

Medlemmerne af Folketingets Europaudvalg
og deres stedfortrædere

Asiatisk Plads 2
DK-1448 København K
Tel. +45 33 92 00 00
Fax +45 32 54 05 33
E-mail: um@um.dk
Telex 31292 ETR DK
Telegr. adr. Etrangeres
Girokonto 300-1806

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COMMUNICATION FROM THE COMMISSION

**Choosing to grow:
Knowledge, innovation and jobs in a cohesive society**

**Report to the Spring European Council, 21 March 2003 on the Lisbon strategy of
economic, social and environmental renewal**

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EXECUTIVE SUMMARY

The Lisbon strategy remains the right approach

In March 2000 the Lisbon European Council launched the Union's decade long strategy for economic, social and environmental renewal. Conditions today could hardly be more different. Political uncertainty and the protracted downturn over the last eighteen months have knocked business and consumer confidence. The vulnerability of our economy to external conditions reinforces the case for accelerating the pace of change.

The Lisbon strategy will make the Union stronger and provides it with an opportunity to show global leadership. It remains the right course for an enlarged Union. Its added value lies in its co-ordinated, comprehensive and mutually reinforcing approach. Past achievements – ten years of the internal market, five years of a European Employment Strategy and the first anniversary of the arrival of the euro – show the Union's capacity to deliver ambitious reforms. In many areas, they are already driving growth and job creation within flexible, strong and open markets, but pressure for further structural reforms must be maintained.

Is the Union still on track?

Successfully transforming the Union by the end of the decade depends on improving the Union's potential to grow. This requires action that increases employment and improves productivity. While progress has been seen in almost all areas of the Lisbon strategy, it has generally neither been fast enough nor sufficiently co-ordinated to produce the results that Heads of State and Government signed up to three years ago.

- **Employment.** Despite the rise in unemployment in response to the downturn, there are strong signs that reforms over the last five years have produced important structural changes in many, but not all, European labour markets. More than 12 million new jobs have been created since 1996 with around 500,000 jobs still being added during 2002. Nevertheless, performance varies considerably and reforms have not been pursued in a sufficiently comprehensive way in all Member States.

As a result without additional efforts (particularly from those Member States who have not yet contributed significantly to employment growth), the Union looks set to miss its intermediate employment rate target for 2005 (67% of the working age population). And it remains far away from its goals of keeping at least 50% of older workers in the workforce by the end of the decade and raising the average effective exit age from the workforce by five years – both key factors in achieving full employment by 2010. Given current economic conditions, the priority (already signalled in last year's Spring Report) attached to strengthening activation measures for the unemployed remains valid.

Moreover, the picture is just as mixed as regards progress towards providing the workforce with the skills needed to drive a knowledge-based economy and improving not only the number of jobs, but their quality as well; both important factors for better productivity.

- **Reforms of product, service and capital markets.** Significant parts of the internal market have worked well over the last decade. But in others the benefits have had less impact. This is why the Lisbon strategy targets areas such as services, public procurement, transport, energy, financial services and the modernisation of competition rules, as well as certain areas of taxation. Agreement on important reforms for many of these has however

been seen over the last twelve months.

The greatest risk— in contrast to last year's European Council in Barcelona - is not the lack of decisions at European level, but the failure by Member States to ensure that agreed rules and new policies are effectively implemented and applied. This means that in key areas the Union has yet to unleash the full potential of the internal market. Each Member State must do much more to ensure that agreed measures are implemented properly and on time.

- **Knowledge, innovation and business dynamism.** These are key to opening up new opportunities for growth, stimulating competition, and delivering new, more effective ways of approaching common problems such as disease or climate change. Many of the Union's knowledge industries have been badly hit by current conditions, and business and industry as a whole is still held back by a complex and incomplete regulatory environment. Business is not investing sufficiently in knowledge and innovation. The proposed Community Patent – a touchstone for the Union's commitment to innovation – remains blocked.

Despite current strains on national budgets, Member States should create the conditions for more public and private investment in education, research and the knowledge economy, as these are essential for medium-term growth. Fiscal and regulatory incentives, as well as a competitive environment are therefore needed to ensure that private spending follows these priorities.

Establishing bridges between knowledge and the market place and putting in place the ~~right environment for innovation is the new competitiveness challenge. Both existing and~~ future Member States have been doing more in recent years and initiatives such as eEurope and the European Small Firms Charter are helping; but once again a more co-ordinated and consistent approach is needed if EU businesses are to take advantage of new opportunities in order to contribute fully to Lisbon strategy, create jobs and drive growth.

- **Social cohesion.** Developing an accurate picture of progress in tackling poverty and social exclusion is still held back by the lack of up to date data. Nevertheless, improvements in employment, particularly reductions in long-term unemployment and in the number of jobless households, are helping. On the other hand, little progress has been registered in reducing the numbers of early school leavers or gender inequality. Reform and the modernisation of social protection systems, which continue to play a central role in strengthening cohesion across the Union, are underway in most Member States. Their pursuit is central to long-term success. It is, of particular concern, however, that Member States have not yet done enough to ensure the long-term sustainability and quality of their social protection systems, particularly in the face of an ageing population. In the short-term, enlargement, is likely to increase significantly the diversity in performance and cohesion across the Union.
- **The environmental dimension of sustainable development** - Higher economic growth and increased market opening will not be sustainable over the long-term if not accompanied by action to curb environmental pressures and to preserve natural resources. Natural and man-made disasters – like the recent “Prestige” catastrophe – calls for renewed attention to the implementation of the Union's agenda for sustainable development.

Continued efforts are needed to implement Community environmental legislation, and to complement it through the use of economic instruments. Measures to ensure a continued reduction in greenhouse gas emissions and improved air quality must be treated as a

priority, and Member States have to ensure that they stay on track to meet their Kyoto commitments. Pricing mechanisms and tax systems need to reflect better the broader cost to society of economic activity to ensure long-term-sustainability and to encourage the take up of clean technologies, so that both the economy and society can reap their potential benefits. In turn this will help boost competitiveness, while helping to meet commonly agreed international goals.

The EU commitment to sustainable development on a global scale. The Union has chosen to take a leading role in promoting sustainable development on a global scale, and has been on the forefront in setting up the international agenda in recent years. Important decisions were taken in 2002. At a global level, important decisions were taken in 2002 through the launch of the Doha development agenda, the Monterrey Conference on development assistance and the World Summit on Sustainable Development in Johannesburg last August. But decisions must now turn into delivery.

Given its ten-year perspective, time is needed to formulate, agree and deliver the Lisbon strategy policies, but there is a lack of progress and urgency at a national level in many of the most important areas. Developments since the last Spring European Council, taking account of the current slowdown, therefore show that while the Lisbon strategy goals remain well within reach, there is not yet a firm guarantee of success. Economic and political conditions have made things considerably more difficult. The next twelve months will be crucial. At European level, they offer the narrowing window of opportunity before the next European Parliament elections to deliver the full set of reforms proposed by the European Council. At a national level, they must be used to push the pace of change.

Enlargement and the Lisbon Strategy

Enlargement too reinforces the case for accelerating progress. The new Member States are increasingly familiar with Lisbon's logic and working methods. It forms the basis of many of the policies that they are now adopting and efforts to integrate them further into the process must accelerate.

Enlargement does not, however, require a wholesale rewriting of the Lisbon strategy or the relaxation of its key targets – those are targets for the whole of the Union rather than for individual countries. They remain valid for a Union of 25 or more.

It does, however, mean that additional efforts are needed from existing Member States to keep the Union on track. But such efforts are possible. As this Report shows, in almost every area of the Lisbon strategy, the best performing Member States serve as a benchmark of often world beating performance. The structural and sectoral indicators developed through the open method of co-ordination promoted by the Lisbon Strategy provides a valuable tool for mutual learning and sharing common solutions to common problems. It should be strengthened in key areas in view of accession.

In the face of enlargement, existing and new Member States must now choose to grow – but in a way which anchors future growth and new and better jobs to steady improvements in cohesion and our environment.

Choosing to grow – the March 2003 Spring European Council

The European Council must assume its enhanced role at the centre of economic, social and environmental policy-making. Its spring meeting must look beyond the short-term challenges

and pressures to focus attention on action, which can stimulate our medium-term prospects and ensure that decisions are consistent with long-term objectives. It must set the direction and speed of future work, in partnership with the European Parliament.

To do this, Member States and the EU Institutions must do two things – **set the conditions for improved investment in knowledge and innovation**, while **delivering and accelerating the reforms already agreed**.

The Lisbon strategy must continue to lay the foundations for new opportunities for future generations.

The European Council, building on the Spring Report, needs to **reinforce its central role each year in setting the direction for the Union's economic, social and environmental action**. This March it will have a particular opportunity to set priorities within three of the main policy instruments - **the Broad Economic Policy Guidelines**, the revamped **Employment Guidelines** and the **Internal Market Strategy** – used to deliver the Lisbon strategy. All of which from this year take on a new three-year perspective.

In doing this, the European Council must ensure that:

- (1) **A boost is given to knowledge and innovation.** This means supporting entrepreneurship, promoting knowledge industries and the diffusion of new ideas, technologies and services. It must be underpinned by effective and increased investment in education, life-long learning and research. Both public and private funding at Community and national level will have a role to play.
- (2) **Final decisions are taken on the remaining Lisbon reforms.** This means delivering agreed reforms of product, capital and labour markets, as well key environmental measures and moving ahead with the modernisation of social protection systems. The Spring European Council must set deadlines and assign responsibilities to ensure that all measures at EU level are adopted ahead of the European Parliament elections in June 2004 – including those still to be tabled up by the Commission before June this year. Commitment is required not only from Governments, but also from a range of stakeholders including the Social Partners, to ensure success.
- (3) **The interaction between the Lisbon strategy and macroeconomic policy is reinforced.** This means that economic policy co-ordination should be strengthened, in line with recent Commission proposals on budgetary co-ordination. The Lisbon objectives should be better taken into account within the Broad Economic Policy Guidelines.

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1. INTRODUCTION

The Lisbon strategy sets out a roadmap for European Union's economic, social and environmental renewal in the medium to long-term. It involves a comprehensive, coherent and mutually reinforcing set of actions designed to transform the performance of the Union and deliver sustainable development.

These actions can deliver the conditions for a continued period of high, non-inflationary growth. They can improve competitiveness and allow businesses to play a full role in seizing new opportunities, creating jobs and wealth. They can enhance social cohesion and ensure that investment in the environment and sustained growth reinforce each other. They mark Europe's positive choice in favour of quality of life.

The strategy has now reached a decisive moment. As it enters its fourth year, building on the decisions taken in Copenhagen, it faces a clear choice. The Union can maintain the current sluggish pace of reforms or show that it is capable of a step change ahead of enlargement.

It is a choice between moderate growth, continuing unemployment, limited cohesion and slow progress in curbing unsustainable trends, or raising the Union's potential and sustaining it over the next seven years to keep the Lisbon goals within reach. A choice between following or leading.

Past reforms in the second half of the 1990s already show what is possible; an additional half a percentage point on growth, 12 million jobs and a reduction in structural unemployment of around 40%. But developments have shown that despite progress, the Union is still too easily knocked off course by global conditions and that greater efforts are needed to curb unsustainable trends and improve cohesion and share prosperity across the Union.

This year's Spring Report contains a special focus on knowledge and innovation. It is the key to taking the agenda forward over the next twelve months, but it remains an area of unfulfilled promise. Lisbon was rapidly followed by the current downturn that burst the dotcom bubble and unjustifiably knocked short-term confidence in a knowledge-driven economy with a follow on effect for sectors such as telecommunications.

An enlarged Union needs to reinforce investment in knowledge and to create the conditions in which businesses can turn innovation into growth and employment. If at the same time it can speed up product, service, capital and labour markets reforms, the medium-term prospects for productivity and more and better jobs are good. By promoting all aspects of the knowledge chain from basic education to advanced research, from finance to entrepreneurial know-how, the Union can boost innovation. It can speed up the creation of employment, modernise traditional industries while securing future ones - from the life sciences to environmental technologies - and it can put ideas and technology to work in ways which strengthen cohesion, relieve environmental pressures and offer greater opportunity to participate in society.

This Report and its accompanying Staff Paper set out the progress that has been made across the whole of the Lisbon strategy. Chapter 2 looks at progress towards the Lisbon goals. It also takes into account the internal and external dimensions of sustainable development in the follow up to the Johannesburg World Summit. Chapter 3 identifies the challenges and opportunities that the Lisbon strategy presents for candidate countries. Chapter 4 draws this analysis together and sets out priorities and actions needed within the broad set of Lisbon

strategy reforms in order to make the biggest contribution to boosting the Union's future performance.

2. PROGRESS TOWARDS THE LISBON GOALS

The Lisbon strategy's potential lies in the comprehensive and co-ordinated nature of the reforms it contains. Market reforms, labour market policies and social protection systems all have a role to play in improving the performance and quality of life within the Union. The European Council has set out an ambitious programme of change.

Box 1 Remaining milestones on the road to economic, social and environmental renewal by 2010

2003	New framework for communications services Rules for VAT and electronic commerce New impact assessment system for EC legislation Integrated risk capital markets Opening of rail freight markets on trans-European networks Revision of the European Employment Strategy Mid-term review of the social policy agenda and of the Structural Funds Programming
2004	European Company New rules on consultation and information of employees Further opening of gas and electricity supply for business customers*; Single European Sky New rules for public procurement* New rules for pharmaceuticals
2005	Integrated financial market
2006	Further stage of opening up postal service markets
2007	Opening of gas and electricity markets for household customers*
2008	Galileo satellite navigation system operational Market opening of the entire rail network**

Reform decisions still pending: Community Patent, 2nd Railway package, climate change package, TENs-transport revision, temporary agency workers, updating of social security co-ordination rules, mutual recognition of qualifications; EU wide regime for taxation of savings.

Reforms where Commission proposals will be tabled in 2003: Proposals on transport infrastructure pricing including a Eurovignette modification (*Mid 2003*); Phasing in of the European health insurance card (*February 2003*); Action plan on raising R&D investment in the Member States (*April 2003*); New framework for management of chemicals (*Mid 2003*); Development of European Technology Platforms (*End 2003*); Environmental technologies action plan (*End 2003*);

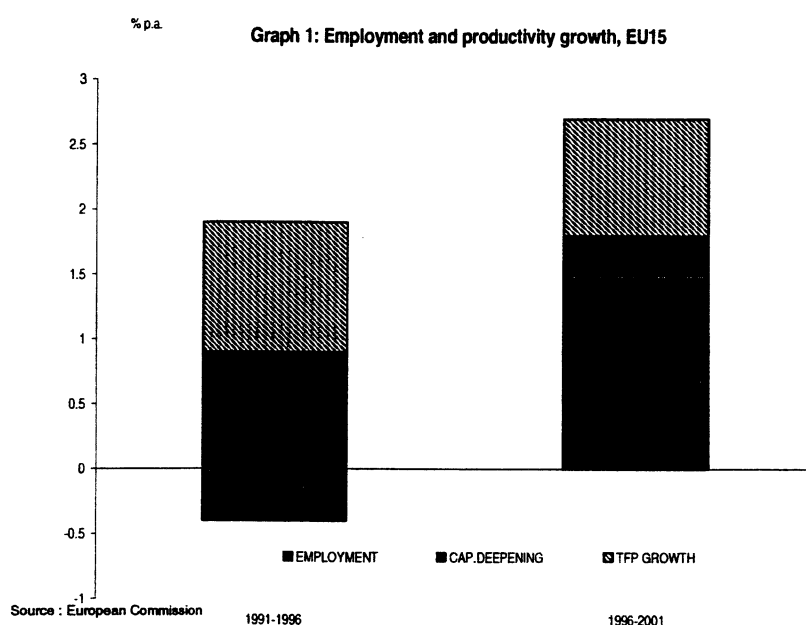
* Agreement in principle in Council **Current rules provide only for freight networks, but second rail package will extend this to all rail services.

Reform today can and will deliver a medium-term growth dividend¹. Current economic and political uncertainty makes it all the more important to accelerate the process of change. This means addressing the factors that can make the biggest contribution to growth and ensuring that is consistent with sustainable development.

Box 2 Key factors behind EU growth

Two principal factors contribute to output growth: the **number of people in work** and **productivity**.

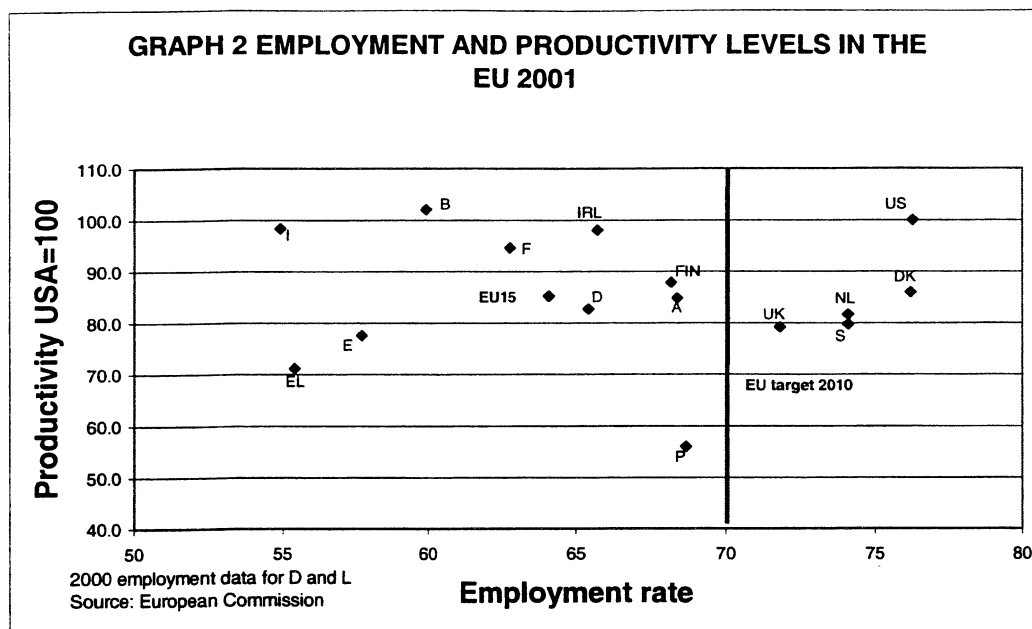
Productivity can be broken further into two areas. One is the level of investment or capital deepening, for example, to expand businesses, adopt new technologies, or to invest in human capital (skills, training and education). The opportunities provided by market reforms tend to stimulate investment. The second is the output-generating effects of both human and business capital investments. It reflects factors such as the degree of competition, the ability to create new ideas and know how and use them to drive innovation and to reorganise work processes, and the overall regulatory environment. This is often described by total factor productivity.



The evidence highlights that growth during the second half of the 1990s and in 2000 was driven by the Union's success in creating and filling new jobs. The contribution of investment to growth dropped significantly and there was little change in the impact of other elements.

This translates into a varied picture across the Union in actual levels of employment and productivity. Absolute levels of productivity per worker are high in some Member States. However, in the second half of 1990s the US made progress in raising both employment rates and labour productivity. The Union succeeded in raising the employment rate, while, in contrast to the US, labour productivity growth has slowed down.

¹ See The 2002 EU economy review, COM(2002) 712, 11.12.2002.



This picture forms the backdrop against which progress on jobs, structural reforms, knowledge, social cohesion and sustainability should be assessed.

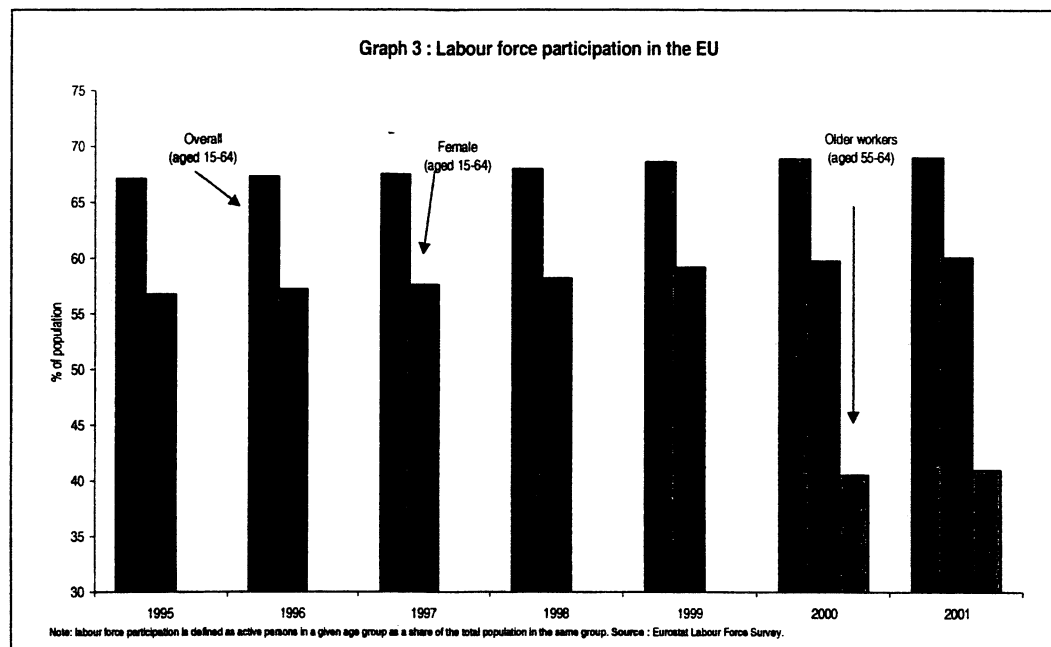
2.1 Employment driven growth in the second half of the 1990s

Overall, the Union has improved its performance in terms of employment rates. Member States have been pursuing structural reforms of their national labour markets, which have started to bear fruit in the form of more people in work and lower unemployment, including a notable reduction in long-term unemployment. One significant development has been that improvements in the labour market have not led to a short-term increase in inflation as companies put up prices in order to recover the higher wages needed to retain and attract employees. This suggests structural improvements in the employment market.

Box 3 Employment performance

- Between 1995 and 2001, the **total number of jobs increased** by about 12 million and the employment rate rose by 4 percentage points.
- Employment increased with the creation of around **500,000 new jobs** during the downturn in 2002.
- Overall **employment in 2001 grew fastest in Luxembourg, Portugal and Ireland** with strong growth in employment for women seen in Ireland at close to 4% and in the accession countries (over 8%). The three best performing Member States saw overall employment grow at 3.9% and female employment around 3.6%.
- **Unemployment fell between 1995 and 2001** by more than 4 million across the Union, though as a result of current conditions there has been a modest increase to an EU average in 2002 to 7.6 %. The average for the three Member States with the lowest levels of unemployment was around 3%.
- **Unemployment in 2002 remained lowest in Luxembourg, the Netherlands and Austria** and rose in all Member States except Greece and Italy. Five of the accession countries (Cyprus, Hungary, Slovenia, the Czech Republic and Malta) had unemployment rates below the EU average.
- **Mobility of the workforce between and even within Member States remains relatively limited** at around 1.2% of the population.
- **Important gender gaps persist** in employment rates, earnings, job status and career progression.

