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# EUROPEAN ECONOMY

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## Report on the implementation of the 2000 broad economic policy guidelines

No 2 2001

*European Economy* appears twice a year. It contains important reports and communications from the Commission to the Council and the Parliament on the economic situation and developments, in particular its *Broad economic policy guidelines* and the *EU Economic review*. As a complement to *European Economy*, the series *Reports and studies* focuses on problems concerning economic policy.

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European Commission

# EUROPEAN ECONOMY

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# Report on the implementation of the 2000 broad economic policy guidelines

## Abbreviations and symbols used

### Member States

| | |
|---|---|
| B | Belgium |
| DK | Denmark |
| D | Germany |
| EL | Greece |
| E | Spain |
| F | France |
| IRL | Ireland |
| I | Italy |
| L | Luxembourg |
| NL | The Netherlands |
| A | Austria |
| P | Portugal |
| FIN | Finland |
| S | Sweden |
| UK | United Kingdom |
| D_90 | Germany Prior to unification in 1990 |

| | |
|---|---|
| EU | European Union |
| EU-12– | European Community, 12 Member States excluding East Germany |
| EU-12+ | European Community, 12 Member States including East Germany |
| EU-15 | European Community, 15 Member States |
| EUR-11 | Group of 11 Member States participating in monetary union (B, D, E, F, IRL, I, L, NL, A, P, FIN) |

### Currencies

| | |
|---|---|
| ECU | European currency unit |
| EUR | Euro |
| ATS | Austrian schilling |
| BEF | Belgian franc |
| DEM | German mark (Deutschmark) |
| DKK | Danish krone |
| ESP | Spanish peseta |
| FIM | Finnish markka |
| FRF | French franc |
| GBP | Pound sterling |
| GRD | Greek drachma |
| IEP | Irish pound (punt) |
| ITL | Italian lira |
| LUF | Luxembourg franc |
| NLG | Dutch guilder |
| PTE | Portuguese escudo |
| SEK | Swedish krona |
| CAD | Canadian dollar |
| CHF | Swiss franc |
| JPY | Japanese yen |
| SUR | Russian rouble |
| USD | US dollar |

**Other abbreviations**

| | |
|---|---|
| CPI | Consumer price index |
| ECB | European Central Bank |
| ECSC | European Coal and Steel Community |
| EDF | European Development Fund |
| EIB | European Investment Bank |
| EMCF | European Monetary Cooperation Fund |
| EMS | European Monetary System |
| EMU | Economic and monetary union |
| ERM | Exchange rate mechanism |
| Euratom | European Atomic Energy Community |
| Eurostat | Statistical Office of the European Communities |
| FDI | Foreign direct investment |
| GDP (GNP) | Gross domestic (national) product |
| GFCF | Gross fixed capital formation |
| HICP | Harmonised index of consumer prices |
| ILO | International Labour Organisation |
| IMF | International Monetary Fund |
| LDCs | Less developed countries |
| Mio | Million |
| Mrd | 1 000 million |
| NCI | New Community Instrument |
| OCTs | Overseas countries and territories |
| OECD | Organisation for Economic Cooperation and Development |
| OPEC | Organisation of Petroleum Exporting Countries |
| PPS | Purchasing power standard |
| SMEs | Small and medium-sized enterprises |
| VAT | Value added tax |
| : | Not available |
| – | None |

# Contents



([1]) Commission report.
([2]) Working document of the Commission services.

# Part I

## General assessment ([1])

([1]) Commission report.

# Contents

# Executive summary

***Globalisation and new technologies prompted the EU to adopt a comprehensive strategy in the 2000 BEPGs***

Building upon and extending the existing economic policy strategy, the 2000 BEPGs focused in particular on policies and reforms aimed at promoting the economic growth potential and employment. The 2000 BEPGs were the first adopted after the Lisbon European Council. They thus reflect the Council's conclusions. The present report offers an overall assessment of the implementation of the policy orientations set in the 2000 BEPGs. It is accompanied by a report of the Commission services that evaluates the implementation of the country-specific recommendations of last year's guidelines.

The following key messages emerge from the report.

***Best macroeconomic performance for a decade, but growth slowing down mildly***

Even though a mild growth deceleration set in last summer in response to a surge in oil prices, the EU achieved in the year 2000 its best economic growth performance for a decade. This was the result of the combined impact of strong domestic and external demand. Job creation continued at a rapid pace while unemployment continued to fall. Headline inflation rose as a result of higher prices for imported goods, but underlying inflation remained low in a favourable domestic price climate.

***Tension-free macroeconomic policy mix***

With import prices rising and the output gap closing, monetary authorities increased official interest rates during the year to counter risks to price stability in the medium term. In the EU as a whole, the fiscal stance was neutral as indicated by an unchanged cyclically-adjusted primary surplus and wage developments remained compatible with price stability and job creation.

***Budgets close to balance, but mostly due to high growth and a lower debt service burden***

Actual budget deficits in the EU as a whole were further reduced to close the balance (including the one-off UMTS receipts there was even a surplus). However, this improvement in 'headline' balances was primarily due to strong growth and lower debt service. By contrast, the estimated unchanged cyclically-adjusted primary surplus suggests that Member States taken together failed to seize the chances offered by strong economic growth to enhance their underlying fiscal position.

***Quality and sustainability of public finances — more progress with tax than with expenditure reform; pension reform imperative***

Progress was made towards making tax systems more efficient, and especially more employment-friendly: in many Member States, taxes on labour were reduced; in some the measures aimed primarily at the low-paid, in some they focused on the efficiency and transparency of the tax system; and in others they were designed to widen the tax base and/or reduce marginal tax rates. Moreover, more Member States plan to reform tax systems from 2001 onwards. In addition, the Council (Ecofin) reached an agreement on key points of the tax package to curb harmful tax competition and reduce current distortions of the single market. Conversely, less progress was made in Member States on the expenditure side: rigorous medium-term expenditure control mechanisms are often lacking. Insufficient steps were taken to address problems in benefit systems, although there have been some attempts to improve their administration, tighten entitlement rights, and enforce eligibility conditions. Substantial pension reforms were implemented in previous years in only a few Member States while some other Member States took some measures in 2000 to alleviate the pressures arising from future demographic changes. As a result, most countries have not yet taken the necessary steps to meet the budgetary challenges of population ageing.

***The knowledge-based society — despite progress still behind the USA***

Europe's transition to a knowledge-based society is progressing, but still lagging in comparison with the United States due to relatively lower investments in human capital, R & D and ICT. Most Member States have taken measures to strengthen ICT education and training efforts. Nevertheless, there remains a need for enhancing and upgrading skills on ICT-related activities. Measures have been taken to remedy the fragmentation of Europe's R & D effort and to create a business environment more favourable to innovation and technological progress, e.g. through incentive schemes and enhanced competition. But the relationship between industry and science, and more precisely the commercialisation of the research effort, remains one of Europe's structural weaknesses. The liberalisation of the telecom industries has contributed to a lowering of Internet access costs, which, in combination with more targeted measures, has led to a rapid rise in Internet penetration.

***Product markets — general progress but problems with public procurement, State aid and integration of service markets***

Over the past year, the functioning of European product markets has improved, thanks to better coordination of national policies in various domains, the increased transposition of internal market directives, the reinforcement of the powers of competition authorities, the liberalisation of the telecommunications and, to a lesser degree, energy sectors. However, a less positive assessment is made of progress in the areas of public procurement, State aid, administrative reform and efforts to reduce the regulatory burden on business. The creation of a truly integrated European market for business services, the further opening up of the transport sector to competition, and the liberalisation of the postal sector continue to pose problems.

***Capital markets — coordination between supervisors strengthened, but other measures need to gather speed***

Several Member States have taken measures to strengthen coordination between their national supervisors in order to help safeguard financial stability. Progress has been made with the implementation of the Financial Services Action Plan. There is also progress with the implementation of the Risk Capital Action Plan, but if the RCAP is to be completed before the 2003 deadline, efforts will have to be speeded up.

***Labour markets — falling unemployment but delays in benefit and labour regulations reform***

The labour market situation continued to improve in 2000, largely owing to the cyclical upswing, but also thanks to structural reforms in the labour market. Long-term unemployment has fallen faster than the overall rate, which is good for social cohesion, but several Member States still have to address structural unemployment and severe regional disparities. In the past year, good progress has been made with the implementation of active labour market policies and several Member States have taken measures to address the low employment rates of women. Problems in tax systems have recently been tackled by most Member States but such reforms have to be better complemented with reforms to the benefit systems, in particular to encourage older workers to stay longer in the labour force. Limited efforts have been made in some countries to improve labour market regulations, and work organisation.

***Sustainable development — some market-based instruments introduced, but no Community energy tax framework***

A number of Member States took action to strengthen market-based approaches to environmental issues. However, in response to rising fuel prices, several Member States took measures that reduce the tax element of transport costs. No progress was made with a framework for energy taxation at Community level.

# 1. Introduction

Recognising that globalisation and the prospects of a new knowledge-driven economy present both major challenges and opportunities for the European Union, at Lisbon the European Council defined an ambitious strategy. It aims at accelerating the ongoing transformation of the European economy with a view to becoming by 2010 '*the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion*'.

For the 2000 Broad Economic Policy Guidelines (BEPGs), the Lisbon Council conclusions meant the inclusion of recommendations that would raise the average employment rate to as close as possible to 70 % in 2010, and recommendations to enhance the absorptive capacity for and the actual take-up of new technologies. Furthermore, the 2000 BEPGs identified the broad policy priorities for macroeconomic stability and structural reform. They also presented country-specific recommendations in all policy domains and for all 15 Member States tailored to their particular circumstances.

This report presents a comprehensive assessment of the implementation of the policy recommendation that were formulated in the 2000 BEPGs. In doing so, it serves two purposes: firstly, it contributes to the continuous multilateral surveillance of the economic policies of the Member States and the Union in accordance with Article 99(3) of the Treaty; and secondly, it provides input for the formulation of the forthcoming BEPGs.

This report makes use of and integrates the conclusions of the various economic policy coordination processes at the Union level, to which it adds a comprehensive evaluation. In this respect, the agreed list of structural indicators provides a useful tool for comparing progress. The report is accompanied by a working document of the Commission services, which presents a detailed examination of the implementation of the country-specific recommendations.

From the onset, the limitations of the present assessment should be noted. The Council adopted the 2000 BEPGs, including recommendations of a medium-term nature, only in June 2000. Therefore, and in view of the gradual impact of some of the measures as well as the provisional nature of most of the data employed ([1]), a conclusive judgment about the degree of implementation cannot be given at this moment.

([1]) The report is based on available data up to 1 March 2001.

**The BEPGs policy strategy**

1. Ensure growth and stability-oriented macroeconomic policies
2. Speed up fiscal consolidation
3. Improve the quality and sustainability of public finances
4. Promote appropriate wage developments
5. Foster a knowledge-based society
6. Ensure efficient product markets
7. Promote capital markets through further integration and deepening
8. Invigorate labour markets
9. Enhance sustainable development

# 2. Overview of key policy areas

## 2.1. Ensure growth and stability-oriented macroeconomic policies

### Strong economic growth, although the recovery is losing momentum

In 2000, the EU achieved its best economic growth performance since 1989. Strong domestic demand, a brisk expansion of the global economy and enhanced price competitiveness of European exporters resulted in real GDP growth of an estimated 3.4 %. However, since last summer, rapid growth has given way to a gentle moderation in economic activity. Notably the high oil prices that prevailed until late in 2000 have increasingly weighed on profits and household income. More recently an emerging global economic slowdown has added to the moderation of growth in the EU. However, with the euro and progress in structural reforms, the EU economy should be able to withstand adverse global developments better than in the past.

Strong economic growth contributed to continued sizeable employment gains in the EU at a rate of some $1^1/_2$ % in 2000. Consequently, the employment rate has risen to approximately 63 %. Current indicators suggest that job creation has remained strong, but a modest slowing is expected in line with more moderate economic growth. Unemployment continued on the clear downward path embarked on in 1997. It fell by 0.8 percentage points to 8.4 % in 2000, and has reached levels last seen a decade ago.

As a result of sharply rising energy prices and a prolonged weakening of the euro, HICP headline inflation in the EU rose by about 1 percentage point to 2.1 % in 2000. Underlying inflation (i.e. excluding energy prices and unprocessed food) increased only marginally to 1.3 % in an overall still favourable domestic price climate. As energy prices seem to have peaked and the euro has risen relative to the USD, headline inflation is expected to abate gradually.

### Macroeconomic policies in the euro area

The 2000 BEPGs recommended for the euro area an appropriate and tension-free economic policy approach consisting of:

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

*(ii)* *sustained efforts by Member States to speed up the ongoing fiscal consolidation; and*

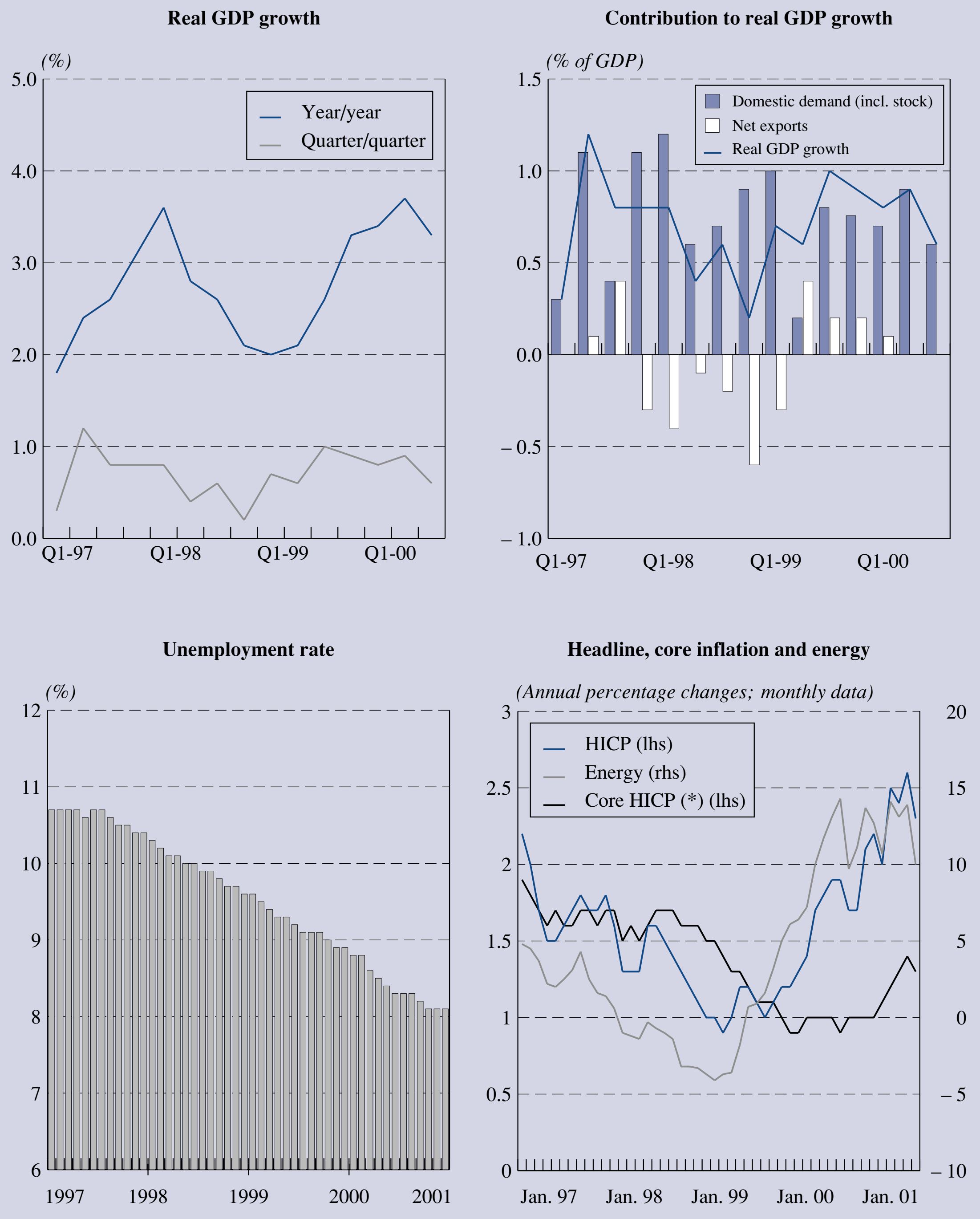
*(iii)* *a continuation of responsible behaviour of social partners.*

The euro-area policy mix was tension-free in 2000. The ECB responded to risks of price stability while monetary conditions remained supportive to growth. The fiscal stance was neutral and wage developments remained consistent with price stability and job creation.

In an environment characterised by a closing output gap and dangers to price stability from imported inflation, the ECB raised its key policy rate on six occasions during 2000, by a cumulative 175 basis points to a minimum bid rate of 4.75 % as of October. Nevertheless, monetary conditions remained growth-supportive but the combination of higher interest rates and a weakening euro prevailing in most of 2000 affected the pattern of growth. More recently, monetary conditions have tightened somewhat as the euro exchange rate responded positively to a favourable shift in growth prospects relative to the USA and Japan.

Budgetary consolidation progressed in 2000 to the extent that actual positions improved in all countries; in the euro area as a whole the deficit fell by $^1/_2$ a percentage point to an estimated 0.7 % of GDP (net of one-off UMTS proceeds), slightly better than foreseen by the 1999/2000 stability programme updates. However, the improvement essentially stemmed from higher than anticipated growth. Clearly, euro-area Member States as

*Graph 1:* **Economic developments in the EU**




(*) Core HICP is HICP excluding unprocessed food and energy.
*Source:* Commission services.

*Graph 2:* **Policy mix in the euro area**


*Source:* Commission services.

a whole did not seize the opportunity to improve underlying fiscal positions.

Wage developments in the euro area as a whole remained appropriate, despite the emergence of some bottlenecks in cyclically advanced countries and skill shortages in some professions in many Member States. The growth of compensation per employee is estimated to have accelerated by half a point to 2½ % in 2000, but as a result of productivity gains, nominal wage increases remained fully compatible with price stability and sound job creation.

**Macroeconomic policies in the Member States outside the euro area in 2000**

For the Member States outside the euro area, the 2000 BEPGs also recommended that they *maintain sound monetary and budgetary policies, in order to respect the exchange rate commitments* (ERM 2 participants), or *to achieve the inflation target* (Sweden and the United Kingdom).

**Denmark** remained in a cyclically advanced position. GDP growth picked up in 2000, the labour market has been tight and there were some domestic pressures on prices. The Danish National Bank succeeded in keeping the krone very close to its central rate of DKK/EUR 7.44 throughout the year by following the interest cycle of the ECB; the spread widened only temporarily in the context of the referendum on adopting the euro. Public finances remained in healthy surplus in 2000, although the fiscal stance was eased.

In **Greece** (which was not part of the euro area when the 2000 BEPGs were adopted), real GDP growth accelerated to about 4 % in 2000. The output gap has been closing while inflation remained contained. Budgetary consolidation progressed and the fiscal stance was tightened, also in view of easier monetary conditions. Short-term rates, still above 10 % at the end of 1999, were gradually reduced to the level of the euro area by late December 2000 while the drachma was gently steered down towards its central rate. This rate of GRD/EUR 340.75 that resulted from a 3.5 % revaluation in January, is also the fixed conversion rate effective since 1 January 2001, as decided at the Feira European Council last June.

**Sweden** again achieved strong growth in 2000. It is in an advanced cyclical position, has registered considerable employment gains, and so far inflation has been well contained. Even though taxes were cut, the strong cycle and the lower debt burden resulted in a further increase in the healthy budget surplus. The Riksbank increased its key repo rate in February by 50 basis points and in December by another 25 basis points to 4 %. Throughout the year, consumer price increases remained in the lower half of the two percentage points tolerance interval around the 2 % inflation target of the central bank.

In the **United Kingdom**, GDP growth accelerated in 2000 and the economy operated close to potential. Budgetary and monetary policies were geared to secure macroeconomic stability. The budget surplus rose, to a large extent owing to stronger growth and lower interest payments. In addition, sizeable UMTS proceeds were received which helped in reducing public debt further. Monetary policy continued to be tightened until February 2000 when the repo rate reached 6 %. The inflation target of 2½ % (retail prices excluding mortgage interest payments) was comfortably met.

## 2.2. Speed up fiscal consolidation

The 2000 BEPGs recommended Member States to:

(i) *take advantage of fiscal improvements due to better-than-expected economic growth to achieve budgetary positions in 2000 better than the objectives set in the updated stability and convergence programmes;*

(ii) *meet a budgetary position of close to balance or in surplus earlier than envisaged in the updated stability and convergence programmes and as a rule in the year 2001;*

(iii) *pursue further fiscal consolidation beyond the minimum to comply with the requirements of the Stability and Growth Pact.*

In 2000, actual budgetary positions in virtually all Member States improved compared to 1999, implying either smaller deficits or higher surpluses and a reduction in government gross debt ratios. Netting out the budgetary impact of the one-off UMTS proceeds, the EU-wide actual budget balance approached a balanced position while in the euro area the deficit is estimated to have been reduced from 1.3 % of GDP in 1999 to 0.7 % of GDP in 2000. In fact, in virtually all countries the estimated 2000 outcome (net of UMTS) is better than or equal to what was foreseen in the 1999 updates of stability and convergence programmes. Some countries significantly overachieved their programme targets (Belgium, Ireland, Luxembourg, the Netherlands, Finland, Sweden and the United Kingdom). Others (in particular Germany, France and Italy) did not take full advantage of the better-than-expected growth conditions to speed up consolidation efforts.

Based on the assessments made in the Commission services' autumn 2000 forecasts, in most Member States the budgetary plans for 2001 provide for an implicit safety margin large enough to allow the automatic stabilisers to play freely in case of a downturn without breaching the 3 % of GDP reference value. The exceptions are Germany, due to the implementation of the tax reform, and Portugal. In France, Italy and Austria the budgetary safety margins still remain on the low side with estimated 2001 structural deficits close to or above 1 % of GDP.

The current emphasis on tax cuts, generally not matched by further expenditure restraint, implies that the more ambitious consolidation targets as set out in the 1999/2000 updates of the stability and convergence programmes are not likely to be fully met. Some countries (Denmark, Greece, Ireland, Luxembourg, the Netherlands, Finland and Sweden) recognised the need to pursue fiscal consolidation beyond the minimum required by the Stability and Growth Pact and accordingly planned to reach (or retain) sizeable budget surpluses in the medium term.

## 2.3. Improve the quality and sustainability of public finances

The 2000 BEPGs recommended Member States to:

*(i)* *improve the sustainability of public finances principally through expenditure restraint;*

*(ii)* *introduce or enhance mechanisms and institutions that help control spending;*

*(iii)* *redirect government spending to investment in physical and human capital, R & D, innovation and information technologies;*

*(iv)* *review benefit systems;*

*Table 1*

**Evolution in estimates of government budgets for 2000 (*)**

| | Stability/convergence programme (*) (1) | | Estimated out-turn (2) | | Difference | |
|---|---|---|---|---|---|---|
| | Real GDP growth (% change) | Budget balance (% GDP) | Real GDP growth (% change) | Budget balance (% GDP) | Real GDP growth (% change) | Budget balance (% GDP) |
| B | 2.5 | – 1.0 | 3.9 | – 0.0 | 1.4 | 1.0 |
| D | 2 1/2 | – 1.0 (3) | 3.0 | – 1.0 | 0.5 | 0.0 |
| E | 3.7 | – 0.8 | 4.1 | – 0.3 | 0.4 | 0.5 |
| F | 3.0 | – 1.7 | 3.3 | – 1.4 | 0.3 | 0.3 |
| IRL | 7.4 | 3.3 | 10.5 | 4.5 | 3.1 | 1.2 |
| I | 2.2 | – 1.5 | 2.9 | – 1.5 | 0.7 | 0.0 |
| L | 4.9 | 2.5 | 8.5 | 4.9 | 3.6 | 2.4 |
| NL | 2 1/2 | – 0.6 | 3.9 | 1.3 | 1.4 | 1.9 |
| A | 2.8 | – 1.7 | 3.5 | – 1.5 | 0.7 | 0.2 |
| P | 3.3 | – 1.5 | 3.0 | – 1.7 | – 0.3 | – 0.2 |
| FIN | 3.9 | 4.7 | 5.7 | 6.7 | 1.8 | 2.0 |
| **Euro area** | 2.8 | – 1.0 | 3.5 | – 0.7 | 0.7 | 0.3 |
| DK | 1.6 | 2.1 | 2.6 | 2.5 | 1.0 | 0.4 |
| EL | 3.8 | – 1.2 | 4.1 | – 0.9 | 0.3 | 0.3 |
| S | 3.0 | 2.1 | 4.0 | 4.0 | 1.0 | 1.9 |
| UK | 2 1/4 (4) | 0.2 (4) | 3.0 | 2.1 | 3/4 (5) | 1.9 (5) |
| **EU-15** | 2.7 | – 0.7 | 3.4 | 0.0 | 0.7 | 0.7 |

(*) Excluding UMTS proceeds.
(1) First round of updates of late 1999/early 2000.
(2) Commission services autumn 2000 economic forecasts or provisional out-turn data.
(3) Addendum of 1 February 2000.
(4) Financial year.
(5) Indicative, since comparison between financial year and calendar year figures.

*Source:* Commission services.

*Table 2*

**Change in actual and cyclically-adjusted budget balances in 2000 (*)**

*(% of GDP)*

| | Actual balance 2000 ([1]) | Change in balance 99/00 | Change in balance due to: | | | Change in balance due to: | | Change in CAB due to: | |
|---|---|---|---|---|---|---|---|---|---|
| | | | Change revenues | Change primary exp. | Change interest exp. | Change cyclical comp. | Change CAB | Change interest exp. | Change primary CAB |
| | 1 | 2 = 3 – 4 – 5 = 6 + 7 | 3 | 4 | 5 | 6 | 7 = – 5 + 9 | 5 | 9 |
| B | – 0.0 | 0.7 | – 0.2 | – 0.7 | – 0.2 | 0.7 | 0.0 | – 0.2 | – 0.1 |
| D | – 1.0 | 0.4 | 0.1 | – 0.2 | – 0.1 | 0.5 | – 0.1 | – 0.1 | – 0.2 |
| E | – 0.3 | 0.9 | 0.1 | – 0.4 | – 0.2 | 0.3 | 0.5 | – 0.2 | 0.3 |
| F | – 1.4 | 0.4 | – 0.6 | – 0.8 | – 0.1 | 0.3 | 0.0 | – 0.1 | – 0.1 |
| IRL | 4.5 | 2.4 | – 1.2 | – 3.1 | – 0.4 | 0.6 | 1.7 | – 0.4 | 1.2 |
| I | – 1.5 | 0.3 | – 0.2 | – 0.4 | – 0.4 | 0.4 | 0.3 | – 0.4 | – 0.1 |
| L | 4.9 | 0.5 | 0.1 | – 0.5 | 0.0 | 1.1 | – 0.6 | 0.0 | – 0.6 |
| NL | 1.3 | 0.3 | – 0.3 | 0.0 | – 0.5 | 0.5 | – 0.3 | – 0.5 | – 0.8 |
| A | – 1.5 | 0.6 | – 0.9 | – 1.2 | – 0.1 | 0.2 | 0.2 | – 0.1 | 0.1 |
| P | – 1.7 | 0.3 | 2.0 | 1.9 | 0.0 | 0.0 | 0.1 | 0.0 | 0.1 |
| FIN | 6.7 | 4.9 | 0.0 | – 2.0 | – 0.3 | 0.4 | 2.0 | – 0.3 | 2.1 |
| **Euro area** | – 0.7 | 0.6 | – 0.2 | – 0.5 | – 0.2 | 0.4 | 0.1 | – 0.2 | – 0.1 |
| DK | 2.5 | – 0.6 | – 1.5 | – 1.0 | – 0.3 | 0.1 | – 0.3 | – 0.3 | – 0.6 |
| EL | – 0.9 | 0.9 | 0.6 | – 0.1 | – 0.3 | 0.3 | 0.7 | – 0.3 | 0.4 |
| S | 4.0 | 2.2 | – 1.7 | – 2.1 | – 1.3 | 0.7 | 1.0 | – 1.3 | – 0.3 |
| UK | 2.1 | 0.8 | 0.1 | – 0.4 | – 0.3 | 0.2 | 0.6 | – 0.3 | 0.3 |
| **EU-15** | 0.0 | 0.6 | – 0.2 | – 0.6 | – 0.3 | 0.4 | 0.3 | – 0.3 | 0.0 |

(*) Excluding UMTS.
([1]) Estimated out-turn: Commission services autumn 2000 economic forecasts or provisional out-turn data. Most recently available information has been used for columns 1 and 2. Due to incompleteness of recent information, the remainder of the table is based on the Commission services autumn 2000 economic forecasts and columns 3 to 9 may not add up to column 2.

*Source:* Commission services.

(v) *reduce the tax burden, especially on low-wage labour;*

(vi) *promptly review pension and health care systems;*

(vii) *improve the efficiency and transparency of tax systems;*

(viii) *engage in reforms of the VAT system; and*

(ix) *pursue tax coordination further and reach an agreement on the tax package.*

### Quality of fiscal consolidation

In contrast with the retrenchment in the 1990s, which relied significantly on tax increases, the current adjustment has so far been essentially based on expenditure restraint. Government revenues as a share of GDP were reduced for the first time in many years while the expenditure ratio declined even further (excluding the impact of UMTS receipts). This achievement is in line with the 2000 BEPGs.

### Efficiency of government spending

Little progress was made in the reform of expenditure systems even if the issue of expenditure control is increasingly highlighted. In some countries, there are substantial mechanisms in place for controlling government expenditure (the Netherlands, Finland and Sweden have rigorous medium-term expenditure frameworks, the UK implements three year envelopes for discretionary central government spending and France has medium-term norms for central government spending) while in many others rigorous medium-term mechanisms are still lacking.

Fixed capital formation by general government in the EU is estimated to have remained at 2.3 % of GDP in 2000. However, investment expenditure is expanding faster than government spending at large and the share of public investment in GDP is expected to rise gradually. Moreover, several Member States (especially Ireland, Italy, the Netherlands and Sweden) re-allocated spend-

*Table 3*

## Projections for general government surplus (+)/deficit (–)

*(% of GDP)*

| | Date (1) | 1999 | 2000 (2) | 2001 (2) | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|---|---|
| **Stability programmes** | | | | | | | |
| B | SP 12/99 | – 1.1 | – 1.0 | – 0.5 | 0.0 | 0.2 | |
| | UD 12/00 | – 0.7 | – 0.1 | 0.2 | 0.3 | 0.5 | 0.6 (3) |
| D | SP 12/99 (6) | – 1.2 | – 1 | – 1 ½ | – 1 | – ½ | |
| | UD 10/00 | – 1.4 | 1 ½ (– 1) | – 1 ½ | – 1 | – ½ | 0 |
| EL | CP 12/99 | – 1.5 | – 1.2 | – 0.2 | 0.2 | | |
| | SP 12/00 | – 1.8 | – 0.8 | 0.5 | 1.5 | 2.0 | 2.0 |
| E | SP 01/00 | – 1.3 | – 0.8 | – 0.4 | 0.1 | 0.2 | |
| | UD 01/01 | – 1.1 | – 0.3 | 0.0 | 0.2 | 0.3 | 0.3 |
| F | SP 01/00 | – 2.1 | – 1.7 | – 1.2 (7) | – 0.7 (7) | – 0.3 (7) | |
| | UD 12/00 | – 1.8 | – 1.4 | 0.1 (– 1.0) | – 0.6 | – 0.4 | 0.3 (0.2) (8) |
| IRL | SP 12/99 (9) | 1.4 | 3.3 | 2.8 | 2.9 | | |
| | UD 12/00 | 2.1 | 4.7 | 4.3 | 3.8 | 4.6 | |
| I | SP 01/00 | – 2.0 | – 1.5 | – 1.0 | – 0.6 | – 0.1 | |
| | UD 12/00 | – 1.9 | – 0.1 (– 1.3) | – 0.8 | – 0.5 | 0.0 | 0.3 |
| L | SP 02/00 | 2.3 | 2.5 | 2.6 | 2.9 | 3.1 | |
| | UD 12/00 | 4.4 | 3.0 | 2.6 | 2.5 | 2.5 | |
| NL | SP 11/99 | – 0.6 | – 0.6 | – 1.3 (10) | – 1.1 (10) | | |
| | UD 09/00 | 1.0 | 1.7 (1.0) | 0.7 | 0.6 (11) | 1.1 (11) | 1.9 (11) |
| A | SP 03/00 | – 2.0 | – 1.7 | – 1.5 | – 1.4 | – 1.3 | |
| | UD 12/00 | – 2.1 | – 1.4 (– 1.8) | – 0.75 | 0.0 | 0.0 | 0.0 |
| P | SP 02/00 | – 2.0 | – 1.5 | – 1.1 | – 0.7 | – 0.3 | 0.0 |
| | UD 01/01 | – 2.0 | – 1.5 (– 1.9) | – 1.1 | – 0.7 | – 0.3 | 0.0 |
| FIN | SP 09/99 | 3.1 | 4.7 | 4.2 | 4.6 | 4.7 | |
| | UD 09/00 | 1.9 | 4.5 | 4.7 | 4.4 | 4.5 | 4.9 |
| **Euro area** | SP 99 | – 1.4 | – 1.0 | – 1.0 | – 0.6 | – 0.3 | |
| | UD 00 | – 1.3 | 0.3 (– 0.7) | – 0.4 (– 0.6) | – 0.3 | 0.1 | 0.4 |
| **Convergence programmes** | | | | | | | |
| DK | CP 12/99 | 2.9 | 2.1 | 2.2 | 2.3 | 2.5 | 2.6 (4) |
| | UD 12/00 | 2.8 | 2.7 | 2.8 | 2.6 | 2.6 | 2.7 (5) |
| S | CP 11/99 | 1.7 | 2.1 | 2.0 | 2.0 | | |
| | UD 11/00 | 1.9 | 3.4 | 3.5 | 2.0 | 2.0 | |
| UK | CP 12/99 (12) | 0.3 | 0.2 | 0.2 | – 0.1 | – 0.4 | – 0.5 |
| | UD 12/00 (12) | 1.8 | 1.1 | 0.6 | – 0.1 | – 0.9 | – 1.0 (13) |
| **EU-15** | C/SP 99 | – 0.9 | – 0.7 | – 0.7 | – 0.4 | – 0.1 | |
| | UD 00 | – 0.6 | 0.6 (– 0.2) | 0.0 (– 0.2) | – 0.1 | 0.0 | 0.2 |

CP = convergence programme; SP = stability programme; UD = updated stability/convergence programme.

(1) Dates of adoption by Member State's government of its first and second updated stability or convergence programme or date of adoption of national budget proposal (NB) for 2001.

(2) Government balances in 2000 or 2001 are affected by receipts from the sale of UMTS licences in several countries. Where relevant and where information is available, two figures are shown: the first includes the proceeds from UMTS licences and the second (in brackets) excludes these proceeds.

(3) Government surplus of 0.7 % of GDP projected for 2005.

(4) Government surplus of 2.8 % of GDP projected for 2005.

(5) Government surplus of 2.9 % of GDP projected for 2005.

(6) Addendum to the updated stability programme as of 1 February 2000.

(7) Government deficit of 1.3 % of GDP in 2001, 0.9 % in 2002, and 0.5 % of GDP in 2003 projected if international environment less favourable (annual GDP growth rate of 2.5 %).

(8) Government deficit of 0.5 % of GDP in 2004 projected in more prudent growth scenario.

(9) From 2000 onwards excludes pensions prefunding and associated once off costs.

(10) Cautious scenario; the middle scenario projects a deficit of ¾ % of GDP in 2001, ¼ % in 2002; the favourable scenario projects a deficit of ½ % of GDP in 2001 and a balanced government deficit (0 % of GDP) in 2002.

(11) Favourable scenario, with margin available used for debt reduction; in the cautious scenario, with margin available used for debt reduction, the government surplus is projected to be 0.3 % of GDP in 2002 and in 2003 and 0.6 % in 2004.

(12) Financial years.

(13) A government deficit of 1.1 % of GDP is projected for 2005–06.

*Source:* National stability and convergence programmes and Commission services.

ing towards productive uses, especially to expenditures in the domain of the emerging knowledge-based society (see also Section 2.5.). Some improvements have been made in the accessibility of lifelong learning and in the provision of affordable childcare facilities, but in virtually all Member States more progress is necessary to facilitate the reconciliation of professional and family life.

Reforms of benefit systems lacked ambition. There have been some efforts (in particular in Denmark, Finland, Sweden and the United Kingdom) to tighten benefit entitlement conditions, thereby supporting participation in active labour market programmes. However, so far the shift from passive to active measures has been fairly limited. Very few Member States have introduced in-work benefits to boost earnings of low-paid workers (most notably the United Kingdom and Ireland). However, more Member States (including Belgium, France, the Netherlands and Finland) plan to do so in the future.

**Pension reform**

Some progress was made in reforming public pension systems in a number of countries (Denmark, Ireland, Netherlands, the Austria, Sweden and the United Kingdom) and ambitious reform plans were announced in Germany. Further reforms are now strongly required in Belgium, France, Greece, Spain, Italy and Portugal. While dialogue and consensus amongst social partners are needed for reforms to succeed, there is a disturbing trend for reforms in these countries to be repeatedly postponed. With the post-war baby boom generation fast approaching retirement age, delays only increase the cost of reform. Several Member States (Belgium, Spain, France, Ireland and Finland) have created or announced the establishment of pension reserve funds that will be used to offset some of the future increase in age-related expenditures. While this is a welcome development, these reserve funds, with the exception of Ireland, remain relatively small in relation to the budgetary impact of ageing populations and need to be supplemented with other policies. Where reforms have been undertaken, there is a trend towards limiting entitlements rather than raising contribution rates. This is an appropriate development which needs to be accompanied by more ambitious plans to promote funded systems, via the establishment of a sound regulatory and fiscal framework.

**Reform of the tax system**

For the first time since the 1970s, the overall tax burden is on a declining trend. Some progress was made towards making tax systems more efficient, and especially more employment-friendly. Many countries took steps to reduce taxes on labour (Belgium, Denmark, Germany, Greece, Spain France, Italy, Austria, Finland and Sweden), notably employers' social security contributions, especially at the lower end of the wage scale. Although most reforms provided for generalised reductions in taxes, some countries clearly targeted reductions at low-paid families with children (Greece, Austria and the United Kingdom).

Efficiency and transparency of the personal income tax were improved as several countries (Denmark, Germany, Spain, France, Ireland, Italy and the United Kingdom) widened the tax base and/or reduced marginal tax rates and plan to go further in this direction in the coming years. Other countries (the Netherlands, Portugal, Finland and Sweden) planned to do so from 2001 onwards. These reforms are expected to be all the more efficient as they mainly concern direct taxes, which typically have larger distortionary effects.

As regards the reform of VAT, measures envisaged or implemented have been rather limited in the last few years. Afraid of losing tax revenues, several Member States were reluctant to go further with the harmonisation of the tax as required by the definitive system proposed in 1987 by the Commission.

Consequently, in June 2000 the Commission proposed a new VAT strategy which concentrates on improving the current VAT system. Furthermore, following Council Directive 99/85/EC of 22 October 1999, a significant number of Member States were authorised to apply a reduced rate to certain categories of labour-intensive services, which, although only affecting a small share of the total tax base, led to the lowering of the tax rate in these countries.

**Tax package**

At the Ecofin Council meeting in November 2000, finance ministers reached a significant agreement on the key points for the implementation of the tax package agreed in December 1997 and designed to curb harmful tax competition and reduce the current distortions of the Single Market. Progress was made on all three elements of the tax package: the code of conduct (business taxation), the proposal for a directive on taxation of savings income and the proposal for a directive on interest and royalty payments between associated companies.

As for the code of conduct, the finance ministers confirmed the timetable agreed in 1997 for the rollback of the harmful measures. They also agreed that no new beneficiaries shall enter into the harmful regimes after 31 December 2001 and that, irrespective of whether granted for a fixed period of time or not, all the benefits from the harmful measures must run out by the end of 2005. Only in the presence of particular circumstances and an express decision by the Council on a case-by-case basis the effects of the harmful measures may continue beyond that date. As regards the taxation of savings income the finance ministers approved the substantial content of the future directive. Equally, it was agreed that the Presidency and the Commission should enter into discussions with key non-member countries to ensure the adoption of equivalent measures in those countries and the Member States were invited to report regularly, starting from June 2001, on similar discussions with their dependent or associated territories with a view to ensuring the adoption of the same measures in these territories. With respect to the interest and royalty payments between associated companies the finance ministers reached a compromise solution on all outstanding points of disagreement.

The Ecofin Council reaffirmed the deadline of 31 December 2002 established at the European Council in Feira for the final agreement on the tax package as a whole. Work will continue on all three elements of the package with this timetable in view.

## 2.4. Promote appropriate wage developments

The 2000 broad economic policy guidelines:

(i) *required that nominal wage increases be consistent with price stability;*

(ii) *stressed the importance of real wage developments for strong employment growth;*

(iii) *demanded that collective bargaining systems take account of productivity differences; and*

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

### Aggregate wage developments

Wage moderation continued to prevail, although nominal wage increases in 2000 accelerated slightly from the very low rate in 1999. Wage growth in the euro area

*Table 4*

**Wage developments in 2000**

*(Annual percentage change)*

| | Nominal compensation per employee | Real wages (1) | Labour productivity | NULC (2) | RULC (3) |
|---|---|---|---|---|---|
| B | 3.2 | 2.7 | 2.6 | 0.6 | 0.1 |
| D | 1.2 | 1.6 | 1.5 | – 0.3 | 0.0 |
| E | 3.4 | 0.1 | 1.0 | 2.4 | – 0.9 |
| F | 1.5 | 0.7 | 1.3 | 0.2 | – 0.6 |
| IRL | 7.7 | 3.2 | 5.2 | 2.4 | – 1.9 |
| I | 2.6 | 0.7 | 1.5 | 1.0 | – 0.8 |
| L | 5.0 | 3.3 | 2.2 | 2.8 | 1.1 |
| NL | 4.2 | 1.9 | 1.6 | 2.6 | 0.3 |
| A | 2.1 | 1.3 | 2.6 | – 0.5 | – 1.2 |
| P | 5.4 | 3.6 | 1.5 | 3.9 | 2.1 |
| FIN | 4.1 | 0.9 | 2.8 | 1.2 | – 1.9 |
| **Euro area** | 2.3 | 1.1 | 1.6 | 0.7 | – 0.5 |
| DK | 4.2 | 1.3 | 1.7 | 2.4 | – 0.4 |
| EL | 4.6 | 2.2 | 2.9 | 1.6 | – 0.6 |
| S | 4.0 | 2.7 | 2.0 | 1.9 | 0.7 |
| UK | 4.1 | 1.7 | 2.2 | 1.9 | – 0.4 |
| **EU-15** | 2.7 | 1.3 | 1.7 | 1.0 | – 0.4 |

(1) Nominal compensation adjusted by the GDP deflator.
(2) Nominal unit labour costs.
(3) Real unit labour costs.

*Source:* Commission services.

remained stable at 3.2 % in the third quarter of 2000 and there is no evidence that wage earners have been trying to recoup the losses in purchasing power resulting from high oil prices. Structural reforms in the labour markets are dampening wage claims and the terms of trade shock due to energy price developments seemed to be largely perceived as temporary. However, it is worth stressing that wage moderation in 2000 owed much to wage settlements concluded before the oil prices went up.

Hourly wage increases accelerated in a third of the Member States (especially in Ireland, but also in Belgium, Denmark, Luxembourg and Portugal) — these are chiefly the countries with the tightest labour markets. On the other hand, high increases in hourly wage rates in France in 2000, were the result of the implementation of the 35-hour working week, and are not likely to be repeated in 2001. Some other Member States with high unemployment, such as Germany, Spain and Italy, had limited wage increases.

Wage moderation is likely to continue in 2001 as the partial reversal of the terms of trade shock diminishes the risk of second round effects. Furthermore, although there is some evidence of labour shortages in some Member States or some sectors, this does not seem to be enough to jeopardise the current trend of wage moderation. Finally, cuts in income taxes should help to keep wage claims in check.

As a result of these developments, real unit labour costs are expected to have fallen in 2000. In 2001 a further annual fall of some $^1/_2$ % is likely in the EU. In five Member States (Belgium, Germany, the Netherlands, Portugal and Sweden) real unit labour costs have gone up, in the others they have fallen.

**Wage differentiation and gender gap**

The degree of difference in wages according to skill or qualification, a pressing issue at the lower end of the pay scale, has only been dealt with through the lowering of non-wage labour cost for the low paid. No major initiatives have been taken to reform statutory minimum wages or the collective wage bargaining process. Hardly any reforms have been implemented to allow wages to develop more in line with regional productivity differences (see also below, under labour market reforms).

Data do not allow to conclude whether there has been an improvement over the last year with respect to the gender gap. On average women's earnings are 83 % of men's — with the difference being larger in the private sector than in the public sector — but this is due to a combination of factors, including the fact that many women work in lower paid sectors. Among the Member States, the differences are largest in Germany, Austria and the United Kingdom, and the smallest in Belgium, Spain and Portugal. Although many Member States report on policies to decrease the gender gap in wages, the results still have to be closely monitored and assessed.

## 2.5. Foster a knowledge-based society

The 2000 BEPGs recommended to:

(i) *provide conditions to increase the involvement of the private sector in the financing of research & development expenditures;*

(ii) *stimulate competition in product and capital markets;*

(iii) *ensure efficient and adequate public support for the funding of research, the establishment of better links between research institutes and business and ensure the dissemination of information;*

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

(v) *reduce the fragmentation and compartmentalisation of the research & development effort; and*

(vi) *strengthen education and training efforts.*

Europe's transition to the knowledge-based society is progressing, but should be speeded up. This late transition can be associated with insufficient investments in human capital, in research and development (R & D) and in information and communication technologies (ICT). The Lisbon European Council identified innovation and research as one of the pillars of the Union's effort to achieve its strategic goal of becoming the most competitive knowledge-based economy in the world. In response, the Member States have made a serious effort to catch up.

