

THE 2007 UPDATE OF THE INTEGRATED POLICY GUIDELINES FOR THE IMPLEMENTATION OF THE LISBON STRATEGY BY THE EURO AREA MEMBER STATES

In 2005, following the mid-term review of the Lisbon strategy, the EU Council of Ministers adopted a package of Integrated Guidelines for Growth and Jobs that brought together the Broad Economic Policy Guidelines and the Employment Guidelines, and that was addressed to the Member States and the Community, for a three-year period (2005-08).¹ In 2006 these Integrated Guidelines were updated slightly following the submission, for the first time in autumn 2005, of the Member States' National Reform Programmes (NRPs) and of the European Commission's Community Lisbon Programme.² In October 2006 Member States submitted updated NRPs, which were assessed by the Commission in its 2007 Annual Progress Report and by the Council, who also considered the Commission's updated Community Lisbon Programme. On the basis of this assessment, in March 2007, the European Council endorsed a second update of the Integrated Guidelines, which still needs to be formally adopted by the EU Council of Ministers.

The 2007 update of the Integrated Guidelines introduces country-specific guidelines for the first time since 2005. Moreover, it entails specific guidelines for euro area Member States, who are called upon to use the momentum of the current economic upturn to press ahead with vigour with the implementation of their budgetary consolidation and structural reform strategies. More precisely, recommendations mainly address the following key macroeconomic issues:

1) Aiming at ambitious budgetary consolidation

In 2006 government budget balances in most euro area countries improved significantly, mainly owing to buoyant tax revenues in the context of a favourable macroeconomic environment. In some countries, however, at least part of these higher than expected tax revenues were used to offset expenditure that was higher than initially planned, thus limiting the pace of deficit reduction. Looking ahead, it is essential that euro area countries with budgetary imbalances take full advantage of the current favourable economic conditions to accelerate the pace of fiscal consolidation and to achieve their medium-term budgetary objectives as soon as possible, and at the latest by 2010. This implies that windfall revenues in these countries should be allocated in full to the reduction of deficits and debt. The achievement of sound budgetary positions is necessary to create room for the operation of the automatic fiscal stabilisers without incurring excessive deficits and to contribute to ensuring the long-term sustainability of public finances in view of ageing populations.³

2) Improving the quality of public finances

In addition to maintaining an appropriate fiscal stance and ensuring the sustainability of public finances, fiscal policies can make an important contribution to economic growth and job creation by improving the quality of public expenditure and taxation. In this context, there is considerable scope in many euro area countries for redirecting public spending towards more productive uses

1 See the box entitled "The integrated guidelines for growth and jobs 2005-2008" in the August 2005 issue of the Monthly Bulletin.
 2 See the box entitled "The 2005-2008 Lisbon National Reform Programmes of the euro area countries" in the January 2006 issue of the Monthly Bulletin.
 3 For a discussion thereof, see the article entitled "Challenges to fiscal sustainability in the euro area" in the February 2007 issue of the Monthly Bulletin.

and for increasing the efficiency with which public services are offered. This would create scope for a reduction of high tax burdens and related distortions in the economy, which should also be tackled by appropriate reforms of tax systems. Such policies should help to stimulate investment and innovation, thereby raising productivity levels and potential growth.

3) Enhancing competition and market integration in the services sector

Reforms should aim to increase competition in order to improve the functioning of the internal market, especially in the case of services. Insufficient competition in the services sector is often referred to as one of the factors that hinders labour productivity growth and contributes to sharper price increases than in the manufacturing sector. Moreover, more competition in services could help to increase the flexibility of services prices⁴ and thereby facilitate euro area adjustment processes, including the reallocation of resources across sectors where necessary, and to increase the resilience of the euro area to economic shocks, thus making a smoother functioning of EMU possible. To this end, a timely transposition of the Services Directive into national law is called for. In the area of financial services, further efforts to remove remaining obstacles to the full integration of euro area financial markets are essential in view of their importance in the transmission of monetary policy and to overall economic activity and economic adjustments. Retail banking markets, in particular, continue to be less integrated, which is also reflected in the fragmented underlying financial infrastructure.⁵

4) Increasing labour market flexibility

A fully functioning euro area labour market is crucial to ensure prompt internal adjustment mechanisms in the euro area. Greater wage flexibility and a sufficient degree of wage differentiation that reflects productivity developments could allow euro area countries to adjust more smoothly to competitive pressures and to improve employment opportunities, especially those for less-skilled workers and in regions with high unemployment. With regard to reforms of labour market institutions, little progress has been made to reduce net replacement rates for the unemployed and employment protection on regular contracts. In addition, increasing the cross-border mobility of labour in the euro area would both allow a more efficient matching of workers' skills with job vacancies and promote the ability of national labour markets to adjust in the face of economic fluctuations and asymmetric shocks.⁶ Now that Slovenia has entered the euro area, its labour force needs to be granted full access to the labour markets of all euro area countries.

It is to be welcomed that the Council has decided to adopt country-specific guidelines in 2007 in order to focus the implementation and assessment of policies on the most pressing issues concerning each Member State. The recommendations generally point in the right direction, also within the context of the euro area. The implementation of these recommendations by the euro area countries further strengthens their ability to respond and adjust quickly to adverse shocks, allows for a smoother functioning of EMU and helps to fully reap the benefits of the Single Market.

4 See Task Force of the Monetary Policy Committee of the ESCB, "Competition, productivity and prices in the euro area services sector", ECB Occasional Paper No 44, April 2006.

5 See the ECB report entitled "Financial Integration in Europe", March 2007.

6 See F. F. Heinz and M. Ward-Warmedinger, "Cross-border labour mobility within an enlarged EU", ECB Occasional Paper No 52, October 2006.