Employment performance varies considerably across the Union. Denmark, the Netherlands, Sweden and the UK currently meet the 70% target set for 2010 for the overall employment rate, while another three Portugal, Austria and Finland are above the 67% intermediate target set for 2005. Yet overall, despite these positive performances, the Union may not meet its intermediate target unless all Member States make greater efforts.



There is strong evidence that the countries that have made the strongest progress are those that have undertaken wide ranging reforms². Denmark, Ireland and the Netherlands stand out as having implemented the most comprehensive set of labour market reforms, tackling wage bargaining structures; training and activation policies, benefit levels and eligibility criteria; and high levels of general and labour taxation. In addition, labour market reforms in these countries were often accompanied by other structural reforms in product markets. The need for a broad approach was also recognised by the Spring European Council 2002, which identified priorities for further labour market reforms in the Member States³.

The most significant challenge is to boost employment and participation rates, first and foremost, for older workers, but also for women and for minority and other groups. Attracting and retaining these people depends on a range of factors, amongst which tackling the gender gap that is visible in many Member States.

A sizeable proportion of new jobs created during the 1990s and 2000 were in sectors requiring medium to high levels of educational attainment. It is essential to equip all levels and age groups within the workforce with the skills needed in a knowledge-driven economy.

² See EU Economy Review, footnote 1 above.

³ In Barcelona the European Council set the following objectives for national labour market reforms: (1) reduction of tax burden on low-wage earners, (2) make work pay within tax and benefit systems, (3) national labour institutions and collective bargaining to take account of relationship between wage developments and labour market conditions in order to bring wage developments in line with productivity, (4) review employment contract regulations in order to strike a proper balance between flexibility and security, (5) remove disincentives for female participation in workforce and strive to improve childcare provision, (6) promote active ageing and reduce early retirement incentives for individuals and companies. Presidency Conclusions, Paragraph 32, Barcelona, 21 March 2002.

This is why the Lisbon strategy places a premium on educational achievement and on life-long learning. Yet, public spending on education seems to have stagnated since the mid-1990s, while the performance in terms of life-long learning across the Union is extremely varied. Participation rates are above one in four in the UK and one person in five in Sweden, Finland and Denmark, but below one in twenty in six Member States and eight of the future Member States and candidate countries.

2.2 Boosting investment and productivity

2.2.1 *Boosting investment and productivity through market reforms*

The internal market has succeeded over the last decade in boosting growth and creating jobs. It has increased trade and investment flows within the Union. Open markets and greater competition has also stimulated innovation and helped businesses to grow, while offering users benefits in terms of lower prices and greater choice in utility sectors such as telecommunications, and to a lesser degree, electricity. There appears to have been a permanent reduction in price differences between Member States as a result of market integration and competition, but evidence suggests that the impact may now be tailing off⁴ – enlargement may help to re-ignite this effect.

Box 4 Examples of the benefits of economic reforms

Ten years of the internal market⁵

- 2.5 million people extra are in work today as a result of the internal market.
- The Union is €877 billion better off amounting to €5,700 per household.
- The internal market has contributed to growth. Without it, EU GDP would be 1.8% lower this year.

The Integration of Financial Markets

Recent studies for the Commission have highlighted the potential impact of integrated financial markets over a ten-year period⁶. The benefits translated into:

- A 1.1% rise in GDP or €130 billion (at today's prices) and a boost to total employment of 0.5%.
- Businesses will be able to get cheaper finance: with an expected drop in the cost of equity capital of 0.5% and a corresponding fall of 0.4% for bond-finance. Investors should benefit as well from higher returns on their investments.
- Eliminating inefficiencies in the retail sector could bring an increase of 0.5% in GDP.

The Community Patent

- Estimated annual savings in processing and administering intellectual property rights under the current proposal would be around €0.5 billion with a saving of around €5,000 per patent compared to a European Patent.
- A one off benefit to the economy of around €18 billion could be felt as a result of the increased value of patent portfolios because of lower litigation costs and simpler enforcement.

⁴ Economic Reform: report on the functioning of Community product and capital markets, COM(2002) 743, 23.12.2002, (the "Cardiff Report").

⁵ The Internal Market - Ten years without frontiers, SEC(2002) 1417. 7.1.02.

⁶ London Economics study for the European Commission / European Round Table on Financial Services/CEPR Study for the European Commission, November 2002.

Untapped potential in key sectors. The internal market's benefits have not yet been effectively felt in those areas where there has been less reform and less competition such as energy markets, transport, service markets, financial services and public procurement all of which are targeted by the Lisbon strategy. As a result businesses in these and other areas have found it harder to grow, while past reforms have not always done enough to curb pressures on the environment.

Taxation also remains a source of fragmentation across the Union. Discrimination and double taxation, for instance, create problems in several fields, such as pensions, car taxation and corporate taxation. Having to comply with 15 different tax systems comes at a cost and is stopping companies from reaping the full benefit of the internal market⁷. The lack of a common approach in key areas has prevented the tax system playing a consistent role in supporting Lisbon priorities, such as investment in R&D or a better environment. Moreover, rapid progress is hampered by the requirement for unanimity to adopt such measures and the unwillingness of Member States to give this the priority that it deserves. All this acts as a brake on growth and employment.

Strong competition and an effective competition policy have also been an important factor for the internal market. At Union level there has been a trend in Member States to reduce and redirect State aid. Total aid in the Union fell from €105 billion in 1996 to €82 billion in 2000 (the last year available). Member States have also been redirecting aid to horizontal objectives such as the environment and research and development. In parallel, Member States have been reforming national competition rules to align them with the Community approach and will shortly take over responsibilities as regards the application of the Community level rules within their national markets.

Transforming decisions into action at a national level

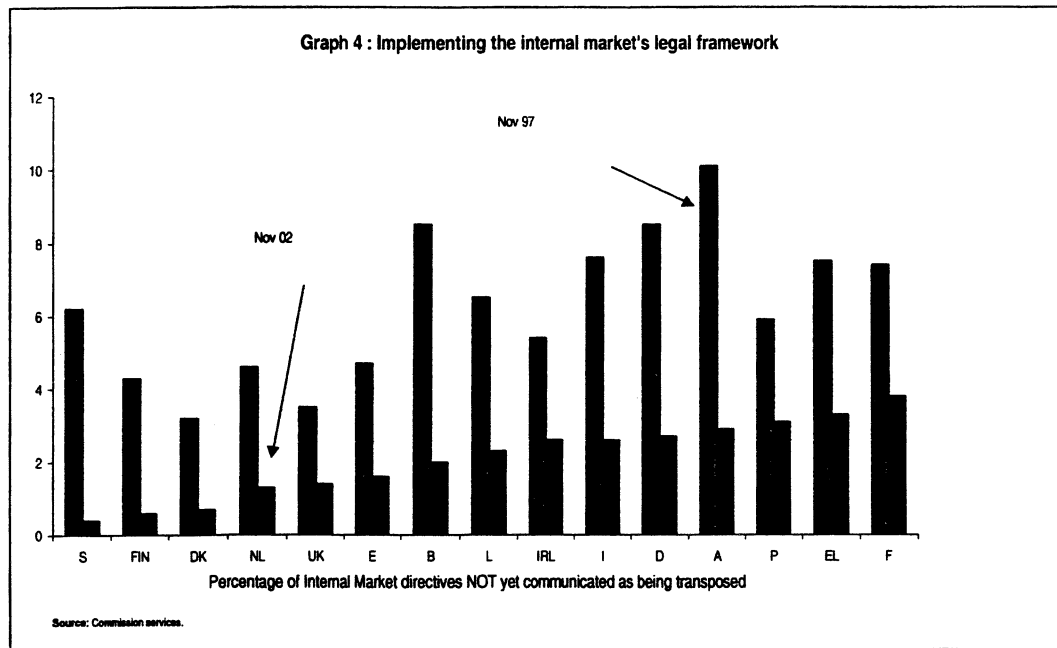
Progress on delivering further market reforms has been mixed so far. Much has been done by the Commission, the European Parliament and by the Council to overcome the "delivery gap" at EU level signalled by the Barcelona European Council. There have been notable recent successes such as those on opening of energy markets, the Single European Sky and postal services. But some of the most pressing reforms are still being delayed. The Community Patent and pending proposals on tax and on procurement are just some examples.

A source of even greater concern is the continuing problem of ensuring that rules agreed by the Council and European Parliament and the orientations given by the European Council are transformed into national action:

- On average, for legislation, it takes four and half years from the moment rules are proposed before they are uniformly applied across all Member States. This is around two years longer than should be the case taking account of the time needed to steer measures through the decision-making machinery and implement them at a national level.

⁷ The Commission has identified priority areas; in particular for immediate action in the field of corporate taxation to address obstacles deriving from the tax rules applied to transfer prices, to mergers and to transactions between parents and subsidiaries. Towards an Internal Market without tax obstacles. A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities. COM(2001) 582, 23.10.2001.

- Nevertheless there has been some progress. The European Council in Stockholm set a target transposition rate of 98.5% of all internal market directives set by the European Council, as well as the additional target set in Barcelona of zero tolerance for measures that were more than two years overdue. Such targets can only be viewed as staging posts on the road to full compliance with Community law.



- In November 1997 the transposition deficit was still above three percentage points in all Member States, in November 2002 this was only true for three. The improvements in Sweden and to a lesser extent in Belgium and Austria show what is possible with political will over a relatively short period. Nevertheless, in the months since the Barcelona European Council the transposition deficit has started to increase once again with the number of Member States meeting the Stockholm target slipping back from six to five and only one Member State – Finland, meeting the zero tolerance target.

All this increases costs for business, impacts trade and often undermines the regulatory goals such measures pursue.

2.2.2 *Boosting investment and productivity through knowledge, innovation and business dynamism*

Knowledge is an important factor in releasing the potential of the Lisbon agenda. The knowledge captured in new technologies and processes can drive growth, competition and new jobs and deliver a cleaner environment. But knowledge must be treated as part of the wider framework in which businesses grow and operate. Equipping people with the right skills is a key tool in overcoming risks of exclusion and improving cohesion. Establishing the bridge between knowledge and the market place and backing it by the right environment for innovation is the new competitiveness challenge.

In general terms, Member States are increasingly conscious of the need to **improve the overall business environment**. Actions underway vary from cutting red-tape, reducing the formalities and costs involved in creating a new business, easing the process of transferring such businesses, promoting public and private business support mechanisms, such as business

angel schemes, and changing approaches to business failure. Yet although Europe is as good at creating businesses as the US, businesses here often have difficulty growing. The entrepreneurial culture within the Union needs to be further strengthened.

Box 5 The Lisbon strategy and Industry

The Lisbon strategy actions will be a **key factor in the competitiveness of the whole of the EU economy**. It is relevant to businesses of all sizes and all sectors. The Union's industrial base – and the low to medium-technology businesses that predominate in the future Member States – is central to Lisbon's success. It has played an important role in driving the successes of the late 1990s and the fragile signs of recovery seen in 2002 have been largely export-led.

In the face of competition from newly industrial countries, **EU industry has outperformed its main competitors**. While the Union's share in world exports fell from an average of 19.3% over the 1991/95 period to 18.4% in 2002, the US share over the same period dropped from 15.1% to 12.1%, and Japan's share from 12.2% to 8.2%. Furthermore, in some major industrial sectors such as automobiles, aeronautics, mobile communications or pharmaceuticals, EU companies have achieved world leadership.

The Commission has recently set out its ideas for the role of industrial policy in fostering competitiveness in an enlarged Union⁸. This is part of a broader reflection to be continued in a forthcoming Green Paper on Entrepreneurship and a Communication on Innovation Policy – both to be presented before the Spring European Council. The Commission will return in the second half of the year to pull together these separate strands to reinforce its approach to the businesses across all sectors that are the driving force behind jobs and growth.

Insufficient investment in knowledge by business

Although progress has been made in moving towards a knowledge-based economy, the Union is still lagging behind its main competitors in terms of investment and performance⁹, despite policy measures put in place in many Member States. The paybacks on research and innovation are often more favourable in other parts of the world, and industry in the last decade has increasingly voted with its feet. Today 40% of the research of Europe's largest companies takes place outside the Union. Enlargement will add a new dimension to this. The skills base and lower costs in the future Member States and candidate countries can offer an attractive home for new research.

There are numerous examples of the problems faced by the Union as a whole when compared with its competitors or the best performing Member States:

- There are **five researchers per 1000 working people** compared to eight in the US and nine in Japan. In the three best performing Member States the figure is around ten per 1000.
- The average level of **high-tech patents** (28 per million inhabitants) highlights a wide variation across the Union with Finland (138), Sweden (95) and the Netherlands (58) ranking well above average.
- Public expenditure on **education** (around 5%) and total expenditure on **R&D** (around 1.9%) as a share of GDP, hardly changed in the second half of the 1990s, even if for R&D Member States are now strengthening measures to boost investment, for example, through

⁸ Communication on industrial policy in an enlarged Union, COM(2002) 714, 11.12.02.

⁹ Sectoral composite indicators developed by the Commission services confirm this trend, which is found in the individual structural indicators. See *Science, Technology and Innovation - Key Figures 2002*, European Commission.

fiscal incentives, promotion of risk capital, university-industry collaboration and selective immigration policies. Yet the public investment in education in the three best performing Member States amounts to 7.3% of GDP and for research the figure is above 3%.

- **ICT spending** has risen significantly, since the mid-1990s, even if it has remained below that in the US and does not seem on its own to have brought about a similar or uniform boost to EU productivity. Continued investment in ICT is also critical to modernising public services.

Investment tends to be higher in education, R&D and information technology in Sweden, Denmark, Finland, while the rise in overall business investment as a percentage of GDP has been steepest in catching-up countries – Greece, Ireland, Portugal and Spain. Higher investment and the impact of the internal market and improved competitiveness contributed to productivity growth, even if it failed to close the gap with growth in the US. Improvements in total factor productivity – possibly reflecting stronger investments in technology, innovation and knowledge – were highest in Greece, Ireland and Finland. TFP growth in Ireland and Greece was twice that in Spain and Portugal despite comparable increases in the level of overall business investment in all those countries.

2.3 Improving social cohesion

Assessing progress in relation to cohesion continues to be hampered by the lack of up to date data in several areas. Nevertheless, both the improvements in employment since the mid-eighties and the continuing fall in long-term unemployment between 2000 and 2002 should help to reduce the risk of exclusion. This is reflected in a stabilisation or modest decline in the number of jobless households – a factor closely linked to the risk of poverty – in nine of the twelve Member States for which data is available. The reduction in the tax burden on the low paid should also have helped in reducing the risk of poverty, while helping to remove disincentives which keep people outside the workforce. Other improvements, such as the efforts being made in most Member States, to boost childcare provision – sometimes by setting national targets is a further positive step.

Yet disparities across the Union continue, both in income distribution (where the gap between the income of the top and bottom 20% of society in the three best performing Member States is half of that in the three worst performers) and in the regional distribution of employment.

Exclusion imposes unjustifiable and avoidable costs on society. The Lisbon strategy's response - a European social agenda - is to provide basic skills for all, promote employment for those who are able to work and ensure adequate social protection for those who cannot. This approach recognises the role of well-developed social protection systems in reducing poverty and promoting employment and employability, as well as the need for such systems to be modernised to ensure their long-term sustainability in the face of an ageing population¹⁰. Ageing is returned to in the section below.

Action and targets at a national level are important, but not yet sufficiently developed, within the two-yearly plans on poverty and social exclusion. The use of the open method of co-ordination in this field can help to overcome the lack of recent data by monitoring progress on the ground.

¹⁰ The Commission assesses progress in its social policy agenda scoreboard. The next edition is foreseen before the Spring European Council.

2.4 Sustainable development

In June 2001, the Göteborg European Council agreed a strategy for sustainable development that completed the Union's political commitment to economic and social renewal, added an environmental dimension to the Lisbon strategy and established a new approach to policy making. It highlighted unsustainable trends posing a threat to the Union's quality of life¹¹. These included economic and social issues such as poverty and social exclusion, but also a number of environmental problems such as climate change, the depletion of natural resources, transport and land-use pressures and the longer term effects of many hazardous chemicals in everyday use.

Many of the Lisbon strategy reforms are already helping to address these problems. However, Göteborg emphasised that many of them are closely tied to economic structure and development. In making policy choices and assessing results, greater account needs to be taken of the long run impact of different choices, the "spill over" between policy areas and the fact that the effects of new policy measures take time to be felt. This approach is essential if the Union is to succeed in decoupling economic growth from environmental damage. This Report focuses on three aspects of sustainability – ageing, environmental trends in the Union and the external developments impacting Lisbon and sustainability in the light of the World Summit on Sustainable Development held in South Africa in August 2002.

2.4.1 *The challenge of ageing*

All Member States are facing up to the impact of an ageing population, but few have so far taken sufficient steps to cope with the financial challenges ahead while maintaining the adequacy of pensions, and other benefits and services.

Box 6 The challenge of an ageing population

Ageing has far reaching implications for public budgets, for continuing improvements in growth and employment, but also for pensions, health systems and long-term care.

- The number of **people over 65 is expected to rise from 61 million in 2000 to 103 million by 2050** and those over 80 from 14 million to 38 million.
- At the same time, the **working age population will decrease significantly** so that from one person over 65 for every four of working age today, the ratio will fall to one for every two by 2050.
- The ageing population will make it even more **necessary beyond 2010 to maintain high levels of employment and improving productivity** levels.
- **Public pension spending is set to rise by between 3 and 5% of GDP** in most Member States over the coming decades, but could be as high as 7.9% in Spain and 12.2% in Greece¹².

The national Pension Strategy Reports submitted for the first time last September show that all Member States are committed to maintaining adequate pensions and protecting older

¹¹ Communication on a sustainable Europe for a better world, COM(2001) 264, 15.5.01.

¹² Estimates from the work of the Pensions Working Group of the Economic Policy Committee in 2000. They do not take account of the latest reforms undertaken by Member States since then. Large increases in Spain and Greece reflect the maturing of the pension system with an increasing number of people during the period having a full working career.

people against the risk of poverty¹³. Similar messages emerge from the questionnaires on healthcare and long-term care¹⁴. They also show to varying degrees how Member States have started addressing these challenges, for example, by raising employment rates for older workers, designing tax and benefit systems to provide rewards for those remaining in the workforce longer and continuing the consolidation of public finances which has the benefit of providing a greater margin of manoeuvre for pension systems and other age-related expenditure.

2.4.2 Environmental trends

With less than two years since Göteborg the pace and direction of progress in this area is difficult to assess. Certain industrial sectors have succeeded in cutting emissions while increasing output. There are positive signs in terms of policy development and implementation – particularly in terms of developing the global perspective of sustainability. On the basis of the data available for 2000, the worrying trends that were observed at the time of the launch of the Union's sustainable development strategy have continued.

Box 7 Developments concerning unsustainable environmental pressures

- **Freight transport** continues to grow more quickly than GDP while passenger transport growth is slightly less, although both generate large environmental costs.
- **Road transport**, even though trends towards lower emissions and fewer road deaths continue, imposes a particularly high cost in terms of air pollution, congestion, noise and road fatalities (still over 40,000 per year).
- Overall progress towards **Kyoto targets** is mixed. While overall emissions fell by around 3.5% from 1990 to 2000, much of the improvement results from reductions in the UK and Germany. In 2000 nine Member States remained well above their Kyoto targets paths.
- **Renewable energy sources** represent an increasing share of electricity generation but progress is not fast enough to meet the indicative target for renewables set by the European Council, unless the Member States implement effectively the Community measures recently approved¹⁵.
- The **energy intensity of the Union** is slowly reducing. The future Member States and candidate countries must make a major effort, as average energy intensity is four times higher than the current Member States.
- In relation to **public health**, the European Food Agency is operational from the beginning of this year. Air quality has improved and that is expected to continue in coming years, but there are significant problems with some specific pollutants and in "hotspots".
- Despite progress made by Member States in proposing sites for nature protection under the Natura 2000 network, **bio-diversity and habitats** are under pressure from a range of economic activities, such as agriculture and over fishing.

These trends highlight the need to accelerate efforts, reflected in recently adopted and pending proposals, to address unsustainable trends. Clean, environmental technologies may have a particular role.

¹³ Draft Joint Report by the Commission and the Council on adequate and sustainable pensions, COM(2002) 737, 17.12.2002.

¹⁴ Draft Joint Report by the Commission and the Council on health care and care for the elderly: supporting national strategies for ensuring a high level of social protection, COM (2002) 774, 3. 01. 2003.

¹⁵ Directive 2001/77/EC on the promotion of electricity produced from renewable energy sources, OJ L283, 27.10.2001.

Box 8 Stimulating the take up of environmental technologies

Environmental technologies – already a €180 billion market world-wide - will be major factor in ensuring that environmental pressures can be decoupled from economic growth. EU businesses are well placed to tap into rapidly growing export markets. Trade in environmental technologies is good for the Union, but it is also good for our trading partners by offering them a wider range of options for the environmental problems they face.

However, **investment in clean technology is held back where market prices** are distorted by subsidies, tax breaks or price structures that support environmentally damaging technologies, especially in key sectors such as transport and energy.

Decisions at the Community level are needed to **provide the right incentives**. The proposed emissions trading regime for greenhouse gases will be an important step forward. The Commission during 2003 will propose a Europe-wide framework to ensure that all transport modes are properly priced. The energy tax directive which should be agreed before the Spring European Council after five years of discussion will be a welcome first step leading perhaps to a small cut in emissions equivalent 0.5% reduction. All of these instruments are important tools, which need to be followed up by further and broad ranging action.

2.4.3 External developments

The focus of the Lisbon strategy is on internal policy reforms. This is also true of sustainable development strategy adopted at Göteborg. However, the Union's "internal" policies have a significant effect on the policies and prospects for third countries. Moreover, some policy issues such as climate change are intrinsically global. It is therefore important to ensure that internal policies are coherent with external commitments.

