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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Concluding the first European semester of economic policy coordination: Guidance for national policies in 2011-2012

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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Concluding the first European semester of economic policy coordination: Guidance for national policies in 2011-2012

1. HELPING THE EU TO EMERGE STRONGER FROM THE CRISIS

The EU is tackling the worst economic crisis since its foundation – governments and citizens alike have faced pressures like never before, unprecedented decisions have been taken in a very short timespan and this has been costly and painful. The crisis did not start in Europe and other major economies have suffered similar shocks. Inside the EU, the impact has varied from country to country – some Member States rebounded quickly from the initial downturn but others are facing huge challenges. The Commission's forecasts show that economic recovery is gaining ground in the EU, but it remains uneven and subject to uncertainties.

There is no "back to business-as-usual": our societies will be radically affected and transformed by the shocks experienced over the last three years, our growth potential has suffered, our public finances and financial systems have been adversely affected and unemployment has hit a significant part of our population, notably our young people. For many people, there is a prospect of hardship for some time to come, and for others, a growing realisation of what a jobless recovery could entail. In many places, the reaction has been anger and frustration.

The crisis has brought home to us that our economies are interconnected and that our futures are intertwined. The EU is a shared economic space, not 27 economies, and what affects one country, affects all. This is particularly the case for the 17 Member States sharing a single currency as part of the Euro area. To regain our capacity to grow and ensure that Member States performances reinforce rather than hinder each other, we need to inject the collective EU dimension into national policy-making, before decisions are taken. The need for stronger policy co-ordination at EU level is not only linked to the crisis – macro-economic imbalances had built up over several years, leaving many Member States with little or no room for manoeuvre when the crisis hit. Stronger policy co-ordination is also the best response the EU can make to the challenges of globalisation. Outside the EU, the emerging economies were less affected by the crisis and they are enjoying very strong growth rates: the EU needs constant efforts to boost its competitiveness in world markets to sustain its standards of living.

A key lesson from this experience was that focusing only on the deficit criteria of the Stability and Growth Pact (SGP) and weak implementation did not prevent serious problems in other areas. This meant we were too late in picking up on crucial issues. And when we did pick up on them, our reticence to challenge each other constructively meant there was no sense of collective responsibility for the outcome. All too often, market pressures dictated our course of action.

Faced with the immediacy of the crisis, the EU has been developing a common, coherent and comprehensive response – putting together recovery plans, coordinating the rescue and restructuring of banks and completely overhauling the supervision of financial services, providing macro-financial assistance to several Member States[1], creating new support mechanisms to safeguard financial stability in the Euro area and setting ambitious goals for a new path to smart, sustainable and inclusive growth as part of the Europe 2020 strategy[2].

A new EU economic governance is emerging. The legislative proposals of the Commission and the work of the Task Force headed by the President of the European Council will lead to a complete redesign of the EU tools to prevent macro-economic imbalances and reinforce the operation of the Stability and Growth Pact. In Spring this year, Euro area Member States and several other Member States[3] agreed to make additional efforts to foster competitiveness, employment, sustainability of public finances and financial stability as part of the Euro Plus Pact.

The EU is now implementing a new working method – the European semester – to ensure that collective discussion on key priorities takes place at EU level, before and not after national decisions are taken. The results of this discussion must then be effectively reflected in national decision-making, in particular in national budgets and structural reforms, so that national and EU efforts are brought together in the right sequence to deliver and monitor progress over time.

Based on its assessment of the programmes presented by the Member States, the Commission is now putting forward country-specific recommendations as well as recommendations for the Euro area. This guidance is limited to key priorities to be addressed in the next 12-18 months. This reflects a deliberate choice to concentrate on the most pressing challenges and what can realistically be achieved in that time frame, taking into account the specific circumstances of each Member State. For those Member States that are receiving external financial assistance, the Commission has chosen to make only one recommendation – that they implement their programme commitments on schedule. More detailed analysis is provided in supporting documents to highlight aspects of a structural nature and point to medium-term priorities, notably linked to delivering the Europe 2020 targets. Once adopted by the Council, each Member State should reflect this guidance in its national decision-making and annual budgetary processes.

