



Council of the
European Union

Brussels, 19 December 2019
(OR. en)

15321/19

ECOFIN 1166
UEM 393
SOC 817
EMPL 617
COMPET 808
ENV 1050
EDUC 490
RECH 532
ENER 548
JAI 1347

COVER NOTE

From: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 18 December 2019

To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
the European Union

No. Cion doc.: COM(2019) 650 final

Subject: COMMUNICATION FROM THE COMMISSION Annual Sustainable
Growth Strategy 2020

Delegations will find attached document COM(2019) 650 final.

Encl.: COM(2019) 650 final



Brussels, 17.12.2019
COM(2019) 650 final

**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 Sustainable Growth Strategy 2020

{SWD(2019) 444 final}

‘I want Europe to strive for more when it comes to social fairness
and prosperity. This is the Union’s founding promise.’
Ursula von der Leyen, 16 July 2019

INTRODUCTION

Economic growth is not an end in itself. An economy must work for the people and the planet. Climate and environmental concerns, technological progress and demographic change are set to transform our societies profoundly. The European Union and its Member States must now respond to these structural shifts with a new growth model that will respect the limitations on our natural resources and ensure job creation and lasting prosperity for the future.

The European economy has successfully left the years of financial crisis management behind. While it is now in its seventh year of consecutive growth, external and geopolitical prospects are dimming, uncertainty is running high and Europe looks to be heading towards a period of subdued growth and low inflation.

To stay competitive in tomorrow’s world and to achieve Europe’s goal of climate neutrality, we must now turn to addressing the economy’s longer-term challenges. The coming into office of a new Commission with an ambitious European Green Deal, with priorities on a Europe that works for the people and a Europe fit for the digital age is a good moment for a new start towards this sustainable, new growth model.

This economic agenda must transform the Union into a sustainable economy, helping the EU and its Member States to achieve the United Nations Sustainable Development Goals, which they committed to. It must drive and accompany the twin digital and climate transition, transforming our Social Market Economy to ensure that Europe remains the home of the world’s most advanced welfare systems and is a vibrant hub of innovation and competitive entrepreneurship.

The European Green Deal is our new growth strategy. It puts sustainability – in all of its senses – and the well-being of citizens at the centre of our action. This requires bringing together four dimensions: environment, productivity, stability and fairness.

At the heart of our growth strategy are four complementary dimensions.

First, our efforts should focus on leading the transition to a nature-friendly and climate neutral continent by 2050, while ensuring that everyone can take advantage of the opportunities that this will bring along

Second, by developing new technologies and sustainable solutions, Europe can be at the forefront of future economic growth and become a global leader in an increasingly digitalised world, including in key areas for its technological sovereignty such as cybersecurity, artificial intelligence and 5G. Digital technologies are a key enabler of the European Green Deal.

Third, the Union needs to complete its Economic and Monetary Union to ensure that all economic tools are ready and available should there be a significant adverse economic shock. The international role of the euro must be strengthened to enhance Europe’s clout in the world

and on global markets and to help protect European firms, consumers and governments from unfavourable external developments. A vibrant and resilient Economic and Monetary Union, resting on the solid foundations provided by the Banking Union and the Capital Markets Union, is the best means to increase financial stability in Europe and thereby, the international role of the euro.

Fourth, the new economic agenda must ensure that the transition is fair and inclusive and puts people first. It must pay particular attention to the regions, industries and workers who will have to make the largest transitions.

At the core of this will be an industrial strategy with strong foundations in the Single Market that enables our businesses to innovate and to develop new technologies while boosting circularity and creating new markets. That means refocusing Europe's economic policy towards the long term, with the objective of offering younger generations in all parts of Europe a sustainable and prosperous future. We need to move from an incremental to a systemic approach across all policies, taking a “whole-of-government’ approach. It will need to be an inclusive process, developed with the European Parliament, the Member States, social partners and the stakeholders. The Sustainable Development Goals will be at the heart of EU’s policymaking and action. To this end, the European Semester provides a well-established framework for the coordination of economic and employment policies needed to guide the Union and its Member States through these transformations, which have economy-wide implications. In this Annual Sustainable Growth Strategy, the Commission outlines the economic and employment policy priorities for the EU. Within this approach, synergies can be created, trade-offs between the four dimensions of the growth agenda can be addressed and solutions presented.

1. Europe’s economic outlook

The European economy is now in its seventh consecutive year of growth. The economy is expected to continue expanding in 2020 and 2021, even though growth prospects have weakened. Labour markets remain strong and unemployment continues to fall, though at a slower pace ⁽¹⁾. Public finances continue to improve, our banking system is more robust and the foundations of our Economic and Monetary Union are stronger. Investment and potential growth, however, still remain below pre-crisis levels. Government budgetary balances are expected to deteriorate slightly between 2019 and 2021, due to the impact of lower growth and somewhat looser discretionary fiscal policies in some Member States, including expansionary fiscal policies in some.

