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

2016 European Semester: Country-specific recommendations

1. INTRODUCTION

Supporting investment, pursuing structural reforms and preserving responsible public finances is essential to sustain Europe's recovery and modernise its economies. These three areas for priority action - the "virtuous triangle" - were confirmed in the 2016 Annual Growth Survey and underpin the country-specific recommendations and decisions under the Stability and Growth Pact that the Commission is presenting today. This package builds on the assessment of the national programmes presented by the Member States in March and April 2016 as part of the European Semester of economic policy coordination and incorporates the data from the latest Commission economic forecast¹. In parallel to this package, the Commission is also launching a formal consultation of the Contracting Parties to the Treaty on Stability, Coordination and Governance on the transposition of the Fiscal Compact.

At the European level, the Commission is working hard with other EU institutions to establish the right framework conditions for jobs and growth. Progress is being made on the implementation of the Commission Work Programme for 2016. The Commission will issue in the coming weeks a stocktaking of progress on the Investment Plan for Europe, the Capital Markets Union, the Digital Single Market and the Single Market Strategy, all of which are essential elements in stimulating jobs and growth. Efforts at EU level are underpinned by the Better Regulation agenda. At national level, there is progress but it remains uneven. The onus is on the Member States to pursue the measures recommended by the Council, in order to improve the situation of their own economies and also of the European Union as a whole.

The European economy is pursuing its moderate recovery and domestic sources of growth must gradually take over. Mainly driven by private consumption, economic output has been benefiting from the support of low oil prices, favourable financing conditions and the euro's low exchange rate in recent times. As these supportive factors may soon have run their course, it is crucial to stimulate further domestic sources of growth, notably productive investment in line with the Investment Plan for Europe, as it can step up today's demand and tomorrow's supply. Investment is still low compared to pre-crisis levels, from both private and public sources, but it is gaining traction and the trend is now clearly reversing. Further progress requires overcoming a combination of weak demand, high private debt, a difficult business environment in some countries and overall still fragile private sector confidence.

The structure of global growth is changing with the international environment, presenting both opportunities and challenges to the European Union. Growth in emerging economies is expected to remain subdued amid more volatility in the financial markets. More recently, growth in major advanced economies has also slowed down. These elements create uncertainty and highlight the need for the EU to strengthen its capacity to grow and stimulate demand in its large integrated economy.

¹ See national programmes at:

http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

and Commission Spring 2016 Economic Forecast of 3 May 2016 at:

http://ec.europa.eu/economy_finance/eu/forecasts/2016_spring_forecast_en.htm

Faster progress on structural reforms, including through adequate sequencing, is necessary to boost recovery and raise the long-term growth potential of EU economies. This is particularly true given the legacy of the economic crisis, weak demographic trends and relatively low productivity growth. The Commission has repeatedly argued that all policy tools – monetary, fiscal and structural – are needed to foster confidence and strengthen the recovery. It has put the focus of its action on promoting upward convergence between Member States, to foster job creation and reduce poverty and social exclusion. Since accommodative monetary policy alone cannot lead to sustained and balanced growth and fiscal space is still limited in many Member States, structural reforms are essential to modernise the economy and to deliver the range of objectives set down in the EU treaties, combining balanced, sustainable growth, full employment and social progress. By raising productivity, well-designed and sequenced reforms can have a sizeable positive medium-term impact on the potential growth of the economy and enhance adjustment capacity. Their short-term impact on growth can be maximised when rapid reform implementation boosts confidence and when combined with complementary measures that support domestic demand, particularly investment.

Social models have been put to a test during the crisis and need to be modernised and strengthened by combining the right elements of flexibility and security, including sustainable return and integration pathways into the world of work. While employment levels have risen since 2013 by over 5.5 million people and unemployment is decreasing significantly to its lowest levels in years, most of the Member States are still facing the acute social legacy from the crisis. Long-term unemployment is still high at 10.5 million people in the EU and 122 million people are considered to be at risk of poverty or social exclusion². Household real income per capita is still below the 2008 level in the euro area. Moreover, looking ahead, the effects of an ageing population call for further modernisation in long-term care, pensions and health care, covering not only the extent of their provision but also their financing. To help address some of these issues and encourage convergence towards the best performers, the Commission has initiated work on the establishment of a European Pillar of Social Rights³, which is part of the broader efforts to deliver a deeper and fairer Economic and Monetary Union.

The high influx of refugees and migrants over the past year has a number of social and economic consequences for the EU. In the short run, the inflow of refugees is set to require additional public expenditure and increase domestic demand, with positive effects on GDP. The medium-term effect on employment and growth hinges on the successful labour market and social integration of refugees, including via educational support.

