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REPORT

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- Draft Report from ECOFIN to the European Council

Delegations will find attached a Draft Report from the Council (ECOFIN) to the European Council on the Broad Economic Policy Guidelines 2008-2010.

The text has been prepared by the Economic and Financial Committee, the Economic Policy Committee in cooperation with the High Level Group on Competitiveness and the COREPER.

Annex

**INTEGRATED GUIDELINES FOR GROWTH AND JOBS
(2008-2010)**

including

a draft for a COUNCIL RECOMMENDATION

**on the broad guidelines for the economic policies of
the Member States and the Community
(under Article 99 of the EC Treaty)**

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Introduction

In the Spring Council in 2005, Heads of State and Government renewed the Lisbon Strategy and placed its focus on growth and jobs. They organised the Lisbon Strategy around three-year cycles, whilst strengthening ownership and accountability by clearly distinguishing between reforms which should be undertaken by Member States and those for which the Community should take the lead. As one of the instruments to implement the Strategy, the Council approved a set of integrated guidelines and adopted the necessary legal instruments based on Article 99 and 128 of the Treaty. These guidelines are meant to guide Member States as they draw up and implement national reforms through their National Reform Programmes (NRP). The guidelines for the period 2008-2010 are built on three pillars – macroeconomic policies, microeconomic reforms and employment policies which together contribute to the objectives of sustainable growth and employment and reinforce social cohesion. The integrated guidelines expire at the end of the first three-year cycle, and therefore need to be renewed for the next cycle 2008-2010. The re-launch of the Lisbon Strategy in Spring 2005 put Europe back on track to create sustainable growth and jobs.

During the first cycle of the renewed Lisbon Strategy (2005-2008), while economic and budgetary conditions have improved, including in the Euro area, Member States have stepped up the implementation of structural reforms, although the pace and intensity differs between them. Whilst most of the upturn of the EU economy is due to cyclical factors, Lisbon-type reforms have helped increase the growth potential of Member States' economies. They have also helped to make the European economy more resilient in dealing with external shocks, such as higher energy and commodity prices and currency fluctuations. Further integration of Member States economies and alignment of business cycles, especially in the euro area, will allow for a monetary policy geared better to Member States needs.

Viewed as a whole, therefore, the strategy has helped to speed up the pace of reform, helping Member States to implement sometimes difficult but necessary change to respond to the opportunities and challenges of globalisation and prepare for ageing populations. The new governance of the Lisbon Strategy, with its emphasis on partnership between the European and the Member States level, has proved its worth. An independent evaluation of the Integrated Guidelines concluded that they constitute a comprehensive and open framework which accommodates the essential policy developments related to growth and employment in Europe. The evaluation also concluded that the focus should be on implementation, as the guidelines remain relevant. The four priority areas for reform agreed by the European Council – knowledge and innovation; unlocking the business potential; investing in people and modernising labour markets; and energy and climate change – continue to provide the right framework for reform. The integrated guidelines, hence, are fulfilling their role and thus do not require revision.

However, more remains to be done to get the EU and its Member States into shape for globalisation and to strengthen the foundations for economic success in the medium- to longer term. At the same time they need to keep pace with fast changing social realities (increased life expectancy, increasingly diverse family structures, new patterns of mobility and diversity). The EU must better adapt its existing policies and instruments, but also build upon new policies, in order to better respond to the legitimate concerns of people adversely affected by changes in trade patterns and by economic, demographic and social change. The goal of making the EU a dynamic, competitive, knowledge based society remains essential. Within this framework, more attention needs to be given to the social dimension, more flexible and secure labour markets (flexicurity), longer working lives, energy and climate change and to education and skills as elements to modernise European markets, promote innovation and ensure new opportunities for its citizens in a knowledge society.

The Lisbon toolbox is already bringing the different strands of policy together to offer a more comprehensive vision of how the EU and Member States can work in harness to tackle the complex issues facing Europe today. In this context, it is also essential to give due consideration to the external dimension of the Lisbon Strategy, in accordance with the EU declaration on globalisation adopted by the European Council of December 2007. The common objective during the next cycle should be to use the Lisbon instruments, including the country-specific recommendations as adopted by Council in 2007 linked to the integrated guidelines, to full effect in order to speed up the effective delivery of outstanding reforms.

The integrated guidelines for the period 2008-2010 are presented in one comprehensive document with two parts:

Part 1 – The Broad Economic Policy Guidelines

Section A deals with the contribution that macroeconomic and fiscal policies can make in this respect, by maintaining macro stability and fiscal sustainability at the same time. Section B focuses on the measures and policies that the Union and the Member States must carry out in order to make Europe a more attractive place to invest and work and to boost knowledge and innovation for growth.

Part 2 – The Employment Guidelines: This part of the integrated guidelines includes the proposal for a Council decision on the Employment Guidelines, on which the European Parliament, the European Social and Economic Committee and the Committee of the Regions will be consulted, in accordance with Article 128 of the Treaty.

For Member States both economic, and employment policy, are a matter of common concern (Articles 99 and 126). For the purpose of multilateral surveillance and to ensure closer cooperation of economic and employment policies, Member States report on measures taken under these guidelines through National Reform Programmes (and Annual Implementation Reports). Based on these reports, where it is established that the economic or employment policies of a Member State are not consistent with the Integrated Guidelines, the Council may, using the possibilities under article 99 and 128 and, make recommendations to the Member State concerned.

