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COMMUNICATION FROM THE COMMISSION

Annual Growth Survey 2014

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COMMUNICATION FROM THE COMMISSION

Annual Growth Survey 2014

1. INTRODUCTION

The Annual Growth Survey (AGS) takes stock of the economic and social situation in Europe and sets out broad policy priorities for the EU as a whole for the coming year[1]. In so doing, it launches a new European Semester of economic policy coordination, ensuring that the EU and its Member States co-ordinate their economic policies and their efforts to promote growth and jobs. This year's guidance is set against the background of several significant economic and policy developments.

Firstly, the economic forecasts just published by the Commission[2] confirm signs of a slow recovery in the EU. After five years of very limited or negative growth, the EU has experienced positive growth in the second quarter of 2013. The recovery is expected to continue and to become more robust in 2014. Inflation is expected to remain subdued. At the same time, as illustrated in the Alert Mechanism Report[3] published alongside this AGS, first signs of rebalancing of the EU economy are visible and a number of important macro-economic imbalances are being corrected.

We have reached a turning point in the crisis but the incipient recovery is still modest and fragile, and the global economic context presents uncertainties, such as reduced demand in emerging economies. Risks linked to lack of confidence about banking sector resilience and to high sovereign debt are still present. The legacy of the crisis, deleveraging needs in the public and private sector, fragmentation of financial systems and credit markets, sectoral restructuring and adjustment and high levels of unemployment will continue to weigh on growth in the coming period. Its impact will gradually subside as accumulated macroeconomic imbalances are corrected. Improvements in the labour market will take time to materialise, with unemployment expected to remain unacceptably high in many parts of Europe for some time to come, and the broader social situation remains depressed[4].The duration and depth of the crisis has created hardship across Europe and particularly in countries implementing adjustment programmes.

Signs of economic improvements should thus be taken as an encouragement to pursue efforts with determination, avoiding risks of fall-back, complacency or "reform fatigue". The biggest challenge now is to keep up the pace of reform to improve competitiveness and secure a lasting recovery. The gradual recovery will underpin domestic demand which is expected to take over as the main engine of growth. Fairness considerations and clarity about the goals to be achieved will be essential to secure the lasting success, efficiency and public acceptability of efforts at national and European level.

Secondly, this AGS is published at the same time as new rules on the coordination of budgetary policies in the Euro area are implemented for the first time in full. In mid-October, all Euro area Member States, except those implementing a macroeconomic adjustment programme, had to present draft budgetary plans for the coming year. The role of the Commission is to review whether Member States are adopting the necessary measures to achieve the objectives agreed at EU level, before budgets are finalised at national level. The Commission's detailed assessment will be published shortly.

In parallel with this strengthening of EU economic governance, discussions on further developing Economic and Monetary Union (EMU) are progressing, as advocated in the Commission's Blueprint on a deep and genuine EMU[5] and the four Presidents' report "towards a genuine EMU"[6].

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1 Annex 1 provides an overview of country-specific recommendations adopted by the EU in July 2013. More information is available at: http://ec.europa.eu/europe2020/index_en.htm

2 http://ec.europa.eu/economy_finance/eu/forecasts/2013_autumn_forecast_en.htm

3 COM(2013)790.

4 Draft Joint Employment Report, COM(2013) 801.

5 COM(2012)777.

The establishment of a Banking Union, built on a strong common EU rulebook and a more effective regime for supervision and resolution of banks, will be key to strengthening financial stability in Europe. The Commission has also made proposals to strengthen the social dimension of EMU[7] and published consultative communications on the ex-ante coordination of major economic policy reform plans[8] and a convergence and competitiveness instrument[9].

Thirdly, 2014 will be the first year of implementation of the new European multi-annual financial framework. In addition to projects conducted jointly at EU level to boost Europe-wide innovation and infrastructure, an investment capacity of more than EUR 400 billion will be mobilised to boost growth and jobs at national and regional level through the European Structural and Investment Funds (ESIF). The Commission has been discussing priorities with the Member States and is also providing technical assistance to make sure operational programmes can start rapidly. The new ESIF will support the goals of the Europe 2020 strategy and will be used to support reforms identified in the EU country-specific recommendations. For the first time the policy and the funding are being brought together in what can be a very powerful driver of growth, provided funds are concentrated on priorities.

Taken together, the combination of the strengthened EU system of economic governance, the new EU multi-annual financial framework and EU-level policies such as completing the Internal Market and connecting Europe through physical infrastructure and pursuit of the digital agenda, amounts to real progress in creating the EU-level framework conditions for future growth in Europe. Member States should design their national policies taking these EU level instruments fully into account. This will not only enhance the impact of national policies but will also produce synergies at EU level.

Against this background, the Commission considers it crucial to stay the course of the policy response deployed in recent years. While maintaining the same medium term priorities as last year, the Commission is proposing to adapt their implementation to the changing economic and social circumstances described above. The EU and its Member States should thus pursue – and in some cases reinforce – their focus on making progress in the following five priority areas, with varying degrees of emphasis as described in the rest of this text:

- Pursuing differentiated, growth-friendly fiscal consolidation
- Restoring lending to the economy
- Promoting growth and competitiveness for today and tomorrow
- Tackling unemployment and the social consequences of the crisis
- Modernising public administration.