The near-term economic outlook is overshadowed by a much less supportive economic and geopolitical environment and high uncertainty. Global growth prospects are fragile. Trade tensions in the manufacturing sector and geopolitical uncertainty are having a negative

¹ The Proposal for a Joint Employment Report from the Commission and the Council, adopted together with the Annual Sustainable Growth Strategy (COM(2019) 653), presents a detailed account of labour market and social policy developments, including through the Social Scoreboard

impact on investment decisions. A decrease in trade intensity, coupled with low productivity growth could have a long-lasting impact on Europe's position in a world that is increasingly defined by the rivalries between the United States and China. This in particular affects the manufacturing sector, which is also experiencing structural shifts. As a result, the European economy looks to be heading towards a period of more subdued growth and low inflation. Euro area gross domestic product (GDP) is now forecast to expand by 1.1% in 2019 and by 1.2% in 2020 and 2021. For the EU as a whole, GDP is expected to rise by 1.4% per annum between 2019 and 2021.

The medium-term economic prospects are hampered by an ageing population, sluggish productivity growth and the rising impact of environmental degradation. By 2024, an ageing populations means the work force in 11 Member States is estimated to fall by more than 3% compared to today². By 2060, the EU's workforce will decline by 12%. This, combined with a decades-long trend of declining productivity growth puts a strain on the growth potential of the economy and put on public finances in the future. In addition, the impact of environmental degradation is expected to increasingly affect economic activity, through more frequent extreme weather conditions, influences on human health and less reliable access to material resources and ecosystem services.

With clouds forming on the horizon, Europe must develop a new growth paradigm that effectively addresses the long-term challenges transforming its society. This new paradigm will also be key in establishing Europe's political and economic leadership at global level. It will also boost potential growth, helping Europe to remain strong in the face of rising uncertainty in the short-term.

2. A new paradigm to address interrelated key challenges

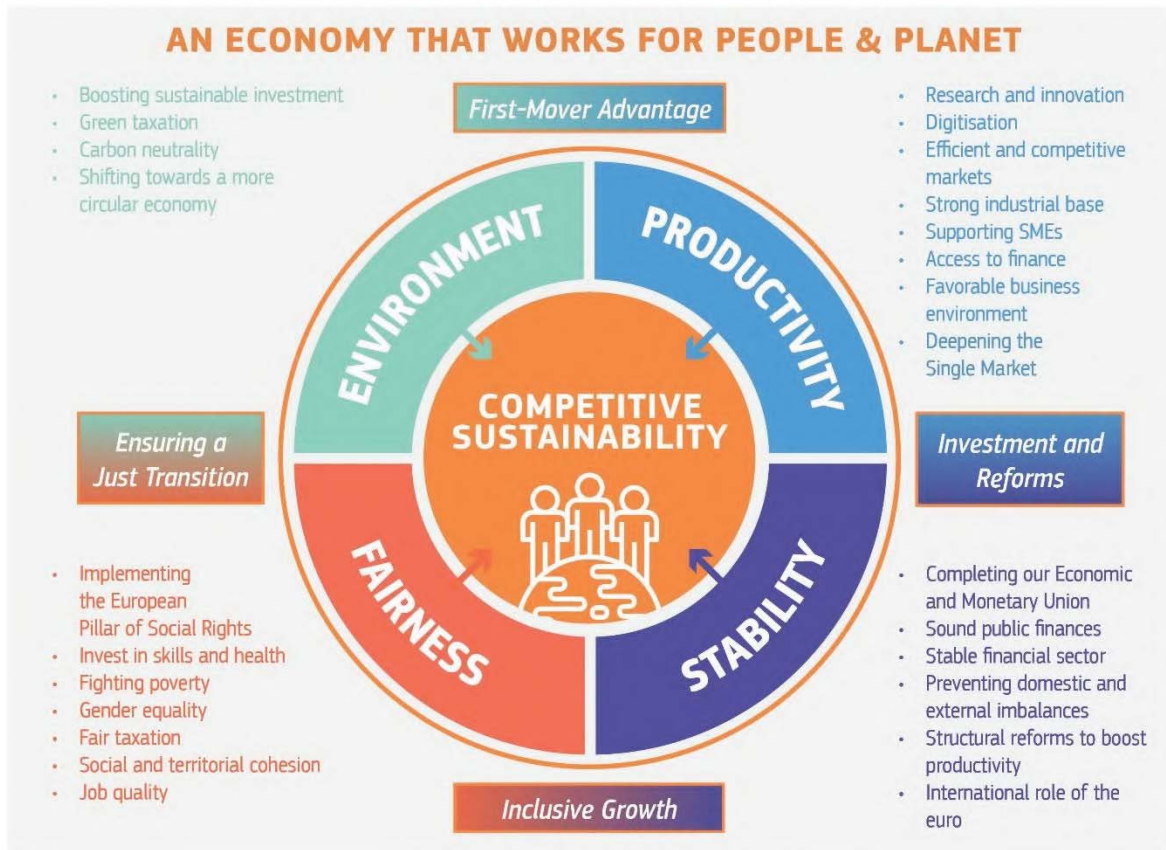
Competitive sustainability has always been at the heart of Europe's social market economy and should remain its guiding principle for the future. Moving towards a sustainable economic model, enabled by digital and clean technologies, can make Europe a transformational frontrunner. Leadership on environmental protection and a strong, innovative industrial base must be seen as two sides of the same coin, giving the EU a competitive first-mover advantage. A stable economy, allowing for policies focused towards the long-term, and a just transition for those most affected by the transformations are prerequisite for success and should complete our framework.