**Research and Development (R & D)**

In spite of this effort, overall spending on R & D in the European Union remains at 1.8 % of GDP. The European picture is heterogeneous though: Sweden (with close to 4 %) and Finland, followed by Germany and France, appear to be most advanced, while the southern Member States, in particular, are less advanced ([1]). While public

([1]) The corresponding figure for the United States is 2.7 %.

expenditures on R & D expressed in percentage of GDP are equivalent in Europe and in the United States (at around 0.7 %), business expenditures are much lower in the former (1.2 % in 1999) than in the latter (2.0 %). In some countries such as Finland and Sweden, a rapid rise in business R & D expenditures has taken place over the recent period, but in most other EU Member States, private sector involvement in R & D as a percentage of GDP has not increased.

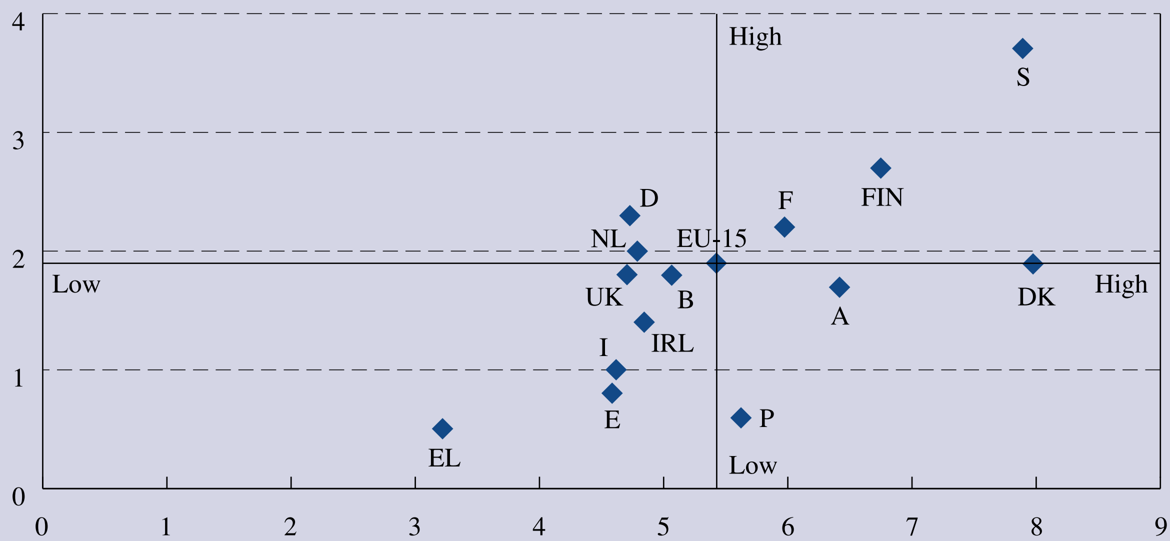
In order to encourage business expenditures on R & D, Germany, Greece, Spain, Ireland, the Netherlands, Austria, Portugal and the United Kingdom have introduced new incentive schemes or upgraded existing ones, for example by using tax measures. Progress has been made in the implementation of the Risk Capital Action Plan (see Section 2.7.). Measures to enhance competition in product and capital markets continue to be implemented, creating a business environment more favourable to innovation and technological progress (see Section 2.6.).

Despite progress made in streamlining the research infrastructure, the industry–science relationship, and more precisely the commercialisation of the research effort, remains one of Europe's structural weaknesses. In spite of a significant rise in the share of high-tech exports in total European exports (from 13.5 % in 1991 to 19.3 % in the first half of the year 2000) [1], the high-tech export share is particularly low in Belgium, Greece, Spain, Italy and Portugal. Many Member States have introduced new measures aimed at improving the links between publicly owned research institutes and business. However, there is still room for improvement in the design of the collaboration mechanisms, in order to have more commercially oriented technology transfers.

Additional public funds have been allocated to R & D in Ireland, Italy, the Netherlands and Sweden, but more importantly the focus is shifting toward the creation of centres of excellence, innovative clusters, and various technology transfer mechanisms to facilitate the commercialisation of R & D. Moreover, the Community strategy, 'Towards a European research area', has been introduced to remedy fragmentation and compartmentalisation of R & D efforts in Europe by linking research networks across borders and facilitating collaboration. However, an agreement on a Community patent has not yet been achieved.

(1) The corresponding figure for the United States was 28.7 % in 1998.

*Graph 3:* **Public education and R & D expenditures in 1997**




Note: No data available on R & D for L.
*Source:* Unesco/OECD/Eurostat.

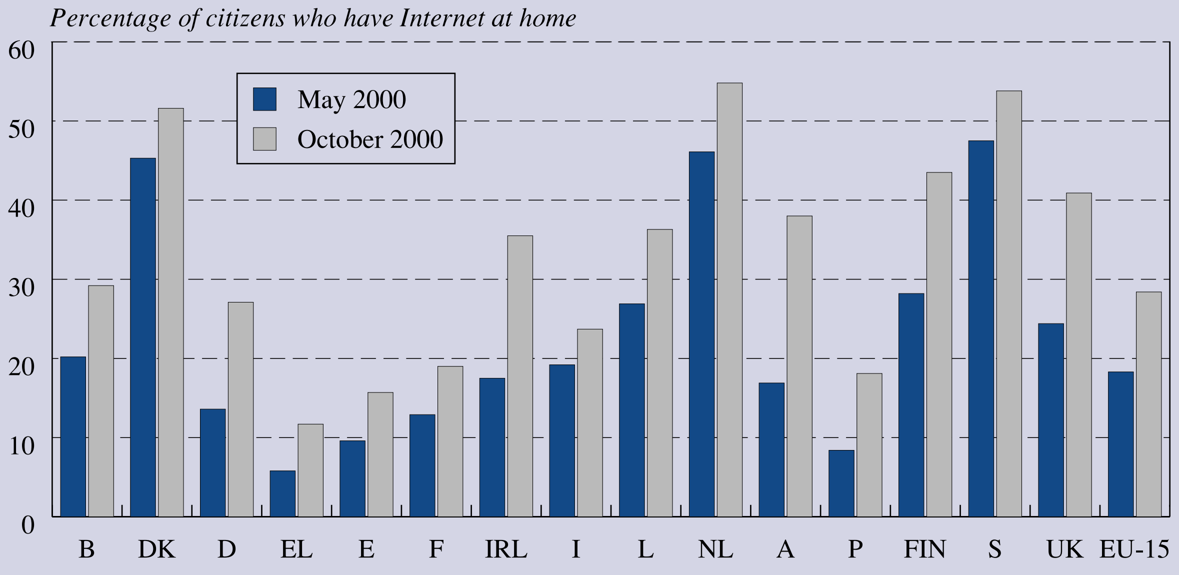
**Information and communication technologies (ICT)**

The lagging growth rate of the EU economy in comparison with the USA in the second half of the 1990s has been associated with the smaller size of the ICT producing sector in Europe as well as with lower investments in ICT in other sectors of the economy. In 1999, the GDP share of the ICT producing sector in the EU (4.2 %) remained well below that in the US (6.8 %). However, the EU has been catching up with the USA in terms of ICT diffusion. In the year 2000, ICT expenditures in the Union were 5.8 % of GDP, which was marginally above the 5.6 % recorded for the USA. This is one indicator of the widespread progress across the EU in ICT diffusion.

Another indicator is the Internet penetration rate in EU homes, which went up by ten percentage points between April and October 2000 (to 28 %). However, there are important differences between Member States. Some Member States (Denmark, the Netherlands and Sweden) have reached levels of Internet penetration that surpass even the USA, while in others (Greece, France, Spain, and Portugal) Internet penetration rates are much lower. The cross-country variation in Internet usage may be explained by differences in local phone charges, home personal computer ownership and the reliability of service providers. In combination with the liberalisation of telecom industries, in particular the local loop unbundling, high bandwidth networks and new access tools are making Internet access both faster and cheaper. Countries such as Denmark, Germany, France and the United Kingdom are also extending Internet access through public–private partnerships or by establishing connections at public libraries. In line with the *e*Europe action plan, all Member States are linking schools to the Internet with the aim of increasing digital literacy through better and more widespread access and use of the Internet in schools. The impact of the differences between Member States in the allocation mechanisms for UMTS licences has yet to unfold, but the choices made could have an effect on the diffusion of third-generation mobile phone technology.

The slower than expected take-up of electronic commerce, especially by consumers, is a particular area of concern. This is despite significant progress on the regulatory framework and steps to strengthen consumer confidence. Only 66 % of SMEs and 76 % of large companies have access to the Internet. However, only 6 % can carry out true e-commerce. In this area as well there are important

*Graph 4:* **Level of Internet access**




*Source:* Eurobarometer.

cross-country differences. The introduction of 'unmetered' phone charges in countries such as Germany, the UK and Spain makes it possible for Internet shoppers to browse and purchase without being concerned by per minute charges.

**Education and training aspects of the knowledge-based society**

Most Member States have taken measures to strengthen ICT education and training efforts, particularly in view of the well-publicised shortage of skilled ICT professionals in Europe. Although almost half of the working population use computers as part of their work, less than 22 % have had any formal computer training. Of course, the role of general education is also critical in this respect — it is interesting to note that in the Nordic countries, where the diffusion of ICT has been most rapid, public expenditure on education is also the highest as a share of GDP. The US experience so far suggests that the knowledge-based society has the potential to create jobs throughout the economy — across a wide range of sectors, occupations and skill levels. Recent job creation in the EU has been predominantly in 'high education' areas (i.e. managers, professionals, technicians), where ICT skills may be more in demand. The other side of the coin, however, is that job creation among the low-skilled in the EU remains very low. Progress on education initiatives which take into account the needs of this group (including the need to improve general basic skills, as well as ICT skills) has perhaps been more limited.

## 2.6. Ensure efficient product markets

The 2000 BEPGs recommended to:

(i) *implement the internal market legislation fully and effectively;*

(ii) *ensure the independence of competition authorities;*

(iii) *reduce State aid;*

(iv) *complete the liberalisation of the telecommunications market;*

(v) *speed up the liberalisation of the energy, postal services and transport sectors and fully implement the Community directives that open markets for public utilities;*

(vi) *reinforce competition in services sectors;*

(vii) *reduce regulatory burdens on business;*

(viii) *develop a systematic approach to the regulatory framework for services; and*

(ix) *monitor the effective implementation of the many regulatory reforms.*

Over the course of the past year, the functioning of European product markets has improved thanks to better coordination of national policies in various domains, the increased transposition of internal market directives, the reinforcement of competition authorities' powers, the liberalisation of the telecommunications and, to a lesser degree, energy sectors. A less positive assessment is made of progress in the areas of public procurement, State aid, administrative reform and efforts to reduce the regulatory burden on business, while the creation of a truly integrated European market for business services and the liberalisation of the transport and postal sectors remain problematic.

**Completion of the internal market**

Survey results show an increasing level of satisfaction among businesses with the operation of the internal market. This is consistent with the observation that transposition of internal market directives has considerably improved in most Member States. However, the transposition gap between Greece and other Member States has increased as important reforms are still pending in that country. France and Portugal have improved their performance, but their transposition deficits are still more than three times as large as those of the best performers.

Some Member States, including Spain and Italy, have significantly increased their efforts to facilitate the opening up of public procurement. In particular, a more widespread use of the electronic publication and dissemination of calls for tenders is foreseen. This might help resolve the structural problem of insufficiently transparent tendering procedures, particularly at the local and regional level. The share of public procurement tenders published in the Official Journal as a percentage of GDP is still relatively low in Germany, the Netherlands and Austria. The rapid adoption and enforcement of the new legislative package presented by the Commission in May 2000 will increase transparency, openness and competition in public procurement markets.

Progress in the area of competition policy is encouraging. The reinforced capacity, independence and resources of the competition agencies in most Member States is a positive development, even if progress could be more rapid in improving the institutional framework in some countries.

Sectoral and ad hoc State aid levels are declining gradually in most Member States, but continue to distort competition in European markets, particularly in Belgium, Germany, France and Portugal ([1]), where such aids remain relatively high. The European Commission intends to create a public register of State aids and publish its first scoreboard on State aid in the first half of 2001. The register and the scoreboard serve to increase the transparency of national and Community policies.

Over the last decade, EU goods markets have become more and more integrated, resulting in stronger competition and a gradual convergence of price levels between Member States. The variation of consumer prices between Member States declined from 18.2 % in 1992 to an estimated 14.4 % in 1999. Technical barriers to cross-border trade within the EU remain a problem, especially in certain sectors (food and beverages, and motor vehicles, in particular).

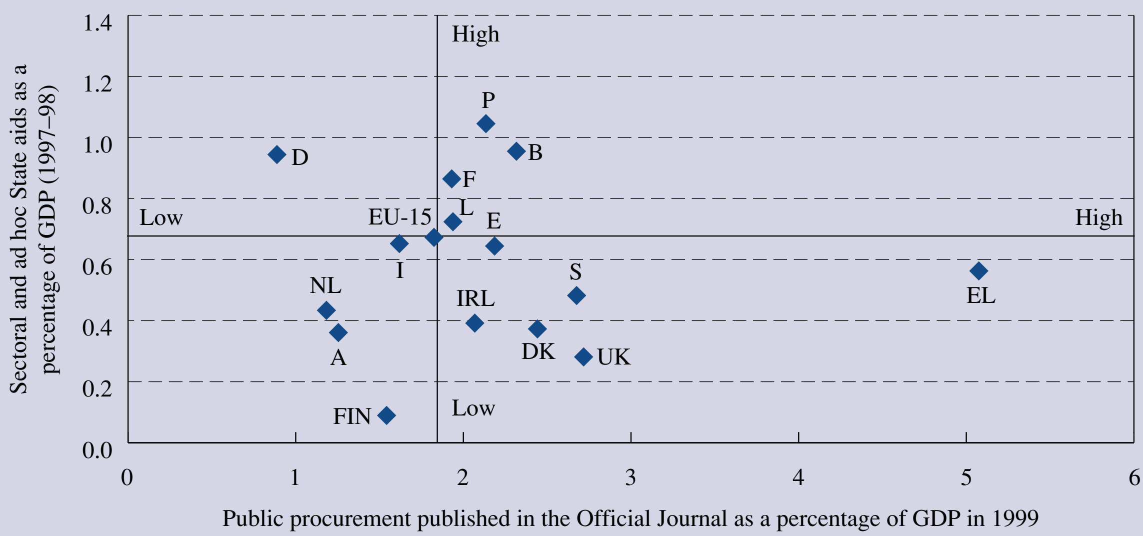
([1]) The high amount of such aid in Portugal is largely due to a single regional aid scheme for Madeira — accounting for 0.8 % of GDP — that has many characteristics of a sectoral scheme. Since January 2001, this aid scheme is closed for new applications and the Portuguese proposal for its renewal is currently being examined by the Commission.

**Public utilities**

Some of the sector-specific economic reforms undertaken have already started to pay off in terms of price reductions for the consumer. The liberalisation of the telecommunications sector, for instance, has contributed to significant reductions in the costs of long-distance calls. Technical progress has had an impact as well. In Belgium, Spain, Italy and Austria, however, long-distance national calls remain relatively expensive. Prices have fallen less for local calls, which is due to a large extent (in many cases) to a re-balancing of tariffs. However, it also indicates that work towards strengthening competition in local access networks needs to continue.

In the energy market, progress is somewhat less clear. Price reductions and improvements in choice and quality of service delivered have generally been most evident in those countries that have gone furthest and fastest in opening up their markets, while ensuring the fulfilment

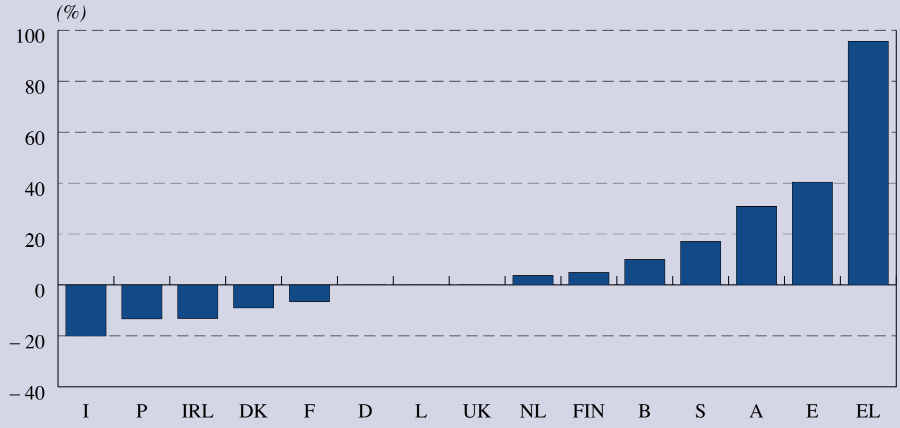
*Graph 5:* **Public procurement and sectoral and ad hoc State aids**



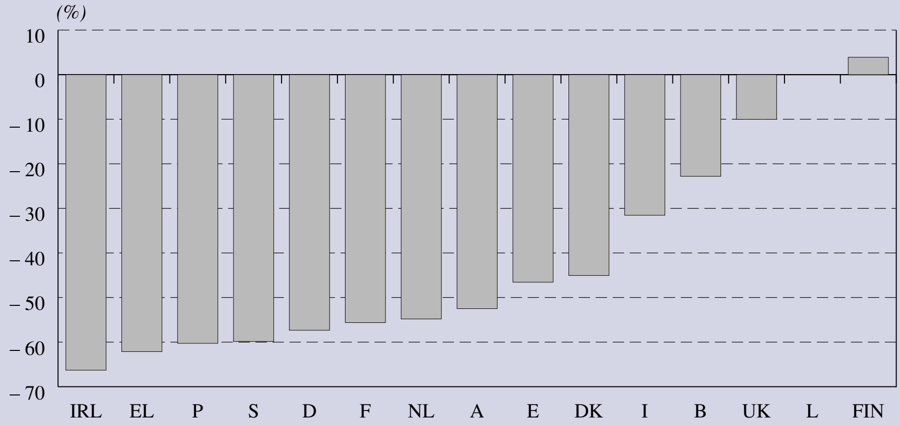

*Source:* Commission services.

*Graph 6:* **Telecommunication price change in % between 1997 and 2000**

**Local calls**

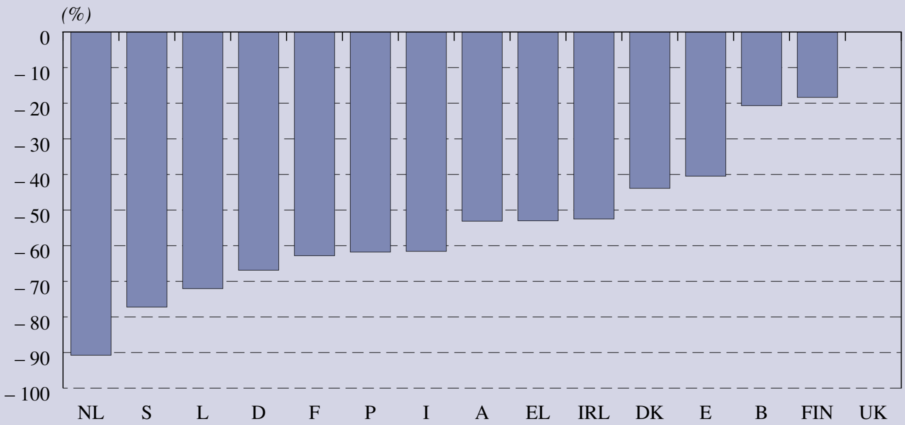



**National calls**




10 minute call at 11 a.m. on a weekday; price in national currency, excluding taxes.

**Calls to US**

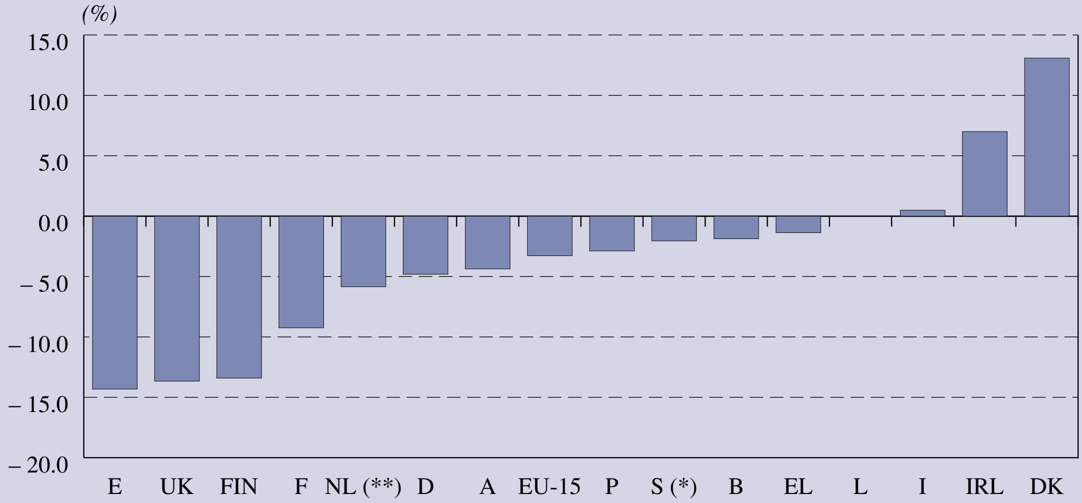



10 minute call; pmce in national currency, excluding taxes.

*Source:* Commission services.

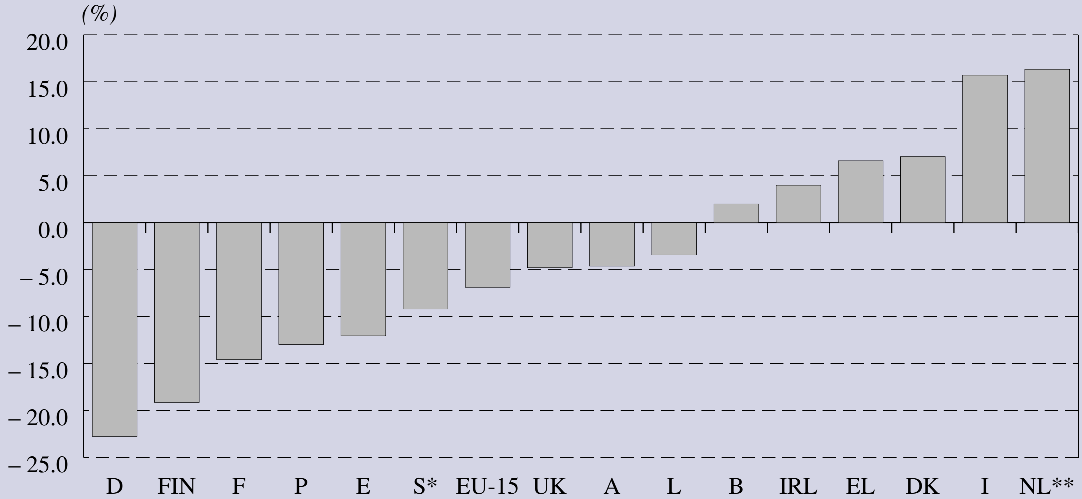
*Graph 7:* **Electricity price change in % between January 1996 and July 2000**

**Households**




Domestic standard consumer consuming 3 500 kWh among which 1 300 kWh overnight with a reduced rate for a standard dwelling of 90m²; price in national currency excluding taxes.
(*) S data for July 1996 and July 2000.
(**) NL data for Jan. 1996 and Jan. 2000.

**Industry users**




Industrial standard consumer consuming 2 GWh annually with a maximum demand of 500 kW and an annual load of 4 000 hours; price in national currency excluding taxes.
(*) S data for July 1996 and July 2000.
(**) NL data for Jan. 1996 and Jan. 2000.
*Source:* Eurostat.

of the universal service obligations and a sufficient level of competition in the liberalised markets. The setting up of independent regulatory bodies has contributed to consolidate reforms in most Member States. In Germany, for example, the liberalisation of the energy sector is well advanced but no independent regulatory body has been created, which has been a factor contributing to large regional differences in the fees for the use of local electricity distribution networks. Complete market opening with uniformly implemented rules and tight deadlines in both production and distribution should now be the target.

The further opening up of the transport sector to competition and the liberalisation of the postal sector continue to pose problems. In the postal sector, the need to reach an agreement on market opening and on the regulatory framework to be put in place is becoming increasingly urgent. In rail transport, an agreement was reached on the market opening of international rail freight, but the challenge regarding passenger transport and domestic rail freight remains. In public rail and road transport, a number of smaller steps (a revision of the tariff system for access to the rail infrastructure network in France, the legal separation of rail infrastructure management and operations in Italy, the introduction of a system of concessions to bus, tram and underground transport networks in the Netherlands, etc.) have been taken to facilitate market opening at a later stage. In air transport, further action is urgently needed, building on the recommendations of the high-level group on air traffic reform concerning the creation of a single European sky and revising the rules on the allocation of airport slots.

**Services**

A majority of firms involved in the cross-border provision of services report remaining barriers to their activities in other countries. Professional services (lawyers, auditors etc.), in particular, remain subject to access restrictions in many Member States, including Germany, Greece and Italy. The absence of a true internal market in services has led the Commission to adopt a new horizontal strategy for this sector. Moreover, competition in the distribution sector will benefit from the growth of B2B e-commerce, especially in the Netherlands, Sweden, and the United Kingdom, countries with an e-commerce share in total retail sales similar to that in the United States. This development is especially important in countries like Sweden and Finland, which suffered most from an insufficient level of competition in distribution. However, specific measures to deal with this problem have yet to be introduced in these two countries.

**Regulatory reform**

Different measures (including one-stop shops, e-government and business tax reform) have been taken to reduce the administrative burden on enterprises, whereby particular attention has been given to the needs of start-ups as well as other small and medium-sized enterprises. Nevertheless, there remains a significant scope for a simplification of administrative procedures imposed on businesses in the Member States, especially in Belgium, Greece, Spain and France. Efforts to increase the efficiency of public administration have been particularly evident in countries with a large public sector, such as the Nordic Member States, but also in Italy, the Netherlands and Portugal.

Increasingly, public sector bodies or public–private partnerships are supplying market goods or services. As they enter into direct competition with private enterprises, rules need to be laid down ensuring transparency and competition on equal terms. For competition to lead to efficient outcomes, public and the private entities must compete on a level playing field. In the Netherlands and Sweden, specific measures are being considered to ensure that this is the case.

The Commission has published several reports on its monitoring of the effective implementation of the reforms and of their impact in terms of efficiency and consumer benefits. Benchmarking has been increasingly used in several structural policy domains. In this respect, the agreed list of structural indicators provides a useful tool for comparing progress.

## 2.7. Promote capital markets through further integration and deepening

The 2000 BEPGs recommended to:

(i) *establish a 'single passport for issuers';*

(ii) *eliminate barriers to investments in and by pension funds and clarify the distinction between sophisticated and retail investors;*

(iii) *promote further integration of government bond markets;*

(iv) *improve the efficiency of securities clearing and settlement systems;*

(v) *enhance the efficiency of cross-border retail payment services;*

(vi) *enhance the comparability of financial statements of companies;*

(vii) *promote the development of new firms and investment in venture capital;*

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

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

Specifically, the Lisbon European Council, which highlighted the need to intensify efforts to create an integrated EU financial system, called for implementation of the Community's financial service action plan (FSAP) by 2005 and for implementation of the risk capital action plan (RCAP) by 2003. In line with this mandate, the 2000 BEPGs recommended swift action in a set of priority areas identified in the FSAP and in the RCAP.

### Implementing the financial services action plan (FSAP)

Progress has been made in many of these priority areas. For instance, the Commission has tabled proposals designed to create a fully operational 'single passport' for investment firms, to clarify the distinction between sophisticated and retail investors, to ensure that pension funds enjoy sufficient freedom to develop an effective investment policy and to harmonise accounting standards. The Commission has also tabled a communication on e-commerce and financial services, which should help negotiations on the draft directive on distance marketing of financial services to make progress in the Council. The adoption of a proposed directive on takeover bids hoped for the by end of 2000 will be subject to conciliation between the Council and the Parliament. The directive on the winding up of insurance institutions was adopted and the negotiations on the draft directive for the winding up of credit institutions are progressing well. In order to facilitate implementation of the FSAP, the Lamfalussy Group was established in July 2000 with a mandate to propose improvements in the framework for EU regulation of securities markets. The Group's final report, which recommends a series of procedural changes, was published on 15 February 2001.

### Implementing the risk capital action plan (RCAP)

Progress has also been made in developing the EU risk capital market. In addition to those actions under the FSAP that are relevant to the implementation of the RCAP, progress has been made at the national level.

A key area requiring a national response has been the easing of legal/regulatory constraints on institutional investment in equity markets and venture capital. Only four Member States (Ireland, the Netherlands, Finland and the United Kingdom) have no such constraints — beyond a general requirement for prudence — on institutional investment in equities. Constraints have been eased in Belgium, Sweden, France, Italy and Spain and the Danish Government proposes to introduce rules on institutional investment in equity based on prudential considerations. Finland and the United Kingdom are taking measures to further encourage investment by institutional investors in equity markets.

A second key area requiring a national response relates to the removal of fiscal disincentives to risk-capital investment (to be achieved by adjustment of taxation of corporate profits and capital gains). Fiscal disincentives have been addressed in several Member States. Belgium has taken fiscal measures in favour of spin-off and start-up companies; France has offered fiscal incentives for investment by business angels; Greece and Spain have increased existing tax relief on capital gains; Italy has reinforced its dual income tax system of 1998 which favours equity financing of corporations. On the other hand, little has been done to address the disincentive effects of bankruptcy and insolvency procedures, except in Italy and the Netherlands. Similarly, too few countries have taken steps to ensure that the taxation of share ownership and stock options does not act as a disincentive to entrepreneurship.

As recommended in the October 2000 progress report on the RCAP, Member States' efforts will need to be intensified, accelerated and extended if the RCAP is to be implemented by the 2003 deadline.

### Safeguarding financial stability

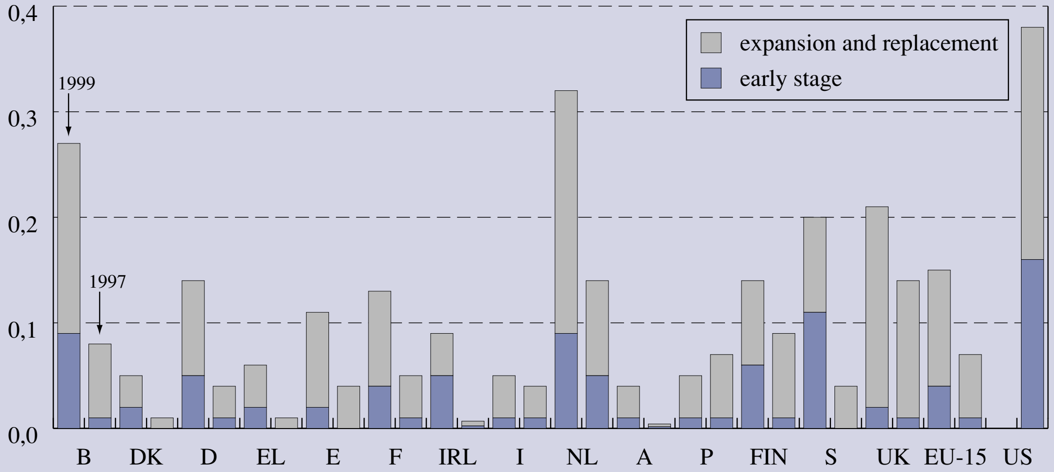
The 2000 BEPGs addressed the issue of stability in the EU financial system, recommending improved coordination among national supervisors. While no change was advocated to the existing institutional arrangements, it was recommended that the practical functioning of those arrangements should be enhanced.

Several Member States have taken measures to strengthen coordination between their national supervisors. In Germany, plans to integrate the supervisory authorities for the banking sector, the insurance sector and securities markets have been announced. In France, the banking and insurance supervisory authorities are to coordinate more

*Graph 8:* **Equity financing in the EU**

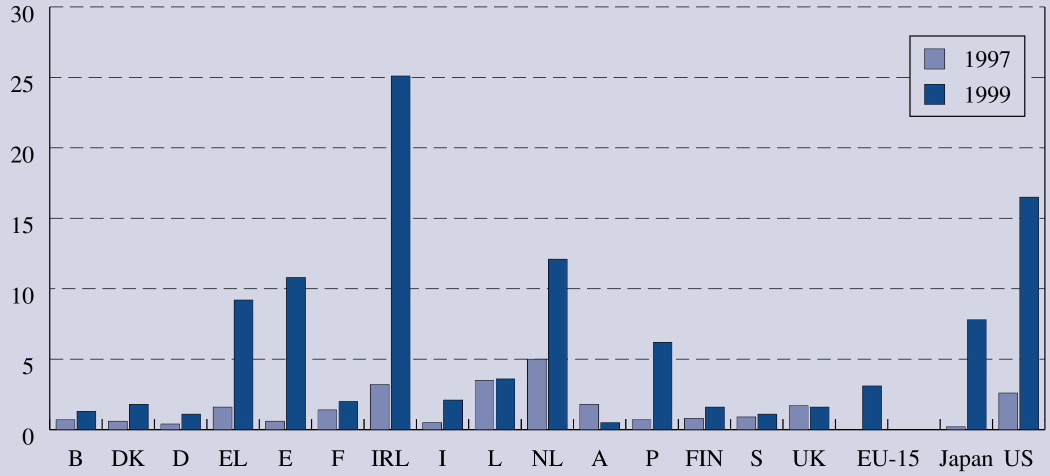
**Innovation and research — venture capital**

*(Venture capital investment as a percentage of GDP)*




**Economic reform — capital raised on stock markets**

*(Amount of new capital raised by domestic companies as a percentage of GDP)*




*Source:* EVCA and FIBV.

closely, while the securities regulatory authorities are to be merged. In the Netherlands, a formal consultative body has been set up as a forum in which the various financial supervisors discuss cross-sectoral issues. In Portugal, the creation of the National Council of Financial Supervisors should contribute to promote coordination among the different supervisors of the financial system. Measures have also been taken to improve the exchange of information between supervisors in different Member States. For instance, the Danish, Swedish and Norwegian financial supervisory authorities have signed a cooperation agreement covering the entire financial sector. However, it would seem necessary to build on the progress made so far.

## 2.8. Invigorate labour markets

The 2000 BEPGs recommended to:

(i) *promote the transition from passive to active measures;*

(ii) *review and reform tax and benefit systems;*

(iii) *enhance labour mobility;*

(iv) *modernise work organisation;*

(v) *strengthen efforts on equal opportunities policy; and*

(vi) *work towards a more inclusive labour market by the end of 2000.*

The improvement in labour market performance continues, with rapid employment growth (1.7 %) and a fall of almost one percentage point in unemployment during 2000. This is to a large extent due to the cyclical upswing, but the evidence also suggests a fall in structural unemployment, thanks to the strategy of labour market reforms and active measures to improve employability. Long-term unemployment fell from over 49 % of total unemployment in 1997 to 45.7 % in 1999. However, progress has been uneven with some labour markets showing signs of tightening.

A few Member States (Denmark, the Netherlands and the United Kingdom) are reaping the benefits of earlier comprehensive labour market reforms. However, problems remain in all Member States, and most have pursued a piecemeal approach, thereby failing to exploit the possible synergies between different reforms. On the whole, Member States have not taken full advantage of the current macroeconomic conditions to introduce the structural reforms that will be needed to sustain the favourable employment performance of recent years.

### Active labour market policies

One area where good progress has been made is in implementing active and preventive measures to tackle youth and long-term unemployment. Only Belgium, Greece and Italy still need to take significant further steps to hit the targets for early activation set in the employment guidelines by 2002. However, while many Member States have increased spending on active measures in recent years, efforts to improve the design and monitoring of these policies need to be redoubled, in order to ensure efficiency.

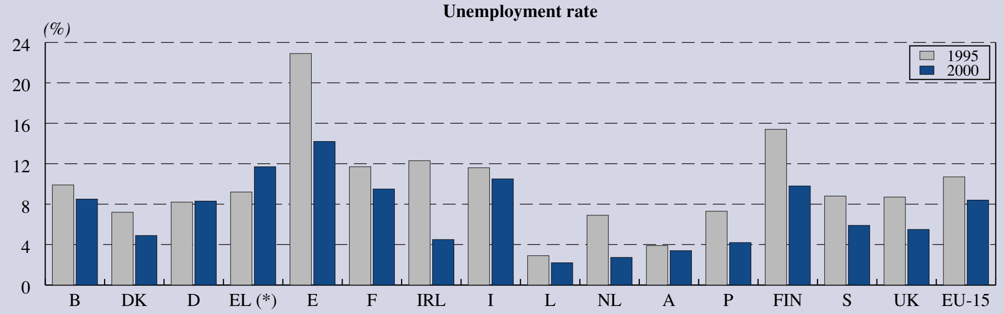
Most Member States are broadening support for young people with learning difficulties and taking steps to equip young people with a greater capacity to adapt to technological and economic change. All Member States are improving ICT equipment in schools. They are also devoting increased attention to the promotion of lifelong learning, although only Denmark, Ireland, the Netherlands, Finland, Sweden and the United Kingdom have set out a comprehensive approach.

### Tax and benefit systems

There remains ample scope for further reform of tax and benefit systems to ensure appropriate incentives to seek and take up employment, particularly given the need to increase labour supply in many Member States. This applies also to some with very low official unemployment rates, but with significant numbers of 'hidden unemployed' receiving passive benefits, such as Denmark, Luxembourg, the Netherlands and the United Kingdom. Passive benefits include disability and early retirement pensions, which are not conditional on seeking work. Some Member States have reformed early retirement schemes or taken other measures to reduce incentives to withdraw early from the labour market.

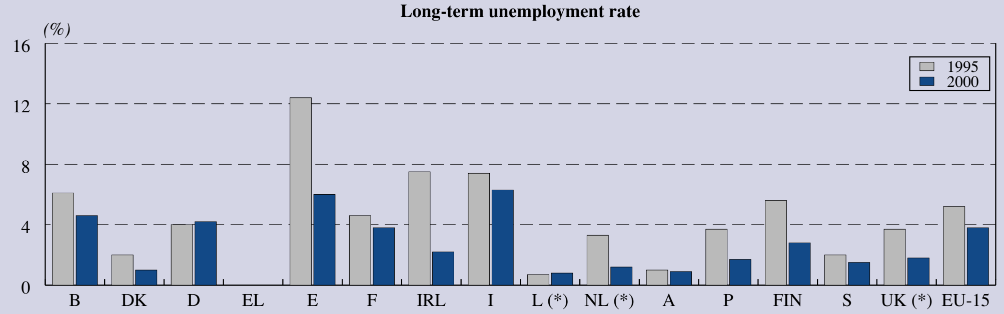
During the 1990s, a number of Member States undertook reforms of tax and benefit systems, but only in some cases addressing both taxes and benefits in a comprehensive manner. Many Member States have reduced taxes on labour recently (see Section 2.3.), and further reforms have been announced. However, during the year 2000 there has been little in the way of benefit reforms or comprehensive tax and benefit reforms, even though it is the overall impact of taxes and benefits that is crucial to people's labour supply decisions. Several Member

*Graph 9:* **Labour market situation in the EU**

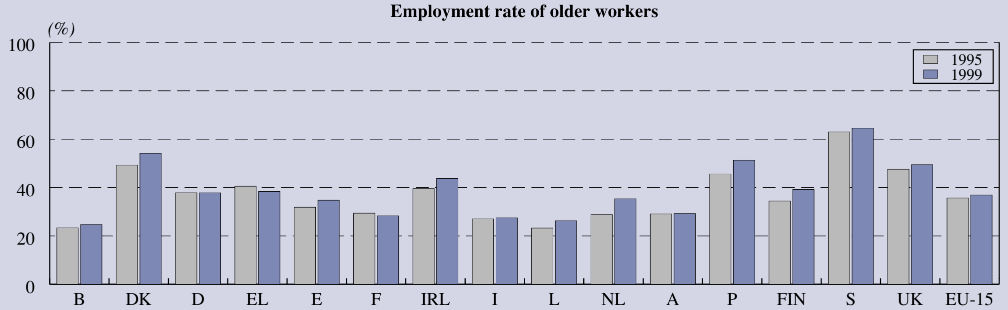



(*) EL is 1995 and 1999.


(*) Data for 2000 are estimates. Data for Sweden is 1996 and 2000.




(*) L, NL and UK are 1995 and 1999.




*Source:* Commission services.

States (Belgium, France, the Netherlands, Austria and the United Kingdom) have pursued or intend to pursue measures that explicitly address the combined incentive effects of taxes and benefits. These in-work benefits typically aim to boost the income of low-paid working people or families while minimising disincentive effects due to high marginal effective tax rates.

**Flexibility and modernisation of the labour market**

A lack of labour market flexibility is one of the factors underlying the high rates of structural unemployment still witnessed in Belgium, Germany, Greece, Spain, France, Italy and Finland. In most cases, this is accompanied by severe regional disparities, yet little has been done to reform where appropriate wage formation systems so that these better reflect local productivity and labour market conditions. Limited measures have been taken to promote labour mobility, but further progress here is needed. Mobility is impeded by rigidities in the housing market in several Member States, as well as the lack of progress on mutual recognition of qualifications and portability of pension rights.

There has been some progress in the modernisation of work organisation, including the facilitation of part-time work and more flexible working arrangements. Agreements in these areas may have served to minimise any negative effects of statutory reductions in working time. However, the degree of involvement of the social partners in this area has been disappointing. Moreover, unless rigidities under existing employment contracts are addressed, there is a risk that employers will be forced to rely on temporary contracts, even when longer-term arrangements would be appropriate.

Nothing has been done in 2000 to address strict employment protection legislation for permanent contracts in Spain, France, Italy and Portugal. In these countries, the growth of fixed-term contracts was well in excess of the increase in permanent jobs, underlining the need for greater flexibility.

**Equal opportunities and social inclusion**

As far as equal opportunities are concerned, most Member States have taken specific measures to address low female employment rates, occupational segregation and pay differentials between men and women. These are assessed in detail in the Joint Employment Report 2000. Few measures are proposed in two of the countries with the lowest female employment rates, Greece and Italy. Tax and benefit reforms in some Member States (such as Luxembourg and the Netherlands) appear to paying off in terms of increased female participation. In addition, almost all Member States have taken significant steps to improve childcare facilities for working parents.

As regards social inclusion, the progress made in reducing unemployment — particularly youth and long-term unemployment — over the course of 2000 is encouraging. Little has been done, however, to tackle the basic rigidities that underlie severe regional unemployment disparities, which have serious consequences in terms of cohesion. In addition, as overall unemployment has fallen, its disproportionate impact on certain communities and social groups has become more apparent. Several Member States have taken employment initiatives targeted at deprived areas, single parents and ethnic minorities, to name three examples. Many Member States have targeted reductions in the tax burden on labour towards the low-paid, partly with the aim of improving the job prospects of the low skilled, who are also heavily overrepresented among the unemployed. However, there is a need for a more integrated approach towards social inclusion, combining policy measures in different areas, in light of the common objectives agreed by the European Council of Nice.

## 2.9. Enhance sustainable development

The 2000 BEPGs were the first to include a separate section on sustainable development. Member States were recommended to:

(i) *introduce or strengthen market-based policies like taxation, user charges, insurance/liability schemes and tradable permits; help achieving the EU objectives under the Kyoto Protocol; and contribute to break the link between environmental pressure and economic growth;*

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

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

A number of Member States took action to strengthen market-based approaches to environmental issues. Germany continued to implement its policy of shifting the tax burden from labour to energy. Attempts by France to do likewise by extending the scope of the Taxe générale sur les activités polluantes (TGAP) to electricity use were ruled out by the constitutional court. The United Kingdom continued preparations to introduce a revenue-neutral climate change levy, with revenues being used to cut social insurance contributions. Denmark established a scheme of tradable emission permits for carbon dioxide emissions from the electricity sector. In the Netherlands, a trading scheme for NOx emissions by industry has been linked to a voluntary agreement by industry to reduce the NOx intensity of energy consumption and total emissions.

Some Member States recently introduced specific incentives for environmentally beneficial behaviour.

Appropriate pricing of water to cover the full costs is essential to encourage a more sustainable use of this resource. In line with the water framework directive, pricing is playing an increasing role in the water policy of several Member States. However, there are major differences between Member States in the systems they apply and in many cases the supply conditions for water are still strongly influenced by sectoral subsidies.

Some Member States continue to grant substantial subsidies for certain sources of energy, such as coal, that have a negative environmental impact. Furthermore, in response to rising fuel prices some Member States offered excise duty exemptions (France, Italy and the Netherlands) or other measures aimed at reducing the costs of transport (Belgium, Germany and Finland). In Italy, the planned step-by-step increase of excise duties in the framework of an environmental tax reform was thus (temporarily) abandoned. The fact that the sectors concerned benefit from fuel tax reductions and exemptions or derogations from Community legislation — and for which the relative increase in price compared to those that do not benefit from these derogations was therefore greater — argues in favour of a less generous approach to the granting of such measures. Most recently, the February 2001 Ecofin Council took note of the intention of the Commission not to propose further prolongations relating to the derogations in favour of road haulage after the year 2002.

No progress was made with the third recommendation, to agree a framework for energy taxation at Community level.

# Part II

## Country notes [1]

[1] Working document of the Commission services.

# Contents

# 1. Belgium

## 1.1. Economic developments and key policy issues

The economy of Belgium has grown at an average rate of 3 % in the last four years, almost double than in the period 1991–96. Real GDP growth in 2000 was close to 4 %, the highest rate in more than 10 years. The standardised unemployment rate has been falling since 1997 but remains relatively high at 8.3 %. The annual inflation rate rose to 2.9 % last year up from 1.1 % in 1999, mainly due to the rise in oil prices and the depreciation of the euro. The improved growth performance in recent years should be primarily ascribed to sound macroeconomic policies followed for a number years; policies of wage moderation agreed among social partners, by preserving the competitiveness of the economy, have enabled the open economy of Belgium to benefit from favourable international developments. Of particular importance in improving the economic climate and prospects has been the remarkable progress made in budgetary adjustment, by enlarging the budgetary margin for financing other policy priorities and by increasing expectations for a reduced tax burden. Robust real GDP growth, though lower than in 2000, is expected for 2001.