The order of this list does not reflect a hierarchy of priorities. As this year's Annual Growth Survey demonstrates, the top priority now is to build growth and competitiveness. The key challenge is to build a lasting recovery.

6 http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf
7 COM(2013)690.
8 COM(2013)166.
9 COM(2013)165.

Before developing these priorities further the next section looks at the achievements to date of the European Semester and highlights a number of areas where further political decisions are still needed.

2. DEEPENING THE EUROPEAN SEMESTER

Launched in 2010, the European Semester is the cornerstone of the EU's strengthened framework for integrated coordination and surveillance of Member States' economic and budgetary policies. This strengthened framework builds on the Stability and Growth Pact provisions, as well as on the new EU tools to prevent and correct macro-economic imbalances and covers the implementation of the Europe 2020 strategy for smart, sustainable and inclusive growth.

This framework has started to deliver results. A close partnership is being built between the Member States and the EU institutions, national procedures and timetables have been adjusted to enable EU level policy co-ordination to take place in a predictable framework. As a result, Member States have embarked on important reforms, putting in place the right conditions for a return to growth. Further detail on the implementation of country-specific recommendations is provided in annex.

Substantial progress has been made on fiscal consolidation. National fiscal frameworks have been significantly strengthened through e.g. the establishment of independent fiscal bodies and the setting of numerical fiscal rules and important fiscal reforms have been implemented in a difficult economic environment. This has helped to stabilise the increase in debt levels and improved financial markets' perception of the sustainability of public finances, thus lowering sovereign bond spreads. This has also contributed to preserving the integrity of the common currency and stabilising the financial system.

Important measures have also been taken by Member States to reform labour markets and enhance their resilience, combat segmentation and promote labour market participation. A special focus has been put on policies to reduce the unacceptably high levels of unemployment of young people. Youth Guarantees are being put in place to ensure that all young people under 25 receive a good quality offer of employment, continued education, an apprenticeship or a traineeship within four months of leaving formal education or becoming unemployed. However, given the time lag between reforms, economic recovery and labour market performance, the employment situation will take time to improve.

More needs to be done to improve the functioning and flexibility of product and services markets, e.g. by modernising network industries and further opening services sectors to support growth and jobs. Most vulnerable Member States are implementing significant reforms and in current account surplus countries, wage growth has become more dynamic supporting internal demand. However, in several Member States, further progress is needed in the implementation of structural reforms to assist in creating the much needed investment opportunities that will help shift resources towards the production of tradable goods and services, increasing external competitiveness and boosting productivity. In some less vulnerable Member States, reform efforts have been slower or even delayed and have been less ambitious. In particular this is the case of product market reforms which could improve competition in non-tradable sectors, spur investment and facilitate the reallocation of resources to non-tradable sectors.

More generally, in terms of deepening the European Semester as a process, there are a number of areas where further improvements are needed if the EU's new economic governance is to deliver its full potential. These include:

- Greater ownership at national level. National policy making is being changed by Europe's new economic governance. There is a need for national processes to take active account of this development, including by stepping up interactions with the European level. In many Member States, there is a need for greater involvement of national parliaments, social partners and civil society in the process in order to secure public understanding and acceptance of the necessary reforms. The Commission continues to recommend that the National Reform Programmes (NRP) and Stability or Convergence Programmes (SCP) be discussed with national parliaments and all relevant parties, notably social partners and sub-national actors.

- Stronger co-ordination among the members of the Euro area. The urgency of the crisis and time pressures have prevented the Euro area so far from moving from the consideration of country-specific recommendations to the consideration of policy measures and reforms that are needed for the well-functioning of the common currency as a whole. As the economy improves more time should be devoted to the ex ante co-ordination of key economic policies in the Euro area. This AGS has identified issues relating to productivity and competitiveness, weaknesses in labour and product markets that should be tackled holistically by the Euro area – removing rigidities in some Member States can create new opportunities for them and for all other Member States.

- Better implementation of the country-specific recommendations. Member States have the responsibility to decide on the policy mix that suits their national systems best but they should also, particularly those that share the Euro, take policy decisions that reflect the wider interests of their fellow EU members. This means a responsibility for national governments to realise that decisions in other countries are a matter of common interest, and to engage openly in multilateral decision-making, within existing institutional frameworks. In its EMU Blueprint[10] and a subsequent Communication[11] the Commission set out ideas on how quasi-contractual arrangements could, in combination with funding designed to support the implementation of key reforms, provide stronger incentives for implementation. It proposed that following adoption of the country-specific recommendations, notably those under the macro-economic imbalances procedure (MIP), Member States would make proposals for contractual arrangements. These would be voluntary under the preventive arm of the MIP and mandatory under the corrective arm (where they would correspond to the corrective action plan as set out in Regulation 1176/2011). The Commission also proposed that the contractual arrangements would be accompanied by financial support to help Member States to implement them more rapidly and more thoroughly than would be possible without additional financial support.

The Commission considers that it is now time to tackle the three areas described above in order to further enhance the effectiveness of the economic governance arrangements. The European Council meeting of October 2013 agreed to return to some of these issues at its December 2013 meeting. The Commission will provide input for that meeting in the form of principles that could be agreed and then developed in 2014.

[10] COM(2012)777.
[11] COM(2013)165.

