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Annual Growth Survey 2016

Strengthening the recovery and fostering convergence

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INTRODUCTION

The European Union's economy is experiencing a moderate recovery. **The pace of activity is expected to accelerate gradually**. Unemployment has been falling but remains at a historically high level. The recovery benefits from temporary positive factors including low oil prices, a relatively weak euro and accommodative monetary policies. It also reflects the first effects of reforms implemented in the last few years. At the same time, security concerns and geopolitical tensions have intensified and the global economic outlook is becoming more challenging, in particular in emerging economies.

Economic performance and social conditions, as well as reform implementation, remain uneven across the EU. Many economies still face the far-reaching challenges of high long-term and youth unemployment. Productivity growth remains slow, affecting competitiveness and living standards. High private and public debt levels contribute to holding back investment. Growth and employment are also constrained by the persistence of a number of macroeconomic imbalances. These are highlighted in the Alert Mechanism Report 2016 adopted alongside this Annual Growth Survey.[1]

The unprecedented inflow of refugees and asylum seekers over the last year has represented a significant new development in some Member States. This development has an immediate impact in terms of additional public expenditure in the short run. In the medium and longer term, it may also have a positive impact on labour supply and growth, provided the right policies are in place to access to the labour market and to the integration process.

In this context, policies should be directed at consolidating the recovery and fostering convergence towards the best performers. Member States should take advantage of the current "tailwinds" to effectively implement ambitious reforms and pursue responsible fiscal policies. A renewed process of upward economic and social convergence is needed in order to tackle the economic and social disparities between Member States and within societies.

Key findings of the Commission's 2015 autumn forecast

- For the EU as a whole, real GDP growth is expected to rise from 1.9% in 2015 to 2.0% in 2016 and 2.1% in 2017.
- Employment in the EU is set to increase by 1.0% in 2015 and by 0.9% in 2016 and 2017. Unemployment rate is expected to fall from 9.5% in 2015 to 9.2% and 8.9% in 2016 and 2017 respectively.
- Annual inflation is to rise from 0% in the EU in 2015, to 1.1% next year, and to 1.6% in 2017.
- The aggregate deficit-to-GDP ratio for the EU as a whole is forecast to decline from an estimated 2.5% this year to 1.6% in 2017, while the debt-to-GDP ratio is expected to fall from 87.8% expected this year to 85.8% in 2017.

Throughout its first year, the Commission has delivered on its announcements and presented ambitious initiatives to support jobs and growth, reinforce economic convergence and strengthen social fairness. The Commission's EUR 315 billion Investment Plan for Europe to kick-start jobs and growth is up and running. The Commission has also made a series of concrete proposals to put in place the building blocks of the Single Market,

[1] COM(2015) 691.

Strategy,[2] Capital Markets Union,[3] Energy Union,[4] and the Digital Single Market.[5] Important steps were taken to ensure fair and efficient corporate taxation.[6] The Commission ensured a swift follow-up to the roadmap for deepening of the Economic and Monetary Union (EMU) set out in the Five Presidents' Report. [7] Finally, the Commission continues to work consistently and continuously on promoting a coordinated European response to the refugee and migration issues.

This Commission set out its jobs and growth strategy last year when presenting its 2015 Annual Growth Survey. **Today it puts forward the priorities for the coming year with its 2016 Annual Growth Survey**. Bringing recovery to a sustainable path and reviving the convergence process can only be achieved if all EU Institutions and Member States act together. This requires close involvement of the European and national Parliaments, social partners, national, regional and local authorities and the civil society at large. In line with its proposal set out in the Communication on completing the EMU, the Commission has engaged with the European Parliament prior to the presentation of this Annual Growth Survey.[8] The European Parliament will continue to play its guiding role and provide political orientation on economic and social priorities. The role of national Parliaments is particularly valuable to strengthen democratic accountability, transparency and promote ownership of the reforms.

1. Policy priorities

The economic and social priorities of the 2015 Annual Growth Survey remain valid, but policy efforts need to be strengthened to set the recovery on a sustainable path, unlock investment, strengthen the adjustment capacity of EU Member States, foster productivity and accelerate the process of convergence. In this light, the Commission proposes to focus efforts on the three following priorities for 2016:

– **Re-launching investment** – (i) the progress made on mobilising private and public investments and the selection of the strategic projects under the Investment Plan for Europe need to be accompanied by an improved investment and regulatory environment at the national as well as the European level; (ii) the Banking Union needs to be completed to reinforce financial stability in the euro area and beyond; work on the Capital Markets Union needs to be accelerated, so that companies have access to increased and more diversified sources of funding and the financial sector can fully support the real economy; stocks of debt holding back financing and investment decisions also need to be addressed; (iii) investment priorities must go beyond traditional infrastructure and extend to human capital and related social investment.

