112110/EU XXV.GP
Eingelangt am 18/07/16

Eurogroup
The President

Brussels, 15 July 2016
ecfin.cef.cpe(2016)4009868

To the members of the Eurogroup

Subject: Eurogroup of 11 July 2016

Dear Colleagues,

I would like to share with you the main content and course of our discussions at the Eurogroup meeting of 11 July 2016 in Brussels, to which we welcomed Rasa Budbergytė the newly appointed Lithuanian Minister of Finance. Our meeting was attended by Vice-President Valdis Dombrovskis, Commissioner Pierre Moscovici, ECB's Executive Board Member Benoit Coeuré, and ESM Managing Director Klaus Regling. We were also joined by Jeffrey Franks, Senior Resident Representative of the IMF to the European Union, for the discussions on Ireland and Portugal.

We were informed by Vice-President Dombrovskis and Commissioner Moscovici on the adjustments to their respective areas of responsibility following the resignation of Commissioner Hill.

1. Economic and financial situation in the euro area

We were informed by the institutions on economic and financial market developments since the UK referendum. The institutions highlighted the costs of prolonged uncertainty for economic activity and will be updating their forecasts in the coming months. As regards the policy response, the Commission highlighted the need to increase the resilience of the euro area banking sector, ensure the right policy mix and live up to the structural reform commitments.

2. Ireland – post-programme surveillance – 5th review

We were debriefed by the institutions on the main findings of the fifth Post-Programme Surveillance (PPS) mission to Ireland, which took place in the first half of June. We concurred with the assessment of the institutions that the Irish economy was performing remarkably well. We also noted that the result of the UK referendum was a source of risk to the Irish macroeconomic

outlook. We commended the Irish authorities for their excellent track record regarding public finances and stressed the need to avoid procyclicality. We welcomed the positive developments towards strengthening the resilience of the banking sector, acknowledging that further efforts remained to be made in this regard. The Irish Minister further informed us about the priorities of the new government.

3. Portugal – post-programme surveillance – 4th review

We were debriefed by the institutions on the main findings of the fourth Post-Programme Surveillance (PPS) mission to Portugal, which took place in the second half of June. We concurred with the assessment of the institutions that while repayment risks to the EFSF remain low, the risks to the macroeconomic outlook had increased since the last mission early February. We agreed with the concerns expressed by the institutions regarding financial sector issues, the fiscal strategy and some reversal of past structural reforms. Going forward, we called on the Portuguese government to pursue a clear and comprehensive strategy with a view to strengthening confidence in the Portuguese economy.

4. Euro area fiscal stance

The Commission presented its analysis on the euro area fiscal stance and stressed three key messages, namely that (i) the broadly neutral aggregate fiscal stance in 2017 is appropriate, (ii) the geographical distribution of the fiscal stance is sub-optimal and (iii) Member States should improve the quality of public finances, notably through further fiscal structural reforms that raise the efficiency of public spending and maintain the momentum of spending reviews. The importance of safeguarding both fiscal sustainability and competitiveness was mentioned in the discussion. There was general agreement that the broadly neutral euro area stance in 2017 strikes an appropriate balance between sustainability and stabilisation concerns, including in the aftermath of the UK referendum. The specific challenges faced in each country would need to be addressed in their forthcoming Draft Budgetary Plans. We stressed the need to continue with our efforts to make our budgets as growth friendly as possible to strengthen potential growth in the euro area. Finally, we invited the EWG to look at the case of early and late submissions of Draft Budgetary Plans and to report to us at our next meeting.

5. Stability and Growth Pact implementation for euro area countries

The Commission presented its recommendations to the Council under article 126.8 TFEU establishing that no effective action has been taken by Spain and Portugal to correct their excessive deficits. It also clarified the next steps under the SGP procedure. If the Council adopts the two decisions on lack of effective action the following day, only then the various steps of the sanctions procedures would be triggered. The Council legal service further clarified the applicable provision under the fiscal compact and notably the commitment by participating euro area Member States to support the recommendations submitted by the Commission when the latter considers that a Member State is in breach of the deficit criterion in the framework of the EDP, unless there is

a qualified majority against the Commission recommendation. This provision warranted a discussion in the Eurogroup before the formal Council adoption.

There was strong support for the Commission proposal. The Spanish and Portuguese Minister explained in detail why they did not agree with the Commission's assessment of no effective action having been taken. The importance of carefully calibrated communication, notably clarifying that at this stage our discussion was exclusively focused on the establishment of no effective action not on sanctions, and of a consistent and transparent enforcement of the SGP was also highlighted.

In the absence of a qualified majority of Member States against the Commission proposal, we confirmed our commitment to express unanimous support for the two Commission's recommendations, which I would convey to the Council the following day. We also agreed that we should continue swiftly with the next steps foreseen by the SGP to provide greater certainty.

6. Thematic discussion on growth and jobs – investment in the euro area

We exchanged views on investment in the euro area in the context of our thematic discussions on jobs and growth. The prioritisation of investment featured in the first and second 2015 euro area recommendations under the European Semester. The Commission presented the main findings of its analysis regarding barriers to investment in euro area Member States. We concurred that the euro area has a specific interest in addressing barriers to investment in order to support the rebalancing process. Several Ministers shared their own experiences with boosting investment. They stressed the importance of public and private investment for lifting growth prospects and raised concerns about the statistical treatment of Public Private Partnerships (PPP) and the constrained flexibility for investment under the existing EU fiscal framework. We concluded by asking the EWG to work further on three key areas of relevance to investment (i.e. the efficiency of public administration, the business environment and sector-specific regulatory bottlenecks) with a view to the elaboration of common principles and subsequently on possible benchmarking. We also asked the EWG to look further into the statistical treatment of PPP and the criteria of the investment clause in the SGP.