3. PURSUING DIFFERENTIATED, GROWTH-FRIENDLY FISCAL CONSOLIDATION

Progress in fiscal consolidation is visible over time. The latest figures show that fiscal deficits, in nominal terms, are being reduced from 6.9% of GDP in 2009 to 3.5% in 2013 in the EU. In structural terms – taking account of the cyclical changes in the economic situation and net of one-off and other temporary measures – progress over the last year is in the order of 0.6 percentage point of GDP. Furthermore, debt levels are expected to peak in 2014, decreasing from 2015 onwards. This, together with other policy measures at EU and national level, has reduced pressure on sovereign bond markets, and means in many cases that the pace of consolidation can be moderated. Creating fiscal room for manoeuvre is also necessary in the light of the rising costs associated with Europe's ageing population.

The process of consolidation is noticeable at country level. A number of Member States have already reached sound budgetary positions. At the same time, following Latvia more than a year ago, Ireland is expected to exit its adjustment programme in December 2013, Spain will complete its bank restructuring programme in early 2014 and Portugal will conclude its adjustment programme in mid-2014. These examples show that well-targeted assistance programmes can help countries successfully return to the markets and sustain their financial needs.

Notwithstanding progress in returning to sound public finances, debt levels in most of the Member States remain high. This is why it is crucial to stay the course of the growth friendly, differentiated fiscal consolidation strategy that has been advocated by the Commission. As the remaining consolidation needs are now lower, the negative impact on growth should also be reduced. The overall improved fiscal and financial situation, which reduces the urgency of policy measures, will enable Member States to better design consolidation programmes and pay increased attention to their quality and composition as well as to the influence of fiscal policy on growth, public sector efficiency and social equity. While expenditure-led consolidation should be favoured the focus should be on an overall efficient and growth friendly mix of expenditure and revenue measures. Moreover, consolidation measures should be complemented by further measures to strengthen growth potential as strong economic fundamentals are needed to underpin fiscal sustainability.

For countries with relatively high tax rates, reductions in the levels of expenditure or a broadening of the tax base and the removal of ill-targeted exemptions, instead of tax rate increases, are effective ways of securing public finances without hindering growth potential. For Member States with greater fiscal room for manoeuvre, the Commission recommends measures to stimulate private investment and consumption and growth-friendly public investment, while remaining in line with the Stability and Growth Pact. Such measures include for instance more efficient public spending including by modernising public administrations, giving priority to public spending that reinforces economic growth potential, tax cuts and reductions of social security contributions. This should also help the rebalancing of the EU economy.

In terms of expenditure, Member States need to find ways to protect or promote longer term investment in education, research, innovation, energy and climate action. Particular attention should also be paid to maintaining or reinforcing the coverage and effectiveness of employment services and active labour market policies, such as training for the unemployed and Youth Guarantee schemes. At the same time, there is a widespread need to strengthen the efficiency and financial sustainability of social protection systems, notably pensions and healthcare systems while enhancing their effectiveness and adequacy in meeting social needs and ensuring essential social safety nets. In many countries, pension reforms should be completed by linking statutory retirement age to life expectancy more systematically.

In terms of revenues, tax levels have increased as a result of the crisis. Tax systems should be redesigned by broadening tax bases, and shifting the tax burden away from labour on to tax bases linked to consumption, property and pollution. Environmentally harmful subsidies should be reduced. Tax compliance should also be improved through fighting tax fraud and tax evasion, coordinated action to tackle aggressive tax planning and tax havens, by ensuring greater efficiency of tax administration and simplifying tax compliance procedures.

The Commission's assessment of the draft national budgetary plans for 2014 confirms the determination of the Member States to pursue the pace of fiscal consolidation, in line with the country-specific recommendations. It is also encouraging to see that, as part of the new EU rules, national fiscal frameworks have been reinforced, with economic forecasts and budgetary figures now subject to independent reviews. As a result, Member States' forecasts are more in line with those of the Commission and international organisations such as the IMF and OECD. This enhances the credibility and transparency of national and EU decision-making.

The Commission has identified the following priorities:

Fiscal consolidation should be a growth-friendly mix of expenditure and revenue measures, putting more emphasis on the quality of public expenditure, and the modernisation of administration at all levels. Where greater fiscal room for manoeuvre exists, private investment and consumption should be stimulated, for instance through tax cuts and reductions of social security contributions.

Longer term investment in education, research, innovation, energy and climate action should be protected and the needs of the most vulnerable in our society should be catered for.

Tax should be designed to be more growth-friendly, for instance by shifting the tax burden away from labour on to tax bases linked to consumption, property, and combatting pollution.

4. RESTORING LENDING TO THE ECONOMY

The signs of improvement in financial conditions detected last year have become more solid and financial markets have proven relatively robust. However, risks remain and lending conditions for businesses are far from being normalised.

Moreover, financial market fragmentation has led to very divergent interest rates for loans to businesses and households across the EU, with rates that are twice as high in some Member States than in others, and loan volumes and financing possibilities differ widely among potential borrowers depending on their location. According to an ECB survey[12] on the access to finance of SMEs, 85% of German SMEs that applied for credit in the second half of 2012 received the full amount but the average for southern European countries was just over 40% and only 25% for Greece. Such differences in access to credit cannot be explained only by differences in prevailing economic conditions.

