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

Annual Growth Survey 2015

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INTRODUCTION

Having come through the worst financial and economic crisis in generations, the EU has done a lot to create the foundations for more sound and sustainable growth in the future. But despite national and European efforts, recovery is weaker than expected one year ago. The momentum began to slow in spring 2014. The economic crisis triggered an ongoing social crisis and the slow recovery is hampering efforts to reduce the high levels of unemployment.

While the global economic environment explains some of the current slowdown, specific domestic factors are preventing faster growth in the EU. There are large variations between Member States. Growth continues to be held back by the fragmentation of financial markets as a result of the financial and sovereign debt crisis; the need to reduce company, household and government debt; incomplete adjustment of macroeconomic imbalances; and shaky confidence, due to uncertainty about the economic outlook and commitment to structural and institutional reforms. Low productivity gains, low levels of investment and high structural unemployment limit Europe's growth prospects.

At the same time the EU and its Member States must deal with a range of long-term trends affecting job creation and growth, notably linked to societal and demographic change, globalisation, productivity and technological developments, pressure on resources and environmental concerns as well as generally weaker growth in emerging and developing countries.

The arrival of a new Commission, with an ambitious agenda for "Jobs, Growth, Fairness and Democratic Change"¹, is the right moment for a fresh start. It is urgent to revitalise growth across the EU and to generate a new momentum for change. This Annual Growth Survey, together with the documents accompanying it, sets out the Jobs, Growth and Investment Package announced as a first priority in the Political Guidelines for this Commission.

Box 1. Key findings of the Commission's autumn 2014 forecast²

- Real GDP growth is expected to reach 1.3 % in the EU and 0.8% in the euro area for 2014 as a whole. This should rise slowly in 2015, to 1.5 % and 1.1% respectively, as foreign and domestic demand improve. For 2016, an acceleration of economic activity to 2.0% and 1.7% respectively is expected.
- Unemployment reached 24.6 million people in August 2014 – 5 million are aged between 15 and 24. Long-term unemployment is very high. Unemployment rates strongly vary across Member States, from 5.1% in Germany and 5.3% in Austria to 24.8% in Spain and 26.8% in Greece in 2014.
- The low inflation trend is expected to continue this year, with lower commodity prices, in particular for energy and food, and the weaker-than-expected economic outlook. The gradual recovery of economic activity over the forecast horizon is expected to lead to an increase in inflation in the EU, from 0.6% in 2014 to 1.0% in 2015 and 1.6% in 2016.

¹ Cf. Political Guidelines for the new Commission of 15 July 2014: http://ec.europa.eu/about/junker-commission/docs/pg_en.pdf

² Commission's autumn 2014 forecast, 4 November 2014: http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee7_en.pdf

- The deficit-to-GDP ratios are set to decrease further this year, albeit more slowly than in 2013, from 4.5% in 2011 to respectively 3.0% for the EU and 2.6% for the euro area. Government deficits are forecast to continue falling over the next two years, driven by strengthening economic activity. The debt-to-GDP ratios of the EU and the euro area are expected to peak next year at 88.3% and 94.8% respectively and remain high in a number of countries.

In this Annual Growth Survey for 2015, the Commission which took office on 1 November 2014 outlines the main features of its new jobs and growth agenda. Reviving growth can only be achieved if the EU Institutions and the Member States work together to deliver on Europe's social market economy. This Annual Growth Survey thus sets out what more can be done at EU level to help Member States return to higher growth levels and make progress towards sustainable development. Making it happen will require a determined commitment to change and to doing things differently at national level.

1. AN INTEGRATED APPROACH

Today, the risk of persistent low growth, close to zero inflation and high unemployment has become a primary concern. The impact of the crisis has not only been cyclical, as highlighted by the weakness in aggregate demand, but also has a significant structural component which has lowered the potential growth of EU economies.

Structural, fiscal and monetary policies have to be combined in an integrated, growth-friendly approach to tackle this challenge effectively, acting both on the demand and supply sides of our economies. This requires action at all levels of government from global, notably in the context of the G20, to EU, national, regional and local levels.

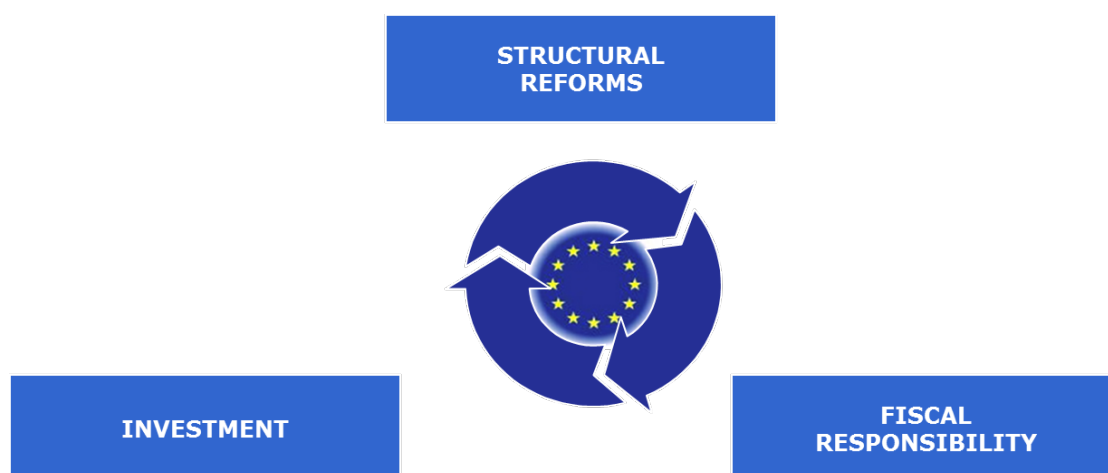
Meanwhile, within its mandate and in full independence, the European Central Bank (ECB) will continue to play a key role in the overall policy setting of the euro area. The ECB has the exclusive responsibility for monetary policy in the Euro area. It has taken a number of important measures to ease the monetary policy stance and enhance its transmission to broader financial conditions, notably through its Asset Backed Securities (ABS) purchase programme which started last October. Combined with the covered bond programme and the Targeted Longer-Term Refinancing Operations (TLTRO) programme, the overall impact of these three measures on the balance sheet of the ECB will be significant. It is expected that the size of the balance sheet will steer toward the size reached at the beginning of 2012. These measures should support economic activity as they work their way through the economy.