[1] Greece, Ireland, Latvia, Portugal and Romania.

[2] The Strategy includes five headline targets to be met by the EU by 2020: raising its employment rate to 75%, raising its investment levels in R&D to 3% of GDP, meeting its climate change and energy objectives ("20 20 20"), increasing the share of the population at tertiary or equivalent education levels to at least 40% and reducing early-school leaving to less than 10%, promoting social inclusion by lifting at least 20 million people out of the risk of poverty and exclusion.

[3] Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

Box 1. The first European semester

The European semester started in January 2011 with the presentation of key EU socio-economic challenges by the Commission in its Annual Growth Survey (AGS) and the Joint Employment Report[4]. The Spring European Council endorsed and complemented the guidance given by the AGS. Against this background, Member States were requested to present Stability or Convergence Programmes (SCPs) – dealing with the situation of their public finances – and National Reform Programmes (NRPs) – presenting key policy measures to sustain growth and jobs and reach the goals of the Europe 2020 strategy – at the end of April[5]. In addition, most members of the Euro Plus Pact have presented specific commitments made under the Pact (see below).

The Commission has assessed these programmes and commitments, and is now presenting its guidance on a country-by-country basis so that the June European Council can conclude the first semester. While it is acknowledged that reforms may take time to deliver results, the Commission has focused on areas where new steps need to be taken now.

In the light of this first experience, the Commissions considers that the European semester can become an effective governance method to support EU and national policy making in an integrated, transparent and timely manner, provided the Member States decide collectively on the key policy orientations to be implemented and follow up on the Council's recommendations:

- The simultaneous presentation of the SCPs and NRPs enables the EU to assess national growth and fiscal strategies together, including possible risks, imbalances or trade-offs that would not otherwise be picked up. This is why the Commission is presenting an integrated set of recommendations for each Member State, respecting the different legal bases that underpin them. The Council is invited to send a single set of recommendations to each Member State, which includes the Council opinion on its fiscal situation.

- Bringing together EU-level and country-specific guidance allows national agendas to be discussed and presented against the background of EU goals. This means that the EU dimension can be inserted into national policy-making before decisions are taken. It also allows the EU to take stock of national efforts and decide on complementary actions to be taken at EU level, for instance in the context of the Europe 2020 flagship initiatives[6].

- The combination of short-term guidance and of medium-term targets gives the EU and its Member States the means to develop a sequence of reforms and stronger, better co-ordinated policies over time.

[4] "Annual Growth Survey 2011: advancing the EU's comprehensive response to the crisis" - COM(2011) 11, 12.1.2011, including the draft Joint Employment Report.

[5] Portugal and Greece did not formally present Stability Programmes. Their policy priorities will be regularly discussed in the context of the follow-up to the assistance programmes.

[6] The Commission has put forward a series of EU-level initiatives ("Europe 2020 flagships") to support the achievements of the Europe 2020 objectives: "Digital Agenda", "Innovation Union", "A new Industrial Policy", "Youth on the Move", "New Skills and Jobs", "A Platform Against Poverty", "Resource Efficiency". It has also put forward several key actions to tap the potential of the European single market in the form of a new "Single Market Act".

2. COMMISSION ASSESSMENT AND RECOMMENDATIONS

The overall assessment of the Commission is that the programmes presented by the Member States constitute a good starting point for sustaining Europe's recovery, for addressing fiscal challenges and for driving more ambitious reforms at national level. The guidance of the Annual Growth Survey has been broadly taken up in national efforts. The adoption of national targets shows there is a significant degree of commitment to the goals of the Europe 2020 strategy[7].

However, the Commission is concerned to see that the combination of these commitments would not allow the EU to meet its headline targets by 2020. On the basis of the national commitments, the EU is on track to achieve its targets for emissions reduction, for renewable energy and for early school-leaving. Additional efforts are required for reaching the targets in the areas of employment, research and development, energy efficiency, tertiary education and poverty.

In 2011-2012, Member States face far-reaching challenges in a particularly demanding context. Fiscal room for manoeuvre is very limited and there is discontent among citizens in several Member States as the impact of the crisis makes itself felt. However, under the pressure of events, many of the changes needed to remedy structural weaknesses, which have often been delayed for years, are now being considered or implemented. This is most obvious in the Member States receiving assistance from the EU, other Member States and the IMF, but it is also evident, to varying degrees, in all national programmes.

