ECONOMIC POLICY COMMITTEE

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Synthesis report on structural reforms in Member States

- Report addressed to the Council and the Commission -

Quick Guide to the Synthesis Report

Introduction

* This Synthesis Report is the product of a country examination of all 15 Member States of progress made in the structural reform of product, service and capital markets, labour markets and long-term public finances.

* This is a new process which provides a peer review of Cardiff Economic Progress reports. It takes a comprehensive look at the reform process, provides "bench marking" comparisons between countries and gives examples of "good practice". It is intended to serve as an input to the formulation of the Broad Economic Guidelines.

* Structural reforms will support stability-oriented macroeconomic policy in promoting non-inflationary growth and a high level of employment. They will also raise living standards and employability.

* Many encouraging reforms are under way; some countries are further advanced than others but there is plenty to learn from one another; the EPC should continue to examine "transferability" of good practice.

* Historical structures tend to favour "insiders" (those who already have jobs and own businesses) against "outsiders" (those without jobs and potential entrepreneurs). There is a need to change these structures if the EU is to match the performance of the US on jobs and growth or new technology.

* Structural reforms should be mutually reinforcing: more competition in services, for example, needs to be accompanied by tax-benefit reforms, better training and childcare. The result is an increase in employment and labour supply as well as improving longer-term fiscal sustainability and so keep its taxes down.

<u>Product and Capital Markets</u>

* Liberalisation should not be inconsistent with public service values, such as the equal provision of high quality accessible and universal services, including new technologies, to all consumers.

Privatisation (paras 2.8 – 2.9)

* Privatisation should ultimately promote competition and efficiency, as well as reducing deficits and changing management culture. A pragmatic approach must prevail, focussing on actual performance, efficiency of services provision and consumer protection.

Private financing (paras 2.10 – 2.12)

* Some countries are experimenting with the use of private management and capital to provide public services, whilst others have modernised public operators.

Utility Liberalisation (paras 2.15 – 2.21)

* Utility liberalisation is proceeding fast at both the national and EU level. Significant benefits have accrued in telecommunications. Experience in some countries suggest there may also be benefits in gas and electricity. Progress in transport and water is less marked. Thorough sectoral assessment of experiences is needed to determine where and how such benefits can be expected.

* Sector-specific price regulation to protect consumers is necessary where competition is not feasible, using examples of good practice from Member States.

Competition Policy (paras 2.24 – 2.26)

* Market liberalisation should be backed up by a new regulation environment better adapted to changing social and economic circumstances as well as by strong and independent regulators.

* The effective implementation of competition policy requires strengthened enforcement of existing rules through independent competition authorities.

State Aids (paras 2.27 – 2.28)

* State Aids are decreasing in importance but Member States need to reinforce their efforts to ensure that respect for the Treaty rules is effective at all administrative levels so that all public measures are subject to Commission control and do not distort competition.

  The EPC intends to deepen its understanding of state aids. This will require further conceptual and analytical work, in particular on the distortionary impact of state aids on competition and the functioning of the single market.

Promoting SME's and Innovation (paras 2.29 – 2.40)

* SMEs can create the jobs and dynamism the EU needs but regulation must be improved to ensure this dynamism is not stifled, using examples of good practice from Member States, for example by lowering the administrative burden.

* Effective measures to raise productive R&D must be identified, building on good country examples.

Liberalising financial markets (paras 2.41 – 2.44)

* There is a need to spread good examples in the venture capital field across EU.

* The role of state-owned banks must be consistent with efforts in many countries to increase banking competition and efficiency.

<u>Labour Markets</u>

* Liberalisation of service markets may encourage more self-employment.

The demand side (para 3.5)

* Lower non-wage labour costs will promote competitiveness and encourage employers to take on more workers.

* Tax burdens on low paid workers need to be a priority for reduction (for example through lower marginal tax rates). However, further reduction of the general tax burden may also be required.

The supply side (paras 3.6 – 3.13)

* Tax benefit reforms could increase the supply and demand for labour by improving incentives for employers and potential employees.

* It is best to concentrate tax-benefit reforms at the lower end of the wage distribution.

* Benefit systems need to reinforce effective job search through better targeting and administration and by ensuring workers remain in touch with the labour market, building on examples of good country practice.

Improving employability (paras 3.14 – 3.25)

* Younger workers, older workers, women and the long-term unemployed are particularly likely to suffer from “outsider” problems.

* Education systems and training policies play a major role in raising productivity and human capital. Improving the standard and quality of provision is a continuous process in view of the changing qualifications required by businesses and the labour force, and the growing importance of life-long learning. Reforms to education and training should also focus on improving the transition from school to the labour market. Member States should critically review their education systems and exchange examples of “good practice”.

* Active labour market policies are particularly important for the young and the long-term unemployed. These policies need to be continuously evaluated and benchmarked against other countries’ performance to ensure that they are effective in promoting employability.

* A range of reforms in both service and labour markets are needed to raise employment among women, in particular by making work more family-friendly and improving the level of skills of women.

* Many countries can improve their benefit and labour market systems so as to remove barriers and disincentives to older workers continuing to work and to encourage them to rejoin the labour markets.

Increasing labour mobility (para 3.26)

* Given that many countries suffer from regional imbalances, a lack of labour mobility can increase unemployment,. Reforms to pensions, benefits and housing systems as well as cross border exchange of information between employment services could encourage mobility at both the national and the EU level.

The role of social pacts (paras 3.27 – 3.31)

* A number of countries encourage dialogue between the social partners not only on wages but also on macroeconomic policies and structural reform. There is a need to reconcile the usefulness of this social dialogue at a national level with the trend to increasing decentralisation of wage-bargaining in many countries.

Fairness (paras 3.32 – 3.37)

* The structural reform process needs to be based on fairness, a concern for social exclusion and the distribution of income. Many countries have national minimum wages to protect the incomes of low paid workers, but such programmes need to ensure that total labour costs are compatible with the productivity of different groups if they are not to have adverse effects on employment. Given that employment is a key weapon in the fight against social exclusion, this is important for the fairness agenda itself. There may be scope, in some cases, for in-work benefits or tax-credits to combat low incomes and increase incentives to take up work.

Fiscal sustainability

* Further debt and structural deficits reductions are called for in most Member States. This will create room for manouevre to meet future challenges, such as those resulting from the ageing of the population and to allow the automatic stabilisers to operate in case of a slowdown, while fully respecting the Stability and Growth Pact.

Rules play a role in some Member States (paras 4.2 – 4.6)

* Medium term rules, e.g. for controlling government spending and for dealing with effects due to cyclical and structural developments could contribute to the achievement of sustainable public finances.

* In federal states, central, regional and local governments must work together, perhaps through the use of national stability pacts, to meet the medium-term fiscal targets and to fulfil national fiscal obligations.

The problem of an ageing population is imminent (paras 4.8 – 4.14)

* Most countries will be faced with severe financing problems as a result of ageing but not all countries have begun to tackle these problems effectively. In combination with reforms of pension systems, it is likely that a mix of public and private funding regimes will be necessary to deal with mounting pension liabilities. In addition, it will be necessary to increase the employment rate and especially the participation of older workers in the labour force.

EPC SYNTHESIS REPORT

INTRODUCTION

1.1 This synthesis report is the outcome of a country examination process carried out by an ad hoc group of the Economic Policy Committee, in which all 15 Member States of the European Union and the Commission participated. Material provided by the European Commission, and the Member States themselves, in particular the Economic Progress Reports, the Joint Employment Report, the National Action Plans, the Stability Programmes and the Cardiff I and II Reports, formed the basis of the examinations.

1.2 The objective of the process was to:

- engage in peer review of Member States' economic reform policies following Cardiff;
- integrate the various elements of the economic reform agenda, namely labour markets, product and capital markets, and the public finances, and thereby provide material for Ministers to orientate the debate on the Broad Economic Guidelines ;
- learn from one another about what works and what does not work.

Member States have committed to undertaking structural reforms

1.3 In their declaration on 1 May 1998, accompanying the draft Council decisions on membership of the first wave of EMU, Economics and Finance Ministers committed themselves to complementing their work on budgetary consolidation "by increased efforts for improving the favourable environment for growth, high employment and social cohesion"[1].