Yours sincerely,

Jeroen DIJSSELBLOEM

Ref. Ares(2016)3280080 - 08/07/2016

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 6 July 2016

THEMATIC DISCUSSION ON INVESTMENT IN THE EURO AREA

(Note to the Eurogroup)

EXECUTIVE SUMMARY

The European economy is in its fourth year of recovery but economic growth in the euro area is expected to remain modest, relying mainly on domestic consumption. The latest data suggest that the conditions for a pick-up in investment may be starting to have their long awaited impact on capital formation. The Investment Plan for Europe is also expected to yield increasingly tangible results. However, investment prospects are still held back by a range of factors, including weak global demand, the legacy of the crisis, high uncertainty and sluggish medium-term growth prospects. It is therefore important to mobilise all available policy instruments to support investment and, in particular, to tackle the related structural and regulatory rigidities.

At EU level, the Commission has launched intensive work as explained in the Communications 'Taking stock of the Investment Plan for Europe and next steps' and 'Delivering the Single Market Agenda for Jobs, Growth and Investment'. This work includes notably initiatives regarding the Single Market, in particular the Capital market Union (CMU), the simplification of EU funds, and actions in a number of areas with direct impact on investment . At the Member State level, the European Semester also places a particular emphasis on the identification of investment challenges and the related reforms.

The review of investment challenges carried out in the context of the European Semester shows that the most frequent barriers to investment in the euro area include inefficiencies in public administration, an unfavourable business environment, and high sector-specific administrative and regulatory burdens. However, barriers to investment vary across euro area countries. In some of them, barriers may also include a lack of transparency in public administration, a high level of taxation and overly complex taxation systems, product and labour markets distortions, weaknesses in research and innovation frameworks, and barriers to accessing finance, particularly for SMEs.

The review of actions taken so far to address investment challenges shows that progress across categories of barriers and across countries has been uneven and that more needs to done. Three groups of countries can be distinguished. The euro area countries heavily hit by the crisis appear to have been overall the most active in addressing barriers to investment in 2015. In the euro area cohesion countries, actions have been taken to address barriers to investment, in particular in the area of 'Public Administration/ Business Environment'. Finally, other euro area countries, actions have been more limited notably in the areas of 'Public Administration/ Business Environment' and 'Sector-specific Regulation, which represent the main categories of barriers to investment in that group.

Reflecting the increasing importance of the third pillar in the euro area policy strategy, the number of investment related recommendations has increased in the Member States' CSRs proposed in 2016. These CSRs take into account the progress made at country level as well as the current obstacles to investment in each Member State.

Overall, the assessment presented in this note shows that further reforms efforts are needed to tackle investment barriers in the euro area Member States. Speeding up the adoption and implementation of national reforms is crucial to improve the investment environment and complementary with other EU policy initiatives. These reforms would also help the ongoing process of rebalancing within the euro area particularly if joint action by all Member States allows magnifying the benefits of related growth spillovers.

INTRODUCTION

The Investment Plan for Europe, adopted by the Commission in November 2014, is a comprehensive strategy to foster investment and improve the business environment in Europe, thereby contributing to growth and jobs. It is composed of three mutually reinforcing pillars: (i) mobilising finance for investments through the European Fund for Strategic Investments (EFSI); (ii) increasing technical assistance for project promoters and transparency of investment opportunities through the establishment of the European Investment Advisory Hub and the European Investment Project Portal; and (iii) improving the framework conditions for investment and tackling regulatory and non-regulatory barriers to investment.

The objectives of the Plan are to reverse the negative trends in investment without adding to public debt, to support investment that meets the long-term needs of the economy, and to strengthen Europe's productive capacity and infrastructure. While the initiatives under the first and second pillars (EFSI, advisory hub, and project portal) are expected to yield increasingly tangible results, as a growing number of projects move to the implementation phase, further action is needed to continue advancing on the third pillar of the Investment Plan for Europe. The third pillar of the Plan involves actions by both the EU and Member States to unlock the full potential of investment in Europe by providing greater regulatory predictability, removing bottlenecks to investment, and further reinforcing the Single Market.

At EU level, the Commission has launched intensive work across all relevant areas of EU competence, as mentioned in the Communication 'Taking stock of the Investment Plan for Europe and next steps'[1] and the Communication 'Delivering the Single Market Agenda for Jobs, Growth and Investment'[2]; such as initiatives to develop the Capital market Union (e.g. lowering capital charges under Solvency II) and a better use of EU funds (e.g. combination of ESI funds) as well as other actions in a number of areas with direct impact on investment decisions in Europe. The European Semester has also placed a particular emphasis on the identification of investment challenges and priority reforms to address them; both are well reflected in the Country Specific Recommendations for 27 Member States for 2016 proposed by the Commission last May and approved by the Economic and Financial Affairs Council on 17 June.

This note focuses on the national dimension and is part of the broader work on the third pillar of the Investment Plan for Europe. It discusses regulatory rigidities and bottlenecks to investment in the euro area countries and how these challenges are being addressed in the context of reforms at both the national and the EU level. The note is a contribution to the reflections that will be held in the Eurogroup and its committees in view of their roles in promoting the initiatives underlying the third pillar of the Investment Plan at the EU level and in the Member States. The ECOFIN *filière* also plays a prominent role in the third pillar and

[1] Communication 'Taking stock of the Investment Plan for Europe and next steps', COM(2016) 359 final, 1 June 2016.

[2] Communication 'Delivering the Single Market Agenda for Jobs, Growth and Investment', COM(2016) 361 final, 1 June 2016.

important work is taking place in its committees (EPC/EFC) to analyse barriers to investment and the reforms to address them, including in infrastructure and in intangibles.

Section 1 presents the general economic background for investment and the constraints acting on the demand side and the supply side. Section 2 presents an attempt to distinguish three groups of countries in the euro area,[3] based on macroeconomic features and the main trends in investment – with a distinction between private and public investment, and between investment components – in the euro area. Section 3 maps out the main investment challenges defined in broad categories[4] and by groups of countries. Section 4 discusses the role of removing barriers to investment in the context of rebalancing within the euro area. Finally, Section 5 focuses on national reforms and presents an overview of the 2016 country-specific recommendations (CSRs) addressing investment challenges and their role, together with EU policies, in unlocking investment in the euro area.