The Union has chosen to take a leading role in promoting sustainable development on a global scale. It can do this by aiming to make its own policies more sustainable, but also through a more pro-active stance on issues of trade, aid and debt relief. In the past year there have been a number of important developments:

- At *Doha*, an agenda for a new trade round was established, raising the prospect of further trade liberalisation. Free and fair trade will be a further stimulus to reform and innovation within the European Union, underpinning the Lisbon reforms. But more than that, Doha offers a way to manage globalisation in a responsible manner. It can support sustainable development by providing a level playing field for trade, by ensuring that the developed world opens its markets to the developing world and finding new ways of working with all stakeholders in addressing common problems.
- In the run-up to the *Monterrey Conference on Financing for Development*, the Union established clear commitments to increase the EU's Official Development Assistance (ODA) providing an additional €20 billion by 2006. This will raise ODA from the current level of 0.33% of ODA to the 0.39% level between now and 2006, as a first step towards the long-term objective of the 0.7% ODA target. It is essential that Member States act decisively on these commitments.
- The *World Summit on Sustainable Development in Johannesburg*, the 10 year follow up to the United Nations summit in Rio in 1992, added new momentum to the objective of sustainable development. It led to a range of important commitments, which the Union is now actively seeking to implement. Delivery of the Monterrey commitments will be crucial to its ability to do so.

Box 9 Commitments from the World Summit on Sustainable Development

- Halving the number of people lacking **access to basic sanitation** by 2015, currently 3 billion people or half the world's population.
- Minimising the harmful effects on human health and the environment from the production and use of **chemicals** by 2020.
- Halting the **decline in fish stocks** and restoring them to sustainable levels no later than 2015.
- Beginning **national strategies on sustainable development** by 2005.
- Curbing the loss of **bio-diversity** by 2010 in line with the Bio-diversity Convention.
- The Summit also agreed to establish ten-year framework programmes for **sustainable production and consumption** and agreed concrete actions to support sustainable trade and to strengthen corporate social responsibility.
- On **energy** while the Union was unsuccessful in establishing global targets for the share of renewable energy within the overall energy mix, it launched a coalition of countries prepared to set such targets.

The outcome of the World Summit on Sustainable Development (WSSD), together with the Doha Development Agenda and the Monterrey consensus, has shaped a global partnership for sustainable development. The issue is now to follow up and deliver on these commitments. The Union should consolidate its leading role in the follow up process by translating its political ambitions into concrete actions. This will require a long-term effort focusing on:

- *Policy coherence.* The Union will need to redouble its efforts to ensure coherence between its internal and external policies. Some domestic EU policies have negative spillover effects on other countries, notably in the developing world. In several important areas, like agriculture and fisheries where the Commission has proposed important reforms, EU policies need to change.
- *Sustainable globalisation.* Globalisation and increased trade and investment flows have created new opportunities for economic development. But the pace of change also creates new challenges, particularly for developing countries and countries with economies in transition.

The Union should continue to ensure that market liberalisation takes place within a broader regulatory framework that aims to spread the potential benefits of globalisation. Pursuing negotiations in the WTO on the basis of the Doha Development Agenda is the main task, but other actions can contribute. In particular, enhancing corporate social and environmental responsibility in the Union and internationally, promoting sustainable and fair trade through developing incentives to trade in sustainably produced goods and ensuring that export credit agencies act in a way which supports sustainable development.

- *Sustainable consumption and production.* Some challenges, such as climate change, can only be tackled through fundamental changes in the way societies produce and consume. In Johannesburg it was agreed that developed countries should take the lead in decoupling economic growth from environmental damage, in particular by making full use of the potential of new environmental technologies. The Union should push forward at the international level a 10-year framework for regional and national programmes on sustainable consumption and production, building on existing initiatives.

In addition, the Union should also develop and consolidate the Johannesburg coalition of

countries prepared to make commitments on renewable energy, for example, by achieving the indicative EU target for renewable energy (12% of the total energy mix by 2010).

- *Poverty eradication.* Meeting the United Nations Millennium Development Goal of halving extreme poverty in the world by 2015 is a huge challenge. From the Union side significant efforts are needed to improve the effectiveness of development policy and to help promote good governance in developing countries. The timely delivery of the Monterrey commitment for additional ODA resources including agreement on monitoring arrangements will help. In addition, the Union should finalise arrangements to implement the "water of life" and the "energy initiative for poverty eradication and sustainable development".

3. ENLARGEMENT

The negotiations have been concluded with Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia. After ratification these countries will join the European Union on 1 May 2004.

Detailed roadmaps have been agreed for Bulgaria and Romania, which offer them the perspective of membership from 2007 and the prospect established of starting Turkey's accession negotiations without delay after December 2004 if it fulfils the Copenhagen political criteria.

Enlargement offers the expectation in the medium to long-term of giving a substantial boost the Union's performance and its capacity to grow. It provides opportunities that with time will bring the Union closer to the Lisbon strategy goals.

The challenges posed by those goals are common to both future and existing Member States. The integration of the future Member States and the candidates into the Lisbon strategy is already well underway. For example, they are preparing their involvement in the European Employment Strategy and Social Inclusion Process, have adopted an eEurope Plus strategy and are participating in both the structural indicators for this Report and in sectoral benchmarking.

The future Member States has achieved a high degree of macro-economic stability and the process of structural reform is well underway. This has resulted in market opening, accompanied by significant industrial restructuring. They have also made progress in modernising their institutional, legal and administrative environment.

A key factor in their future success will be ensuring and maintaining high levels of investment in order to improve overall performance in the medium-term, creating the conditions for economic convergence and greater cohesion. The Union is providing around €21.7 billion for investment through the Structural Funds in the future Member States over the period 2004-2006, a significant share of which will support human and physical capital. The aim is to help reduce the wide disparities within an enlarged Union and to contribute to improving the quality of life (including the environment) and releasing the full potential of those countries.

Box 10 Enlargement brings with it considerable challenges

- Candidate countries have experienced **rapid growth in the last five years**, partly due to economic reforms and inward investment. However, catch up implies sustained investment into physical and human capital to allow substantial improvements in productivity. But patterns are varied. In 2001 direct foreign investment ranged from €521 per person in Slovakia to €2,284 per person in the Czech Republic.
- The **enlarged Union will be much more diverse**. The gap in GDP between the richest 10% and the poorest 10% of the population will be nearly twice what it is at present, and more than a quarter of the population will live in regions where GDP per capita will be below 75% of the EU average.
- The **employment rate of an enlarged Union today would be 62.6%** - somewhat lower than the current Member States, however, employment growth can pick up even ahead of accession if the future Member States embrace further reforms in line with priorities jointly established with the Community.
- The **structure of industry and employment is different** to the current Member States, with agriculture representing a larger share of employment. The industrial base of those countries is biased towards low to medium-technology sectors.
- **Infrastructure needs are large**. Completing the transport infrastructure alone, which gives access to the internal market, as identified in the enlargement negotiations on trans-European networks, will require investment of around € 100 billion. That is 1. 5% of the GDP of the future Member States until 2015.
- **Further industrial restructuring is likely to be necessary**, particularly in the steel sector where over-capacity remains and within industries still in public ownership that may find it difficult dealing with increased competition.

In many of the future Member States, the Lisbon strategy has acted as a further catalyst for their comprehensive structural reforms. Progress has, however, been uneven and is notably **lagging in a number of priority areas**. For most candidate countries, achieving income levels close to the EU average will take time. In 2001, the future Member States had on average a GDP per capita of 45% (in PPS) of the EU average, despite last years' economic growth figures for most them that exceeded those of the current Member States.

Labour productivity has improved for all future Member States since 1995, although sometimes interrupted by temporary down turns in the countries concerned. Levels of labour productivity are still very divergent varying between 83% of the EU average in Cyprus and 33% in Latvia.

Future and existing Member states alike share several challenges. These include: the need to improve incentives embedded in tax and benefit systems and labour market institutions so as to increase employment rates, the strengthening of competition rules and competition authorities, further efforts to make the public sector more efficient, reform of network industries to increase competitiveness, and the need to build up their skills base and their knowledge infrastructure. This will help them adapt to the knowledge-economy. Even though recent developments in these countries have been impressive, the magnitude of the shared challenges is still substantially greater than for the existing Member States. However, the ten new Member States are aware of these challenges and in the Pre-Accession Economic Programmes they have already defined their own agenda of reforms.

4. CHOOSING TO GROW: PRIORITIES FOR NEXT TWELVE MONTHS

This Report has made the case for **accelerating structural reforms** to boost productivity and jobs, and to help decouple environmental damage from economic growth. This should deliver the improvements in performance needed to make all the Lisbon strategy goals possible, at the same time that the Union is opening its arms to ten new Member States.

The **Spring European Council must set the direction and speed of future work**. It must provide orientations for the Council in partnership with the European Parliament. It must take **advantage of the new three year perspective of the Union's main policy tools** for structural reforms – the Broad Economic Policy Guidelines (BEPG), the Internal Market Strategy and the Employment Guidelines. It must identify dates and responsibilities for the next steps.

Tough economic conditions and political uncertainty over the last year cannot be allowed to slow down change. Instead, they strengthen the case for the Lisbon reforms. They are needed to ensure in the medium-term that the Union is better able to cope with future uncertainties and economic shocks. Lisbon remains the right way to bring this about, not least because of its co-ordinated, mutually re-enforcing and comprehensive approach.

4.1 Lisbon remains the right strategy

The Report has **shown the potential of structural reforms to raise the overall performance** of the Union. Recent reforms have stimulated growth, created jobs and helped to remove people from the risk of poverty and exclusion. Future reforms will produce similar improvements potentially raising annual growth rates to close to 3 percent or more during the course of the decade and creating the additional 15 million jobs needed to achieve the Lisbon employment targets. At the same time, Lisbon's comprehensive approach should allow reforms to go ahead in a way that ensures improvements are economically, socially and environmentally sustainable.

In many areas of the Lisbon strategy, **some Member States are already doing as well or better than the targets that have been set for 2010**. Moreover, in assessing the best performers within the structural indicators chosen in agreement with the Council, the same countries – Denmark, Sweden, Finland, come up time and time again as best performers. This proves that progress can be made on all fronts – economic, social and environmental – if the policy mix is right. It signals the unfulfilled potential in other Member States and the importance of benchmarking and learning from the experience of others.

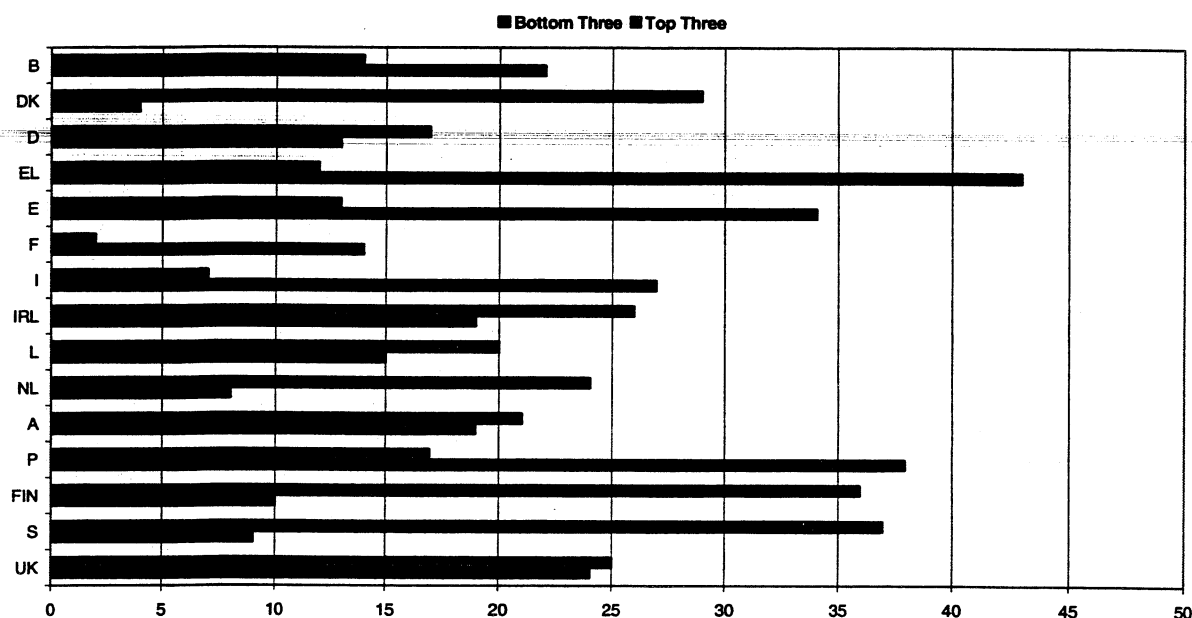
Box 11 Structural Indicators - Best Performers

The Lisbon strategy is backed up by a broad and balanced set of structural indicators that reflect the performance of Member States across six areas (general economic performance, employment, research and innovation, economic reform, social cohesion and the environment). While the indicators cover a wide range of factors, which make varying contributions to the success of the Lisbon reforms, they nevertheless provide a **snapshot of relative performance between Member States** and – for the first time this year – the future Member States and candidate countries. The full set of indicators can be found in the Staff Paper¹⁶ supporting this Report. An overview table is also annexed to this Report.

One striking fact is the frequency that certain countries appear again and again amongst the top three Member States, most notably **Sweden, Finland and Denmark**. These are countries that had already undertaken deep and successful reforms well before the launch of the Lisbon strategy.

The Graph below should the frequency with which Member States appear in the Top/Bottom Three of the Structural Indicators. It should, of course, be treated with a degree of caution. First, it only provides a static picture of the situation based on the current indicators without taking account of the different starting points that exist. Nor does it capture the strong growth and progress made by some countries – Greece, Portugal and particularly, Ireland and Spain, over recent years in catching up with the Union's best performers. Finally, the indicators selected by Council in agreement with the Commission are quite diverse, so the graph should not be taken as an aggregate measure of performance.

Graph 5: Frequency of Appearance in the Top/Bottom Three of the Structural Indicators



Other countries do well, but not so consistently across all the indicators. At the same time all Member States appear among the best performers at least once across the full set of structural indicators.

¹⁶ SEC(2003) 25, 14.1.2003. The Structural Indicators can also be found on the Eurostat Website, where they are updated around the middle of each month (<http://europa.eu.int/comm/eurostat/>).

A further indication of progress over the last year is provided below, which summarises the Commission's assessment of progress made in relation to the country specific recommendations within the 2002 Broad Economic Policy Guidelines¹⁷. These, of course, cover some but not all of the Lisbon strategy.

	Public finances	Labour markets	Product markets
<i>BELGIUM</i>	SOME	SOME	SOME
<i>DENMARK</i>	GOOD	SOME	GOOD
<i>GERMANY</i>	LIMITED	LIMITED	SOME
<i>GREECE</i>	SOME	SOME	SOME
<i>SPAIN</i>	SOME	SOME	SOME
<i>FRANCE</i>	LIMITED	SOME	SOME
<i>IRELAND</i>	SOME	SOME	SOME
<i>ITALY</i>	LIMITED	SOME	SOME
<i>LUXEMBOURG</i>	SOME	SOME	LIMITED
<i>NETHERLANDS</i>	SOME	SOME	SOME
<i>AUSTRIA</i>	LIMITED	LIMITED	SOME
<i>PORTUGAL</i>	SOME	SOME	SOME
<i>FINLAND</i>	SOME	SOME	LIMITED
<i>SWEDEN</i>	GOOD	GOOD	SOME
<i>UNITED KINGDOM</i>	SOME	SOME	GOOD

The challenge of **enlargement does not call the Lisbon targets into question**. Existing Member States must keep to those targets and new Member States must use the best performers as their benchmark. Enlargement offers opportunities for both new and existing Member States.

At the same time, the **credibility of the Lisbon reforms depends most on transforming policy declarations into action**, allowing Member States to be judged by what they do and not just by what they say.

The Council and the European Parliament have done much to close the "delivery gap" at the level of the European Union. However, progress should be a matter of commitment rather than brinkmanship. Ensuring that European level decisions lead to action on the ground is a difficult challenge. It can and must be tackled more seriously. Whether measured in terms of implementing directives on time or delivering national policies to keep the Lisbon goals on track, the performance of Member States is too varied. This undermines the internal market and harms jobs, innovation and growth. Showing a greater capacity to deliver change at a national level and unblocking key decisions in the run up to the Spring European Council would be an important short-term step to boost confidence in the Union's capacity to change.

¹⁷ Communication on the implementation of the 2002 Broad Economic Policy Guidelines, COM(2003) 4, 14.1.2003.

Box 12 A comprehensive and a co-ordinated approach to reform

This report has provided evidence that:

- **Comprehensive reform is most beneficial.** A piecemeal approach to reforms is much less effective. Ensuring more effective co-ordination and coherence across different policies, as well as internally and externally, will reinforce the Union's success. However, Member States must also follow an equally comprehensive approach when pursuing national reforms.
- **A co-ordinated approach is most effective.** The Lisbon reforms, if pursued across all Member States in a co-ordinated manner, maximise the spill over effects from one country to another. This removes the disincentive for Member States of bearing the full costs of reforms, but seeing the benefits accrue in other Member States as well as their own. It also creates a critical mass, which may justify a more accommodating monetary stance from the European Central Bank, which can in turn help to ease the short-term impact of certain reforms.
- **The interaction between structural reform and macro-economic policies should be strengthened.** This is not new. Sound macro-economic policies have long been recognised as offering the best framework for the delivering reforms. By strengthening economic policy co-ordination in line with the Commission's Communication last November on strengthening the co-ordination of budgetary policies¹⁸, the Union can reinforce the interaction between the two, in particular, by securing sound and sustainable public finances and raising the contribution of public finances to growth and employment in line with the Lisbon strategy.

4.2 Building economic, social and environmental governance around the Spring European Council

The Lisbon strategy must pursue this comprehensive and co-ordinated approach. Progress must be maintained and, in some cases, strengthened along its three dimensions.

During 2002, the governance system has been adjusted to allow it to play a more effective role in the pursuit of the Lisbon strategy objectives. The Spring European Council, drawing on the Commission's Spring Report, will continue to be the central annual event to review progress. It must set priorities for Council work and give guidance for the Member States through the Union's principal, Treaty-based co-ordination instruments, as well as for policies delivering structural reforms. The timing of these instruments - the Broad Economic Policy Guidelines and the Employment Guidelines – has now been synchronised¹⁹. Together with the Internal Market Strategy, they will take on from 2003 a three rather than single year perspective.

In parallel, the Council has streamlined its individual configurations creating amongst others a new Competitiveness Council and giving a clear, overall co-ordination role to the General Affairs and External Relations Council in preparing the Spring European Council²⁰.

Finally, the European Council must also strengthen its partnership with the European Parliament to pursue the Lisbon strategy agenda in terms of planning, which allows for all key decisions to be taken ahead of the European Parliament elections in June 2004.

¹⁸ Commission Communication on strengthening the co-ordination of budgetary policies, COM(2002) 668, 27.11.2002.

¹⁹ Communication from the Commission on streamlining the annual economic and employment policy co-ordination cycles, COM(2002) 487, 3.9.2002.

²⁰ Notwithstanding this streamlining the Lisbon Strategy impacts the work of six of the nine Council configurations, in addition to the co-ordination role given to the GEARC, namely, Economic and Financial Affairs; Employment, Social Policy, Health and Consumer Affairs; Competitiveness; Transport, Telecommunications and Energy; Environment, and Education, Youth and Culture.

All this reinforces the Union's governance and the Spring European Council's role in the overall co-ordination of economic, social and environmental policies.

4.3 Achieving sustainable growth and raising employment within a cohesive society

The Union's priority for the next twelve months must be to stimulate investment in knowledge and innovation alongside faster structural changes in order to boost productivity and employment.

This relies on:

- **Strengthening public and private investment in research, education and training, and in the take up of new technologies**, while adopting urgent reforms of product, service and capital markets to open opportunities and boost competition and innovation.
- Sustaining and extending **labour market reforms** especially in Member States that are lagging behind, investing in human capital and lifelong learning, and **modernising Europe's social model**, which should include strengthening the open method of co-ordination for social protection.
- Ensuring reforms **address environmental pressures and taking the lead in environmental technologies**.

These actions need to be reinforced by **better integration of Lisbon strategy priorities** into the Union's instruments and monitoring mechanisms for macro-economic policy co-ordination and by **ensuring that sustainability is properly addressed in policy formulation**, and that our internal policy measures are consistent with our external commitments.

The **Spring European Council must set deadlines for decisions** at a European Union level. (Table 13 at the end of this Chapter identifies timetable and maps specific actions to different Council responsibilities). Member States must assume a double role in this regard; first, to work towards rapid agreement within the EU Institutions, and second, to put agreed measures in place at a national level.

In other areas, the Community and Member States will use different instruments. The Community, through the Structural Funds, plays an important financial role. Around ten percent of the funds are used to support investment in the area of research, innovation and the information society, whilst more than a quarter relates to the development of human resources and education. A further twenty five percent relates to the financing of transport and energy trans-European networks. A mid-term review is foreseen during 2003 will provide an opportunity for Member States to assess the impact of their programmes. Ministers in charge of regional development together with ministers in charge of employment meeting in spring 2003 should assess how the well the Lisbon objectives have been supported in national programmes and consider possible changes taking into account the orientations in this Report.

However, in most cases, Member States have the greatest responsibility for delivery of the Lisbon strategy. Their active commitment and involvement is vital, as is that of the social partners and other interested actors. The work programme of the social partners agreed in November 2002 is an important step forward in their contribution to the Lisbon agenda. In order to enhance their involvement, the Employment, Social Policy, Health and Consumer

Affairs Council must formalise the Tripartite Social Summit through a Council Decision ahead of the Spring European Council.

4.3.1 Opportunities through knowledge and market reforms

Exploiting knowledge, skills and innovation

The Union's long-term success will depend to a large extent on how easily businesses and people can generate and transform knowledge into commercial realities and new skills. The low level of investment in research is a key factor holding back innovation and the Union's growth potential.

For this reason, the Competitiveness and Education, Youth and Culture Councils must also focus on how Governments and more importantly, business can be encouraged to invest in knowledge and innovation. The Competitiveness Council must also actively assume its horizontal role of ensuring overall competitiveness taking account of developments in the internal market, industry and the research world. The open method of co-ordination – including the setting of national targets – is starting to work in areas of education, research, innovation and enterprise, but it must be better exploited as a way of sharing best practice and fostering progress.