In its assessment, the Commission acknowledges the breadth of the reforms already embraced by the Member States and recognises that there is no "one-size-fits-all" solution, and no "silver bullet": not everything should or can be done by all at once. Yet, given the seriousness of the situation and the interdependences of our economies, the Commission is recommending actions at national level in the following areas identified in the Annual Growth Survey:

Pre-requisites for growth

- With 24 Member States currently in excessive deficit procedure, and public debt levels still worryingly high, most governments are now engaged in far-reaching fiscal consolidation efforts and confronted with the task of substantially revisiting the levels and structures of both their expenditure and revenue sides of national budgets. The adoption of reinforced fiscal frameworks in some Member States, including through the use of expenditure ceilings and "debt brakes", is a positive step forward. Several Member States are also reforming their public administration and social security systems in order to better control expenditure levels. The Commission considers that it is essential to stick to agreed deadlines for the correction of excessive deficits and to consolidate swiftly, moving towards the medium-term budgetary objectives specified by the Council. In this process, the Commission also calls for careful attention to be given to the quality of public spending and tax structures to

[7] With the exception of the UK, which presented qualitative objectives for several areas, and Luxembourg, which recently withdrew its poverty target.

preserve or reinforce growth-friendly items, such as investment in research, education and energy efficiency[8].

- Progress in correcting macro-economic imbalances, which emerged over the last decade, has been slow in some Member States; further corrections are required. In particular, those Member States with large current account deficits linked to sustained losses in competitiveness and to previously favourable debt financing conditions, must take further steps to address their structural weaknesses. In some instances, this may involve reviewing wage-setting systems, in consultation with social partners, to ensure that wages support competitiveness and develop in line with productivity growth. In other instances, the primary challenge is to proceed with productivity-enhancing structural reforms that *inter alia* shift economic activity towards high value-added and tradable sectors. In Member States with current account surpluses, some offsetting trends can be observed. There is scope for a further strengthening of domestic demand which lies mainly in measures to bring more people into employment and open up the services and network markets.

- The capacity of the banking sector to deliver effectively for the economy remains an area of concern in a number of Member States. The results of the new bank stress tests, which will be published shortly, must be immediately followed up by measures to address remaining vulnerabilities. Besides the ongoing regulatory overhaul at EU level, the Commission advocates a number of systemic reforms aiming at the modernisation of the governance and functioning of some national systems. Several Member States should also consider strengthening their regulatory framework for mortgages with a view to preventing housing bubbles and reducing over-indebtedness of private households.

Mobilising labour markets, creating job opportunities

- Most Member States are engaged in reforming their pensions systems, both as a way to curb future ageing-related expenditure as their populations grow older, and to create additional incentives for longer working lives. Increasing the statutory retirement age and linking it to life-expectancy remain priorities, and the creation of automatic or formula-based links between retirement age and life expectancy can be an effective tool. Phasing out early retirement schemes and boosting employability of workers over 50 are a necessary part of the policy response. Given the impact of the financial crisis on private pension funds, Member States relying on a two- or three-pillar system should ensure the stand-alone viability of each of the pillars. In a number of Member States, the adequacy of pensions' level to ensure a decent standard of living in old age is or may become an issue.

- In several Member States, the crisis has led to drastic increases in unemployment, sometimes coupled with sharp falls in employment levels, and the most vulnerable have often been the most affected. The risks for certain

[8] Which include the removal of environmentally harmful subsidies.

people to fall into inactivity or exclusion may materialise if not prevented and tackled. Effective support measures and employment services are thus essential to help unemployed people find jobs and continue developing their skills. The situation of people experiencing poverty and other particularly vulnerable groups also calls for particular attention.

- Several Member States should be more pro-active in improving education performances and access to lifelong learning, both as a way to improve employability and to boost human capital. Particular efforts are needed in some Member States to tackle the issue of early school-leaving and to provide apprenticeship places and vocational training. Targeted action is also recommended to tackle the high unemployment levels of young people. Many Member States are experiencing rapid ageing of their workforces and the return to growth raises the prospect of increasing skills bottlenecks: matching educational and training outcomes with labour market needs is thus a priority.