Making sure the banking sector functions correctly in providing finance for productive activity is essential to sustaining economic recovery. Much has already been done to improve bank regulation and supervision, and the banks themselves have acted to restructure their balance sheets and raise

[12] European Central Bank (2013), ‘Report on the results of the survey on the access to finance of SMEs in the euro area - October 2012 to March 2013’.

capital to meet new standards.[13] However, the on-going process of balance-sheet repair in the banking sector, which plays a dominant role in financial intermediation, partly explains Europe's more limited ability to rebound after the crisis. In the process of repairing bank balance sheet, the onus is on the banks to find private sector solutions with access to public funds only as a last resort. In this context, the new state aid guidelines of the Commission provide for an appropriate level of burden sharing with bank shareholders when banks have to be recapitalised with public means.

Important and necessary steps have been taken at EU level to set adequate framework conditions and restore lending to the economy. The completion of a fully-fledged Banking Union is the core element of the EU response. It is essential not only for the stability of the euro area, but also for the functioning of the single market and overcoming the increasing fragmentation of financial markets. The recent agreement on a single supervisory mechanism for banks was a first big step towards Banking Union. It is essential to make the next step by agreeing on a single resolution mechanism and fund. To prepare the transfer of the supervision mandate to the ECB, a comprehensive assessment has been launched to enhance transparency regarding the health of banks' balance sheets, identify and repair any remaining weaknesses, and so improve market confidence. This should help to accelerate the process of balance-sheet repair and lay the conditions for a strong and sustainable resumption of credit growth. Beyond the banking sector, households and companies in many Member States remain over-indebted as a result of the crisis and still need to complete their financial deleveraging.

Specific measures have also been taken at EU level to facilitate access to finance for SMEs[14]. With the support of the European Structural and Investment Funds (ESIF), the amount of funding available through leverage-based financial instruments for SMEs should double on average for the period 2014-2020 compared to the period 2007-2013, helping in particular countries where financial conditions remain tight. Moreover, the Commission and the EIB are working to expand joint risk-sharing financial instruments to leverage private sector and capital market investments in SMEs, which should become operational in January 2014.

Priorities at national level will vary from country to country. Closer monitoring of private debt and associated financial risks, such as real estate bubbles, is necessary in a number of countries. This includes reducing the corporate tax bias towards debt financing and reviewing aspects of tax schemes which increase the debt bias of households, typically through tax relief for mortgages, as well as improving corporate and personal insolvency regimes[15]. New forms of financing should be promoted as alternatives to bank financing, such as options for venture capital, development of SME bonds and alternative stock markets[16].

The Commission has identified the following priorities:

[13] Cf. Directive 2013/36/EU and Regulation (EU) No 575/2013 OJ L 176, 27.6.2013.

[14] A number of recent or forthcoming EU legislative measures will also help SMEs gain access to sources of funding across Europe: the Regulation on ‘European Venture Capital Funds’, which is in force since July 2013, will facilitate cross-border fundraising and the creation of a genuine internal market for venture capital funds; the proposed Markets in Financial Instruments Directive (MiFiD), which should help the development of stock markets specialised in SMEs, and the proposal for a modification of the Transparency Directive, which will give better information on listed companies, will make SMEs more attractive to investors; the migration to the Single Euro Payments Area (SEPA) by 1 February 2014, which should cover most credit transfers and direct debits, will improve the efficiency of payment systems within the Euro area.

[15] These issues are covered in the relevant country-specific recommendations and where appropriate in the Alert Mechanism Report.

[16] Detailed proposals were made by the Commission in its Green Paper on the long-term financing of the European economy (COM(2013)150 of 25 March 2013).

Restructuring and repair of banks: this includes adopting and implementing the Banking Union swiftly as well as strengthening the capacity of banks to manage risks in line with the new rules on capital requirements and preparing for the asset quality reviews and stress tests.

Developing alternatives to bank financing, including options for venture capital, development of SME bonds and alternative stock markets.

Close monitoring of private debt levels and associated financial risks, such as real estate bubbles, and the impact of corporate and personal insolvency regimes, where necessary. This also includes schemes creating a tax bias towards debt financing.

5. PROMOTING GROWTH AND COMPETITIVENESS FOR TODAY AND TOMORROW

Important restructuring is taking place across Europe as a result of the crisis. As companies and households shed excessive debt and production factors move to more productive sectors of the economy, growth is returning. The driver for growth is moving from external to internal demand too. At the same time, it is becoming clear that its composition will be – and needs to be – different from ten or just five years ago. Moreover, globalisation and technological progress are steering further changes. Recovery in Europe does not mean getting back to "business-as-usual"; it means finding new sources of growth and competitiveness for the longer term, with knowledge-intensive and high-productivity activities for our economy. This is well illustrated by the increased integration of EU industries into global value chains which will help strengthen Europe's industrial base and requires open and interconnected product and services markets, investment in research and innovation and an appropriately skilled work force.

Economic growth is currently still held back in an important number of Member States by the high level of private indebtedness. This means that firms have no room to invest in productive activities and consumers are limited in what they can buy. Rigidities in labour and product markets have hindered competitiveness adjustment, efficient resource allocation and productivity growth and partly explain the divergence in potential growth rates across Member States.

