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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE
EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF
THE REGIONS AND THE EUROPEAN INVESTMENT BANK**

Annual Growth Survey 2017

Introduction

The Annual Growth Survey 2017 outlines the most pressing economic and social priorities on which the European Union and its Member States need to focus their attention in the coming months. The President's State of the Union address of 14 September 2016 underlined the need for Europe to strengthen its economic recovery and invest strongly in its youth and jobseekers, as well as in its start-ups and SMEs. The Letter of Intent signed by the President and the First Vice-President on the same day, and addressed to the Presidents of the European Parliament and of the Council, highlights the need to achieve an economic recovery which benefits all, notably the weaker parts of our societies, and strengthens fairness and the social dimension of our single market. It identifies a number of ways in which we can create more jobs, growth and investment for the Union, which is the number one priority of the Commission.¹ Ensuring a promising economic future for all, safeguarding our way of life and providing better opportunities for young people were also highlighted as priorities in the "Bratislava roadmap" endorsed by the Heads of State or Government of 27 Member States on 16 September 2016.

The policy guidance provided in this Annual Growth Survey is accompanied by a specific recommendation for a Council recommendation on the economic policy for the euro area², a Communication on a positive fiscal stance for the euro area,³ and a thorough analysis of economic,⁴ labour market and social conditions.⁵ It builds on the economic policy strategy of the virtuous triangle of investment, structural reforms and responsible public finances, which this Commission has pursued since the start of its mandate, as part of its overall agenda for jobs, growth, fairness and democratic change. It has also benefited from discussions in the European Parliament, the Council and the other EU institutions following the State of the Union Address. Moreover, the views expressed by social partners in the established dialogues have also been taken into account.

There are a number of positive developments in the EU, signalling the resilience and recovery of the European economy, despite the broader uncertainty worldwide. All Member States are growing again. Investment has started to pick up. 8 million new jobs have been created since 2013. The employment rate has also increased. If current trends continue, the Europe 2020 employment rate target of 75% could in fact be reached. The rise in activity rates over the years, in spite of the crisis, is a further testimony of structural improvements in the performance of labour markets. The average public deficit level, which was over 6% for the euro area a few years ago, is below 2% this year and will continue to reduce. Levels of government debt have stabilised and are expected to decrease.

However, there is no scope for complacency as the recovery remains fragile. Growth, employment and investment are still held back by legacies inherited from the crisis, as well as by structural deficiencies dating back to the pre-crisis years. Despite recent improvements, unemployment remains far too high in many parts of Europe and the prolonged period of high unemployment is taking its social toll on many Member States. Moreover, GDP and productivity growth rates remain below full potential and investment levels remain below pre-crisis levels. Furthermore, there are still significant imbalances and broader risks within the euro area and the EU more generally, with convergence among and within the Member States stalled in many cases.

¹ http://ec.europa.eu/priorities/state-union-2016_en

² COM(2016) 726

³ COM(2016) 727

⁴ COM(2016) 728

⁵ COM(2016) 729

Box 1. Key economic and social developments 2014-2016

Since this Commission has taken office, there have been a number of positive developments:

- For a few years now, the EU and euro area economy have returned to moderate growth which is forecast to continue in the coming years. The GDP of the EU is now higher than before the crisis.
- The recovery is increasingly job-intensive, also thanks to recent structural reforms in a number of Member States. 8 million new jobs have been created since 2013, out of which almost 5 million since the beginning of the mandate of this Commission.
- The EU unemployment rate kept falling and stood at 8.6% in September 2016, reaching its lowest level since 2009.
- At the same time, the employment rate in the age group 20-64 is above that observed in 2008 for the first time, at 71.1% (second quarter of 2016). This means that the 75% employment rate target set by the Europe 2020 strategy may be within reach, if the current trend continues.
- Total investment has started to grow again in the EU since 2014 and is forecast to continue to increase (EU: 2014: +1.2%; 2015: +2.2%; 2016: +2.0%; 2017: +2.1% 2018: +2.8%).
- Public deficits in the euro area have decreased from an average 6% of GDP a few years ago to well below 2% this year, and this reduction is expected to continue. This allowed a number of countries to exit the Excessive Deficit Procedure in recent years.
- Government debt in the EU and euro area is set to continue to decrease from its 2014 peak and is expected to stand at 86.0% in 2016 (91.6 % in the euro area) and to continue to diminish slightly over the coming two years.

However, there is no room for complacency:

- The tailwinds that have supported the recovery so far are fading (falling oil prices, a depreciating euro), and there are risks to the outlook, including from the global environment, but also as a result of the uncertainty created by the UK referendum.
- The recovery has been greatly helped by the monetary policy of the European Central Bank (ECB), including the resulting low interest rates, so far.
- Growth remains modest and is still held back by legacies inherited from the crisis, such as private debt, but also by structural deficiencies dating back to the pre-crisis years. The situation of the banking sector is a prominent example.
- There is still evidence of macroeconomic imbalances and limited convergence, notably within the euro area.
- Ageing puts pressure on the financial sustainability and adequacy of social protection systems.
- There are very high levels of debt in certain countries, with seven euro area Member States with a debt close or above 100% of GDP.
- Structural reforms remain incomplete in many Member States and delivery on the country-specific recommendations is too often patchy. The modernisation of products, services and labour markets remains a priority in many Member States.
- High levels of inequality reduce the output of the economy and the potential for sustainable growth, and risks of poverty and social exclusion remain very high, although they are decreasing.
- Although unemployment diminishes, it remains very high in some Member States.

