1,6	1,6	1,7	1,1	1,2	1,3
GDP	1,6	2,5	2,9	2,6	3,3	1,7	2,4	3,6

1) GDP per person employed. Total economy.

2) Commission forecast for 2001.

Source: Commission Services.

As a result, cumulative employment growth over that period became close to 9 per cent, only one percentage point lower than employment growth in the USA, despite the significantly lower population growth than in the USA. The average unemployment rate decreased by more than 3 percentage points in Member States while labour force participation increased by almost 3 percentage points, *cf. figure 2.2a.*

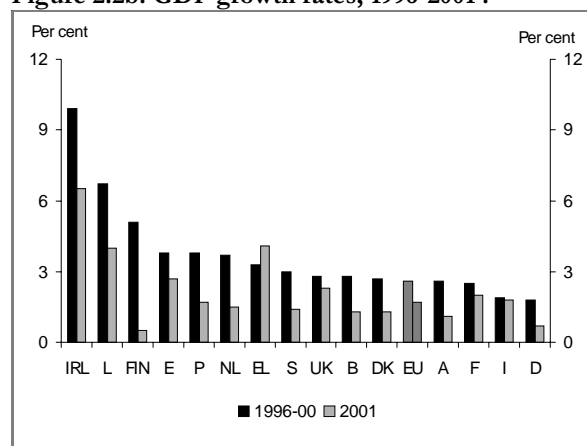
Figure 2.2a. The labour market, EU-15¹.



1) Including Commission estimate for 2001.

Source: Commission Services, Eurostat.

Figure 2.2b. GDP growth rates, 1996-2001¹.



The strong employment performance was partly due to the elimination of cyclical slack, but also significant structural labour market improvements due to, e.g., the reduction of labour costs at the low end of the skill distribution, more extensive use of temporary work con-

tracts, efforts in education, training and active labour market policies as well as generally sustainable wage developments.

Labour productivity growth has been much less encouraging. On the one hand, improving labour market conditions have slowed down average labour productivity growth due to higher employment among those with below average productivity and potentially also some substitution of labour for capital reflecting the relatively moderate growth of labour costs. Also some reduction in average hours worked took place, thus reducing output growth per person employed. On the other hand, a number of structural reforms promoting competition, the diffusion of new technologies and globalisation have worked to increase productivity growth.

The net result is substantially lower productivity growth than in the USA over the period. This should partly be seen as a reversal of the relative performance in the first half of the 1990s, where on average productivity growth in Member States outperformed the USA. However in the second half of the 1990s the US and the EU shared roughly similar external environments and labour market improvements.

The weaker productivity performance of the EU in the second half of the 90s suggests – in spite of the efforts made so far by Member States – that structural impediments to growth remain, particularly in areas such as competition, market integration, the diffusion of new technologies, innovation and the efficient use of human resources.

The average performance of the Union masks significant differences in growth between Member States, *cf. figure 2.2b above*. To some extent, these differences reflect different cyclical positions and the fact that Member States with relatively low GDP per capita tend to catch up with high-income Member States. However, it also reflects differences in structural conditions affecting potential growth rates of Member States.

2.3. The sustainable growth strategy and structural challenges

The special European Council in Lisbon agreed on the objective to make Europe the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. This ambition was supplemented by the Social Policy Agenda at the Nice European Council, and through the addition of the environmental dimension at the Gothenburg European Council, Member States are committed to an overall Sustainable Development Strategy.

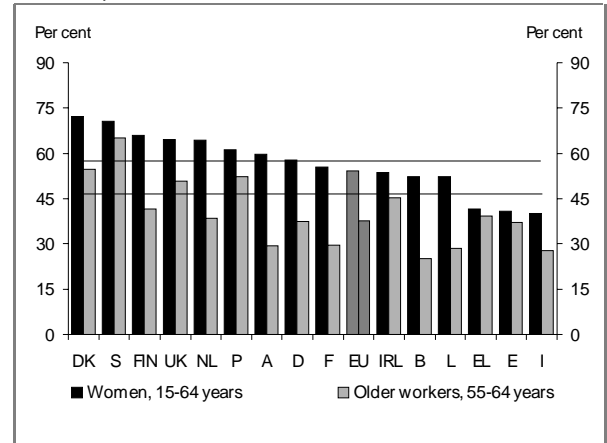
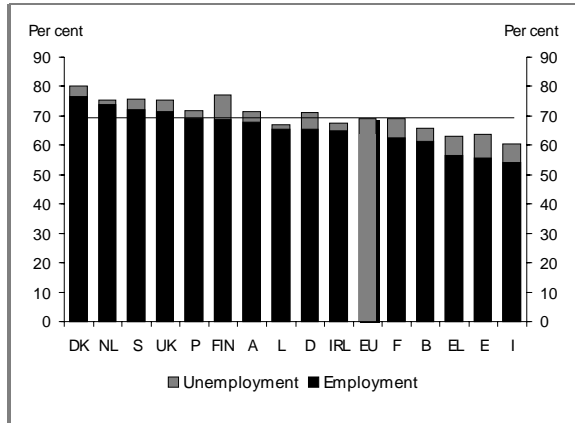
Employment

With respect to labour markets, meeting the agreed objectives requires raising the overall employment rate from an average of 63 per cent today to 70 per cent by 2010, and raising the female employment rate from 51 to 60 per cent by 2010. For older workers an employment target of 50 per cent for the 55-64 year old has been agreed.

Member States, where employment rates have already met the Lisbon targets, have typically set more ambitious national targets exceeding the achievements made so far. The average employment rate was close to 64 per cent in 2001, *cf. figure 2.3a*, although large differences between Member States persist. Several Member States thus already meet the 70 per cent target, while others are substantially short of the target. Achieving an employment rate of 70 per cent in 2010 will require an average increase roughly comparable to the gains realised from 1995 until 2001, but from a substantially higher starting position. As the remain-

ing scope for increasing employment is more limited in Member States with already high employment rates, large improvements are needed in Member States with presently lower employment rates. Also, higher employment must to a larger extent be generated through improvements in the functioning of labour markets as cyclical slack is currently much lower than in the mid 90's .

Figure 2.3a. Employment and participation rates, 2001.¹ **Figure 2.3b. Employment rates of women and older workers, 2001.**



1) Estimated values for 2001, age 15-64 years.
Source: Commission Services, Eurostat.

The unemployment rate has become fairly low in a number of Member States, but remains high or fairly high in seven – mostly large – Member States.

Female employment rates have developed favourably since the mid-1990s. In particular some Member States with relatively low employment rates for women have experienced significant improvement, cf. figure 2.3b and 2.4a. Facilitating a further increase in female employment rates is a key requirement in order to satisfy the overall employment rate objectives.

Figure 2.4a. Employment rates, women.

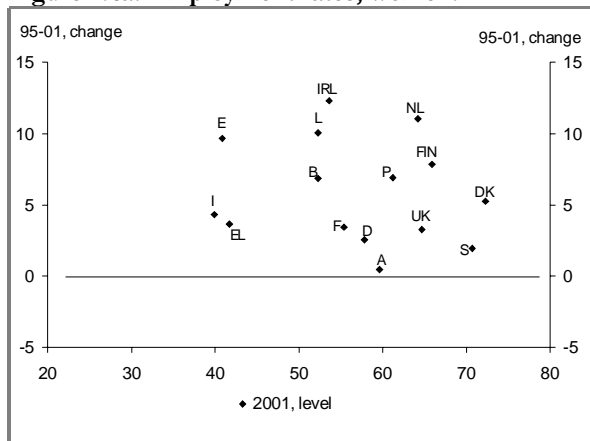
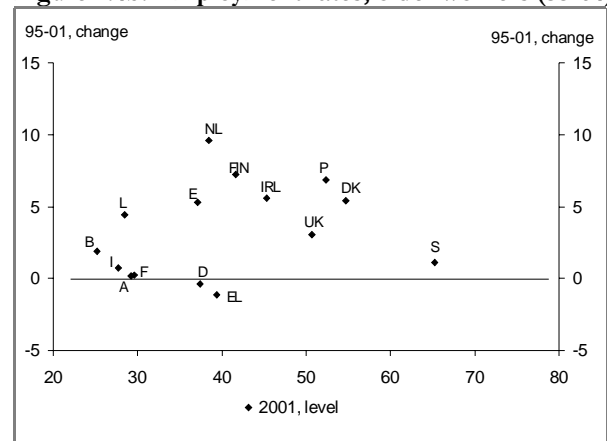


Figure 2.4b. Employment rates, older workers (55-64).



Note: Level and changes are reported in percentage points. Commission forecast for 2001.
Source: Commission Services, Eurostat.

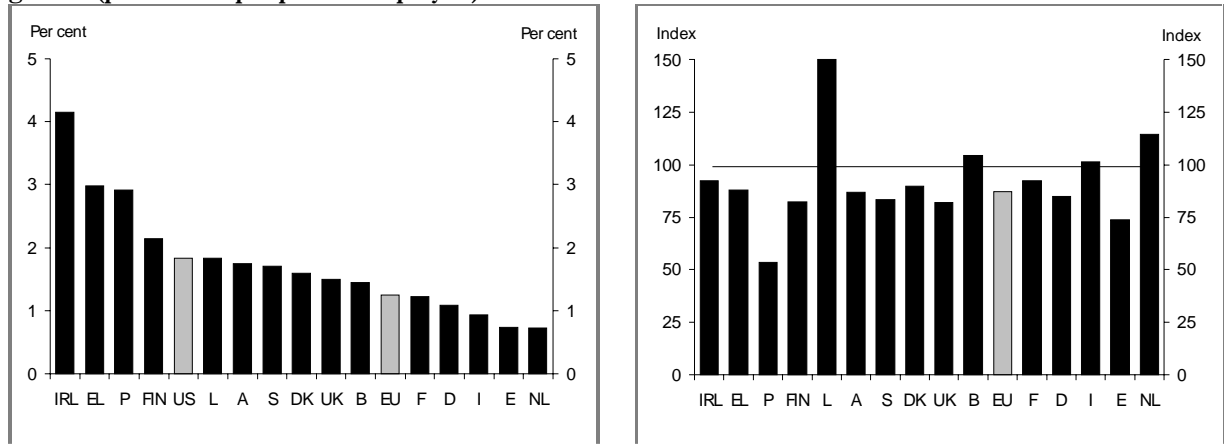
Less progress has been made with respect to the employment of older workers. Average employment rates remain low among the 55-64 year age group. Wide differences between Member States persist, and in a number of Member States the employment rate of older workers is very low. With a few exceptions least progress has been made in those Member

States with the lowest levels currently. The large variation across countries in the employment rates of older workers is only to a modest extent correlated with unemployment conditions. This suggests that employment of older workers, apart from tradition, is determined by incentives in pension and other social security systems, including early retirement schemes, more than health and labour market conditions.

Productivity and living standards

Labour productivity increases have also varied substantially between Member States, *cf.* *figure 2.5.a*. The average rate of increase since 1995 has been of the order of 1-2 per cent per year, but with more rapid increases in a number of, mainly smaller, Member States.

Figure 2.5a. Labour productivity. Average annual growth (production per person employed) 1996-2001¹ **Figure 2.5b. GDP per hour, USA=100, 2001¹**



1) Estimated values for 2001.
Source: Commission Services.

On average, hourly productivity remains generally at 80-90 per cent of the level in the USA, *cf.* *figure 2.5b*. However, in some Member States hourly productivity is higher than in the USA, while it is significantly lower in others, although it should be emphasised that the measurement of productivity is subject to substantial statistical uncertainty.

Relative living standards differ from hourly productivity to the extent that employment rates and hours worked differ. Compared to the USA, the differences in hourly productivity explains only one third of the difference in living standards, while the remaining two thirds are due to – approximately even contributions from – shorter working hours and lower employment rates in the EU area. At present, average EU income per head comprises less than 70 per cent of average US income per head, and this ratio has deteriorated during the last decade.

3. Network industries

3.1. Introduction

Overall the national reports on structural reform are unambiguous: Liberalising network industries and public utilities work. Production is becoming more efficient, prices are lower than they would have been otherwise, consumers face a greater choice of services and quality is improved.³ And there are no signs that universal service obligations are compromised in liberalised markets, or that efficiency is achieved at the cost of increased inequality.

However, the reform agenda is far from complete. Despite the favourable results so far, reforms of network utilities have been relatively few and modest during 2001. This may indicate a slow-down in the willingness to reform, while there appears to be good reasons to speed-up the liberalisation of network industries instead.

On the one hand, a coordinated and faster liberalisation process at the community level is necessary to achieve the objective of a European Single Market. Two key issues must be addressed at the EU-level. First, co-ordinated action is required to maintain the momentum in structural reform in terms of opening network industries to competition in all Member States. Second, common rules – e.g. for cross-border tariffs for electricity – are required to ensure cross-border trade in the services produced in certain network industries.

On the other hand, several markets need to be formally opened to competition at the national level, and additional measures are required to ensure effective competition in markets that have already been liberalised. Member States should be urged to open markets without necessarily requiring parallel action in other countries, as unilateral market opening will generally provide positive benefits to domestic consumers, even if the speed of opening in neighbouring countries is slow. Yet the full benefits of an effective Single Market can only be achieved with coordinated efforts to ensure full market opening in all Member States.

Although reforms of network industries have been successful, some potential challenges will have to be dealt with. For instance, the gains from energy market liberalisation may be threatened by lack of capacity in electricity generation and networks in the medium-term. Some of these challenges are mentioned below.

3.2. Progress of structural reform in main network industries

There have been few major reforms of network industries during 2001. This partly reflects that no deadlines for the implementation of EU-directives expired in the past year. Thus, Member States have generally focused on catching up with transposition backlogs and measures to improve legislation and regulation enacted previously.

Table 3.1 summarizes the initiatives in key network industries during 2001. As few major reforms have taken place, most of the initiatives have a relatively limited scope in terms of liberalisation, which is one of the reservations that must be accounted for when interpret-

³ In some instances consumers have experienced higher prices. However, this phenomenon is explained by factors not related to liberalisation *per se*. The existence of cross-subsidies prior to liberalisation may lead to rebalancing of tariffs to make them more cost reflective. Increased taxation of energy, requirements to purchase energy produced by specific and more expensive technologies for environmental reasons and high oil prices during most of 2000 and 2001 have in some countries led to higher consumer prices of gas and electricity.

ing the table.⁴ However, it clearly appears that most reforms have taken place in energy sectors and to a lesser extent in telecommunications. This reflects to a large degree that the liberalisation of telecommunications has been taking place in all Member States for some years, while the opening of energy markets is more recent. Yet it may be a cause for concern that only few initiatives are reported in other network industries. This is true for the three sectors – postal services, air transport and railways – included in the table, but also other sectors.

Table 3.1. Policy measures in 2001

	Telecommunic.	Energy	Postal Services	Air transport	Railways
Quantitative market opening	B,E,EL,IRL,L	A,EL,IRL,L	P		
Unbundling	F,UK	DK,EL,I,UK	F		
TPA regime	E	D,DK,I,P			
Establishment of TSO		BE			
Other legislation	F	A,B,D,L,P	FIN,I,UK		B,NL
Reduc incumb. market share		B,E,F,I,IRL			DK
Other competitive measures	D,DK,FIN,P,S	FIN,I,UK		E,S	
Establishment of regulator		A,IRL		IRL	
Strengthening of regulator	FIN,EL	(D)			D
Restructuring state company		I,IRL	IRL	IRL	EL,I,IRL
Privatisation	A,EL	EL,I,NL	DK	A,E,EL	

Source: National Cardiff reports, 2001.

Telecommunications

Competition in telecommunications is well-established in most market segments, aided by new technologies that reduce the monopoly position of fixed networks. Yet several Member States report insufficient competition in the local loop and vis-à-vis smaller consumers. This market segment was only recently opened to competition in many Member States. Thus, in Belgium, Greece, Ireland, Luxembourg and Spain the fixed-line local loop was unbundled formally in 2001 in accordance with EU regulation, while new measures in relation to unbundling were introduced in France and the UK. Some countries still have to overcome technical obstacles to make competition firmly rooted.

However, even countries which have had unbundled local loops for a number of years experience lack of competition. To address this, Denmark and Sweden introduced measures to promote number portability, while firmer regulation of the network owner's access charges was introduced in Germany. The telecoms regulator was reformed and strengthened in Finland and Greece, and reforms are underway in Belgium, Ireland and Portugal.

A Commission survey has revealed some consumer dissatisfaction with quality and prices, which may be due to a perception that telecoms operators are “cheating”. Several Member States raise this point and underline the need for regulators to contribute to transparency, e.g. by publishing price comparison, setting principles for the layout of consumer bills etc. While such initiatives might be helpful, it must be acknowledged that the reduction of

⁴ The table is only intended to give rough indications. First, it contains initiatives initiated, implementation of past decision as well as decisions taken in 2001 that will only have effect later. Second, it refers to new initiatives, but does not account for the point of departure, i.e. a lack of initiatives may indicate that there is no need. Third, the importance of initiatives may differ significantly.

transparency is a reflection of the greater choice of services that are offered in telecoms. Thus, consumers face the same transparency problems in other markets, e.g. banking services.

Privatisation of telecommunications companies has been modest in 2001, partly due to capital market developments for IT-stocks. Austria partly privatised the state company in the autumn of 2000, and Greece sold a share of 10 per cent in 2001, reducing state ownership to 41 per cent.

Energy – electricity and natural gas

At the end of 2001, the current electricity and gas directives were transposed correctly into the national legislation of most Member States. During 2001, Belgium and Germany amended the gas legislation in response to infringement procedures, and Luxembourg transposed the gas directive. France has still not transposed the gas directive and the case was referred to the European Court of Justice in May 2001. However, temporary measures corresponding to the directive's requirements have been introduced until legislation is finalised.

In 2001 the quantitative market opening was increased in several Member States, and some opted for new deadlines that should lead to faster full liberalisation. Austria's electricity market was fully liberalised. Greece officially initiated a gradual market opening, but the incumbent dominates and new entrants are not expected before 2004-05. Ireland enacted new legislation that provides for full market opening in 2005. Luxembourg increased market opening to 57 per cent. Wholesale electricity trade was fully liberalised in the Netherlands, and full market opening is aimed for in 2004.

While Finland's geographical location prevents competition in the import of gas, new legislation allows for the establishment of a secondary market. Full opening of gas markets will take place in 2002 in Austria and possibly Greece, while the Danish government has announced full market opening in 2004. Ireland has proposed to open the gas market more, but 50 per cent of transport capacity is already used by competitors to the incumbent.

Most Member States have determined or at least announced targets for the complete opening of electricity and gas markets. The exceptions are France in gas and electricity and Greece, Italy and Portugal in electricity, while Finland, Greece and Portugal have derogations with respect to gas market opening. In some Member States, full liberalisation is moreover only expected in the medium term. As delays in market opening imply that the full benefits of a Single Market for energy services cannot be achieved, it would be preferable if an agreement could be reached on a coordinated and faster path towards competitive markets. The Commission's proposal for amendments to the electricity and gas directives from March 2001 provides an appropriate basis for obtaining political agreement in this respect.

Similarly, the Commission's proposals for strengthening the qualitative aspects of market opening should be seriously considered. This includes the potential problems associated with the use of negotiated, as opposed to regulated, access as this may constitute a barrier to entry. Also, stronger rules for unbundling network activities might be needed to avoid the risk of cross-subsidies and other non-competitive practices of vertically integrated utilities.

Regulated access to transmission and legal unbundling were in 2001 introduced into Denmark's revised gas legislation, and in Italy a new company was formed for the gas infrastructure, but it is still related to the incumbent. Greece amended gas market legislation, implying unbundling and a proposal for a new tariff structure. In the UK, stronger unbundling was introduced in electricity. Thus, the same legal person can no longer hold licenses for both electricity supply and electricity distribution.