The state of the EU economy

Economic conditions have been favourable since 2005 when the Lisbon Growth and Jobs Strategy was re-launched, although recent months have witnessed growing downside risks. Growth picked up to almost 3% in 2007, increasingly driven by domestic demand and leaving Europe better placed to cope with adverse external shocks. However, recent financial turmoil and the slowdown of the US economy have sharpened the risks to the downside, and the outlook for 2008-2009 indicates a deceleration in growth. Tighter financial conditions will take their toll on investment growth, in particular of construction investment, while the good performance of the labour market will support private consumption growth. While most of the recent upturn is cyclical in nature, there is some evidence of a structural component linked to past reforms enacted by EU Member States. Improvements have been most evident in labour markets. The unemployment rate has declined to below 7% and the employment rate approaching 65%, with particular strong increases recorded amongst women and older workers. It is encouraging that job creation and productivity improvements have occurred simultaneously for the first time in a decade. However, while there are signs that the decade-long decline in trend productivity growth may have come to a halt, a sustained improvement in productivity growth is still a key challenge for economic policies in the EU.

Notwithstanding the favourable developments over recent years, the recent international turbulences call for action to increase the resilience of the economy and to use the existing scope to improve both labour utilisation and labour productivity. In some countries, unfortunately, reform seems to be slowing down. The EU's employment rate has remained low relative to our competitors. Moreover, the rate of unemployment, especially of long-term nature and amongst young people, remains far too high. While many manufacturing enterprises have been sufficiently productive to withstand international competition, productivity growth in several service sectors has stalled. Looking forward, the economic and budgetary impact of ageing populations resulting, among others, from increased life expectancy is fast approaching, as made apparent with the large baby boom cohorts coming towards retirement in many countries. This makes it imperative to modernise pension and health care systems, to increase employment rates and labour supply and thus facilitate longer working lives whilst also achieving sustainable levels of public debt. An emerging challenge is also to improve capacity of the financial system to respond to shocks. Financial market transparency, effective competition rules and appropriate regulation and supervision will continue to be crucial for both confidence and performance as will wage developments compatible with employment growth and macroeconomic stability.

The EU now has an opportunity to accelerate structural reform efforts. The policy challenge is to avoid complacency and to continue addressing the structural weaknesses that are still holding back labour supply and job creation, innovative activity, the adoption of technological progress, and limit the EU capacity to respond to international shocks. At the same time, there is a need to pursue macroeconomic policies that succeed in ensuring stability, containing inflationary pressures and maintaining sound fiscal positions as well as improving the sustainability and quality of public finances.

INTEGRATED GUIDELINES FOR GROWTH AND JOBS (2008-2010)

Macroeconomic guidelines

- (1) To secure economic stability for sustainable growth.
- (2) To safeguard economic and fiscal sustainability as a basis for increased employment.
- (3) To promote a growth and employment orientated and efficient allocation of resources.
- (4) To ensure that wage developments contribute to macroeconomic stability and growth.
- (5) To promote greater coherence between macroeconomic, structural and employment policies.
- (6) To contribute to a dynamic and well-functioning EMU.

Microeconomic guidelines

- (7) To increase and improve investment in R&D, in particular by private business.
- (8) To facilitate all forms of innovation.
- (9) To facilitate the spread and effective use of ICT and build a fully inclusive information society.
- (10) To strengthen the competitive advantages of its industrial base.
- (11) To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth.
- (12) To extend and deepen the internal market.
- (13) To ensure open and competitive markets inside and outside Europe and to reap the benefits of globalisation.
- (14) To create a more competitive business environment and encourage private initiative through better regulation.
- (15) To promote a more entrepreneurial culture and create a supportive environment for SMEs.
- (16) To expand, improve and link up European infrastructure and complete priority cross-border projects.

Employment guidelines

- (17) Implement employment policies aimed at achieving full employment, improving quality and productivity at work, and strengthening social and territorial cohesion.
- (18) Promote a lifecycle approach to work.
- (19) Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job seekers, including disadvantaged people and the inactive.
- (20) Improve matching of labour market needs.
- (21) Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners.
- (22) Ensure employment-friendly labour cost developments and wage setting mechanisms.
- (23) Expand and improve investment in human capital.
- (24) Adapt education and training systems in response to new competence requirements.

Part 1

Council Recommendation on the Broad Economic Policy Guidelines (2008-2010)

COUNCIL RECOMMENDATION

on the broad guidelines for the economic policies of the Member States and the Community

Section A – Macroeconomic Policies for Growth and Jobs

A.1 Macroeconomic policies creating the conditions for more growth and jobs

Securing economic stability to raise employment and growth potential

Sound macroeconomic policies and structural reforms on product, labour and capital markets are essential to support a well balanced economic growth and the full realisation of growth potential. Monetary policies can contribute by pursuing price stability and, without prejudice to this objective, by supporting other general economic policies with regard to growth and employment. For new Member States, it will be important that monetary and exchange rate policies contribute towards achieving convergence. Exchange rate regimes constitute an important part of the overall economic and monetary policy framework and should be orientated towards achieving real and sustainable nominal convergence. Participation in ERM II, at an appropriate stage after accession, should help those endeavours.

Securing a sound budgetary position will allow the full and symmetric play of the automatic budgetary stabilisers over the cycle with a view to stabilising output around potential. For those Member States that have already achieved sound budgetary positions, the challenge is to retain that position. For the remaining Member States, it is vital to take all the necessary corrective measures to achieve their medium term budgetary objectives in particular if economic conditions improve, thus avoiding pro-cyclical policies and putting themselves in a position in which sufficient room for the full play of automatic stabilisers over the cycle is ensured prior to the next economic downturn. In particular, in accordance with the report on the SGP reform endorsed by the European Council on 22 March 2005, euro area and ERM II Member States that have not yet reached their medium-term budgetary objectives (MTOs) should achieve an annual adjustment in cyclically adjusted terms, net of one-offs and other temporary measures, of 0.5% of GDP as a benchmark.

For individual Member States the MTO's are differentiated according to the diversity of economic and budgetary positions and developments. In line with the 2005 SGP reform, the MTOs will be reviewed to better take into account the ageing-induced fiscal burden. Moreover, also in accordance with the 2005 reform, introducing or strengthening national fiscal rules and institutions, including monitoring mechanisms can usefully complement the Pact and support its objectives.

