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Implementation of the Lisbon Strategy Structural Reforms in the context of the European Economic Recovery Plan: Annual country assessments – a detailed overview of progress made with the implementation of the Lisbon Strategy reforms in Member States in 2008

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INTRODUCTION

In 2005, the Lisbon Strategy was streamlined and renewed and the focus placed firmly on growth and employment. New governance structures were established, based on a clear partnership between the Community and Member States. As part of the partnership, all Member States have drawn up National Reform Programmes (NRPs) setting out their response to the particular challenges facing them. They also submit implementation reports to the Commission, detailing progress made on their key challenges.

In the context of this partnership, the Commission each year assesses progress made by Member States with the implementation of structural reforms as set out in their NRPs and, more recently, in their action plans responding to the Council's country specific recommendations.

The economic conditions in the European Union have recently worsened significantly as a result of the global financial crisis, whose effects are being felt in the wider economy. At the request of the European Council, the Commission at the end of November submitted a European Economic Recovery Plan¹, which the European Council in December 2008 agreed to.

To take account of the exceptional situation, as part of its yearly country assessments in the framework of the Lisbon strategy for growth and jobs, the Commission has on 28th January 2009 adopted a recommendation for a Council recommendation on the "Implementation of the Lisbon Strategy Structural Reforms in the context of the European Economic Recovery Plan - Annual country assessments"². This recommendation translates the principles of the European Economic Recovery Plan into specific policy advice for each Member State in the form of updated country-specific recommendations under the Treaty (Art. 99 and 128) issued as in previous years to assess progress accomplished by Member States in implementing the recommendations formulated in the framework of the Lisbon strategy for growth and jobs. It calls on Member States to swiftly implement these recommendations to address the crisis and strengthen the future growth potential of the European economy. According to the Treaty provisions, the recommendations should be endorsed by the European Council and then adopted by the Council.

In support of the above-mentioned recommendation, this Commission paper provides a more detailed overview of progress made with the implementation of the Lisbon Strategy reforms in Member States in 2008.

Given the rapidly changing economic environment, it contains information on reforms taken and progress made until the end of 2008.

¹ COM (2008) 800

² COM (2009) 34

BELGIUM

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The Belgian National Reform Programme (NRP) provides detail of the measures recently taken to respond to the areas the Council recommended Belgium should focus upon. The NRP also gives some indications on future initiatives, but the lack of expected budgetary impacts and timeframes for these initiatives make it very difficult to assess if these measures will be sufficient to tackle Belgium's structural reform challenges. Structural funds programming has resulted in high Lisbon earmarking, but it is too early to demonstrate progress in implementation. Nevertheless, the funds evidently support areas highlighted by these priorities.
2. The NRP results from intense interaction between the federal and regional authorities. The Federal Parliament is invited to make its contribution and a draft version is presented for consultation to the social partners via the Central Economic Council and the National Labour Council. New procedures covering the transposition of directives and the impact on administrative burden of new measures permit the systematic follow-up of progress.
3. In the light of the following assessment Belgium should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: long-term sustainability of public finances, R&D performance, and Belgium's wage development in relation to its neighbours.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Belgium's macro-economic challenges remain the sustainability of public finances and competitiveness. Ensuring in the medium term the sustainability of public finances effectively means containing expenditure in order to build up increasing structural primary budgetary surpluses and to reduce the high government debt level. To increase employment and secure Belgium's competitiveness, the tax wedge on labour needs to be reduced further, while wage moderation through an efficient wage formation system is also needed.
5. The Council recommended that Belgium further reduce its tax burden on labour, especially the tax wedge on low skilled workers, while strengthening fiscal consolidation. The 2008 budget extended existing labour tax reductions and included a number of additional ones such as an increase in the amount of tax-exempt income for low and average-income workers, a higher reduction of individual social contributions for low-income workers and, for workers resident in the Flemish Region, a fixed-rate reduction of income tax. Although these measures led to a decline of the tax wedge, more is needed to increase the employment rate, in particular of the low-paid.

6. The Council recommended that euro area countries align wage and productivity developments. Belgium's 1996 competitiveness law provides a mechanism for wage moderation but, since the introduction of the law, Belgian salaries have exceeded those in neighbouring countries. In 2008, the slippage was particularly important as a result of the indexation of wages to Belgium's comparatively high inflation rate. Social partners should ensure that past slippages are corrected in the future, as specified in this law (and specified in the NRP).
7. The Council also referred to the need to focus on the long-term sustainability of public finances. In spite of initial steps taken in recent years (for example, the Generation Pact), age-related spending in Belgium is projected to increase by 6.3 percentage points of GDP between 2004 and 2050, significantly above the EU-average. Plans for fiscal consolidation in consecutive updates of Belgium's Stability Programme have only been partly achieved, even in years of above trend economic growth. Additional measures are thus needed, including growth and productivity enhancing reforms encompassing the welfare system and product and labour markets.

MICRO-ECONOMIC POLICIES

8. The long-term sustainability of public finance requires productivity growth of 1.8% after 2012, even though productivity only increased 1.0% per year on average between 2002 and 2007. Policies that could improve Belgium's productivity include improving the R&D and innovation framework, the educational system and lifelong learning, and increasing the competitiveness of companies through administrative simplification, better regulation and effective competition policies.
9. The Council referred to the need to increase substantially R&D spending and its impact through a coordinated policy mix. R&D intensity has stagnated and is currently just over 1.8% of GDP (2006), the same level as in 1997. Considerable efforts to raise public investment in R&D have not resulted in increased R&D intensity and momentum seems to be slowing. The Federal government does not foresee major new initiatives except for a further limited decline in the tax burden for researchers. Regional governments are focusing on strengthening existing measures. The research system could be made more efficient by coordinating better the policy mix between the various levels of government.
10. The Council also referred to the urgent need to improve competition in Belgium's gas and electricity markets. The legal framework and the incumbent's market power hamper competition in the wholesale, short-term balancing and retail markets for gas and electricity. As a result, Belgium's gas and electricity prices have risen much faster than average across the euro area in 2008. This explains up to 80% of Belgium's current overall inflation differential of over 1.5 percentage points with the euro area. Gas and electricity price inflation has adverse impacts on wage negotiations, erodes the purchasing power of households and undermines the economy's competitiveness. Although the competence of the regulator has been reinforced, it cannot decide independently or regulate certain distribution and network tariffs. The regulator's limited power, contractual congestion and the lack of entry point and gas storage capacity limit gas market competition. Meanwhile, public service obligations to distributors for the provision of energy in Brussels remain an

entry barrier. Since the problems in this sector affect the entire economy and the policy response is inadequate, this issue demands greater policy attention.

11. The announced SME action plan should strengthen SMEs' important role in Belgium. Simplification and measurement of administrative burden has made substantial progress over the last few years. Further progress could be made by setting a target to reduce the administrative burden, broadening impact assessment tools, and implementing the Services Directive. Further efforts are encouraged to reinforce sectoral regulators and open up public procurement markets.
12. Belgium has taken initiatives that make progress on environmental sustainability. Implementing these initiatives could contribute to a further decline in greenhouse gas emissions and increase the share of renewable energies from low levels.

EMPLOYMENT POLICIES

13. Belgium's labour market is characterised by regional employment disparities, a high number of job vacancies and low labour mobility. In addition, Belgium's ageing population will result in a declining relative share of workers of prime-age, putting downward pressure on labour productivity growth and potential output.
14. While not explicitly defining a flexicurity pathway, Belgium's Implementation Report describes recent initiatives taken on all four components. These initiatives build on a large set of measures approved at different moments and at national and regional level. There is thus an urgent need for coordination and simplification to come to a coherent set of structural measures that are balanced between the four components of flexicurity. Within this approach attention should focus on encouraging lifelong learning, facilitating work-to-work transitions and integrating groups that remain under-represented on the labour market.
15. The Council recommended that Belgium enhance its labour market participation, lower regional disparities and increase participation in lifelong learning through an integrated flexicurity approach. Although the employment rate increased from 61% in 2006 to 62% in 2007, employment growth remained below the EU average. Total employment remains low due to a variety of reasons including the low level of labour market participation, poor efficiency in matching people to jobs, insufficient labour market relevance of education and training, and a lack of both geographical and functional mobility. Long unemployment benefit duration, together with a limited difference between short-term and long-term benefit levels, also reduces labour market transitions. Something that is particularly important in the current climate. Initial steps have been taken to encourage labour market entry and a more efficient matching of demand and supply. Measures were taken to promote geographical mobility in order to reduce regional disparities and to encourage lifelong learning, although substantial results are still awaited. Tackling the challenge of Belgium's ageing population will necessitate coherent, decisive action to reach the EU's and the government's employment targets.
16. The Council also referred to the need to increase the employment rate for older workers and disadvantaged groups. The labour market participation of disadvantaged groups, in particular older persons and people with a migrant background, continues to be very low, representing a significant untapped potential workforce. Although

some measures were taken in this area important challenges remain in view of the future unfavourable trend in the working age population and the possible impact on economic growth and public finances. It is therefore necessary to accelerate and strengthen measures to broaden the Belgian labour market. Because the employment and unemployment rate gaps between EU and those with a migrant background remain very high and measures taken are insufficient, this issue demands much more policy focus.

17. The activation policy pursued since 2004 to encourage the unemployed to step up job search efforts was accompanied by stricter controls. An evaluation concludes that this policy has had a positive impact on labour market participation. The scheme could therefore be strengthened, especially in regions with the worst labour market problems, and also extended to other specific target groups. It is also important to take structural reform measures that safeguard the traditional robustness of the Belgian social security system.

BULGARIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. Bulgaria's economic and social development remains hampered by weak public administration, both at the central and local level, and by an inefficient judiciary system. Ineffective oversight by regulatory and supervisory authorities results in a failure to tackle non-competitive market behaviour. Corruption still affects the business environment and access to and quality of the public services. In this context Bulgaria presented a report on the implementation of the Action Plan under the Strategy for Transparent Governance and for Prevention and Counteraction of Corruption. Progress in this area is monitored through the cooperation and verification mechanism under which the Commission drafts regular progress reports.
2. The Council recommended Bulgaria to urgently strengthen administrative capacity. Progress however has been limited. Whilst Bulgaria has attempted to reduce the size of the public sector by an across-the-board cut of some 12% of civil service posts, this seems to have been done in a rather arbitrary way without at the same time improving the quality and efficiency of the public sector.
3. Problem analysis, conceptual development and enforcement of policies remain weak. Pending the compliance assessment of financial management structure, the Commission has had to suspend the payment of Structural Funds. Further significant improvements on these aspects remain urgently needed. A planned independent review of the public administration, to be undertaken by the World Bank, should lead to a blueprint for a more effective public administration and the steps needed to achieve this. Such reform should be comprehensive, clearly identify priorities, match public sector needs to available resources, and look at ways of raising the efficiency and independence of the civil service by changes to the legal framework and management practices.
4. Political recognition of the need to speed up reforms as part of the Lisbon Strategy is fairly recent. In mid-October, the Prime Minister announced an Action Plan to address the country-specific recommendations, focusing mainly on reducing inflation, enhancing administrative capacity, improving the functioning of markets, and cutting red tape. A number of these measures have in the meantime been implemented which should have a positive impact on the strength of the Bulgarian economy.
5. Ownership of the Lisbon strategy has recently significantly improved with regular discussions in the Council of Ministers and oversight at the level of deputy-prime ministers, particularly with regard to the design and implementation of the Action Plan. Awareness of the Lisbon strategy has improved through the organisation of conferences involving government, social partners and other stakeholders with the assistance of the Commission. However, the Bulgarian authorities need to invest more in raising awareness and pursuing a constructive dialogue with stakeholders. Also, parliament must be involved more closely.

6. In the light of the following assessment Bulgaria should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain: long-term sustainability of public finances, effective powers of the competition and other regulatory authorities, R&D performance, undeclared work; adult participation in training, and energy efficiency.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

7. Despite a continued tight fiscal stance, Bulgaria's demand-driven boom has come at the expense of high external imbalances and overheating, putting its future growth path at risk. Tackling these macro-economic imbalances has become even more urgent given the current financial and economic crisis, and in order to facilitate the management of the currency board.
8. The Council recommended Bulgaria to contain the current account deficit and inflationary pressures, in particular by implementing a tight fiscal policy, improving the quality of public expenditure and promoting wage moderation in order to keep wage developments in line with productivity gains. Bulgaria has continued to conduct a sound fiscal policy and as part of its Action plan has committed to stick to its tight fiscal stance in the medium term, which are welcome developments. The budgetary surplus is projected to have exceeded the end-year target of 3% of GDP in 2008. However, the government has contributed to overall high wage increases and inflationary pressures by substantially raising the public wage bill and pensions.
9. The Action Plan contains measures that may prove useful, such as legislation to enhance competition and energy efficiency, but is not ambitious enough to preserve and boost the country's overall competitiveness curbing domestic demand pressure. Additional measures promoting wage moderation and preventing ad hoc spending at the end of the budgetary year are also needed. Even though credit growth has begun to slow, public expenditure growth will need to be contained in order to reduce the high current account deficit, which is no longer fully covered by foreign direct investment.
10. With an ageing and shrinking population, and relatively low levels of labour participation, Bulgaria faces an important demographic challenge to its long-term financial sustainability. It is important to continue with health and pension reforms, in particular to ensure the adequacy and sustainability of pensions where progress has been limited. After significant delays the Parliament has finally adopted a law on establishing a reserve fund. However, following a revision of the pension calculation formula, pensions have recently been further significantly increased while social security contributions were reduced. In 2009 the state has been included as a third contributor towards pension insurance, covering more than 1/3 of these contributions. Faced with the risk of an economic slowdown, this financing will place significant pressure on the budget, and thus further affect the long-term sustainability of public finances. Progress on healthcare reform has been limited, with a national health strategy being adopted only recently.

MICRO-ECONOMIC POLICIES

11. Bulgaria's main micro-economic challenge is to reform a business environment that is hampered by red tape resulting from extensive over-regulation at national and local level, and too numerous and lengthy delays in obtaining permits and authorisations. Some have estimated that businesses spent around 20% of their time on compliance. A large part of administrative burdens result from measures taken at local level, often in contravention of national law. The business environment also suffers from the lengthy time needed to settle contractual and legal disputes and continued corruption.
12. Bulgaria's competitiveness also suffers from market entry barriers, particularly in network industries, and poor transport, energy and telecommunications infrastructure. As Bulgaria is the most energy-intensive economy in the Union, it is particularly vulnerable to energy price shocks. Bulgaria has, as part of its Action Plan, announced some encouraging short-term actions to address these challenges. Effective implementation and monitoring of these policies is now essential.
13. In 2008 the Council recommended Bulgaria to adopt and implement measures to substantially cut red tape and improve the business environment. By way of response Bulgaria has introduced the long-awaited centralised electronic commercial register to reduce the number of procedures demanded in order to start up a company, and to increase transparency by obliging re-registration of all existing companies. Despite important teething problems, the registry seems now to be working smoothly. However, there remains a considerable backlog to be processed before the registry will be fully operational.
14. In addition, earlier this year, the Prime Minister presented a better regulation programme, which included a commitment to eliminate or simplify more than a dozen of rules by December 2008, some of which appear to be rather sector-specific. However, actual simplification has been regularly delayed. In its Action Plan, Bulgaria committed, by the end of the year, to draw up a list of the most burdensome measures to business to be simplified or removed. The Action Plan also commits that Bulgaria will, by March 2009, eliminate local illegal regimes, adopt an administrative burden reduction target, launch an administrative register, extend the time-period for consultation and create a framework for impact assessments for new legislation. The actual impact of these measures will depend on their effective implementation and whilst the central government's legal action to tackle local regimes is an important first step, more fundamental measures are called for to address the root of the problem. A more strategic approach will be needed from standard public consultation on any new measures to systematic efforts to simplifying existing measures.
15. The recent surge of inflation exposed low levels of competition in network industries, wholesale markets, and in a range of other service and products markets. The Council called on Bulgaria to create all the necessary pre-conditions for strong competition in network industries. Progress, however, has been slow. There is still no effective competition in telecom services where the incumbent operator continues to enjoy a quasi monopoly. There is only limited competition in the energy sector where until recently prices were kept artificially low and not based on real costs. Measures announced in the Action Plan to review prices of utility services and establish an energy stock exchange should be implemented urgently.

16. The competition and other regulatory authorities so far lacked the powers and administrative efficiency to ensure effective competition in the market. Therefore, the recent adoption of legislation to bring the competition authorities' powers in line with EU rules, as foreseen by the Action Plan, is a welcome development. The Action Plan also announces measures to expand the competition authorities' powers to monitor risk companies and market segments where competition rules and consumers' rights are often violated. Effective implementation, translating into a significant increase in the number of investigations in key sectors, will require a much more pro-active attitude of the competition and other regulatory authorities which will in turn depend on greater independence, more effective management, and in some cases, an increase in qualified resources.
17. The Council also referred to the need for elaborating an integrated policy for R&D and innovation, notably aimed at reforming the public system, and shifting public support to R & D towards more competitive funding focused on key priorities. Whilst Bulgaria has presented a draft R&D strategy and introduced some measures to make public R&D more relevant for industry and attract private funds, it does not tackle the real challenges, notably reforming public institutions, particularly the Bulgarian Academy of Sciences, and focusing scarce resources on only a limited number of priorities where Bulgaria has specific strengths. The planned increase in public R&D spending should be made conditional on improving the efficiency of the R&D system. Little progress has been achieved in rolling out ICT and introducing e-government, which is an important source of innovation and productivity. Stronger competition and further measures are needed if Bulgaria is to improve upon the lowest level of broadband take up in the EU.
18. Improving Bulgaria's transport infrastructures is a key and urgent prerequisite for the country's economic development. It is for this reason that close to a quarter of cohesion funds has been assigned to this objective. However, weak uncoordinated and inefficient administration, as well as corruption, has led to substantial delays in rolling-out projects. These challenges need to be tackled with the utmost urgency and as a first priority the road infrastructure agency should be re-organised.
19. Urgent improvements in energy efficiency would help raise Bulgaria's competitiveness, cut significant energy losses during transformation, and reduce its high external energy dependency. Given the large scope for energy savings, policy initiatives undertaken so far have not been sufficiently ambitious. Particularly important is the need to renovate buildings and industrial sites and apply the highest standards for insulation for new construction. The recent adoption of a law on energy efficiency, which is part of the Action Plan, is a modest first step that should be rapidly implemented.

EMPLOYMENT POLICIES

20. As a result of high growth and emigration, the labour market has tightened considerably in 2008, resulting in average wage increases of the order of 20 to 25%, well in excess of productivity growth. This in turn has fuelled inflation and eroded Bulgaria's competitiveness. It has thus become even more urgent for Bulgaria to address the Council's recommendation to improve the efficiency and effectiveness of active labour market policies and further reform the education system to provide skills that better match labour market needs and reduce early school leaving.

Adequate activation, job search assistance and counselling, and retraining of unemployed workers will remain key policy tools in the context of possible worker redundancies in the short to medium-term. Bulgaria should make full use of ESF assistance to promote employability. Bulgaria has begun to reflect on implementing the flexicurity principles and has committed to defining its flexicurity 'pathway' by the end of 2008.

21. International assessments show that Bulgaria's educational performance has been declining over the past years. For example, about half of 15-year olds have poor reading scores. More than 20% of pupils leave school without qualifications. To counter these developments, Bulgaria has implemented a number of substantive measures: quality assurance mechanisms and general performance evaluation have been introduced, school financing has been decentralised and linked to performance and a system of differentiated pay and teacher training has been set up. Additional efforts will be necessary regarding general and vocational school curricula that remains insufficiently adapted to labour market needs, and to the needs of minorities, especially Roma. The Council also called for the completion of Bulgaria's lifelong learning strategy and increased participation. The strategy was recently adopted and implementation now remains the key challenge as participation and investment levels in life-long learning remain very low.
22. The response to the Council's recommendation on labour market activation has been more limited. Activation policies need further streamlining and, taking account of the results of a needs analysis to be conducted by the end of 2008 must be targeted more closely on vulnerable groups, particularly the young (who suffer from the highest unemployment levels in the EU). This can be done by facilitating their transition into employment, for example through job placements and training. In the Action Plan the government committed to launching a package of youth policy measures, starting in 2009. A number of successful pilot projects should be mainstreamed.
23. Measures to modernise job search services have been introduced (including services adapted to the Roma) but levels of efficiency and resources of the Public Employment Services remains low. A mechanism to improve skills matching by monitoring employers' short-to-mid-term skills needs is still under discussion. As part of its Action Plan, Bulgaria is considering legislation to extend the activities of temporary work agencies. If implemented these could improve the quality of employment service provision, have a positive impact on labour market flexibility, and stimulate part-time work (which is the lowest in the EU).
24. The Council also called on Bulgaria to tackle undeclared work by strengthening institutional capacity to perform inspections and ensure legal enforcement. While significant measures have been enacted in 2008 focusing on revenue collection, their impact remains to be assessed. Stronger cooperation between labour inspectorates and revenue collection authorities is necessary in order to intensify controls further and put in place sufficiently dissuasive penalties.

THE CZECH REPUBLIC

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The Czech government adopted a new National Reform Programme (NRP) for 2008-2010 that broadly confirms the previous reform priorities for addressing major economic challenges. The NRP contains a list of actions that address these challenges to some extent but a more detailed elaboration of timetable and budget would have been welcome. The resources provided by the Structural Funds have significantly contributed to the implementation of reforms. Their implementation is closely linked to the governance of the NRP. Structural Funds programmes for 2007-2013 are earmarked to a large extent towards Lisbon priorities.
2. The preparation of the NRP was coordinated by the Office of the vice-prime minister for European Affairs. Economic and social partners, representatives of regions and non-government organizations were involved in the preparation and discussion of the Programme. However, trade unions did not feel able to support this NRP.
3. In the light of the following assessment the Czech Republic should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: protection and enforcement of intellectual property rights, ICT, access to finance for innovative companies, implementation and application of EU legislation; position of disadvantaged groups on the labour market, gender pay gap, and regional labour market mobility.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Given the Czech Republic's rapidly ageing population, the NRP identifies fiscal stabilisation and the long-term sustainability of public finances as the main macro-economic challenges. Ageing will have a significant impact on public finances via a projected large increase in pension and health care expenditure and will impact on economic growth potential by shrinking the share of the working-age population.
5. The budget deficit was substantially reduced in 2007 on the back of strong growth, falling unemployment and government expenditure restraint. Despite the slowdown in 2008, the deficit should not increase significantly given the positive balance of expenditure and revenue measures in the "stabilisation package". The introduction of health charges for consultations, basic medicines and hospitalisation will further contribute to budgetary savings.
6. The Council recommended that the Czech Republic reform pension and health care systems with a view to improving the long-term sustainability of public finances. The first stage of the pension reform involved increasing the retirement age to 65 by 2030 and extending the minimum contribution period required for a full pension from 25

to 35 years. This was approved by the Parliament in July 2008. As part of the health care reform, health care charges were introduced as of 2008 but further reforms, aimed at introducing competition in the health care system, are still under consideration. Whilst further action may well be required, these reforms will improve the prospects of ensuring the long-term sustainability of public finances.

MICRO-ECONOMIC POLICIES

7. The Czech Republic confirms that its main micro-economic challenge is to improve its R&D and innovation performance to move towards a knowledge and quality-based economy. This also demands an improved business environment, including better access to finance and enforcement of intellectual property rights and a continued increase in the use of ICT and e-government. The progress towards the 2006 and 2008 Spring European Council commitments on knowledge, entrepreneurship and energy needs to be accelerated.
8. The Council recommended that the Czech Republic take steps to improve R&D collaboration and the level and effectiveness of R&D investment. There has been progress towards reaching the overall R&D target of 2.06% of the GDP by 2010 thanks in particular to increased Structural Funds allocations, and to increases in private expenditure stimulated by tax incentives. However, the tax incentives are limited to R&D expenditure that is entirely financed in-house, which may discourage research collaboration, and SMEs with a low level of resources from investing in R&D. National public R&D expenditure as a percentage of GDP has stagnated. To encourage progress more ambitious actions are needed to enhance collaboration among business, universities and R&D institutions, to increase the national public R&D spending, to up-grade R&D infrastructure, and to provide adequately skilled personnel for R&D activities.
9. Progress towards the effective enforcement of intellectual property rights has been limited, although Structural Funds projects do aim at raising awareness and alleviating patent costs. The use of European and international patents remains limited and needs further promotion. ICT up-take is progressing, with broadband penetration having reached 14.6%. However, the relatively low ICT use by citizens remains to be addressed. Good performance has been achieved in providing e-government services to businesses and the introduction of the e-government act will increase efficiency of government services, but further progress is needed to streamline and interconnect public registers and facilitate the use of electronic certificates.
10. Important steps towards enhancing the business environment were taken in 2008 through the enforcement of the long-pending trade licensing and bankruptcy acts. However, the timely and effective implementation and application of EU legislation needs urgent attention, since the Czech Republic has the highest transposition deficit in the EU. Structural Fund allocations for R&D and innovation have increased. However, a general lack of finance for innovative companies persists. The current economic climate highlights the urgency of measures to improve conditions for entrepreneurial activity, including for small and medium-sized enterprises. Starting and running a business needs to be further developed by simplifying currently lengthy procedures to help facilitate recruitment. Entrepreneurship education has been introduced as a horizontal element in most school curricula, representing a good

policy response, although the full implementation in vocational and grammar schools needs to be monitored. Notwithstanding past progress in bringing the better regulation agenda forward, focus should now be on more rigorous and effective implementation of the various initiatives.

EMPLOYMENT POLICIES

11. Employment developments in the Czech Republic have been favourable over many years and in 2008 the employment rate reached its highest level (66.6%) since 1996. This is now putting a tightening labour market under pressure. The main labour market challenge for the Czech Republic is therefore to reduce labour shortages and skills gaps. This requires greater flexibility, mobility and employability, and an education system that can adapt to future labour market needs. In this context, a high youth unemployment rate, very low levels of labour market participation of women with young children, and a high share of the unemployed that are long-term unemployed all indicate considerable potential for further increases in skills and labour supply.
12. The NRP defines no explicit flexicurity approach, although it presents plans for measures in all four areas. The most visible progress is seen in modernising social security systems, with increased work-incentives and a declining benefit dependency. However, active labour market policies are still small-scale and not sufficiently targeted towards disadvantaged groups. The participation of adults in lifelong learning, especially older people and the low skilled, is low and well below the EU target. The implementation plan for a lifelong learning strategy is still under preparation and incentives to invest in training remain low.
13. There has been some progress in response to the recommendation the Council issued to improve the functioning and efficiency of the labour market and the education and training system, but a lot remains to be done. A small step towards more flexible and reliable contractual arrangements was taken in 2008 with technical amendments of the Labour Code. These will enhance internal flexibility, in particular through facilitating more flexible working arrangements, but fail to address employment protection for those on permanent contracts. A major change of the Labour Code that would offer more contractual freedom is currently being prepared.
14. Although progress, especially at legislative level, has been achieved, most of the announced reforms on the education and training system are still to be implemented. This is especially the case concerning those that target older and low-skilled people and those aiming to reform the system to better respond to labour market needs. The ESF will continue to provide significant resources in this respect. The National System of Qualifications has been developed but not yet implemented. A comprehensive reform of tertiary education is only at a preparatory stage and a new act on tertiary education yet to be developed. The implementation of the Framework Curricular Reform, however, is already quite advanced.
15. The Council also underlined the importance for the Czech Republic to focus on better integrating disadvantaged groups into the labour market, reducing regional disparities, reconciling work and family life, tackling the gender pay gap and implementing the active ageing strategy. Despite some positive developments, further efforts are needed to promote the inclusion of disadvantaged groups,

especially the Roma, the low skilled and people with disabilities. The efficient use of ESF funds will play an important role in this regard. A low and decreasing level of geographical and occupational mobility is a particular problem for disadvantaged regions and requires addressing in ways that will benefit these regions and reduce regional disparities. Recent changes to the parental leave regulation should encourage women to return more rapidly to the labour market. In order to be effective and to ensure a better reconciliation of work and family life, these measures need to be complemented by a distinct increase in childcare facilities. The high gender pay gap has not been given any attention so far and is not explicitly mentioned in the NRP. Important steps have been taken to increase incentives for older people to continue working, which are expected to have positive effects on their employment rate. In order to alleviate shortages on the labour market, several measures liberalising work migration have been agreed.

DENMARK

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) is characterised by stability in objectives, coherence in efforts and consistency with the priorities of the Lisbon Strategy. In general, reform proposals are supported by the analysis underpinning the Denmark 2015-plan and the globalisation strategy, ensuring a high degree of policy integration. In the field of education, a wide range of measures are being implemented, with further reform activity awaiting the impact thereof. While specifying the underlying reform requirements in terms of employment growth and hours worked, the NRP does not flesh out new labour supply measures. Satisfactory progress is reported in respect of interconnectivity of gas and electricity markets.
2. The NRP and the Implementation Reports are the main tools for taking stock of Danish structural policy. The new programme is the product of a process involving a wide range of stakeholders. Meanwhile The NRP is however sent to Parliament for information only.
3. In the light of the following assessment for Denmark the following challenges remain important: labour market participation and hours worked, incentives to work, maintain older workers in employment and improve the integration of people with a migrant background into the labour market; primary and secondary education, competition, and the Kyoto target for greenhouse gas emission reductions.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Denmark is addressing the challenges of ensuring macro-economic stability and fiscal sustainability through a strategy combining structural adjustments and savings. In the medium-term, the growth potential is set to decrease as further contributions from labour and capital are limited by high participation rates and levels of investment that are foreseen to recede. According to Denmark's 2015-plan, fiscal sustainability will require a permanent increase in labour supply. The close link between employment and sound public finances is clearly identified and quantified within a comprehensive macro-fiscal framework. The current trend of slipping wage competitiveness, the on-going housing market correction and the financial turmoil could pose risks to the strategy. Moreover, recruitment is becoming increasingly difficult in the public sector, which, in combination with growing demand for public services, is causing cost pressures. There are thus good reasons for scrutinising public service provision and the financial aspects of the welfare model.
5. Tax adjustments were agreed in 2007 and are being implemented in 2008 and 2009. In view of the weak economic growth prospects and the increase in net transfer incomes, the tax amendments are expect to have limited immediate impact on labour supply. Employment measures target initiatives to enhance the labour supply of

specific groups. As recognised in the NRP, additional tax and labour market reform measures are necessary.