In order to maintain this positive trend and ensure a sustainable economic expansion and employment creation, Belgium has to address a number of key challenges. These include:

(1) the still very high government debt as a percentage of GDP, particularly in connection with future challenges stemming from ageing population;

(2) the low employment rate, especially for older workers, and the persistently high regional and skill-specific divergences in labour market performances; and

(3) the lack of competition in specific sectors and the need to improve the efficiency of the public sector.

Rapid reduction in the high government debt has been a first priority for the Belgian government in order to comply with Community rules and to regain the necessary margin to realise other public policy objectives. This commitment was reiterated in the 2000 update of the stability programme of Belgium. A major policy challenge for Belgium in the years ahead is to make an optimal use of new budgetary margins in order to continue fiscal consolidation and at the same time to allocate resources to new projects and policy actions, in particular in order to improve public infrastructure. The government has identified as priority areas an active employment policy, tax reforms favourable to labour and the environment, the modernisation of the social security system, the funding of the communities and regions, the improvement in public administration and increased investment in public transport and preparation for future demographic developments. A first response of the government to the need to prepare for the financial challenge of ageing population was the creation of the ‘Silver Fund’, funded initially by the proceeds from the sale of UMTS licences and, in the medium to long-term, from the planned budgetary surpluses. The rise in the employment rate and the reform of the pension system should provide more lasting solutions to long-term sustainability of public finances.

The low employment rate in Belgium, estimated at 60 % in 2000 compared to the EU average of about 63 %, suggests that there is wide room for improvement in this area. The standardised unemployment rate, currently at an estimated 8.3 % and declining in recent years, conceals a very diverse situation between, and within, regions and between age groups and qualifications. The objective, set in the Lisbon Summit, to increase substantially the employment rate over the following 10 years is indeed a big challenge for Belgium and requires the combined and coordinated use of fiscal, labour market and other structural policies in order to achieve this ambitious goal. Important steps have already been taken in reducing the tax and non-tax financial burden on labour through substantial reductions in social security contributions.

Currently, one of the main challenges facing the Belgian labour market is the very low employment rate of older workers (55–64 years). At 24.7 % in 1999, this was the lowest rate in the European Union. In Spring 2000 more than 15 % of the population aged 50–64 years (22 % of the male and 9 % of the female population over fifty) had withdrawn from the labour market and was drawing benefits from either 'the collective early retirement' or 'the older unemployed people' scheme. The ageing population and the increasing number of vacancies suggest a need for measures aimed at mobilising the non-occupied potential labour force, thereby increasing participation rates. This points to the need of a more substantial review of all relevant schemes, such as the early retirement scheme. The labour market situation, with high and lasting regional and skill-specific unemployment divergences, suggests a need for higher wage differentiation. In addition, labour mobility appears to be hampered by high housing costs due to heavy registration taxes, an inadequate public transportation and increasing traffic congestion, as well as linguistic barriers.

In Belgium, the services sectors are areas where competition could be increased. In general, competition authorities seem to suffer from a lack of resources and power. While the liberalisation process is progressing well in telecommunications, it remains limited in rail transport and in the energy sectors. In the latter, the historical operators still enjoy a near-monopoly position and there is a lack of transparency in the relationships between the public and the private sectors at local and provincial level. A comprehensive reform of federal public administrations (Copernicus reform) aiming at simplifying administrative procedures and at reducing the regulatory burden on business is currently being undertaken. Nevertheless, product market regulation is still high, and no reform has been announced in the regional entities, which, in the light of the transfer of economic matters to regions, could become a problem.

## 1.2. Public finances

### Overall assessment

Belgium continued, last year, the fiscal consolidation effort pursued with determination during most of the last decade. A visible sign of progress made in this area was the balance achieved in 2000 in the accounts of the general government, the first in 50 years. Also, the government debt ratio was reduced to 110.6 % of GDP in 2000 from a peak of 138.8 % in 1993. The progress made in establishing sound public finances has started creating some budgetary margin for financing other policy actions and, also, for reducing the tax burden, in particular that on labour. However, the need to reduce rapidly the very high debt ratio and prepare for the challenges that an ageing population would pose for public finances, requires the continuation of the budgetary consolidation effort based on the strategy followed, so far, with remarkable success.

*Table 1*

**Economic developments in Belgium**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.4 | 3.4 | 2.4 | 2.7 | 3.9 |
| Domestic demand | 1.2 | 2.6 | 3.9 | 2.1 | 3.0 |
| Private consumption | 1.3 | 2.1 | 3.3 | 1.9 | 2.5 |
| GFCF (Investment) | 0.0 | 6.7 | 4.6 | 4.8 | 4.6 |
| Exports (G & S) | 3.6 | 6.7 | 4.4 | 5.2 | 9.4 |
| Imports (G & S) | 3.2 | 5.7 | 6.5 | 4.5 | 8.6 |
| Inflation (1) (2) | : | 1.6 | 1.0 | 1.2 | 2.9 (*) |
| Compensation/employee (1) | 4.2 | 2.9 | 2.0 | 2.3 | 3.2 |

NB: Data in this and subsequent tables are based on the Commission services' autumn 2000 economic forecasts. Where these data have been replaced by more up-to-date figures, these new data have been marked with an asterisk. If this resulted in an inconsistent data set due to an incomplete update, the original autumn 2000 forecast figure is shown in brackets.

(1) Annual percentage change.
(2) Harmonised index of consumer prices.

*Source:* Commission services.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • To achieve better budgetary results in 2000 than the 1 % if GDP deficit target set in the budget and in the updated stability programme, in the light of the better budgetary results in 1999 and higher GDP growth prospects for 2000 than projected in the budget. | ✔ |
| • To contain the real annual growth rate of primary expenditure within the 1.5 % figure implicitly derived from the commitments under the updated stability programme, thus allowing a reduction in the tax burden, notably on labour, while preserving the achievement of a lower government deficit target. | ✔ |
| • To maintain the primary surplus at levels at somewhat above 6 % of GDP in order to ensure a continuous reduction in the general government deficit and to allow a fast reduction in government debt ratio. | ✔ |
| • To allocate the proceeds of privatisation or other sales of assets owned by the State to the reduction of government debt. | None |

NB: The degree of implementation is indicated as '✔' for (practically) completed, 'still in progress', 'partially' (difference between 'still in progress' and 'partially' being that in the former a more complete realisation of the recommendation is expected without further external efforts) and 'none'.

Available evidence shows that the recommendations of the 2000 BEPGs were met, in some cases with a comfortable margin. Although robust economic growth and higher fiscal revenues contributed to this result, the central element of the budgetary consolidation strategy remained the high primary surpluses resulting from control on the increase in primary expenditure.

The recommendation to achieve better budgetary results in 2000 was met by a wide margin as the general government accounts were in equilibrium last year compared to a deficit of 1 % of GDP targeted in the budget and the 1999 update of the stability programme.

Increase in primary expenditures in real terms in 2000 is estimated to have remained within the 1.5 % objective, a development facilitated by the higher than expected inflation rate. In 2000, social security contributions as percent of GDP were reduced considerably, by 0.6 percentage point; the overall tax burden was reduced by 0.4 percentage point of GDP.

High primary surpluses are essential elements in fiscal consolidation and the debt reduction strategy in Belgium. In 2000, the general government primary surplus reached 7 % of GDP as against 6.5 % in the previous year; control of primary expenditure contributed importantly to this development.

Practically no privatisation or asset sales operations have taken place in 2000.

## 1.3. Economic reforms

### 1.3.1. Product markets

**Overall assessment**

The openness of the Belgian economy stimulates competition, especially on the goods markets. This contributes to the good labour productivity performance in this economy and helps to maintain consumer price levels just below the EU average, despite the relatively high GDP per capita. However, competition is relatively weak in services sectors such as distribution, electricity, gas and rail transport, and overall product market regulation was rather strict. Despite the reforms of 1999, the Competition Office still lacks resources and this hampers effec-

*Table 2*

**Trends in public finances in Belgium (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 7.3 | – 4.3 | – 1.9 | – 0.9 | – 0.7 | 0.0 |
| — Current receipts | 48.9 | 48.9 | 49.7 | 50.0 | 49.9 | 49.8 |
| Tax burden (3) | 45.2 | 45.2 | 46.1 | 46.5 | 46.4 | 46.4 |
| — Total expenditure | 55.9 | 53.0 | 51.6 | 50.9 | 50.7 | 49.8 |
| Primary current expenditure | 42.2 | 41.6 | 41.2 | 40.8 | 40.8 | 40.3 |
| Interest payments | 11.2 | 9.3 | 8.0 | 7.7 | 7.2 | 6.9 (*) |
| Investment | 2.0 | 1.8 | 1.6 | 1.5 | 1.8 | 1.8 |
| Primary balance | 3.8 | 5.0 | 6.1 | 6.7 | 6.5 | 6.9 (*) |
| Government debt | 138.8 | 133.8 | 125.2 | 119.7 | 116.4 | 110.9 |
| Cyclically-adjusted balance | – 6.3 | – 4.0 | – 1.4 | – 0.3 | 0.0 | 0.0 |
| Cyclically-adjusted primary balance | 4.9 | 5.3 | 6.6 | 7.3 | 7.2 | 7.0 |

(1) 1993 = ESA 79; 1995–2000 = ESA 95.
(2) Percentage of GDP.
(3) Taxes linked to imports and production (total economy), current taxes on income and wealth and social contributions.

*Source:* Commission services.

tive implementation of the comprehensive competition legislation. In 2000, the Belgian priorities on product markets were to modernise public administration, to simplify administrative procedures, especially for SMEs, to speed up the liberalisation of the energy market and to reinforce competition on the telecom market, while organising good quality universal service. Measures have been taken in these areas but with mixed results.

Belgium's record in developing a knowledge-based economy is mixed compared to countries with similar levels of GDP per capita. Regarding the penetration of new information and communication technologies, Belgian is in the medium range. In 2000, the Belgian market recorded a strong increase in Internet penetration which is now equivalent to the EU average. Belgian has experienced delays in e-learning and in computerisation and Internet connections of schools. But, in 2000, programs have been launched to tackle these problems. R & D expenditures as a percentage of GDP are equivalent to the EU average. Public sector financing has strongly increased in recent years and this trend is expected to continue. Federal and regional initiatives have also been launched to develop clusters in know-how, to encourage partnerships between research centres and universities and to promote technological development and innovation in SMEs.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Address the problem of a lack of competition in services (energy, telecommunications, rail transport and business services). | In progress |
| • Speed up liberalisation of the electricity and gas sectors and strengthen the powers of the regulatory authorities responsible for energy and telecommunications. | In progress |
| • Reduce the regulatory burden for businesses. | In progress |
| • Increase the transparency of the relationships between the public and private sectors. | None |

A number of measures have been taken to increase competition in telecommunications, gas, and electricity (see also 16) but prices in these sectors remain above EU-average. In the telecommunications sector, market entry has been enhanced through a simplification of licensing procedures, number portability, improvement of cost accounting system for lease lines, and carrier pre-select code. Licences for UMTS should be awarded in the first quarter of 2001. In the rail transport, a number of principles has been defined in order to increase competition but no measures have already been taken. The government is seeking to improve the way the rail sector and especially the national rail company (SNCB-NMBS) operate and progressively open some segments to private initiates. To

*Table 3*

**Product market indicators for Belgium**

| | Belgium | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 63.5 | 65.2 | 69.1 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 46.1 | 48.1 | 50.8 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 8.0 | 11.2 | 22.6 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 3.7 | 4.1 | 4.7 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 5.2 | 3.5 | 2.9 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.98 | 2.32 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.92 (6) | — | 0.95 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 19.0 | 19.4 | 19.5 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 124.3 | 124.7 | 124.5 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 99.0 | 99.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 121.3 | 123.0 | 124.8 | 100.0 | 100.0 | 100.0 |
| — national calls | 105.8 | 97.5 | 116.8 | 100.0 | 100.0 | 100.0 |
| — call to US | 107.8 | 117.2 | 143.8 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 124.1 | 125.4 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 118.4 | 120.9 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 96.7 | 94.0 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 106.2 | 101.1 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 5.1 | 4.9 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 1.84 | : | : | 1.86 | 1.86 | : |
| Patent applications (12) | 86.2 | 101.8 | 99.5 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (16) | 4.9 | 4.9 | 5.4 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 20.2 (14) | 29.2 (15) | — | 18.3 (14) | 28.4 (15) |

(1) (Exports + imports of goods)/(2 × GDP); EU-15: average for small EU Member States in the case of B, DK, EL, IRL, L, NL, A, P, FIN and S, and average for large EU Member States in the case of D, E, F, I and the UK. For Belgium and Luxembourg, BLEU (1997 and 1998).
(2) Percentage of GDP. For Belgium and Luxembourg, BLEU (1997 and 1998).
(3) Percentage of EU total.
(4) 1998–2000; for EU-15, percentage rate of internal market directives not yet transposed across the whole of the Union.
(5) Percentage of GDP.
(6) Percentage of GDP (avg. 1995–97); provisional data.
(7) Percentage of GDP (avg. 1997–99); provisional data.
(8) Per employee; PPS; EU-15 = 100.
(9) Private final consumption, including taxes; EU-15 = 100.
(10) Price level index, excluding taxes; EU-15 = 100.
(11) Public spending as a percentage of GDP.
(12) Per million inhabitants; EPO.
(13) Percentage of citizens with access at home; Eurobarometer.
(14) May 2000.
(15) October 2000.
(16) BLEU, percentage of GDP.

*Source:* Commission services.

that end, accounting and operational separation should be implemented between infrastructure management, public services transport, and other transport activities. Finally, in order to strengthen competition in the services sector, the Competition Office has decided to give priority to a limited number of cases in telecommunications, electricity, audiovisual, liberal professions and distribution.

The liberalisation of gas and electricity has been speeded up and regulatory bodies have seen their powers strengthened. Nevertheless, there is still a lack of competition in these sectors. Electrabel, the incumbent operator, still enjoys a near monopoly position in electricity production and owns around 90 % of the existing high-voltage transmission network manager (CPTE). Municipalities, grouped into 'intercommunales', have a stake in production, transmission, and, not least, distribution of electricity, which could reduce their incentive to lower prices. Recently, Belgium has received a reasoned opinion for failing to implement correctly EU rules opening the power markets to competition. However, the government has decided to speed up the liberalisation process and to reduce significantly captive end-users prices. In the gas sector, Belgium has decided to replace a negotiated access to the gas transportation network by an organised system of access based upon regulated rates. Exclusive transportation or storage rights will be abolished. These facilities will be accessible through licensing. Further legislative work is expected in this field. The government is planning a reform of the regulatory authority for telecommunications, aiming at reinforcing its role and independence but no move has been identified so far.

Efforts to simplify administrative procedures and to reduce the regulatory burden on business have been announced but only few measures have been taken yet. The government has appointed a commissioner to head the Agency for Administrative Reform. Priorities are the use of ICT (e-government), the simplification of administrative procedures, the implementation of evaluation procedures, and simplification of public procurement procedures. Furthermore, a major reform of the federal public administration (Copernicus reform) is on the way to change organisation and management procedures in the public sector.

This recommendation has not been addressed. Yet, the government has commissioned the 'société fédérale de participation' (public holding) and international experts to examine a regulatory framework and to define good practices for the set-up of public–private partnerships. But no action has been announced and the problem at local and provincial level has not been tackled.

### 1.3.2. Capital markets

**Overall assessment**

Belgian capital markets are highly integrated with international markets. Over the last years, the banking sector has been restructured through a process of mergers and acquisitions and cross-border operations. After the reform of the Belgian stock market in 1999, the already substantial integration has been increased by the merger between the Brussels, Paris and Amsterdam stock exchanges. Over the past few years, the private equity market has shown exceptional growth. It is characterised by a large number of small investment companies and high venture capital investments (relative to GDP), especially in early-stage and high-tech.

In terms of legal framework, a group of experts set up by the federal government has proposed a set of legislative actions to improve corporate governance (e.g. to increase independence for the company auditor or the transparency regarding shareholders' interests). Consequently, a new company code will come into force early next year. Finally, in view of the draft European directives in this field, the government is considering a reform of the Belgian legislation on takeovers.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Make further efforts to encourage private, as opposed to public venture capital through an improvement of the fiscal environment. | In progress |
| • Give consideration, in particular, to reducing corporate tax rates and making capital losses deductible. | Partial |

Some fiscal measures have been taken in favour of researchers, as well as in favour of spin-off and start-up companies. The share of the public sector in new venture capital investments is decreasing. The corporate tax rate is to be reformed to attract more foreign investment and encourage innovative activities. Policy initiatives, including some legal actions, designed to stimulate the development of risk capital at regional and federal levels will be presented in a risk action plan to be forwarded to the European Commission early 2001.

### 1.3.3. Labour markets

**Overall assessment**

The performance of the Belgian labour market improved in 2000, although structural problems remain relevant. The share of long-term unemployment (LTU) in total unemployment was just below 60 % in 1999, amongst the highest recorded in the EU (after Spain and Italy), and the employment rate of older workers (55–64 years) was only 24.7 % in 1999, the lowest rate in the EU. Regarding the labour market recommendations, within the framework of the Luxembourg process and the national action plan for employment, the government has moved toward the implementation of an 'active welfare state' characterised, among other things, by a gradual shift from passive policies to a preventive and more active approach to labour market issues. Several measures to reinforce active policies are described in the national action plan 2000. The Belgian authorities have begun to address the work disincentives of the current benefit schemes, mainly unemployment benefits and early retirement. However, it seems that further efforts in this field are needed in order to tackle the very low activity and employment rates of older workers and the high share of long-term unemployment in total unemployment. The wage setting system has not been modified. Within the framework of the national inter-sectoral agreement, only a limited degree of wage differentiation continues to be allowed, while sectoral and regional differences remain marked.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Reinforce measures to promote labour mobility and encourage social partners to allow wages to better reflect local conditions; upgrade skills and educational attainment. | Partial |
| • Reinforce active labour market policies to create incentives to participate and take up new job offers; combine with a review of potential disincentives effects of tax and benefit systems. | In progress |

No major measures have been undertaken to promote wage flexibility. Some measures to upgrade skills have been taken by the regional authorities. The social partners agreed to gradually step up investment in training, so as to reach the average level of the three neighbouring countries by 2005.

In 2000, some targeted cuts in taxes and social security contributions were implemented in favour of the most disadvantaged segments of the labour market (low-wage workers, young unemployed, long-term unemployed). The new fiscal reform plan, envisaging more significant and permanent tax-cutting measures, is expected to substantially reduce taxation on labour in the years ahead. Some measures were adopted to reduce the risk of unemployment traps and benefit dependency, such as the 5-years' reduction of social contributions on low wages and on the hiring of long-term and older (over 45 years) unemployed. For unemployment benefits, rules concerning sanctions have been revised. Now a more flexible application of eligibility criteria is allowed for, while strengthening control over the job-search behaviour and availability for work of unemployed people. The duration of unemployment benefits remains unlimited in time for some recipients. In the years ahead, the planned introduction of a tax credit for low-income earners (similar to the WFTC in the UK) should increase incentives to take up a job for low-skilled people, thereby reducing 'unemployment traps' and benefit dependency. The early retirement schemes are still operational, notwithstanding increasing awareness of their negative impact on both labour supply and the long-term sustainability of public finances. The age limit for the 'collective early retirement scheme' (raised to 58 in the past), was not altered in 2000. Older unemployed people (the threshold age limit for the scheme was reduced to 50 years in 1996) are not considered to be job-seekers by the National Office for Employment (ONEM/RVA) and their unemployment benefits are higher than for people aged below 50.

*Table 4*

**Labour market indicators for Belgium**

| | Belgium | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 55.7 | 57.3 | 58.9 | 60.9 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 44.8 | 47.5 | 50.2 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 22.4 | 22.5 | 24.7 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | – 0.4 | 1.2 | 1.3 | 1.3 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 52.9 | 53.5 | 58.3 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 10.0 | 9.5 | 9.1 | 8.5 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 5.9 | 5.8 | 5.2 | 4.6 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 24.2 | 23.2 | 24.9 | 23.3 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 3.6 | 4.4 | 4.4 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 4.0 | 2.0 | 2.3 | 3.2 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 1.2 | – 0.8 | – 0.1 | 0.1 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 3.4 | 1.2 | 1.4 | 2.6 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 38.6 | 41.1 | 41.2 | 40.4 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 51.1 | 51.0 | 49.9 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 60.0 | 60.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 84.0 | 84.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

(1) The figures for 2000 are estimates.
(2) Coefficient of variation (standard deviation/average) for all NUTS level 3 regions, in percentages.
(3) Income tax plus employer and employee contributions, as a percentage of labour costs for a representative taxpayer (employee) — average rate.
Low-income families = married, single income on the average production worker wage level (APW), two children.
Low-wage earners = single earner at 67 % of the APW, no children. *Source:* OECD.
(4) NRR: the net replacement rate figures are for 1995 and 1997 and relate to the first month of unemployment.
Low income/wage definitions as per footnote 3. *Source:* OECD.
(5) Employment rate figures for US are from OECD.

*Source:* Commission services. OECD where footnoted.

# 2. Denmark

## 2.1. Economic developments and key policy issues

Following a policy-induced growth pause in 1999, output accelerated in 2000, mainly due to robust growth in equipment investment, repair works after the storm in December 1999 and a strong rise in external demand. In 2001, economic growth is expected to decelerate somewhat. Private consumption, which remained feeble in 2000 on the back of the fiscal retrenchment package and sluggish real disposable income, and government consumption, based on the budget for 2001, are expected to strengthen. However, these developments are likely to be more than offset by a much weakened investment growth. Employment growth should slow and unemployment, which remained relatively stable in 2000, is set to hover around a level close to 5 % of the labour force. Headline inflation continued to be relatively high in 2000, but is projected to gradually fall back facilitated by the exchange-rate developments towards the end of 2000 and the recent drop in oil prices. Wage increases (per hour) are expected to decelerate slightly following a weaker domestic demand growth, but given the continued tightness of the labour market an upward risk to the forecast remains.

In spite of the current healthy situation of the Danish economy a number of key policy issues can be identified, primarily on the basis of the 2000 BEPGs:

(1) an inflationary risk remains;

(2) labour supply constraints persist;

(3) there is a frequent overshooting of the target for government consumption growth; and

(4) inadequate competition and an insufficient level of efficiency remain in the public sector.

Inflation started to rise in 1999, in the beginning mainly driven by domestic factors such as strong wage growth. Since the middle of 1999 high energy and import prices have played a dominant role behind the continued high headline inflation. The HICP rose by 2.7 % in 2000 and is expected to decelerate in 2001, facilitated by the appreciation of the Danish *krone* towards the end of 2000 and the recent fall in energy prices. However, an upward risk to the inflationary outlook remains and it is mainly related to wage developments. Although wage increases per hour have come down somewhat since their peak in the beginning of 1999, data for the third quarter of 2000 again show a rise by some 4 %. Given that the labour market continues to be very tight with actual unemployment being below most estimates of structural unemployment, sector-specific bottlenecks could spark a renewed pick-up in wage growth.

To alleviate supply-side constraints on the labour market, a main challenge for Denmark will be to further raise labour supply and the employment rate — both in the short and longer term. This could prove particularly difficult since demographic developments imply a slight decline in the labour force in the coming years. Given that the old-age dependency ratio is expected to increase substantially in the years to come, a further expansion of the labour supply will also be necessary in order to afford the high level of social welfare in the future. Labour market and early retirement reforms already in place have played a role in further raising the employment rate, which is the highest in the Union. However, it does not seem likely that these measures can continue to expand the labour supply much further. More particularly, taxation of labour income remains high, with a large share of full-time employees in the highest tax bracket, and benefit schemes are generous, contributing to a substantial number of people in working age being inactive on various benefit schemes. Also, the relatively high frictional unemployment calls for consideration of further structural reforms.

Since the government took office in 1993, it has set a target of limiting real growth in government consumption to 1 % per year. Although data for 2000 are not yet publicly available it seems likely that this ‘ceiling’ was respected. However, this target has been repeatedly surpassed in the past and the average annual increase of government consumption between 1994–99 was 2.3 % in real terms. Often, the overshooting of targets was a result of higher spending at lower levels of government, despite the agreements with central government aimed at limiting the expansion of government consumption (and taxes). A main weakness with these agreements is that they are not legally binding in relation to individual municipalities or counties. Thus, the framework needs to be strengthened in the future and given a more binding character in order to avoid further slippage from targets. Taking the forthcoming budgetary impact of the ageing population into account, the need to better restrain government consumption becomes even more apparent.

Despite some signs of convergence in 1998, the Danish price level remains the highest overall in the EU. Aside from high living standards and high indirect taxes, this is due in part to an insufficient degree of competition in a significant number of industries. Although it is too soon to evaluate the effect of the recently introduced merger control and Article 81 and 82 enforcement, it is clear that the real impact will depend on how competition authorities enforce regulations. Moreover, achieving a high level of efficiency in the public sector is very important in Denmark, because the sector is relatively large. Already, the government has demonstrated noticeable improvements from exposing more of public procurement to competition and studies show that there is a potential for more cost savings in the outsourcing of public services provision. Further improvements do, however, depend crucially on imposing greater budgetary discipline on local authorities, which are responsible for some 70 % of public spending.

*Table 1*

**Economic developments in Denmark**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 2.1 | 3.0 | 2.8 | 2.1 | 2.6 |
| Domestic demand | 2.3 | 4.9 | 4.5 | – 0.6 | 2.5 |
| Private consumption | 2.3 | 2.9 | 3.6 | 0.5 | 0.5 |
| GFCF (Investment) | 2.2 | 10.9 | 7.8 | 1.6 | 7.9 |
| Exports (G & S) | 2.9 | 4.1 | 2.4 | 9.7 | 6.3 |
| Imports (G & S) | 3.7 | 10.0 | 7.4 | 2.2 | 6.2 |
| Inflation (1) (2) | 1.8 | 1.9 | 1.3 | 2.1 | 2.7 (*) |
| Compensation/employee (1) | 3.3 | 3.7 | 3.8 | 4.0 | 4.2 |

NB: For footnotes and sources see Table 1 for Belgium.

## 2.2. Public finances

### Overall assessment

The strengthening of general government finances has continued in recent years, mainly owing to a gradually declining expenditure ratio to GDP. The 2000 update of the convergence programme revised the projections of the budgetary balances upwards and the budgetary surplus — based on moderate growth rates — is now expected to be above 2.5 % of GDP for the period 2001–05. The government maintains its ambition to substantially reduce the general government debt in order to prepare for the budgetary impact of an ageing population, which is well in line with the general BEPGs. According to the projections in the updated convergence programme, Danish general government finances seem to have a capacity to cope with the financial burden of the ageing population.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Adhere to the government's aim to restrict real growth in government consumption to 1.2 %. | ✔ |
| • Pursue the decline of both the tax and expenditure ratios. | Partial |

Although full budgetary data for 2000 are not yet available, it is expected that growth in government consumption remained below the 1.2 % stated in the budget for 2000. Even if the expansion of 1.2 % included in the budget departed slightly from the general target of 1 % already from the outset, it seems likely that growth in 2000 ended up even below the general target of 1 %.

The 2000 update of the convergence programme largely maintains the budgetary consolidation strategy of the previous update, with gradually falling primary expenditure and tax ratios to GDP. In 2000 both the primary expenditure ratio and the tax burden have turned out lower than what was earlier assumed. However, in 2001 both ratios are expected to increase slightly, in contrast to the projected decline by some 0.3–0.4 pp. of GDP in the 1999 update. Taxes are raised by local and regional governments, clearly going beyond the non-binding agreements undertaken with central government. Furthermore, all levels of government contribute to the stronger expansion in government consumption, projected to increase by 2.2 % in 2001, and this could be seen in the light of upcoming general elections (due to take place at the latest in March 2002). Thus, the declared target of limiting real growth in government consumption to 1 % annually is very likely to be much exceeded in 2001. From 2002 on, primary expenditure and taxes as a percentage of GDP are projected to decline slightly.

## 2.3. Economic reforms

### 2.3.1. Product markets

**Overall assessment**

The Danish economy is less open to international competition than other small Member States and, in particular, than the two other Nordic countries. This may be one reason why competition is insufficient in a series of markets and why the consumer price level is higher than anywhere

*Table 2*

**Trends in public finances in Denmark (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 2.9 | – 2.3 | 0.4 (*) | 1.1 (*) | 3.1 (*) | 2.5 (*) |
| — Current receipts | 57.8 | 56.8 | (57.1) | (56.8) | (56.6) | (55.2) |
| Tax burden (3) | 48.9 | 49.4 | (49.9) | (49.6) | (50.2) | (49.1) |
| — Total expenditure | 61.7 | 60.3 | (57.9) | (56.9) | (55.3) | (54.1) |
| Primary current expenditure | 51.5 | 50.9 | (49.2) | (48.6) | (47.8) | (46.7) |
| Interest payments | 7.3 | 6.4 | 5.7 | 5.3 | 4.7 (*) | 4.2 (*) |
| Investment | 1.8 | 1.8 | 1.9 | 1.7 | 1.7 (*) | 1.8 (*) |
| Primary balance | 4.4 | 4.1 | 6.1 (*) | 6.5 | 7.8 (*) | 6.7 (*) |
| Government debt | 78.0 | 69.3 | 61.4 (*) | 55.8 (*) | 52.6 (*) | 47.3 (*) |
| Cyclically-adjusted balance | 0.2 | – 2.2 | (0.0) | (0.5) | (2.4) | (2.1) |
| Cyclically-adjusted primary balance | 7.5 | 4.2 | (5.7) | (5.8) | (7.0) | (6.4) |

NB: For footnotes and sources see Table 2 for Belgium.

else in the Community. However, the legal framework for enforcing competition policy is expected to strengthen. The public sector in Denmark remains relatively large, which adds to the pressure for achieving efficiency in the sector. Denmark has the best record in transposing single market directives and the opening-up of public procurement has been increasing in recent years; even if further improvement is possible at the local level. State aids (excluding agriculture) are low. Start-ups in Denmark are less encumbered by administrative burdens and red tape than is true for most other Member States, and there has been considerable progress in liberalising and deregulating network industries. Despite high efficiency in electricity generation, however, the levying of high taxes on energy consumption means that after-tax prices in Denmark are among the highest in the EU.

In the area of R & D, Denmark does not measure up to the other Nordic Member States, in part owing to lower business expenditure on R & D and a poorer commercialisation record. The government has announced a new strategy to tackle this problem. By comparison, Denmark matches Finland and Sweden in ICT diffusion, and is far ahead of many other Member States, which bodes well for the future exploitation of these technologies.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue to take policy action to strengthen competition policy. | In progress |
| • Continue the effort to improve the efficiency of the comparatively large public sector. | In progress |
| • Increase the effort to raise technology transfers and to induce entrepreneurship in high-tech sectors. | In progress |

Amendments to the competition law have been enacted, including merger control and the powers to enforce Articles 81 and 82 of the Treaty. In addition, the Competition Authority will enforce policy more rigorously, for instance, on suppliers' fixed-price practices in retail markets. Markets for books and non-prescription drugs are also being partially liberalised.

The government has had some success in using EU tendering rules to promote outsourcing of public services and it is gradually extending the use of benchmarking of services. Although the company coordinating public sector procurement handles only a fraction of all purchases, turnover should be increasing on the back of electronic services introduced in 2000.

Some new initiatives have been floated and existing ones have been expanded in order to strengthen ties between science and industry. The new strategy for business policy contains a series of initiatives designed to further reinforce technology transfers. However, it is too early to pass judgment on the efficacy of these measures.

### 2.3.2. Capital markets

**Overall assessment**

The Danish Government's policy focuses on financial supervision, competitive conditions for financial companies and increased transparency. In 2000, 13 actions from a total of 35 (designed to increase market efficiency and competition, to improve financial supervision and to develop risk capital) have been realised, with another 14 due to be implemented in 2001. The government will present legislation that gathers all rules affecting the financial sector in a single legislative framework. Similar developments are taking place regarding supervision to achieve a common set of rules and a uniform supervision of all financial service activity.

Equity markets remain rather small in Denmark, especially compared to the size of the bond market. To promote the growth of the equity market, the government is proposing to replace strict limits on equity holdings for pension institutions with more flexible rules based on prudential considerations. Investment in venture capital has doubled from 1998 to 2000 to 0.5 % of GDP but still

*Table 3*

**Product market indicators for Denmark**

| | Denmark | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 27.9 | 27.6 | 27.6 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 19.1 | 18.8 | 18.8 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 1.0 | 2.8 | 2.5 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 3.3 | 2.6 | 3.2 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 1.5 | 1.3 | 1.1 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 2.27 | 2.45 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.41 (6) | — | 0.37 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 17.5 | 18.5 | 18.1 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 99.7 | 98.6 | 98.7 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 126.0 | 124.0 | 124.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 120.3 | 110.8 | 102.2 | 100.0 | 100.0 | 100.0 |
| — national calls | 46.2 | 37.1 | 42.6 | 100.0 | 100.0 | 100.0 |
| — call to US | 96.6 | 102.5 | 113.8 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 70.5 | 72.3 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 81.4 | 79.3 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | : | : | 100.0 | 100.0 | 100.0 |
| — industry users | : | 89.7 | 77.4 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 8.0 | 8.3 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 1.84 | 1.94 | 1.93 | 1.86 | 1.86 | : |
| Patent applications (12) | 100.7 | 109.4 | 128.0 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 5.6 | 5.5 | 5.8 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 45.3 (14) | 51.6 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

remains relatively small. Against this background, the government has introduced a credit guarantee system in 2000 that can guarantee up to 75 % of a loan from a financial institution to an SME. Also, legislation has been enacted to allow for special innovation funds to be set up to make it easier for institutional investors to invest in new technologies.

Restructuring in the banking sector has continued in 2000 with two major mergers. The second largest bank, Unibank, merged with the Swedish-Finnish Nordbanken to create the largest financial institution in the Nordic region. To ensure efficient financial supervision, Danish, Finnish and Swedish financial supervisors have signed a cooperation agreement in relation to this cross-border institution. Later in the year, the largest Danish bank, Danske Bank, merged with the third largest financial institution, RealDanmark.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Increase the sources of funds for venture capital investments by further reducing the quantitative constraints on pension funds investment. | In progress |
| • Give attention to examples of good practice in the areas of taxation of investments in venture capital, legislation on bankruptcy, and promotion of innovative employee ownership schemes. | Partial |

The government is proposing to replace strict limits on equity holdings for pension institutions with more flexible rules based on prudential considerations. Private individual pension schemes will be allowed to make investments in unlisted shares, provided that they are traded on regulated markets.

For institutional investors, taxation for equities and for bonds will be harmonised to a single tax rate of 15 % on the return of savings. Tax treatment for employee ownership schemes (including stocks, stock-options and warrants) will be improved. No efforts to improve bankruptcy legislation have been reported.

### 2.3.3. Labour markets

**Overall assessment**

The employment rate in Denmark has already for several years been the highest in the Union and the unemployment rate among the lowest, partly thanks to a long-term strategy of labour market reforms. This strategy has concentrated on improving active labour market policies and tightening the eligibility criteria for benefits. Regarding the labour market recommendation to increase incentives to take up or remain in jobs, the decision taken in 2000 to reform the disability pension scheme continues on this track. However, the additional week of annual holidays, which was agreed for the private sector in the last collective negotiations in January 2000, will reduce the average hours worked.

**Implementation of the 2000 BEPGs**

The so-called 'Whitsun package', agreed in 1998, includes a gradual reduction of marginal tax rates totalling 2 percentage points for most wage earners, and somewhat more for low income earners, to be implemented in 1999–2002. However, increases in local government taxes have partly offset reductions at the State level. Notwithstanding these efforts, taxation of labour remains high, with a particular feature of a large share of full-time employees in the highest tax bracket.

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Implement reforms to reduce the overall fiscal pressure on labour, and to increase incentives to take up or remain in jobs; monitor closely the reform of early retirement and leave schemes in the light of the need to increase labour supply. | In progress |

The early retirement scheme was reformed, with the aim of allowing greater flexibility for combining part-time work and retirement, and it became operational in 1999. The intensified and extended implementation of the policy of a right and duty to an activation measure (such as education or job training) when being on benefits has been judged to increase job-seeking, with the result that a larger number of unemployed persons find a job before the activation measure takes effect. Increased preventive efforts and the creation (in 1998) of so-called 'flex-jobs' for people with reduced working ability have lowered the inflow into the disability pension scheme in recent years. A reform of the disability pension scheme was decided in December 2000, to be implemented in 2003. The reform calls for increased spending. Although the elements of revising the criteria for granting pensions on the basis of working capacity rather than on the lack of working capacity, and increased activation measures before the granting of a disability pension will contribute to staying longer in the work life, the elements of improved benefit levels are likely to go in the opposite direction.

*Table 4*

**Labour market indicators for Denmark**

| | Denmark | | | | EU | | | US ([5]) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) ([1]) | 72.4 | 75.3 | 76.5 | 76.4 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 67.1 | 70.3 | 71.6 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 50.2 | 50.4 | 54.2 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth ([1]) | 1.4 | 2.0 | 1.1 | 0.9 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 64.8 | 66.9 | 68.6 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 8.2 | 5.2 | 5.2 | 4.9 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 2.5 | 1.3 | 1.1 | 1.0 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 11.1 | 8.0 | 9.8 | 8.3 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation ([2]) | 2.0 | 1.7 | 1.7 | : | — | — | — | — | — | — |
| Nominal wage growth ([1]) | 1.5 | 3.2 | 4.0 | 4.2 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth ([1]) | – 4.1 | 0.6 | 0.6 | – 0.4 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth ([1]) | 4.0 | 0.5 | 0.6 | 1.7 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families ([1]) ([3]) | 30.3 | 30.1 | 31.1 | 31.2 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners ([1]) ([3]) | : | 40.4 | 41.3 | 41.3 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families ([4]) | 77.0 | 77.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners ([4]) | 90.0 | 89.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 3. Germany

## 3.1. Economic developments and key policy issues

Germany has been a latecomer in the current European upswing, but the year 2000 saw the best economic performance since the reunification boom, with output growing at 3.0 %. Export growth was particularly strong, thanks to a fast expansion of the world economy and gains in competitiveness, while domestic demand held steady, with a favourable economic climate spurring equipment investment and good job growth underpinning private consumption. The impact of higher oil prices on output growth has been limited so far but the recent evolution of business indicators signals a slowdown. However, despite a moderating impact of tighter monetary conditions and weaker external demand, sizeable tax cuts providing fiscal stimulus of the order of 1 % of GDP should help sustain output growth in 2001 which, as a consequence, is projected to decline moderately. This should buttress employment growth, which has already improved considerably over the last three years, owing partly to the expansion of labour market programmes and an increase in part-time and casual jobs. Despite its recent fall, overall unemployment is still at unacceptably high levels, but employment growth combined with demographic factors should make for a further reduction in the period ahead. Following the steep rise in headline inflation in 2000, attributable chiefly to the increase in oil prices, consumer prices are expected to ease somewhat in 2001 as there is still slack in labour and product markets and import price pressures abate. Wage increases have been subdued in recent years and are expected to remain moderate in the near term.

While the short-term outlook for the German economy thus remains favourable, the following key economic policy issues need to be addressed:

(1) the still very high unemployment rate, especially in eastern Germany;

(2) the catching-up process in the new Länder, not least their insufficient innovative capacity;

(3) the consolidation and sustainability of public finances, including the reform of the pension system; and

(4) the high degree of regulation, in particular in labour and product markets.

The unemployment problem as a whole as well as its pronounced regional dimension is intricately linked with the management of Germany's economic unification. Most notably, fast rising general wage and tax levels in the early 1990s bear part of the blame for the surge in unemployment in the 1990s. In the framework of the government-sponsored 'Alliance for jobs', the social partners recently have put strong emphasis on wage moderation. This has already contributed to a considerable improvement on the labour market, even though labour costs are still comparatively high. It did not address, however, the need for greater regional differentiation of wages. Furthermore, the wage spread across skill categories appears too narrow. As a consequence, low-skilled workers have increasingly been priced out of the labour market, both in manufacturing and, perhaps more importantly, in the private services sector, the low-wage segment of which is particularly small in Germany. Thus, while overall wage moderation will be necessary for the continuation of employment growth, the current wage policy is poorly geared to combating highly diverging unemployment across regions and skill categories. Increased mobility between sectors and regions and the removal of regulatory obstacles could also contribute to a further improvement in employment. Moreover, despite the recent reduction of income tax rates, with the benefit system remaining largely unchanged, unemployment traps due to high marginal tax rates continue to exist for the lower wage brackets.

Wages out of step with productivity have shown their most devastating result in the New Länder, which have been suffering from a stubbornly high level of unemployment of around 17 % of the labour force, twice the rate of the West. In recent years, unit labour costs have fallen relative to the West, in particular in the manufacturing sectors. This is due in part to the fact that only a small and efficient fraction of the industry survived the economic collapse. Furthermore, subsidies promoted the establishment of a number of modern and efficient industries, which, however, tend to be capital and not labour-intensive. Job creation in the new Länder has also been held back by the under-developed business services sector, the inward orientation and lack of innovative capacity, as well as the weakness of the regional research and sales network, which are still very much dependent on a few large companies.

In order to guarantee the long-term sustainability of the public pension system without raising contribution rates to a prohibitive level, a reform proposal has been presented, foreseeing the State subsidised creation of private pension savings (of up to 4 % of income by 2008) and the slower rise from 2010 onwards of pension payments compared to net wages. However, the formula finally agreed upon seems inadequate to ensure that the contributions to the public pension system will not rise above the level originally considered prohibitive (22 % of income). Furthermore, under current rules, an unacceptable rise in contribution rates to the health insurance and to the old age care insurance systems would be necessary in order to face the increasing problems of these systems associated with the ageing population. So far, efforts into this direction have not been very successful.

Despite some progress since the mid-1990s, the German economy is still characterised by a high degree of regulation. This concerns first of all the labour market where serious structural rigidities remain, with a number of recent policy measures even going in the wrong direction. Furthermore, competition on product markets is restricted in the professions and handicraft trades, in energy, rail transport and in public procurement. Recent privatisation efforts and the deregulation of some network industries such as telecommunications should, however, strengthen the competitiveness of the economy.

*Table 1*

**Economic developments in Germany**

| | 1992–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.2 | 1.4 | 2.1 | 1.6 | 3.0 (*) |
| Domestic demand | 1.2 | 0.6 | 2.4 | 2.4 | 2.0 (*) |
| Private consumption | 1.6 | 0.3 | 1.6 | 1.9 | 1.6 (*) |
| GFCF (Investment) | 0.5 | 0.6 | 3.0 | 3.3 | 2.4 (*) |
| Exports (G & S) | 2.3 | 11.3 | 7.0 | 5.1 | 13.2 (*) |
| Imports (G & S) | 2.3 | 8.4 | 8.6 | 8.1 | 10.2 (*) |
| Inflation (1) (2) | : | 1.5 | 0.6 | 0.6 | 2.1 (*) |
| Compensation/employee (1) | 4.4 | 0.8 | 1.1 | 1.1 | 1.2 (*) |

NB: For footnotes and sources see Table 1 for Belgium.
No data available in 1991 due to German unification.

## 3.2. Public finances

### Overall assessment

Based on expenditure restraint, budgetary consolidation has made notable progress in recent years, which — by creating some room for tax reforms — will render government finances more conducive to growth. However, the tax cuts in 2001 will lead to a significant increase in the government deficit. Utmost expenditure restraint at all levels of government will, therefore, be necessary to ensure that the adjustment path towards a balanced budget in 2004, envisaged in the stability programme, is adhered to. Moreover, in view of population ageing, sweeping reforms are necessary to put government finances on a sustainable footing in the longer term. The recent government proposal for a pension reform represents an important, albeit in the long-term not sufficient step in this direction.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Use the fiscal gains in the event of higher growth than expected to reduce the deficit in 2000 below the targeted level. | Not applicable |
| • Implement the reforms of income and corporate taxation in 2001 with greatest caution in order to limit the renewed increase in the government deficit and to minimise the risk of a lasting deterioration of the structural deficit. | Partially |
| • Elaborate structural reforms of the social security system (especially pension and health) as they are key to sustainable finances in the medium term. | In progress |
| • Make sure that the debt ratio is put on a downward trend by fully respecting the envisaged deficit targets and pursuing available privatisation opportunities. Furthermore, one-off revenues should be used fully for debt reduction. | ✔ |

In the face of the government's emphasis on expenditure restraint the budget deficit fell by a 0.4 percentage point in 2000, which is what could be expected in the light of output growth of 3.0 %. Expenditure by regional and local government, however, grew by around 2.5 % on the year, compared to the agreed 2 % suggesting that the current financial agreements between different levels of government are not fully sufficient to ensure that expenditure targets are adhered to.

The recent reforms of income and corporate taxes are important steps in reducing the tax burden for both households and enterprises. However, the sizeable revenue shortfalls implied by the tax reforms, which are only partially offset by expenditure cuts, will move the budget deficit in 2001 close to the minimum position required by the Stability and Growth Pact. Strict budgetary discipline by all levels of government is necessary to limit as far as possible the deterioration in the structural government balance.

The government proposal for a pension reform to be implemented on 1 January 2002 represents an important — though in the long term not sufficient — step to ensure sustainability of government finances. The recent health sector reform is not likely to achieve its aims, namely stabilising contributions rates while preserving service quality; further reforms improving incentive structures seem necessary.

The government decided to use the full amount of the UMTS receipts for debt redemption. This together with substantial privatisations has contributed to reverse the trend rise in the gross debt ratio and will push it clearly below the 60 % of GDP reference value in 2001.

## 3.3. Economic reforms

### 3.3.1. Product markets

**Overall assessment**

Germany has taken several measures to improve the functioning of its product markets, resulting in a better environment for business. In particular, the tax reform, the streamlining of business support mechanisms and the liberalisation of the telecommunications sector have started to have a positive impact. The electricity markets have also been liberalised, but prices remain above the EU average. Public procurement and some services sectors are still insufficiently open to competition; it is e.g. still difficult to obtain a licence for offering certain professional services and handicrafts and restrictions on shop-opening hours remain in force. State aids, while gradually declining, continue to be above the EU average.