In particular, supporting knowledge, skills and innovation means:

- Member States must look at **investment in knowledge** - both public and private - from teaching basic skills to pursuing high level research if they are to meet demand from high and medium-technology industries for a highly skilled labour force. At a national level within current budgetary constraints, investment must focus more on building skills, supporting R&D and encouraging the uptake of information and communication technologies, and particular attention should be paid to ensuring the more effective use of the funds available.
- The Education, Youth and Culture Council must move forward with the **implementation of the action plan on the ten year objectives for education systems** and set and use benchmarks for improving overall investment in human resources, monitor progress and identify best practice.
- To make progress on the **Barcelona R&D investment objective**, public funding for R&D should be used in ways which can leverage private financing and which take account of the growing role of trans-national research collaboration. The Commission will present an Action Plan to Council and the European Parliament later this year to boost R&D investment and innovation based on the lessons learned and best practices from on-going national efforts. The Competitiveness Council and Member States should set both common and individual objectives and should monitor progress and best practice in the context of the open method of co-ordination in the research area.
- More generally, action at Union and national level to **improve the business environment** must intensify, in particular, to reduce and simplify the regulatory burden on businesses. The Commission will contribute to this at a European level by shortly launching a comprehensive rolling **programme to simplify and consolidate existing Community legislation** between now and the Spring European Council in 2005.

- Member States must **improve the overall environment for frontier and other leading technologies**, for example, by moving ahead rapidly with the European Biotechnology Action Plan. In the latter area key legislation has yet to be implemented by nine Member States, progress is very much in the hands of Governments. An emphasis should be placed on **clusters at national, regional and local levels** to bring together technological know how, industry, regulators and financial institutions to develop a strategic agenda for leading technologies or to address particular problems that may have a profound impact on growth or sustainability. These could also take the form of **European Technology Platforms** in areas such as railways, aeronautics, clean steel production, plant genomics or the transition to hydrogen as a fuel within the energy sector.
- The European Investment Bank should step up its support for the Lisbon strategy beyond its successful Innovation 2000 Initiative (i2I), which is now coming to an end. The EIB's follow up should target investment in the European knowledge economy, in particular, R&D and innovation in the private and public sectors, as well as support risk capital markets.
- The Competitiveness Council must **achieve a decisive breakthrough on the Community Patent** before the Spring European Council, failing which the Commission will consider withdrawing its proposal at the spring summit. The Community Patent has now become a touchstone for the Union's commitment to knowledge and innovation.

Delivering promised reforms

The economic reform agenda builds on ten years of success of the internal market. It focuses on improving the performance of goods, services and capital markets across the Union. Reforms open new opportunities for investment and business growth. Work is already well underway. Attention over the next year must focus on ensuring that reforms already agreed are finalised and that the businesses and people are equipped to seize these new opportunities.

First, final decisions are needed for pending reforms for example on energy, transport, procurement, social security and qualifications. The Competitiveness Council must also inject fresh momentum into the **completion of the internal market for services**, while the Economic and Financial Affairs Council must **ensure that remaining barriers are removed to a risk capital market at the end of 2003 and that the Financial Services Action Plan is delivered** by the end of 2005. Progress on the latter should take into account new issues such as corporate governance in order to raise confidence and bolster the overall stability of financial markets.

Second, at the start of the fourth year of the strategy, it is time to ensure that **all the necessary conditions are in place to make the most of reforms already agreed**. Examples include:

- Improving cross-border connections and moving ahead on the development of trans-European networks²¹, as recognised in Barcelona, in order to underpin market opening in energy, and overcome congestion in transport, particular in view of enlargement. Public financing of infrastructure could be enhanced by public-private partnerships.

²¹

To take forward the revision of the Community Guidelines on the trans-European transport network, a High Level Group chaired by former Commissioner, Karel Van Miert and made up of Member State representatives, observers from accession countries, EIB and the Commission will draw up recommendations in Spring 2003 on the priorities for the TEN transport network up to 2020 in both the current and future Member States.

- A knowledge-driven economy – particularly in the current business climate – which has particularly affected the telecommunications industry- depends on the new regulatory framework for communications services being in place on time with action to stimulate broadband networks and the use of new multi-platform on-line services in government, health, education and business, in line with the eEurope 2005 Action Plan. The Commission will report before the Spring European Council on the regulatory, technical and other issues relating to information society and the telecommunications sector.
- Reinforcing business investment in the leading industries in the Union such as the pharmaceutical and chemicals industries needs rapid progress in defining and agreeing new rules governing the operation of those sectors in order to exploit better technological progress and to take account of the objective of sustainable development.
- Consolidating the framework for the operation of services of general interest in the Union, thereby underpinning the development of the internal market, long term economic growth and improved cohesion. The Commission will shortly issue a Green Paper on general interest services and is developing guidelines for the application of State aid rules in the area.

4.3.2 New jobs and an updated social model for a knowledge society

More and better jobs within an inclusive labour market

Labour markets in many Member States have already have shown greater resilience to the economic cycle, proving that the **Lisbon employment targets are attainable** as a result of on-going reforms within the Lisbon strategy. However, sluggish productivity, an insufficient skill base and high levels of inactivity and unemployment continue to hold back growth. At the same time they put at risk the long-term sustainability of the improvements seen and limit opportunity across the Union. This is particularly true for women and older workers.

The Employment, Social Policy, Health and Consumer Affairs Council and the Member States must therefore maintain the momentum for reforms of national labour markets. They should promote and manage change on the basis of a **revamped European Employment Strategy**²², which will more closely link employment goals to the Lisbon objectives. Those Member States that have made only small contributions to improving the operation of EU labour markets so far should do more by pursuing comprehensive reforms.

The new strategy should foster three mutually supportive objectives: full employment and higher labour market participation; raising quality and productivity at work; and promoting cohesion and inclusive labour markets. The strategy will therefore focus on issues highlighted in earlier Spring Reports, such as the balance between flexibility and security at work, entrepreneurship and reducing undeclared work; gender gaps and regional disparities and increasing employability and the integration of disadvantaged groups.

In the context of this year's Spring European Council, particular emphasis should be paid to three aspects of the new strategy:

²² Communication on the future of the European Employment Strategy, COM(2003) 6, 14.1.2003.

- **Boosting employment and participation rates for older workers.** This is where performance is still a long way from the Lisbon targets. Comprehensive strategies are needed to attract older workers and reward people for remaining in employment²³.
- **Improving productivity** by promoting adaptability and job quality and by ensuring the right incentives and resources for private and public investment in human capital and lifelong learning.
- **Strengthening prevention and activation measures** for the unemployed and **reforming tax/benefit systems** to make work pay and further reduce structural unemployment.

A fresh approach must be taken to immigration as a means of ensuring that high levels of employment and productivity can be maintained in future decades. At the heart of any approach must be the better integration of migrants – who are often able to make a substantial contribution to entrepreneurship - into society, while taking account of the impact of such immigration on the countries from which migrants come.

The revised **European Employment Strategy should be results-oriented and include quantified targets**, where these can help to achieve the Union's goals. This could be the case, for example, in relation to prevention and activation policies, gender equality, life-long learning, and health and safety actions.

In many of these areas, action is not just a matter for Government. It requires investment from industry, other stakeholders and the full and active involvement of the social partners.

Modernising social protection systems in view of an ageing society

Sustained progress towards the Lisbon goals can only be achieved by moving ahead at the same time in the social area. Particular emphasis should be put during the coming year on reducing the risk of poverty and modernising social protection systems to meet the challenge of an ageing population:

- Member-States should seize the opportunity to set, in their Social Inclusion National Action Plans covering the period 2003-2005, **national targets to reduce significantly the number of people at risk of poverty and social exclusion by 2010**, as a means to inject more ambition into their policies in this domain.
- The momentum behind the **on-going reforms to secure sustainable and adequate pension systems** must be maintained. Similar challenges are posed for health and long-term care systems by ageing. Adapting pension systems to new needs, increasing employment rates and improving incentives so that older workers remain longer on the labour market will be particularly important. The Economic and Financial Affairs Council and the Employment, Social Policy, Health and Consumer Affairs Council must work together to ensure that all Member States are actively addressing these issues.
- The **streamlining of current disparate actions linked to social inclusion and pensions** and, in time, co-operation in relation to health care and 'making work pay' into a single open method of co-ordination will contribute to the necessary modernisation of social protection systems. The Employment, Social Policy, Health and Consumer Affairs Council

²³ Joint Council/Commission report on increasing labour market participation and promoting active ageing, Council doc No 6707 of 8 March 2002 adopted on the basis of COM(2002) 9, 24.1.2002.

in co-operation with the Economic and Financial Affairs Council must actively pursue this streamlining, which will considerably strengthen the social dimension of the Lisbon Strategy. The Commission will adopt a Communication on this topic.

4.3.3 Addressing environmental pressures

As markets are opened and new jobs created, it is also essential to ensure that the opportunities are sustainable and that growth and environmental policies reinforce each other. A renewed effort is needed to implement Community environmental legislation, complement it through the use of economic instruments to provide the right signals and incentives to change behaviour, as well as removing damaging subsidies, and using fewer resources or using and reusing them more efficiently.

This should support the decoupling needed to **ensure that the economy can grow faster without increasing pressure on the environment and can benefit from the growth potential of cleaner technologies.**

New environmental technologies will help by offering more environmental protection for less money. The countries and regions that can harness these technologies today will play a major role in shaping the world of tomorrow. The Commission will shortly publish a progress report on the way to a fully-fledged Action Plan in December 2003. That Action Plan will identify the steps needed to support Europe's leading role in their diffusion.

Recent accidents such as the sinking of the Prestige oil tanker cause long-term environmental and economic damage for the areas and sectors concerned. New and modern technologies, as well as early implementation of adopted maritime safety measures by Member States, will also help to make the Union's coastlines safer.

The Transport, Telecoms and Energy Council and the Environment Council must both play a full role. In particular:

- Member States must accelerate implementation of the existing ERIKA I and II legislation and the Transport, Telecommunications and Energy Council and the Environment Council must ensure early adoption of the measures proposed by the Commission to further limit the risk of future accidents²⁴.
- Measures to ensure a **continued reduction in greenhouse gas emissions and improved air quality** against the trends of increasing transport demand and energy consumption must be treated as a priority. For energy, an important first step should be for the Economic and Financial Affairs Council to agree the pending energy tax proposal before the Spring European Council.
- Member States must make renewed efforts to ensure that they stay on track to meet their **Kyoto commitments**. The focus should be on measures where costs are likely to be low, such as emissions trading and removing environmentally harmful subsidies. Such steps will be important to meet the European Council's indicative target for renewable energy.

²⁴

In view of the increased political uncertainty and its consequences for oil prices and energy supplies, progress is also needed from the Transport, Telecommunications and Energy Council on proposals on oil and gas stocks in the context of the security of EU energy supplies.

- **Bio-diversity and habitats** are under pressure from a range of economic activities. Successful adoption by the Agriculture and Fisheries Councils of Commission proposals on agriculture and fisheries would make a significant contribution to the protection of bio-diversity and help to secure the long-term future of these sectors. The decisions in December 2002 on fishery reforms are an important step forward.
- Measures have already been agreed which should help to break the link between transport growth and GDP by shifting transport to more environmental friendly modes, but more is needed. **Transport infrastructure pricing** will be an important tool in controlling environmental pressures and bringing about a faster switch to more sustainable modes of transport. Revenues raised might be used to help finance infrastructure on the basis of public-private partnerships. Member States should also restructure national transport taxes in a way more closely linked to pollution and CO₂ emissions, which can be achieved without increasing the total tax burden.
- More generally, **pricing mechanisms and tax systems** need to reflect better the broader costs to society of economic activity to ensure long-term sustainability. Unless distortions in markets are removed, there will be a bias against investment in cleaner technologies.

4.4 Embedding Lisbon within sound economic policies

The steps set out above will be achieved most effectively if supported by well co-ordinated macro-economic policies. Here the Economic and Financial Affairs Council must play its role in preparing the 2003 Broad Economic Policy Guidelines for endorsement by the European Council in June. Those guidelines must seek to ensure an economic environment that supports the priorities set out in this Report. They have a **double role** of mapping out the macro-economic conditions for stable growth and employment and providing the economic framework for structural reforms on the basis of the orientations provided by the Spring European Council.

In terms of macro-economic policy reform, the Commission's Communication of November 2002 set out proposals for improving the implementation of the Stability and Growth Pact²⁵. In addition to securing the core budgetary objectives of sound and sustainable public finances, the proposals recognise the need to raise the contribution of public finances to growth and employment in line with the Lisbon strategy. This forms part of a more general approach to strengthen economic policy co-ordination and is consistent with the relevant proposals forwarded by the Commission to the Convention on the Future of Europe.²⁶

4.5 Ensuring sustainability is properly addressed

The Union's sustainable development strategy, as recognised in previous Spring Reports, underpins all of the Lisbon actions. This means moving ahead on the three pillars of sustainability – economic, social and environmental. Implementing this strategy is essential, but it presents a challenge. Policy makers need to pay close attention to the interaction of these different dimensions and making sure that the short-term concerns do not lead to “quick fix” solutions that undermine progress towards longer term objectives.

²⁵ Commission Communication on strengthening the co-ordination of budgetary policies, COM(2002) 668, 27.11.2002

²⁶ Communication from the Commission: For the European Union Peace, Freedom, Solidarity COM(2002) 728 final, 4.12.2002.

The Commission's new system of impact assessment will be an important instrument in improving the coherence of key Commission proposals. The same attention is now needed from the European Parliament and from the Member States in assessing the impact of amendments to proposed new rules or of national measures implementing Community law.

The additional priority for this Spring European Council is for Member States and the Union to follow up Doha, Monterrey and Johannesburg. This can contribute to the long-term improvement in the performance of both the Union and its partners around the world. It will require leadership in pursuing global solutions to curb key unsustainable trends.

This means moving forward on the broad trade and development agenda that has been identified, but it also highlights again the importance of agriculture and fisheries reforms in order to deliver economic and environmental benefits.

Table 13 Role and responsibilities – Mapping Councils and the necessary legislative decisions / guidelines to take Lisbon forward

Priority	Council	Deliverable
Opportunities through Knowledge and Market Reforms	Competitiveness	▪ Breakthrough on the Community Patent <u>before</u> the Spring European Council 2003 ▪ Procurement Package (<i>June 2003</i>) ▪ Action Plan on raising R&D investment (<i>Dec 2003</i>) <i>Final adoption by March 2004</i> ▪ A Corporate Governance Strategy ▪ Take-over Bids Directive
	Transport, Telecoms, Energy	<i>Final Adoption by June 2003</i> ▪ European Single Sky ▪ Public service contracts for passenger transport ▪ Access to port services ▪ Airport slot allocation ▪ Energy package ▪ TENs transport <i>Final Adoption by Dec 2003</i> ▪ Second railway package ▪ European network and information security unit ▪ Public sector information ▪ Transport infrastructure pricing (including a Eurovignette modification) (<i>mid 2004</i>)
	Economic and Financial Affairs	<u>Agreement before the Spring European Council:</u> ▪ Tax Package ▪ Energy tax <u>Financial Services Action Plan</u> <i>Final adoption by July 2003 on</i> ▪ Prospectus Directive ▪ Pensions Directive and extension of Lamfalussy process to banks, insurance and conglomerates <i>Final adoption by March 2004 on</i> ▪ Investment Services Directive ▪ Transparency Directive
	Employment, Social Policy, Health and Consumer Affairs	▪ Pharmaceutical regulation package (<i>Dec 2003</i>)
	Education, Culture and Youth	▪ ERASMUS World and eLearning Programmes (<i>Nov 2003</i>)
Employment / Social Dimension	Employment, Social Policy, Health and Consumer Affairs	▪ Employment Guidelines 2003 ▪ Temporary agency workers (<i>Dec 2003</i>) ▪ Updated regulation on social security co-ordination (<i>Dec 2003</i>)
Addressing environmental pressures	Environment	<i>Final adoption by March 2004</i> ▪ Climate change package ▪ Environmental liability ▪ Air quality package
	Economic and Financial Affairs	▪ Energy taxation (<i>January 2003</i>)
Economic Policy Framework	Economic and Financial Affairs	▪ Broad Economic Policy Guidelines 2003

Annex: Summary Table showing the frequency with which Member States appear within the top three and bottom three of the Structural Indicators

The attached table provides an overview of where Member States are positioned in relation to the agreed set of indicators established by the Commission and the Council.

It highlights those countries appearing in the top three for a given indicator (“+”) and those appearing in the bottom three (“-”).

The complete set of indicator graphs are annexed to the Staff Paper (SEC(2003) 25, 14.1.2003) accompanying this year’s Spring Report and are also available on line www.europa.eu.int/comm/eurostat where the indicators are updated on a monthly basis and a full explanation of the methodology used is available.

This diverse set of indicators covers the broad range of areas touched by the Lisbon strategy, but are very different in character and cover different reference years, sometimes still predating the Lisbon Strategy. This must be taken into account in looking at the picture presented by this annex.

Finally, not all of the agreed indicators are suited to producing a ranked order for Member States.

Table shows the appearances in the top (+) / bottom (-) positions for each of the structural indicators agreed between the Commission and Council.

nd = Data not available for that Member State for the year used

* = Indicator not suitable for ranking either because of type of data recorded or lack of sufficient current data

		B	DK	D	EL	E	F	I	IRL	L	NL	A	P	FIN	S	UK
Core Economic Indicators																
a1	GDP per capita in PPS (2002)		+		-	-			+	+			-			
a2	Real GDP growth rate (2002)				+	+		-	+	-	-					
b1	Labour productivity per person employed (2002)	+			-	-			+	+			-			
b2	Labour productivity per hour worked (2002)	+			-	-		+		+			-			
c1	Total employment growth (2001)		-		-				+	+		-	+			
c2	Employment growth - females (2001)		-	nd	-	+		+	+	nd						-
c3	Employment growth - males (2001)		nd	nd	-		+		+	nd		-	+			-
d	Inflation rate (2002)			+	-				-		-	+				+
e	Unit labour cost growth (2001)	-			+	+			-		+	nd		-		
f	Public balance (2001)			-				-		+			-	+	+	
g	General government debt (2001)	-			-			-	+	+						+
Employment																
l.1.1	Total employment rate (2001)		+	nd	-	-		-		nd	+				+	
l.1.2	Employment rate - females (2001)		+	nd	-	-		-		nd				+	+	
l.1.3	Employment rate - males (2001)	-	+	nd			-		-	nd		+				+
l.1.4	Total employment rate of older workers (2001)	-	+	nd				-		nd		-			+	+
l.1.5	Employment rate of older workers - females (2001)	-	+	nd				-		nd		-		+	+	
l.1.6	Employment rate of older workers - males (2001)	-	+	nd			-		+	nd		-			+	
l.2.1	Total effective average exit age (2001)	-					-		+	-			+			+
l.2.2	Effective average exit age - females (2001)	-			-				+		-		+		+	
l.2.3	Effective average exit age - males (2001)	-	+				-		+	-						+
l.3	Gender pay gap in unadjusted form (1999)	+						+	-	nd		-	+			-
l.4	Tax rate on low-wage earners (2001)	-		-					+	+					-	+
l.5.1	Life-long learning (adult participation in education and training) - total (2002)		+		-		-						-	+		+
l.5.2	Life-long learning (adult participation in education and training) - females (2002)				-		-						-	+	+	+
l.5.3	Life-long learning (adult participation in education and training) - males (2002)				-		-				+		-	+		+
l.6.1.1	Accidents at work - serious accidents - total (2000)	+			+	-			+						-	-
l.6.1.2	Accidents at work - serious accidents - females (2000)				+	-	-		+		nd			+		-
l.6.1.3	Accidents at work - serious accidents - males (2000)	+	+			-			+		nd				-	-
l.6.2	Accidents at work - fatal accidents (2000)		+					+	+	-	-	-				
l.7.1	Total unemployment rate (2002)				-	-				+	+	+		-		
l.7.2	Unemployment rate - females (2002)				-	-		-	+	+	+					
l.7.3	Unemployment rate - males (2002)			-	-					+	+	+		-		

Innovation and Education														
Spending on human resources (public expenditure on education) (2000)														
II.1	nd	+	nd	-								nd	+	-
II.2.1				+										+
II.2.2														+
II.2.3	+									nd		nd		+
II.2.4	-									nd		nd		-
II.3.1														+
II.3.2	nd	+											+	+
II.4.1										nd		nd		+
II.4.2										nd		nd		+
II.4.3										nd		nd		+
II.5.1														+
II.5.2														+
II.6.1														+
II.6.2												nd		+
II.7.1														+
II.7.2													+	-
Economic Policy														
III.1.1	*	*	*	*	*	*	*	*	*	*	*	*	*	*
III.1.2	*	*	*	*	*	*	*	*	*	*	*	*	*	*
III.2a.1	-									+				-
III.2a.2		+												-
III.2a.3													+	-
III.2b.1	-									+				+
III.2b.2														+
III.2c1		+								nd				+
III.2c2														+
III.3.1	-											nd	nd	+
Market share of the incumbent in fixed telecommunications - local calls (including calls to the Internet)* (2000)														
III.3.2.1		+												+
III.3.2.2														+
III.3.2.3		nd												+
III.3.3		+												+
III.4														+
III.5.1	-													+
Market Integration - Convergence of interest rates - mortgages														
III.6.1	*	*	*	*	*	*	*	*	*	*	*	*	*	*
III.6.2	*	*	*	*	*	*	*	*	*	*	*	*	*	*
III.6.3	*	*	*	*	*	*	*	*	*	*	*	*	*	*
III.6.4	+													-
III.6.5	+													-
III.6.6	+													-
III.7	+													-



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels,
SEC(2003) 25

COMMISSION STAFF WORKING PAPER

**in support of the Report from the Commission to the Spring European Council in
Brussels (COM (2003) 5 final) (“The Spring Report”)**

Progress on the Lisbon strategy

EXECUTIVE SUMMARY

The main conclusions from Staff Paper are as follows:

- The European Union has made progress on the Lisbon strategy, but the speed and breadth of progress is generally insufficient to achieve the goals for 2010 set out in Lisbon. EU GDP per capita measured in terms of purchasing power rose from 70% of the US level in 1999 to 71% in 2002. This gain can be explained by a rise in the EU employment rate, which was largely offset by a decline in EU labour productivity relative to that in the US. There is no sign of a narrowing of the productivity gap between the Union and the US, neither in terms of labour productivity per hour worked (which stayed at 97% of the US level) nor in terms of hours worked per worker.
- The European labour market has so far proved to be quite resilient to the effects of the slow economic growth. Employment growth continued in 2001 and 2002, as did the decline in structural unemployment. The employment rate rose from 62% in 1999 to 64% in 2001, which shows good progress. The rise in the employment rate of women was satisfactory, but that of older workers rather disappointing, in particular because some Member States still showed a decline in the employment rate of older workers.
- Labour productivity per person employed in the Union declined from 86% of the US level in 1999 to 83% in 2002. The difference in productivity per person employed compared to US levels may be explained primarily by the gap between the Union and the US in the number of hours worked. However, attention also needs to be paid to the development of productivity per hour. Improving the Union's relative performance in terms of labour productivity per hour worked remains important and is necessary to offset the effects of a more rapidly ageing population on potential growth.
- In this respect, the insufficient integration and competition in product markets is a serious cause for concern. Slow investment growth in areas such as R&D and education, which are key to creating a knowledge-based economy, also endangers the Union's future growth and competitiveness. The disappointing increase in industry financed R&D in the Union between 1999 and 2001 and the stabilisation of public spending on education are also factors in the lower innovative capacity of the Union in comparison with the US. Developments in patenting rates clearly reflect the problems for European businesses and research organisations due to the non-existence of a Community patent. In spite of the current financial situation of the electronic communications sector, the Information and Communications Technology (ICT) sector has continued to grow faster than the rest of the economy, driven by telecommunications services. Broadband and 3G services are expected to drive future growth.
- The process of product market integration appears to have slowed down. Most Member States have failed to meet the target on the transposition of Internal Market directives; price convergence has come to a halt; public procurement is mostly done within national borders; energy markets remain insufficiently integrated; and in telecommunications competition at the local level is insufficient. Progress has been made in capital market integration, and Member States are making efforts to improve the business environment by easing the regulatory burden and by reducing ad hoc and sectorial State aids.
- In 1998, 18% of people in the Union were living below the poverty line, even when taking into account the important role of the welfare system in alleviating poverty. The highest

rates of poverty tended to be in the least affluent Member States and amongst the long-term unemployed as well as in single parent households. The employment gains in recent years may thus help in bringing the poverty rate down. Improvements achieved in the educational attainments of the population, as well as increasing access to life-long learning, and in the provision of child care facilities, should be a positive factor as well, but more needs to be done.