Environmental sustainability, productivity gains, fairness and macro-economic stability will be the four dimensions of our economic policy in the years to come. These dimensions, which are closely interrelated and mutually reinforcing, should guide structural reforms, investments and responsible fiscal policies across all Member States.

These four key dimensions will be crucial in implementing the Sustainable Development Goals (SDGs). Integrating the objectives of the SDGs in the European Semester, with a specific focus on the economic and employment aspects, provides a unique opportunity to put

² The 2018 Ageing Report https://ec.europa.eu/info/sites/info/files/economy-finance/ip079_en.pdf

people, their health and the planet at the centre stage of economic policy. In today's geopolitical context, putting the SDGs at the centre of the Union's policymaking and action also sends a strong message about Europe's commitment towards sustainability.



To succeed, costs and benefits need to be balanced in the short and long term. Benefits should be shared and costs must not be borne by the most vulnerable. Both climate change itself and the flanking policies required to overcome the challenges it creates have significant distributional consequences, especially in the short term. When designing policies and formulating recommendations for structural reforms, we need to ensure that support for the people most affected by these societal changes is put in place. On the other hand, the green transition will also create new jobs and greater well-being, for example in the form of healthier working and living environments. Also in other policy areas, short term trade-offs exist. For example, when it comes to seeking a more inclusive growth, the labour market integration of more lower-skilled workers may reduce average productivity in the short-term. This, however, does not change the long-term advantage of labour market integration contributing to a more balanced and prosperous society over time. To maximise synergies between the various policy goals outlined, significant public and private investments will be needed, for example in education, retraining and innovation.

3. Environmental sustainability

Tackling climate and environmental challenges is this generation's defining task. It will remain so for the years to come. The transition to climate neutrality requires a profound transformation of the economy within one generation. These changes do not only concern the energy, building and transport sectors, but also industry, agriculture and services sectors. At the same time, these changes offer a unique opportunity to modernise the ageing capital stock of the EU economy and to relaunch competitiveness in a sustainable way with people at the centre of the transition

With a stronger focus on climate and environmental policies, the European Semester is reinforced as an encompassing tool for economic and employment policy. The growth opportunities arising from a stronger focus on environmental sustainability are central to Europe's economic agenda. The Semester can provide specific guidance to Member States on where structural reforms and investment towards a more sustainable and competitive economic model are most needed. It can also help Member States to identify and address key trade-offs, for instance by tackling the social impacts of rising energy prices through adequate social and fiscal policies. Europe needs to act decisively in areas like the circular economy, renewable energy, energy-efficient buildings and low-emission transport. The EU's industry is already one of the most energy-efficient in the world. Europe needs to capitalise on this and provide additional incentives for businesses and investors to enable Member States attain ambitious climate objectives. Support for the people, sectors and regions, which are most affected by the transformation, needs to be factored into the reforms. Further deepening cohesion policy's emphasis on green and digital investment will contribute to the strategy

Europe needs to invest record amounts in cutting-edge research and innovation, using the full flexibility of the next EU budget to focus on the areas with the greatest potential. Investments should be directed towards clean assets that are the most productive in mitigating climate change and to disruptive innovation efforts both at EU and national level. Achieving the existing 2030 climate and energy targets will require EUR 260 billion of additional investment in the energy system annually in 2021-2030. The biggest investment push will be required to improve energy efficiency in the residential and tertiary sectors. In addition, significant investments are needed in power generation and grid infrastructure. The swift roll out of alternative fuels infrastructure within the next two years will be critical for the automotive industry to achieve the emissions targets for new cars.