– **Pursuing structural reforms to modernise our economies** – (i) reforms must be based on effective coordination between the Member States and aim at higher productivity and upward convergence; (ii) labour market policies need to balance flexibility and security considerations; a particular focus should be on tackling youth and long term unemployment,

[2] COM(2015) 550.
[3] COM(2015) 468.
[4] COM(2015) 080.
[5] COM(2015) 192.
[6] COM(2015) 302.
[7] COM(2015) 600.
[8] Including at the plenary session on 11 November 2015.

(iii) more integrated and competitive product and services markets should stimulate innovation and job creation.

– **Responsible fiscal policies** – (i) there is a need to continue to support growth- and equity-friendly fiscal consolidation in many countries, (ii) tax systems need to address disincentives to employment creation and be made fairer and still more effective, (iii) social protection systems should be modernised to efficiently respond to risks throughout the lifecycle while remaining fiscally sustainable in view of the upcoming demographic challenges.

These priorities support the roadmap set out by the Five Presidents for the completion of the Europe's Economic and Monetary Union. They also include a stronger focus on employment and social performance.

Building on the experience of the last year, from now on the European Semester will be sequenced in two successive phases distinguishing more clearly between a European phase (from November to February) and a national phase (from February to June). Beyond the necessary enhanced coordination and stronger surveillance of economic policies and budgetary processes of all euro area Member States, there is a need to monitor and analyse closely the aggregate economic, social and fiscal situation of the euro area as a whole and to consider this analysis in the formulation of national policies. To better take account of challenges to the whole euro area early on, the Commission now publishes its proposal for recommendations for the euro area together with this Annual Growth Survey. [9]

The Europe 2020 Strategy – better implementation and monitoring

Launched in 2010 as the EU strategy to deliver smart, sustainable and inclusive growth for Europe, the Europe 2020 Strategy set out five ambitious targets in the fields of employment, research and development, climate change and energy, education and the fight against poverty and social exclusion to be achieved by the EU by 2020. While we are on track for reaching the targets on climate change, energy and education, the crisis has derailed progress on the other targets, in particular for poverty and social exclusion where the situation has worsened. The Europe 2020 strategy has served as a reference framework for activities at EU level, in the Parliament and various Council formations, but also at the national and regional levels: Member States have set national targets in response to the EU targets; reporting on these targets has taken place in the context of the annual National Reform Programmes; Eurostat has regularly published comprehensive reports detailing the progress made.[10] The Europe 2020 strategy has guided the strategic choices of the Commission's work. These strategic choices are also guiding the EU's expenditure: they provided direction in preparing the 2014-2020 Multiannual Financial Framework (MFF), in programming the European Structural and Investment Funds, and in launching new funding programmes at the EU level. A good example is the creation of the HORIZON 2020 programme for research, innovation and technological development, which funding benefited from a substantial increase, in spite of overall scarce budgetary resources at EU level.

In 2014-15, approaching the halfway mark towards the 2020 horizon, the Commission carried out a review of the Europe 2020 Strategy, starting with a Communication "Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth". A public consultation was carried out as a part of this process, which showed that the Europe 2020 Strategy is still seen as an appropriate framework to promote jobs and growth at the EU and national levels. While not delivering in all areas, it has added value and has generated positive effects notably by triggering action at the European level and in Member States in a number of areas that represent key drivers for jobs and growth. However, the consultation also showed that that the strategy is not yet sufficiently embraced by the Member States, and that it requires deeper involvement on the ground.

Following this review, the Commission will make the best use of the existing strategy and its tools by improving its implementation and monitoring in the context of the European Semester. On this basis, the Commission has adjusted the guidance to Member States on the preparation of their National Reform Programmes to make sure that the Europe 2020 strategy continues to play a prominent role.

[9] COM(2015) 692 and SWD(2015) 700.
[10] Smarter, greener, more inclusive? Indicators to support the Europe 2020 strategy, Eurostat 2015.

In parallel, next year the Commission will start a process for developing a longer term vision going beyond the horizon of the year 2020, also in the light of the new Sustainable Development Goals agreed by the United Nations for 2030. The lessons of the Europe 2020 review mentioned above will be taken into account in this exercise.