- The Göteborg European Council in June 2001 completed the Lisbon strategy by giving it an additional environmental dimension. While in the 1990s the Union made some progress in reducing greenhouse gas emissions, efforts need to be stepped up in order to meet the Kyoto commitments. On the basis of the latest data, at the time of the launch of the Lisbon Strategy (2000), the link between the GDP growth rate and the rate of growth in transport volumes had not yet been broken and road continued to be the preferred transport mode. Air quality has improved, but municipal waste volumes keep growing. Time is needed for the impact of measures since Göteborg to show up in the statistics.
- The acceding countries have already come a long way in making the transition to market economies. They are already relatively well integrated with the Union in terms of international trade and have generally made good progress in their efforts to improve the functioning of the economy. Nevertheless, the need for further efforts on structural reforms is apparent if an enlarged Union is to achieve the goals set by the Lisbon European Council.
- While the challenges faced by the future Member States and candidate countries do not differ fundamentally in nature from those in the current Member States, the scale of these challenges is in general greater. In particular, these countries have low employment rates and high unemployment rates and on the whole, competition is still relatively limited. They are also lagging behind in the transition to the knowledge-based economy and the upgrading of their infrastructure together with the extension of the trans-European networks will require substantial investments over the next years. The future Member States are aware of these problems and have already their own agenda of reforms. From a policy perspective, their main challenges are to improve tax and benefit systems and labour institutions, to strengthen competition rules and authorities, to make the public sector more efficient and to increase business R&D and investment in human capital.

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1. INTRODUCTION

This Staff Paper accompanies the 2003 Spring Report to the Spring European Council on the progress achieved in pursuing the Lisbon strategy of economic, social and environmental renewal¹. It provides a snapshot of progress towards the Lisbon strategy goals, identifying where it is helpful both the good performers and those who face the biggest challenges; in this way it helps to guide the choice of political priorities set out in the Spring Report itself.

It draws on the broad set of structural indicators agreed with Council to measure progress towards the Lisbon goals, as well as the analysis and assessment of progress prepared by the Commission services. That analysis benefits from the wealth of information now emerging through the sectorial benchmarking of performance in specific areas of the Lisbon strategy, often in the context of the open method of co-ordination.

This is one of the major strengths of the Lisbon strategy. By developing a common picture of progress across an enlarged Union, the European Council is able to provide policy orientations based on the situation on the ground. At the same time, further efforts are needed to reinforce the quality and timeliness of this statistical base, particularly in areas such as social cohesion and the environment, where reference data sometimes still predates the launch of the Lisbon strategy.

This report follows the grouping of the structural indicators (annexed to this report). It covers six areas:

- Economic performance
- Employment
- Education, research and innovation
- Economic reforms
- Social cohesion
- The environment.

For the first time the Spring Report and the structural indicators include coverage of the future Member States and candidate countries. This Paper therefore includes a separate Chapter analysing the challenges and opportunities they face in integrating themselves within the policies and objectives of the Lisbon strategy.

¹ Choosing to grow: Knowledge, innovation and jobs in a cohesive society, COM(2003) 5, 14.1.2003.

2. ECONOMIC PERFORMANCE

Lisbon Strategy Targets / Objectives

The Lisbon strategy does not set particular targets for economic performance. However, a sound economy is a precondition for achieving the objectives of the strategy. That is why particular emphasis has been placed on the Stability and Growth Pact and on structural reforms intended to raise the growth and employment potential of the Union.

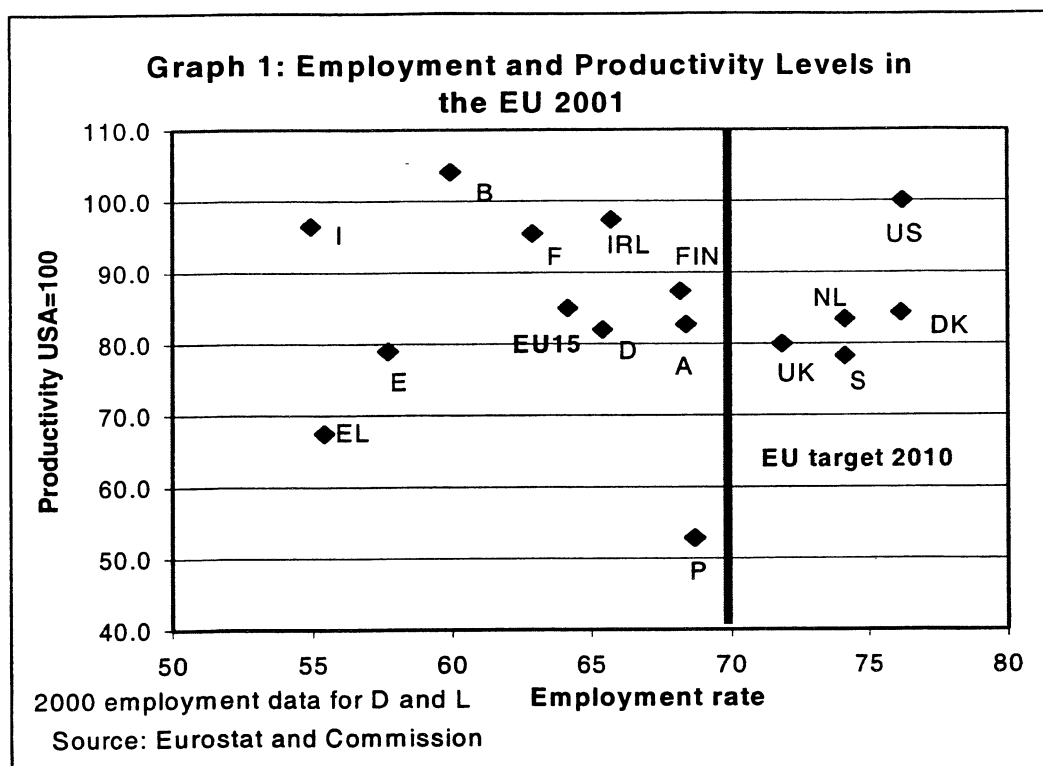
The Lisbon approach implies:

- That if the Lisbon measures are implemented against a sound macroeconomic background an average growth rate of around 3% per year should be a realistic prospect
- Member States' budgets close to balance or in surplus over the medium term, ensuring the long-term sustainability of public finances
- Redirecting public expenditure towards increasing the relative importance of capital accumulation (physical and human) and supporting R&D, innovation and IT

Economic reforms under the Lisbon strategy are aimed at raising the level of potential growth while ensuring its long-term economic, social and environmental sustainability. An increase in potential growth needs improvements at the same time in employment and productivity, requiring amongst other things a sound macroeconomic environment. This translates into increases in productive inputs (capital stock and employment) and technological progress. The twin Lisbon objectives of achieving full employment (by raising overall employment rates to 70%, to 60% for women and to 50% for older workers) and matching the productivity levels of the world's best performers are quite a challenge for most if not all Member States (see graph 1). For the Union as a whole, the employment rate went up from 62.4% in 1999 to 64.1% in 2001, while relative labour productivity per person employed (in PPP) declined from 86% of the US level in 1999 to 83% in 2002.

In terms of output per worker, productivity growth depends on the rate of technological progress, the accumulation of capital per worker and the number of hours worked. Improvements that raise workers ability to produce more with time-saving technologies may increase the level of hourly productivity.

A significant portion of the labour productivity gap with the US is due to the fewer number of hours worked per worker in the Union. Long-term sustainability is ensured by appropriate social and environmental policies, prudent budgetary policies and due account of developments in the world as a whole.



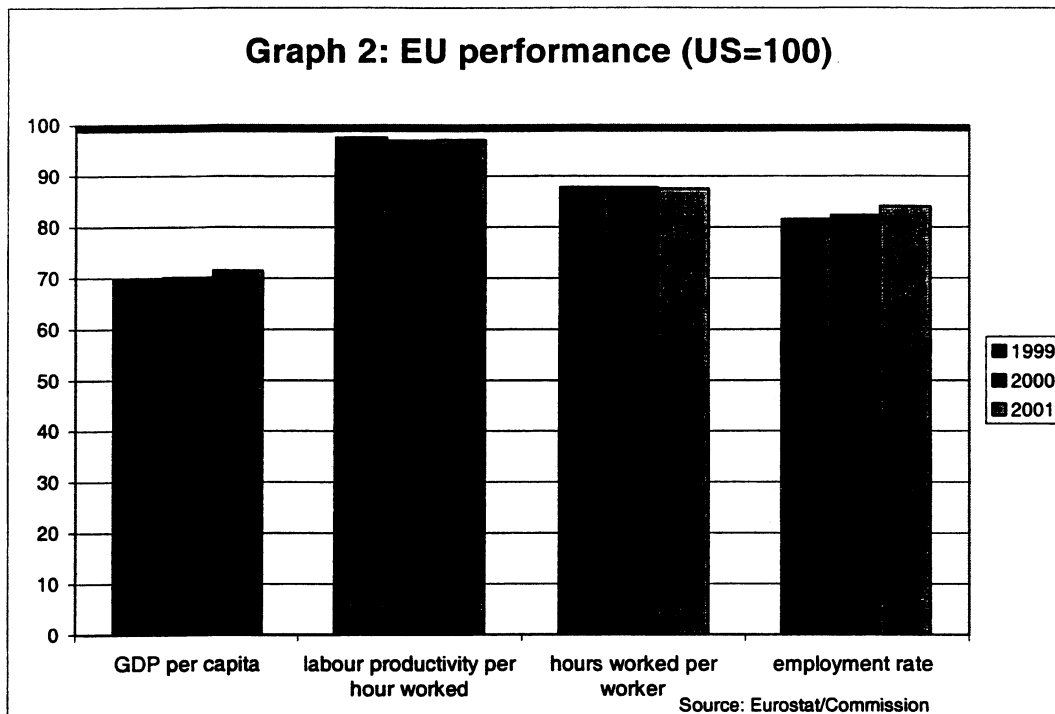
The gap between the Union and the US in terms of GDP per capita has narrowed somewhat since Lisbon

Hourly productivity, the employment rate and the hours worked determine, with the demographic component of the population the level and the dynamics of GDP per capita. The fewer numbers of hours worked per worker in Europe contributes to a per capita GDP that is lower than in the US. Nevertheless, this difference working hours reflects in part a positive choice by European citizens for more free time, in particular through longer holidays. Moreover developments of working hours may also be influenced by efforts to increase the participation rates of older people and to balance work and family life, as well as care responsibilities. On the other hand there are workers - in particular some part timers - who would like to work longer hours and better services, such as the provision of childcare, would help them to do so.

In the second half of the 1990s, high GDP growth, underpinned by strong employment creation, allowed EU living standards, as measured by per capita GDP, to improve markedly. GDP growth rates gradually rose from 1.6% in 1996 to 3.4% in 2000. US growth rates were even higher, fluctuating around 4%. However, in the face of external shocks and more recently a higher geopolitical uncertainty, this period of buoyant growth unexpectedly gave way to a period of sluggish growth, with growth rates averaging only 1¼ per cent in both the Union and the US over the years 2001 and 2002.

In spite of the lower GDP growth rates in the Union over the second half of the 1990s, the gap between the Union and the US in terms of GDP per capita in Purchasing Power Parity narrowed due to relatively lower population growth and lower inflation in the Union. While in 1996, EU GDP per capita in PPP was equivalent to 69% that in the US, in 1999 this ratio had risen to 70% (data available at the Lisbon summit) and in 2002 it was a little over 71%. The 1½ % gain since Lisbon can be fully attributed to a rise in the EU employment rate relative to that of the US (see graph 2). There is no sign of a narrowing of the productivity gap between

the Union and the US, neither in terms of labour productivity per hour worked nor in terms of hours worked per worker.



The labour market proved resilient

Despite the much more-sluggish-than-anticipated economic recovery, the EU labour market exhibited a certain resilience. In 2001 employment growth continued at 1.3% close to the average rate of the 1996-2000 period. In 2002, employment is estimated to have increased by some 500,000, which is equivalent to a 0.4% growth rate, and the deterioration of the unemployment rate has been quite moderate.

A side effect of the positive employment growth in the environment of slow economic growth has been a largely cyclical, reduction in labour productivity growth. Such behaviour by enterprises may make sense in terms of preserving employability. The slowdown in the rate of labour productivity growth to less than ½ per cent on average in 2001 and 2002 is likely to be reversed when growth recovers. Belgium, France, Luxembourg, Austria and Sweden experienced a particularly steep drop in the rate of labour productivity growth between 2000 and 2002. Meanwhile, the rate of labour productivity growth climbed to almost 3 per cent in 2002 in the US, as companies restored profit margins by cutting costs with large lay-offs. As a consequence, labour productivity per worker in the Union has fallen relative to the US to around 16.6% below the US level. This is a reflection largely of a difference in the number of hours worked, as the difference between the Union and the US in terms of labour productivity per hour worked has been less than 5% in recent years.

However, strains have started to be exerted on the macro-economic stability of the European economies

Three elements point in this direction:

- First, the steady decline in real unit labour costs has now come to a halt and continued moderate increases in nominal wages put upward pressure on real unit labour costs. In

2000, real unit labour costs increased for the first time since 1992. The increase accelerated to 0.6% in 2001, before dropping to 0.2% in 2002.

- Second, inflationary pressures have remained stubborn in a slow-growth environment. In the euro area, headline inflation has been above the European Central Bank's medium term reference value of 2% since 2000 and core inflation has remained at around 2.5%, after having risen gradually from below 1 per cent in 1999.
- Third, fiscal consolidation has levelled off and now requires renewed efforts. After 1999, several Member States have reduced their consolidation efforts. Initially, high growth, leading to strong cyclical increases in revenue, masked the fiscal adjustment fatigue in the large Member States. However, reflecting the deterioration of the economic environment, the average budget deficit in the Union (excluding receipts from the licensing of third general mobile communications systems) deteriorated from 0.2 per cent in 2000 to 1.9 per cent in 2002, the first increase in the deficit since 1993. As a result of the deterioration of budget balances and slow economic growth, the steady decline of general government debt to GDP ratio since 1996 came to a halt in 2002.

There is little evidence of a significant redirection of public spending towards the Lisbon goals

Public investment (as a percentage of GDP) remained constant between 2001 and 2002 in Union (2.3% of GDP). However, those countries with sound budgetary positions increased their level of investment while countries with some unbalances tended to reduce investment. In terms of composition of public expenditure at the EU level, there is little evidence of redirection of public expenditure towards productive investment. It is therefore important to improve the composition of the whole expenditure, while at the same time continuing to increase the efficiency of public investment in infrastructure, R&D and education.

3. EMPLOYMENT (MORE AND BETTER JOBS)

Lisbon Strategy Targets / Objectives

Lisbon has set an overall target of bringing the Union back towards full employment. This means for the Union:

- An overall employment rate of 70% in 2010 (67% in 2005)
- A female employment rate of 60% in 2010 (57% in 2005)
- An employment rate for older workers (55-64) in 2010 of 50%
- An increase by 2010 of five years in the average age at which people stop working
- Availability of childcare by 2010 for 90% of children (3 years +) and 33% of children under 3

As well as action at EU level to:

- Remove barriers to mobility between and within Member States (e.g. recognition of qualifications, pension portability, better provision of information, etc.)
- Improve quality in work, in particular the working environment and health and safety

For Member States:

- Reduction of tax burden on low-wage earners
- Make work pay within tax and benefit systems
- National labour institutions and collective bargaining to take account of relationship between wage developments and labour market conditions in order to bring wage developments in line with productivity
- Review employment contract regulations in order to strike a proper balance between flexibility and security
- Remove disincentives for female participation in workforce, promote active ageing and reduce early retirement incentives for individuals and companies
- Reduce the informal economy

Economic reforms under the Lisbon strategy are aimed at increasing the Union's growth potential and at regaining the conditions for full employment. The underlying policies focus in line with the Employment Policy Guidelines in the framework of the European Employment Strategy on creating more and better jobs by improving the adaptability of companies and workers, by increasing investment in human capital and enhancing quality in work and removing bottlenecks and disincentives. This will improve not only the sustainability of higher growth in the medium term, but also, through increased participation, the long-term sustainability of the social system.

Employment rates have increased since Lisbon, in particular for women...

Compared to 1999, the year before the start of the Lisbon strategy, the total employment rate in the Union increased by 1.7 percentage points, to 64.1% in 2001. For women, this increase in the employment rate over the period 1999-2001 was more pronounced (2.1%), leading to a female employment rate of 55% in 2001. In that year, four Member States (Denmark, the Netherlands, Sweden and the United Kingdom) had total employment rates already above the EU target of 70% set for 2010, and three additional Member States (Austria, Portugal and Finland) had already reached the intermediate target of 67% set for 2005. Some convergence between Member States can be observed as the improvement of (total and female) employment rates was generally stronger in those Member States with less favourable starting points. Differences among Member States are relatively small for male workers (11 percentage points between the best performing three and the lowest three in 2000), but far more pronounced for women (28 percentage points) and older workers (32 percentage points).

...but employment rates of older workers are still declining in some Member States

The employment rate of older workers in the Union as a whole increased from 37.1% in 1999 to 38.8% in 2001. However, Belgium, Greece, Austria and Portugal recorded a decline in the employment rate of older workers in 2001. In the light of this disappointing performance, reaching the target of 50% by 2010 represents a formidable challenge. The additional target set at Barcelona last year indicates the way forward (see below), namely through policies that will increase the average age at which people effectively leave the labour market.

Promoting active ageing

Member States have given increased attention to implementing a range of policies to raise the employment rates of older workers and extend working life but few have developed national **active ageing** strategies. Most Member States concentrate on benefit reforms, and give less attention to working capacity (for example, there is limited access to training) or to incentives for employers to retain or recruit older workers. Efforts are being made to discourage early exit or to provide financial and other incentives for staying longer in the labour market. However, little attention is given to promoting flexible forms of employment combining gradual retirement with part-time work. The tendency is to cover a broader age group than those aged 55-64 and to focus on older workers in employment rather than those in unemployment. Social partners are playing an important role in changing the attitude among their members to overcome the tradition of early withdrawal from the labour market.

Most Member States are encouraging an increase in the average age of exiting the labour force

The Barcelona European Council established the target of seeking “*a progressive increase of about 5 years in the effective age at which people stop working in the European Union*”. The preliminary assessment of progress towards this new target shows that the average age at which people stopped working in 2001 was just below the age of 60. To meet the EU target, this means that most people should leave the workforce at around 65, implying an increase in the average of about 6 months per year until 2010. Men tend to exit the workforce later than women. The countries needing to make the greatest efforts are Belgium, Germany, Italy, France, Luxembourg and Austria. Reforms are underway to reduce incentives for early retirement, for example, by permitting gradual retirement via part-time work and for older workers to earn more without losing benefit entitlements. Some have reduced pension rights for those retiring earlier, while others have added incentives for those working beyond the statutory retirement age.

Limited increase in the unemployment rate...

Following the slowdown, unemployment began to pick up in the second half of 2001 in most Member States. However, the increase has been limited so far, and the annual average unemployment rate of the Union in 2002 is, at 7.6%, expected to be no more than 0.2 percentage points above the 2001 average. The differential between the highest unemployment rate (11.4% in Spain) and the lowest (2.3% in Luxembourg) remains rather substantial, but the dispersion of unemployment rates across Member States has slightly declined over the past year.

...but continued decline in structural unemployment

Structural reforms have contributed to the decline of unemployment since the second half of the 1990s and also to the labour market's relative resilience in the slowdown. Structural unemployment is estimated to have decreased by just over a percentage point between 1996 and 2001, and it continued to fall slightly in 2002. Despite of structural improvements in the EU labour market there remains a major structural component in EU unemployment as witnessed by the long-term unemployment rate of 3.1% (i.e. more than two fifths of total unemployment) down from 4.9 in 1997

Gender gaps persist

Female unemployment continues to be higher than overall unemployment; in 2001, the female unemployment rate of 8.5% exceeded the total unemployment rate by 1.1 percentage points. Data for 1998 indicate that gross hourly earnings of women were, on average, 16.2% lower than male earnings. The gender pay gap is highest in the UK, the Netherlands, Ireland, and Austria, amounting to 20% or more. The gender pay gap is particularly high among older workers (30%), the high-skilled (23%), those in the private sector in general (24%) and financial services (28%) and manufacturing (25%) in particular, and among craft workers (31%) and plant and machine operators (25%). These data are not adjusted for differences in labour market characteristics (i.e. differences between men and women in terms of skills, working experience and the sectorial composition of employment).

Women have supervisory responsibilities much less frequently than men: 16% of men in paid employment in the Union had supervisory responsibilities and additional 19% intermediate responsibilities in 1998 compared to less than 9% and 16%, respectively, of women. Men were overall twice as likely to occupy such supervisory functions. This is a general feature in all Member States, with women least likely to be in supervisory functions relative to men in Italy, Greece and the Netherlands.