In this context, changes to tax/subsidy systems are needed, to ensure the incentives are climate and environmentally-friendly, and to raise the necessary funding to invest. Yet, public funding alone will not be enough. We need to tap into private investment by putting green and sustainable financing at the heart of Europe's investment chain and financial system.

Through the Sustainable Europe Investment Plan, the European Union can play a catalysing role for private and public green investments. This plan will combine dedicated financing to support sustainable investments with proposals for an improved regulatory framework, mobilising sustainable investment in every corner of the EU. This will be achieved by devoting a greater share of EU expenses to climate than ever before, by crowding in private funding through guarantees, by creating an enabling framework, and by helping project promoters structure bankable green projects. The InvestEU Programme will contribute significantly here. In addition, the European Investment Bank (EIB) Group will become

Europe's climate bank by doubling its climate target to 50%. Under the upcoming Just Transition Mechanism, the Commission is also working with the EIB Group towards mobilising significant investments for regions that will need to be particularly assisted in the environmental and climate transition during the period of the next MFF.

Increasing revenues from the EU emissions trading system (ETS) provides an additional source for financing climate action and the modernisation of the economy. In 2018, revenues from ETS auctions amounted to some EUR 14 billion. In 2019, the revenues from EU ETS auctions are expected to be even higher and over the coming years, annual revenues will remain considerable. This money should be used to support the achievement of 2030 climate and energy targets and invest in the transition to climate-neutrality.

4. Productivity growth

In the context of population ageing and increasingly binding resource constraints, future income and employment growth in Europe will depend crucially on higher productivity and innovation. Productivity growth in the EU remains significantly below the level of other global players. Member States stopped converging with the United States in the 1980s. This also reflects the global situation of European firms. Among the top 100 largest publicly listed companies, today only 23 are European. Ten years ago, 40 were European. At the same time, disparities within the EU have increased, with the top 10% of the regions more than six times more productive than the bottom 10%. The establishment of National Productivity Boards could benefit national debates on how to boost productivity by providing high-quality and independent analysis and enhancing national ownership of structural reforms.

Achieving higher productivity requires a systematic and forward-looking research and innovation strategy. The productivity gap between the best performing and laggard firms has increased in most Member States. Structural reforms aimed at fostering the spread of innovation and improving access to finance could enable a much wider set of firms to benefit from innovations, thus boosting productivity growth. Public and private investment in innovative technologies, including advanced digital technologies, should be supported to foster the creation of new goods, services and business models. More young and nimble innovators with breakthrough technologies are needed, like this generation's tech giants were only a decade ago.

Digital technologies, like Artificial Intelligence or the Internet of Things and access to data are crucial to a more productive and green economy. They are changing how we communicate, live and work. The changing dynamics brought about by the digital transformation require additional ambition at EU and national levels in terms of increased investment, innovation-conducive regulation, effective reforms and a human-centric approach based on European values. Europe needs a strong industrial base, built on a common strategy and pooled resources in key sectors, to be able to produce domestically the technologies it needs to stay at the forefront of global competition. Europe also needs to remain technologically sovereign by investing in innovative technologies like block-chain, high-performance and quantum computing, algorithms and tools to allow data sharing and data usage. Data and Artificial Intelligence are major drivers for innovation that can help us to

find solutions to societal challenges, from health to farming and food production, from security to manufacturing.

In times of increasing global tensions, the EU Single Market offers Member States multiple opportunities to expand trade, create jobs and boost growth. The Single Market is a major source of resilience for the EU economy. Europe's competitors are continent-sized economies, so the EU needs a true, continent-sized single market. The benefits are clear: technological advances spread faster in a unified market. Well-functioning product and services markets are a key driver of productivity growth, as they enable a more efficient allocation of resources. However, progress in market integration is uneven and we need a new impetus is needed not least for the digital single market, European networks and the Capital Markets Union.

At the core of the Single Market, standardisation plays a key role to further the EU sustainable development agenda. Standards are essential to steer business towards Sustainable Development Goals as they act as bridges linking legal provisions with down-to-earth technical practice. Standards also contribute to competitiveness by reducing production costs and increasing market size. For these reasons, standardisation can help developing innovative products and production processes that based on recent technological progress contribute to energy efficiency, enhanced recycling, and sustainable production. The clearest examples of the role of standards in promoting the sustainable development agenda are "Ecodesign" and the Energy Labelling policy framework³. Finally, standards also contribute to a fair global competition.

Box 1: Contribution of the Single Market and Single Market Performance Report⁴

The Single Market is a major asset of the Union. The unprecedented integration of the past 25 years has resulted in closer economic and social connections between individuals and businesses across Member States. The Single Market holds potential to deliver more benefits to individuals and businesses.