A new energy regulator was established in Austria in 2001 and is proposed in Ireland. Germany allocated more resources to the competition authorities dealing with discriminatory behaviour in the electricity sector. In Belgium and Spain a technical manager of the transport system (TSO) was appointed in 2001, although measures to achieve full compliance with the EU directive, e.g. independence of the TSO, have not yet been implemented. Austria awarded licences to two settlement agencies in charge of handling transactions and pricing of balancing energy.

Besides adapting the legal framework for energy markets, several countries implemented measures to make competition more effective. The UK established a new wholesale trading arrangement in electricity in 2001. The arrangement replaced the existing pool and is based on bilateral contracts, thereby introducing genuine competition. A review after three months showed that the new arrangement had led to lower prices and higher liquidity. Although somewhat delayed, Italy expects to establish a "Single Buyer" of electricity charged with acquiring electricity at the lowest costs for those customers without market access.

To reduce the market share of the incumbent in electricity generation, the French incumbent had to sell 6 per cent of capacity for a merger transaction to be authorised by the European Commission. Ireland has carried out virtual independent power producer auctions, which function as a substitute until new power plants are coming on-stream. In Italy, three electricity generation companies that were demerged from the incumbent are about to be sold. To strengthen cross-border trade, Belgium and France have established auctions over import/export electricity capacity. In Spain, an auction covering 25 per cent of Algerian gas imports was held in 2001.

In a majority of Member States measures have been taken or are under consideration to promote electricity production based on, e.g., renewable energy sources and small-scale CHP (combined heat and power). In several cases the establishment of these types of alternative generation capacity has been fully liberalised.

Privatisations have been limited in the energy sector. Greece has made a public offering of the incumbent electricity company and is preparing the sale of the gas company. Bills governing privatisation of, or restructuring state-owned, energy companies are under debate in Ireland and the Netherlands. Italy has privatised part of the electricity incumbent, but imposed certain restrictions on ownership, cf. below, and plan to make further privatisations in the energy sector.

While liberalisation of energy markets has led to immediate gains, one crucial challenge lies ahead. It remains to be seen if and how liberalised markets can supply sufficient investment in new capacity, be it generation capacity in electricity or networks in electricity and gas. The risk of capacity constraints is apparently largest in electricity generation. Moreover, facilitated by inadequate national regulation, the marginal capacity is often only used inefficiently to meet peak demand for short periods during the year, which may not provide sufficient investment incentives. In California lack of capacity was one explanation for the

extreme peak prices, but also in other liberalised markets such as the Nordic region extreme prices have been observed for brief periods. Similarly, there are examples that privatised network companies – e.g. the British rail and gas infrastructure companies – seemingly have under-invested in new capacity and maintenance of existing networks.

In the long term, high prices should lead to investment in new capacity, but capacity constraints may exist for prolonged time periods. This is partly due to the long time it takes for an investment project to come on-stream, which in some cases may span a decade. While the problem is easily identified, it is likely to be more difficult to solve. One obvious solution would be to introduce measures that could reduce the difference between peak and average demand. This requires that price variations are transmitted to end-users that can then act by reducing demand when prices are high. However, today the available technology needed is too expensive to be economical for especially smaller consumers, but technological development may make this a viable option in the future. Meanwhile, Member States should monitor the development of capacity investment carefully, and situations might occur where direct public intervention is necessary for a successful outcome.

Moreover, it should be noted that several Member States are expecting increased investment as a consequence of liberalisation. Belgium and France foresee investment in new electricity generation. In Italy new legislation has simplified the requirements for installation of electricity generation capacity.

Postal services

In December 2001, the Council adopted a common position on the future liberalisation of postal services. Today the reserved area is defined by weight and price limits of 350 gr./5 times the basic tariff. These are intended to be reduced to 100 gr./3 times the basic tariff in 2003 and 50 gr./2.5 times the basic tariff in 2006. While agreement on a path towards liberalisation is a step in the right direction, the speed is not impressive and it would have been preferable with a deadline for the full opening of postal markets.

In Sweden and Finland postal services have been fully liberalised for a number of years and are functioning well. In both countries, the incumbent still dominates the market and effective competition is primarily taking place in certain niches, i.e. specific types of services and in densely populated areas around the larger cities. In Finland one operating license has been granted to a private operator, which has not yet started postal operations. Interestingly, the Swedish and Finnish incumbents have been able to meet all public service obligations without requiring compensation from either state or competitors. In Spain, local mail, for instance inside the Madrid area, but not between cities, and direct advertising services have also been liberalised.

While Member States generally report that competition in non-restricted areas is functioning, relatively little was done in the restricted area during 2001. At the end of 2000, Luxembourg transposed the existing postal directive, and a new access regime for mail operation came into effect in Portugal during 2001. The French government has submitted a bill that will require the minister to create conditions for effective competition. In the UK, as a first, albeit small, step in the direction of liberalisation the statutory monopoly of the Consignia was replaced by a licensing system, and five interim licenses for specific postal services were issued.

Ireland published legislation in 2001 permitting private equity investment in the postal company, and the Danish government intends to privatise its postal company.

Air transport

The current downturn in the airline industry – worsened, but not caused by the terrorist attacks on 11 September 2001 – has clearly revealed significant structural weaknesses of the traditional European flag carriers. Having until now survived partly due to direct or indirect state aid as well as a traditional system of regulation through bilateral air transport agreements, they are now under large pressure from low cost carriers to implement structural reforms and cost cutting. This is likely to benefit consumers in the medium-term, but further policy measures are likely to be needed to achieve all potential benefits. For instance, concerns have been expressed that the current regulatory framework based on bilateral air transport agreements prevents an appropriate consolidation of the European airline industry.

Few and seemingly minor changes in air transport regulation have taken place in 2001. Ireland established a new Commission for aviation regulation, and required reduction in airport charges. In many Member States competition is very limited on domestic flights. In Sweden this was in 2001 addressed by a ruling of the authorities, preventing points earned on the dominant airline's frequent flyer programme from being used on domestic routes subject to competition. A similar measure has been considered in Denmark, but does not appear to be implemented. Spain introduced new regulation of slot allocation rules supposed to increase competition in 2001. The Commission is considering a new proposal for market-based allocation of airport slots, which could provide new impetus to competition.

Austria privatised Vienna Airport late 2000, and Ireland is giving consideration to the involvement of the private sector in the ownership of the State-owned airport company. The Spanish flag carrier was floated on the stock market in 2001, and Greece is considering reorganising Olympic Air as part of a privatisation plan.

Railways

Progress in the liberalisation of railways has been limited. Freight transport has been fully liberalised in several Member States, for instance in Italy in 2001. Moreover, Community regulation requires that international freight transport be opened for competition in 2003. Less is happening in passenger transport, although systems of licenses for local/regional railways have been in place in, e.g., Germany, the Netherlands, Portugal, Sweden and the UK for a number of years. In 2001, Denmark awarded the first license to a private operator, which will take over 15 per cent of passenger transport in 2003.

Belgium is currently preparing a reform of railways, including a revision of the legal framework governing the relationship between the state and the railway company. In Germany, a draft law was presented in 2001 which if enacted will strengthen supervision of competition in railways and give the regulator a more proactive role. Moreover, a task force has recommended that a more transparent relationship between the operating and network division of the national railway company be established. However, it is also recommended that the network division should not be demerged from the operating company. Correspondingly, an Irish report recommended, due to the scale of the country's railways, that the railway activities of the existing national transport company should not be placed in a separate railway company. By contrast, Italy established a separate infrastructure company in 2001.

Based on the national reports it appears that Member States are pursuing different models for railway liberalisation. The key question is if networks should remain as part of the in-

cumbent company – as in telecommunications – or unbundled into a separate company – the model chosen in energy markets in many Member States. Both models seem to be associated with problems, as illustrated by a general dissatisfaction with railway services, and the mixed experience with liberalisation in, e.g., the Netherlands, Sweden and the UK. This suggests that further analyses could be useful. One important topic is whether economies of scope are so strong that unbundling the network from service operations yields inherent unsatisfactory outcomes, at least with current paradigms for which services that are allocated to the network company.

Belgium, Germany and the UK have published plans for large-scale investment in rail infrastructure. PPPs are expected to be a central vehicle to provide for investment in railway infrastructure in some Member States, including Portugal.

3.3. Horizontal issues

Regulatory authorities – need to be strong

Gradually regulatory authorities are being adapted to the challenges of liberalised markets. This trend can be found in all Member States and all recently liberalised network industries, although progress varies considerably. First, the responsibilities of regulators are being extended and clarified. Second, the powers to enforce legislation are being strengthened. Third, more resources are allocated to regulators, although there are remarkable differences between countries.⁵ Fourth, the existing regulators are often merged into fewer regulatory bodies to correspond with market developments. E.g., regulators are being established for the entire communications and energy markets, respectively.

Most Member States have opted for sector-specific and independent regulators. There are a few important exceptions, however. Germany, for instance, has not established an energy regulator. Instead regulation of network access etc. is governed by Association Agreements, while public interests are to be handled under the general competition laws. In principle, the prohibition of cartels and abuse of dominant position encompassed in general competition legislation could be sufficient. Yet the inherent natural monopoly characteristic of networks has led to the establishment of sector-specific regulation and regulators in most countries. Independently of the regulatory set-up, some elements seem to be essential to ensure effectively competition. First, continuous monitoring and supervision of access tariffs and conditions is likely to be required. Second, extended powers to interfere fast and effectively in response to uncompetitive practices are likely to be advantageous. Third, lengthy procedures to settle claims of non-competitive practices will discourage potential new entrants and have to be avoided.

Dominant incumbents – the need for a Single Market

A common characteristic in most network industries and countries is that the incumbent, i.e. the company that prior to liberalisation had a national or regional monopoly, maintains a very dominant market position. This is particularly true in the retail segment.

⁵ For instance, the Greek energy regulator employs 10 persons and the Finnish 15. By contrast, the British employs a staff of 340 and the Swedish 165, cf. Commission Working Paper: *First report in the implementation of the internal electricity and gas market*, SEC(2001) 1957. Some of these differences can be explained by country-size, the degree of liberalisation etc. But it also seems as if countries that liberalised early and are more committed to liberalisation devote more resources to the regulator. While it should be avoided increasing the staff unnecessarily, these figures suggest that some Member States have found a significant strengthening of regulators necessary to ensure effective competition.

A large market share can be a sign of lack of competition and must be addressed by monitoring and assessment of the functioning of markets. Yet it must also be recognised that there are significant economies of scale, also in market segments without inherent natural monopoly characteristics such as networks. Thus, retailing is characterised by high fixed costs in the form of marketing, development of IT-systems etc.⁶ For especially smaller Member States this implies that national markets can only support few competitors, if they are to be cost effective. When considering measures to reduce dominant market share at the national level, the benefits of increased competition must therefore be weighted against the potential loss of economies of scale.

This highlights clearly why the objective of a Single Market should be pursued vigorously also in network industries. By eliminating national borders for trade in network industries, a market large enough to support enough companies for effective competition can be established. National efforts to liberalise network industries should therefore be complemented by coordinated measures at the EU-level in areas such as cross-border infrastructure and tariffication of cross-border trade in electricity. Cross-border infrastructure – e.g. gas pipeline and electricity grids – must be extended to eliminate current capacity constraints. This requires that Member States set the right incentives for relevant industries to invest in pipelines, grids and generation capacity. Concerning tariffication of cross-border trade in electricity a common framework must be established as the current the lack of a common framework appears to be a significant barrier to the free flow of services. Finally, it must also be considered if the principles for setting tariffs for gas transport in individual Member States need to be made more compatible in order to support the establishment of a Single Market.

Public ownership in open markets – cause for latent conflicts

Most Member States still have significant direct economic interests in companies in the newly liberalised network industries. Yet some have embarked on extensive privatisation programmes as markets are being opened, while others have been much more reluctant to reduce public ownership. However, it is necessary to monitor and consider the extent to which continued public ownership can be consistent with well-functioning, liberalised markets.

First, a conflict may arise as governments become responsible for the functioning of markets, while owning one or more competing firms. This conflict might be alleviated, however, through the separation of regulatory and ownership roles via, e.g., independence of the regulatory authority. Similarly, when liberalisation takes the form of public tendering, government can end up being both bidder through the state-owned company and responsible for selecting the winning bid. There is a risk that this will lead to accusations of government granting favours to the public companies, which may lead to public distrust in the market. Moreover, continued public ownership may prove harder to justify if the market is well functioning as this implies that private firms compete and deliver services just as well as the public companies. And in most network industries a liberalised and well-functioning market can be found in at least one Member State.

Second, lack of privatisation – combined with limited liberalisation – in some Member States has proven to increase public objections to liberalisation in other Member States. Thus, it is perceived to be unfair that some state-owned companies in the energy sector apparently use monopoly profits from domestic markets to purchase utilities in other

⁶ While estimates differ, evidence suggests that energy companies engaged in retail sales should have at least ½ million (some estimates indicate several millions) customers to be cost effective.

countries. Italy has, e.g., responded by introducing limits to voting powers and foreign ownership. This may lead to a variety of problems. Consumers facing domestic state-owned monopolies may end up paying too high prices. Italian consumers lose because restrictions on ownership rights may prevent optimal trades of stakes in utilities and lead to lower prices for the assets that are sold. And consumers across Europe loose if progress towards an effective Single Market is slowed down.

4. Ageing, pensions and fiscal sustainability

The Gothenburg European Council noted that a comprehensive approach is needed to meet the challenges of an ageing society and endorsed three broad principles: safeguarding the capacity of systems to meet social objectives, maintaining financial sustainability and meeting changing social needs.

With respect to the objective of financial sustainability, Member States face substantial long-term budgetary pressures due to population changes. The Ageing Working Group of the EPC⁷ (AWG) analysed these budgetary pressures on the basis of policies in place or legislated in mid 2000, the time the study was launched. As documented by the AWG, the average projected increase in pension and other old-age benefit outlays is approximately 3 per cent of GDP on a pre-tax basis from 2000 until 2050.

However, this masks substantial variation across Member States, *cf. table 4.1*. Thus, in the UK, pension spending is expected to be almost unchanged, while in Greece, the projected increase amounts to 12 per cent of GDP. The numerical results of the projection exercise must be interpreted with some caution as full standardisation is not ensured in terms of, e.g., the expenditures included and the impact on net tax receipts. The projections are part of an ongoing analysis which will be further developed and harmonized in the coming years in order to ensure comprehensiveness and facilitate comparability.

The differences between Member States are accounted for by a number of factors, including differences in the demographic outlook, eligibility rules, benefit levels as well as the underlying development in labour market participation and unemployment.

The AWG projections indicate that spending on health care is likely to increase by, for the average Member State, approximately 2 per cent of GDP until 2050, thus implying total demographic pressure on the public expenditure side slightly in excess of 5 per cent of GDP.

The long-term fiscal outlook implied by population ageing is quite sensitive to, e.g., the future development of labour force participation and employment rates. In many Member States, the substantial scope for increasing employment rates has been included in the projections, but will require additional measures to reduce the structural rate of unemployment and increase the effective retirement age. Moreover, even the full realization of the ambitious Lisbon targets concerning growth and employment combined with a more favourable demographic scenario, is likely to reduce budgetary pressure by no more than 1,5 per cent of GDP on average, i.e. to about 4 per cent of GDP.

This underscores the need for continuing and accelerating the process of fiscal consolidation. In addition several Member States should pursue the implementation of comprehensive reforms aimed at containing the costs of pension benefit and health care programmes and providing stronger incentives for elderly workers to remain in employment.

Public pension systems may be divided into two broad categories: those providing a basic income and those where pensions are related to past earnings, while at the same time preserving a minimum pension.

⁷ "Budgetary challenges posed by ageing populations", Economic Policy Committee, October 2001.

Flat rate pension systems are mainly found in Denmark, Ireland, the Netherlands and the UK. The other Member States have earnings related systems, but with very different features and generosity. This diversity explains the difference in acuity of the pension reform debates and the greater or lesser recourse on pre-funding by the general budget.

Table 4.1 provides an indicative overview of steps taken in recent years in Member States to address the public expenditure increases related to ageing by reforming pensions, increasing the incentive for later retirement and pre-funding spending through the build-up of public funds or government debt reduction.

Table 4.1 Reforms of first pillar pension systems in EU Member States.

	Peak change in pension expenditure ¹⁾	Pension reform (budget impact) ²⁾	Reforms of early retirement schemes ³⁾	Prefunding ⁴⁾
B	3,7	Partial	Partial	Moderate
DK	4,1	None	Partial	Substantial
D	5,0	Partial	Partial	Little
EL	11,2	Partial (exp. 2002)	None	Moderate
E	7,9	Partial	Partial	Moderate
F	4,0	None	Partial	Little
IRL	4,4	None	None	Substantial
I	2,1	Comprehensive (exp. 2002)	Partial	Moderate
L	2,2	Partial	Partial	Substantial
NL	6,2	None	Partial	Moderate
A	4,2	Partial	Partial	Moderate
P	4,1	Partial	None	Little
FIN	4,7	Partial	Partial	Substantial
S	2,6	Comprehensive	Partial	Substantial
UK	-1,1	Comprehensive	None	Moderate

Source:

"Budgetary challenges posed by ageing populations", Economic Policy Committee, October 2001 and the European Commission.

Notes:

- 1) Per cent of GDP. No account is taken of future changes in tax revenue. In some Member States (including DK and NL), maturing 2nd and 3rd pillar systems are expected to generate substantial revenue – previously paid for through a loss of tax revenue from deductible contributions – associated with income taxable pension benefits, thus to some extent offsetting the increase in spending.
- 2) Reforms characterized as "comprehensive" involve large reductions in the future expenditure increase through, e.g., the adjustment of benefits for changes in life expectancy or substantially reducing indexation of benefits compared to wages. "Partial" reforms involve, e.g., increasing the statutory retirement age, the introduction of a stronger actuarial relationship between the retirement age and pension benefits or small reductions of indexation compared to wages.
- 3) E.g. phasing out of schemes or increasing the actuarial relationship individual retirement age and early retirement benefits.
- 4) Through substantial build-up of separate public pension funds or government debt reduction.

Two Member States (I and S) have prepared or completed comprehensive reforms aimed at substantially alleviating the fiscal burden associated with population ageing. The final decision of fully implementing the reform in Italy has not yet been taken, and in this Member State the reform will be phased in over a very long period. A key element in these reforms involves moving the pay-as-you-go pension system towards an actuarial basis, where individual (basic) pension benefits are calculated taking into account life expectancy. Ac-

cordingly, further increases in life expectancy will not like previous systems increase the overall pensions received compared to contributions made, thereby neutralising the financial effects for individuals and government.

In the UK most public pension benefits are price indexed. Given present demographic projections this broadly, with respect to public pension expenditures and replacement rates, effectually compares to adjusting pensions according to increased life expectancy.

Only one Member State (A) with defined benefit systems has recently increased the statutory retirement age, although the impact on the average age of retirement – and hence the fiscal consequences of ageing – may be limited. A few Member States (E, I) have increased the required contribution period or raised the participation requirement for earnings-related pension benefits. In Germany, the retirement age was raised in 1989 with a long phase-in, which is still on-going.

In Germany the pension reform of 2001 is a substantial systemic change bringing the pension formula for the statutory scheme better in line with demographic developments, implying a slight reduction of the replacement rate in the long run, while strengthening the in practice voluntary funded occupational system, and introducing a private pillar scheme benefiting from substantial subsidies. The budgetary effect is likely to imply a modest net reduction of future expenditure increases associated with ageing. A legally binding commitment has been given to act if the mandatory contribution rate is to increase beyond 20/22 per cent in 2020 and 2030 respectively (presently 19 per cent), the nature and budgetary effects of which is not decided. The 2001 reform also applies to the civil service pensions scheme, thus contributing to reducing the expected future expenditure increases.

A number of other countries (including A, EL, FIN and NL) are currently discussing pension reforms, typically following lengthy consultation with social partners. Also, a long implementation phase is often envisioned. However, timely reform is essential in order to exploit the opportunity provided by the relatively low – and in some cases even decreasing – demographic pressure over the next 5-10 years.