An additional macroeconomic policy challenge for some Member States is to operate in an environment of fast catching up, which is to varying degrees accompanied by external deficits, rapid credit expansion and financial deepening. Fiscal restraint, effective financial supervision and promoting competitiveness are essential in order to contain external and internal imbalances. A cautious fiscal stance is an important way to keep external deficits within the range where sound external financing can be secured. In addition to contributing to sound budgetary positions, fiscal restraint can also limit the risk of surging domestic demand causing persistently higher inflation and the occurrence of macro-financial risks which could cause swings in real exchange rates and a protracted loss of competitiveness. Structural reforms and appropriate co-ordination of policies play an essential role in helping economies to withstand possible adverse developments in the global economy.

Guideline 1. To secure economic stability for sustainable growth

1. In line with the Stability and Growth Pact, Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it. Member States should avoid pro-cyclical fiscal policies. Furthermore, it is necessary that those Member States having an excessive deficit take effective action in order to ensure a prompt correction of excessive deficits.
2. Member States posting current account deficits that risk being unsustainable should work towards correcting them by implementing structural reforms, boosting external competitiveness and, where appropriate, contributing to their correction via fiscal policies. See also integrated guideline 'To contribute to a dynamic and well-functioning EMU' (No.6).

To safeguard economic and fiscal sustainability as a basis for increased employment

Without changes in policies and behavioural changes more widely, Europe's ageing population poses risks to the long-term sustainability of the European Union economy from lower potential output growth per capita due to a reduction in the share of the working age population, and rising spending on pensions, social insurance, health and long-term care systems. If not addressed in a timely manner, these potential developments would lead to a substantial increase in the debt burden. As documented in the Commission's Sustainability Report, several Member States are exposed to high sustainability risk, and a number of others to medium risk.

Member States should address the economic implications of ageing, in line with the well established three pronged strategy for tackling the budgetary implications of ageing. This includes an appropriate combination of policies to achieve a satisfactory pace of debt reduction, including by attaining the MTOs, and to provide incentives to raise employment rates and labour supply, so as to offset the impact of future declines in the share of persons of working age, as well as reforms to pension and health care systems. It is also essential to modernise social protection systems so as to ensure that they are financially viable, provide incentives to the working age population to actively participate in the labour market, while at the same time supporting their goals in terms of access and adequacy. Improved interaction between social protection systems and labour markets can remove distortions and encourage the extension of working lives against a background of increased life expectancy. Health promotion policies, including preventive health care, could help to increase the share of life spent in good health and thus support the sustainability of health care systems.

Guideline 2. To safeguard economic and fiscal sustainability as a basis for increased employment

Member States should, in view of the projected costs of ageing populations,

1. undertake a satisfactory pace of government debt reduction to strengthen public finances;
2. reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible;
3. take measures to increase labour market participation and labour supply especially amongst women, young and older workers, and promote a lifecycle approach to work in order to increase hours worked in the economy.

See also integrated guideline ‘Promote a lifecycle approach to work’ (No.18, and 4, 19, 21).

Promote a growth and employment-orientated and efficient allocation of resources

Well-designed tax and expenditure systems that promote an efficient allocation of resources are a necessity for the public sector to make a full contribution towards growth and employment. This can be achieved by redirecting expenditure towards growth-enhancing categories such as Research and Development (R&D), physical infrastructure, environmentally friendly technologies, human capital and knowledge, without jeopardising the goals of economic stability and sustainability. Public resources have to be used in the most efficient and effective manner. Member States can help to control expenditure categories through adequate budgetary institutions and fiscal frameworks such as the use of expenditure rules and performance budgeting, which moves the focus away from spending towards actual achievements and by putting assessment mechanisms in place to ensure that individual reform measures and overall reform packages are well-designed. Key priorities for the EU economy are to ensure that tax structures and their interaction with benefit systems increase incentives to work and to invest, to promote higher growth through more employment and investment and to enhance the efficiency and effectiveness of expenditure in order to improve the quality of public finances.

Guideline 3. To promote a growth- and employment-orientated and efficient allocation of resources

Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives, and ensure the overall coherence of reform packages.

See also integrated guideline ‘To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth’ (No 11).

Ensure that wage developments contribute to growth and stability and complement structural reforms

Wage developments can contribute to stable macroeconomic conditions and an employment friendly policy mix. This requires that real wage increases are in line with the underlying rate of productivity growth over the medium term and consistent with a rate of profitability that allows for productivity, capacity and employment-enhancing investment. This requires that temporary factors such as variation in productivity caused by cyclical factors or one off rises in the headline rate of inflation do not cause an unsustainable trend in wage growth and that wage developments reflect local labour market conditions. In countries with declining market shares, wage moderation together with reforms boosting productivity are necessary so as to ensure that unit labour costs adjust in order to restore competitiveness. These issues need to be taken into account in the continued dialogue and information exchange between monetary and fiscal authorities and the social partners via the Macroeconomic Dialogue.

Guideline 4. To ensure that wage developments contribute to macroeconomic stability and growth and to increase adaptability, Member States should encourage the right framework conditions for wage-bargaining systems, while fully respecting the role of the social partners, with a view to promote nominal wage and labour cost developments consistent with price stability and the trend in productivity over the medium term, taking into account differences across skills and local labour market conditions.

See also integrated guideline ‘Ensure employment-friendly labour cost developments and wage-setting mechanisms’ (No 22).

