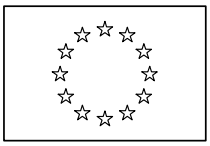

ECONOMIC POLICY COMMITTEE

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REPORT ON FIRST PROGRESS REPORTS ON THE LISBON NATIONAL REFORM PROGRAMMES 2005-2008

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Report on First Progress Reports on the Lisbon National Reform Programmes 2005-2008

1. Main Findings

The European Union and its Member States have entered the second stage of the re-launched Lisbon Strategy. Last year's National Reform Programmes 2005-2008 (NRPs) identified the challenges and priorities for action for Member States to foster growth and employment. In October 2006, Member States submitted their first progress reports focusing on the implementation of the policies developed in the NRPs. Last year ECOFIN concluded that ambitions should be stepped up matched by concrete policies. Like last year, Member States have consulted with national parliaments, regional and local authorities and social partners. 23 Member States submitted a progress report in the autumn of 2006. Due to the electoral cycle, no progress report was available yet for CZ and SE. These Member States presented a brief update.

In line with the existing multilateral surveillance arrangement, the Economic Policy Committee (EPC) has conducted a first round of multilateral surveillance of the progress reports on 6-8 November 2006, focusing on four themes: Innovation, Labour Markets, Energy and Better Regulation.[1] The objective of the exercise is to sketch an early picture of progress made towards the Lisbon objectives, which will feed into the Commission's annual progress report and the Spring European Council and to identify best practices and challenges in these four key policy areas. The thematic approach of this round of multilateral surveillance has allowed the EPC to consider in more detail each of the four policy areas covered.

The overall picture that emerged from the examinations is encouraging. All Member States are conscious of the necessity to reform. Many actions are being taken, and first results are starting to show, but there is more work to be done. All Member States are making progress with the implementation of their NRP's for the period 2005 – 2008, although the performance of Member States is varied. If the EU is to achieve the overall employment target of 70% and the R&D-target of 3% of GDP in 2010 a major effort is required. Europe should make good use of the current relatively favourable economic outlook to build upon the reforms already underway and turn to some of the areas where progress remains limited, such as fostering competition, increasing incentives in benefit systems, the adaptability of the labour market and improving fiscal sustainability. Europe should learn from the experiences of Member States in the areas of better regulation, increasing the employment rate, extending working lives, improving the functioning of energy markets as well as promoting energy efficiency and renewable energy sources, and formulation of a broad based innovation strategy.

The **development of innovation policies** is a key element in all NRPs. There is broad recognition among Member States that the right framework conditions, such as competition, legal and technical infrastructure, access to capital particularly for SMEs, well functioning labour markets, and the competences of the workforce are a necessary condition for successful innovation performance. More should be done to create fully competitive markets, as this is a key incentive for companies to innovate and thus contribute to raising private

[1] Representatives of the High Level Group of the Competitiveness Council participated in the reviews. Representatives of the OECD and the International Energy Agency also took part to strengthen the surveillance process.

sector spending on R&D. In addition to improving the innovation environment Member States have formulated specific measures to stimulate private R&D that fall into three broad categories: fiscal measures for stimulating private R&D; measures to stimulate networking and public private partnerships; and measures aimed at increasing the innovative capacity of SMEs. However, Member States underline that there is no 'one size fits all' policy-mix on innovation.

Labour market reform will have to move up a gear for the EU to reach the target of an overall employment rate of 70% by 2010 and at the same time ensure social cohesion by providing employment opportunities for all. This requires speeding up reforms of tax/benefit systems in particular with benefit systems, and increasing the adaptability of the labour market where progress has been relatively limited. Member States put much effort into increasing the participation of older workers, but more progress is necessary for the EU to reach the employment rate target for older workers of 50% in 2010. However, achieving the 50% target for the employment rate of older workers will not be sufficient to raise the effective retirement age in line with life expectancy increases which will be indispensable to assure at the same time financial sustainability and adequacy in the long run. In the area of labour market reform monitoring and evaluation of already implemented reforms is also important.

A truly integrated and well functioning **European electricity and gas market** is far away. Proper implementation of agreed directives would be a first step toward a more efficient energy market in the EU. Competition could also be enhanced by increasing interconnection capacity, a better implementation of the provisions for unbundling and third party access, and by improving market transparency. In relation to the rest of the world the EU has achieved much in the area of sustainability. Climate change needs to be addressed by Member States in a way that is not only cost-effective and neutral between competing innovative technologies, but also takes into consideration the functioning of the European energy market. Europe is a leader on combating climate change, as shown by the European Emissions Trading Scheme. The design of the ETS, including the participation of other relevant emitting countries and more rational allocation of permits, is a key issue and needs to be improved in the review taking place in 2007.

Better regulation has been given increased attention in the Lisbon strategy and is also an important element in promoting innovation and improving the business environment, in particular for SMEs. Much progress is being made, especially in the area of measuring and reducing the unnecessary administrative burden. A number of countries have set quantitative targets in this area. This momentum should be maintained. Member States should follow the experiences of 'first movers' by undertaking concrete actions to reduce administrative burdens to businesses. Follow-up needs to be given to simplification of existing regulations, consultations with stakeholders on legislative proposals and impact assessments. The European better regulation agenda is also picking up speed, though additional efforts are clearly required, notably with respect to impact assessment by Council and European Parliament. EU level action to support Member States efforts is also needed.