- A number of Member States still suffer from the segmentation of their labour market with different types of contracts and need to move resolutely towards a more effective – and fair – combination of flexibility and security in working arrangements ("flexicurity"), including by rebalancing employment protection legislation, so as to stimulate job creation, labour market participation, mobility across sectors and human capital accumulation.

- Insufficient attention has so far been given to reducing the tax wedge on labour, in particular for low-wage and low-skilled workers. In a context of fiscal consolidation, many Member States will be led to revisit both the tax and expenditure sides of the national budgets. It is generally recommended to shift taxation away from labour and onto consumption and/or to support environmental objectives. Further action is also needed to remove social and tax obstacles for second earners to join or remain in the labour force. Reviewing the tax and benefit systems, improving the availability of childcare and allowing for more flexible forms of employment are recommended as priorities in this context.

Frontloading growth

- Several Member States are flagged as lagging behind with the implementation of the Services Directive[9], unnecessarily delaying the dynamism of the services sector. A number of concrete steps are recommended so that they can tap into the potential of the single market to boost growth and create jobs, notably by removing unjustified barriers to entry or further opening professional services by removing quotas and closed shops, fostering greater competition in network industries and making more strategic use of the large amounts invested through public procurement.

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9 Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the Internal Market.

- As part of their budgetary consolidation strategies, Member States need to consider how to prioritise expenditure on research and education and the key infrastructures that are needed to sustain growth, whilst maximising the quality of spending and efficiency of services.

- There is a need to improve access to funding for innovative companies, in particular venture capital for SMEs, and to help SMEs focusing on start-up conditions, for instance simplifying procedures for licences and permits, reducing the time and cost for granting them, and improving the protection of investors.

- Particular emphasis is placed on the need for a number of Member States to promote greater energy efficiency. This will not only support energy security and help to combat climate change but would also promote the spread of innovative technologies and boost skilled job creation.

- A number of Member States need to take steps to reduce administrative burdens on companies and to increase the capacity and performance of public administrations and of the judicial system. In several cases, urgent action is needed to modernise the business environment by reducing red tape and increasing transparency in public procurement. Several Member States are also recommended to make better use of EU funds.

Box 2. The Euro Plus Pact: taking stock of first commitments

The Euro Plus Pact was agreed in March 2011 by Heads of State or Government of the Euro area and joined by Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania. The purpose of the Pact is to strengthen the economic pillar of the monetary union, to achieve a new quality of economic policy coordination, to improve competitiveness, thereby leading to a higher degree of convergence. The Pact focuses primarily on areas that fall under national competences and are key for increasing competitiveness and avoiding harmful imbalances. It is designed to involve a special additional effort, including concrete commitments and actions that are more ambitious than those already agreed within the EU framework, accompanied with a timetable for implementation. These new commitments will be included in the NRPs and SCPs and be subject to the regular EU surveillance framework.

Most of the 23 participants have presented commitments - over 100 separate measures in total - relating to most if not all of the four areas covered by the Pact: to foster competitiveness, to foster employment, to contribute to sustainability of public finances and to reinforce financial stability.

However, the degree of ambition and precision of these commitments are uneven:

- Five members of the Pact have not yet communicated their commitments[10].

- The commitments generally focus on frontloading growth-enhancing reforms to foster competitiveness, for instance in network industries, and the service sector. Many relate to employment actions focusing on improving educational outcomes and skills. Others involve fiscal consolidation measures, for example by anchoring stricter fiscal discipline in national legislation. To a lesser extent, the commitments deal with the reinforcement of financial stability, in particular by reinforcing national supervision of financial actors. Aspects related to pragmatic coordination of tax policies, in

10 Finland, Greece, Latvia, Portugal and Slovenia.

the form of exchange of best practices, avoidance of harmful practices and proposals to fight fraud and tax evasion, would also deserve further attention in future.

- Some members commit to measureable initiatives, e.g. to implement specific legislation or programmes including by indicating their financial volumes, whilst others make more general commitments to reduce unemployment of low-skilled workers, to maintain a low tax burden, to improve the business environment by reducing red tape or to implement EU directives.