Member States and the Commission have established a process for monitoring progress

1.4 "The Council intends to establish a light procedure, fully respecting the subsidiarity principle, for monitoring progress on economic reform. From next year, the preparation of the broad economic policy guidelines will draw on short assessments of progress and plans by Member States and the Commission on product and capital markets, as well as on the Employment Action Plans.[2]"

1.5 The European Council in Cardiff and Vienna endorsed and further developed this commitment.

Peer review is an important part of this

1.6 By setting out examples of good practice by Member States, and identifying where further efforts need to be focussed, the report provides the ECOFIN Council with country-specific examples to help produce a more effective set of Broad Economic Policy Guidelines. The report addresses the three key areas of structural reform, namely the efficiency of product and capital markets, labour market developments and policies, and long-term sustainability of the public finances. There is a particular emphasis this time on goods, services and capital markets.

The right framework for macroeconomic policies plays an important role.

1.7 The right macro-economic policy-framework is of key importance for promoting non-inflationary growth and a high level of employment. Preparation for the third stage of EMU has brought significant macroeconomic progress in all Member States. Across the Union inflation levels

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[1] Declaration by the Council (ECOFIN) and the Ministers meeting in that Council issued on 1 May 1998, 98/316/EC (OJ L139, 11.5.98, p.28 - 29), paragraph 7

[2] Ibid, paragraphs 8 and 9

have fallen and government borrowing has been reduced. This has begun to deliver the macroeconomic stability which is needed for higher investment and job creation. The single currency and the new policy framework for co-ordinating economic policy at Community level should help consolidate these gains. However there still may be a need for closer macroeconomic coordination..

This needs to be combined with efforts on the microeconomic side
1.8 While macroeconomic policies aimed at stability and high levels of growth and employment are clearly important, they cannot work in isolation and without support of other policies. Structural reforms can contribute to the stability of the macro-economic framework by enhancing the effectiveness of macroeconomic policies. What is needed is a “two-sided” approach with macroeconomic polices and structural reforms operating alongside and in a mutually reinforcing way. Without recourse to national monetary policy solutions, Member States will be more reliant on sound microeconomic frameworks to respond to asymmetric shocks than before. The increased price transparency, and reduced exchange rate uncertainty, which accompanies the single currency, will further sharpen the competitive pressures faced by European business, and promote restructuring, for example, in the financial sector. Even for those Member States not joining EMU from the start, the challenges of globalisation make more urgent the need to have markets which are flexible and can adapt quickly to changing circumstances. There is clearly a high premium on all the Member States of the European Union to push ahead with structural reforms.

1.9 In the longer term, undertaking structural reforms will help to raise Europe’s long-run growth rate by facilitating productivity growth and higher employment fates. Comprehensive structural reform will benefit consumers through lower prices and better quality. Removing supply-side bottlenecks also reduces the risk of inflationary pressures following a rise in demand and increases the employment and productive capacity of the economy. It allows a more expansionary monetary policy than would otherwise have been the case.

1.10 But in the shorter term, structural reforms have the potential to impose adjustment costs on certain sectors of society. It is important therefore to balance the interests of firms, workers and households, allowing Europe to combine a commitment to social cohesion and justice with the rewards of an efficient, dynamic economy.

Insider-outsider effects are important
1.11 Barriers dividing ‘insiders’ and ‘outsiders’ are prevalent in both product markets and labour markets. In product markets such barriers to the entry of new firms can limit competition and innovation. In labour markets these barriers reduce the opportunity for vulnerable groups to (re)join the labour market. Most countries recognise the existence of these effects, and are working, via a process of structural reform, to reduce them.

Efforts must be comprehensive
1.12 Undertaking *all* types of structural reform will help in this regard. For consumers, we need to create a fairer and more efficient Single Market. To help workers and the unemployed, besides offering men and women new opportunities for education, work and training, we need a new approach to tax and welfare to make work pay. In goods and services markets, we must ensure decent minimum standards (for example, in hygiene and safety) without imposing burdensome rules on business or creating unnecessary barriers to trade. We must use competition policy and the tax system to support innovation and dynamism, recognising the potential of small firms as job creators. In capital markets, we must ensure openness and transparency, establish codes of good behaviour and ensure there are adequate prudential rules to protect investment and savings. We need to make some of the longer-term structural adjustments to ensure that the burden of ageing on pensions and long-term care does not become unsustainable. While recognising the importance and need for a comprehensive reform effort, a clear and specific evaluation of structural reform is required.

Interaction between the various reforms is important
1.13 It is particularly important to look at the interaction between these various microeconomic

reforms. For example, liberalisation in product markets, such as extending shop opening hours, will mutually reinforce family-friendly reforms to working practices in the labour market. However, Member States also need to be aware that certain reforms may have offsetting effects. For example, moves to offset the long-term burden of ageing may, if they are not properly designed, reduce labour supply by increasing taxes and other costs to employers and workers.

1.14 Economic reform presents a challenging agenda, but is an important next step for Europe. Increased exchange of experience and information, of the type set out in this report, will help Europe's economies in their pursuit of effective structural reform. The report begins by focussing on Member States' experience in product and capital markets; it then turns to developments and policies in the labour market; finally, there is some discussion of the long-term sustainability of public finances.

EFFICIENCY OF PRODUCT AND CAPITAL MARKETS

2.1 One of the key challenges facing reform of product and capital markets is the need to secure the right balance between the interests of consumers and producers. *In most cases this means strengthening the opportunities for consumers*.

2.2 Opening up markets to competition, at both a national and EU level, will mean lower prices for consumers. Although good data are difficult to come by, the persistence of price differentials within the EU are a good gauge of a lack of competition. The table below, which is taken from the Cardiff I report of the Commission, shows that persistent differentials for pre-tax car prices exist despite the development of the single market. It is not clear exactly why these differences remain, but Member States have agreed that it is an area where further work is needed, which could perhaps be addressed through the framework of EPC. On the international scale, European productivity and price levels compare less favourably to the United States. Further research is required to discover those elements of best practice which could be applied to Europe.

PRE-TAX CAR PRICE DIFFERENTIALS IN THE EU (MAY 1995-NOV 1998)

	May 1995	November 1996	November 1998
Largest price difference between two Member States (as % of the lower price)	147,9% (Fiesta)	137,8% (Corsa)	136,6% (Mondeo)
Model with the minimum price dispersion across Member States*	7,2% (Laguna)	4,6% (BMW 316i)	5,1% (Corsa)
Model with the greatest price dispersion across Member States*	12,8% (Fiesta)	10,4% (Corsa)	10,1% (Fiesta)
Average price dispersion for all the models sampled across Member States*	10,2%	7,1%	7,2%

Source: Services of the European Commission
Sample of 15 models for 12 Member States (excluding countries with the highest automobile taxation)
*Price dispersion as measured by standard deviation

2.3 Furthermore, by giving consumers more information about quality of products, facilitating enforcement of their consumer rights and minimising producers' anti-competitive behaviour, market power will be reduced to bring about production which is more efficient. The entry of new firms into markets also provides more choice for consumers.

2.4 In the longer term, open and competitive markets will facilitate innovation and the transmission of new technologies. A more innovative and more competitive economy will increase overall levels of output and employment. This will be an important step in completing the Single Market.

2.5 The Single Market is a vital element for the improved functioning of the product and capital markets. Single market issues are not dealt with in the report given that they are covered extensively in the Cardiff I and II reports as well as in the conclusions of the Internal Market Council of 25 February 1999. These documents provide a very useful input in the discussion and preparation of the Broad Economic Policy Guidelines.

LIBERALISATION

Where beneficial, more competition should become possible

2.6 In some fields, as technological and other developments have gathered pace, more competition has become possible.

Public service values must be respected, but this does not necessarily mean public sector provision

2.7 There are certain areas of the public sector where public service values are important, and moves to increase competition must respect this. But public service obligations do not always have to be met by public service provision. All Member States have room to improve the cost effectiveness and quality of public services. This will benefit immediately not only those consumers who directly use the service, but it will also improve the value for money and increase efficiency.

Privatisation is one possibility

2.8 One area where Member States have sought to improve services, by reconsidering the role of the state, is through privatisation. The success of privatisation, in terms of efficiency, depends on the competitiveness of the market in which the privatised enterprise operates. *Privatisation can also play a role in longer-term fiscal sustainability, by reducing debt levels and ongoing subsidies. But to be really effective privatisation needs to be part of a process towards more competition.* It is not the ownership of capital which is important in the end but the performance and efficiency in the provision of services within a competitive environment.