Some Member States (B, E, F, IRL, NL and P) have recently launched pre-funding schemes that aim at accumulating reserves that may be used to partly cover the future increases in government pension spending. Compared to the extent of future spending increases, the build-up of assets is typically quite modest, however large in the case of Ireland.

Box 4.1. The effects of different pension indexation rules.

A key role is played by the indexation rule applied to pension benefits after retirement. The effects of price indexation compared to wage indexation differ substantially between pensions in flat rate versus earnings related defined benefit systems. In four Member States (DK, IRL, NL and UK), basic public pension benefits are determined as a flat-rate income, whereas in remaining Member States public benefits are largely earnings related.

In flat rate systems, price indexation of pensions implies lower pension increases – compared to wage indexation – and lower replacement rates in the long run, thereby also substantially alleviating public expenditure increases.

In Member States with earnings related pensions, the reference wage used generally increases along with the general wage level thus providing an unchanged replacement rate over time for new pensioners. A reduction in indexation – applied either to pensions or previous earnings – will contribute to containing pension expenditures. Portugal and Spain has recently reduced the indexation of previous earnings, thus moderating the increase in pension expenditures.

After the point of retirement pensions in the earnings related systems are indexed according to different rules, in a number of cases (E, I and L) according to consumer prices. Compared to wage indexation this alleviates the increase in pension expenditures somewhat, but does not imply systematic changes over time in expenditure ratios. However in the case of increasing life expectancy the future public expenditure increases will be slightly more effectively contained in the case of price indexation compared to wage indexation of pensions after the point of retirement.

Another difference between flat rate and earnings related systems is that, other things being equal, the impact of ageing on government expenditures is somewhat more modest in flat-rate schemes because pension benefit rights do not automatically increase along with, e.g., labour force participation or employment.

Initiatives along these lines are equivalent to a general policy of fiscal consolidation and debt reduction through sustained budget surpluses. Ireland has pursued this strategy successfully, which has led to very substantial debt reduction. In four Member States (DK, FIN, L and S), the structural government surplus already exceeded 1,5 pct. of GDP in 2001, thus contributing substantially to lower public debt. However, on average, the structural budget balance in EU Member States was –1 pct. of GDP in 2001. This highlights the need to accelerate and sustain the fiscal consolidation process during the next several years.

Some Member States (including B and P) have increased pension generosity, partly in combination with other reform initiatives. In Finland and Germany, the rules regarding accrual of pension rights have been modified for certain groups (including women in part-time or out of employment). These efforts tend to increase the long-term pressure on government finances implied by population ageing, although the importance is likely to be small.

A substantial number of Member States (A, D, DK, F, FIN, I, NL, S and L) have attempted to establish a closer actuarial link between the age of retirement and individual pension or early retirement benefits. The changes imply that – at the margin – individuals to a higher degree will bear the cost associated with their early retirement decision, thus providing a stronger incentive to labour force participation among older workers. The effects are still to be assessed, but are generally likely to be modest.

The budgetary consequences of the steps taken to promote later retirement are not unambiguous, however, as the increased actuarial element is often introduced along with more

flexible rules with respect to the timing of retirement, or higher pension or other benefits, for those who remain longer on the labour market. Efforts in assessing the importance of these measures compared to the expected overall expenditure increases in ageing related expenditures are so far limited and needs to be speeded up.

Second and third pillar pension systems are being expanded in several Member States, especially those where public pensions are or are getting less generous, partly through agreements between social partners. In addition to the improved opportunities for retirement savings offered to households, this development may also – through, e.g., investment in equity markets – contribute to more efficient and liquid capital markets, provided a sound regulatory regime is in place.

Second and third pillar systems have generally been introduced as supplements to existing, tax-financed pension schemes. There is accordingly no direct reduction in the fiscal impact of ageing, but the growth of supplementary pensions may partly offset future demands for more generous, tax-financed pension or other social benefits.⁸ However, second and third pillar systems may also adversely influence the retirement decision, although the likely scale of this effect is difficult to estimate. The development of second pillar systems may also to some extent increase the cost of labour in the short term.

In some Member States, additional fiscal incentives – in the form of preferential tax treatment or subsidies – to second and third pillar systems (B, D, E, I, NL and the UK) have been introduced or expanded. These efforts will promote the accumulation of private pension assets, but could also imply deadweight costs and, through the diversion of assets into tax-favoured or subsidised forms, lead to a negative long-run influence on the government budget balance. The overall consequences of such incentive schemes for fiscal sustainability are therefore uncertain. The benefits and costs of tax and other fiscal incentives for 2nd and 3rd pillar systems will be further analysed and assessed by the AWG.

A few Member States (A, D and FIN) have taken steps towards aligning (typically more generous) pension benefit rules for government employees with those prevailing in the private sector, thus facilitating a more transparent old-age income support system and eliminating preferential treatment of public sector employees.

⁸ Future income tax receipts in some Member States, where significant private pension assets have already been built up through tax-deductible contributions, will increase due to the taxation of pension benefits. This represents an effect of postponed taxes as the historical annual loss of tax revenue from net payments to private pension systems gradually shifts to balance or net payments from these systems.

5. Market-based instruments to protect the environment

As in other areas, it is important that measures to help protect the environment are well designed. It is therefore essential that policy development is informed by a systematic analysis of costs and benefits so that these can be weighed against each other.

The use of market-based instruments has gained increased importance throughout the years, but only on a very gradual basis. The more traditional command-and-control measures still seem to be the dominating methods to regulate the effects of economic activity on environment in many Member States and in most Community legislation.

Two purposes drive the growing interest of market-based instruments such as environmental taxes:

- There is an increasing awareness that market-based instruments can lead to a more efficient allocation of the costs needed to reach agreed environmental targets compared to traditional command-and-control measures.
- The revenues generated by environmental taxes can be used to reduce other taxes, e.g. as part of a more general “green tax reform” where taxes on labour and corporate profits are reduced at the same time.

The market-based instruments mainly used are taxes on products and user charges on water and waste. Tradable emission permits are used very scarcely by only a few Member States – and then only for some quite specific fields. Yet various Member States report that they are about to examine the possibilities of introducing such schemes.

The following description covers the use of market-based instruments in three environmental fields:

- Climate change and energy use
- Water supply, water quality and waste water
- Solid waste and products

5.1. Climate change and energy use

Most targets for the reduction of CO₂-emissions have been set in order to reach the commitments in the Kyoto Protocol and the subsequent burden-sharing agreement among the EU countries. The Member States have each set up a strategy comprising a range of political measures to reach this objective as well as other targets related to energy use. The various types of instruments used are often mixed in a way that complicates a thorough assessment of the environmental and economic effects of each instrument. It would be appropriate, if the strategies chosen included some intermediate targets, whereupon it can be evaluated whether the mix of instruments chosen has a reasonable cost-efficiency.

Two main tendencies show up when observing the use of market-based instruments in this field. First, the use of economic instruments to reduce CO₂-emissions, energy use and improve air quality by reduction of SO₂ and NO_x-emissions is more widespread in the transport sector than in other sectors such as manufacturing and agriculture. Second, taxation of energy consumption by households is applied much more effectively than taxation of energy use by the business sector.

All Member States use some kind of vehicle taxation – as a registration tax and/or an annual tax on car ownership – but there are rather large variations in level and structure. A few Member States have altered their vehicle taxation schemes to give a larger premium to purchasers/owners of vehicles with less energy use (apart from a general tendency to tax heavier vehicles more than light etc.). For example, Denmark has introduced a much lower registration tax on vehicles running more than 40 km per litre. And Austria, Denmark, Germany, Luxembourg and the UK use various differentiated schemes for the annual ownership tax that result in lower taxes on cars with higher energy efficiency.

Fuels for vehicles are taxed in all Member States, albeit at very different levels. In general, gasoline is taxed at a higher level than diesel, the UK being the only exception to this rule. In some Member States – mainly the Northern countries (except the UK) – the tax differences between gasoline and diesel are quite remarkable with almost a double tax level on gasoline compared to diesel. On one hand, diesel results in relatively larger emissions of different compounds with negative, local environmental effects (NO_x, VOC, particles). On the other hand, CO₂ emissions – and hence the impact on global environmental problems – are lower than for petrol. In addition, in some Member States there is a rebate on diesel use for road haulage, thereby enlarging the effective difference in taxation, at least for some purposes, although in some cases this is partly offset by, e.g., higher registration taxes applicable to diesel vehicles. The UK and Sweden have been the first EU countries to introduce low sulphur diesels. In 2001, Belgium, Germany, Ireland and the Netherlands implemented differentiated fuel excise taxes in favour of low sulphur fuels.

Most Member States tax energy use in households. Not only the level, but also the structure of taxation differs much. Some Member States operate with a more general CO₂-tax in combination with separate energy taxes on the various fuels. Denmark, Finland, Italy, the Netherlands and Sweden have introduced special CO₂-taxes, where the taxation of various fuels in principle is proportional to the inherent CO₂-generation in the fuels.

Various Member States report that the possibilities of raising fuel taxes seem to depend on the development of the price of crude oil, which at various times has shown markedly variations.

In most Member States the use of electricity is taxed – the exceptions being Greece, Ireland and Luxembourg. The tax levels differ markedly. Presumably, this can be explained partly by the large differences in the use of nuclear power and hydraulic power among Member States. Furthermore, it differs in what way the use of electricity is taxed: a tax directed on the final consumption of electricity or various taxes on the fuels used for the generation of electricity. The mix of taxation has some impact on the efficiency whereby the taxes lead to less emission of CO₂ and other substances with environmental effects.

In general, it is not clear how the various kinds of taxation interfere – for example whether there is a rationale behind the overall level of energy taxation and CO₂-taxes on various fuel products. In some Member States, the energy tax rate is calculated according to energy content of the fuels (e.g. Belgium), but this seems not in general to be the case.

There is a broad tendency to either exempt or relieve the taxation on energy intensive business sectors. Thereby the main advantage by using economic instruments to get a cost-effective reduction of emissions is lost. For example, in some Member States where house-

hold consumption of energy is taxed at one level, there is a general tax rebate on energy used for commercial purposes.

In general there seems to be much concern about the effects of the taxes on business competitiveness. The Member States that were the first to implement an overall CO₂-tax have taken the competitive pressure into consideration when confronting the task of designing their CO₂-tax system. The result is a tax system whereby energy-intensive sectors are either exempted or get rebates.

Finland was the first country to introduce a CO₂-tax as a form of general energy taxation (in 1990). Initially, the system had very few reliefs and exemptions. The system gradually came under pressure due to the effects on the competitiveness of energy-intensive industries and electricity generators, to some extent because other Member States did not follow up with similar measures. Therefore the system was altered in 1997 when the CO₂-tax was replaced by taxation of electricity consumption, supplemented by a ceiling system for energy intensive enterprises. It is not even certain, however, that it is rational for a country to include tax exemptions or reliefs for energy-intensive sectors, even though there seems to be an immediate competitive advantage. Confronted with binding national CO₂-emission reduction targets, such special treatments inevitably implicate that stronger reductions would be required in others sectors – and inevitably in places where reductions would be more costly to achieve. This is the drawback of not having a cost-effective reduction policy.

Certainly, it would be more cost-efficient for the entire EU, if energy-intensive sectors were taxed at a level more in line with the tax rates levied on other. Progress in this field requires a coordinated effort among Member States. It could thus be facilitated by common action at the Community level agreeing on minimum levels for the taxation of CO₂-emissions as well as common rules regarding phase-out of exemptions. An alternative to this could be implementation of an ambitious emissions trading scheme at the European level, as proposed by the Commission in 2001.

In some Member States increases in CO₂ and energy taxation have been part of “green tax reforms”, where (some of) the revenue from the increase in green taxes has been returned to the private sector as part of an overall package. Denmark, Germany, the Netherlands, Sweden and the UK have made such arrangements in the last decade. The increase in green tax revenue has been returned mainly in the form of lower taxes on labour income or lower social contribution rates, thereby giving a positive contribution to the employment stance of the economy. The overall effect of these initiatives is however difficult to assess, as they have been implemented as part of a larger package with other measures: Subsidies for investments in energy-saving equipment, voluntary agreements on energy conservation with the business sector in change for tax exemptions or rebates, and so forth.

Tradable emission permits are especially well suited in the case of greenhouse gas emissions because of the global nature of the problem: The environmental effect per unit of greenhouse gas emitted is independent of the site of emission.

Denmark has introduced an emissions trading system for CO₂-emissions used by power plants for electricity generation. The UK has planned to introduce a greenhouse gas emissions trading scheme, which will be voluntary for all kind of companies in the economy to step into. Other Member States are actively examining the possibilities of introducing tradable CO₂-emission permits schemes (Germany, the Netherlands and Sweden).

Deregulation or liberalisation of the energy sector can have some implications for the overall use of energy and the use of fossil fuels by power plants. Greater competition should be expected to lead to more efficient use of the resources in power generation and thereby lower prices on electricity. It is possible that effects like this will counteract the beneficial environmental effects of higher taxes on energy and CO₂. This was the expectation in Sweden after the deregulation of the electricity market in 1996. On the other hand, such decreases in electricity prices could in principle be met by increases in tax levels.

If energy sector deregulation and the phasing-in of electricity taxes take place simultaneously it can have the unfavourable effect that consumers do not appreciate the benefits of deregulation as they do not experience decreasing prices on electricity. Yet this should not conceal the fact that such a process is an unconditional social economic benefit, which among other things gives a revenue gain that can be used to reduce other taxes.

The restructuring of the energy sector following a deregulation or liberalisation can alter the way taxes bring incentives for both electricity producers and end-users of electricity. Optimally, such structural changes should be followed by a review of the design of the energy- and CO₂-tax structures.

5.2. Water supply, water quality and wastewater

The amount of water resources varies markedly among the Member States (depending on population density, weather conditions, and agricultural use), for which reason it is natural to observe some variations in the scope of central authority control with the pricing of water supply.

Whether the water is supplied by extraction of ground water or by purification of surface water, supplier companies have to be financed. This is usually done by charges on the household and business users of water. Depending on the organizational structure of the water suppliers, these charges are either paid directly to the supplier company or to the local authorities – but in itself this should not be seen as taxation.

However, it is possible on top of these charges – which are payments to the supplier company or the local authority for the service – to levy an additional tax on the use of water. A few Member States use such taxes as a way to spare the overall extraction of ground water.

Extraction of ground water is taxed on a regional basis in Germany (the Länder) and Belgium (the two regions Flanders and Wallonia). In the Netherlands various levies on ground water extraction are used on a regional basis. Denmark is the only country having a central governmental tax on water supply paid directly by households – in this case on the amount of piped water irrespective of its origin.

Many Member States operate with a regulatory basis, which at the local level ensures some correspondence between the amount of water used by consumers and firms and the payment for the service. France and Finland report having a regulatory basis requiring the use of a kind of “polluter pays” principle for the setting of charges: Thereby the charges should fully reflect the investment, maintenance and operation costs of the water suppliers, and should include a further element, if it is needed to regulate the amount of water consumption – depending on water scarcity in the location.

However, some Member States seem to have a regulatory set-up, which does not even ensure that household or firm payments for water supply correspond with the amount of

water used. Arrangements based solely on a fixed connection fee do not give any incentives for efficient use of water resources. In the absence of pricing mechanisms corresponding to the amount of water supplied, there is a continued risk of depletion of the water resources.

Almost all Member States charges waste water and various forms of water pollution.

Belgium, Denmark, Germany and the Netherlands have introduced governmental levies – either central or regional – on industrial and household wastewater sent into the sewage system.

Remarkably, the UK has actively taken the stance *not* to use charges on water pollution. Instead the UK favours the use of traditional emission controls, with the rationale that whether a given amount of pollution will be harmful to the nature is most frequent very site-specific. After examination of the issue, the British government concluded that a system of national pollution charges would be unlikely to deliver the same environmental benefits as targeted emission controls.

The quality of water is affected much by the use of fertilizers and pesticides in agriculture, why agricultural policy can be of considerable importance. A range of Member States is reported to tax agricultural use of pesticides at various degrees (Belgium, Denmark, France, Finland, Greece and Sweden), but only Sweden has a tax on the use of fertilizers in agriculture.

5.3. Solid waste and products

An increasing number of Member States has introduced taxes on solid waste. In general, however, administrative regulations based on controls still form the basis of the overall strategies to handle a proper management of the waste formed.

A range of Member States has introduced a governmental tax on waste brought to landfill (Austria, Denmark, Finland, France, Greece, Italy, the Netherlands, Sweden and the UK) – the aim being to improve incentives so that a larger part of the potentially combustible waste will be brought to combustion instead of landfills. In addition to the tax on landfills, Denmark has a tax on waste brought to combustion – with a lower level than the tax rate for waste brought to landfills, thereby keeping incentives for proper handling. If the waste is used to combustion for electricity or heat production the rate is even lower.

The functioning of the overall waste management systems depends very much on the organizational structure at the local authority level. Whether a tax on waste will lead to less waste and/or a better allocation of it for subsequent handling by waste management companies depends on the tax structure and the setting of charges. On the one hand, there should be a charging structure that has a direct impact on the behaviour of the waste producers: households and firms. On the other hand, waste management companies should have good incentives to reduce overall managements costs and at the same time incentives to seek the most environmentally favourable treatment of the waste, depending on the kind of waste. An objective of approaching the "polluter pays principle" could very well require a thorough examination of the actual incentives for the various agents in waste management.

It should be noted that the UK is considering the introduction of a tradable landfill permits scheme. This scheme will, however, only be applied to biodegradable waste, but if introduced it will be an innovative measure in this field.

In addition to the more general taxes on waste, several Member States have introduced various environmental taxes on special products, which are seen as environmentally hazardous (e.g. packaging, batteries, electrical equipment, solvents). The amount of such products taxes varies markedly among Member States – Belgium and Denmark being the Member States with the largest amount of different tax objects – but almost all Member States levy taxes on some kinds of environmental hazardous products.

In most Member States there is an increased tendency to focus on obligatory recycling of various products. Especially Germany, the Netherlands and Sweden put much focus on a more general producer responsibility of products – the rationale being that the costs of subsequent environmental handling thereby will be internalised in the pricing of the products, in accordance with the “polluter pays principle”. In a range of Member States re-use or recycling of special products has been made mandatory. However, in general there have not been comprehensive examinations of whether producer responsibility is the best way to achieve cost-efficient solutions with regard to the environmental targets, or whether a system of taxes or tradable permits would be more efficient. Taxes and other economic instruments are used more frequently in Member States to reach a more environmentally sound management of waste.

6. Structural reforms in Member States

This chapter contains a summary – based on the 2002 country examinations - of the present conditions, future challenges and initiatives taken with respect to structural conditions and policies in the individual Member States.

The main text highlights the most important issues with respect to ageing and fiscal sustainability, product and capital markets and labour markets and concludes by raising the most important future structural challenges to be considered.

The summary tables are organised according to the structural issues being examined and include three columns. The first column indicates the present stance of performance and policies with respect to the issues considered. The second column summarises action taken in 2001. The third column assesses and repeats the specific recommendations given in the 2001 Broad Economic Policy Guidelines (BEPG) to the extent recommendations were given in the policy area considered.

Compared to the previous annual reports the scope is thus widened aiming at providing an overview of the structural issues in all the areas examined. This gives a broader perspective with respect to previous achievements and other initiatives taken when assessing the specific BEPG-recommendations given and being addressed in 2001.

Belgium

Belgium enjoyed strong growth up to 2000 followed by a considerable weakening in 2001 triggered by the international slowdown. Employment, however, increased further in 2001. Inflation was at the EU-average.

Belgium recorded in 2000 and 2001 its first (small) **budgetary surpluses** in 50 years. The – still very high – debt to GDP ratio is falling rapidly and estimated to fall below 100 per cent of GDP in 2003. Strictly controlling the annual increase in primary expenditure will be necessary in order to maintain a primary surplus at or above 6 per cent of GDP as envisaged by the government in its Stability Programme. Debt reduction contributes to the preparation for the **ageing** population for which also budgetary surpluses and one-off revenues will be collected in a still very small special fund. Limited measures have been taken so far to reform pension and early retirement systems and promote later retirement. Second and third pension pillars will be developed.