SECTION 1- INVESTMENT CHALLENGES IN A MACROECONOMIC PERSPECTIVE

The main motivation for tackling bottlenecks to investment is that raising investment is key to improving the EU's growth potential. Investment increases the productive capacity of the economy by boosting labour productivity. Removing obstacles to investment also raises the effectiveness of other macroeconomic and structural policies, for example expansionary monetary policies.

Although investment has recently picked up in the euro area, investment-to-GDP ratios are still low. The investment/ GDP ratio declined between 2008 and 2013 and has picked up moderately since 2014. In the crisis years, the drop in investment was the main cause of the decline in domestic demand. Residential construction can explain part of the decline but other components of total investment fell as well; the exception was investment in intangibles (proxied by "other investment"), which proved quite resilient. Moreover, while some countries were more resilient in the face of the global and euro area crises, others saw a steeper decline of investment (see Annex 1). Due to persistent factors hampering investment, investment ratios in 2015 in euro area crisis-hit countries (Italy, Spain, Portugal, Greece, Ireland and Cyprus) were still markedly below the 2000-2008 average, by a margin ranging from 12.5% in Greece to 4.4% in Ireland. In the rest of the euro area, the only countries where investment ratios in 2015 were higher than in 2000-2008 were Belgium and Malta. For the euro area as a whole the ratio was still 2.6% below its pre-crisis average.

It is hard to define an 'optimal' level of investment in an economy. Comparisons between countries can be misleading and historical values for investment do not necessarily represent the optimal state. Nevertheless, several studies have identified an investment gap in the euro

---

[3] The three groups of countries are (i) the euro area countries heavily hit by the crisis, (ii) the euro area cohesion countries, and (iii) the remaining 'core' euro area countries.

[4] These categories are 1) Public Administration/Business Environment; 2) Labour Market/Education, 3) Financial Sector/ Taxation; 4) Research, Development and Innovation; and 5) Sector-specific Regulation.

area.[5] A number of factors can explain the persistent weakness of investment in the euro area. Sluggish economic growth has had a dampening effect on investment via the accelerator channel. This accelerator effect has been compounded by the need for deleveraging in the private and the public sector in countries with high stocks of debt. In addition, in some countries, the share of non-performing loans is still high; risk aversion has increased; and high economic and policy uncertainty continue to weigh on investment demand.[6]

Regulatory bottlenecks and rigidities hamper investment. While these structural factors do not explain the decline in public investment *per se*, barriers to entry, activity, and exit, reduce the incentive of firms to invest and hamper resource reallocation. Similarly, inefficiencies in public administration potentially weigh on the absorption of EU funds.

Although investment has picked up moderately recently, prospects are still uncertain. Investment grew in the first quarter of 2016: the favourable conditions for a pick-up in investment may thus be starting to have their impact. However, investment in the near term is still held back by expectations of weak global demand and increased uncertainty.

SECTION 2 — INVESTMENT TRENDS IN THE EURO AREA COUNTRIES

Macroeconomic features, in particular investment levels and trends, indebtedness and the potential for catching-up, point to a distinction of three groups of countries in the euro area. However, there is still a great diversity across countries, even within these groups.

(i) Euro area countries heavily hit by the crisis

For most of the euro area countries heavily hit by the crisis (Cyprus, Greece, Spain, Portugal, Ireland, Italy) both private and public investment have fallen significantly in the wake of the crisis (see graphs in Annex 1). The weakness of investment partly reflects a necessary process of correction to excessive capital accumulation in some sectors in pre-crisis years. But, even when taking into account the necessary adjustment, investment levels appear currently low. Despite a recovery in investment in most countries in this group, limited fiscal space, debt overhang in the non-financial corporate sector and problems of access to credit (e.g. a high share of non-performing loans on bank balance sheets) will continue to weigh on investment for some time. Deleveraging is ongoing but the legacy of high indebtedness is proving difficult to reverse in a low-growth, low-inflation environment, and while public debt remains high.[7] This concerns Cyprus, Ireland, Portugal and Spain for both corporate and household debt, and Greece and Italy for corporate debt. Furthermore, investment rates could remain low

---

[5] An investment gap implies an investment rate below the 'equilibrium' one. See Lewis, C., N. Pain and J. Strasky (2014) 'Investment Gaps after the Crisis' OECD Economics Department Working Papers No 1168. And Baldi, G., Fichtner, F., Michelsen, C. and Rieth, M. (2014), 'Weak Investment Dampens Europe's Growth', DIW Economic Bulletin, No 7, pp. 8-21.

[6] For instance, an investment gap of 2% of euro area GDP was estimated in Baldi, G., Fichtner, F., Michelsen, C. and Rieth, M. (2014), 'Weak Investment Dampens Europe's Growth', DIW Economic Bulletin, No 7, pp. 8-21.

[7] Cuerpo C., Drumond I., Lendvai J., Pontuch P., and Raciborski R. (2013), 'Indebtedness, Deleveraging Dynamics and Macroeconomic Adjustment', European Commission, Economic Papers 477, April 2013. This paper aims in particular to identify the EU Member States that are currently facing deleveraging pressures in the non-financial private sector.

due to expectations that demand will remain weak. Equipment investment has rebounded over the last few years in Spain, as well as in Portugal, Greece and Cyprus, and to a more limited extent in Italy. In Ireland, investment in 'other' construction (which includes infrastructure) and in intangibles has rebounded and is expected to increase further. 'Other' construction is expected to remain quite flat in the other countries, except Cyprus.