Promote coherent macroeconomic, structural and employment policies

The role of sound macroeconomic policies is to provide conditions conducive to employment creation and growth. Structural reforms, consistent with sound fiscal positions in the short and medium term, are essential to increase productivity and employment in the medium-term, thus leading to the full realisation and strengthening of growth potential. They also contribute to fiscal sustainability, macroeconomic stability and resilience to shocks. At the same time, appropriate macro-economic policies are key for reaping the full growth and employment benefits of structural reforms. A key feature of Member States’ overall economic strategy is to ensure that they have a consistent set of structural policies that support the macroeconomic framework and vice versa. In particular, market reforms and investment in human capital need to improve the overall adaptability and adjustment capacity of economies in response to changes in both cyclical economic conditions and longer-term trends such as globalisation and technology. In this regard, reform of tax and benefit systems are important in order to make work pay and minimize disincentives for labour market participation.

Guideline 5. To promote greater coherence between macroeconomic, structural and employment policies

Member States should pursue labour and product markets reforms that at the same time increases the growth potential and support the macroeconomic framework by increasing flexibility, factor mobility and adjustment capacity in labour and product markets in response to globalisation, technological advances, demand shift, and cyclical changes. In particular, Member States should: renew impetus in tax and benefit reforms to improve incentives and to make work pay; increase adaptability of labour markets combining employment flexibility and security and improve employability by investing in human capital.

See also integrated guideline ‘Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners’ (No 21; No 19).

A.2 Ensuring a dynamic and well-functioning euro area

Since the creation of the euro area almost ten years ago four further countries joined the euro area. The euro has helped to embed economic stability in euro area countries, consequently providing euro area countries with favourable financing conditions and mitigating the effects of external exchange rate fluctuations. Subdued growth performance in some parts of the euro area and persistent divergences in growth and inflation between euro area countries raise questions as to whether internal adjustment in the euro area is working smoothly, suggesting that economic policies and governance structures may not yet have fully adjusted to draw the full benefit from the monetary union. Since euro-area countries can no longer make independent use of monetary or exchange rate policies, further structural reforms are key to foster smooth adjustment to economic shocks and regain competitiveness, thus firmly putting economic growth on a sustainable basis.

The policy mix in the euro area needs to support economic growth while safeguarding long-term sustainability and stability. At the current juncture, it is important that the policy mix underpins confidence among consumers and investors, which also implies commitment to medium-term stability. Budgetary policy has to ensure a fiscal position which can support price stability, and is consistent with the need to prepare for the impact of ageing populations on the one hand and to accomplish a composition of public expenditure and revenues that fosters economic growth on the other. In April 2007, the Eurogroup agreed that "taking advantage of the favourable cyclical conditions, most euro-area members would achieve their MTOs in 2008 or 2009 and all of them should aim for 2010 at the latest." Due to the high share of the public sector in economic activity in the euro area, the quality of public finances has a considerable influence on economic performance. It is also crucial that resources are spent in an efficient and effective manner, with a view to enhancing growth potential, and to minimise the distortions arising from the financing of public activity. Comprehensive structural reforms will allow the euro area to raise its growth potential over time and ensure that stronger growth does not build up potential for higher inflation. Reforms catering for more adaptable, inclusive and integrated labour markets, more competition on product markets and deeper financial market integration accompanied by growth and stability-oriented macroeconomic policies are particularly salient for euro area Member States as they have an important impact on their capacity to adequately adjust to shocks.

To contribute to international economic stability and better represent its economic interests, it is critical for the euro area to play its full role in international monetary and economic policy cooperation. While the appointment of a Eurogroup President for a two-year term of office as of 2005 has brought greater stability to the external representation of the euro area, the external representation of the euro area should be further improved in line with the existing agreements, so that the euro area can take a leading strategic role in the development of the global economic system that is commensurate with its economic weight.

Spill-over effects are most powerful and the need for a common agenda is strongest in the euro area. Sharing a common currency and a common monetary policy offers an extra dimension to coordination that could strengthen the role of the euro area in delivering growth and jobs for the whole EU.

Guideline 6. To contribute to a dynamic and well-functioning EMU, euro area Member States need to ensure better co-ordination of their economic and budgetary policies, in particular:

1. pay particular attention to fiscal sustainability of their public finances in full compliance with the Stability and Growth Pact;
2. contribute to a policy mix that supports economic recovery and is compatible with price stability, and thereby enhances confidence among business and consumers in the short run, while being compatible with long term sustainable growth;
3. press forward with structural reforms that will increase euro area long-term potential growth and will improve its productivity, competitiveness and economic adjustment to asymmetric shocks, paying particular attention to employment policies; and
4. ensure that the euro area's influence in the global economic system is commensurate with its economic weight.

Section B – Microeconomic reforms to raise Europe's growth potential

Structural reforms are essential to increase the EU's growth potential and support macroeconomic stability, because they increase the efficiency and adaptability of the European economy.

Productivity gains are fuelled by competition, human capital, investment, innovation. Raising Europe's growth potential requires making progress in both job creation and productivity growth. After lagging US productivity growth for more than a decade, productivity growth in the EU has accelerated since mid-2005, although productivity growth in several service sectors has stalled. Sustaining this improvement is a major challenge facing the Union, especially in the light of its ageing population. Population ageing alone is estimated to reduce by nearly half the current rate of potential growth. A continuation of the productivity upswing, better educated, skilled and motivated labour force and increasing the hours worked are thus indispensable to maintain and increase future living standards, and to ensure a high level of social protection. Moreover, greater cooperation between the different government levels will allow for more coherent, coordinated and effective policy making.

B.1 Knowledge and innovation — engines of sustainable growth

Knowledge accumulated through investment in R & D, innovation, education, skills and life long learning, is a key driver of long-run growth. Policies aimed at increasing investment in knowledge and strengthening the innovation capacity of the EU economy are at the heart of the Lisbon strategy for growth and employment. This is why national and regional programmes for the period 2007-2013 have been increasingly targeted on investments in these fields in accordance with the Lisbon objectives.