The **product markets** in Belgium generally work well. The average productivity level is substantially higher than the EU-average, due to, e.g. a highly qualified labour force in manufacturing and a very open economy. A low employment rate undoubtedly contributes to the high productivity level, as workers with relative low productive potentials appear to be broadly out of work. Competition in domestic services is less advanced and administrative burdens are considered fairly high, even if significant improvement has taken place. Liberalisation of network industries proceeds slowly and the effect on prices is not yet important for consumers. The strong involvement of local authorities in some public services could impede the liberalisation process. On the whole, the activity of regulatory authorities lacks transparency. Investments in railways are projected to increase sharply. **Capital markets** develop rapidly in Belgium, notably with the creation of Euronext. The trend towards concentration in the banking sector should be closely monitored by regulators.

Unemployment is somewhat below the EU-average, but higher than in a number of countries. Employment has increased strongly over the last five years, but the employment rate is still below the average EU-level. Large regional disparities and other signs of segmentation persist in the **labour market**. Female employment rates are low and the employment rate of older workers is very low and hardly increasing. Efforts to improve labour market structures include tax reductions and more active labour market policies, while little has been done to reform benefit systems and employment protection.

Good progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Stimulating social partners' negotiations over **wage moderation and differentiation** and tackle obstacles to labour mobility such as housing registration taxes, traffic congestion and public transport difficulties
- Clarifying and strengthening the **regulatory authorities** to enhance competition in product markets
- Continuing the reduction of administrative burdens
- Continuing the reduction of **government debt** and increasing the pre-funding of future ageing related expenditures
- Accelerating reform of pension systems and **early retirement** programmes to promote later retirement

<i>Position and challenges (B)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives Implementation deficit slightly above average and many infringement proceedings. State aid High level (mainly railways).	An action plan and a special Commissioner have helped reducing the transposition deficit. However, these efforts have slowed down and needs to be pursued further.	
Administrative burdens are still considered to be high.	Significant efforts have promoted administrative and fiscal simplification, introduced e-government and reforms of the public administration.	In progress "Take measures to reduce and simplify the administrative burden on business."

Position and challenges (B)	Action taken	2001 BEPG recommendations
<p>Competition policy Belgium has empowered its competition authority to apply EC law. Provinces and municipalities are very active in diverse sectors such as distribution of electricity and gas, waste disposal, and private partners enjoy preferential treatment.</p>	<p>Regions have undertaken to separate their transport and sales activities in energy, but more progress should be done to clarify public intervention in economic activities.</p>	<p>Partial “Increase the transparency of the links between the public and private sectors at the local and provincial level, especially the role of municipalities and their associations in different sectors such as energy, in order to avoid distortions of competition and conflicts of interests.”</p>
<p>Network industries Household and industrial electricity prices are significantly above EU average, as are gas household prices. Full liberalisation in these sectors is planned quite late. Close to monopoly positions in the generation and local monopolies in the distribution of electricity and gas. In telecommunication, competition has intensified on the international calls segments but local costs remain high above EU average. In mobile telecommunication, while prices are relatively low, the network is near saturation due to strict regulations and uncertainty about the granting of the fourth licence.</p>	<p>Liberalisation of electricity and gas is proceeding slowly and could be speeded up. The new independent regulator for eligible consumers will have to address the distortions caused by lack of transparency in public-private partnerships. Following the infringement procedure launched by the Commission, a reform is in preparation to resolve the conflict of interest between both shareholder and regulator roles of government in telecommunications. Effective number portability and full unbundling of the local loop have been delayed but should start to take off thanks to cheap unbundled lines and interconnection charges. A reform of the railways is scheduled.</p>	<p>Partial i. “Increase competition in transport and distribution of gas and electricity and set up independent transportation network managers in these sectors in order to ensure non-discriminatory access.” ii. “Ensure that the planned reform of the railways will increase efficiency and quality of service and reduce the need for operating subsidies.”</p>
<p>Risk capital and capital markets have developed over recent years through the creation of Euronext, the intervention of new operators like pension or mutual funds and specific measures. Concentration in the banking sector poses a challenge to the supervisory authorities, yet in reorganisation.</p>	<p>The requirement for pension funds to invest a minimum percentage in Belgian shares is to be removed. The efficiency of corporate taxation will be increased by rate reductions tax exemptions for reinvested profits, while the tax base will be broadened. Procedures in case of corporate insolvency are to be adapted in order to limit the negative consequences of bankruptcy.</p>	<p>In progress “Develop further the risk capital market by easing quantitative constraints on institutional investment in equity capital, by establishing a fiscal framework more conducive to investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws.”</p>
<p>Human capital and R&D R&D and patent activity are evolving in line with the EU average. R&D business share is however low. Number of graduates in science and technology is low despite a high share of population with tertiary education.</p>		
<p>ICT The use of ICT is well developed in households, but slower in business and schools. Internet charges are high.</p>		

<i>Position and challenges (B)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Labour market The unemployment rate is somewhat below EU average, but large regional disparities persist. Wage flexibility remains low. Labour mobility is high to Brussels but low from Wallonia to Flanders.</p> <p>The employment rate has been growing steadily during the second half of the nineties but is still below EU average, mainly because of relatively lower rates for youth (15-24 years), women above 40 years and in particular older workers (55-64 years).</p> <p>Tax rates and benefit levels are high.</p>	<p>Significant tax reductions including indirect labour costs for low skilled have been implemented or are foreseen during 2001-2006.</p> <p>Active labour market measures have been enhanced.</p> <p>The latest intersectoral agreement allowed somewhat greater scope for wage differentiation at sectoral level.</p> <p>Temporary contracts were introduced in the construction sector.</p> <p>The new time-credit system and of the gradual reduction of the working week needs to be closely observed.</p> <p>Early retirement schemes have been slightly revised.</p> <p>The generous unemployment benefit system has not been modified.</p>	<p>In progress “... reform further tax and benefit systems to make work pay, ... create adequate incentives for older people to continue to work or re-enter the labour market... revise the special arrangements exempting older unemployed people ... from active job search ... address the main obstacles to labour mobility and encourage Social Partners to allow wage-setting Mechanisms to better take into account productivity and local labour market conditions ... continue to enhance ... labour market flexibility by further relaxing conditions for fixed term and temporary contracts and increasing working-time flexibility, while ensuring that any reduction in working time has no adverse impact on unit labour costs and supply. ”</p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is on average. Public debt reduction is proceeding and a reserve fund has been initiated. Few measures to reform pensions or promote later retirement until now.</p>	<p>Pension reform limited to supplementing state pensions on a sector-based level. Creation of a fund to be financed with exceptional receipts and budgetary surpluses.</p>	<p>In progress “ Prepare for ... ageing by timely reform of the pension system, including the identification of the budgetary resources to be allocated annually to the Ageing Fund. ”</p>
<p>Environment Negotiable permit system for greenhouse gas has been set up.</p>		

Denmark

The international slowdown and the aftermath of a hurricane initiated construction boom in 2000 reduced growth in 2001 in line with the EU-average. Employment growth levelled off in 2001 and unemployment is stabilised below EU-average. Inflation is around the EU-average.

The **budget balance** has been in surplus for several years, and surpluses are also projected in forthcoming years. The new Danish government is implementing a tax freeze, which will slightly and gradually decrease the tax burden due to fixed nominal excise duties and property taxes. Expenditures will be reduced simultaneously, and the medium-term debt reduction strategy is unchanged. The projected future increase in **ageing** related expenditures is about average, but due to a return of postponed tax revenues in private pension funds and a comprehensive debt reduction strategy preparations are advanced.

Average labour productivity has recently improved from being slightly below to being above EU-average. The average price level is still more than 20 percent above EU-average. Even if to large extent accounted for by very high indirect taxes this, combined with a trade to GDP ratio that is lower than expected for a small country, suggests too weak competition in **product markets**. The Competition Authority, the efforts of which have become more targeted and offensive, has identified a large number of sub-sectors with insufficient competition. The legislative process of liberalisation is well advanced in telecommunications and electricity, and the new government has announced that other network industries will be liberalised in the coming years, and that privatisation efforts will be speeded up. Due to the large size of the public sector, measures to enhance efficiency are particularly important. **R&D** investments are on average, but businesses and consumers adopt new technologies quickly. The use of ICT is very well developed. **Capital markets** are undergoing substantial changes, and the regulatory framework has been changed in recent years.

The **labour market** is characterised by a low rate of unemployment and employment rates are among the highest, in particular among youth and women, whereas employment rates of prime age men and older workers are less impressive. An important share of working age population receives disability or early retirement benefits. A substantial number of reforms have addressed these problems, although these have not been far reaching. Due to unfavourable demographic developments and already low unemployment, further measures to increase labour supply are necessary if employment is to increase significantly more.

Some progress has been made with respect to implementing the specific BEPG recommendations for 2001.

The most important policy areas to be addressed are:

- Developing **competition** in domestic services and construction markets
- Improving the **regulation of network industries** and considering further liberalisation
- Improving **public sector efficiency**, e.g., through better tendering and use of new technologies
- Pursuing reforms of **higher education** to increase performance and meet demands of private sector
- Reforming the **tax and in particular benefit system** further to foster a higher labour supply and job participation, notably among older workers

<i>Position and challenges (DK)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Implementation of EU Directives The transposition deficit is very low.</p>	The deficit has fallen slightly.	
<p>State aid Is at the EU-average, but primarily for horizontal purposes and very little sector specific and <i>ad hoc</i> aid.</p>	The level has been unchanged.	
<p>Public procurement The value of tenders in Official Journal is higher than EU-average. If relative size of public sector is taken into account, tendering in local government is low due to very low tendering in health, education and care sectors.</p>	Based on a survey of local authorities, the Competition Authority has formulated a series of recommendations on how to expand the use of tendering as a means to increase efficiency in the provision of services.	<p>In progress “ Enhance conditions for competition in public procurement, and heighten competitive pressures in public services provision at the local level through benchmarking and increased use of public tendering.”</p>

<i>Position and challenges (DK)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Administrative burdens Complex rules with respect to environment, health and safety etc.</p>	<p>A new deregulation unit has been established, and the government intends to remove administrative demands on in particular SMEs.</p>	
<p>Competition policy The competition authority complies with EU law and has become increasingly active with respect to monitoring and targeted measures. High relative prices due to weak competition in construction, many service and some manufacturing sectors.</p>	<p>Measures to facilitate cartels investigations and raise penalties from their currently very low level are envisaged. Tendering in the construction sector has been opened.</p>	<p>Partial <i>“Strengthen enforcement of competition rules in those industries where competition has been found to be inadequate.”</i></p>
<p>Network industries Liberalisation completed for telecommunication and advanced for electricity. Limited opening of gas, postal and railways markets. Prices are generally low by EU-standards. Concentration is high in some cases, and needs to be considered taking into account the relatively small markets size. Public ownership in most industries. This has caused some problems in recent tendering of part of railways system.</p>	<p>Gas legislation changed and includes provisions for the qualitative market opening suggested by the Commission. New government announced intentions to fully liberalise all network industries, including gas in 2004. Privatisation of state-owned enterprises will be regularly considered, and the gas and post incumbents will be prepared for privatisation.</p>	
<p>Risk capital and capital markets Generally well developed. Significant merger activities. Venture capital markets appears to be relatively underdeveloped, especially regarding early-stage funding. Recent analysis, however, suggests that previous data significantly underestimates the level.</p>	<p>Law enacted that consolidates in one act all rules that are common to different types of financial institutions. Corporate tax rate reduced from 32 to 30 per cent. Working group established to make recommendations in relation to rules on debt rescheduling and restructuring of insolvent firms. Larger flexibility in publicly owned growth fund stimulates risk capital.</p>	<p>Partial <i>“Develop the risk capital market by further adapting the fiscal framework so as to facilitate investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws”</i></p>
<p>Human capital and R&D R&D expenditure are on average, but low in private sector. Patenting is on average, but lower than in neighbouring countries. Insufficient supply of sciences and technology specialists. Fairly high level of education and large spending. However, this includes very high student grants, which may distort behaviour.</p>	<p>To boost commercialisation of research, government envisages measures to more closely associate public research with private enterprises.</p>	
<p>ICT Diffusion of ICT to businesses and consumers is very high.</p>	<p>A new tax credit on PC purchases and probably broadband access is implemented.</p>	

<i>Position and challenges (DK)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Labour markets Low unemployment rate and very high employment rate, yet a significant share of working age population is inactive (ALMPs, early retirement or disability benefits). A large medium-term challenge of raising employment rate further to meet fiscal policy objectives, including increasing labour market participation by immigrants. Benefits as well as average and marginal tax rates on labour are still high. A low level of employment protection contributes to large job turn over and low youth unemployment.</p>	<p>Final step of previous tax reform reduces income tax rates somewhat. Income taxation may be reduced in 2004 if sufficient leverage in public finances has been achieved. A key challenge will be to contain the historical upward drift in tax rates and expenditure in local government</p> <p>The inflow to disability pensions continues at much lower levels than in the past. A further reform is being implemented. The inflow rate to early retirement has flattened as expected due to a previous, but not far-reaching, reform.</p>	<p>Partial <i>“Reduce further the overall fiscal pressure on labour over the coming years, especially through lowering high marginal effective tax rates on low and medium wage earners to make work pay, and thus continue reforms of transfer systems.”</i></p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is on average. The comprehensive strategy relies primarily on government debt reduction.</p>	<p>The reduction of public debt has continued.</p> <p>No further measures to promote later retirement were announced.</p>	
<p>Environment Widespread use of taxes, subsidies and trading schemes.</p>	<p>The level of green taxes increased slightly in 2001.</p>	

Germany

Economic growth in Germany deteriorated more than average in the course of the international slowdown 2001, while employment stagnated. Inflation was below the EU-average in 2001. Growth performance since the unification boom has been negatively affected by the necessary adjustment and consolidation.

Following a **budget surplus** in 2000 (affected by large UMTS proceeds) a deficit of 2.5 per cent of GDP is estimated for 2001 mainly due to the weakening of economic activities, but also a somewhat higher than expected increase in expenditures and the tax reform. The future expenditure increases associated with population **ageing** are potentially higher than the EU-average. A promotion of later retirement and the pension reform of 2001 – being a large systemic change contributing to some reduction of the net future budgetary impact of ageing – are steps towards developing a comprehensive strategy in this area.

The average productivity level is a little below the EU average, hiding a large difference between the Eastern and Western parts of the country. Productivity growth has been weak in recent years. The price level has converged from above to the EU average. **Product market competition** is fairly advanced, as the German economy is well integrated into the European economy and due to high levels of competition in the retail sector. Liberalisation in network industries is advanced, but the fees for the use of local electricity distribution networks differ considerably. Concerns have been expressed if the reliance on Association Agreements and negotiated access to energy networks will *de facto* allow new entries and effective competition. **R&D** investment and educational standards are high, although enrolment in tertiary education is below average. Reforms in education and research are currently being implemented to safeguard advanced positions in technology and innovation. **Capital markets** are likely to improve as legislation enhancing transparency of public security offers and take-over procedures came into force in January 2002. Together with the company tax reform, this could provide incentives to reduce the widespread cross-ownership of German companies and enhance pressures for shareholder value.

In **labour markets** unemployment is at the EU average. Large regional differences persist with particularly high unemployment in the Eastern part of the country. The employment rate is slightly above the EU average, although employment has increased significantly less than average in the 1990's. While the employment rate of older workers aged 55-59 is relatively high, the employment rate of those aged 60-64 is below the EU average. Education standards and a relatively low youth unemployment rate are labour market advantages. Policies to reduce structural labour market problems include tax reductions, a fairly high level of active labour market measures and a particular reliance on consensual central wage negotiations containing wage increases within sustainable levels. Wage differentiation is somewhat limited, but wage flexibility has been increased in sectoral agreements. The tax measures have increased incentives also for the low skilled workers, where the incidence of unemployment is particularly large. Improving incentives in benefit systems remains a major task. Job protection legislation is extensive.

Progress has been made with respect to implementing the specific BEPG recommendations for 2001.

The most important policy areas to be addressed are:

- Continuing to pursue **labour market reforms**, in particular by addressing disincentives imbedded in transfer systems
- Improving transposition record of **single market directives**
- Continuing reduction of **administrative burdens** and reviewing **employment protection**
- Monitoring and enforcing competition under Association Agreements in **energy sectors**
- Strengthening efforts to prepare for the **ageing** population, including public debt reduction, further promoting later retirement, closely assessing the impact of the pension reform and ensuring the ability of the reform to contain future net spending increases

<i>Position and challenges (D)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Implementation of EU directives Implementation deficit is above average several infringement proceedings.</p> <p>State aid Sector specific and <i>ad hoc</i> state aid is slightly above EU-average.</p>	<p>The non-transposition rate declined in 2001, but directives on environment and plant health are not implemented. State aid has fallen during a number of years, a trend that is set to continue according to plan until 2005.</p>	<p>In progress <i>"Reinforce competition in product markets by further opening-up of public procurement, continuing the policy of gradual reductions in State aid, and continuing to decrease the regulations for the professions and handicrafts trade."</i></p>
<p>Public procurement The value of public tenders published in the EU Official Journal was the lowest among Member States in 2000.</p> <p>Administrative burden The burdens are perceived to be relative high according to some indicators and surveys among German companies.</p>	<p>New regulation entered into force in 2001 implying the transposition of all Community directives on public procurement.</p> <p>Several measures have been taken to reduce the regulatory burden on business and offer e-services.</p>	
<p>Competition policy The competition authorities comply with community rules. The German economy is well integrated into the European and world economies. Falling relative price level indicates increasing competition.</p>	<p>A change in legislation is under preparation, which should facilitate the cross-border delivery of handicrafts.</p> <p>Legal constraints on the professions have been lifted.</p>	
<p>Network industries Full formal market opening in telecommunication and energy has taken place. A competitive framework is also in place in other network industries. Large private and foreign ownership in network industries.</p> <p>Fees for local electricity distribution networks differ considerably. Concerns that negotiated third party access in electricity and gas may act as a barrier to new entry. Effective competition in and contestability of energy markets has to be monitored and enforced by authorities.</p> <p>Prices in telecommunication are somewhat below average, whereas electricity prices for households are relatively high.</p>	<p>Investigations of fees charged for the use of electricity distribution networks is carried out. A test case against a large network operator has already led to a decline in transport fees. Other cases are pending. In order to handle the increased caseload, a new department was created within the federal competition authority and additional resources were made available for this purpose.</p> <p>A ministerial task force has mediated amendments to AA for the electricity industry to facilitate switching for small customers. It also addresses access fees. While electricity prices for industry have come down, consumer prices remain above average. Competition in the railway sector is being strengthened.</p>	<p>Partial <i>"Make efforts to reduce the large regional differences in the fees for the use of local electricity distribution networks".</i></p>
<p>Risk capital and capital markets Venture capital is well developed, but suffered in 2001 due to stock market developments.</p> <p>Inward foreign direct investment is low compared to the EU average.</p> <p>Merger activities in the banking sector are weak.</p>	<p>In addition to the tax reform changes in the fiscal and regulatory framework on risk capital (e.g. the creation of pension funds and plans for a modified taxation of asset management funds) were made.</p> <p>The equity capital program on participation capital for small high-tech companies will be continued.</p>	<p>Partial <i>"Further develop the risk capital market by continuing efforts to establish a fiscal and regulatory framework more conducive to investment and entrepreneurship".</i></p>