2. Re-launching investment

In the context of low interest rates, ample liquidity in financial markets and deleveraging by public and private actors, investment levels remain low. This highlights the need for the Investment Plan for Europe: concerted action on investment to maintain competitiveness and to spur economic activity. The plan targets stimulating finacing for investment, removing barriers, increasing innovation and deepening the Single Market.

Implementation of the Investment Plan for Europe

A year ago, the Commission proposed an Investment Plan, aimed at mobilising at least EUR 315 billion of additional investment over three years and bringing investment back to sustainable pre-crisis levels. The aim of the Investment Plan is to mobilise additional investments in Europe with both existing and new tools, creating a better environment for investment and further strengthening the Single Market.

Thanks to the swift support of the European Parliament and the Council, and the operational work of the European Investment Bank, the Investment Plan is now operational. The European Fund for Strategic Investments (EFSI), proposed by the Commission in January, is up and running to support higher risk, higher return projects that would struggle to find financing otherwise. The European Investment Advisory Hub, aimed at supporting investors and project promoters, has become operational. The European Investment Project Portal will be launched early next year: this will serve to advertise potential investment projects to investors based on reliable and simple reference criteria. A large number of Member States have also committed substantial financial contributions to the Fund's activities through their National Promotional Banks or otherwise.

To build on this progress, Member States are encouraged to continue raising awareness about the EFSI, support development of private and public investment projects and co-investment platforms for submission to the European Investment Bank for potential EFSI financing and to the European Investment Project Portal, in order to attract potential investors. The services of the European Investment Advisory Hub could be used to build better investment projects and access EU funding opportunities. Moreover, the Member States which have not yet committed resources to the Investment Plan are encouraged to do so.

Furthermore, Member States should make full use of the possibility to combine the EFSI with other EU funds under Horizon 2020, the Connecting Europe Facility and the European Structural and Investment Funds, especially as EU programmes under the 2014-2020 Multiannual Financial Framework are now ramping up and are increasingly supporting investments on the ground across Europe, in infrastructure, innovation and knowledge. Specific barriers, administrative or regulatory, hindering the swift delivery of funding should be identified and tackled by Member States. The Commission will also examine the progress made with the use of EU funds in the context of the ongoing review of the Multiannual

Financial Framework to simplify and streamline their implementation and increase synergies with national funds and private financing, maximising leverage on national investments.

Progress on the EFSI[11]: Member State contributions and projects approved

Nine Member States have pledged contributions to the Investment Plan, in most cases through their national promotional banks: Bulgaria (EUR 100 million), Germany (EUR 8 billion), Spain (EUR 1.5 billion), France (EUR 8 billion), Italy (EUR 8 billion), Luxembourg (EUR 80 million), Slovakia (EUR 400 million), Poland (EUR 8 billion) and the United Kingdom (EUR 8.5 billion/GBP 6 billion).

As regards SME and Midcap companies, through the 'SME window', the EFSI has allowed the European Investment Fund (EIF) to strengthen operations under COSME and HORIZON 2020 programmes and boost growth in the SME sector. So far, the EIF has approved 69 projects with financial intermediaries in 18 countries: Belgium, Bulgaria, Czech Republic, Denmark, Estonia, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Romania, Slovenia, Sweden and the UK. The EIF has already signed 56 operations, with total financing under EFSI of around EUR 1.4 billion, which is expected to trigger more than EUR 22 billion of investments. Around 71,000 SMEs and Midcaps are expected to benefit, including in Belgium, Bulgaria, Czech Republic, France, Germany, Italy, Luxembourg, Netherlands, Poland, Portugal, Slovenia and UK.

Moreover, the European Investment Bank has approved 32 projects in the 'infrastructure and innovation window' for which it requested the EU guarantee under the EFSI. These projects are located in the following Member States: Austria, Belgium, Denmark, France, Finland, Germany, Ireland, Italy, Netherlands, Slovakia, Spain and the UK. Around half of these projects support renewable energy, energy efficiency and other investment that contribute to the move towards a low-carbon economy. Others are in the fields of R&D and industrial innovation, digital and social infrastructure, transport, as well as access to finance for smaller businesses.

Based on the progress made so far under these two windows, the Investment Plan will have triggered more than EUR 44 billion of additional financing in the EU. The EIB recently announced that EFSI is expected to have mobilised around EUR 50 billion of investments in Europe by the end of 2015.

In addition, there is an urgent need to focus on improving the investment environment: by providing greater regulatory predictability; by improving and diversifying sources of finance; and by reinforcing the level playing field in the European Union and removing barriers to investment from within the EU as well as from outside the EU. Several work strands have been launched at EU level, as laid out in the Single Market Strategy, the Energy Union and the Digital Single Market. This EU effort needs to be accompanied by an effort at national level.