2.9 Some Member States have relatively low levels of state ownership such as the UK, Spain, Denmark, Sweden and the Netherlands. Others, such as Germany, Italy and Portugal have been making large strides to reduce state holdings. The Portuguese public sector share of business activity has fallen over the last 10 years from nearly 20 per cent to around 8 per cent of GDP. Other Member States have taken a more cautious approach. In Greece, in parallel with initiatives to promote privatisation, there is emphasis in securing greater managerial competence in preparation for privatisation. This has been achieved through the appointment of managers from the private sector.

Private financing is another

2.10 A number of Member States are considering ways to encourage market incentives to improve efficiency, while reconciling the obligations on the public sector to offer certain essential services. Private Finance and Public Private Partnerships (PPPs) are two such initiatives. These allow greater involvement of private sector management or capital in the provision of services while the public sector can retain the necessary degree of ultimate responsibility for the service provided. Such initiatives are only justifiable if they promise to deliver the relevant service at lower cost or better quality than would public-sector provision; they should not be employed as devices to defer inevitable public costs. The effects of private finance on future expenditure needs therefore to be borne in mind. Member States are at different stages of development in this area and it is important that in future Member States continue to feed back results and evaluations of such schemes.

2.11 In Greece private financing is encouraged in major infrastructure projects. Ireland, Portugal and Italy are to develop pilot PPPs to examine the economic benefits. Initial pilot projects will also be concentrated on economic infrastructure. In the UK, Private Finance accounts for 14 per cent of overall public sector investment and after a significant build up of experience major deal completions are being made. Spain has also taken steps to use Private Finance, in particular in the areas of railway infrastructure management, hydraulic works and the management of public hospitals.

2.12 Some Member States are introducing market-based incentives in areas close to core government activities. For example, the Netherlands has introduced elements of the market mechanism into the provision of social security (see paragraph X).

Granting public service to the private sector is a third possibility

2.13 The provision of public services can also be granted to private enterprises. On the basis of a public tender, a renewable contract is concluded for a limited time with the enterprise that delivers the service. The enterprise manages the service according to private rules, but the level of service provision must correspondence to the regulations specified in the contract, e.g. those concerning equality of access, the quality of service and its evolution. A special remuneration may in some cases be given to the enterprise if such constraints impose undue financial costs on it.

2.14 In France for instance, a number of local public services, including water distribution, urban transport and collective food delivering, are granted to private enterprises, instead of being managed by local collectives**.**

Utilities provides a good example of the liberalisation process in practice

2.15 In the utilities sector, liberalisation is proceeding rapidly though progress varies considerably between Member States and sectors. In many parts of the utilities sector competition can be beneficial. Here the intention should be for Member States to promote as much competition as possible, both at a national and EU level. However, some utilities are natural monopolies and need to be regulated. The system of price regulation should ensure that, as far as possible, consumers reap the benefits of increased efficiency through lower prices and higher quality. In addition, such regulation should not hamper technological developments which can increase the scope for more competitive framework in traditional natural monopoly sectors.

2.16 The degree of competition appears greatest in the telecommunications sector. Tangible benefits are being secured where significant liberalisation has been pursued. For example, Finland has exposed all sectors of the telecommunications industry to competition. This has reduced prices to amongst the lowest in the EU, while quality of service has also improved (see box). In Germany, Austria and Spain, where the national telephone companies recently lost their monopoly, the benefits of liberalisation have quickly become apparent. For example, in Germany, where the telecom sector was fully liberalised in 1998, some providers are already offering long- distance calls at rates which are as much as 70% lower than the previous year's prices.

Good practice box: **Liberlisation of Finland's telecommunication sector**

A liberal regulatory framework and active policy strategy geared at fostering structural change have promoted very rapid growth of the telecommunications sector. A traditionally open and competitive framework in the field of communications has contributed to the low price level of telecommunication services and to the rapid spread of information technology. The rates of domestic long-distance calls are now only one sixth of the level of mid-1980s and tariffs of cross-border operations have been more than halved. Finland is a leading country in terms of the number of mobile phones and internet connections. This is part of the general policy of the Government to promote the information society. Related to that, the share of R&D expenditure in GDP- the bulk of which is from private sources- is expected to reach 3 percent this year. At the same time, during the 1990s, the number of jobs in the manufacturing of telecommunication equipment has doubled. This has also contributed to the diversification of the Finnish economy and these industries now account for one fifth of total manufacturing exports.

2.17 In the electricity and gas sectors there have also been some examples of liberalisation, albeit at a slower pace than in telecommunications. While all Member States are making progress in implementing EU directives, some countries have gone further. For example since 1996, the Swedish electricity sector has been substantially liberalised.

Good practice box: **The Swedish experience with Deregulation of the Electricity Market**

In 1996, Sweden carried out a reform of the electricity market. A key principle is the distinction between production/sales of electricity and its transmission. Production and sales have been transformed into competitive markets, while the network is still a natural monopoly and subject to regulation of accessibility and pricing. The reforms have led to a downward pressure on prices, which are low compared to the OECD average.

The reform applied to all customers -households as well as companies- but an evaluation indicated that larger customers benefited the most. To facilitate smaller customers switching between suppliers to search for lower prices, a price ceiling (SEK 2.500) on time-registering meters was introduced in 1997. As this was still viewed as a high cost, the meter requirements for households were abolished in the end of 1998. These changes should allow for lower prices for households.

Liberalisation can be facilitated by some degree of separation between distribution networks and production/service provision

2.18 The main feature of the Swedish reform has been to separate electricity production and transmission, with production being fully exposed to competition. In Spain, recent reform has also gone further than the EU Directives. Production and transmission have been separated, at more than just an accounting level, and a wholesale spot market is operating. Similarly in the UK gas sector, the natural monopoly element of transmission has been separated from supply, with the latter being opened up to competition. This has lead to significant reductions in gas prices for both residential consumers and industry (prices to residential customers have been reduced by over 25% since the liberalisation). These Member States' experiences point to a broad conclusion that effective liberalisation in more difficult sectors can be achieved through segmenting the ownership of distribution networks and production/service provision. A thorough assessment of such experiences, most of which are fairly recent, will be needed to determine where and under which conditions they are beneficial, including for employment and consumers, in the short and longer term.

2.19 In relation to transport and water, progress has been mixed. As air transport has become subject to competitive pressures prices have fallen, resulting in greater demand and enhanced intra-EU mobility. This development has been particularly important for the more geographically isolated countries such as Ireland. In most countries, less progress has been made in the railway and water sectors. With the exception of Sweden and Denmark, rail still operates as a virtual monopoly. Natural monopoly limits competition in water to some extent, thus warranting appropriate regulation instead.

Where this is not possible strong sector-specific regulators are needed to protect the interests of consumers.

2.20 Member States' experience shows that developing effective competition in the utility sector can take time. The balance between protecting the interests of producers and consumers becomes crucial during this transition. Introducing sector-specific regulators has been a common response to ensure the interests of consumers are pursued. The UK has had comparably long experience of using sector-specific regulators (see box).

Good Practice box: **The UK's Experience with Utility Regulation**

In line with utility liberalisation, the UK Government set up independent regulators to promote and encourage competition. Where competition was deemed too weak, a price cap system was put in place which put downward pressure on prices, encouraging the incumbent operator to increase productivity. Service standards and compensation arrangements for breaches of these standards were also introduced.

Prices, particularly in telecommunications and gas supply, have tended to fall. However, in the early days, because of asymmetric information, regulators underestimated the efficiency gains from privatisation. This illustrates the importance of reviews, which take account of revealed gains in efficiency. In selecting a time-period and method for price reviews a balance needs to be struck between giving incentives to enterprises to make efficiency savings and ensuring they are passed on to consumers within a reasonable timeframe. Following a review, regulators' primary duty will now be to protect consumers through, encouraging greater competition where possible. Price-capping regulation is to remain a feature where competition is not sufficient to bear down on prices. Service standards will also be taken into account.

2.21 Most countries now appear to be withdrawing from state involvement in activities where there is no or limited public service interest or obligation, and where competition is possible. Examples of such sectors include banking and air transport.

Shop opening hours

2.22 Shop opening hours provide another example of the liberalisation process in practice. Strict regulation of shop opening hours is usually intended to protect employees. However, it can also reduce the ability of the retail sector to meet the preferences of consumers, improve productivity and expand services. It can therefore limit the potential to increase employment in this sector. Deregulation needs to take account of the impact on particular types of retailers, particularly relatively small shops. However, there is evidence of the benefits of liberalisation. For example, in the Netherlands evening shopping is estimated to have increased output in the supermarket sector by 3 per cent.