An important change is taking place in countries which have engaged in deep structural reforms, with signs of an emerging shift in economic activities from the non-tradable sector to the tradable sector, in particular in the Member States which cannot use the exchange rate instrument. This is exemplified by an increase in exports and reduction of current account deficits in several countries. Such trends were helped by adjustments to labour costs as part of a broader strategy to reinforce the competitiveness and productivity of the economy. Improving the export performance of individual countries is also supported by an ambitious trade policy at EU level.

The country-specific recommendations identify a number of product and service market reforms of priority to each Member State, taking into account the need to sequence reforms according to national situations, and stress the need to open services markets, for example by screening regulatory restrictions including on access to regulated professions. Completing the internal energy market by 2014 would play an important role in helping to reduce energy costs and improving the cost-effectiveness of support schemes for renewable energy. More can be done to improve the efficiency of network industries, and boost innovation and research. Increasing resource efficiency and reducing the EU's dependence on external energy sources must be part of the EU's growth strategy. There are divergences between Member States, for example in waste and water management, which are holding back the considerable growth potential of the green economy.

While a number of these reforms may take time to produce their effect, their delivery is essential to support recovery and boost Europe's growth potential.

The impact of such reforms greatly benefits from the economies of scale of the European single market, supported by better physical and digital connections and appropriate data protection[17] across the continent. Several important work strands are currently being pursued[18]: an ambitious implementation of the Services Directive should boost domestic and cross-border supply and demand; the Commission's proposals for a more integrated single market in the telecommunications sector should be adopted as a matter of priority to boost the sector and the development of online economic activities and deliver fairer prices; the completion of the core TEN-T corridors, the enhancement of cross-border connections as well as the upgrading of existing infrastructure, the removal of restrictions on market access in particular in port and railway services, will serve the integration and competitiveness of the logistics and transport sector.

European research and innovation are held back by fragmentation and inadequate framework conditions. There is not enough collaboration between the public and private sectors. The inability to transfer research results into goods and services and a growing skills mismatch are particularly affecting knowledge intensive sectors. These negative trends can be reversed by accelerating the reform of national research systems in line with the proposed European Research Area. At the same time, new forms of cooperation can boost Europe's lead in the world. The implementation of the new EU-level research and innovation Horizon 2020 and COSME programmes will help the development of EU public-private partnerships in the field of R&D and support the modernisation of national innovation and research systems.

The Commission has identified the following priorities:

Full implementation of the third energy package in 2014, and improving the cost effectiveness of support schemes for renewable energy. Promoting resource efficiency by improving waste and water management, recycling and energy efficiency.

Improving the implementation of the Services Directive, including through the screening of restrictions affecting access to regulated professions, and their replacement where appropriate, with less restrictive mechanisms.

Accelerating the modernisation of national research systems in line with the objectives of the European Research Area.

6. TACKLING UNEMPLOYMENT AND THE SOCIAL CONSEQUENCES OF THE CRISIS

The social impact of the crisis is still being heavily felt. Unemployment rates remain historically high, at 11% on average in the EU (in July 2013), with a youth unemployment rate of 23.4%. These rates vary widely across Europe leading to growing divergence in employment and social outcomes between Member States. Given the time lag between economic recovery and impact on employment, the situation is not expected to improve rapidly and inequalities may rise. The crisis has had a particularly negative impact on the most disadvantaged and the share of people at risk of poverty has risen to 25% in the EU. This also includes a growing risk of structural unemployment and increased exit from the labour market, which could have significantly negative effects on EU growth potential.

[17] See the Commission Proposal for a General Data Protection Regulation, COM(2012) 11.
[18] See more information in the Single Market Report published alongside this Annual Growth Survey.

Europe's labour market and social fabric will take time to recover and needs reinvigorating as the economy emerges from the crisis. The immediate priority should be given to ambitious implementation and follow up of reforms regarding the functioning of the labour market so that participation can be increased. This also includes boosting sources of jobs in expanding sectors, maintaining the employability of the labour force including the long term unemployed and the most vulnerable groups, including through active support and training of the unemployed and making sure that social safety nets fully play their role. In a context of an ageing labour force, longer and more fulfilling working lives require adequate skills and lifelong learning, enabling working environments, and also addressing the impact of gender pay and activity gaps on women's pension entitlements. Access to affordable care services will help the participation of women in the labour market. Stronger involvement of social partners, in line with national practice and tradition, are essential for the design and implementation of the policy response.

Several important reforms have been adopted by Member States to modernise their labour markets and promote enhanced labour market participation. The positive impact of such reforms should become visible as the macro-economic environment improves.

To stimulate job creation, action should be taken to reduce the tax wedge on labour, as part of overall efforts to shift the tax burden, in particular for low paid workers and young workers; to make sure that wage developments should be in line with productivity and thus supportive of both cost competitiveness and aggregate demand; continue to modernise employment protection legislation to remedy persistent labour market segmentation and to reinforce the fight against undeclared work. The greening of the economy, the digital sector and health care services are areas that will generate significant job opportunities in the years to come. There is a need to develop strategic frameworks in which labour market and skills policies play an active role in supporting the job creation in these sectors and anticipating and adjusting to new patterns of growth. Labour mobility, including cross-border, will benefit from the reinforced cooperation and from a strengthened EURES-network, that will help firms and job-seekers find opportunities in other Member States.