To accelerate change in these areas and to boost the attractiveness of Member States for investment, country-specific information about key challenges to investment at national level is published alongside this Annual Growth Survey [12]. This preliminary analysis of investment obstacles in each Member State confirms that there is a great deal of diversity across Member States in investment patterns and barriers to investment. There is no one-size-fits-all solution. As part of the revamped European Semester, the Commission intends to engage in a dialogue with the Member States on the identification of these challenges and their possible removal, including through thematic discussions at the Council. These challenges will be further analysed in the context of the Country Reports foreseen in February 2016.

Improving financing conditions for the real economy

[11] Situation as per 18 November 2015.
[12] SWD(2015) 400.

Lending conditions have substantially improved but differences between Member States persist. Companies continue to face varying financing conditions depending on their location. There is therefore a need to continue pushing ahead with policies aimed at restoring affordable funding conditions in all Member States.

Moreover, many Member States face the challenge of private debt overhang and a high level of non-performing loans that impede the functioning of financial intermediation and hold back investment decisions in the corporate sector. In some Member States, the limited capacity to facilitate the resolution of non-performing loans are an obstacle for banks to restart lending.

Further challenges include the need to ease the debt-servicing burden on the private sector. This requires having in place modern and effective frameworks to deal with insolvency and business failure. Well-functioning insolvency frameworks are crucial for the investment decisions since they define rights of creditors and borrowers in the event of financial difficulties.

The Banking Union is a major achievement to strengthen the financial stability of the Economic and Monetary Union. All Member States need to transpose all the relevant legislation as rapidly as possible. In particular, swift implementation of the Bank Recovery and Resolution Directive and the latest revisions to the Directive on Deposit Guarantee Schemes is essential. In parallel, the Commission has put forward additional measures to complete the Banking Union by proposing a European Deposit Insurance Scheme.[13] In parallel, work will continue to further reduce risks in the banking sector.

Work is also needed to remove obstacles to the free movement of capital in the Single Market and to diversify and expand sources of financing for the real economy. To this end, the Commission has presented an ambitious roadmap to deliver a Capital Markets Union by 2019. Some of the measures necessary to achieve this are of a legal nature and need to be agreed at the European level. However, such EU initiatives must be complemented with actions at the national level, for example by efforts to reduce administrative burden or by avoiding adding additional requirements when transposing Directives into national law ("gold-plating"), such as tax barriers to cross-border investment.

Investing in human capital

Smart investments in Europe's human capital and performance-oriented reforms of education and training systems are part of the necessary efforts to restore jobs and sustainable growth. Equipping people with relevant skills drives innovation and competitiveness; it is the basis for high productivity and it is the best way to prevent individuals becoming unemployed, as well as to reduce the risk of poverty and social exclusion. While the EU is a major producer of skills and knowledge, its education and training systems do not perform as well as they should internationally. About 20% of the working-age population has only very basic skills such as literacy or numeracy, and 39% of companies have difficulty finding staff with the required skills. These difficulties have been accentuated both as a result of years of crisis and of the fast evolving pattern of work in the digital economy: unemployment has struck particularly among the low-skilled. Skills mismatches have increased in many sectors or regions.

[13] COM(2015) 586.

In addition, it is essential that Member States promote social investment more broadly, including in healthcare, childcare, housing support and rehabilitation services to strengthen people's current and future capacities to engage in the labour market and adapt. A lot can be done with the support of EU programmes, such as the European Structural and Investment Funds. Social investment offers economic and social returns over time, notably in terms of employment prospects, labour incomes and productivity, prevention of poverty and strengthening of social cohesion. Social infrastructure should be provided in a more flexible way, personalised and better integrated to promote the active inclusion of people with the weakest link to the labour market.

3. Pursuing structural reforms to modernise our economies

Effective implementation of reforms to ensure a sound regulatory and institutional environment and a smoothly-functioning economy is crucial in encouraging investment, fostering new employment, raising living standards and promoting convergence in the European Union.

All Member States should use the current favourable momentum to strengthen their efforts to ensure well-functioning labour, product and capital markets, quality education and training systems, modern and efficient social security systems and to promote innovation and entrepreneurship.