Increase and improve investment in R & D, with a view to establishing the European Knowledge Area

A high level of R&D is a crucial input to the innovative process and therefore makes an important contribution to our future competitiveness. R&D affects economic growth through various channels: first, it can contribute to the creation of new markets or production processes; second, it can lead to incremental improvements in already existing products and production processes; third, it increases the capacity of a country to absorb new technologies; and fourth, it promotes the innovative potential. In achieving sustainable growth, environmental technologies and eco-innovation play an important role.

The EU is currently spending about 1.85% of GDP on R&D (although ranging from below 0.5 % to nearly 4 % of GDP across Member States). The level of R&D spending compared to GDP has slightly decreased since 2000. Moreover, only around 55 % of research spending in the EU is financed by the business sector. Low levels of private R&D investments are identified as one of the main explanations for the EU/US innovation gap. More rapid progress towards establishing the European Research Area, including meeting the collective EU target of raising research investment to 3 % of GDP by 2010 is needed. Member States are invited to report on their R&D expenditure targets and the measures to achieve these in their National Reform programmes and the annual Implementation Reports paying attention in particular to integrating the European dimension within their national R&D policies. The main challenge is to put in place framework conditions, instruments and incentives for companies to invest more in research.

Public research expenditure must be made more effective and the links between public research and the private sector have to be improved. Poles and networks of excellence should be strengthened and modern research infrastructure developed in a co-ordinated way, better overall use should be made of public support mechanisms to boost private sector innovation, and a better leverage effect of public investments and a modernised management of research institutions and universities should be ensured. It is also essential to ensure that companies operate in a competitive environment since competition provides an important incentive to private spending on innovation. In addition, a determined effort must be made to increase the number and quality of researchers active in Europe, in particular by attracting more students into scientific, technical and engineering disciplines, enhancing the career development and reducing the barriers to international, European and intersectoral mobility of researchers, including the recruitment and re-integration of excellent expatriate and foreign researchers, and students. The European dimension of R & D should be strengthened in terms of joint financing, development of a critical mass of researchers and an optimal number of research infrastructures at the EU level in priority areas requiring large funds, and through reducing barriers to mobility of researchers, university teaching staff and students. To enhance the capacity of creating and adopting new knowledge, more efforts are required in improving and maintaining the quality of education, particularly of higher education.

Guideline 7. To increase and improve investment in R & D, in particular by private business, the overall objective for 2010 of 3 % of GDP is confirmed with an adequate split between private and public investment, Member States will define specific intermediate levels. Member States should further develop a mix of measures appropriate to foster R & D, in particular business R & D, through:

1. improved framework conditions and ensuring that companies operate in a sufficiently competitive and attractive environment;
2. more effective and efficient public expenditure on R & D and developing PPPs;
3. developing and strengthening centres of excellence of educational and research institutions in Member States, as well as creating new ones where appropriate, and improving the cooperation and transfer of technologies between public research institute and private enterprises;
4. developing and making better use of incentives to leverage private R & D;
5. modernising the management of research institutions and universities;
6. ensuring a sufficient supply of qualified researchers by attracting more students into scientific, technical and engineering disciplines and enhancing the career development and the European, international as well as inter-sectoral mobility of researchers and development personnel.

Facilitate innovation

The dynamism of the European economy is dependent on its capacity for creativity and innovation. The economic framework conditions for innovation need to be in place. This implies well-functioning financial and product markets as well as efficient and affordable means to enforce intellectual property rights. Innovations are often introduced to the market by new enterprises, which may meet particular difficulties in obtaining finance. Measures to encourage the creation and growth of innovative enterprises, including improving access to finance, should therefore enhance innovative activity. Technology diffusion, and policies to better integrate national innovation and education systems, can be fostered by the development of innovation poles and networks as well as by innovation support services targeted at SMEs. Knowledge transfer via researcher mobility, foreign direct investment (FDI) or imported technology is particularly beneficial for lagging countries and regions. It is also crucial to strengthen further the integration of the knowledge triangle of R&D, education and innovation. In particular, high quality education and training systems are among the prerequisites for excellence and innovation.

The EU's broad based innovation strategy therefore addresses intellectual property rights, standardisation, the use of public procurement to stimulate innovation, joint technology initiatives, boosting innovation in lead markets, cooperation between higher education, research and business including open source-type innovation, encouraging innovation in regions, innovation in services and non-technological innovation, and improving businesses' access to finance, especially to risk capital.

It is necessary for the EU to find solutions for a patent litigation system and a Community patent.

Guideline 8. To facilitate all forms of innovation, Member States should focus on:

1. improvements in innovation support services, in particular for dissemination and technology transfer;
2. the creation and development of innovation poles, networks and incubators bringing together universities, research institutions and enterprises, including at regional and local level, helping to bridge the technology gap between regions;
3. the encouragement of cross-border knowledge transfer, including from foreign direct investment;
4. encouraging public procurement of innovative products and services;
5. better access to domestic and international finance;
6. efficient and affordable means to enforce intellectual property rights.

The diffusion of information and communication technologies (ICT), in line with the objectives and actions of the i2010 initiative, is also an important way to improve productivity and, consequently, economic growth. The EU has been unable to reap the full benefits of the Information and communication technologies (ICT), due especially to the continuing under-investment in ICT, organisational innovation and digital skills. Wider and more effective use of ICT and the establishment of a seamless Single Market in electronic communication services will bolster the future competitiveness of European businesses. It is also important to reduce and prevent fragmentation of the 'e-Internal Market' by putting in place interoperable e-services between the Member States in all segments. Open ICT standards are useful as a basis for interoperability and innovation. Security of networks, the security and privacy of information, as well as convergence should also be ensured. Member States should encourage the deployment of broadband networks, including for the poorly served regions, in order to develop the knowledge economy and reduce regional disparities in terms of economic, social and cultural development, and foster growth and innovation in new services by promoting the deployment of very high speed broadband networks.