It is time for public authorities at all levels to take responsibility. Given the differences between Member States, the right approach will inevitably vary from country to country, whilst nevertheless remaining part of a common, integrated approach. The Commission recommends three main pillars for the EU's economic and social policy in 2015:

- **A coordinated boost to investment:** alongside this Annual Growth Survey, the Commission is putting forward an Investment Plan for Europe which should mobilise at least EUR 315 billion of additional public and private investment over the period 2015-2017 and improve significantly the overall investment environment.

- **A renewed commitment to structural reforms:** this is essential for countries to grow out of debt and to stimulate the creation of more and better jobs. Progress at national and EU level in areas like services, energy, telecoms and the digital economy, as well as in improving conditions for business create new opportunities for jobs and growth. Cutting "red tape" at European and national level as part of the Better Regulation Agenda is essential to create the right regulatory environment and promote a climate of entrepreneurship and job creation. This requires national ownership and commitment at the highest government level as well as by national Parliaments. Europeanising these efforts offers great potential.
- **Pursuing fiscal responsibility:** despite considerable progress in fiscal consolidation, Member States still need to secure long term control over deficit and debt levels. Fiscal policies should be differentiated, depending on the situation of each country. Member States with more fiscal space should take measures to encourage domestic demand, with a particular emphasis on investment. Moreover, the quality of public finance should be raised by improving expenditure efficiency and prioritising productive investment in government spending, by making the tax system more efficient and supportive of investment. Addressing tax fraud and tax evasion is essential to ensure fairness and allows Member States to collect the tax revenues due to them.

Graph 1. An integrated approach



Simultaneous action in all three areas is critical to restore confidence, reduce the uncertainty that is impeding investment and to maximise the strong mutually reinforcing effects of all three pillars working together. In particular, it is clear that a renewed commitment to structural reforms will be essential for the sustainability of public finances and for mobilising investment.

To implement the logic of the new integrated approach, the Commission proposes to streamline and reinforce the European Semester of economic policy coordination in support of the three pillars.

To strengthen the link between structural reforms, investment and fiscal responsibility, the Commission will also provide further guidance on the best possible use of the flexibility that is built into the existing rules of the Stability and Growth Pact.³

2. BOOSTING INVESTMENT

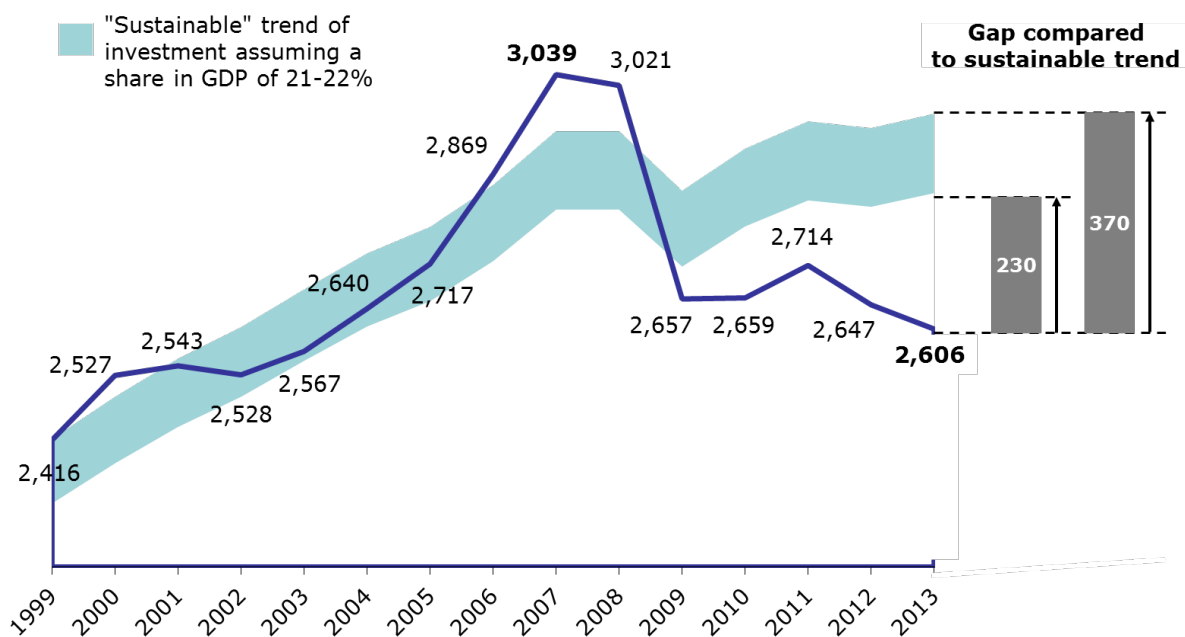
Weak investment hampers Europe's recovery

There is an urgent need to boost investment in Europe. Due to the crisis, the level of investment has fallen by about EUR 430 billion since its peak in 2007 – a 15% drop. In some Member States, that dip is even more dramatic.⁴ The Commission's autumn forecasts show that weak investment is holding back the EU's fragile recovery.