(ii) Euro area cohesion countries

The euro area cohesion countries (Estonia, Lithuania, Latvia, Malta, Slovenia and Slovakia) show a number of similarities with the countries of the first group. Some of them have also been severely hit by the crisis, with housing booms and busts (e.g. Estonia and Latvia), and competitiveness losses due to rising ULCs. Private investment has also slowed down since the crisis. However, some key patterns differ from those of the first group (see graphs in Annex 1). For most of the euro area cohesion countries, the decrease in private investment, although still significant, was milder than in other euro area countries hit by the crisis. Public investment has been much more resilient, owing to the supportive role of EU funds. In addition, both private and public indebtedness remain significantly lower than in the first group, which means that deleveraging pressures are likely to weigh less on investment. At the same time, according to the Commission’s 2016 spring forecast, the recovery of investment may be subdued in a number of countries of this group over the next few years. Construction investment is expected to remain flat. The recovery in investment is necessary to address infrastructure needs and to increase R&D and innovation. It depends, among other things, on foreign direct investments, which have decreased in the wake of the crisis but remain crucial for the continuation of the catching-up process.

(iii) The other euro area countries

The remaining group includes mainly core-euro area countries (Austria, Belgium, Germany, Finland, France, Luxembourg and the Netherlands). In these euro area countries, both private and public investment has proven relatively more resilient to the crisis. There are, however, different patterns across countries in terms of the level and composition of investment. For instance, public investment was relatively low even before the crisis in a number of countries, such as Germany and Belgium. Within this group, euro area countries with persistent current account surpluses (Germany, the Netherlands, Austria and Luxembourg) tend to have lower investment rates than the euro area average. In some of them, high corporate savings are not reflected in high investment. In other countries (e.g. Belgium, France and Finland), investment has been increasingly oriented towards the services sector and has decreased in manufacturing since the 2000s. Focusing on the composition of investment (see graphs in Annex 1), since the beginning of the 2000s, the decreasing trend in equipment investment (except in the Netherlands and Luxembourg) has been partly compensated by an increasing trend in ‘other’ investment (except in Luxembourg and Finland). This reflects in part the increasing importance of intangibles in more advanced economies, although it still represents a smaller share of the total.

SECTION 3- A MAPPING OF INVESTMENT CHALLENGES IN THE EURO AREA COUNTRIES

A key priority at the current juncture is to implement the necessary structural reforms that promote investment as an engine of productivity growth and a source of productive jobs. While the euro area overall has a comparatively favourable, stable and predictable regulatory framework, the systematic assessment of the framework conditions for investment carried out in the context of the European Semester shows considerable differences among Member States and across the sub-domains of the framework. For many euro area countries structural reforms are central to higher long-run growth. They also contribute to improving the adjustment capacity of the economy. It is particularly important for euro area countries to increase their ability to adjust to asymmetric shocks.

At national level, the identification of the main barriers to investment and priority actions to remove them is an important part of the 2016 European Semester.[8] In order to get an overview at national level (see overview table in the Annex 2), a mapping of potential challenges to investment into five broad categories has first been carried out, using the information collected in the Country Reports, then a selection of main challenges has been proposed, based on existing knowledge and further analysis. For the areas where indicators are available, they have been used as a complementary source of information (e.g. World Bank Doing Business indicators, OECD Product Market Regulation indicators, Innovation Union Scoreboard, EU Justice Scoreboard). These five broad categories (with sub-divisions into main topics and main types of challenges) include: 1) Public Administration/Business Environment; 2) Labour Market/Education, 3) Financial Sector/Taxation; 4) Research, Development and Innovation; and 5) Sector-specific Regulation (in business services/regulated professions, retail, construction, digital economy/telecommunications, energy and transport). They are used in the note to describe the main investment challenges in the three groups of countries described in section 2.

(i) Euro area countries heavily hit by the crisis

The main challenges to investment are linked to the legacy of private and public debt and the need to reallocate resources to the tradable sector, including through further labour market reforms such as the wage setting mechanism, the framework for labour contracts and active labour market policies. The challenges identified often encompass difficulties in accessing finance, which in some countries is associated with weak insolvency frameworks (see table in Annex 2), a lack of alternative sources of finance. Other issues include the functioning of labour markets and, in all countries of the group except Ireland, high administrative and regulatory burden (including an overly complex tax system), or the unpredictability of regulation. In addition, competitiveness gains need to be further strengthened through productivity-enhancing reforms.

[8] In November 2015, the Commission presented together with the 2016 Annual Growth Survey, a document identifying key challenges and regulatory barriers to investment in each Member State. Commission Staff Working Document (2015) 'Member States Investment Challenges', SWD(2015)400.

(ii) Euro area cohesion countries

The main bottlenecks to investment often relate to the unpredictability, complexity, and heavy burden of regulatory frameworks, a lack of transparency in public administration, an inefficient judicial system, and often, difficulties in accessing finance (see table in Annex 2). In particular, reforms to improve the business environment and the management of EU funds would help to overcome investment challenges, by raising the absorption capacity of EU funds and enhancing their attractiveness for FDI. In addition, education and innovation systems need reforms. Cooperation between academia, research and business needs to be improved in order to generate the skills and knowledge required for the catching-up process to continue. Inadequate access to credit or to alternative sources of finance for innovative activities represents a challenge for the development of higher value added activities. Finally, sector-specific barriers to investment are also present, particularly in the construction and energy sectors.

(iii) The other euro area countries

Countries in this group generally face fewer barriers to investment than those in the other groups. Some horizontal barriers such as public administration and the business environment are less marked than for the other groups of countries. The main obstacles to investment currently include sector-specific regulatory challenges, particularly in retail, construction, business services and regulated professions (see table in Annex 2). While the adoption of reforms in services could help boost investment in those sectors and improve the purchasing power of consumers, they could also indirectly enhance competitiveness in the manufacturing sector through lower prices or higher productivity in services used as inputs. In these countries, challenges to investment are mainly sector specific but also include some aspects of labour market/education, notably wage-setting mechanisms, as well as complex taxation systems and high levels of taxation (e.g. Belgium, France). Weaknesses in R&D financing, including inefficient public funding and a lack of development of alternative sources of finance, are therefore prominent barriers to investment in some of these countries (Germany, the Netherlands and France).