Women are further more often in non-standard employment such as fixed-term and part-time work. Compared to 6.2% of all employed men, for instance, 33.4% of all women work in part-time. Men are thus not only more concentrated in higher paid sectors and occupations, but within these sectors and occupations they are also more likely than women to hold supervisory responsibilities and if they do so their earnings are relatively higher.

Creating better jobs with fewer accidents at work

Relevant indicators to measure and monitor developments in quality at work include gender pay gaps, participation in lifelong learning, employment rates for older workers and labour productivity.

Research shows that improvements in the quality in work - the creation of "better jobs" - are positively correlated with all three elements: Labour market participation and employment rates are generally higher in Member States with relatively higher levels of quality in work. This applies in particular to women and older people. Labour productivity seems to be higher in sectors with higher shares of good quality jobs. In particular, access to training at the workplace contributes to fostering productivity and sustaining employment.

Therefore, to reach its full employment potential the Union needs to pursue the twofold Lisbon objectives of more and better jobs. People working in jobs without contractual security or without access to training are at significantly higher risk of unemployment and labour market exclusion. While for higher skilled and the young temporary contracts often functions as a stepping stone to more stable employment low skilled people and older workers are often forced into cycles of low productivity jobs and unemployment.

Accidents at work are measured by two indicators, namely the indices for fatal accidents and for serious accidents at work. Here the picture is mixed. Fatal accidents decreased substantially, by 21% in 2000 as compared to the base year 1998, while serious accidents decreased by 1%. However, these two indicators can only give a partial picture of quality at work.

Childcare places have increased, but still insufficient to meet the demand

Progress in Member States towards attaining the targets on childcare provision set at the Barcelona Council to cover at least 90% of children between 3 years old and the mandatory school age and at least 33% of children under 3 years old by 2010 is difficult to measure due to lack of complete and comparable data. According to the information available from the National Action Plans on employment in 2002, there has been a small increase since last year in the provision of childcare facilities, but it is still insufficient to meet the demand. However, there are now ten countries setting national targets for increasing childcare provision, compared to six last year. The targets are ambitious and are in line with the Barcelona objectives, but it is essential to improve national data to monitor the progress of childcare facilities.

Implementing lifelong learning strategies

In 2001, Member States have reinforced lifelong learning policies and all have now laid the groundwork for comprehensive strategies. However, further development and concretisation of the strategies are required, especially to improve coherence of policies and to ensure that adequate attention is given to disadvantaged persons. The school drop out rate is only decreasing slowly, which calls into question the feasibility of meeting the common target of cutting the rate in half by 2010. Attention has continued to focus on basic skills, developing continuing education and training for adults and improving the responsiveness of systems to the labour market. The common e-learning targets have not yet been fully met in all Member States but generally strong progress has been made, although more attention needs to be devoted to ICT training of teachers.

Combating undeclared work

The size of the informal economy is by its very nature difficult to measure, and so is the effect of the efforts undertaken to fight undeclared work. Member States are addressing undeclared work through general labour market reforms. Their efforts concentrate on: simplifying procedures for the declaration of new jobs, increased inspection and control campaigns, combining job incentives with sanctions, including measures to combat tax and social insurance fraud, reduction of the VAT rate in labour-intensive services enabling more equal competition with the same services provided through the informal economy, and developing legislation to control the undeclared work of immigrants. Most Member States have implemented or announced new initiatives in these areas, thus giving reasons to conclude that some progress have been made in taking measures to combat undeclared work and reduce the size of the informal economy, even though the effects of the measures are so far difficult to establish.

4. EDUCATION, INNOVATION AND RESEARCH (EUROPEAN KNOWLEDGE AREA)

Lisbon Strategy Targets / Objectives

Under the umbrella of a European knowledge area, a key element of the Lisbon strategy has been to speed up the transition towards a knowledge-driven economy. Action has been shaped around a range of initiatives from eEurope and the creation of a European Research Area to promoting innovation and establishing common objectives at EU level for national education policies. This has been translated into targets such as:

- Increase R&D spending with the aim of approaching 3% of GDP by 2010. The proportion financed by business should rise to two thirds of that total (target set at Barcelona)
- 100% of schools to be connected to the internet by 2002 (target set at Lisbon)

Research

- Network national and joint research programmes on a voluntary basis around freely chosen objectives
- Improve the environment for private research investment, R&D partnerships and high-technology start ups
- Develop an open method of co-ordination for national research policies
- Roll out a world class research communications infrastructure
- Remove obstacles to the mobility of researchers, attract and retain high-quality research talent in Europe
- Introduce a cost-effective Community Patent
- Harness new and frontier technologies, notably biotechnology and environmental technologies (Stockholm)

Information Society

- All teachers to have training in digital skills by 2003
- Ensure access to widespread, world class communications infrastructure and ensure significant reduction in the cost of using the Internet (local loop unbundling)
- Create conditions for e-commerce to flourish
- Prevent info exclusion
- Stimulate eGovernment
- Support take up of 3G mobile communications and introduction of Internet Protocol version 6

Education

- Achieve a substantial increase in per capita spending on human resources
- Promoting lifelong learning
- Adapt skills base better to needs of knowledge society
- Better recognition of qualifications
- Promote learning of EU languages and introduce a European dimension to education
- Promote school twinning via Internet

Productivity gains are highly dependent on technological progress and improvements in the quality of labour and capital inputs into the production process. It is not surprising therefore that the transition to the knowledge-based economy is at the centre of the Lisbon Strategy. The Union has taken some steps forward and reaffirmed its political commitment at Barcelona, but the Union as a whole is still lagging behind the US in terms of both investment and performance in this area. Faster progress is needed to achieve the Lisbon and Barcelona goals. Policy action thus far has focused on improving the educational achievements of the population, spurring R&D and innovation, and encouraging ICT usage. Ensuring more effective target of education spending is an important element in achieving this.

Progress in building up the skills base in the Union is central to the Lisbon goals...

Education contributes to growth even more than investment in equipment or capital. Investment in human capital was responsible for an additional point of growth in several Member States during the 1990's. For individuals, their school attainment is the main factor in determining their job and standard of living. On average an additional year of schooling increases wages by 6.5% across the Union.

However, public expenditure on education in the Union as a percentage of GDP increased only marginally between 1999 and 2000 from 5.0% to 5.1%, a level similar to that in the US. Differences between Member States remain significant. There is a clear gap between private sector investment in skills and training in the Union. The level is half that of what business

spends in Japan and third of what is spent in the US. This led the Commission in November 2002 to invite Member States² to set national benchmarks for increasing overall investment in human resources². Investment should focus on the areas with greatest returns in terms of quality, efficiency and relevance. The necessary incentives to bring this about should be put in place.

...and access to lifelong learning remains a problem

Access to lifelong learning in the Union is clearly insufficient. The EU average is 8.4% and variations between countries are significant (in the best three performers participation in lifelong learning averages 19.6% and in the three worst only 2%).

Slow progress in reducing the number of early school leavers

Some Member States have made an effort to increase the efficiency of education and training systems. Nevertheless, wide differences in outputs remain, e.g. in terms of the share of 18-24 year-olds with only lower secondary education and not in further education and training, and in terms of educational attainment of the population. There has been little progress to date in moving towards the objective of halving the number of early school drop-outs. The current rate of completion of secondary education has been increasing steadily over the last decades to reach 66% in 2000. The average of the three best European performers is 82.7%, which is lower than the corresponding US figure (87%).

Marked variations can also be seen in the number of science and technology graduates. This supply of newly skilled researchers is important to improve a country's future research potential. Women are particularly under-represented in these fields. Another problem is the relatively low proportion of researchers in the Union compared. Here there are five for every thousand in the working population, compared to eight in the US and nine in Japan. Research careers therefore need to be made more attractive to build up the Union's research base.

Barcelona established a goal of boosting language performance in the Union

Over half the population of the Union is able to speak another language in addition to their mother tongue and a quarter can speak two languages. These skills are increasingly important to do business within an internal market, as well as for fostering integration. There are wide variations between Member States, social groups, and age groups. Although more than half of European citizens would be willing to learn another European language, the lack of lifelong language learning often prevents them from doing so. Finally, following the call from the Barcelona European Council, the Commission is working with national experts to devise a European Indicator of Language Competence to compare performance among Member States.

...and improving recognition of qualifications.

In order for European citizens to move freely within the Union for study, training or work purposes, the Lisbon strategy has promoted improvements in the recognition and transparency of qualifications. A key factor is ensuring that people are aware of the systems that exist. For example, transparency tools such as the common format for certificates and the common format for Curriculum Vitae, which have been promoted at EU level, are now being introduced nationally. However, further political commitment is needed to make a real

² Communication on European benchmarks on education and training, COM(2002) 629, 20.11.2002.

difference on the ground, including progress on the pending proposal on updated rules on the mutual recognition of professional qualifications.

In this context, Member States, together with the EEA, the future Member States and the candidate countries, and the European social partners, have committed themselves to improving recognition of vocational qualifications and competences. This will include the development of a single instrument to facilitate recognition, the development of a credit transfer system for vocational education and training, and the development of common criteria for quality assurance.

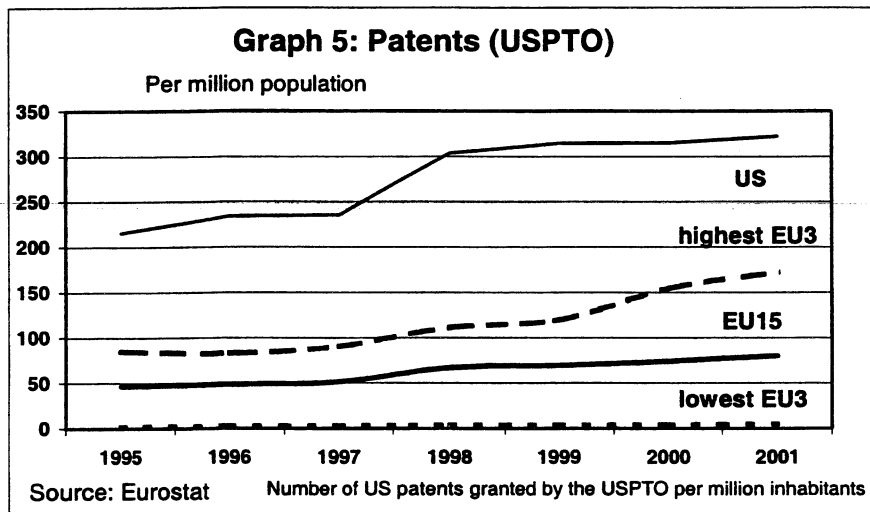
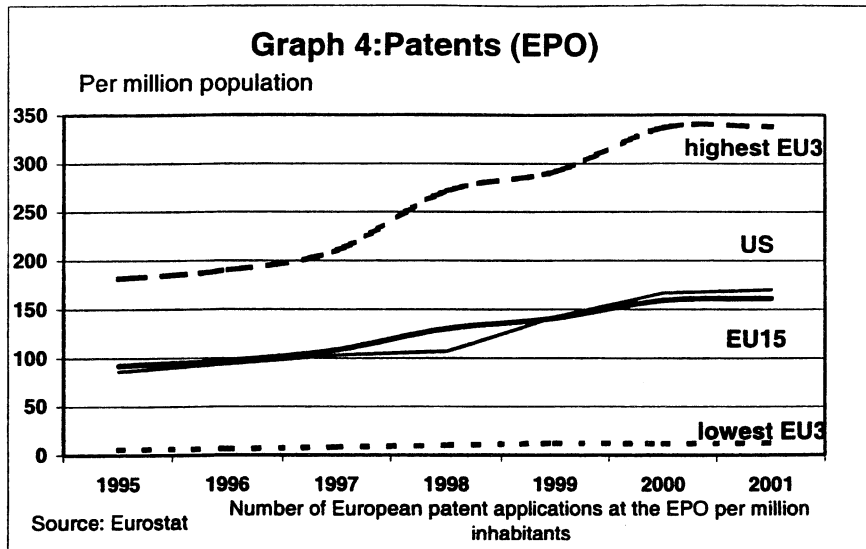
The gap in business investment in R&D makes the Barcelona target particularly challenging.

In 2001, average expenditure on R&D in 2001 for the Union was less than 2% of GDP, with only 55% being financed by industry. This illustrates the large gap between the current situation and the Barcelona target of reaching a level of the 3% of GDP level by 2010, with two thirds funded by industry. Between 1998 and 2001, there was a small increase in industry financed R&D, but this increase was not sufficient to stop the EU average from falling further behind the US. Clearly, a break in current trends will be necessary to reach the Barcelona target. While measures have been taken to improve the framework conditions for R&D and innovation, it is doubtful that these measures will be sufficient. Differences in R&D spending between Member States are substantial and widening. Countries such as Sweden and Finland are already at the spending levels identified in the Barcelona target and have recorded the biggest improvements. However, there were also positive signs in Greece and Portugal, which trailed the leaders by far, but drew slightly closer to the EU average.

Venture capital investments fell sharply...

The availability of venture capital facilitates investment in R&D and innovation, particularly for start-ups and young companies. In 2001, the venture capital market across the Union has contracted, largely because of the continuing deflation of the bubble in ICT investment. The contraction was especially strong in early-stage financing, except in the Nordic countries, with a significant increase of investments in Denmark, and stable levels in Finland and Sweden (where early-stage investments are rather high), countries that performed best in terms of business R&D as well.

... while patenting remains well below US levels



The patenting rate is a rough measure of the output of national innovation systems. In 2000, the number of US patent applications with the European Patent Office increased faster than that of the Union. The number of patents granted by the USPTO to EU organisations and companies, on the other hand, is rising even if the Union continues to trail far behind the US. This partly reflects the greater efficiency of the US innovation system, but also the weakness of the European patenting system, since the single Community patent has not yet been agreed. Also, since Lisbon there has been a substantial and widening gap between Member States as patenting rates in three countries with the highest rates (Sweden, Finland and Germany) have risen faster than in the three countries with the lowest rates (Portugal, Greece and Spain).

There has been real progress in pursuing a range of eEurope objectives that support the knowledge economy...

There has been a strong take-up of ICT in most Member States, with household Internet penetration rising above 40% on average in 2002. The percentage of households that have Internet access at home increased to above 60% in the Netherlands, Denmark and Sweden, but it remained below 30% in Greece and Spain. Internet penetration in the Union continues to be less than that in the US, in part because access prices are still higher in the Union. More

than 90% of EU schools have Internet connections, and the number of computers per pupil is also increasing. The Commission's newly proposed programme for eLearning will support action promoting digital literacy, the setting up of virtual campuses and Internet school-twinning activities. The latter was one of the actions promoted by the European Council in Barcelona as an effective way of combining cultural exchange with the fun use of computers.

The eEurope 2002 Action Plan is now coming to an end and has been successful in accelerating this entry into the digital age, focusing on connectivity as the driving element. The shift on line signalled above has connected up homes, businesses and administrations and should lead to improvements in productivity and growth. However, the Union has yet to feel the same improvements from ICT investment as those experienced during the 1990s by the US and despite increased spending, the level continues to lag behind the US, even if it is slightly ahead of Japan. The level of spending varies across Member States.

New services and the Internet have opened new opportunities for society as a whole. This has been helped by the creation of a comprehensive legal framework for e-commerce and will be further underpinned from next summer by the new regulatory framework adopted for electronic communications, which should give a further boost to competition, investment and choice.

There have been significant advances across the board. The number of homes with Internet access increased from 28% in October 2000 to 40% in June 2002 when more than 90% of EU schools had an Internet connection, as well as 90% of EU businesses with more than 90 employees. The Géant network has been running since 1 November 2001, offering a capacity of 120 Gbit/second. It connects together 32 national research networks across Europe. There has been substantial progress in getting an increasing number of government services on line as part of a move towards eGovernment. Benchmarking progress has focused on 20 basic services for citizens and businesses varying from getting information to be able to complete forms or tax returns and file them on line with progress being seen in all Member States.

Currently, technological developments of broadband and multi-platform access (the possibility to connect to the Internet via other means than the PC, such as digital TV and 3G mobile communications) are opening up significant economic and social opportunities. The new eEurope 2005 Action Plan (launched in the summer of 2002) focuses on the exploitation of these technologies to modernise public services, making them more productive and more accessible, to complete a favourable environment for e-business, and to secure a broadband information infrastructure, as networks have become the lifeblood of today's economy. On the demand side, actions on e-government, e-health, e-learning and e-business are designed to foster the development of new services, also providing a crucial pull for investment in new networks. On the supply side, actions on broadband and security should advance the roll-out of infrastructure, stimulating further the development of new applications, services, and content.

5. ECONOMIC REFORM

Lisbon Strategy Targets / Objectives

The Lisbon strategy has identified a wide range of structural economic reforms, often translated into requests for the adoption of specific legislative proposals by a given deadline. The following specific targets have been set:

- Ensure full implementation of the Risk Capital Action Plan by 2003 and the Financial Services Action Plan by 2005 (target set at Lisbon)
- Increase the percentage of Internal Market directives transposed into national law to 98.5% (target set at Stockholm)
- Increase the percentage of Internal Market directives, which are more than two years overdue, transposed into national law to 100% (target set at Barcelona)
- Ensure the opening of energy markets for business customers in 2004 and subsequently for domestic users (target set at Barcelona)
- Ensure cross-border energy transmission capacity equivalent to at least 10% of installed production capacity by 2005 (target set at Barcelona)
- Achieve a single European sky by 2004 (target set at Barcelona)

In addition, the Lisbon strategy calls for economic reforms to:

- Increase the supply of venture capital (including via EIB/EIF support)
- Further opening of market for postal services, railway and port services, and agreement on rules for public service contracts in transport
- Increase the openness of public procurement
- Complete the internal market for services
- Lower the costs of doing business and reduce red tape
- Introduce an improved impact assessment system for Community proposals
- Continue downward trend in state aid as a percentage of GDP and redirect aid towards horizontal objectives
- Promote a competitive business environment by eliminating harmful tax competition for businesses
- Promote quality public services

Economic reform is essential to make European markets function more effectively. Well functioning and competitive markets lead to productivity gains and thus raise the economy's potential growth rate. Better functioning markets can also help the economy to respond more flexibly to economic changes. Companies and people can thus adapt more quickly, delivering the benefits of economic change while reducing the transition costs sometimes accompanying this change.

Product markets are increasingly integrated, but the process may be slowing down

During the 1990s the creation of the Internal Market increased economic integration between the Member States. This was demonstrated by a convergence in Member States' price levels from a coefficient of variation of 18.9% in 1992 to 14.5% in 1998. Since 1998 price convergence has come to a halt, even though considerable price differences remain for many products. In 2001, the degree of price dispersion between Member States equalled 14.8%. Price dispersion within the euro area, however, was less at 12%. This picture of slowing integration is supported by a decline in the intra-EU trade-to-GDP ratios for the Union as a whole in 2001, the first decline since the achievement of the internal market in 1992. Cross-border foreign direct investment also experienced its first year of decline since the mid-1990s in 2001.

Insufficient progress in transposition of internal market directives and public procurement

The apparent slowdown in economic integration may reflect the insufficient progress over the past couple of years in terms of economic reform. For example, the rate of transposition of internal market directives rose from 97% in November 2000 to 97.9% in November 2002, but for most Member States remained below the target of 98.5% set in Stockholm. Similarly, the value of public procurement calls for tender published in the Official Journal as a share of the total value of public procurement was unchanged at 15% between 2000 and 2001. Also, the

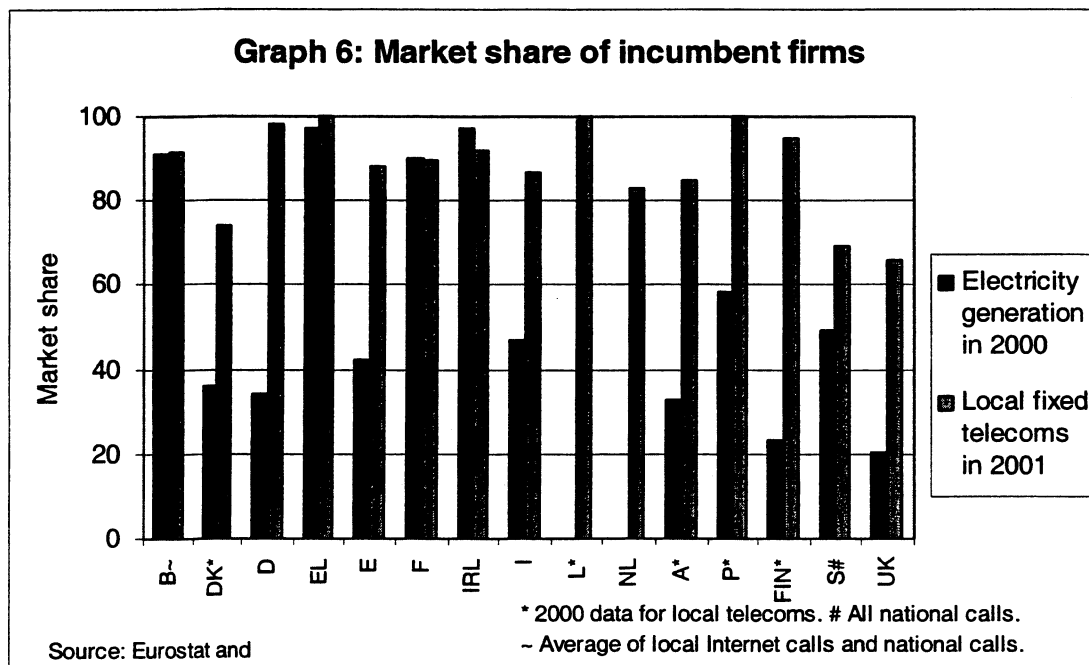
number of cross-border award notices remained very low, accounting for just 1.3% of total award notices.

Capital market integration is progressing

Thanks to the Maastricht convergence process, which has led to more similar inflation and budgetary behaviour across the Union, and to the single monetary policy which has allowed for the integration of the inter-bank market, there has been a considerable convergence of interest rates on bank loans since the late-1990s. For instance, the standard deviation between the interest rates charged on short-term loans across the Member States fell from 5.1% in 1995 to 1.6% in 2001. Convergence in retail interest rates seems to have come to a halt in 2001, suggesting the presence of still considerable barriers to the integration of retail financial markets. On the other hand, good progress has been made so far in implementing the Financial Services Action Plan (as of November 2002, 30 out of the 42 measures have been completed).

Liberalisation of the network industries continues, but incumbents retain high market shares and markets remain insufficiently integrated

The liberalisation of the network industries continued in 2002 but at varying speeds in different sectors and in different Member States. The price of long-distance and international phone calls (to the US) both fell by over 45% during 1998-2002. However local phone call prices fell only marginally over the same period. This difference in price trends in part reflects need to rebalance the line rentals and local call tariffs of incumbent firms. The incumbent firm had a market share of over 80% in the local telecommunications market in 12 Member States in 2000 / 2001.