Action is also needed to improve education and skills performance. The EU is still lagging behind its 2020 targets on tertiary educational levels and reducing early school drop-outs. Moreover, according to the OECD, 20% of the EU workforce still has a serious lack of skills, including low literacy and low numeracy skills. 25% of adults also lack the skills to effectively make use of ICT. This creates bottlenecks and mismatches[19] for a number of jobs and professions, and more generally reduces the capacity of the EU labour force to adapt and progress in the labour market. It is essential to invest in the modernisation of education and training systems, including life-long learning, in particular dual learning schemes, and to facilitate the transition from school to work, notably by increasing the availability of good quality traineeships or apprenticeships. In this context, Member States should swiftly adopt Youth Guarantee Implementation Plans, and related funding programmes (Youth Employment Initiative and European Social Fund) should be finalised as soon as possible.

Better performing social protection is essential to support social change and reduce inequalities and poverty over time. Active inclusion strategies should be developed, encompassing efficient and adequate income support, activation measures as well as measures to tackle poverty, including child poverty, and broad access to affordable and high-quality services, such as social and health services, childcare, housing and energy supply. The link between social assistance and activation measures should be strengthened through more personalised services ("one-stop shop") and efforts to simplify

[19] Currently, there are about 1,9 million job vacancies in the EU.

and better target benefits will help improving the take-up of measures by vulnerable groups and their effectiveness.

The Commission has identified the following priorities:

Stepping up active labour market measures, notably active support and training for the unemployed, improving the performance of public employment services and implementing a Youth Guarantee.

Further reform efforts to ensure that wage developments should be in line with productivity and thus support both competitiveness and aggregate demand, to remedy labour market segmentation, notably by modernising employment protection legislation, to support job creation in fast-growing sectors and to facilitate labour mobility.

Pursuing the modernisation of education and training systems, including life-long learning, vocational training and dual learning schemes.

Improving the performance of social protection systems, in particular by strengthening the link between social assistance and activation measures through access to more personalised services ("one-stop shop") and efforts to simplify and better target benefits with particular attention to the situation of the most vulnerable.

7. MODERNISING PUBLIC ADMINISTRATION

In the current climate, public administrations across the EU face the challenge of delivering "better with less", i.e. meeting public needs in times of tighter budgets, improving the business environment by providing better services to business and citizens, and adapting service provision to the needs of a more digital economy.

Several Member States are looking to make efficiency gains in the organisation of their administrations, including by improving cooperation between different layers of government. Some Member States also have scope to strengthen the administrative capacity of the public service, its professionalism and the quality of policy-making. Increasing the use of ICT and further deployment of e-government services in Europe, such as e-procurement, can help to increase efficiency and reduce costs in the order of 15-20%[20]. In this respect, the integration of the national points of single contact, established as part of the Services Directive, into e-government services is essential to cross-border cooperation. There is further scope to modernize tax collection and other systems, for example by providing pre-filled tax forms, on line services and "one time only" provision of data by citizens to the public sector. Well-targeted financial support, in particular through the European Social Fund and the European Regional Development Fund, can make a major contribution to the modernisation of public administrations. At the same time, Member States need to bolster the public investment capacity of national, regional and local administrations to mobilise the ESIF programmes 2014-2020.

There is potential to simplify the business environment, reduce red tape and improve the quality of legislation. There is also a continued need to put in place lighter regulatory regimes, particularly for SMEs. This includes reducing the complexity of setting up a business and the length of permit and licensing requirements. Improving the quality, independence and efficiency of judicial systems,

[20] Public Services Online, e-gov benchmark insight report for the European Commission.

including by ensuring that claims are settled within a reasonable period of time and modernising national insolvency legislation would considerably improve conditions for firms.

At EU level, simplification and streamlining of EU legislation is promoted through the on-going regulatory fitness and performance programme (REFIT). Some important progress has already been achieved. The Commission will publish an annual REFIT scoreboard to track progress and facilitate dialogue on regulatory fitness with Member States, business, social partners and civil society at large. In addition, a smooth and consistent implementation of EU law, moving away from 28 solutions to a common framework, will contribute to good cooperation among public administrations and help make activities in the single market simpler and rules more predictable. More cooperation between tax administrations is essential to fight against tax fraud and tax evasion.

The Commission has identified the following priorities:

Further deploying e-government services and increasing the use of ICT by public administrations, including for tax collection systems, and for single market points of contact of the Services Directive.

Simplifying the business environment, reducing red tape through the introduction of lighter processes and regulatory regimes.

8. CONCLUSION

Important progress has been achieved over the last year in putting Europe back on track for a more sustainable recovery. The integrity of the common currency was preserved, with greater financial stability and decisive steps taken to put public finances in order. Countries most exposed to financial vulnerabilities have been most engaged in initiating ambitious structural reforms, with visible first results. Raising levels of competitiveness and improving productivity to create sustainable jobs remain clear priorities across Europe.

This Annual Growth Survey confirms that far-reaching changes are taking place in Europe, more than is sometimes perceived, and that the reforms which are underway are producing their effects. Since its inception, the European Semester of economic policy coordination has raised the sense of priority and transparency, and given focus to national and European reform agendas. In a short time it has succeeded in laying the groundwork for deeper co-ordination of economic policy between Member States. The macro economic imbalances procedure is helping to identify economic developments which are harmful for individual Member States or the Euro area so that they can be tackled before they get out of hand. The annual country specific recommendations identify the key areas where Member States need to make changes accordingly.