<i>Position and challenges (D)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Human capital and R&D Germany continues to build on its relatively strong position in the knowledge-based economy. The share of the labour force with at least upper secondary education is the highest amongst EU Member States.</p> <p>R&D expenditure well above EU-average, and number of patent applications are twice the EU-level.</p>	<p>R&D investments have risen somewhat further as a per cent of GDP.</p> <p>The historical relative advantage in human capital might decrease in the future as enrolment in tertiary education is below average. The recent reform of the higher education system implies the introduction of a performance-linked pay scale for professors and the creation of positions for so-called 'junior professors'. Measures encourage stronger transfer of knowledge to the business sector.</p>	<p>Satisfactory "Reform the higher education system and reduce shortages of IT personnel through education and training".</p>
<p>ICT Internet access at home and in the work place is now somewhat above the average EU-level. However, the use of government services on line and internet connections in schools is below average. e-Commerce is well above the EU average,</p>	<p>New measures resulted in an additional 100,000 IT experts being mobilised by the end of 2000.</p> <p>The programme "Bund online 2005" is being implemented and brings online all government services suitable for the internet.</p> <p>All schools got access to the internet.</p>	
<p>Labour markets Unemployment is at the EU average with large regional differences. The employment rate is slightly higher than average. Youth unemployment is relatively low.</p> <p>The wage inflation outcome relies heavily on central wage negotiations facilitated successfully by tri-partite institutions in recent years. Wage differentiation is somewhat limited. The tax reform increases work incentives across the board, but few measures or plans to address the disincentives arising from benefit schemes have so far been put forward. Employment protection is extensive.</p> <p>Limited efficiency of large-scale ALMPs, in particular in the eastern part of the country.</p>	<p>Marginal tax rates have been cut over the whole tariff.</p> <p>Flexibility of working time has been increased for a significant share of workers.</p> <p>Pilot project to reduce social security contributions for low wage earners. The government has decided to extend the model to the whole country.</p> <p>"Job AQTIV" is a bill strengthening early activation and job search assistance. Enforcement measures are strengthened. Training measures and job-rotation are introduced. However, the coverage of unemployment insurance is increased.</p> <p>The trend towards introducing decentralised elements of wage bargaining seems to be continuing.</p>	<p>Partial "Target ALMPs better towards those groups most prone to the risk of long-term unemployment and ensure that training better matches the demands of the labour market. Improve the efficiency of ALMPs, in particular in the New Länder. Continue to encourage the wage formation process to better take into account productivity and regional labour market conditions".</p> <p>Partial "Complement the income tax reform with further reforms of the tax and benefit system to make work pay. Further steps should be taken to reduce the still-high level of non-wage labour costs, in particular for low wage labour".</p> <p>Partial "Take measures, where appropriate in the framework of the "Alliance for Jobs", to make work contracts and work organisation more flexible and to improve the conditions for life-long learning".</p>

<i>Position and challenges (D)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Ageing and pension reform The future increase in ageing related spending pressures is potentially above average.</p> <p>Government debt needs to be reduced. Steps have been taken towards developing a comprehensive pension strategy including the promotion of later retirement and reforming the pension system.</p>	<p>The pension reform passed in May is a substantial systemic change, although with a likely modest alleviation of the net future budgetary impact of ageing, partly because the partial shift from public to private benefits involve substantial subsidies for the new private schemes.</p> <p>Early retirement schemes are phased out by the end of 2004. Larger actuarial incentives to later retirement have been implemented.</p> <p>A comprehensive strategy with respect to health care has not been developed.</p>	
<p>Environment The use of market-based instruments including energy taxes is highly developed.</p> <p>Credit programmes, partial tax reductions and extension of consumer information to improve energy-efficiency in households and transportation.</p>	<p>An ecological tax reform is being implemented. The promotion of renewable energies is continuing.</p>	

Greece

Economic growth has been sustained at rates above EU average and was virtually as high in 2001. This growth is mainly driven by a productivity catch-up, while unemployment rates are still high. Inflation is above the EU average, but the transmission to a low inflation environment consistent with participation in the euro appears to be completed with success.

Public finances have become balanced and the very high government debt level is being reduced. The consolidation effort needs to be continued forcefully. A major overall tax reform is to be announced in early 2002 focusing on simplification and tax-base broadening. The underground economy is big. The challenge of **ageing** is very high in the case of Greece. No significant step has been taken to prepare for this and a comprehensive strategy has not yet been developed.

The productivity level is still low compared to the EU average. In **product markets** important new steps have been undertaken to liberalise the electricity and telecommunication markets. The monopoly in the electricity sector ceased in 2001 at the end of the derogation, but the position of the incumbent is still dominant in the main network industries. Liberalisation of the coastal shipping sector is planned in 2002. Full or partial privatisation is part of the strategy in network companies. The competition authority has been strengthened, but there are constraints on its independent decision-making. The integration of the Greek product market is not advanced and with a view to its geographic location it is even more important to reduce barriers to foreign competition and promote the domestic competitive environment in all sectors. **R&D** activities are low, and Greece has a backlog in the development of human capital. The use of ICT is below average. In capital markets the supervisory framework has been reviewed and consolidation in the banking sector has taken place. Venture capital needs to be developed further. Efforts have been made to enhance the attractiveness of the stock exchange by creating a more integrated operating framework and increasing transparency in the equity market. However, further efforts might be needed to improve the attractiveness of the national stock exchange.

In **labour markets** the employment rate is low and unemployment remains at a high level. The employment of women is very low, while increasing slowly. The employment rate of older workers is closer to the EU-average, but stagnating. Taxes on labour remain high compared to the otherwise relatively low tax pressure in Greece. Minimum wages remain relatively high and labour market regulations have not been eased significantly. Limited efforts have been undertaken so far to reduce structural unemployment problems and the problems of low participation rates.

Some progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important structural policy areas to be addressed are:

- Implementing measures to increase **labour market participation** and **reduce structural unemployment**
- Increasing the **educational attainment rates** in order to improve the quality of labour supply
- Continue liberalising and privatising **network industries**, while promoting less concentration and higher entry
- Ensuring the implementation of a **comprehensive tax reform** aiming at simplification and tax-base broadening
- Developing a comprehensive strategy to prepare for the **ageing** population and promote later retirement.

<i>Position and challenges (EL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Public procurement</p> <p>Administrative burdens According to a Commission survey, of all businesses in the EU, those in Greece remain among the most dissatisfied with their country's legislation. The tax system is very complex.</p>	<p>Several initiatives (e.g. one-stop shops, business support services) have been undertaken recently. Governance of the public sector needs to be reinforced in order to enhance the performance of the administration.</p> <p>A comprehensive tax reform is planned for 2002 aimed at simplifications, better administration and tax base broad-</p>	<p>Partial</p> <p><i>“ Continue to reduce the regulatory and administrative burden on business, enhance the performance of the public administration and improve the coherence of the corporate taxation system“.</i></p>

<i>Position and challenges (EL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
	ening.	
Competition policy Competition Committee is independent with a power of initiative, but decisions may be overruled.	Resources and responsibility of competition authority was strengthened. Ferry transport is liberalised in 2002. A derogation is however still in place.	Partial “Implement the reform of the sea transport sector as announced and reinforce competition in already liberalised utilities“.
Network industries The reform process started late, but is underway. Markets remain concentrated and barriers to entry should be reduced. Relatively poor interconnections with neighbouring countries. Telecommunication prices are around the EU-average, while electricity prices are low.	Telecommunication and electricity were liberalised early 2001. Liberalisation of gas markets before 2006 has been announced. Privatisation is underway or envisaged in all network sectors. Postal services are being opened up and restructuring has been successful. Promoting domestic competition is particularly important due to location.	Partial “Speed up the announced liberalisation of the gas sector“.
Risk capital and capital markets Significant government influence. Consolidation and mergers are taking place in the banking sector The venture capital market is less developed.	Role of government is being reduced. Apart from publicly financed initiatives and tax incentives for SME mergers, quantitative constraints on institutional investments remain high. Bankruptcy legislation has not been reformed.	Partial “Develop further the risk capital market by easing quantitative constraints on institutional investment in equity capital, by establishing a fiscal framework that is conducive to investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws“.
Human capital and R&D Low investments in R&D and a low number of patents filed. Level of educational attainment remains below EU-average. Reforms continue to take effect. Challenge for Greece to pursue a coherent strategy further as investment in human and knowledge capital is key to real convergence with EU partners.	Implementation of educational reform programme of 1998 continues with various specifically targeted measures (e.g. to reduce the number of school drop-out etc.). Knowledge and research permeability between universities and the business sector has been strengthened by the introduction of a new legal framework for university spin-offs. Fiscal and financial incentives for R&D exist.	In progress “Increase investment in and improve educational and training systems in order to enhance the skills of the labour force“. None “Take additional measures to increase R&D spending“.
ICT Overall internet diffusion low. Number of pupils with internet access among lowest of the EU.	The government has recently set out a comprehensive strategy for ICT diffusion.	In progress “Continue to promote the wider diffusion of ICT and the use of e-commerce“.
Labour market The unemployment is high and has not decreased significantly. The employment rate is low. Female labour market participation is low, but has increased somewhat. The employment rate of older workers is low. Although not among the lowest in the EU, the employment rate of older workers has not increased. High minimum wages, insufficient wage differentiation and strict employment legislation. The tax burden on labour is relatively low, but complex, progressive and discriminating against employees.	No significant further steps foreseen since new legislation on labour market reforms came into force in 2001. The overall effect of changes in work regulation is ambiguous. However, a rationalisation of threshold for dismissals is planned. Key sources of distortions on the labour market (strong progressiveness in income taxation, heavier burden on dependent employees) not yet addressed. No changes to wage formation process foreseen, remains relatively centralised.	In progress “Ensure the full implementation of recent labour market reform packages, and further build upon these efforts by loosening restrictive employment protection legislation in particular“. Partial “Eliminate major distortions arising from labour taxes and pension entitlements, thus improving incentives to work to take up work in the formal sector“. None “Ensure that wages better take into account productivity and local labour market conditions, in particular by making opt-outs included in the territorial employment pacts a practical possibility“.
Ageing and pension reform The future increase in ageing related	No significant progress on pensions reforms has been made. No official	

<i>Position and challenges (EL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>spending pressures is very high. Government debt is very high. Pension system continues to inhibit labour supply by offering generous benefits and favourable eligibility conditions. A comprehensive strategy has not been developed.</p>	<p>announcement has been made on new reform measures. Reform options currently considered focus only on parametric reforms. Fiscal consolidation has improved strongly compared to the past and the government debt burden is being reduced.</p>	
<p>Environment Results and efforts are mixed.</p>	<p>Energy intensity has not improved over last decade. Relatively little use of economic instruments.</p>	

Spain

Spain has recorded strong growth in recent years and in 2001 only a mild growth reduction took place, and employment increased strongly once more. Within a short period the previously very high unemployment rates have been substantially reduced, even if remaining high. Inflation was above the EU-average in 2000 and 2001, but decreased somewhat during 2001.

As a result of the strong growth and expenditure reductions, Spain has achieved a remarkable return to a **balanced budget**. The debt level is moderate and decreasing gradually. The challenge of **ageing** is very large in the case of Spain, and the efforts to address this by reforming pensions have not been sufficient. A comprehensive assessment of the sufficiency of the present strategy is needed.

Productivity levels are below the EU average and only catching up to a limited extent, as productivity growth has been very weak in recent years, partly caused by the strong take-up of jobs by workers previously out of work with potentially lower than average productivity. The Spanish **product market** is relatively well integrated in the European market, but domestic competition is insufficient in some service sectors. Liberalisation of network industries is advanced, but concentration is high. High administrative burdens have been substantially reduced. Investments in R&D, patent application and the use of ICT are below average EU-levels. Education results are weak. **Capital markets** are developing at a high speed.

The **labour market** has strongly improved, although from a very low level of employment. The level of unemployment is still high and fragmented with large problems relating to regional disparities, long-term unemployment as well as low or very low employment rates for women, youth, and older workers. The use of temporary work contracts has contributed strongly to higher employment.

Progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Progressing further in ensuring competition in **network industries**
- Continuing efforts to reduce dualism in **labour markets**
- Increasing efforts to improve quality and quantity of **education** systems
- Increasing **participation rates**, particularly among women, young people and older workers
- Developing a comprehensive strategy to prepare for **ageing** populations including reforming the pension system

<i>Position and challenges (E)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives Transposition deficit is below average State aid Overall aid expenditures are still above EU average.	Considerable efforts have been made. A number of consumers and environment directives remain unimplemented. Aid has fallen slowly and has not yet been redirected towards horizontal purposes.	
Administrative burdens The cost to create a new company remains high.	A network of 15 one-stop shops has been established. Documents have been simplified and e-government is developing from a low level. There are plans to revise legislation to remove administrative obstacles.	In progress <i>“Continue the implementation of the plan to simplify the regulatory framework for SMEs.”</i>
Competition policy The independent Competition Tribunal can ask for procedures to be initiated by the Servicio. The government makes the final decision in merger cases. Entry barriers exist in several sectors due to strict regulation.	Enforcement of competition law has in practice been quite vigorous. The number of staff of the competition authority has been increased.	

Position and challenges (E)	Action taken	2001 BEPG recommendations
<p>Network industries Liberalisation is advanced, but concentration is high. Telecommunication prices are high, but low for local calls. Electricity prices are relatively low. In electricity and gas, full liberalisation should be completed in 2003. However, the electricity market is still dominated by two vertically integrated companies covering both generation and supply and interconnections with other countries are limited.</p>	<p>In mobile telephony the government has launched a number of initiatives to encourage competition that go beyond the current minimum requirements of the Community framework. Gas distribution is still a near monopoly owned by Enagas, but divestments of activities are required by current legislation. Ban on construction of new distribution networks by competitors to be lifted in 2005.</p>	
<p>Risk capital and capital markets The long-term trend towards increased liquidity suffered a setback during 2001, with a sharp reversal in the stock markets, including the Nuevo Mercado.</p>	<p>Efforts have been taken to, e.g., to reduce entry barriers at the stock market, develop electronic trading and increasing investor protection and prudential supervision. Spain envisages several incentives to further develop the risk capital market.</p>	<p>In progress <i>“Develop further the risk capital market by further easing constraints on institutional investors, which may limit their investment in equity capital, and by establishing a fiscal framework more conducive to investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws.”</i></p>
<p>Human capital and R&D Public expenditure on education is below EU average. Spain is among countries with lowest percentage of population that has attained upper 2nd education. Public and business expenditure on R&D is low and very few patent applications are taken. A tax credit for R&D and ICT investment expenses is provided.</p>	<p>Central government investment in education has risen significantly in real terms and will continue to do so in 2002. The government aims to improve the quality of the university system with the draft laws on universities and professional training and grading. More could be done to implement a fully coherent strategy on lifelong learning. The “National Plan for scientific research and technological development and innovation” includes an initiative to promote training in R&D and innovation, as well as the diffusion of innovation.</p>	
<p>ICT Investments are lower than average, particular if excluding telecommunication equipment. Internet use is lower than average, but increasing rapidly.</p>	<p>A variety of programmes have been launched to promote e-Government and ICT in education.</p>	<p>In progress <i>“Take measures to increase the basic ICT skills ... and the supply of highly qualified research and ICT personnel”.</i></p>

<i>Position and challenges (E)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Labour markets Strong employment gain have been made in recent years, however from a very low level. Unemployment is still high and structural. Large regional problems and segmentation as regards youth and long-term unemployed exist. Employment rates are low for youth, women and older workers.</p> <p>The share of employees on temporary contracts has fallen slightly, but remains high .</p> <p>The tax burden on labour is low by EU standards and taxes on the low-paid are among the lowest. Unemployment benefits are reasonably generous for those who qualify, with replacement rates at around EU average. Coverage is low, however, with many people, particularly the young unemployed, relying on family support.</p> <p>The regional benefit schemes for seasonal workers in certain regions limit inter-regional labour mobility and contribute to structural unemployment</p>	<p>The government has encouraged social partners to agree on a reform of the collective bargaining system, which would take better account of productivity and local labour market conditions. The National Action Plan for employment announced some initiatives aimed at encouraging labour mobility. However, some of the principal obstacles, including the housing market and regional benefit schemes, have not been addressed.</p> <p>Widespread use of indexation clauses has not been addressed.</p> <p>There has been some progress on follow-up and monitoring of active labour market policies, although this falls short of the kind of evaluation necessary to ensure that measures are efficient and tailored to the needs of beneficiaries and the labour market.</p> <p>A significant reform of employment contracts was approved in 2001 increasing flexibility.</p> <p>Social security rebates are given to encourage recruitment of certain groups facing high labour market problems.</p>	<p>Partial “Encourage reform of wage formation in order to better take into account productivity and local ... conditions, and diminish obstacles to labour mobility, ... through improvements to the functioning of the housing market and regional benefit schemes;</p> <p>Partial “Increase investment in and improve education and training, and ensure that active labour market measures are ... tailored to the needs of those most prone to the risk of long-term unemployment or those with lower participation rates ... and to the demands of the labour market</p> <p>In progress “Take steps to ensure ...an appropriate balance between flexibility and security, by means of the effective implementation of recently approved employment contract reforms, with a view to early progress in terms of a reduced share of fixed-term contracts, greater use of the part-time contract and a higher share of female employment..”</p>
<p>Ageing and pension reform The future increase in ageing related spending pressures are very high. The strategy is being developed, but pension system and early retirement schemes have not been reformed. A full comprehensive strategy is needed.</p>	<p>A so far small social security fund to finance future liabilities has been created.</p> <p>The public debt ratio is decreasing and is under the 60 per cent threshold.</p> <p>The pension system is under revision. Gradual adjustment improving long-term sustainability is envisaged.</p>	<p>Partial “ Increase the public pension fund reserve created in the 2000 Budget Law to at least 1 per cent of GDP by 2004 ... Additionally, legislate already in 2001 for an overhaul of the public pension system to ensure its future viability.”</p>
<p>Environment Despite water scarcity in the country, Spain remains one of the biggest water consumers in the EU and prices are kept very low. Regarding the Kyoto objectives, Spain has not reduced its energy intensity.</p>	<p>Putting a price such as charges and taxes directed at the use of natural resources and emissions are limited. Elements of market-based instruments are primarily focused on tax credits or subsidies. Direct government funding of environmental activities has increased significantly.</p>	

France

France has been hit less than average by the international slowdown, and employment growth continued in 2001. Inflation is presently somewhat below the EU average, suggesting smaller than average capacity constraints.

The **budget balance** was in deficit in 2001 affected by automatic stabilisers, tax cuts and a larger expenditure growth than planned for. The challenge of **ageing** is of average size and will start to affect public finances from 2010. This challenge has not been sufficiently addressed yet. The last pension reforms were in 1993 and 1996 and are still being phased in. Little has been done to promote later retirement.

The productivity level is high and above average, possibly to some extent affected by low employment rates among low skilled, young people and older workers. Increases in overall productivity have been relatively weak recently, partly due to large employment gains for the low skilled, but also indicating a need for stronger efforts in **product markets**. Competition is relatively weak in electricity and gas, but more developed on the product market as a whole, where special measures have been taken, for example, to curb the monopsony power of big distributors. Administrative burdens are considered to be high even if some reductions are taking place. R&D expenditures are higher than average, but are stagnating. **Capital markets**, especially risk capital, are not sufficiently developed.

Employment gains in recent years have been remarkable. However the **labour market** is still characterised by a high unemployment rate and fairly low employment rates. The employment rate among older workers is very low and has not increased over the recent period. Outsider problems contribute to high unemployment among youth and low skilled. Structural labour market efforts have concentrated on a reduction of indirect labour costs for low skilled and to some extent the alleviation of high effective marginal tax rates. This strategy has been successful, but the further scope is limited due to budgetary constraints. Little has been done to reform benefit and job protection systems with a view to increasing employment. Recent changes suggest mixed effects.

Some progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important structural policy areas to be addressed are:

- Increasing **labour supply** and monitoring possible effects of **working-time reductions**
- Speeding up the **liberalisation of network** industries
- Continuing to alleviate the **administrative burden**, especially for SMEs
- Developing a comprehensive strategy to prepare for population **ageing** including stronger fiscal consolidation and developing the pension reserve fund, considering pension reforms and in particular promoting later retirement.