6. The initiatives in the "Quality Reform" are being implemented with the aim of maintaining or increasing welfare service standards and reaping administrative efficiency gains. Mechanisms to contain local government spending have also been introduced. Following on from the public sector wage negotiations in the spring, a pay commission has been established to analyse wage differentials, remuneration instruments, and possible responses to public sector recruitment problems.

MICRO-ECONOMIC POLICIES

7. Denmark highlights micro-economic challenges of developing a knowledge society and improving the framework conditions for enterprises to unlock their potential, including by encouraging entrepreneurship, whilst protecting the climate and the environment.
8. The Council referred to the importance of continuing to implement measures on energy interconnectivity. Denmark is improving its interconnections both domestically and with other countries, notably by expanding infrastructure and through the German-Danish electricity market-coupling project. Additional extensions of the networks are under consideration. These improvements contribute to competition in energy markets, with access for new suppliers being encouraged through a central contact with the distribution system operators. This could also enhance energy efficiency, in particular because wind energy suppliers have better access to the network. More transparency about energy price differences could also further strengthen competition. Overall, the policy response in this field is reassuring, permitting reform focus to be widened to more general competition issues.
9. In some sectors, especially in services, there are concerns about limited innovation and relatively high price levels. According to the Danish Competition Authority, this is partly due to insufficient competition and increased competition could accelerate the uptake of new technologies and increase productivity. Denmark shows a gradual decrease in the number of sectors with competition problems, from 64 in 2001 to 35 to date, with a target set to reduce this to no more than 32 by 2010. Competition problems are partly related to regulatory barriers to entry and other planning or price regulation constraints. Examples include the retail sector, financial services, including the administration of pensions and insurance products, and retail sale of electricity and gas. There is scope for strengthening the enforcement regime. Fines for antitrust infringements, including the most serious infringements, continue to be very low in the European context, and this may have a stifling effect on the use of the leniency programme for the voluntary disclosure of cartels.
10. Denmark has introduced a number of measures in order to reduce greenhouse gas emissions. However, in 2006 emissions were actually 1.7% higher than in Denmark's Kyoto base year. This is therefore some way off from approaching the committed reduction of 21%. Projections for 2010 indicate that Denmark might reach its target if the additional measures announced in its National Allocation Plan are implemented as soon as possible. However, should progress towards the national target continue to prove inadequate, additional measures would need to be identified and implemented.

11. Denmark already has a well-established knowledge society and performs well with regard to the priority actions identified by the Spring European Council. Overall innovation performance is well above the EU average. While the objective to increase public R&D spending to 1% of GDP by 2010 seems realistic, private R&D expenditures relative to GDP have been slightly decreasing since 2003, making it more difficult for Denmark to reach the 2% of GDP expenditure target set for 2010. Denmark's Innovation Strategy outlines initiatives to improve co-operation between academic institutions and businesses that should contribute toward reaching the R&D target and enhance the overall efficiency in R&D activities. Further expansion of R&D is at risk of being limited by increased scarcity of science and technology graduates. Denmark has an excellent broadband network, and ICT uptake by government, enterprises and households is among the highest in the EU. Denmark has an attractive business environment, and efforts for further improvement are being taken. Work is ongoing to fully integrate recruitment of the first employee in the one-stop-shop philosophy. About 10% of the planned 25% reduction in administrative burden has already been achieved.

EMPLOYMENT POLICIES

12. The Danish labour market is performing very well thanks to strong demand, successful activation measures, and recent tax and benefit reforms. Unemployment is at the lowest level since the early 1970s. While labour shortages have recently declined, high capacity utilisation and demographic pressure continue to restrain the growth and jobs potential. In this light Denmark highlights the employment challenges of increasing labour supply and improving primary and secondary education.
13. Denmark has a highly integrated flexicurity model and performs well on all four components. Reform efforts are therefore focused on continuous fine-tuning. Eligibility criteria for unemployment and social benefits have been tightened through tougher work-availability tests, frequent interviews and targeted employment measures for people of migrant background and other vulnerable groups have been developed further. Financial incentives to work are also being strengthened through adjustments of the tax and benefit systems. The recent "Job plan" includes additional initiatives to enhance activation and work incentives, *inter alia* for disability and old age pensioners, and measures to recruit workers from abroad.
14. The Council referred to the need for Denmark to focus on measures to increase labour force participation. The government maintains its focus on achieving an increase in the labour force and raising employment by 20.000 persons by 2015, while keeping the average working time unchanged. Measures have been taken in this regard but there still remain resources that can be tapped into, especially by retaining older workers in employment. Important in this respect is the negative impact of voluntary early retirement benefits. The adopted measures to increase the retirement age will only gradually come into effect from 2019. There is also scope for further improving the integration of people with a migrant background, given that, despite recent improvements, the employment rate gap between this group and the rest of the population remains significant. The estimated effects of agreed tax cuts and of the Action Plan to reduce sickness absenteeism are uncertain and it will be important to continue reviewing tax and benefit systems to strengthen work incentives. Given that an increase in labour supply remains a key requirement for

ensuring fiscal sustainability, efforts in this area, although promising, must be sustained. Policy advice for further reform measures will be provided by the Labour Market Commission, which will submit its full report mid-2009. The Tax Commission is also examining reform options and will submit its report early 2009.

15. The Council also stressed the need to improve primary and secondary education and increase the number of students finalising upper-secondary or tertiary education. This is seen as one of the key national priorities in view of future skills needs and possible labour shortages. Denmark is implementing a range of measures to reform education. Nevertheless, cost-efficiency remains an issue as spending (8% of GDP) does not appear to yield the level of results that would be expected from this magnitude of spending. The upper secondary completion rate stands at 70.8%, both below the EU average and national targets (85% by 2010, 95% by 2015). Efforts are still needed to bridge the gap to the national target for tertiary youth completion rate of 50%. The median age of students in graduating from tertiary education remains 27 years, but the starting age has recently declined. The implementation of the existing measures needs to be closely monitored, evaluated, and if necessary reinforced. Additional measures may also be needed in order to reach the ambitious education targets, and thus enhance the quality of labour and boost labour supply in the longer term. This challenge should be seen in light of the general labour shortages also expected to worsen in the education sector in the coming years.
16. Denmark is implementing initiatives to promote women in management and address the gender segregation of the labour market. The government-appointed Pay Commission will also analyse gender pay gaps.

GERMANY

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) addresses all key challenges. There is a high degree of policy integration in crosscutting areas such as the knowledge society, industrial policy and “Better Regulation”, but this is less visible for flexicurity. Links between the new NRP for 2008-2010 and programmes under the Structural Funds (2007-2013) are strong with 81% of the funds under the competitiveness objective and 71% of the funds under the convergence objective allocated to Lisbon objectives.
2. The political ownership of the new NRP is adequate. The NRP has been subject to consultations with other federal ministries, the Parliament, regional governments and social partners. The involvement of stakeholders has improved. Nonetheless, a wider group of stakeholders could be consulted (for example ecological and welfare institutions) and the national Parliament as well as the *Länder* could be involved more actively.
3. In the light of the following assessment Germany should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important:: long-term fiscal sustainability of public finances, competition in the gas and electricity networks, one-stop-shops, and the outcome of the education system, especially those with a migrant background.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The long-term sustainability of public finance remains a key challenge in the NRP. Key priorities of this challenge are budgetary consolidation, improving the long-term sustainability of social security systems and the reform of federal fiscal relations.
5. Progress towards addressing the euro area recommendations on the medium-term budgetary objective and the quality of public finances has been good. The fiscal situation has improved markedly from a deficit of 3.4% of GDP in 2005 towards a balanced budgetary position in 2008. This is the result of buoyant tax revenues due to structural reforms and favourable cyclical conditions. The 2007 and 2008 cuts in unemployment insurance contributions led to lower non-wage labour costs, improving the quality of public finances. The effect has been partly offset by higher contribution rates to health, long-term care and pension systems. The 2008 corporate tax reform has reduced statutory rates, partly funded by a broadening of the tax base.
6. The Council highlighted the need to improve the long-term sustainability of public finances and to strengthen budgetary institutions. In 2008 the pension adjustment formula was modified by suspending the factor accounting for government-subsidised supplementary pensions, which resulted in higher pension adjustment than

originally envisaged. This ad hoc intervention introduces uncertainty as to the lasting success of the reforms. The recent reform of long-term care, while introducing a number of improvements in terms of coverage and services, has not addressed concerns regarding the long-term financial sustainability of the system, for example through the introduction of supplementary funded elements as announced by the NRP.

7. The evidence on the effects of the 2007 health care reform is still lacking. Competition among the public health insurers may intensify if the insurers deviate from the collectively agreed fee structure for outpatient services and negotiate individual contracts. However, only few public health insurers have used this possibility so far. The main reform measure, the central health fund, will become operational in 2009. The extent to which it can improve competition and increase the efficiency of the health care system remains uncertain. This merits close monitoring and systematic evaluation. The second round of the reform of federal fiscal relations began in 2007 with the aim to create more effective budgetary rules for all layers of government and to develop an early warning system to prevent budgetary emergencies. Only moderate progress was made in 2008. The NRP foresees a close-to-balance rule modelled on the Stability and Growth Pact to be implemented by the end of the legislative period in 2009.

MICRO-ECONOMIC POLICIES

8. The challenges of the knowledge society, ecological innovation, market functioning and improving the business environment were confirmed in the NRP. In addition, the framework for competition in network industries, and in other services, could be further oriented towards enabling more opening up of markets.
9. The Council recommended Germany to improve the framework for competition in a number of services areas. While there has been good progress on the regulation of wholesale bit stream access, progress on modernising the public procurement system and on further relaxing restrictive rules on regulated trades and professions has been limited. On wholesale bit stream access, the regulator has introduced in 2008 a standard contract between the incumbent and its competitors to ensure that access to infrastructure is provided at market conditions. On this basis, several wholesale bit stream providers have already entered the market. Progress in the area of public procurement has been limited. A draft public procurement law has been subject to public consultation in fall 2008 and it is still unclear how procedures will become less complex and more transparent. Contrary to announcements in the 2007 Implementation Report reforms to increase competition among tax advisers, architects and engineers have not been implemented and are not addressed by the new NRP. Progress has been only achieved for accountancy and out-of-court legal services. The German Pharmacies Act seems incompatible with the freedom of establishment. More progress is noticeable on competition in financial markets through a new law limiting the possibilities that financial investors take over firms by buying their shares in a hidden way. However, recent developments on the financial markets, including stock exchanges, suggest that the surveillance should be further strengthened.
10. The Council also highlighted the need to improve the competition framework in the rail, gas and electricity networks, to establish one-stop-shops and to shorten start-up

times. Germany will make progress on start-up times following the recent legal reform of private limited companies. The reform will, in specific cases, simplify administrative procedures, lower costs and reduce the required minimum capital to establish a company. Good progress has been made in establishing one-stop-shops in several regions, but the nationwide implementation is delayed. The latter should be combined with the points of single contact under the Service Directive. Several decisions have been adopted to promote competition in energy markets, including the switch from cost to incentive-based regulation of network tariffs in 2009. However, more effort is needed to address vertical integration and regional monopolies of energy producers. There has been no progress on the legal and institutional framework for competition in the rail sector. The EU directives on rail liberalisation require the separation of infrastructure management from the provision of transport services. They also call for sufficient incentives for the infrastructure manager to reduce the level of access charges. Both requirements have been insufficiently transposed. The powers of the rail regulatory authority to obtain information from market actors have been weakened by a decision of a higher administrative court. The opportunity to secure the independence of rail infrastructure management from rail operations was missed in the privatisation programme.

11. The challenges of the knowledge society and the ecological innovation, including energy efficiency, are addressed comprehensively. The overarching high-tech initiative is progressing well with new measures to strengthen clusters and the excellence of research in universities. The efforts to reach a 3% of GDP R&D expenditure target are significant. However, the low number of graduates in engineering and natural sciences, and the need to have a high mobility of researchers deserve to be addressed more systematically. Ecological innovation, including energy efficiency, is being addressed through comprehensive climate protection packages. The business environment is being improved by measures facilitating access to finance for SMEs and the reduction of administrative burden. The scope and the transparency of impact assessments could be further improved by going beyond the reduction of administrative costs. Progress and plans to improve market functioning are largely focused on the financial sector, network services and the screening of norms in the context of the service directive. The level of the minimum wage introduced in the postal sector may act to the benefit of the incumbent as a barrier to competition.

EMPLOYMENT POLICIES

12. Notwithstanding the improvement of labour market conditions since 2006, Germany's labour market remains characterized by relatively high unemployment, particularly high long-term unemployment and unemployment amongst the low qualified. The education system seems to reinforce inequalities between young people from diverse social backgrounds. The main challenges are therefore to improve the labour market participation of low skilled persons including migrants, and to ensure lifelong access to, and quality of, education and skills development.
13. Germany's new NRP does not define a flexicurity pathway, but describes recent initiatives taken on all four components. There is particular scope for improvement in the field of life long learning including access to qualifications for low skilled. In the context of modern social security systems it remains important to review the tax

benefit system in order to further increase incentives to take up work or move to a full time job.

14. The Council recommended Germany to tackle structural unemployment. Qualification and training measures for the unemployed have been stepped up after a severe cutback in 2005. However, participation rates are still lower than in other active labour market measures particularly as compared to those targeted at subsidised employment. After having dropped plans announced in the previous NRP for a comprehensive reform of the low wage sector, wage subsidies for certain target groups have been redesigned to make them more effective. However, a more systematic reform is needed to increase financial incentives to take up work and to move to full time jobs. Some progress has been achieved as regards the employment services for unemployed recipients of basic income support and the planned reforms of active labour market policies and employment services may further increase efficiency. In view of the expected rise in unemployment, efficient implementation will be crucial to ensure the success of these reforms.

15. The Council pointed to the need to enhance continuous vocational training. Reform measures implemented over the last 12 months focus on supporting employees to finance continuous vocational training. However, no steps have been taken to strengthen incentives for employers to increase the participation of their employees. Moreover, given the fragmentation of the policy field, more systematic reforms to increase transparency as regards supply and quality of courses would be necessary. Efforts to improve continuous vocational training for the low skilled must be stepped up to facilitate upward mobility of workers and reduce their risk of unemployment. A stronger policy response is needed in the field of initial education, which currently seems to reinforce inequalities between young people with different social backgrounds. School performance gaps between nationals and non-nationals are also among the highest in Europe. It is now important to tackle this issue with comprehensive reforms and commit all stakeholders to financing and implementation. The coordination between Bund and *Länder* is crucial in this respect.

ESTONIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) presents an ambitious and integrated set of measures including measures to respond to Estonia's challenges. It is based on a clear analysis and provides the budgetary impact of the measures and a clear timetable for their implementation. The new NRP departs from the previous one by having a separate objective on the energy sector, reflecting the importance of this issue at the current juncture. After deficits foreseen in 2009 and 2010, Estonia targets a return to a balanced budget in 2011, at the latest, while enhancing public sector efficiency. There are positive measures to continue investing in R&D and innovation but reaching the R&D intensity target of 2.0% of GDP for 2011 remains a considerable challenge as these investments might come under pressure in the current economic downturn. The budgetary provisions for measures in the energy sector remain rather limited. While the proposed measures on increasing lifelong learning and reducing labour market rigidities represent a good response towards tackling Estonia's priorities, a full implementation of the planned reforms is still needed.
2. Consultation practices and efforts to develop ownership of the new NRP are good. They included the consultation of stakeholders and a web-based consultation process. Various parliamentary committees have commented on the NRP before government adopted it.
3. In the light of the following assessment Estonia should pay particular attention to the country-specific recommendation presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important : macro-economic stability and inflation, through adequate structural reforms and determined fiscal policy; external competitiveness; translation of R&D results into innovative services or products; launching the new immunity and leniency programme and strengthening competition enforcement; active labour market policies and the supply of skilled labour

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Ensuring macro-economic stability, fiscal sustainability, and a tax system that strongly promotes economic growth are the government's main macro-economic objectives. However, in recent years, expansionary monetary conditions resulted in a consumption and real estate-related boom, in external deficits, and high inflation, which has been reinforced by excessively high wage growth, and triggered the end of the boom.
5. The Council advocated a determined fiscal policy and adequate structural reforms to restore macro-economic stability and reduce inflation. In 2007, as in previous years, Estonia's state budget was in surplus but budget expenditure increased rapidly. This

has led to a worsening fiscal balance during the present downturn, while macro-economic imbalances although receding, still persist. In June 2008, the government adopted a supplementary budget substituting a balance target for an initial surplus target of 1.3% of GDP. However, the steep economic contraction is estimated to have resulted in a deficit of at least 2% in 2008. Estonia's government has projected a deficit of 1.7% of GDP for 2009, while it intends to reduce the budget deficit to 1% of GDP in 2010 and to restore budgetary balance from 2011. This confirms a prudent fiscal policy as the key element of Estonia's macro-economic policy. Nevertheless, without further expenditure cuts, steeper economic contraction than expected would result in a significantly weaker budgetary position.

6. In 2008, wages continued to grow at levels in excess of productivity growth, eroding Estonia's competitiveness. This was particularly problematic because recovery will depend on a large contribution from exports (and hence competitiveness). Public sector wages should send the right signal of wage moderation to the private sector. However, in 2008 public wage increases, including in public administration and defence, were higher than productivity gains in the whole economy and also than average wage increases.. The NRP mentions the intention to increase administrative effectiveness and reduce current expenditure, including the public sector wage bill. In this respect, the projected cuts in operational expenditure in 2009, the recent freezing of the high ranking state officials' salaries, as well as efforts to modernise the Public Service Law, together with the recently modernised Labour Law, are all welcome developments. With a progressive decline in the working age population and the adoption of more generous social policies, Estonia's fiscal sustainability, although still comparatively strong in EU terms, is weakening. However, a number of measures in the new NRP are welcome and could go a long way to prevent a progressive budgetary slippage.

MICRO-ECONOMIC POLICIES

7. Estonia identifies R&D and innovation, an attractive business environment to support international competitiveness, and the energy sector as the key challenges for continuing economic development. The Commission also regards the strengthening of competition policy as a key issue. Against the background of the sharp economic deceleration including the worsening of public finances, continuing investment in R&D and innovation, enhancing energy efficiency and improving the business regulatory framework are indispensable to increase productivity growth and strengthen external competitiveness in the medium term.
8. The Council highlighted the need to ensure that R&D results are translated into innovative services or products and the need to closer cooperation between universities and enterprises. It is envisaged to further strengthen applied research with the development of new competence centres and the setting up of a system of innovation vouchers. While there is progress in terms of knowledge transfer through the establishment in Estonian universities of technology centres aimed at improving the relationship with the businesses, knowledge creation and subsequent patenting remain a problem. While there has been very strong growth over the last years, the total R&D intensity is with 1.14% of GDP in 2006 still relatively low. Given the economic climate is likely to put pressure on R&D investment; it therefore remains a serious challenge to reach the total R&D intensity target of 2.0% of GDP for 2011.

9. The Council also referred to the need to strengthen competition policy, but in this respect the policy response has been rather weak. The government proposal for a new immunity and leniency programme to disclose illegal cartels is still not ready. In view of strengthening competition enforcement, the merger of the competition board with a number of regulatory agencies took place in January 2008 but it remains unclear whether it will produce the expected synergies.
10. Estonia has undertaken a number of initiatives to improve the business environment including the re-designing of the state-financed start-up scheme and the introduction of one-stop-shops for the start-up of companies. Almost one third of new registrations are already made online. In order to support exports and the internationalisation of companies more generally, relevant consulting services are provided and it is envisaged to substantially enlarge the target group that receives international marketing support. In terms of the regulatory environment, Estonia is encouraged to take further its initiatives for the reduction of administrative burdens including by the identification of a national target. More efforts are also needed to encourage the use of a comprehensive impact assessments system that covers more than impacts on the state budget. The introduction of entrepreneurship education into the curriculum of the secondary level education has again been postponed.
11. Estonia has recently put energy issues high on its reform agenda. Increasing energy efficiency is not only likely to have a positive impact on inflation but also on the environment and on the security of energy supply. The country is doing relatively well in terms of renewable energy provision. However, energy efficiency and the sustainability of energy provision, including the production of electricity through oil shale remains an important challenge. The National Energy Efficiency Plan proposed by Estonia is considered insufficient to address this challenge. Moreover, the budgetary resources reserved for energy efficiency measures over 2008-2010 remain limited.

EMPLOYMENT POLICIES

12. After rapid employment growth over the recent years, the impact of the economic downturn is starting to emerge in the labour market and unemployment is expected to rise in the coming years. In the second half of 2008 employment decreased for some disadvantaged groups, inactivity has slightly increased, and the number of vacancies has been decreasing. The new NRP defines the development of educational system based on labour market needs and modernising labour relations as main challenges for Estonia. In addition, in view of the ageing population, the better adaptation of the labour force to the changing economic structure, and increasing labour productivity are important challenges for Estonia. The relatively high numbers of pupils dropping out of school early, and one of the highest gender pay gaps in the EU are important challenges.
13. The recent policy developments take flexicurity into account. The NRP does not explicitly define the national pathway, but important initiatives are taken on all four components. There is a need to define a reasonable balance between labour market flexibility and employment security policies. Effort should further focus on the continuation of the labour law reform and the implementation of lifelong learning policies in order to diminish the skills gaps.

14. The Council highlighted the need to reduce labour market rigidities by urgent progress towards labour law modernisation and the promotion of flexible forms of work. The labour law reform has been proposed by the government but is still subject to the parliamentary approval. Further efforts are needed to promote contractual and working time diversity in order to generate more job opportunities for disadvantaged groups and increase labour supply.
15. The Council also referred to the need to focus more on reinforcing active labour market policies (ALMPs) and increasing the supply of skilled labour by implementing a comprehensive lifelong learning strategy. Efforts to increase the labour supply have focussed on improving the access to adult learning, simplifying procedures for employing third-country nationals and abolishing age discrimination from current employment legislation. The participation rate in lifelong learning continues to be relatively low, especially for the low skilled. Progress has been made in setting up the financing model for lifelong learning policies. The new NRP aims at giving more attention to preventive measures and at extending the target group for ALMPs. Poor data collection and a lack of a monitoring and evaluation system do not allow for the qualitative assessment of the efficiency of these policies, and thus the impact of recent ALMP reform is not clear. Expenditure on ALMP continues to be one of the lowest in the EU, and only small shares of the unemployed are covered by labour market measures. The attention should therefore focus on enhancing the efficiency of active labour market policy and further encouraging the participation in lifelong learning.
16. Both gender segregation (by occupation, and sector) and the gender pay gap is among the highest in the EU. While women have on average a considerably better educational level compared to men, they are underrepresented in professions with higher salaries. The NRP does not provide measures to address the gender pay gap. Since the persistence of this gap leads to efficiency losses in the labour market, there is an urgent need for an in-depth analysis of the origins of the pay gap. Well-designed and targeted multi-faced policies are necessary to effectively use the skills potential of women and thereby increase productivity.

IRELAND

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. In response to the newly identified key challenge of maintaining macro-economic stability and returning to sustained growth, macro-economic and micro-economic policies to boost productivity growth and competitiveness figure prominently in the new National Reform Programme (NRP). In particular, it focuses on maintaining high levels of investment in infrastructure and human capital while at the same time ensuring budget consolidation. It also specifically addresses the recommendations issued to the euro area countries. The ambition and quality of the policies is in line with the scale of the challenges Ireland is facing, but there are only few new initiatives. Ireland has earmarked 82% of Structural Funds towards Lisbon priorities, although this figure conceals considerable disparities between individual programmes.
2. Consultation and efforts to develop ownership of the NRP at the level of central and local government and with the social partners continue, in particular in the context of the Social Partnership Process. Monitoring of structural reforms also takes place in this framework rather than as a separate exercise.
3. In the light of the following assessment Ireland should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: pension arrangements, investment in energy and transport infrastructure, foster competition in the retailing sector, childcare infrastructure, labour market integration of disadvantaged groups, and training support to older and low-skilled workers.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Ireland confirms that its main macro-economic challenge remains one of ensuring macro-economic stability. This challenge has clearly become more pertinent in the face of the unexpected speed of the slowdown in the domestic economy, coupled with the financial crisis and the downturn in Ireland's main trading partners. At the same time, the Irish economy has become more vulnerable as price and wage inflation together with declining productivity growth have gradually eroded the competitive position, so that the external deficit has been on the increase since 2004. Growth needs to be rebalanced through a reallocation of resources from construction to more productive sectors, while fiscal stability needs to be restored. Another challenge is to reform the pension system so as to improve the long-term sustainability of public finances.
5. The Council asked Ireland to speed up progress in formulating concrete measures to reform pension arrangements. Limited progress was made in this area. A green paper

on pension reform was published in October 2007 setting out a number of options. Consultation on this ended in May 2008. The government is now developing a framework for longer-term pension policy, expected to be published in the coming months.

6. After peaking in 2006, housing output declined by some 10% in 2007, is estimated to have fallen by some 30% in 2008, and may further adjust downward in 2009. This acts as a severe drag on the domestic economy. Moreover, the deterioration has now spread to other sectors through negative effects on confidence and employment. The budget for 2009 announced some measures to support the housing market, targeted on first-time buyers, as well as commercial construction.
7. The implications for the economic and budgetary situation of the turnaround in the housing market are significant. The economy is expected to experience two successive years of negative economic growth, although that reflects also the global economic downturn. The sharp budgetary deterioration in 2008 reflects both a significant tax undershoot and continued high growth of expenditure. The former owes to a broad based economic downturn and a significant drop in housing related revenues. The 2009 budget has tried to balance the need to gradually restore fiscal stability, mainly through various revenue enhancing measures, and to support the economy, with income support measures targeted at more vulnerable groups, while reprioritising capital expenditure plans. Following a planned further deterioration in 2009, the addendum to the Stability Programme submitted in January 2009 targets a narrowing of the deficit going forward, based on as yet to be specified consolidation measures. This has to be seen against the need to pursue budgetary consolidation in the medium term while improving the quality of public finances as highlighted by the euro area recommendations.
8. Concerning the alignment of wage and productivity growth recommended to euro area countries, the most recent wage agreement in the context of social partnership include a pay pause. This is a step in the right direction to regain competitiveness but more could be done to increase flexibility at the firm or sector level.

MICRO-ECONOMIC POLICIES

9. Ireland's growth performance has exacerbated structural constraints, which are likely to dampen medium-term growth prospects, if not addressed. Rapid growth over several years has, in particular, brought to the fore the need for improvements to both energy and transport infrastructure. In addition, sectoral imbalances highlight the importance of enhancing the capacity of the economy to make a smooth transition to sustainable growth. To this end, it will be important to foster competition in order to keep inflation at bay, enhance productivity and secure continued price competitiveness. Moreover, innovation should be fostered, not least for services, and policies should be set in place that ensure compliance with Ireland's greenhouse gas reduction targets.
10. Significant measures are planned to improve interconnection capacity to support the functioning of the all-Ireland electricity market and a large-scale investment programme should help to curb congestion if carried out as planned. However, a coherent strategy together with an action plan for a sustainable transport system, which would help to reverse current trends and induce sustainable travel patterns, has

not yet been devised. The government has recently launched a consultation to prepare such a strategy, which is worthwhile, but it should also make sure that an appropriate and comprehensive action plan is derived from the strategy that can be swiftly implemented.

11. High and increasing consumer prices have mostly been due to a lack of competition in retailing. Abolishing the Groceries Order has stimulated competitive pricing but limited market entry leaves large parts of the retailing market without sufficient competition. The government is therefore encouraged to follow the recommendations of the Competition Authority, reducing in particular regulatory impediments to entry. In this context, attention should be paid to the benefits from integrating interdependencies between spatial planning and infrastructure provision.
12. According to preliminary estimates, greenhouse gas emissions are unlikely to decrease as projected but for the effects of the economic downturn on greenhouse gas emissions. The government should therefore maintain its commitment to permanently curb emissions and consider further action if necessary. Particular attention should be paid to the transport sector, where emissions have almost tripled over the period 1990-2008 and are forecasted to increase further.
13. With respect to innovation, the new Services Strategy, which sets out new policy proposals on how to ensure the continued development and growth of the services sector, acknowledges the importance of innovation for services export growth and proposes further actions. These include providing integrated inter-disciplinary education for service activities and facilitating the establishment of industry-led competence centres for services to stimulate research in services. The Irish government also seeks to encourage using public procurement as a means to promote innovation but no concrete measures have as yet been devised. If used more actively, this would support the aim of shifting the industrial base towards more innovative products.
14. With a view to further improve the business environment the government has set a 25% target for reducing administrative burden to be achieved by 2012. As a first step, the burden arising from all domestic legislation is to be measured. A more enhanced use of the integrated impact assessment system would also support the achievement of the reduction target. In addition, there is scope for improving the ICT-use by public authorities. In this area, no improvements have been recorded since last year. The envisaged action plan to promote government, business, citizen and non-profit sector ICT use, will thus be crucial to stimulate progress. The plan was already announced for 2007 and is expected to be published soon. In terms of R&D, Ireland has progressed towards the 2013 research investment target, and intermediate investment levels, notably for 2010, have now been established which document further progress.

EMPLOYMENT

15. In view of the economic downturn, the rise in unemployment is now a major challenge that only further emphasises the need for effective education and training opportunities, as well as active labour market policies, for all and especially for those in the 16–24 age category. Moreover, those furthest from the labour market continue to need special attention to ensure they are not further isolated.