2.23 Some Member States have recently taken important steps towards liberalisation of shop opening hours. Italy and Denmark have significantly relaxed restrictions. Opening hours have also undergone some liberalisation in Germany and Austria though, along with Spain, rules are still restrictive relative to other EU Member States.

COMPETITION POLICY

The effective enforcement of competition rules requires effective competition authorities, independent from political interference and industry groups with vested interests

2.24 Five Member States have recently adopted new competition legislation bringing national law into line with that of the Community. And Eight Member States have given powers to competition authorities to enforce the Articles 85 and 86 prohibitions on anti-competitive practices and abuse of dominant positions at a national level.

2.25 During the Country Reviews, it was **the enforcement of competition rules** that received particular attention. To be effective authorities need a high degree of independence, both from political interference and also from vested interests in industry and other lobby groups. The authority needs to be strong and proactive in encouraging competition. The ability to administer fines acts as a deterrent against future, potential anti-competitive behaviour.

2.26 In recent years, several Member States have taken measures to strengthen the role of competition authorities through greater independence, greater powers or more resources to enforce competition laws such as Belgium, Ireland, Denmark, the UK and Spain. The Netherlands has given its competition authority powers to impose fines on enterprises. Italy’s independent authority has increasingly used its powers to suggest amendments to regulations which affect competition. Since the beginning of the 1990s, Greece has set up regulatory authorities in the area of telecommunications, capital markets and broadcasting and an authority to safeguard competition in all areas. In some Member States, further reform is needed, though progress is heading in the right direction. The Austrian government, for instance, plans to improve the efficiency of the national competition authority.

Good practice box: **Italy - A new competition environment**

Since the beginning of the 1990s, Italy has adopted a new Competition Act and implemented a wide range of liberalisation and competition enhancing reforms in product markets, public utilities and the financial sector. The Competition Act has been modelled on that of the Community, with the independent competition authority having the power to enforce both Articles 85 and 86 of the EC Treaty. This authority has become increasingly active and in 1997 it found evidence of horizontal agreements in several sectors, along with evidence of particularly dominant positions in the financial service sector.

The Italian retail sector has been increasingly liberalised, allowing a greater diffusion of large chain stores leading to relevant reductions in consumer prices. In the telecommunications sector, greater competition stimulated by several new suppliers of mobile and telephone services has reduced costs for long distance and international calls. The electricity market has been liberalised in accordance with the EU directive. A successful privatisation programme coupled with a liberalisation process has produced important results including: industrial restructuring; deregulation of savings management; transparent corporate governance; higher protection of minority shareholders; the transformation of the stock exchange and securities markets from public institutions into private corporations; and a growing interest by households in equity investment.

STATE AIDS

Member States should develop strategies which reduce subsidies which constitute distortions of competition

2.27 State Aids are decreasing in importance but Member States need to reinforce their efforts to ensure that respect for the Treaty rules is effective at all administrative levels so that all public measures are subject to Commission control and do not distort competition. More needs to be done to reduce the overall level of state aids, which distort competition, and to redirect them towards transparent measures pursuing objectives, such as employment or R&D, which are in the common interest.

2.28 The EPC intends to deepen its understanding of state aids. This will require further conceptual and analytical work, in particular, on the distortionary impact of state aids on competition and the functioning of the single market.

PROMOTING SMEs AND INNOVATION

Promoting the entry of new firms and making markets more contestable is another way of enhancing competitive pressures

2.29 In addition to the consumer/producer trade-off, the country reviews exposed the issue of ‘insider’ and ‘outsider’ problems in industry, i.e. the tendency for existing firms to engage in practices which prevent the emergence of new, rival companies and lead to anti-competitive behaviour. To promote competitive markets, new firms need to be able to set up in business and challenge existing firms with minimum delay and restriction; legal barriers to the the exit of firms should also be reduced. Product markets can then become more innovative, meeting consumer needs at lower prices while increasing the employment creating potential of the economy in expanding sectors.

2.30 In addition to the role of competition law and enforcement, promoting the development of new firms can reduce the ‘insider’ ‘outsider’ problem. Policies have been underway in the EU for quite sometime to promote this.

Easing the administrative burden is an important way to facilitate the development of new firms

2.31 Progress is probably most advanced in Denmark which has the lowest number of procedures for company registration - which normally takes only one week. The number of procedures for registration is relatively high in France, Germany, Greece, Spain and Italy compared to the EU average. However, reforms in this area appear particularly promising. France has introduced reforms that will allow for the creation of a new enterprise within 24 hours. Portugal has reduced the set-up time for a new company from 6 months to 20 days. Italy has enacted a fixed term of 60 days to process administrative procedures. This provision is enforced by the "silent assent" mechanism. In 1998, Germany reformed its commercial code, simplified the procedure for registration and limited the number of participating parties in the process. The Netherlands has developed a system for reviewing all regulations on business (see box). This has brought benefits to SMEs directly but should improve the regulatory environment more generally. The Belgian Government is implementing similar proposals.

Good practice box: **Netherlands' Competition, Deregulation and Legislative Quality Project (MDW operation).**

Launched in 1994 the MDW operation aims to eliminate competition-limiting measures, ensuring objectives of regulations are met with minimum cost to business. Special multi-disciplinary teams are drawn from various Ministries ensuring broad political support for initiatives. The operation has permanent areas of attention but sector-specific projects are also initiated. Of benefit for SMEs has been the liberalisation of the Establishment Law. As a result of a MDW review, the business establishment requirements were cut from 88 to 8 for start-ups.

The current Cabinet seeks a more client-orientated approach in the new MDW projects, to improve the public support for implementing reform measures. An inter-departmental task force executes the implementation of reforms and keeps the Cabinet informed about the progress being made.

Facilitating access of SMEs to venture capital can increase their growth potential

2.32 Fast growing SMEs are one of the main driving forces for growth and employment in Europe. For SMEs to develop, they need access to capital markets at the various stages of their development. Very often SMEs are dependent on external financing from banks, for which they often have to pay higher interest rates than big and established firms. Facilitating the access of SMEs to equity financing may increase their growth potential.

2.33 Compared to the US, the venture capital market is still quite underdeveloped in all Member States. The amounts of venture capital provided are particularly limited in Portugal, Italy and Greece. In Greece, the plan is ready for establishing a new area in the stock market for small, dynamic companies to start trading in 1999. This is just one of a number of measures Greece is taking to promote entrepreneurship (see box).

Good practice box: **Greece promotes entrepreneurship**

Greece has set up a one-stop shop (Hellenic Investment Centre) for large scale investments in an attempt to attract domestic and foreign investment. The number of new firms created in 1997 is very high: 85,000 new enterprises have been established, 4,000 of which are Societe Anonyme, or of a limited liability form. Also as part of process of strengthening entrepreneurship emphasis is being placed on revising institutional procedures in order to increase the survival of firms, and on the development of the venture capital market.

2.34 Many Member States have recently taken measures to improve access to risk capital. In some cases, as in Austria, specific financing programmes have been set up, whilst others, like Spain, have chosen to improve the legal framework for venture capital providers. In Belgium, Germany, France, Austria and the UK, new stock markets reserved for young, expanding firms have been created. In France, tax provisions to encourage individuals to invest in new firms or to buy stocks in them have been introduced. Germany has also implemented a number of reforms (see box).

Good practice box: **Germany's third law to promote the financial market**

This law should bolster funding support for SMEs. It includes measures to encourage the supply of risk capital for non-listed SMEs. The conditions for access to the stock exchange have been deregulated to make it easier for companies to raise capital. Regulations have been liberalised relating to Investment Companies and the licensing of new types of funds. A rating agency for SME's has been founded. This should contribute to the reduction of transaction costs.

A new stock market was opened in 1997 to accommodate small companies with good growth prospects. 49 companies were listed by September 1998 and many more companies are interested in participating. The risk capital market has also been developing with the use of a supra-regional information exchange which brings together the providers of risk capital with potential shareholders.

Other barriers to entrepreneurship

2.35 In addition to the administrative burden caused by regulations, Member States need to tackle other barriers to entrepreneurship. For example, minimum capital requirements are relatively high for some forms of enterprises in Germany, Austria and Belgium, but the countries concerned do not regard this as a significant barrier. Other initiatives to promote SMEs include 'one-stop shops' where start-ups can complete the necessary regulatory requirements and get advice in order to set up their business (e.g. in Austria).