Better coordination of and support to structural reforms

Member States are pursuing their efforts to modernise their economies and address macroeconomic imbalances identified in previous years[14] **but areas of concern remain and new challenges are emerging**. This is shown in the Alert Mechanism Report 2016, published alongside this Annual Growth Survey, where a number of countries are identified for an in-depth review within the framework of the Macroeconomic Imbalances Procedure.

Even though convergence has restarted, the performance of Member States varies significantly in some areas that are crucial for productivity and convergence. The Commission intends to engage in discussion with Member States and key stakeholders about the challenges faced and the optimal policy responses, by encouraging convergence towards the best performers. Benchmarking, i.e. the cross-examination against a particular benchmark[15] of indicators related to economic and social performance and policies in each Member State, can be a useful tool to identify underperformance and the need for action at an early stage, to monitor progress and to effectively communicate the results of policy action. It can contribute to increasing the ownership of the structural reforms by the Member States and towards ensuring their implementation.

The Commission will progressively suggest developing benchmarks and the exchange of best practices across policy areas, building on the existing thematic analysis developed with the Member States in various fora. As indicated in the Five Presidents' Report on "Completing Europe's Economic and Monetary Union",[16] common standards can serve the

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[14] COM(2015) 691.
[15] Typically, the indicators are evaluated against one or several relevant values, for instance the average, the top quarter, the best in class, a neighbouring country, or just a country whose performance one wants to emulate.
[16] Report of 22 June 2015. See also COM(2015) 600.

convergence process towards more resilient economic structures. The Report suggests that such common standards should focus primarily on labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy.

In addition, EU funding can play a vital role in supporting reform implementation and injecting investment directly into the real economy, if targeted wisely and effectively applied. In this context, the priorities set out in recent country-specific recommendations have been factored into the programming of the European Structural and Investment Funds for 2014-2020. To support structural reforms, the Commission will seek to enhance the use of the European Structural and Investment Funds in support of the implementation of the country-specific recommendations, including through the use of the measures linking effectiveness of these Funds to sound economic governance. Member States should make all efforts to ensure that EU funding is used to its full potential. In the meantime, reform implementation will be supported through relevant EU funding programmes in their policy fields and the progressive roll-out of technical assistance offered by the Commission's Structural Reform Support Service. This Annual Growth Survey is accompanied by a proposal for funding for technical assistance to the Member States.[17]

Fostering employment and inclusive social policies

Job creation must remain a key focus of reform efforts. Unemployment has started to decrease against the backdrop of a gradual recovery. Supportive macroeconomic policies and the impact of structural reforms have played a role in these positive developments. Yet, for too many job seekers it remains difficult to find a job as demand remains low and as their skills might not match those required for vacant jobs.

As highlighted in the draft Joint Employment Report,[18] unemployment remains far too high, with 23 million Europeans unemployed in August 2015. Moreover, about half of the people unemployed[19] have been so for more than one year. Long term unemployment has almost doubled since 2008 [20] with large variations between Member States. Youth unemployment, although declining overall, still remains very high, at above 20% in most Member States. National, regional and local authorities should advance the work on youth unemployment in line with the Youth Guarantee through systemic changes to school-to-work transitions, activation policies and well-functioning public employment services.

Persistent long-term unemployment has implications for society as a whole, with dire social consequences for the persons concerned and a negative impact on growth and public finances. Long-term unemployment is one of the factors linked to the increase in poverty in the EU since the start of the crisis. In 2014,[21] a quarter of the EU population was at risk of poverty or social exclusion.

Member States should step up efforts to tackle long-term unemployment in line with the guidance proposed in the Recommendation on the integration of the long-term unemployed

[17] COM(2015) 701.
[18] COM(2015) 700.
[19] More than 12 million.
[20] Reaching 5.1% in the EU and 6.1% in 2014 in the euro area.
[21] Latest available data.

into the labour market.[22] In particular, job integration agreements and a single point of contact should be pursued to ensure that the long-term unemployed benefit from an individualised approach, simplified access and more transparent support.

Policy action must continue to address the disincentives to entrepreneurship and job creation inherent in the different national systems. In particular, taxation related to labour and benefit systems should be designed and implemented to encourage investment and employment. In September 2015, the Eurogroup issued common principles that should guide euro area Member States' efforts to reduce the tax wedge on labour. The Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average. The ongoing benchmarking exercise, combined with an exchange of best practices, should provide a new impetus for labour tax reform at national level and support Member States in their efforts to reduce total employment costs by lowering the tax wedge.[23] In addition, Member States should take measures to stimulate innovative 'start-up' activity and to facilitate job creation notably in SMEs.