The aim is not to return to the peak of 2007 with the same kind of investments – some pre-crisis investments were unsustainable. However, it is worrying to see that investment has not rebounded recently in Europe, in contrast to the U.S. In 2013, investment was still at 19.3% of GDP, roughly 2 percentage points below its historical average if one excludes the boom-bust years. This leaves Europe with an investment gap of EUR 230 to 370 billion below its long-term trends.

Graph 2. Recent investment trends in the EU

(Real gross fixed capital formation, EU-28, 2013 prices, EUR billion)



At the same time, large investment needs are not being met. For example, households and companies need and want to benefit from the latest technologies and become more energy and resource efficient. Education and innovation systems are less well equipped and less funded than those of our key competitors. Our welfare systems need to be modernised to meet the challenges of the rapid ageing of our population. Our energy sector needs to upgrade its

³ As announced in the Political Guidelines for the new Commission of 15 July 2014.

⁴ This is notably the case for Italy (-25%), Portugal (-36%), Spain (-38%), Ireland (-39%), and Greece (-64%).

networks with the latest technologies, integrate renewable sources of energy and diversify our sources of supply. Our transport sector must modernise its infrastructure, reduce congestion and improve trade connections. Our environment needs better waste, recycling and water treatment facilities. And we need far-reaching and faster broadband and smarter data centres across Europe.

These needs are acutely felt after so many years of low or no growth, with a risk that Europe's productive capital stock shrinks and ages. This would further reduce our competitiveness and growth potential, weighing on our productivity and capacity to create jobs.

There is no single or simple answer. This lacklustre investment performance has several sources: low investor confidence, subdued expectations of demand and high indebtedness of households, businesses and public authorities. In many regions, the uncertain outlook and credit risk worries have prevented SME's from getting finance for worthwhile projects.

There are substantial private sector savings and ample liquidity now, but this money is not finding its way to Europe's real economy. This is where public authorities at all levels have a role to play.

A lot can be done at national and regional level

National and regional authorities have a key role to play in promoting the necessary structural reforms, exercising fiscal responsibility and boosting investment in support of jobs and growth. Member States with fiscal room for manoeuvre need to invest more. All Member States, but in particular those with more limited fiscal space, should ensure an efficient use of resources, prioritise investment and growth-related expenditure in their budgets, getting more investment out of EU Funds at their disposal and creating an environment more conducive to investment by private actors.

There is a unique window of opportunity for national and regional authorities in the coming months to make the best possible use of the EU budget for the period 2014-2020, since new tools and instruments are becoming available. The EU budget amounts to EUR 960 billion for this seven-year period, corresponding to EUR 140 billion per year, the equivalent of 1% of EU GDP. Key EU programmes such as Horizon 2020 (for innovation and research), the Connecting Europe Facility (for infrastructure) and COSME (for SMEs finance) are coming on stream now.

This is also true for the new generation of European Structural and Investment Funds, which will provide EUR 350 billion for new investment during 2014-2020. This will turn into investments of over EUR 600 billion when national co-financing is included. The significance of the Funds varies across countries but they can play a very strategic role everywhere, representing 10% of total public investment on average in the EU.

An Investment Plan for Europe

The Investment Plan for Europe that the Commission is presenting alongside this Annual Growth Survey will complement and boost existing efforts. It will mobilise at least EUR 315 billion between now and end 2017 in additional public and private investment. In the first instance, this can be done through a joint effort of the EU institutions and the European Investment Bank (EIB) by setting up a new European Fund for Strategic Investments. However, the impact of the Plan will be multiplied going beyond the EUR 315 billion as more

stakeholders join in with additional voluntary contributions: Member States, National Promotional Banks (NPBs), regional authorities and private investors all have a central role to play. Importantly, in the context of the assessment of public finances under the Stability and Growth Pact, the Commission will take a favourable position towards capital contributions into the new Fund.

This additional money should be focused on infrastructure, notably energy and broadband networks; as well as transport infrastructure in particular in industrial centres; education, research and innovation; renewable energy and energy efficiency. These are areas where clear needs exist and where progress is expected to bring large economic and societal returns.

As it is deployed, the Investment Plan will serve three related policy objectives: to reverse recent downward investment trends and provide an additional boost to job creation and the recovery of the EU economy; to take a decisive step towards meeting the long-term needs of our economy by boosting its competitiveness in strategic areas; to strengthen the European dimension of our human capital and physical infrastructure, with a special focus on the interconnections that are vital to our single market.

This Investment Plan has been developed taking account of national governments' limited fiscal space to avoid weighing on national public finances. Fiscal responsibility is part of restoring the confidence which Europe needs to recover from the crisis. This is why the Plan is built on solutions available at EU level, and on established bodies and procedures that will help to speed delivery, as well as rigorous execution and accountability.

Box 2. Main features of the Investment Plan for Europe

The Investment Plan for Europe is based on three mutually reinforcing strands:

- The mobilisation of at least EUR 315 billion in additional investment finance between now and end 2017.
- Targeted initiatives to make sure that investment reaches the needs of the real economy.
- Measures to improve the investment environment, making investment in Europe more attractive.

Mobilising at least EUR 315 billion additional finance for investment at EU level

- A new European Fund for Strategic Investments will be set up, in close partnership with the EIB, to support strategic investments of European significance and risk finance for SMEs and mid-cap companies across Europe.
- The European Structural and Investment Funds will be fully exploited. This means making sure EU funds remaining in the 2007-2013 programming period are used to best effect. This also means increasing the leverage of the 2014-2020 EU funds by overall doubling the share of innovative financial instruments and maximising the use of private co-financing.