2.36 Bankruptcy laws need to allow firms to exit as efficiently as possible without causing disruption to markets while safeguarding the interests of employees, capital providers and consumers. The stigma attached to bankruptcy can hinder risk-taking and innovation also needs to be minimised. In this respect, Belgium introduced legislation last year to encourage winding-up arrangements and to allow entrepreneurs another chance in business after bankruptcy.

Innovation needs to be encouraged to maintain competition and increase employment in expanding, high-tech industries.

2.37 The level of R&D expenditure by European companies is 1.2 per cent of GDP, against 1.8 per cent in the US and 2 per cent in Japan. While some Member States are spending above the US level (Sweden has the highest level in the EU at 3.5 per cent), the general level of spending needs to be encouraged if the EU is to maintain competitiveness and increase employment in expanding, higher technology industries.

2.38 Many Member States are taking action to improve R & D levels. In France, tax concessions are being made available to households which invest in non-quoted companies or risk capital funds. Public funds are to be made available to provide finance to risk capital companies which invest in innovative SMEs. Austria has launched several initiatives to improve the underlying structure to support innovation (see box). In Greece, incentives for R&D expenditure are being created and the links between universities and enterprises are being improved. However the level of R&D in Greece is low, as is the case in Portugal and Spain. These Member States need to maintain momentum to drive forward new incentive frameworks to encourage R&D.

Good practice box: **Austrian 'Bringing Knowledge to Business' Initiative**

Several new measures are being implemented in Austria to boost the innovative capacity of the economy:

- A Technical College Stimulus Campaign will seek to support research projects in polytechnics if private sector companies participate.
- Centres of competence (K-ind) are to bring together groups of businesses and research institutes which have facilities in related R & D interests.
- A programme to stimulate high-level industrial research (K plus) will promote business cooperation with academic research but on the basis of legally independent centres.
- A Patent Exploitation Agency is to provide assistance in the commercial exploitation of existing patents.

E-commerce is an important innovation that should be exploited

2.39 The opportunities offered by electronic commerce, particularly to new and expanding firms, is considerable. It can expand market opportunities geographically and reduce company set- up costs and hence it can promote competition and increase consumer choice. At the EU level, work is underway on a directive establishing a legal framework for electronic commerce. The Commission's report on Community product and capital markets addressed the balance between protection and mechanisms for redress to ensure consumer confidence and the action needed to develop the potential of E-commerce at a pan-European level.

2.40 At the Member State level, action is also being taken to encourage the development of E-commerce. For, example in the UK the Government has set a target that 90% of Central Government goods should be purchased electronically by March 2001. Regional authorities in Belgium are directly supporting SME participation in E-commerce. In its national report, the French government noted that it needed to catch up in order to fully exploit IT opportunities including E-commerce. Major initiatives are being pursued to develop IT skills in education as well as in-work training particularly for the lower skilled and employees of SMEs

LIBERALISING FINANCIAL MARKETS

2.41 The Commission's report on product and capital markets noted significant technical and legal barriers which have fragmented national financial markets. The impact is often felt particularly by SMEs who have reduced access to flexible and competitive financing. More efficient financial intermediation can improve the allocation of funds, raise the return on savings and reduce the cost of investment finance at the same time.

Restructuring of the banking sector required in a number of EU countries

2.42 The introduction of the euro should help increase the transparency of financial service prices and subsequently the competition between providers within the EU, while taking into account the need for a high level of consumer protection and a well- functioning prudential financial supervision system. But the Commission's communication on Financial Services (Building a framework for Action) showed that there were still significant impediments to a single financial market[3]. While work is going on at a European level to help develop a truly single financial market (creation of the 'high level group'), there are many measures that Member States can take to help increase competition within their own markets.

The opportunities presented by capital market liberalisation will help to promote competition at both a national and EU level

2.43 The banking sector continues to face a process of consolidation Europe-wide. For example, in Italy between 1990 and 1997 around 350 merger and take over transactions were carried out in the banking sector. Tax incentives were introduced last year to speed up sales of public banks owned by regional or municipal authorities.

2.44 Reducing the importance of state-owned banks has been a feature in Austria and Greece. Portugal has undertaken one of the most impressive reforms of financial markets (see box).

Good practice box: **Portuguese Experience of Financial Market Liberalisation**

Over the last 15 years the Portuguese banking sector was transformed from one of Europe's most tightly controlled systems into one of the more liberal. The reforms have involved privatising the public banks, opening up the sector to private competitors (domestic and foreign) and widening the operations that banks can participate in.

Financial margins in the sector have fallen by over half and there has been a process of consolidation and rationalisation with 5 banking groups accounting for about 80 per cent of the market share. Greater competition has led to a diversification in the range of financial products available and greater innovation to meet consumer demands.

3 According to the Commission, in the retail financial sector, the cost of obtaining a credit card in the most expensive Member State is 3 times higher than in the least expensive. Commission on equity transactions can vary up to 17 times in value between Member States.

LABOUR MARKET DEVELOPMENTS AND POLICIES

3.1 Member States have agreed that employment is the top priority of the European Union. Luxembourg set in motion a process for annual surveillance and coordination of Member States' labour market policies, via the National Action Plans for Employment, the Joint Employment Report and the Employment Guidelines, with the ultimate objective of cutting unemployment and producing a significant increase in the employment rate on a sustainable basis.

3.2 The 1998 Joint Employment Report has already provided an analysis and assessment of the employment situation and the labour market policies in the member States, based on the National Action Plans. This section of the report reviews Member States' labour market policies in the context of the wider structural reform process.

INCENTIVES TO WORK AND TO EMPLOY

3.3 The Members of the EPC agreed on the need to provide encouragement and support for the unemployed and inactive to take up work or training opportunities (to increase labour supply), and increase incentives for employers to create new jobs (to increase labour demand).

***For both demand and supply reasons, it is appropriate to concentrate tax/benefit reforms at the lower end of the wage distribution (consistent with the new Employment Guidelines*)**

3.4 There was a recognition that in some countries the advantages of taking a job compared to receiving benefits offers little advantage, for low-income earners experiencing long unemployment spells: combined benefits for unemployment, housing and childcare, together with high marginal tax rates, can in some circumstances result in unemployment traps for low income workers in Belgium, Denmark, Finland, France, Germany, the Netherlands and the UK. Similarly, non-wage costs for low earners are such that employers are reluctant to take on such workers.

The demand side

3.5 It is very important to undertake reforms which encourage employers to create jobs. Reducing non-wage labour costs, especially for those at the bottom end of the wage distribution, will make employers much more willing to expand employment for this group. In France, indirect labour costs are being reduced to boost labour demand (see box). In the Netherlands, the tax burden has been reduced by 2.5% of GDP during the last Cabinet period. Emphasis has been put on the reduction of non-wage labour costs at the lower end of the market. In other Member States, including Germany and Belgium, efforts to reduce non-wage labour costs need to be continued.

Good Practice Box: **Improving labour market functioning in France through tax reform**

Since 1993 the French authorities have engaged in measures to facilitate job creation using tax policy. Policies to promote labour demand have been geared towards reducing non-wage labour costs especially for those at the lower end of the labour market. One particular measure taken has been a reduction of employers' social security contributions for low wage earners (labour costs for those earning the minimum wage have been reduced by over 12%). In addition, to their positive employment effects, such measures reduce labour costs while maintaining the purchasing power of the of the low paid.

On efforts to improve incentives to take up work the French government is currently in a process of eliminating the "taxe professionnelle" on labour income. This measure should have considerable employment effects in labour intensive services sector (for example in the construction and commercial sectors).

The supply side

3.6 Encouraging work and making work pay requires a double strategy: reducing taxes on low-income workers and making the benefits system compatible with intensive job search and training.

Reforms to benefit systems can help encourage job search

3.7 To make the benefits system work with the grain of job creation it is necessary to examine carefully the eligibility criteria, making "availability for work" conditions effective, enhance training requirements and, in some cases, adapt the time profile of benefits, in order to make job search more effective. In a number of countries long benefit durations often combined with high levels of minimum social assistance, and fairly non-stringent job availability requirements may undermine job search behaviour instead of helping workers to find jobs.

3.8 In Finland, France and the Netherlands, the benefit system is characterised by benefit durations of up to four years and together with high minimum unemployment benefits (particularly for families with children) and job availability requirements which are often less stringent than elsewhere, may reduce incentives to search effectively for jobs. In Belgium, benefit duration is indefinite for those with dependents, although work availability requirements have been tightened in recent years and the benefit level is not very different from income support in other countries.