- Even where specific commitments are made, the majority appears to relate to on-going legislative projects rather than forward-looking reform projects initiated as a reaction to the Pact. So far, none of the commitments appear to reflect the focus on best practices and benchmarking against best performers within Europe and vis-à-vis other strategic partners which is set out in the Pact.

The Commission's assessment of the commitments is reflected in its recommendations. In many cases, a specific recommendation is made in areas which are more generally described in the commitments made under the Pact, for example in areas such as pension reform, labour taxation and skills improvements.

3. NEXT STEPS

The Commission invites the European Council to endorse its recommendations at its June 2011 meeting before formal adoption by the Council.

At EU level, work will continue to follow up on the European semester:

- The legislator should adopt the new legislative package on the prevention and correction of imbalances and on the reinforcement of the Stability and Growth Pact. This will reinforce our collective tools to assess the situation and ensure adequate follow-up.

- In the light of the country-specific recommendations, the various Council formations should examine national policies and performances in their areas, monitor implementation and carry out peer reviews on specific themes to encourage mutual learning of interesting practices.

- Following on the specific recommendations addressed to its members, the Euro Group should intensify its policy co-ordination with a particular focus on identifying and preventing imbalances. It should also monitor implementation of the recommendations.

- As stated in the Euro Plus Pact, Heads of State or Government of participating Member States will monitor their commitments politically. In the light of the Commission's assessment of the first experience of the Pact, participating Member States should make their next commitments more specific, measurable and time-bound so that progress can be monitored. These commitments should be anchored in the development and implementation of the National Reform Programmes and Stability or Convergence Programmes.

- The European Parliament should be given the opportunity to examine progress on the main elements of the Europe 2020 strategy and to present its views on the Commission's next Annual Growth Survey. The European Economic and Social Committee and the Committee of the Regions also have a role to play in this respect.

- The Commission will take stock of progress in implementing the country-specific recommendations, first at EU level in its next Annual Growth Survey in January 2012, and then for each Member State in its guidance to follow next year. It will continue to support Member States efforts through EU level action to implement the Europe 2020 flagships and by intensifying efforts to unlock the potential of the Single Market, including through the Single Market Act.

The conclusion of the first European semester marks the opening of a "national semester": in the second semester of this year, it will be for the Member States to discuss and incorporate European guidance into their 2012 budgets and national decision-making, also in view of the preparation of the next national programmes foreseen in Spring 2012.

While some Member States may have chosen cautious targets and measures in this first year in the light of current difficulties, additional efforts will be required in the coming years to make sure that the EU is investing sufficiently in smart, sustainable and inclusive growth. Member States need to do more to protect expenditure on research and education and key infrastructures. They should open up more opportunities in the services' sector, including by breaking down barriers to job creation and competition in key network industries and by deciding rapidly on the measures proposed in the Single Market Act. Most Member States could do more to improve the business environment, through better regulation, less gold plating and by improving the access of SMEs to finance. Measures to implement "flexicurity" and to adapt skills to labour market needs should be pursued.

In their pursuit of fiscal consolidation and structural reforms, Member States need to find ways of tackling the social impact of the changes now underway. In the Europe 2020 strategy, the EU chose to have a social inclusion target, with the aim of lifting 20 million people out of poverty and exclusion by 2020. The trends visible in many countries highlight a growing risk of poverty and marginalisation unless active measures are taken to counter them. On the basis of the actions described in the national programmes, Member States need to do more to deliver on this target.

To build the legitimacy and effectiveness of the new EU economic governance, the Member States should decide on the best ways to involve their national parliaments, as well sub-national authorities and other stakeholders, in the development and follow-up of their programmes. The Commission stands ready to assist and engage in national discussions as part of this new, stronger EU economic governance.

We need to use the momentum for change driven by the crisis to help the EU emerge stronger and fitter for the future, well able to compete with confidence and success in global markets. This first European semester is a crucial step towards achieving our Europe 2020 objectives and marks a qualitative change in the economic policy co-ordination and governance of the EU. By stepping up national action and by working together at EU level we are better placed to deliver sustainable growth and to help our citizens realise their hopes for the future.