While Member States have outlined their economic reform efforts at the national level in their NRPs, the Community Lisbon Programme (CLP) presented on 20 July 2005 covers policy actions at the Community level. The European Union has been making steady progress with regard to the implementation of the CLP. By 31 July 2006, the European Commission (EC) had adopted 75 of the 102 actions. An important number of policy actions are currently in the

inter-institutional decision-making process. Close cooperation between EU institutions will be required in order to secure the successful implementation of the legislative part of the Community programme. The EPC intends to review the CLP in more detail during its multilateral surveillance round foreseen early in 2007.

2. Results of the Country Reviews

2.1 Innovation and R&D

Improving the innovative capacity of economies is about developing a systemic approach towards innovation and implementing a whole set of policies that enhance innovation systems. This is increasingly important as innovation systems both at the national and EU level have to be competitive in the global economy. This view was already emphasised by the European Council in Spring 2006 when it requested the development of a broad-based innovation strategy. Spending on R&D alone is not enough to deliver an innovative economy and should be complemented by a wider range of policy measures including labour and product market reforms.

Innovation and R&D Targets

The EU has set a target for overall R&D-expenditure of 3% of GDP in 2010 of which two thirds should be carried out by the private sector. Only two Member States (FI, SE) have met the 3% target. Given the policies put in place, EU **public R&D spending** will probably reach 1% of GDP in 2010. 18 Member States further increased government spending on R&D. The main challenge is to increase **private R&D expenditure** which is still substantially below the level required to reach the overall EU-wide target for 2010 and is crucial for business innovation, and on which very little progress has been made since 2000.

Last year's EPC report showed already that strict implementation of the NRPs is expected to be sufficient for Member States to reach their national R&D-targets. The report also showed that implementation of the NRPs will not be sufficient to reach the overall EU-target, as the 25 national targets add up to 2.6% R&D-expenditure in 2010 (up from the current level of 1.9% of GDP). This would mean that even if all Member States implemented their plans the 3% target would not be reached. To maximise the returns on innovation inputs Member States have to increase the efficient use of funds alongside the increase of overall funding.

Improving the Framework Conditions for Innovations

Appropriate market conditions and an increased absorptive capacity are necessary requirements for fostering innovation. In order to improve **framework conditions**, actions need to be taken in the areas of increasing competition, improving the functioning of labour markets, enhancing education and training, access to capital, better regulation, improving the application and protection of intellectual property rights and enhancing standardisation. Member States should also take account of spillovers and cross border co-operation in their policies.

The ECOFIN Council of December 2005 highlighted the importance of additional measures to **create competitive markets**. Some sectors, including the services sector, could benefit from stronger competition, as the lack of competition limits companies' incentives to innovate. Despite progress made in recent years on strengthening national competition authorities, Member States could put more effort into removing barriers to entry and increasing competition.

All Member States have recognised the need for a highly educated workforce and the necessity of life long learning in a knowledge-based economy. Member States have increased their focus on **education and training** and taken a variety of measures in this area. For example, DE introduced the Top Universities Excellence Initiative and AT has a similar initiative in place. Almost all Member States have managed to increase the **number of science and engineering graduates** and should also aim to increase the share of science and engineering graduates in the student population and their move into employment in business. Others (DK, EE, NL) aim to increase the number of university graduates in general. Some Member States (CZ, DK, EE, FI, LU, NL, UK) have put in place a policy regime to attract high skilled people from outside the EU. The EC has identified a European labour market for researchers as one of its priorities and published a green paper on legal migration.

The application and protection of **intellectual property rights** (IPR) is still relatively costly and time-consuming in Europe. Some Member States have taken action to address this issue. For example in IT and EL, the patenting costs are being reduced and the product labelling system is being reformed. In DE, the patent exploitation agencies will be further developed and expanded. In the UK, the government has launched an independent review to examine how the UK's IP-framework functions in the digital and technologically changing age. In 2006, the EC launched a public consultation on future patent policy in Europe, where the European Patent Litigation Agreement featured prominently next to the Community Patent and the harmonisation and mutual recognition of national patents. In the meantime, translation costs of national patents will be reduced once the London Protocol enters into force. Furthermore, the EC will present a patent strategy in December 2006 and an IPR strategy in 2007. The issue of standardisation has not received the attention it deserves. Through **EU-wide standards** a larger market could rapidly be provided to a company that brings a new product to the market. Simplifying procedures and promoting cooperation between standardising bodies offers an opportunity for Europe to improve its framework conditions.

Stimulating Private R&D

In addition to framework conditions that foster innovation, specific policy measures to promote private R&D and the commercialisation of its results are also required. All Member States have formulated specific policies for stimulating private R&D spending and there is a broad recognition that a comprehensive and systematically oriented approach is needed to improve performance. Almost all Member States have implemented or are in the stage of implementing medium to long-term strategic frameworks for research and/or innovation. A related activity is the improvement of governance by installing coordinating structures as done by some Member States (DK, FR, PT, SI, SK, UK).

The specific measures taken to stimulate private R&D fall into three broad categories: fiscal measures for stimulating private R&D, measures to stimulate public-private partnerships and measures aimed at increasing the innovative capacity of SMEs:

A number of Member States (AT, BE, CZ, EL, FR, IE, IT, HU, LT, MT, PL, PT, SI, UK) have recently introduced **new targeted tax incentives** to stimulate private R&D expenditure or have strengthened the existing ones. For example, FR, IE, IT and PL have joined those Member States that have specific tax credits for private R&D expenditures. Member States have made increasing use of a favourable tax regime to encourage private R&D. Such measures should be carefully assessed for cost efficiency.

