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UDENRIGSMINISTERIET

Medlemmerne af Folketingets Europaudvalg
og deres stedfortrædere

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

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UEM 46
ECOFIN 83
SOC 117
MI 74
COMPET 39
EDUC 48
ENV 148
AG 9
RECH 53

REPORT

from :	the Council (ECOFIN)
to :	European Council, 25-26 March 2004
Subject :	Key Issues Paper on the 2004 update of the Broad Economic Policy Guidelines

Delegations will find attached the text of the (ECOFIN) Council's Key Issues Paper on the 2004 update of the Broad Economic Policy Guidelines, as adopted by the (ECOFIN) Council on 9 March 2004.

ANNEX

'Realising Europe's Growth Potential'

Key Issues Paper from the ECOFIN Council

Key Message to the Spring European Council

1. The Lisbon strategy aims to increase the rate of sustainable economic growth and enable Europe become the most dynamic knowledge based economy in the world. It calls for an integrated approach to progressing the economic, social and environmental dimensions of the strategy.

2. The existing Lisbon strategy is the correct one. Structural reforms should have a positive impact on confidence and thus increase growth and employment in the medium term. What is needed is a much sharper focus on implementation.

3. Ecofin therefore calls for stepping up the pace of reform, especially at Member State level, enhanced monitoring based on benchmarking Member State's progress toward the Lisbon goals, information exchange on best practices and a mid-term review of Lisbon focussed on implementation.

4. In line with the BEPGs, ECOFIN has identified the following priorities for policy action to reach the Lisbon goals: (I) promoting growth through investment, innovation and competitiveness, (II) increasing the flexibility of our labour markets, and (III) ensuring the sustainability of public finances.

5. While the emphasis on specific areas may differ, taking into account that the challenges appear more demanding in acceding countries, these priorities are relevant to both existing and future member states -which will be integrated into the Broad Economic Policy Guidelines in 2004.

I. Promoting Growth

6. The improvement in the world economy provides a favourable background for renewed efforts to get back on track with the Lisbon strategy. Reaching or maintaining sound budgetary positions in line with the Stability and Growth Pact, and price stability are the two key bases on which to build on this sound macroeconomic environment.

7. In promoting sustainable growth we highlight three areas for special attention over the next year: Investment, Innovation and Competitiveness in particular through investment in R&D and human capital, better regulation and completing the single market, especially in services. The opportunity that the enlargement of the EU represents should also be used to promote the acceleration of economic growth in the EU.

II. Increasing the Flexibility and the Adaptability of our Labour Markets

8. A range of policy reforms have been suggested and identified by the Employment Taskforce. It is important that Member States should commit, at the Spring Council, to implement initiatives in their own labour markets along the lines suggested by the Taskforce within the framework of the BEPGs and the European Employment Strategy.

III. Ensuring the Sustainability of our Public Finances

9. Long term sustainability of public finances is secured in only about half of the fifteen Member States. The Council encourages Member States to tackle the financial implications of population ageing by reducing public debt and strengthening employment, health and pension reforms.

More Detailed Comments

1. The Lisbon strategy aims to increase the rate of sustainable economic growth and enable Europe become the most dynamic knowledge based economy in the world. The Broad Economic Policy Guidelines (BEPGs) set out the EU's medium term economic policy agenda to reach the Lisbon goal.

2. ECOFIN has identified the following priorities for policy action to meet the objectives set out in the Broad Economic Policy Guidelines: (I) promoting growth through investment, innovation and competitiveness, (II) increasing the flexibility of our labour markets, and (III) ensuring the sustainability of public finances. While the emphasis on specific areas may differ, taking into account that the challenges appear more demanding in acceding countries, these priorities are relevant to both existing and future member states -which will be integrated into the BEPGs in 2004.

I. Promoting Growth

3. The main economic challenge facing the European Union is to realise its economic growth potential. The economic recovery that started in the second half of 2003 is likely to gather pace this year. Real GDP growth may rise to 2% this year and approach 2½ % in 2005.

4. The improvement in the world economy provides a favourable background for renewed efforts to implement the Broad Economic Policy Guidelines in line with the Lisbon strategy. Completing the internal market, encouraging the increase of external openness and improving the dynamic economic relationships between trading partners will sustain and develop further economic growth. Reaching or maintaining sound budgetary positions and price stability are the two key bases on which to build on this sound macroeconomic environment.

5. Structural reforms will also contribute significantly to increasing growth and employment in the medium term through a positive impact on confidence and on the business environment, and by promoting a better allocation of resources. In this regard, we highlight three areas for special attention over the next year: Investment, Innovation and Competitiveness.

- Investment and Innovation

6. In order to exploit the internal market fully, Europe's knowledge and network infrastructure must provide for the efficient movement of people, products, capital and information. In December 2003 the European Council endorsed the European Action for Growth to mobilise investment in areas that will reinforce on-going structural reform, stimulate growth and create jobs. Now it is time to implement it. We must also fully implement the Financial Services Action Plan by 2005.