Guideline 9. To facilitate the spread and effective use of ICT and build a fully inclusive information society, Member States should:

1. encourage the widespread use of ICT in public services, SMEs and households ;
2. fix the necessary framework for the related changes in the organisation of work in the economy;
3. promote a strong European industrial presence in the key segments of ICT;
4. encourage the development of strong ICT and content industries, and well-functioning markets;
5. ensure the security of networks and information, as well as convergence and interoperability in order to establish an information area without frontiers;
6. encourage the deployment of broad band networks including for the poorly served regions, in order to develop the knowledge economy See also integrated guideline ‘Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners’ (No 21).

To strengthen the competitive advantages of the European industrial base

A strong industrial base is of key importance for Europe's economy. The competitiveness of the EU depends on the ability of the economy to reorient activities towards sectors with higher productivity. An approach where public policies are conducive to innovation, employment, and regional and other policies are well integrated, supports upgrading the EU industrial base. Furthermore, in order to enhance and sustain economic and technological leadership, Europe must increase its capacity to develop and market new technologies, including ICT and environmental technologies. The synergies from jointly addressing research, regulatory and financing challenges at the European level, where for reasons of scale or scope individual Member States cannot successfully tackle market failures in isolation, should be analysed and exploited. The EU has still not managed to fully realise its technological potential. European industrial policy should endeavour to create level playing field for business based on fair competition. The pooling of European excellence and the development of public-private partnerships and cooperation between Member States where the benefits for society are larger than those for the private sector will help tap this technological potential.

Guideline 10. To strengthen the competitive advantages of its industrial base, Europe needs a solid industrial fabric throughout its territory. The necessary pursuit of a modern and active industrial policy means strengthening the competitive advantages of the industrial base, including by contributing to attractive framework conditions for both manufacturing and services, while ensuring the complementarity of the action at national, transnational and European level. Member States should:

1. start by identify the added value and competitiveness factors in key industrial sectors, and addressing the challenges of globalisation
2. also focus on the development of new technologies and markets.
 - (a) This implies in particular commitment to promote new technological initiatives based on public private partnerships and cooperation between Member States, that help tackle genuine market failures.
 - (b) This also implies the creation and development of networks of regional or local clusters across the EU with greater involvement of SMEs.

See also integrated guideline ‘Improve matching of labour market needs’ (No 20).

Encourage the sustainable use of resources

Lasting success for the Union also depends on addressing a range of resource and environmental challenges which, if left unchecked or dealt with in a way which is not cost effective, will act as a brake on future growth. Recent developments have emphasised the importance of energy efficiency and reducing the vulnerability of the European economy to oil prices variations. An integrated approach to climate and energy policy is needed to increase the security of supply, ensure the competitiveness of the EU economy and the availability of affordable energy, and combat climate change. Member States and the Community must both contribute to achieving the EU targets of at least a 20 % reduction in greenhouse gas emissions, a 20 % share of renewable energies as well as a 20 % improvement in energy efficiency by 2020, as well as the preparation of a 30 % reduction in greenhouse gas emissions by 2020 as the EU’s contribution to a global and comprehensive

agreement for the period beyond 2012, provided that other developed countries commit themselves to comparable emission reductions and economically more advanced developing countries to contributing adequately. Policies should be developed to ensure the targets are met in the most economically efficient way and on a least cost basis. A key challenge will be to ensure that the transition to a low-carbon economy is handled in a way that is consistent with EU competitiveness, supports sound and sustainable management of public finances and that contributes to broader growth objectives consistent with the Lisbon Strategy for Growth and Jobs. It is of vital importance that Member States continue the fight against climate change in order that the global temperature increase does not exceed 2°C above pre-industrial levels, and implementing the Kyoto as well as the 2020 targets in a cost-effective way. Member States should halt the loss of biological diversity between now and 2010, and preserve ecosystem services, in particular by incorporating this requirement into other policies, given the importance of biodiversity for certain economic sectors. The development of an efficient and sustainable transport policy including by allowing an effective internalisation of external costs, is of crucial importance. The use of market-based instruments, so that prices better reflect environmental damage and social costs, plays a key role in this context, and it is important to let appropriate price signals play out fully. There should also be a strengthening of the EU emissions trading scheme. Promoting the development and use of environment-friendly technologies and eco-innovations, the greening of public procurement with particular attention to SMEs, and the removal of environmentally harmful subsidies alongside other policy instruments including taxation, environmental subsidies and charging can improve innovative performance and enhance the contribution to sustainable development. For example, EU companies are amongst the world leaders in developing new renewable energy technologies. In a context of continued upward pressure on energy prices, and accumulating threats to the climate, it is important to push energy efficiency improvements as a contribution to both growth and sustainable development.

Guideline 11. To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth, Member States should:

1. give priority to energy efficiency and co-generation, the development of sustainable, renewable, energies and the rapid spread of environmentally friendly and eco-efficient technologies, (a) inside the internal market on the one hand particularly in transport and energy, *inter alia* in order to reduce the vulnerability of the European economy to oil price variations, and (b) towards the rest of the world on the other hand as a sector with a considerable export potential;
2. promote the development of means of internalisation of external environmental costs and decoupling of economic growth from environmental degradations. The implementation of these priorities should be in line with existing Community legislation and with the actions and instruments proposed in the Environmental Technologies Action Plan (ETAP), *inter alia*, through, (a) the use of market based instruments, (b) risk funds and R & D funding, (c) the promotion of sustainable production and consumption patterns including the greening of public procurement, (d) paying particular attention to SMEs, and (e) a reform of subsidies that have considerable negative effects on the environment and are incompatible with sustainable development, with a view to eliminating them gradually;
3. pursue the objective of halting the loss of biological diversity between now and 2010, in particular by incorporating this requirement into other policies, given the importance of biodiversity for certain economic sectors;
4. continue to fight against climate change, while implementing the Kyoto targets in a cost-effective way, particularly in regard to SMEs.