A large majority of the Member States aim to improve the dissemination of knowledge both nationally and internationally by **stimulating networking and public-private partnerships,** for example through the creation and development of **innovation poles and networks.** Member States also devoted attention to the improvement of innovation support services (AT, CY, EL, HU, IE, PT) and the introduction of "matchmakers" i.e. arrangements to couple universities and public research organisations with industry (DK, FI, SI). Initiatives for the promotion of clusters and national technology platforms are being conducted as an effective form of science and industry co-operation. On the EU-level the concept of the Joint Technology Initiatives was further developed, and the **creation of a European Institute of Technology** has been proposed**.** Both these initiatives aim to intensify co-operation between companies, research institutes and universities.

In view of their share of the total economy, the untapped **innovative capacity of SMEs** requires special measures to unleash it. Measures taken in this regard include the use of public procurement policy to stimulate the development of innovative products and services by SMEs (UK) or improving the innovation capacity of new and existing SMEs (DK, ES, NL, FR). Innovation in the service sector requires special attention. On the EU-level, plans have been formulated for a new R&D and innovation state aid framework. The **access to finance** for SMEs also requires improvement. The overall picture is that insufficient availability of finance hinders innovation development. Measures are taken or planned to provide innovative SMEs with support (ES, FR, PL), boost the venture capital market (EE, EL, ES, FI, FR, PL, SI, LV, MT, UK) or Foreign Direct Investment (SI, HU). Both start-up financing and later-stage venture capital are given attention by Member States, although more emphasis is given to the former. Sufficient financing options for both types of companies are needed.

Priorities for further action

Despite progress made, measures taken will not be sufficient to reach the 3% R&D-target by 2010. Favourable framework conditions, especially competitive markets and better education achievements, are necessary for innovation, but progress has been limited. Therefore Europe should pay increased attention to creating an innovation friendly environment for companies, as a critical part of a broad based innovation strategy. Particular attention should be given also to assessing and supporting innovation in the services sector. Furthermore, Member States should strive for maximising the returns on innovation inputs, through enhancing the efficiency and quality of their policy measures.

2.2 Labour markets

The EU managed to increase its employment rate by 1.4% between 2000 and 2005. Such a performance is the result of heterogeneous developments across the EU with some Member States performing better than others. Some Member States perform particularly well showing an employment rate rise of more than 3% in this period (EE, EL, ES, IT, LV, LT, SI). In 2006, benefiting from a variety of policies and improved cyclical conditions, the employment rate for the EU rose by 0.6%. At present, the EU has an employment rate of 63.8%, though considerable differences between Member States still exist. To reach the overall employment rate target of 70% in 2010 (which only DK, NL, SE, UK have met), Europe would therefore have to achieve the increase in the employment rate of the first 5 years of the Lisbon strategy on an annual basis in the years to come.

The target for female employment is 60% in 2010. Currently the EU achieves an average of 56.3%, which puts the EU on track to meet this target provided reform continues and previous

reforms are implemented. 9 Member States (AT, DK, EE, FI, NL, PT, SE, SI, UK) have already reached this target in 2005, others are close to it.

Increasing the incentives for extending working lives and additional tax and benefit reform are essential to achieve higher overall employment rates. Whilst progress has been made, a broader reform effort is required, as other issues strongly weigh upon labour market outcomes, including the functioning of wage bargaining institutions; investing in human capital; and the modernisation of employment protection legislation where progress has been relatively slow. Further progress is also required to raise youth employment and tackle long term unemployment in order to promote employment and social cohesion.

Extending Working Lives

The **employment target for older workers** (those aged 55-64) across the EU25 is set at 50% in 2010. Eight Member States (CY, DK, EE, IE, FI, PT, SE, UK) have already reached this target while two others (LT and LV) are very close to it. Most Member States have introduced reforms in their retirement systems over the past years. The downward trend in labour force participation of older workers turned around in 1994. Considerable improvement has also been made in recent years: the current EU employment of older workers is 42.5 percent (2005) against 36.6 percent in 2000. This achievement is a clear illustration of the fact that reforms pay off. However, achieving the 50% target for the employment rate of older workers will not be sufficient to raise the effective retirement age in line with life expectancy increases which will be indispensable to assure at the same time financial sustainability and adequacy in the long run. More should be done to extend working lives.

A variety of measures have been implemented during the past year, mainly focussing on four policy areas: increasing the statutory retirement age, stricter eligibility criteria, tackling early retirement regimes and limiting the use of alternative benefit schemes (e.g. unemployment and disability schemes) as an alternative route for early retirement.

A great number of countries, currently with a statutory retirement age below 65 years, are **increasing their statutory pension ages** over the years to come. DE has taken the decision to raise the retirement age to 67 (fully implemented in 2029) as has DK (fully implemented in 2027). The UK has proposed to increase the pension age to 68 by 2050. Other Member States (ES, FI, IE, SE) have introduced a flexible pension age in recent years. Recent reforms have also encouraged longer working lives through the continued accrual of pension rights when continuing work after the statutory pension age (HU, LT, UK). There is also a recent development to link pensions or retirement age to life expectancy.

Box 1: Linking Pensions to Life Expectancy

- In Sweden, Latvia, Italy, and Poland, the introduction of notional defined contribution pension systems in the late 1990s linked the initial level of pensions to life expectancy at the time of retirement.
- In Finland from 2009 onwards, the benefit level of state pensions will be adjusted every year to account for the change in longevity for 62-year-olds.
- In Portugal the level of pension benefits has been proposed to be related to the average life expectancy.
- In Denmark, starting from 2025, it has been decided to index the age thresholds in the pension system to the mean life expectancy of 60 year-olds, so that the combined period over which people receive early retirement and public old age pensions will remain constant around 19 ½ years.
- Germany introduced in 2004 a sustainability factor adjustment in its pension indexation formula, which automatically slows down annual pension adjustments when the number of pensioners to working people rises.
- France introduced in 2004 a rule which will adjust the number of contribution years required for a full pension to life expectancy so as to keep the balance between years in employment and retirement.
- In Austria, a sustainability factor was introduced in 2005. Deviations from the expected path of life expectancies will lead to adjustments in the statutory retirement age, the contribution rate and budget contributions.
- The Italian pension scheme is maintained on an actuarially fair basis with a revision of the pension value scheduled every ten years.