The Single Market needs to be completed and implemented in those areas where the results of past efforts still fall short of the expectations, and it needs to be continuously updated to face new challenges. This is also true for recently adopted legal acts affecting the **digital** side of the economy. The financial crisis has emphasised the importance of stability and integration in **capital and financial markets**, where fragmentation remains a handicap for firm growth and investment. **Energy** has become a key element of integration for the Union, but energy markets still remain largely fragmented at national level. Environmental, climate and infrastructure objectives are also critical to ensure that the Single Market performs in line with social expectations. The Single Market is being deeply transformed to enable EU firms and individuals to get the most out of the possibilities offered by new technologies, such as digitalisation.

³ Since 2009, Ecodesign has been delivering substantial energy savings and associated avoided CO₂ emissions, as well as, increasingly, material efficiency savings.

⁴ Single Market Performance Report SWD(2019) 443

The Single Market is key to the European Semester and vice versa. Many of the structural barriers preventing full delivery of the benefits of the Single Market are actually due to regulations or administrative practices at national, regional or local levels, worsening the business environment and discouraging firms from operating cross-border. The lack of administrative capacity or professionally qualified staff damages the performance of public procurement markets in some Member States.

These findings are reflected in the **Single Market Performance Report**, which is a novelty in the 2020 European Semester cycle, and which is published alongside this Annual Sustainable Growth Strategy.

The objective of the report is to **assess the market performance of the real economy in the Single Market**. Whilst in the past, monitoring efforts focused mainly on the legal environment of the Single Market to ensure that it was properly enforced, the report focuses primarily **on the results and achievements of the Single Market**.

The report firstly takes into account the **obstacles hindering the delivery of Single Market benefits to citizens and businesses**. Secondly, it assesses the **Single Market achievements**: more choice for consumers and businesses, lower prices, and high standards of consumer safety and environmental protection. Lastly, it scrutinizes a broad range of activities relevant for the good performance of the Single Market **including its environmental performance and digitalisation**. Against this background, the Single Market Performance Report intends to highlight the importance of structural reforms at a Member State level for a good performance of the Single Market.

Closer attention to Single Market issues will also support integration. The benefits of structural reforms in a closely integrated market will benefit domestic consumers in the country where such reforms are carried out, but they will also spill over to consumers in other Member States.

The financial sector in Europe needs to better support innovation and investments in the economy. Europe needs to continue developing its financial markets so that all viable companies can get funding to invest in job creation and growth, including the innovative companies of the future. Further measures towards completing the Capital Markets Union will ensure that companies have access to the financing they need to grow, innovate and scale up. Firms, and in particular SMEs, need to benefit fully from the integration in cross-border value-chains and the seamless coalescence of industry and services that characterises the digital age. The EU budget will also contribute to this by unlocking private investment in these sectors.

Higher productivity and innovation cannot be achieved without a far reaching investment in education and skills development. It is vital to support adult workers, in particular the 60 million low qualified adults, to develop broader skills sets at a higher level. Similarly, reforms in initial education and training are needed to reverse the trend of an increasing share of underperforming pupils – now above 20% in reading, maths and science. The digital skills gap needs to be addressed. Comprehensive skills strategies should be focused on the individual needs for up-and re-skilling, a shared responsibility between

individuals, businesses and governments, taking into consideration the needs of the most vulnerable.

Growth and productivity need to be supported by competitive and efficient markets and structural reforms that remove bottlenecks in the business environment. Good governance, effective institutions, independent and efficient justice systems, quality public administrations, robust anti-corruption frameworks, an efficient delivery of public procurement, effective insolvency frameworks and efficient tax systems are important determinants of a Member State's business environment. All these aspects, including those related to the rule of law, can have an impact on investment decisions and are therefore important to increase productivity and competitiveness. This is all the more so in a globalised and digitalised environment with very mobile capital. Insights into the institutional and administrative performance of the Member States, gathered from other existing governance processes, will feed into the European Semester and inform the macroeconomic assessment.

5. Fairness

To strengthen its economic and social performance, the EU must fully deliver on the principles of the European Pillar of Social Rights. While the economic recovery helped to improve employment and social outcomes across Europe, action is needed to ensure the enjoyment of social rights and to counter the risks posed by a growing social divide.

Every worker in Europe deserves fair working conditions. In-work poverty is still above the pre-crisis levels in the majority of EU countries, with almost 1 out of 10 workers in Europe at risk of poverty. While decreasing, involuntary part-time work remains high in several Member States, and the spread of atypical forms of work contributes to labour market segmentation. In this perspective, making sure that each worker earns a fair wage, promoting transitions towards open-ended full-time contracts, as well as investing in people and their skills are important policy objectives. A stronger involvement of social partners and more support for building their capacities should be promoted in countries where social dialogue is weak. To ensure that workers continue to receive support also in case of a strong economic shock, a European Unemployment Benefit Reinsurance Scheme - SURE could complement the national action. In addition, the EU should step up the efforts to address all forms of irregular employment that contribute to social dumping and exploitation of workers.