SECTION 4- INVESTMENT BARRIERS AND REBALANCING WITHIN THE EURO AREA

Adjustment of external imbalances is taking place but remains incomplete and asymmetric

On the one hand, in euro area countries with high external liabilities — notably those most hit by the crisis — the large and unsustainable current account deficits of the pre-crisis period have been eliminated. However, most of these countries continue to display very negative net international investment positions, sometimes more negative than in 2008. External positions which are balanced or in surplus in the medium and long run, as well as positive GDP growth, would need to be sustained in order to significantly reduce remaining external vulnerabilities. On the other hand, countries with persistent current account surpluses, such as Germany and the Netherlands, have further increased their already large surpluses and these are expected to remain large over the next two years according to the 2016 spring forecast.

Removing barriers to investment could help reduce external imbalances within the euro area

In the Council Recommendation on the economic policy of the euro area[9], the remaining weakness of investment is stressed. It is recommended that Member States take action to remove barriers to investment, such as an unfavourable business environment, inadequate insolvency regimes, public administration inefficiencies as well as obstacles to access to finance. Reforms to improve the framework conditions for investment can influence the saving and investment behaviour of households, firms and governments, thereby affecting the current account balance and net international investment positions. If they boost growth, they can also reduce the relative size of the imbalances (in terms of GDP) and their associated risks. The direction of the impact of such reforms on the current account is ambiguous, both from a theoretical point of view and an empirical one.[10] A number of reforms have a negative impact on the current account position, at least in the short run, as they help raise investment but not, or to a lesser extent, savings. However, some reforms to boost investment can have positive impacts on the current account in the longer run through their impact on productivity growth and on GDP growth.

In the short run, surplus countries may have more scope for structural reforms that would both enhance economic growth and reduce external imbalances. In particular, reforming competition-unfriendly product market regulations could encourage capital spending and thereby help to reduce surpluses in the short run (although the effect in the long run may be to increase the surplus depending on the effect on competitiveness)[11].

In countries with high external liabilities, some policies may also help to boost growth and reduce imbalances in the short run, but there is less scope here. For instance, some policy settings, such as tax deductibility of interest payments on mortgages, introduce distortions that encourage household demand. Reform in this area could increase household saving thus improving a country's current account position.[12]

Most reforms that boost investment may have a negative effect on the current account in the short run. However, in the medium-run, ongoing rebalancing processes in countries with large external liabilities could benefit from such reforms. In fact, although the external imbalances

---

[9] 2016: Council Recommendation on the economic policy of the euro area, European Council February 2016.

[10] See, for example: OECD (2011), 'The Impact of Structural Reforms on Current Account Imbalances', OECD Economics Department Policy Notes, No 3; Jaumotte, F. and P. Sodsriwiboon (2010), 'Current account imbalances in the southern euro area', IMF Working paper, No. WP/10/139; Kerdrain, C., I. Koske and I. Wanner (2010), 'The Impact of Structural Policies on Saving, Investment and Current Accounts', OECD Economics Department Working Papers, No 815.

[11] Boosting domestic demand may increase export opportunities in other countries, and associated wages rises can improve the cost competitiveness of the other countries. For instance, in DG ECFIN (2016) QUEST simulations of spillovers of a public investment stimulus in surplus countries, Internal note for LIME, June 2016 estimates suggest that an increase in public investment of 1% of GDP in Germany and the Netherlands would result, for other euro area countries, in an increase in GDP 0.3%, and a small improvement in the ratio of current account to GDP, about 0.05%..

[12] OECD 2011, 'The Impact of Structural Reforms on Current Account Imbalances', OECD Economics Department Policy Notes, No 3.

in these countries have been improving, there is a need to make these improvements more sustainable by lifting the growth path. This would facilitate the reduction of debt to GDP ratios (both public and private) and help address high internal imbalances, notably in the form of high unemployment, that have partly replaced the external imbalances. Reforms to improve the investment climate can contribute to the sustainability of the rebalancing process in countries with large external liabilities by boosting growth and productivity in the medium to long run.

Finally, the removal of barriers to investment in countries with external surpluses and in countries with high external debt would also facilitate the ongoing rebalancing process. Reforms tend to have positive cross-border spillovers via the trade channel and negative cross border spillovers via the competitiveness channel. However, simulations carried out with the European Commission's QUEST model suggest that the trade channel is usually stronger than the competitiveness channel, so that all Member States benefit from somewhat faster short- to medium-term growth when reforms take place at the same time[13] [14].

SECTION 5- ADDRESSING INVESTMENT CHALLENGES AND THE EUROPEAN SEMESTER

Structural reforms by the Member States to address national barriers to investment have to be considered as complementary to the initiatives at EU level to improve framework conditions, remove regulatory and non-regulatory barriers to investment and further deepen the Single Market, notably in the context of the third pillar of the Investment Plan. Actions to address national barriers to investment have to focus on weaknesses in the business environment and bottlenecks that have their origin in national regulations and that can affect business efficiency and hamper investment. Member States can benefit from the technical assistance provided by the 'Structural Reform Support Service' to assist them in implementing growth-enhancing administrative and structural reforms. The role of the SRSS will be focused on supporting reforms through EU funds and technical assistance.

A first stocktaking exercise[15] *of the actions taken so far at national level to address investment challenges*

The stocktaking exercise, carried out on the basis of the information available in the 2016 country reports (notably in the box on investment challenges), tracked all the investment challenges (covered by a 2015 country-specific recommendation or not) and distinguished the ones for which action had been taken. This exercise confirmed that progress in tackling barriers varies across categories. The two areas with the lowest rate of policy response are

[13] Varga, J., In't Veld, J. (2014), 'The potential growth impact of structural reforms in the EU — A benchmarking exercise', European Commission, European Economy Economic Paper 541, December 2014.

[14] D'Auria, F., Linden, S., Monteiro, D., in 't Veld, J., Zeugner, S. (2014) 'Cross-border spillovers in the euro area', European Commission, Quarterly Report on the Euro Area vol. 13 no. 4.

[15] This first stocktaking exercise was discussed in the EPC meeting on 23 February 2016. It is based on the number of CSRs and whether action has been taken by the Member State or not. The usual caveat applies in this regard as CSRs are not all equally important, both within each country and across countries. The more detailed information provided in the country reports is therefore important to complement the assessment.

those which generate most of the bottlenecks: 'Public Administration/Business Environment' and 'Sector-specific Regulations'. The 2016 country reports confirmed that priority actions should focus on these domains.