Access to **early retirement schemes** over recent years has been tightened in many ways. In many countries (AT, DE, ES, IE, LV, PT, SE, SK, and in the reformed scheme of IT) early retirement has been made possible only on the conditions of (more or less) actuarial reductions to the pension level. Some countries (BE, CZ, DE, DK, ES, FR, LU) have either taken measures to make reductions more actuarially fair or increased the requirement of contribution years regarding the eligibility to early retirement, hence effectively increasing the eligibility age to early retirement. Also incentives to continue working beyond the first eligible retirement age have been increased through a high accrual of pension rights (AT, BE, CZ, ES, FI, FR, HU, LU, PT, SI, SK).

Some Member States have taken actions to **reduce the use of benefit schemes** – either unemployment or disability schemes – as an alternative route for early retirement (DK, FI, NL, BE, DE). This issue becomes even more urgent when actions are being taken to increase the statutory retirement age or tackle early retirement schemes, as this will lead to additional pressure on benefit schemes.

Increasing Participation Through Tax and Benefit Reforms

The reduction of the tax burden on labour for both employers and employees continued to be on the top of the policy agenda in 2006. To make work pay, Member States lowered **the level of income taxation**, either general (CZ, EE, ES, FI, FR, LT, LV, MT, SI) or for specific groups such as long term unemployed, low paid, young and older workers (AT, BE,FI, IE, FR). To boost labour demand, a few Member States implemented reductions on employers' social security contributions, either general (ES) or targeted at specific groups (AT, BE, ES) or reduced payroll taxes (SI). Italy decreased both employers' and employees' tax burden on

labour through general taxation. In HU, general contributions increased but a 50% reduction on social security contributions is available to some disadvantaged groups. Despite progress, further action in many Member States is required as the poverty, unemployment and inactivity traps remain high.

As in previous years only limited action was taken in the field of **unemployment and welfare-related benefits**. The UK adopted a substantial reform programme, with the introduction of a new employment and support allowance replacing incapacity benefits. For a majority of incapacity claimants, this will require active engagement with an employment adviser, construction of a personal action plan, and delivery against agreed actions. In the NL, the maximum duration of unemployment benefits was reduced from 60 months to 38 months, and eligibility criteria were tightened. The benefit level in the first two months was raised to 75% of the last earned wage, up from 70%. HU replaced unemployment benefits by job-search assistance.

In several other Member States, policy actions have been taken to promote the move from benefits to work through stricter work availability criteria, the use of sanctions for repeated non-compliance with rules, strengthening of control mechanisms and a streamlining of the financing for labour market subsidies and income support (BE, CZ, CY, DE, DK, EE, ES, FI, HU, LT, NL, PT, SE, SI).

Priorities for further action

Given the impact of ageing, achieving the 50% target for the employment rate of older workers will not be sufficient to raise the effective retirement age in line with life expectancy increases which will be indispensable to assure at the same time financial sustainability and adequacy in the long run. More should be done to extend working lives. Furthermore, additional efforts are required to increase incentives in benefit systems and increase the adaptability of the labour market – an area where progress has been relatively limited compared to tax-reform - and to further reduce poverty and unemployment traps. Efforts in these areas would boost the overall employment rate which still remains significantly below the target of 70%.

2.3 Energy

Recent volatile and high energy prices, security of supply issues and climate change have shown that stronger European cooperation in the field of energy is crucial. The issue is now rightly at the top of the European agenda. Following the 2006 Spring and June European Councils, the Commission is currently finalising work on a Strategic Energy Review that will identify priority actions to achieve the challenging goals of **sustainability, competitiveness and security of supply**.

Improving the Functioning of Energy Markets

In 2003 the Second Electricity and Gas directives were adopted with the aim of gradually creating one large integrated market for energy in the EU. The deadline for implementation of these directives was set for 1 July 2004. This deadline is long overdue, but still many Member States have not properly implemented these directives, as is reflected in the high number of about 30 infringement cases brought forward by the EC.

Additional investment in (cross border) **electricity interconnection capacity** is needed, while existing capacity must be made available to market participants in a non-discriminatory way. This is important in order to realise a truly European electricity market and achieve effective

competition, economies of scale, increased security of supply and, as a consequence more stable and predictable prices. The EU set itself the target of a level of electricity interconnections equivalent to at least 10% of the installed production capacity. 15 Member States have fulfilled this target in their electricity markets (AT, BE, CZ, DE, DK, EE, FI, HU, IT, LU, LT, LV, PL, SI, SK). Baltic countries have electricity interconnections to each other, but they are isolated from the EU electricity market and would benefit from fuller integration. The EC has supported the construction of priority electricity and gas infrastructure under the TEN-Energy programme (€ 20 million per year).