3.9 In other countries, benefits systems encourage a greater degree of job search. For example, in Greece, and Luxembourg benefits are limited to cover, at most, the first year of unemployment. Luxembourg has the strictest job availability requirements in the EU. Recent reforms in Denmark which included measures to lower unemployment benefit for young people have helped to contribute to large falls in unemployment for this group (see box). This suggests that other Member States might well benefit from further reforms too. But a balance has to be found; Member States need to be able to provide their citizens with a safety net in the event of unemployment, and if Member States provide low unemployment benefit, there may be less incentive for workers to keep in touch with the labour market.

Good Practice Box: **Denmark’s measures to reduce youth unemployment**

The rate of youth unemployment in Denmark is currently around 4 per cent. This is substantially below the EU-average and less than half the level in Denmark 3-4 years ago. The drop in youth unemployment can to a large part be explained by considerable and focused reforms in this area.

Since early 1996 the principle of “right and duty” has been the cornerstone of the Danish efforts towards reductions in youth unemployment. Today all unemployed individuals under the age of 25 has the right and duty to either enroll in an education programme or commence activation, for a duration of 18 months.

The principle of right and duty ensures both an upgrading of the unemployed youth’s skills and motivates the unemployed youth to seek and find a job by her or himself.

The motivation is further enhanced by the fact that the level of benefits for young unemployed in activation or employment are only half the level of maximum unemployment benefits.

3.10 Member States agreed on the importance of reviewing other benefits systems at the same time as unemployment benefit, to ensure that it always pays to take up a job compared to receiving benefits - there was a desire to avoid reforms to unemployment benefit which simply shifts the long-term unemployed, for example, onto invalidity benefits and early retirement schemes, which again would cause them to lose touch with the jobs market.

3.11 In this light, the Netherlands have introduced reforms to increase the efficiency of the sickness and disability benefits system.

Good Practice Box: **Dutch reforms to the benefits system**

In the Netherlands, incentives have been introduced in recent years for employers to reduce the use of social security. The responsibility for sickness benefits is now devolved to employers who can decide how to cover their risks. A form of experience rating has been introduced in the invalidity insurance scheme. Premiums for invalidity insurance are partly differentiated between branches and individual employers. Employers therefore have an incentive to re-integrate employees back into the labour market.

In the present Cabinet period, attention has shifted to the provision of services by the social security organisations. Introduction of market mechanisms in these services is intended to reduce the number of people entering the benefit system and increase the number of people leaving. This will be achieved through the introduction of financial incentives and competition between both the organisations responsible for re-integration and the organisations for the provision of benefits.

But to be effective they must be combined with reforms to the tax system

3.12 The tax system, and its interaction with the benefits system, also plays an important part in providing the correct incentives for creating and taking up work. A large tax wedge between what workers receive and what employers’ pay can have harmful effects on labour demand and labour supply, particularly at the low end of the wage distribution, where it can price out low skilled, low paid jobs. Some progress has already been made, and most Member States have undertaken substantial reforms in order to make tax systems more supportive to employment creation.

3.13 The tax burden on labour remains very high in Sweden, Finland and Denmark. However, in Denmark, the Netherlands, Spain, Italy, Ireland, France and Portugal, particular efforts have been made to reduce the tax burden at the lower end of the wage distribution. In Spain, the personal income tax system has been substantially reformed (see box). Denmark and Germany are embarking on a tax reform which includes shifting the tax burden from labour income to energy and the environment. Reform of this type should be implemented in such a way that the taxes on low wage workers are reduced, as on its own, simple tax shifting is unlikely to have a significant impact on employment.

Good practice box: **Spanish Reform of the Personal Income Tax**

The goals pursued by the Personal Income Tax reform are structural in nature and, therefore, the effects of the reform will extend beyond the short term. The main thrust of this reform is reduction of the fiscal pressure through a decrease in the tax burden on earned income. Specifically the reform entails a general reduction in tax rates combined with streamlining and redefinition of tax brackets. The top marginal rate has been lowered from 56% to 48%, while the minimum rate has dropped from 20% to 18%. The number of brackets has been reduced from eight to six.

The new tax will affect both, supply and demand for labour and it should foster job creation. It will significantly reduce the tax wedge (i.e. the difference between employers' gross labour costs and workers' take-home pay). The impact of the new tax will be felt from January 1999, when withholding tax on wages will be reduced thus boosting net labour income by approximately 6%. For the low wage earners the increase will be about 11%. In addition, the positive impact of the reform on the employee take-home pay, should favour an appropriate level of wage settlements.

Furthermore, the increase in permanent disposable income will simultaneously stimulate consumption and the household savings. Although the tax system will entail a loss of tax receipts (approx. 0.6% of GDP), it will not endanger the process of fiscal consolidation as public expenditure is expected to drop. In any case, the reform should increase potential output growth in the Spanish economy, and subsequently offset the short term losses in tax receipts.

IMPROVING EMPLOYMENT AND EMPLOYABILITY / ADAPTABILITY

3.14 Europe suffers from both a low level of employment and a high level of unemployment. The low participation rates are a reflection of poor employment prospects over long periods (a considerable part of it is due to unbalanced macroeconomic policy in the past) which have reduced the employability of those inside and outside the labour market.

3.15 Member States are agreed on the need to develop a skilled and adaptable workforce. This will contribute to reducing barriers to employment and help the labour market adapt to structural changes in the economy.

Effort needs to be focused on providing opportunities for those 'outsiders' to the labour market to improve their employability. Groups affected include . . .

The young

3.16 Operational targets for the offer of a new start within 6 months to young unemployed have been set out in the Employment Guidelines. The starting point in implementing this approach is different fom country to country and some Member States are more advanced than others. In Denmark, Spain, France, Finland, the Netherlands and Sweden this target has been fully addressed. Luxembourg has set even more ambitious targets. But more effort is needed in the remaining Member States, where the targets are often interpreted rather more flexibly.

3.17 Member States are also agreed on the importance of strategies to improve employment prospects for young people who leave the school system without having acquired the aptitudes required for entering the job market. Measures recognised as important include improving the quality of school systems and developing skills relevant to the labour market, where appropriate by implementing apprenticeship training.

3.18 An encouraging framework for in-house training and apprenticeship schemes has been set up in Austria, France, Luxembourg, Spain, Sweden, Finland, Italy, Greece, and the Netherlands. Experience in Germany suggests that systems of apprenticeship need continuous evaluation and adaptation to avoid segmentation to keep training in line with skills needed. More progress needs to be made in other Member States. In Portugal and Ireland, for example, there appears to be a disproportionate share of low skilled people among the unemployed. Portugal aims to counter this by doubling the number of young people on apprenticeship schemes over the next five years. Luxembourg's scheme for in-company induction traineeships provides an example of good practice for improving the employability of young people. The UK's New Deal- which offers a variety of remedial education, guidance, vocational training and further education, to both young and long- term unemployed- is another.

Good Practice Box: **Luxembourg's experience of apprenticeships and in-house training**

At less than 4% Luxembourg's unemployment rate is lowest in the EU. Moreover, youth unemployment is substantially below the EU average. This strong performance is at least partially due to advanced in-house training and apprenticeship schemes. To tackle rising youth unemployment the apprentice scheme is currently being reorganised. The main features of the system and new measures include;

- High Rates of take up - 60% of the young who follow technical training do so under "vocational training" and apprenticeship
- An increase in the number of training positions in firms (this year the number of positions will be increased by one third)
- New Initiatives: In certain sectors (engineering, business and electronics), firms, worker representatives and relevant government bodies have made agreements on both the theoretical and practical aspects of training, so as to reorientate training to the needs of the firm.

To reintegrate the young unemployed, temporary support contracts and integration apprenticeships have been reformed. Measures include;

- Individual reintegration courses under the supervision of a "tutor"
- Skills assessment
- Obligation to place a priority to hiring the young who are undergoing an apprenticeship or have a support temporary contract where a vacancy arises.

In addition, the social partners in their collective negotiations, must specify their provisions for training and how many positions are opened to the unemployed.

Older Workers

3.19 Member States have made less progress in increasing participation rates for older workers than with the young. This is not only due to the fact that older workers are sometimes more difficult to take on but also to the structure of pension systems and the existence of early retirement schemes. The Netherlands, for example, has one of the weakest participation rates for older males, and correspondingly excessive numbers drawing disability or early retirement benefits. Italy has one of the most generous pension schemes along with the lowest standard retirement age in the EU. This works to reduce effective labour supply. In Finland too, a generous unemployment pension scheme acts as a powerful incentive to drop out of the labour market. But there is progress in some Member States, for example, in Denmark access to early retirement for the long- term unemployed aged 50-59 has been abolished.