Making finance reach the real economy

- A transparent pipeline of projects ripe for investment will be established at EU level, based on the December 2014 report of a Task Force of the Commission, the EIB and the Member States.

- Sources of expertise and technical assistance will be brought together into a single investment advisory "Hub" for project promoters, investors and managing authorities.
- The Commission and the EIB, together with national and regional authorities, will engage with project promoters, investors and institutional stakeholders to facilitate key investment projects.

Improving the investment environment

- Measures to improve the regulatory framework, at national as well as European level, to make it clear and predictable, and to incentivise investment.
- Measures to develop new and alternative sources of long-term financing for the economy and to move towards a Capital Markets Union.
- Measures to complete the single market in key sectors such as energy, transport and the digital economy.

3. RENEWED COMMITMENT TO STRUCTURAL REFORMS

Making the European economy more competitive and ensuring the right regulatory environment for long-term investment is crucial for growth. Structural reforms can help to attract private productive investment, particularly in network industries and smart manufacturing where investment needs are high. At EU level, this requires further deepening of the single market and avoiding unduly burdensome regulations, particularly for small and medium sized enterprises, improving access to finance and ensuring the quality of investment in research and innovation. At Member State level, these efforts have to be complemented by an ambitious implementation of structural reforms of product, services and labour markets.

REMOVING KEY BARRIERS AT EU LEVEL

Implementing the single market in goods and services is a priority. With more than 500 million consumers, the European single market remains the most powerful engine of growth at EU level. This will require a strong focus on further integration of services and goods markets where the potential for jobs, growth, and innovation is significant, online and off-line. In doing this, it is important to exploit the synergies between a well-functioning single market and industry. Consumers should be able to benefit from an integrated single market which offers the same possibilities as their home markets. A deeper single market will create benefits also on the external scene. It will reinforce the position of European companies in global value chains, attract investment and put the Union in a better position to create stronger links with new centres of global growth through trade agreements that enhance regulatory convergence with our major trading partners.

The Digital Single Market is essential for jobs, growth and innovation. The global economy is transforming into a digital one. Information and Communications Technology is not only a sector but the foundation of a modern innovative economy. A connected Digital Single Market could generate up to EUR 260 billion in efficiency gains per year.⁵ Digital technology introduces new ways of producing goods and delivering services from cars and chemicals to retail distribution and energy, reshaping the way we work and learn. Being well-positioned in the digital economy will determine the EU's future competitiveness and pathway to renewed growth. Digital services are vital for the efficiency and security of Europe's key

⁵ "Mapping the Cost of Non-Europe 2014-19", study published by the European Parliament in July 2014.

strategic infrastructures, such as energy and rail. And most importantly, it offers enormous benefits to society – access to goods and services and to information, freedom of expression, creativity, better healthcare and public services. Yet, we do not have a Digital Single Market. Only 14% of SMEs use the Internet to sell online. Only 12% of consumers shop across borders. Consumers are frustrated when they are unable to access digital services in another Member State because of restrictive business practices or legal impediments. Only when common European high-standard data protection rules are in place and when consumers' confidence is restored, will businesses be able to tap the full potential of the digital sector.

Further structural reforms in energy markets are necessary to achieve a resilient Energy Union with a forward-looking climate change policy, in line with the Europe 2020 objectives and the 2030 climate and energy framework agreed by the European Council in October 2014, and to enhance security of energy supply and complete the internal energy market. This requires improving the energy market design, strengthening the existing market based instruments and modernising and extending energy infrastructure. This should allow energy to flow freely within the EU, to eliminate energy islands and to integrate renewables into the network. Financing the investments needed will be a major challenge. While significant support will be provided by EU Structural and Investment Funds, innovative financial mechanisms are needed to stimulate and leverage investments in energy modernisation and to incentivise investment by private households in energy efficiency.

Ambitious action is required to ensure an EU regulatory framework supportive of jobs, growth and investment. The Commission will prioritise the work it started in December 2012 with the launching of the Regulatory Fitness and Performance Programme (REFIT) – a general review of existing legislation. It should make EU law lighter, simpler and less costly for the benefit of citizens and enterprises. The Commission will further strengthen its regulatory tools (impact assessment, evaluation), in close cooperation with the other European institutions, the Member States and stakeholders.

The removal of the regulatory barriers mentioned above should go hand in hand with the deployment of the new European Fund for Strategic Investments developed in partnership between the Commission and the EIB.

STRUCTURAL REFORMS AT MEMBER STATE LEVEL

Ultimately, reforming and modernising our economies is needed to underpin our European social model. It is important that all members of society, in particular the social partners, can play a role and proactively support change.

Ambitious implementation of structural reforms in product, services and labour markets can contribute to increasing productivity, regaining competitiveness and improving the business environment, thereby also fostering investment. It can contribute to a durable rebalancing of our growth model, lessen the negative impact of the necessary financial deleveraging from the private sector and contribute to the prevention of harmful macroeconomic imbalances. Moreover, through the effects on growth, productivity and employment, provided the right channels are in place, it can contribute to improving the overall social situation and reducing poverty, as well as the sustainability of private and public debt.

Despite the achievements of some Member States – particularly the more vulnerable – additional reform efforts are needed in all Member States. Recent experience has given ample evidence that ambitious action brings clear results (see Box 3).