Box 2: Regional Energy Initiatives

- The Nordic electricity market (Nordpool) of Denmark, Finland, Sweden and Norway integrates these countries' national electricity markets.
- The Baltic countries and Finland are connecting through Estlink.
- The Baltic countries work also together in the field of nuclear energy.
- Last July Spain and Portugal launched the Iberian electricity market.
- Since January 2006 Belgium, France, Germany, Luxemburg and the Netherlands meet bi-annually to discuss cooperation in the Northwest European energy market.
- The Energy Community of South East Europe was founded in 2005 by the European Commission, Greece, Bulgaria, Romania, Croatia, Bosnia and Herzegovina, Serbia, Montenegro, FYROM, Albania, and UNMIK.
- Electricity link between Lithuania and Poland will create conditions to integrate electricity markets of Baltic countries into the common EU electricity market.

In order to use the available interconnection infrastructure efficiently, **national regulators should have an independent position and cooperate more closely with each other**. Differences in the mandates of the national regulatory authorities to take decisions and enforce them form a barrier for cross-border cooperation and should thus be reduced. The degree of regulatory independence varies between countries. Some Member States have implemented measures to increase regulatory powers (BE, CY, DE).

Many national electricity and gas markets display a **high degree of market concentration**, as is shown by the fact that in 11 Member States the market share of the largest producer is still above 75%. These national energy markets need to be made more competitive by facilitating new entry to the (national) energy markets and by creating a level playing field. Efforts to improve market transparency are important in this respect. DK, FI, SE and UK already have a relatively high number of active generators and suppliers in their electricity markets, and a high number of active producers and suppliers in the gas market (ES, UK).

Some Member States have taken measures to **increase third party access** through changes to the regulation (ES, HU, IT, FR, PL); more Member States should follow. Cross subsidisation from transmission towards production and supply activities prevents a level playing field between incumbents and new entrants to the market. A level playing field can only be ensured by effective separation of networks from production and distribution activities ("unbundling"). Only some Member States have effectively unbundled or are in the process of unbundling networks effectively in both the gas and electricity market. **More efforts should be dedicated to realising the benefits of unbundling**.

Promoting Energy Efficiency and Renewable Energy Sources

The impact of climate change increases the urgency to take measures to improve energy efficiency and the use of renewable energy. In the UK the Stern report on the global economics of climate change has just been released. The EU is a leader on the global stage in promoting energy efficiency and the use of renewable energy sources. The EU set itself the target that the contribution of electricity produced from renewable energy sources to gross electricity consumption should be 21% at Community level by 2010. Many initiatives have been taken and are under way. The progress made with promoting the use of renewable energy sources is noteworthy. This should be done in a way that is cost-effective, neutral between competing innovative technologies, and not competition distorting, while making use of price incentives. More has to be done to address incentives and financial barriers to investment in technologies and infrastructure that promote energy efficiency. Further attention should be paid to energy saving and a rational allocation of emission rights, also after 2012.

The European Commission has shown that **up to 20% of Europe's energy use can be saved** if appropriate investments are made and has recently introduced an Action Plan for Energy Efficiency consisting of concrete measures to reach this potential by 2020. This requires mostly action by the Member States. Some Member States (CY, CZ, DK, ES, FI, LT, UK) have implemented overall action plans or formulated strategies in order to promote energy efficiency. Other Member States (CZ, FI, IE, HU, PL) formulated environmental technology strategies and certain Member States put in place measures that promote eco-efficient technology and innovations (CZ, DE, DK, ES, FI, SE, SI, SK, UK). Only some countries (BE, DK, ES, FR, LT, NL, UK) have set specific energy savings targets. Some others introduced changes in the tax system in order to make investments in energy efficiency more attractive (CZ, DK, ES, IT, SI). A reduction in energy intensity is most necessary in countries with high energy intensities (CZ, EE, LT, PL, LV, SK). The benefits of the Internal Market should also be considered. Member States should take into account when devising policies that these are not hindering cross border trade and that economies of scale can be realised.

To ensure a sustainable energy policy, **all Member States support the promotion of renewable energy use** and aim to keep open all technology options. The progress reports show that the use of renewable energy sources is increasing. In many cases, governments provide financial support to stimulate renewable energy, e.g. by incentives through taxes (AT, IE, FR, HU, CY, NL, SE, UK), financial promotion of investments (CY, CZ, EL, HU, LU, SK, UK), green certificates (BE, NL, PL, PT, SE) and feed-in tariffs (DE, DK, ES, IT, LT). With regard to the national targets set by Member States for a larger share of renewable energy of gross domestic energy consumption, 9 Member States (CY, DE, DK, ES, FI, HU, LU, LV, NL) are on track to reach their national targets. The other Member States will, to varying degrees, have to take further action to meet the targets.

At the European level, the current main market based instrument for reducing greenhouse gas emissions in a cost effective way is the **EU Emissions Trading Scheme** (ETS). The review of the ETS will be an important moment for its further development and design, including the participation of other relevant emitting countries. It is important to indicate to the market in a timely manner how the EU ETS will be shaped for the post 2012 period. Rational allocation of emission permits is essential in order to guarantee a level playing field and achieve economies of scale.

Priorities for further action

Unleashing the potential of the European energy markets will produce great benefits. Progress requires a broad European approach, enhancing competition both between and within Member States together with increasing co-operation between national regulators. Member States should not only implement the agreed directives, but should also take additional measures to make national markets more competitive, including through increased third party access, improved market transparency, effective unbundling, and independence of regulators. Efforts should also be made to enable consumers to take actions and respond to market conditions. Interconnection capacity should be increased. Climate change needs to be addressed by Member States in a way that is not only cost-effective and neutral between competing innovative technologies, but also takes into consideration the functioning of an integrated European energy market. Europe is a leader on combating climate change, as shown by the European Emissions Trading Scheme. Improving the design of the ETS, including a more rational allocation of permits, is a key issue for 2007.