*Table 2*

**Trends in public finances in Germany (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 3.1 | – 3.5 | – 2.7 | – 2.1 | – 1.4 | 1.5 (*) (**) |
| — Current receipts | 44.9 | 44.8 | 45.4 | 45.5 | 46.1 | 46.3 (*) |
| Tax burden (3) | 41.1 | 41.3 | 42.0 | 42.0 | 42.7 | 43.2 (*) |
| — Total expenditure | 49.3 | 49.6 | 49.2 | 48.6 | 48.6 | 45.8 (*) (**) |
| Primary current expenditure | 40.7 | 41.2 | 41.9 | 41.2 | 41.2 | (41.1) |
| Interest payments | 3.4 | 3.7 | 3.6 | 3.6 | 3.5 | 3.4 (*) |
| Investment | 2.8 | 2.3 | 1.9 | 1.8 | 1.8 | 1.7 (*) |
| Primary balance | 0.2 | 0.2 | 0.9 | 1.5 | 2.1 | 4.9 (*) |
| Government debt | 47.2 | 57.1 | 60.9 | 60.7 | 61.1 | 60.3 (*) |
| Cyclically-adjusted balance | – 3.5 | – 3.7 | – 2.1 | – 1.4 | – 0.5 | (– 0.7) |
| Cyclically-adjusted primary balance | – 0.1 | 0.0 | 1.6 | 2.2 | 3.0 | (2.8) |

NB: For footnotes and sources see Table 2 for Belgium.
(**) Including UMTS receipts in the order of 2.5 % of GDP registered as negative expenditure.

In spite of the fact that R & D expenditures and patent applications are above the EU average, the share of German high-tech exports in total exports remains below the EU average. This may be explained by the fact that Germany is specialised in medium-tech industries, which nevertheless require a substantial research effort. However, it may also be associated with a problem in commercialising the results of the research efforts made. To resolve this problem, the German Government has taken measures to create closer networks between research and industry. ICT penetration, as measured by ICT expenditures and Internet access, is rising rapidly. Several measures, such as training, connection of schools to Internet, tax breaks on private use of the Internet, have been taken to prevent a digital divide from appearing. Despite this effort, a serious shortage of ICT personnel has emerged.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Ensure an increased opening-up of public procurement; promote electronic access to public tenders. | Partial |
| • Liberalise the advertising regulations according to European standards (i.e. eliminating the restrictions on discounts and free gifts), taking into account the requirements of the new e-commerce directive. | ✔ |
| • Improve competitive structures and efficiency by exploiting the possibilities of privatisation. | Partial |
| • Continue to reduce State aid, including ad hoc aid and sector-specific aid. | In progress |
| • Review the new agreement on electricity payments, which lasts until the end of 2001, in the light of experience gained, so as to capture the full benefits of the liberalisation of the electricity sector. | Partial |
| • Undertake further efforts to reduce restrictions and administrative burdens on SMEs, in particular for business services and craft firms. | In progress |

The value of tenders published in the Official Journal as a percentage of GDP showed a decline in 1999 to a level less than half the EU average. This is also due to the fact that a large share of public procurement is carried out by local or regional authorities. According to the latest single market scoreboard, the Commission addressed three reasoned opinions on public procurement to Germany. On the positive side, the federal government has decided upon a draft regulation implying the transposition of the final two Community directives and permitting the delivery of electronic tenders. The regulation is expected to enter into force on 1 February 2001.

To avoid discrimination of the domestic retail sector vis-à-vis foreign e-commerce suppliers the federal government decided, in December 2000, to abolish restrictions on discounts and free gifts.

Progress in privatisation at the level of the federal government is good. Deutsche Bahn AG, however, remains State-owned. Furthermore, it retains its dual role in maintaining the rail infrastructure network and in exploiting it. At the level of the lower-level governments, progress in privatisations has been slower with, e.g., large parts of the financial services sector still being controlled by the public authorities.

The government intends to continue its policy of gradual reduction in State aid. Nevertheless, the share of State aid in GDP remains above the EU average. The federal budget devoted to State aid will be reduced by 35 % between 2000 and 2004.

The initially foreseen division of Germany into two tariff zones with higher tariffs to electricity transport between the zones has not been carried out in practice, which is a positive development. However, there continue to be large regional differences in the fees for the use of local distribution networks, which may be associated with the system of negotiated third-party access to the

*Table 3*

**Product market indicators for Germany**

| | Germany | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 22.6 | 23.6 | 24.1 | 21.3 | 21.7 | 21.7 |
| Intra-EU trade to GDP ratio (%) (1) | 13.0 | 13.6 | 13.9 | 12.6 | 13.0 | 13.0 |
| FDI inflows (2) | 1.0 | 1.5 | 4.6 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 16.1 | 15.4 | 17.1 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 2.7 | 2.9 | 3.1 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.12 | 0.89 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 1.23 (6) | — | 0.94 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 19.5 | 19.5 | 19.5 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 100.0 | 99.9 | 99.8 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 106.0 | 106.0 | 110.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 115.7 | 108.5 | 109.2 | 100.0 | 100.0 | 100.0 |
| — national calls | 135.6 | 164.7 | 124.8 | 100.0 | 100.0 | 100.0 |
| — call to US | 106.5 | 84.3 | 59.3 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 131.5 | 135.3 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 131.8 | 129.4 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 96.3 | 96.6 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 124.4 | 123.0 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.7 | 4.6 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 2.29 | 2.31 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 168.8 | 196.4 | 221.7 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 4.5 | 5.0 | 5.3 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 13.6 (14) | 27.1 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

electricity grid and with the absence of an independent regulatory authority.

Germany has taken a number of measures to help SMEs in particular. In the 'Aktionsprogramm Mittelstand' these various measures have been bundled. Furthermore, a single institution (the 'Deutsche Ausgleichsbank') has been made responsible for all federal financial support programmes. Finally, the task force 'Abbau von Bürokratie' has proposed a number of measures to further reduce the regulatory burden on business.

### 3.3.2. Capital markets

**Assessment and implementation of the 2000 BEPG**

Several actions were taken in 2000 to improve the functioning of the regulatory framework for capital markets. Notably, the 4th financial market promotion act (Finanzmarktförderungsgesetz) will be implemented in spring 2001, and by adapting legislation to market developments, it should further boost markets. In particular it deregulates stock market law, improves rules on stock market manipulation, and provides greater legal certainty for futures. Furthermore, measures were implemented relating to the risk capital action plan and a law was tabled on takeover bids. In the area of risk capital, important developments include the 'Aktionsprogramm Mittelstand' and a first evaluation of the 'Startgeld' programme, which aim at making capital available to SMEs and start-ups. In terms of taxation, the reform of the corporate tax system as well as the proposed reform of the pension system are likely to give a boost to further the development of capital markets.

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Give consideration to the examples of good practices given in the October 1999 risk capital communication in the field of taxation, bankruptcy laws and support to stock option schemes. | Partially |

In the autumn, a draft law was put forward to clarify implementation of the 1999 reform of the bankruptcy law. While it focuses in particular on provisions for forgiveness of outstanding debts (Restschuldbefreiung'), the delay for granting remains long. An expert commission has been created to draw up a code of good practice in the field of corporate governance, and a law will be introduced at the beginning of 2001 to facilitate the introduction of registered shares (Namensaktien). No proposal has been made yet regarding taxation of stock options.

### 3.3.3. Labour markets

**Overall assessment**

The labour market situation improved in 2000, with accelerating employment growth and a decline in unemployment. However, unemployment has stagnated and remains very high in the eastern part of Germany. On the labour market recommendations, most progress has been made in the area of taxes, where the tax reform reduces taxation on labour. The future pension reform is still under discussion, but the aim is to increase the pensions system's sustainability. One important feature of the German economy is the close cooperation with the social partners in the so-called job alliance (Bündnis für Arbeit), which has contributed to the moderate wage growth in recent years. It has also resulted in two pilot projects that improve the incentives to hire or take up a job for low-skilled and long-term unemployed. However, other labour market issues that could increase labour market flexibility, such as labour mobility, have not been addressed in the cooperation with the social partners. Little progress has been made in the assessment of the policy towards the east, but a review of the labour market policy in general will be made in 2001.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Critically reassess its policy towards the eastern part of the country, where labour market problems are still — 10 years after unification — especially severe. This assessment should cover, in particular, the efficiency of transfers, and also how social partners could encourage job creation by means of increased labour market flexibility and adequate wage structures. | Partial |
| • Continue and monitor efforts to bring down gradually the fiscal pressure on labour by reducing taxes and social security contributions. Labour costs should be reduced further over the whole wage scale and in particular at the lowest end, while respecting the need for fiscal consolidation. The policy strategy of shifting taxation from labour to eco-taxes, which has already contributed to a decline of pension contribution rates of about 5 %, should be continued in line with the envisaged further steps of the reform. | In progress |
| • Reduce disincentives within the tax and benefit system which discourage labour market participation of all groups, especially of older workers; consider the policy choices most appropriate to avoid the early withdrawal of workers from the labour market and to promote employment of older workers. | Partial |

The dual labour market situation persists, with unemployment being more than twice as high in the east. In contrast to the western part of the country, the number of vacancies has also not increased since last year. Net public transfers from the west to the east amount to 2 ½ to 3 % of GDP. Such transfers are mainly used for infrastructure investment, grants to investments and ALMPs. The massive spending on ALMPs in the east has been criticised (for example by OECD) as inefficient, too general and wrongly used as a social policy instrument. However, the government plans to assess the effectiveness and efficiency of its labour market policy in general, with a view to a reform in 2002. The close cooperation with the social partners has clearly contributed to the modest wage growth on average in recent years. Nevertheless, wage dispersion seems to be too limited to fully reflect differences in skills and qualifications between different sectors and regions. Some efforts have been made to increase labour market flexibility.

The tax reform will gradually reduce the tax burden on labour, through a shift in taxation from labour to eco-taxes, reductions in statutory income tax rates and an increase in the basic income tax-free threshold. The tax reform is not specifically targeted at low wage earners, but the effects of the increase in the basic income tax free threshold will improve the incentives to take up work.

Two recently launched pilot projects (the so-called ‘Mainzer Modell’ and the ‘Saar-Gemeinschaftsinitiative’) are trying to improve the incentives to either take up or create jobs for low skilled and long-term unemployed persons by either reducing the employee’s or the employers social security contributions. Concerning older workers, the proposed pension reform will increase the pension system’s sustainability, but it does not include changes to the statutory retirement age or policies on early retirement. However, the act on part-time work in old age is expected to provide an environment in which a transition from full-time work to part-time work in the later stages of working life does not involve unacceptably high costs.

*Table 4*

**Labour market indicators for Germany**

| | Germany | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 64.7 | 63.7 | 64.8 | 66.0 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 55.0 | 55.6 | 57.1 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 36.3 | 37.7 | 37.8 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | – 0.2 | 0.9 | 1.1 | 1.5 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 59.5 | 57.3 | 58.0 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 8.5 | 9.4 | 8.8 | 8.3 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 3.8 | 4.8 | 4.5 | 4.2 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 8.8 | 9.9 | 9.2 | 9.2 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 2.1 | 5.9 | 5.2 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 3.0 | 1.1 | 1.1 | 1.7 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 2.0 | – 1.1 | – 0.3 | 0.3 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 2.5 | 1.1 | 0.5 | 1.7 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 35.7 | 35.9 | 34.4 | 33.1 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 47.5 | 47.0 | 46.1 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 80.0 | 74.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 73.0 | 69.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 4. Greece

## 4.1. Economic developments and key policy issues

In recent years Greece has implemented a successful stabilisation strategy, which led to the adoption of the euro from 1 January 2001. Economic activity was robust, real GDP growth reaching 4.1 % in 2000 and exceeding the EU average for the fifth consecutive year. High rates of investment, close to 9 % in real terms per year, were a key feature of the growth profile in recent years. The unemployment rate was still high at an estimated 11.2 % in 2000. The annual average inflation rate, measured by the HICP, rose to 2.9 % in 2000 from 2.1 % in 1999, mainly under the impact of the increase in oil prices and the euro depreciation. Economic activity is forecast to accelerate in 2001 and the next few years supported by still higher rates of investment, employment creation and productivity growth.

In order to maintain the current positive growth momentum and ensure a sustainable non-inflationary economic expansion, Greece needs to face the following key policy issues:

(1) fiscal consolidation;

(2) price stability;

(3) the high rate of structural unemployment; and

(4) the low level of productivity which can be associated to problems in the functioning of product markets and the late development of the knowledge-based society.

An acceleration of the structural reform effort is all the more necessary in order to accelerate real convergence, as Greece's per capita income is at present about 70 percent of the EU average.

The high government debt ratio, estimated at 103.9 % of GDP in 2000, underlines the need for the continuation of the budgetary adjustment; in parallel, budgetary consolidation is expected to increase the available margins for other policy priorities and for reducing the tax and non-tax burden on labour. The first stability programme of Greece covering the period 2000–04, is projecting a general government surplus of 0.5 % of GDP in 2001, the first surplus in many years, and continuing reduction in the government debt ratio expected to reach about 20 percentage points of GDP by 2004. The long-term sustainability of public finances is an area of concern, taking into account, in particular, future challenges in the form of pension and healthcare expenditure from an ageing population. The government has announced a comprehensive pension reform for 2001.

Within a framework of easier monetary conditions due to the convergence of interest rates in Greece to those of the euro zone, and accelerating GDP growth, inflationary pressures might emerge and put at risk macroeconomic stability if not timely contained. Such pressures must be contained through appropriate domestic policies, mainly a tight fiscal policy. Wage developments will also be crucial in this respect, suggesting that every effort should be made to ensure wage moderation. Developments so far in this area, as they are reflected in the two-year private sector agreement in May 2000, have shown a positive response from the social partners, conscious of the need to preserve competitiveness and jobs in the new economic and monetary environment.

The labour market in Greece is characterised by a low employment rate (54.4 % in 1999), a high overall unemployment rate, and a strong degree of labour market segmentation evidenced by high rates of unemployment for women and the young, and a high share of long-term unemployment. The related problems of high structural unemployment and low employment rates are the result of a wide range of factors. Firstly, complex labour market regulation imposes a significant burden on enterprises thus hampering the creation of new jobs, and of part-time work in particular. This situation seems to persist despite two recent packages of labour market reforms. Secondly, the tax and benefit system is complex and introduces significant distortions into the labour market, including strong incentives for self-employment and for workers to remain outside the formal sector, until shortly before retirement Moreover, there are rigidities in wage-setting implying that wages do not adequately reflect differences in productivity across regions and workers. This may act to prevent the employment of unskilled workers, especially as education and training systems seem to only badly equip people for the labour market.

Reforms in the product markets remain relatively slow. The transposition record of internal market legislation is poor and privatisation and liberalisation of key utilities has so far proceeded slowly, with extensive time derogations and market opening often limited to the minimum requirements of EU directives. Modest progress was made to ease the regulatory burden on companies and improve the efficiency in the public administration, which is still perceived as a barrier to enterpreneurial activity. Companies are confronted with a complex and non-transparent corporate taxation system. All this contributes to create a difficult operating environment for Greek businesses. Greece is also a relative late-comer in the development of the knowledge-based society. Expenditure on R & D and innovation as a share of GDP is among the lowest in the EU and the participation of the business sector is particularly weak. ICT investment has rapidly increased in recent years, but the use of information technologies is well below the EU average, as indicated by the low levels of computer and Internet penetration. Fiscal and financial incentives have been recently offered to promote ICT diffusion in businesses and households.

*Table 1*

**Economic developments in Greece**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.4 | 3.5 | 3.1 | 3.4 | 4.1 |
| Domestic demand | 1.8 | 3.6 | 4.6 | 3.0 | 4.2 |
| Private consumption | 1.9 | 2.7 | 3.0 | 2.7 | 3.1 |
| GFCF (Investment) | 1.2 | 7.8 | 11.8 | 7.3 | 9.3 |
| Exports (G & S) | 3.5 | 18.2 | 5.9 | 6.5 | 8.0 |
| Imports (G & S) | 4.1 | 13.9 | 11.3 | 3.9 | 7.4 |
| Inflation (1) (2) | : | 5.4 | 4.5 | 2.1 | 2.9 |
| Compensation/employee (1) | 11.6 | 6.0 | 4.8 | 4.6 | 4.5 |

NB: For footnotes and sources see Table 1 for Belgium.

## 4.2. Public finances

### Overall assessment

Budgetary adjustment has been pursued with consistency for a number of years, within the framework of convergence programmes. In 2000 the general government deficit was lowered to an estimated 0.8 % of GDP as against 1.8 % of GDP in 1999. The fiscal consolidation strategy has been based on high primary surpluses, which reached 5.8 % of GDP in 1999 and 6.5 % in 2000 and made possible the reduction of the government debt ratio to an estimated 103.9 % of GDP in 2000. The first Greek stability programme, 2000–04, which follows the fiscal consolidation strategy of the convergence programmes, is projecting a general government surplus of 0.5 % in 2001 which would rise to 2 % of GDP in 2003 and 2004; according to the programme, the government debt ratio might decline by about 20 percentage points to 84 % in 2004.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Consider as an upper limit the target set in the budget for the general government deficit in 2000 at 1.2 % of GDP; a better outcome on the revenue side should be reflected in a lower general government deficit; tighten the budgetary policy further in 2001 if inflation pressures emerge. | ✔ |
| • Secure expenditure control through clear and binding norms with the aim to reduce the primary current expenditure ratio. | ✔, but no explicit norms |
| • Pursue the reform of the social security sector with a view to ensuring long-term viability in the system; in addition, improve the asset management by social security funds combined with the continuation of the rationalisation and control of expenditure. | In progress |
| • Implement the privatisations scheduled for 2000 and in subsequent years with a view to securing a faster reduction in debt ratio. | In progress |

Higher than expected revenues in 2000 were reflected in a decline in the general government deficit which reached 0.9 % of GDP compared to a targeted 1.2 %. The targeted surplus of 0.5 % of GDP for 2001 would imply a tightening fiscal stance.

Compared to 1999, the expenditure ratio is estimated to be lower by 0.6 percentage points of GDP and the current expenditure ratio, excluding interest payments, lower by 0.3 percentage points of GDP in 2000. However, no explicit norms have been announced for overall expenditure growth or main categories of expenditure.

A reform of the social security system was announced for 2001, following the first phase of reform in 1999 when a number of social security funds were merged and measures were taken to rationalise pension fund management and contain expenditures.

The implementation of the privatisation programme continued in 2000 although at a lesser pace than in previous years, partly due to the weakness in the Athens Stock Exchange over the past 15 months. Most of receipts from privatisations have been used in lowering the government debt (part of the receipts were used to strengthen the capital base of the companies concerned), although their effect was more than offset by debt-increasing valuation changes from dollar and yen appreciation during 2000.

## 4.3. Economic reforms

### 4.3.1. Product markets

**Overall assessment**

Greece is less exposed to international competition than any other Member State, not least due to its geographical position. This may be one reason why, despite progress made, the level of labour productivity remains relatively low. Structural reforms in product markets continued during 2000, but at a somewhat slow pace. Progress was made in completing the regulatory and institutional framework in preparation of the opening up of network industries. However, the pace of privatisation slowed down during 2000 and the actual liberalisation continued to be postponed until the expiry of the derogations from EU directives (2001 for telecoms and electricity, 2006 for gas). A sign of the government's commitment towards increased competitive market conditions is the recent decision to allow the sale of majority stakes in partially privatised companies. Still during 2000, single market implementation remained the worst in the EU and modest progress was recorded in improving the business environment, which still remains difficult in terms of administrative burden on companies, efficiency of the public administration and complexity of the system of corporate taxation. A comprehensive tax reform is under preparation for 2002. Steps were taken to review the conditions

*Table 2*

**Trends in public finances in Greece (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 6.7 | – 10.2 | – 4.7 | – 3.1 | – 1.8 | – 0.9 |
| — Current receipts | 35.4 | 36.4 | 38.8 | 40.1 | 42.1 | 42.6 |
| Tax burden (3) | 32.6 | 32.6 | 34.2 | 36.4 | 38.4 | 38.8 |
| — Total expenditure | 47.8 | 47.8 | 44.7 | 44.6 | 45.2 | 44.7 |
| Primary current expenditure | 30.8 | 32.2 | 32.1 | 31.9 | 32.3 | 32.4 |
| Interest payments | 12.6 | 11.1 | 8.2 | 7.8 | 7.6 | 7.2 |
| Investment | : | 3.2 | 3.4 | 3.6 | 4.1 | 4.3 |
| Primary balance | – 1.0 | 1.0 | 3.6 | 4.7 | 5.8 | 6.4 |
| Government debt | 110.2 | 108.7 | 108.3 | 105.5 | 104.6 | 103.9 |
| Cyclically-adjusted balance | – 12.9 | – 9.5 | – 4.2 | – 2.7 | – 1.4 | (– 0.7) |
| Cyclically-adjusted primary balance | – 0.3 | 1.6 | 4.0 | 5.1 | 6.2 | (6.6) |

NB: For footnotes and sources see Table 2 for Belgium.

for access to some service professions in order to increase competition.

Greece stepped up efforts to catch up with the developments in the ICT sector. ICT expenditures increased considerably, also thanks to provision of financial and fiscal incentives to companies and households purchasing ICT equipment. However, there is large scope for further ICT diffusion as the levels of computer and Internet penetration remain well below EU average and the use of e-commerce is still limited. Although some progress was made in recent years, Greece remains a relatively low performer in terms of R & D and innovation. Investment in R & D, particularly by the business sector, is among the lowest in the EU despite the existence of fiscal and financial incentives to innovating companies. A number of new initiatives have been announced for the period 2000–06 in the framework of the EU structural funds.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Improve the transposition record and the implementation of internal market legislation. | None |
| • Speed up the process of liberalisation in the telecommunication, electricity and gas sectors. | Partial |
| • Take concrete measures to promote business start-ups. | Partial |
| • Take further measures to increase R & D and ICT diffusion and stimulate private sector involvement in R & D financing. | In progress |

During 2000, the transposition record of internal market legislation remained the poorest in the EU and did not seem to be improving. Infringement procedures have been instituted for non-implementation of older directives. A committee to deal with the backlog and improve the transposition record was set up in late 2000.

Fixed telecommunications were liberalised in January 2001. The electricity market was opened in February 2001 at the end of the derogation period and according to the minimum requirements of the EU electricity directive. The gas market has been granted a derogation until 2006 although the government is considering a liberalisation ahead of schedule.

A few concrete actions were taken during 2000 to foster start-ups. These mainly consist in the creation of an interactive web site and a telephone information line for start-ups, and the pilot launch of five one-stop shops.

During 2000, the government continued to encourage private R & D mainly through fiscal and financial incentives to innovating firms. Recent actions to promote ICT diffusion include the 'Networking initiative for small enterprises' and the partial deduction from taxable income of household expenses for the purchase of a PC and Internet subscription. The majority of the initiatives in the area of R & D and ICT are expected to be launched in the context of the 2000–06 community support framework.

### 4.3.2. Capital markets

**Overall assessment**

Greece's capital markets have developed rapidly in recent years and the equity market is now an important source of funds. Improvements to the regulatory framework were introduced in 2000 mainly aimed at increasing investor protection. The minimum amount of initial share capital required for equity market listing was increased and transparency of operations of listed firms was improved. The minimum amount of initial share capital for setting up a mutual fund management firm has also been raised and minimum professional credentials have been established for those employed in brokerage firms. Procedures for obtaining a listing on the equity market have been rationalised via the introduction of time limits for approving companies' information prospectuses. In addition, the existing integrated electronic trading system and the clearing and settlement system for dematerialised securities are being expanded to accommodate corporate bonds.

Competition in the banking sector has increased due to further privatisation, notably involving the Hellenic Industrial Bank and the Agricultural Bank of Greece.

*Table 3*

**Product market indicators for Greece**

| | Greece | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 15.8 | 16.9 | 15.4 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 9.6 | 10.6 | 9.6 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 1.0 | 0.03 | 1.2 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 0.3 | 0.6 | 1.0 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 5.2 | 6.2 | 6.5 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 5.89 | 5.08 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.73 (6) | — | 0.56 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 17.6 | 18.5 | 18.9 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 76.3 | 75.0 | 77.6 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 83.0 | 80.0 | 79.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 43.4 | 45.2 | 53.0 | 100.0 | 100.0 | 100.0 |
| — national calls | 176.1 | 178.9 | 189.3 | 100.0 | 100.0 | 100.0 |
| — call to US | 100.6 | 114.9 | 142.2 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 65.6 | 66.1 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 93.4 | 95.5 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | : | : | 100.0 | 100.0 | 100.0 |
| — industry users | : | : | : | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 3.2 | 3.5 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 0.51 | : | : | 1.86 | 1.86 | : |
| Patent applications (12) | 2.2 | 4.5 | 5.0 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 4.0 | 4.7 | 5.3 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 5.8 (14) | 11.7 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

However, State involvement in the Greek banking sector is still relatively important. The profound structural changes affecting the financial sector and the blurring of boundaries between the different market segments create pressure for strengthening cooperation between the different financial market supervisors.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Speed up the implementation of the actions put forward in the 1998 risk capital action plan, and give particular consideration to the examples of good practice provided in the October 1999 Communication. | Partial |

The risk capital market is growing, with the amount invested increasing rapidly. To encourage further development, a new market for SMEs started operating in 2000. Further tax relief on capital gains has also been introduced. In order to address the problem of the equity gap faced by new economy based firms at their start-up and seed stage, a 'new economy fund' has been created to support, on the basis of a 50/50 participation, risk capital funds which invest in high-growth SMEs active in the knowledge-based economy. No efforts to improve bankruptcy legislation and promote employee ownership schemes have been reported.

### 4.3.3. Labour markets

**Overall assessment**

The Greek labour market is characterised by a low employment rate (55.4 % in 2000) and a high level of structural unemployment. Moreover, the labour market seems to be strongly segmented with high rates of youth and female unemployment, and a high share of long-term unemployment. With regard to the labour market recommendations, the key labour market initiative in 2000, was the adoption of a new wide-ranging package of labour market reforms at the end of the year. To some extent, this new package of measures was adopted to address the problem of the limited impact of the 1998 package of reforms, which were dogged by administrative problems. However, this package seems to introduce further complexity into labour market regulations in Greece. Efforts to tackle long-term unemployment have mostly focused on the implementation of existing active labour market measures and the continued reform of the public employment service. Nothing has been done to address rigidities in wage formation.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Take decisive, coherent and measurable action to prevent young and adult unemployed people from drifting into long-term unemployment; make, in particular, strengthened efforts to complete the reform of employment services, to implement preventive policies in compliance with employment guidelines 1 and 2; pursue efforts to reform training and education systems in line with the needs of the productive system. | Partial |
| • Ensure full and effective implementation of the labour market reforms agreed in 1998, in particular regarding the extension of part-time work and more flexible working time. | Partial |
| • Review wage formation systems with the social partners, with a view to adapting wage developments to productivity differentials at geographical, sectoral and company level, ensuring in particular that opting out of sectoral agreements (respecting, however, the minimum level set by the general collective bargaining agreement) under the territorial employment pacts becomes a practical possibility. | None |

Action to tackle youth and long-term unemployment continues to focus on the 'young into active life' and 'back to work' programmes introduced in 1999, which rely heavily on employment subsidies. Relatively little effort has been put into ensuring the effectiveness of these programmes. Reform of the public employment service is continuing; 50 regional employment promotion centres have been opened offering more individualised assistance to jobseekers. Measures have been taken on vocational training, but overall efforts still seem to be unfocused. Little attention has been paid to the deficiencies of the public education system in preparing young people for the workforce.

Some progress has been made in implementing the 1998 package of labour market reforms, especially in establishing private employment agencies and extending part-time work to the public sector. Administrative difficulties have nevertheless dogged other initiatives and the impact of the package as a whole in creating new employment has been disappointing. In particular, rates of part-time work have increased but still remain low, and the government has highlighted this area as a priority. Partly due to the limited impact of the 1998 reforms, a further wide-ranging package of labour market measures was adopted at the end of 2000. However, many of the new measures risk further complicating employment legislation, and imposing a further burden on employers.

Administrative difficulties with the opt-outs to the territorial employment pacts continue, meaning that little progress has been made in increasing wage differentiation at the regional level. No review of wage formation has been undertaken.

*Table 4*

**Labour market indicators for Greece**

| | Greece | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 54.1 | 55.6 | 55.4 | 55.4 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 37.1 | 40.3 | 40.7 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 39.5 | 39.1 | 38.4 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 1.9 | 3.4 | – 0.7 | 1.2 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 53.0 | 54.1 | 53.8 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 8.9 | 10.9 | 11.7 | : | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | : | : | : | : | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 27.7 | 30.1 | 31.6 | : | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 2.6 | 2.8 | 3.0 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 10.9 | 6.0 | 4.8 | 4.6 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 0.5 | 1.2 | – 2.2 | – 0.6 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 0.1 | – 0.3 | 4.1 | 2.9 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 34.4 | 36.5 | 35.8 | 35.8 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 35.1 | 34.3 | 34.3 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | : | 46.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | : | 55.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 5. Spain

## 5.1. Economic developments and key policy issues

GDP grew at around 4.0 % in 1999 and 2000. Commission autumn forecasts projected output growth to moderate to 3.5 % in 2001, along with an accentuation of the trends previously followed by GDP components: private consumption should continue slowing due mainly to slower employment creation whereas investment should remain growing moderately. The external sector is envisaged to record a less negative contribution since imports should decelerate in line with domestic demand. Employment rose briskly in 2000 as a whole but gradually moderated keeping pace with economic activity. This deceleration should continue in 2001 with the more labour-intensive sectors, services and construction, registering lower growth. Unemployment is continuing to decline although the share of fixed-term contracts remains high and there are wide disparities of unemployment between regions. Despite moderate wage growth, price developments were worse than expected in 2000. This was due both to the behaviour of the more volatile items, energy and unprocessed food, and to a deterioration in underlying inflation. On average, headline inflation grew by 3.4 % and for 2001 is expected to moderate, based on more moderate oil and food prices and less dynamic domestic demand. However, it is essential that wage growth remains moderate to avoid a wage-price spiral driving up inflation. Price rigidities in some sectors are giving rise to a significantly higher underlying inflation than the EU average and suggest the need for speeding up deregulation measures. Moreover, fiscal policy should tighten if additional inflationary pressures emerge.

Prospects for the Spanish economy in the short term remain favourable although the following key economic policy issues need to be considered:

(1) factors underlying the still very high unemployment rate, and in particular wide regional unemployment disparities;

(2) rigidities in unemployment contracts;

(3) reduction of underlying inflation;

(4) ensuring the current fiscal consolidation through the implementation of the new stability budget law and improving the long-term sustainability of public finances by reforming the pensions system; and (5) boosting the knowledge-based society.

Unemployment in Spain is characterised by severe regional disparities, with some regions enjoying almost full employment while others register an unemployment rate as high as 25 %. Several factors appear to underlie these disparities and the implied lack of labour mobility. These include the special benefit schemes for seasonal workers in some regions, rigidities in the housing market and a lack of (de facto) decentralisation in wage bargaining so that wage increases do not always reflect regional productivity performance.

Employment contracts in Spain are problematic in a number of respects. First, there is a dual labour market, segmented between those in well-protected jobs on permanent contracts, and those (nearly one third of employees) on temporary contracts, which in many cases are short-term and offer few prospects for career development or training. Secondly, the permanent part-time contract introduced in 1998 has proved too complex in practice and does not seem to be facilitating a rise in the share of part-time work. This is currently less than half of the EU average, which may partly explain why the female employment rate remains the lowest in the EU. The current social dialogue should address these problems.

Underlying inflation in Spain accelerated in 2000. The HICP excluding energy, food and tobacco grew by 3.4 % year-on-year in December 2000 compared to 2.1 % in the same month one year ago. In contrast, in the euro area as a whole, it rose by 1.5 % and 1.1 % respectively. This differential vis-à-vis the main European partners partially stems from the catching-up process in which the Spanish economy is involved. Nevertheless, to a certain extent, this gap might be explained by the existing price rigidities in some sectors, such as services and housing, suggesting additional deregulation measures are still needed. Competition in the network industries is still at an early stage of development and these sectors remain dominated by the incumbent operators, although steps have been taken to improve the regulatory framework. Measures have also been taken to enhance the effectiveness of the competition authorities, although the institutional structure still gives some cause for concern. The effect of all these measures should be monitored closely and speeded up and reinforced if necessary. In addition, the output gap between 1999 and 2000 widened markedly, suggesting increasing pressure from the demand side.

Ongoing fiscal consolidation is key to maintaining healthy macroeconomic fundamentals. In this respect, the announced new stability budget law, which aims at keeping public accounts in balance or in a surplus through a commitment of all general government sub-sectors, is extremely important in a country with a high decentralisation in some public expenditure categories. Moreover, so as to ensure the long-term sustainability of public finances, additional measures are needed to achieve a greater rationalisation of the public pension system. Two main questions remain open. On the one hand, so far no further steps have been taken to reform the pension system within the 1995 Pacto de Toledo framework, since negotiations between the government and the social partners are still in progress. On the other hand, the social security pension fund created in 2000 needs not only to be increased but also managed efficiently.

The promotion of, and increase in, the use of new technologies are essential for the medium-term prospects of the Spanish economy. The development of the knowledge-based society in Spain lags behind the EU average — partly due to the comparatively low level of R & D expenditures. The comparatively low level of spending on education also gives cause for concern. The diffusion of the Internet is slower than in many other EU countries but the potential for future developments seem to be present as Internet access costs are among the lowest in Europe. Little progress has been made in the areas of bankruptcy law and promotion of innovative employee ownership schemes advocated in the 2000 BEPGs.

*Table 1*

**Economic developments in Spain**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.5 | 3.9 | 4.3 | 4.0 | 4.1 |
| Domestic demand | 1.0 | 3.4 | 5.6 | 5.5 | 4.4 |
| Private consumption | 1.2 | 3.1 | 4.5 | 4.7 | 4.1 |
| GFCF (Investment) | – 0.3 | 0.5 | 9.7 | 8.9 | 6.7 |
| Exports (G & S) | 10.1 | 15.3 | 8.3 | 6.6 | 9.7 |
| Imports (G & S) | 6.7 | 13.3 | 13.4 | 11.9 | 10.2 |
| Inflation (1) (2) | : | 1.9 | 1.8 | 2.2 | 3.4 |
| Compensation/employee (1) | 6.1 | 2.1 | 2.8 | 2.8 | 3.4 |

NB: For footnotes and sources see Table 1 for Belgium.

## 5.2. Public finances

### Overall assessment

Based both on increased revenues and current expenditure restraint, fiscal consolidation made further progress in 2000. This has been achieved despite the income tax reform implemented in 1999. According to the updated stability programme (2000–04) of January 2001, the general government is expected to be in balance in 2001 and to be in surplus in the following years up to 2004. This strategy relies on the restraint of primary current expenditure, creating scope for a reinforcement of public investment and a new income tax reform reducing revenues in the years 2003 and 2004. It is especially noticeable that social security surpluses will be devoted to increase the fund created in 2000 to face the problem of an ageing population.

## Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Achieve and possibly improve upon the budgetary targets set in the updated stability programme, given the better-than-expected out-turn in 1999; be prepared, already in 2000, to tighten fiscal policy further to counterbalance any possible overheating risk. | Partially |
| • Implement the pending reform of the national budget law in 2000 with a view to improving the control of primary current expenditure, which is central to the strategy of fiscal consolidation; this should allow non-budgeted expenditures to be limited mainly to unforeseeable contingencies. | In progress |
| • Gradually increase the pension fund reserve created in the 2000 budget law to cope with the long-term problem of the ageing population; take additional steps in the new round of talks about reform of the pension system between the government and the social partners which have to take place in 2000 within the 1995 Pacto de Toledo framework. | Partially |
| • Continue and respect fully the existing internal stability pact between regions and the State, as territorial governments have an increasing role in many fields of expenditure. | ✔ |

*Table 2*

**Trends in public finances in Spain (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | : | – 6.6 | – 3.2 | – 2.6 | – 1.2 (*) | – 0.3 |
| — Current receipts | : | 37.4 | 38.1 | 38.2 | (38.6) | 38.9 |
| Tax burden (3) | : | 33.4 | 34.3 | 34.6 | (35.2) | 35.7 |
| — Total expenditure | : | 45.0 | 42.2 | 41.8 | 40.7 (*) | 40.1 |
| Primary current expenditure | : | 34.0 | 32.9 | 32.7 | 32.3 (*) | 34.0 |
| Interest payments | : | 5.2 | 4.8 | 4.3 | (3.6) | 3.4 |
| Investment | : | 3.7 | 3.1 | 3.3 | (3.3) | 3.3 |
| Primary balance | : | – 1.4 | 1.6 | 1.7 | 2.4 (*) | 3.0 |
| Government debt | : | 63.9 | 66.7 | 64.6 | (63.3) | 61.1 |
| Cyclically-adjusted balance | : | – 5.8 | – 2.5 | – 2.3 | (– 1.1) | – 0.7 |
| Cyclically-adjusted primary balance | : | – 0.6 | 2.2 | 2.0 | (2.5) | 2.7 |

NB: For footnotes and sources see Table 2 for Belgium.

Previous fiscal targets were tightened in the January 2001 stability programme update. In 2000, the general government deficit posted a figure of 0.3 % of GDP (half a point below the original target). This improvement stems from both increased tax revenues and expenditure restraint. However, in spite of the rise in prices, the fiscal effort, measured by the change in the cyclically adjusted primary balance, has been inferior to 1999 (an improvement of 0.2 % of GDP in 2000 compared to 0.5 % of GDP in the previous year).

On 26 January 2001, the draft law of budgetary stability was presented to Parliament. The main goal of this law is to maintain the general government sector in balance or in surplus over the medium term. To ensure this, a public agent going into deficit will have to present a plan to return to balance.

A national pension fund was created in 2000 to face the problem of an ageing population, with ESP 60 billion (EUR 0.4 billion, 0.1 % of GDP), afterwards increased to ESP 100 billion (EUR 0.6 billion, 0.1 % of GDP). Nevertheless, no additional steps have so far been taken to reform the public pension system, since negotiations between the government and the social partners within the 1995 Pacto de Toledo framework are still in progress. According to the recent projections for the Economic Policy Committee, the greater deterioration in public pension finances would take place between 2020 and 2040, with a global increase in expenditure from 9.4 % of GDP in 2000 to almost 18 % by 2050. In the absence of other measures, extra revenues of around 8 % of GDP would therefore need to be raised if the Stability and Growth Pact objective of maintaining the general government in balance or in surplus were not to be jeopardised. A key issue for discussion is how the new pension fund shall be managed to contribute to this increased funding.

The existing internal stability pact between regions and the State seems to be performing quite well. As a result, in 2000 territorial governments are expected to achieve the deficit target of 0.1 % of GDP set up in the January 2000 stability programme update.

## 5.3. Economic reforms

### 5.3.1. Product markets

**Overall assessment**

Spain's integration into the European goods markets has constantly increased in the 1990s but its total trade to GDP ratio and FDI inflows are lower than those of other large Member States. This may contribute to the low labour productivity. However, in 2000, Spain has made great efforts to improve the functioning of its product markets. Its record in transposing Single Market legislation has significantly improved and in 2000 Spain was the fourth best performer after the Nordic countries. The value of tenders published in the Official Journal as a percentage of total public procurement is above the EU average. New measures should simplify procurement procedures and increase their transparency. State aids have been reduced and are now equal to the EU average. Substantial reforms have also been made to liberalise the telecommunications and energy sectors. However, so far, competition remains limited in these sectors, as well as in other sectors such as retailing and professional services. To tackle this problem, the powers of the competition authorities have been reinforced. Finally, measures to reduce the relatively high administrative burden have continued, especially for SMEs which account for a large share of economic activity.

The knowledge-based society has developed slowly in Spain and this might explain why labour productivity has, relativel to other Member States, continuously fallen since 1996. R & D expenditure is half the EU average and has changed little in recent years. A three-year national R & D and innovation plan has been launched to improve synergies in the R & D field. Public expenditure on education is also relatively low compared to other EU countries. Finally, despite low access costs, the level of Internet penetration is the second lowest in the EU, after Greece. No specific measures have been taken in 2000 but reforms to telecommunications and taxation incentives should help stimulate an increased level of Internet access.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue the implementation of the 1999 reform of the competition law; within this reform, give particular attention to reinforcing the capacity and the resources of the independent competition authority to investigate cases. | In progress |
| • Continue to reduce sector-specific (railways, coal, shipbuilding) aid. | In progress |
| • Take measures to reinforce the competition framework in sectors such as electricity, gas and retail distribution, to remove restrictions on land supply and to bring the price of water closer to its real cost. | Partial |
| • Continue the measures to reduce administrative burdens, especially for SMEs, and expand the geographical coverage of the one-stop shops for businesses. | In progress |

In 2000, the competition authorities have broadened their scope of action, tighter controls have been put on concentrations and stricter limits have been imposed on ownership interests in the liberalised sectors. However, the decision to investigate or not a case remains in the hands of the Ministry of Economy, putting at risk the independence of the tribunal.

Sector-specific (railways, coal, shipbuilding) aid has decreased substantially in recent years. The Competition Tribunal has recently been given new powers to deal with the control of State aids.

In July 2000, the government adopted a wide range of liberalisation measures in several sectors. In electricity and gas, measures have been taken to develop a more competitive market. Similarly, barriers to competition should be eliminated in retail distribution, the land market, the pharmaceutical sector, professional services, the financial sector, road passenger transport and some other sectors. By contrast, reform of the water sector has not advanced and a draft law, aiming at improving the efficiency of supply, is still under preparation.

The Spanish government has taken additional measures to reduce the administrative burden on business. A plan to simplify the regulatory framework for SME competitiveness has already introduced a number of changes. The government has also made efforts to spread the use of information technology in public services and to develop one-stop shops for SMEs. Simplified procedures have been set up for tax returns, labour relations and registration requirements.

### 5.3.2. Capital markets

#### Overall assessment

Capital market deepening in Spain has been supported by deregulation and a major privatisation programme. Stock exchange capitalisation represented about 90 % of

*Table 3*

**Product market indicators for Spain**

| | Spain | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 19.3 | 21.2 | 20.0 | 21.3 | 21.7 | 21.7 |
| Intra-EU trade to GDP ratio (%) (1) | 12.9 | 15.0 | 13.9 | 12.6 | 13.0 | 13.0 |
| FDI inflows (2) | 1.1 | 1.2 | 0.7 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 4.7 | 5.6 | 5.4 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 2.7 | 2.2 | 1.6 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.5 | 2.19 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 1.09 (6) | — | 0.64 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 18.8 | 19.6 | 20.9 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 93.0 | 92.3 | 92.1 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 82.0 | 84.0 | 85.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 53.1 | 78.4 | 79.5 | 100.0 | 100.0 | 100.0 |
| — national calls | 152.0 | 199.1 | 177.9 | 100.0 | 100.0 | 100.0 |
| — call to US | 88.7 | 119.8 | 109.6 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 99.0 | 98.5 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 98.5 | 102.0 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 125.0 | 128.7 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 91.7 | 83.0 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.6 | 4.5 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 0.82 | 0.90 | | 1.86 | 1.86 | : |
| Patent applications (12) | 9.8 | 11.0 | 12.1 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 5.0 | 5.5 | 6.1 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 9.6 (14) | 15.7 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

GDP in June 2000, ahead of several other large Member States. To further the development of capital markets and enhance market transparency, several regulatory measures have been taken. New regulations for stock options have been introduced, which impose the obligation to notify any acquisition or disposal of stock option rights. A modification of the rules on undertakings for collective investment in transferable securities (UCITS) is planned so as to account for new investment modalities (e.g. funds of funds, index tracker funds, mutual funds specialising in unlisted companies). The listing requirements have been made more flexible by providing for an exemption from the profit generation requirement for new or recently created companies.

Thanks to an active consolidation process, the Spanish banking sector has emerged as a leader in terms of profitability and technology platforms. Efficiency gains should also result from the consolidation of the several national securities clearing and settlement systems which is starting to take place.

The venture capital market is growing, with total funds invested increasing by 20 % in 1999 as compared to 1998. However, the Spanish venture capital market still fails to attract large capital inflows from domestic institutions. The bulk of the business in Spain involves foreign funds. A very small part of funds raised originate from Spanish pension funds and insurance companies. Moreover, more than half of investments are in expansion rather than start-ups.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Make further efforts to develop venture capital markets and in particular to increase early-stage investments; give consideration to the examples of good practice put forward in the October 1999 Risk Capital Communication in the areas of legislation on bankruptcy, promotion of innovative employee ownership schemes, and promotion of stock markets for small and medium-sized businesses. | In progress |

Several measures have been taken to favour SMEs access to capital and develop venture capital markets. The time for which Spanish venture capital entities need to hold shares in unlisted companies to benefit from an exemption of 99 % of the capital gains realised has been reduced from two years to one year. In April, a specialised stock market for high-growth high technology stocks called IBEX Nuevo Mercado was launched. However, the market has not expanded beyond the 10 companies that had formed its initial index. The government has created a credit facility, managed by ENISA (National innovation enterprise) aimed at small innovative companies and backed by the Ministry of Science and Technology which will meet any payment default. No measure has been reported in the areas of bankruptcy law and promotion of innovative employee ownership schemes.

### 5.3.3. Labour markets

**Overall assessment**

Labour market performance continued to improve in 2000, with strong employment growth and a further decline in unemployment. However, Spain still suffers from very high structural unemployment with severe regional disparities, and a very low employment rate, especially among women. Regarding the labour market recommendations, progress in addressing the key structural problems remains in the balance, dependent on the outcome of the social dialogue on a new round of labour market reforms. There have been some improvements in the tax-benefit system, and further increases in expenditure on active labour market policies. These could play an important role in matching labour supply and demand, although relatively little attention seems to have been devoted to ensuring that they are efficiently targeted. Legislation following an agreement in the social dialogue could in principle cover a range of areas, but a resolution seems most likely in the (related) areas of employment protection in permanent contracts and over-use of short-term temporary contracts. It remains to be seen whether any agreement will be reached in other key areas: improvements to the part-time contract (also important for raising the female employment rate); effective decentralisation of wage bargaining; and a review of incentives in regional benefit systems.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Review, together with the social partners, the wage formation system and the regional–local enforcement of the welfare system and take action to improve the functioning of the housing market in order to promote labour mobility and tackle regional disparities in unemployment. | Partial |
| • Pursue efforts to improve the efficiency of active labour market policies and to enhance their coordination with passive labour market policies to reduce inflows into long-term unemployment and combine this with a review of tax and benefit systems to improve incentives to hire, to take up work and to participate in active labour market programmes; review the quality and efficiency of technical training in schools. | Partial |
| • Review further, together with the social partners, tight job protection legislation for employees on permanent contracts and lower barriers to dismissal in order to reduce the weight of temporary contracts and enhance the flexibility of the labour market. | In progress |

The 2000 national action plan for employment (NAP) details a number of measures aimed at improving labour mobility, but there are no concrete initiatives to tackle the fundamental problems. Wage bargaining and regional benefit schemes are in principle on the agenda in the current social dialogue, although the prospects of a resolution here are unclear. An agreement in the social dialogue leading to a reduced share of temporary contracts could help to improve labour mobility. As for the housing market, tax incentives for owner-occupation are being gradually reduced. Some limits have been placed on the discretion of local authorities in assessing planning applications.