Box 3. Examples of effective structural reforms in the Member States

- In **Spain**, in December 2013, the government approved a Law guaranteeing market unity in the interest of the freedom of movement and establishment of persons and the free movement of goods. The law is an ambitious rationalisation of overlapping legislation in Spain, addressing the fragmentation of the domestic market and increasing competition in product markets. According to the Spanish Authorities, the reform is estimated to raise GDP by more than 1.5% over time.
- **Portugal** enacted a number of labour market reforms between 2011 and 2013. The protection of workers under permanent and fixed-term contracts was aligned. Working time legislation was made more flexible, and measures were taken to better adapt wages to productivity at the firm level. Unemployment benefits were reformed and eligibility was extended. The Public Employment Service was reformed, existing Active Labour Market Policies were reviewed and new programmes introduced, including targeted to the youth. The unemployment rate declined by about 2 percentage points between 2013 and 2014.
- **Poland** initiated an ambitious reform facilitating access to regulated professions. Access to 50 professions – including lawyers, notaries, real estate agents and taxi drivers – has been liberalised in the first wave of reform in 2013. Decisions covering a further 91 professions were adopted by the Polish Parliament in April 2014 and deregulation of 101 additional professions is planned for early 2015.
- **Italy** implemented a set of measures in 2013 aimed at increasing competition and transparency in the gas and electricity markets. The initiatives taken by the Italian government have helped to address the long-standing issue of high energy prices in Italy and, according to estimates from the energy regulator, have helped to reduce end-users prices.

For 2015, the Commission recommends focusing attention on a number of key reforms. The areas chosen are relevant for all Member States although the exact measures to be taken will vary from country to country. Within the euro area, particular attention should be paid to better co-ordination of some of these reforms to enhance positive synergies and to avoid negative spill overs. The areas for reform are the following:

1. Improving the dynamics in labour markets and tackling the high level of unemployment. The most competitive and resilient countries are those where companies and entrepreneurs value and invest most in continuous skills development and innovation is encouraged and where people are able to move easily between occupations, sectors and/or regions.

Employment protection rules and institutions should provide a suitable environment to stimulate recruitment, while offering modern levels of protection to both those who are already in employment and those looking for a job. Member States must do more to remove obstacles to job creation, with the involvement of social partners, including where necessary by reforming labour dispute resolution schemes. Reforms targeting labour tax reductions to help restore employment should be intensified. Reducing labour market segmentation should help to eliminate employment barriers for those who are currently unemployed, under-employed or employed on a temporary contract, and facilitate upward professional mobility.

The EU needs a skilled work force in growing sectors such as the digital economy, green sectors and health care. Education has a key role to play to ensure the responsiveness of skills to labour market signals. Vocational training and dual education systems should be upgraded to provide young people with the necessary skills sets. Lifelong learning should become a central priority, through the mobilisation of both public and private actors, with broader access at all ages and for those most in need. A better assessment of the skills needs at regional and sectoral levels is also necessary.

The situation of young people and the long-term unemployed in particular requires determined action. Benefit systems should combine adequate income replacement with activating and enabling services, targeted at individual needs and delivered through one-stop shops. Fiscal disincentives to seeking employment must be removed. The Youth Guarantee represents an ambitious effort combining different instruments to address youth unemployment effectively. However, the available funds, including the EUR 6.4 billion of the Youth Employment Initiative, should be used faster and more efficiently by Member States, and enhanced by national means. Only three relevant Operational Programmes worth a total of EUR 1.6 billion have been adopted for France, Italy and Lithuania allowing pre-financing payments to be made to these countries. In order to be able to adopt most of the relevant Operational Programmes by the end of the year, Member States must address the Commission's observations as soon as possible.

On average, there are more than 2 million unfilled vacancies in the EU. While there are limits to geographic mobility, it appears that workers are not using the opportunities of free movement to the full. Removing barriers will require increasing the scope of portability of pension rights across the EU and helping workers make an informed choice about mobility, for example through the EURES network. At the same time, steps must be taken against the abuse of existing rules and to prevent a permanent brain drain from certain regions. Enhanced EU cooperation in exchange of information and good practices will be essential.

A high level of employment requires real wages to move in line with productivity developments, including at industry and firm level. Some Member States still need to complete the correction of pre-crisis trends, with wages outpacing productivity gains. The role of social partners is crucial. Collective agreements should allow a certain degree of flexibility for differentiated wage increases across sectors and within sectors, according to specific productivity developments.

2. Pension reforms. Across the EU there is a need to ensure both sustainability and adequacy of pension systems. A majority of Member States have reformed their public pension systems in recent years so as to put them on a sounder footing as European society ages. However, as mirrored in the 2014 country-specific recommendations, in many cases further reforms are necessary to increase the efficiency and financial sustainability of pensions. At the same time, the adequacy of pension systems needs to be preserved, so that a decent level of income after retirement is ensured. Given the trend of increasing longevity, in many countries a more dynamic view on the age at which people can retire needs to be established, including linking statutory retirement ages to life expectancy more systematically to ensure an adequate balance between life spent working and spent in retirement.

3. Modernising social protection systems. Social protection mechanisms should be efficient and adequate at all stages of a person's life. There is a need for simplified and better targeted social policies complemented by affordable quality childcare and education, prevention of early school leaving, training and job assistance, housing support and accessible health care.

Healthcare systems need to be reformed to provide quality health care through efficient structures, including eHealth.

4. Improving the flexibility of product and services markets. Modernising the functioning of network industries, upgrading infrastructure capacity and further opening services sectors remains a challenge for most Member States, as shown the country-specific recommendation issued to the Member States in 2014, which put the focus on measures to improve the functioning of their network industries and to enhance competition in product and services sectors, notably as regards regulated professions. Effective enforcement of consumer legislation can also increase trust and create demand in the single market.