The gender gap in terms of employment rate remains particularly wide in several Member States. Despite the fact that women tend to outperform men in terms of educational attainment, they continue to be underrepresented in the labour market. Member States should have a comprehensive approach to improving the work-life balance, including through care facilities, leave and flexible working time arrangements, as well as tax and benefit systems free of disincentives for second earners to work or to work more. Particular attention is needed to single parents and people with caring responsibilities.

Achieving both flexibility and security in the world of work requires comprehensive reform efforts that tackle at the same time labour market segmentation, adequate wage developments, well-designed income support systems, policies to ease transitions to new jobs, equip jobseekers with the right skills and better match them with vacancies. This approach will only be successful if based on strong involvement of social partners.[24]

To ensure high employment levels throughout the EU and to advance convergence, real wages must continue to move in line with productivity over the medium term. The role of social partners is crucial in this process. Wage setting frameworks, including collective agreements should allow a certain degree of flexibility for differentiated wage increases across and within sectors, so that real wages and productivity developments are properly aligned over time. In this context, it is important that workers' representation is well ensured and that there is effective coordination of bargaining modalities between and across the various levels.

Member States should continue to modernise and simplify employment protection legislation, ensuring effective protection of workers and the promotion of labour market transitions between different jobs and occupations. Stable and predictable work relationships and in particular more permanent types of contracts induce employers and employees to invest more in skills and life-long learning. They allow individuals to plan for their future by providing sustainable prospects of career and earnings progression. In recent years, the

[22] Proposal for a Council recommendation on the integration of the long-term unemployed into the labour market, COM(2015) 462

[23] Eurogroup statement on structural reform agenda – thematic discussions on growth and jobs: benchmarking the tax burden on labour, 638/15, 12/09/2015.

[24] The employment guidelines (Council Decision 11360/15 of 5 October 2015) invite Member States to follow national practices of social dialogue and allow the necessary policy space for a broad consideration of socio-economic issues, when pursuing labour market reforms, including the national wage-setting mechanisms.

increase in overall employment has been driven mainly by an increase in temporary contracts which is not unusual in the early stages of a recovery. The more general move towards more flexible labour markets should facilitate employment creation but should also enable transitions towards more permanent contracts. It should not result in more precarious jobs. Member States should also step up efforts to combat undeclared work.

More effective social protection systems are needed to confront poverty and social exclusion, while preserving sustainable public finances and incentives to work. Any such development will have to continue to ensure that the design of in-work benefits, unemployment benefits and minimum income schemes constitutes an incentive to enter the job market. Adequate and well-designed income support, such as unemployment benefits and minimum income schemes, allow those out of work to invest in job search and training, increasing their chances to find adequate employment that matches their skills.

Finally, comprehensive integration measures are required for those further away from the labour market and especially in response to the recent arrival of a large number of refugees. Integration of migrants and especially refugees calls for a comprehensive approach to facilitate their access to the labour market and more generally their participation in society.

Further improve product and services markets and the business environment

Improving the functioning of product and services markets remains a challenge for many Member States. Challenges differ between Member States but include improving the flexibility of product and services markets, improving the quality of research and innovation, reducing regulatory and administrative burden, strengthening public administration and improving the judicial system and insolvency frameworks. Given their uneven and often unambitious implementation of the Services Directive in the period 2012-2014, many Member States have only been able to tap part of the benefits while significant gains still remain to be made.

Open and competitive product and services markets are necessary to encourage efficient allocation of resources and to facilitate investment. More flexible regulation of services markets would lead to higher productivity and could ease the market entry of new players, reduce the price for services and ensure wider choices for consumers. In addition, the productivity of business services is critical for the competitiveness of certain economic sectors, for example manufacturing. Barriers to entry in these markets are high in some Member States. The national reform efforts should focus on eliminating disproportionate and unjustified authorisation requirements. The Commission will continue to work closely with the Member States to remove these barriers.

Retail plays an important role in the EU economy (9.6% of value added and 13.1% of employment). The lack of dynamism in this sector results in high retail prices, effectively reducing consumers' purchasing power. Research indicates that, to some degree, these high retail prices are due to entry barriers and other restrictions that reduce the level of competition in the retail sector in certain Member States. Low productivity in the retail sector hampers the efficiency of the overall economy.

Increasing transparency, efficiency, and accountability in public procurement, which accounts for 19% of EU GDP, is crucial for investment. Member States should ensure adequate administrative capacity and focus on the increased use of e-procurement (digital tools) and on tackling corruption.