Despite a substantial increase in expenditure on active policies in recent years, relatively little attention seems to be devoted to ensuring efficiency. Some efforts have been made to combine active and passive measures. The NAP refers to a minimum of 25 % of active measures which must be targeted at those in receipt of unemployment benefits; in practice (according to the Ministry of Labour and Social Affairs) the figure is much higher, and all benefit recipients (with some exceptions for over-55s) must be available for active programmes. The new active income subsidy, which applies to over-45s with a family but without unemployment protection who are willing to follow an integration programme, has been extended in the 2001 budget. Efforts to reduce the tax wedge were assessed positively in last year's BEPG implementation report. There is no indication of any further review of tax and benefit systems, although some issues on the benefits side (such as regional benefit schemes) remain outstanding. The NAP devotes considerable attention to professional training, including lifelong learning, but technical training in schools is not addressed.

Job protection in permanent contracts, dismissals costs and the weight of temporary contracts are the main items on the agenda in the current social dialogue. It is thought that there is a good chance of an agreement in these areas, since both employers and unions have an interest in making the permanent contract more flexible and reducing the share of temporary contracts.

*Table 4*

**Labour market indicators for Spain**

| | Spain | | | | EU | | | US ([5]) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) ([1]) | 45.0 | 49.7 | 52.3 | 54.7 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 30.2 | 34.8 | 37.3 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 32.5 | 35.0 | 34.8 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth ([1]) | – 0.5 | 3.7 | 3.5 | 3.1 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 43.3 | 47.4 | 50.0 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 24.2 | 18.8 | 15.9 | 14.2 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 12.7 | 9.4 | 7.3 | 6.0 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 45.1 | 35.4 | 29.5 | 25.9 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation ([2]) | 7.1 | 6.8 | 6.6 | : | — | — | — | — | — | — |
| Nominal wage growth ([1]) | 2.8 | 2.8 | 2.8 | 3.4 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth ([1]) | – 3.8 | 0.0 | – 0.5 | – 0.9 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth ([1]) | 2.8 | 0.5 | 0.4 | 1.0 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families ([1]) ([3]) | 33.7 | 33.3 | 30.4 | 30.6 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners ([1]) ([3]) | : | 35.1 | 32.6 | 32.9 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families ([4]) | 76.0 | 74.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners ([4]) | 71.0 | 70.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 6. France

## 6.1. Economic developments and key policy issues

The phase of expansion which began three years ago continued in 2000. Real GDP increased by slightly more than 3 %, the highest rate in the decade. Growth was driven by dynamic investment and robust consumer demand despite a short-lived slowdown in the spring due to the oil price shock. The main feature of the current recovery is the high content of job creation. Employment in the private sector increased by almost 3.5 % in 2000, and the unemployment rate declined markedly, reaching 9.2 % last December, three percentage points lower than three years ago. This strong decrease in the unemployment rate triggered some hiring difficulties, but so far wage developments remain moderate. The implementation of the working time reduction law for large companies did not induce a significant increase in unit labour costs: social contribution rebates, wage moderation and hourly productivity gains were the main factors behind this. In this context, and despite the significant impact of the rise in oil prices, inflation remained moderate last year. Despite weaker external demand, real GDP growth should remain robust in 2001, even if slightly decelerating. Tax cuts and lower inflation related to moderating oil prices should sustain households consumption. Given the gradual increase in capacity constraints observed last year and sound economic prospects for the French economy, business investment is expected to remain dynamic.

The short-term outlook for the French economy remains clearly positive. In order to strengthen current developments, the following key economic policy issues can be identified:

(1) labour market participation and the structural unemployment rate;

(2) the consolidation of the government finances by a tight control of expenditures;

(3) the long-term challenges associated with an ageing population; and

(4) the economic environment and the process of liberalisation in network industries.

The French labour market, still characterised by a relatively low employment rate and a high unemployment rate, has shown signs of tightening in 2000, with employers reporting hiring difficulties in some sectors. Whilst these difficulties do not seem to have constrained production yet, they pose a risk to future economic developments. Moreover they could interact with the implementation of the working time reduction law in small firms from 2002, which will trigger a reduction in the hours of labour supplied. In this context the authorities are considering a flexible implementation of the law for small firms. At the same time, after progress made for several years in promoting labour demand by reducing non-wage labour costs, the French authorities turned their attention in 2000 to improving incentives to work and to reducing inactivity traps. A number of different tax measures have been taken to increase labour supply, but little has been done to review the key income guarantee benefits. The interaction of taxes and benefits still seems to reduce the incentives to take up low-paid work, especially for part-time jobs. On the demand side, the recent rapid increases in the minimum wage may prevent the employment of some low skilled workers.

The control of government expenditures in real terms is the cornerstone of the French budgetary consolidation strategy. Overall real expenditures are set to increase by less than projected real GDP growth. In 2000, the increase in government expenditures in real terms was lower than planned (+ 1 % against 1.3 %), partly due to higher than expected inflation. This allowed the government deficit to be reduced from 1.8 % of GDP in 1999 to 1.4 % of GDP. However, healthcare expenditures and real spending by the local authorities overshot in 2000 the limit fixed in the 1999 update of the stability programme, as had already happened in 1999. Despite various attempts by the government to curb the health care spending dynamic, targets have systematically been overshot in recent years. The difficulty encountered by the French authorities in containing healthcare expenditures is a matter of concern. The existing mechanisms aimed at controlling health expenditures need to be reinforced.

As in other EU countries, recent Eurostat projections suggest that there will be important demographic changes in France in the coming decades. As regards policy measures, a pension reserve fund was created in 1999. This fund is expected to reach 10 % of GDP by 2020 (in constant terms). Contributions to a pension reserve fund of this nature will help, but will contribute to finance only a relatively small percentage of additional expenditures. It is time to press ahead with a comprehensive reform of the pension system which has already been delayed several times.

Despite significant progress made in recent years to increase competition and stimulate entrepreneurship, the regulatory framework, in particular the business taxation system, is still relatively complex and the nature of the system of competition regulation is considered as not dissuasive enough. The large share of State-owned companies may also affect the development of competition, especially in network industries. In these sectors, liberalisation and privatisation of public utilities have proceeded relatively slowly, with market opening often limited to the minimum requirement of EU directives. In telecommunications, the diffusion of Internet and mobiles was substantial in 2000, but slower than in most other Member States in comparable situations and starting from a relatively low level. The local loop was unbundled in January 2001, which should lead to an increase in competition in this sector.

## 6.2. Public finances

### Overall assessment

The cornerstone of the French budgetary strategy is the binding norm set for real government expenditures; this strategy, coupled with favourable economic developments, allowed a further reduction in the government deficit in 2000. The spending target in real terms set for 2000 was met (1 % versus 1.3 %) partly due to higher than expected inflation (1.7 % instead of 0.9 % as expected in the 2000 budget). The government deficit was reduced to 1.4 % of GDP in 2000, a level clearly below the target of 1.7 % of GDP set in the 1999 update of the stability programme. This outcome only reflects the progress achieved in 1999 when the government deficit was reduced by a larger than expected 0.9 percentage points of GDP. In fact, despite higher than budgeted fiscal revenues, the pace of deficit reduction decelerated in 2000 (– 0.4 percentage points of GDP) compared to 1999. The magnitude of deficit reduction was the same as planned in the 1999 updated stability programme. After several years of continuous rise, the tax burden declined from an all-time record of 45.7 % of GDP reached in 1999 to 45.2 % of GDP in 2000. In order to sustain government finances consolidation over the medium term, the tight control of expenditures has to be maintained, given the projected tax relief over the 2001–04 amounting to 2 % of GDP and the cost associated with labour market policies.

*Table 1*

**Economic developments in France**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.1 | 1.9 | 3.1 | 2.9 | 3.3 |
| Domestic demand | 0.7 | 0.7 | 3.7 | 2.7 | 3.1 |
| Private consumption | 1.1 | 0.2 | 3.3 | 2.1 | 2.6 |
| GFCF (Investment) | – 1.0 | – 0.1 | 6.3 | 7.1 | 6.2 |
| Exports (G & S) | 5.0 | 11.8 | 7.8 | 3.7 | 12.6 |
| Imports (G & S) | 3.1 | 6.9 | 11.0 | 3.6 | 13.1 |
| Inflation (1) (2) | 2.3 | 1.3 | 0.7 | 0.6 | 1.8 |
| Compensation/employee (1) | 3.1 | 2.3 | 2.4 | 1.8 | 1.5 |

NB: For footnotes and sources see Table 1 for Belgium.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Reduce the government deficit in 2000 to a level clearly below the one set in the updated stability programme, given the better than planned outcome for the government deficit in 1999 and the strong growth prospects. | ✔ |
| • Take prompt corrective measures in the event of any significant slippage from the expenditure targets in specific sectors, which have been established by the updated stability programme; whenever possible, implement such corrective measures within the same year or, at the latest, in the following year. | None |
| • Take the opportunity to reduce the deficit more quickly in case of a wider budgetary room for manoeuvre so a to fulfil the Stability and Growth Pact objectives even in 2000 or in 2001 with a more comfortable margin. | Partial |
| • Orient the reform of the pension system, which is intended to begin in 2000, towards long-term sustainability of government finances, taking into account considerations of equity — including between generations. | None |

In the 1999 update of the stability programme, the government deficit was expected to reach 1.7 % of GDP in 2000. The latest estimates, contained in the 2000 update of the stability programme, point to a figure of 1.4 % of GDP, a level clearly below the planned one.

At an aggregate level, the spending norm in real terms was respected in 2000. However, expenditures in particular sub-sectors have significantly slipped. In the health sector, expenditures have largely overshot the projections of the 1999 programme, despite the attempts by the government to rein them in. In the 2000 updated stability programme, the government estimated that real spending in the health sector had increased by 3.3 % (as against the limit of 1.5 % set in the 1999 stability programme) but latest estimates point to a figure close to 4.3 %. Expenditures by local authorities also proved to be slightly higher than projected (2.1 % in real terms, against 1.9 % planned in the 1999 stability programme).

In the 1999 update of the stability programme, the projected deficit was 2.1 % and 1.7 % of GDP for 1999 and 2000 respectively. Stronger than expected tax revenues triggered a faster deficit reduction in 1999 to 1.8 % of GDP. The target for 2000 has then been lowered to 1.4 % of GDP in the course of 2000. In this context, despite higher than expected revenues, the pace of deficit reduction in 2000 (0.4 % of GDP) proved to be exactly the same as projected in the 1999 updated stability programme; however, the adjustment was significantly less marked than in 1999 when it reached 0.9 % of GDP. Given the positive macroeconomic and fiscal developments (GDP and revenue growth were higher than expected), a better outcome could have been possible in 2000.

The partial pre-funding of the pension system proceeds as planned, but no comprehensive reform has been proposed. In this context, the problem of the sustainability of public finances over the long term remains unsolved.

## 6.3. Economic reforms

### 6.3.1. Product markets

**Overall assessment**

France is open to international competition and exhibits high labour productivity. The relative consumer price level has been gradually falling towards the EU average. Boosted by the buoyant macroeconomic situation and by tax cuts in 2000 intended to facilitate business transfers and business creation, there has been an increase in entrepreneurial initiative. However, due to its complexity, the regulatory environment is still insufficiently business-friendly, especially for SMEs. Moreover, France's record in transposing internal market directives was the second

*Table 2*

**Trends in public finances in France (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 6.0 | – 5.5 | – 3.0 | – 2.7 | – 1.8 | – 1.4 |
| — Current receipts | 48.0 | 48.1 | 49.7 | 49.6 | 50.4 | 49.8 |
| Tax burden (3) (**) | 43.3 | 44.0 | 45.2 | 45.2 | 46.0 | 45.5 |
| — Total expenditure | 55.2 | 55.2 | 55.0 | 54.0 | 53.9 | 53.0 |
| Primary current expenditure | 46.3 | 45.4 | 46.1 | 44.9 | 44.9 | 44.2 |
| Interest payments | 3.5 | 3.8 | 3.7 | 3.6 | 3.4 | 3.3 |
| Investment | 3.5 | 3.3 | 3.0 | 2.9 | 2.9 | 3.0 |
| Primary balance | – 2.5 | – 1.8 | 0.7 | 0.9 | 1.6 | 1.8 |
| Government debt | 46.1 | 54.0 | 59.3 | 59.7 | 58.9 | 58.3 |
| Cyclically-adjusted balance | – 5.6 | – 5.1 | – 2.2 | – 2.2 | – 1.5 | – 1.4 |
| Cyclically-adjusted primary balance | – 2.1 | – 1.4 | 1.5 | 1.4 | 1.9 | 1.8 |

NB: For footnotes and sources see Table 2 for Belgium.
(**) The official French figure differs slightly because it takes into account the adjustments for unpaid taxes.

worst in November 2000. The Competition Council is very active but competitive regulations need to be modernised and the Council remains understaffed. New measures to address these two issues have recently been proposed. However, several sectors, notably the banking and the audiovisual sectors, are not fully under the supervision of the competition authority. Finally, network industries are being liberalised slowly. The liberalisation of the gas and electricity markets started in 2000 but at a slow pace.

R & D expenditure in France is above the EU average. Around two thirds of the total is funded by business, the rest by the public sector. France has one of the highest shares of exports of high-technology products in the EU. Moreover, public expenditure on education as a percentage of GDP is above the EU average. In 2000, the government continued to take measures to support cooperation in R & D between the public and private sectors. However R & D expenditure has stayed very stable during the 1990s and did not increase from 1997 onwards as the EU average did. France has been slow in moving towards the knowledge-based society, as shown by the relatively low penetration rates of both Internet and mobile phones. The growth rate, however, increased in 2000, without being outstanding. In 2000, the government adopted a wide range of measures to encourage the diffusion of IT throughout the population.

### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Improve its record in transposing internal market directives which is relatively poor and has deteriorated recently; resolve problems in the application of internal market rules; and continue efforts to introduce greater transparency in public procurement procedures. | None |
| • Avoid granting large ad hoc aid such as those that were granted in the recent past. | Partial |
| • Widen the liberalisation, already initiated, of network industries, particularly in the energy sector. | In progress |
| • Continue efforts to simplify formalities for business and to encourage innovation. | In progress |

Backlogs in the transposition of directives continued throughout 2000. However, in December 2000, the French Government received authorisation from the Parliament to speed up implementation. A reform of the rules on public procurement aimed at increasing transparency, initiated in April 1999, is still under preparation.

The most recent data show that the share of ad hoc aid in total State aid has started to decrease but remains above EU average when expressed as a share of GDP.

In the electricity sector, France transposed the European directive and created a new regulatory authority for the electricity sector at the beginning of 2000. Accounting separation has been achieved for the activities of EDF (the former French electricity monopoly), whilst the division responsible for managing the transmission network has been given considerable autonomy subject to the detailed control of the new regulator. The gas market was partially liberalised in 2000. A further draft law scheduled for adoption in 2001 should open the way for accounting separation for GDF (the French gas monopoly), creation of a regulatory authority, and limited access to the transport network. In the telecommunications sector, it was decided to unbundle the local loop from 1 January 2001. UMTS licences will be granted in mid-2001 on the basis of a 'beauty contest'.

Additional measures in 2000 include the announcement of tax cuts aimed at facilitating business transfers and business creation. In order to support R & D, the government launched a series of measures to encourage cooperation between the public and private sectors in 1999 and 2000, including: the setting up of seed capital funds; support for incubators; and tax incentives for investment by business angels. The government is also preparing a draft law on the information society for the beginning of 2001 in order to ensure the freedom of communication,

*Table 3*

**Product market indicators for France**

| | France | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 20.9 | 21.7 | 22.3 | 21.3 | 21.7 | 21.7 |
| Intra-EU trade to GDP ratio (%) (1) | 13.3 | 14.1 | 14.3 | 12.6 | 13.0 | 13.0 |
| FDI inflows (2) | 1.1 | 1.4 | 5.0 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 14.3 | 13.5 | 11.9 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 5.5 | 5.6 | 4.5 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.82 | 1.93 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.91 (6) | — | 0.86 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 15.1 | 15.6 | 16.2 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 107.8 | 108.4 | 108.3 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 106.0 | 104.0 | 109.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 121.9 | 105.1 | 106.6 | 100.0 | 100.0 | 100.0 |
| — national calls | 101.0 | 98.1 | 102.6 | 100.0 | 100.0 | 100.0 |
| — call to US | 97.5 | 67.2 | 73.7 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 100.6 | 100.3 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 94.7 | 95.0 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 105.5 | 107.1 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 92.5 | 99.1 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 6.0 | 5.9 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 2.21 | 2.20 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 87.0 | 96.1 | 105.7 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 4.8 | 5.3 | 5.7 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 12.9 (14) | 19.0 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

to safeguard consumers in on-line trade and to ensure access to the Internet for disadvantaged groups. The government also adopted a wide range of measures in July 2000 that should further encourage the diffusion of IT.

### 6.3.2. Capital markets

**Overall assessment**

The French capital market is, to a large extent, mature and efficient. Equity markets continued to develop in 2000, both in terms of companies listed and market capitalisation. Their integration has been increased with the merger between the Paris, Amsterdam and Brussels exchanges to form Euronext. The creation of long-term savings plans should further boost demand for equities over the coming years, while market efficiency will be improved by better protection of minority shareholders. Regarding the banking sector privatisation is continuing as the State is divesting its share in the last publicly owned bank, the Hervet Bank.

In terms of legal framework, reforms are being implemented with a view to improving transparency in the financial system. The new eonomic regulation bill proposes to:

(1) make takeovers more transparent vis à vis employees;

(2) make takeovers more transparent vis à vis shareholders; and

(3) increase transparency of regulation by ensuring better provision of information to the Parliament.

Reforms have also been undertaken in the areas of financial regulation and supervision. The banking and insurance supervisory authorities (the Commission bancaire and the Commission de contrôle des assurances) are to coordinate more closely, while the securities regulatory authorities (Commission des opérations de Bourse et Conseil des marchés financiers) are to be merged. Regarding the banking sector, the authorities are considering a proposal to improve risk control by provisioning credits at grant. The extension of EU directives on insurance to mutual benefit insurance societies will improve freedom to provide services and guarantee of financial safety.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Further facilitate investment by institutional investors in stock markets and in venture capital. | None |
| • Give particular attention to the actions put forward in the October 1999 Risk Capital Communication, as examples of good practice to improve the taxation framework, enhance enforcement of bankruptcy legislation and to promote the further development of employee ownership schemes. | Partial |

In the late 1990s, some fiscal measures have been introduced to support equity investments (e.g. so-called 'DSK life-insurance contracts'; creation of UCITS allowed to invest up to 50 % in unlisted securities). However, no further progress has been made in 2000.

A number of measures to encourage risk capital investment were taken in 1999 and further measures have been introduced in 2000. The regulatory and tax framework for SMEs has been further improved. Tax exemptions to stimulate investment by business angels have been extended, while the tax framework for venture capital funds has been simplified. Public funding for seed capital funds and incubators has been increased. Capital gains tax on the acquisition of stock options has been lowered to that applying to ordinary capital gains, in case of modest capital gains and when shares are held for more than two years. Nevertheless, proposals to extend and make permanent the 'entreprise creator share certificate' (BSPCE), still under consideration, would also help in further promoting entrepreneurship.

### 6.3.3. Labour markets

**Overall assessment**

Despite strong employment creation in France in recent years, the French labour market continues to be characterised by a relatively low employment rate (61.7 % in

2000), particularly for older persons, and a high level of structural unemployment. Moreover, young people and women seem to be disproportionately affected by unemployment. With regard to the labour market recommendations, the French authorities have recently been implementing policies to reduce the fiscal pressure on labour and to eliminate inactivity and poverty traps, in particular through changes to the tax system. However, the key income guarantee benefit schemes remain untouched. The authorities are closely monitoring the implementation of the reduction of working time, along with the social partners. In particular, there has been much discussion of a more flexible implementation of legislation on working time for small firms. This is especially important in a context of a tightening labour market and emerging skills shortages. No review has been made of employment protection legislation.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Pursue and evaluate policy measures designed to reduce the fiscal pressure on labour, particularly those addressing unskilled and low-paid workers, and, in this context, review benefit schemes in order to avoid poverty traps. | Partial |
| • Review employment protection legislation in order to assess its impact on employment. | None |
| • Monitor the negotiation of the 35 hours working week reform closely so as to avoid adverse effects on wage costs, labour supply and work organisation in the medium term. | In progress |

After a series of cuts to employer social security contributions designed to increase labour demand, the French authorities have recently turned their attention to reducing marginal effective tax rates on low-paid workers. The lowest rate of personal income tax has been cut and further cuts will be effected through until 2003. In order to reduce some important distortions in the schedule of marginal effective tax rates at the low end of the wage scale, changes have been made to housing taxes and benefits, and to eligibility requirements for health coverage. Moreover, at the beginning of 2001, the government announced the introduction of a tax credit scheme for low-wage earners, which increases the incentives to take up full-time work at or just above the minimum wage. This measure however will do little to further encourage the take-up of part-time work. No significant changes have been made to the main income guarantee schemes.

No specific action has been taken to review employment protection legislation or its impact on employment.

Whilst no specific evaluation or monitoring exercise has been undertaken, the authorities and the social partners continue to closely follow the implementation of the reduction of working time. This focus has been heightened with the transition of smaller firms to reduced working hours since the beginning of 2000. In particular, there has been a lengthy debate over the flexible application of the legislation in the case of smaller firms.

*Table 4*

**Labour market indicators for France**

| | France | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 58.9 | 59.9 | 60.4 | 61.7 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 51.3 | 52.9 | 53.5 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 29.4 | 28.3 | 28.3 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 0.0 | 1.2 | 1.8 | 1.9 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 55.8 | 56.7 | 57.0 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 12.3 | 11.8 | 11.2 | 9.5 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 4.7 | 4.8 | 4.4 | 3.8 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 29.2 | 26.5 | 24.3 | 20.1 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 2.3 | 2.7 | 2.9 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 2.1 | 2.6 | 1.8 | 1.5 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 2.0 | – 0.4 | 0.3 | – 0.6 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 2.4 | 2.1 | 1.1 | 1.3 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | : | 38.5 | 38.9 | 39.0 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 39.4 | 40.3 | 41.2 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 79.0 | 74.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 85.0 | 83.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 7. Ireland

## 7.1. Economic developments and key policy issues

The Irish economy continued to expand very rapidly in 2000 with estimated real GDP growth of 10.5 %, up from 9.8 % in 1999. Private consumption responded to strong employment and earnings growth, further tax cuts and easy credit conditions. The conditions for further investment growth were favourable with a still rising profit share in nominal income. Booming exports were driven by rapid growth in Ireland's exports markets and the weakness of the euro. On the supply side, there were further sizeable productivity gains and strong employment growth. The harmonised unemployment rate was brought further down to 4.5 % from a peak of 15.6 % in 1993. However, with a positive output gap that widened further in 2000, this spectacular real performance was accompanied by increasing inflationary pressures. While the upsurge in headline HICP-inflation in the course of 2000 was partly due to external or temporary factors, underlying inflation has been on the rise too, in evidence of growing supply/demand imbalances. Together with a tight labour market, this is already putting upward pressure on wages. In coming years, economic growth will have to slow to a more sustainable pace. As the influence of special factors unwinds, the inflation outlook is for a gentle decline, but, given the extent of overheating, the risks are on the upside.

Key policy issues in Ireland are the following:

(1) the contribution of fiscal policy to the overall policy mix;

(2) capacity constraints and labour shortages;

(3) wage inflation in a tight labour market;

(4) inadequate competition in some product markets; and

(5) the uneven distribution of business R & D expenditure between different parts of the economy.

The loss of monetary independence in monetary union requires a greater willingness to deploy the budgetary instrument to manage overall demand in the economy. The current stance of the single monetary policy set for the euro area as a whole is at present too easy for the needs of the Irish economy. Some degree of fiscal tightening is clearly desirable in view of overheating and inflationary pressures. In spite of full compliance with the requirements of the Stability and Growth Pact, budgetary measures that improve the overall quality of public finances, however desirable, must therefore only be implemented if they avoid adding further to demand. Most of the measures in the budget for 2001 do improve the quality of public finances, but the overall package is expansionary, which is inappropriate.

The National Development Plan 2000–06 aims to ease capacity constraints through increased investment in physical infrastructure and human capital. Nevertheless, labour shortages are becoming more widespread. There remains little or no slack in the labour market, implying that further labour force increases must come from the natural increase, higher (female) participation and net immigration. Recent data show that the labour force is growing at a declining rate, with the considerable gains in participation rates recorded in the past dropping off. Despite abundant employment opportunities and stepped-up government efforts to attract foreign workers, growth in net immigration, which turned positive in 1997, may be held back by a lack of affordable housing and increasing congestion.

Recent wage inflation in Ireland has been largely due to the continuing tightness of the labour market combined with higher than expected price inflation. Following a re-negotiation of the February 2000 national pay agreement in December 2000, wages are set to increase by 7.5 % in 2001, but there is a significant risk of further wage drift even beyond this rise. A moderation in headline price inflation from the highs of last year should have a positive effect on future wage expectations. However, the outlook for both wage and price inflation will greatly depend on whether the tax reductions and other measures included in the budget for 2001 succeed in their stated aim of increasing the labour supply or simply add to aggregate demand. More fundamentally, the traditional approach underlying recent national wage agreements, which is to consider tax relief as a *quid pro quo* for wage moderation, may have to be revised in a tight labour market. In particular, there is no guarantee that wage moderation can be sustained given the tightness of the labour market.

While Irish product markets are generally characterised by a high degree of competition, competition remains weak in retail distribution and pharmacies, and, while the network industries are being liberalised, there are still large State-owned incumbents in the airline, public transport, electricity and gas sectors. The authorities have plans to restructure or privatise some of these companies. Competition-strengthening measures would also be helpful in combating domestically-generated inflation.

The Irish economy has the highest share of ICT production to total production in the EU, reflecting the presence of many research-intensive foreign-owned firms, although domestic firms tend to be less research-intensive. The authorities plan a substantial increase in R & D spending, but this needs to promote R & D expenditure across all parts of the economy including SMEs to avoid exacerbating the gap between different parts of the economy.

*Table 1*

**Economic developments in Ireland**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 5.2 | 10.7 | 8.6 | 9.8 | 10.5 |
| Domestic demand | 3.3 | 9.3 | 10.2 | 6.0 | 9.5 |
| Private consumption | 3.7 | 7.5 | 7.8 | 7.8 | 10.1 |
| GFCF (Investment) | 4.5 | 17.8 | 14.7 | 12.5 | 9.4 |
| Exports (G & S) | 12.7 | 17.4 | 21.4 | 12.4 | 14.5 |
| Imports (G & S) | 10.3 | 16.8 | 25.8 | 8.7 | 14.5 |
| Inflation (1) (2) | : | 1.2 | 2.1 | 2.5 | 5.3 (*) |
| Compensation/employee (1) | 4.3 | 3.6 | 4.4 | 5.1 | 7.7 |

NB: For footnotes and sources see Table 1 for Belgium.

## 7.2. Public finances

### Overall assessment

After an early and rapid fiscal consolidation process, budgetary policy in Ireland in recent years has achieved an improvement in the quality of public finances, *inter alia* an alleviation of the direct tax burden and an increased focus on capital spending. While the most recent budget plans take this process one step further, which in itself is welcome, budgetary policy faces another, more immediate challenge in an overheating economy, namely to maintain economic stability by not adding unduly to demand. This overriding near-term concern underlay the guidelines on budgetary policy. Nevertheless, the most recent budgetary plans are expansionary in an economy with a sizeable positive output gap.

### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Be ready, already in 2000, to use budgetary policy to ensure economic stability. | None |
| • Restrain the growth in real public consumption from the 4.3 % estimated in 1999 to 2.7 % in 2002. | Partial |
| • Ensure that the objectives of the national development plan are accorded high priority, subject to achieving fiscal policy stability objectives. | Partial |

As a result of higher-than-expected growth, tax revenues in 2000 have exceeded previous projections by a large margin: tax revenues grew 14.9 % in 2000 rather than 9.6 % predicted at budget time (December 1999). However, as there were also expenditure overruns, these additional revenues were not entirely used for improving the actual surplus. This implies that, as far as 2000 is concerned, the first guideline was not fully respected. Likewise, the budget for 2001 is expansionary and pro-cyclical and is therefore not consistent with this guideline. In particular, the budget for 2001 contains direct and indirect tax cuts as well as very large increases in both current and capital spending, which give a further sizeable boost to demand. The 2000 update of Ireland's stability programme shows a deterioration in the structural surplus of 0.7 % of GDP. While more recent official estimates show a more moderate deterioration of the budgetary position in 2001 due to revisions of the headline surpluses for 2000 and 2001 to take account of some one-off factors, there is still a decline in the primary surplus of 0.6 % of GDP.

The 1999 update of Ireland's stability programme, referred to in the second guideline, envisaged a gradual decline in the growth rate of real public consumption from 2000 onwards. However, the 2000 update shows a sizeable upward revision for 1999 and 2000 and projects a more erratic growth path thereafter, which is unexplained. Together with the fact that the government recently abandoned its self-imposed limit on the nominal growth in net current spending, this suggests only partial compliance with the guideline.

*Table 2*

**Trends in public finances in Ireland (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 2.7 | – 2.2 | 0.7 | 2.1 | 2.1 (*) | 4.5 (*) |
| — Current receipts | 39.4 | 36.7 | 36.1 | 35.3 | (35.1) | (33.9) |
| Tax burden (3) | 35.0 | 33.4 | 32.8 | 32.4 | (32.5) | (31.5) |
| — Total expenditure | 45.1 | 41.6 | 37.8 | 35.6 | (35.8) | (32.3) |
| Primary current expenditure | 34.0 | 31.4 | 29.4 | 27.8 | (26.8) | (25.8) |
| Interest payments | 6.7 | 5.4 | 4.2 | 3.4 | (2.5) | (2.1) |
| Investment | 2.3 | 2.3 | 2.5 | 2.7 | 3.1 (*) | 3.8 (*) |
| Primary balance | 3.9 | 3.2 | 4.9 | 5.5 | 4.6 (*) | 6.7 (*) |
| Government debt | 98.8 | 84.4 | 65.1 | 55.0 | 50.1 | 39.1 (*) |
| Cyclically-adjusted balance | – 0.9 | – 1.1 | 0.7 | 1.9 | (1.2) | (2.9) |
| Cyclically-adjusted primary balance | 5.7 | 4.2 | 4.9 | 5.3 | (3.7) | (5.0) |

NB: For footnotes and sources see Table 2 for Belgium.

The seven-year National Development Plan is given high priority in the budget for 2001, which plans a rise in voted capital expenditure of about 29 % in 2001. However, in line with the first and third guidelines on budgetary policy, this must not jeopardise economic stability. In the budget for 2001, the demand-stimulating effects of this stepped-up public investment effort are not moderated by offsetting budgetary measures. Given the overriding need to safeguard economic stability and the capacity constraints currently experienced in the construction sector, which lead to increasing implementation costs, there is a strong case for deferring less urgent projects.

## 7.3. Economic reforms

### 7.3.1. Product markets

**Overall assessment**

The Irish economy is well exposed to international competition with the second highest total trade to GDP ratio in the EU and high FDI inflows. This may contribute to product market efficiency as labour productivity is well above the EU average and consumer prices are around the EU average. In addition, the regulatory burden on business is relatively low and the liberalisation process is advancing, in particular in the electricity and gas sectors. However, due to the presence of large State-owned incumbents there is still insufficient competition in the network industries as well as in other sectors such as pharmacies and retail distribution. Measures are underway to address these problems, most notably the plans to reform competition policy and to reinforce the powers of independent regulators.

Ireland has the highest share of ICT production to total production in the EU, but this is mainly due to the presence of many multinational firms which re-export ICT goods from Ireland. Internet penetration is above the EU average. Recent measures to improve ICT penetration include additional funding for ICT in education and the Electronic Commerce Act 2000, which gives legal validity to electronic contracts. R & D expenditure as a percentage of GDP in Ireland is below the EU average. In particular, government spending on R & D is among the lowest in the EU. Moreover, foreign-owned companies account for nearly two thirds of Ireland's business R & D. To help improve Ireland's R & D performance the national development plan has allocated the equivalent of 2.4 % of 2000 GDP to research, development and innovation over the period 2000–06.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Give the Competition Authority the power to enforce Articles 81 and 82 of the EC Treaty; permit a real strengthening of competition policy. | In progress |
| • Liberalise further the transport sector. | In progress |

The Irish Government has announced that it will introduce new legislation giving the Competition Authority the power to enforce Articles 81 and 82 of the EC Treaty when this power is devolved to Member States. The government announced in October 2000 that it would be introducing new competition and mergers legislation. The proposals to strengthen competition law include: transferring responsibility for examining and deciding upon mergers and takeovers from the Minister to the Competition Authority; determining merger and takeover cases on the basis of competition criteria alone; and extending powers of arrest and detention to competition law offences.

A government consultation paper was published in September 2000 which presented proposals for the regulatory reform of public transport, although more detailed proposals will follow later. For urban bus transport the main proposals were to establish Bus Átha Cliath and Bus Éireann as independent companies and to remove the geographical restrictions on their areas of operation; for the State to divest itself of at least one of the bus companies; and to introduce competition for public bus service franchises in the Dublin area. It was also proposed that the State railway company will be divided into a company responsible for the railway infrastructure and a company responsible for the operation of train services.

Consideration will be given at a later stage to transferring the train services operator to the private sector or to franchising the operation of railway services.

### 7.3.2. Capital markets

**Overall assessment**

A strategic review of the banking system, published in August 2000, suggested that concentration of the banking sector is not a problem, but proposed a revision of the assessment of proposed mergers to ensure that they are in the interests of customers and the economy generally. In February 2001, agreement was reached on a new structure for financial services regulation in Ireland. The Irish Financial Services Regulatory Authority (IFSRA) will be responsible for prudential regulation of both the banking and insurance sectors and for consumer protection. Finally, in July 2000, an office of the director of corporate enforcement was established with the aim of improving standards of adherence to company law by active enforcement.

Evidence of structural change on financial markets is seen in the decision by the Irish Stock Exchange to buy the Xetra electronic trading technology from the Deutsche Börse and in the creation of the ITEQ stock market for high technology shares. Privatisation of the banking sector, including of ICC Bank and the TSB, is proceeding. The decision to move settlement of Irish Government bonds to Euroclear will increase the liquidity of these bonds in the international capital markets by facilitating access to a broader range of investors.

*Table 3*

**Product market indicators for Ireland**

| | Ireland | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 56.9 | 62.2 | 63.1 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 38.1 | 41.2 | 40.6 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 7.2 | 9.4 | 10.6 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 2.5 | 2.8 | 2.1 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 5.8 | 4.4 | 3.6 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.94 | 2.07 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.44 (6) | — | 0.39 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 17.8 | 19.2 | 20.8 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 112.2 | 114.1 | 115.9 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 97.0 | 99.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 157.3 | 145.1 | 122.8 | 100.0 | 100.0 | 100.0 |
| — national calls | 130.4 | 114.7 | 85.3 | 100.0 | 100.0 | 100.0 |
| — call to US | 66.2 | 72.0 | 70.6 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 83.3 | 84.3 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 105.2 | 108.3 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 99.5 | 106.9 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 74.0 | 90.3 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.8 | 4.5 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 1.4 | : | : | 1.86 | 1.86 | : |
| Patent applications (12) | 32.6 | 49.3 | 43.4 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 5.7 | 5.4 | 5.4 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 17.5 (14) | 35.5 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Make further efforts in particular to develop start-up and early-stage venture capital. | In progress |

While the government has taken measures to respond to this need, notably through the seed and venture capital measure of the EU operational programme for industry, there are still notable gaps in the provision of seed and early stage financing. The absolute amount of early-stage financing more than doubled in 1999 compared to 1998, but the share of early stage finance in total venture capital investments fell from 23 % to 16.7 % in that period.

### 7.3.3. Labour markets

**Overall assessment**

Ireland's labour market has continued to perform strongly in 2000, with high employment growth and unemployment continuing to fall. The female employment rate gap with the EU has narrowed considerably. The strongly growing economy is leading to continuing labour shortages across the skill spectrum and wage inflation is the highest in the EU. Regarding the labour market recommendations, a number of measures have been taken to encourage increased female participation in the labour market. The increasing tightness of the labour market in 2000 and the declining contribution of increases in participation rates to labour force growth emphasise the continuing relevance and importance of the labour market recommendations on moderate wage developments and measures to increase labour supply. The recommendation on wage developments has been only partially met, with wages renegotiated to a level significantly exceeding the original terms of the programme for prosperity and fairness (PPF).

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Monitor compliance of wage developments with the PPF. | Partial |
| • Adopt a comprehensive strategy to increase the participation of women in the labour market; put in place measures which facilitate the reconciliation of work and family life. | In progress |

Except in the public service, wage developments appear to have exceeded the pay terms of the national agreement in 2000. Because of the increase in the pay terms negotiated in December 2000, wages in 2001 in both the public and the private sector are set to exceed the original terms of the PPF by a minimum of 2 %. Moreover, the possibility of further wage drift cannot be excluded.

Further steps have been taken in the process of tax individualisation of dual-income couples, maternity leave has been increased and a number of childcare initiatives have been introduced. These include the making available of capital grants for the provision of childcare facilities, supports for childcare training and developing local childcare networks. However, little is yet known about the effects of the childcare measures on the level of childcare provision. The special tax allowance introduced in the budget for 2000 for 'non-working' spouses taking care of children, elderly or handicapped would tend to reduce the incentives for female labour force participation. The increase in child benefit in the proposed budget for 2001 is not specifically targeted at childcare per se.

*Table 4*

**Labour market indicators for Ireland**

| | Ireland | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 52.6 | 59.7 | 62.5 | 65.6 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 39.8 | 48.2 | 51.4 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 39.4 | 41.6 | 43.8 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 3.1 | 5.0 | 6.4 | 5.0 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 49.3 | 55.4 | : | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 14.3 | 7.6 | 5.7 | 4.5 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 9.1 | 2.9 | 2.7 | 2.2 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 23.0 | 11.3 | 8.3 | 6.2 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 1.5 | 1.4 | 1.7 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 2.5 | 6.9 | 5.6 | 7.7 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 1.8 | – 1.9 | – 1.4 | – 1.9 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 2.6 | 3.0 | 3.2 | 5.2 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 28.4 | 22.5 | 20.1 | 15.5 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 23.4 | 21.5 | 18.1 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 64.0 | 62.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 45.0 | 45.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 8. Italy

## 8.1. Economic developments and key economic policy issues

Economic growth recovered sharply in 2000. The increase in real GDP has almost doubled compared to 1999, narrowing the still negative growth gap with the euro area as a whole. The economic revival was mainly driven by net exports whose contribution to GDP growth turned positive for the first time since 1995 thanks to a strong expansion of world trade and the weak euro. On the domestic side the upswing was backed by a recovery in private consumption expenditure and robust gross capital formation. Private consumption expenditure benefited from improved consumer confidence, from tax cuts put into place in the last two months of 2000 and, in particular, from strong employment creation. In fact, the labour market continued to post a buoyant performance over the entire year 2000 with the latest data showing a further acceleration. Pushed by sustained high energy prices, HICP-inflation accelerated in 2000, peaking in November at 2.9 % on the year. The annual average in 2000 was 2.6 %. Domestic inflationary pressures remained subdued thanks to continuing wage moderation. In 2001 and 2002 economic growth is expected to decelerate echoing the slowdown in the external environment. The contribution of net exports will weaken as world trade growth eases and the euro recovers, while domestic demand, notably private consumption expenditure, will continue to grow at a healthy pace supported by ongoing employment creation and further tax cuts included in the financial law for 2001. HICP-inflation is expected to decelerate over the year 2001 along with the waning impact of the price of oil.

Compared to the relatively meagre growth performance over the 1990s with an average growth rate of real GDP of only 1.4 % per year, the short-term outlook has brightened in 2000. Even so, growth in Italy is still lagging behind the euro area average and its economy appears to be vulnerable in several respects. The key policy issues are:

(1) in public finance, the control and quality of expenditure and the need to reduce the still high government debt to GDP ratio;

(2) in the labour market, the still wide regional unemployment disparities and the balance between employment protection legislation and the unemployment benefit system;

(3) the late development of the knowledge-based society contributing to the continuation of the unskilled labour-intensive production and exports; and

(4) insufficient competition in public utilities, particularly at the local level.

Controlling current primary expenditure is a key issue in budgetary policy. As further substantial savings in interest payments are unlikely, and considering Italy's goal to reduce the tax burden while pursuing a balance in the general government accounts in 2003, achieving the high primary surpluses of the updated stability programme, which are necessary in order to reduce the debt ratio to below 100 % of GDP by 2003, requires two conditions. In the first place, any future reductions of the tax burden will need to be matched by offsetting expenditure cuts. Second, a tight control of current primary expenditure is essential to respect the targets, with healthcare being an area of major potential divergence between plans and outcomes. In this context, starting in 1998 Italy has introduced arrangements to better monitor and control expenditures of the regions. Given that these arrangements did not achieve the desired results, further provisions were included in the financial law for 2001. The effectiveness of these tighter control mechanisms remains to be tested. An additional challenge to public finances is the intention to increase future capital expenditure in percentage of GDP and to mobilise private funds. As regards the future budgetary impact of ageing population, although some isolated measures were introduced with the financial law for 2001, further reform should address the need for a broader overhaul of the welfare system.

Labour market problems in Italy have a strong regional dimension. While clear signs of labour shortage have emerged in the north, unemployment remains high in the southern part of the country. To address regional disparities, one major objective of the Italian authorities, through the new decentralised development programme for Mezzogiorno in 2000–06, is to try to raise productivity via higher public investment in infrastructure. However, this is a long-term process whose success depends, among others, on the ability to address the weaknesses of the public administration in the Mezzogiorno. Only a limited degree of wage differentiation is achieved through localised wage bargaining via the so-called 'negotiating planning instruments'. Labour mobility, although relatively low, is increasing and a greater willingness of workers to move is emerging. The Italian unemployment benefit system remains one of the most fragmented and inadequate in the EU. Over the last three years, a planned comprehensive reform of the 'social shock absorbers' (ammortizzatori sociali) and employment incentives has been postponed many times. Implementation began recently but in a somewhat piecemeal way, with the risk of increasing disincentives to take up a job. Furthermore, it appears unclear whether or not any move towards a more comprehensive income support scheme for the unemployed will be accompanied by an easing of the very tight employment protection.

Italy's move towards the knowledge-based society and higher levels of productivity may be constrained by the small involvement of businesses in R & D and low ICT take-up. Production tends to be concentrated in traditional low-technology sectors and the innovative capacity of SMEs (representing the majority of Italian companies) remains limited. The relatively large share of traditional low-technology sectors in the Italian industry is also reflected in its export specialisation. There are also wide regional disparities, with companies of the Mezzogiorno particularly lagging behind in the field of innovation. Specific issues of productivity and competitiveness also arise from incomplete competition in public utilities. While liberalisation is proceeding, the divestment of the former public monopolists' assets and the privatisation of State-owned utilities are encountering some resistance. The full impact of increased competition on quality, choice and prices for users is still to be felt. Prices for electricity and gas are above the EU average, particularly for households. There is also the risk of insufficient competition in the local provision of utilities.

## 8.2. Public finances

### Overall assessment

In the course of the year 2000, on the basis of evidence of a stronger-than-expected economic upswing, the deficit objectives for the period 2000–04 were slightly tightened. However, the stronger growth assumptions compared to previous projections and the much higher tax receipts obtained thanks to the structural changes and improved efficiency of the taxation system, would have warranted a more ambitious improvement in the overall actual budget balances. Moreover, by implementing tax cuts in 2000 before the final outcome for the year was attained, an opportunity to achieve a significant improvement in the deficit target was missed. In 2001, the achievement of the new deficit target of 0.8 % of GDP could be difficult and it will crucially depend on the capacity to control current primary expenditure.

*Table 1*

**Economic developments in Italy**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.2 | 2.0 (*) | 1.8 (*) | 1.6 (*) | 2.9 (*) |
| Domestic demand | 0.4 | 2.7 (*) | 3.1 (*) | 3.0 (*) | 2.3 (*) |
| Private consumption | 0.9 | 3.2 (*) | 3.1 (*) | 2.3 (*) | 2.9 (*) |
| GFCF (Investment) | – 0.4 | 2.1 (*) | 4.3 (*) | 4.6 (*) | 6.1 (*) |
| Exports (G & S) | 6.2 | 6.4 (*) | 3.6 (*) | 0.0 (*) | 10.2 (*) |
| Imports (G & S) | 2.5 | 10.1 (*) | 9.0 (*) | 5.1 (*) | 8.3 (*) |
| Inflation (1) (2) | 4.9 | 1.9 | 2.0 | 1.7 | 2.6 |
| Compensation/employee (1) | 5.6 | 4.1 | – 1.8 | 1.9 | 2.6 |

NB: For footnotes and sources see Table 1 for Belgium.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Achieve better budgetary outcomes than planned, should growth turn out stronger than projected and thus accelerate the reduction in the still high debt/GDP ratio. | Partial |
| • Achieve a primary surplus of minimum 5.0 % of GDP in 2000 and 2001, namely through a tight control of current primary expenditure. | ✔ |
| • Begin as soon as possible a reassessment of the pension system and take further steps of reform, including promoting the expansion of funded pension provisions. | None |
| • Carry out the planned privatisation programme with vigour and continue to use privatisation receipts to reduce government debt further. | In progress |

In June 2000, the general government net borrowing target for the year was reduced by an amount corresponding to the estimated higher growth dividend from 1.5 % to 1.3 % of GDP. In the last two months of the year tax cuts amounting to some 0.6 % of GDP were implemented. Such tax cuts were backed by higher-than-expected tax receipts and were intended to bring the tax burden back in line with plans, leaving the projected general government deficit ratio unchanged. The outcome for the general government deficit was 1.5 % of GDP ([1]), down from 1.8 % in 1999, but slightly higher than the revised target, despite stronger growth. The departure from the objective appears to be due to lower tax and social contribution receipts, which turned out 0.8 percentage points of GDP lower than expected. This seems to suggest that the estimated higher trend in tax receipts did not materialise fully. Overall, total revenues were one percentage point of GDP lower than projected. The ratio of total expenditure to GDP was also lower than planned, but by around 0.8 percentage points, and thus not enough to offset lower revenues. Current primary expenditure was 0.6 percentage points of GDP lower than planned (in particular, social transfers were 0.6 percentage points of GDP lower than planned, while intermediate consumption was 0.2 percentage points of GDP higher). Interest payments were slightly higher than forecast in value, but unchanged in terms of GDP. Although the new deficit objective was not achieved, the debt/GDP ratio fell to 110.3 %, almost two percentage points of GDP below the earlier estimate of 112.1 % of GDP, largely thanks to the revised better result in 1999 and much higher than forecast nominal GDP growth in 2000. The deficit target for 2001, which was reduced from 1.0 % of GDP to 0.8 % of GDP, was confirmed in the update of the stability programme submitted in late December 2000.