Women remain at a disadvantage in the labour market. Despite generally better educational outcomes for women, the gap with men in terms of employment rate and pay have remained broadly stable in recent years. Closing these gaps would have a positive impact on the economy and society. Promoting effective work-life balance policies, ensuring access to quality childcare and tackling tax and benefit disincentives to working are crucial to increase the employment rates of women and help fight child poverty.

Promoting fairness requires investment in skills, adequate and sustainable social protection systems and fighting against exclusion. Improving the inclusiveness and quality of education and training systems is crucial to foster the inclusion of all people in tomorrow's societies. Early school leaving should be reduced and the quality and attractiveness of vocational education and training increased. Yet, investment in skills is far from sufficient. Social protection systems need to be adapted to protect all those in need, irrespective of their

working status. Europe also has to address more efficiently the inequalities borne by groups at risk of exclusion, including persons with a disability, Roma and migrants, to ensure that they can make full use of their potential to contribute to the economy, social protection systems and society. Population ageing makes investing in healthcare and long-term care increasingly important, while ensuring the sustainability of the social protection system in order to ensure intergenerational fairness.

Challenges to cohesion across and within Member States have increased. In the aftermath of the economic and financial crisis, inequalities in income and access to basic services have grown within the Member States. Regional disparities in Europe continue to pose a challenge as they affect growth negatively. While the poorest regions have become more prosperous since 2010, their economic gap with richer regions has widened including as a result of a decline in investment. In some cases, technological change and the energy transition could increase this gap further, unless suitable measures are taken to boost regional competitiveness.

The EU must remain an engine of cohesion. To address regional and social disparities, opportunities need to be created for those not directly benefiting from market openings and technological change. This includes upgrading skills through better education and training and ensuring appropriate regional convergence on issues like access to healthcare and quality education. Member States need to continue reforming to that end, using the full support of the tools in the EU budget. Connectivity of regions and accessibility to mobility are crucial both for cohesion and productivity and need to be supported by appropriate investment.

When designing and implementing climate and environmental policies not all Member States, regions and cities start from the same place. This is why climate policies must remain framed into a cohesive approach to avoid undermining convergence. While the move towards a sustainable economic model can potentially boost growth and employment across the EU over the medium term, policy measures are required to mitigate negative impact on specific sectors and regions in the short term. Some sectors will need to transform themselves, while many other sectors will have to take action to preserve their competitiveness. The impact of these changes is likely to be unequally felt across Europe. A new Just Transition Mechanism will provide tailored support to the people and regions most affected and to ensure that nobody is left behind. It will put particular emphasis on the reconversion of regions most impacted by the transition out of fossil fuels.

Tax evasion, tax avoidance and a race to the bottom on taxation undermine the ability of countries to set tax policies that meet the needs of their economies and people. National tax and benefit systems should be optimised to strengthen incentives for labour market participation, to increase fairness and transparency and to ensure the financial sustainability and adequacy of welfare systems in a changing world of work. Tax systems should also ensure sufficient revenues for public investment, education, healthcare and welfare, guarantee fair burden-sharing and avoid distortion of competition between firms. The fight against aggressive tax planning practices and the fair taxation of globalised companies are essential in this respect. EU corporate tax systems are in urgent need of reform. They are not fit for the realities of the modern global economy and do not capture the new business models in the digital world. Where profits are generated, taxes and levies must also contribute to our social security systems, our education and health systems and our infrastructure.

6. Macro-economic stability

The European Union must further increase the stability of its economy by addressing the remaining fragilities at the national and EU level. This is a precondition to ensure resilience against future shocks and facilitate the transformation. This means responsible economic, fiscal and financial policies at the national level in the short-term and adequate policy planning for the longer term. This also means that action needs to be taken at the EU level to complete the key reforms to strengthen the euro area.

Coordination of national fiscal policies, in full respect of the Stability and Growth Pact, is needed to support the proper functioning of the Economic and Monetary Union. Responsible and responsive fiscal policies, leading to sound and sustainable public finances are needed to ensure that fiscal policy can fulfil all its functions. The euro area fiscal stance is expected to be broadly neutral to slightly expansionary in 2020 and 2021. At the same time, national fiscal policies remain insufficiently differentiated in light of the available fiscal space in Member States. The pursuit of prudent fiscal policies by Member States with high levels of public debt would put public debt on a downward path, reduce vulnerability to shocks, and allow for the full functioning of automatic stabilisers in the event of an economic downturn. On the other hand, further boosting investment and other productive spending in Member States with a favourable budgetary situation would support growth in the short and medium term, while also helping to rebalance the euro area economy. In case of a worsening outlook, an effective response would call for a supportive fiscal stance at the aggregate level, while pursuing policies in full respect of the Stability and Growth Pact, taking into account country-specific circumstances and avoiding pro-cyclicality to the extent possible.