In addition, globalisation, demographic and technological developments are important

sources of change, which need to benefit all. These developments can and must not be reversed but may need to be complemented, in particular by efforts to ensure that benefits of globalisation and technological change, including digitisation, are distributed fairly across different groups in society, notably young people. Concerns for equality, fairness and inclusiveness call for raising awareness at all levels about the impact of policies and reforms on income distribution.

As underlined by the European Parliament,⁶ the real success of the economic policy coordination under the European Semester can only be assessed through the implementation of the key reforms outlined in the country-specific recommendations. While the Semester has prompted significant reforms in Member States, overall implementation is still disappointing in some areas and varies across countries. Thanks to the streamlining of the Semester, the recommendations are now focused towards the key challenges of each Member State. Moreover, benchmarking and peer review activities have been stepped up in the various Council formations. The implementation of commonly agreed priorities remains a priority.

While the EU should provide an appropriate enabling environment in terms of better regulation and policy orientation, as illustrated by the priorities of the Commission Work Programme,⁷ it is up to the Member States to deliver the bulk of the policy response. The EU has made concrete proposals to strengthen the recovery and increase resilience against future shocks. For example, the Council recommendation on National Productivity Boards, which was adopted in September, encourages Member States to reflect on a comprehensive notion of competitiveness, with a focus on raising productivity and growth. Faster progress on the adoption of reforms in line with the country-specific recommendations addressed to each Member State, together with an appropriate sequencing and implementation, is necessary to raise growth potential and foster economic, social and territorial cohesion. Member States should introduce these reforms in a manner that takes full account of the short and medium term impact, including its distributional effects and costs over time.

Box 2. Summary of key areas for action at EU level

At the level of the European Union, this Commission has been committed to:

- Pursuing an economic policy based on the virtuous triangle of boosting investment, pursuing structural reforms, and ensuring responsible fiscal policies. It has revamped the European Semester accordingly, also by giving more time for dialogue with the Member States and mainstreaming social considerations alongside economic goals.
- Applying the rules of the Stability and Growth Pact, including by using the flexibility built within to take better account of the economic cycle and to facilitate reforms and investment, through the so-called "investment" and "structural reforms" clauses.
- Deploying an Investment Plan for Europe to fill the investment gap, including through the extension of the European Fund for Strategic Investments, a strengthened impact of EU funds in support of the Plan, efforts to tackle barriers to investment and new sources of funding for the real economy, through a Capital Markets Union.
- Taking the necessary measures to deepen the Single Market in the field of services and products, as well as infrastructure, to complete the Energy Union and to establish a true Digital Single Market, to expand opportunities for EU businesses through trade agreements, as well as to ensure a system of fair taxation across the EU.

⁶ European semester for economic policy coordination: implementation of 2016 priorities, 2016/2101(INI).

⁷ COM(2016) 710

- Prioritising investment in human capital by launching a new Skills Agenda, boosting the roll-out of the Youth Guarantee and benchmarking performances in education and training.
- Completing Europe's Economic and Monetary Union, through "deepening by doing", including by supporting EU social dialogue, but also through initiatives to complete the Banking Union and to take better account of euro area priorities as a whole.

The Commission Work Programme for 2017 summarises its priorities for next year.

All policy tools – monetary, fiscal and structural – need to be used individually and collectively to strengthen job creation, growth, investment and financial stability. In the current environment of low inflation, low growth and low interest rates, together with a supportive monetary policy stance, the onus is on other policy areas to safeguard the economic recovery. In a global context marked by increased uncertainties, it is critical to mobilise all internal growth drivers through an appropriate policy mix.

In this light, the Commission calls on Member States to redouble their efforts on the three elements of the virtuous triangle of economic policy, and in so doing, put the focus on social fairness to deliver more inclusive growth:

- boosting investment;
- pursuing structural reforms;
- and ensuring responsible fiscal policies.

1. Boosting investment

1.1 Improving the functioning of the financial sector

Access to finance is crucial for businesses so that they can grow and innovate. In some Member States, the proportion of SMEs identifying access to finance as the most important challenge is still high (30% in Greece and 25% in Cyprus). The problem of financing is also reported by the smallest companies (12% of micro enterprises), relatively young companies (13% of those established within the last two to five years) and young, high growth companies (14% of companies with annual growth rates of 20% or more - *gazelles*).⁸ As SMEs rely primarily on the banking sector for financing, their access to credit remains a concern, especially in countries with banking systems undergoing adjustment. In order to support and reform the venture capital framework that is vital for high-growth companies, in particular, and help financial markets provide more credit to the economy, the Commission proposed amendments to the European Venture Capital Funds and the European Social Entrepreneurship Funds regulations, marking another step towards the creation of the Capital Markets Union.