The primary surplus in 2000 was 5.0 % of GDP (excluding the impact of the proceeds of UMTS auction). During the year, difficulties in keeping healthcare expenditure in line with plans emerged. In 2001, achieving the planned ratio of 5.3 % of GDP of the stability programme update of December 2000 will require strict control of primary expenditure. A major point is that the effectiveness of provisions strengthening the domestic stability pact remains to be tested. The State regions agreement of 3 August 2000 excludes healthcare expenditure, on which the financial law for 2001 introduces new ceilings. Past experience has shown this type of control has not been fully effective. As for the new obligation for regions to increase their own taxes if healthcare expenditure is higher than planned, their efficacy depends very much on how the government will ensure that this commitment is observed.

([1]) In compliance with the decision of Eurostat No 81/2000, the proceeds from the October 2000 auction of UMTS licences (around EUR 13.8 billion or 1.2 % of GDP) have been recorded in 2000. This translates into a deficit ratio of 0.3 % of GDP. To allow an easier comparison with last year's BEPG, this section discusses budgetary figures net of the impact of the proceeds from the UTMS auction.

In 2000, little progress has been made in the areas indicated in the BEPG 2000 as regards a comprehensive reassessment of the pension system and the expansion of supplementary privately funded pension schemes. The reassessment of the parameters of the pension system scheduled to take place in 2001 should not be postponed. The financial law for 2001 includes a few isolated measures affecting the pension system. One of these is aimed at encouraging workers entitled to a seniority pension to stay in employment after reaching the legal retirement age. Although these provisions go in the right direction, they reflect a piecemeal approach to reform in the area of the social shock absorbers, of which pensions should in future no longer represent the major block as it does at present. Therefore, a comprehensive reassessment of the pension system should take place within the framework of a broader overhaul of the Italian welfare system.

The privatisation programme has experienced delays in 2000, but these are expected to be recuperated in 2001. Therefore, over the two years the programme is expected to contribute to the reduction of the government debt as planned.

## 8.3. Economic reforms

### 8.3.1. Product markets

**Overall assessment**

During 2000, Italy has continued to make progress in reforming product markets: implementation of single market legislation improved markedly, and efforts were devoted to improving the businesses environment, streamlining legislation and enhancing the efficiency and accountability of the public administration. Nevertheless, despite these efforts of reform, the administrative burden on business start-ups remains high relative to other Member States. State aid has decreased substantially and the liberalisation of key network industries has progressed, in some cases well beyond the minimum EU requirements. However, competition in some network industries (including energy and transport) still remains limited. In particular, there is a risk of insufficient competition in the local provision of utilities if former municipality utility companies (in which municipalities still maintain at least a 51 % stake) are given preference in the granting of licences. The institutional and legislative framework for the local provision of utilities will be set up in 2001. Competition in some service sectors (such as professional services, retail distribution and other non-traded services) is also insufficient. The lack of competition in some product markets may have contributed to the persisting inflation differential with the euro area in the HICP core rate.

ICT expenditure as a percentage of GDP continued to increase during 2000, but remained below EU average. While the telecom market developed rapidly (particularly the mobile segment), computer take-up remains low. Internet penetration and the use e-commerce increased, also thanks to low access costs, but are still below the EU average. A number of initiatives were launched during 2000 to promote the use of ICTs in education, business

*Table 2*

**Trends in public finances in Italy (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 9.4 | – 7.6 | – 2.7 | – 2.8 | – 1.8 (*) | – 0.3 (*) |
| — Current receipts | 47.7 | 44.8 | 47.2 (*) | 45.8 (*) | 46.3 (*) | 45.5 (*) |
| Tax burden (**) | 44.2 | 41.2 | 44.7 (*) | 43.2 (*) | 43.3 (*) | 42.7 (*) |
| — Total expenditure | 57.1 | 53.4 | 51.1 (*) | 49.6 (*) | 48.9 (*) | 46.5 (*) |
| Primary current expenditure | 41.1 | 37.1 | 38.0 (*) | 37.6 (*) | 38.0 (*) | 37.3 (*) |
| Interest payments | 12.0 | 11.5 | 9.4 | 8.0 (*) | 6.7 (*) | 6.5 (*) |
| Investment | 2.6 | 2.1 | 2.2 | 2.4 | 2.5 (*) | 2.4 (*) |
| Primary balance | 2.6 | 3.9 | 6.7 | 5.2 (*) | 5.0 (*) | 6.1 (*) |
| Government debt | 118.1 | 123.2 | 120.1 (*) | 116.2 | 114.5 (*) | 110.2 (*) |
| Cyclically-adjusted balance | – 8.6 | – 7.5 (*) | – 2.4 (*) | – 2.5 (*) | – 1.2 (*) | – 1.3 (*) |
| Cyclically-adjusted primary balance | 3.4 | 4.0 (*) | 7.0 (*) | 5.5 (*) | 5.5 (*) | 5.1 (*) |

(**) Total tax burden excluding imputed social security contributions (for 1993 current tax burden).
NB: For footnotes and sources see Table 2 for Belgium.

and public administration. Italy also lags behind the EU average in terms of innovative capacity (as expressed by patents and percentage of high-tech exports), which may be one of the reasons for the relatively slow growth of labour productivity. Low innovation performance might be due to low R & D expenditures and, in particular, limited business involvement in R & D despite the availability of incentives for applied research and technological innovation. During 2000, new measures have been approved to further encourage R & D, including the creation of a fund to support investment in basic research. Italy's low innovative capacity is reflected in the relatively large share of traditional low-technology sectors in industrial production and in its export specialisation.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue current progress in transposing internal market legislation and strengthen efforts to reduce remaining problems in the area of public procurement. | ✔ |
| • Increase efforts to reduce further the overall level of non-agricultural State aid and to further improve its structure. | Partial |
| • Reinforce efforts to simplify the regulatory environment for companies and to develop one-stop shops. | In progress |
| • Reinforce initiatives to promote R & D and innovation in the light of the very low ratio of R & D expenditure to GDP. | Partial |

Progress in implementing internal market directives continued and the transposition deficit experienced a marked decline, also supported by the ongoing process of administrative and regulatory simplification. The latest edition of the single market scoreboard points to some remaining delays in implementing legislation relating to telecoms and the transposition of standards. Efforts have also been made and more are planned to rationalise and improve the transparency of public procurement, including the use of on-line procurement and the setting up of a single body to handle common purchases centrally. Figures provided by the Italian Government indicate that this has already allowed important cost savings for the administration. However, the share of public tenders published on the Official Journal as a percentage of GDP is below the EU average.

Preliminary data for 1999 indicate that non-agricultural State aids have substantially decreased. They, however, remain above EU average as a percentage of GDP and there has been no significant improvement in the structure of these aids, which remain mainly oriented to regional objectives.

In 2000 the Italian Government stepped up efforts to improve the regulatory environment for businesses. These are implemented in the framework of a broad reform of the public administration. Regulations are being simplified and a large number of certificates have been replaced by the use of 'self-certification', allowing for cost savings for both companies and the state. The potential impact of existing and proposed regulation is assessed through the use of the regulatory impact analysis. The network of one-stop-shops, introduced at the local municipality level in 1999, was further extended and now covers about 65 % of the population. Efforts to facilitate the registration of new companies have continued, leading to a significant reduction of registration costs and delays between 1998 and 2000. These, however, remain high compared to EU average.

Italy's performance in R & D and innovation remains weak. Investments in R & D by the government and the business sector increased modestly in 2000 and continue to remain lower than the EU average as a percentage of GDP. During 2000, the main government initiative in the field of R & D was the launch of a new fund to support investments in basic research. Moreover, the tax incentives available under the existing funds for applied research and technological innovation have been increased.

*Table 3*

**Product market indicators for Italy**

| | Italy | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 19.3 | 19.2 | 19.1 | 21.3 | 21.7 | 21.7 |
| Intra-EU trade to GDP ratio (%) (1) | 11.2 | 11.3 | 11.3 | 12.6 | 13.0 | 13.0 |
| FDI inflows (2) | 0.7 | 1.2 | 0.8 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 5.5 | 5.7 | 5.5 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 5.7 | 3.9 | 3.3 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.31 | 1.63 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.79 (6) | — | 0.65 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 15.9 | 16.0 | 16.3 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 112.6 | 112.1 | 111.0 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 89.0 | 88.0 | 89.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 104.4 | 97.5 | 87.8 | 100.0 | 100.0 | 100.0 |
| — national calls | 110.1 | 121.5 | 113.8 | 100.0 | 100.0 | 100.0 |
| — call to US | 63.1 | 58.7 | 59.5 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 174.7 | 167.7 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 113.6 | 106.5 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 120.6 | 117.8 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 105.0 | 102.3 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.6 | 4.9 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 0.99 | 1.02 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 43.2 | 49.4 | 52.2 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 3.9 | 4.5 | 5.0 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 19.2 (14) | 23.7 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

### 8.3.2. Capital markets

#### Overall assessment

Italian capital markets are developing rapidly thanks to several legal and regulatory reforms, the continuation of an active privatisation process and the restructuring and consolidation of the banking sector. New rules on mutual funds were adopted allowing for the introduction of new products and facilitating new investment opportunities. A new law on bankruptcy and insolvency was recently submitted to the Parliament, which should encourage entrepreneurship. Several tax reforms were introduced to remove distortions created by the application of different tax regimes to different securities and to collective investment schemes of different nationality. The dual income tax, introduced in 1998 to favour the equity financing of corporations, was reinforced by broadening the range of companies eligible for this regime. Stock market capitalisation as a percentage of GDP grew, reflecting the growing weight of institutional investors.

The venture capital market is also growing rapidly, although it is still one of Europe's smallest. Only 36 companies are listed on the Nuovo Mercato, the exchange for high growth and high technology shares. Moreover, the market lacks depth and breadth as 2 companies represent more than 60 % of market capitalisation.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue efforts to encourage the development of venture capital, in particular by further improving the taxation framework of risk capital, by facilitating investment of institutional investors in stock markets and venture capital and by reforming the bankruptcy legislation. | In progress |

A reform of bankruptcy law was recently submitted to Parliament and measures were introduced in the field of taxation to make equity investments more attractive. There are also plans to review the current taxation regime for stock options to enlarge the range of beneficiaries of the preferential capital gain taxation regime. New rules on mutual funds were introduced although, no specific measures were reported on the promotion of investments in stock markets, or risk capital by insurance companies and pension funds.

### 8.3.3. Labour markets

**Overall assessment**

The Italian labour market performance has improved over the last two years, thanks to the economic recovery and increased flexibility 'at the margin' (viz. 'atypical labour contracts': fixed-term, temporary and part-time). However, unemployment rates for women and youngsters are high and regional disparities remain important, with unemployment at 20.2 % in the south, 7.7 % in the centre and only 4.3 % in the north in October 2000. Regarding the labour market recommendations, a substantial increase in hiring flexibility has been achieved through further liberalisation of 'atypical' labour contracts (fixed-term, temporary and part-time contracts). However, no measure has been taken to increase flexibility on the exit side (dismissal cost and procedures) for permanent workers. Little has been done to reform the unemployment benefit system. Thus, it continues to be the most fragmented and unequal in the EU. One of the main instruments for more active labour market policies and for a better matching of labour supply and demand, the system of local public employment centres, is undergoing a radical reform. But the speed of implementation of this reform is somewhat slow in the geographical areas where unemployment is higher. Labour market problems continued to have a strong regional dimension, but the lack of agreement among social partners has hampered a move towards a greater decentralisation of the wage bargaining system, which could help to address the persistently wide regional disparity in labour market performance. New relevant tax-cutting measures have been undertaken, leading to a further reduction in taxation on labour. Such measures concern primarily low and middle-income households. The incentive measures for the 'surfacing' and 'realignment ' of the hidden economy have been reformulated and extended.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Combine an improvement in the unemployment benefit system with an increase in the flexibility of employment protection legislation and a tightening of eligibility rules for pension and other benefit schemes. | Partial |
| • Continuing to enhance labour market flexibility and, in particular, efforts towards wage flexibility in line with labour productivity differences, in particular, across regions. | Partial |
| • Reduce taxation on labour, and monitor developments closely, especially the effect of temporary tax and social security contribution measures targeted at disadvantaged labour market groups and regions. | In progress |

The reform of the 'social shock absorbers' *(ammortizzatori sociali)* and employment incentives is being accomplished at a very slow pace and the approach is somewhat piecemeal. The level of coverage of the basic unemployment insurance has recently been increased (from 30 % to 40 % of the reference wage). The duration of the benefits for the unemployed over 50 years of age has been raised from six to nine months. The process of decentralisation and reorganisation of the public employment centres is still incomplete and this hinders the enforcement of the few existing eligibility criteria. No major change of the employment protection legislation for workers in permanent employment occurred in 2000. Eligibility rules for pension and other benefit schemes have not been tightened, while the review of the pension system is scheduled for 2001.

The removal of some restrictions on the application of 'atypical contracts' and the relaxation of other working practices agreed by the social partners at sectoral and firm level has increased labour market flexibility. In 2000, the recourse to temporary job contracts ('Treu law' — L. 196/1997) was extended to agriculture and the building industry, and to the public sector as well (up to 7 % of the staff). The use of temporary job contracts has also been allowed when recruiting low-skilled workers. As far as the degree of wage differentiation is concerned, it remains low and appears unable to compensate for productivity gaps among regions. Due to a lack of agreement among the social partners and within trade unions, no relevant change of the two-tier wage bargaining system took place in 2000.

Following the comprehensive tax reform of 1997, additional relevant tax-cutting measures were undertaken in 1999 and 2000 leading to a further, considerable reduction in labour taxation. The overall tax burden remains relatively high, but given the high level of public debt, it cannot be reduced rapidly unless further substantial expenditure cuts are undertaken.

*Table 4*

**Labour market indicators for Italy**

| | Italy | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 50.9 | 51.8 | 52.5 | 53.4 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 35.6 | 37.1 | 38.1 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 28.3 | 27.7 | 27.5 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | – 1.5 | 1.0 | 1.2 | 1.4 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 49.7 | 50.3 | 50.8 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 11.1 | 11.8 | 11.3 | 10.5 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 6.9 | 7.1 | 6.9 | 6.3 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 32.3 | 33.8 | 32.7 | 31.0 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 6.4 | 7.7 | 8.0 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 3.0 | – 1.8 | 1.9 | 2.6 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 3.5 | – 4.7 | 0.0 | – 0.8 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 3.2 | 0.4 | 0.5 | 1.5 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 43.5 | 37.5 | 37.0 | 36.3 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 44.4 | 44.1 | 43.0 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 47.0 | 54.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 35.0 | 36.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 9. Luxembourg

## 9.1. Economic developments and key policy issues

The economic performance of Luxembourg was outstanding throughout the 1990s, real GDP growing annually by 5.8 % on average; 1999 and 2000 were among the brightest years of the decade since GDP growth reached 7.5 % in 1999 and 8.5 % in 2000 according to preliminary estimates. The 2000 performance was mostly due to the dynamism of exports, which rose by almost 15 %. As a result, employment, which had already been dynamic in previous years, increased by about 5 % in both 1999 and 2000. As in previous years, this rapid rise in employment mostly benefited cross-border workers; their number increased by more then 10 % a year over the period 1998–2000, and they now represent about 30 % of the total labour force. The unemployment rate, which was already the lowest in the European Union, declined slightly further from 2.3 % in 1999 to 2.2 % in 2000. Growth should remain buoyant in 2001 but is not expected to repeat the exceptional rates recorded in 1999 and 2000.

However, some policy issues remain:

(1) recent developments in wages and prices raise some concern; and

(2) the national participation and employment rates are still relatively low, especially for women and older workers.

Price inflation accelerated in 2000, the HICP rising by 3.8 %, the second fastest increase in the European Union, against 1.0 % in 1999. Although this partly results from the very high weight of oil products in the Luxembourg price index, due to large purchases by non-residents (75 % of retail sales of motor-oil are estimated to be directed to non-residents), it also reflects to some extent acceleration in underlying inflation. Wages increased by 5 % in 2000, as against 3.1 % in 1999, as a result of the tightening of the labour market, of the acceleration in price inflation, translated to wages by the automatic indexation mechanism and of a relatively high wage agreement in the public sector.

Although registered unemployment is extremely low and Luxembourg is close to full employment, the national employment rate (excluding cross border workers) is slightly below the European average. It has been increasing only slowly in the latter part of 1990s, in contrast with a brisk domestic employment growth, since job creation has mostly benefited cross-border workers. Moreover, the employment rates for women and in particular for older workers, although they have improved very recently, are very low by European Union standards. A contributing factor to the low labour force participation rate is the relatively generous use of early retirement and disability schemes, but taxation on labour is low and will be further reduced in coming years. A low degree of lifelong learning efforts is also likely to discourage the full exploitation of the labour potential. The tightening of the labour market underlines the need to increase the use of labour resources.

## 9.2. Public finances

### Overall assessment

As a result of fast economic growth and buoyant revenues, the general government surplus reached 4.4 % of GDP in 1999. Expenditure rose by 9.1 % over the year, especially social benefits in kind due to the creation of the ‘dependency insurance’; investment kept increasing at a rapid pace, by 8.0 %. However, revenues increased even faster, especially indirect taxes. The general government surplus is likely to have increased further in 2000, as real GDP growth was even stronger than in 1999; moreover, despite the relatively high wage agreement in the public sector, the increase in public expenditure was probably slower than in 1999.

The Luxembourg authorities decided in 2000 on a large reduction in income taxes, which should be operated in

*Table 1*

**Economic developments in Luxembourg**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 5.0 | 7.3 | 5.0 | 7.6 | (8.5) (**) |
| Domestic demand | 3.7 | 5.5 | 2.4 | 11.3 | (3.2) (**) |
| Private consumption | 2.7 | 3.8 | 2.3 | 4.1 | (3.5) (**) |
| GFCF (Investment) | 4.6 | 10.5 | 1.5 | 26.7 | (0.6) (**) |
| Exports (G & S) | 4.5 | 10.5 | 9.9 | 7.9 | (14.3) (**) |
| Imports (G & S) | 3.1 | 9.3 | 8.3 | 11.2 | (10.5) (**) |
| Inflation (1) (2) | : | 1.4 | 1.0 | 1.0 | 3.8 |
| Compensation/employee (1) | 4.3 | 3.1 | 0.9 | 3.1 | 5.0 |

(**) Preliminary estimates (January 2001). *Source*: Statec.
NB: For other footnotes and sources see Table 1 for Belgium.

two steps, tax cuts amounting to 1.2 % of GDP in 2001 and to 0.9 % in 2002. Furthermore, the company tax also should be reduced in 2002. As a result of these tax alleviations, the general government surplus should decrease significantly over the coming years but will most probably remain widely positive. The appropriateness of such an expansionary fiscal impulse for a fast growing economy that is already at full employment might be questioned. However, potential overheating effects are in practice limited by the extreme openness of the economy (total imports amounted to 97.3 % of GDP in 1999). Moreover, despite recurrent and sizeable government surpluses and an extremely low public debt, taxes and social contributions had hardly declined in percentage of GDP in recent years.

## Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Monitor closely current government expenditures in order to facilitate the achievement of the budgetary objectives while making room for a reduction in the tax burden as planned in the updated stability programme. | Partly |
| • Combine the implementation of sound public finance policies with reforms, notably in the field of social security, that are needed in order to maintain the long-term viability of the system and prepare for the challenge of an ageing population. | In progress |

Public finances in the Grand Duchy are indisputably a paragon of healthiness. However, growth in public expenditure was rather fast in recent years: over the period 1995–99, general government current expenditure increased on average by 6.7 % per year and total expenditure by 6.5 %. Government expenditure probably again rose by more then 6 % in 2000. The 2001 budget foresees a rise in central government expenditure by 11.9 %. A part of this increase may be explained by impressive public investment plans, soaring by 29.5 %, but current expenditure is also expected to rise strongly (9.3 %). Due to high real GDP growth rates registered since the beginning of the 1990s, strong increases in expenditures did not prevent their ratio to GDP from declining by about 2 percentage points between 1995 and 1999. Moreover, the even more rapid increase in revenues allowed the general government to record comfortable surpluses repeatedly and the public debt remained negligible. Thus, such a rapid increase in expenditure seems to be sustainable but, clearly, only as long as strong growth in the economy brings buoyancy in public revenues.

The recurrent surpluses recorded by Luxembourg mostly occurred in the social security sector, where they were

*Table 2*

**Trends in public finances in Luxembourg (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | 4.8 | 2.3 | 3.4 | 3.7 | 4.4 | 4.9 |
| — Current receipts | 51.8 | 47.9 | 47.2 | 47.3 | 47.3 | 47.4 |
| Tax burden (3) | 46.5 | 43.8 | 43.5 | 42.9 | 46.0 | : |
| — Total expenditure | 46.4 | 45.1 | 43.3 | 43.1 | 42.7 | 42.3 |
| Primary current expenditure | 40.0 | 39.5 | 38.2 | 37.7 | 37.7 | 37.0 |
| Interest payments | 0.3 | 0.3 | 0.3 | 0.4 | 0.3 | 0.3 |
| Investment | 5.4 | 4.6 | 4.3 | 4.6 | 4.5 | 4.7 |
| Primary balance | 5.2 | 2.6 | 3.8 | 4.1 | 4.7 | 5.2 |
| Government debt | 5.8 | 5.6 | 6.0 | 6.4 | 6.0 | 5.5 |
| Cyclically-adjusted balance | 2.8 | 2.3 | 4.3 | 5.1 | 4.8 | 4.3 |
| Cyclically-adjusted primary balance | 3.1 | 2.7 | 4.6 | 5.5 | 5.2 | 4.6 |

NB: For footnotes and sources see Table 2 for Belgium.

used to feed the reserves of the sector: as a result, the assets of the social security system amounted to 22.4 % of GDP in 2000 (of which 20.4 % for the general pensions regime) and should increase in coming years due to continuing projected surpluses. The Luxembourg authorities have commissioned the ILO to launch an in-depth study of the effects of population ageing on the pensions system, which should be available soon.

## 9.3. Economic reforms

### 9.3.1. Product markets

**Overall assessment**

Thanks to the openness of the economy, product markets are contestable and competition has generally been sufficient. Nevertheless, Luxembourg has in the past lagged behind in transposing internal market directives and in implementing competition reforms. Due to Constitutional problems, Luxembourg still lacks a legal framework permitting the creation of an independent competition authority. In 2000, however, the internal market transposition deficit was significantly reduced. In addition, the gas, electricity and postal sectors are in the process of being liberalised. The Luxembourg Institute for Regulation will in the future regulate these sectors as well as the telecommunications sector. On the other hand, different policies (including price regulation, regional aids, and the lack of power of the competition authority) continue to limit the degree of competition in product markets.

The development of the information society has accelerated aided by the rapidly evolving Internet and mobile telephony markets. The Luxembourg Government has contributed by permitting free market entry for Internet providers and the adoption of the 'Luxembourg' programme. As a result, Internet penetration has increased and remains above the EU average. ICT expenditures as a percentage of GDP are increasing as well but remain below the EU average. A number of patent applications per inhabitant that is well above the EU average, illustrates a significant involvement in R & D.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Speed up the transposition of internal market legislation. | ✔ |
| • Adopt a new competition law permitting a more efficient competition policy by the authorities, giving them the power to enforce EC Articles 81 and 82. | None |
| • Catch-up to the most recent developments in the information society. | ✔ |

The percentage of single market directives not yet transposed has been cut in half between 1998 and 2000. Moreover, a body has been created to monitor progress. However, in the area of 'establishment and provision of services', the European Commission has found it necessary to send five reasoned opinions.

A change in the law on prices, competition, and consumer protection is currently being prepared. This change would consist of three main elements:

(1) abolition of the system of fixed and monitored prices (nevertheless, to avoid sharp movements in prices in specific cases, the government would in exceptional cases be allowed to temporarily control prices);

(2) establishment of a new independent competition authority with powers in terms of inquiries and sanctions, which has been delayed due to internal constitutional problems; and

(3) more price and market transparency through better informed consumers.

The establishment of an independent competition authority is associated with the current move towards a more decentralised European competition policy. The newly established authority would be able to fully enforce EC Articles 81 and 82.

Luxembourg has made good progress in catching up with the developments in the information society. The 'Luxembourg' programme has been adopted as a follow-up to the Lisbon summit. Key domains of the programme are e-government, education and research, organisation of work, venture capital, electronic commerce, and access to infrastructures.

### 9.3.2. Capital markets

**Overall assessment**

Luxembourg's financial market is wide, mature and efficient. The 1999 law establishing pension funds should

*Table 3*

**Product market indicators for Luxembourg**

| | Luxembourg | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 63.5 | 65.2 | 50.2 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 46.1 | 48.1 | 50.8 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 8.0 | 11.2 | 22.6 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 0.7 | 1.1 | 1.0 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 6.2 | 5.7 | 3.2 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 2.05 | 1.94 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.15 (6) | — | 0.72 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 15.8 | 14.6 | 17.9 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 180.5 | 183.6 | 192.6 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 100.0 | 101.0 | 109.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 100.3 | 92.4 | 93.8 | 100.0 | 100.0 | 100.0 |
| — national calls | 17.5 | 20.9 | 25.0 | 100.0 | 100.0 | 100.0 |
| — call to US | 105.9 | 110.8 | 66.2 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 110.9 | 114.1 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 115.2 | 120.4 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 79.2 | 77.0 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 125.7 | 137.1 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.1 | : | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | : | : | : | 1.86 | 1.86 | : |
| Patent applications (12) | 196.0 | 285.6 | 293.6 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (16) | 4.9 | 4.9 | 5.4 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 26.9 (14) | 36.3 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

give it further boost, while the recent law on electronic commerce should stimulate the development of e-banking. Further to the merger between the French, Dutch and Belgian stock exchanges (Euronext), the Luxembourg stock exchange has signed with Euronext a cross-access agreement to replace the one it had since 1999 with Amsterdam and Brussels.

Further to the adoption in 1999 of the law establishing pension funds and to the creation of the first funds in 1999 and 2000, a new law has been tabled to clarify some points (e.g. regarding agreement of assets and liabilities managers) and to create the necessary framework for the future transposition of the projected EU directive on pension funds. Depositing, clearing and settlement are among the leading activities of the Luxembourg financial market. The government intends to further stimulate them by extending existing legislation (on securities, as well as depositories), strengthening depositors' rights, and softening rules regarding guaranties. Further to the opening by the European Commission, of an infringement procedure against Luxembourg for failure to transpose the directive on investor-compensation schemes, Luxembourg transposed the directive in July 2000.

### 9.3.3. Labour markets

**Overall assessment**

The Luxembourg unemployment rate is the lowest in the Union, but at the same time the national employment rate is relatively low. The Luxembourg labour market is highly dependant on cross border workers, who constitute about one third of the employed. The main challenge is to increase national labour supply. Regarding the labour market recommendation, the authorities have taken decisions to reduce taxation on labour in 2001 and 2002. The measures involved should result in a significant reduction in the taxation of labour, which is already the lowest in the Union. The introduction of parental leave with a guarantee of re-employment (in 1999) and targeted activation programmes have begun to produce results in terms of improved employment rates for women and older workers. A tri-partite working group, examining the possibilities of modifying the disability pension legislation with the aim of reducing the inflow into premature retirement, has not made progress in finding an agreement on measures to be taken.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Examine the tax-benefit systems with a view to removing disincentives which may discourage the participation in employment, and to continue efforts to increase the national employment rate, in particular that of women and older workers. | In progress |

The measures taken in recent years have begun to produce results in terms of employment rates of women and older workers, which increased, respectively, by about 3 and 1 percentage points in 1999. However, both of these rates, and in particular that for older workers (26.3 %), are still below the European averages. The announced tax reforms will encourage employment through a significant reduction of taxation on labour. In 2001, the marginal tax rates will be reduced by 2 percentage points and the lowest and the highest income tax brackets will be abolished. In 2002, the tax rates will be further reduced by 4 percentage points, bringing the highest tax rate to 38 %, the lowest maximum rate of income tax in the EU. These reductions are predominantly proportional. Low-wage earners will receive some additional benefit from the rise in the tax threshold, which will be set at a relatively high level. Thus, the room for targeted taxation measures for low-wage earners is narrowing.

*Table 4*

**Labour market indicators for Luxembourg**

| | Luxembourg | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 60.2 | 60.2 | 61.6 | 61.6 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 44.9 | 45.6 | 48.5 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 23.2 | 25.0 | 26.3 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 2.5 | 4.4 | 5.0 | 5.5 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 57.9 | 57.9 | 59.0 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 3.2 | 2.7 | 2.3 | 2.2 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 0.9 | 0.9 | 0.8 | : | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) (*) | 7.3 | 7.1 | 6.8 | 6.0 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | — | — | — | — | — | — | — | — | — | — |
| Nominal wage growth (1) | 4.1 | 0.9 | 3.1 | 5.0 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 2.8 | – 1.2 | – 1.6 | 1.1 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 1.6 | 0.6 | 2.4 | 2.2 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 12.6 | 12.0 | 10.7 | 10.9 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 28.9 | 29.5 | 30.0 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 90.0 | 87.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 85.0 | 82.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

(*) The youth UR figure shown for 2000, for Luxembourg, is the average of the seasonally adjusted monthly rates for Jan.–Nov. 2000.
NB: For other footnotes and sources see Table 4 for Belgium.

# 10. The Netherlands

## 10.1. Economic developments and key policy issues

The Dutch macroeconomic performance has been bright since the recession of 1993, real GDP growth exceeding 3 % in all years but one. In 1999, GDP rose by 3.9 % and by around 4 % in 2000, when activity remained very strong in the first half of the year and then slowed down moderately. However, consumer spending picked up in the fourth quarter, as households anticipated the increase in the standard VAT rate from 1 January 2001. Employment rose by 2.8 % in 1999 and by about 2,5 % in 2000. Consequently, unemployment kept declining, the harmonised Eurostat rate falling from 3.3 % in 1999 to 2.7 % in 2000. Real GDP growth is expected to decelerate mildly in 2001, sustained, however, by still dynamic domestic demand.

Strong increase in employment in the Netherlands is a remarkable achievement, but it also raises some policy issues as it contributed to:

(1) an acceleration of wages and prices, which clearly points to;

(2) the need to foster labour supply and to reform passive benefit schemes; and to

(3) promote productivity growth in the future.

Strong growth in activity and the resulting fall in unemployment have been reflected in a substantial acceleration in wages since 1997, which brought 15 years of wage moderation to an end, the rise in average compensation per head accelerating from 1.4 % in 1996 to probably more than 4 % in 2000. The result was a worsening of the external competitiveness of the Dutch economy following the very significant gains achieved in the 1980s and for most of the 1990s. However, the adverse trend in recent years had been partly offset until recently by the depreciation of the euro. As a result of growing tensions on the labour markets and a fast rise in import prices during the year, inflation accelerated in 2000. Consumer prices increased by 2.6 % as against 2.2 % in 1999 (measured by the HICP — the increase reached 2.3 % as against 2.0 % in 1999). An even sharper increase in prices is forecast for 2001 under the additional impact of higher indirect taxes, especially the increase in the VAT standard rate from 17.5 % to 19 %, implemented at the beginning of the year, as part of a wide-ranging tax reform.

Recent developments on the labour market illustrate the need to increase the labour supply. The official unemployment rate in the Netherlands is low (the harmonised rate was 2.7 % in November 2000). However, around 7 % of the labour force was receiving unemployment or social assistance benefits in 1999, while the number claiming labour disablement benefits has continued to rise to close to 9 % of the population aged 15–64. The Netherlands has pursued a wide range of measures with a view to reducing inactivity among certain groups, which has been reflected, for instance, in the strong growth registered in the employment rate for older workers, from 29.2 % in 1994 to 35.3 % in 1999. However, there are some doubts as to whether key reforms designed to address the high numbers in passive benefit schemes are being pursued with sufficient urgency. In addition, there remains much scope for tax and benefit reforms to lower marginal effective tax rates in order to remove disincentives to work additional hours.

In the same vein, increasing labour productivity is necessary, on the one hand to combat the recent deterioration in the competitiveness of the Dutch economy, and on the other to meet the challenge of an ageing population. Recorded productivity gains in the services have been relatively limited. While slow productivity growth in recent years for a large part reflected strong increase in employment, such an evolution is unlikely to continue, at least at the same pace, given the already very low rate of registered unemployment. Productivity growth should thus be promoted with a view to maintaining rapid and sustainable growth in the future.

*Table 1*

**Economic developments in the Netherlands**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 2.3 | 3.8 | 4.1 | 3.9 | (3.9) (**) |
| Domestic demand | 1.8 | 3.9 | 4.2 | 4.2 | (3.4) (**) |
| Private consumption | 2.3 | 3.0 | 4.4 | 4.4 | (3.7) (**) |
| GFCF (Investment) | 1.8 | 6.6 | 4.1 | 6.5 | (4.3) (**) |
| Exports (G & S) | 4.4 | 8.8 | 7.4 | 5.6 | (9.1) (**) |
| Imports (G & S) | 3.8 | 9.5 | 8.0 | 6.3 | (8.9) (**) |
| Inflation (1) (2) | 2.1 | 1.9 | 1.8 | 2.0 | 2.3 |
| Compensation/employee (1) | 3.1 | 2.2 | 2.8 | 3.0 | 4.2 |

(**) For 2000 preliminary estimates (February 2001). *Source*: CBS.
NB: For other footnotes and sources see Table 1 for Belgium.

## 10.2. Public finances

### Overall assessment

While at the beginning of 1999 the general government deficit was generally expected to rise that year, it actually turned into a surplus, which eventually reached 1.0 % of GDP as a result of faster than expected GDP growth. In 2000 the government surplus increased further. A major tax reform entered into force on 1 January 2001, the major feature of which is a shift from direct taxation of labour income to indirect taxation: households' income taxes and social security contributions were significantly reduced while several indirect taxes were increased, among which the standard VAT rate, which was raised from 17.5 % to 19 %. The ex ante loss of revenues is expected to amount to about 0.7 % of GDP. As a result, the general government surplus should significantly decrease in 2001 but will most probably remain positive.

The tax reform is welcome in principle: although it had already been significantly reduced and below the level in some neighbouring countries, the tax wedge on labour income was still too high, especially for low-skilled workers. The reform aims, by raising after-tax income, at increasing the difference between labour income and social benefits and, consequently, at making work more attractive for the lower paid and contributing to enhance labour supply. The appropriateness of the fiscal impulse which will result from the cut in income tax may be argued in a situation of already rapid economic growth and rising inflationary pressures. However, such an important increase in disposable income (which should raise in 2001 by nearly 10 % in nominal terms and 6 % in real terms) may constitute an incentive for wage-earners to moderate wage claims. Moreover, if the slowdown in economic activity forecast for 2000 turned out to be more pronounced than currently projected, the boost to disposable income and private consumption might well be less pro-cyclical than could have been previously expected.

### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Strengthen the envisaged budgetary position in 2000 and the following years, taking into account the government surplus already achieved in 1999 and current strong economic growth and possible inflationary pressures. | ✔ |
| • Monitor closely public expenditure in 2001 so as to ensure that the deterioration in the budgetary position, resulting from the loss of revenues due to the tax reform, remains limited and temporary. | (Concerns 2001) |

*Table 2*

**Trends in public finances in the Netherlands (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 3.1 | – 4.2 | – 1.1 | – 0.7 | 1.0 | 2.0 (*) |
| — Current receipts | 50.8 | 46.3 | 45.9 | 45.2 | 46.2 | (45.9) |
| Tax burden (3) | 45.8 | 40.6 | 40.7 | 40.4 | 41.7 | (41.4) |
| — Total expenditure | 53.9 | 51.4 | 48.2 | 47.1 | 46.5 | (45.4) |
| Primary current expenditure | 45.2 | 41.5 | 39.5 | 38.2 | 37.9 | (37.7) |
| Interest payments | 6.0 | 5.9 | 5.2 | 4.8 | 4.4 | 4.0 (*) |
| Investment | 2.0 | 3.0 | 2.9 | 3.0 | 3.0 | 3.2 (*) |
| Primary balance | 2.9 | 1.7 | 4.1 | 4.2 | 5.4 | 6.0 (*) |
| Government debt | 77.6 | 77.0 | 70.0 | 66.8 (*) | 63.2 (*) | 56.3 (*) |
| Cyclically-adjusted balance | – 2.5 | – 3.2 | – 0.4 | – 0.4 | 1.0 | (0.7) |
| Cyclically-adjusted primary balance | 3.5 | 2.7 | 4.8 | 4.4 | 5.4 | 4.6 |

NB: For footnotes and sources see Table 2 for Belgium.

The first recommendation has been implemented in 2000: provisional figures indicate that the general government surplus reached about 1.3 % of GDP (excluding the UMTS receipts which amounted to 0.7 % of GDP), significantly higher than in 1999. The central government deficit amounted to 0.4 % of GDP while the social security sector and the local authorities both recorded surpluses of respectively 1.5 % and 0.2 % of GDP.

The second recommendation concerned mainly 2001. It remains all the more valid currently, taking into account that the slowdown in activity forecast in 2001 might be more pronounced and, as a result, revenues might be less buoyant than previously expected.

## 10.3. Economic reforms

### 10.3.1. Product markets

**Overall assessment**

The Netherlands has for some time now been pursuing a policy geared towards improving the functioning of its product markets. A good effort is being made to remove obstacles to the Internal Market (e.g through the transposition of single market directives), to strengthen competition policy, to improve the regulatory environment and to encourage entrepreneurship. However, the value of tenders published in the Official Journal as a percentage of GDP remains relatively low. In light of continued problems in the energy sector and in the cable network, an increasing amount of attention is being devoted to improving the regulatory framework. A certain ‘reform fatigue’ is emerging and this might delay further liberalisation. Nevertheless, the Dutch government aims to introduce more market forces in parts of what it calls the ‘welfare’ (healthcare, education) and ‘public’ sectors (notably public transport, the postal services, water, waste, spatial planning). A discussion is ongoing on the respective roles and responsibilities of public and private agents in these sectors.

The telecommunication sector is fully liberalised, which has contributed to a high ICT penetration. However, the development of the ICT sector and the knowledge economy in general is held back by a shortage of qualified personnel and associated with that, a very low volume of local ICT research, which might also be reflected in a rather disappointing overall labour productivity growth rate.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Make further progress in enforcing the public procurement directives. | Partial |
| • Pursue regulatory reform and privatisation in network industries; in particular safeguard access to the cable network and speed up the transposition of internal market directives in transport. | In progress |
| • Take further measures to raise the involvement of the private sector in R & D and encourage technology transfer between public and private research. | In progress |

In the area of public procurement, all Community directives have been transposed and no reasoned opinions were issued between 1 September 1999 and 31 August 2000. Moreover, the Netherlands has implemented its own action plan for professional procurement and contracting out (PIA), which, amongst other measures, foresees the electronic publication in two years' time of all EU procurement contracts in the Netherlands. Nevertheless, the value of tenders published in the Official Journal as a percentage of GDP remains second lowest.

The Dutch liberalisation process has continued in the year 2000. Nevertheless, in the cable network sector there are a large number of disputes about the network tariffs against which the privately owned monopolistic cable companies give the service providers access to the cable network. Moreover, investments in innovative cable network services are being discouraged by the absence of a single standard decoder and by the large number of public bodies with powers to intervene in the cable network sector. The number of non-transposed directives in the area of transport was reduced from 8 in November 1999 to 6 in November 2000.

The Dutch Government has taken some measures to improve the innovative capacity of industry. In particular, NLG 465 million was set aside to strengthen the knowledge infrastructure by means of some 12 public–private cooperation projects and cooperation between large and small companies was encouraged. Nevertheless, R & D expenditures as a percentage of GDP are only slightly above the EU average, while labour market bottlenecks are increasingly hampering research and innovation.

### 10.3.2. Capital markets

**Overall assessment**

The development of the financial markets in the Netherlands has resulted in a fairly concentrated banking industry, and mature and competitive stock and risk capital markets. In September 2000, the Amsterdam Stock Exchange merged with the Paris Bourse and the Brussels Exchange to form Euronext.

In terms of the framework for regulation and supervision, cross-sectoral supervision has been further improved. While a memorandum of understanding (MoU) on supervisory issues has existed between the Netherlands Bank and the Insurance Board since 1990, a formal consultative body, the Council of Financial Supervisors, was set up in July 1999 as a forum in which the various financial supervisors (banks, insurers, securities) discuss cross-sectoral issues. The system is based on individual responsibility for sector-specific and for operational supervision and a shared responsibility for the regulation of cross-sectoral elements. Sectoral supervision arrangements will be supplemented by legislation which will enable the financial supervisors to impose specific requirements on holding and relevant group companies in the sphere of risk management and administrative organisations.

With a view to ensuring a good operation of the securities market, supervision of takeover bids will be transferred to the Supervision of Securities Transactions Foundation, while a complete review of practical rules regarding takeover bids is being prepared. Among the reforms, it is planned to introduce the mandatory bid on shares in

*Table 3*

**Product market indicators for the Netherlands**

| | Netherlands | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 52.8 | 52.0 | 53.3 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 36.6 | 35.8 | 36.1 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 7.0 | 9.8 | 9.5 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 8.5 | 9.4 | 9.0 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 3.8 | 2.8 | 2.5 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.05 | 1.19 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.40 (6) | — | 0.43 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 18.6 | 18.5 | 19.2 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 97.6 | 96.8 | 96.4 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 96.0 | 95.0 | 98.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 91.7 | 78.9 | 80.1 | 100.0 | 100.0 | 100.0 |
| — national calls | 44.8 | 39.5 | 42.7 | 100.0 | 100.0 | 100.0 |
| — call to US | 121.8 | 54.1 | 21.7 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 90.8 | 93.8 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 90.0 | 94.2 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 84.7 | 83.2 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 93.0 | 90.3 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.8 | 4.9 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 2.04 | 1.94 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 211.5 | 223.8 | 243.5 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 5.9 | 6.1 | 6.5 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 46.1 (14) | 54.8 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

order to protect the interests of minority shareholders. In this respect, various legislative proposals are under preparation to improve accountability by executive boards and supervisory boards and to strengthen the position of shareholders. Finally, in accordance with the FSAP, the Netherlands will abolish any remaining legal obstacles preventing the adoption of international accounting standards.

### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Concentrate its efforts on encouraging early stage investments. | In progress |
| • Give consideration to the examples of good practices put forward in the October 1999 Risk Capital Communication, in particular in the area of promotion of innovative employee ownership schemes, including stock options. | Partial |

Early stage investments, relative to GDP, were among the highest in the EU in 1999. However, they still represent only a mere 28 % of total venture capital investment and should be further encouraged.

Reforms have been engaged in several areas of the risk capital action plan, such as bankruptcy legislation (the Bankruptcy Act is to be modernised, with the view to increase the chances of survival for viable companies) or the stimulation of entrepreneurship (to support the creation of high-tech companies, the Netherlands is pursuing its policy of incubators and improving the tax system (e.g. reduction of corporate income tax for the lowest bracket); it is also going to adapt the eligibility conditions to the State-guaranteed loans in order to allow more starters to qualify). However, no measure promoting employee ownership schemes, and in particular stock options, has been reported.

### 10.3.3. Labour markets

**Overall assessment**

Robust employment growth continued during 2000, leading to a further reduction in official unemployment. However, this now seems to have little further room to fall as the strains of a tightening labour market become apparent. Regarding the labour market recommendations, the Netherlands has pursued its policy of continuous structural reforms to improve the functioning of the labour market, in line with the BEPGs and the employment guidelines. The 2001 tax reform and the work and care bill are notable recent features. The authorities have clearly recognised the principal problem facing the labour market: as the economy faces impending labour supply constraints, high rates of inactivity persist among certain groups. A range of tax/benefit and regulatory measures have been taken to address this issue, and reforms appear to be paying off in the form of high growth in the employment rates of women and older workers. There seems, however, to have been some reluctance to tackle head-on the problems with passive benefit schemes. The government has set up a commission to re-examine the problem of high and rising numbers on invalidity benefits, and are still considering whether a large segment of unemployment benefit recipients should be subject to any requirement to seek work.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue efforts to improve the tax-benefit system with a view to removing disincentives which may discourage participation in employment, in particular of women and older workers; pursue resolutely the efforts to reduce the high number of persons who remain outside the labour market supported by passive income support schemes. | In progress |

Several tax and regulatory measures have been taken to encourage labour supply among women and older workers. The 2001 tax reform is in part designed to alleviate unemployment and poverty traps and to improve work incentives, notably through the introduction of a tax credit for all workers, and the abolition of the tax-free allowance for inactive persons. A package in March 2000 included proposals to end favourable tax treatment of early retirement schemes, to prevent employees from losing accrued pension rights if they take a step back in their career and to extend the scope of a tax reduction scheme for hiring the long-term unemployed. Employers will have to pay 25 % of the unemployment benefits of employees laid off after the age of $57\frac{1}{2}$ (but hired before the age of 50). A comprehensive work and care bill, combining maternity, paternity and other leave schemes and measures aimed at expanding childcare facilities, has been proposed. In July 2000, the working hours (Adjustment) act, which gives employees the right under certain conditions to adjust their contractual hours upwards or downwards, entered into force. However, the number of people on invalidity benefits has increased further, leading the government to establish a high-level commission to re-examine the problem. In addition, the number of unemployment benefit recipients remains well over double the unemployment rate, largely owing to the fact that people aged 57½ and above are still not required to seek work in order to receive unemployment benefits. Such a condition is under consideration for those with 'genuine prospects' on the labour market.