EU legislation provides a framework for modernisation at national level, and for making Europe more attractive and competitive as a whole. Member States have undertaken numerous reforms in the services sector following the entry into force of the Services Directive in 2006, but progress has been more uneven recently. The full implementation of the Services Directive would significantly improve the functioning of the single market for services and could lead to an economic gain of up to 1.6% of EU GDP in the long run on top of the 0.8% of EU GDP under the current level of implementation.⁶ The overall persistence of a high number of exceptions to the general principles foreseen by the Directive, together with lengthy reform processes in a number of Member States, are still weighing on the full implementation of the Directive and thus do not allow reaping its full benefits. Stepping up national reforms should focus on removing the following barriers: (i) disproportionate and unjustified authorisation requirements in some Member States, notably legal form and shareholding requirements; (ii) lack of clarity of domestic legislation as to the rules applicable to businesses providing cross-border services; (iii) lack of mutual recognition; (iv) cumbersome administrative procedures, with scope for improving the performance of the Points of Single Contact; (iv) uneven progress on the ongoing mutual evaluation of professional regulations and reforms of regulated professions; (v) remaining obstacles to the free movement of goods. The Commission will continue to work closely with the Member States to remove these barriers.⁷

5. Improving framework conditions for business investment. Efforts to strengthen the business environment to make it more investment-friendly is key to bring in private investment, in particular in Member States with limited fiscal space for public investment. Public private partnerships and governance of state owned enterprises will need to be carefully designed to make public spending and private investment more efficient. Public procurement contracts should be opened further, in particular using EU legislation. This also implies that the administrative capacity of procuring authorities to plan and implement is strengthened, in particular through e-procurement. In many cases, improved efficiency of procedures and greater transparency are also required. Well-functioning insolvency frameworks are also crucial for an efficient reallocation of resources.

6. Improving the quality of research and innovation (R&I) investment. Investment in R&I at national and regional level has a critical role to play in kick-starting sustainable growth. Member States should continue to prioritise public investment in research and innovation, ensuring its efficiency and leverage with regard to private investment. Member States should focus on the quality of R&I institutions, on their strategy development and

⁶ J. Monteagudo, A. Rutkowski, D. Lorenzani, The economic impact of the Services Directive: A first assessment following implementation, Economic Papers 456, June 2012, http://ec.europa.eu/economy_finance/publications/economic_paper/2012/pdf/ecp_456_en.pdf

⁷ COM(2012) 261 of 8 June 2012.

policy-making processes, and on programmes. At the same time, they need to keep up the pace of reforms to ensure an investment-friendly environment, which is a necessary condition for business investment in R&I and for fast growing innovative SMEs.

7. Improving efficiency in public administration. Public administrations across the EU continue to face the challenge of delivering "better with less", i.e. meeting public needs in times of tighter budgets, improving the business environment by alleviating the administrative and regulatory burden for firms and citizens, and adapting to the needs of the digital economy. This remains a challenge in the vast majority of Member States. A number have embarked on institutional or territorial reforms, with the two-fold objective of achieving savings through the rationalisation of their organisation, and ensuring smooth decision-making and implementation of reforms through a clarification of the competences of the various institutional or government layers.

In addition, similar to the regulatory fitness and performance programme (REFIT) carried out at EU level, most Member States need to pursue simplification and a more digital approach to public administration. Removing red tape and regulatory obstacles should lead to higher quality, simpler and more accessible legislation and pave the way for a more business- and citizen-friendly environment, which in turn fosters investment. In this respect, enhancing the efficiency and securing the fairness of independent judicial systems is also an important prerequisite. There is a clear need to tackle issues such as the length of proceedings, the number of pending cases, the insufficient use of ICT, the promotion of alternative dispute resolution mechanisms and the independence of judicial systems.

4. PURSUING FISCAL RESPONSIBILITY

Given the sharp increase in deficit and debt levels across the EU during the financial crisis, a significant degree of fiscal consolidation was necessary to restore confidence in the sustainability of Member States' public finances and break the vicious circle between sovereign debt developments and financial instability. The significant adjustments undertaken in recent years have succeeded in reducing deficits and stabilising debt levels in the EU. The strong decrease in the number of countries under an excessive deficit procedure – down to 11 in 2014 from 24 in 2011 – reflects these fiscal improvements. According to the latest forecast, the fiscal stance in the EU is now expected to remain neutral in the coming years, which means that fiscal policy will not weigh on growth going forward.

Nevertheless, public debt remains very elevated and this, coupled with high external indebtedness, makes economies more vulnerable to adverse shocks and can act as a drag on growth. Such imbalances can also represent a threat to the smooth functioning of the euro area as a whole. The growth in government debt must still be reversed in the years to come, in line with Member States' obligations under the Stability and Growth Pact. This can be achieved through a combination of responsible fiscal policies and economic growth. First, the pace of fiscal adjustment should be differentiated according to the fiscal challenges faced by different Member States. While those with sustainability challenges should continue consolidating, Member States with fiscal space should use it to support growth. Member States should also make full use of recently enhanced national fiscal frameworks to lay down and stick to the right fiscal trajectory. Second, the composition of fiscal strategies needs to be designed in a growth-friendly manner. In several countries, provided it remains consistent with consolidation requirements, an emphasis on expenditure restraint, possibly coupled with cuts in the most distortive taxes, can help raise growth and investment.

Box 4. Responsible growth-friendly fiscal consolidation

The way Member States have gone about fiscal consolidation has not been very growth-friendly. It has been excessively concentrated on tax hikes, which are not optimal in most Member States where the tax burden is already high. On the expenditure side of national budgets, public investment was the main item targeted for cuts, in spite of its growth-enhancing potential among budgetary expenditures. At the same time, in some Member States both the size of the necessary fiscal adjustment and the dynamics of the financial crisis required a resort to rapid solutions.