See also integrated guideline ‘To promote a growth- and employment-orientated and efficient allocation of resources’ (No 3).

B.2 Making Europe a more attractive place to invest and work

The attractiveness of the European Union as an investment location depends, *inter alia*, on the size and openness of its markets, its regulatory environment, the quality of its labour force and its infrastructure.

Extend and deepen the internal market

Whilst the internal market for goods is relatively well integrated, services markets remain, legally or *de facto*, rather fragmented. The complete and timely implementation of the Services Directive will be a significant step towards a fully operational Internal Market for services. The elimination of all obstacles including through administrative burden reduction to cross-border activities will help unleash the untapped potential of the services sector in Europe. Improving the tax environment is important. The functioning of the Single Market may be improved through continuing efforts to tackle tax fraud, eliminate harmful tax competition and through strengthened cooperation on taxation between Member States and, where appropriate, at European level, while respecting national competences. Work in this area will continue, including addressing obstacles to the Internal Market. Finally, the full integration of financial markets by implementing the strategy set out in the White Paper on Financial Services 2005-2010 would raise output and employment by allowing more efficient allocation of capital and creating better conditions for business finance.

Member States have made progress in the transposition of internal market directives. Nevertheless further improvement should remain a priority in order to reap the benefits of a Single European market. Furthermore, directives are often not implemented or applied correctly, as illustrated by the high number of infringement proceedings launched by the Commission. Member States should exchange best practice with each other and cooperate with the Commission to ensure that they deliver the full benefits of internal market legislation to their citizens and businesses. For example, there is considerable scope for further improvements in public procurement practices. Such improvements would be reflected in an increase in the share of public procurement publicly advertised. Moreover, more open procurement would lead to significant budgetary savings for the Member States.

Guideline 12. To extend and deepen the internal market, Member States should:

1. speed up the transposition of internal market directives;
2. give priority to stricter and better enforcement of internal market legislation;
3. eliminate remaining obstacles to cross-border activity;
4. apply EU public procurement rules effectively;
5. promote a fully operational internal market of services, while preserving the European social model;
6. accelerate financial market integration by a consistent and coherent implementation and enforcement of the Financial Services Action Plan See also integrated guideline ‘To improve matching of labour market needs’ (No 20).

Ensure open and competitive markets inside and outside Europe

An open global trading system is of essential interest for the EU. As the world's leading trader and investor, our openness allows lower cost inputs for industry, lower prices for consumers, a competitive stimulus for business, and new investment. At the same time, it is important for the EU to use its influence in international negotiations to press for increasingly open markets which should lead to reciprocal benefits. Therefore the EU remains committed to further breaking down barriers to trade and investment, and it will stand firm against unfair practices in trade, investment and distorted competition. It is also important to work with our key trading partners to create a common space of compatible regulatory provisions and standards, including co-operation at international level to enhance the efficiency and stability of international financial markets.

Competition policy has played a key role in ensuring a level playing field for firms in the EU. It can also be beneficial to look at the wider regulatory framework around markets, in order to promote the conditions which allow firms to compete effectively, especially taking into account external aspects of competitiveness during the development and implementation of our own internal policies. A further opening of European markets to competition can be achieved by a reduction in the general level of remaining State aid. This movement must be accompanied by a redeployment of remaining State aid in favour of support for certain horizontal objectives. The review of State aid rules has facilitated this.

Structural reforms that ease market entry are particularly effective for enhancing competition. These will be particularly important in markets that were previously sheltered from competition because of anticompetitive behaviour, the existence of monopolies, over-regulation (for example permits, licences, minimum capital requirements, legal barriers, shop opening hours, regulated prices, etc. may hinder the development of an effective competitive environment), or because of trade protection.

In addition, the implementation of agreed measures to open up the network industries to competition (in the areas of electricity and gas, transport, telecommunications and postal services) should help ensure lower overall prices and greater choice whilst guaranteeing the delivery of services of general economic interest to all citizens. Competition and regulatory authorities should ensure competition in liberalised markets. The satisfactory delivery of high quality services of general economic interest at an affordable price must be guaranteed.

Empowered consumers who make informed choices will more quickly reward efficient operators. Further efforts are needed to improve the enforcement of consumer legislation which both empowers consumers and opens up the internal market to more intense competition at retail level.

External openness to trade and investment, by increasing both exports and imports, is an important spur to growth and employment and can reinforce structural reform. An open and strong system of global trade rules is of vital importance for the European economy. The successful completion of an ambitious and balanced agreement in the framework of the Doha-Round as well as the development of bilateral and regional free trade agreements, should further open up markets to trade and investment, thus contributing to raising potential growth. The EU stands ready to assist its trade and investment partners in fostering global standards and in particular to support capacity building in developing countries.

Guideline 13. To ensure open and competitive markets inside and outside Europe and to reap the benefits of globalisation, Member States should give priority to:

1. the removal of regulatory, trade and other barriers that unduly hinder competition;
2. a more effective enforcement of competition policy;
3. selective screening of markets and regulations by competition and regulatory authorities in order to identify and remove obstacles to competition and market entry;
4. a reduction in State aid that distorts competition;
5. in line with the Community Framework, a redeployment of aid in favour of support for certain horizontal objectives such as research, innovation and the optimisation of human capital and for well-identified market failures;
6. the promotion of external openness, also in a multilateral context;
7. full implementation of the agreed measures to open up the network industries to competition in order to ensure effective competition in European wide integrated markets. At the same time, the delivery, at affordable prices, of effective services of general economic interest has an important role to play in a competitive and dynamic economy.

Improve European and national regulation

Market regulation is essential to create an environment in which commercial transactions can take place at a competitive price. It also serves to correct market failures or to protect market participants. Nevertheless, the cumulative impact of legislation and regulation may impose substantial economic costs. It is therefore important that legislation is well-designed, proportionate and regularly reviewed. The quality of the European and national regulatory environments is a matter of joint commitment and shared responsibility at both the EU and Member State level.