16. Ireland has identified up-skilling the labour force as its preferred flexicurity pathway and past performance shows this is an area in which improvement is required, especially in relation to lifelong learning. Further efforts should also be made to modernise the social protection system. On the other hand, Ireland has performed well in recent years in relation to flexible and reliable contractual arrangements and effective active labour market policies. Looking forward, emphasis must be placed on ensuring the unemployed and those outside the labour market are given the skills and other supports needed to adapt to the changing labour market situation.
17. The Council signalled the need for Ireland to accelerate progress with increasing labour market participation, in particular as regards childcare, integration of migrants and support to older and low skilled. Recent improvements in relation to childcare under the National Childcare Investment Programme should be sustained if access and affordability are to be improved and the Barcelona targets met. The position of older and low skilled workers has been addressed with the publication of the National Skills Strategy. However, the recent deterioration in the economic and labour market situation makes this group especially vulnerable and the priority should now be to outline in detail how this strategy will be implemented. The integration of people with a migrant background remains a challenge, especially in relation to those who now find themselves without employment due to the economic downturn. Progress has been made in this area with in particular, the launch of an integration strategy but the challenge now is to implement the actions identified. Other disadvantaged groups, in particular people with disabilities and lone parents, require further attention and additional support. Due to low employment rates both groups have significantly higher 'at risk of poverty' rates than the rest of the population. Full implementation of recent planned areas of reform, such as the Social and Economic Participation Programme and the comprehensive employment strategy for people with disabilities, is now necessary. Furthermore, the economic downturn has had a disproportionate impact on younger workers and the unemployment rate for the 16-24 age group has been rising faster recently than for any other age cohort. The reintegration of young unemployed into the labour market has therefore become an important challenge.
18. The rise in the overall unemployment rate is also a challenge facing Ireland. Several measures to counter this have been announced and these must now be built upon if the risk of rising long-term unemployment is to be avoided. The European Social Fund, with its priority actions aimed at up-skilling the workforce and activation and participation of groups outside the workforce, should be fully utilised in meeting these challenges.

GREECE

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The Greek National Reform Programme (NRP) present the policy response to the key challenges. Notable progress has been achieved in the transposition of internal market legislation. Greece has achieved a high earmarking of Structural Funds in support of the Lisbon Strategy. The Structural Funds strongly support the above priorities. However the pace of implementation of growth oriented investment projects co-financed by the Structural Funds is slow.
2. The Greek NRP outlines a series of policies responding to the Council recommendations and points to watch and underlines the main policy priorities for the period 2008-2010. These include the continuation of efforts to strengthen the financial and long-term sustainability of the economy, an increase of productivity through the implementation of structural reforms, the improvement of the business environment and an increase in employment participation.
3. Consultation on the NRP at the level of the central government and the main social partners appears to be good. A specific committee for monitoring and coordinating the NRP has been created, with the participation of all relevant services, social partners and NGOs. Attention is put on the monitoring and evaluation of implementation of reforms in the context of the Structural Funds.
4. In the light of the following assessment Greece should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: one-stop-shops and start-up times, competition in professional services, solid and water waste management, female participation in employment, and a coherent active ageing strategy.

MACRO-ECONOMIC POLICIES

5. Greece faces a number of structural challenges potentially affecting its competitiveness. Of particular importance is to address positive unit labour cost and inflation differentials with the euro area that are affecting competitiveness and widening the current account deficit. The general government deficit remains too high and the gross level of debt remains amongst the highest in the EU. Persistent fiscal imbalances, inflationary pressures, and worsening competitiveness largely lie behind the mounting external imbalances, which are expected to widen further in the medium term.
6. The Council recommended that Greece pursued fiscal consolidation and debt reduction, and proceeded rapidly with the implementation of the pension reform, with a view to improving long-term fiscal sustainability. The general government deficit in 2007 was 3.5% of GDP, considerably above the budgetary target of 2.4% of GDP. This marks an end to the fiscal consolidation that began in 2004. The

absence of an effective control of primary expenditure, along with the low quality of the fiscal adjustment observed in recent years (which has been basically based on revenue-enhancing measures) entails risks for the sustainability of the fiscal adjustment. For 2008, the budget law projected a deficit target of 1.6% of GDP but significant expenditure overruns and revenue shortfalls have meant an upward revision of the official target deficit to 2.5% of GDP. Government gross debt, which reached 95% of GDP in 2007, is expected to decrease only by $\frac{3}{4}$ % of GDP in 2008. Greece has adopted important legislation to reform pensions in 2008 but the scope and the progress in implementation have been limited and may therefore need to look into additional measures to improve the long-term sustainability of public finances.

7. Greece was also asked to focus on the containment of inflationary pressures and the current account deficit. Persistent high inflation in Greece is mainly associated with the structural weaknesses of both product and labour markets. The limited impact of measures recently taken suggests that better targeted measures are needed to improve the functioning of product and labour markets, which should contain inflationary pressures and address external imbalances.
8. A major reform of the budgetary process introducing a system of program-based budgeting is gradually being implemented. Even though it is expected to contribute positively to the transparency and efficiency of the budgetary process, it does not tackle structural shortcomings both in terms of the preparation of the budget and its execution including in particular expenditure control.

MICRO-ECONOMIC POLICIES

9. Greece's micro-economic priorities are to generate higher productivity growth through addressing structural weaknesses of public administration, to reform product markets, generate higher levels of investment in human capital and knowledge, improve the business environment, enhance competition by further opening product markets, and reinforce export performance and competitiveness.
10. The Council recommended Greece to modernise its public administration by building up effective regulatory, control and enforcement capacities, and by ensuring an effective use of Structural Funds. A specific Structural Funds Operational Programme will support better regulation in line ministries, including the introduction of an integrated impact assessment system and actions to reduce administrative burdens by 25% by 2013. The strategy put in place prioritises the improvement of the regulatory environment of business. However, the simplification of existing legislation should receive more attention.
11. The Council also highlighted the need to focus on investment in R&D, the transposition of internal market legislation, progress towards the 2006 Spring European Council SME policy targets, strengthening competition in the area of professional services and protecting the environment by prioritising effective solid and water waste management and curbing greenhouse gas emissions. An investment in R&D, especially from the business sector, remains low with the levels of R&D investment as a proportion of GDP stagnating since 1999. The set-up of research policy has been redesigned and the actions supporting innovation have been updated for the new programming period. Their effectiveness can only be assessed in the medium term and may also depend on the general business environment. The

implementation of internal market legislation has improved markedly. In a quest to improve the business environment, the start-up of companies has been made easier for limited liability corporations, but some key measures of the NRP have not yet been implemented (for example the creation of the General Commercial Registry and of one-stop-shops for businesses, completing sector-specific land use and planning frameworks). There was no progress regarding competition in professional services where regulations remain among the most restrictive in the EU. Improvements in this area, and in other services sectors, are expected to flow from the implementation of the Services Directive.

12. Waste management is still weak, and efforts to address this are ongoing with the support of Structural Funds. The policy response in the past has been rather weak as illustrated by the number of cases to the European Court of Justice. Green house gas emissions returned to a more sustainable path in 2006 and according to new projections Greece will meet its Kyoto target. Complex licensing procedures and local resistance are slowing down investment in renewable energy sources. However, the energy intensity of the economy is on a downward trend and close to the EU average.
13. Efforts to improve the energy regulatory framework continue. High-voltage retail tariffs were liberalised in 2008 and the entry of new providers is expected shortly. Gas market liberalisation remains incomplete. In telecommunications, 2007 was the first year of the full application of the Community legal framework. A detailed programme of actions for 2008-2009 should complete the liberalisation in all market segments. Competition and lower prices have led to a fast rise in broadband penetration, facilitated by the government's Digital Strategy initiatives. The development of energy infrastructure, including cross-border links, is of high policy priority and pursued with certain success. Transport infrastructure will continue to absorb a high percentage of public investment. Particular emphasis is given to further developing private-public partnerships for an increasing number of infrastructure projects.

EMPLOYMENT POLICIES

14. The Greek labour market is characterized by low employment, especially for women and older workers and a very high long term unemployment and youth unemployment. The main challenge for Greece is to improve the labour market participation and employability of women and various disadvantaged groups. A further challenge is to enhance the efficiency of the labour market by better matching people to jobs and to increase the labour market relevance of education and training.
15. Greece addresses all four flexicurity components, whilst not explicitly defining a national pathway or outlining an integrated approach. Policy focuses on active labour market policies and skills upgrading, although spending on active policies and coverage remain insufficient. Implementation of educational and lifelong learning reforms is slow and a review of labour law is needed. Social security contributions remain high.
16. The Council recommended Greece to focus on, employment protection, the tax burden on labour, active labour market policies and undeclared work. Although the institutional framework for flexible forms of employment is largely in place, these

appear to be unattractive to both employers and employees. An across-the-board review of labour law is missing. In addressing the issue of efficiency of active labour market policies, efforts have focused on integrating services (the creation of one-stop-shops), the delivery of services at local level and the targeting of particular groups. Greece must increase spending for active measures and establish cooperation between public and private sector institutions. Impact evaluation of activities need to receive greater prominence.

17. There has been some progress with regard to reducing the tax burden on labour. Attention should now be given to lifting the burden of high social protection contributions, particularly for the low waged. With regard to undeclared employment, the focus was put on combating tax evasion and on avoidance. The issue needs to be addressed more effectively including by strengthening administrative capacity. Implementation of already announced measures merits higher priority.
18. Greece was also recommended to accelerate the implementation of reforms on education and training. Despite high youth educational attainment, the youth unemployment rate remains three times higher than the average. Greece must proceed faster with the implementation of reforms in order to improve the quality of education at all levels and improve its labour market relevance. Key areas include increasing public spending on education, combating the fragmented governance of the education and training systems, increasing training opportunities for adults, and the implementation of tertiary education reforms. The full and rapid activation of a national system to link education and training with employment is also of fundamental importance. The absence of a system of official recognition of non-formal and informal learning constitutes another major shortcoming. Furthermore, Greece should speed up the implementation of the lifelong learning framework law.
19. The Council also asked Greece to focus on encouraging female employment, reducing early school leaving and putting in place a comprehensive support for active ageing. Additional teaching support programmes and centres for diagnosis of emerging needs have operated, and the number of pupils leaving school early shows a decrease. In addition, the gender employment gap is narrowing, but boosting employment opportunities for women still remains a great policy challenge. An array of initiatives has been implemented, strongly supported by the European Social Fund. The introduction of an additional mandatory year of pre-school education and care is important but more comprehensive action is necessary to better reconcile work and family life. The new law reforming the pension system introduces incentives for working longer. The NRP also outlines measures to support the employment and employability of older persons, but further action is needed in terms of activation policies for older persons, namely to provide them with more employment and training opportunities.
20. The establishment of a National Fund for Social Cohesion is an important policy initiative in alleviating poverty in Greece. The fund will support those persons on low salaries and pensions. The full activation of the fund is essential.

SPAIN

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The updated National Reform Programme (NRP) is forward looking, ambitious, and responds to a number of Spain's main challenges. The measures proposed are presented in general terms, backed by a clear problem analysis, sufficient budgetary information and a good degree of policy integration. The programme sets out a welcome commitment to implement the ambitious better regulation programme, and to strongly encourage social dialogue in order to, among other factors, modernise employment protection and foster flexicurity. It also outlines efforts to continue R&D investment and its translation into innovation. However, there seems to be little to address the challenges of improving education, increasing the attractiveness of part-time work, raising productivity, reducing greenhouse gas emissions, and implementing further pension and healthcare reforms. The Structural Funds have been targeted on the areas highlighted by Spain's recommendations and points to watch, with a significant proportion of the funding earmarked for Lisbon related activities. It is too early to demonstrate progress in terms of implementation.
2. Consultation of the NRP at the level of regional and local governments and the social partners has been reinforced but efforts to develop ownership remain relatively limited. Some doubts remain concerning the involvement of regional governments in the overall strategy. Involvement of the regions is relevant, since responsibilities in certain policy areas, like innovation, regulation of services, and education, are with the regions. The involvement of Parliament remains an area where there is room for improvement.
3. In the light of the following assessment Spain should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: pension and healthcare reforms, greenhouse gas emissions, attractiveness of part-time work, and integrate immigrants into the labour market.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Spain is facing a number of structural changes in the macro-economic area, all aggravated by the impact of the current financial turmoil. These centre on a lack of international competitiveness, as evidenced by a high current account deficit. In particular, insufficient productivity growth is affecting competitiveness. Further challenges include the on-going adjustment of the housing sector, and the long-term fiscal sustainability of public finances, which dictate that further pension and health care reforms are necessary.

5. In the context of rapidly increasing unemployment, the general government balance is rapidly deteriorating and could put in danger the objective set in the NRP of a balanced budget as a way to ensure macro-economic stability.
6. Given the persistence of a high current account deficit, even in a current context of sluggish growth, a closer monitoring of this challenge is now needed. Policy reform over the last twelve months has been limited in order to address the causes behind the large current account deficit, such as insufficient physical and human capital. Over the past year a series of measures have been designed to tackle this structural problem. These have prioritised public spending on R&D, education and infrastructure in order to foster productivity growth, attempted to ensure budgetary stability, and to increase competition in certain sectors. The core inflation differential with the euro area has nonetheless remained close to its historical average. The updated NRP announces efforts to counteract inflation through in particular further liberalisation of the services sector. This is a welcome step and should help narrow the core inflation differential gap.
7. To aid the long-term sustainability of public finances, Spain implemented a low-scale reform of the pension system in January 2008. Although a step in the right direction, its impact seems to be limited and further reform is necessary. Health care expenditure increase remains a source of concern in spite of some improvement in containing pharmaceutical spending.

MICRO-ECONOMIC POLICIES

8. In the updated NRP existing challenges in the micro-economic pillar are confirmed. Focus remains on infrastructure; knowledge and innovation; greater competition, better regulation; the efficiency of the public administration; competitiveness; encouraging entrepreneurship; and enhancing energy efficiency in the fight against climate change.
9. A number of measures are being implemented to improve the functioning of the energy market in Spain. These centre on moves towards an integrated Iberian market, the improved interconnectivity with Portugal and Morocco, and an increasing focus and strong political will placed on promoting interconnectivity with France. Improving competition in the electricity sector has been addressed through a number of reforms including measures to limit the market power of dominant players (for example by making it mandatory for integrated generators to sell energy to third parties) and to facilitate supplier switching. Some elements of the regulated price system favouring incumbents have been removed and the share of the regulated market is shrinking. However, Spain needs to speed up the pace of reforms as below-cost retail and network tariffs remain, accumulating large deficits contrary to the recommendations of the regulator. After the liberalization process is complete a tariff of last resort reserved for specific consumers will be introduced, although the complete details of this have yet to be established by the authorities.
10. Competition in services is considered as a priority way of reducing inflationary pressure. Of particular interest are reforms in retail markets where the ambition to increase price transparency for consumers is welcome. The priority given to the implementation of the Services Directive is important given the very large number of heterogeneous procedures and rules affecting the retail sector (many of which at the

regional and local level). The principles announced in the NRP intended to govern a new legislation on competition in professional services are welcome. Further measures are announced for key industries such as the railway sector, postal services and telecommunications that could have an impact on competition.

11. To improve further the business climate Spain has set an ambitious target for a 30% reduction in the administrative burden by 2012, with an Action Plan to facilitate this envisaged. Better regulation tools are to be found although the extent of their use varies from ministry to ministry and Spain needs to develop a more consistent policy in terms of impact assessment and consultation. In this respect the law making impact assessment compulsory after January 2009 is very encouraging.
12. Spain remains committed to address its climate change challenge. However, despite some progress, Spain's starting position is very low and the estimated gap regarding the green house gas emissions target will have to be covered through the emission permits market (with sizeable budgetary implications). New measures envisaged include further coordination with regional governments. Spain is in a relatively good position to meet its 20% renewable target even significant effort is still required over the coming years.
13. In order to assist the structural change of the productive sector (with a high concentration in traditionally low-tech, low value-added sectors) the authorities need to keep its focus on productive public expenditure in key areas as R&D and innovation, education, and infrastructure. Efforts to increase both the level and efficiency of R&D and innovation spending continue to be a strong point of the Spanish reform agenda. The newly created ministry responsible for high education, scientific research and technology will elaborate a new legal framework covering public policy tools, reducing administrative burdens, and regulating Intellectual Property Rights. Further efforts should be made to encourage private sector R&D expenditure, which represented only 47% over overall R&D in 2006. Additional efforts should be made to increase the return in terms of innovation and to improve knowledge transfer between science and industry.

EMPLOYMENT POLICIES

14. The Spanish labour market faces an economic outlook that differs significantly from that of the previous years. After a period of high employment creation and lower unemployment, the unemployment rate increased significantly, from 7.9 % in July 2007 to 11.3% in the second quarter of 2008. These worsening labour market conditions intensify current structural challenges. Segmentation in the labour market is the highest in Europe; Spain has a high number of pupils leaving school early; labour productivity is low; immigrant workers are not fully integrated into the labour market and female participation is low (although it has increased notably in the last few years).
15. Given the scale of recent changes to the labour market, the development of a flexicurity based approach with a set of national pathways would seem rather essential, but this concept remains under developed in Spain, and the main weakness is the continued segmentation of the labour market.

16. The Council recommended Spain effectively implemented education reforms at regional level, and to reduce the number of pupils leaving school early. These were the main objectives of the education law adopted in 2006. However, in 2007 the early school leaving rate actually increased by 1.1 percentage points to 31%. This is the third highest in the EU, and hides considerable regional variations. The target for 2010 set in the 2006 Implementation Report, for a reduction to 15% now seems unattainable. The NRP does contain measures at both primary and secondary education level aimed at tackling this problem, and a thematic conference with the regional Ministers of Education is foreseen. However, the implementation of most of these measures is due only to start during the fourth quarter of 2008. The NRP also announces a forthcoming roadmap to improve vocational training, where Spain displays a graduation rate of 17 percentage points lower than the EU15 average. Improving the quality and status of vocational training would also have a positive impact on the objective of reducing early school leaving.
17. The Council has also highlighted the need for Spain to focus on countering segmentation in the labour market, raising skill levels and productivity, integrating immigrants into the labour market and increasing access to childcare. An agreement with the social partners in mid-2006 has helped to bring down the rate of fixed-term contracts by 5 percentage points to 29.4% in the second quarter of 2008. However, some of its key measures are limited in time and do not foresee the promotion of part-time employment. Progress is being made to increase skill levels, with the number of workers participating in continuous training increasing by 18.9% in 2007. In order to integrate immigrants into the labour market, Spain has a strategic plan for 2007-2010 foreseeing a broad array of measures under four pillars. However, this challenge has increased in magnitude in the current climate, given that the rate of fixed-term contracts for immigrant workers is extremely high (over 50%) and that the unemployment rate for these groups has increased more rapidly than for the rest of the population. There has been some progress concerning childcare although important regional disparities persist in this field. A plan has been announced to improve childcare services for children aged 0-3. This contains a budget of 1.1 billion euros for the period 2008-2012.
18. In a reaction to the deteriorating labour market situation Spain approved in April 2008 an Extraordinary Plan for "Orientation, Professional Training and Labour Insertion", containing measures to fight against unemployment through active employment policies and training. A series of further measures were approved in September 2008. The implementation of the Law for Gender Equality has continued over the past year, with the adoption of measures aiming to ensure parity between men and women. It is also encouraging that labour market reforms have been approved in the framework of the social dialogue with a high degree of agreement from all social partners. However, initial disagreements have eroded the possibilities to carry the reform process further and undertake much needed and deeper reforms such as those to tackle the segmentation in the labour market.

FRANCE

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The National Reform Programme (NRP) for 2008-2010 has set an objective to stimulate growth and jobs, and through continued structural reform, to increase the capacity of the French economy to resist financial and economic shocks. The NRP represents a sub-set of the government's 2007-2012 policy programme, aiming to contribute to increased growth and full employment. There is a direct link between the Strategy and 2007-2013 Structural Fund investments.
2. In the context of the current global economic situation, the NRP states that France's budgetary policy will be reflecting the exceptional circumstances.
3. Governance and developing ownership of reform has improved over the past year, notably with regard to the social partners and labour market reform. It is essential that this progress be maintained. Political ownership of the Lisbon Strategy with the French authorities has improved.
4. In the light of the following assessment France should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: better regulation policies, participation of older workers, and making work pay

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

5. France's main medium term macro-economic challenge is to improve its public finances and in particular by adhering to its expenditure targets. In recent years with strong economic growth, little progress has been made with reducing the government deficit. The government deficit in France increased in 2007 to 2.7% of GDP and has deteriorated in 2008, due to the weakening economic conditions and a number of tax cuts decided in August 2007. It is expected that the government deficit will be above 3% of GDP in 2008-2010.
6. The Council recommended that France ensures long-term fiscal sustainability, with a view to achieving a balanced budget in 2010. In response France has taken actions in 2008 to achieve a balanced budget. These actions include in particular the implementation of the General Review of Public Policies, which entails annual assessments of the efficiency of public policies, ministerial strategies, and audits for modernising the State. A key element of this review is a zero growth of State expenditure, in particular by replacing only one of two retired civil servants. However, the government has announced that the targets of the expenditure rule will not be achieved in 2009. Moreover, the expenditure rules in the other administration sub-sectors (local government and social security) remain limited,

non-binding or not fully implemented. On the other hand, in an effort to help balance the social security budget by 2012, the government has launched a series of reforms, including measures designed to increase the efficiency of the healthcare system, and new taxes. However, the measures announced to reduce healthcare expenditures are non-binding or of limited impact.

7. To structurally improve France's budgetary situation, it is particularly important in the medium term to ensure zero-volume growth of State expenditures, which would strengthen the pace of budgetary consolidation, help achieve a balanced budget in the medium-term, and reverse the rapid increase in the debt ratio, which is important in the light of the expected costs of an ageing population. France's expenditure-to-GDP ratio is forecast to have been 52.8% in 2008, the highest in the euro area. The debt-to-GDP ratio, according France's November 2008 update of the Stability Programme is supposed to have reached 66.7% in 2008 and is expected to increase.
8. In view of improving the sustainability of public finances, the Council also recommended that the negotiation on pension systems scheduled for 2008 would have to build on the gains made following the introduction of the 2003 reform. The 2008 review was concluded successfully in time and notably decided to increase the number of contribution years required for full pension entitlement from 40 to 41. It also addresses the issue of special pension regimes, with an alignment with the pension regime of civil servants. Such efforts should be pursued at the next round of the review of the reform foreseen in 2010.

MICRO-ECONOMIC POLICIES

9. Improving functioning of markets is a key micro-economic challenge for France. The price level for goods and services could be lowered through enhanced competition, thus sustaining domestic demand and household purchasing power. Enhanced competition and less restrictive regulation in products and services markets would benefit to France's competitiveness, in terms of growth, exports and employment.
10. The Council recommended improving the competition framework in the energy and rail freight sectors. Some positive but limited commercial, regulatory or technical initiatives have been taken in the electricity and gas markets, such as interconnections of networks and connection with neighbouring markets. However, the specific transitory regulatory tariff for industry has been prolonged until 2010. Regulated tariffs still account for a large part of gas and electricity consumption. They block market entry and consolidate the very high concentration in electricity supply. Alternative suppliers represent respectively less than 1% and 20% of residential and non-residential customers. In rail freight, positive measures have ensured better access to infrastructure for alternative operators, whose market shares increased in 2007 (to 4.7%). However, there should be a stronger separation between infrastructure manager (RFF) and the incumbent operator (SNCF), and the draft law creating a strong, independent Regulation Authority should now be adopted and implemented.
11. The Council also pointed out the need to enhance competition in regulated trades and professions. Additional measures are still needed, notably in legal professions. The transposition of the Services Directive represents a significant opportunity to speed up the pace of reform. In the retail sector, in most French municipalities, mayors can

still have recourse to the authorization procedure for opening a retail store below 1000m². Selling at a loss is still forbidden.

12. The Council also stressed the need to further enhance better regulation policies by including impact assessments. The national target to alleviate by 25% the administrative burden by 2011 is welcome. Simplification of legislation is also progressing. The recent constitutional law introduced principles regarding the quality of new legislation. This should lead to mandatory impact assessments that address environmental, social and economic aspects. Taking economic and competitiveness impacts more into consideration within the Better Regulation policy, as well as adopting a more systematic and structured approach to consultation of stakeholders, including SMEs, would also contribute to further improving the overall business environment.
13. A number of important reforms have been taken in the micro field including the welcome establishment of a stronger Competition Authority. However, its investigation and sanction means, and its coordination with the Economics Ministry, notably as regards antitrust activities, remain to be clarified. R&D expenditure in the public sector is in line with the 2012 national target and should contribute to greater innovation. Private expenditure remains insufficient, especially in mid-sized enterprises. The more systematic evaluation of research and innovation is welcome. The Law on the Modernisation of the Economy further simplified the business environment for small enterprises, in line with the European Small Business Act. However, although the number of new firms created annually has significantly increased, the number of mid-sized enterprises remains insufficient. Many actions are ongoing to promote entrepreneurial education, although not integrated in the regular curriculum. The recent comprehensive ICT strategy includes 2012 targets for access to broadband Internet. Broadband Internet access at school is part of the overall ICT plan. A comprehensive and ambitious set of draft environmental legislation will promote better energy efficiency in buildings, greener public procurement, and more renewable energies, and may thus lead to a significant greening of France's economy.

EMPLOYMENT POLICIES

14. The labour market is characterized by high productivity but low labour utilisation. This is reflected in persistently high unemployment of notably the young and low employment of principally older workers, as well comparatively lower hours worked in the economy. Labour market rigidities account for inefficiencies and employment segmentation impacting hardest on employment outsiders like youngsters.
15. Flexicurity is the key to reform of France's dual labour market, with the 2008-2010 NRP pointing to ongoing reform in all four flexicurity domains. Structural reform is contributing to a more integrated employment policy, even if vital flexicurity reforms (employment protection) are partial or reform has slowed (vocational training).
16. The Council recommended France to modernise employment protection and enhance life-long learning. In the past year, social partners reached a first inter-professional agreement on flexicurity, which was subsequently transposed into law. This law aims to develop more flexible contracts through an increase in trial periods, a new special-purpose contract, and a new way to end permanent contracts through consensual

termination. Conversely, workers that have been laid off will have some transferability of rights (e.g. training, complementary health insurance, and unemployment benefits) reflecting contributions made earlier. While the reform should allow for more use of temporary contracts, facilitate terminations on permanent contracts, and help transitions back into work through transferred training rights, it does not tackle contractual segmentation and falls short of comprehensive employment protection legislation reform that would address the insider-outsider duality along permanent - temporary contract lines.

17. Progress to reform vocational training has stalled, with the objective of a more efficient and accessible training system closely aligned to labour market needs, still under negotiation by stakeholders. New legislation has merged and reorganized public job placement services and unemployment compensation agencies. The new operator should be better able to assist companies, workers and job seekers as of 2009. The rights and obligations of job seekers have for the first time been laid out, while reform of the unemployment system is projected to both tighten and open up the system to a wider public. The latter reform, if carried through, could make French unemployment compensation less based on insiders' vested interest and more based on unemployment risks.
18. Efforts to increase the labour supply include the tax exemption of overtime and a new law making the statutory 35-hour working week less binding. In addition, to complement the 2008 pension review, further measures aim to encourage active ageing and discourage early withdrawal from the labour market. However, social benefit reform aimed at facilitating a return to employment has been postponed until mid-2009. Some reforms should stimulate labour supply, in particular the levy on early retirement (raised from 24,15% to 50%), the removal of obstacles to combining employment and retirement, obligatory active ageing targets at branch and company level, and to make work pay by helping bridge the gap between assistance and wages (RSA as of mid-2009). However, other measures may prove to be second-best responses. For example, tax exemption on overtime will encourage hours worked and favour those already employed. However, labour supply is primarily an issue of low levels of participation in France, and these policies do not tackle the heart of the problem.
19. An important reform of social dialogue has been brought in to facilitate majority agreements. Currently, sizeable reductions of employers' social contributions on minimum wages act as a negative incentive to raise the wage of people employed at the minimum wage, helping to create a low wage trap. As a result, 13% of the workforce is employed at the minimum wage. A projected reform is seeking to alter how the minimum wage is set and its link to reductions in employers' social contributions, making the latter conditional on wage negotiations. The continued high tax wedge on low wages may require further tax reform.

ITALY

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) demonstrates awareness of the problems that need to be tackled to increase Italy's growth potential. However, the reform agenda in the micro-economic and employment spheres needs to be further developed. Few new measures have been announced to open up competition in product and services markets and no clear indications are given on how to meet the R&D target. Comprehensive strategies for both a flexicurity-based reform and improving the quality of education, in particular with a view to addressing regional disparities, have not yet been developed.
2. Consultation and efforts to develop ownership of the NRP at the level of central and local governments and the social partners are substantial. Links between governance and monitoring of the NRP, the National Strategic Reference Framework and national operational programmes under the structural funds are strong. The earmarking of structural funding for growth and jobs objectives is applied satisfactorily.
3. In the light of the following assessment Italy should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: R&D efficiency and spending, greenhouse gas emissions, quality of regulation, the effectiveness and efficiency of public administration, infrastructure, labour market participation of women, employment of older workers, and alignment of wage and productivity developments.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Ensuring the long-term sustainability of public finances remains a key challenge for Italy, given the very high level of public debt and demographic pressure. There is also the need to enhance the quality of public finances, in particular as regards fiscal governance and public services. Deteriorating cost competitiveness *vis-à-vis* Italy's main trading partners is resulting in a steady loss of market shares and has thus become an important policy challenge.
5. The Council asked Italy to pursue fiscal consolidation, in particular by curbing growth in current primary expenditure, and fully implement and complete pension reform. Italy's resolute fiscal consolidation strategy over 2006 and 2007 brought the general government deficit down to 1.6% of GDP, its lowest level since 2000. However, also because of the economic downturn, the situation of public finances started deteriorating again in 2008. The further weakening of the economy is expected to lead to breach of the 3% of GDP deficit threshold already in 2009, while the very high and increasing public debt prevents the government from extensively

using discretionary fiscal instruments. The reaffirmed commitment to the multi-annual fiscal consolidation strategy relies on progressive containment of expenditure at all levels of government. This will require improving efficiency and effectiveness of spending in order to safeguard an adequate level of public services. Some recent improvements in fiscal governance will help enhance expenditure control. The current challenge for fiscal governance is to design a new framework for fiscal federalism that ensures the accountability of local governments and fosters efficiency.