In 2002, the gradual legal opening of gas and electricity markets to competition continued. Nevertheless, competition in the energy sector remains limited. According to the latest data available (2000) the market share of the largest electricity generator was above 80% in Belgium, Greece, France and Ireland. As regards electricity prices, over the past five years (1997-2002) prices for industrial users have fallen by 9%. In the less competitive market for household users electricity prices still fell by 5% in absolute terms over the same period. Gas

prices, for both industrial and domestic users, have increased in recent years reflecting the increase in the oil price.

Efforts continue to improve the business environment, promote effective competition and reduce State aid

Efforts to ensure a level playing field in the internal market continue. The modernisation of the enforcement mechanisms of Articles 81 and 82 EC, which seeks to encourage effective competition through increased involvement of Member States authorities, has advanced well. The Council adopted on 16 December the new regulation on enforcement procedures. In December, the Commission also presented its proposal for a revised Merger Regulation as well as guidelines on the assessment of dominance in horizontal mergers. The review is aimed at ensuring for mergers that fulfil certain turnover thresholds a "one-stop shop" and uniform procedural and substantive rules. This exercise aims also at ensuring that the EU merger control remains in step with economic realities, in particular globalisation and the enlargement of the Union.

For the Union as a whole, State aid (including horizontal, sectorial and ad hoc state aid) declined from 1.3% of GDP in 1996-98 to 1.1% of GDP in 1998-2000. This decline in total State aid could be fully attributed to the 0.2 percentage point decline in sectorial and ad hoc State aid as a percentage of GDP. Aid levels declined in all Member States except Denmark, Ireland, Luxembourg and the Netherlands. In this context, it is worth recalling the commitments made by Member States at Stockholm and Barcelona to demonstrate a reduction in aid levels by 2003. For its part the Commission, is continuing its efforts to simplify the EU rules on State aid, to modernise them and clarify their application in order to make them more effective.

In relation to the regulatory environment, most Member States have been pursuing reforms aimed at improving the business environment. Many took measures to reduce the time and costs required for setting up new enterprises. The Commission has been playing its part too, launching two major Better Regulation packages during 2002.

Box 1: Improving the regulatory environment

The Commission's **better regulation** package launched last summer pursues four goals.

- An **improved integrated system of impact assessment** of key proposals at EU level (and the request that Council and the European Parliament also assess the impact of changes they propose to legislation). This system is now up and running and will be applied to forty major initiatives during 2003. This will help to improve the quality of what is finally proposed and, should facilitate the process of adoption by Council and the European Parliament.
- **Wider and more open consultations** before measures are proposed by the Commission so that the views of stakeholders and user needs are better taken into account.
- Using **alternatives to legislation** where that is the most appropriate way of ensuring policy objectives can be quickly and effectively achieved.
- A major **simplification of existing EC rules** by 2005. The aim is to make rules easier to understand and compliance correspondingly less expensive.

The challenge is to find the right balance between protecting the public interest, while avoiding ineffective or unnecessarily burdensome regulation that can hold back business' contribution to competitiveness, job creation and sustainable growth.

Economic reform may be having an effect on business investment

The progress made to date in economic reform may be having an effect on business investment. Business investment had been increasing from 17.1% of GDP in 1996 to 18.3% of GDP in 2000. However, in 2001 it fell to 17.8% of GDP, which may indicate that the increase in business investment was due at least in part to the cyclical upswing in European economies during the late 1990s.

6. SOCIAL COHESION (SOCIAL POLICY AGENDA)

Lisbon Strategy Targets / Objectives

The approach to improving cohesion, particularly social cohesion, is strongly focused on implementing the European Social Policy Agenda launched in Nice, but it also recognises the importance of basic education and training as a stepping stone to the labour markets. Targets for the Union include:

- Halving by 2010 the number of early school leavers who do not continue with further education
- Efforts to reduce by 2010 the numbers living at risk of poverty
- Stimulating the take up of lifelong learning

In addition, other policies should contribute to:

- Strengthening equal opportunities for the disabled,
- Promoting gender equality, a good working environment and involve of the social partners in managing change
- Promote corporate social responsibility
- Adapting pension and healthcare / long-term care systems to an ageing population with twin objectives of ensuring quality and financial sustainability

Many of the structural reforms undertaken as part of the Lisbon strategy will contribute to increasing the growth potential of the European economy thus leading to improvements in living standards. Nevertheless, in order for these improvements in living standards to be shared by all it will be necessary to tackle the existing problems of poverty, exclusion, unemployment and low educational attainment existing in the EU.

The highest rates of poverty continue to be in the least affluent Member States...

Unfortunately, it is not possible to analyse the most recent developments in the social situation in the European Union. This is because the latest data on poverty and income inequality are for the year 1999. In this year, 18% of the population or 60 million people in the Union were living below the poverty line, while 11% had also had income below this level for two of the three previous years. The highest rates of poverty tend to be among the least affluent Member States. This is particularly the case for the persistent risk of poverty rate, which is the highest in Portugal and Greece. The inequality of income indicator reveals that in 1998 (compared with 1997) the income of the highest income 20% of the population increased less than that of the lowest income 20% of the population. As there was a relatively strong cyclical upswing in 1998, this evidence could be a sign that the wealthiest in fact benefited less from good times than the least affluent. This is consistent with the observation that the risk of poverty rate was down slightly in 1998 from its value in 1997.

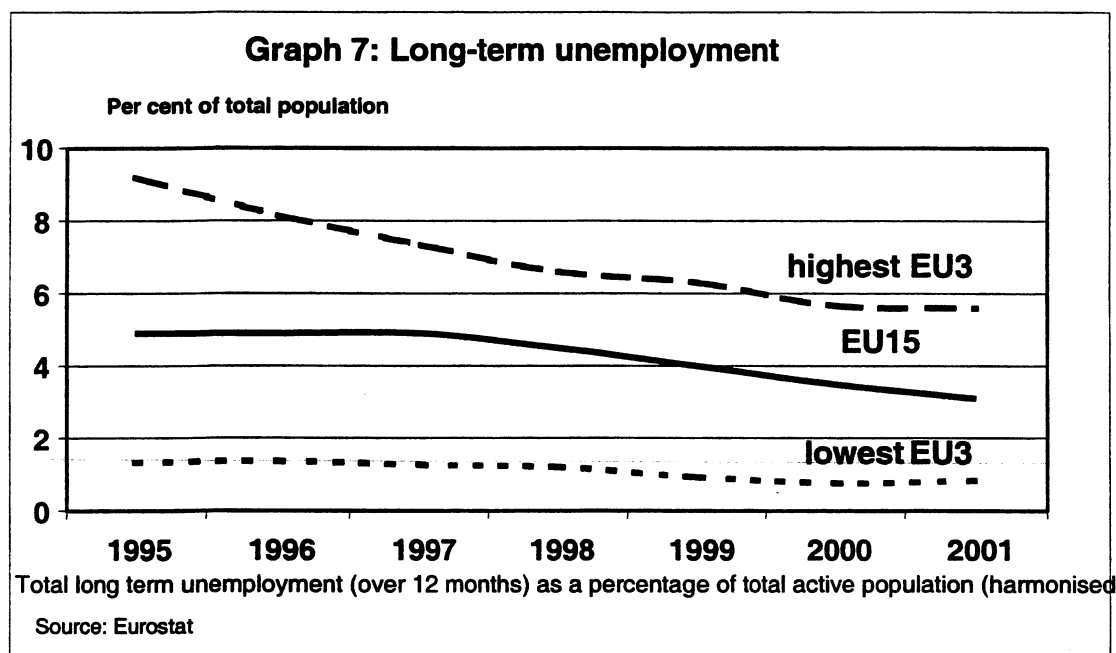
... but the welfare system continues to work to significantly reduce the risk of poverty

Moreover, welfare systems in the Union continue to play an important role in alleviating the effects of poverty – the risk of poverty rate in the Union in 1998 fell from 24% to 15% as a result of social transfers.

However, the improvement in employment since the mid 1990s gives some grounds for optimism...

While, as noted above, poverty and income distribution data provide a mixed and somewhat out-of-date picture, there are grounds for optimism regarding improvements in the social situation more recently. This is because in recent years, particularly up to and including the year 2000, job creation has been strong. In terms of social indicators, the positive impact of job creation for 1998 through a fall in the percentage of persons in jobless households in the Union, which continued until very recently.

Moreover, this improvement in the employment situation manifested itself in a continued notable decline in long-term unemployment in recent years. Long-term unemployment is a key indicator for social exclusion as long spells in unemployment are an important risk factor for poverty and social exclusion. The marked decline in long-term unemployment reflects to some extent the cyclical upswing, but it is also the result of an increased emphasis on active labour market programmes in Member States, partly due to the implementation of the European Employment Strategy since 1997. Placement in an active labour market programme often interrupts an unemployment spell, thus reducing open long-term unemployment. Long-term unemployment fell from 4.9% in the Union to 3.5% in 2000, and continued to fall substantially in 2001 to 31%, despite the slowdown in job creation in line with the slowdown in economic growth.



... although employment prospects continue to be less favourable for some groups

An important element of tackling social exclusion is to improve the prospects of all groups of workers, including older workers, women and young people (see above). While the situation for women was improving, both in terms of employment and unemployment, the situation for older workers improved less rapidly. Youth unemployment, while still high, has fallen in recent years and more rapidly than overall unemployment.

Inclusion in the knowledge-based society will also require better educational attainment and broader access to lifelong learning...

The development of the knowledge-based society also creates further challenges for the European social model. One challenge is to ensure higher educational attainment in the basic education system as well as sufficient investment in adults through lifelong learning and active labour market measures. Only if people have an adequate level of education and training and if they are able to upgrade and update their skills throughout their lives will they be in a position to take full advantage of the opportunities created by the knowledge-based society, and avoid social exclusion. In this regard, there continues to be some progress in the European Union. The rate of early school-leavers not in further education or training declined from 19.7% in 2000 to 18.9% in 2002, but remains high particularly in Portugal, Spain, Ireland and Italy.

The picture is also mixed on regional cohesion...

An important element of cohesion in the European Union is the regional dimension. The dispersion of regional employment rates increased slightly in 2001 compared with 2000. However, this overall EU average masks varying trends within Member States. In terms of the convergence of living standards in the less prosperous Member States, it should be noted that these Member States have generally experienced higher national rates of economic growth than the EU average thus reflecting overall income convergence.

7. ENVIRONMENT / SUSTAINABLE DEVELOPMENT

Lisbon Strategy Targets / Objectives

The Göteborg European Council agreed on a sustainable development strategy that underpins the whole of the Lisbon strategy and adds to it an environmental strand. Importance is attached to how decisions are taken and prepared, and to “getting prices right” in order to provide consumers and producers with better incentives to make the right choices for their activities. Four specific priorities were identified in Göteborg which translate in targets such as:

Climate change

- Reduction in greenhouse gas emissions (i.e. Kyoto targets) with visible progress by 2005
- Progress towards an indicative target for 2010 of 22% for electricity generated from renewable sources

Sustainable transport

- Decoupling GDP and transport growth, in particular by a shift from road to other modes of transport
- Tackling rising traffic volumes and congestion, noise and pollution
- Encourage use of environmentally friendly transport (shift from road) and give priority to investing in environmentally friendly infrastructure

Public health

- Respond to citizen's concerns about safety and quality of food, use of chemicals, infectious diseases and antibiotic resistance

Resource management

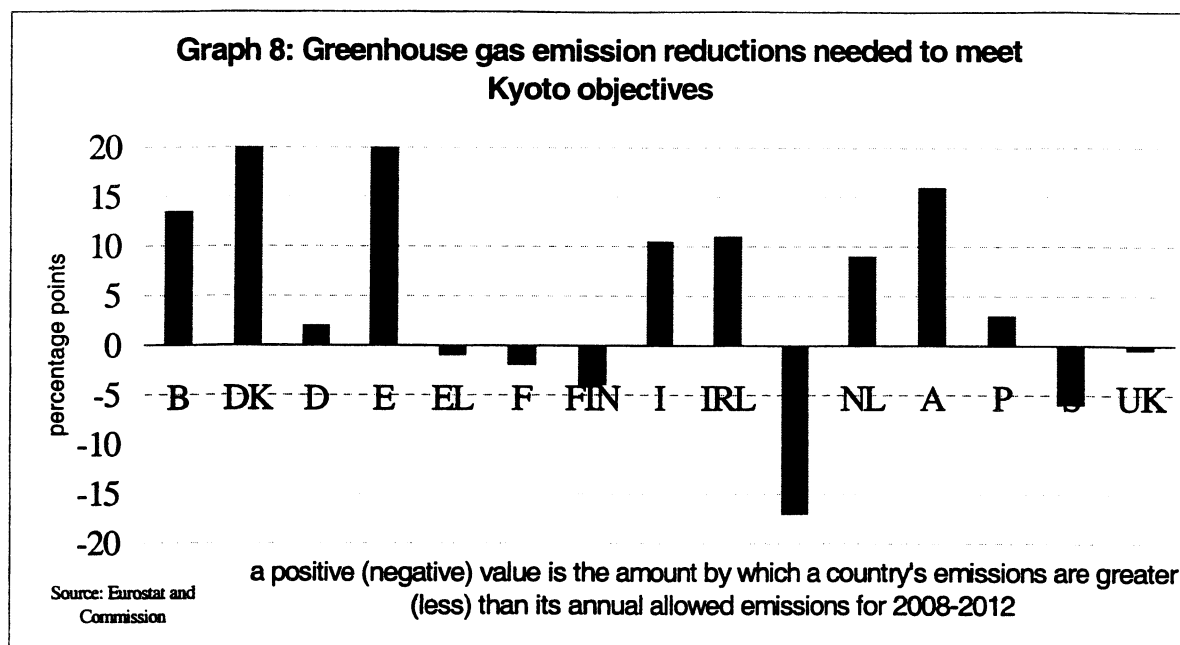
- Decoupling resource use and generation of waste from growth

The Göteborg European Council agreed on a sustainable development strategy that underpins the whole of the Lisbon strategy and adds an environmental strand to it. In addition to the importance attached to how decisions are taken and prepared, and to “getting prices right” in order to provide consumers and producers with better incentives to make the right choices for their activities, four specific priority areas were singled out: climate change, transport, public health and natural resources.

Climate change: Progress in reducing greenhouse gas emissions...

Greenhouse gas emissions for the Union fell by 4% from 1990 to 2000 half the amount needed to meet the commitments under the Kyoto Protocol. In the US, on the other hand, greenhouse gas emissions went up by 11%.

... needs to be stepped up to meet the Kyoto commitments . . .



The Union is much closer to meeting its Kyoto commitment than Japan (the US announced in 2001 it would not ratify the Kyoto protocol). Nevertheless, several Member States need to make large reductions in their emissions from current levels (that is, before allowing for any increases due to economic growth in the next decade) if they are to meet their commitments under the Burden Sharing Agreement.

Moreover, the progress made during the 1990s is largely due to the impact of significant reductions through one off measures in Germany and the UK. In contrast nine Member States in 2000 remained well above their Kyoto target paths. This only serves to highlight the importance of making progress on the pending proposals on emission trading. Emission trends in the transport sector remain of particular concern, mainly due to the increase in road transport volumes, although there are clear signs that the energy efficiency of new vehicles is starting to have an impact.

... and energy intensity changes in some Member States show this will not be easy

The Community economy has recorded steady but slow improvements in its energy intensity during the past decade. This is true for all Member States except Portugal, and to a lesser extent Greece and Spain. The US achieved somewhat greater improvements in energy intensity than the Union, this, however, should not hide the fact that the US is relatively heavy energy user: energy consumption per unit of GDP is 70% higher in the US than in the Union and that energy consumption in absolute terms is growing faster in the US than in the Union. Japan, on the other hand, consumes only about 60% as much energy per unit of GDP as the Union.

Already in the 1996 Green Paper on renewable energy³ proposed a target of doubling the share of renewables in sources of energy from 6% to 12% by 2010. In order to help reach this target, Göteborg established an indicative target of raising their share in electricity production

³ Energy for the future: renewable sources of energy. Green Paper for a Community Strategy, COM(1996) 576, [x].11.1996.

from 14% to 22% by 2010. Moreover, important measures have been agreed at European level:

- The Directive⁴ on the promotion of green electricity is intended to raise their share in electricity production from 14% to 22% by 2010.
- The proposal for a Directive on the promotion of bio fuels for transport, when adopted, will lead to a share of bio fuels of 5.75% by 2010.
- The Directive on the energy performances of buildings will make a substantial contribution to achieving a reduction in demand of up to 20% in buildings in the medium term.

Initiatives in these fields will moreover be financially supported by the “Intelligent Energy for Europe” Community programme. Unless the Member States implement effectively the Community measures recently approved the share of renewables is unlikely to grow beyond 7% in the coming ten years. To complement and support the further development of the energy markets by improving the security of energy supplies, amid rising geopolitical uncertainty, the Commission has also proposed two directives concerning the joint management of oil and gas stocks.

In the area of transport, there is no sign in the Union of decoupling of freight from GDP...

The most recent data available show that EU freight volumes have risen about 1% faster than GDP in the years up to 1999. Sizeable decoupling has occurred in the US: from 1995 to 1998, the ratio of freight to GDP fell by almost 10% coinciding with strong economic growth. EU passenger transport volumes, on the other hand, have grown a little slower than GDP. A failure to achieve decoupling will have a negative effect on the achievement of Kyoto unless rapid progress is made to cut on the emission levels of road vehicles.

...and road continues to be the preferred transport mode.

Road is the dominant form of transport for freight in the Union, accounting for over 40% of tonne-kilometres. Over time, this share has tended to increase. The US moves a smaller percentage of goods by road, but the share is growing faster. Road transport also dominates personal travel within the Union, accounting for 84% of passenger-kilometres. This share has been more or less constant for several years. The same is true for the US. Road transport continues to take a heavy toll on the environment, and even though road transport fatalities dropped by 27 % since 1980 they still numbered over 41 000 in 1998. Road accidents represent the first cause of death for persons under 40.

Public health and natural resources: Air quality has improved, but urban “hot spots” persist...

Total emissions of ambient air pollutants have been declining for several years and will continue to decline in coming years thanks to improvements in vehicle emissions, contributing to improved air quality. However, data for urban air quality are incomplete at EU level, so it is not possible to give a detailed picture of developments. Analysis is further complicated by the fact that there has been a substantial increase in the number of sites across

⁴ Directive 2001/77/EC on the promotion of electricity produced from renewable energy sources in the internal electricity market.

the Union at which air quality is monitored. Subject to these qualifications, exposure to high concentrations of ozone appears to be most acute – and worsening – in the urban areas of Greece and Italy.

...and municipal waste volumes keep on growing.

Volumes of municipal waste are increasing throughout the Union, though data are not available for all countries and years. There is a general trend for waste to increase faster than growth, with this being quite marked in Spain, Austria, and Portugal.

8. THE CHALLENGE OF ENLARGEMENT

The Lisbon strategy will assist the ten countries that will join the European Union in 2004 in their efforts to sustain a healthy economic outlook and favourable growth prospects, to improve employment and social cohesion and to prepare the transition to a knowledge-based economy. In spite of the progress made in recent years, the ten future Member States face a real challenge in contributing to the achievement of the Lisbon targets. All acceding countries will have to further intensify their efforts in order to contribute to the realisation of the Lisbon strategic goal.

The future Member States and the candidates are included for the first time in the Spring Report data...

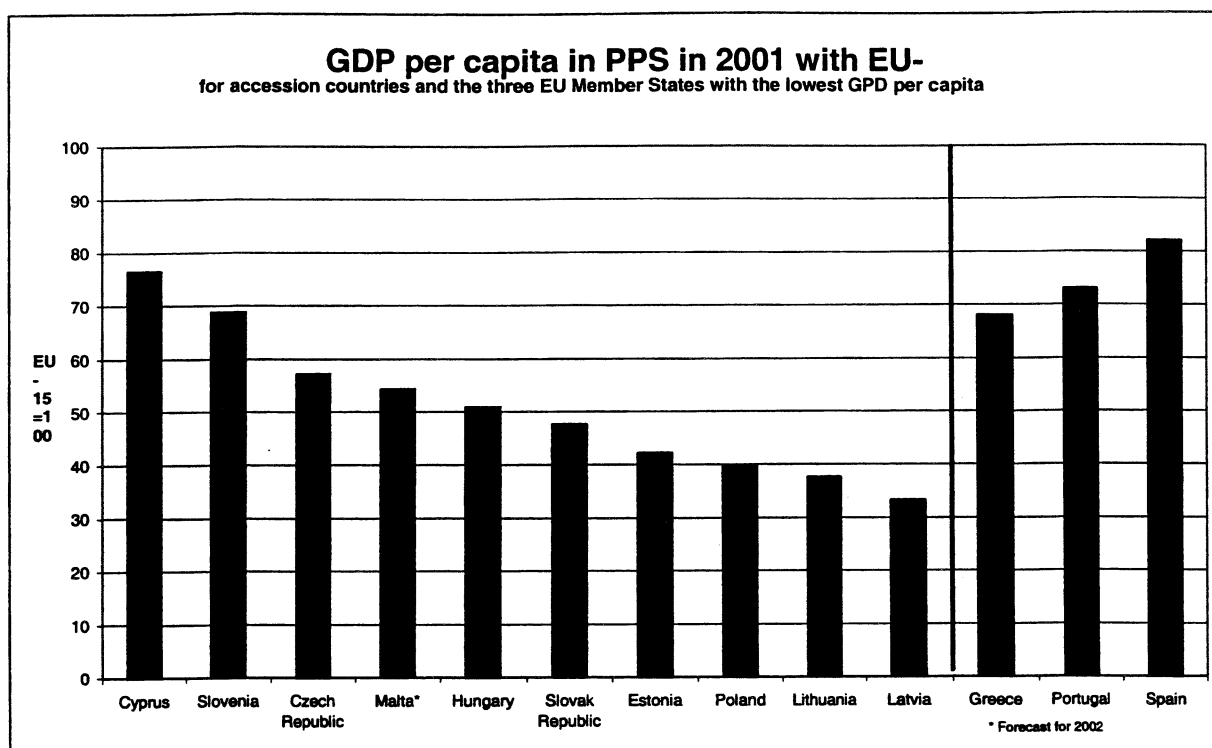
At the European Council in Stockholm in March 2001 it was concluded that the candidate countries should be actively involved in the goals and procedures of the Lisbon strategy. Already now, the acceding countries are participating as observers or associated members in some EU processes and programmes with relevance for the Lisbon strategy. This ongoing integration should continue.

