

European semester for economic policy coordination

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PURPOSE: setting annual priorities for European growth with a view to advancing the EU's comprehensive response to the crisis (Annual growth survey).

BACKGROUND: the EU has taken decisive action to deal with the crisis: as a result, the deterioration of public finances and the increase in unemployment have been less marked than in other parts of the world. The EU's high levels of social protection cushioned the worst impact of the crisis but because of its weak productivity growth, **recovery is slower in Europe**. The consequences of the crisis are still making themselves felt:

- the rise in **unemployment** is a central problem. On aggregate, 9.6% of the working population is unemployed. In some countries, youth unemployment can be as high as 40%. Around 80 million people are estimated to live below the poverty line in Europe;
- by the end of 2012, eleven Member States are expected still to remain at **output levels** below those preceding the crisis;
- EU **gross government debt** rose, on aggregate, to around 85% of GDP in the euro area and to 80% EU-wide. The budgetary impact of the crisis will compound the effect of demographic change, which will add a fiscal burden of some 4.5% of GDP in the long term;
- the **financial sector** has not yet returned to normal conditions and there are situations of vulnerability to stress and dependency on state-support;
- **credit conditions** are not yet back to normal and in a number of Member States household and corporate debts are still excessive;
- price and cost **competitiveness** remain problematic.

Medium term **potential growth** for Europe is projected to remain low and estimated at around **1.5% up to 2020** if no structural action is taken namely to resolve the labour productivity gap with our main competitors. To avoid stagnation, unsustainable debt trends, accumulated imbalances and ensure its competitiveness, Europe needs to accelerate the consolidation of its public finances, the reform of its financial sector and to frontload structural reforms now.

In this context, the EU has also decided to change its economic governance. January 2011 launches the first **European Semester** of ex-ante policy co-ordination starting with this **Annual Growth Survey** which is anchored in the [Europe 2020 strategy](#).

This Annual Growth Survey brings together the different actions which are essential to strengthen the recovery in the short-term, to keep pace with our main competitors and prepare the EU to move towards its Europe 2020 objectives.

CONTENT: given the urgency, the Commission has chosen to present 10 priority actions. It focuses on an integrated approach to recovery concentrating on key measures in the context of Europe 2020 and encompassing three main areas:

- the need for rigorous fiscal consolidation for enhancing macroeconomic stability,
- labour market reforms for higher employment, and
- growth enhancing measures.

This first Annual Growth Survey is designed to **apply to the EU as a whole** but will need to be tailored to the specific situation of each Member State.

The ten actions put forward by the Commission are as follows:

- 1) Implementing a rigorous fiscal consolidation:** public expenditure must be put on a sustainable track as a pre-requisite for future growth. Annual adjustments of the structural budget balance in the order of 0.5% of GDP will be clearly insufficient to bring debt ratios close to the 60% requirement. Therefore, stronger consolidation is needed and should be implemented on the basis of the reinforced fiscal rules proposed by the Commission. All Member States should keep public expenditure growth firmly below the rate of medium term trend GDP growth, while prioritising sustainable growth friendly expenditure in areas such as research and innovation, education and energy. All Member States should demonstrate that their Stability or Convergence Programmes are based on prudent growth and revenue forecasts. Indirect taxes are more growth-friendly than direct taxes and broadening tax bases is preferable to increasing tax rates.
- 2) Correcting macro-economic imbalances:** many Member States need to tackle their lack of competitiveness with greater urgency. Member States with large current account surpluses should identify and tackle the sources of persistently weak domestic demand (including further liberalisation of the service sector and improving conditions for investment).
- 3) Ensuring stability of the financial sector:** at EU level, the regulatory framework must be further reinforced, while the quality of supervision should be enhanced by the ESRB and European Supervisory Authorities, which have become operational at the beginning of 2011. Bank restructuring must be accelerated to safeguard financial stability and underpin the provision of credit to the real economy.
- 4) Making work more attractive:** the participation rate of low income earners, young people and second earners is worryingly low. The most vulnerable face the risk of long term exclusion from employment. In response, training and job search should be tied more closely to benefits. Shifting taxes away from labour should be a priority for all Member States in order to stimulate demand for labour and create growth.
- 5) Reforming pension systems:** Member States that have not already done so should increase the retirement age and link it with life expectancy. They should: (i) reduce early retirement schemes as a priority, and use targeted incentives to employ older workers and promote lifelong learning; (ii) support the development of complementary private savings to enhance retirement incomes; (iii) avoid adopting measures related to their pension systems which undermine the long term sustainability and adequacy of their public finances.
- 6) Getting the unemployed back to work:** once the recovery has gained ground, unemployment benefits should be reviewed to ensure that they provide incentives to work, avoid benefit dependency and support adaptability to the business cycle. Member States should design benefits to reward return to work or incentives to go into self-employment for the unemployed.
- 7) Balancing security and flexibility:** in some Member States, employment protection legislation creates labour market rigidity, and prevents increased participation in the labour market. Such employment protection legislation should be reformed to reduce over-protection of workers with permanent contracts, and provide protection to those left outside or at the margins of the job market. At the same time, reducing early school leaving and improving educational achievements is essential to help young people to have access to the labour market.
- 8) Tapping the potential of the single market:** barriers to market entry and obstacles to entrepreneurship remain acute in the single market. Cross-border services only represent 5% of GDP, less than a third of trade in goods and only 7% of consumers buy on-line because of the numerous restrictions which prevent

the development of cross-border on-line sales. All the Member States should i) fully implement the Services Directive and ii) remove unjustified restrictions on professional services such as quotas and closed shops, together with restrictions on the retail industry. Tax treatment disadvantaging cross-border trade or investment should be eliminated.

9) Attracting private capital to finance growth: innovative solutions are required to mobilise urgently a greater share of private EU and foreign savings. The Commission will make proposals: (i) for EU project bonds to help bring public and private financing together for priority investments and (ii) to enable venture capital funds established in one Member State to operate freely anywhere in the EU and to eliminate remaining tax obstacles to cross-border activities.

10) Creating cost-effective access to energy: Member States should rapidly: (i) implement the third internal market energy package in full, (ii) step up their energy efficiency policies. This will lead to significant savings and create jobs in the construction and services sectors. The Commission is developing EU-wide standards for energy efficient products to help the expansion of markets for innovative products and technologies.

The Commission proposes that **these form the basis of an agreement** by the European Council that Member States should commit to the implementation of these 10 actions. The proposals set out in this Communication would already enable the next meeting of the European Council to take **concrete steps** to maintain and accelerate the momentum of efforts to frontload and raise growth, and agree on the timetable for implementing the comprehensive response to the crisis. For the latter, the European Council has already agreed on two benchmarks: for finalising work on the permanent European Stability Mechanism (ESM) by March and the legislative package to enhance economic governance in the EU by June.