The Capital Markets Union can provide the conditions for equal access to finance for all firms across Member States, thus encouraging investment and innovation free from distortions. Financing conditions and models differ significantly across Member States, thus distorting the main function of the financial sector to act as an efficient intermediary between sources of capital and investment opportunities. A fully-fledged Capital Markets Union will

⁸ Survey on the access to finance of enterprises (SAFE), <http://ec.europa.eu/growth/safe>

provide alternative sources of financing, through equity and bond markets, to complement the banking system on the one hand, and facilitate proper risk assessment and allocation of capital in the financial system on the other hand. Indeed, capital must flow to areas of higher productivity growth, highly productive activities and innovations. Deeper integrated capital markets would also provide a buffer against economic shocks through private sector risk-sharing. Beyond the need to ensure rapid adoption of the measures already proposed by the Commission, additional changes to the legislative framework applicable to investments by insurance companies and banks in infrastructure assets and small and medium-sized enterprises will help to increase the financing of the economy. In addition, inefficiencies in national insolvency frameworks lead to uneven conditions for access to credit in the Member States. The Commission will soon present a proposal on preventive restructuring frameworks, second chance, and measures to improve insolvency procedures.

Member States also need to address remaining vulnerabilities in the banking sector to foster investment and facilitate the financing of the European economy. The high level of non-performing loans remains a serious challenge in a number of Member States. Non-performing loans and operational inefficiencies in combination with a low interest and low growth environment, weigh on banks' profitability, which in turn, weighs on banks' ability to generate or raise new capital in support of new lending and therefore on their ability to support the economic recovery. Breaking this vicious loop requires relieving the banks from this burden, without having an impact on the public purse. Effective out-of-court and insolvency frameworks, including preventive restructuring, are crucial in this context and the adopted reforms should be implemented fully. Servicing by, and sale of non-performing loans to non-bank specialised institutions should be possible and encouraged in all Member States, in line with the relevant legislation.

Banks should be encouraged to continue enhancing their operational efficiency. Cyclical and structural factors – including new regulatory requirements and the low yield environment – have had an impact on banks' profitability. The adjustment of banks' business models to the new operating environment requires further efforts, which can include further reduction of over-capacity and sector consolidation. Outstanding regulatory initiatives should be agreed quickly in order to ensure legal clarity and certainty, while avoiding undue impact on the financing of the real economy. Additional initiatives envisaged at international level should not lead to significant overall increases of capital requirements.

Progress towards completing the Banking Union should be swift and requires parallel improvements on further risk reduction and risk sharing. The resilience of the banking sector has increased considerably in recent years. Nevertheless, bank stock prices have suffered episodes of acute stress in 2016, also due to developments in international markets, such as turbulence in China or following the outcome of the UK referendum. It is essential to safeguard and continue to rebuild confidence in the banking sector. The Bank Recovery and Resolution Directive, together with EU State Aid rules, provide the framework to safeguard financial stability while protecting taxpayers. The work on a common backstop for the Single Resolution Fund should be accelerated. Discussions on a European Deposit Insurance Scheme (EDIS) should continue, with the aim of reaching an agreement by the co-legislators as rapidly as possible, and adoption on the forthcoming risk-reduction proposals should also be given priority.

1.2 Increasing the impact of EU funds in support of the Investment Plan for Europe

The Investment Plan for Europe has proven a useful tool for delivering concrete results and encouraging a sustainable increase in investment in Member States. The European

Fund for Strategic Investments (EFSI) has mobilised close to EUR 138 billion across 27 Member States in just over one year. During the same period, almost 300,000 SMEs are expected to have benefitted from the EFSI.⁹ The Investment Plan for Europe, through its various facets (financial instruments, technical assistance and measures improving the business environment), is making a real difference in a range of sectors by supporting innovative projects that contribute to job creation and growth in local communities, as well as to tackling youth unemployment. These projects are critical for the future of the EU economy and target key areas such as support to SMEs, innovation and R&D, renewable energy, energy efficiency, digital and transport infrastructure.

More projects in more Member States will be able to benefit from the Investment Plan. The Commission has proposed to extend the EFSI (proposal for an "EFSI 2.0") and double its amount to reach EUR 630 billion by 2022, while at the same time improving geographical and sectorial coverage. A swift adoption of this proposal is essential.¹⁰

In addition to the extension of the EFSI, geographical coverage will improve further through additional and simplified possibilities of combining the EFSI with the European Structural and Investment Funds (ESIF), coupled with enhanced technical assistance across Europe. The new programming period of the ESIF, which contribute 454 billion euro to investment in the Member States over the period 2014-2020, has increased focus on the effective and efficient use of EU resources by requiring programmes to clearly identify the intended results and translate them into quantifiable targets. Furthermore, Member States are required to work towards the creation of the legislative and structural conditions enabling the sectors receiving the funds to effectively achieve the targets. For the future, the Commission has proposed to increase the possibilities for blending between the EFSI and the ESIF, as well as with the Connecting Europe Facility.

Sustainable investments boost productivity across the economy through enhanced resource and energy efficiency and reduced input costs, whilst reducing external costs and impacts. More particularly, support for the transition towards a low-carbon and circular economy will create new jobs in services such as innovative, maintenance and repair services and in designing and making new, more sustainable products. Specific areas where the macro-economic relevance of the circular economy and improved resource efficiency is potentially significant include green public procurement, investments in waste and water infrastructure, sustainable construction, critical raw materials, biofuels and biochemicals, as well as energy and climate related investment.

