Situation of the European economy, report on the broad guidelines for economic policies BGEP

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This Communication presents a first assessment of the follow-up given to the general guidelines in the 2003-05 Broad Economic Policy Guidelines (BEPGs). The European Commission focuses on the three main areas defined in the Lisbon strategy:

- growth- and stability-oriented macroeconomic policies;

- economic reforms to raise Europe's growth potential; and

- strengthening sustainability.

Although some progress has been made in a few policy areas, it does not appear as if the overall pace of

reforms has been stepped up as requested by the Council. There is a clear risk that with the current reform pace, full implementation of the BEPGs can not be secured by 2006, thereby putting the fulfillment of the Lisbon targets by 2010 at risk.

The main points cited in this communication are as follows:

- Economic stagnation reigned in the first half of 2003 and, despite a clear improvement in economic activity in the third quarter, growth over the year as a whole is expected to have been a modest 0.8% in the EU (and only 0.4% in the euro area).

- Macroeconomic policies supported growth in 2003. Both the ECB and the national central banks in Denmark, Sweden, and the United Kingdom lowered further their key interest rates, thereby supporting domestic demand. Despite the appreciation of the euro, overall monetary conditions remained accommodative. The free play of automatic stabilisers helped to stabilise the economy. The EU's cyclically-adjusted primary balance remained broadly unchanged, indicating an overall neutral fiscal stance in 2003.

- The economic slowdown continued to weigh on public finances and progress seems mixed as regards reaching or maintaining a sound budgetary position. The average nominal budget deficit worsened further in 2003 to 2.7% of GDP. However, differences are sizeable across Member States. Belgium, Denmark, Spain, Austria, Finland and Sweden had a cyclically-adjusted budgetary position close to balance or in surplus in 2002. With the exception of Austria, the other five Member States maintained such a budgetary position in 2003. Nominal deficits deteriorated sharply in several other Member States, with two countries (Germany and France) expected to have deficits exceeding the 3% of GDP limit by a wide margin in 2003. While the economic slowdown is the main factor behind the recent deterioration in the public finances, part of the slippage in 2003 also stems from discretionary measures in some Member States (notably Greece, Austria, and the United Kingdom).

- The labour market performed quite well in the beginning of this economic downturn, reaping the benefits of earlier reforms but also reflecting labour hoarding. The effect of the slowdown started to be felt more strongly in 2003 with employment growth stagnating and a continued rise in unemployment. The increase in the pace of labour market reforms in 2003 appears encouraging, but it needs to accelerate further. In particular, efforts have been made by most Member States to make work pay, even if reforms

remain focused on the tax side. Some Member States have taken action to address incentive effects in the benefit systems (Denmark, Germany, France, the Netherlands, and the United Kingdom), which contribute most to the risk of unemployment- and inactivity traps. Several Member States have taken further measures to make the work organization more adaptable (notably Denmark, Spain, France, Italy, the Netherlands and Sweden) and most Member States aim to foster occupational mobility through lifelong learning initiatives. Active labour market policies have also become better in responding to the individual needs of the unemployed. However and despite some improvements noted or planned in Denmark, Ireland, and the Netherlands, progress appears limited as regards improving the efficiency of ALMPs: e.g. evaluations are not systematically carried out or reported. Progress also appears limited in promoting wage differentiation or addressing the regulatory burden in the labour market. Despite the progress noted with some types of labour market reforms, the Lisbon- and Stockholm employment rate targets risk being missed.

- Labour productivity growth continued to disappoint and the gap with the USA widened. Lower labour productivity per hour worked now represents 40% of the difference in GDP per capita between the EU and the USA. The gradual deterioration in labour productivity growth since the mid-1990s can be explained in equal parts by the slowdown in investment and in total factor productivity (which generally include effects from more efficient resource utilisation, technological progress and the natural catching-up process of lesser developed EU countries). ICT and their adoption are a key driver of productivity growth and the differentials between the EU and US productivity trends are strongly influenced by differences in the extent to which ICTs have penetrated the respective economies. This illustrates the need to stimulate market integration, business dynamism, and investment, particularly in knowledge.

- As regards capital markets, the Risk Capital Action Plan is almost completely implemented. The Financial Services Action Plan is well on the way to full implementation and transposition of the adopted legislative measures into national law has begun. However, a final effort is required to meet the 2005 deadline. Integration of clearing and settlement arrangements has become a clear priority for action at both the EU and the Member State level in 2003. Following corporate scandals in recent years, several Member States have strengthened corporate governance arrangements at the national level, while the Commission has adopted an Action Plan on company law and corporate governance in May 2003. Financial supervision arrangements are being streamlined, both at Member State- and EU level.

- Long-term sustainability of public finances, particularly in view of the ageing population, is not yet secured in about half of the Member States, notably Belgium, Germany, Greece, Spain, France, Italy, and Portugal. While significant progress has been made through pension reform measures in some Member States in 2003, in particular in France and Austria, less progress was made in bringing the public debt down. Public debt remained above 60% of GDP in 2003 in six Member States, including in Belgium, Greece, and Italy where it continued to exceed 100% of GDP.

- Some progress has been made towards improving environmental sustainability in 2003. At the EU level, the Council extended the coverage of Community legislation in energy taxation (on e.g. minimum taxation levels). Several Member States (e.g. Belgium, the Netherlands, and Sweden) took further measures to promote the use of renewable energy. Other Member States (notably Germany and Austria) took measures in the area of transport pricing. In the United Kingdom, congestion charges were introduced in London, causing a marked change in behaviour. In contrast, and despite the good progress made at the end of the 1990s, no progress was noted as regards reduction of greenhouse gas emissions.