6. With a law adopted in 2007, Italy has taken a further step to reform pensions with a view to limiting future age-related public expenditure increases. Strict implementation of the reform over the years is crucial for fiscal sustainability, but additional measures should be considered, notably a further increase in the retirement age, in particular for women.
7. To restore competitiveness in export markets, a robust recovery of productivity growth is key. In the short-term, better balancing wage coordination at the national level with appropriate wage adjustment at firm level would help. Steps have been taken in this direction through fiscal incentives for performance-related pay, and an overhaul of the collective bargaining framework is currently under discussion. It remains to be seen whether these initiatives will foster productivity growth and to what extent they will bring about a better alignment of wages with productivity as was recommended by the Council to all euro area countries. This would also help address regional disparities in the labour market.

MICRO-ECONOMIC POLICIES

8. The main micro-economic challenges facing Italy involve opening up competition in the market; granting incentives for scientific research and technological innovation; upgrading infrastructure; and protecting the environment. Responding to these challenges would enhance long-term productivity growth and the resilience of the economy.
9. The Council recommended Italy to continue the progress made to enhance competition in product and services markets. A law on the liberalisation of local public services has been adopted, but its impact on competition will depend on its application. Promising initial measures have been taken to open up the fuel distribution market, which should be implemented across the country. No further liberalisation measures are announced in the new NRP, which is mainly backward looking in this respect. The recommendations issued by the National Competition Authority to address the significant barriers to competition that exist in a number of sectors, including retailing, professional and financial services, gas and local public services, provide a clear blueprint for reform. In this context, the bill mandating the government to propose every year a law to take account of the recommendations issued by the National Competition Authority, currently being discussed by the Parliament, would provide an appropriate tool. Furthermore, the national merger control law should be made applicable to all companies, including large insolvent companies, thus again opening up competition in air transport. As regards financial services, the financial crisis should not stop further strengthening the framework for competition.

10. The Council also highlighted the need to focus on: increasing investment on R&D; curbing greenhouse gases emission; implementing plans to improve infrastructure; and improving the quality of regulation, also by strengthening and fully implementing impact assessments. In the area of R&D, Italy has made some progress in supporting innovation and strengthening links between research and industry. This includes public-private partnerships at local level and a tax credit scheme for investments in R&D. Large-scale projects have been launched to promote industrial innovation and support the modernisation of the industrial basis. Measures are being taken to improve the governance of research, including initial steps to reform funding criteria to reflect merit and promote a more responsible use of resources, and the option for universities to become private foundations. However, the implementation of measures is generally slow and R&D spending has not increased since 2005, while the number of researchers remains lower than the EU average. Thus, meeting the expenditure target for R&D (2.5% of GDP by 2010) seems increasingly difficult. Moreover, the foreseen cuts to universities' recurrent funding and personnel are likely to reduce research and education capacities if not accompanied by further efficiency-enhancing measures, including a more comprehensive reform of funding criteria.
11. The NRP provides information on progress made in implementing plans for expanding energy, ICT and transport infrastructure. Additional major infrastructure projects are envisaged, but these should not slow down the implementation of existing plans. Some measures to expand broadband to rural areas have been announced, which should now be implemented.
12. To improve the business environment, Italy has taken steps to improve the quality of existing regulation, including by abolishing a number of redundant laws. Further effort is needed to ensure high quality new legislation, including comprehensive use of impact assessments. Italy is also taking steps to improve the efficiency of the public administration, a key factor undermining the business environment. Measures being introduced aim at enhancing transparency, better rewarding merit and promoting a more rational use of resources. A target has been set for cutting the administrative burden on businesses by 25% by 2012 and a project for measuring the burden is being completed. A law has been introduced to strengthen one-stop shops and reduce the time and costs for starting an enterprise.
13. Italy's greenhouse gas emissions are significantly above 1990 levels and the NRP acknowledges that existing measures will not be sufficient to meet the Kyoto target. Additional interventions need to be urgently identified and implemented.

EMPLOYMENT POLICIES

14. In a context of persistently slow economic and productivity growth, improving employment, labour market participation and employability throughout the country, overcoming the sharp regional disparities and high gender gaps, remain main challenges for Italy.
15. While not explicitly defining a flexicurity pathway or demonstrating an integrated approach, Italy's NRP describes recent or forthcoming initiatives addressing all four components of flexicurity. The design of a coherent set of structural measures that addresses all four components is now required. Focus should in particular be placed

on addressing labour market segmentation; enhancing the provision of active labour market policies throughout the country, including by strengthening the employment services; and developing concrete and effective lifelong learning policies, in particular in SMEs.

16. The Council recommended that Italy, within a flexicurity approach and with a view to reducing regional disparities, focus on education, lifelong learning, undeclared work and the operation of employment services. Little progress is visible in terms of improving the quality of education. Large disparities in education outcomes persist and southern regions remain among the worst performing in Europe. The foreseen cuts in education spending, mainly aimed at bringing the pupil to teaching staff ratio more in line with the EU average, need to be accompanied by decisive action to promote quality teaching so as to avoid deteriorating further education outcomes. In this context, the close monitoring of quality standards is essential. Stabilising the organisation of the education and training system after a series of incomplete reforms is a priority. On lifelong learning, effective action, including efforts to enhance the role of enterprises as training providers, is needed to help increase the participation of the workforce in training. The European Social Fund has been providing an important contribution in this area. Some measures, mainly preventative, have been recently adopted to fight undeclared work, while some previous promising initiatives have been dropped. Measures to simplify recruitment and job regularisation procedures have been adopted that could also enhance transparency of employment relations. A comprehensive policy package, ensuring both the rights and obligations of workers and a stricter control of firms' hiring behaviour, should be designed. Progress in ensuring a better operation of the Employment Services needs to be pursued, in particular to effectively monitor the outcome of their activities and overcome the poorer performance of service in the south.
19. In light of very low employment rates for women when compared with the rest of the EU, the Council also pointed to the need to continue increasing the provision of adequate, accessible and affordable childcare and elderly care. The implementation of the national plan on services for early childhood should therefore be closely monitored. Overall, the NRP still does not clearly set out how to foster the labour market participation of women.
20. The Council also emphasised the need to put in place a consistent active ageing strategy. The gradual increase in retirement age and the recent provision on the full accumulation of pension and work income are steps in the right direction. A wider policy on active ageing has been announced as a follow-up to the 2008 Green Book on Welfare. This would contribute to a sounder financing basis for social protection and to the adequacy of pensions.

CYPRUS

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The Cypriot National Reform Programme (NRP) contains a detailed and comprehensive list of policy objectives and actions aimed at responding to the Council recommendations and points to watch. It also presents analytically the main policy priorities for the period 2008-2010. Overall, the planned measures are ambitious and consistent with Cyprus' medium and long-term structural reform needs and have a defined timetable and budget. Structural Funds programmes for 2007-2013 are earmarked to a large extent for the Lisbon objectives. The utilisation of the Structural Funds contributes significantly to the priority policy areas of the NRP.
2. Governance and ownership of the NRP continues to be strong. All stakeholders are involved in the consultation and implementation process. The government has actively sought to increase further public awareness through seminars and public events, extensively covered by the media.
3. In the light of the following assessment Cyprus should pay particular attention to the the country-specific recommendation presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: health care reform, current account developments, gender pay gap; competition in professional services; private sector R&D, and broadband.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The macro-economic challenges presented in the NRP continue to be fiscal consolidation and debt reduction in order to stabilise the economy and to improve the long-term sustainability of public finances. The NRP targets a policy mix that supports economic growth and price stability. In this context, it envisages an improvement in the quality and management of public finances, by redirecting government expenditure towards growth enhancing activities. The implementation, since 2007, of a 3-year budgetary framework and a performance-based budget has been key. However, the NRP does not tackle the persistent current account deficit. While this has temporarily deteriorated due to high commodity prices, the NRP indicates that the process of real convergence will demand a much more significant reduction in the current account deficit, but without detailing the means.
5. The Council recommended Cyprus to take steps to implement reforms of the pension and health care systems and to set a timetable for their implementation. Progress in pension reform has been very substantial in 2008. A vigorous reform package, including higher contribution rates and stricter eligibility criteria, has been agreed with the social partners and is currently under discussion in Parliament. Furthermore, the increase of the retirement age from 60 to 63 years for an additional nine semi-

governmental organisations is at the stage of legal vetting. The implementation date for the reform is 1 January 2009. In contrast, the need for progress on healthcare reform is imperative, not only for securing the long-term sustainability of public finances but also due to its social impact. Although preparatory work continues unabated, progress has been slower than planned. The delay in the two pillars of reform, transforming hospitals into autonomous units and establishing a comprehensive National Health Insurance System, has been mainly due to lack of consensus and technical problems. The large number of stakeholders and interests involved make a consensus hard to reach.

6. In 2007, for the first time, the general government balance recorded a surplus, of 3.5% of GDP, on the back of strong economic growth and exceptionally buoyant revenues. For 2008, the government surplus is projected about 1% of GDP, despite the expected adverse cyclical impact. The 2009 budget provides a balanced mix of fiscal prudence and support for the economy, with measures targeted at the more vulnerable social groups. However, public finances are projected to move into deficit in 2009, on account of a significant slowdown of economic activity and subdued tax revenue. Expenditure would remain at a similar level as in 2008, as a rise in current expenditure would be offset by a reduction in interest rate payments. The level of debt should continue declining, approaching 45% of GDP by 2010, largely reflecting the planned reduction of deposits with the central bank.

MICRO-ECONOMIC POLICIES

7. The challenges for Cyprus for the next two years are to create a more competitive environment for businesses, increase private sector research and innovation, and accelerate the transition of the economy towards diversified and renewable energy sources. Improved broadband availability and speed at a lower cost are also necessary to boost uptake of ICT and increase its contribution to the overall economy. A systematic simplification of existing legislation, a consistent approach towards consultation and a fully integrated impact assessment system through the implementation of the 2007 National Action Plan and the welcome commitment to reduce administrative burdens by 20% by 2010 would help to improve business environment.
8. The Council pointed to the need for Cyprus to improve competition in professional services. Cyprus has commissioned an independent study to be completed by May 2009 to examine the existing restrictions for certain professions. As regards business ownership and structure restrictions, Cyprus is currently changing the legislative framework to allow the formation of private limited companies for lawyers, architects and engineers. Furthermore, the recently reinforced National Competition Authority (NCA) has launched investigations into most professions to tackle pricing and other restrictions on competition. This represents a step in the right direction but it has yet to produce the expected result and it remains very important to step up the pace of reform, complete the relaxation of the regulatory framework restricting ownership and corporate formation, and ensure that the NCA has all the statutory guarantees and the resources needed to carry out its enforcement and advocacy role.
9. The Council also pointed to the need to further stimulate R&D in the private sector. R&D spending remains low in Cyprus (0.43% GDP in 2006). The share of private sector investments has declined to only 16% despite the existence of relatively big

companies in the services and tourism sectors that could undertake such R&D activities. In this context, it is unlikely that Cyprus will attain its target for 1% GDP R&D expenditures by 2010. In 2008 Cyprus introduced policies that address organizational and infrastructure weaknesses and budgeted adequate funding for them. However, key actions such as the launch of the high-tech business incubator program, the establishment of the Science and Technology Park and the setting up of a loan guarantee granting facility for SMEs, are not yet completed. The introduction of fiscal measures and the encouragement of venture capital investment in start-up and early-stage R&D-intensive projects would be important to promote a higher level of private sector investment in R&D.

10. Notwithstanding the rapid pace of broadband deployment in Cyprus over the last year, access to broadband remains below the EU average and a stronger policy response is needed to facilitate the development of infrastructure and in particular to increase speed, availability and lower costs. Cyprus has substantial further potential to further exploit the opportunities offered by ICT across society. Despite a series of measures taken in 2007 and 2008 to develop eGovernment services and promote ICT investment and uptake, key policy actions such as the design of a National Information Society Strategy are delayed considerably.
11. Since 2005 Cyprus has been implementing programmes for energy efficiency, energy security, diversification, and the as well as promotion of renewable energy. A number of measures and incentives are in place to facilitate investment in renewable energy technologies. These policies are reinforced in the revised NRP by significant new support schemes for all types of renewable energies, as well as by the establishment of a new organizational structure. However, water management remains problematic. The new National Action Plan for Drought aims to ensure reliable water supply to households by building necessary infrastructure and at the same time decreasing demand. Drought management measures should also contribute to improving the business climate and tourism.

EMPLOYMENT POLICIES

12. Maintaining a sustained supply of labour, developing further human capital and enhancing social cohesion continue to be the main challenges. The labour market in Cyprus is characterised by overall high employment, low unemployment and labour supply shortages, particularly in low-skill occupations, which is being addressed by large-scale migratory flows. However, productivity is stagnant and is below the EU average.
13. The NRP reports on a number of on-going or planned initiatives on all four components of Flexicurity but without explicitly referring to an integrated national flexicurity pathway. Initiatives have focused on a national lifelong learning strategy, Public Employment Services, and measures mostly co-funded by the European Social Fund (ESF) aiming at promoting active labour market policy and flexible forms of employment. In the light of the continuing scarcity of such forms of employment, there remains scope to further enhance the integration of groups that remain under-represented in the labour market through adequate contractual arrangements.

14. The Council recommendation for Cyprus focused on lifelong learning, employment and training opportunities for young people and reforms of the vocational, education, training and apprenticeship system. The participation of adult population in lifelong learning has been increasing over the last two years to reach 8.4% in 2007 and the ratio of pupils leaving school early has been falling. However, in the light of the national strategic priorities to restructure the economy by shifting emphasis from low to high-skilled jobs, and to address the key problem of low labour productivity, enhanced efforts are needed to increase participation in lifelong learning of the low-skilled and unemployed and to reduce the high early school leaving rates among young people with a migrant background. Initiatives in these areas are planned and supported by the ESF. Following the adoption of the national Lifelong Learning Strategy in 2007, a National Committee and a Technical supporting Committee have been appointed. Their remit is to monitor, coordinate and promote the implementation of the Strategy. The Technical Committee is currently preparing a mapping of lifelong learning measures promoted by the authorities. The regular evaluation of the efficiency and effectiveness of lifelong learning measures needs to be reinforced. In the last 12 months there has been slow progress in upgrading the secondary technical and vocational education, and the implementation of the Modern Apprenticeship Scheme has been delayed, with it now due to start by the end of 2008.
15. The Council also pointed to the need to address the very high gender pay gap. Following the completion of a study on the issue, the Ministry of Labour and Social Insurance has prepared a proposal of measures to be co-funded by ESF (with a projected total cost of €4.5 million), during 2009-2013. This is a welcome start that should be followed by a comprehensive policy plan to address in an integrated way all social, occupational and educational causes underlying this gap.
16. A number of labour tax and benefit measures have been launched with a view to making work pay and strengthening social cohesion. More effective policy measures to encourage the labour market integration of people with disabilities are needed as well as measures to reduce the very high poverty risk among the age group of 65+. There is also a need to reinforce actions to improve health and safety at work, and to improve reconciliation of work and family life by expanding the availability of childcare facilities, especially for the age group of 0-2 years old.

LATVIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. Concerning the priority areas for action, implementation of an ICT programme in the education sector is behind schedule. The National Reform Programme (NRP) confirms the ambitious target to more than double the current level of household access to broadband to 75% by 2013 (50% by 2010). The planned initiatives in the field of energy and climate change, in particular the programme for environmentally friendly public procurement, are promising but remain to be implemented. Links between the governance of the implementation of the NRP and programmes under the Structural and Cohesion Funds are quite strong and the earmarking of structural funding for Growth and Jobs objectives has so far been applied satisfactorily. It remains to be seen if this will continue from 2009 in light of the tighter budgetary outlook. The implementation of the Structural Fund programmes for the period 2007-2013 is falling behind schedule.
2. Governance and ownership of the NRP at the level of central and local governments and social partners is rather weak and public visibility of the Lisbon reform process remains low. Discussions on the NRP are held within the Lisbon Strategy Supervisory Council, the Lisbon Strategy Consultative Working Group, as well as with other stakeholders. However there seems to be limited assessment of the implementation of the NRP. In general the NRP is not a forward-looking document, and lacks a strategic approach.
3. In the light of the following assessment Latvia should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: the regulatory environment, financial incentives to work, and take-up of ICT.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. In the context of the global and domestic economic climate, ensuring macro-economic stability remains the main challenge for Latvia.
5. In this context the Council recommended Latvia to pursue a more restrictive fiscal policy and bring wage developments in line with productivity. However, in 2008 the budgetary situation deteriorated rapidly due to the deepening economic downturn..
6. On 14 November 2008 Parliament adopted a 2009 state budget with a forecast deficit of 1.5% of GDP, based on a projected 1% GDP contraction. In view of international financial assistance negotiations, as well as the evidently deepening budget imbalances, on 12 December 2008 the Parliament adopted the "Programme for stabilisation of the economy and renewal of growth" aimed at stemming immediate

liquidity pressures, strengthening the banking sector, correcting fiscal imbalances, and adopting domestic policies that will improve competitiveness. This should help maintain domestic and international confidence in the financial system and contribute to reversing worsening cost competitiveness and inflationary pressures. It should also strengthen the economy's growth potential through structural reforms. Importantly, the implementation of EU co-financed projects should proceed as planned. Timely and determined implementation of the Programme will be crucial. To underpin this programme, the government adopted an amended budget for 2009. This aims to cap the 2009 general government fiscal deficit at below 5% of GDP, implying a very large budgetary adjustment compared with the budget passed in November 2008. A new budget law for 2009, consistent with this amended budget, should be adopted by the end of March 2009.

7. Medium-term fiscal consolidation would be aided by a strict medium-term fiscal framework and by ensuring public sector wages develop in line with productivity. In this context, amendments to the Budgetary and Financial Management Law are planned for 2009. There has also been significant progress to limit and progressively reduce public sector remuneration. The government has proposed substantial reductions in public sector wage expenditure, achieved by both cuts in average remuneration as well as by headcount reductions, as a centrepiece of a much tighter fiscal stance. By example and competitive pressures, this should help to align private sector wage levels more closely with productivity. Further progress in this area will be key to restoring Latvia's cost-competitiveness.
8. The proposed corporate income tax measures to stimulate the manufacturing sector should help improve competitiveness in the medium term. Other export and manufacturing-promoting instruments should be applied without further delay using the available Structural Funds' financing.

MICRO-ECONOMIC POLICIES

9. The NRP identifies knowledge and innovation, and a business environment conducive to investment and employment as the micro-economic challenges. The main goals are to increase R&D spending, renew the human resource base in science, generate innovation and new technologies, and to increase the penetration and efficiency of ICT. In the short term, policies requiring additional expenditure may prove challenging and further structural reforms will be needed alongside an increase in effective R&D spending to ensure sustainable growth in the future.
10. The Council recommended that Latvia progressed faster with its research and innovation policy reforms. Progress has been made, but policy formulation remains fragmented and inter-ministerial co-ordination could be improved. R&D policy is centred on the academic community and integration of the private sector remains the main challenge. The impact of recently adopted policies to stimulate partnerships between research institutions and business is also unclear, since there is no systematic monitoring and evaluation. Research activities could be further concentrated in areas with the highest potential for productivity gains. Given the generally low level of technological development in the private sector, additional emphasis should be put on the promotion of skills and resources that enable the application of existing technologies. Innovation in the service sector (including non-

technological innovation) has considerable potential. Latvia has so far not leveraged public procurement to boost innovation.

11. National data suggests a decrease in R&D intensity in 2007 to 0.63% of GDP, reversing increases between 2004 and 2006. The ambitious R&D targets of 1.1% of GDP in 2008 and 1.5% in 2010 are unlikely to be met. The shortage of qualified workers, especially researchers and engineers, needed to absorb the planned increase in total R&D investment remains an important challenge. A reinforced exposure of the R&D and innovation system to international cooperation is highly relevant in this respect.
12. The Council also invited Latvia to improve further the regulatory environment. Latvia has continued making progress and the setting of a 25% target for administrative burden reduction at national level is particularly welcome. The work on the general framework of better regulation policy should lead to the consolidation of fragmented initiatives, and ensure that the entire public administration takes ownership of this agenda. Systematic efforts to simplify the existing legislation are still lacking, as is a consistent approach to public consultation. More efforts are needed to enhance the use of a comprehensive impact assessment system as an instrument for ensuring a high quality of new legislation.
13. Latvia performs unfavourably concerning supply of online public services and their use by enterprises despite a significant increase in the supply of e-government. The take-up of broadband by enterprises in 2007 slightly diminished. The legal basis for e-services is still missing and their commercial rollout remains limited. ICT is mainly used for support functions instead of core business activities, leaving its potential in raising productivity largely unexploited.

EMPLOYMENT POLICIES

14. The NRP identifies the promotion of an inclusive labour market, social dialogue, flexicurity, health and safety at work, regional mobility and tackling undeclared work as challenges for 2008-2010. The increasingly difficult labour market conditions necessitate a strong policy response to ensure that the unemployed return to the labour market quickly.
15. While a flexicurity pathway has not been explicitly defined, the intention is to make contractual arrangements more flexible, strengthen the capacity of social partners and implement active labour market programmes. Measures have been taken to review some social benefits and tackle undeclared work. More emphasis is needed on lifelong learning, on supporting effective transitions and progression in jobs and on recognition of non-formal learning.
16. The Council recommendation focused on labour supply and productivity. Overall labour market performance has been good, resulting in an increase in the overall employment target and those for women and older workers. Until now the labour market has been slow to reflect the economic downturn, but more demanding times lie ahead, with unemployment set to become a particular challenge, especially for disadvantaged groups and youth. The quality of labour supply and labour shortages will need to be addressed by enhanced training and a better match between skills and labour market needs. Very low labour productivity across most economic sectors is a

concern. Some progress has been made in plans to support regional mobility, but implementation is now needed. Efforts have been made to forecast future labour market developments, enabling education and training systems to better anticipate skill needs. However, the quality of education and training (particularly vocational education) needs to continue to improve. Although the lifelong learning action programme for 2008-2010 has been approved, implementation is delayed. It focuses on disadvantaged groups and supporting local governments, but the overall need to develop skills and qualifications is insufficiently stressed.

17. The Council invited Latvia to improve access to childcare and to focus on pursuing active labour market policies. The provision of childcare is still insufficient to effectively help the combination of parenthood and work. Steps have been taken to introduce alternative, including short-term solutions. It is not enough if parents work full-time, as part-time wages are often too low. Support from the Structural Funds will help improve pre-school education infrastructure in regional centres. Active labour market policies have become more demand driven and place new focus on inactive and disadvantaged groups, this needs to be maintained in the expected downturn. The extensive labour market adjustment to be expected as the economy restructures will put extra pressure on these programs and the additional resources needed will be substantial.
18. Although Latvia continues to increase its minimum wage and personal income tax threshold, the tax wedge on average and low wage earners remains high, as are marginal effective tax rates. The steps undertaken in 2008 go in the right direction, but could be taken further in view of the need to improve competitiveness and growth prospects.

LITHUANIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The Lithuanian National Reform Programme (NRP) presents a list of measures to respond to the Council recommendations and other priority areas. It sets some quantified targets, but it is difficult to assess whether the measures will be sufficient to achieve them, as some measures are rather general. The NRP does not identify budgetary resources and only offers a general timeframe for implementation. The NRP fails to provide a clear and concise Action Plan that allows discerning political intentions on addressing the outlined priorities. Lithuania plans to invest a high share of Structural Funds into R&D and innovation and human capital. It is still too early to see how these plans have been put into practice.
2. Lithuanian efforts to ensure ownership and visibility of the Lisbon strategy are reflected in the consultation of working groups of stakeholders and members of Parliament. Nonetheless, ownership of the Lisbon Strategy tends to be at a technical rather than political level. Parliamentary elections took place in October 2008 after the approval of the NRP and a new coalition government was appointed in December.
3. In the light of the following assessment Lithuania should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: better regulation, regional labour mobility, availability of childcare, and occupational health and safety

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The immediate challenge for Lithuania is to manage the economic slowdown so as to preserve macro-economic stability. In particular, this relates to containing inflationary pressures and reducing the large external deficit. Fiscal discipline and wage setting in line with productivity will be vital so as to not exacerbating existing imbalances. Strengthening the supply side of the economy will be very important to ensure a sustainable economic recovery. Structural reforms could support the required re-allocations of resources to exporting sectors.
5. In 2008 public finances are expected to have registered a deficit of nearly 3% of GDP, due to expansionary policies. Looking forward, in view of continuing threats to macro-economic stability, the incoming government adopted in December 2008 a substantial fiscal austerity package. The package foresees considerable budgetary savings coming through a tax reform and cuts in budgetary expenditure. The tax rate changes (standard VAT up from 18% to 19%, personal income tax down from 24% to 21% and corporate profits tax up from 15% to 20%), increases in excise duties as well as removal of most of the existing tax exemptions entered into force on 1

January 2009. Significant cuts in the public wage bill, other current expenditure as well as in investment are planned in the budget. Furthermore, the government plans significant receipts from privatization in 2009.

6. The Council invited Lithuania to focus on containing inflationary pressures. Inflation rose substantially from 5.8% in 2007 to around 11% in 2008. Wage growth remained high in 2008 and was 19% year-on-year in the third quarter, well above productivity growth, thus eroding Lithuania's competitiveness. Further price increases stem from higher gas and oil prices translating into higher heating costs, higher food prices, as well as from the harmonisation of indirect taxes for tobacco, fuel and alcohol. The counter-inflationary measures set out in the anti-inflationary plans of 2007 have yet to be implemented. Looking forward in 2009, after the impact of the indirect tax increases in January, inflation is nevertheless expected to ease rapidly due to a slump in domestic and external demand.

MICRO-ECONOMIC POLICIES

7. The NRP identifies the following priorities in the micro-economic domain: encouraging research and innovation; strengthening competitive industrial potential; the creation of a favourable business environment; encouraging a rational use of resources to strengthen the synergy of environment protection and economic growth; promoting information and communications technology; and up-dating infrastructure.
8. The Council recommended Lithuania to accelerate the reform of its R&D and innovation system. In response, the Research Council was created to administer funds on a competitive basis and five Integrated Research, Higher-Education and Business Centres (Valleys) are being established to concentrate physical and human resources, strengthen science-industry interactions and help restructure public research institutions. Increases in salaries are aiming to boost attractiveness of researcher positions. Support from Structural Funds and better conditions for R&D and innovation activities in enterprises are also being provided. These reforms are expected to improve the capacity of Lithuania to attract and retain students, researchers and innovative companies and their implementation needs to be closely monitored. This is particularly important given that the ageing of researchers and the decline in the number of doctoral graduates remain a major concern. Innovation support services should also target traditional and low-tech sectors that are important for the economy but where growth is hampered by low levels of innovation.
9. In terms of R&D spending, there are no signs of progress on the public side with the intensity of R&D government funding decreasing from 0.48% in 2005 to 0.43% of GDP in 2006. Therefore, the 1% of GDP target for R&D public funding by 2010 will be difficult to achieve. However, there are positive signals from the business sector where R&D intensity increased in 2006 to 0.21% of GDP (from 0.16% in 2005). Further analysis of this increase should be carried out to better design future measures promoting business R&D.
10. The Council also highlighted the need to improve the efficiency of regulatory environment with particular focus on legislative simplification, and to focus on increasing foreign direct investment (FDI). In 2007 Lithuania adopted an investment promotion programme. However, the programme focuses almost exclusively on

infrastructure, while most of the reasons for low FDI are due to labour market bottlenecks and weaknesses of the business environment. Improving the business environment through far reaching legislative simplification and by reducing red tape would help to encourage economic activity, attract FDI and counterbalance the current slowdown without impinging on the public budget. However the Better Regulation Programme adopted in 2008 remains ineffective. While Lithuania's intention to set an administrative burden reduction target is welcome, this should be followed by concrete legislative and administrative simplification. Furthermore, more effort is needed to improve the quality of impact assessments of new legislation through an integrated analysis of environmental, social and economic impacts. While a number of steps have been taken on the application of the 'Think Small First' principle, the Better Regulation agenda still lacks sufficient focus on SME.

11. Lithuania continues improving environmental protection by promoting renewable energy resources, production and use of bio fuels, management of the seacoast and the modernisation of apartment blocks. ICT up-take is slow, with broadband penetration reaching 13.7%. While Lithuania's efforts to a new broadband network of information technologies in rural areas are welcome, further efforts are needed to speed up progress. Lithuania is encouraged to set a broadband penetration target and making high-speed Internet available to all schools by 2010. In 2007, Lithuania revised its National Energy Strategy to prepare for the closure of the second unit of the Ignalina nuclear power plant in 2009. However, most of the planned measures still need urgently to be implemented.