2.4 Better regulation and reduction of administrative burden

In order to face stronger international competition, support the single European market and facilitate innovation Europe needs to create a more competitive business environment. In addition to other measures, all Member States recognise that improving the quality of regulation is key. Improving the quality of regulation is built on three pillars besides the importance of enforcement and compliance: reducing administrative costs, considering the impact of proposed legislation and simplifying existing regulation. These instruments are part of a comprehensive better regulation strategy and require strong political support and an appropriate governance structure.

The speed at EU level is also picking up: the Better Regulation Strategy launched in 2002 has shown considerable progress since then and is likely to be supported by an ambitious agenda in the months ahead. The Commission as well as Members States should engage to carry this work further, learning from the experience of others. The better regulation agenda should take into account the need to pursue the importance of further harmonisation in certain areas where the EU has an added value.

Reducing Administrative Costs

Most Member States show progress in the measuring and **reduction of administrative costs**. 18 Member States (AT, BE, CZ, DE, DK, EE, FI, FR, HU, IT, LU, LT, LV, NL, PL, PT, SE, UK) are now part of a network of countries cooperating on the standard cost model, and are carrying out pilot projects or introducing baseline measurements. Of this group six Member States (AT, CZ, DK, FR, NL, SE) have set concrete quantitative targets for the reduction of the administrative burden. DE and UK are planning to do so in the near future. Other Member States should build on these Member States' experiences and might consider further concrete actions to reduce unnecessary administrative burden and improve the competitive environment especially for businesses.

On the Community level, a common methodology to measure administrative costs of EU proposals was outlined in a communication in October 2005 and this methodology has now been integrated in the impact assessment guidelines. Concerning existing legislation a pilot project has been completed, which has identified priority policy areas where the largest potential for reduction lies. Targets should be introduced as soon as possible, as a sizeable share of the administrative burden for businesses stems from EU regulation.

Considering the Impact of Legislation

There has been significant progress across the EU in **introducing impact assessments,** with the majority of Member States and the EC assessing the impacts of proposed legislation. However, it should also be ensured that all relevant proposals are systematically assessed including the consideration of all relevant impacts. Of the Member States that have introduced impact assessments, about half cover all three dimensions of economic, environmental and social impacts. A thorough system of impact assessments plays an important role in improving the quality of regulation and more efforts are needed by Member States in order to ensure the quality and further development of impact assessments. Five Member States (BE, LU, NL, PL, UK) have introduced control bodies in the assessment process in order to provide an independent evaluation. Systematic and consistent consultation is also an important tool to improve the quality of the regulatory process. EE, IE, PL and the UK hold mandatory public consultations on draft legislative proposals and their impact assessments, which is one of the ways to complement more targeted approaches. The EC has adopted minimum public consultation standards which ensure that systematic consultations on new proposals are carried out.

On the Community level, in March 2006, the European Commission updated the internal Guidelines for impact assessments, so that assessment of administrative costs is now a compulsory and integrated part of policy formulation. The EC has completed more than 150 impact assessments up to October 2006. An external review of the EC's impact assessment system is also under way, and may lead to improved quality control arrangements. The Council and the European Parliament have, to date, carried out less than 10 impact assessments on amendments to Commission proposals. A stronger effort is clearly needed to respect the inter-institutional agreement on better lawmaking and better regulation.

Simplifying Legislation

Member States show **progress towards the simplification** of existing EU and national legislation. Nearly all Member States are taking measures aimed at simplifying administrative procedures for businesses and increasing quality of public services including an increasing use of ICT and one-stop-shops. While these measures contribute to the improvement of the business climate, simplification of the regulatory environment also calls for programmes aimed at improving the regulatory environment itself by simplifying, repealing or rewriting existing regulation. A majority of Member States launched a systematic and ongoing simplification programme or are in the planning stage for such a programme. In their efforts a number of Member States have benefited from bottom up approaches, taking account of simplification proposals by relevant stakeholders. Several Member States are using systems in which governments solicit specific complaints and suggestions from stakeholders via the internet, examine them and take the appropriate measures. This approach ensures that the simplification is aimed at areas that concern businesses most.

Simplification on the EU level has continued in line with the three-year-rolling programme as part of the Better Regulation initiative launched in October 2005, covering 222 basic legislations. The EC has screened pending proposals from before January 2004. Of these 183, the EC withdrew 67. In terms of simplification, further progress is desirable as only a part of simplification proposals planned for 2006 has been delivered. The Council and the European Parliament should also give greater priority to processing simplification proposals - there are currently more than 20 proposals pending before the Council and the European Parliament.

In November 2006 the EC will present a global review of better regulation and will identify further actions to be taken with regard to impact assessments, administrative burdens and simplification.

Priorities for further action

Better regulation has been given increased attention in the Lisbon strategy. This momentum should be maintained. Member States should follow the experiences of 'first movers' by taking additional concrete measures. Follow-up needs to be given to simplification of existing regulations and consultations with stakeholders on legislative proposals and impact assessments. The European better regulation agenda is also picking up speed, though additional efforts are clearly required. The Commission on 14 November published a proposal to set a target for the reduction of the administrative burden of EU and national regulation. Action to control and reduce the burden of administration should safeguard the wider objectives and benefits of legislation and regulation including the acquis communautaire.