7. Europe lags behind the US in terms of R&D, with nearly all of the investment gap due to lower funding by the private sector in Europe. Little progress has been made in raising the level of R&D investment towards the Lisbon target of 3% of GDP by 2010. Therefore we must redouble our efforts in particular by stimulating efficient investment in private sector R&D, including innovation by SMEs, and in human capital through the creation of appropriate framework conditions and incentives to enhance competition and ensure effective education and training systems and by transfer of technology to the new member States.

8. Special emphasis should be put on achieving results to ensure the effective translation of investment into innovative output. According to Commission estimates, in terms of returns to R&D, achieving the 3% target could build up to an additional ½ % of GDP growth and 400,000 more jobs per annum from 2010[1].

The Council calls on Member States to improve framework conditions and incentives so as to enhance competition and ensure effective education and training systems, in order to encourage efficient and effective R&D investment by business. More effort is also needed to strengthen the links between public research bodies and industry, improve intellectual property regimes, and increase the supply of risk capital.

[1] Investing in Research : An Action Plan for Europe, European Commission, 2003 (page7)

- Competitiveness

9. Excessive levels of regulation, high administrative burdens and high business start-up costs reduce economic dynamism in the EU. Thereby, it reduces the level of competition and the competitiveness of European firms, particularly in the industrial sector, in a global context. Improvements in the regulatory framework could deliver a considerable increase in GDP and productivity in the longer term.

The Council welcomes the recent initiative by Ireland, the Netherlands, Luxembourg and the UK to address the issue of better regulation during their four Presidencies and supports an action plan to drive this forward over the coming year.

10. Services account for 70% of GDP in the EU, as well as 70% of employment. Yet the internal market for services is far from complete. More competition will promote efficiency and increase output and employment levels, as well as benefiting customers.

The Council welcomes the Commission proposal for a Directive on Services, and considers it vital that the Directive be agreed in line with the timeframe set out within it.

11. The promotion of enterprise is a vital element in delivering sustained employment and productivity growth. The creation of new businesses increases the competitive pressure on firms, generates new ideas and innovative approaches and can lead to greater choice and value for money for consumers.

To raise the profile of pro-enterprise policies and to celebrate success in enterprise across the Union, the Commission should bring forward proposals to establish a competition to identify "European Centres of Enterprise".

II. Increasing the Flexibility and Adaptability of our Labour Markets

12. The Implementation Report on the Broad Economic Policy Guidelines highlights that more effort is needed to increase employment by the 15 million required if the Lisbon target is to be achieved. A range of policy reforms have been suggested by the Employment Taskforce.

13. It is important that Member States should commit, at the Spring Council to implement initiatives in their own labour market along the lines suggested by the Taskforce. Building on recent ECOFIN discussions, the following priorities can be identified.

> Each Member state should commit in specific terms to implement measures which will:
>
> - Increase flexibility of labour markets in order to unlock the dynamics of employment creation, including appropriate adjustments in the wage bargaining systems;
> - Modernising the concept of job security to focus on improving employability; and
> - Take action on benefit and tax reform to improve incentives and make work pay.

III. Ensuring the Sustainability of our Public Finances

14. Few member states maintained budgetary positions close to balance or in surplus in 2003 while the long term sustainability of public finances is secured in only about half of the fifteen. Consolidation of the public finances focussed on reduction of public debt, combined with increasing employment rates and pensions and health care reform will help to ensure that Europe is well placed to meet the fiscal challenge associated with population ageing.

> Over the coming years, member states must ensure that they meet their pre-existing commitments for budgetary consolidation in order to achieve the medium term position of close to balance or in surplus and return the debt ratio to a declining path.

15. A number of member states have successfully introduced significant employment and pension reforms and several are also seeking a better return to the public in terms of health care delivery. A more widespread implementation of such initiatives will strengthen the sustainability of the public finances.

The Council encourages Member States to tackle the financial implications of population ageing by reducing public debt and strengthening employment, health and pension reforms. In this regard, Member States should consider enhancing relevant incentives for workers to remain in work and for employers to hire and retain older workers and continue to increase progressively the effective age at which people stop working in the European Union, in line with the Barcelona European Council conclusions.

Implementation and Monitoring are the Key

16. The existing strategy is the correct one and is relevant to both existing and accession member states. No new strategy or community-wide guidelines are required. However, it should be taken into account that the challenges appear more demanding in many areas in acceding countries and the Broad Economic Policy Guidelines should be updated to reflect this. What is needed now is a much sharper focus on implementation.

Accordingly, the Council recommends a four point plan to ensure that reform is delivered:

- The pace of reform has to be stepped up, especially at Member State level, if the Lisbon targets are to be achieved.
- The Commission should benchmark Member States' performances in terms of progress towards the Lisbon goals.
- Information on best practice as well as country specific examples should be clearly identified.
- A special mid-term review of the Lisbon Strategy should be carried out to take stock of the progress made in achieving the Lisbon objectives and targets and to identify the ways forward, taking into account the key issues identified in this paper.