It is also clear from experience to date that national ownership of the process (and in particular of the country-specific recommendations) needs to be developed further. This is important for the democratic legitimacy of the new governance system as well as to ensure that EU level policy elements are factored into national decision making at the right time. The Euro area also needs to step up its co-ordination of certain key policy areas and to move beyond assessing the bilateral recommendations to its members. The European Council has scheduled a discussion on several of these issues for its December 2013 meeting. Building on its EMU Blueprint and subsequent communications the Commission will provide input on how to strengthen further the European Semester process.

The guidance provided in this Annual Growth Survey will be discussed at the EU level to prepare for the March 2014 European Council and to help in the preparation of the next round of national programmes and country-specific recommendations. The Commission will work closely with national authorities, including national parliaments, other EU institutions, social partners and stakeholders to create a shared sense of ownership and steer progress as part of wider EU efforts to lay the foundations for smart, sustainable and inclusive growth across the EU. The Commission invites the European Parliament and the Council to endorse the priorities set out in this Annual Growth Survey and to pursue their realisation at EU and national level.

<u>ANNEX 1 - OVERVIEW OF EU COUNTRY-SPECIFIC RECOMMENDATIONS FOR 2013-2014</u>

	Public finances				Financial sector		Structural reforms					Employment and social policies					
	Sound public finances	Pension and healthcare systems	Fiscal framework	Taxation	Banking and access to finance	Housing market	Network industries	Competition in service sector	Public administration and smart regulation	R&D and innovation	Resource efficiency	Labour market participation	Active labour market policy	Wage setting mechanisms	Labour market segmentation	Education and training	Poverty and social inclusion
AT	■	■	■	■	■		■	■	■			■				■	
BE	■	■	■	■			■	■	■		■	■	■	■		■	■
BG	■	■	■	■	■		■	■	■		■	■	■			■	■
CZ	■	■		■				■	■	■	■	■	■			■	
DE	■	■	■	■	■		■	■				■	■			■	
DK	■							■	■			■				■	
EE	■		■				■		■	■	■	■	■			■	
ES	■	■	■	■	■	■	■	■	■			■	■		■	■	■
FI	■	■	■					■	■	■	■	■	■	■		■	
FR	■	■	■	■			■	■	■			■	■	■	■	■	
HU	■		■	■	■		■	■	■	■		■	■			■	■
IT	■		■	■	■		■	■	■	■		■	■	■	■	■	■
LT	■	■	■	■			■		■		■	■	■		■	■	■
LU	■	■	■	■						■	■	■	■	■		■	
LV	■		■	■			■		■	■	■	■	■			■	■
MT	■	■	■	■	■		■		■		■	■	■			■	
NL	■	■		■		■						■			■		
PL	■	■	■	■			■	■	■	■	■	■	■		■	■	■
RO	■	■		■	■		■	■	■	■	■	■	■			■	■
SE	■			■		■		■				■	■			■	
SI	■	■	■	■	■			■	■			■	■	■	■	■	
SK	■	■		■			■		■	■	■	■	■			■	■
UK	■			■	■	■	■					■	■			■	■

Note: Country specific recommendations for 2013-2014 adopted by the Council on 9 July 2013. Cyprus, Greece, Ireland and Portugal should implement commitments under EU/IMF financial assistance programmes. More information at: http://ec.europa.eu/europe2020/index_en.htm

<u>ANNEX 2 - PROGRESS IN KEY AREAS OF THE COUNTRY-SPECIFIC RECOMMENDATIONS</u>

This annex provides a thematic overview of 3 years of experience of how Member States have implemented the country-specific recommendations in key areas.

Overall, significant progress has been made on fiscal consolidation in recent years, although the composition of the fiscal adjustment has not always been growth-friendly.

- The fiscal adjustment in 2013 has been mainly expenditure-based in IE, EL, LT and PL. Sizeable cuts in public investment expenditure were done in PL and SK. Other countries have relied on a mix of revenue-based and expenditure-based fiscal consolidation, such as in BE, ES, IT, RO and SI. The adjustment has been mostly revenue-based in CZ, FR, LU, NL, PT and FI.

- When consolidating their finances, Member States have generally increased tax rates (standard VAT rates in particular) and not many have broadened the bases. Environmental and property taxes have increased but there is still room to make these taxes more efficient. All Member States have adopted some measures to counter tax evasion and improve tax compliance.

- Many Member States have increased the overall tax burden (direct and indirect taxes as well as social contributions). However, it is positive to note that tax shifts are taking place to some extent, such as reforms of property taxation and more emphasis on indirect taxes instead of labour taxation.

- 23 Member States have now legislated to increase the pensionable age.[21] In many cases, this is accompanied by an equalisation of pensionable ages for men and women (CZ, EE, EL, HR, IT, LT, MT, PL, SI, SK, UK). Many Member States have introduced an explicit and sustainable link between the pensionable age and future gains in life expectancy (CY, DK, EL, IT, NL, SK). Most have also taken steps to restrict access to early retirement, as well as to prolonged forms of unemployment (e.g. ES) or invalidity benefits (e.g. AT, BE, BG, DK) which were used as substitute for early retirement.

Difficulties in accessing finance remain one of the main obstacles to growth, particularly for small and medium sized enterprises (SMEs).