	Structural Indicators															
	Headline		Energy				Labour Markets									
	Real GDP growth		Market share of the largest generator in the electricity market		Energy intensity[i]		Labour Productivity per person employed[ii]		Total employment rate[iii]		Total employment rate – female[iv]		Employment rate - older workers[v]		Long term unemployment rate[vi]	
	2000	2005	2000	2004	2000	2004	2000	2005	2000	2005	2000	2005	2000	2005	2000	2005
EU (25 countries)	**3.9**	**1.7**	**n.a**	**n.a.**	**208.8**	**204.9**	**100.0**	**100.0**	**62.4**	**63.8**	**53.6**	**56.3**	**36.6**	**42.5**	**3.9**	**3.9**
EU (15 countries)	**3.9**	**1.5**	**n.a**	**n.a.**	**190.5**	**187.5**	**107.5**	**105.5**	**63.4**	**65.2**	**54.1**	**57.4**	**37.8**	**44.1**	**3.4**	**3.3**
Euro area	**3.9**	**1.4**	**n.a**	**n.a.**	**n.a**	**n.a.**	**109.0**	**105.0**	**61.7**	**63.5**	**51.7**	**55.2**	**34.2**	**40.4**	**3.9**	**3.8**
Belgium	3.7	1.1	91.1	87.7	236.1	208.2	125.8	127.9	60.5	61.1	51.5	53.8	26.3	31.8	3.7	4.4
Czech Republic	3.6	6.1	69.2	73.1	888.4	851.8	58.1	65.8	65.0	64.8	56.9	56.3	36.3	44.5	4.2	4.2
Denmark	3.5	3.0	36.0	43.0	125.0	120.3	104.9	106.5	76.3	75.9	71.6	71.9	55.7	59.5	0.9	1.1
Germany	3.2	0.9	34.0	n.a.	159.7	158.8	101.2	101.4	65.6	65.4	58.1	59.6	37.6	45.4	3.7	5.0
Estonia	10.8	10.5	91.0	93.0	1214.8	1140.2	43.5	58.6	60.4	64.4	56.9	62.1	46.3	56.1	5.9	4.2
Greece	4.5	3.7	97.0	97.0	263.6	240.4	90.4 (e)	98.4 (e)	56.5	60.1	41.7	46.1	39.0	41.6	6.2	5.1
Spain	5.0	3.5	42.4	36.0	227.0	222.5	97.5	97.3	56.3	63.3	41.3	51.2	37.0	43.1	4.6	2.2
France	4.0	1.2	90.2	90.2	186.6	185.5	122.0	119.0	62.1	63.1	55.2	57.6	29.9	37.9	3.5	3.9
Ireland	9.4	5.5	97.0	83.0	175.1	156.9	121.8	127.4	65.2	67.6	53.9	58.3	45.3	51.6	1.6	1.5
Italy	3.6	0.0	46.7	43.4	186.9	189.1	121.2	108.0	53.7	57.6	39.6	45.3	27.7	31.4	6.3	3.9
Cyprus	7.0	3.9	99.6	100.0	282.3	261.8	79.2	75.6	65.7	68.5	53.5	58.4	49.4	50.6	1.2	1.2
Latvia	6.9	10.2	95.8	91.1	756.0	696.3	38.3	46.3	57.5	63.3	53.8	59.3	36.0	49.5	7.9	4.1
Lithuania	4.1	7.6	72.8	78.6	1208.4	1135.6	40.8	53.1	59.1	62.6	57.7	59.4	40.4	49.2	8.0	4.3
Luxembourg	8.4	4.0	n.a.	80.9	186.6	194.3	159.2	160.9	62.7	63.6	50.1	53.7	26.7	31.7	0.6	1.2
Hungary	8.1	4.2	41.3	35.4	600.5	534.1	61.7	69.8	56.3	56.9	49.7	51.0	22.2	33.0	3.1	3.2
Malta	6.4	2.2	100.0	100.0	303.2	292.4	90.2	80.4	54.2	53.9	33.1	33.7	28.5	30.8	4.4	3.4
Netherlands	3.9	1.5	n.a.	n.a.	198.5	203.2	105.0	107.8	72.9	73.2	63.5	66.4	38.2	46.1	0.8	1.9
Austria	3.4	2.0	32.6	n.a.	134.4	146.1	n.a.	n.a.	68.5	68.6	59.6	62.0	28.8	31.8	1.0	1.3
Poland	4.2	3.2	19.5	18.5	680.2	596.6	58.0 (e)	63.0	55.0	52.8	48.9	46.8	28.4	27.2	7.4	10.2
Portugal	3.9	0.4	58.5	55.8	241.5	239.6	71.9	65.5 (f)	68.4	67.5	60.5	61.7	50.7	50.5	1.7	3.7
Slovenia	4.1	4.0	n.a.	53.0	341.7	329.2	69.7	76.9	62.8	66.0	58.4	61.3	22.7	30.7	4.1	3.1
Slovakia	0.7	6.0	85.1	83.7	955.9	854.3	54.5	62.1	56.8	57.7	51.5	50.9	21.3	30.3	10.3	11.7
Finland	5.0	2.9	23.3	26.0	260.1	272.1	110.9	108.3	67.2	68.4	64.2	66.5	41.6	52.7	2.8	2.2
Sweden	4.3	2.7	49.5	47.0	215.0	217.5	106.6	104.4	73.0	72.5	70.9	70.4	64.9	69.4	1.4	1.2
United Kingdom	3.8	1.9	20.6	20.1	227.3	207.2	103.4	106.6	71.2 (b)	71.7	64.7 (b)	65.9	50.7 (b)	56.9	1.4	1.0