Moreover, progress also differs by country. Euro area countries heavily hit by the crisis were the most active in addressing barriers to investment in 2015, which shows that they continued to adopt and implement reforms that year. In the euro area cohesion countries,[16] actions were taken to address barriers, particularly in the area of 'Public Administration/ Business Environment', while in the areas of 'Sector-specific Regulation' and 'Research, Development and Innovation' there was only limited or no action to address barriers. Finally, in the group of the other euro area countries (including most of the surplus countries), some actions have generally been taken to address barriers to investment but actions have been more limited in the areas of 'Public Administration/ Business Environment' and 'Sector-specific Regulation'.

Investment challenges are well reflected in the 2016 country-specific Recommendations

The country-specific Recommendations (CSRs) proposed by the Commission in May 2016 cover a more significant part of investment challenges than in 2015 (see overview table in Annex 2).

Looking at the **main categories of investment challenges** and the CSRs issued in the 2016 exercise of the European Semester, the number of recommendations related to investment challenges has increased. This is reflecting the increasing importance of the third pillar in the euro area policy strategy. The highest number of CSRs related to an investment challenge is still in the areas of 'Public Administration/Business Environment' and 'Sector-specific Regulation,' while the number is significantly lower in the areas of 'Access to Finance/Taxation' and 'Labour Market/ Education'. This can be partly explained by the lack of progress made in addressing the first two investment barriers while more significant advances have been registered in the area of 'Labour Market/ Education' and access to finance in a number of countries. The CSRs now include a significant number of recommendations in the area of 'Research, Development and Innovation' show that the medium term productivity performance has become a new priority for many countries.

Concerning the investment related CSRs **per groups of countries** (see Annex 3), CSRs recommendations in the areas of 'Public Administration/Business Environment' and 'Access to finance' (related to significant non-performing loans which still weigh on the ability of banks to finance the economy), appear to be more frequent in the euro area countries heavily hit by the crisis, partly reflecting the need to address the crisis legacy in these countries. By contrast, CSRs related to an investment challenge in the area 'Sector-specific Regulation' (potentially hampering investment in services and in infrastructure) are more frequent in the euro area core countries. In addition, CSRs related to an investment challenge in the area

[16] It can also be stressed that the fulfilment of the ex-ante conditionality to ensure the effective use of EU funds should also help cohesion countries to put in place a framework conducive to investment. Ex-ante conditionality in the field of transport, public administration or research for example, is expected to improve the conditions for investment in these areas. More specifically, Member States have until the end of 2016 to fulfil these conditions and it is important that they continue the efforts made until now.

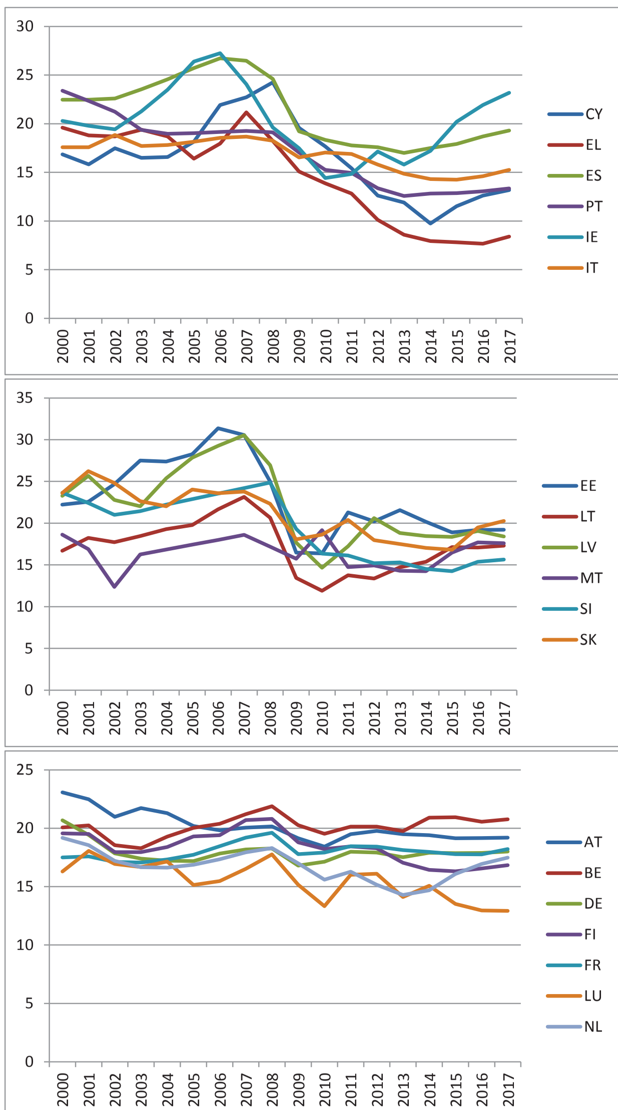
‘Labour Market/Education’ are more frequent in the euro area core countries having a competitiveness issue. Finally, CSRs related to an investment challenge in the area ‘Research, Development and Innovation’ are present in all groups of countries in 2016, including in some euro area cohesion countries. This shows the pervasiveness of medium- to long-terms growth challenges across most euro area Member States.