With the financial crisis abating and the consolidation pace moderating, the composition of budgetary measures has started to improve. This has already been visible in 2014 and can be seen in the draft budgets for 2015 as well. The fall in investment expenditure has been halted, while the composition of revenues has become more growth-friendly. In particular, the draft budgets for 2015 feature some positive tax measures reducing tax burden on labour, although the level of ambition still falls short of meeting the challenges.

On the revenue side, it is important to ensure an efficient and growth-friendly tax system. Employment and growth can be stimulated by shifting the tax burden away from labour towards other types of taxes which are less detrimental to growth, such as recurrent property, environment and consumption taxes, taking into account the potential distributional impact of such a shift. The high tax burden on labour has been a long-standing problem in Europe with differences of 40% between Member States in the cost of employing a worker at the average wage and worker's take-home pay. Broadening tax bases, simplification and enhanced transparency can also help increase the efficiency of the tax system and improve tax compliance as well as the fight against aggressive tax planning.

On the expenditure side, productive public investment and more growth-friendly items of current expenditures should be prioritised – and quick decisions on the Commission's proposed Investment Plan for Europe will help to support these priorities. Welfare systems should play their role to combat poverty and foster social inclusion. The efficiency of existing expenditure programmes in achieving their targets should be enhanced by the adoption of reforms and other measures, such as spending reviews. At least eight Member States are currently or were recently engaged in one form or another of spending review: the United Kingdom, the Netherlands, France, Italy, Ireland, Denmark, Spain and Sweden. Sharing the results and experience gained from these reviews more widely should be part of the overall governance system.

The Stability and Growth Pact provides the right framework to deliver long-term growth in the context of sustainable public finances, including flexibility where required. It puts emphasis on budgetary developments in structural terms and not just on the nominal deficit. This allows developments outside the control of government to be filtered out, whether they are negative (e.g. asymmetric shocks) or positive (e.g. windfall revenues). This means we get a better idea of the underlying budgetary position. Each Member State is assessed individually, taking into account their particular economic situation and national challenges posed by ageing, including in the areas of pension and health care policies, and the public debt level.

5. STREAMLINING OUR GOVERNANCE SYSTEM TO MAKE IT MORE EFFECTIVE AND TO INCREASE OWNERSHIP

This Annual Growth Survey launches the annual cycle of economic governance known as the European Semester. It combines fiscal, macroeconomic and structural policy surveillance at EU level before national budgets and decisions are prepared for the following year. Since 2011, the European Semester has been used to initiate and guide important fiscal and structural reforms in the Member States. Accompanying this Annual Growth Survey, the Commission has carried out **a review of the "six pack" and "two pack" legislation** which reinforced the EU's economic governance.⁸

The European Semester has become an important vehicle for delivering reforms at the national and the EU levels, by ensuring that the EU and its Member States coordinate their economic policies and their efforts to promote jobs, growth and investment. However, the monitoring by the Commission⁹ has shown that there is still a lack of ownership resulting in an unsatisfactory level of implementation of the country-specific recommendations, in particular in the area of structural reforms. In the face of Europe's economic challenges, the Commission considers that now is the right time to **streamline and reinforce the European Semester** to make it more effective by giving it greater focus, clarity and political role for the future, in line with the integrated approach presented in this Annual Growth Survey. A reformed European Semester should aim to increase the effectiveness of economic policy coordination at the EU level through an increased accountability and an improved ownership by all actors (see Annex).

The aim of streamlining of the Semester is to increase political ownership, accountability and acceptance of the process, to strengthen its credibility and comparability across Member States and to help improve the implementation of the country-specific recommendations.

The discussion on the European Semester is also important in view of the **mid-term review of the Europe 2020 strategy, which will be presented in time for discussion at the spring 2015 European Council**. Following the stock-taking Communication on the implementation of the Europe 2020 strategy released last March¹⁰ and based on the outcome of the public consultation, the summary of the debates in the Council and the inputs received from interested parties, the Commission is working on the mid-term review of the Europe 2020 strategy and will present its ideas early in 2015.

For the EU to succeed in meeting its jobs and growth challenge, there is a need for broad consensus on the right policy direction and strong stakeholder support for reform efforts. This means that national Parliaments, the social partners and civil society at large all need to be more involved in the implementation of policies decided at EU and national levels. To associate national Parliaments more closely to the process, every year, national Parliaments and the European Parliament meet during the Parliamentary week to debate the European Semester with the involvement of the Commission.

⁸ COM (2014) 905 of 28 November 2014.

⁹ The assessments by the Commission are presented in the yearly staff working documents accompanying the country-specific recommendations http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

¹⁰ COM(2014) 130 final, "Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth", http://ec.europa.eu/europe2020/pdf/europe2020stocktaking_en.pdf and http://ec.europa.eu/europe2020/pdf/europe2020stocktaking_en.pdf

There is also a clear need to monitor social progress and the impact of reforms over time. Work has already started to reinforce the social dimension of the Economic and Monetary Union. In particular, employment and social indicators are being introduced into the macroeconomic imbalances procedure and should be fully used to gain a better understanding of the labour market and social developments and risks. The Commission will also make sure that European social partners are better associated to the European Semester process.

While first ideas will be tested and implemented for the 2015 European Semester, further proposals will be elaborated in the months to come as part of the work on the deepening of economic governance, coordinated by the President of the Commission, together with the Presidents of the European Council, of the European Central Bank and of the Eurogroup.¹¹

6. CONCLUSION

There is an urgent need for a fresh start in EU economic policy making. In its Annual Growth Survey for 2015, the Commission proposes that the EU pursue an integrated approach to economic policy built around three main pillars, all of which must act together – boosting investment, accelerating structural reforms and pursuing responsible growth-friendly fiscal consolidation.