Investments also need to focus on human capital and social infrastructure. The development of long-term care services and affordable and flexible childcare facilities is particularly important to decrease care obligations towards the elderly and children, frequently affecting women. Sustained investment efforts are also needed in education and life-long learning in order to support employability and redress the risk of gaps in wages and working conditions between high-skilled and low-skilled workers.

Member States will benefit from clearer guidance on public accounting rules (ESA 2010), particularly in the area of public-private partnerships. A guide to the statistical treatment of public and private partnerships, produced by Eurostat in cooperation with the European Investment Bank and addressed mainly to private stakeholders, was released on 29

⁹ COM(2016) 359 and COM(2016) 581

¹⁰ European Council conclusions, October 2016: The European Council calls on the Council to agree its negotiating position on the Commission's new EFSI proposal at its meeting on 6 December, taking into account the independent external evaluation that will be delivered in November.

September 2016.¹¹ This publication is being followed up by an active outreach campaign. In addition, the Commission is closely monitoring the impact of the interpretation of public accounting rules on the creation of public and private partnerships in different sectors and will consider further action where it is appropriate.

1.3 Tackling barriers to investment

The EU and its Member States have taken steps to tackle barriers to investment, but more needs to be done. While the Commission will continue with its efforts to improve the overall investment environment at EU level, including by deepening the single market, Member States should step up their efforts to remove obstacles to investment at national, regional and local level.

Sustainable investments require a solid and predictable business environment. The Commission has already put forward initiatives to facilitate the financing of the real economy, such as the lowering of capital charges for insurance and reinsurance companies with regard to infrastructure investments and the adoption of practical guidance on the application of state aid rules on the public funding of infrastructure.¹² In addition, work on the Energy Union, the Capital Markets Union, the Single Market Strategy, the Digital Single Market Strategy, the circular economy package and international trade and investment agreements covers specific measures that will help to remove barriers, promote innovation and improve the environment for investment, when fully implemented. For example, as part of the Energy Union, there should be a governance process building on national energy and climate plans for 2030 and beyond, providing predictability for businesses, investors and society at large. There should also be increased *ex ante* certainty on public accounting for specific sectors, such as energy efficiency. Full deployment of 5G, the fifth generation of mobile communication systems, across the European Union by 2025 has the potential to create two million jobs. In addition, the recent re-launch of the Common Consolidated Corporate Tax Base¹³ will contribute to make the EU a more attractive place to invest by offering companies predictable rules, a level-playing field and reduced compliance costs. It will also support innovation in Europe by making sure that costs of R&D investment are tax deductible and addressing the bias in taxation towards debt financing instead of equity.

The importance of investment in knowledge, innovation, education and ICT as drivers of growth is also high on the agenda. In several Member States, the significant fall in investment in equipment and machinery partly explains the drop in productivity after the crisis. At the same time, higher investment in intangible assets such as R&D, ICT and training, will be needed to push up growth of total factor productivity and crowd-in investment. Member States need to ensure that capital is as efficiently allocated as possible. In the past, total factor productivity, which includes a number of factors such as innovation and a more efficient allocation of resources, contributed less to growth and productivity in the EU than in the United States. Structural issues affecting product, services, capital and labour markets are responsible for this subdued performance in Europe. Improving the interaction between university research and business development of products and services is crucial to boost competitiveness and growth. In the same vein, the creation of national platforms on digitising industry would help leverage the EU funds committed to this to deliver significant investments that will also strengthen the competitiveness of our economy.

¹¹ Eurostat / EPEC / European Investment Bank, 'A Guide to the Statistical Treatment of PPPs', September 2016.

¹² C/2016/2946

¹³ COM(2016) 685

Member States need to step up their efforts to implement the necessary reforms aimed at removing obstacles to investment that were identified in the context of the European Semester. Despite action taken by some Member States, in particular by euro area countries heavily hit by the crisis, progress to address barriers to investment has been overall uneven and more needs to be done. This concerns areas such as insolvency, public procurement, the efficiency and transparency of public administration or sector-specific regulations, as well as the functioning of labour and product markets. In particular, efficient and transparent public administration and effective justice systems are necessary to support economic growth and deliver high quality services for firms and citizens. In some Member States, barriers to investment may also include a high level of taxation and overly complex taxation systems, corruption, weak research and innovation frameworks, as well as difficulties in access to finance, particularly for SMEs. These reforms identified in the country-specific recommendations are necessary to sustain and increase investment levels in Member States, taking into account national specificities.

1.4 Opportunities for EU businesses to benefit from global markets and investment

Exports to the rest of the world have become an increasingly significant source of jobs for Europeans. Thanks to our companies' international competitiveness, more than 30 million jobs are now supported by exports outside the EU — two thirds more than 15 years ago — meaning exports now support almost one in seven jobs in Europe. These jobs are highly skilled and better paid than average. They are spread across all EU Member States, and are both directly and indirectly linked to exports outside the EU. For example, 200,000 jobs in Poland, 140,000 in Italy, and 130,000 in the United Kingdom are linked to German exports outside the EU. French exports outside the EU support 150,000 jobs in Germany, 50,000 in Spain and 30,000 in Belgium. As a result, the benefits of trade are spread much more widely than is often realised, including considerable benefits for European consumers. Against the backdrop of first signs of trend reversals in global trade, there is a need to uphold openness and to facilitate the further integration of EU companies in global value chains, notably for service providers and SMEs.