<i>Position and challenges (F)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives High implementation deficit and large number of infringement proceedings State aid Close to the EU average	Deficit reduced in 2001 and a timetable for 2002 indicates substantial further progress. Marked reduction of aid in 2000.	In progress <i>"Continue progress made in transposing internal market directives."</i> Satisfactory <i>"Continue the reduction of ad hoc State aid."</i>
Public procurement Administrative burdens Large, particularly on SMEs.	Reform of public procurement code has been made. Effects to be seen. The administrative burden on business was reduced in 2001, in particular by enhancing e-government.	In progress <i>"Continue efforts to reduce the administrative burden on business by simplifying procedures and developing new means of electronic communication with the public authorities."</i>
Competition policy The competition authority is not fully independent.	The authority of the Minister of the economy has been confirmed. The power of the Competition Council has been increased.	

<i>Position and challenges (F)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Network industries Telecommunication is well liberalised, but prices are average. Electricity prices are lower than average due to nuclear power. Markets have opened up, but rather late. In gas, third-party access, while theoretically regulated, still leaves margins for negotiation. Few consumers switched which seems to indicate entry barriers. In addition, the provision of joint services by EDF and GDF give them a strong advantage in distribution services.</p>	<p>Problems identified in last year's BEPGs concerning the slow liberalisation of the gas and electricity sectors have not yet been resolved. Liberalisation follows the minimum rules in the electricity sector while the transposition of the European directive of gas markets is delayed.</p> <p>Projects include selling off some of EDF's capacity (30% in 2003).</p>	<p>None "Step up efforts to liberalise network industries, especially the gas and electricity sectors."</p>
<p>Risk capital and capital markets The development of risk capital remains weak</p>	<p>Large efforts of rationalisation have been made in the regulation authorities of financial activities. Public funding for young high-tech companies increased and tax deductibility of capital losses extended.</p>	<p>Partial "Develop further the risk capital market ... [encourage] entrepreneurship ... by adjusting the enforcement of bankruptcy laws."</p>
<p>Human capital and R&D Higher R&D than the average, but stagnating. Large efforts in public research are not fully exploited for commercial use.</p>	<p>No special step taken recently.</p>	
<p>ICT Record seems a little below average.</p>	<p>The diffusion of IT is encouraged.</p>	
<p>Labour markets The unemployment rate has fallen substantially while increasing slightly in 2001. It however remains high and employment rates are relatively low, in particular for older workers. Past efforts have in particular concentrated on lower indirect wage costs for low skilled and contributed to higher employment by this group. Wage moderation has generally taken place. However nearly one quarter of the total increase in employment is accounted for by publicly funded job creation schemes and employment subsidies. Job search conditions are weak.</p>	<p>Marginal tax rates for people taking a low wage job have been reduced. The most important measure is a tax credit, which benefits full-time rather than part-time work. The reduction of unemployment benefits with the length of unemployment spells was abolished in 2000, implying a higher average replacement rate. At the same time, an active and individualised scheme has been implemented to assist re-employment."</p> <p>There is a risk that the implementation of the 35-hour working week might trigger excessive wage cost increases, especially for low-skilled labour.</p>	<p>Partial i. "Consolidate recent reforms of the tax and benefit system by improving the incentives for older workers to remain in work, and by addressing remaining disincentives to take up part-time and full-time work, in particular for unskilled and low-paid workers. In this context, particular attention should be paid to early retirement schemes and income guarantee schemes". ii. "Monitor closely the positive and negative effects of the implementation of the 35-hours working week legislation to continue to ensure that it does not generate any adverse medium-term effects on wage costs, labour supply and work organisation"; iii. "Reform employment protection legislation with a view to better combining security with greater adaptability to facilitate access to employment".</p>
<p>Ageing and pension reform The future increase in ageing related spending is comparable to the EU average. Public debt reduction and reserve fund build up is less than average. No measures to reform pensions or promote later retirement.</p>	<p>The ambitious target set for the Pension Reserve Fund is not to be met, unless significant steps are taken. Reforms of pensions and of numerous early retirement schemes are being considered although they have not taken place yet. The access to early retirement has been slightly reduced.</p>	

<i>Position and challenges (F)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Environment CO₂ emissions are well below the EU average due to a high use of nuclear energy. Insufficient levels of eco-taxes to enable France to meet its Kyoto targets. Substantial backlog in directives implementation.</p>	<p>France should develop its market-based instruments to decrease its energy-intensity. It should also fully integrate the social costs in fuel taxes.</p>	

Ireland

Production and employment growth in Ireland have been unusually large for a decade and remains comparatively large also after a strong slowdown in 2001. Recent years have shown clear signs of overheating with inflation above average. It will be a significant challenge to adjust expectations for increases in wages and living standards if productivity increases settle at more standard European levels.

The **budget balance** has been in surplus for sustained period and Ireland has moved from a position with very high debt to a low debt country. The surplus diminished substantially in 2001, but is still solid. The future increases in ageing related expenditures are around average, but due to the low debt and the development of a National Pensions Fund, Ireland is among the best prepared Member States to meet this challenge. Also the tax burden as a share of GDP is significantly below average.

Output per worker has risen to a level markedly above average EU levels, although hourly productivity is roughly at the EU average. National income is only marginally above average when profits attributable to foreign investors are taken into account. **Product markets** are highly integrated, liberalisation of network industries is proceeding and prices in these sectors are low. However, in some service sectors, and the network industries, competition is relatively weak and should be further promoted. Investment in **R&D** is below average, but Ireland has benefited from very strong foreign inward investment and technology transfers, thus contributing to strong productivity growth. The use of ICT is around average. Structural reforms in **capital markets** have recently focused on three main areas: Regulation of markets and intermediaries, where consolidation of regulatory bodies has taken place, the banking system, where state-owned banks have been privatised, and initiatives to develop the venture capital industry.

Labour market performance has improved strongly. Unemployment is low and the average employment rate is now slightly above average EU levels after having been very low historically. Employment has within in six years expanded by more than 25 per cent. The employment rate of women has expanded strongly, while that of older workers, although above the EU average, significantly less. Wage formation is characterised by a high reliance on agreements with social partners facilitated by tax reductions, but with actual outcomes in recent years being substantially above negotiated levels. Increased differentiation of wages between sectors could be enhanced. The tax reductions from an already low level have however also contributed to stronger work incentives. Unemployment benefits and employment protection are moderate.

Good progress has been made with respect to implementing the specific BEPG recommendations for 2001.

The most important policy areas to be addressed are:

- Containing inflationary pressures in **labour** markets and adjusting expectations to potentially lower future productivity increases
- Enhancing the capacity related to child care in order release the additional potential **labour supply** provided by women
- Further liberalising **network industries** and promoting competition in domestic sectors
- Continuing to improve the **infrastructure**
- Continuing the well developed strategy to prepare for the **ageing** population

<i>Position and challenges (IRL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Implementation of EU directives The transposition deficit is above average, particularly due to non-implementation in transportation.</p> <p>State aid Sector specific and ad-hoc state aid below the EU-average in 1997-99.</p>	Transposition deficit declined from 2000 to 2001.	
<p>Public procurement Value of tenders published in the Official Journal is above EU-average. Relative high share of cross-border procurement.</p>	Internet-site dedicated to public procurement has been set up.	

<i>Position and challenges (IRL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Administrative burdens Low administrative burden on enterprises. The net creation rate of enterprises was one of highest in the EU in 1995-2000. According to a recent OECD report Ireland is one of the less regulated OECD-countries.</p>	<p>Further measures are being examined.</p>	
<p>Competition policy The competition authorities are complying with EU legislation . Competition remains weak in certain sectors of the economy.</p>	<p>Some sector-specific measures undertaken in 2001. New Competition Bill grants competition regulator authority in mergers (except in media). Tough penalties for violations are introduced. Restrictions on taxi and liquor licenses, and on establishment of pharmacies have been removed or reduced.</p>	<p>In progress "Take measures to introduce more competition into specific market segments." In progress "Strengthen the application of competition policy economy-wide."</p>
<p>Network industries Liberalisation is proceeding, but concentration is high and electricity has not been fully liberalised yet. Prices in telecommunication and particular electricity (households) are low. Competition in the local loop of fixed networks and in the mobile telephone market is weak.</p>	<p>Legislation enacted in 2001 provided for the full liberalisation of the electricity market by 2005. In the gas sector an integrated energy regulator has been proposed. Private equity investment to be permitted in postal services. Competition in bus services has been enhanced.</p>	<p>In progress "Continue to implement measures to progress competition and liberalisation of transport, electricity and gas sectors, thereby enabling new entrants to compete with large State-owned incumbents in the network industries."</p>
<p>Risk capital and capital markets Restructuring of the banking system continued with the sale of state-owned banks.</p>	<p>Government-sponsored seed- and venture capital fund scheme will focus on the provision of relatively small amounts of seed and early-stage capital to SMEs.</p>	<p>In progress "Further develop the risk capital market, particularly with a view to continuing to improve access to start-up and early-stage financing."</p>
<p>Human capital and R&D The average educational level is somewhat below the EU average, but the proportion of young people obtaining secondary education is closer to average. R&D expenditures and patents are below EU-average. Foreign firms account for most business R&D (e.g., pharmaceuticals and electronics), while public R&D spending is among the lowest of the EU.</p>	<p>National development plan has allocated additional funding to research, technological development and innovation over the period 2000-2006. Assistance is provided for R&D infrastructure, training and management within firms. Co-operative measures within industry are promoted. Several other measures aim at improving the national technology infrastructure.</p>	<p>Satisfactory "Implement the government's plans for a substantial increase in R&D expenditure through programmes to support R&D in SMEs, to promote co-operative networks within industry and to develop the national and regional research infrastructure."</p>
<p>ICT ICT diffusion is well developed, but ICT expenditure below EU-average.</p>	<p>Government announced in 2001 a 10-point plan for communication and e-commerce. E-government is being developed.</p>	

<i>Position and challenges (IRL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Labour market Low unemployment and employment rate somewhat above average. The labour market has become very tight. Employment growth has been further supported by immigration and favourable demographics.</p> <p>Wage formation relies heavily on social partners and tax reductions.</p> <p>Relative low benefits, low tax rates and lax employment protection.</p>	<p>Tax reductions seek to facilitate wage negotiations but contribute also to improved work incentives at the micro level.</p> <p>Tax reductions for dual-income couples and grants for more childcare places will support enhancing the labour supply of married women.</p> <p>An increase of child benefits has ambiguous labour supply effects.</p>	<p>Partial <i>“Promote wage developments that are consistent with the maintenance of price stability.”</i></p> <p>In progress <i>“Continue to focus measures on increasing the participation of women in the labour market.”</i></p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is on average. Preparations are advanced due to low government debt, continuous budget surpluses and the build up of a government pension fund.</p>	<p>The employment rate of older workers is somewhat above average, but could be promoted further.</p>	
<p>Environment Energy intensity has been reduced significantly.</p>	<p>Shift towards more fuel-efficient cars following a restructuring of vehicle registration tax.</p>	

Italy

Italy has been hit less than average by the international slowdown in 2001 and employment continued to increase. Unemployment has fallen moderately in recent years. Inflation is above the EU average, indicating some capacity constraints.

The **budget balance** shows a low deficit, which is projected to persist in forthcoming years. Announced future tax cuts are made conditional on fiscal sustainability and need to be carefully assessed before considered implemented. The very high debt ratio is falling gradually. Italy has taken significant steps to reform public pensions including consistently accounting for future increases in life expectancy. The reform is, however, implemented very gradually and not yet fully decided upon. The need for such extensive preparations for the **ageing** population is highlighted not only by the very high public debt level, but also by a higher than average generosity of public pensions.

The average labour productivity level is significantly above average EU-level, although undoubtedly affected by the very low employment rates of groups with less than average productivity and potentially also measurement problems due to the hidden economy. Labour productivity growth has been weak in recent years. Labour productivity is high in spite of the relatively low efforts and investments in **R&D** and human capital. **Product market** liberalisation is being enhanced and administrative burdens are increasingly being addressed. The use of ICT is increasing, although from a level below average. In **capital markets** venture capital is not well developed.

The unemployment rate is high and structural, even if important reductions have taken place. The employment rate is low, influenced by a very low and stagnating participation of older workers and a very low, but significantly increasing employment rate of women. **Labour markets** are characterised by large regional differences and segmentation with very large youth and long-term unemployment problems. These problems have been addressed by reforming employment protection, in particular enhancing the use of temporary work contracts and targeted fiscal incentives including tax reductions. While gradually shifting from employment protection to a broader and more generous unemployment benefit system may reduce labour market dualism and increase flexibility, care should be taken that this is not replaced by disincentives and budgetary costs. However, the generosity of the unemployment benefit system is initially substantially below that of other Member States.

Progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Enhancing further **educational reforms** aimed at raising educational levels
- Pursuing further **labour market reforms** aimed at reducing dualism, but avoid introducing unemployment traps.
- Making assessments and following up on measures to increase **competition**.
- Implementing and accelerating the transition phase of the comprehensive **pension reform**
- Speeding up efforts to **raise the participation rates** of women and older workers
- Continuing to reform taxation and administration in order to reduce **regulatory burdens** and the underground economy

<i>Position and challenges (I)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Implementation of EU directives Transposition deficit is slightly below average, however a very high number of infringement proceedings opened.</p> <p>State aid State aid is around the EU-average.</p>	<p>A strong reduction in the transposition deficit has taken place. Efforts to avoid the high number of infringement cases opened for violation of Internal Market Rules need to be speeded up.</p> <p>State aid has been reduced. The composition has improved with priority given to horizontal and regional aids.</p>	
<p>Public procurement Openness in terms of tendering published in the official EU journal is slightly below average.</p>	<p>Transparency and open tendering has increased. E-government has been promoted. Burdens have been reduced significantly. Further methods to simplify fiscal obligations and to reform</p>	<p>In progress “Reduce further the administrative burden for businesses and continue efforts to streamline regulations and administrative procedures”.</p>

Position and challenges (I)	Action taken	2001 BEPG recommendations
<p>Administrative burden Burdens are considered to be high, but have been broadly addressed.</p> <p>Barriers to entry in many markets.</p> <p>Widespread underground economy, which should be tackled by increasing the efficiency of the tax authority and a reduction and simplification of corporation and labour taxes.</p>	<p>company law were approved in 2001. Regional tax rates for companies have been suggested abolished. A system of dual income taxation taxing all capital income at 12.5 per cent is suggested. Measures still wait for parliamentary approval.</p> <p>A regional group of evaluators of submitted projects has been planned (use of European structural funds).</p>	
<p>Competition policy The institutions comply with Community rules.</p> <p>Liberalisation of retail distribution remains constrained by interests at the local level.</p> <p>The need to define a first best-regulatory framework should not postpone privatisation plans.</p>	<p>The competition authority has been strengthened and is pursuing an increasingly active and targeted approach.</p> <p>Regulation of professional services has seen little follow-up. A new regulatory framework in retail is being implemented, but liberalisation of shop opening hours has been turned down and barriers to large outlets persist.</p>	<p>None "Increase competition and remove access restrictions in the area of professional services".</p>
<p>Network industries Liberalisation is advanced in telecommunication and energy, but concentration and prices are high, in particular in electricity where oil dependency as well as insufficient competition contributes to high prices.</p> <p>Interconnection with other countries is limited, and its efficient use is hampered by inappropriate regulatory framework.</p>	<p>In electricity the incumbent is broken up and assets partly sold. The threshold for customers eligible to choose supplier has been reduced. Interconnection capacity vis-à-vis Greece has been increased.</p> <p>The gas market has been liberalised beyond minimum rules, but there is de facto limited choice. Simplification, unbundling and interconnection capacity is being considered.</p>	<p>In progress "Ensure that the liberalisation process in the energy sector will lower prices for households and small business users who are still unable to choose their provider; ensure the competitive provision of utilities at the local level in the framework of the reform of local public services".</p>
<p>Risk capital and capital markets The venture capital remains among the least developed.</p>	<p>Some constraints on investments by institutional investors were removed. Tax incentives granted to those who join supplementary pension funds were increased. The draft law on bankruptcy and insolvency has not been adopted by the Parliament.</p>	<p>Partial "Develop further the risk capital market by easing constraints on institutional investment in equity capital, and adapting the fiscal framework so as to facilitate investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws".</p>
<p>Human capital and R&D R&D expenditures are low and little growth of business R&D has been seen in the 1990s, although private R&D increased somewhat recently. This broadly reflects lack of a strong comparative advantage in R&D, because of average lower levels of education. Measurement problems may account for part of the recorded backlog, as e.g. process innovation is not recorded as well as product innovation.</p> <p>The need to foster education at secondary and university level is very high whereas efforts to support demand may not work well as long as capacity is constrained.</p>	<p>The strategy for R&D focuses on raising educational achievement levels and raising the efficiency of the university system, as completion rates are very low.</p> <p>The commercial use of public research has been promoted through patents. Tax measures have aimed at increasing investments in physical and human capital. New innovative companies can also replace capital through an insurance policy.</p> <p>Responsibility for R&D promotion and education has partly been transferred to the local level.</p>	<p>In progress "Promote business sector involvement in R&D and further encourage the wider diffusion of ICT and the use of e-commerce".</p>

Position and challenges (I)	Action taken	2001 BEPG recommendations
<p>ICT Internet diffusion has progressed well, but due to low investments in software, hardware and other services, ICT expenditure figures have not increased by much.</p>	<p>Infrastructure and technologies including broadband developments and digital services are being considered.</p>	
<p>Labour market High and structural unemployment even if some reduction has taken place in recent years. Very low employment rates for women and older workers, even if the former has increased.</p> <p>Large regional differences, but Southern Italy has recently contributed significantly to the reduction of average unemployment. Migration from South to North is limited, but increasing.</p> <p>Benefit levels are low and wage differentiation might effectually be higher than recorded. Wage determination mechanism remains in the domain of social partners. Wage drift is substantially higher in the North than in the South. Employment protection is strict, but is being loosened.</p>	<p>Good progress in reducing the tax burden on labour. Targeted tax incentives have also been introduced.</p> <p>Efforts have been pursued at building a simpler and more effective tax system, bringing this close to a flat rate system where the high rate applies only to very few. System of tax allowances allows for a certain degree of progressiveness. Private employment services have been liberalised.</p> <p>The use of temporary work contracts increased substantially in recent years. Steps are taken to shift from strict employment protection to protection in the unemployment benefit system.</p>	<p>Partial <i>"Reinforce efforts to let wage developments better take into account productivity and local labour market conditions".</i></p> <p>Partial <i>"Continue to increase labour market flexibility by combining measures to improve social protection of the unemployed with an easing of job protection for employees on permanent contracts".</i></p> <p>In progress <i>"Continue to bring down the tax burden on labour by gradually reducing tax and social security contributions. In particular, the reduction of the tax wedge on labour costs should be particularly targeted at the lowest end of the wage scale as a follow-up to recent measures, thereby increasing the employment opportunities for low-skilled workers, while reducing the budgetary impact of the tax cuts and complying with the need for continued progress in public debt reduction".</i></p>
<p>Ageing and pension reform Comprehensive reform of pensions systems is progressing from a very high level of pensions. The speed by which a full transformation to the new system will take place is very slow.</p> <p>Public sector debt reduction is fairly slow and efforts to increase the participation of older workers are limited.</p>	<p>The further pension reform is to be decided by parliament.</p> <p>The tax penalty on later retirement for aged workers has been reduced and the role of private pension funds has been enhanced.</p>	
<p>Environment Energy taxes are among the highest in the EU, but regulation seems to be the instrument most widely used.</p>	<p>Greenhouse gas emission certificates will be introduced in 2002 as well as tradable certificates between power plants.</p>	

Luxembourg

The growth performance of Luxembourg has been outstanding. Even in 2001, growth was substantially above average, although a significant reduction took place. Unemployment is very low, and inflation is slightly above average. In many respects Luxembourg can be considered to be a special case due to its size and the importance of the financial sector.