A skilled workforce is crucial for the EU to compete globally, foster social inclusion and sustain its high living standards. A more skilled workforce would raise productivity. In turn, higher productivity growth would allow for higher wages and purchasing power for Europeans. Urgent action is needed to make sure that the EU workforce has the necessary skills to keep pace with a fast-changing labour market. While some employers have difficulties finding people with the right skills, more than four million young people are still

²According to the data of EU-Statistics and Living Conditions (EU SILC): <http://ec.europa.eu/eurostat/web/income-and-living-conditions/overview>

³ COM(2016) 127 final of 8 March 2016.

unemployed and matching today's and tomorrow's needs of the world of work is a challenge across the board. This is also critical in view of demographic developments.

The European Fund for Strategic Investments (EFSI) has started to deliver results on the ground. So far, the European Investment Bank (EIB) has approved 57 projects for financing under the EFSI, which represent a volume of financing of EUR 7.8 billion. More projects are being selected for financing each month. Of the projects approved so far, around half support renewable energy, energy and resource efficiency and other investments that contribute to low-carbon growth. The others include R&D and industrial innovation, digital and social infrastructure, transport, as well as access to finance for smaller businesses. The European Investment Fund (EIF) has approved more than 165 SME financing agreements, with total financing under the EFSI of EUR 3.4 billion. Some 136,000 SMEs and midcaps are expected to benefit. Together, these operations are expected to trigger total investment of EUR 82.1 billion.

Another major source of EU support to investment is provided through the European Structural and Investment Funds (ESIF) with planned EU investment of EUR 454 billion up to 2020 targeted on the drivers of jobs and growth. With the closure in late 2015 of the previous generation of programmes, 2016 will see the acceleration in delivery of the 2014-2020 ESIF programmes. The Commission, together with the Member States, will keep implementation of these programmes under close review.

2. IMPLEMENTATION OF THE NEW ELEMENTS IN THE EUROPEAN SEMESTER 2016

Better integration of the euro area and national dimensions

The 2016 European Semester is the first policy cycle in which the Commission proposed recommendations for the euro area together with the Annual Growth Survey. These were subsequently adopted by the Council ahead of the country-specific recommendations. The five recommendations highlight the policy actions for the euro area in the areas of structural reforms, fiscal policy and financial markets. These have provided a coherent benchmark for the preparation of the country-specific recommendations, ensuring a stronger integration of the euro area dimension in domestic policies and reforms. The country-specific recommendations proposed by the Commission are thus geared towards supporting the implementation of the euro area recommendations⁴. This, in particular, concerns recommendations linked to the overall fiscal stance, current account surpluses, labour markets, non-performing loans and insolvency frameworks.

More focused country-specific recommendations

Country-specific recommendations set the policy objectives for the next 12 to 18 months. In order to increase the ownership of reforms and to contribute to better reform implementation, in 2015, the Commission introduced greater focus by significantly decreasing the number of recommendations, only covering key priority issues of macro-economic and social relevance that require Member States' immediate attention. The recommendations also put the focus on what to achieve, instead of prescribing how to

⁴ Council document 5134/16.

achieve it, in order to guide Member States while leaving the necessary room for manoeuvre. The 2016 recommendations consolidate this approach. They also take into account the intense dialogue with the other EU institutions and with national authorities and stakeholders following the publication of the country reports in February 2016⁵.

The Commission will continue to monitor a wide range of economic and social policy developments. While the country reports cover a broader range of topics and challenges with economic and social relevance for the Member States, the country-specific recommendations maintain a narrower focus, as a way to guide and steer reform efforts. At the same time, adequate differentiation between Member States is ensured, depending on the nature and extent of the challenges. This is reflected both in the number of country-specific recommendations and their degree of specificity.

A stronger macroeconomic imbalances procedure

The nature of macroeconomic imbalances that Member States experience has been made clearer and has been better communicated. As indicated in its Communication following the country reports⁶, the Commission has taken steps to improve the transparency of the macroeconomic imbalances procedure and the categorisation of Member States' imbalances. The findings of the in-depth reviews of the relevant Member States under the procedure have been presented more clearly and effectively in the country reports. This strengthens the link from challenges to the policy response and the identification of outstanding policy gaps. The streamlining and stabilisation of the categories of macroeconomic imbalances from six to four (no imbalance, imbalances, excessive imbalances, and excessive imbalances with corrective action) also contributes in this regard. As in previous cycles, the severity and scope of identified imbalances are reflected in the proposals for country-specific recommendations where, in particular, countries with excessive imbalances have more targeted country-specific recommendations.