Modern and efficient public administration is necessary to ensure fast and high-quality services for firms and citizens. Enhancing the quality, independence and efficiency of Member States' justice systems is a prerequisite for an investment and business friendly environment. It is necessary to ensure swift proceedings, address the court backlogs, increase safeguards for judicial independence and improve the quality of the judiciary, including through better use of ICT in courts and use of quality standards.

Moreover, the deployment of new technologies and business models can open up additional sources of growth and lead to significant job creation. To make the best use of these sources, Member States should create an appropriate and accommodating business and regulatory environment, and strengthen partnerships between businesses and universities, notably for the digital transformation of industry and services, big data applications and the collaborative economy.

Furthermore, Member State action is necessary to improve efficiency in the use of resources and bringing forward a much more circular economy. The circular economy approach[25] aims to preserve and maintain the value of products, materials and resources in the economy for as long as possible, while minimising the creation of waste. A more circular economy and improving resource efficiency will contribute towards stimulating investments with both short-term and long-term benefits for the economy, environment and employment.

4. Responsible fiscal policies

Budget deficits are being reduced and government debt appears to have peaked. The economic recovery and lower interest rates, as well as continuing consolidation efforts in some countries, are supporting a fall in headline budget deficits. Government debt in the EU and euro area is set to decrease marginally in 2015, after several consecutive years of strong rises. The falling number of countries under an excessive deficit procedure reflects the efforts made over the past years. Nevertheless, public debt remains very high in many Member States. This acts as a drag on growth and makes them more vulnerable to adverse shocks.

The Stability and Growth Pact provides the right framework to ensure that public finances are brought to and maintained on a sustainable path, while making full use of the available fiscal space. The Commission just issued its Opinions on the Draft Budgetary Plans of euro area Member States.[26] In applying the Stability and Growth Pact, as confirmed as part of this package, the Commission will take into account the budgetary impact of the exceptional inflow of refugees. The information provided by the Member States will be used when assessing (ex-post) possible temporary deviations from the SGP requirements in 2015 and 2016.

The fiscal stance for this and next year is broadly neutral both in the euro area and in the EU as a whole. This appears appropriate against the twin objectives of long-term sustainability of public finances and short-term macroeconomic stabilisation.

At Member States' level responsible fiscal policies that respect the common fiscal rules should be maintained. This is key to reduce public debt and to restore necessary fiscal

[25] As foreseen in its Work Programme, the Commission will present a circular economy package at the end of 2015.
[26] For more details, see COM(2015) 800.

buffers while avoiding pro-cyclical policies. The fiscal effort should be differentiated across Member States, in order to reflect country-specific challenges in terms of reducing public debt and stabilisation of the cyclical position, while taking into account the spill-overs, in particular across euro area countries. Progress is being made towards stronger national fiscal frameworks, which are key to achieving and maintaining appropriate fiscal policies. The Commission intends to publish its report on the incorporation of the Fiscal Compact into national law as foreseen in Article 8 (1) TSCG early in 2016,

The composition of fiscal strategies should further prioritise growth-friendly expenditure and preserve productive public investment. The largest spending cuts planned by euro area Member States for next year are affecting the public sector wage bill and government purchases of goods and services. The planned adjustment would probably not affect medium-term growth prospects, though there may be scope for more growth-friendly choices in the composition of expenditures. In addition, the efficiency of Member States' existing expenditure programmes in achieving their targets should be systematically reviewed and, where appropriate, enhanced by the adoption of reforms.

Increasing the effectiveness and fairness of the tax systems

On the revenue side, it is important to ensure efficient and growth-friendly tax systems. This includes shifting taxes away from labour. This can contribute significantly to increasing employment and adaptability of the labour market.

Moreover, debt bias in taxation needs to be addressed. In stimulating access to finance and therefore investment, the preferential tax treatment of debt, resulting from the tax deductibility of interest rate payments, is one of the reasons for the preference for debt against equity. At the level of the Member States, this debt bias in business finance can be addressed by removing the distortions from differential taxation. As part of the broader work being carried out to bring forward the Common Consolidated Corporate Tax Base (CCTB), the Commission will examine ways to address this "debt bias". It will present a new proposal in 2016.

In addition, Member States should focus on reducing aggressive tax planning and fighting tax fraud and tax evasion. This will help to secure revenues e.g. for public investment or for lowering taxes. Member States can fight tax evasion, tax fraud and tax avoidance through enforcement, increasing transparency and cooperation between the various national tax administrations. The Commission presented an Action Plan in June aimed at re-establishing the link between taxation and the location of economic activity, tackling base erosion and profit shifting by certain multinational companies and increasing tax transparency. Likewise, in March, the Commission proposed a package of measures to enhance tax transparency, a key element being the introduction of the automatic exchange of information between Member States on their tax rulings[27] related to any corporate entity.