EMPLOYMENT POLICIES

12. After a period of strong growth and a rapidly tightening labour market, the difficult economic conditions have resulted in negative employment growth and increased unemployment. Slowing emigration should also relax the tight labour market, but further contribute to increased unemployment. In the light of negative demographic trends and an ageing population, maintaining adequate labour supply, both in quantity and quality, is a key challenge for Lithuania. To reach the national employment target of 68.8% by 2010 (64.9% in 2007), Lithuania needs to address low territorial mobility, social inclusion, undeclared work, disincentives to work and insufficient opportunities to balance work and private life. Efforts are needed to boost productivity and alleviate skills mismatches by improving education and training systems, lifelong learning, and occupational health and safety.
13. Lithuania has been addressing all flexicurity components to some extent without a clearly established pathway. It now plans to set up a Flexicurity Task Force to agree on an integrated set of flexicurity measures by 2010. The Lithuanian labour market is insufficiently flexible, as there is more focus on job rather than employment security. Expenditure on active labour market policy measures is higher than on passive, but the participation in lifelong learning is critically low.
14. The Council recommended Lithuania to increase the supply of skilled labour by promoting regional mobility and reforming education and training systems. The Programme for the Promotion of Labour Mobility approved in 2008 plans financial compensation for commuting and improvements in transport infrastructure. This is welcome, although the measures need to be further specified and implemented. Progress is more limited in reforming education and training. The draft law on

Studies and Science should help make higher education more responsive to the needs of the economy and society, encourage better competition between universities, help reform of university governance by involving more social partners, and increase financing of higher education and research. However, this law has yet to be adopted. Lithuania plans to raise participation in lifelong learning to 8% by 2010 (4.9% in 2006). No target has been set for older workers and the measure proposed in the NRP to give priority to training to people over 45 seems to cover only the unemployed. The revised lifelong learning strategy was approved in October 2008 but because of its general nature, lack of quantified targets and budgetary resources, its expected impact is difficult to assess. The NRP sets an ambitious target for the share of students in vocational training programmes of 32% by 2010 (2% in 2007). To help achieve this, initial and continuous vocational education and training systems are to be integrated, pupil-based financing introduced and modular programmes created. This should raise the attractiveness of vocational education, especially if the quality is also improved.

15. The Council invited Lithuania to improve youth employability, expand entrepreneurship education, increase the availability of childcare and strengthen occupational health and safety. Important initiatives on youth employability and entrepreneurship education should help support the young in view of the expected rise in youth unemployment. Lithuania plans to broaden pre-school education to cover the period from birth to the school age and establish multifunctional education centres. This could help increase currently limited childcare services. However, already generous child-care leave and benefits have been further increased, with likely negative repercussions on public finances and female employment. It is thus important to promote more sustainable ways to reconcile work and family life, including via more flexible benefits, work and childcare arrangements. On health and safety, a monitoring system of working conditions and employee health has been launched and employers can now use social insurance funds for prevention. The Occupational Health and Safety Strategy is under preparation and should provide an integrated approach covering legislation, training, information, quality at work, and preventative healthcare.
16. The NRP also plans to facilitate the integration of vulnerable groups, improve employment services, and strengthen social dialogue. These measures are especially important now when unemployment is starting to rise.

LUXEMBOURG

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The National Reform Programme (NRP) provides a comprehensive picture of measures recently taken to respond to the areas Luxembourg was asked to focus upon. However, the NRP remains backward looking, containing little detail on future initiatives, nor information on the timetable for their implementation or their budgetary impact, making it difficult to assess whether initiatives will be sufficient to tackle Luxembourg's remaining structural challenges. Links between the governance and implementation of the National Reform Programme (NRP) and the programmes under the structural funds are also fairly strong. The earmarking of Structural Funds for Growth and Jobs objectives is being applied satisfactorily with 82% of ERDF and 100% of ESF budgets devoted to achieving these objectives.
2. Consultation and efforts to develop ownership of the NRP at the level of central and local government and the social partners continue to be very substantial. Social partners were involved in drafting the 2008 Implementation Report. The visibility of the Lisbon process is reinforced by the regular publication of the "Observatoire de la Compétitivité".
3. In the light of the following assessment for Luxembourg the following challenges remain important: pension system reform, early school leaving, unemployment amongst the young, strengthening competitive markets, transposition of EU legislation, and greenhouse gas emissions.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The main macro-economic challenges identified for Luxembourg are to reverse the deterioration in public finances, and to reduce the risk of accelerating inflation and worsening competitiveness. The public finance challenge has been addressed, at least in the short run. Government finances recorded a surplus of 0.7% of GDP in 2006, which widened to 3.0% in 2008, creating welcome room for manoeuvre in view of the worsening economic conditions. Luxembourg's budgetary medium-term objective is a structural deficit of ¾% of GDP. Government debt is one of the lowest in the EU.
5. The long-term sustainability of public finances and the viability of the pension system remain a concern, given that the very strong employment growth observed since the early 1980s will inevitably translate in the future into a comparable increase in the number of pensioners. The rise in age-related government expenditure is projected to be among the strongest in the EU. Despite this, there has been very little progress in reforming the pension system and no progress at all was recorded in 2008.

6. Luxembourg has seen a significantly stronger increase in unit labour costs since the beginning of the decade than its neighbours and the EU-15, due both to a faster increase in wages and a slower rise in productivity. The latter was essentially due to a sizeable labour hoarding during the 2001-2003 slowdown. Wages increased by 4.3% in 2007, following a 3.1% increase in 2006, (despite the partial de-indexation agreed in April 2006). They slowed to about 2.7% in 2008. The partial de-indexation is scheduled to remain into force until 2009. These developments clearly threaten price competitiveness and undermine future growth prospects. Some restraint in wage increases in the coming years would thus be needed.

MICRO-ECONOMIC POLICIES

7. Priorities identified by Luxembourg in the micro-economic area are to integrate the economy into the European and international framework, to foster an attractive economic environment, and to apply the principles of sustainable development. While progress has been made on the integration of the economy and in further improving the economic environment, respecting the principle of sustainable development turns out to be a significant challenge in the context of climate change.
8. The Council asked Luxembourg to focus on creating a more attractive economic environment by fostering competition, speeding up the transposition of EU legislation, and supporting SMEs. There has been some progress in each of these areas, which now needs to be consolidated and complemented by further action. A proposal submitted by the government to merge the competition authorities and to broaden their mandate are steps towards promoting a competitive environment. However, this needs to be complemented by an increase in staffing levels in these authorities, addressing barriers to competition in the professional services sector, and revising the regulatory framework for railway services in line with European legislation to ensure competition. Luxembourg still has one of the highest transposition deficits in the EU, but has made notable progress over 2007-2008 in reducing it 1.8% (May 2008). The 1.5% target is now within reach, and Luxembourg should look at setting a date for achieving the new 1.0% target agreed by the Council. Efforts to set up one-stop-shops have been announced and should be fully implemented soon. Entrepreneurship education should also become routine in secondary schools.
9. Luxembourg is undertaking a number of measures in a wide range of areas to promote sustainable development, committing itself to a 28% reduction in greenhouse gas emissions, the most ambitious target in the EU. However, with total emissions in 2006 standing at approximately the same level as in 1990, this target will be very hard to attain by 2012, especially in view of population and economic growth. It is therefore important for Luxembourg to implement further measures, especially those targeting big and growing sources of greenhouse gas emissions. Road transport in particular remains the major source of emissions, partly because of the fuel exports triggered by price differentials with neighbouring countries.
10. To address the Spring European Council commitments, investment have been made in safe ICT solutions and electronic infrastructure, putting the 30% broadband penetration rate for 2010 in sight. Initiatives to speed up administrative procedures and increase eGovernment have also been announced. A quantitative target to reduce administrative burdens would be desirable. The public research budget has

significantly increased, doubling from 2005 to 2009. The present focus on efficient governance and absorption capacity therefore seems appropriate. However, the 3% of GDP target for public and private investments in research is unlikely to be met, and it is important not to lose sight of the target in the mid-term. Public-private partnership should be further strengthened, including to facilitate private research investment by SMEs.

EMPLOYMENT POLICIES

11. In order to avoid shortages of (high) skilled workers and to ensure the long-term sustainability of the pension system, Luxembourg's main employment challenges remain to raise the employability and increase the labour market participation of young people and older workers. Luxembourg has reiterated its commitment to address these challenges in the priorities set for 2008-2010. These encompass fostering innovation, creating full employment, and supporting a high-quality education and training system.
12. In close cooperation with the social partners, Luxembourg is developing an integrated flexicurity approach without having defined any specific national pathway. This approach strongly focus on contractual arrangements, active labour market policies, and lifelong learning. However, in the field of "modern social security systems", there still remain insufficient incentives for older workers to extent their working life and disincentives to retire ealier.
13. The Council asked Luxembourg to focus on reforming the pension system to discourage early retirement and increase the employment rate of older workers. The recent constitution of a working group on pensions, the introduction of vocational training leave, and of supporting mechanisms focused on better career transitions, may have a positive impact on the employment rate of older workers. However, these actions are not specifically focused on older workers and the package as a whole is not yet substantial enough to produce tangible results. This response needs to be complemented with concrete actions to support active ageing through proper incentives to work and disincentives to retire earlier.
14. Luxembourg was also asked to focus on reducing the number of early school leavers. Measures have been introduced to support disadvantaged young people with fewer opportunities and to facilitate their re-entry into the educational and training system. In spite of recent progress, performance still remains below EU average and someway from the 2010 targets for completion of upper secondary education and early school leaving. Further efforts are needed to remove artificial barriers between different types of education. Specifically, the practice of placing students in different groups or school types according to their educational performance should be reduced to increase the level of educational attainment of students from weak socio-economic or immigrant backgrounds. Luxembourg is also concentrating on the improvement of training opportunities and on the formal recognition of skills gained on the job. However, the implementation of measures is still ongoing, and it therefore remains to be seen if they are sufficient to raise levels of human capital.
15. Several actions have been launched in order to reduce youth unemployment and to facilitate the transition between school and work. Vocational guidance services have been developed, activation measures have been aligned with the needs of the labour

market and opportunities for informal learning and skills certification have been expanded. However, at this stage, many measures are not yet fully implemented or take the form of pilot projects. So, it remains important to strengthen policies to tackle youth unemployment and to continue with the evaluation of current activation policies.

HUNGARY

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The National Reform Programme (NRP) for 2008-2010 does not reflect a clear coherent strategy for the medium-long term. The action plan provides some elements to illustrate the country's response to policy recommendations and a general timetable, though it does not offer budget coverage. Following the financial market turmoil the Hungarian authorities adopted a series of measures to restore market confidence, including accelerated deficit reduction, enhanced fiscal governance and strengthened financial sector regulation and supervision. These measures are supported by a coordinated international loan package of € 20 billion to assist Hungary's balance of payments.
2. Consultation on the NRP continues to improve. A draft report was submitted to public consultation on the Internet. Political ownership appears limited and the Lisbon strategy is mostly followed at technical level.
3. In the light of the following assessment Hungary should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: R&D performance, state aids, the regulatory environment, incentives to work and to remain in the labour market, the employment and social services system, and undeclared work.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The NRP identified reducing the fiscal deficit and improving the sustainability of public finances as key macro-economic challenges. Further important challenges are to arrest the decline in competitiveness seen over the last two years as a result of a growing tax-wedge on labour and the persistency of wage increases. The accumulated imbalances, in particular the high public debt ratio and external debt still make portfolio investors hesitant to invest in the country.
5. The Council recommended Hungary to implement the necessary measures to ensure a durable reduction of the government deficit and of the public debt ratio. Hungary has been making strong efforts since the middle of 2006 to respond to these challenges with good performance during 2007 and 2008. The deficit was reduced to 5% of GDP in 2007 (from 9.3% of GDP in 2006), with a broadly even distribution between the revenue and the expenditure side. The deficit is likely to have been further reduced to around 3.3% of GDP in 2008, lower than the target of 4% of GDP. For 2009 the deficit target was revised in the context of the new policy programme, to below 3% of GDP, despite the anticipated deterioration in growth. This additional adjustment is foreseen to take place entirely through expenditure cuts, primarily important cuts in the public sector wage bill and a reduction in the 13th month

pension. Until recently, progress on the comprehensive reform of fiscal governance had not advanced as planned, but the new economic programme also envisaged the revitalisation of this process. A new reform law was adopted in late 2008 containing multi-annual expenditure ceilings and the establishment of a Fiscal Council.

6. The Council also recommended Hungary to reform the public administration, health care, pension and education systems with a view to ensuring long-term fiscal sustainability and improving economic efficiency. A large-scale regional reorganisation and institutional streamlining of the public administration was finalised by the middle of 2008, which is expected to result in significant expenditure reductions. In the field of public education, the coverage of performance-based financing formula was further extended in 2008. Little further progress has been made on pension reform, where the effective retirement age remains very low (58.6 years in 2007) compared to both the EU average and statutory retirement age (over 61 years). The recent welcome reform of the disability benefit system focuses on establishing stricter eligibility criteria, coordinated service provisions and back-to-work incentives. In health-care, after important progress in 2006 through the streamlining of hospital structures and a revamped pharmaceutical subsidy scheme, the reform process suffered some serious setbacks as a result of the March 2008 referendum, which abolished fees for doctor's visits and for daily hospitalisation. The Parliament also annulled the recently approved bill on health insurance reform. Afterwards, the authorities announced a new health reform, which focuses on strengthening the 'gate-keeper' function of general practitioners and proposes to revamp the health insurance system with a view to mitigate regional disparities (the concrete design and timetable need to be spelled out). Overall, given the expected rise in long-term age-related expenditures, announced reforms do not go far enough and the sustainability of Hungarian public finances is still regarded as at high risk.

MICRO-ECONOMIC POLICIES

7. The key micro-economic challenges remain those of increasing R&D and innovation, encouraging the use of ICT, improving competition, in particular by reducing and redirecting state aids, improving the business environment, and further reducing the administrative burden on enterprises. The Council asked Hungary to place focus on these challenges.
8. There have been few concrete measures to reduce state aid and re-direct funds towards horizontal objectives. In 2007 total state aid amounted to 0.86% of GDP. The share of horizontal aid accounted for only 53% of total aid in 2007, compared to the EU average of 82%.
9. There has been some progress towards improving R&D and innovation performance through the implementation of the Science, Technology and Innovation Action Plan. The actions within this plan concentrate mainly on strengthening business R&D. The level of private expenditure on R&D remained low in 2006 at 0.5% of GDP although this has increased since 2004. According to Hungarian government figures total R&D spending will have represented 1.1% of GDP in 2008, and is forecast to rise to 1.4% by 2010. However, given the slow progress being made in terms of implementing the planned reforms, the target set for 2010 of 1.4% of GDP is challenging. A range of measures have been announced in the field of innovation, in

particular within the New Hungary Development Plan. This is important progress that needs to be built upon given the relatively low level of innovation in the economy. In particular, measures should aim at enhancing co-operation between industry and public research institutes, and integrating the Hungarian Academy of Sciences into the innovation system.

10. Hungary's efforts to further improve the business environment were mainly focused on simplification proposals in 2008. Whilst the setting of a target to reduce the administrative burden is welcome, Hungary also needs to implement further concrete measures to ensure some reduction in the burden. Further efforts are warranted in assessing the impact of the new legislation, including through the use of an enhanced comprehensive impact assessment system. Progress has been made to improve the business environment. In particular, the introduction of the compulsory electronic registration means that start-up costs and the time required for company registration have significantly decreased in 2008.
11. Hungary needs to make further progress to make ICT more readily used and available. Delays in implementing measures to increase the take up of broadband and of ICT in general by business risk slowing down innovative efforts in the whole economy. Policies designed to foster the availability of ICT services and their adoption by enterprises should be considered a priority for the future.

EMPLOYMENT POLICIES

12. In the context of an increasingly difficult economic climate, with likely reductions in employment and continued increases in unemployment, the main labour market challenge for Hungary is to increase employment and labour market participation and to adapt education and training systems better to labour market needs. Employment activity of young people, young mothers, older people, the low skilled and other disadvantaged groups, including the Roma population and people with disabilities is particularly low. Moreover, the multiple disadvantaged social groups are concentrated in worse-off localities with poor job opportunities.
13. The existence of an integrated flexicurity approach and an elaborated national pathway is not evident. Many active labour market programmes are in place, but their effectiveness needs to be improved. A comprehensive lifelong learning strategy exists, but its implementation is rather underdeveloped. Contractual arrangements vary between the extremes of the high level of protection offered to public sector workers and complete flexibility of the self-employed entrepreneurs. The comprehensive review of the Labour Code is still pending.
14. In response to the Council recommendation on improving the labour market situation the government announced the 'Pathway to work' programme aimed at creating incentives and improving employability of the low skilled and long-term unemployed. This is welcome progress, but the specific design, budget and timetable for this programme remains unclear. Increasing the efficiency and coverage of active labour market policies remain a challenge. In particular, a higher level of monitoring and evaluation is important, especially for the programmes targeting the Roma population. Although the new range of policies directed at the Roma are steps in the right direction, it will be crucial to develop further concrete policy instruments and to focus on implementation. A number of targeted programmes have been announced

which aim to improve the labour market situation in the most disadvantaged micro-regions. However, this needs to be complemented by measures to foster labour mobility.

15. In response to the Council's recommendation on education and training the government is implementing a range of recent measures and foresees further measures with ESF assistance to improve the quality, effectiveness and accessibility of education. These include combating segregation in public education, the introduction of an integrated assessment system of both schools and teachers, and the involvement of employers in the development of educational plans in tertiary education. The impact of these measures is thus far unclear.
16. The Council asked Hungary to focus attention on improving incentives to work and to remain in the labour market. In response conditions for early retirement have been tightened slightly and financial incentives to remain in employment have been introduced. These represent important first steps, but further action is required in order to reduce current disincentives within the tax and benefit systems and to develop a long-term pension and active ageing strategy. There has been no significant policy response to improve the reconciliation between work and private life. In particular, the commitment made to improve pre-kindergarten childcare provision should now be translated into concrete action, accompanied by a reform of lengthy maternity leave schemes and reforms to encourage more flexible work arrangements. Although the establishment of the integrated employment and social services system appears to be on the right path, further integration and strengthening of the system is needed. Further adequate measures have been implemented and introduced to transform undeclared work into formal employment, and Hungary's clear determination to improve the situation is welcome. The implementation of the lifelong learning strategy is ongoing, and measures now need to be implemented to increase adult participation in lifelong learning, especially the low-skilled and older workers.

MALTA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) shows ambition in addressing Malta's challenges, and demonstrates a good level of synergy and policy integration. In general, the content of the strategic response seems adequate. However, in most cases, the proposal is to continue with existing initiatives and additional reforms remain quite general. Given the ambitious plans, it seems all the more necessary to link these visions to the current situation, to give detailed timelines and quantitative targets for implementation, and to develop clear monitoring and evaluation tools. The links between the new NRP and the Cohesion Policy programmes are good: 45% of the total Cohesion budget is earmarked for implementing the Lisbon strategy (20% in the previous programming period). Implementation has started well, with almost 59% of ERDF funds thus far contributing to NRP priorities and the ESF also providing substantial support.
2. There are signs of a strong political ownership of the new NRP. Consultation with social partners is institutionalised via the Maltese Council for Economic and Social Development, the new NRP underwent an additional public consultation, and it was debated intensely in the Cabinet. However, the stakeholder consultation could be wider, for example by including the social NGO's and environmental groups, and could be made earlier.
3. In the light of the following assessment Malta should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: fiscal consolidation, healthcare reform, regulatory environment, diversify its energy dependence, educational attainment and early school leaving, and lifelong learning.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Malta confirms the sustainability of public finances as one of its main macro-economic challenges and aims at reaching a balanced budget in structural terms by 2010. The new NRP recognises that future demographic changes will pose a challenge to age-related public expenditure, namely healthcare and long-term care, thus endangering long-term fiscal sustainability. Enhanced competitiveness within the euro area is particularly important and relies heavily on sustainable wage growth, achieved mainly by ensuring wages move in line with productivity, as well as on increasing productivity, and on tackling labour market shortages. Competitiveness also relies on maintaining low and stable inflation, primarily through effective competition. Malta's small open economy, together with its narrow productive base, makes it more vulnerable to external shocks. To address this, the new NRP envisages

further economic diversification by encouraging foreign direct investment in high-value added activities.

5. Following a notable improvement in public finances over 2005-2007, the situation was reversed in 2008, with the general government deficit estimated to have increased to around 3.5% of GDP. This reflects overspending due to a higher-than-planned increase in the public wage bill, in particular in the healthcare sector, higher energy subsidies and the one-off cost related to early retirement schemes in preparation for the privatisation of the Malta Shipyards. The deterioration will stall the declining trend of the deficit and debt-to-GDP ratios and could jeopardise the authorities' plans for a balanced budget in 2010.
6. The Council highlighted the need to continue implementing and reinforcing healthcare reform measures to ensure sustainable public finances. While the planned changes would allow for better resource utilisation and contribute to expenditure savings, the proposed healthcare reform measures seem inadequate, and progress in separating the regulation and delivery of the healthcare system has been limited. The spending pressures brought about by an ageing population and the rising cost of health provision, heightened by the expected higher running costs of the new hospital, point to the need for a more ambitious reform of the healthcare system, but the new NRP does not foresee any additional measures to support the financial sustainability of the healthcare system.
7. Public expenditure is still characterised by rigidities and discretionary decisions that may derail budgetary consolidation, as evidenced by the experience in 2008. Introducing control mechanisms to restrict growth in expenditure would release resources that could be used to bolster potential growth, to generate savings or to respond more effectively to changing policy priorities or macro-economic circumstances. Although the new NRP acknowledges the importance of redirecting spending to growth-enhancing categories, details on how this would be achieved are lacking.

MICRO-ECONOMIC POLICIES

8. Malta has set the twin challenges of improving competitiveness and protecting the environment, with focus on the business environment and better regulation, R&D, innovation and ICT, tourism, infrastructure and competition. Tourism is an important sector for Malta. The challenge is to further exploit its potential and to update transport infrastructure, whilst taking care to protect the environment and Malta's cultural heritage.
9. The Council recommended Malta should take steps to strengthen competition. This concerned the status and competencies of the Competition Authority, the high degree of state aid, and competition in the professional services sector. Malta is progressing towards an adequately staffed Competition Authority. Independence from political influence is an issue as the Competition Authority is part of a government ministry. However, reporting on actual activities, a prerequisite for the assessment of independence and impact has not yet started. An amendment of the Competition Act, which would also include the introduction of a leniency programme, is now foreseen for autumn 2008. State aids represented 2.29% of GDP in 2006, with a share of sector specific aid of 93%, considerably above the EU average. These values are a

severe concern, and whilst still in line with derogations included in the accession treaty, several of these will no longer be in force after 2008. Malta has finally taken decisive steps to terminate state aids to the shipyards. The implementation of this privatisation needs to be closely monitored to exclude undue distortion of competition. The NRP reports that the Competition Authority has taken active steps to address competition within professional services.

10. The Council highlighted the need to focus on a further improvement of the business environment. The implementation of a simplification action plan is progressing, and work on administrative burden reduction has begun. Malta has set a target for the reduction of administrative burden of 15% by 2012. The simplification process would benefit from more focus being placed on the administrative burden for business and on the monitoring of impact (as announced in the NRP). It should also be clarified according to which criteria a full impact assessment would be carried out for specific initiatives. The Legal Notice Checklist, used in Malta to consider smaller scale projects not justifying a full impact assessment, could also be strengthened. A number of initiatives have been established to help towards the setting up of a one-stop-shop for business and an improvement in start-up conditions but it is still too early to assess their impact.
11. Malta is completely dependent on imported oil for its energy supply, making diversification a pressing urgency. However, actual progress to develop renewable energy is quite modest. This is despite the fact that solar energy and on-shore wind farms seem to offer viable options for Malta. A thorough feasibility study on options for energy policy, including on connection to the European grid was expected to be submitted to the government in the spring 2008, but is still not ready. The decision process on new energy infrastructure investments needs to be pushed forward. Improving energy efficiency is an important element to reduce Malta's dependency on imports. However, it is not sufficiently clear whether the objectives of the national energy efficiency plan are realistic. Recent reforms of energy utility rates can have a positive impact on energy efficiency and the use of renewable energy, and thus also contribute to an urgently needed reduction of greenhouse gas emissions.
12. With R&D spending at 0.54% of GDP (2006), Malta does not seem to be on track to reach its modest target of 0.75% by 2010. Further funding of R&D is mainly planned to come from EU Structural Funds. Malta remains committed to invest in its ICT base and to improve broadband penetration that remains below the EU average. There has been some clear success in this respect, as well as for the European Research Area.

EMPLOYMENT POLICIES

13. Malta's main labour market challenge is the need to increase employment and skills. The key policy challenges are therefore to attract more people into the labour market, in particular women and older workers, to increase educational attainment, and to reduce the number of pupils leaving school early. Undeclared work also remains a pressing issue.
14. Based on the proposal of a working group involving social partners, the new NRP defines an integrated flexicurity pathway with a set of measures to be implemented, focused in particular on the improvement of the skilled labour supply.

Implementation of this pathway is now crucial and it is positive that the NRP presents a detailed timetable for this.

15. The Council recommended Malta to step up efforts to increase labour supply. Malta has implemented measures to attract more people, in particular women, into the labour market. The improvement in female employment has been driven by fiscal measures such as tax credits for women returning to work, support for part-time workers, and by the expansion of part-time work. Maternity protection legislation has been updated and special leave rights to employees not covered by existing agreements have been extended. The government is focusing on family-work reconciliation measures, such as childcare services, and teleworking. However, the employment rate for women with at least one child below the age of six years is the lowest in the EU, whilst the employment rate for young women (aged 15 to 24) is above the EU average. This illustrates that a number of women with young children do not return quickly to the labour market after a period of maternity and suggests it is crucial to step up these reconciliation efforts.
16. Some initiatives have been taken to encourage older workers to re-integrate in the labour market, such as the payment of social security contributions in specific cases and allowing pensioners to work without a reduction in their pension. However, the benefits of these measures may be offset by early retirement schemes to support the privatisation of Malta Shipyards. The resort to undeclared work remains an issue that partially explains low employment rates for women and older people. Malta has expressed determination to address the issue. However, the scale of the problem has yet to be quantified, and progress achieved is unclear. Additional efforts through law enforcement and a revision of the benefit system to make-work pay would help.
17. Education remains a major challenge. Further reform of education and training systems is important to raise the general qualification level, to reduce early school leaving, and increase the number of students in higher education. Reforms have begun to enhance infrastructure and the quality of teaching. Upper secondary school attainment is now on the increase. The government now needs to accelerate the implementation of the Educational Reform Agreement of July 2007 to improve links between education and the labour market and to reinforce career guidance. The government is working to better match training and education policies with emerging labour market needs with a focus on the IT sector. This is welcome but other sectors may also require an increase of skilled labour.
18. Life long learning remains a strategic challenge for Malta, with low participation rates, particularly for the low skilled. More substantial efforts are urgently needed to up-grade labour force skills in order to support economic development. Initiatives are being implemented through different bodies and actions, but a comprehensive strategy is still missing. Access should be facilitated by more flexible arrangements, in particular for older workers, and by making full use of the ESF.

THE NETHERLANDS

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The policy response towards the challenges presented in the National Reform Programme (NRP) is based on a clear analysis and is supported by a multi-annual budget planning. The NRP provides detail on a number of measures aimed at improving the labour supply. Although welcome, a concern remains that incentives for entering and remaining in the labour market and increasing the number of hours worked may not be sufficient for the Netherlands to reach the national employment target of 80% by 2016. Continued implementation of the long-term strategy for research and innovation is now needed in order to increase private R&D investment. To raise labour market participation and to create better conditions for a moderate wage development, the government has reduced unemployment insurance contributions; to avoid a further rise in inflation the government has postponed the VAT increase. Expenditures earmarked for the Lisbon Strategy represent 80% of the total Structural Funds allocated for the Netherlands. For the European Regional Development Fund, this implies a significant increase compared to the 2000-2006 period.
2. Political ownership of the Lisbon Strategy remains strong in the Netherlands. The reform agenda is evolving in close co-operation with social partners and stakeholders, including regional actors.
3. In the light of the following assessment the Netherlands should pay particular attention to country-specific recommendation presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: R&D performance.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The macro-economic situation in the Netherlands has been very good over the past years, but is expected to deteriorate. Public finances are still sound and government debt is still beneath the 60% of GDP threshold. In the NRP, the Dutch government confirms its commitment to ensuring long-term fiscal sustainability. This is of particular importance given the projected increase in age-related spending is above the EU average. To this end, it is important to ensure that the structural government balance is in surplus over the medium term. Furthermore, it is also necessary to continue implementing measures that increase labour market participation and the average numbers of hours worked.
5. The Dutch authorities have committed themselves to further improve the long-term sustainability of public finances. The long-term fiscal position is expected to benefit somewhat from planned measures to further increase labour participation, such as the introduction of a working bonus for employed persons over 62 and the

individualisation of the general tax credit. The government will have to continue to ensure the long-term sustainability of public finances.

6. The Council recommended euro area Member States to improve the alignment of wage and productivity developments. The strong increase in labour market participation has been putting downward pressure on productivity growth during the past few years. With a view to limiting wage developments in the coming year, the Dutch government has decided to postpone the planned VAT increase of 1 percentage point in 2009 and to lower social security contributions for employees.

MICRO-ECONOMIC POLICIES

7. In the micro-economic domain the key challenges for the Dutch economy are to support productivity growth, strengthen the knowledge base, and to address the societal challenges of sustainability, ageing and globalisation. This demands policies to encourage increases in R&D investment and improved innovation performance.
8. The Council referred to the need to focus on measures to increase private sector R&D investment. Given that the Netherlands has in recent years seen little progress towards the ambitions reflected by its R&D investment target for 2010 (3% of GDP), a continued sense of urgency and a close coordination, at the highest political level, of R&D and innovation policies are important. The development of a long-term innovation strategy is an important and welcome step towards building an integrated approach to strengthening research and innovation capacity. Linking the strategy to broader societal challenges is also a welcome development, although care should be taken not to fragment the portfolio of policy measures. It is important that the reform efforts, notably to create favourable incentives for R&D investment, are continued in order to counterbalance possible downward pressure on R&D investment as a result of the difficult economic circumstances. The strengthened focus on developing the excellence of the public research base will be crucial in attracting more private research investment, but should at the same time be complemented with measures to increase its socio-economic relevance. Addressing both of these issues through measures oriented at the institutional funding of universities and research organisations could prove to be more effective. The portfolio of instruments to directly support private R&D investment continues to be strengthened and diversified, but care should be taken to avoid risks of further fragmentation.
9. The Netherlands has made further progress in improving the business climate. Measures include encouraging entrepreneurship and the beginning of implementation of one-stop-shop for start-ups (although there is no one-stop-shop for private limited companies). Internet broadband penetration (34.3%) is far above EU average. Efforts in the area of better regulation and in particular in administrative burden reduction continue. The additional net 25% reduction aimed at by 2011 is being implemented with a new baseline measurement. Another positive element is the planned integrated system for measuring the impact of new legislation on businesses, employment, and environment. The Netherlands has a well-developed strategy for environmental sustainability and energy and is committed to meeting its targets for greenhouse gas emissions and energy-efficiency. The long-term climate and energy strategy introduces ambitious targets to reverse the trend in energy consumption and production. This strategy puts forward a comprehensive package of measures actively supported by the business community, although implementation has only

just begun. A substantial part of the Dutch competitiveness is due to a well functioning transport infrastructure. However, road congestion remains high and the steps announced in the mobility strategy, especially the introduction of road pricing, go in the right direction.