The EU is well placed to use trade and investment policy to contribute to this objective and benefit companies, consumers and workers alike. The EU is the world's largest exporter and importer of goods and services taken together. This scale makes the EU the largest trading partner of about 80 countries and the second most important partner for another 40. The EU should use this strength to benefit both its own citizens and people in other parts of the world, particularly those in the world's poorest countries.

The ratification of the Paris climate change agreement will create further new opportunities for EU business. The agreement creates policy and investment certainty for EU companies operating in low carbon and low emissions sectors, not only in Europe but in the rest of the world. The EU and its Member States are the biggest contributors of public climate finance to developing countries. Together they provide around a third of public funding available for action to tackle climate change and account for almost half of the pledges in the Green Climate Fund. In the period 2014-2020, at least 20% of the EU budget will be spent on climate-related action. The EU funds the Global Climate Change Alliance, one of the world's largest climate initiatives. To scale up support for the poorest and most vulnerable, the EU has launched a new phase, with an expected commitment of around EUR 350 million for 2014-2020. This will support least developed countries and small island developing states in adapting to the impacts of climate change. The EU and the Member States last year provided EUR 17.6 billion to help developing countries tackle climate change. This demonstrates the EU's determination to contribute its fair share of the goal set by

developed countries to provide USD 100 billion in annual finance to developing countries from various sources by 2020.

The EU's attractiveness as an investment destination for both foreign and domestic investors needs to be increased. The EU share of global foreign direct investment flows fell from about 50% before the crisis to 20% in 2014. While foreign direct investment flows are driven by global developments and events largely exogenous to EU, inflows respond to a range of country-specific location factors, firm-specific factors and sector-specific factors that affect the investment climate and that can be directly affected by policy makers in the short and medium term.

2. Pursuing structural reforms

2.1. Creating jobs and enhancing skills

Member States need to invest more in creating supportive conditions for greater labour market participation, more quality jobs and effective training and upskilling. Well-functioning, flexible, labour markets must be matched with enhanced skills and income support during work transitions, and welfare systems firmly anchored in strong social standards. Those Member States that pursued comprehensive labour market and social protection reforms prior to the crisis have been better able to support employment and preserve fairness during the economic downturn. Such reforms encompass flexible and reliable contractual arrangements that promote labour market transitions and avoid a two-tier labour market, comprehensive lifelong learning strategies, effective active labour market policies, and modern social protection systems. Other Member States have introduced reforms in this direction during the crisis, contributing to the increased job intensity of the current recovery.

In many Member States, the working-age population and the labour force continue to shrink, notably as a result of low birth rates, ageing, emigration and health-related exits from the labour market. Precariousness, segmentation of the labour market and their impact on productivity growth need to be addressed in this context to reduce their negative impact on internal demand and productivity growth. Moreover, equality of opportunities is key for social fairness. Increasing female labour market participation, closing unjustified gender pay gaps, improving the work-life balance of men and women, making further progress in the inclusion of disadvantaged groups and addressing discrimination of persons with a migrant background, are examples of how growth and social fairness go hand in hand. In this light, Member States need to ensure access to quality services and in-kind benefits, such as childcare, housing, healthcare and long-term care, education and training. Quality services and in-kind benefits contribute to increased labour market participation, notably for women, and to social inclusion. Housing policies also deserve attention as they can remove obstacles to geographical mobility at national levels, through targeted allowances or social housing programmes.

A number of Member States will need to put in place adequate structures for dealing with the influx of migrants including refugees beyond the immediate short-term needs. While there are clear economic and fiscal impacts, they are neither unmanageable nor sizeable from a macroeconomic point of view. The strategic challenge lies in a smooth welcome into

hosting societies in the short term in a way that also addresses the longer term challenges to labour market and education policies and institutions and social systems. The ability to adjust policies and develop incentives and skills-building that promote labour market integration will have a direct bearing on the long-term sustainability of public finances. For instance, several Member States have developed strategies to facilitate the integration of migrants with previous experience and entrepreneurship abilities. These Member States have provided migrants with support to help them to adapt their skills and experience to local market conditions¹⁴.

Despite recent progress more action is needed from the Member States to fight youth unemployment. 9 million young people have benefitted from the EU Youth Guarantee so far, a framework to improve school-to-work transitions, invest in young people's employability and prevent the risk of social exclusion. However, Member States need to pursue the roll-out of the Youth Guarantee and enhance its effectiveness in order to reach out to the young and regions most in need. The Commission will mobilise all its instruments, has proposed additional funding for the Youth Guarantee and will come with a new youth initiative shortly. Moreover, almost four million students have already benefitted from the Erasmus programme. One in three young Erasmus beneficiaries has been offered a job by the companies in which they trained.

Member States need to focus on labour market relevance of skills as forecasts indicate a future shortage of people with vocational and training qualifications. For too many young people, initial vocational education and training remains a second choice and only a minority of workers are offered opportunities for further skills development. Modernising vocational education and training, including by promoting flexible learning pathways, will help people to develop the appropriate transferable skills throughout their lives. This requires close partnerships with the business, higher education and research sectors. The active involvement of social partners can lead to the development of apprenticeships in new areas covering various skills levels, which can be expected to address skills mismatches. At the EU level, the revision of the Blue Card directive aims at harmonising and clarifying the legal framework to attract high skilled third country nationals, while the Skills Guarantee underlines the need to assess specific needs for third country nationals.