Monitoring of the main economic and policy developments to address imbalances will be broadened. With the streamlining of the European Semester, it was also decided that, as from the forthcoming cycle, there would be specific monitoring for all Member States with identified macroeconomic imbalances and excessive macroeconomic imbalances. As in previous cycles, this aims to contribute to a swifter and more comprehensive policy response to the imbalances identified, through an intensified dialogue between the Commission and the national authorities, supported by expert missions and regular progress reports. Such contacts will also help the monitoring of the implementation of the country-specific recommendations in the Member States concerned. The monitoring will vary according to the gravity of the underlying challenges.

The European Semester now has a stronger focus on employment and social performance. The assessment and advice in the Semester systematically takes into account employment and social conditions. The inclusion of three new employment variables in the scoreboard of the macroeconomic imbalances procedure is a reflection of the Commission's commitment to broaden its analysis of macroeconomic imbalances. The indicators are added

⁵See the country reports at:

http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

⁶ See COM(2016) 95 final/2 of 7 April 2016.

in order better to capture the employment and social dimension of adjustment processes. Greater attention is paid to the social fairness of macroeconomic adjustment programmes.

More systematic use of cross-examination and benchmarking

Further cross-country comparison tools are being developed. Convergence can be promoted by benchmarking and pursuing best practices. The Commission has progressively started suggesting benchmarks and cross-examination exercises across policy or thematic areas, to foster a common understanding of challenges and policy responses and to increase reform implementation. Several useful discussions have taken place or started at political and committee level within the Council formations and will be further expanded in the next European Semester round. Cross-country analyses have thus become an important tool to support the Commission's policy advice given in the country-specific recommendations, facilitating a transparent discussion of best practices and results in various policy areas. Building on the experience of EU Member States in the European Semester, the Commission is also strengthening its support to improving economic governance and competitiveness in enlargement countries.

More support to reforms through EU funds and technical assistance

There is by now an explicit link between the use of the EU budget in the Member States and the promotion of policy reforms. In accordance with the legal framework covering the European Structural and Investment (ESI) Funds⁷, the programmes co-financed by ESI Funds for the period 2014-2020 address all relevant country-specific recommendations in the context of the European Semester. The operational programmes have been closely aligned with past country-specific recommendations and their approval has been subject to the implementation of a number of reforms (*ex ante* conditionalities) in order to facilitate the use and effectiveness of ESI Funds. The Commission will closely monitor and report on progress towards the agreed objectives by 2017. It also intends to discuss with Member States the effectiveness of programming in support of reforms to ensure full alignment over time, in line with the macroeconomic conditionality provisions of the ESI Funds. It will engage Member States in more detailed discussion of their technical assistance needs and ensure that the EUR 5 billion of ESI Funds dedicated to administrative capacity building is mobilised to support necessary reforms.

Effective reform implementation is also being supported through the roll-out of technical assistance by the Commission's recently established Structural Reform Support Service. Building on the experience of the support offered to Cyprus and Greece, a legislative proposal for funding technical support to the Member States that may request it was tabled in November of last year and is currently being negotiated with the co-legislators. The proposed Structural Reform Support Programme (SRSP) will provide a dedicated EU instrument to provide comprehensive and targeted support to Member States, at their request, to assist them with the design and implementation of institutional, structural and administrative reforms.

The Structural Reform Support Programme will allow the mobilisation of technical support for a broad range of key reform areas. In the case of general administrative reform, support can, for example, be provided to improve governance, efficiency and quality, including on measures to fight corruption and fraud. Support in the domain of fiscal policy could encompass,

⁷ Regulation (EU) No 1303/2013.

for example, help with the improvement of public finance management, as well as support to ensure the more efficient collection of tax and social security contributions. Reform of the business environment could benefit from assistance in the process of simplification of the regulatory system, the rollout of policies for promoting innovation, entrepreneurship, foreign direct investment and exports. Support in the domain of financial markets may include assistance in the design and implementation of individual and corporate insolvency legislation and securitisation frameworks in the context of the Capital Markets Union. Technical assistance for reforms in the areas of labour market and social policy could be mobilised, for example to increase the efficiency and effectiveness of social welfare systems in the light of long-term sustainability risks.

Democratic legitimacy and accountability

Effective democratic legitimacy and accountability is crucial for strengthening ownership of the European Semester process. The dialogue with national stakeholders (governments, parliaments, social partners, civil society) and the European Parliament at key points of the Semester process has been significantly strengthened, both at technical and political level. The early publication of the country reports provided more time to engage in in-depth discussions before the Commission publishes its proposals for the country-specific recommendations. Member States also increasingly involve national parliaments and social partners. The role of the national parliaments should be further strengthened, with enhanced interaction in the debate on the country-specific recommendations addressed to the Member States and within the annual budgetary procedure. The Commission took an active part in national debates, at both political and technical levels, throughout the year. These contacts intensified after the publication of the country reports, in the run-up to the national programmes and today's package.