EMPLOYMENT POLICIES

10. The Dutch labour market is characterised by overall high employment and very low unemployment. The main challenge is to increase further labour market participation as well as the overall number of hours worked in the economy. The NRP confirms the overall employment target of 80% by 2016.
11. The Dutch labour market policies include most elements of the flexicurity approach. To increase labour participation and further improve the functioning of the labour market, the government created the Labour Participation committee (Bakker committee). Following the advice of this committee to further develop the integrated flexicurity approach, the Dutch government engages in discussions with social partners on designing work-to-work transitions and stimulating participation in lifelong learning to strengthen employability. A positive outcome of these discussions is a prerequisite for further developing flexicurity in the Netherlands. The recent tri-partite agreement limiting severance pay for high-income earners is a step in the right direction, but more efforts are needed to improve labour mobility. Despite a wide range of contractual arrangements granting varying employment protection, some groups remain under-represented in the labour market. Recent reforms of social protection systems prioritise work over income; however, they need to be combined with more effective implementation of active labour market policies focusing sufficiently on the large group of partly disabled, long-term unemployed and people with a migrant background.
12. The Council recommended the Netherlands to take further measures to improve the labour supply of women, older workers and disadvantaged groups with a view to increasing the overall hours worked in the economy. The NRP recalls the creation of the “Task Force Part-Time Plus” and fiscal measures in 2009 directed at women. A review of the 2005 Child Care Act has been announced, designed to more effectively and efficiently stimulate participation. According to Dutch studies the individualisation of the general tax credit is the most effective measure for encouraging women to take up a job. However the government plans in this domain remain limited in scope, with a transition period of 15 years. Given this, and the fact that fiscal measures are likely to be insufficient for tackling the high marginal tax on a second income, it is highly unlikely that the 2010 national target of 65% of women working at least 12 hours a week will be reached (it stood at 57.7% in 2007).
13. Older workers will be encouraged to stay in the labour market by granting them a bonus (from 62 years), whilst employers will benefit from reduced social security contributions when hiring the older unemployed or maintaining older workers in employment. Through these measures, the Dutch government intends to avoid increasing the statutory retirement age, something the Bakker committee deemed necessary. Although in a recent past the government has successfully influenced the older worker's behaviour (by abolishing the pay-as-you-go early retirement schemes), it appears that besides the newly proposed financial incentives, additional measures are needed to substantially close the difference in labour market

participation of the 55-59 and 60-64 age groups. The introduction of an earned income tax credit aims at making work pay for the low-skilled, benefit recipients and the economically inactive. Implementation of the Integration Plan announced in 2007, and aimed at improving integration and participation of immigrants, has so far been limited and more efforts will be required to bridge the persistent high employment and unemployment gaps with the native population. Furthermore, it is likely that, as has been observed in the past, the labour market performance of people with a migrant background risks deteriorating strongly with the economic slowdown.

14. Pre and early school education will be extended to improve the achievement levels of children with a migrant background or from disadvantaged groups. Financial incentives for schools, an extension of compulsory education, and the planned introduction of the obligation for young social assistance claimants (up to 27 years) to study or work, should contribute towards further progress in reducing the numbers leaving school early and increasing the number of youngsters completing secondary education (currently standing at 76.2%, significantly below the EU target of 85% by 2010).

AUSTRIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. Due to the national elections held in September 2008, the Austrian National Reform Programme (NRP) for 2008-2010 contains no binding statements on future policy measures but mainly informs about implemented measures and provides background analysis. An adapted NRP will be developed after the adoption of a new government programme.
2. Governance and ownership of the NRP continue to be strong. Responsibility for national co-ordination is taken at Ministerial level, and a wide range of stakeholders are included in the consultation process.
3. In the light of the following assessment Austria should pay particular attention to the country-specific recommendation presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: fiscal adjustment; supply of skilled workers at all levels, competition in services, in particular professional services and the retail sector; emission reduction policies; and female labour market participation.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Austria confirms its main macro-economic challenge remains one of ensuring the sustainability of its public finances. Although pension reforms introduced in the early 2000s have helped to keep the risk to the long-term sustainability of Austria's public finances relatively low, there is nonetheless still significant room for improvement. In the previous NRP, and associated Implementation Reports, the Austrian authorities committed to a budgetary strategy aimed at achieving a balanced budget over the economic cycle. This involved general expenditure restraint and further reforms of the public administration and health care system. However, negotiations within the previous coalition government on health care reform broke down, alongside those on the introduction of an automatic adjustment mechanism in the pension system. Since these budgetary savings did not materialize, progress towards long-term sustainability has been limited.
5. The Council highlighted the need for Austria to make greater effort to ensure the achievement of a balanced budget before 2010. In 2007, on the back of lively economic growth, the general government deficit narrowed to 0.5% of GDP. The budget deficit increased slightly in 2008. In an effort to sustain overall demand, the newly installed government is providing fiscal stimulus, notably by carrying forward direct tax cuts originally planned for 2010. Plans for budgetary consolidation have been back-loaded and the goal of a balanced budget has been dropped for the entire legislation period until 2013.

6. The 2009 budget will be the first one to be prepared under a new medium-term budgetary framework, adopted by the Austrian Parliament in December 2007. This new framework could enhance the predictability of the budgetary process. Although welcome, this framework only encompasses the federal government's budget and its extension to the sub-national authorities' finances would be highly desirable.

MICRO-ECONOMIC POLICIES

7. Austria has outlined a priority of making effective use of high R&D spending (representing 2.55% of GDP in 2007), a good international ranking on innovation, and exemplary performance in eGovernment to ensure a transition towards a knowledge-based economy. The current success of Austria's micro-economic policies is reflected in the growth in foreign direct investment and the large contribution of exports to Austria's overall growth. However, these exports remain mainly from traditional areas of industry.
8. The Council referred to the need for Austria to strengthen entrepreneurship education. Austria's overall performance with regard to entrepreneurial *activity* is only in line with the EU25 average, despite the fact that it is ranked one of the highest in the EU on almost all indicators of the entrepreneurial *climate* index. As a result of many excellent initiatives the climate for entrepreneurship in Austria is one of the best in Europe and Austrian citizens are among the least likely to say that starting a business is difficult. However, the number of people taking advantage of this positive climate remains low, suggesting that it is the attitude towards entrepreneurship that needs to be addressed, with education holding the key to progress. This is compounded by recent indications that industry will suffer from a shortage of skilled workers in the coming years, making it difficult to maintain high growth, to increase productivity, and drive structural change. The situation is aggravated by the low number of qualified migrants, loss of know-how and skills as a result of early retirement of older workers, and the low share of science and technology graduates. Targeted measures are therefore needed to improve the supply of skilled workers at all levels and promote more entrepreneurial attitudes. Cooperation between relevant government departments in this area has improved, but has not yet led to concrete results.
9. The Council also pointed to the need to increase competition in services, in particular professional services. The retail sector is also subject to heavy regulation and shows the highest degree of concentration in Europe. A comprehensive series of measures have been taken in recent years related to reducing regulation and increasing competition in professional services. It is widely believed in Austria that further deregulation would undermine the quality of these services. Despite the good progress there is scope for further action in the fields of legal services and notaries, though at present the competition authority (BWB) is not actively working on any service-related actions.
10. The Council also stressed the need to reduce emissions. Road transport remains the major source of greenhouse gas emissions, a significant part of which is due to export of fuel due to the price differential to neighbouring countries and because Austria is a transit country. The climate and energy fund became operational in July 2007, but the selection of projects in the 2008 work programme started only in June 2008, and the impact remains unclear. Further energy saving measures, for example

the insulation of buildings and efficient heating devices, are being heavily promoted. Austria has also put forward a comprehensive package of measures on renewable energies, including a doubling of the amount of electricity generated by water, wind and bio fuels by 2015. Austria's National Energy Efficiency Plan contains a long list of measures and indicative energy savings targets, but a lack of sufficient detail on these measures makes it impossible to assess whether the targets can be met. So far, no new measures have been introduced as foreseen at the "climate summit" in April 2008. In spite of ongoing and planned additional measures, there remains a gap between greenhouse gas projections and the 2010 Kyoto targets.

11. A comprehensive R&D review announced for 2009 should not only reinforce Austria's strong position in the European Research Area, but also bring more clarity into the complex administrative structures currently in place. Further progress has also been made on the reduction of administrative burdens. However, the same attention should be paid to the quality of new legislation, in particular through the effective and transparent implementation of the existing impact assessment system. Specific attention is paid to the needs of SMEs in the wide range of initiatives aimed at strengthening Austria's position in international trade.

EMPLOYMENT POLICIES

12. Austria's labour market is characterized by overall high employment and relatively low unemployment. The main challenge is now one of improving labour market participation and employability of various disadvantaged groups, such as older workers, the low skilled, disabled people, young migrants and women with small children.
13. Austria has shown a commitment to address these challenges through a flexicurity approach developed in cooperation with the social partners. The Austrian pathway to flexicurity appears strongest in relation to contractual arrangements and active labour market policies. However, the pension and invalidity systems still contain insufficient incentives to stay at work, and Austria still lacks a coherent lifelong learning strategy, given its rather fragmented education system. There remains scope to improve job-related training for older workers, education outcomes of disadvantaged youth and transition from education to work.
14. The Council recommended Austria to further improve incentives for older workers to continue working and improve education outcomes for vulnerable youth. The employment rate of older workers has considerably increased in recent years, although it is still well below the EU average. Recent pension reforms have strengthened incentives to work longer but they have long transition periods and early retirement is still a widely used option. The recent prolongation of provisions for early retirement for the long-term insured, and the suspension of the mechanism for adjustment of the pension system to longer life expectancy are backward steps. The high number of disability pension recipients underlines the need to modify the disability pension scheme and to adapt working conditions for older workers including enhanced health prevention. Some progress has been achieved with regard to job-related training of older workers, notably through the promotion of company-based training. These efforts have been supported by the European Social Fund and need to be enhanced.

15. In the last 12 months, significant measures have been taken in favour of disadvantaged youth, such as individual learning support, subsidies to companies recruiting apprentices and a guarantee for young people to receive a vocational education. However, enhanced efforts are necessary, in particular for young people with migrant background, who tend to obtain lower education levels, and have a higher share of early school leavers.
16. The Council also pointed to the need to tackle the gender segregation of the labour market, including by improving the availability of childcare. A key measure in this regard is the move to make the childcare allowance scheme more flexible. This aims to facilitate re-entry into gainful employment. Increased funds will enhance childcare facilities, especially for children under 3 years old. However, this financial increase is not likely to be significant enough to fully meet the needs. To effectively tackle segregation and the gender pay gap (still one of the highest in the EU) requires a comprehensive approach aimed at improving career opportunities for women in higher paid positions and sectors.

POLAND

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. In the new National Reform Programme (NRP), Poland presents its policy response to the key challenges. Notable progress has been made in implementing the e-government programmes and improving the transposition of internal market legislation. There has not been much progress in upgrading transport infrastructure, speeding-up the business registration process and increasing the provision of childcare facilities.
2. Poland has not made much progress towards achieving the specific policy commitments agreed at the Spring European Councils. The one-stop-shop and a single administrative contact point for recruiting the first employee have yet to be established. The leveraging of more private investment into R&D remains a challenge, as does the commitment of offering every unemployed young person a job or training within six months.
3. The new NRP briefly reports on the main actions undertaken over the past 12 months. It then outlines three main priorities for the future: creating an active society, an innovative economy and efficient institutions. The actions described are targeted towards achieving Poland's main challenges but they are described only in general terms, making it difficult to judge their likely effect. Budgetary implications and monitoring and evaluation procedures are missing. Poland has earmarked 64% of cohesion policy funding for growth and jobs objectives, and although the role of structural funds is highlighted, it is not elaborated upon.
4. The NRP does not present an Action Plan that indicates concrete measures to be taken in addressing Poland's challenges. The consultation process and efforts to develop ownership of the NRP have also not been presented. The Minister for Economic Affairs remains responsible for the effective coordination, preparation and reporting of the NRP, supported by an inter-ministerial working group. However, more efforts are needed to support implementation at regional and local levels.
5. In the light of the following assessment Poland should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: competition in network industries, the business environment, transposition of internal market legislation, education and training systems, and childcare facilities.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

6. Bringing high mandatory public expenditure on social protection under control remains Poland's major macro-economic challenge. Generous and poorly targeted

disability and early retirement benefits cause a large and persistent budget deficit and contribute to very low activity rates. In addition, the farmers' social security fund (KRUS), to significant extent subsidised by the public budget, is a major factor in hampering the restructuring of agriculture and preserves hidden unemployment in rural areas. A heavily indebted public healthcare sector requires a better management of hospitals and private co-financing of medical services. Recent price developments in the housing market need to be closely monitored and supply side structural rigidities limiting labour mobility need tackling.

7. The Council recommended Poland to strengthen fiscal consolidation and enhance control over expenditure. While fiscal consolidation improved in 2007 and 2008 to deficits below 3% of GDP, Poland has not taken steps to introduce an expenditure rule.
8. Poland continues efforts to complete the pension reform. A law on "bridge" pensions (temporary early pensions for people working in difficult conditions) has been adopted by the Parliament, but the rules according to which teachers' early pensions and the standard pensions in the general system after 1 January 2014 will be calculated and paid are still being discussed. The announced reform of KRUS does not go far enough and will not have any noticeable impact. However, the plan to improve the effectiveness of the healthcare sector is promising, although the feasibility of a quick implementation of far-reaching reforms is uncertain due to political uncertainty. In an effort to avoid long run budgetary problems, the government has adopted an active ageing strategy. Its implementation, however, is yet to begin.

MICRO-ECONOMIC POLICIES

9. Poland has a range of micro-economic challenges linked to the aim of completing the transition of the economy. To address this requires increases in R&D expenditure, which remains very low (0.6% of GDP), a research sector with better links to businesses, and increases in the level of investment in innovation. The low number of motorways and express roads, combined with slow train services, represent a significant obstacle for a growing economy. The energy sector requires more competition, the development of an information society is held back by low broadband deployment and a low provision of e-government services. Over regulation, a lack of legal stability, and slow procedures for business registration hamper entrepreneurship.
10. The Council recommended Poland to improve the framework for competition in network industries. Steps have been taken in this regard. For industry, electricity prices were liberalised in January 2008 and long-term power purchase agreements have been terminated, thus no longer constituting an obstacle to competition. Actions have also been taken to strengthen the unbundling of the transmission system operators in both the gas and electricity market. The government has announced that it will fully liberalise electricity prices for households in 2009, and electricity operators are to be privatised over 2008-2009. However, effective competition in the electricity and gas market is not yet visible for consumers, and only a very low proportion of consumers have changed their suppliers. The ambitious privatisation plan, with four electricity operators, is welcome but in the current economic climate it may be difficult to implement. The NRP details measures that would ensure a

stronger role for the regulator, but does not address the key issue of the regulator's independence.

11. The Council recommended Poland to reform the public research sector to boost R&D and innovation, and to encourage private R&D. Progress in this respect is mainly limited to the adoption and preparation of legislation for the reform of the public research base. A draft national R&D strategy, together with a proposal for the reform of the higher education and science sectors is being prepared. According to government commitments, the R&D target 0.92% of GDP by 2010 will be reached by yearly increases of public R&D spending of 0.158% of GDP.
12. There has been a promising response towards improving innovation policy, but increasing the cooperation between science and industry remains a challenge. The recently drafted National Innovation Strategy has been followed up by the adoption of an implementation plan. A Council for Innovation and Science, directly supervised by the Prime Minister, has been established to co-ordinate central and regional activities. Pilot measures on the business environment and to develop innovation centres are rolled out to develop full-scale projects financed with the structural funds. Tax policy has been designed to provide relief to support the creation of R&D centres.
13. The Council also highlighted the need to place focus on upgrading the transport infrastructure. Extensive bureaucracy has so far led to limited road construction. In 2007 only 11 km of new motorways and 92 km of new express roads were built, and little more is expected in 2008. The recent step by the Ministry of Infrastructure to adopt a special law to simplify road construction procedures will help accelerate progress, but effective construction remains very limited. Construction budgets are being revised upwards as a result of an increase in costs of material, equipment and skilled labour, and many projects are suspended pending an environmental impact assessment.
14. Further areas demanding policy focus include steps to speed-up the business registration process, ensuring timely implementation of the e-government programmes, and improving the transposition of internal market directives. The implementation of a one-stop shop has again been postponed to 2009. The implementation of the promising better regulation programme has been stalled and indeed refocused only on the reduction of administrative burden. This could undermine the achievements made in the application of impact assessments. The government has taken steps to monitor the transposition of internal market directives, although the effect of this has yet to materialise. Progress has been made in developing e-government, but this needs complementing with the adoption of an ICT strategy, substantial investment in ICT projects and training for officials.

EMPLOYMENT POLICIES

15. Sustained economic growth has helped raise the employment rate, substantially reduce unemployment, and thus achieve national employment and unemployment targets set for 2010 earlier than foreseen. Nevertheless, low employment, in particular among older workers, high structural unemployment and decreasing labour activity remain key challenges.

16. Poland has started moving towards developing an integrated flexicurity approach with active labour market policy playing an important role. Reform of the pension system with a view to prolonging working life remains important but is delayed. Part-time employment has limited use despite legal framework being in place, and increasing participation in lifelong learning is a challenge. The government has engaged in a broader dialogue on the subject with social partners.
17. The Council recommended Poland to develop an integrated flexicurity approach with focus on active labour market policy for disadvantaged groups, improving incentives to work, developing the lifelong learning strategy, and adjusting education and training to labour market needs. Work is in progress on further legislative amendments to enhance job-search activity and to reinforce employment services. A number of measures were launched to improve the labour market situation of groups at risk of poverty, including the adoption of the National Strategy for Social Protection/Social Inclusion for 2008-2010. The rapid implementation of this is now essential. The employment rate of older workers is the second lowest in the EU, but an active ageing strategy agreed by the government constitutes a promising response. The thorough review of the benefit systems has not been brought forward. Actions to match education and skills with labour market needs are in progress, designed with a view to increasing the attractiveness of vocational education, developing a National Qualification Framework, modernising curricula and placing more emphasis on key competences. The preparation of the lifelong learning strategy has been ongoing for several years and is now postponed until 2009.
18. The Council also highlighted the need to increase childcare provision with a view to reconciling work and private life. Measures have been proposed to increase women's employment, in particular through support for the reintegration of women after maternity leave. However, these proposals are still under elaboration and do not tackle the increase in accessibility of childcare.
19. Poland is facing increasing labour shortages in certain sectors as a result of fast economic growth, outward migration and skills mismatches. To address this, the government plans a wider opening of the labour market to high-skilled non-EU workers and a smooth integration of migrant workers returning home. The modernisation of public administration is presented as crucial and measures are planned to improve the capacity of all administrative levels.

PORTUGAL

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The updated National Reform Programme (NRP) for 2008-2010 shows continuity with the previous version and stability in its objectives. It recognises the inter-linkages across the three domains and introduces a new integrated approach. It also exploits the advantages of a clear convergence with the objectives of the National Strategic Reference Framework (NSRF). It appears to be sufficiently backed up by financial resources, with the structural funds playing an important role. A more precise timetable for implementation of the measures included would be welcome and the evaluation, assessment and monitoring mechanisms of the NRP need to be strengthened in order to measure results and ensure timely and effective implementation of reforms. Against the backdrop of the economic downturn, the government has announced a number of actions to ease the impacts upon the most vulnerable, including property owners. While these measures are important to deal with the impacts of the crisis, they will put further pressure on public finances.
2. The NSRF includes a significant commitment to move to a new competitiveness and innovation agenda. The indicative earmarking of Structural Funds for Growth and Jobs objectives is satisfactory (82% of the Portuguese structural funds 2007-2013).
3. The implementation of an ambitious reform programme through the Lisbon Strategy remains at the top of the political agenda of the Portuguese government. The implementation of the NRP will continue to be monitored by the Lisbon coordinator who reports directly to the Prime Minister, is in charge of the Technological Plan, and is involved in the coordination of Structural Funds, all of which resulted in a very integrated policy approach. Parliament, social partners and other stakeholders are closely involved in the preparation and the monitoring of the NRP. Not only are public awareness campaigns organised on a regular basis on the Lisbon strategy, but also their impact is also closely monitored which results in a very high awareness rate.
4. In the light of the following assessment Portugal should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: unit labour cost developments, long-term fiscal sustainability, continued implementation of the technological plan, the liberalisation of the energy sector; regulatory environment, and social cohesion.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

5. The 2008-2010 NRP confirms Portugal's commitment to fiscal consolidation as a key macro-economic policy concern, and gives priority to improving the quality of public finances and modernising public services. Despite the good progress made in

recent years, fiscal consolidation remains a key challenge in the face of still fragile public finances as well as a quickly deteriorating economic outlook. Furthermore, Portugal continues to record a low growth potential and a persistently large external deficit, the latter reflecting a continued sizeable deficit in the balance of goods and aggravated by the costs of servicing a growing external debt. Following the recent pension reform, the risks to the long-term sustainability of public finances have been lowered. Fiscal policy faces the double challenge of containing public spending in a sustained manner and reorienting it towards uses more supportive of economic growth and competitiveness gains.

6. Portugal has made good progress with fiscal consolidation. The government deficit has been reduced from 6.1% of GDP in 2005 to 2.6% in 2007, as a result of both revenue increases and expenditure containment. A further containment of the government deficit in 2008 seems attainable. The downward path of the debt-to-GDP ratio initiated in 2007 seems to have halted in 2008, with a further deterioration foreseen in the near future. Important steps have either been taken, or are due to enter into force in the area of public administration reform, which has been a pillar of the fiscal consolidation strategy of recent years. These include, most notably, the partial replacement of government employees who leave, the introduction of new career and pay scales and employment standards for government personnel, and performance evaluation for services, workers and managers. Progress in redirecting public spending towards uses more supportive to potential growth has been less evident. The current macro-economic outlook reinforces the need to improve the efficiency and effectiveness of public spending, which would benefit from a systematic and thorough monitoring and evaluation of public policies.
7. The already sizeable external deficit increased further in 2008, and despite low economic growth it is expected to remain high. The financial crisis makes it even more urgent for Portugal to regain its cost competitiveness, notably by pursuing structural reforms aimed at raising productivity growth in an integrated way and ensuring wage and price moderation.
8. The recent reforms of old-age pension schemes contributed markedly to containing the increase in age-related expenditure and lowered the risk to the sustainability of public finances. Nevertheless, the rapid increase in pension expenditure, which is expected to continue along with population ageing, still raises concerns for the sustainability of public finances. These concerns are magnified by the evolution of government debt, which increased from 50½% of GDP in 2000 to an estimated 64½ % by 2008.

MICRO-ECONOMIC POLICIES

9. The 2008-2010 NRP gives priority to the continued implementation and furthering of the reforms foreseen previously. It identifies three priorities in the micro-economic area: Improving the business environment, especially for SMEs; More R&D and a better innovation system; and the fight against climate change based on renewable and efficient energy. A horizontal aim has been set to promote the attractiveness of the territory by improving growth, productivity and cohesion through investment in infrastructures. These priority areas are mainly in line with the challenges identified by Portugal and the Commission in previous assessments and are coherent with the

NSRF (2007-2013). However, the challenge posed by a lack of effective competition in energy markets has not been sufficiently dealt with.

10. Portugal has strengthened its science, technology and innovation measures on the basis of the “Technological Plan”. In 2007, Portugal presents for the first time a positive technological balance and the 2008 budget foresees the achievement of the targeted 1% of GDP for public R&D spending. However, the targeted tripling of business R&D by 2010 may be difficult to reach despite a recent recovery in business R&D expenditure. Despite improvements, the innovation system still presents systemic deficiencies, in particular a weak inter-linkage among its various actors. The updated NRP supports the development of collective efficiency strategies and strengthens the role of clusters to promote innovation and global competitiveness. These efforts to boost private R&D capacity and strengthen innovation performance need to be continued, especially since they will benefit from the strong support of measures framed in the NSRF 2007-2013.
11. The level of competition in the electricity market for consumers with low levels of demand is very low, due to dominance of the incumbent. Furthermore, the continuous presence of regulated tariffs distorts individual choice and creates a barrier for new entrants, leading to failure of the liberalised retail market. A clear roadmap for the phasing out of regulated tariffs is essential before effective competition can begin in the sector. Despite improvements in better integrating the Iberian market and, notably, the creation of a daily market, the electricity market remains insufficiently integrated. Portugal has completed the transposition of the Financial Services Action Plan directives and has increased the supervision role of the Central Bank on credit and financial institutions to protect consumers. In the retail banking sector concerns remain in the area of credit card payments where fees paid by merchants are still high. Even in the pre-financial crisis period Portugal suffered from relatively high barriers in terms of access to credit.
12. In 2008, Portugal’s efforts to further improve business environment focused mainly on simplification proposals, including a reduction of the administrative burden. The target of a 25% the reduction of the administrative burden is welcome and reaching this through concrete measures is strongly encouraged. Efforts need to be stepped up to assess the impact of new legislation. More generally, an effective system of evaluation, assessment and monitoring of policy initiatives is strongly encouraged in order to ensure that ambitious measures translate into the desired results.
13. Portugal’s backlog with regard to the transposition of EU legislation is still above the 1.5% target despite strong recent progress. Concerted further efforts are ensuring good progress towards the target. Portugal has considerably stepped up its efforts and is progressing well in the implementation of the Services Directive.
14. Projections of greenhouse gas emission reductions indicate that Portugal will reach the 27% Kyoto target with existing policies, Kyoto mechanisms and carbon sinks. Portugal continued its progress in terms of improving the business environment. Simplification, in particular via solutions in the realm of greater e-government, has not lost momentum and continues to produce concrete results. The introduction of a series of programs in the area of entrepreneurship education, a weak point in last year’s assessment, is welcome though plans to introduce entrepreneurship education in secondary schools have yet to be implemented.

EMPLOYMENT POLICIES

15. The main challenges in the employment domain are to further enhance the education and training systems, to foster job creation and prevent unemployment, to promote flexibility and security in labour market, and to reinforce social cohesion. Despite recent improvements, Portugal continues to face a deficit in qualifications, training systems are still not adjusted to labour market needs and the labour market remains highly segmented. The updated NRP gives the high priority to these challenges. This is backed by substantial financial resources, namely through the ESF.
16. Portugal has undertaken reforms to address the flexicurity challenges in cooperation with social partners. The updated NRP does not explicitly identify a national pathway and the existence of an integrated approach is not evident, although measures are being taken under all four components. While progress has been made in modernising social security systems, more efforts will be required for implementing a truly comprehensive life-long learning strategy and the planned reform of active labour market policies. It will also be essential to swiftly apply the revised Labour Code.
17. Extensive reforms are being implemented to improve the efficiency of education and training systems, with concrete measures to improve young and adult qualification levels through the "Novas Oportunidades" initiative. The number of pupils leaving school early is decreasing and youth educational attainment is on the rise. This trend must be consolidated in order to further narrow the substantial gap with the EU averages and benchmarks. The full implementation of the National Qualifications Framework is essential, with the active involvement of stakeholders, in order to provide a qualification system relevant to labour market needs. Some progress has been achieved in terms of modernizing employment protection through the agreement reached with the social partners to reform the Labour Code. This is expected to enter in force in early 2009. It contains specific measures to counter labour segmentation and fight the precariousness of some jobs. Whilst this is undoubtedly a fundamental step, the focus should now turn to its full and swift implementation. It is also important to insert a review clause in the Code. The full implementation of both recommendations issued to Portugal is essential in the context of the current crisis. By overcoming the qualifications deficit and reducing labour segmentation, Portugal will be better equipped to face the rapid and changing needs of its economic situation.
18. The Council also pointed to the need to address the factors undermining social cohesion. It is welcome that the updated NRP attributes special attention to the reinforcement of social cohesion and this will closely integrated with the National Strategy for Social Protection and Social Inclusion 2008-2010. Some measures were taken in an effort to alleviate poverty, in particular the network of proximity services providing social and health-related support for vulnerable groups, investment in social facilities, and the introduction of a benefit to support the social and professional integration of vulnerable groups. Yet Portugal continues to stand out as having one of the most unequal distribution of income and social cohesion remains an important concern.

ROMANIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. Romania's economic and social development remains hampered by weak public administration, both at the central and local level, and by an inefficient judiciary system. The Council, therefore, recommended Romania to urgently strengthen administrative capacity, especially in essential functions of government. Progress however has been limited. Problem analysis, conceptual development, budget planning and execution as well as enforcement of policies remain weak. Ineffective oversight and lack of independence of regulatory and supervisory authorities often results in failure to tackle non-competitive market behaviour. An inefficient judiciary system adds to legal insecurity. Corruption still affects the business environment and access to and quality of the public services. Progress in this area is monitored through the co-operation and verification mechanism under which the Commission drafts regular progress reports.
2. Progress in setting clear and organised financial and management procedures, especially as regards procurement, is still too slow. These weaknesses cause substantial delays in infrastructure development and use of structural funds. The key to improved performance lies in reforming public administration, clearly identifying tasks and responsibilities, ensuring officials' independence and rewarding merit, in delegation of decision-making to avoid bottlenecks at the top. Plans have been developed, and should now be implemented.
3. Political recognition of the need to speed up reforms as part of the Lisbon Strategy is fairly recent. There have been some efforts to build broader support across the political spectrum but this has not had a lasting effect. In August, Romania adopted an Action Plan with short-term measures to implement the country-specific recommendations. While the Action Plan contains a number of measures that, if delivered, could have had a positive effect on the Romanian economy, only few have effectively been implemented as attention shifted to the campaign for the parliamentary elections that took place at the end of November.
4. There have been substantial efforts to raise awareness and build ownership for the Lisbon reform agenda, for example through high-level conferences and round tables with close involvement of the Prime Minister and his office. Members of the Parliamentary Committee for European Integration have actively participated in discussions on the reform agenda, although a regular debate in Parliament on progress could contribute to a more sustained reform effort. Consultation of the social partners, local authorities and other stakeholders has improved during the course of the year but needs further strengthening. Monitoring requires considerable effort, particularly by focusing on key measures, setting outcome indicators and assessing progress regularly in the Council of Ministers.
5. In the light of the following assessment Romania should pay particular attention to the country-specific recommendations presented in the recommendation for a

Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: ensure the long-term sustainability of public finances, R&D performance, infrastructure, public employment services, and energy efficiency.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

6. Romania's demand-driven boom has come at the expense of rising external imbalances and an overheating economy, making the economy more vulnerable to the impacts of the international financial crisis. The main macro-economic challenge is therefore one of addressing these imbalances and ensuring fiscal and monetary policy deliver sustainable medium term growth. The central bank has reacted by significantly tightening monetary policy conditions.
7. With this in mind the Council recommended Romania avoid pro-cyclical fiscal policy to contain the growing current account deficit and inflationary pressures, keep wage developments in line with productivity growth, improve budget planning and execution and improve the composition of public spending.
8. Fiscal policy has continued to be expansionary with the general government deficit likely to increase to 5.2% of GDP in 2008 up from 2.5% of GDP in 2007. This is partly due to continued weak budgetary planning and execution, with frequent in-year rectifications using revenue windfalls to increase expenditure, in particular wages, social transfers and subsidies. Despite several announcements, including in its recent action plan, Romania has yet to introduce a medium-term fiscal framework and a multi-annual investment programme to improve budgetary planning and the quality of public expenditure. State aid in remains high in comparison with the EU-27 average. In 2006, total State aid for industry and services was estimated at 0.56% of GDP, above the 0.42% EU-27 average. In addition, over the period 2002–2006, Romania granted only 16% to horizontal objectives, a rather low share in comparison to the EU-27 average (73%).
9. The current account deficit is forecast to decrease slightly but remains very high. Reliance on short-term debt has increased over recent years. In the context of increased risk aversion in international financial markets, continued imbalances in the Romanian economy affect investor confidence, and could result in additional pressures on the currency, tighter strains on external financing and reduced FDI inflows. This pleads for tightening Romania's fiscal stance, pursuing wage moderation and implementing structural reforms to reinforce external competitiveness.
10. A tight labour market and skills shortages have driven up real wages (by around 14% in 2008), far outpacing productivity growth. Public sector wages have grown even faster than those in the private sector. In September 2008, the Parliament approved a law to increase teachers' wages by 50%. If this increase were implemented under the 2009 budget there would be serious implications for the budget deficit, inflation and the economy as a whole, especially given that it could trigger similar wage claims in the rest of the public sector.
11. The Council asked Romania to ensure the long-term sustainability of public finances, in particular with regard to potential risks in terms of adequacy and sustainability of

pensions. Over recent years, measures have been taken to increase the long-term sustainability of the pension system, including by setting up a voluntary third pension pillar (in 2007), a compulsory second pension pillar (in 2008), and gradually increasing the statutory retirement age and minimum contribution period. The adequacy of pensions has also improved through a real increase of 85% between 2004 and 2008. This has however, resulted in additional pressure on the pension bill, compounded by recent reductions of pension contributions.

12. Given the impact of ageing on expenditure, further reforms are necessary to ensure the long-term sustainability of public finances. This would include raising the labour market participation of older workers and discouraging early retirement. The aim must be to improve the dependency ratio (currently close to 1:1) and thus increase the number of people in work contributing to social security. Improving the quality of health care can make a significant contribution to improving the health of the population, and keeping costs in check.

MICROECONOMIC POLICIES

13. Romania's main micro-economic challenge is to substantially improve its business environment by cutting red tape, ensuring the independence of its regulators and improving infrastructure. In order to address gradually eroding cost-advantages it will be crucial to pursue higher productivity and more innovation
14. The Council recommended Romania to take rapid measures to substantially reduce red tape, in order to remove an important source of corruption, and improve the business environment. In spite of several high-level political announcements and the adoption of a Better Regulation Strategy, the effective removal and simplification of procedures and authorisations has been further delayed. Romania continues to operate one of the most burdensome tax administration systems in the world with companies paying 113 taxes per year. While Romania's commitment to reduce administrative burdens by 25% by 2012 is welcome, if determined action were taken this goal could be achieved much more quickly. To avoid adding further to red tape, the regulatory system needs to become more transparent and predictable. To this end, stakeholders should be systematically consulted on forthcoming legislation with a minimum consultation period of 8 weeks, in line with European standards, and more impact assessments, of better quality, should be carried out.
15. The Council also highlighted the need to reinforce measures to tackle fragmentation of the research base and to pursue a more integrated approach to infrastructure development, to stimulate the innovative capacity of enterprises, and rollout of ICT.
16. Implementation of the National R&D Strategy for 2007-2013 is underway but major challenges remain. In particular the foreseen increase in public R&D funding (to 1% of GDP by 2010) should go hand in hand with a reform of the R&D system and measures to address the key factors that constrain innovation. A significant consolidation of the still fragmented research base is required, by cutting off funding to institutes with low scientific performance and by consolidating those that have potential. In spite of rising public financing, business expenditure on R&D has declined during the last decade and the R&D content of FDI has remained low. Public funding should be used more to leverage private sector investment, strengthen links between business and research institutes, increase the attractiveness of research

careers, and better link knowledge production with societal demand. Romania should set up a comprehensive monitoring system, based on international standards, to measure results and make adjustments.

17. Infrastructure, particularly in transport and ICT, continues to present serious shortcomings. With only a few hundred kilometres of motorways, an outdated railway system, and weak interconnections to the rest of the EU, infrastructure continues to act as a brake on growth and investment. In addition, due to inadequate administrative capacity, the preparation and launch of projects according to schedule and the compliance with requirements remains a major challenge, thus putting at risk Romania's capacity to absorb the EU's structural funds.
18. ICT services still play a limited role in the economy, despite a dynamic electronic communications market. Progress towards an information society continues to remain insufficient: enterprise connectivity to broadband is one of the lowest in Europe resulting in low levels of e-commerce and use of e-applications. Only 35% of public services in Romania are fully available online. Concrete actions are necessary to speed up progress in this area. The independence of regulators, particularly in energy and telecommunications continues to remain a serious concern.
19. As one of the most energy-intensive economies in Europe, energy efficiency should be a key priority for Romania. Whilst some measures are foreseen, what is needed is an ambitious and integrated strategy to radically improve energy efficiency of buildings (many of which are poorly insulated) and production structures. Moves to increase cooperation between Romania and other member states, such as the proposal for a New European Transmission System in the gas sector in which Romania is collaborating with Hungary, could help secure energy supply and market integration in the region.

EMPLOYMENT POLICIES

20. Romania continues to face labour shortages due to large migratory outflows, fast growth in particular sectors, and skill obsolescence. The lack of basic skills amongst young people, resulting primarily from weaknesses in the education system and from inefficient active labour market policies, reduces their chances to enter into the labour market, and holds productivity back. Adult participation in education and training remains the lowest in the EU. Agriculture still represents about one third of employment, although its productivity and contribution to GDP remains at very low levels.
21. The Council recommended Romania to tackle low activity, employment and productivity levels in an integrated manner. Progress to date remains limited. Many initiatives are prepared, but are often insufficiently targeted to the needs of the labour market, and of different groups, in particular vulnerable people, the largest share of which are the Roma. Greater attention is now given to life-long learning and active labour market measures. However, the lifelong learning strategy has yet to be adopted, and the downsizing of the Public Employment Service will limit its capacity to improve and expand its services, particularly against the background of increasing inflows into unemployment.

22. Whilst some positive initiatives have been taken to increase investment and modernise higher education, major challenges remain in primary and secondary education. The proportion of pupils with low achievement in reading, mathematics and sciences has increased. More than half of 15 years old have low reading skills (one of the worst scores in the EU). One in five pupils leaves school early. For Romania to achieve its ambitions to become a knowledge-based economy, it must urgently tackle the causes of its weak educational outcomes.
23. The Council also recommended Romania to tackle undeclared work. Prevention and control efforts have been stepped up, but so far with limited effect. More extensive enforcement and stronger sanctions are essential, as is the need to reinforce the weak link between social contributions and actual benefits.
24. Romania has announced measures to provide a better reconciliation of work and family life by reforming child care provision. This involves increasing the number of facilities, improving quality, and integrating it into the education system. This welcome policy development, if implemented, should increase female labour participation.

SLOVENIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) contains an Action Plan and envisages further progress. In most areas the measures are formulated in general terms without clear indication of the allocated budgets and timetables for their implementation. However, both documents explicitly address all current recommendations and watch-list items and identify most underlying domestic problems. Cohesion policy underpins the Lisbon strategy with over 60% of the funds earmarked for Lisbon-related investments. The funds clearly intervene in the areas highlighted by the above priorities.
2. Slovenia is very committed to the Lisbon process. However, due to parliamentary elections in September 2008, involvement of the National Assembly in the preparation of the NRP and Action Plan was limited. The government included in the NRP results from a public consultation that included the social partners and the civil society.
3. In the light of the following assessment Slovenia should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: wage growth in excess of productivity improvements, competition in the services sector, the national research and innovation strategy, energy efficiency, the link between the education system and the labour market, and the system of social transfers and the tax wedge on low paid.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The long-term sustainability of public finances, threatened by the budgetary costs of the ageing population, is the main macro-economic challenge facing Slovenia. The rigidity of public expenditure remains a concern as the high share of non-discretionary spending commitments leaves little scope for shifting expenditure towards growth-enhancing expenditures. It also limits the capacity to adjust to macro-economic shocks, which is more urgent given the current economic downturn. Public spending on health and to a lesser extent education is marked by low efficiency. Inflation stood at 5.6% in 2008, by far the highest rate in the euro area. This was not only driven by rising energy and food prices and strong demand pressure, but also by a lack of competition in some sectors. Since wages are clearly expected to grow faster than productivity, recent wage agreements, combined with persisting rigidities in the labour market, could deteriorate competitiveness vis-à-vis other euro area countries.
5. The Council recommended that Slovenia should continue reforming its pension system and promote active ageing. However, no additional measures to strengthen

the 1999 pension reform have been taken. Although the employment rate of older workers has been gradually improving, more decisive steps towards an active ageing strategy are now needed. The NRP recognises the need to change the current pension system and envisages further measures to keep older persons active for longer but offers no details. There has been some progress in addressing the euro area recommendations, especially in terms of budgetary consolidation with the achievement of a budget surplus in 2007. The budgetary position is expected to show a deficit slightly below 1% of GDP in 2008. However, recently agreed public sector wage increases constitute a strain on budgetary resources and a risk to inflation. Some progress was made to improve the quality of public finances through continued implementation of the 2006 comprehensive tax reform, including a further reduction of the corporate income tax rate and a phasing out of the payroll tax by January 2009. The NRP also envisages a reduction in the GDP-share of expenditure, spending efficiency improvements, and a reallocation to growth-enhancing expenditures but does not lie out concrete measures.

6. The NRP does not sufficiently recognise the risk of inflation and wage developments to competitiveness. A comprehensive strategy to tackle inflation is necessary. While the slowdown of domestic demand is likely to ease inflationary pressures, only limited progress has been made to stimulate competition in certain sectors. In order to maintain competitiveness, the risk of wage growth in excess of productivity improvements should be contained.

MICRO-ECONOMIC POLICIES

7. In order to contain inflationary pressures and sustain competitiveness, the key micro-economic challenges are to improve competition and energy efficiency and to better implement the national R&D and innovation strategy. It will be a challenge for the newly established Competitiveness Council to ensure a more effective implementation and monitoring of competitiveness and innovation measures without adding to the coordination problems in R&D and innovation due to the high number of actors involved.
8. A lack of competition in certain sectors contributes to inflationary pressures. The high concentration in the retail sector, a relatively low efficiency of the food processing industry, and insufficient regulation of competition are the main factors. The powers of the Competition Protection Office have been increased allowing investigations into the abuse of a dominant position and the imposition of fines. Since the end of 2007, the Office has fined five electricity distributors for price-fixing and initiated proceedings regarding cartel agreements and abuse of dominant position. Competition has risen gradually in telecommunications, but not in energy, retail and professional services. The banking sector is one of the most concentrated in the EU, but competition in retail financial services should increase with the implementation of the EU Directive on payment services and the Directive on the Single Euro Payments Area. Overall progress in the area of competition is limited but the new NRP envisages further measures, albeit without details.
9. While business R&D investment has increased, public sector financing of R&D has lagged considerably behind. Recognizing this fact, the new NRP postpones the achievement of the R&D target of 3% of GDP from 2010 to 2013. A more efficient

implementation of the R&D and innovation strategy, stronger coordination, and regular independent evaluation are now important.

10. Both the manufacturing sector and households are reducing their energy intensity. Slovenia has adopted a national energy efficiency action plan 2008-2016, targeting a reduction of final energy consumption of 9% and of greenhouse gas emissions of about 1.1 million tons per year. Additional financial incentives are provided for households and the Energy Act was amended to provide incentives for projects involving power plants using either renewable sources or high-efficiency heat and power cogeneration technologies. The implementation of measures to reduce greenhouse gas emissions has been limited, in particular in the area of the modernisation of thermal plants and transport. Transport emissions increased over the last two years at an accelerated pace. Without additional measures, Slovenia is unlikely to meet its Kyoto targets.
11. Slovenia made good progress in recent years to unlock business potential with easier and cheaper start-up procedures, improved access to finance for SMEs through the Enterprise Fund, and the re-introduction of a tax break for R&D investments. However, further efforts are needed to improve entrepreneurship education at all levels and to attract FDI and venture capital inflows. A more comprehensive administrative burden strategy would be welcome. The legislation on electronic communications has been amended and a broadband strategy set up which should be implemented by 2010. Broadband penetration is still below the EU average. Broadband penetration in schools is above the EU average.

EMPLOYMENT POLICIES

12. The Slovenian labour market is characterized by employment rates just above the EU average and low unemployment. Slovenia managed to reach the targets it set in the 2005 NRP for overall employment and unemployment, but did not achieve the target for the employment rate of older workers. Integrating young people into the labour market and raising the low employment rate of older people constitute the main structural labour market challenges.
13. The new NRP envisages a gradual approach towards flexicurity, to be developed in agreement with the social partners. Slovenia would benefit from further developing flexicurity. The dichotomy between permanent and other types of contracts leads to labour market segmentation that particularly affects young people. Active labour market policy has been reinforced with the modernisation of the Employment Service and new programmes supported by the European Social Fund. However, efforts to reach the activation targets should continue in light of the economic downturn. Performance in relation to lifelong learning is generally good, but participation of older and low skilled workers remains low. More efforts are needed to reform the pension system and achieve active ageing. The announced reform of social transfers still needs implementing.
14. The Council recommended that Slovenia should promote more flexible contractual arrangements to counter labour market segmentation and further improve the effectiveness of employment services. The 2007 amendments to the Employment Relationship Act extended the flexibility within companies, but did not fundamentally affect employment protection for permanent contracts. Temporary

employment and so-called student work, a form of flexible and cheap employment with lower social protection and employment rights, constitute the main types of employment of young people. The plan to integrate student work into the regular labour market was abandoned and labour market segmentation remains a key issue. The Employment Service is now more effective thanks to modernisation, IT tools and internal training to promote a more proactive approach. In view of the important number of unemployed first job seekers, it is intended to strengthen on the job training activities and implement innovative employment programmes for young people. In addition, every young person that fails to find employment is planned to be involved in active labour market policies within four months of completing his or her education.

15. The Council pointed at the need to strengthen the link between the educational system and labour market. The reform of the educational system launched in 2004 and to be completed in 2009 entails a continued streamlining of vocational programmes with a view to better responding to the needs of the economy and allowing for greater relevance of and flexibility between study paths. New tertiary education programmes were accredited. The system of scholarships was reviewed to better orient students towards the needs of enterprises. Steps were taken to increase the number of students in technical and mathematical sciences but Slovenia continues to lag behind in EU. Further measures to facilitate the transition of the young from education to the labour market, e.g. through subsidies and tax relief for employers, are envisaged as well as the reinforcement of other relevant institutions. Since such measures only show their full impact after a few years, progress should be closely monitored.
16. The new NRP recognises the need for a better interaction between taxes and benefits, but concrete measures are not outlined. The unemployment and low wage trap are among the highest in the EU. Further effort is needed since earlier reforms have not significantly improved the situation. The 2005 NRP announced a reform of social transfers and a reduction of the tax burden on labour in order to increase the incentives to work. However, the 2006 tax reform only marginally affected incentives for low wage earners and the implementation of the reform of social transfers has been delayed.

SLOVAKIA

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The new National Reform Programme (NRP) for the period 2008-2010 describes the Slovak priorities and initiatives in response to its key structural challenges in rather fragmented and general manner, without the assurance of sufficient budgetary allocations. An estimated 57% of Structural Funds has been earmarked to achieve Growth and Jobs objectives. Progress with implementation is so far very limited as it started only in 2008.
2. The NRP has been prepared by the central administration in cooperation with social partners and the academic community, while the involvement of regional governments and other stakeholders remains limited. A draft version of the NRP was submitted for consultation to the Parliament, the Economic and Social Council and the Council for EU Affairs.
3. In the light of the following assessment Slovakia should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: broadband infrastructure and ICT take-up, competition, in particular in the gas and electricity; and gender pay and employment gaps.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Slovakia's main macro-economic challenge is to ensure a stable macro-economic environment through sustained fiscal consolidation. This is particularly relevant as Slovakia will adopt the euro in January 2009 and, in the absence of formal monetary policy autonomy, fiscal policy will have to play a more prominent role in ensuring macro-economic stability.
5. Based on moderating, but still resilient GDP and employment growth, the general government deficit is estimated to have remained close to 2¼ % of GDP in 2008 and to increase to some 2¾% of GDP in 2009. In the medium term, a lowering of the deficit is needed to ensure that public finances will be able to effectively cope with likely future challenges stemming mainly from ageing population and gradual slow-down in the catch-up process. The 2009 budget relies on substantial one-off revenue estimated at some ¼% of GDP. A temporary opening of the second pension pillar in the first half of 2009 is expected to induce an outflow of participants from this pension scheme and thus result in a transfer of accumulated pension savings from private to the general government sector. On the expenditure side, the 2009 budget foresees an increase in public expenditure on education, science and technology to around 4½% of GDP in 2009 (from 4% in 2008). This is fully in line with the Council request that Slovakia reallocate resources to education, R&D and innovation, and with the euro area recommendation to improve the quality of public

finances. This increase is planned to be entirely financed by a higher use of the EU funds.

6. In view of the adoption of the euro, the government has introduced a set of measures aimed at preventing undue price increases during the changeover period, including price monitoring and various consumer protection measures. The government will also have the possibility to regulate prices if deemed necessary. It would seem appropriate to accompany these measures with more effective product market competition, productivity increasing measures and continued responsible fiscal policies.

MICRO-ECONOMIC POLICIES

7. In order to sustain Slovakia's competitiveness, the main micro-economic challenge is one of increasing the quality of R&D output and further eliminating barriers for business. Further priorities are to increase the up-take of ICT and to improve energy efficiency. Slovakia has approved a conceptual document on energy efficiency and is also working on a comprehensive national strategy for energy and climate change, whilst its performance is around EU average.
8. The Council recommended Slovakia to implement a coherent R&D and innovation strategy by focussing on institutional reform and co-operation between business and research, as well as by allocating more resources. Despite the substantial increase in R&D investment planned for 2008, the overall R&D spending of about ½% of GDP is substantially below the EU average. During 2008, Slovakia has continued improving the institutional framework, but hardly any operational measures have been implemented. The aim is to reach an overall R&D spending level of 0.88% of GDP by 2010, with the main increase in public funding coming from the EU Structural Funds. The achievement of this target is subject to a new financing model still under development. The link between research and business remains weak and participation in EU research programmes is diminishing. The new NRP puts forward several good initiatives aimed at improving the quality of R&D output and funding and a plan for regular monitoring and review. In the area of innovation, there are plans to establish technology transfer contact points and regional innovation centres. Although the overall coherence of the proposed measures could be improved and the incentives for private sector participation need reinforcement, they have the potential of initiating positive changes.
9. The Council also recommended Slovakia to improve the regulatory environment by implementing a comprehensive better regulation strategy. Progress in this area is so far disappointing with only limited steps taken to reduce administrative burden and to introduce the impact assessment system. Moreover, implementation of the action plan for the reduction of administrative burdens has been further delayed until 2009.
10. User uptake of ICT is low, mainly due to the underdeveloped infrastructure, a limited supply of e-services, and an including incomplete legislative framework. To address this, Slovakia aims to make high-speed Internet available to all schools by 2011 (63% in 2007) and targets that 35% of households will have access by 2010 (27% in 2007). Measures to improve broadband access in remote regions have been delayed with the first public tenders currently planned for mid-2009 and mainly financed from the EU Structural Funds. Slovakia has adopted the main strategic planning

documents on ICT. As of 2009, all calls for public procurement are to be submitted electronically, whilst a complete changeover to e-procurement is planned for 2011.

11. The Council also signalled the need to fully implement the one-stop shop for company registration and to introduce entrepreneurship education. While one-stop-shops for the self-employed have been operational since 2007, the system is not yet in place for private limited companies. Even after the implementation of the EU Services Directive in 2009 it will still take 20 days to register a company - significantly longer than the one-week target. The merger of the collection of tax, customs and social security contributions by 2014 is a welcome step. As regards entrepreneurship education the intention to integrate this subject in all schools at secondary level by 2014 (70% by 2013), is welcome. However, the precise measures are still rather vague and appropriate financial means need to be allocated to ensure their implementation. The Commission takes note of the government's recent decision to improve access to loans for SMEs.
12. The Council also highlighted the needs to increase competition in power supply. No specific measures have been reported apart from plans to strengthen consumer awareness, to be achieved through additional information obligations on market operators. This risks increasing the administrative burden. Comprehensive price regulation on the basis of the price cap method is to be introduced as of 2009. It should be ensured, however, that this method is applied in a way that does not discourage new investment. Discrimination of market entrants needs to be prevented more effectively and the national market more closely integrated with the neighbouring countries.

EMPLOYMENT POLICIES

13. The Slovak labour market is characterized by very high long-term unemployment, persisting skill mismatches and a low employability of disadvantaged groups. In order to continue reducing unemployment and to achieve the national targets for overall employment (62.7%) and long-term unemployment (5.9%), the quality of the educational system needs to be improved, participation in lifelong learning increased, and provision of employment services intensified. In addition, to make up for the low fertility rate and the increasing share of older workers, labour supply and productivity need to be increased. The persisting gender pay and employment gaps also require further attention.
14. Without clearly defining the flexicurity pathway, Slovakia has taken several measures in areas of the four flexicurity components, mainly to strengthen workers' security in employment and to modernise the active labour market policy. Insufficient response has been given to the low participation in lifelong learning. The announced intention of the government to analyse the flexicurity areas and to launch a public debate on the best-suited concept for Slovakia in 2009, is very welcome.
15. The Council recommended Slovakia to implement a lifelong learning strategy, complete the education reform and to enhance access to employment for disadvantaged groups. The lifelong learning strategy was approved in April 2007, but still needs to be transformed into concrete legislative and institutional measures. Legislative proposals both on lifelong learning and vocational training and education are under preparation and should help citizens to upgrade their competencies and

skills throughout their life. The education reform of the primary and secondary level continued in 2008 and focuses on modernising and improving the quality of the education system and increasing the possibilities of schools to better respond to the labour market needs. To ensure effective implementation, the training of teachers and efficient monitoring mechanism will now be necessary. No progress has been recorded in reforming tertiary education. While strong employment growth has contributed to reducing long-term unemployment, it remains the highest in the EU. Recently introduced active labour market policy (ALMP) measures risk to hamper transition into regular employment. Support provided to the disadvantaged groups, notably the Roma minority, would be more efficient if combined with education, social protection, housing and business promoting policies.

16. The Council also asked Slovakia to address the gender pay and employment gaps, develop an active ageing strategy and create job opportunities for young. In spite of recent legislative and institutional measures, the high gender pay gap and limited access of women to better paid jobs remain problems. Reconciliation of work and family life has been facilitated by increased family-related social benefits and flexible working arrangements, but a thorough analysis of the reasons underlying the increasing gender employment gap is lacking. Although remaining at a high level, youth unemployment has radically decreased (from 30.1% in 2005 to 20.3% in 2007), mainly due to better-targeted ALMP measures and increased participation in education and training. In spite of the positive trend, the employment rate of older people remains 10 percentage points below the EU average. The increasing share of older people in the workforce requires an adaptation of working conditions for older workers, enhanced health prevention and much stronger participation in training activities to maintain their productivity. The development of a comprehensive active ageing strategy, presenting a combined response in terms of social protection, labour market, and health care policies, has only been announced for 2009.

FINLAND

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The Finnish government has adopted a new National Reform Programme (NRP) for the 2008-2010 period. It is characterised by stability in objectives, coherence in efforts, and consistency with the priorities of the Lisbon Growth and Jobs agenda. It also identifies strong inter-linkages with goals from other policy areas, notably raising the employment rate to counteract the imminent decline in the working-age population and gearing the national innovation strategy to a higher degree towards improving the provision of public services. An estimated 88% of the total Structural Funds have been earmarked to achieve Growth and Jobs objectives, which is among the highest in all Member States. Significant delays in the earlier phases of implementation are now starting to be rectified.
2. The new NRP has been extensively prepared with very close involvement of stakeholders and parliament. Furthermore political ownership of the Lisbon Strategy has been enhanced, owing to a special informal ministerial meeting organised to define the priorities of the new NRP. Focus on assessing and measuring progress of reforms has also been increased, with a view to adapting agreed measures if necessary.
3. In the light of the following assessment for Finland the following challenges remain important: competition in services, energy efficiency, and the mismatch between labour supply and demand, with a particular emphasis on increasing the participation of the young, migrants and the low skilled.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. Despite Finland's strong and balanced macro-economic performance, the ageing of the population will pose a major challenge in the medium and long term, adversely affecting the growth potential of the economy and the fiscal situation. In a setting of a declining workforce economic growth will become increasingly dependent on advances in productivity. In view of the rise of inflation in 2008, securing price stability and wage growth in line with productivity developments has become a priority for macro-economic policy.
5. Macro-economic policy measures are divided into three priority areas: the pension system, curbing public spending, and securing welfare services and public sector productivity. The reform measures in these areas are advancing well overall. The most notable ongoing reforms concern the reorganisation of service provision both at the central and local government level, merging municipalities into larger and more viable entities, maintaining the central government spending limits system, and implementing and monitoring the 2005 pension reform measures. Some measures have been further reinforced. The central government has extended its productivity

programme, now aiming to reduce personnel by over 10% by 2015. A reform initiative from spring 2008 aims at reorganising regional administrations. The implementation of a comprehensive reform of social security, focused on strengthening incentives to work while securing basic income, has been accelerated, with proposals for legislative changes scheduled for early 2009. Taken together, these measures should help address long-term macro-economic challenges and further reinforce the sustainability of public finances. Some of the reforms are not implemented through direct enforcement, but principally through incentives and might need adjustments if the targets are not met.

6. In line with the euro area recommendations, Finland appropriately used the cyclical upswing in the economy to further strengthen its public finances. This has created leeway for substantial tax cuts, notably personal income taxes, which would support domestic demand during the predicted slowdown of economic activity in 2009, while also improving incentives to work. Furthermore, the announced reform measures of the public sector are foreseen to enhance the quality of public finances.

MICRO-ECONOMIC POLICIES

7. Finland has identified micro-economic challenges regarding knowledge and innovation; the promotion of entrepreneurship; market efficiency and competition; information, communication and transport networks; and sustainable development. Finland's highly successful innovation performance over the last years has not yet helped to stimulate productivity growth or dampen prices. It stills exhibits relatively low levels of productivity and high price levels compared to other innovation leaders.
8. The Council concluded that special attention should be paid towards continued reforms to improve competition and productivity in some services, and towards creating the necessary leverage to reduce high price levels. Some progress has been achieved in this area, in particular in fighting cartels and in addressing competition restrictions within and outside the scope of the Competition Restriction Act. Although competition has improved in some service sectors in Finland, concrete measures to address restrictive regulation in certain sectors are still needed, in particular concerning retail opening hours. Restrictions regarding land access also remain extensive. Reflections are ongoing on ways to improve competition enforcement. Lengthy court proceedings and the lack of deterring fines have been identified as main obstacles for effective enforcement. A level playing field between private and public service companies in areas such as public procurement, in particular SMEs, is also part of Finland's reform effort. Increasing competition outside the most densely populated areas remains a challenge.
9. The Council also pointed to the need for Finland to implement announced measures to reach the Kyoto targets. Some progress has been achieved in this area with the launching of the long-term Climate and Energy Strategy, the main aims of which are saving energy and promoting renewable energy. Measures have been put in place to improve households' energy efficiency and for a reform of car taxation. Although these measures imply an important step towards meeting the Kyoto-emissions target and improving energy-efficiency, Finland still remains one of the most energy intensive economies of the euro area.