Modernising education and training is necessary to equip people with better skills, ranging from basic skills in numeracy and literacy to entrepreneurial and digital skills. Educational attainment indicators kept improving in 2015 and the early school leaving rate has declined in most Member States, reaching 11%. Yet, early school leaving rates are higher for Roma pupils and those with a migrant background, particularly foreign-born pupils. Tertiary education attainment has also been consistently and significantly increasing, standing at 38.7% in 2015, with 17 Member States above the Europe 2020 headline target of 40%. Still, by international standards, too many Europeans acquire only a low level of basic and digital skills. This puts Europe at a competitive disadvantage in a fast-changing global economy. Nurturing skills is essential to drive upward convergence and sustain the European social model, while fostering greater entrepreneurship and innovation capabilities. The New Skills Agenda for Europe¹⁵ puts a particular emphasis on supporting adults who have not reached upper secondary with the opportunity of assessing their skills level, providing them a new training opportunity and validating the skills acquired.

¹⁴ A recently published Commission Guidebook including 22 good practice case studies and an interactive Self-Assessment Tool (<http://ec.europa.eu/DocsRoom/documents/18421>) to support service providers in improving their actions targeting migrant entrepreneurs and would-be entrepreneurs.

¹⁵ COM(2016) 381

Effective social dialogue is crucial for a well-functioning social market economy. Better performing Member States tend to have a more strongly established social dialogue. The success of social dialogue is dependent on a number of factors, including the willingness and capacity of different partners to engage and work towards solutions, for example where it concerns wage setting.¹⁶ The engagement of social partners at EU and national level is crucial for striking the right balance when designing and implementing economic and social policies in a comprehensive and forward-looking manner.

Member States should, together with social partners, and in line with national practices, make sure that their wage-setting systems are effective in delivering both job creation and real income increases, and for that adjust better to changes in productivity over time. In a number of Member States, developments in wages do not sufficiently follow productivity developments. This may lead either to an erosion of competitiveness or, in the case of too modest wage developments, to weaker aggregate demand and growth. This may also discourage productivity gains, research, development and innovation and investment in human capital aimed at improving skills. It may also distort incentives for resource reallocation towards sectors with higher value added and thus hinder further structural change of the EU economies to make them more competitive. It is important to ensure that differences in skills and divergences in economic performance across regions, sectors and companies are into account. When setting minimum wages, Member States and social partners should consider their impact on in-work poverty, job creation and competitiveness.

2.2. Social policy as a productive factor – modernising the welfare state

Member States need to redesign their social protection systems to improve the promotion of labour market participation and provide adequate employment security and income replacement. The percentage of people at risk of poverty or social exclusion in the EU decreased further in 2015 but remains very high¹⁷. Even if the EU is still far from achieving its Europe 2020 target of lifting at least 20 million people from poverty or social exclusion by 2020, the number of people at risk of poverty or social exclusion is now again approaching the level of 2008, the reference year for which the Europe 2020 target was set. Social protection accounts for a large share of Member States' public expenditure, also on account of the increases in spending in recent years, but there is scope for better targeting.

Tax and benefits schemes should provide adequate social support and work incentives. Improving the adequacy and coverage of income support schemes (unemployment benefits; social assistance including minimum income; pensions) is crucial to prevent social exclusion and, in the case of unemployment benefits, can increase both macro-economic stability and labour market attachment whilst reducing precariousness. Unemployment benefits should be sufficient in terms of duration, eligibility and levels, and be accessible to all employees irrespective of their contract, while preserving incentives to work and including activation requirements as regards job search and participation in active measures. Furthermore, adequate minimum income benefits should be ensured for those who lack sufficient resources for a decent standard of living. For those of working age, these benefits should include requirements for participation in active support to encourage labour market (re)integration, thus contributing to the sustainability of these support systems. This may call in some cases

¹⁶ On 24 October 2016, a first tri-partite multilateral surveillance on social dialogue in Member States took place in the Employment Committee, on the basis of the Employment Guidelines, confirmed by the EPSCO Council on 13 October 2016. It was conducted together with national representatives from trade unions and business associations.

¹⁷ In 2015, around 119 million people were at risk of poverty or social exclusion, around 3.5 million people less than in 2014.

for setting one-stop shops in charge of both the short-term and long-term unemployed. Tax and benefit reforms aimed at improving work incentives and making work pay should also be promoted. Tax systems can also contribute to combating income inequalities and poverty.

National pension systems should better reflect growing life expectancy. Pension systems, in coordination with labour market measures, should enable and encourage men and women to remain in employment until a higher age, reflecting growing life expectancy, and restrict early retirement pathways to those genuinely unable to work longer. Longer and more fulfilling working lives also depend on adequate skills, lifelong learning opportunities and enabling working environments, including flexible task allocations and working time schedules. To facilitate work-life balance in working age and help reduce the gender pension gap, pension systems could credit care duties, taking due account of fiscal positions and future expenditure implications. Broad coverage of supplementary pensions can play a key role in retirement income provision, in particular where the adequacy of public pensions might be a challenge, and should be promoted by appropriate means, depending on the national context.