*Table 4*

**Labour market indicators for the Netherlands**

| | Netherlands | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 63.8 | 69.4 | 70.9 | 72.7 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 52.7 | 58.9 | 61.3 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 29.2 | 33.0 | 35.3 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 0.5 | 3.0 | 2.8 | 2.7 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 51.0 | 55.2 | 56.3 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) (**) | 7.1 | 4.0 | 3.3 | 2.7 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 3.5 | 1.7 | 1.2 | : | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) (**) | 11.5 | 8.0 | 7.2 | 5.2 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 1.4 | 1.1 | 1.2 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 2.8 | 2.8 | 3.0 | 4.2 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 3.1 | – 0.2 | 0.4 | 0.3 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 3.6 | 1.0 | 0.9 | 1.6 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 35.9 | 33.2 | 34.1 | 35.4 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 39.2 | 40.2 | 40.5 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 82.0 | 85.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 86.0 | 92.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

(**) The unemployment rate and youth UR figures shown for 2000, for the Netherlands, are the averages of the seasonally adjusted monthly rates for Jan.–Nov. 2000.
NB: For other footnotes and sources see Table 4 for Belgium.

# 11. Austria

## 11.1. Economic developments and key policy issues

After a quite solid economic expansion in 1999, output growth in the year 2000 accelerated further and is estimated at around 3.3 to 3.5 %, with all demand components contributing. Private consumption, in particular, benefited from a major income tax relief, amounting to some 1 % of GDP in 2000. In addition, households' propensity to consume was underpinned by rising employment and rapidly declining unemployment, falling to its lowest level for the last eight years. Export growth — bolstered by further gains in competitiveness — was robust, thanks not only to the fast expansion of the world economy but in particular to the recovery of Austria's main extra-EU trading partners. In 2001 however, budgetary consolidation is expected to exert a drag on growth. Restrictive fiscal policy should curb not only public consumption but a series of tax measures will also affect enterprises and private households. Moreover, external demand is expected to slow down somewhat in step with the economic development of Austria's main trading partners. As a result, annual growth in 2001 should reduce speed somewhat. While wage settlements for 2001 compensate workers for their real term losses in 2000, they still remain fairly moderate and should thus not put Austria's cost-competitiveness at risk. Consumer prices have risen in 2000 due to external and domestic factors, namely the oil price hike and higher excise duties introduced in June 2000, but inflation remains at a fairly low level compared with the EU average. In 2001, inflation should ease as no import price pressures are projected and capacity constraints should be limited both in production and in the labour market (with the exception of the ICT sector).

While the shorter term outlook for the Austrian economy is rather favourable, the following key economic policy issues can be identified:

(1) sustainability of public finances in the medium and long term, in the light, namely, of the low employment rate of older workers;

(2) the level of competition in several areas; and

(3) the conditions for a rapid development of the knowledge-based economy are not fully in place.

Despite the ongoing budgetary consolidation programme, public finances are not yet on a sustainable footing in the medium and long term. In particular, spending pressure in the public pension system is bound to increase. Measures have been undertaken to make withdrawal from the labour market to take up early retirement and/or (general) pension benefits less attractive. However, in view of the relatively low unemployment rate and the ageing population, Austria still faces a major challenge to increase labour participation, in particular of older workers where the employment rate is well below the EU average. Moreover, the invalidity pension scheme, which might weaken the enforcement of early retirement rules, remains essentially untouched. In the health sector, spending has also increased rapidly and recent reforms do not seem to be sufficient to contain mounting spending pressures in this sector. Expenditure drift stems also from the size of the public sector in Austria. The number of public employees in administration, education and the healthcare sector more than doubled from 1964 to 1999, while in the entire economy, employment only grew by 15 %. Expenditure restraint in these areas would improve the sustainability of public finances. In addition, this should help to lower the high tax burden, in particular on labour.

A number of restrictions still hinder competition on Austrian product markets. First, there have been delays in the transposition of the Community's public procurement directives and the share of public calls for tender published in the Official Journal is relatively low. Second, despite plans to liberalise public utilities in the near future, the telecommunication, gas, electricity and transport sectors are still characterised by rigidities and high prices. Third, the enforcement of competition policy has so far been hampered by the lack of an independent competition authority able to open cases and bring them to the cartel court. Measures are envisaged to tackle some of these problems.

The conditions for a rapid transition to the knowledge-based economy are not fully in place. Spending on research and development in % of GDP is below the EU average. The same diagnosis can be made for ICT expenditure. Different initiatives have been launched, ranging from tax incentives for private R & D to raising public funds for universities and research. The significant shortage of ICT skills, which is expected to further increase in the coming years, may be a symptom of possible inefficiencies in the education system. Austria has announced several programmes to enhance its technology diffusion, promote e-business and e-learning, etc. to meet Lisbon's conclusions. The technology base is slim, which results in a structural current account deficit.

## 11.2. Public finances

### Overall assessment

Budgetary consolidation in the year 2000 was challenging due to two factors, the late adoption of the annual budget and an income tax relief, which needed to be financed. To meet the costs of the tax reform — more than 1 % of GDP from 2000 onwards — the government raised excise duties considerably. Helped by higher-than-projected growth and even excluding the proceeds from the UMTS auction, the deficit fell in 2000. For the years 2001 and beyond, the government plans substantial measures on both the revenue and the expenditure side, which should result in a sharp decline in the deficit. The government intends to reach a balanced budgetary position by the year 2002 but at the cost of an increase in the already high tax burden.

*Table 1*

**Economic developments in Austria**

| | 1992–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 2.0 | 1.3 | 3.3 | 2.8 | 3.5 |
| Domestic demand | 2.4 | 1.3 | 2.5 | 2.6 | 3.1 |
| Private consumption | 2.5 | 0.6 | 2.9 | 2.5 | 2.7 |
| GFCF (Investment) | 2.4 | 1.0 | 2.7 | 3.2 | 5.2 |
| Exports (G & S) | 3.9 | 9.9 | 5.5 | 7.6 | 9.6 |
| Imports (G & S) | 4.8 | 9.7 | 3.7 | 7.1 | 8.8 |
| Inflation (1) (2) | 2.6 | 1.2 | 0.8 | 0.5 | 2.1 |
| Compensation/employee (1) | 4.6 | 1.3 | 3.4 | 2.9 | 2.1 |

NB: For footnotes and sources see Table 1 for Belgium.

### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • As a minimum, achieve a better deficit outcome than projected for 2000. | ✔ |
| • Replace one-off measures taken in 2000 by permanent measures. | ✔ |
| • Implement the announced pension reform. | In progress |

In 2000, the general government deficit declined to 1.1 % of GDP according to the Spring 2001 notification with output growth estimated at some 3¼ to 3½ %. When the UMTS proceeds — worth 0.4 % of GDP — are excluded, the deficit amounts to 1.5 % of GDP. This outcome is in line with the high-growth scenario of the March 2000 update of the stability programme. The debt ratio fell by nearly 2 percentage points and in the light of the government's consolidation plans a downward trend now seems to be established. However, instead of substantial savings on the expenditure side, a sizeable increase in excise duties helped to finance the cost of the reform of income taxes and family assistance.

Contrary to the previous update of the Austrian stability programme, the December 2000 update of the stability programme covering the period 2001–04 does not rely on one-off measures to attain the envisaged budgetary targets.

A pension reform became effective in October 2000, gradually raising the age limit for early retirement. Given the particularly low average retirement age in Austria, currently some 58 years, focusing on the age limit for early versus regular retirement seems appropriate. While the PAYG system can be expected to remain the dominant pension scheme in Austria, current discussions relate to strengthening the second and third pillars. In this context, some steps have already been taken, such as introducing a tax allowance for investing in a private scheme. While this does not seem sufficient to provide a genuine incentive, future measures currently under discussion such as transforming the system of severance payments could pave the way to building up a funded pillar, which could, as a positive side-effect, also stimulate the listless Austrian capital market.

## 11.3. Economic reforms

### 11.3.1. Product markets

**Overall assessment**

Austria is becoming increasingly integrated into the European trading system, but its involvement in foreign direct investment and cross-border M & A activity remains below par. Austria has had a rather cautious approach to product market reform. Nevertheless, progress has been made in transposing single market legislation, even if in the areas of transport and public procurement a number of Community directives have not yet been transposed. The process of liberalising the network industries in Austria has started only in the past couple of years. In 2000, access costs to the telephony network came down by 40 %, an energy liberalisation act was passed by Parliament meeting the requirements of the internal market directive on natural gas, and the rail transport market regulation act entered into force. Further measures in the electricity and gas sectors were announced. If fully implemented, it is expected to help reduce the still high relative price levels and widen the choice for consumers. Efforts have been undertaken to improve the quality of public governance and enhance entrepreneurship. Shop-opening hours remain restricted. Finally, the enforcement of competition

*Table 2*

**Trends in public finances in Austria (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 4.2 | – 5.1 | – 1.7 | – 2.3 | – 2.1 | – 1.1 (*) |
| — Current receipts | 51.3 | 49.5 | 49.5 | 49.3 | 48.8 | (48.3) |
| Tax burden (3) | 43.2 | 42.7 | 44.9 | 44.8 | 44.4 | (43.9) |
| — Total expenditure | 57.9 | 57.2 | 53.8 | 54.2 | 53.6 | (52.0) |
| Primary current expenditure | 46.0 | 45.4 | 43.7 | 43.6 | 43.5 | (43.0) |
| Interest payments | 4.3 | 4.3 | 3.9 | 3.8 | 3.5 (*) | 3.6 (*) |
| Investment | 3.3 | 3.0 | 2.0 | 1.9 | 1.8 | 1.7 (*) |
| Primary balance | 0.1 | – 0.8 | 2.1 | 1.5 | 1.4 | 2.1 (*) |
| Government debt | 62.0 | 68.5 | 64.7 | 63.9 (*) | 64.7 (*) | 62.4 (*) |
| Cyclically-adjusted balance | – 4.4 | – 5.1 | – 1.2 | – 2.0 | – 1.9 | (– 1.7) |
| Cyclically-adjusted primary balance | 0.0 | – 0.7 | 2.6 | 1.8 | 1.7 | (1.8) |

NB: For footnotes and sources see Table 2 for Belgium.

policy should be improved by the creation of an independent competition authority, as agreed by the Austrian Government in January 2001.

Telecommunications prices in general and Internet access costs in particular are amongst the highest in the Union. Nevertheless, Internet penetration is rising rapidly. While a wide range of initiatives has been announced to facilitate the transition to a knowledge-based society, ICT expenditures as a share of GDP remain below the EU average. R & D expenditures (by the private sector in particular) are below average as well, but the government has announced a number of measures to address this problem.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Make further progress in the transposition of public procurement guidelines. | None |
| • Ensure effective competition in the energy and transport sectors. | In progress |
| • Take further measures to raise the involvement of the private sector in R & D. | In progress |

Two single market directives on public procurement still need to be transposed. Moreover, the 1999 value of calls for tenders published in the Official Journal as a percentage of GDP was even less than that recorded in previous years. An increased use of electronic media in the public procurement procedures is foreseen. A simplification of the legal framework guiding public procurement and the establishment of a federal procurement company are being discussed.

The Austrian Government aims to fully open the electricity sector by 1 October 2001. The main objectives of the reform are the access to the European market for all consumers, a cut in prices, the setting up of an independent regulator, the avoidance of cross-subsidies and the promotion of renewable energies. Similarly, the gas industry act should lead to free market access for all natural gas consumers by late 2002. Large consumers already have had access to the gas network since August 2000, allowing them to transport natural gas to cover their own needs. The 2000 Rail transport market act has created the legal framework for regulation in the rail sector. However, it is too early to assess the effects of these measures on competition.

The 2000 tax reform has increased tax allowances for research. The government has announced plans to increase public expenditure on R & D. In addition, a number of programmes are being carried out which aim to stimulate the production of innovative goods and services by the private sector (e.g. development of business angels networks under the Seed financing programme, technical and financial assessment of projects under the Tecnet programme, and the Tecma programme to enhance the marketing of R & D results). In spite of these efforts, the GDP share of business expenditures on R & D remains below the EU average.

### 11.3.2. Capital markets

**Overall assessment**

A number of reforms have been carried out to improve the regulatory framework for capital markets, including implementation of EU directives, and actions to combat money laundering. Further measures are planned in the context of implementation of the risk capital action plan as detailed below. The report on the reorganisation of the banking supervisory authority, which was expected at the end of 2000, has not yet been made.

Restructuring of the financial sector has led to an increase in the market share of the five largest banks and a further reduction in State holdings. The stock exchange has formed a strategic alliance with the Deutsche Börse with the aim of implementing the Xetra electronic trading system, and the two exchanges have jointly created Newex in cooperation with the relevant exchanges for the trading of central and east European securities.

*Table 3*

**Product market indicators for Austria**

| | Austria | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 30.4 | 31.6 | 32.7 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 20.7 | 21.8 | 22.2 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 1.1 | 1.4 | 1.4 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 2.5 | 1.7 | 3.0 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 4.2 | 3.7 | 2.9 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | | 1.47 | 1.26 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.40 (6) | — | 0.36 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 21.5 | 21.6 | 21.9 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 95.7 | 96.6 | 97.1 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 106.0 | 107.0 | 107.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 131.2 | 199.4 | 202.3 | 100.0 | 100.0 | 100.0 |
| — national calls | 182.1 | 129.2 | 154.8 | 100.0 | 100.0 | 100.0 |
| — call to US | 132.3 | 112.5 | 146.9 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 101.4 | 103.8 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 102.3 | 124.9 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 106.2 | 113.5 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 105.7 | 123.6 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 6.4 | 6.3 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 1.68 | 1.80 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 79.7 | 94.4 | 98.2 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 4.4 | 5.8 | 5.3 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 16.9 (14) | 38.0 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

A series of fiscal measures have been implemented or are planned to improve the functioning of financial markets. These include the abolition of the stock exchange turnover tax, changes to the inheritance tax on shares, and tax benefits under certain conditions for stock options.

While the private equity market and the use of guarantees are becoming increasingly important for financing innovation, and for the development and restructuring of SMEs, there remain significant structural weaknesses, for example in early stage financing. Total available risk capital as a proportion of GDP, remains significantly lower than in other Member States.

## Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Upgrade the supervisory framework, improve corporate governance. | In progress |
| • Develop fiscal incentives for equity and risk capital investments; implement the actions put forward in the 1998 risk capital action plan. | In progress |

Different measures related to the RCAP have been implemented: A prospectus in English will be allowed for security issues, with prospectuses available on the Internet, and there will be an extension of the scope of the exemption from the duty to publish prospectuses for euro securities. There has also been a reform of 'other security trading' in the stock exchange act. Furthermore, stock options are granted tax benefits under certain conditions, and the allowance for issue of employee shares will be doubled in 2001.

### 11.3.3. Labour markets

#### Overall assessment

Overall labour market performance is very favourable in Austria, and the already low unemployment rate has fallen further in 2000. However, the employment rate of older workers is persistently low. Where the labour market recommendations are concerned, the recent pension reform, effective from October 2000, provides for a stepped increase in the early retirement age. Furthermore, incentives for early retirement have been somewhat weakened, and disincentives to work for people drawing regular old-age pension benefits have also been reduced. A tax reform was implemented in 2000 to reduce the overall tax burden on labour. The net replacement rates for low wage earners are either at or below the EU average. Nevertheless, the unemployment insurance system is undergoing a reform to ensure a smooth transition from unemployment to employment. The maximum replacement rate was reduced, and the eligibility conditions for unemployment benefits were tightened. In addition, measures targeting specific groups (older workers, women, workers in seasonal occupations) were also introduced. Continued efforts to increase the labour participation of the elderly and to lower tax on labour are still warranted.

#### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
| --- | --- |
| • Rapidly implement the announced reforms on increasing the early retirement age and review benefit systems; accompany the pension reform measures by further measures targeted at older workers. | In progress |
| • Continue efforts to reduce the high tax burden on labour. | In progress |

There has been a reform of the statutory pension system to decrease incentives for early retirement. It includes a gradual increase in the early retirement age by a total of 18 months (56½ years for women, 61½ years for men) during the 2-year period starting October 2000, a penalty/reward for taking early retirement/postponing retirement (e.g., increasing the reduction factors applied in the calculation of pension benefit levels), and the abolition of early retirement due to reduced ability to work. Furthermore, a set of regulations accompanied by a reorganisation of active labour market programmes targeting older workers came into effect on 1 January 2000. The public employment service introduced allowances for elderly workers taking up part-time jobs. Reductions in employers' social security contributions as an incentive for hiring older workers (and handicapped persons) also entered into force in October 2000.

The tax reform in 2000 reduced the tax burden on labour by lowering income tax rates, and the size of the reduction is more pronounced at the middle to lower end of the income distribution. A reduction in non-wage labour costs of ATS 15 billion (about 0.6 % of GDP) per year is planned to take effect by 2003.

*Table 4*

**Labour market indicators for Austria**

| | Austria | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | : | 67.4 | 68.2 | 69.2 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | : | 59.0 | 59.7 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | : | 28.0 | 29.2 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 0.1 | 0.8 | 1.4 | 0.9 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | : | 62.7 | 63.0 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 3.8 | 4.5 | 3.8 | 3.4 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 1.1 | 1.3 | 1.1 | 0.9 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 5.7 | 6.4 | 5.1 | 4.4 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 1.8 | 1.7 | 1.5 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 3.5 | 2.8 | 2.0 | 2.1 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 1.7 | – 0.4 | – 0.3 | – 1.2 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 2.3 | 2.5 | 1.4 | 2.6 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 24.6 | 32.7 | 31.6 | 29.6 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 41.5 | 41.6 | 40.3 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 71.0 | 73.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 57.0 | 57.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 12. Portugal

## 12.1. Economic developments and key policy issues

The Portuguese economy is estimated to have grown by some 3.0 % in 2000, the same rate as the year before. However, the composition of growth has changed markedly. In particular, due mainly to slower growth in private consumption, domestic demand eased, while growth of exports of goods and services accelerated on the back of a firming external demand and a good year for tourism. The slowdown of domestic demand notwithstanding, the deficit in the trade balance widened to over 12 % of GDP, from some 10¾ % the year before, as the improvement in volume terms was by far outstripped by the deterioration in the terms of trade. In addition, the surplus on capital transactions declined from about 2½ % of GDP in 1999 to 1¾ %, reflecting to a large extent teething problems with the implementation of the third Community Support Framework (CSF), which was approved in April. As a counterpart, indebtedness of the private sector increased significantly. While this should act to dampen domestic demand in 2001, output growth is forecast to decelerate to some 2¾ % as a further improvement in net exports will not be sufficient to make up for the slowdown in the growth of domestic demand. In 2000, the rise in oil prices was only partially passed through to consumer prices, owing to the policy of stabilising prices, although inflation measured by the HICP rose from 2.2 % in 1999 to 2.8 % in 2000. Also, with unemployment approaching the levels corresponding to full employment, wages have increased by about 5 % in 2000.

After a prolonged period of real convergence, Portugal is expected to experience a spell of more moderate growth in the period ahead. Economic policy is faced with a number of key issues, namely:

(1) the widening external imbalance and the consequent risks for sustained economic growth;

(2) the use of budgetary policy for stabilisation purposes; and

(3) the overall competitiveness of the economy, involving, *inter alia*, wage and productivity developments.

The buoyancy of domestic demand in Portugal led to the accumulation of a large external imbalance in recent years. The gap between domestic demand and production was financed abroad by the private banking sector, which is estimated to have moved from a net creditor position towards the rest of the world of around 5 % of GDP in 1997 to a debtor position of close to 20 % at the end of 2000. Excessive demand conditions in the economy have also tightened the labour market, leading to nominal wage increases significantly above those in the euro area, thereby weakening external competitiveness. The correction of the large external imbalance via improvements in external competitiveness is a prerequisite for Portugal to return to higher levels of growth on a sounder footing.

In the current macroeconomic policy setting, the stabilisation role of budgetary policy is essential to correct excessive demand conditions. In fact, a fiscal tightening would have the desired effect of slowing down domestic demand and, hence, imports, thereby improving the current account. It appears, however, that in recent years, budgetary policy in Portugal has added to demand pressures rather than alleviate them. This is particularly evident as regards the very fast growth rates of government current primary expenditure, especially of healthcare spending and the public sector wage bill.

Average wages per employee in the whole economy are estimated to have risen by about 5½ % per year since 1996. These wage increases have only partly been offset by productivity growth, leading to a rise in unit labour cost for the total economy much above those in the eurozone. While, due to comparatively high productivity gains, the export-oriented manufacturing sector has largely escaped this deterioration in relative unit labour costs, there are, nevertheless, signs of an erosion of Portuguese overall price-competitiveness, such as a loss in export market shares in recent years. Eventually, continued high wage inflation will reduce capital profitability, lowering employment and growth rates.

In the period 1997–2001, labour productivity is expected to grow by a meagre $1^1/_2$ % per year in Portugal. There are various reasons for the low level and growth of labour productivity in Portugal. The rapid shift to the services sector in recent years, and more particularly to the public sector, has been one factor that has reigned in, at least statistically, the overall dynamics of productivity growth. More importantly, Portugal remains the country with the lowest level of educational attainment and vocational training in the EU. While the educational level of younger workers has improved considerably compared to the previous generation, it still lags far behind other Member States. There is also some evidence of inefficiencies in Portugal's relatively high expenditure on education. Low educational attainment also affects Portugal's ability to catch up with the knowledge-based society and embark on a path of sustainable knowledge-intensive growth. R & D expenditures are below the EU average and, despite the availability of fiscal incentives, the involvement of the business sector in R & D investment is limited. Moreover, the ICT penetration, while significantly improving over the recent period, is still below the EU average. All of this contributes to explain the poor innovative capacity of the Portuguese economy. The pursuit of higher levels of productivity is also constrained by the relatively low efficiency in the functioning of product markets, linked to insufficiencies in the current competition policy framework and the relatively slow pace of liberalisation and government control in key utilities. These factors constrain the unleashing of competitive forces on the market that would stimulate higher levels of competitiveness.

*Table 1*

**Economic developments in Portugal**

| | 1992–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 2.0 | 3.8 | 3.8 | 3.0 | 3.0 |
| Domestic demand | 2.4 | 5.4 | 6.2 | 5.0 | 3.7 |
| Private consumption | 2.5 | 3.1 | 5.9 | 4.8 | 3.0 |
| GFCF (Investment) | 2.6 | 14.4 | 9.1 | 6.4 | 6.0 |
| Exports (G & S) | 5.1 | 7.2 | 7.7 | 3.0 | 8.0 |
| Imports (G & S) | 5.7 | 10.0 | 13.8 | 8.5 | 8.4 |
| Inflation (1) (2) | 6.0 | 2.9 | 2.6 | 2.3 | 2.8 |
| Compensation/employee (1) | 7.9 | 3.7 | 3.7 | 5.3 | 5.4 |

NB: For footnotes and sources see Table 1 for Belgium.

## 12.2. Public finances

### Overall assessment

Budgetary consolidation in recent years owed much to the decline in interest payments. In fact, the primary government balance as a percentage of GDP worsened between 1996 and 1999 and, if proceeds from the sale of UMTS licences are excluded, improved only marginally in 2000. In the process, the ratios of primary expenditure and total revenue to GDP increased both by more than 3 percentage points between 1996 and 2000. In addition to its fast expansion, the composition of primary expenditure developed in an unfavourable way. While capital outlays expanded only moderately in terms of GDP, government consumption and social transfers increased significantly. Among these outlays, expenditure on healthcare and on the government's wage bill saw a particularly dynamic development. Underlying the fast rise in the government's wage bill has been, *inter alia*, a rapid expansion of government employment, totalling almost 9 % since 1998. While much of the growth in tax income has been achieved through a welcome broadening of the tax base and the combat against tax evasion and fraud, rate cuts with a view to making the tax system more conducive to growth have been very limited up to 2000.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • As a minimum, achieve the 1.5 % of GDP deficit target for 2000. | Partial |
| • Ensure that budgetary policy contributes to a more balanced policy mix. | None |
| • Approve before the end of 2000 the new basic law for the budget. | In progress |

Preliminary estimates indicate that the general government deficit target declined to 1.4 % of GDP. However, the deficit includes the proceeds from the sale of UMTS licences amounting to 0.4 % of GDP, which were not included in the original budget for the year 2000. Tax revenues fell short by some 0.5 % of GDP due to losses in excise taxes on petroleum products, as a result of the policy of limiting the pass through to final users of rises in crude oil prices. In addition, current primary expenditure grew by over 10 %, above budgetary plans, raising the corresponding GDP ratio by nearly 2 percentage points. The overrun of expenditure plans partly reflects insufficient control in the area of healthcare and the rapid rise in the wage bill.

Budgetary policy did not contribute to alleviate demand pressures in 2000. Primary expenditure continued to expand at a rapid pace; the deficit ratio, excluding UMTS licences, remained broadly unchanged when compared with 1999. The 2001 update of the stability programme maintains the budgetary targets set in the previous update:

(1) a reduction in the deficit ratio from 1.4 % in 2000 to a balanced budget in 2004; and

(2) an adjustment profile spread more or less evenly over the period 2000–04.

The deficit ratio is therefore not declining faster than foreseen when the 2000 BEPGs were issued.

A new framework law for pensions was approved, representing an important step towards a more sustainable system. However, the more generous regime for civil servants has not yet been incorporated into the general regime. The government is currently drafting the secondary legislation that will define the details of the reform of the pension system. A new Framework Law for the budget, initially due before the end of 2000 (i.e. in time for the 2001 budget) is now expected to be approved in the first quarter of 2001. This law aims to improve budgetary procedures, to enhance the control of budgetary execution, and to strengthen the role of auditing.

## 12.3. Economic reforms

### 12.3.1. Product markets

**Overall assessment**

The Portuguese economy is characterised by relatively low levels of productivity and competitiveness, which affect its prospects of structural convergence with the rest of the EU. With the view of improving productivity, during 2000, Portugal pursued efforts to improve the functioning of product markets. Progress was made in improving the operating environment for business by simplifying administrative procedures, upgrading public services for companies and modernising the public administration. Steps were also taken to improve access to public procurement, including the development of on-line procurement. Meanwhile, privatisation of State-owned companies continued, and the telecoms and electricity sectors were opened to competition. Despite the above progress, a number of problems continue to constrain the functioning of product markets. The implementation record of single market legislation, although improving, is still among the poorest in the EU; liberalisation of key network industries (such as electricity and gas) proceeds at a slow pace and government still retains control in some partially privatised utilities; the framework for competition policy enforcement is still not fully satisfactory in terms of power of initiative and independence of the competition authority; State aid, particularly sectoral and ad hoc aid, remains above the EU average.

*Table 2*

**Trends in public finances in Portugal (1) (2)**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 4.6 | – 4.0 | – 2.6 | – 2.3 | – 2.0 | – 1.4 (*) |
| — Current receipts | 40.4 | 41.6 | 41.7 | 41.6 | 42.9 | (44.9) |
| Tax burden (3) | 34.5 | 35.3 | 35.4 | 35.7 | 36.8 | (37.8) |
| — Total expenditure | 44.9 | 45.6 | 44.3 | 43.9 | 44.9 | (46.4) |
| Primary current expenditure | 33.4 | 34.2 | 33.9 | 34.1 | 35.1 | (36.9) |
| Interest payments | 6.2 | 5.4 | 4.2 | 3.4 | 3.2 | 3.1 (*) |
| Investment | 5.3 | 6.0 | 6.2 | 6.4 | 6.6 | (6.3) |
| Primary balance | 1.7 | 1.4 | 1.6 | 1.2 | 1.2 | 1.8 (*) |
| Government debt | : | 62.8 | 59.1 | 55.3 | 55.0 | 53.8 (*) |
| Cyclically-adjusted balance | – 3.9 | – 3.6 | – 2.5 | – 2.4 | – 2.2 | (– 2.1) |
| Cyclically-adjusted primary balance | 2.3 | 1.8 | 1.7 | 1.0 | 1.0 | (1.1) |

NB: For footnotes and sources see Table 2 for Belgium.

Portugal's transition towards the knowledge-based society gained impetus during 2000, particularly in the field of ICT. A wide range of government-supported initiatives were launched to promote ICT diffusion in all areas of work. Total ICT expenditures as a percentage of GDP increased significantly, reaching above EU average levels. However, due to the relatively late start of the catch-up and problems in the levels of educational qualification of the workforce, Internet and computer penetration remains below the EU average. Less visible progress was made in improving the R & D and innovative capacity of the Portuguese productive system. R & D expenditures from the public and particularly the private sector remained well below the EU average, despite the existence of fiscal incentives.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue efforts to improve the record in transposing internal market legislation, especially in transport. | In progress |
| • Reduce State aid and take action to bring competition law more in line with European Union legislation and to reinforce the independence of the Competition authority. | Partial |
| • Monitor the measures taken to simplify administrative procedures. | In progress |
| • Undertake further efforts to promote R & D and ICT diffusion. | In progress |

During 2000, progress was made in implementing single market legislation, including the transposition of transport directives. However, the transposition record is still the third worst in the EU.

Preliminary data for 1999 indicate that State aid has continued to decrease, but it remains above EU average as a percentage of GDP. In particular, sectoral and ad hoc aid in percentage of GDP remains among the highest in the EU. The enforcement of competition policy by national authorities remains not fully satisfactory with respect to the power of initiative and the independence of the Council for Competition. The government has reiterated its commitment to set up an independent regulatory authority for competition but there is no indication as to when this will be actually established.

Portugal continued the process of simplification of administrative procedures for companies and improvement of public services for businesses. An overall reform of the public administration is also under way. A simplified tax system was also introduced for self-employed and SMEs. The burden on businesses including SMEs appears to have been reduced, although there was no quantitative assessment of the impact of the reforms in terms of actual cost savings.

A wide number of programmes have been undertaken during the course of 2000 to promote ICT diffusion in business, education and public administration. The efforts to promote R & D were more limited and mainly consisted in the continuation of programmes launched in the mid-1990s. According to the Portuguese authorities, the provision of tax incentives to encourage private sector involvement in R & D has delivered some positive results, but there is no clear evidence of this. R & D was made one of the priorities for co-financing under the structural funds for the period 2000–06.

### 12.3.2. Capital markets

**Overall assessment**

The Portuguese financial system is undergoing rapid change, with the consolidation and conglomeration of institutions. New products are also being developed, particular in the field of e-banking. Several measures have been taken to strengthen the regulatory framework by tightening the rules governing general provisions, capital adequacy and large exposures. The Bank of Portugal is

*Table 3*

**Product market indicators for Portugal**

| | Portugal | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 27.8 | 28.4 | 28.5 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 21.7 | 22.7 | 22.8 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 1.8 | 2.0 | 0.4 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 1.1 | 1.3 | 1.3 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 5.6 | 4.9 | 4.4 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 2.18 | 2.13 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 1.19 (6) | — | 1.04 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 19.5 | 20.7 | 20.8 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 67.1 | 67.7 | 67.1 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 73.0 | 72.0 | 70.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 72.6 | 61.6 | 67.7 | 100.0 | 100.0 | 100.0 |
| — national calls | 152.0 | 142.0 | 144.4 | 100.0 | 100.0 | 100.0 |
| — call to US | 118.5 | 119.9 | 102.3 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 130.9 | 127.5 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 113.3 | 105.8 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | : | : | 100.0 | 100.0 | 100.0 |
| — industry users | : | : | : | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 5.6 | 5.7 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 0.63 | : | : | 1.86 | 1.86 | : |
| Patent applications (12) | 2.1 | 1.8 | 3.4 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 5.4 | 6.1 | 6.4 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 8.4 (14) | 18.1 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

also taking measures to strengthen the monitoring of banks' risk management processes and practices, and to enhance market discipline through more public disclosure. The creation of the National Council of Financial Supervisors should contribute to promote coordination among supervisors of the financial system and reinforce the supervision process notably with respect to conglomerates.

Protection of financial market users has also been improved through the implementation of several measures concerning information to be provided on securities investment funds, comparability of financial reporting, protection of pension funds contributors. A new securities market code entered into force in March 2000 with the objective of making rules more flexible and more in line with those applying to international markets. In this framework, the regime for the public sale of securities was reorganised.

The regulatory framework for the privatisation of the entities managing securities markets has also been set up. On that basis, the Lisbon Stock Exchange and the Oporto Derivatives Exchange merged in 1999 to create a single Portuguese securities market (BVLP) under private-sector ownership and management. This new legal framework should facilitate linkages and partnerships between markets. Indeed, BVLP now foresees a merger with Euronext to overcome the disadvantage of the small size and peripheral status of the Portuguese market.

The risk capital market has grown, however, the market remains among the smallest in Europe with venture capital investments below 0.05 % of GDP in 1999.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Make further efforts to develop venture capital. | Partial |

Several initiatives mainly based on public funding have been undertaken to facilitate SMEs' access to finance. These encompass the creation of an 'incentive system for small entrepreneurship initiatives', the creation of venture capital firms and the creation of the real estate management fund which aims at facilitating SMEs' access to finance through the use of their real estate as collateral. This fund benefits from a 50 % coverage of losses by the State. A tax reform is underway in Portugal since 1997 and will have a new impetus in 2001. However, it does not seem to provide for any explicit measures to reduce the relative cost of risk capital as compared to other financial instruments. No measure to ease regulatory constraints limiting the scope for institutional investment in risk capital has been reported.

### 12.3.3. Labour markets

**Overall assessment**

The Portuguese labour market continued to perform well in 2000, as evidenced by the currently low level of unemployment and an employment rate well above the EU average and close to 70 %. There have also been growing signs of labour shortages in some regions and sectors. On the labour market recommendations, progress has been made to enhance the cost-effectiveness of education spending and to improve labour force skills and competencies. However, the low level of educational attainment of the workforce remains one of the most serious structural problems. The use of ALMPs has been increasing. The benefit system is strictly integrated with the new, decentralised, public employment services, which are in charge of the enforcement of rather strict eligibility criteria. Some flexibility in the labour market has been achieved by the new laws on temporary jobs, part-time contracts, and the slight reduction of the costs linked to dismissals. However, EPL for permanent workers remains relatively strict. The social dialogue in order to modernise the work organisation and the functioning of the labour market has started to make some, albeit little, progress.

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Improve education and training; accompany this by an adequate benefit system to ensure incentives to participate in ALMPs. | In progress |
| • Pursue further labour market reforms, including the dismissal and job assignment rules and higher working time flexibility. | Partial |
| • Encourage partnership among social partners in order to modernise the labour market. | In progress |

In order to improve the quality of the education and training system, further initiatives were adopted during 2000 and some others are already planned, particularly in the context of the new community support framework 2000–06 and in the NAP. These measures are aimed to address some of the most problematic aspects of the education system and to enhance the adaptability and employability of the population groups most at risk of unemployment. As far as the benefit system is concerned, the social security and solidarity framework law adopted in July 2000 defines a new system of social protection based on three main pillars: a universal means-tested social protection based on the solidarity regime; family social protection; and a compulsory contribution-based system, financed by employers and employees, covering unemployment insurance and pensions. The government is now drafting the secondary legislation that will define the details of the reform of the social protection system. Within the framework law, some relevant changes to the pension scheme have been introduced, representing an important step towards a more sustainable system. Yet, the more generous regime for civil servants has not yet been incorporated into the general regime.

Although the law aimed at lowering the costs (severance payments) linked to dismissals, which was approved last year, slightly reduced the strictness of employment regulation, the degree of job protection for regular workers remains high. Some flexibility in the labour market has been achieved by the further liberalisation of temporary jobs and part-time contracts.

The government and the social partners have agreed upon a new tri-partite partnership approach to enhance adaptability and modernise the organisation of work. Contrary to the past, the new social dialogue will try to reach separate agreements on specific issues instead of seeking another comprehensive and multiannual concertation pact. Indeed, the new tri-partite dialogue is now focusing on four major issues (jobs and training, health and safety, social security, productivity, and income redistribution), but it has produced only minor results in 2000.

*Table 4*

**Labour market indicators for Portugal**

| | Portugal | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 62.9 | 66.8 | 67.4 | 68.1 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 54.1 | 58.3 | 59.6 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 45.8 | 50.5 | 51.3 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | – 1.0 | 2.7 | 1.8 | 1.5 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 61.0 | 63.8 | 64.6 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 6.9 | 5.2 | 4.5 | 4.2 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 3.1 | 2.2 | 1.7 | 1.7 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 15.0 | 10.6 | 9.0 | 8.9 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 2.4 | 2.1 | 1.5 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 5.6 | 3.7 | 5.3 | 5.4 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 3.9 | – 1.0 | 0.6 | 2.1 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 3.3 | 0.9 | 1.2 | 1.5 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 27.0 | 26.5 | 26.0 | 26.2 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 30.7 | 30.2 | 30.4 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 77.0 | 77.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 89.0 | 87.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 13. Finland

## 13.1. Economic developments and key policy issues

Output growth in Finland accelerated to 5.7 % in 2000 from some 4 % in 1999, spurred mainly by buoyant exports in the electronics sector. Domestic demand decelerated during the summer half-year of 2000 but picked up in the last quarter, reflecting a similar development of private consumption. Growth of exports increased strongly based on good price competitiveness and growth of export markets. In 2001, output growth is expected to decelerate moderately to some 4 % mainly due to lower export growth. Employment grew by 2 % in 2000. However, the unemployment rate decreased only slightly, suggesting structural problems in the labour market. Labour force participation has increased but remains below the levels of 1990. The labour market has tightened in recent years, as indicated by relatively high wage increases and an emerging wage drift. In 2000, nominal wages rose by an average of about 4 %. Linked to a reduction in labour income taxes the recently concluded wage agreement envisages a slowdown of the increase in contract wages from 3.1 % in 2001 to 2.3 % in 2002. Inflation was fuelled by rising energy prices and the depreciation of the euro against other major currencies but also by domestic factors, in particular high pay rises, rapidly increasing housing costs and mounting price pressures for certain services.

Despite the impressive recovery from the deep recession in the early 1990s and very favourable short-term prospects, the following key economic policy issues need to be addressed:

(1) the functioning of the labour market and the high level of structural unemployment;

(2) the long-term sustainability of public finances and the pension system; and

(3) achieving a higher degree of competition in industries where this remains insufficient as well as improving the efficiency in the public sector.

Despite a good employment performance, in particular in full-time equivalents, unemployment remains strikingly high, at almost 10 %. Prevailing unemployment is predominantly structural, as manifested by high unemployment rates among low-skilled and elderly workers. Moreover, regional differences are relatively large, especially in comparison with other smaller Member States. In addition, the labour market situation has been tightening in recent years, as indicated by relatively high wage increases and emerging wage drifts. Notably, there is a risk of an overheating labour market in the Helsinki area. With output growth concentrated in some sectors and areas, a rather slow labour market adjustment has contributed to a rise in the geographical and skill mismatch. The wage distribution being rather compressed, the centralised collective bargaining system provides little room for taking regional and sectoral differences in productivity developments into account.

These developments point to problems in the functioning of the labour market and in the underlying tax-benefit structure, which is characterised by relatively high taxation on labour, on the one hand, and generous benefit schemes, on the other. In recognition of this issue the government has embarked on a medium-term programme of reducing the high taxation on labour. It appears, however, that the reform is too little focused on low-wage earners where high marginal effective tax rates remain largely unaddressed. Moreover, despite the clear commitment of the authorities to taking measures to increase the effective retirement age, progress has been sluggish so far. Some recent decisions on the unemployment benefit scheme, in particular the increase in the replacement rate of unemployment benefits, appear to work against the goal of improving incentives to take up work. There is a need to support the structural reforms already undertaken by focusing on incentives in benefit schemes.

As budgetary consolidation is well advanced, the aim is now to safeguard the progress achieved and to put government finances on a sound footing in the long term.

With Finland likely to experience a significant deterioration in the old-age dependency ratio, further measures will be needed to avoid a drastic increase in the contributions rates in the pay-as-you-go financed part of the pension system. Reducing debt, as planned by the government, is an important step in making government finances more robust with regard to the forthcoming demographic shock. However, a low effective retirement age and participation rates, which are still below those observed in the early 1990s, do suggest further room for improvement also in these areas.

Finland has the third highest price level in the Union, 12 % above average, which is partly due to the combined effect of high living standards and barriers to competition owing to a peripheral location on the European continent. Particular competition problems are felt in housing markets, where prices have soared in many high-growth areas owing to supply constraints and weak competition in building materials. Related to this, competition in the distribution sector is sometimes affected by supermarkets having difficulties to locate sites for new shops. The competition also looks inadequate in the media sector as prices on books and journals in Finland are more than 40 % above the EU average. Along with the other Nordic Member States, the public sector is large in Finland, which warrants close monitoring to ensure that general administration, procurement, and the provision of services are conducted in the most cost-effective manner possible. In that regard, it is slightly worrying that the GDP-share of public procurement published in the Official Journal is 1.55 % in Finland compared with a European average of 1.83 %. The reluctance of some local authorities to comply with regulations poses a real challenge in opening up the market further to competition.

*Table 1*

**Economic developments in Finland**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 0.1 | 6.3 | 5.3 | 4.2 (*) | 5.7 (*) |
| Domestic demand | – 1.6 | 4.7 | 4.8 | 2.9 (*) | 2.5 (*) |
| Private consumption | – 0.1 | 3.5 | 5.1 | 3.7 (*) | 3.0 (*) |
| GFCF (Investment) | – 6.7 | 11.9 | 9.3 | 2.7 (*) | 4.8 (*) |
| Exports (G & S) | 7.6 | 14.1 | 8.9 | 7.1 (*) | 17.7 (*) |
| Imports (G & S) | 2.2 | 11.3 | 8.5 | 4.3 (*) | 12.8 (*) |
| Inflation (1) (2) | 2.4 | 1.2 | 1.4 | 1.2 (*) | 3.4 (*) |
| Compensation/employee (1) | 3.2 | 1.7 | 4.1 | 2.7 | 3.9 (*) |

NB: For footnotes and sources see Table 1 for Belgium.

## 13.2. Public finances

### Overall assessment

The government balance in Finland moved into surplus in 1998. Since then, surpluses have further increased, reaching 6.7 % of GDP in 2000. Combined with higher than projected proceeds from privatisation targeted for debt reduction, this made government debt fall rapidly. The updated stability programme aims at reaching surpluses above 4 % of GDP throughout the period 2000–03. The strategy is built on reducing government expenditure in relation to GDP while at the same time alleviating somewhat the high tax burden. The envisaged high surpluses appear justified by long-term concerns over the sustainability of public finances in the light of a marked ageing of the population in the coming decades and its implications for the pension system and health-related expenditure. However, the policy of debt reduction needs to be complemented by measures aimed at increasing the still low effective retirement age and labour market participation rates, which remain below those registered prior to the recession in the early 1990s.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Maintain the tight fiscal stance represented in the 2000 budget. | ✔ |
| • Continue to increase the government surplus. | ✔ |
| • Continue the reductions in the high burden of taxation on labour. | In progress |

The fiscal stance in 2000 remained firmly on the restrictive side. The government primary balance improved by 4½ % of GDP. However, the high inflation rate suggests that overheating risks have not abated so that budgetary policy needs to maintain its restrictive stance.

Despite the reduction in income tax rates providing tax relief equal to 0.6 % of GDP in nominal terms, revenues increased strongly, thanks to buoyant output growth. This resulted in a significant improvement of the government surplus despite the fact that current expenditure rose above target.

Despite their reduction in 2000, labour income taxes are still among the highest in the Union and ought to be adjusted with a view to supporting employment growth. The government has embarked on a medium-term programme of reducing labour taxes. Between 1997 and 2002, labour taxes should have declined by 2½ % of GDP in nominal terms.

*Table 2*

**Trends in public finances in Finland (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 7.3 | – 3.7 | – 1.5 | 1.3 | 1.8 | 6.7 (*) |
| — Current receipts | 54.3 | 53.2 | 52.3 | 51.8 | 51.0 | (50.9) |
| Tax burden (3) | 45.5 | 46.6 | 46.7 | 46.6 | 46.7 (*) | 47.5 (*) |
| — Total expenditure | 65.1 | 59.9 | 56.8 | 53.2 | 52.3 (*) | 49.7 (*) |
| Primary current expenditure | 53.9 | 49.7 | 46.4 | 43.3 | 43.6 (*) | 44.6 (*) |
| Interest payments | 4.5 | 4.0 | 4.3 | 3.6 | 3.1 | (2.8) |
| Investment | 2.9 | 2.8 | 3.2 | 2.9 | 2.9 (*) | 2.6 (*) |
| Primary balance | – 2.8 | 0.3 | 2.7 | 4.9 | 4.6 (*) | 9.2 (*) |
| Government debt | 57.3 | 57.1 | 54.1 | 48.8 | 46.9 (*) | 44.0 (*) |
| Cyclically-adjusted balance | – 1.8 | – 0.5 | – 1.0 | 0.7 | 1.0 | (3.0) |
| Cyclically-adjusted primary balance | 2.7 | 3.5 | 3.2 | 4.3 | 4.1 | (6.2) |

NB: For footnotes and sources see Table 2 for Belgium.

## 13.3. Economic reforms

### 13.3.1. Product markets

**Overall assessment**

High living standards and poor competition in several industries contribute to the high consumer price level in Finland. Competition, similarly, seems to be subdued or absent in certain areas of public procurement and public services. According to OECD indicators on business regulation, Finland's overall regulatory regime is reasonably lenient in an EU context, but it compares unfavourably with the other Nordic Member States, not least because the Finnish State wields great control of the business sector. By contrast, the transposition record for single market directives is excellent and State aids (excluding agriculture) are very low. Finland has also achieved substantial progress in liberalising and deregulating network industries, producing some of the lowest prices on both telecommunication and electricity.