At the Göteborg European Council in June 2001 it was decided that starting from 2003 the Spring Report should also cover the candidate countries. To that end, the future Member States and candidate countries have for the first time been included in the work on structural indicators. A good effort has been made, but there are some gaps in the data on certain structural indicators. This lack of data prevents a full comparison between the future and existing Member States this year. This section focuses on where the acceding countries stand in relation to the Lisbon strategy.

Embracing the Lisbon strategy should enhance the catching up process and speed up structural reform.

In many acceding countries, the Lisbon strategy has acted as a catalyst for comprehensive structural reforms already underway. Progress has, however, been uneven and is notably lagging in a number of priority areas. For most acceding countries, achieving income levels close to the EU average will be a longer-term process, which will depend on progress of reforms. In 2001, the future Member States had on average a GDP per capita of 45% (in PPS) of the EU average, despite economic growth figures for most of them over the last year that exceeded the EU average. However, some of these countries are rapidly closing the gap vis-à-vis the least prosperous Member States.

As regards catching up in terms of labour productivity, it has improved for all acceding countries since 1995, although sometimes interrupted by temporary cyclical downturns in the countries concerned. Levels of labour productivity are still very divergent, varying between 83% of the EU average in Cyprus and 33% in Latvia.



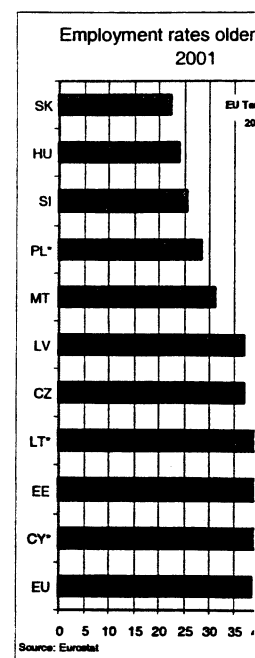
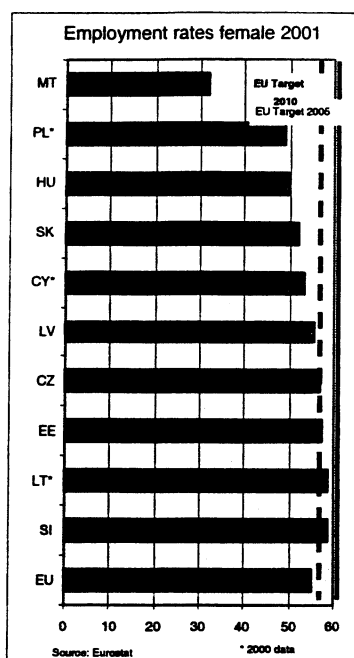
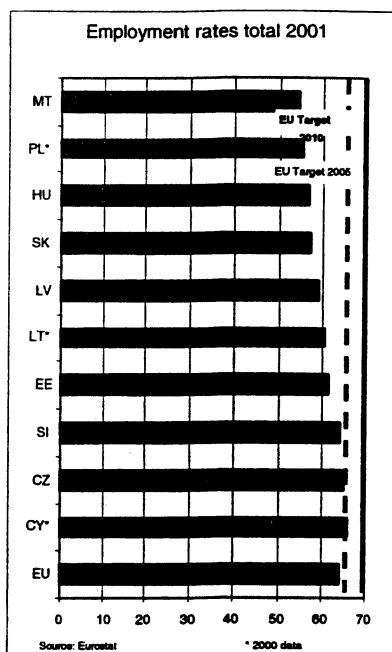
Challenges of different magnitude, but shared goal

The acceding and candidate countries and the current Member states alike share several challenges. These include: the need to improve incentives embedded in tax and benefit systems and labour market institutions so as to increase employment rates, the strengthening of competition rules and competition authorities, further efforts to make the public sector more efficient, reform of network industries to increase competitiveness, and the need to build up their skills base and their knowledge infrastructure. This will help them adapt to the knowledge economy. Even though recent developments have been impressive, the magnitude of the shared challenges is still substantially greater in the acceding countries than for the current Member States. However, the future Member States are aware of these challenges and in the Pre-Accession Economic Programmes, they have already defined their own agenda of reforms.

A. Employment and social cohesion

The magnitude of the challenge is illustrated by low employment rates...

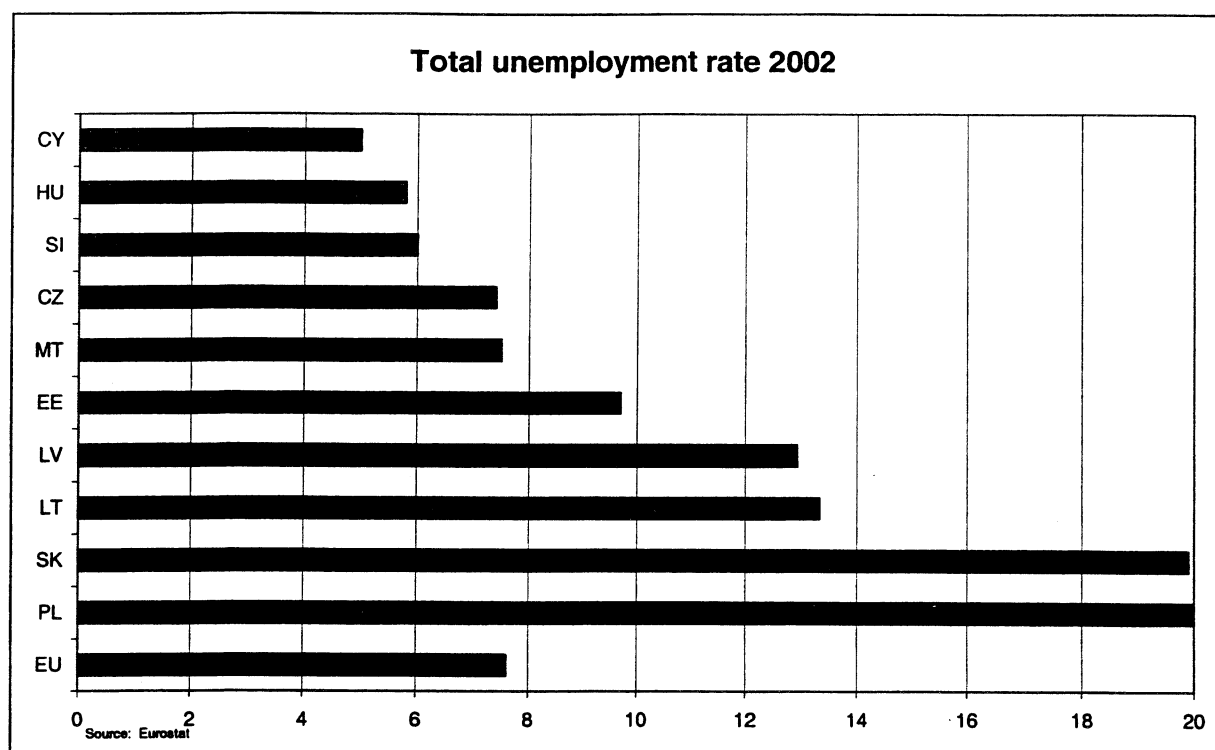
The future Member States have still a long way to go to meet the Lisbon and Stockholm targets for employment rates. They had an overall employment rate of 56.8% in 2001, clearly below the EU average and the Stockholm and Lisbon goals. Concerning older workers, only 30% were employed in the future Member States, which was approximately one quarter lower than in the Union, and none of them in 2001 exceeded the Stockholm goal of 50% for older workers. The female employment rate amounted to 51.1% in 2001, compared to 55% in the Union and about one third of the countries met the intermediate goal of 57% for the female employment rate.



Generally, the employment rates varied considerably across countries. The overall employment rate in 2001 ranged from 54.2% (for Malta) to 65.1% (for the Czech Republic). About two thirds of the future Member States experienced an increase in the employment rates in comparison with the previous year. This increase was particularly pronounced in Latvia and Slovenia. The disparities across the ten in terms of the employment rate of female and older workers were particularly large.

The need for greater efforts must also be seen in the light of the fact that the average employment rate across the future Member States fell in 2001. And among those countries with positive growth rates, only Latvia and Slovenia recorded higher growth rates than the Union.

...and high unemployment rates



Although unemployment has improved over recent years, there is still a need for further improvements. Unemployment presents a very diverse picture in the future Member States, with rates ranging between 5% and 20% in 2002. Differences in unemployment between women and men persist, with about two thirds of the countries showing higher male than female unemployment rates, which is the opposite of the EU situation. Long-term unemployment seems to be a more severe problem than in the Union: in all except two acceding countries, the long-term unemployment rate exceeded the rate for EU as a whole in 2001.

Room for manoeuvre to address these challenges is indicated by...

The pace of labour market reform is rather divergent among the future Member States. They are, however, following a similar mix of employment policies to the range of approaches observed in existing Member States.

...the relatively high tax burden on low wage earners...

The relatively high tax burden on labour is a shared problem between future and current Member States. Nevertheless, between 2000 and 2001, only about half of the acceding countries reduced the tax rate on low wage earners, as a measure to encourage job creation. There were, however, pronounced differences in this tax burden, ranging from a tax rate of 49.7% in Hungary to 17% in Cyprus in 2001. Only in three countries was the tax rate on low wage earners lower than the EU average. As is the case in current Member States, there is some room for manoeuvre in the combined effects of the tax-benefit systems.

... and the skills mismatch

Human capital formation is an important challenge for the future Member States, since there is a general gap in terms of qualifications of the adult population, both in quantity and quality terms. Participation is very high in upper secondary education but sharply drops after 17 years of age, thereby limiting the throughput into the qualified work force. Educational systems in their previously centrally planned economies also focused more on narrow job requirements and did not prepare people for lifelong adaptability of their skills. Therefore, the introduction of lifelong learning as a general concept of educational and employment policy is crucial. Adult participation in lifelong learning in 2002 ranged from 3.3% in Hungary and Lithuania to 9% in the Slovak Republic compared with the EU average of 8.4%. The direction of change was, however, not uniform, with some countries showing an increase and others a decrease in 2002.

There is room for improvement in social cohesion...

Data on social cohesion are particularly scarce. The trends in employment rates and employment growth, already described above, illustrate the scope of improving social inclusion through increasing employment rates. The high long-term unemployment is also a cause of concern, since long periods of unemployment are an important risk factor for poverty and social exclusion. Experience in Member States has shown that a significant improvement of the situation could be achieved by active labour market policies targeted at specific groups who have a higher risk of exclusion.

Those leaving the educational system without sufficient skills for the workplace are also at risk. In 2002, the development of the share of early school leavers was very divergent in the future Member States. In general there were more male early drop-outs than female. Compared to the Union, however, they perform reasonably well.

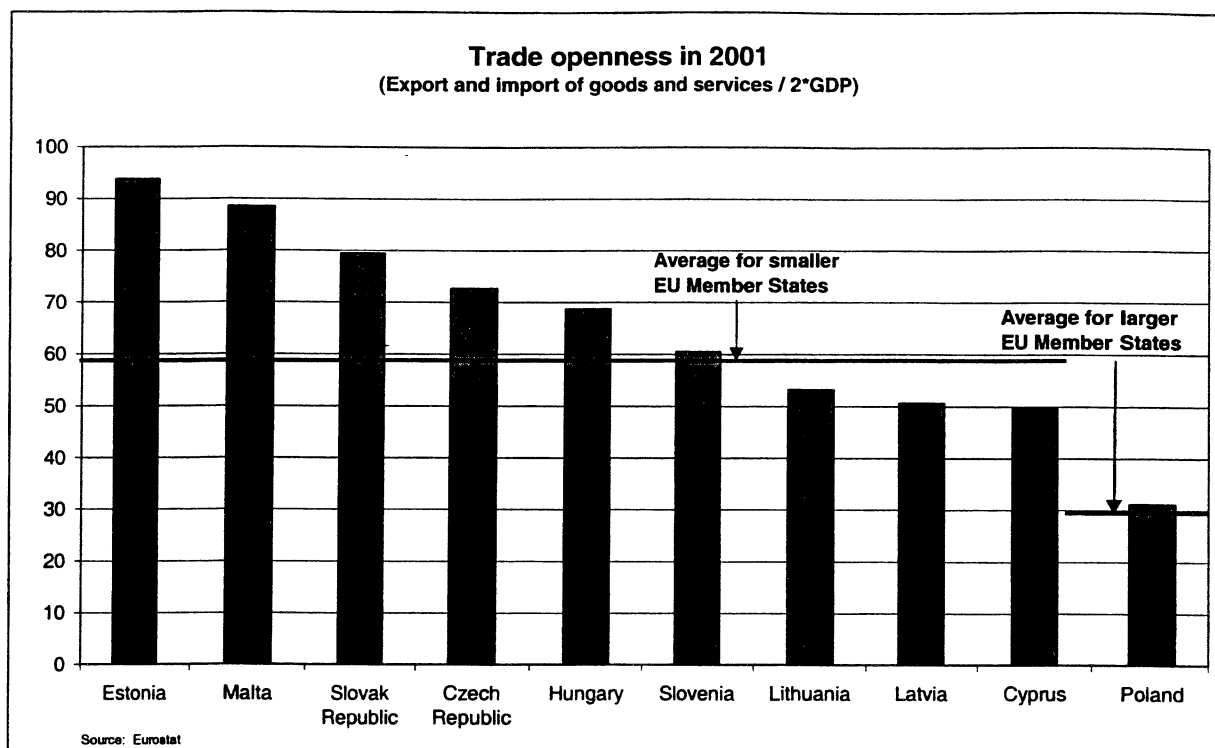
...although the share of the population in jobless households is relatively low.

The share of the population in jobless households in 2002 varied between 15.6% in Hungary and 6% in Cyprus (for the age group of 0 to 65). Only two of the future Member States, Hungary and the Slovak Republic exceed the EU share of 12.1% of the population in jobless households.

B. Economic reform

Product markets in acceding countries are already well integrated with those in the Union...

The future Member States are highly open economies. For about half of them the total trade-to-GDP ratio in 2001 was higher than the EU average trade-to-GDP ratio for smaller Member States and all had a trade-to-GDP ratio above the EU average for larger Member States. Their economies are also well integrated with the Union. A large share of the acceding countries' exports goes to the Union: more than 50% of total exports in all countries except Cyprus, Malta and Lithuania. Seven of them have a higher export share to the EU than average intra-EU trade for current Member States, although they are not yet part of the internal market. Thus, in trade terms these countries seem to be as integrated in the Union as current Member States.



...and price levels are relatively low

Price levels in most acceding countries are low when compared with EU price levels, which may be partly due to their relatively low levels of GDP per capita as well as the still common use of administered prices. In four acceding countries the price level in 2001 was less than half the EU average. All of the future Central or Eastern European Member States had a price level below the current Member State with the lowest price level.

Progress has been made in tackling distortions to product market competition, but much remains to be done

The future Member States are characterised by a large agricultural and manufacturing sector while the service sector is poorly developed. Therefore, further restructuring and a shift in human and capital resources is likely with accession. On the whole, competition in these countries is still limited and a large number of enterprises are still subsidised. This could deter new entrants and prevent the reallocation of resources to more competitive businesses. However, progress is being made in reducing State aid, even if State aid control still needs to be improved in certain sectors. In 2000, State aid granted by the candidate countries represented on average 1.3% of GDP compared with an EU average of 0.8%. However, this average masks considerable differences between the countries ranging from around 0.5% or less in Estonia and the Slovak Republic up to 1.7% in Hungary. The acceding countries face important challenges in terms of strengthening of competition rules and competition authorities, reducing the regulatory burden on business, and encouraging entrepreneurship.

Network industries are starting to be opened up to competition.

Most of the future Member States have taken the first steps on the way to opening energy and telecommunications markets. However, further reforms in network industries must still be undertaken in several of them. The prospects for future price reductions in electricity markets are likely to be affected by the continued high market shares of some of the incumbents in

these sectors. In 2000 the largest electricity generator still had a significant market share in all acceding countries, with the exception of Hungary and Poland where the share was lower than 50%. Clearly, price reductions, where they occur must be consistent with other policy goals such as sustainable development.]

Structural change has had positive environmental side-effects

Largely due to the major structural changes in their economies since the break up of the Soviet Union, the future Member States from Central and Eastern Europe⁵ have recorded steep falls in their greenhouse gas emissions compared with 1990. Slovenia is a notable exception: its greenhouse gas emissions are estimated to be 30% higher than in 1990.

C. Education, innovation and research

The acceding countries substantially lag behind the current Member States in the transition to the knowledge-based economy

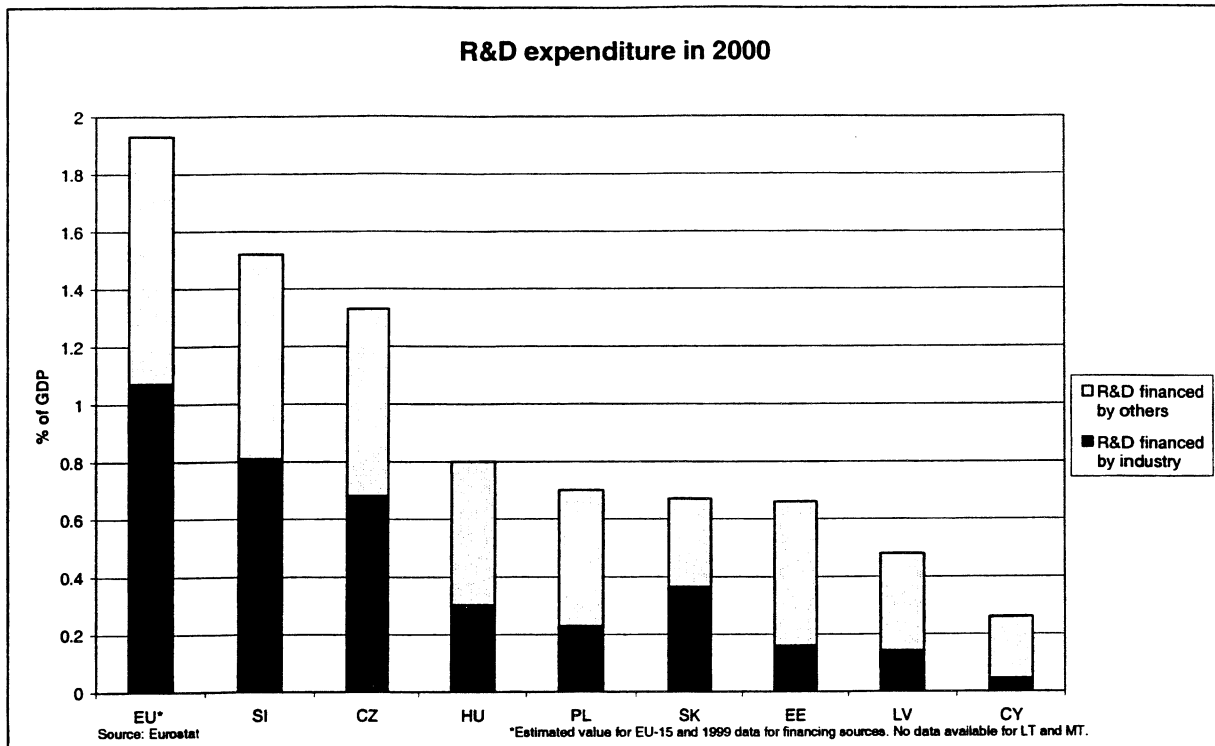
The future Member States take an active part in the Union work to promote the knowledge-based society. All of them will participate in the Sixth Research Framework Programme, covering the period 2003 to 2007, which focuses on promoting the European Research Area. They already participate extensively in EU initiatives in the field of education and lifelong learning. The eEurope+ Action Plan was launched specifically by them to allow them to pursue the Union's eEurope objectives. It will be followed up by progress reports. To promote eLearning activities they will participate in eSchola 2002 as well.

Still, they substantially lag behind the current Member States in the transition to the knowledge-based economy. Low levels of spending on R&D and ICT may hamper them in their effort to catch-up with the EU mainstream.

A large and widening R&D gap...

The future Member States have a poor record for both total and business R&D as share of GDP. In 2000 the average total R&D spending was below 1% of GDP, compared with almost 2% of GDP for the EU average. This poor record was matched by weak industry financed R&D in most of these countries, not reaching even a third of the EU average. Moreover, the share of R&D financed by industry decreased between 1998 and 2000, while it increased in several EU Member States. There is therefore no sign that this large gap in R&D financed by industry between those and the Union is about to disappear. The low R&D expenditure is reflected by low patenting activities (8 EPO patents per million inhabitants compared with 161 in the Union in 2001).

⁵ Malta & Cyprus do not have commitments under the Kyoto Protocol



...a varying performance in terms of education, and...

A crucial factor for a successful transition to the knowledge-based economy is a highly qualified and adaptable population. Average public expenditures on education as a percentage of GDP remained above 5% (in 1999) compared with 5% in the Union. Countries such as Estonia, Latvia and Lithuania performed better, while education expenditure was lower in the Czech Republic.

Investment in human capital brings many advantages. The continuous participation of adults in education and training, for example, creates a more adaptable labour force, which permits the introduction of a more flexible organisation of work and the use of innovative technologies. High education expenditures are also reflected in countries' output of university graduates. In this respect the acceding countries average is below most current Member States in terms of science and technology graduates per 1000 of the population aged 20-29 in the year 2000. Some of the future Member States, notably Lithuania and Slovenia score well in comparison to certain current Member States.

...low ICT investment and ICT take up may hamper the catching-up process,

In 2001, expenditures on IT as a percentage of GDP varied substantially in the future Member States. While the Czech Republic and Hungary invested around 9% of GDP in ICT others invested considerably less. Moreover, the growth rate of IT spending for the period 1995-2000 was below that in the Union. This trend points to a further widening of the gap in ICT maturity between the Member States and the acceding countries. The low level of the ICT take up is reflected in the low Internet household penetration in acceding countries which in 2001 ranged from 2% in Latvia to 24% in Slovenia compared with 36% in the Union.

...but high-tech production and exports are increasing in some future Member States

Despite the gloomy general picture regarding R&D and ICT in the future Member States there are some indications that a high-tech industry is developing in some of them. Even though

most acceding countries have considerably less high-technology exports than the EU average, Malta, Estonia and Hungary exceed the EU average high-tech export share of 20% of total exports of manufactured goods. Moreover, export structures have in all of them have seen a substantial shift towards capital- or technology-intensive production over the past several years. In Estonia and Hungary there have been dramatic increases in the share of high technology export during the period 1995 to 2000, with an average increase of more than 3 percentage points per year. This development may give some hope for the future.

ANNEX: Structural Indicators