Health policies should support and reinforce social safety nets and active inclusion strategies, through preventive, but also curative and rehabilitation policies. Member States therefore need to continue to reform their health systems, thus ensuring universal access to cost effective public health and healthcare services. Protecting the population from falling into poverty or social exclusion due to ill-health and related expenditure is essential, both from a social and economic view-point. This is also relevant for the activation of persons with disabilities. Despite the action taken at EU level, lack of equal opportunities in the labour market remains the most important challenge for persons with disabilities. Efforts should be enhanced to ensure focus on abilities instead of disabilities.

2.3 Deepening the single market and making national markets bigger

Member States should make full use of the instruments available at the EU level to unlock the full potential of investment and productivity in Europe. Productivity growth has slowed down in recent years, but this has not affected all firms to the same degree. In many cases, the least productive firms have experienced negative productivity growth. Member States must introduce reforms and policies to facilitate the diffusion of new technologies to ensure that their benefits can spill over a wider range of firms. The implementation of the Single Market Strategy will create new business opportunities and remove existing regulatory and administrative barriers, notably for service providers seeking to expand across Europe. Work is ongoing on concrete proposals linked to the enforcement of single market rules as well as measures in the area of business services, including facilitating their cross-border provision, business restructuring and insolvency, and the creation of a simple, modern and fraud-proof VAT system. The Digital Single Market Strategy will enhance regulatory certainty in the digital sector. Better enforcement of consumer rules would ensure a level playing field across the Single Market, increases trust and contribute to unlock the full potential of the Digital Single Market. The Commission is also exploring the design of a single EU authorisation framework that would directly apply to large projects with a cross-border dimension or major investment platforms that involve national co-financing.

Public procurement is important for competitiveness as it can drive structural changes. Every year, public authorities in the EU spend around 14% of GDP on public procurement, which amounts to more than EUR 1.9 trillion spent annually in the EU¹⁸. This is especially true in sectors such as energy, transport, defence, IT or the provision of health services, where

¹⁸ This is the latest estimate not including spending by utility companies. Former estimates including utility procurement are around 19% of EU GDP, i.e. roughly EUR 2.3 trillion.

the public sector is a key source of demand. Modern public procurement systems require public procurers who understand the economic implications of their work and whose integrity and transparency is without doubt. Institutions must be available to coordinate procurement between bodies at various levels to attain economies of scale, manage complaints by companies, and audit public contracts. Processes must be in place that prevent corruption and collusion between suppliers and address firmly instances of unfair procurement. In addition, in some Member States where state-owned enterprises exert tangible impact on the economy, it is important to ensure appropriate governance structures to contribute best to economic development.

In many Member States, structural change implies the transfer of capital and labour resources from traditional to new activities, often in the services sector. Labour productivity in this sector is lower and has been growing in the EU more slowly than in other advanced economies, in particular the United States. Raising productivity in this growing sector becomes imperative to ensure quality jobs and high wages. Unfortunately, the incomplete integration of the internal market for services and remaining barriers to access to some segments of these markets limits the expansion of intra-EU trade and the expansion of the markets for those services. Enhanced competition in more integrated services markets would also benefit consumers and downstream producers, as mark-ups tend to fall in a more competitive environment, while the quality of products and services may improve. However, employees need to have the right skills and capacity to adjust to change, which can require an active role of public authorities to facilitate this process. Problems in the application of mutual recognition and, in some cases, national marking requirements threaten the integrity of the internal market. A number of excessive barriers in the area of regulated professions continue to impede the realisation of the full potential of the internal market. In the case of business services, professional services and retail, the impact of removing these barriers has a broader economic effect.

Adopting legislative environments to new business models is particularly important for economic dynamism, but must not come at the expense of fairness. The EU and its Member States need to have an open mind to new ways of doing business in the context of the collaborative economy. At the same time, a fragmented approach across Europe to new business models creates uncertainty for traditional operators, new services providers and consumers alike. This is why the Commission has put forward guidance on how existing Union law should be applied to this dynamic and fast evolving sector¹⁹. As part of that guidance, Member States should assess the justification and proportionality of existing restrictions and use absolute bans only as measures of last resort; they should also ensure that consumers enjoy a high level of protection, while not imposing disproportionate obligations on private individuals who only provide services on an occasional basis. Moreover, Member States should continue simplifying and clarifying the application of tax and liability rules and labour law to the collaborative economy. By cooperating with national authorities in the recording of economic activity, collaborative economy platforms can contribute significantly to facilitating tax collection. All together, these initiatives should contribute to stronger framework conditions for innovation, the reduction of existing market fragmentation and ultimately to job creation.

Member States need to put in place modern tax systems that can support growth and fairness between businesses. EU initiatives will bring a new level of cooperation in the area of taxation in the fight against tax abuse, from increasing transparency on tax rulings and multinationals' tax-related information, to securing common anti-abuse measures against the

¹⁹ COM(2016) 356

most pervasive tax avoidance schemes and the Commission Action Plan on VAT. The cross-border nature of tax evasion and avoidance and the integration of the Member States' economies call for a coordinated approach, not only through European initiatives but also through the coordination of national policies. The Commission's recent proposal on the common consolidated corporate tax base and on double taxation dispute resolution will build a modern, fair and competitive tax framework for the EU. Growth-friendly activities such as R&D investment and equity financing will be incentivised, supporting the wider objectives of reviving growth, jobs and investment. Addressing inefficiencies in tax collection is relevant for many Member States, and some have taken measures. Member States should use these opportunities also to lower taxation of labour. At the same time, Member States should pay particular attention to the distributive effects of their tax reforms.