The better regulation culture has begun to take root in the EU. In the Commission's approach to better regulation, the economic, social and environmental impacts of new or revised legislation are carefully assessed to identify the potential trade-offs and synergies between different policy objectives. Moreover, existing regulation is screened for simplification potential, including of administrative burdens, and its impact on competitiveness is assessed. Finally, the Commission has adopted an approach to measuring the administrative costs of new and existing EU legislation, and an ambitious target has been set to achieve a 25% reduction in the burden arising from EU legislation and its national transposition by 2012.

Member States should set equally ambitious national reduction targets within their spheres of competence. In order to decrease administrative burden, e-public services should be actively promoted and other ICT tools widely used by the Member States. More generally, Member States should adopt a comprehensive and explicit better regulation strategy, including appropriate institutional structures, monitoring tools and resources and involving appropriate stakeholders. Member States should systematically assess costs and benefits of legislative initiatives and revisions. They should improve the quality of regulation, while preserving their objectives, and simplify existing legislation. They should consult widely on the costs and benefits of regulatory initiatives; particularly where trade-offs between different policy objectives are implied. Member States should also ensure that appropriate alternatives to regulation are given full consideration. This is especially important for small and medium-sized enterprises (SMEs), which usually have only limited resources to deal with the regulatory requirements imposed by both Community and national legislation. Hence, special consideration should be given to whether SMEs could be exempted in total or in part from administrative requirements.

Guideline 14. *To create a more competitive business environment and encourage private initiative through better regulation*, Member States should:

1. reduce the administrative burden that bears upon enterprises, particularly on SMEs and startups;
2. improve the quality of existing and new regulations, while preserving their objectives, through a systematic and rigorous assessment of their economic, social (including health) and environmental impacts, while considering and making progress in measurement of the administrative burden associated with regulation, as well as the impact on competitiveness, including in relation to enforcement;
3. encourage enterprises in developing their corporate social responsibility.

Europe needs to foster its entrepreneurial drive more effectively and it needs more firms willing to embark on creative or innovative ventures. Policies should create a framework for innovative SMEs that have the potential for high added value and high growth. Learning about entrepreneurship through all forms of education and training should be supported and relevant skills provided. The entrepreneurship dimension should be integrated in the life long learning process from school. Partnerships with companies should be encouraged. The creation and growth of businesses can be encouraged by improving conditions for access to finance, more efficient financial intermediation, and strengthening economic incentives. This can include adapting tax systems to reward success, reducing non-wage labour costs and reducing the administrative burdens for start-ups, notably through the provision of relevant business support services (especially for young entrepreneurs) and setting up of single contact points. Particular emphasis should be put on facilitating the transfer of ownership including of family businesses, and improving rescue and restructuring proceedings in particular with more efficient bankruptcy laws. Member States should also promote the diffusion of ICT to SMEs in order to improve productivity and to foster exportation by fostering online administrative procedures. Due regard is needed to the particular barriers experienced by women entrepreneurs and to identify and develop support to increase the number of women entrepreneurs. The proposals which will be part of the upcoming 'Small Business Act' for the EU to be presented by the Commission, should be designed so as to ensure they contribute to unlocking the growth and jobs potential of SMEs.

Guideline 15. To promote a more entrepreneurial culture and create a supportive environment for SMEs, Member States should:

1. improve access to finance, in order to favour their creation and growth, in particular micro-loans and other forms of risk capital,;
2. strengthen economic incentives, including by simplifying tax systems and reducing non-wage labour costs;
3. strengthen the innovative potential of SMEs;
4. provide relevant support services, like the creation of one-stop contact points and the stimulation of national support networks for enterprises, in order to favour their creation and growth in line with Small firms' Charter. In addition, Member States should reinforce entrepreneurship education and training for SMEs. They should also facilitate the transfer of ownership, modernise where necessary their bankruptcy laws, and improve their rescue and restructuring proceedings.

See also integrated guidelines 'To promote a growth- and employment-orientated and efficient allocation of resources' (No 3) and 'To facilitate all forms of innovation' (No 8, Nos 23 and 24).

Expand and improve European infrastructure

Modern infrastructure (transport, energy and digital communication) is an important factor affecting the attractiveness of locations. It facilitates mobility of persons, goods and services throughout the Union. By reducing transport and communication costs and by widening markets, interconnected and interoperable trans-European networks help foster international trade and fuel internal market dynamics. Moreover, the ongoing liberalisation of European network industries fosters competition and drives efficiency gains in these sectors.

In terms of future investment in European infrastructure, the implementation of 30 priority transport projects identified by Parliament and Council in the trans-European network (TEN) transport guidelines, as well as the completion of the quick-start cross-border projects for transport, renewable energy and broadband communications and research (identified under the European Initiative for Growth) and the implementation of the other transport projects, supported by the Cohesion Fund should be a priority. Infrastructure bottlenecks within countries also need to be tackled. Appropriate infrastructure pricing systems can contribute to the efficient use of infrastructure and the development of a sustainable modal balance.

Guideline 16. *To expand, improve and link up European infrastructure and complete priority cross-border projects* with the particular aim of achieving a greater integration of national markets within the enlarged EU. Member States should:

1. develop adequate conditions for resource-efficient transport, energy and ICT infrastructures, in priority, those included in the TEN networks, by complementing Community mechanisms, notably including in cross-border sections and peripheral regions, as an essential condition to achieve a successful opening up of the network industries to competition;
2. consider the development of public-private partnerships;
3. consider the case for appropriate infrastructure pricing systems to ensure the efficient use of infrastructures and the development of a sustainable modal balance, emphasizing technology shift and innovation and taking due account of environmental costs and the impact on growth.

See also integrated guideline ‘To facilitate the spread and effective use of ICT and build a fully inclusive information society’ (No 9).