

Box 4

**THE 2005-2008 LISBON NATIONAL REFORM PROGRAMMES OF THE EURO AREA COUNTRIES**

The March 2005 European Council meeting relaunched the Lisbon strategy by focusing on growth and employment.<sup>1</sup> At the same time, in order to improve the implementation of structural reforms, a number of changes were made to the governance framework of the strategy.

<sup>1</sup> See the article entitled “The Lisbon strategy – five years on” in the July 2005 issue of the Monthly Bulletin.

Specifically, the European Commission put forward an Integrated Guidelines package, consisting of a new set of Broad Economic Policy Guidelines (BEPGs) and Employment Guidelines. The ECOFIN Council adopted the 2005-2008 Integrated Guidelines in July 2005.<sup>2</sup> The Integrated Guidelines will remain valid for three years, thus providing policy continuity for this period.

In response to the Integrated Guidelines, EU Member States submitted in autumn 2005 National Reform Programmes (NRPs), in consultation with key stakeholders in the implementation of the Lisbon strategy, such as national parliaments, regional and local authorities, and social partners.<sup>3</sup> The NRPs set out a comprehensive three-year strategy to implement the Integrated Guidelines at the national level. They present key country-specific challenges and an outline of policy initiatives and concrete measures in response to the challenges identified at the EU level. As part of the existing multilateral surveillance arrangements, the ECOFIN Council, assisted by the Economic Policy Committee of the EU, undertook a preliminary review of the NRPs.<sup>4</sup> In addition, the Commission will present its own assessment of the NRPs in the form of a first annual progress report on the Lisbon strategy in late January 2006.

This box provides an overview of the main structural measures decided or planned by the euro area countries in their NRPs for the period 2005-2008. The focus of the NRPs is on reforms aimed at achieving higher labour participation and employment growth, and at boosting labour productivity growth and competitiveness. To achieve this, the NRPs include measures to boost innovation, continue the completion of the EU internal market, create the right climate for entrepreneurs and ensure the long-term sustainability and quality of public finances.

With regard to labour market reforms, stimulating labour participation and employment is a core challenge for policy. It is essential to provide stronger incentives for people to stay in or enter the labour market and to increase the employment rate, in particular for women, the young and older workers. Therefore, the labour market measures in the NRPs target these groups as a matter of priority. Measures have been announced in some countries to develop childcare facilities in order to support an increase in the female employment rate. Measures aimed at raising older workers' employment rates mainly consist in increasing financial incentives to remain in the labour market (e.g. by providing the possibility to draw a pension and a salary at the same time), in limiting the possibilities for early retirement (e.g. by withdrawing tax incentives for early retirement schemes) or in adapting the incentive structure for companies to hire older workers by introducing a more flexible employment contract. Finally, measures aimed at reducing youth unemployment mainly include tax cuts at the lower end of the wage scale in order to reduce labour costs and/or measures to develop human capital by improving the educational and training system. By contrast, little or no action aimed at easing employment protection legislation or increasing wage flexibility has been taken in most euro area countries. These remain important issues that need to be addressed, especially with regard to the employment prospects for unskilled workers.

Turning to measures aimed at boosting labour productivity growth and competitiveness, most euro area countries have decided to significantly enhance investment in research and

2 See the box entitled "The Integrated Guidelines for Growth and Jobs 2005-2008" in the August 2005 issue of the Monthly Bulletin.

3 A parallel Community Lisbon Programme was adopted by the Commission in July 2005 to complement the NRPs with action to be taken at the European level.

4 See the ECOFIN Council conclusions of 6 December 2005 and the Economic Policy Committee's November 2005 "Report on the Lisbon National Reform Programmes 2005".

development. However, while specific actions to boost public R&D investment have been announced, measures aimed at increasing private R&D investment focus often on strengthening fiscal incentives. In addition, some countries intend to step up cooperation with the private sector to achieve this goal.

With regard to reforms aimed at increasing product market competition, the NRPs would have benefited from focusing more on concrete measures decided or envisaged. Even though progress has been recorded over the past few years, more still needs to be done in this field, particularly in the services sector, including network industries. In June 2005 nine euro area countries had not reached the EU target of reducing the transposition deficit for internal market directives to below 1.5%, with three of them being the worst performers of the 25 EU Member States in this respect.

With respect to measures on the fiscal side, the NRPs address two broad areas for structural reforms, namely: (i) the sustainability of public finances, especially in view of the ageing of the EU population; and (ii) the composition of public expenditure and the economic efficiency of taxation and public spending. In the area of fiscal sustainability, demographic ageing has been projected to have a pronounced effect on fiscal balances, in particular through its impact on public expenditure on pensions as well as health and long-term care. In light of such projections, several euro area countries have implemented pension reforms in the past few years with a view to making their public pension systems financially sustainable. In particular, the financial soundness of public pay-as-you-go pension systems has been strengthened, partly through measures to raise the effective retirement age and to tighten benefits. At the same time, the role of funded pension pillars has been increased. Intentions for future pension reforms tend to go in the same direction. Overall, however, it appears that more needs to be done to ensure the financial viability of public pension systems in several countries.

A number of programmes elaborate on ongoing or planned reforms to tackle ageing-induced fiscal pressures in public healthcare systems. While such reforms are generally targeted at addressing current inefficiencies, they would also contribute to preparing the systems for future challenges.

Some NRPs present concrete plans to raise the efficiency of taxation and public spending and to strengthen institutions of budget management and control. The design of tax-benefit systems represents a direct link between the need to ensure fiscal sustainability and the incentive structure for the entire economy, in particular in the area of labour supply and demand. Several programmes acknowledge the disincentive effects arising from high effective marginal tax rates due to the loss of social transfers for workers re-entering employment after a period of unemployment. In addition to lowering overall taxation on labour, some countries have implemented or envisage a reduction in the tax rates on low incomes to make work pay. Further measures in this regard consist in granting low-wage employees continued entitlement to some social benefits and introducing negative income taxes. Such efforts are targeted in particular at raising the work incentives for recipients of disability benefits.

Overall, the NRPs appear to demonstrate a stronger political commitment to the reform process in the context of the Lisbon strategy. All euro area governments acknowledge the need for further reforms and the benefits arising from implementing such reforms. However, despite

important progress in some areas, the NRPs would have benefited from focusing more on concrete measures to meet the identified challenges.

Looking ahead, it will be important to communicate, monitor and evaluate the implementation of the reform process effectively. It is likely that in some areas euro area countries will need to go beyond the reforms presented in their NRPs in order to meet the objectives of the Lisbon strategy by 2010. The submission of the updated NRPs in autumn 2006, which will include an assessment of the previous year's implementation efforts, should also provide the opportunity to review to a certain degree national strategies and commitments while maintaining policy continuity over the period 2005-2008.