Long-term unemployed

3.20 Measures to tackle long-term unemployment should complement policies to improve participation for this group. In order to prevent long-term unemployment, an operational target has been set to offer unemployed adults a fresh start before reaching twelve months of unemployment. Moreover, at least 20% of the unemployed should benefit from active measure like training or equivalent measures. There was little evidence, however, of effective policies by Member States to tackle the problem of long-term unemployment, particularly in countries with a disproportionate share of low skilled workers amongst the unemployed. However, Member States agreed on the importance of reducing the outstanding stock of unemployed as well as the flow into unemployment. This ought to be a policy priority in the future. In Belgium, a new policy (d'activation des allocations de chomage) has recently been put into action with a specific objective to reduce long-term unemployment

Good practice box: **Reducing long term unemployment in Belgium**

A new measure has been introduced to reintegrate the long-term unemployed into the labour market through the creation of jobs in the services sector. The emphasis is on creating and building on activities which are not normally very profitable such as personal service sectors, environmental protection, etc.

The policy is specifically targeted at those who have been unemployed for at least 5 years or for at least 2 years if they have not finished their secondary education. The measure will reduce the cost of labour:

- by giving an in-work benefit to the formerly unemployed individual. This benefit reduces the net salary paid by the employer and can be applied up to a maximum of 3 years
- through a generous reduction in social security benefits, valid for the period while the in-work benefit is paid

The worker gets a contract and is paid on the basis of current collective agreements. Salary is, however limited to 120% of the minimum salary.

(The measure was introduced at the beginning of 1998 and is already showing signs of success, especially for the part time employed).

Female

3.21 In the majority of Member States, women still have particular problems in gaining access to the labour market, in career advancement, and in reconciling professional and family life. EPC Members recognised the need for active support to increase female employment, in particular via the design, implementation and promotion of family-friendly policies including affordable, accessible and high quality services for children as well as parental and other leave schemes.

3.22 In a number of countries, progress has been made. Many have tax subsidies and benefits available to help make the costs of childcare affordable. Traditionally, childcare facilities in France, Belgium and the Nordic countries have been well developed. This has undoubtedly contributed to higher female participation in these countries. In Austria, the Netherlands, the UK and Luxembourg, reforms are currently under way, with concrete targets being set for the provision of childcare and nursery facilities. Austria has adopted an integrated approach to women's access to employment. But a number of Member States still have much to do, in particular to overcome the cultural problems associated with integrating women into the workforce.

Flexible working arrangements play an important role in increasing employment and improving adaptability

3.23 Member States agree that flexible working arrangements, including policies on career breaks, parental leave and part-time work, will not only help to encourage female employment but will contribute to a more general improvement in the adaptability of the work force. A number of Member States have recently undertaken reforms to improve the flexibility of its labour force, including in some cases measures relating to employment protection. In Greece, where the current level of part-time employment is among the lowest, new types of work contracts (such as teleworking and part-time) have been introduced; in Italy, restrictions on fixed-term work have been eased and temporary work agencies introduced; in the Netherlands a law has been introduced which regulates the legal situation of part-time workers and gives them full parity with full-time employees. Experience in the Netherlands suggests that part time work is an option that employees have voluntarily chosen rather than a form of employment imposed by employers. In Spain, laws have been recently introduced to make part-time work more attractive for employers and employees. In

France, more adaptable working arrangements are being discussed in the context of the negotiations on the reduction of working time.

Member States must take full advantage of new opportunities for job creation
3.24 The service sector and industry-related services offer great potential for all Member States to create new jobs, particularly those of a part-time nature, and more traditionally filled by women. The liberalisation of shop opening hours has important implications here, both directly in terms of creating more service sector jobs, and indirectly via its family-friendly impact.

3.25 Encouraging self-employment or the creation of companies in the service sector often does not require high levels of capital. Lowering firms' entry barriers to such markets may therefore generate important employment opportunities. The recent liberalisation of the taxi market in Sweden is a good example of this in practice. Certain countries are investigating the creation of jobs in personal services that meet emerging needs not yet satisfied by the market.

Much scope to increase labour mobility
3.26 As well as improving the occupational mobility of labour, through measures to improve the skills of the labour force, Member States also recognised the importance of improving geographical mobility of labour, both between and within Member States. This is an additional measure which would help raise levels of employment in Europe, and would be particularly beneficial in those Member States, such as Belgium, Germany, Italy, Spain, and Portugal where regional differences in employment and unemployment are particularly strong. EPC Members noted that differences in the benefits systems (including pensions) were important in keeping labour mobility low between Member States. The structure of the housing market, including the existence of taxes on renting, planning restrictions and administrative constraints was thought to be another barrier to labour mobility both between and within Member States.

MAINTAINING SOCIAL CONSENSUS AND SOCIAL PACTS

Social consensus is vital for steering through structural reforms
3.27 The EPC stressed the importance of achieving overall social consensus for the national economic strategy. Member States recognise that in the face of what sometimes can be a painful or controversial structural reform agenda, shared diagnoses and shared solutions amongst social partners often offer the best route for successful implementation of policy. In this light, many Member States, in accordance with their traditions, have institutionalised this process where a formal forum of social partners and government actively engage in developing economic strategy.

3.28 While many of these social pacts also include the wage formation process, (which in many Member States is otherwise the exclusive domain of social partners) they serve as a platform to seek agreement on broader thrusts of government policy (measures to improve labour market functioning, reforms to the welfare state and public finance consolidation). For example, in France and Austria, the government actively involves social partners in defining the problems and solutions to the challenge of the ageing population. Involvement of social partners in the reform agenda is viewed as being beneficial as long as such a process does not lead to a disproportionate influence by insiders to the detriment of other social groups (eg the unemployed, or consumers who may not be adequately represented in the consultation procedure). In other words such a process needs to be truly inclusive and consensual.

Social pacts can aid the wage formation process, though the trend is towards decentralised wage bargaining
3.29 In terms of wage formation policy, it is difficult to prescribe good and bad practices. The merits of social pacts will depend on the level at which bargaining is conducted and the particular

challenges facing the economy. For example, in the face of a perceptible need for wage moderation, recent social pacts along the centralised model in Ireland, Italy and Belgium have been successful in ensuring that wage development is consistent with low inflation and trends in productivity. Moreover, the agreements have contributed to the stability of the macroeconomic environment.

3.30 However, as circumstances, expectations and priorities change in some cases Member States and social partners have recognised that more innovative solutions will be required with perhaps more elements of decentralisation and micro bargaining. Indeed, in Ireland, as a result of its recent strong economic performance, the current system has come under pressure in some sectors. However, the pact is generally holding and is expected to be renewed in negotiations this year (see box). In Belgium, it is recognised that its current system of centralised bargaining will need to be adapted over time.

3.31 In addition, potential benefits could emerge from an intensified dialogue with the social partners at the EU-level. This would increase the transparency of structural reforms in the labour market and awareness on the consequences of wage developments at the EU-level.

Good Practice Box: **Social Partnership in Ireland**

Since 1987, the Irish social partners, who in this context include the Government, have concluded a series of three year national agreements on pay, taxation and general management of the economy. These agreements have complemented a policy of fiscal consolidation and have underpinned a virtuous cycle of pay moderation, low inflation, strong economic growth and, particularly more recently, strong employment growth. In recent years, the social partners have been extended to include the community and voluntary sectors, including the representatives of the unemployed.

Each three year agreement is preceded by an analytical strategic study of the economy's prospects over the coming three years, a study in which all of the social partners participate and which provides an agreed framework for the subsequent detailed bargaining.

The current Partnership comes to an end in 2000. A new strategic study is being prepared, in anticipation of negotiations on a further agreement later this year.

FAIRNESS

Structural reform should not compromise social cohesion and fairness

3.32 The issue of fairness was a recurrent theme during the review process. Structural reform, whether in the labour, product or capital markets is often accompanied by a degree of social change as the economy adjusts to a more efficient path. Such adjustment can have negative repercussions especially upon the most vulnerable groups in society and this can detract from social cohesion. The structural reform agenda should therefore attempt to reconcile both efficiency and equity considerations and give due regard to the maintenance of social cohesion. In addition, as mentioned earlier, in order to ensure the viability of reform, it was felt that the social partners should be made aware of its underlying rationale and be actively involved in developing appropriately "fair" solutions.