10. Finland is further improving upon an attractive business environment where enterprises face a relatively low administrative burden. Efforts need to be stepped up in assessing impacts of legislation, leading to an integrated analysis of environmental, social and economic impacts, including impacts on businesses. Providing a detailed guidance and ensuring adequate quality control would help achieving those. Finland's leading position in research and innovation has slightly eroded in recent years and R&D intensity has fallen back to its 2002 level. Nonetheless, with R&D spending still above 3% of GDP, Finland still remains one of the top performers in the EU. Reacting to the changing international environment Finland is now transforming its innovation system from a technology-driven innovation model to a more demand-driven and broad-based innovation strategy. In this strategy the adaptation of its governance structure to accommodate horizontal innovation policies is of high importance. Major reform processes were initiated comprising restructuring of the public research sector and the university system as well as better coordination of resources. The recent proposal for a National Innovation Strategy will align these reforms with the operational strategies of the research and innovation agencies.

EMPLOYMENT POLICIES

11. As a result of a long period of high growth, Finland is expected to face major labour market challenges, namely increasing labour shortages as well as regional, sectoral and skills mismatches. In this context timely measures to prolong working life are necessary with respect to both the youth and older workers, as is the need to increase economic immigration and the participation of people with a migrant background and the low skilled in the labour market.
12. Flexicurity is highly placed in the political agenda. So far the tripartite working group, set up to define the Finnish flexicurity model has outlined an initial draft. The pathway indicates an integrated approach focusing on quick transitions from job to job, the quality of working life and the full use of the workforce. Active labour market measures seem to focus on proactive training. A more detailed proposal will be presented in 2009 linked to the results of the working groups reforming social security and adult education. Although the flexicurity model is still work in progress, the first outline suggests an appropriate policy response.
13. The Council referred to the need to continue reforms to address bottlenecks in the labour market, with a particular view to tackling high structural unemployment notably among low skilled (including young), and by taking into account the potential contribution from economic migration. Overall, progress is promising in addressing labour market bottlenecks although developments need to be monitored closely to ensure that the expected impact of reforms in terms of reducing labour market shortages materialises. In 2008, structural unemployment, defined as the long-term unemployment rate, has been reduced to about 1½% of the workforce. The employment of older people, who are generally also less skilled, has also increased during the past year. Youth employment also improved recently, but remained still at a relatively low level. The national target to raise the total employment rate to 72% by 2011 and the measures outlined in the NRP both represent positive steps towards a further reduction in unemployment. In order to improve financial incentives to work and to further reduce structural unemployment the 2009 budget proposal includes tax reductions and proposals to revise benefit systems. Despite these

positive developments, labour shortages remain in some sectors while there is an over supply of labour in other sectors. This suggests that unemployment is essentially structural by nature, following from a mismatch between available skills and the needs of employers. It will be important to find effective solutions to this mismatch.

14. During the past year some progress has been made in increasing economic migration. In 2008 about one third of residence permits were work based, reflecting an annual increase by more than 20%. The policy response includes the implementation of the national immigration programme through various projects focused on recruiting foreign labour and promoting the opportunities in the Finnish labour market. A legislative change simplifying the work permit procedure of non-EU citizens is expected to come into force in 2009. In addition, a programme aimed at attracting foreign students and researchers in universities is being drafted. An effective implementation of these measures will be important for the future labour market needs. The integration of the already existing population with migrant background has so far not been very successful, which is demonstrated by a great disparity between the unemployment rates of natives and immigrants. Reinforced measures are necessary to improve their inclusion in the labour market.
15. So as to alleviate the effects of gender segregation in the labour market, the government has introduced a firm policy response by presenting a package of measures aimed at reducing the relatively wide gender pay gap by 5 percentage points by 2015.

SWEDEN

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. Sweden has announced in its National Reform Programme (NRP) further measures to tackle its challenges. The Swedish government is committed to pursuing its structural reform agenda and has made job creation the centrepiece of its policy priorities. In response to the need to focus on competition, the government has commissioned an in-depth study of the causes of the lack of competition for delivery by the end of March 2009. In an effort to increase labour supply, measures have been announced to further reduce taxes and employers' contributions, and to raise the productivity and employability of people. However, it is too early to assess the impact of these initiatives.
2. In the current situation of decelerating economic growth, the government is using part of the fiscal room of manoeuvre to support economic activity. A third phase of the in-work tax credit scheme (lowering taxes on income from work) will be implemented as from 2009, as well as a reduction in the corporate tax rate and employers' social contributions. Apart from cushioning the downturn, these policies are also likely to have positive supply-side effects in the medium term.
3. Political ownership of the Lisbon Strategy remains strong. Various stakeholders, such as representatives of local and regional governments and social partners, play an important role in the preparation of the reform agenda. Notably, the social partners are regularly consulted by the government on labour market issues, and have made a joint contribution in the framework of the specific consultation prior to the drafting of the NRP.
4. Sweden's national strategic priorities for regional competitiveness, entrepreneurship and employment are well in line with the NRP objectives to encourage innovation and entrepreneurship, to increase labour supply and to ensure a highly skilled workforce. Links between NRP implementation and Structural Funds programmes are strong, with an increased investment share earmarked for the Lisbon priorities of jobs and growth to 91% (compared to 73% in the previous programming period). High priority is given to increasing labour supply through higher labour force participation and more working hours, given the ageing population and the current high level of welfare services. There is also a considerable emphasis on support for R&D, innovation, entrepreneurship and risk capital.
5. In the light of the following assessment for Sweden the following challenges remain important: recent reforms to increase work incentives, youth unemployment, the employment rate of people with a migrant background, and to reintegration of people on sickness-related schemes

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

6. Despite the current deceleration in economic activity, which has seen GDP growth slowing from an annual pace of above 4% in early 2006 to negative growth in 2008, Sweden is coping well with the key macro-economic challenges of maintaining sound public finances and safeguarding fiscal sustainability.
7. During the years of strong economic expansion, the general government budget recorded successive surpluses well above the target of running a surplus of 1% of GDP over the cycle, contributing to a further consolidation of public finances. This makes public finances well positioned to remain a stabilising factor during the current phase of economic slowdown. In 2008, the government further enhanced the rules-based budgetary framework, notably by reverting to the initial practice of presenting in the budget an expenditure ceiling for the three coming years (compared to two in recent years). The recently created Fiscal Policy Council has started work and published its first report in 2008.
8. The implementation of a range of reforms of the tax and benefit systems is likely to contribute to increasing the long-run employment rate and to making labour markets more flexible, which should contribute to fiscal sustainability.

MICRO-ECONOMIC POLICIES

9. The micro-economic challenges facing Sweden are dominated by concerns related to increasing competition, complemented by the need for monitoring of further progress related to R&D, and creating a favourable business environment by ensuring a better environment for entrepreneurship and SMEs.
10. The Council underlined that Sweden should take further regulatory measures to increase competition, notably in services. Both the completed and planned actions set out in the NRP are welcome steps in the right direction. The new Competition Law may help deter competition law infringement, and in particular the formation and continuation of cartels. However, further progress will depend on the actual application of the law given the relatively low level of fines imposed so far. The forthcoming proposal aimed at ensuring a level playing field for competition between public and private operators through new conflict resolution powers conferred on the Competition Authority is welcome. Such improvements might be particularly beneficial for SMEs. The implementation of EU public procurement directives and the announced three-year programme to facilitate public procurement constitute positive steps. The implementation of the proposal within the report to give the competition authority standing before the courts in procurement cases would be extremely useful in enhancing the agency's effectiveness. In another promising step, the government has commissioned an in-depth study of the causes of the lack of competition in the Swedish economy, including concrete proposals for removing these causes, to the Competition Authority, for delivery by end-March 2009. However, any tangible progress will depend on the practical follow-up to the recommendations of the study. It is also important to step up the pace of reform in this field in order to bring Swedish price levels closer to the EU average in areas where competition is weak.
11. With the proposed budgetary increases presented in the 2009 Budget Bill, Sweden may well reach its targets of a 4% of GDP overall, and 1% public, R&D expenditure intensity. Since 2007, Sweden has also made efforts to strengthen governmental

financial support to innovation in SMEs. To improve the efficiency of R&D and innovation spending and to further improve competitiveness in international markets, Sweden would benefit from continued efforts to commercialise R&D, to consider non-R&D drivers of innovation, and to bring innovation closer to market needs. Continued improvements have been made to simplify the regulatory and fiscal framework for small entrepreneurs. However, SME participation in public procurement is still hindered by the extensive use of large framework contracts. Moreover, private undertakings still have to compete on unequal terms with public enterprises. Attention needs to be paid to the implementation and use by authorities allowing for an integrated assessment of economic, environmental and social impacts.

12. Sweden is on track to achieve its Kyoto climate targets. With a share of about 40% in 2005, Sweden has the highest share of renewables in domestic energy consumption in the EU.

EMPLOYMENT POLICIES

13. Sweden's main employment challenge consists of increasing labour market participation among disadvantaged groups, such as the long-term unemployed, the young, those returning from long periods of sick leave and people with a migrant background. With this in mind, the government maintains its strong focus on increasing labour supply.
14. While not explicitly defining a national pathway, Sweden addresses the four flexicurity components in an integrated way, with a strong involvement of social partners in regulating the labour market. The use of fixed-term contracts has been facilitated and a number of initiatives have been taken or announced to encourage life-long learning and ensure the delivery of skills in line with labour market needs. Active labour market policies focus on those furthest from the labour market. Recent initiatives in the context of modernizing social security systems aim at making work pay. These measures point in the right direction. However, the appropriate balance between work incentives on one hand and employability and long-term employment on the other could be further developed.
15. The Council pointed to the need to focus on the implementation and impact evaluation of recent reforms to increase work incentives, to tackle youth unemployment, to raise the employment rate of people with a migrant background, and to reintegrate people on sickness-related schemes. A comprehensive impact evaluation framework has been announced, which will include quantitative targets and indicators for the development of sickness and unemployment absence, as well as for activities of people outside the labour force. Future reporting is intended to better reflect the impact of specific policy initiatives. However, the new framework is not yet in place and the results of recent reforms are not clear.
16. Sweden has continued its efforts to address work incentives, in particular through further labour income tax reductions (in-work tax credit) and stricter rules and controls of the social security and unemployment benefit systems. The long-term effects are difficult to assess, in particular in view of the current economic downturn. The new reform measures for young people focuses on incentives to work and improving the transition from school to work. However, although unemployment

decreased in the last year more for young people than for other age groups, the youth unemployment rate is still high at 19.3%. Differences in employment rates between foreign-born and people born in Sweden remain significant and unemployment is twice as high for foreign-born people. Initiatives announced in the NRP for people with a migrant background will include financial incentives for municipalities that are successful in raising labour market participation or proficiency in the Swedish language, as well as reduced employers' contributions. Foreign-born entrepreneurship and validation of professional skills will be facilitated. A number of measures have been announced to help people on sick benefits move back into employment. Benefit levels have been cut, and maximum benefit periods limited in time. A wage subsidy has been launched to favour the recruitment of people on long-term sick leave. Rehabilitation will be further strengthened, and co-operation sought with actors in the social economy to provide adapted employment opportunities.

17. While considerable efforts have been made to improve the incentives to work for these target groups, measures to ensure sustainable employment for the new labour market entrants seem less developed. Furthermore, it is expected that the need for financial assistance will increase in the next few years. For all these groups, substantial support to ensure their employability would presumably be needed in addition to financial incentives.

UNITED KINGDOM

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. The UK's Action Plan represents overall a good response to the Council's recommendation and on those other areas demanding focus. Most measures are of appropriate ambition and quality relative to the challenges. Measures have clearly identified budgets and timetables. There is good policy integration between measures, including between different levels of government. The proposed measures on skills and disadvantage and those on R&D and innovation represent good responses, albeit still needing full implementation.
2. Consultation on the National Reform Programme (NRP) at the level of central and local governments and amongst the social partners continues to be good. Specific consultation in preparing the NRP has included a stakeholder seminar. The devolved administrations in Scotland, Wales and Northern Ireland were involved in preparing the NRP concerning their own policy responsibilities. Nonetheless, ownership of the Lisbon strategy is mostly limited to the administrative level with little political involvement. In the new 2007-2013 Structural Funds programming period, over 80% of Structural Fund resources are earmarked for Lisbon-type activities. This represents one of the highest earmarking targets in the EU, with 41% of the ERDF allocation devoted to innovation, research and technological development. 96% of ESF allocation is devoted to develop a skilled and adaptable workforce and to extend employment opportunities.
3. In the light of the following assessment the UK should pay particular attention to the country-specific recommendations presented in the recommendation for a Council recommendation COM(2009)34. Alongside this, the following challenges also remain important: R&D intensity and increasing housing supply in order to meet medium- to long-term demand pressures.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The 2008-2010 NRP identified maintaining macro-economic stability despite the ongoing challenges facing the global economy as one of the government's main goals over the coming cycle. Given the UK's greater exposure to credit and equity market weaknesses, the financial crisis together with the on-going sharp housing market correction will have a significant impact on the medium-term outlook for economic growth and public finances.
5. Notwithstanding the current housing market downturn, in order to meet medium- and long-term demand pressures the Council referred to the importance for the UK of progressively increasing housing supply. The UK continues the implementation of its housing strategy and planned policy responses based on the Housing Green Paper released in 2007. These include the integration by 2010 of regional housing plans

(aimed at ensuring housing supply in areas where they are most needed) with wider economic, social and environmental objectives as well as targeted funding for infrastructure to support sustainable development and housing growth at the local and regional level. However, the depth and duration of the financial market crises and on-going housing market correction - and possible short-term policy responses – will be an important factor in determining the long-term housing market outlook. Although the tightening of credit conditions has reduced demand for housing considerably in the short-term, ensuring a sufficient long-term housing supply to cater for the projected increase in the number of households still looks very challenging, especially when the recent slowdown in housebuilding activity is taken into account. To reach the government's overall supply target of building 240,000 new additional homes per year in England by 2016 the growth in new builds would have to be 40% higher than the already strong completion rates in 2007. In this context, in particular the continued implementation of measures to improve the effectiveness of the UK planning system will be a key factor.

6. The general government gross debt ratio is forecasted to rise by almost 20 percentage points over the next three financial years to over 70% of GDP in 2010/11. While expansionary fiscal policy can soften the economic downturn, there is a need for a credible fiscal framework to restore a sound fiscal position in the medium term with consolidation measures geared towards enhancing the quality of the public finances and reinforcing the economy's growth potential. Relative to a weak base the budgetary outlook has deteriorated markedly over the present financial year. The general government deficit is expected to widen further to around 10% of GDP in financial year 2009/10, leaving the UK with one of the highest deficits in the EU. Considerable challenges lie in the continued efforts to refocus public resources and further enhance the efficiency of public spending, including by implementing the ambitious "value for money" programme.
7. Planned or already introduced measures to reform the pension system are considered to be a good response to a previously identified challenge, aimed at addressing the adequacy of retirement income, while limiting the risks to the sustainability of public finances. However, much of the overall success of the reform is reliant on increased participation in private pensions, which will be more challenging given the backdrop of current financial market conditions.

MICRO-ECONOMIC POLICIES

8. The NRP identified reforms that promote enterprise, support business growth, simplify the tax system, encourage investment and competition, and enhance flexibility and promote science, innovation and skills as key long-term goals. The government has also identified ensuring an environmentally sustainable world with specific actions to address climate change as a further goal.
9. In the field of R&D and innovation, the UK has a strong research base, reflected by its scientific performance and quality assurance system, and established knowledge transfer mechanisms, although the engagement of companies in innovative activities is not well developed particularly in the important services sectors. The UK government has implemented many of the recommendations of the recent comprehensive Sainsbury review, and set out new policy orientations on innovation in a new Innovation White Paper. Key measures include ensuring the sustainability

of the public research base, strengthening R&D tax credits, promoting technology transfer and setting knowledge transfer targets for the Research Councils, and stimulating the demand for innovation from public procurement. The establishment of the Technology Strategy Board, a newly reformed agency with expanded responsibilities to implement new innovation policies, is an important development and brings the UK in line with several other Member States that have dedicated agencies. The UK government needs to ensure that the new agency is given the delivery capacity and focus required to successfully co-ordinate policy as well as running a host of programmes itself. Public investment in the science base has increased in real terms during the last decade and the NRP states further increases by 2010-2011. However, raising private R&D investment and innovation continues to be an important challenge for the UK and is moreover vulnerable to the unstable global macro-economic conditions, which may impact research and innovation budgets. The fluctuation of the number of science and engineering graduates in the last decade poses a potential risk of shortage, which may require a long-term strategy for sustainability.

10. The UK continues to build further upon its good track record in providing a business-friendly regulatory environment. The proposal to introduce "regulatory budgets", to limit the cost to businesses of new legislation, is particularly promising. Strengths in entrepreneurship education continue to be reinforced, and several new initiatives will promote entrepreneurship among women and ethnic minorities. Further progress has also been made in creating a one-stop-shop for business support services, as well as in improving SMEs' access to finance and to public procurement contracts.

EMPLOYMENT POLICIES

11. The UK exceeds all quantitative Lisbon targets on employment. The major employment related challenges are raising the skill levels of the population, ensuring opportunities for progression and moving more people into work. The economic downturn is increasing unemployment and may affect the effectiveness of current efforts to improve the employment prospects of disadvantaged groups.
12. Flexicurity is seen in a broadly integrated way in the UK. The UK labour market contains many components of flexicurity, although the flexibility elements are considerably stronger than security elements. The level of social protection is low and work is considered as the best route out of poverty. The NRP does not explicitly define an integrated flexicurity pathway but there have been many policy developments regarding the active labour market policies, life long learning and welfare reform.
13. The Council referred to the need to improve skill levels and to increase the opportunities of disadvantaged. The UK has made good progress in the preparation and implementation of plans to raise skills levels. These are long-term and wide-ranging responses and most measures will be fully implemented in the next years. The employer-led UK-wide advisory Commission for Employment and Skills has become fully operational. The UK has made good progress in reaching the skills targets set nationally, however much of the planned and achieved progress is in relatively low level skills. In England, the main government programme to increase the skills of the workforce has been expanded significantly. There are plans to offer virtual vouchers to individuals to purchase relevant training funded by the state. In

England, the government is planning to introduce significant reforms to apprenticeships accompanied by major institutional changes in planning and provision of post-16 education. These institutional reforms have not contributed yet to simplify the complexity of the skills delivery system, which together with the number of awarding bodies and qualifications are a source of uncertainty to employers, individuals and providers.

14. The UK has implemented or is planning to introduce a range of measures to increase the employment opportunities of lone parents, people with disabilities, ethnic minorities, the least qualified and older people. The employment rates have increased for all categories with the exception of the least qualified. The rate of young people not in education, employment or training has been stagnating for the last decade. In England, the government has proposed to raise the compulsory participation age in education or training to 17 by 2013 and to 18 by 2015. After extensive piloting and evaluation, the programme aimed at people with disabilities has been implemented nationally. Policies are undergoing a process of transformation towards a more personalized support, integration of employment and skills services, greater focus on sustainable employment, increased involvement of employers and devolution of more powers to local communities. The reform also envisaged increased contracting out of employment services with emphasis on payment by results. There are uncertainties related to the implementation of these measures - aggravated by the current economic difficulties. The system will be fully operational by 2010-2011, although several aspects will be introduced at an earlier stage. Finally, the welfare reform emphasizes moving people off the benefits and into work through increased conditionality combined with additional support, simplification of the benefit system, introduction of a new medical test to better identify benefit eligibility for disabled people and financial incentives to stimulate employment of lone parents.
15. Many reforms are still at an early stage of implementation and the effects will only be visible after an extended period of time. Besides, much of initiatives and success is predicated on the ability of growing economy to finance activities and on the input from employers and this is not guaranteed given the current economic slowdown.
16. The UK has taken important measures to address equality between men and women such as encouraging organizations to carry out Equal Pay Reviews and introducing a duty on all public authorities to eliminate discrimination and to promote equality. Further measures are announced in the Equality Bill. Nevertheless, the gender pay gap remains one of the highest in the EU.

EURO AREA MEMBER STATES

OVERVIEW OF PROGRESS

PART I: GENERAL ASSESSMENT

1. In addition to respecting their country specific recommendations, euro area Member States were recommended to undertake structural reforms that improve the functioning of monetary union. They should target budgetary consolidation, the quality of public finances, competition on product markets, especially in services and financial integration, the alignment of wage with productivity developments and the implementation of flexicurity principles on labour markets. A further strengthening of both governance and international representation in international fora were considered items the euro area should also focus upon. While there has been considerable variation across policy areas and Member States, the euro area made overall limited progress over the last year with meeting the recommendations addressed to its Member States.
2. Policy coordination in the euro area was faced in 2008 first of all with the challenge of addressing the common global macroeconomic and financial shocks. With respect to high food and oil prices, policy makers agreed on a common approach to avoid distorting budgetary and other political interventions (Manchester agreement). As a coordinated response to the financial turmoil, euro area Member States committed themselves to implementing policy actions on an unprecedented scale, guided by EU common principles. Regarding policy actions in the face of the economic slowdown, the Council agreed that coordination should be broadened to macroeconomic developments beyond fiscal policy. The need for monitoring competitiveness developments within the euro area in the light of the recent experience was recognised. As structural reforms have an added value for the euro area as a whole, Ministers from the euro area Member States agreed to devote specific attention to euro area recommendations. Concerning international representation, progress has remained limited to the installation of first strategic dialogues with key partners.
3. In the light of the following assessment, the euro area Member States should pay particular attention to the country-specific and euro area recommendations presented in the recommendation for a Council recommendation COM(2009)34 and to the following issues: sustainability of public finances and their contribution to growth, competition in product markets, especially in the energy sector and retail services in order to curb inflationary pressure, stability and integration on financial markets, flexicurity on labour markets in accordance with the agreed common principles and more labour mobility in order to foster labour market adjustment and adequate wage developments in line with productivity developments with a view to price stability, employment and competitiveness.

PART II: ASSESSMENT BY POLICY AREA

MACRO-ECONOMIC POLICIES

4. The Stability and Growth Pact provides the right policy framework for balancing short-term stabilisation needs and long-term structural reform requirements. Implementation of the Pact should ensure that any deterioration of public finances is accompanied by structural reform measures adequate to the situation, while ensuring that sustainable positions are being restored. Fiscal policy should be maintained on a sustainable course, anchoring expectations of an ordered resolution of the crisis. The recent economic shocks may impact also unfavourably on the quality of public finances, because against the backdrop of declining public revenues, expenditure on growth-enhancing items such as R&D and education is in danger to be reduced. Moreover, the existing differences in economic performance across Member States, of which some are exposed to large current account deficits, may challenge policy making in the euro area. Country-specific differences in fiscal room for manoeuvre should be considered, conditional on strong and credible national budgetary institutions and medium-term budgetary frameworks; Moreover, in Member States where room for budgetary manoeuvre exists, carefully designed timely, temporary and targeted discretionary fiscal measures may be taken, provided they support structural reforms or those most affected by the current economic situation. Following the fiscal stimulus injected during the current economic crisis, euro area member states should take appropriate measures to secure the sustainability of their public finances.
5. Budgetary consolidation has stalled in the euro area in 2008 as evidenced by a budget deficit rising from 0.6 to 1.7 % of GDP. This deterioration, which stems largely from the revenue side, is not fully explained by slowing economic growth and the operation of automatic stabilisers. In consequence, the structural deficit also increased in the euro area as a whole and all its Member States with the notable exceptions of DE, LU, MT, NL and PT. The budgetary deterioration implies that countries without a sufficient safety margin or with a rapidly deteriorating deficit risk breaching the 3% excessive deficit limit in 2008. Safety margins emerged to be too low in EL, FR and MT to cope with the impact of discretionary policy measures on public expenditures, while the magnitude of the budgetary swing turned IE's surplus into a huge excessive deficit within one year. Large budgetary deterioration is also registered in ES and CY, but both had sufficient margins to avoid an excessive deficit. CY even continues to record a budget surplus. Despite the deteriorated economic context, DE, EL, NL and PT managed to improve their budgetary position.
6. The assessment of budgetary developments in 2009 needs to take the uncertainty surrounding the macroeconomic situation into account. Upon current information, the euro area deficit will deteriorate by 2.3% of GDP in headline terms and by 0.9% of GDP in structural terms, which means that automatic stabilisers will be buffering the cyclical slowdown by 1.4% of GDP. Public revenues are forecast to increase by 0.2% of GDP while public expenditures are set to move up by 2.1% of GDP. All Member States (except MT) are likely to increase their headline deficit relative to GDP while EL, IT and SK may register an improvement in structural terms.
7. Several Member States documented policy measures to improve the quality of public finances. Significant changes to the tax system have been introduced in DE, FR and SI. Reforms of the public administration are implemented in EL, PT and FI. DE and AT continued to pursue the reform of its federal constitution, with a focus on the fiscal domain while CY, EL and IT undertook measures to improve budgetary procedures.

MICRO-ECONOMIC POLICIES

8. The request for more competition on product markets and especially in services had initially been motivated by the euro area's disappointing productivity performance, the relatively high inflation rates in services and with a view to its importance in coping with differences in competitiveness among the euro area Member States. Although the rate of core inflation of around 2.5% up to autumn 2008 was consistent with the euro area reaching a mature cyclical position, it also reflected a certain pass through of strong increases in primary commodity prices, particularly oil and food prices. Since firms in sectors, which are more sheltered from competition, are better able to pass on rising costs to consumers, inflation prospects in the euro area could benefit in particular from removing barriers in energy markets and from tackling problems in the food supply chain and competition in retail services. In the medium to long term, integrated and well-functioning financial markets are crucial to exploiting the euro area's growth potential and improving its capacity to adjust. The recent episode of financial distress puts into question the ability of euro area financial markets and institutions to properly fulfil this role. It will therefore be important for the euro area Member States that pending and new EU financial services legislation is implemented in a timely and consistent manner and that cooperation among national authorities in the fields of crisis prevention, management and resolution is deepened.
9. The Council recommended that the euro area Member States should implement measures that improve competition, especially in services. Competition on service markets is expected to receive considerable impetus from the transposition of the service directive, which is due by December 2009. Most countries report that preparation is progressing as planned. At the EU level, an analysis of possible causes of product market malfunctioning is being carried out with the aim to identify the scope and priorities for policy interventions to improve market performance. At the level of Member States, there has been overall limited progress in those countries that face competition problems in services. Despite measures taken in various Member States (DE, FR, ES, BE, EL, PT, CY), the level of competition on energy markets has remained insufficient and energy prices contributed considerably to inflation in many Member States. A few countries have implemented measures aiming to improve competition in the retail sector (DE, FR, ES). Some progress can also be noticed regarding the overall regulatory and effective governance of competition policies, e.g. in SI and FI.
10. As regards financial integration, progress at the EU level was made in 2008 with the scheme for credit transfers in the Single Euro Payment Area (SEPA), the adoption of the Payment Service Directive and the Commission proposal for an improved EU framework for investment funds (UCITS). In response to the financial crisis, a series of immediate measures have been agreed to protect citizens' savings and rescue banks in difficulty. It included proposals to change legislation on deposit guarantees, capital requirements, accounting standards and the regulation of credit agencies. Member States implemented rescue measures based on EU-wide agreed principles. A High-Level Group was established to review the EU regulatory and supervisory framework and a working group started to review the issue of pro-cyclicality. As regards the reform of the international financial system, Member States, Commission and ECB work together in framing the discussions at G-20 level.

EMPLOYMENT POLICIES

11. As unemployment is set to increase by a substantial margin, a balanced approach that promotes both flexibility and security on labour markets (flexicurity) gains further importance. Unemployment benefit and other income support systems are instrumental as a means to provide assistance to vulnerable workers and groups, thereby supporting their confidence, while at the same time ensuring appropriate incentives to work. It would be important to direct tax and benefit reforms at low-wage earners, since the situation is set to become particularly difficult at the lower end of the labour market, and to ensure that active labour market policies support persons undergoing transitions between jobs, including those across occupations and sectors. Implementation of comprehensive lifelong learning strategies, including training and retraining people, identifying and matching skills and jobs remain important to retain and enhance employability, therefore employment security. Also, while maintaining a proper social safety net, improving labour market flexibility and mobility can contribute to a quicker adjustment of the economy. In some Member States, social partner needs to ensure that wage developments take account of the competitiveness position of the country, especially when there are large external imbalances.
12. Progress with reforms aimed at improving flexibility and security on labour markets and putting in place national strategies for the implementation of the common principles of flexicurity has been uneven across countries and limited in most of them over the year 2008. Only few countries define a national pathway; nevertheless all of them report on measures along the four flexicurity components most with highest emphasis lifelong learning. On-the-job and adult training is encouraged and supported in FI, FR, IE, NL, MT, EL, also in the form of training leave in BE, LU and AT. Job-to-job transitions of redundant employees are supported in NL, DE, LU and FI. IE, FR and AT undertook reforms to develop flexible and reliable contractual arrangements, while improving the protection of employees engaged in more flexible forms. Measures were taken to promote geographical mobility (BE), in particular as regards facilitating labour market access by foreigners (e.g. AT, FI). Innovative actions to promote professional mobility especially for youth took place in BE, DE, PT and SI. The adoption of the European Qualification Framework further promotes workers' and learners' mobility.
13. In an attempt to compensate for higher inflation and foregone increases in previous years, nominal wage growth accelerated to 3.5% in the euro area 2008, up by 1 percentage point a year earlier, and unit labour costs grew at the highest rates since 1992. There seems to be a close relationship between countries with above-average inflation and those where indexation is fully automatic (BE, LU, CY and MT), or activated through the use of collective agreements (ES and FI). Increases in the legal minimum wage (ES), generous wage increases in public health employees (MT) or the elimination of pay differences in the public sector (SI) risk contributing to downward rigidity of wages. In order to limit wage growth, NL withdrew the planned VAT-increase and a pay pause has been agreed in the wage agreement in IE. In IT an overhaul of the wage bargaining framework is currently on the agenda. The current-year overshooting in labour costs can be considered a typical feature in an economy at the end of a cyclical boom that is faced with an abrupt downturn. It nevertheless represents an important risk in particular in countries that are exposed to high external imbalances. Since insufficient alignment of wages to labour

productivity resulted in non-benign losses of competitiveness and large current account deficits in a number of euro area Member States, the Eurogroup's decision to strengthen the monitoring of competitiveness developments is to be welcomed.