The **budgetary position** is very sound with large surpluses and an absence of public debt. Luxembourg is accordingly well prepared for population **ageing**, in particular if the average growth rates can keep up with those of the last years.

Labour productivity is very high, although probably partly due to foreign workers with high educational levels and measurement problems related to cross-border flows of workers. Competition on **product markets** is quite effective due to the geographical size and market integration, but could be increased by implementing the long announced reform of the competition legislation. Luxembourg has developed a strong position and great expertise in **capital markets**, the heavy reliance on the banking sector, however, makes the economy potentially vulnerable to shocks affecting the financial sector.

Labour markets are characterised by a very low rate of unemployment. Yet employment rates for women and especially older workers are significantly lower than the EU average. 60 per cent of workers are foreign of which 30 percentage points are commuting from neighbouring regions in other countries.

Some progress has been made with respect to implementing the specific BEPG recommendation in 2001.

The most important policy areas to be addressed are:

- Enhancing the **participation** rate of women and older workers.
- Completing the legislative process leading to a new **competition policy** and **price liberalisation**
- Strengthening efforts to improve **human capital**

<i>Position and challenges (L)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Implementation of EU directives The transposition deficit is slightly lower than average.</p> <p>State aid State aid is about average</p>	<p>The transposition deficit has been significantly reduced between 2000 and 2001.</p> <p>Aid has increased recently due to take-over of railway debt.</p>	
<p>Competition policy Competition authorities have not yet been empowered the authority to apply EU law.</p> <p>Public procurement Reform of public procurement, announced in 2000, is awaiting parliamentary decision.</p> <p>Administrative burdens Administrative burdens are relatively high</p>	<p>Reforms to adapt competition law, abolish monitored prices and increase market transparency are currently underway.</p> <p>Creation of one-stop shop.</p> <p>Measures to improve SME access to venture capital and training.</p>	<p>None <i>“Implement the announced reform of the competition legislation and thus the abolition of fixed and monitored prices.”</i></p>

<i>Position and challenges (L)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Network industries Liberalisation is advanced in telecommunications, but slow in other network sectors. Telecommunications prices are low compared to the EU average. The fixed-line market is dynamic with multiple competitors. Mobile telephone market is still a duopoly, partly due to limited market size. Household prices for electricity, and industrial prices for gas, remain above the EU average.</p>	<p>Legislation now allows carrier pre-selection, number portability and unbundling of local loop in the fixed line telephone market. Gas and electricity are being gradually liberalised. Market opening in postal services and in railways has been transposed into national law.</p>	
<p>Risk capital and capital markets This market is particular well developed.</p>	<p>Exchange of information between supervisory authorities has been improved.</p>	
<p>Human capital and R&D The effectiveness of the education system is considered to be low according to a recent OECD study. The level of educational attainment of the resident population is below the EU average. Patent applications per capita are somewhat above average.</p>		
<p>ICT Diffusion of ICT is above average.</p>	<p>The E-Luxembourg program is promoting e-government. E-commerce directives have been implemented since august 2000. Internet access in schools is very high.</p>	
<p>Labour market Despite very low unemployment, the national employment rate is below the EU average. The employment of women and in particular older workers is low and stagnating. Employment growth has concentrated mainly on non-residents. Benefit systems, especially where early retirement provisions are concerned, are generous, contributing to rapid decrease in participation rates after the age of 55. High unemployment benefits have been balanced by limited duration and strict job availability requirements. Wage formation includes price indexation.</p>	<p>The already low taxes are being cut further reflecting the solid budget balance. The government has proposed a revision of the definition of eligibility for a disability pension with the aim of restricting access to the scheme and keeping older workers longer in employment.</p>	<p>Partial <i>"Make further efforts to increase the national employment rate, especially for older workers by increasing the incentives in early retirement, pre-retirement and disability pension schemes to remain in employment, and for women by removing obstacles to their remaining in employment or re-entering the labour market."</i></p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is below average. A substantial part of pension expenditures benefit non-residents. Due also to the very solid budget position the ageing is well prepared.</p>		

<i>Position and challenges (L)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Environment</p> <p>Luxembourg has substantially reduced CO₂ emissions and further reductions are likely following, among other things, voluntary agreement with enterprises.</p> <p>Revenues from energy taxes are to some extent paid by foreigners because of substantial tax differentials vis-à-vis surrounding Member States.</p>		

The Netherlands

After a long period of strong increases in economic activity and employment, growth took a sharp downturn in 2001 due to the international slowdown. Before the slowdown capacity constraints were emerging and inflation ran higher than the EU average.

The **budget balance** is in surplus despite the recent tax cuts, and should remain so in the next two years according to the Dutch Stability Programme. Public debt should thus continue to decrease. The impact of **ageing** on public expenditures is expected to be in the high end compared to most Member States, but the Netherlands is also reasonably well prepared. At unchanged tax rates and social insurance contributions about half of the increase in ageing-related expenditures will be financed through higher tax revenues out of the increasing public and private benefits paid. Efforts to promote later retirement are proceeding gradually.

Hourly productivity is very high in the Netherlands while the number of average working hours per year is low. As a result, productivity per worker is below the EU average. Recent productivity increases have been disappointingly low. **Product market** competition is satisfactory for all tradable goods, the Netherlands being one of the most open European economies. However, prices remain high in some non-tradable products, especially in the housing sector, which is partly due to a lack of competition and strict planning policies. Having liberalised networks industries at an early stage, low price levels in both telecommunication and electricity have been obtained. Centralised wage moderation might have contributed to slow productivity growth. **R&D** expenditures are at the average EU level, but business R&D investments are low, affected by a lack of science and technology workers in the labour force. The use of ICT is very well developed. Regarding **capital markets**, in view of increasing concentration in the banking sector, a Board of Financial Supervisors has been set up in 1999 to reinforce the supervisory framework. Other measures are aimed to strengthen shareholder and consumer rights.

On the **labour market**, despite remarkable achievements, a fairly high average employment rate and a very low unemployment rate at 2.2 per cent according to ILO standards, the Dutch economy is still characterised by a substantial untapped reserve of labour (7 per cent of working-age population receive unemployment benefits and social assistance benefits, while 11 per cent receive disability benefits – which are interacting with the unemployment benefit system - including those with partial disabilities, and 2 per cent early retirement benefits). Large achievements have been made with respect to increasing employment rates of women and older workers, but from very low levels. Previous and ongoing significant tax reductions have also worked to increase labour supply, but further progress needs to address also disincentives embedded in benefit systems. In full time equivalents the employment rate is somewhat below the EU average.

Good progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Pursuing **tax and benefit** reforms to increase labour supply including implementing recommendations to actively prevent disability pensions
- Increasing **competition** in certain non-tradable sectors, especially the housing sector.
- Enhancing **human capital** and promoting a more technology-oriented education and innovation.
- Continuing **public debt** reduction and promoting **later retirement** to prepare for the ageing population

<i>Position and challenges (NL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives Transposition deficit is below average. State aid Low level of state aid, even if increase in 1999.	The non-transposition rate has been brought further down. Further reorientation of funds towards horizontal and R&D aid could take place.	
Public procurement Less than average value of tenders is published in the EU official journal.	The value of tenders published has increased. Reduction of administrative burdens by action plans on legislation for central	In progress <i>“Reinforce the level of competition by further opening up public procurement”.</i>

<i>Position and challenges (NL)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Administrative burdens The administrative burdens are considered to be reasonable.	government. E-government is stimulated for contacts between government and business.	
Competition policy Policies are well developed, but the level of competition in construction and some service sectors is low.	A general competition authority in was created in 1998.	
Network industries Liberalisation took place early and prices in telecommunication and electricity are low. Competition in the gas sector is not sufficient yet. There are problems related to efficiency in the railway sector.	Wholesale markets in electricity and gas were liberalised early 2001. The aim is to liberalise fully in 2004. Making the regulator independent is under consideration. Privatisation of energy suppliers would facilitate the reduction of incumbents' market share.	In progress <i>"Reinforce the level of competition by facilitating market entry in electricity, gas, cable networks and public transport".</i>
Risk capital and capital markets Capital markets are well integrated, partly due to the Euronext stock exchange integration with B and F. Venture capital is well developed, but still problems related to the early stage development.	Mergers in banking and insurance continued in 2001. Some measures have been taken to better accompany enterprise creations (extension of qualification period for early stage financing). The taxation of stock options has been reformed.	In progress <i>"Develop the risk capital market by further adapting the fiscal framework so as to facilitate investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws".</i>
Human capital and R&D Business expenditures as a percentage of GDP have fallen below EU average. There is an insufficiently supply of researchers. A tax credit is offered to private R&D.	Efforts have been made with respect to the development of ties between public and private research, increasing the budget for innovation-orientated research programmes and reviewing a subsidy programmes to private research.	In progress <i>"... increase the supply of qualified ICT personnel and trained researchers".</i>
ICT The use of ICT is very well developed. High internet charges may however hamper further internet penetration.	Budgetary resources for ICT training have been increased, and a task force launched new projects aiming at reducing the shortage of ICT experts.	In progress <i>"Take measures to improve the climate for innovation and to stimulate further ICT penetration".</i>
Labour market A low unemployment rate and a fairly high employment rate coexist with high proportion of active population receiving unemployment or disability benefits. As indicated by inflationary pressures unemployment is probably well under structural levels. Policies are active and well developed in most areas, however little has been done to increase work incentives imbedded in benefit systems. Eligibility rules and job search requirements are loose.	Further tax reductions and in-work benefits have been introduced. A bonus for leaving passive benefits is foreseen. The reform integrating administration of unemployment and disability benefits is being implemented. In 2000 a commission recommended a better targeting of disability pension at disabled persons and that a more active preventive approach should be pursued. The draft bills broadly following these lines should be implemented.	Partial <i>"Continue reforms of the tax and benefit system to make work pay. Reforms should focus on the still high marginal effective tax rates, especially at the lower end, and relatively lax eligibility rules, in particular to foster labour force participation among older workers and to facilitate the labour market re-integration of people receiving passive benefits, including those receiving disability benefits".</i>
Ageing and pension reform The demographic challenge of ageing is somewhat larger than average, but this is due to previous financial efforts is better prepared for than average.	The public debt reduction continues. The participation of older workers has increased from a low level. Early retirement is transferred gradually into more actuarial schemes and public support for early retirement will be phased out.	
Environment Comparatively high level of protection already achieved.	Some improvements still envisaged through the use of market instruments. A European approach is however desirable.	

Austria

Growth decreased substantially in 2001, affected by the international slowdown. Unemployment remains one of the lowest and inflation is presently at the EU average.

Austria recorded a balanced **budgetary position** last year as consolidation efforts were speeded up. However the improvement was due to an increase in the already high tax pressure. The increase in the tax level was due to broadening of the tax base, which is warranted from a structural point of view, and not increasing tax rates. The challenge of ageing is large and no comprehensive strategy has been developed. Public debt reduction has so far been limited. A few efforts have been made to promote later retirement.

Labour productivity has increased in relative terms to a level close to the EU average. Price levels are at EU-average. Compared to its location and size, the openness of the Austrian market is below average but has recently increased, thereby fostering competition on **product markets**. Although Austria is quite advanced in deregulating the network industries, the full effects of liberalisation are still to be seen, pending on the completion of a satisfactory regulatory framework. In particular, **competition** should benefit from separating the investigatory authority from government as envisaged. The law and enforcement in competition policy is not yet applied to EU law, but a planned reform has been developed as a response to this criticism. R&D expenditures are relatively low, but increasing. The use of ICT is increasing strongly. **Capital markets** remain insufficiently developed, although efforts have been made recently both to develop risk capital through fiscal incentives and to clarify the overall financial regulatory framework.

The **labour market** in Austria is characterised by a remarkably low unemployment rate and a fairly high overall employment rate. The employment rate among older workers is however very low and has not increased. Labour demand and labour supply are still hampered among certain categories by large social contributions and important disincentives on the supply side.

Some progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Developing a comprehensive strategy to prepare for population ageing, including in particular increasing **older workers'** participation
- Clarifying the **regulatory competition framework**
- Pursuing efforts to develop the **capital market, including risk capital**.

<i>Position and challenges (A)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives Fairly high implementation deficit. State aid In line with EU average.	Some efforts to reduce implementation backlog has been pursued and should be pursued further.	
Public procurement Less than average open advertisement Recommendations to harmonise Federal and Regional procurement legislation date from 1999.	No legislative step has been taken so far, but advertisement is taking place more openly. A Federal Procurement Company has taken over the responsibilities of the federal administration in this field.	Partial <i>i. "Transpose the Community's public procurement directives and further open up public procurement to competition, in particular at the provincial and local levels;"</i> <i>ii. "Realise expenditure savings [...] in the area of administrative reform and the social security sector;"</i>
Administrative burdens Are considered relative high	Significant steps have been taken including the creation of one-stop shops	
Competition policy Austria has not yet empowered its competition authority to apply EC law. Enforcement difficulties of regulators' decisions might also sometimes occur, as in telecommunication.	Independence has been granted to regulators in most fields. Some clarification of the regulatory context is however needed in almost all fields.	

<i>Position and challenges (A)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Network industries Legislative process is well advanced in electricity, gas and telecommunications. Telecommunication prices are somewhat high, but falling.</p>	<p>In electricity, full liberalisation has prompted a fall in prices. Local loop unbundling is starting. Some confusion over regulation activity in telecommunication could lead to protracted abuse by the incumbent.</p>	
<p>Risk capital Is insufficiently developed to respond to business needs</p> <p>Capital markets Low share of equity ownership, high number of preference shares.</p>	<p>Some progress on establishing a fiscal framework more conducive to investment and entrepreneurship. Measures are taken to foster financial participation of employees. Creation of the Financial market Supervisory Authority in 2002 in a context of rapid concentration of banks.</p>	<p>In progress <i>“Develop further the risk capital market by easing constraints on institutional investment in equity capital, by establishing a fiscal framework more conducive to investment and entrepreneurship.”</i></p>
<p>Human capital and R&D Shortage of ICT experts, and skilled workers in manufacturing and services. Available research personnel are in line with EU average. Expenditure on R&D below EU average, in particular in business</p>	<p>The Foreigner Employment Act has been modified to facilitate the recruitment of foreign ICT experts.</p> <p>R&D infrastructure is being revised.</p>	<p>In progress <i>“Implement fully the announced reforms to promote the development of the knowledge economy and take measures to increase the supply of ICT-skilled personnel.”</i></p>
<p>ICT Business expenditures in this field are below EU average. This may be due to a lack of competition, especially in telecommunication.</p>	<p>The impact of recent programmes to foster R&D and ICT use are yet to be seen, even though internet use has recently increased</p>	
<p>Labour market The unemployment rate is low. The overall employment rate is above average, but employment rate of older workers is very low and stagnating.</p> <p>Agreement over measures to tighten job acceptance criteria is desirable.</p> <p>Fairy strong regulation</p>	<p>Eligibility period to obtain unemployment benefits has been increased for older workers, which reduces incentives to look for employment. Impact of new childcare allowance on female participation is ambiguous. Recent privatisation/regionalisation of public employment service could improve efficiency. Bringing unemployed benefits and means-tested social assistance under same administration is also desirable. Additional wage-flexibility at firm level has been introduced and should be extended and used in practice.</p>	<p>Partial i. <i>“... in the following years reduce the high tax burden, in particular on labour [...]”</i> ii. <i>“further reform tax and benefit systems to increase incentives for older workers to remain active in the labour market.”</i></p>
<p>Ageing and pension reform The future increase in ageing related spending pressures are higher than average and pension expenditures are already higher than the EU average.</p> <p>Strong work disincentives encourage early retirement.</p> <p>A comprehensive strategy is not developed yet.</p>	<p>The 2000 pension reform, which increased the minimum age for early retirement, is expected to limit the increase in future federal transfers to the statutory pension scheme and provide some incentives for later retirement.</p> <p>Austria has announced further reforms, in particular to develop the second and third pillars.</p>	<p>Partial <i>“In view of long term challenges – notably resulting from population ageing – continue reforms in the pension system: in particular review already in 2001 benefit levels and reconsider access to invalidity pensions in order to increase the average retirement age; in the health care sector: take measures to counter the rising spending pressures.”</i></p>
<p>Environment Among the most advanced countries.</p>	<p>Regulation should progressively be replaced by market-based instruments when possible.</p>	

Portugal

Portugal has achieved robust growth in production and employment and unemployment is low. The growth slowdown in 2001 was less than average. Macro-economic risks to the medium-term growth outlook exist in terms of an eroding level of competitiveness lately and a very large current account deficit. Inflation was well above average in 2001.

The **budget balance** deteriorated in 2001, partly because of a revenue shortfall due to compliance and enforcement problems with the 2001 tax reform, the financing elements of which aimed at tax base broadening and higher efficiency. There are risks associated with weakened competitiveness and adjustments from the very high consumption and investment spending from materialising into weaker growth. The future fiscal **ageing** burden in Portugal is of average size. Some measures have been taken to reduce the projected increase in government spending. A comprehensive strategy is not fully developed.

The productivity level is below the EU-average, although it is to some extent affected by the high employment rate covering also low productive workers. For a catch-up country recent productivity increases have been disappointingly low, contributing to an eroding level of competitiveness, as wage increases have not followed suite. A low level of educational levels and attainments remains a key problem and an obstacle to skill- and technology-intensive growth. The economy is less integrated than average due to its geographical location. In **product markets**, the move towards liberalisation of the energy and telecom sectors has been relatively slow, and prices in network industries are relatively high. **R&D** expenditures and patents are very low, hampered by insufficient human capital build-up. The use of ICT is catching up from a relatively low level. In **capital markets**, high levels of private bank debt and continued strong expansion of credit are posing important challenges to financial sector supervision and regulation.

Performance **in labour market** has been strong with further improvements in already relatively high employment rates and low unemployment. Inflationary pressures until the recent slowdown suggested, however, overheating indicating that present levels may not be sustainable in the absence of further reform. Employment protection legislation is strict, but a large share of self-employees and a strong concentration of employment in fixed-term contracts have counteracted potential flexibility problem with respect to employment creation. Yet the expansion of employment on non-permanent contracts implies a risk of a segmented labour market emerging, and the strict employment protection may have hampered productivity.

Progress has been made with respect to implementing the specific BEPG recommendations for 2001.