Fairness can be maintained through a variety of policies

3.33 Maintaining fairness is a very broad concept. Given, diverse backgrounds and social norms

Member States have had varied experiences in safe-guarding fairness in the structural reform process.

3.34 In some of the Nordic countries, where the social consensus has been for the preservation of the generous social security net and a relatively narrow income distribution, reform to the benefit system has focused on firming up the eligibility criteria for benefits and work availability requirements, rather than direct reductions in replacement rates. This policy has had some success in reducing unemployment, while maintaining social objectives.

Promoting employment is the most effective measure, though other measures may be needed to reduce social exclusion , such as minimum wages or in work benefits

3.35 Promoting high levels of gainful employment is the most effective way of reducing social exclusion and poverty. But accompanying a focus on employment there may be a need for policies such as minimum wages or in-work benefits which are designed to avoid heightening income inequality and the rise of a class of working poor. For example, in the UK, where the track-record on social exclusion has been poor, the Government is now having to address the problems of inequality posed by low paid jobs and the polarisation of work between two job and no job households, through policy measures such as the New Deal, the Working Families Tax Credit and reforms to the education system.

3.36 In-work benefits are one method of providing help to poorer workers and at the same time alleviating the unemployment trap. However, at the point where benefit is withdrawn, they can have the effect of reducing the incentive to take up better pay or increase labour supply as workers are faced with high real marginal tax rates. Therefore the specificity of each labour market has to be taken into account when designing in-work-benefits.

3.37 Some form of national minimum wage is another method. Whilst this can ensure that vulnerable groups are not exploited, the minimum wage arrangements may need to be accompanied by other measures to ensure that the total labour cost remains compatible with the employability of these groups if the wage is set at too high a level. The Netherlands, Belgium and the UK have a reduced minimum wage for young people. In Denmark, the guaranteed minimum income scheme is lower for single people than families with children.

LONG-TERM SUSTAINABILITY OF THE PUBLIC FINANCES

4.1 In the framework of EMU, fiscal policy plays an important role in the macro and micro economic framework. Sound public finances are a prerequisite for a smooth functioning of Economic and Monetary Union, for sustained, non-inflationary growth and a high level of employment. Fiscal responses to actual cyclical developments have to be brought in line with the long-term requirements of sustainable public finances. Member States have shown their commitment to sound public finances through the submission of Stability and Convergence Programmes and commitment to medium-term budgetary objectives of "close to balance or in surplus" according to the requirements of the Stability and Growth Pact.

Further progress required in most Member States

4.2 Even though Member States have made important progress in recent years in reducing public deficits, in most Member States further progress is necessary in order to reach the medium- term budgetary objectives and to put debt levels on a robust downward path. Further reductions in government deficits and debt are called for in most Member States. This will create room for manouevre to meet future challenges, such as those resulting from the ageing of the population and to allow the automatic stabilisers to operate in case of a slowdown, while fully respecting the Stability and Growth Pact. A particular strategy to bring down debt levels is necessary in Belgium, Italy and Greece. Moreover, public budgets have to be restructured to cope with future challenges.

4.3 In the past, in most Member States, deficit reductions have been brought about by expenditure restraints, reductions in interest payments and to a lesser extent by tax increases. It has been noted that, in many cases, expenditure reduction has been disproportionately on public investment. In some Member States, like Germany, Sweden, Finland, Belgium or the Netherlands and Finland, setting explicit multi- annual ceilings for overall government expenditures in addition to ceilings for particular categories of expenditure has helped to reduce the size of government expenditure relative to GDP.

4.4 In the Netherlands and Belgium, rules have also been set to cope with windfall tax revenues. The Belgian and Dutch governments have announced that they will use a major part of extra tax income resulting from stronger than expected growth for deficit reduction and the remainder for other purposes, in particular for reductions in the tax burden. Such rules may help to contain demands for extra-spending in case of larger than expected tax revenues.

Fiscal consolidation must be pursued at lower levels of government too

4.5 Federal states, in which lower levels of government decide on a significant proportion of government spending and revenue, may face particular problems in defining and implementing budgetary policies aiming for a specific medium term fiscal position for the general government.

4.6 It should be borne in mind that in accordance with protocol No 5 of the excessive deficit procedure, Member States are under an obligation to ensure that national procedures in the budgetary area enable them to meet their obligation under the deficit procedure. National stability pacts as already implemented in Austria, Belgium and Spain and as envisaged in Germany and Italy, which define the responsibilities of the different layers of government may be helpful in fulfilling these obligations.

Maintaining budgetary surpluses is a challenge in some Member States

4.7 Several Member States like Denmark, Ireland, Luxembourg, Finland, Sweden and Spain have set a budget surplus as a medium-term target in their stability or convergence programmes. It is important that the existence of significant budget surpluses ought not make it more difficult to resist demands for extra spending. An intensification of "rent-seeking" from interest groups can only be contained if there is a firm political commitment from the authorities not to deviate from the objectives set in the stability or convergence programs. In these circumstances it is very important to emphasise the longer-term public finances position.

The problem of an ageing population is imminent

4.8 All Member States will, to varying degrees, face profound demographic changes. The drop in birth rates and the rise in life expectancy will lead to an ageing of our populations. This development will put pressure on all parts of the welfare system: pensions, health care, disability schemes, long-term residential care.

4.9 In the absence of corrective measures, Member States relying on pay-as-you-go social security schemes will be faced with a substantial increase in social security contributions. According to estimates from the Commission, expenditures on social protection might increase by up to 6 or 7% of GDP until 2030. Challenges for pension systems are particularly great in Germany, France, Italy, Austria and Luxembourg, where expenditure for pensions may by then represent between 15-20% of GDP.

Structural reforms to social security systems are important

4.10 Lowering current levels of government debt through sound fiscal management is one important strategic answer to the demographic changes. Structural reforms in social security systems are a necessary complement to that.

4.11 In recent years, most Member States, namely Austria, Belgium, Germany, Italy, France, Greece, Portugal, Sweden and the United Kingdom have undertaken substantial reforms of their pension systems in view of the new challenges: effective retirement ages have been increased, benefit indexation rules have been made less generous, eligibility criteria for disability benefits have been tightened. Nevertheless, further reforms are necessary in most Member States in order to improve the incentive structures of welfare systems, to encourage an efficient use of resources and to increase the employment rate.

4.12 Member States should systematically assess the implications of the demographic changes on all areas of the welfare system in order to find solutions which limit the increase in social security expenditures. This applies in particular to those Member States, such as Germany, Italy and Finland, where the demographic changes are expected to be important and which have not yet undertaken radical reforms of their welfare systems.

So too are mechanisms in the private sector

4.13 Markets for private pension funds, which compared to the US are still rather underdeveloped in the Community, may be developed as a second pillar for retirement provisions. Alternatively the incorporation of elements of funding in public pension schemes may contribute to reduce the financial burden for future generations. In those Member States, like the Netherlands or the United Kingdom, where pension schemes are mostly funded, the impact of ageing on the overall fiscal position could be more limited than in Member States relying on pay-as-you-go schemes.

4.14 Experience in France, Ireland and Austria suggests that a broad consultation procedure, involving social partners, may be instrumental in order to make substantial reforms of the welfare systems acceptable to the various groups of society.

Tax systems are also undergoing reform

4.15 Most Member States have undertaken substantial reforms in order to make tax systems more supportive of growth and employment creation. Over the last ten years, there has been a general tendency to lower tax rates, to broaden tax bases and to increase the transparency of the tax system. Such measures help to increase the neutrality and efficiency of tax systems and to reduce tax evasion and avoidance. This is particularly in those countries where the problems posed by the black economy are particularly strong.

4.16 However, tax burdens remain high in a number of countries. Several Member States, in particular Denmark, Spain, Italy, Ireland, the Netherlands, and Portugal have taken measures to lower the tax burden for low income workers, thereby improving employment prospects for low-skill workers. Germany and Denmark are implementing tax reforms which include a shift in the tax and social charges burden from labour to the environment/energy.

Reinforced tax policy co-operation

4.17 The introduction of the euro and the creation of an integrated euro capital market, is likely to increase the interdependencies between tax systems. Most members of the EPC consider that increased capital mobility inside the euro area, but also globally, will make it more difficult to tax relatively mobile factors, like capital, and thereby put a heavier burden on other factors, like labour.

4.18 There is a clear need to tackle harmful tax competition. Co-operation in the tax policy area is called for to reduce the continuing distortions in the single market, to prevent excessive losses of tax revenue or to allow tax structures to develop in a more employment friendly way.