	Innovation											
	Gross Domestic Expenditure on Research and Development[vii]		GERD by industry (% of total GERD)		Patents per 1m inhabitants[viii]		Science and technology graduates – total[ix]		High-tech exports[x]		Venture capital - early stage (% of GDP)	
	2000	2004	2000	2003	2000	2003	2000	2004	2000	2004	2000	2005
EU (25 countries)	**1.86 (s)**	**1.86**	**55.2 (s)**	**54.3 (s)**	**134.655**	**n.a.**	**10.2 (s)**	**12.7**	**21.37**	**18.37**	**n.a**	**n.a**
EU (15 countries)	**1.91**	**1.92**	**55.5 (s)**	**54.6 (s)**	**159.9**	**n.a.**	**11.0 (s)**	**13.6**	**20.6**	**17.7**	**0.0735 (s)**	**0.0223 (s)**
Euro area	**1.85**	**1.86**	**56.9 (s)**	**55.8 (s)**	**158**	**n.a.**	**n.a**	**n.a.**	**n.a**	**n.a.**	**n.a**	**n.a**
Belgium	1.97	1.9	62.4	60.3	143.545	70.204	9.7	11.2	8.69	7.12	0.1052	0.0207
Czech Republic	1.23	1.27	51.2	51.4	10.373	7.369	5.5	7.4	7.78	13.66	0.0259	0
Denmark	2.24	2.58	n.a.	59.9	220.92	110.761	11.7	13.8	14.43	13.31	0.0196	0.0514
Germany	2.45	2.49	66	66.3	305.317	155.961	8.2	9	16.08	15.35	0.0801	0.0136
Estonia	0.62	0.91	24.2	33	9.781	4.668	7.0	8.9	25.12	10.07	n.a	n.a
Greece	n.a.	0.57	n.a.	30.7	6.635	6.186	n.a.	8	7.46	7.12	0.0073	0
Spain	0.91	1.07	49.7	48.4	26.144	14.359	9.9	12.5	6.37	5.7	0.0317	0.013
France	2.15 (b)	2.16	52.5 (b)	50.8	143.003	76.282	19.6	n.a.	25.47	20.07	0.0801	0.0278
Ireland	1.13	1.2	65.8	59.5	75.007	36.89	24.2	23.1	40.54	29.08	0.1069	0.0225
Italy	1.05	n.a.	n.a.	n.a.	78.57	46.947	5.7	10.1	8.53	7.08	0.0453	0.0021
Cyprus	0.25	0.37	17.5	19.8	15.496	4.894	3.4 (h)	4.2 (h)	3.04	15.89	n.a	n.a
Latvia	0.44	0.42	29.4	33.2	6.449	2.668	7.4	9.4	2.25	3.21	n.a	n.a
Lithuania	0.59	0.76	31.6	16.7	2.474	2.68	13.5	17.5	2.55	2.72	n.a	n.a
Luxembourg	1.65	1.65	90.7	80.4 (p)	234.156	116.641	1.8	n.a.	20.56	29.46	n.a	n.a
Hungary	0.79	0.89	37.8 (i)	30.7	20.036	8.727	4.5	5.1	23.11	21.72	0.0033	0.0041
Malta	n.a.	0.64	n.a.	n.a.	11.836	8.81	3.4	3.6 (g).	64.4	55.9	n.a	n.a
Netherlands	1.9	1.78	51.4	51.1	244.498	113.314	5.8	7.9	22.82	19.1	0.0926	0.002
Austria	1.91 (e)	2.26	41.8 (e)	45.2 (e)	172.718	103.114	7.2	8.7	14.04	14.74	0.0286	0.0115
Poland	0.64	0.56	29.5	27	3.123	1.877	6.6	9.4	2.84	2.73	0.0225	0.0002
Portugal	0.76 (e)	0.74	27 (e)	31.7	5.751	3.936	6.3	11	5.57	7.49	0.0252	0.0397
Slovenia	1.43	1.45	53.3	52.2	36.182	21.889	8.9	9.3	4.46	5.2	n.a	n.a
Slovakia	0.65	0.53	54.4	45.1	7.206	8.137	5.3	9.2	2.87	4.62	0.0002	0.0009
Finland	3.38	3.51	70.2	70	347.21	143.052	16	n.a.	23.48	17.77	0.1035	0.0443
Sweden	n.a.	3.7	n.a.	65	367.372	136.75	11.6	15.9	18.71	14.14	0.0867	0.0516
United Kingdom	1.86	1.79	48.3	43.9	128.555	n.a.	16.6	18.1	28.89	22.79	0.103	0.0474

Notes: (f) Forecast; (b) Break in series; (s) Eurostat estimate; (p) Provisional value; (e) Estimated value; (g) 2003; (h) figures do not include Cypriot science and engineering students who have graduated from tertiary institutions abroad. When adjusted for Cypriot science and engineering students abroad, the figures are 13.3 in 2000 and 16.6 in 2004.

Source: Eurostat

[i] Gross inland consumption of energy divided by GDP - at constant prices, 1995 - kilogram of oil equivalent per 1000 €

[ii] GDP in Purchasing Power Standards - PPS - per person employed relative to EU-25; EU-25 = 100

[iii] Number of persons aged 15 to 64 in employment by the total population of the same age group; %

[iv] Number of women aged 15 to 64 in employment by the female population of the same age group; %

[v] Number of persons aged 55 to 64 in employment by the total population of the same age group; %

[vi] Persons aged at least 15 who have been unemployed for 12 months or more divided by the total labour force (employed and unemployed persons); %

[vii] % of GDP

[viii] Number of patent applications to the European Patent Office (EPO) per million inhabitants

[ix] Tertiary graduates in science and technology per 1 000 of population aged 20-29 years

[x] Exports of high technology products as a share of total exports