The most important structural policy areas to be addressed are:

- Improving the quality and level of **educational attainment**
- Ensuring larger efficiency and **training programmes** and address labour market segmentation and flexibility
- Speeding up the liberalisation of **network industries** and ensuring effective competition
- Improving **investment efficiency** and continuing the reduction of **administrative burdens**
- Speeding up the preparation for the **ageing** population

<i>Position and challenges (P)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Implementation of EU directives Implementation deficit is somewhat higher than average</p> <p>State aid Is higher than average and is particularly sector specific and ad hoc</p>	<p>The implementation deficit has been reduced substantially in 2001.</p> <p>Aid has been reduced slightly</p>	<p>Satisfactory "Continue progress made in transposing internal market directives"</p> <p>Partial "Sustain the progress made in containing State aids (particularly sector-specific ones)"</p>
<p>Public procurement</p> <p>Administrative burden Administrative burdens remain substantial for new businesses.</p>	<p>Measures seek to increase information and simplifying documents thereby increasing competition for public contracts. Public bids via the internet are underway.</p> <p>A commission for legislative simplification has been created.</p>	

<i>Position and challenges (P)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Competition policy	New independent competition authority to be established in 2002. Some final decisions however taken by the Minister.	
Network industries Liberalisation has taken place somewhat late, markets are highly concentrated and prices are high, particularly in electricity. Liberalisation of the electricity sector has progressed since 1999. Telecommunications liberalised in 2000. Liberalisation of gas market due in 2007 (derogation).	Unbundling of the local telecommunication loop is under way. Some elements of the EU Gas directive were transposed in 2000. Ownership of the electricity grid is removed from the former public monopolist. Railways are being opened up to competition.	Partial "Step up efforts to liberalise energy sectors, particularly to the benefit of small business users and households"
Risk capital and capital markets The capital market is gradually becoming more internationally integrated. The already limited venture capital market suffered from stock market developments in 2001.	Efforts to eliminate double taxation on return to venture capital. Public funding is provided. Co-ordination among financial supervisors has been strengthened. Little improvement has been achieved in the adjustment of the bankruptcy laws.	Partial "Develop further the risk capital market by easing constraints on institutional investment in equity capital, by establishing a fiscal framework more conducive to investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws"
Human capital and R&D The level of R&D expenditures and patenting are very low. Expenditures on education are higher than during early 1990s, but the educational achievement rate remains among the lowest of the EU. There are concerns for low efficiency.	The government has started to implement a reform of the educational system. Measures have been taken in the areas of secondary and higher education and for the diffusion of technologies in the enterprise sector, including actions targeted at SMEs. Some increase in R&D spending took place. Network links between the business sector, universities and public research centres have been strengthened. A tax credit is provided for R&D.	In progress "Enhance efforts to raise the level of R&D investments, particularly by the business sector"
ICT ICT investments have grown to above EU average, but the share of computer hardware and software is low. Household internet penetration stands at less than half the EU average.	Many initiatives are taken to increase the take up of ICT in business, schools and public administration. Infrastructure and training is promoted. The "Internet initiative" aims at connecting all schools to the Internet by end 2001.	In progress "Further promote the diffusion of ICT, in particular by taking measures to increase the supply of skilled ICT personnel"
Labour market Employment is high and unemployment is low. The employment rate of older workers is among the highest and still increasing. High employment among people over the normal retirement age is a special factor. The replacement rate in benefit systems is high. Relatively strict severance pay and dismissal requirements hamper labour mobility.	The labour market has become very tight. Employment growth has been highly concentrated on fixed contracts, reflecting strict employment protection. The low average tax burden on labour is still below average, but steadily increasing. Efforts to simplify and systemise the extensive system of active labour market policies were launched in 2001. The efficiency of these policies must be evaluated carefully.	In progress "Increase investments in and improve education and training systems in order to raise the employability, adaptability and productivity of the labour force" Partial "Enhance, together with Social Partners, quality of work and promote modernisation of the labour market institutions, adapting labour regulations and continuous training, in order to minimise the risk of segmentation between regular and atypical contracts"

<i>Position and challenges (P)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Ageing and pension reform The future increase in ageing related spending pressures is about average. The debt level is moderate, but stagnating. A comprehensive preparation for ageing is not fully developed.</p>	<p>A new framework law for social security is in place and a number of measures have been taken to reform the pension system, although only partly directed at preparing for the ageing population.</p> <p>Pension benefit formula was changed towards longer contribution period and the indexation of past wages has been reduced and the flexibility of retirement age is increased. On the other hand minimum pensions are increased.</p> <p>A capitalization fund has been strengthened.</p>	
<p>Environment</p>	<p>Ecological tax reform is underway. Efforts taken to improve the environment in the areas of water quality and waste, but the agricultural sector is exempt from additional fees on water use for irrigation or for polluting ground water.</p>	

Finland

Economic growth was very strong until 2000. The slowdown in 2001 has been very strong, partly due to a reversal of the in the case of Finland particularly important ICT-cycle which boosted previous years. Employment growth was fairly strong in recent years, including 2001. Inflation is a little higher than EU average.

Substantial surpluses in the **budget balance** imply that fiscal consolidation is well underway, although necessary as Finland in facing one of the largest **ageing** challenges among Member States. A pension reform is underway and expected to reduce pension expenditures by 2 per cent of GDP in the long term.

The productivity level is at the EU-average, but the overall price-level remains above the EU average due to insufficient **product market** competition affecting some sectors, partly as a result of geographical remoteness of many regions. Finland is advanced in the liberalisation of network industries, in particular in the telecommunication sector, where prices have decreased significantly. But further efforts are necessary. Very few households have so far changed electricity supplier following liberalisation, which indicates that full benefits still remain to be reaped. Competition can also be further strengthened in the media sector. Open competition in public procurement has not advanced significantly. In general a more active and targeted competition policy and enforcement might be pursued. Results in **R&D**, patenting, the use of ICT and human capital are among the highest in the EU. In **capital markets** reforms have been targeted at improving the regulatory and supervisory framework. In particular they have focused on new regulations on insider trading. However, the number of business start-ups in Finland remains low.

With respect to the **labour market**, the decline in unemployment has slowed down recently and unemployment stands somewhat above the EU average, considerably higher than the low level experienced until the early 1990s. The government has recently increased unemployment benefits, to some extent offsetting the improved work incentives for the low skilled due to tax and other reforms.

Finland has a strong record in environmental and sustainable development as **environmental policy** has been well developed, e.g. through the use of taxation as an environmental policy instrument.

Some progress has been made with respect to implementing the specific BEPG recommendations for 2001.

The most important structural policy areas to be addressed are:

- Pursuing a more active **competition** policy in order to reduce high price levels, including the retail sector.
- Further developing the set of instruments, in addition to tax measures, used to **reduce unemployment**
- Improving **public procurement** practices
- Continuing public debt reduction and implementing the reforms of pension systems currently under consideration in preparation for the rapid **ageing** of the population.

<i>Position and challenges (SF)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives Very low transposition deficit State aid Highest level of sector-specific and ad hoc state aid in the EU, a large share of which is to agriculture.	Transposition deficit has been further reduced.	
Public procurement Relatively low use of EU-wide tendering. VAT rules have impeded private service provision. Administrative burden One of the most time-consuming processes in the EU to set up new company. Fewer business start-ups in Finland than in most other Member States.	Electronic information exchange to aid public procurement set up in 2001. VAT rules have been revised. Revision of the Companies and Accounting Act in 2001 aims at reducing burdens. Further improvements are possible.	In progress <i>“Enhance compliance with regulations in public procurement, especially at the local level, and increase transparency in the provision of public services in order to heighten private firms participation.”</i>

<i>Position and challenges (SF)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Competition policy Competition law complies in principle with EU law, but penalties are modest. Relatively weak competition in retail sector, construction and media.</p>	<p>Regulatory framework of retail distribution has been further liberalised. General framework for competitive oversight improved.</p>	<p>Partial “Enhance competition in industries such as distribution, construction, and the media sector.”</p>
<p>Network industries Telecommunications and electricity markets have been fully liberalised, leading to significantly lower prices. Households have been slow to reap full benefits.</p>		
<p>Risk capital and capital markets Good progress achieved with financial market reforms.</p>	<p>New working group set up recently to reform capital income and corporate taxation.</p>	<p>Partial “Develop further the risk capital market by adapting the fiscal framework to make it more conducive to investment and entrepreneurship.”</p>
<p>Human capital and R&D Strong human capital base and well above average expenditures for R&D expenditure. Large patent uptake. Good innovation networks between private companies, universities and capital markets.</p>		
<p>ICT Among the highest ranking countries in internet penetration. Among leading countries in mobile internet technology worldwide.</p>		
<p>Labour markets High level of structural unemployment, but fairly high participation rates for all groups. Substantial regional unemployment disparities remain. Labour market and pension reforms underway. Previously ineffective targeting of active labour market programmes.</p>	<p>Tax reforms are reducing labour taxes, but no large reduction in marginal effective tax rates including for the low skilled is envisaged. Further tax reductions in 2002, but tax rates on low and medium wage earners well above EU average. ALMP have been better targeted through new measures in 2001. The gross UIB replacement rate is being increased somewhat.</p>	<p>In progress “Strengthen efforts to reduce high marginal effective tax rates especially on low wage earners and to improve incentives in benefit, especially pension, schemes to take up a job offer and to stay in the labour force.” “Increase the efficiency of active labour market programmes and refocus them to the needs of those most prone to the risk of long-term unemployment.”</p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is higher than average. Preparation through government debt reduction is advanced, and a pension reform is to be finalised soon.</p>	<p>A few steps have been taken to increase the effective retirement age, but reform momentum should be kept up further.</p>	<p>In progress See labour market recommendation above.</p>
<p>Environment Widespread use of environmental taxes to reduce CO2 emissions.</p>		

Sweden

Growth performance since the deep recession in the early 1990s has been strong even if the international slowdown triggered a significant reduction in 2001. Unemployment had not yet increased. Inflation is presently running higher than the EU-average.

The government has set a target of 2 per cent of GDP **budgetary surplus** on average over the business cycle and the surplus has in recent years been higher than that. Due to the remarkable fiscal consolidation, the debt to GDP ratio is falling strongly to a level below EU-average. Despite a reduction in the expenditure-to-GDP ratio and significant tax cuts, Sweden retains the highest tax-burden in the EU. Debt reduction and the recent comprehensive pension reform put Sweden in a good position to absorb the impact of **ageing** on its pension and health care expenditures, which, partly due to the comprehensive pension reform, is lower than average.

The productivity level is below the EU-average and the gap has increased slightly during recent years, as productivity growth has been relatively weak. **Product markets** are probably insufficiently competitive in view of a very high price level, although this also reflects high indirect taxes and the remote location of many regions. Public ownership, and the size of the public sector as a whole, could also act as an impediment to competition. Liberalisation of network industries is advanced and prices are low, in particular electricity prices fostered by a rich supply of hydroelectric power. In sectors such as electricity, gas, telecommunication or pharmaceuticals, public ownership could imply a conflict between the government's roles as shareholder and regulator. Sweden has introduced competition in parts of public service provision, and employment in private companies providing welfare services has increased. The performance in R&D, patents and the use of ICT is very advanced. Also venture capital is well developed until the recent setback in financial markets. In **capital markets**, venture capital activities were very high in 2000, but declined significantly as stock markets deteriorated.

The Swedish **labour market** is characterised by high employment rates and high ambitions in this respect. The high employment rate of older workers is particularly outstanding, and the employment rate of women is also high. Unemployment has been stabilised at a low level, although further 2.5-3 per cent of the labour force participates in active labour market programmes and training programmes.

Good progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Promoting **competition** in products markets
- Continuing to improve the **efficiency of the public sector**
- Achieving a better balance between the state's interests as shareholder and **regulator**
- Furthering better **diversification** of the economy
- Continuing to **reduce government debt** to prepare for the ageing population

<i>Position and challenges (S)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU Directives Low transposition deficit State aid Well below EU average, most aid is horizontal or regional	Transposition deficit has been further reduced.	
Public procurement Fairly high advertisement rate, but some public institutions fail to comply with existing regulations, particularly at the local level. Administrative burdens Lower than average	The Public Procurement Committee aims to reform and simplify procurement procedures. Proposal on a dispute resolution clause of the Competition Act is under consideration. A planned database on municipal services will facilitate benchmarking. Special efforts to reduce administrative burden for companies and develop entrepreneurship	In progress <i>"Enhance compliance with regulations on public procurement and enhance competition in public services provision at local levels."</i>

<i>Position and challenges (S)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
<p>Competition policy Competition policy complies with EU legislation and is pursued actively. The price level is high above EU average, partly due to insufficient competition, especially in food retailing and construction. SAS remains dominant in domestic air transportation.</p>	<p>A recent court decision bans SAS' use of its frequent-flyer programme on domestic routes. A proposal to enhance competition has been presented. In the retail market for pharmaceuticals, the government has maintained the state-owned monopoly, but is taking steps to reduce prices. Generally, the competition regime has been improved and the regulation authority strengthened.</p>	<p>Partial "Increase competition in areas such as air transport and pharmaceuticals."</p>
<p>Network industries In <i>telecommunication</i>, prices have fallen significantly although difficulties in unbundling local loop remain. <i>Energy</i> markets are relatively open to competition. The electricity market is fully deregulated. <i>Railway</i> transport deregulated. Generally, incumbents retained significant market share, possibly partly due to lack of transparency.</p>	<p>Improved regulation regarding number portability and sale of excess network capacity in telecommunications. Improved consumer information services planned in electricity.</p>	
<p>Risk capital and capital markets A high level of venture capital was obtained until the recent sharp fall in stock markets.</p>	<p>Progress in improving bankruptcy legislation to encourage reconstruction of failing companies. Some proposals to reform corporate taxation. No efforts yet to promote employee ownership schemes.</p>	<p>In progress "Develop further the risk capital market by adapting the fiscal framework to make it more conducive to investment and entrepreneurship, the latter to be also encouraged by adjusting bankruptcy laws."</p>
<p>Human capital and R&D Investment in R&D is very high. Education is advanced, although concerns for quality in some areas persist.</p>		
<p>ICT Sweden is front-runner in ICT. However, diversification of the economy diversity could be a way to reduce vulnerability to ICT-driven downturns.</p>	<p>The Swedish government strives to make its policies neutral towards the different sectors.</p>	
<p>Labour markets High employment rate above EU average and Lisbon targets. Unilateral employment rate target of 80 per cent by 2004 among the 20-64 years. High female employment and very high among older workers. The efficiency of active labour market policies is uneven, the most successful involving private sector employment rather than classroom teaching, and self-employment grants preferably to employment subsidies.</p>	<p>Tax reforms have generally aimed tax cuts at low-income groups. Recent reforms strengthening the eligibility criteria for unemployment benefits will promote incentives to work. Measures designed to make social benefits more generous could however exert a negative effect on employment rates for some groups. Based on evaluation of experience the least efficient programmes have been cut, while targeting active measures at the most vulnerable groups. Significant effects, especially with respect to the weakest groups (e.g. the youth), remain to be seen.</p>	<p>In progress "Pursue reforms of tax and benefit systems to promote work incentives and, in particular, reduce the tax burden for low wage earners." In progress "Ensure the efficiency of the ALMPs and target them at those most prone to the risk of long-term unemployment, as well as to meet the demands of the labour market"</p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is lower than average, partly due to a comprehensive pension reform.</p>	<p>The 1999 pension reform is the most comprehensive one in the EU so far, taking, e.g., variations in life expectancy into account.</p>	

<i>Position and challenges (S)</i>	<i>Action taken</i>	<i>2001 BEPG recommendations</i>
Environment The use of market-based instruments including taxes is well developed.		

United Kingdom

The UK economy slowed considerably less than most Member States in 2001, and unemployment came further down before increasing slightly during the year. Inflation is very low, however affected by exchange rate developments.

Government finances are healthy, although with a diminishing surplus on the **budget balance**. A strong projected increase in public investments directed at reducing an infrastructure backlog might turn the budget into a small deficit. Government debt is low and decreasing. Due to this the UK is well prepared for the **ageing** population in particular if price indexation of the majority of public pensions is maintained in the long run.

The average productivity level is somewhat below the average of EU-countries, although the gap has diminished slightly. The price level is high, however partly due to present exchange rates. **Product market** competition works well and the UK is among the front-running Member States as concerns liberalisation of networks, the reduction of state aid, tendering of public procurement and an active competition policy. The transposition of single market directives is less encouraging. The early liberalisation of network industries provided substantial consumer benefits, but prices have in recent years fallen slowly compared to other Member States. The railway system is not working well, which is considered to be the result of a large historical investment backlog. Many efforts are taken directed at enhancing the quality of public services. Tax policies are very active and selective and while the many individual tax credits are well argued, concerns include transparency and tax rates for those activities not enjoying such preferential treatment. **R&D activities** are at the EU average and the use of ICT is above average. The impact of extending the R&D tax credit to larger enterprises must be assessed carefully as the key issues are to ensure a high supply of researchers and the transformation of knowledge into research and value-addition. With respect to **capital markets**, integration with other EU countries continued, in particular in financial services and the stock market. The introduction of a single regulatory body – the Financial Services Authority – has contributed to further promote a level playing field among financial institutions. New regional venture capital funds have been introduced and designed to correct adverse incentives of fund managers, however the first half of 2001 saw a steep fall in risk capital investments.

The employment rate in the UK is relatively high and average unemployment is low. Significant unemployment pockets remain concentrated on workless households and in deprived areas. **Labour market** policies include a wide range of measures including in-work tax credits, active labour market policies, local action teams and stronger public employment services. Benefit levels are low and the level of wage differentiation is high.

Good progress has been made with respect to implementing the specific BEPG-recommendations for 2001.

The most important policy areas to be addressed are:

- Reducing the backlog in **single market transposition**
- Improving public/private investment backlog and continue policies aimed at diminishing the **productivity** gap
- Improving **competition** in selected problem areas
- Ensuring that the **tax system** remains transparent and assess the outcome of selective tax measures
- Continue addressing **labour market** problems in deprived areas and promote later retirement

<i>Position and challenges (UK)</i>	<i>Action undertaken</i>	<i>2001 BEPG recommendations</i>
Implementation of EU directives High transposition deficit	Transposition record has deteriorated.	
State aid One of the lowest rates in EU	Aid and the use of tax credits should be assessed in combination.	

<i>Position and challenges (UK)</i>	<i>Action undertaken</i>	<i>2001 BEPG recommendations</i>
<p>Public procurement Good performance. High rate of tenders published in EU official journal.</p> <p>Administrative burdens Regulatory burden on business is relatively low. Good progress with introduction of efficient public policy management structures.</p>	Public expenditure system refocused on outputs and outcomes rather than inputs. Peer review and cost-benefit analysis introduced. Performance-pay for public servants improves incentives.	
<p>Competition policy Institutions are in line with Community legislation, and an active targeted approach is pursued.</p>	Competition regime further strengthened with a view to introduce more competition focused tests. Reports on retail banking, car retailing and postal services are being considered. Temporary specific postal licenses have been issued.	<p>In progress "Take measures to address the relatively low level of productivity, in particular by increasing competition in sectors such as retail banking services, car retailing and postal services".</p>
<p>Network industries Liberalisation is advanced, but the initial performance advantage is fading. Efficiency problems remain in the rail sector and water.</p>	New electricity trading arrangement is considered to be successful. Access of new operators in telecommunications is promoted. Principle behind rail reform is to link expenditures to outcomes. Substantial new investments are planned over the next 10 years.	<p>Partial "Ensure that the announced investment to improve the transport infrastructure and to improve the quality of public transport is delivered in practice and ensure that there is adequate co-ordination between different public bodies, regulators and private firms".</p>
<p>Risk capital and capital markets Good performance in financial services reform but further efforts in developing venture capital markets possible.</p>	UK Government intends to consult on legal change to pension funds trustees' duties.	<p>In progress "Further encourage the role of pension funds in the development of the risk capital market".</p>
<p>Human capital and R&D R&D expenditures at average EU-level. Patent applications are lower.</p>	R&D tax credit has been extended to larger companies. A new review will be issued in 2002 on skills improvement for scientists. Work-permit-regime for high-skilled foreign workers has been overhauled. The problem of making better commercial use of public research is being addressed.	
<p>ICT Expenditures in and the use of ICT is above the EU-average.</p>	Considerable new resources allocated to ICT in schools. Compulsory courses for improving ICT skills.	<p>In progress "Take measures to address the relatively low level of productivity by increasing the supply of skilled ICT personnel."</p>
<p>Labour market The average unemployment rate is low and the employment rate is relatively high. Concentration of long-term unemployment and inactivity continue to be a problem in specific pockets of the labour market.</p> <p>Low taxes and benefits. Lax employment protection.</p>	Further efforts in public employment services. Merger of employment service with service of benefits agency is a significant step. In-work tax credits are being extended. A range of active measures has been maintained and reinforced. In several areas, reforms could be taken further beyond the 'pilot stage'.	<p>In progress "Reinforce active measures targeted at those communities and individuals most prone to the risk of concentrated or long-term unemployment and inactivity, and reform passive benefit schemes to provide people who are able to work with the opportunities and incentives to do so".</p>
<p>Ageing and pension reform The future increase in ageing related spending pressures is less than average. Public debt is low and the majority of pensions are indexed to prices.</p>	Minimum income guarantee for pensioners has been extended. Second and third pillar pensions are widespread and a subsidy has been introduced to promote further use.	

<i>Position and challenges (UK)</i>	<i>Action undertaken</i>	<i>2001 BEPG recommendations</i>
Environment Comprehensive environmental strategy.	Introduction of new greenhouse gas emissions trading instruments.	