- Member States have adopted measures to combat payment delays in order to alleviate businesses' liquidity constraints. PT, EL, ES and IT have all adopted plans to reduce the backlog from public administrations and deal with the stock of arrears.

- Growing attention is paid to forms of loan securitisation to unlock credit supply for SMEs, with ES as a good example. In parallel, growing efforts are made to develop non-banking market-based financing, such as the development of a corporate bond market in DK, EE, IT and PT.

- Most Member States have put measures in place to develop venture capital funds. CZ, DE and ES are launching new public venture capital funds, while PT has consolidated existing funds to maximise their impact. In addition, several Member States, including EE, NL, PL and ES, are setting up 'funds of funds' to promote the emergence of a venture capital market with numerous private funds.

[21] For an overview of the pensionable age across the EU see COM(2013) 350.

– FR has announced a five-year tax relief for equity investments in start-ups. A new programme was launched in DE to provide private investors with additional financial incentives to invest in young and innovative companies.

More needs be done in product and services markets to boost the EU's growth potential.

– Some Member States have undertaken important reforms to open their services sector and make it more effective, including PT, ES, IT, EL, PL, SI and CZ. There is however important scope for reforms in several Member States including in AT, BE, DE and FR, which have not fully implemented their country-specific recommendations in this area and all need to renew efforts under the Services Directive implementation.

– The sum of all public R&D budgets in the EU decreased for the first time in 2011 since the beginning of the crisis, and is now below the one of China. Over the last two years, some Member States made significant efforts in favour of R&D (AT, BE, LU, HU, PL and SE), while others reduced considerably their budgets (ES, IE, IT, MT and PT). Most Member States have expanded or introduced new tax breaks for research and innovation to stimulate private investment. The innovation gap is widening in Europe, with SE, DE, DK and FI as the most innovative economies. A number of countries are catching up (LV, SK, LT and EE) but others (UK, PL, CZ, HU, PT, RO, EL, BG, MT) have lost ground in comparative terms since 2010.

– As regards energy markets, there are still 14 Member States lagging behind in the transposition of the third energy package. Considerable investment is still needed in energy infrastructure across Europe, but measures have been taken to improve interconnections both for gas and electricity (e.g. electricity interconnections between PT and ES, the UK and IE and in the Baltic region). Furthermore, in order to limit energy consumption BG, CZ, EE, LT, LV, RO, SK are working on energy efficiency programmes which could be financed by ETS revenues and ESIF.

– Obstacles to the development of the rail services sector are noticeable in the following Member States: AT, BG, CZ, DE, EL, ES, FR, HU, IE, LU, PL, PT, SI. They concern the separation of accounts between infrastructure managers and railway undertakings, the use of track access charges, and interoperability issues.

Important reforms are on-going in most Member States to modernise labour markets.

– Top personal income rates are at their highest level since 2008. The overall tax burden on labour has increased, but Member States (BE, DK, FI, FR, HU, IT, NL, PT, SE) have decreased labour taxes for specific groups. There is a tendency to increase progressivity.

– Countries with large imbalances have implemented far-reaching reforms in their wage-bargaining system to allow for greater flexibility in wage adjustment. Over 2007-2012, the fall in unit labour costs compared with competitors has been significant for countries such as IE, EL, ES and PT. On-going reforms, notably of wage setting mechanisms, are expected to further support the adjustment process in countries such as EL and ES.

– ES, IT and FR undertook reforms to modernise their employment protection legislation and combat the segmentation of their labour market. Significant reforms are also initiated or considered in LT, NL, PL and SI.

- A number of Member States have reinforced and better targeted their ALMP measures and improved public employment services (BG, DE, EE, IE, EL, IT, LT, LU, SK, FI, SE, UK).

- Action is being stepped up to combat youth unemployment, including through the establishment of Youth Guarantees. Overall investment in education and training has diminished during the crisis in particular in BG, EL, IT, SK and RO. The modernisation of education and training systems remains an urgent priority in many Member States. Some (CZ, SK, UK) are developing the use of innovative performance based funding models in higher education.

- The development of high-quality apprenticeships and dual vocational training is a priority in many countries (EL, ES, IT, LV, PT, SK). Several countries have initiated reforms to reduce school drop-outs and to adapt higher education curriculae to labour market needs (AT, IT, PL). In the light of increasing unemployment, notably long-term, most Member States report measures to increase participation in life-long learning.

- In their efforts to address poverty, a number of countries are introducing or strengthening activation measures and reforming their social assistance systems (LT, CY, DK, EL, HR, IT, PL and RO).

Overall, the business environment is still lagging behind that of our global competitors.

- Relative weaknesses differ widely across countries. Starting up a business is easy in Ireland and the UK, but enforcing contracts less so. Compared to other Member States, the time needed to resolve insolvency is relatively low in IE, BE, FI, DK, UK, AU, NL and DE, but the protection of investors is considered weaker in some cases. In FR, ES and LU, obtaining a construction permit is cumbersome, and in ES and LU start-up conditions are complex. Enforcing a contract in IT, EL, MT, CY and SI is still considered costly and time-consuming.

- According to the recent EU competitiveness report, based on a series of indicators, moderate performers and countries lagging behind have been improving their business environment most significantly since 2007, while leading countries have slid down in the ranking, or have improved only marginally. This means that in spite of considerable differences remaining, an overall catching up in performance and practices is taking place across the EU.