3. Responsible fiscal policies

The reduction in the average public deficit of the euro area and in the number of countries under an excessive deficit procedure reflect the efforts made in recent years. The Commission just issued its Opinions on the Draft Budgetary Plans on the euro area Member States²⁰. The aggregate picture hides large differences across the Member States. Challenges in terms of fiscal sustainability remain in a number of countries where public debt are high, which may be a source of vulnerability to adverse shocks. Some other countries have fiscal space. From an economic point of view, the fiscal stance has to be assessed against the double objective of the long-term sustainability of public finances and the need to support the economic recovery.²¹

At this point in time, given the need to support the on-going recovery, more efforts are needed to bring about a positive fiscal stance for the euro area as a whole, also in support of the monetary policy of the European Central Bank.²² This was already announced in the Letter of Intent of the President to the European Parliament and Council and it is now reflected in the proposed Recommendation on the economic policy of the euro area.²³ Member States' fiscal policy should be supportive to growth while ensuring longer term debt sustainability. The Member States where fiscal space exists should use the available scope to help stabilise demand. Member States where such space does not exist should deliver on the requirements given by the Stability and Growth Pact, and use every opportunity to boost reforms and improve the quality of their public finances in support of jobs and growth. They need to focus on the quality and the composition of budgets (both revenues and expenditures) in order to maximise the impact on growth. Spending reviews are widely recognised as a helpful tool to that effect. This would lead to a better distribution of the fiscal stances across countries and avoid a situation where macro-stabilisation in the short term would be achieved at the cost of increasing risks to sustainability in the medium-term.

In applying the rules, the Commission will continue to make use of the appropriate flexibility built into the Stability and Growth Pact²⁴. The Commission will also take into account the budgetary impact of the exceptional inflow of refugees and of exceptional security needs, applying its current methodology. Considerable flexibility has already been

²⁰ COM(2016) 730

²¹ COM(2016) 727

²² COM(2016) 727

²³ COM(2016) 726

²⁴ COM(2015) 12

provided to a number of countries that made use of the structural reforms and investment clauses.

The low funding cost environment makes it an ideal time for the Member States to frontload public investments. In conjunction with gradually strengthening nominal growth, it also offers an opportunity to curb high debt ratios. This can be facilitated by cutting non-future oriented spending and closing tax loopholes. The Stability and Growth Pact provides the right framework to guide fiscal policy under different circumstances. Fiscal surveillance tools need to be exploited to their full extent to provide incentives for good policies and to strengthen the economic recovery.

Pension systems have been reformed in a majority of Member States to enhance their sustainability, efficiency and adequacy, but additional steps are needed to consolidate these reform efforts.²⁵ To this end, policy actions should seek to complement enacted pension reforms with flanking policies, including by boosting retirement incomes by extending working lives, for example by linking the retirement age to life expectancy and by supporting other complementary means of retirement incomes. Member States should also put in place resilience-enhancing measures to ensure that public pension system sustainability can be preserved, even under adverse conditions.

Driven by population ageing and technological developments, public expenditure on health care and long-term care is expected to increase significantly in the coming decades. To safeguard sustainable health systems and support their positive contribution to population health and economic prosperity, further policy action will be needed enabling the individual to stay healthy for longer, while making health systems more effective, accessible and resilient.²⁶

4. Next steps

The Member States should step up implementation of the key reforms highlighted in the country-specific recommendations addressed to them. At the same time, they should make full use of the opportunities offered to them at EU level. The effects of the reforms take time, and the more they are delayed, the longer economies continue to grow below their potential. Member States are encouraged to make effective use of the tools available at the EU level, for example the European Structural and Investment Funds, the Structural Reform Support Programme, as soon as it is adopted by the co-legislators, and the Investment Plan for Europe. The Commission is ready to assist, as necessary. The Commission will continue its constructive dialogue with the European Parliament and Council to ensure swift advances on the priority initiatives at EU.

The Commission will also intensify the dialogue with the Member States in the run-up to the national programmes and country-specific recommendations next spring. This should build on a common understanding of successful reform implementation and sequencing, taking into account short- and medium-term impacts and distributional costs and benefits. Following the publication of the country reports during the winter, the Commission will continue to discuss with Member States through a variety of channels, including

²⁵ See Economic Policy Committee (AWG) and European Commission (DG ECFIN), (2015), “The 2015 Ageing Report: economic and budgetary projections for the 28 EU Member States (2013 – 2060)”, European Economy, No. 3, and European Commission (DG EMPL) and Social Protection Committee, (2015), “The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU”, European Union”, Vol I and II.

²⁶ COM(2014) 215

dedicated visits at political level under the steer of the responsible Vice-President. Member States will also have the possibility to provide their feedback on the Commission's analysis during the second round of bilateral meetings, and in the national reform programmes and stability and convergence programmes. In all these contacts, the Commission will put a strong focus on the implementation of country-specific recommendations adopted by the Council.

To prepare the national programmes, the Communication calls for a strong role of national Parliaments and a stronger involvement of social partners. The inclusive preparation of these programmes contribute to their ownership and to the broader reform support, and the Commission stands ready to facilitate contacts at all levels.