[27] Tax ruling refers to how the National administration determines the taxation for a particular structure and business practice in that Member State.

Responding to the demographic challenge

Longer and healthier lives are a remarkable achievement for our societies. **Responsible policies are now needed to ensure that pension, healthcare and long-term care systems are financially sustainable and can provide adequate protection for all**. There has been considerable progress in the reform of the European social protection models in the last decade, notably in the field of pension. A majority have adapted their systems to better withstand the demographic impact that will become apparent within the next decade. This not only includes general increases in retirement ages, but also restrictions on early retirement.

These sustainability-enhancing pension reforms in most Member States can lead to new challenges. Generally, reforms went hand in hand with a streamlining of public pension schemes. To ensure that these reforms will enjoy lasting support and success, other flanking measures are likely to be necessary to maintain retirement incomes such as extending working lives and providing other means of retirement incomes through complementary pension savings. In parallel, Member States need to support the development of collective and individual pension plans to complement public pension schemes, including by removing obstacles at European level. Social partners may have an important role to play here, depending on national practices.

Regarding health care and long-term care systems, reforms need to continue to enhance their cost-effectiveness and to ensure adequate access. The demographic challenge affects not only pensions but also health care and long-term care related expenditure. A healthier population will also improve labour market participation and labour productivity. Member States need to introduce measures to ensure a sustainable financing basis, encourage the provision of and access to effective primary health care services, the cost-effective use of medicines, better public procurement, improve integration of care through up to date information channels (such as e-health), assess the relative effectiveness of health technologies and to encourage health promotion and disease prevention.

5. Next steps

The EU needs to act ambitiously and collectively to overcome its economic and social challenges. In this Annual Growth Survey, the Commission proposes that this takes place based on the integrated pillars of **re-launching investment, pursuing structural reforms and modernising public finances**, with a strong focus on job creation and social inclusion. The Annual Growth Survey launches the 2016 European Semester. The Commission looks forward to the views of the European Parliament as well as stakeholders at all levels to enrich the discussion and focus priorities for action.

Alongside discussions on euro area priorities outlined in the dedicated recommendation, the EU institutions should agree EU and euro area priorities for the coming year. These should then provide orientation for Member States' National Reform and Stability or Convergence Programmes in April, as well as the respective country-specific recommendations in May.

Success requires strong commitment from the Member States and the EU institutions together. The Commission will continue to work with all actors to ensure that the recovery is set on a sustainable path, and that Europe can tap its full jobs and growth potential.

The Commission has substantially streamlined the European Semester since last year, establishing more genuine dialogue with the Member States, for instance by engaging pro-actively with stakeholders at all levels, focusing the guidance provided and publishing Country Reports in February, leaving more time to prepare the Country-Specific Recommendations. As announced in its Communication of 21 October 2015,[28] from this Semester cycle, there will be further improvements:

- Better integrating the euro area and national dimensions. A well-performing, robust euro area economy is vital for the sound functioning of the entire EU. To facilitate such co-ordination, the 2016 Annual Growth Survey is accompanied by a set of recommendations for the euro area; this is an important change from the previous semester cycles where the euro area recommendations were proposed along with the country-specific recommendations towards the end of the semester.

- A stronger focus on employment and social performance. Employment and social aspects are further emphasised in the Macroeconomic Imbalances Procedure. Three headline indicators (activity rate, youth unemployment, long-term unemployment) are used in the 2016 Alert Mechanism Report accompanying this Annual Growth Survey. Greater attention is given to social fairness in the context of the new macroeconomic adjustment programmes. The draft Joint Employment Report summarises challenges and priorities. The close involvement of social partners is promoted at all levels.

- Promoting convergence by benchmarking and pursuing best practices. The Commission will progressively suggest benchmarks and strengthen exchanges of best practices across policy or thematic areas.

- More focused support to reforms through EU funds and technical assistance. This Annual Growth Survey is accompanied by a proposal for funding for technical assistance for Member States.[29]

In addition, as proposed on 21 October, the EU economic governance will be improved through practical improvements to the Macroeconomic Imbalances Procedure and to the implementation of the Stability and Growth Pact, as well as by the establishment of an advisory European Fiscal Board and of a network of national Competitiveness Boards.

[28] COM (2015) 600.
[29] COM(2015) 701.