To ensure stability, potential sources of domestic and external imbalances need to be addressed, while protecting investments in future sustainability and productivity. Both domestic and external imbalances need to be kept in check through appropriate monitoring and structural reforms. With the low interest rate environment, Member States with deleveraging needs should make swift process to reduce debt without jeopardising investment. Current high levels of public debt are a source of vulnerability in some Member States and a constraint on governments delivering macroeconomic stabilisation when needed. Debt reduction will also be necessary to provide Member States with fiscal room for manoeuvre to deal with future challenges and free up funds for investment. This is especially true, considering the constrained balance sheets of banks and the indebtedness of the private sector. Further correcting large external stock imbalances and reducing corporate and household debt is important to decrease vulnerabilities.

Improving the quality of public finances is important to boost potential growth and support the economic transformation related to climate and digital challenges. Efforts should take place on the revenue side as well as on the expenditure side through regular spending reviews, prioritising expenditure that fosters long-term growth and making use of green budgeting tools. On the expenditure side, spending reviews should be carried out regularly and expenditure that fosters long-term growth, in particular for education, employment and investment, should be prioritised. On the revenue side, taxes should support the transition to a green economy, become fairer and move to sources less detrimental to growth.

The financial sector needs to be strengthened further through the completion of the Banking and Capital Markets Union. This should be achieved, inter alia, by setting up a European Deposit Insurance Scheme, reducing non-performing loans, addressing the bank-sovereign nexus, improving bank insolvency laws and by adopting measures to further enhance financial integration. Simultaneously, rising unit labour costs or sharp increases in housing prices in a number of countries need to be monitored closely, while macro-prudential frameworks need to be adapted and appropriate measures to be taken where necessary to prevent the accumulation of new imbalances. Further work on the Capital Markets Union is necessary to diversify sources of funding for companies and investment opportunities for savers, thereby increasing private risk sharing in the euro area. The financial system also needs to be made more resilient to cyber and climate threats.

Europe needs well-targeted investments to support the move to a climate-neutral and fully digital economy deployed. The flexibility allowed within the Stability and Growth Pact should be fully used to enable the necessary investment while safeguarding fiscal sustainability. This will help us achieve a more growth-friendly fiscal stance in the euro area while safeguarding fiscal responsibility. A swift adoption of the new multiannual financial framework is also key to ensure the prompt availability of additional investment in support of the digital and climate transformation (see Box 2).

All the above will be essential to reinforce the international role of the euro, a key enabler to increase European clout on global markets. It will help European firms, consumers and governments to withstand unfavourable external developments and assert the role of euro area economy on the world stage. The urgency to act has become even stronger in the current context, where global rivalries and threats to the multilateral system are giving rise to new economic conflicts via trade and currency conflicts, which risk undermining many of the benefits of globalization.

Box 2: The contribution of the EU budget – the need to swiftly adopt the new multiannual financial framework

The European Union budget is at the center of our policy ambitions coming to life.

Building on existing and new mechanisms, a **Sustainable Europe Investment Plan** will deliver investments necessary to deliver on the European Green Deal. A **Just Transition Mechanism** will deal with the most affected regions and ensure no one is left behind.

The InvestEU Programme is expected to mobilize over EUR 650 billion of additional investment by 2027, through the use of an EU guarantee. It is a key instrument to crowd-in private financial resources to promote EU objectives.

Cohesion policy funds (European Regional Development Fund, European Social Fund Plus, Cohesion Fund) play a crucial role in supporting social and territorial cohesion in our Member States, regions and rural areas, to keep up with the digital and green transformations of our world. The Commission's proposal for the next multiannual financial framework established the overall allocation for cohesion policy for 2021-2027 at EUR 374 billion in current prices.

The Reform Support Programme will expand the tools available at EU level to help implement structural reforms in all Member States, providing both technical and financial support. Within that, the Budgetary Instrument for Convergence and Competitiveness is expected to provide support for reforms and investment in euro-area Member States.

The EU budget will invest record amounts in cutting-edge research and innovation, using the full flexibility of the next EU budget to focus on the areas with the greatest potential. Horizon Europe will provide EUR 98 billion to investments in innovation in the EU.