As a matter of priority, Member States should endorse the EUR 315 billion Investment Plan proposed as part of this Annual Growth Survey. They should commit to concluding the necessary legislative changes required to create the proposed new Fund by the end of June 2015. Member States should also commit to at least an overall doubling of the use of innovative financial instruments used to implement projects under the European Structural and Investment Funds in the coming three years.

Depending on the situation of each Member State, the proposed integrated approach should be implemented at national level by addressing rigidities in the labour market so as to tackle high levels of unemployment, by pursuing pension reforms, by modernising social protection systems, by improving the flexibility of product and services markets, by improving framework conditions for business investment, by improving the quality of investment in research, innovation, education and training and by improving the efficiency of public administration. The social partners are invited to actively contribute to domestic reform agendas.

An increased involvement of national Parliaments, social partners and stakeholders in the European Semester is necessary to strengthen national ownership and accountability. The streamlining of the 2015 European Semester will be a first step in this direction.

The proposed integrated approach calls for political leadership from the Member States, the European Parliament and the European Council. The Commission will work with all actors to ensure that Europe is put back on the path of a sustainable economic recovery.

¹¹ As agreed at the Euro area summit of 24 October 2014.

ANNEX

Streamlining and reinforcing the European Semester

The European Semester refers to the annual cycle of economic and budgetary policy coordination in which guidance is provided to Member States before they take policy decisions at national level. The guidance is provided in the context of the Stability and Growth Pact and the Macroeconomic Imbalances Procedure. The European Semester also serves to implement the Europe 2020 strategy.

The European Semester starts every year with the publication by the Commission of the Annual Growth Survey. It outlines general economic priorities for the EU. It is debated by the other institutions and feeds the discussion leading to the spring European Council. Member States present national programmes in the spring of each year. The Commission then proposes country-specific policy recommendations to each Member State, based on its assessment of national economic situations and programmes. All relevant policy areas are covered: fiscal, macro-economic and structural reforms. The recommendations are discussed in the Council and endorsed by the June European Council, before being finally adopted by the Council. Member States are expected to reflect the recommendations in their budgetary and policy plans for the subsequent year and to implement them in the coming 12 months.

While the European Semester has reinforced economic policy coordination at EU level, the limited and sometimes lack of implementation of key country-specific recommendations has put its effectiveness into question. A streamlined and reinforced European Semester should build on the existing strengths of the process and address its weaknesses, by simplifying the various stages and their outputs, by improving cooperation and dialogue with Member States, by limiting reporting requirements, by enhancing the multilateral nature of the process and by strengthening ownership at all levels.

Simplifying Commission outputs and allowing for more feedback on Commission analysis. The practice of presenting the Annual Growth Survey and the Alert Mechanism Report jointly in the autumn works well, as the two documents complement each other and set out the overall EU approach for the coming year. However, the two main country-specific documents produced later in the process, the staff working documents accompanying the country-specific recommendations and the In-depth Reviews presented as a follow-up to the Alert Mechanism Report, are currently presented at two different points in time in the spring. A comprehensive single economic assessment per Member State which provides the basis for the recommendations to be addressed to the Member States would improve the coherence of the process and reduce administrative burden. An earlier publication date of these documents – for instance in March – would also allow for greater transparency and possible feedback on the Commission's analysis.

Streamlining reporting requirements of Member States: The reporting requirements placed on the Member States should be proportionate and have a clear added value. They should follow a "tell only once" approach, whereby available information gathered through documents and missions on the ground is effectively shared and re-used, while the focus of the work at European level is put on analysing and updating it. National Reform Programmes can play an important communication and ownership role at national level if they are refocused, to provide a more targeted national input into the Commission analysis at an earlier stage and national Parliaments and social partners are involved in their formulation.

Enhancing the multilateral nature of the process: Ownership of the European Semester by Member States is overall still too weak at national level, but also at European level. This limits the quality of the discussion and subsequent implementation of the country-specific recommendations. In areas where surveillance tools are stronger, such as public finance and fiscal frameworks, the implementation record is significantly higher. A streamlined process should allow more time to examine and discuss EU guidance. The early presentation of the Commission's country-specific analysis would also help in this respect. Moreover, together with the Council Presidency, it should be possible to enhance cross-examination of performance and policies throughout the year. Improved comparability of policy actions and outcomes across Member States would also help peer pressure and inform further such multilateral thematic discussions. Exchanging views on the Commission's monitoring of the delivery of reforms is particularly important in the context of the preparation of the Council discussion of the draft recommendations and in view of the debate at the June European Council.

Opening up the process and increasing engagement with other actors: The democratic legitimacy of the European Semester process has sometimes been called into question. In recent years, the Commission has gradually established deeper and more permanent dialogue with the Member States, through bilateral meetings, more targeted discussion in the Council committees and more widespread technical missions. There have also been improvements in parliamentary involvement. As regards the European Parliament, a close involvement has been made possible through the Economic Dialogue, introduced by the Six-Pack legislation, that provides for discussions between the European Parliament on the one hand, and Member States, the Council, the Commission, the European Council and the Eurogroup on the other hand. In addition, the Parliament hold important political debates at crucial moments of the European Semester. The awareness of national Parliaments about the European Semester has increased throughout the years, thanks to the implementation of the Two-Pack legislation and more direct involvement of the Commission through presentations and debates. In spite of such positive developments, there is room for wider dialogue, not only with the Parliaments, but also with the social partners. For example, the Commission could in the future engage with the European Parliament and the social partners at European level before the Annual Growth Survey is presented and continue the debate following its adoption. Based on its country-specific analysis, the Commission could also engage with the European Parliament to discuss emerging horizontal aspects and, as relevant, with social partners to receive feedback on topical country-specific issues.



European Semester: a partnership EU-Member States