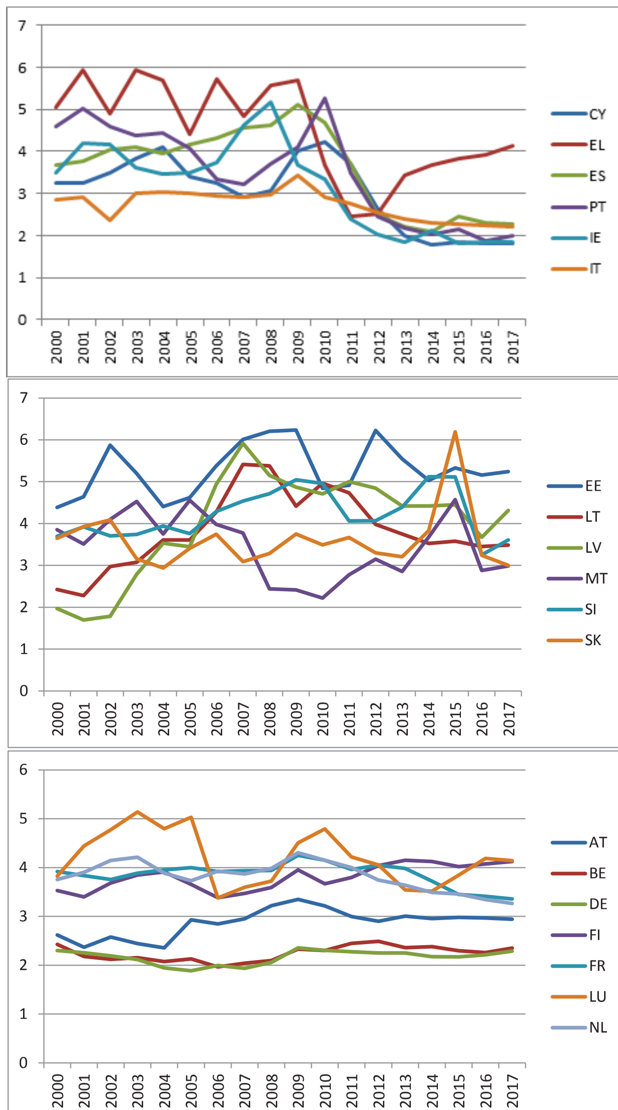
ISSUES FOR DISCUSSION

- Do Members agree with the identification of the main investment challenges and bottlenecks?
- Do Members agree that, despite some common features, investment challenges differ across groups of countries within the euro area? What are Members’ views on the broad reform priorities identified in the paper to tackle remaining barriers at both national and EU level?
- While further action is needed to unlock investment, the pace of reforms in the euro area has slowed down in the recent years and compliance with the country-specific recommendations remains limited. What are Members’ views on the best ways to promote reforms?