The EU budget will act as a catalyst to leverage sustainable private and public investment and channel EU support for the clean energy transition to where it is most needed. Already under the current long-term budget for 2014-2020, the EU budget has increased the weight of climate and environment in its spending programmes. Climate change mitigation and adaptation has been integrated and mainstreamed into all major EU spending areas. In its proposal for an EU budget of over EUR 1 trillion over 2021-2027⁽⁵⁾, the European Commission increased its ambition to spend at least 25% of expenditure on climate-related activities; this represents EUR 320 billion. Under the future common agricultural policy (CAP), a new green architecture will make a stronger contribution to care for the environment and climate, with actions under the CAP expected to contribute 40% of the overall financial envelope of the CAP to climate objectives.

7. Refocusing the European Semester

The new growth strategy with its focus on competitive sustainability will help us achieve the Sustainable Development Goals (SDGs). The economic, social and environmental challenges are of economy-wide relevance. To succeed we will require considerable efforts in all policy areas, at EU and national level. A key factor of success is the ability of public authorities to drive economic, social and fiscal policies towards the achievement of the SDGs. The contribution of the different levels of governance within the EU towards achieving the SDGs is complex due to the division of competences between Member States and EU institutions. While the transformational challenges are commonly shared, the starting point differs: some Member States more exposed to economic, social and environmental risks or have more progress to make towards reaching the Sustainable Development Goals. Differentiated, yet closely coordinated, policies in Member States are therefore necessary. Over the past decade, the European Semester has established itself as the key tool for the coordination of national economic and employment policies. As such, it can help drive these policies towards the achievement of the SDGs by monitoring progress and ensuring closer coordination of national efforts in the area of economic and employment policies, keeping its focus on issues that have economy-wide implications.

The refocusing of the European Semester has already started through the broader economic narrative put forward in this Annual Sustainable Growth Strategy. It will continue with the 2020 country reports, the Commission's analysis of the Member States' social and economic situation. As a first step, the 2020 reports will feature a reinforced analysis and monitoring on the SDGs. They will include anew dedicated section focusing on

⁵ Commission proposal for a Council Regulation laying down the multiannual financial framework for the years 2021 to 2027, COM/2018/322

environmental sustainability will be added to complement the analysis on economic and social challenges. The aim is to support Member States' actions by identifying synergies and trade-offs between environmental, social and economic policies at national level. The analysis of the reports will also support the use of EU funds for sustainable investments in the European Union. In addition to this new section, each country report will also include a new annex setting out the individual Member States' SDG performance. This new annex will monitor each country's progress, based on Eurostat's EU SDG indicator set. In addition, the Commission has invited Member States to take stock of progress made on the SDGs in their national reform programmes, as a qualitative complement to the indicator-based monitoring by the Commission within the Semester that will capture the economy-wide aspects of the related policies. The objective is not to create additional administrative burden for the national administrations but rather to build on existing national monitoring tools, such as for instance the annual Voluntary National Reviews foreseen at the UN level, in order to provide more useful guidance and coordination at EU level. Building on the country reports, the Commission's proposals for the 2020 country-specific recommendations, to be adopted in May, will highlight the contribution of national reforms to progress towards specific SDGs, where instrumental to ensure the coordination of economic and employment policies on economic challenges that are a matter of common concern.

By developing this new approach in this Semester cycle and over the years to come, the European Semester will directly support the European Union and its Member States in delivering the SDGs across its economic and employment policies and ensure that the economy works for everyone and growth is sustainable.



Source: United Nations.

CONCLUSIONS AND NEXT STEPS

Putting this sustainable growth strategy to work is a joint endeavour. It will require the combined action and commitment of all European actors. The European Council is invited to endorse this strategy. Member States should take account of the priorities the Commission has identified here in their national policies and strategies, as set out in their Stability or Convergence Programmes and their National Reform Programmes. On that basis, the Commission will propose country-specific recommendations, which Member States will eventually adopt in the Council. Member States are thus ultimately responsible for the content and implementation of these recommendations.

Member States should make full use of the available EU policy and funding instruments. The Commission stands ready to support Member States in their reform efforts by providing technical support, in particular through its proposed Reform Support Programme, for all Member States. As part of that, for euro-area Member States, the Budgetary Instrument for Convergence and Competitiveness is expected to provide tailored incentives and support for reforms and investment. Finally, cohesion policy funds play a crucial role in supporting social and territorial cohesion.

Economic governance and democratic accountability must go hand in hand. The European Parliament should have a stronger voice on the EU economic governance. To this end, the Commission will engage in a dialogue with the European Parliament on how to make this operational going forward. As a first step, Members of the Commission in charge of economic matters will come to the European Parliament before each key stage in the European Semester cycle. This enhanced democratic accountability of the European Semester should help to enhance ownership and therefore reform implementation. More broadly, the Commission will continue the dialogue with Member States, and invites the Member States to involve national parliaments, social partners and all other relevant stakeholders.