Finland is well underway in the transition to the knowledge-based society with about 3 % of GDP spent on R & D, which is second-highest in the EU and higher than in the US. Two thirds of total R & D comes from the business sector, most of which is very successful judging from the country's strong record on patent applications and its buoyant high-tech exports. Finland may also very well be the most 'wired' country in the Union given its impressive ICT penetration rates. In a broader perspective, the early telecom liberalisation is frequently cited as one of the main contributors to the rapid growth in the manufacture of ICT products in Finland. The growth has, however, been so strong that concerns have been raised about the Finnish economy being overly susceptible to ICT developments.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Take further measures to strengthen competition in a range of sectors; consider reforming the competition law to give national competition authorities more powers. | Partial |
| • Further open up markets for public services. | Partial |

A working group has been formed to assess developments in market concentration and market integration, as well as address key issues in competition policy, but no specific action has been taken in the distribution sector as of yet. The competition authority has not been given the power to exercise Articles 81 and 82, but appropriate amendments to Finnish law are envisaged.

VAT regulations and inadequate cost accounting rules still discriminate against private companies in the provision of services, and the share of public procurement published in the Official Journal remains below the EU average, despite stiffer rules than required in the directive. Local authorities seem relatively slow to allow competition in procurement and public services.

### 13.3.2. Capital markets

**Overall assessment**

Finnish capital investment ratios are high compared to the EU average. Investment opportunities will further increase by new legislation, allowing the establishment of mortgage banks. Issuance of mortgage bonds will create an internationally recognised, low-risk, asset class previously not available to investors. The current review of pensions aimed at promoting competition in the statutory employment pension system could have a profound impact on the market as pension funds play an important role in the financial market. Regulatory reform has been aimed at developing the financial market and putting different investment vehicles on an equal footing. Taxation of various types of investment has been made more homogeneous and consistent. In terms of market infrastructure, measures have been taken to improve the efficiency in clearing and settlement. The planned introduction of an omnibus account system for shareholders should enhance the functioning of the stock market. The plan by the Helsinki Stock Exchange to transform into a public limited company could also help to increase the capacity of the exchange to adapt to changes in the market. Growth, technology and SME funds have emerged over the past year, which should improve the risk capital market in Finland. However, investment in emerging companies in new sectors is lagging behind comparable countries. The government is aware of this and has introduced some measures to improve the situation. Restructuring in the

*Table 3*

**Product market indicators for Finland**

| | Finland | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 29.8 | 29.7 | 28.7 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 17.3 | 17.9 | 17.5 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 2.0 | 19.3 | 2.2 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 3.1 | 2.5 | 3.3 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 0.9 | 1.7 | 1.3 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 1.47 | 1.55 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.08 (6) | — | 0.09 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 14.8 | 15.8 | 16.0 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 100.0 | 101.6 | 100.6 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 119.0 | 118.0 | 112.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 56.2 | 51.8 | 52.6 | 100.0 | 100.0 | 100.0 |
| — national calls | 39.5 | 47.1 | 58.1 | 100.0 | 100.0 | 100.0 |
| — call to US | 119.4 | 145.1 | 136.7 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 73.8 | 69.5 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 63.7 | 63.5 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 97.9 | 95.7 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 90.5 | 73.4 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 6.7 | 6.2 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 2.72 | 2.89 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 145.4 | 165.9 | 197.1 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 5.5 | 5.8 | 6.2 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 28.2 (14) | 43.5 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

banking sector has continued in 2000 with a merger between the Swedish-Finnish Nordbanken and the Danish Unibank, creating the largest financial institution in the Nordic region. To ensure efficient financial supervision, Finnish, Swedish and Danish financial supervisors have signed a cooperation agreement in relation to this cross-border institution.

### Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Efforts should be made to encourage investment by institutional investors in equity markets. | In progress |
| • Consideration should be given to the examples of good practice put forward in the Commission 1999 Risk Capital communication in the areas of legislation on bankruptcy and promotion of innovative employee ownership schemes. | Partial |

Progress has been made on promoting institutional investment in the equity market, with the introduction of a centralised book-entry system for equities and a planned introduction of an omnibus account system for shareholders. A reform of the bankruptcy legislation is in preparation, to be submitted to the Parliament in 2001, while no efforts to promote employee ownership schemes have been reported.

### 13.3.3. Labour markets

**Overall assessment**

Employment growth has been brisk for the six successive years up to 2000. Unemployment has also declined, but the pace diminished in 2000, leaving the unemployment rate disappointingly high. Dualistic labour market developments are manifested by disproportionately high unemployment rates among low-skilled, older workers and in some regions, while labour bottlenecks have emerged in other regions and certain sectors, pointing to continued structural problems on the labour market. Taxation on labour has already been reduced over the last three years and further cuts have been announced for 2001 and 2002. By contrast, there is still a long way to go in order to fulfil the government's objective: to raise the effective retirement age by 2–3 years in the long run. Only minor measures on pension schemes were implemented in 2000 in order to increase incentives for older workers to remain longer in employment. Progress concerning other benefit schemes is somewhat disappointing. As far as ALMPs are concerned, the increased early activation of unemployed people has resulted in a very high rate of activation (90 %), but has led simultaneously to a high non-compliance rate and high dead-weight costs. It has failed to reach half of those (10 % of all unemployed) flowing into long-term unemployment.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Review the overall benefit system. | Partial |
| • Pursue recent policy orientations to reduce the tax burden on labour. | ✔ |

A government working group has reviewed benefit schemes with the aim of increasing activation elements in the labour market support and social assistance schemes. Their proposals are directed at increasing cooperation between labour and social authorities in 2001 in order to enhance rehabilitation and activation measures for such persons. Some measures in pension schemes were implemented in 2000 in order to keep older workers longer in employment, including a reduction (about 5 %) in the level of the unemployment pension and a rise in the age limit (from 58 to 60) for the individual early retirement (disability) pension. However, these reforms are likely to have only minor effects. The recent collective agreement includes a decision to raise the level of earnings-related unemployment benefit in 2002, which will increase the gross replacement rate by 3 percentage points compared with the 2000 level; this measure runs contrary to the aim of improving incentives to take up work.

The 2000 personal income tax reduction accounted for FIM 2.5 billion in real terms (0.3 % of GDP), accompanied by a rise of corporate and capital income tax rate (from 28 to 29 %). This measure continued the path of reductions in the labour taxation undertaken in 1998 and 1999 (0.2 and 0.4 % of GDP). In addition, the government budget proposal for 2001 includes an income tax reduction of FIM 6.0 billion in real terms, (0.65 % of GDP). Furthermore, the government has agreed an outline tax reduction for 2002 as part of the wage agreement, with an impact of FIM 3.0 billion in real terms (0.3 % of GDP). These reforms will entail significant reductions in the tax burden on labour. However, essentially, the reductions remain proportional. Also the impact on the marginal effective tax rate, both on low wage earners and in general, will be very limited.

*Table 4*

**Labour market indicators for Finland**

| | Finland | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | : | 63.4 | 67.4 | 68.1 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | : | 60.5 | 64.6 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | : | 35.7 | 39.2 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | – 1.1 | 2.1 | 2.2 | 1.9 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | : | 60.0 | 63.5 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 16.6 | 11.4 | 10.2 | 9.8 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 6.2 | 3.9 | 2.9 | 2.8 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 34.0 | 23.5 | 21.4 | 21.4 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 4.4 | 4.1 | 4.0 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 3.1 | 4.1 | 2.3 | 4.1 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 3.9 | – 2.3 | – 0.1 | – 1.9 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 5.2 | 3.3 | 1.8 | 2.8 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 40.5 | 40.7 | 39.6 | 39.8 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 44.0 | 42.6 | 42.4 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 87.0 | 84.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 83.0 | 72.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 14. Sweden

## 14.1. Economic developments and key policy issues

In the first three quarters of 2000, GDP grew by 3.9 %, due to strong private consumption growth and robust exports. The labour market developed favourably in 2000. Employment grew strongly in 2000, with an impressive annual increase of 3.3 % in December 2000 and unemployment fell substantially in 2000 and was only 4.8 % in December 2000. This has been aided by moderate pay rises in recent years and the first wage agreements in industry in the current wage negotiation round suggest that wage moderation is likely to continue, despite the tighter labour market. Consumer price inflation has remained subdued and averaged a surprisingly low 1.3 % in 2000, despite the strong shifts in oil prices. Nevertheless, this may change as the economy is operating close to potential and supply-side constraints could result in higher inflation, given the tight labour market. However, towards the end of 2000, economic indicators suggest a slowing of growth. In particular, the international outlook has worsened, which affects Swedish exports adversely. Also, the sluggish developments in the stock market have affected consumers' confidence and growth of retail sales has been slowing, pointing to less encouraging private consumption growth into 2001. This suggests a further slowing of growth in 2001, which would also lessen the inflationary pressures.

While the indications are for continued good economic growth, there are several key policy issues that need to be addressed:

(1) the macroeconomic policy mix in an environment where output is close to potential;

(2) reforming the tax and benefit systems;

(3) the policy on labour market programmes and job creation; and

(4) achieving a higher degree of competition in industries where this remains insufficient as well as improving efficiency in the public sector.

Inflation in Sweden has been low since 1996 and the monetary framework, with explicit and credible inflation targeting, has aided this achievement. Although inflation rose to 1.3 % in 2000 (from 0.6 % in 1999), it remains below the inflation target. This achievement might seem somewhat surprising, as GDP growth has been robust since 1998 and real GDP growth has exceeded 3.5 % in each year. The tight fiscal stance in 2000, in accordance with the 2000 broad economic policy guidelines, has helped to keep inflation under control. However, a loosening of the fiscal stance in 2001 might not be appropriate when the economy is operating close to potential. Therefore, inflation developments need to be monitored closely in order to coherently, in terms of the overall macroeconomic policy mix, achieve the inflation target.

The tax burden is high in Sweden. In fact, Sweden has the highest tax burden in the Union on low-wage earners. Even after the measures already introduced in the 2000 and 2001 budgets, it will still remain well above the EU average. This might hamper an adequate labour supply in the medium term. Benefit systems also play an important role, as marginal effects arising from income-dependent benefits are substantial for many households. Marginal effects of the tax and benefit systems appear to be highest among low- and high- income earners. Efforts to diminish the distortionary effects for these groups would also help to alleviate the traditionally compressed wage structure in net terms in Sweden across skills groups, and so provide better financial incentives for people to work. The lowering of taxes and income tax in particular should be achieved within an appropriate fiscal stance, in line with the overall macroeconomic policy mix, as described above.

Around 2.5 % of the labour force participated in various active labour market programmes (ALMPs) in 2000, despite the improvement in the labour market. Various evaluations have called into question the efficiency of both supply-side and demand-side programmes. The labour market training programme has been shown to have very little or no positive effect on the participants' income and/or employment prospects. Employment creation measures have had much better results regarding the participants' employment prospects, but substantial displacement effects have limited the net effect on employment. In this context, one could question the appropriateness of expanding the number of persons enrolled in programmes towards the end of 2000, as open unemployment has fallen substantially and at the same time some sectors are experiencing labour shortages.

Sweden's geographical location in the EU and the country's low population density create natural barriers to competition, which contribute to pushing up the consumer price level. At 20 % above the EU average, government estimates indicate that half of the difference may be attributable to weak competitive forces. Though the Competition Authority is to have power to enforce Articles 81 and 82 of the Treaty, and despite efforts targeted at particular industries, competition still remains subdued in several areas, notably retail distribution, pharmaceuticals, construction, and transport. In pharmaceuticals, in particular, the challenge is all the greater, because of the government's decision not to dismantle monopoly protection for the State retailer. In railways and air transport, there is also scope for expanding competition. Moreover, the public sector in Sweden remains relatively large, which adds to the pressure on the sector to continuously increase efficiency. Appropriately, some new measures have been adopted including on-line access to public tenders and the use of benchmarking for comparing price and quality for public services. Notwithstanding these improvements, the opening-up of public procurement remains insufficient and there appears to be some variation in efficiency for public services, indicating that there is scope for further progress.

*Table 1*

**Economic developments in Sweden**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 0.7 | 2.1 (*) | 3.6 (*) | 4.1 (*) | 4.0 |
| Domestic demand | – 0.6 | 0.8 (*) | 4.3 (*) | 3.2 (*) | 3.6 |
| Private consumption | 0.0 | 2.0 (*) | 2.7 (*) | 3.8 (*) | 4.9 |
| GFCF (Investment) | – 3.3 | – 1.1 (*) | 8.5 (*) | 8.1 (*) | 6.0 |
| Exports (G & S) | 5.9 | 13.7 (*) | 8.4 (*) | 5.9 (*) | 9.4 |
| Imports (G & S) | 2.5 | 12.5 (*) | 11.2 (*) | 4.3 (*) | 9.2 |
| Inflation (1) (2) | : | 1.8 | 1.0 | 0.6 | 1.3 |
| Compensation/employee (1) | 4.9 | 3.8 (*) | 3.3 (*) | 1.3 (*) | 4.0 |

NB: For footnotes and sources see Table 1 for Belgium.

## 14.2. Public finances

### Overall assessment

The general government balance has been in surplus since 1998 and a surplus of 4 % of GDP was reached in 2000. The latest update of the convergence programme estimates continued surpluses higher than 3 % of GDP in the period 2001–03 on unchanged policies. The strategy of lowering the tax burden further is maintained and, conditional on the position in the business cycle in the latter two years, together with an assessment of inflationary pressures, decisions on further tax cuts (if any) will be taken according to the national budgetary process. The rule of a budget surplus of 2 % of GDP on average over the business cycle is maintained, which allows for further debt reduction, resulting in lower interest payments. This debt reduction is welcome and forms an important part of Sweden's medium-term fiscal policy.

## Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Tighten the stance of budgetary policy. | ✔ |
| • Maintain tight expenditure control this year and next. | ✔ |
| • Reduce further the tax burden. | In progress |

Despite strong GDP growth, inflation remained surprisingly low in 2000. The overall fiscal stance was tight, in accordance with the recommendation. The general government budget surplus increased from 1.7 % of GDP in 1999 to 4 % of GDP in 2000, which results in a stronger cyclically-adjusted budgetary position in 2000.

The expenditure ceilings on central government are likely to have been respected in 2000 and are expected to be so in 2001, although the contingency reserve has been narrowed slightly. This should result in a decline in the expenditure to GDP ratio in 2000 and 2001. However, some expenditure areas, such as healthcare, are a cause for concern. While expenditure on e.g. health-care tends to increase in times of high economic activity, measures should be taken to contain expenditure over-runs in all areas, in order to maintain the use of expenditure ceilings as a credible tool for multiannual budgetary planning.

The recommendation to lower the tax burden was implemented in 2000, and taxes, in particular income tax, were reduced by about 0.7 % of GDP. Further tax cuts, of a similar magnitude, are being implemented in 2001. Similar measures should be continued. Indeed, as the tax burden remains higher than in most other countries, efforts should be made to reduce the tax burden further, not least with respect to the continuing globalisation of the economy and its possible implications for tax base erosion as well as the need for Sweden to remain competitive. In this context, the overall impact of the tax and benefit systems on households disposable income and the marginal effects arising from these should therefore be considered explicitly in reforming the incentive structure for people to work. For example, the maximum day-care charge is a step in the right direction. However, further tax cuts and/or comprehensive reforms need to be implemented within an appropriate fiscal policy stance, given that the economy is operating close to potential as described above.

*Table 2*

**Trends in public finances in Sweden (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 11.9 | – 7.9 | – 1.8 (*) | 1.7 (*) | 1.7 (*) | 4.0 (*) |
| — Current receipts | 57.9 | 56.5 | 58.6 | 59.9 | 59.5 | (58.0) |
| Tax burden (3) | 48.3 | 47.8 | 51.6 | 52.4 | 52.4 | (51.1) |
| — Total expenditure | 73.0 | 67.9 | 63.5 | 61.2 | 61.1 | (57.7) |
| Primary current expenditure | 58.1 | 53.5 | 53.9 | 52.3 | 52.6 | (46.5) |
| Interest payments | 6.0 | 7.1 | 6.4 (*) | 5.8 (*) | 4.8 (*) | 4.3 (*) |
| Investment | 3.3 | 3.4 | 2.6 | 2.7 | 2.7 | (2.6) |
| Primary balance | – 5.9 | – 0.8 | 4.6 (*) | 7.9 (*) | 6.5 (*) | 8.3 (*) |
| Government debt | 75.1 | 76.6 | 73.0 (*) | 71.8 | 65.2 (*) | 55.6 (*) |
| Cyclically-adjusted balance | – 8.5 | – 7.4 | – 0.4 | 2.8 | 1.9 | (2.9) |
| Cyclically-adjusted primary balance | – 2.5 | – 0.2 | 6.4 | 8.9 | 7.4 | (7.0) |

NB: For footnotes and sources see Table 2 for Belgium.

## 14.3. Economic reforms

### 14.3.1. Product markets

**Overall assessment**

Compared with Denmark and Finland, Sweden appears to be more integrated with the international economy. Trade in goods is higher, and FDI inflows have been on an upward trend in the recent decade. While increasing economic integration may have produced some price convergence, the consumer price level remains second highest in the EU at 20 % above the average. This is partly due to high living standards and high levels of indirect taxes. The value of public procurement published in the Official Journal amounts to 2.7 % of GDP, which is almost 1 percentage point higher than the EU average. However, total public procurement is estimated to be worth more than 23 % of GDP. Competition is insufficient in selected markets such as retail distribution, pharmaceuticals, construction, and transport. Moreover, State ownership in the Swedish economy continues to loom large. On the other hand, Sweden has the second-best record in transposing single market directives, State aids (excluding agriculture) are very low, and there has been considerable progress in liberalising some network industries leading to benefits for consumers notably in the telecom and electricity sectors.

Sweden has the highest total expenditure on R & D in the EU, more than double the EU average and about 1 percentage point higher than in the US. Much of the R & D are, however, carried out by large companies in selected industries. Thus, to accelerate the spread of R & D in the economy, the government is planning an increase in public funding for R & D in the period 2000–03, and a new agency structure is being created to enhance cooperation and collaboration between research areas. Total spending on ICT is also higher in Sweden than in both the US and the rest of the Community, and diffusion rates are equally enviable. This indicates the existence of positive externalities from the country's relatively large ICT production. A recent surge in venture capital volumes and the spread of technology clusters are also strong indications of the presence of powerful ICT drivers in the Swedish economy.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Continue efforts to remove regulation that hinders or limits competition in retail distribution, construction and pharmaceuticals, give the Competition authority the power to enforce Articles 81 and 82 of the EC Treaty. | In progress |
| • Continue efforts to improve competition in railways and air transport. | Partial |
| • Pursue vigorously initiatives to enhance efficiency in public procurement and the provision of public services. | In progress |

Current block exemptions for retail chains are expected to be modified in 2001. The government has put off until 2001 any decisions on profit margins for the State monopoly in pharmaceutical retailing, but it remains committed to looking at ways to expand parallel imports. In the construction industry, a recently proposed bill contains measures to encourage residential building supply. The government has drafted a proposal for a new competition policy bill, giving the Competition Authority the power to enforce Articles 81 and 82 of the Treaty.

Market developments have further reinforced SAS' market dominance in air transport, but the Competition Authority has opened investigations into allegations about abuse of dominant position. SAS has appealed the decision. Only those segments of Swedish State Railway's passenger operations that were unprofitable have been opened to competition.

The government has adopted some of the measures proposed by the Public Procurement Committee, including

*Table 3*

**Product market indicators for Sweden**

| | Sweden | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 31.0 | 31.8 | 31.8 | 40.4 | 41.2 | 41.9 |
| Intra-EU trade to GDP ratio (%) (1) | 18.9 | 20.0 | 19.9 | 27.6 | 28.5 | 28.7 |
| FDI inflows (2) | 2.7 | 13.2 | 21.8 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 5.2 | 5.8 | 7.5 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 1.5 | 2.1 | 1.2 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | : | 2.48 | 2.68 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.60 (6) | — | 0.48 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 12.6 | 13.3 | 14.1 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 94.3 | 94.6 | 94.5 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 126.0 | 122.0 | 120.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 75.5 | 78.5 | 81.1 | 100.0 | 100.0 | 100.0 |
| — national calls | 38.4 | 36.1 | 33.6 | 100.0 | 100.0 | 100.0 |
| — call to US | 77.6 | 105.7 | 130.8 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 70.4 | 69.3 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 62.4 | 56.9 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 99.6 | 98.8 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 114.7 | 98.5 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 7.9 | 8.0 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 3.70 | 3.77 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 164.5 | 196.9 | 223.3 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 6.5 | 7.3 | 7.7 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 47.5 (14) | 53.8 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

facilities to allow tenders and applications for tenders, both below and above threshold values, to be submitted via Internet. Nevertheless, non-compliance with regulations on public procurement remains ‘non-insignificant’ at local level, indicating that there is still scope for improvement.

### 14.3.2. Capital markets

#### Overall assessment

The financial sector in Sweden has been characterised by continued banking sector consolidation, legislative and regulatory reform, technological development and growth in venture capital investments. A number of legislative changes were carried out in 2000 to improve conditions on the securities markets. Legislation was introduced clarifying the responsibility of insurance companies for financial stability as well as furthering competition and product development in the insurance industry. Rules were tightened regarding insider trading. Also, companies listed on the stock exchange were given the opportunity to buy back their own shares.

The Financial Supervisory Authority (FSA) has reorganised its activities in 2000 to adapt to the growing importance of financial conglomerates and to develop an overall view of the financial strength and risk situation in the financial sector. In October, a cooperation agreement was signed with its counterparts in Denmark, Finland and Norway, covering the entire financial sector. The reform of the pension system has continued this year with the introduction of a fully funded element where the individual himself can choose a fund manager. The new system has increased the demand for investment management services and increased the presence of foreign mutual fund companies on the Swedish market.

The venture capital market in Sweden grew substantially during the second half of the 1990s and is today one of Europe's most active markets. From having consisted of a few mostly government sponsored institutions, in August 2000 it comprised almost 200 private venture capital companies with total capital exceeding EUR 20 billion. Measures have been taken to provide a more favourable climate in general for venture capital providers, such as extending the possibilities for tax-free reserves aimed at building internal venture capital, and extending the period of tax respite for the allocation of capital from 5 to 6 years.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Facilitate access to risk capital. | In progress |
| • Consider the good practices of Risk Capital Communication in the areas of taxation, and promotion of innovative employee ownership schemes, including stock options. | No progress |

Progress has been made in promoting investments into companies not involved in high-tech business. In 1999, more than 60 % of venture capital investments were made outside the technology sector.

No efforts to improve bankruptcy legislation and promote employee ownership schemes have been reported.

### 14.3.3. Labour markets

**Overall assessment**

The labour market situation has improved markedly in recent years. Employment has increased by almost 2 % a year in 1998–2000, leading to a reduction of unemployment to 6 % of the labour force in 2000. On the labour market recommendations, several measures have been taken to reduce the tax burden on labour, even if it still remains well above the EU average. The initiatives were not targeted at those with a low take-home pay from work. However, the combined effect of an increased basic tax allowance and a ceiling on childcare fees (planned for 2002) will improve the incentives to take up a job. Efforts have also been made to tighten the conditions for access to unemployment insurance and to improve job placement. The matching process is also facilitated by the strong emphasis put on lifelong learning in Sweden. The comprehensive use of ALMPs appears to have minimised the discouraged worker effect and improved the employability of the unemployed in general. Various evaluations indicate an increasing need to target these programmes in order to minimise dead-weight losses etc. as demand for labour picks up.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Take additional measures to reduce the high tax burden on labour income. | In progress |
| • Further adapt the benefit and assistance schemes in order to clarify eligibility criteria; limit the benefit duration by activation policy, strengthen the administration and ensure efficient incentives to take up a job. | In progress |

A number of measures have reduced the tax burden on labour. The minimum income level for paying income tax to the central government (on top of the regular income tax paid to the local government) was increased, reducing the share of taxpayers paying State tax to 18 % in 2000 and 17 % in 2001. The new individual contributions to the pension systems were partly compensated, starting with a compensation of 25 % of the contribution in 2000 and a further 25 % in 2001. The tax credit to employers hiring long-term unemployed was extended (both in terms of coverage and the level of the tax credit for elderly long-term unemployed). The basic tax allowance will be increased from SEK 8 700 in 2000 to SEK 10 000 in 2001.

Eligibility criteria for unemployment insurance have been tightened in 2000 (in terms of occupational and geographical mobility), while benefit duration remains open ended. However, the new 'activation guarantee' will focus on those unemployed without regular employment for a long period of time. Additional resources will be devoted to reinforce job placement at the public employment service in 2001. Entitlement to childcare for all unemployed parents (in 2001), a ceiling on childcare fees (in 2002), and general pre-schools providing 3 hours free pre-school activities for all children (in 2003) have been proposed to improve the environment for working parents as well as for the unemployed trying to take up jobs.

*Table 4*

**Labour market indicators for Sweden**

| | Sweden | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | : | 68.6 | 70.6 | 72.2 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | : | 66.4 | 68.9 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | : | 62.7 | 64.6 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | – 0.8 | 1.3 | 2.3 | 2.0 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | : | 61.7 | 63.1 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 9.4 | 8.3 | 7.2 | 5.9 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 1.9 | 2.9 | 2.1 | 1.5 | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) | 22.0 | 16.6 | 13.6 | 11.3 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 1.6 | 2.1 | 2.0 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 4.8 | 3.3 | 4.1 | 4.0 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 2.4 | 0.3 | 2.1 | 0.7 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 4.9 | 1.7 | 1.4 | 2.0 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 39.3 | 44.4 | 44.4 | 42.8 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 49.3 | 48.7 | 47.8 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 85.0 | 84.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 78.0 | 77.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

NB: For footnotes and sources see Table 4 for Belgium.

# 15. United Kingdom

## 15.1. Economic developments and key policy issues

The development of the United Kingdom economy was more favourable in 2000 than in the years before. Growth is estimated to have been 3.0 % over the year, though the rate slowed in the second half of the year. Private consumption contributed strongly to growth. Despite GBP sterling being well above its levels of 1995, export volumes increased firmly, largely reflecting strong growth in UK markets, particularly the recovery in Europe. Employment growth was reflected in a further decrease in the already low level of unemployment. Subdued inflation and the prospects of a slow-down in US growth, produced a cut of $^1/_4$ percentage point in interest rates in February of this year following one year in which they had been held constant. Despite a fall in unemployment, wage growth remains moderate. The slow-down in growth in the second half of 2000 suggests that growth in 2001 may be slightly slower than in 2000, in fact due to a slow-down in external demand.

While the overall economic outlook looks positive, a number of challenges remain:

(1) a relatively low level of productivity;

(2) high concentration of unemployment in certain social categories; and

(3) low public investment.

While productivity has shown some signs of stronger growth in 2000, the level remains low compared with competitors. Factors related to product markets may contribute to this relatively poor performance. These include:

(1) weak competition in certain sectors of the economy such as car retailing, retail banking and some utilities and professional services;

(2) business R & D as a percentage of GDP declined during the 1990s and although this decline was reversed in 1999 it is too early to tell whether it is a long-lasting trend; and

(3) there has been insufficient investment in the past though in recent years business investment as a share of GDP has risen markedly.

The authorities have taken measures to address these problems such as strengthening the independence and powers of the competition authorities and promoting partnerships between universities and business; the challenge is that these and other measures subsequently taken, translate into higher productivity.

The performance of the labour market continued to improve in 2000. Unemployment came down by more than half a percentage point to 5.3 %, its lowest level for around 20 years. However, a remaining problem is the high concentration of unemployment in deprived communities and among certain groups, such as ethnic minorities and single parents. In around 16 % of households with at least one person of working age, no-one was in employment in spring 2000 — down from 19 % in 1996, but still among the highest rates in the EU. The key issue is whether the range of active labour market policies, centred on the New Deal, are sufficient to tackle the problems of social exclusion associated with remaining unemployment and inactivity.

Public investment fell to very low levels in recent years. The government has allocated additional resources to this, to more than double the share of net investment over the coming years. Nevertheless, public investment still remains low and indeed in 2000–01 the out-turn is expected to be lower than planned. The challenge will be to ensure that public investment rises as planned and makes a full contribution to economic growth.

## 15.2. Public finances

### Overall assessment

The general government balance was in surplus of 4.4 % of GDP in 2000 or 2.1 % of GDP excluding UMTS

*Table 1*

**Economic developments in the United Kingdom**

| | 1991–96 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Real GDP (1) | 1.8 | 3.5 | 2.6 | 2.3 | 3.0 (*) |
| Domestic demand | 1.4 | 3.8 | 4.6 | 3.7 | 3.7 (*) |
| Private consumption | 1.6 | 3.9 | 4.0 | 4.4 | 3.6 (*) |
| GFCF (Investment) | 0.4 | 7.5 | 10.1 | 5.4 | 2.3 (*) |
| Exports (G & S) | 5.6 | 8.6 | 2.6 | 4.0 | 7.4 (*) |
| Imports (G & S) | 4.1 | 9.2 | 8.8 | 8.1 | 8.9 (*) |
| Inflation (1) (2) | 3.5 | 1.8 | 1.6 | 1.3 | 0.8 (*) |
| Compensation/employee (1) | 4.4 | 4.4 | 5.1 | 4.5 | 4.0 (*) |

NB: For footnotes and sources see Table 1 for Belgium.

receipts. (The latter were equivalent to 2.4 % of GDP and will reduce debt, and debt interest payments significantly in future years). The latest update of the convergence programme estimates a surplus of 1.1 % of GDP in financial year 2000–01 (excluding UMTS receipts), a surplus of 0.6 % in 2001–02, close to balance in 2002–03 and deficits of around 1 % of GDP in the three subsequent years. Allowing for the cycle, the picture is very similar in an economy that is operating close to productive potential. The position shows bigger surpluses in 2000–01 and 2001–02 but bigger deficits in 2003–04 and 2004–05 than the previous convergence programme on which the 2000 BEPGs were based. The programme's outlook for the public finances could be over-cautious given that it is based on a very prudent assumption of trend growth of $2^1/_4$ % a year. Nevertheless the projections, as they stand, for the years 2003–04 to 2005–06 would not be in line with the prescription of the Stability and Growth Pact. The public finances look to be sustainable in the long term, on present policies, yet the government is alive to potential measures that may need to be introduced to alleviate the adverse affect of ageing on the population.

## Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Keep the underlying position of the government finances broadly unchanged. | Partially |
| • Pursue the policy of substantially raising the ratio of government fixed investment to GDP. | In progress |

The out-turn in 2000–01 (excluding UMTS revenues) is likely to show a significantly larger surplus, cyclically adjusted, as a percentage of GDP, than suggested in the previous update of the convergence programme, referred to in the 2000 BEPG. This is because of higher than expected cyclically adjusted receipts and lower than expected expenditure as described above. Further, the cyclically adjusted surplus in 2001–02, on current policies, is also likely to be larger than projected in the previous update. The position for 2002–03 is broadly unchanged. However, deficits some half a percentage point of GDP greater than those of the previous update, are now projected in 2003–04 and 2004–05. These rises in the deficit result mainly from an increased provision for public investment from the previous update. Nevertheless, should they occur, they would not be in line with the BEPG nor the Stability and Growth Pact.

The government, in its first comprehensive spending review, in 1998, provided for a doubling of net government investment, as a share of GDP, between 1998–99 and 2001–02. The second review, of 2000, took this process forward and made additional resources available to investment. The share is now expected to rise from a very low 0.4 % of GDP in 1999–2000, to 0.7 % in 2000–01 and to 1.7 % of GDP in 2003–04. In gross terms, which includes depreciation, the share relative to GDP is somewhat higher as is shown in the table below.

While, in net terms, some progress has been made, public investment, so far, is a little lower than originally planned and a challenge will be for the government to achieve its medium-term plans. Elsewhere, as stipulated in the recommendation, current expenditure is expected to remain under control as it has in recent years — underpinned by the comprehensive spending review with its firm three year allocations to departments. Nevertheless, total expenditure as a share of GDP is planned to rise very significantly from 37.5 % of GDP in 2000–01 to 39.1 % in 2003–04. While this projected rise results, in part, from the over-cautious trend growth assumption of 2¼ %, out-turns such as these, if they were to occur, would compromise the achievement of this broad economic policy guideline.

*Table 2*

**Trends in public finances in the United Kingdom (1) (2)**

| | 1993 | 1995 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Government balance | – 8.0 | – 5.8 | – 2.0 | 0.4 | 1.3 | 4.4 (*) |
| — Current receipts | 37.5 | 38.6 | 38.9 | 40.2 | 40.4 | (40.5) |
| Tax burden (3) | 34.7 | 36.2 | 36.4 | 37.9 | 38.0 | (38.2) |
| — Total expenditure | 46.9 | 45.8 | 42.0 | 40.7 | 39.9 | (36.8) |
| Primary current expenditure | 39.2 | 37.8 | 35.5 | 34.5 | 34.0 | (34.1) |
| Interest payments | 3.1 | 3.7 | 3.7 | 3.6 | 3.0 | 2.8 (*) |
| Investment | 2.1 | 2.0 | 1.2 | 1.2 | 1.1 | 1.3 (*) |
| Primary balance | – 4.9 | – 2.1 | 1.7 | 4.0 | 4.2 (*) | 7.2 (*) |
| Government debt | 47.8 | 52.1 | 51.1 | 48.1 (*) | 45.7 | 42.9 (*) |
| Cyclically-adjusted balance | – 6.6 | – 5.5 | – 2.2 | 0.3 | 1.4 | (2.0) |
| Cyclically-adjusted primary balance | – 3.5 | – 1.8 | 1.5 | 3.9 | 4.4 | (4.6) |

NB: For footnotes and sources see Table 2 for Belgium.

## 15.3. Economic reforms

### 15.3.1. Product markets

**Overall assessment**

The United Kingdom is open to international competition and is well advanced in terms of regulatory reform and liberalisation of the network industries. The economic environment is favourable to business and entrepreneurship with low levels of regulation and relatively low corporate tax rates. Recent reforms have been aimed at consolidating this good performance. For example, a small business service has been set up to help dismantle regulatory barriers to the growth of small businesses, independent regulators have been given reinforced powers (gas and electricity) and new regulators have been established (postal services). The UK's record in transposing single market legislation is also relatively good, even if further progress could be made to open up public procurement. Similarly, State aids (excluding agriculture) are among the lowest in the EU. However, the UK's relatively low level of labour productivity remains a problem and, as explained in Section 15.1, insufficient competition in some areas of the economy may be one reason for this. Some measures have been taken recently to tackle these problems.

The UK has a relatively good record on the transition to the knowledge-based economy. For example, ICT expenditure and the level of Internet access are both above the EU average, although the UK still lags behind the US on these measures. The government has set itself three targets in the area of ICT: to improve the environment for e-commerce; to provide Internet access for everyone who wants it by 2005; and to provide all government services on-line by 2005. Recent progress includes the UK's Electronic Communications Act 2000, which should facilitate e-commerce through the increased use of electronic signatures, and by July 2000 a third of government services were already on-line.

Both the UK's total and business R & D expenditure as a percentage of GDP are around the EU average. Business R & D after declining during the 1990s, increased in 1999. Several measures have been taken to encourage more R & D investment such as a new science research investment fund, encouraging universities to work more effectively with business and an R & D tax credit for SMEs. Recent measures to improve the level of skills have included an investment programme for ICT in schools and free training in basic ICT skills for the unemployed.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Monitor and reinforce the effectiveness of measures to tackle the problems of declining R & D efforts, low innovation intensity, skill shortages and the high failure rate of SMEs. | ✔ |
| • Develop a long-term plan for transport. | ✔ |

A number of measures have been taken to tackle the problems of declining R & D efforts, low innovation intensity, skills shortages and the high failure rate of SMEs. Measures to stimulate R & D and innovation include a new Science Research Investment Fund and schemes to encourage universities to work more effectively with business. The decline in business R & D as a percentage of GDP was reversed in 1999, however it is too early to tell whether this is a long-lasting trend. To tackle skill shortages, the UK Government is investing GBP 1 billion in ICT in schools over the next three years. Measures to help SMEs have included an R & D tax credit of 150 % and the establishment of a small business service (SBS) to act as a single 'gateway' in delivering services to SMEs. However, it is too early to judge the effectiveness of these measures.

The UK Government published its long-term strategy for transport policy 'Transport 2000: the 10 Year Plan' in July 2000. To tackle road congestion the strategy envisages an improvement of the road infrastructure. Road traffic congestion is now predicted to fall by 5 % by 2010 compared to previous projections of 15 % growth. The strategy also plans increased investment in the railway network to allow for an increase in passengers and freight transport. Other plans to improve public transport include up to 25 light rail lines in urban areas, more integration of different forms of transport and applying modern technology more widely. The strategy expects total investment to increase by 75 % in real terms in the next 10 years, compared with the previous 10 years. The capital investment is to be delivered through partnerships between the private and public sector.

### 15.3.2. Capital markets

**Overall assessment**

Financial markets in the UK remain the most developed in the EU. The Financial Services and Markets Act, expected to come into force in 2001, will further promote a level playing field among financial institutions by creating a single regulator — the Financial Services Authority. Actions to help consumers include the provision by the FSA from mid-2001 of comparative information on a variety of financial products; and the introduction in April 2001 of stakeholder pensions for people who have not previously had access to funded pension schemes.

The government has followed up on the Cruickshank banking review with measures that aim both to improve competition and to bring benefits to consumers. These

*Table 3*

**Product market indicators for the United Kingdom**

| | United Kingdom | | | EU-15 | | |
|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 1997 | 1998 | 1999 |
| Total trade to GDP ratio (%) (1) | 22.3 | 21.1 | 20.7 | 21.3 | 21.7 | 21.7 |
| Intra-EU trade to GDP ratio (%) (1) | 12.2 | 11.7 | 11.5 | 12.6 | 13.0 | 14.1 |
| FDI inflows (2) | 2.5 | 3.1 | 9.6 | 1.9 | 3.1 | 5.8 |
| Cross-border M & A share (3) | 28.6 | 28.0 | 24.0 | 100.0 | 100.0 | 100.0 |
| Single market transposition deficit (4) | 2.1 | 2.8 | 2.7 | 14.9 | 12.6 | 12.6 |
| Public procurement tenders in the OJ (5) | | 3.04 | 2.73 | : | 1.80 | 1.83 |
| Sectoral and ad hoc State aids | 0.37 (6) | — | 0.28 (7) | 0.83 (6) | — | 0.67 (7) |
| Business investment (5) | 15.5 | 16.2 | 16.6 | 17.2 | 17.6 | 17.9 |
| Labour productivity (8) | 93.5 | 94.1 | 94.8 | 100.0 | 100.0 | 100.0 |
| Relative price levels (9) | 104.0 | 108.0 | 108.0 | 100.0 | 100.0 | 100.0 |
| Prices in telecommunications (10) | | | | | | |
| — local calls | 176.4 | 162.6 | 165.0 | 100.0 | 100.0 | 100.0 |
| — national calls | 68.5 | 73.6 | 88.1 | 100.0 | 100.0 | 100.0 |
| — call to US | 56.3 | 76.5 | 94.7 | 100.0 | 100.0 | 100.0 |
| Electricity prices (10) | | | | | | |
| — households | : | 72.3 | 72.0 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 98.0 | 97.5 | 100.0 | 100.0 | 100.0 |
| Gas prices (10) | | | | | | |
| — households | : | 88.7 | 80.7 | 100.0 | 100.0 | 100.0 |
| — industry users | : | 87.2 | 101.0 | 100.0 | 100.0 | 100.0 |
| Education expenditure (11) | 4.7 | 4.7 | : | 5.4 | 5.5 | : |
| R & D expenditure (5) | 1.84 | 1.82 | : | 1.86 | 1.86 | : |
| Patent applications (12) | 67.8 | 67.2 | 69.7 | 89.1 | 101.1 | 111.2 |
| ICT expenditure (5) | 6.4 | 6.2 | 6.6 | 4.9 | 5.2 | 5.6 |
| Internet access (13) | — | 24.4 (14) | 40.9 (15) | — | 18.3 (14) | 28.4 (15) |

NB: For footnotes and sources see Table 3 for Belgium.

measures include planned legislation to open up access to payment systems and to oversee access charges, a review of self-regulatory codes to see if they deliver sufficiently strong consumer benefits, and reforming the Treasury's objectives on promoting competition in financial services.

In 1999 there was a significant increase in private equity invested compared to 1998, with a shift to technology sectors. Greater policy attention has been paid to increasing equity flows to the early stage of development and a number of fiscal and financial regulatory reforms have been introduced. These include changes in the capital gains tax treatment of investment in business assets, reduced restrictions on small higher-risk companies raising capital under the tax-advantaged enterprise investment scheme, and help for smaller companies to promote investment opportunities to 'business angel' investors. In addition, the government is promoting public private partnerships to improve the supply of small scale and early-stage risk capital across the country. These include the UK high technology fund, and the creation of a network of regional venture capital funds.

## Implementation of the 2000 BEPGs

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Analyse the reasons which prevent pension funds from investing in venture capital, and take actions to stimulate this investment. | In progress |

This issue is being examined in the Myners Review of institutional investment that will report in early 2001. The interim conclusions were that the minimum funding requirement applied to pension funds is seriously inadequate and should be replaced on the grounds that it distorts asset allocation and does not provide necessary or effective protection for investors.

### 15.3.3. Labour markets

**Overall assessment**

The impressive labour market performance of the United Kingdom has continued, with unemployment falling to a 20-year low in 2000. Employment growth is now beginning to ease slightly, with some indications of a tightening labour market, even though there has been little reduction in economic inactivity. Regarding the labour market recommendations, the UK has continued to pursue its policies of comprehensive tax and benefit reforms designed to 'make work pay', and a range of active labour market measures centred on the New Deal. In the context of a good overall labour market performance, problems of social exclusion associated with the high concentration of remaining unemployment and inactivity stand out. The UK authorities have clearly recognised and addressed these issues with a range of measures targeted at deprived areas and particular social groups, as well as a reinforcement of the preventive approach against long-term unemployment.

**Implementation of the 2000 BEPGs**

| *Country-specific recommendations in the 2000 BEPGs* | *Degree of implementation* |
|---|---|
| • Pursue efforts to address the problem of concentrated unemployment in deprived areas and communities; reinforce the preventive strategy against long-term unemployment. | ✔ |

Efforts to tackle concentrated unemployment and jobless households have been pursued. Notable initiatives include the existing employment zones scheme and the recently launched action teams, which aim to identify suitable vacancies in neighbouring areas for unemployed and inactive people. Further extensions to the New Deal for lone parents (NDLP) have been announced, with a view to tackling the low employment rate in this group and the consequences for child poverty. From autumn next year, the NDLP will be available to all lone parents who are not working or who work fewer than 16 hours per week, even if they are not eligible for income support. From April 2001, those on income support with children over the age of five will be required to meet a personal adviser to discuss the opportunities available to them. The national childcare strategy, detailed in the UK national action plan for employment (NAP), aims to significantly increase the number of affordable childcare places. As previously announced, the preventive strategy against long-term unemployment has been reinforced, and the threshold for more intensive action under the New Deal for the over-25s has been reduced from 24 months to 18 months, although there are no plans to bring this down to 12 months. According to the UK NAP, 9 % of job-seekers allowance (JSA) claimants (the figure would be higher in terms of ILO unemployment) are still unemployed after 12 months, so there may still be room for improvement in the implementation of the preventive strategy. On the other hand, the UK does have one of the lowest rates of long-term unemployment in the Community. In addition, while active measures can play a key role in tackling exclusion and matching labour supply and demand, intensive active measures may not necessarily be a cost-effective strategy for all JSA claimants.

*Table 4*

**Labour market indicators for the United Kingdom**

| | United Kingdom | | | | EU | | | US (5) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1998 | 1999 | 2000 | 1994 | 1999 | 2000 | 1994 | 1999 | 2000 |
| Employment rate (ER) (1) | 67.7 | 70.2 | 70.6 | 71.2 | 59.0 | 62.1 | 63.3 | 72.0 | 73.9 | : |
| Female ER | 61.1 | 63.2 | 63.9 | : | 48.4 | 52.6 | : | : | : | : |
| Older workers ER | 47.4 | 48.3 | 49.4 | : | 35.0 | 36.9 | : | : | : | : |
| Employment growth (1) | 0.7 | 1.2 | 1.3 | 0.9 | – 0.1 | 1.6 | 1.7 | 2.3 | 1.9 | 1.5 |
| ER full-time equivalent | 58.3 | 60.3 | 60.8 | : | 54.5 | 56.7 | : | : | : | : |
| Unemployment rate (UR) | 9.6 | 6.3 | 6.1 | 5.5 | 11.1 | 9.2 | 8.4 | 6.1 | 4.2 | 4.0 |
| Long-term UR | 4.3 | 2.1 | 1.8 | : | 5.3 | 4.2 | 3.8 | : | : | : |
| Youth UR (< 25) (**) | 17.0 | 13.6 | 13.0 | 12.4 | 22.0 | 17.9 | 16.4 | 12.5 | 9.9 | 9.3 |
| Regional unemployment variation (2) | 2.2 | 3.0 | 2.9 | : | — | — | — | — | — | — |
| Nominal wage growth (1) | 3.4 | 5.1 | 4.5 | 4.1 | 3.1 | 2.5 | 2.8 | 2.4 | 4.0 | 4.7 |
| Real unit labour cost growth (1) | – 1.7 | 0.6 | 1.1 | – 0.4 | – 2.4 | 0.1 | – 0.4 | – 1.1 | 0.1 | – 1.1 |
| Labour productivity growth (1) | 3.6 | 1.5 | 0.9 | 2.2 | 2.9 | 0.9 | 1.8 | 1.5 | 2.3 | 3.6 |
| Tax rate on low-income families (1) (3) | 25.2 | 24.9 | 23.3 | 22.6 | : | 33.5 | 32.7 | 24.7 | 21.1 | 21.6 |
| Tax rate on low-wage earners (1) (3) | : | 28.5 | 25.8 | 25.6 | : | 39.7 | 39.1 | : | 29.2 | 29.0 |
| NRR on low-income families (4) | 67.0 | 64.0 | : | : | 72.0 | 70.0 | : | 59.0 | 61.0 | : |
| NRR on low-wage earners (4) | 75.0 | 73.0 | : | : | 71.0 | 70.0 | : | 59.0 | 59.0 | : |

(**) The youth UR figure shown for 2000, for the UK, is the average of the seasonally adjusted monthly rates for Jan.–Oct. 2000.
NB: For footnotes and sources see Table 4 for Belgium.

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