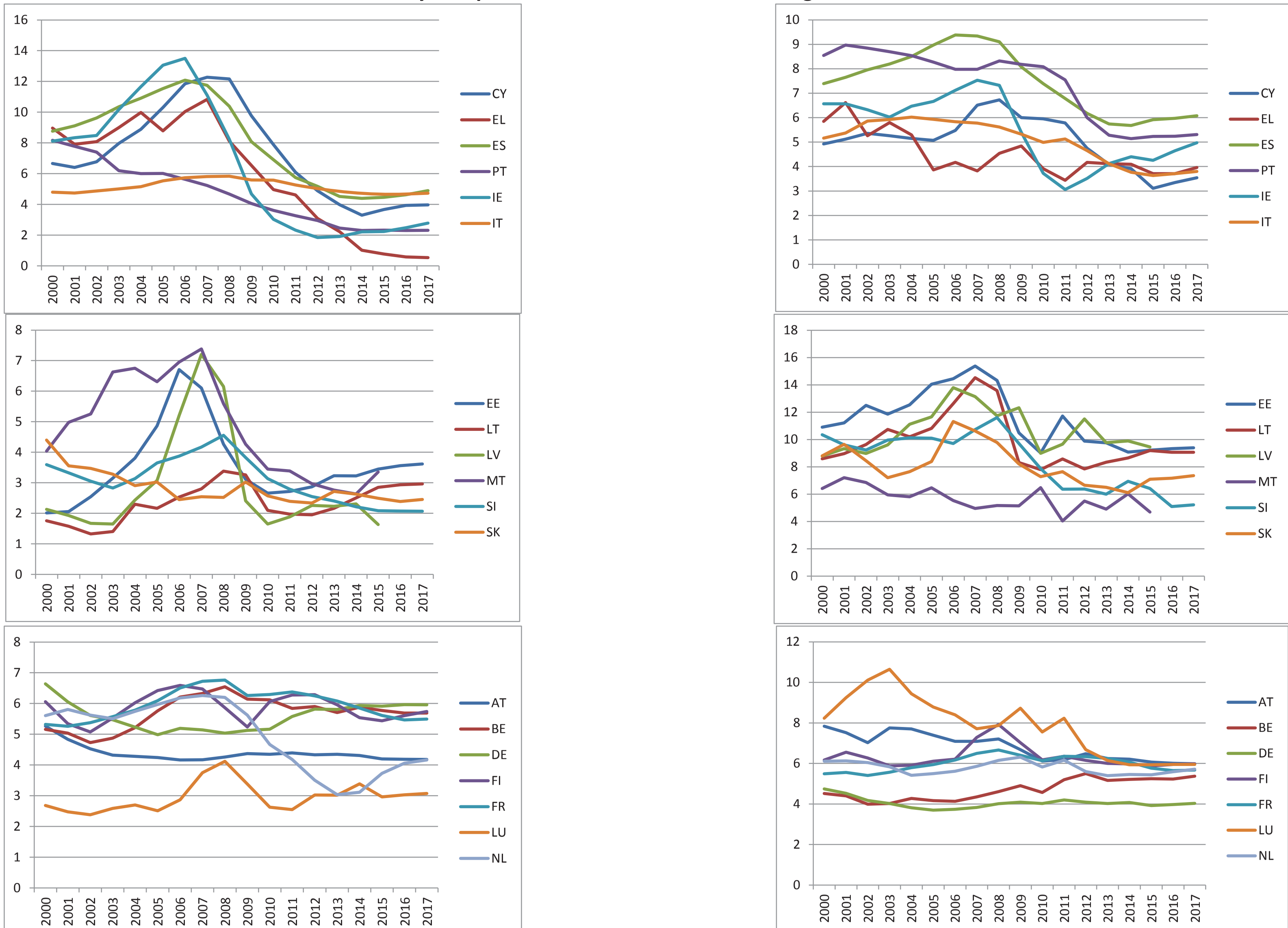
ANNEX 1 — INVESTMENT TRENDS IN THE EURO AREA COUNTRIES

Private and public investment as a % of GDP

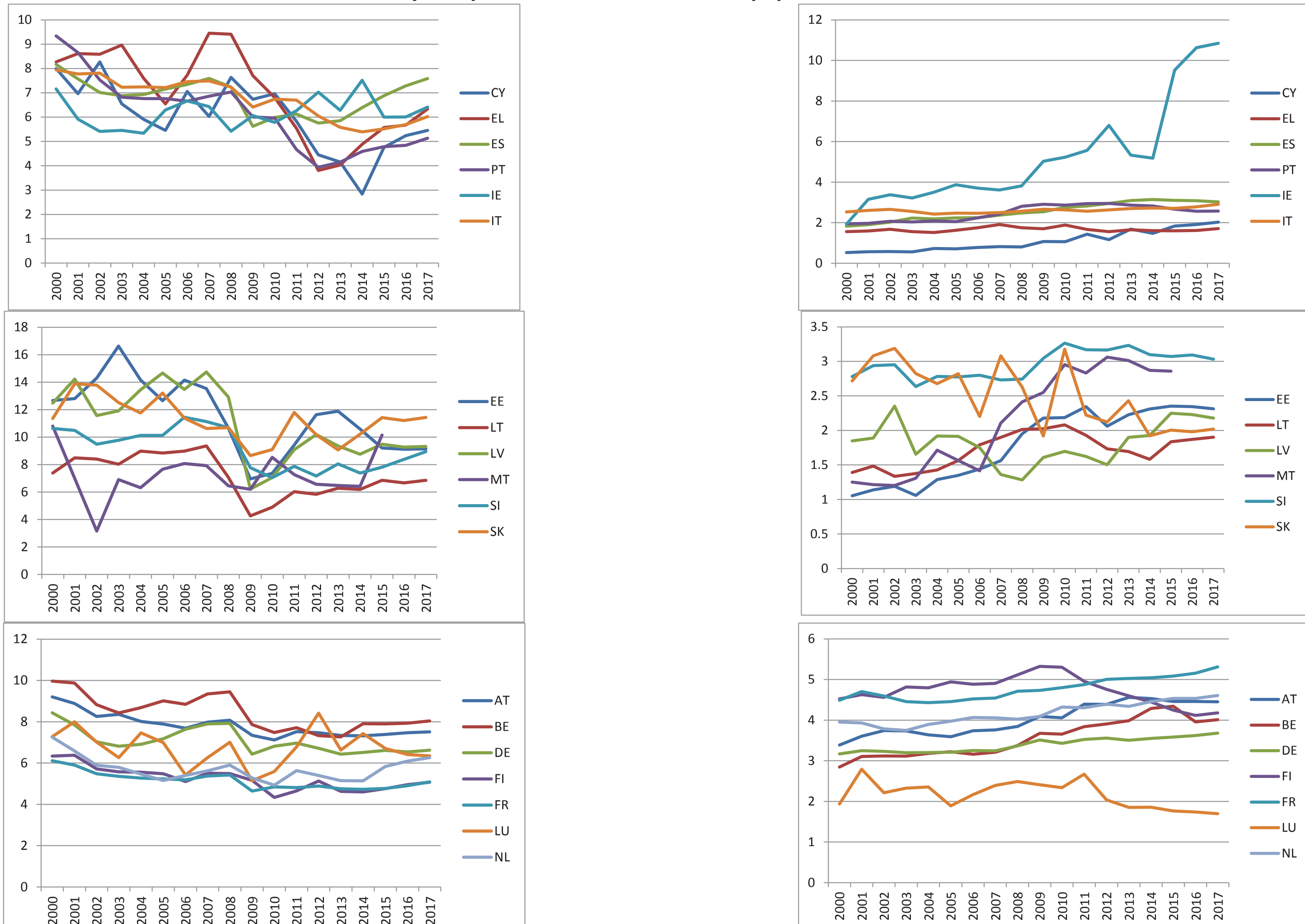




Investment by components as a % of GDP — dwelling and other construction



Investment by components as a % of GDP — equipment and ‘other’ investment



Source: European Commission (Ameco), 2016 Spring forecast.

ANNEX 2. OVERVIEW OF INVESTMENT CHALLENGES[17] AND RELATED COUNTRY SPECIFIC RECOMMENDATIONS

	Investment Challenges	CY**	ES	IE	IT	PT	EE	LT	LV	MT	SI	SK	BE	FI	FR	AT	DE	LU	NL
Public administration/ Business environment	Regulatory and administrative burden					N								*	*	N			
	Public administration	N									N			N			N		
	Public procurement /PPPs		N			*													
	Judicial system	N																	
	Insolvency framework	N			N														
	Competition and regulatory framework	N																	
Labour market/ Education	EPL & framework for labour contracts	N																	
	Wages & wage setting																		
	Education		N		N				N										
Fin. Sect. / Taxation	Taxation				N														
	Access to finance	N		N	N	N													
R&D&I	Coop. between academia,research & business		N			N	N	N	N									N	
	Financing of R&D&I		N												N				
Sector specific regulation	Business services / Regulated professions					N							N					*	
	Retail		N										N						
	Construction																	N	N
	Digital Economy / Telecommunications																		
	Energy												N				N		
	Transport				N								N						

Barrier covered by a CSR | Barrier not covered by a CSR

** In 2015, there were no CSRs as it was under Economic Surveillance Programme

Note: All the red cells (with and without 'N') correspond to a CSR in 2016. A red cell with the letter "N" is for a new CSR in 2016 (compared to 2015) on an investment challenge (as identified in the November 2015 SWD)

The star (*) is for a new CSR on a new investment challenge (additional to the list of the SWD)

[17] The investment challenges are those identified in the Commission Staff Working Document (2015) 'Member States Investment Challenges', SWD(2015)400.

ANNEX 3. MAIN INVESTMENT CHALLENGES AND RELATED CSRS PER GROUPS OF COUNTRIES