The close involvement of social partners at all levels in the design and implementation of reforms is important in ensuring successful outcomes. The involvement of social partners is well-established at European level, while there is a room for increasing the involvement of social partners in the design of reforms at national level. The Commission has continuously called on Member States to consult closely national social partners when preparing their National Reform Programmes. Member States have consulted the national social partners on the National Reform Programmes and some of them submitted the social partners' positions to the Commission.

EU institutions have helped to steer the European Semester. The European Parliament adopted resolutions on three separate reports on the European Semester, covering the issues of the Annual Growth Survey 2016⁸, employment and social aspects⁹, and single market governance¹⁰. In the Council, in-depth discussion in various formations preceded the adoption of the euro area recommendations and their endorsement by the European Council in February. On 17 March, the European Council¹¹ endorsed the policy priority areas of the Annual Growth Survey and noted that Member States would reflect the priorities in their forthcoming National Reform Programmes and stability or convergence programmes.

⁸ A8-0030/2016.

⁹ A8-0031/2016.

¹⁰ A8-0017/2016.

¹¹ EUCO 12/1/16 REV1.

3. OVERALL PROGRESS IN REFORMS AND CORRECTING IMBALANCES

The Member States have advanced reforms over the last year, but the pace of such progress needs to be accelerated. Overall, the Member States made limited to some progress in addressing the issues identified in the country-specific recommendations issued in 2015¹². Progress thus stayed at a similar level during the last year, compared to the year before. The implementation of country-specific recommendations varies across policy areas. This can be due to the complexity of the reforms to be undertaken, such as reforms of labour and product markets, pensions systems and banking sectors. Most significant progress is observed with regard to recommendations in the areas of financial services and active labour market policies. In contrast, more progress could have been expected in generating a business and employment friendly and regulatory environment, increasing female labour market participation and reducing barriers in the services sector. More progress in the implementation of country-specific recommendations is identified for Member States experiencing imbalances than for Member States without imbalances, presumably due to the larger need for reform, stronger policy dialogue and, in some cases, in response to stronger market pressure.

Member States are making progress in addressing imbalances in their economies, in spite of a challenging environment. In countries with high external liabilities, the large current account deficits of the pre-crisis period have been considerably reduced or even turned into surpluses. In some other Member States, surpluses persist and remain very large. Cost competitiveness has generally improved and there is evidence of structural adjustment in terms of resources shifting to the tradable sector. Unemployment is declining, albeit to different degrees across the Member States. In most countries, the process of balance-sheet repairs is progressing, with deleveraging ongoing in the household and corporate sectors, and bank capitalisation improving. In most countries, deleveraging is mainly linked to reduced spending, while in some countries, the relative level of debt has gone down due to robust growth. In this context, vulnerabilities associated with persisting debt overhang in some sectors remain a source of concern, while the financial sector is affected by low profitability coupled with high levels of non-performing legacy loans and the need to adjust to a more demanding regulatory environment.

Fewer Member States than last year are considered to have macroeconomic imbalances as the MIP categorisation of imbalances was streamlined and MIP surveillance was more focused. For six Member States examined in an in-depth review, it was concluded that there are no imbalances in terms of the MIP. Seven Member States were found still to experience imbalances and six Member States to experience excessive imbalances. For Croatia and Portugal, which have excessive imbalances, the Commission announced in March that it would review its assessment, taking into account the level of ambition of their National Reform Programmes. Based on the assessment of the policy commitments of both Member States, the Commission concludes that there is no need at this stage to step up the macroeconomic imbalances procedure, provided that there is swift and full implementation of the reforms set out in their country-specific recommendations.

¹² A comprehensive assessment of the implementation of the country-specific recommendations adopted in July 2015 was presented in the country reports published on 26 February 2016.

4. KEY OBJECTIVES OF THE 2016 RECOMMENDATIONS

A coherent policy framework is an important stabilisation factor. To strengthen the recovery and foster upward economic and social convergence, the Commission builds its proposals for country-specific recommendations on the three main pillars identified in the 2016 Annual Growth Survey. These recommendations and the decisions taken under the Stability and Growth Pact and the Macroeconomic Imbalances Procedure form an integrated policy package that brings together various economic governance tools, hence providing for a more effective coordination of policies. Additionally, the recommendations for the euro area also serve as an important guide for the euro area Member States.

The longer-term vision set out in the Europe 2020 strategy is firmly anchored in the European Semester. The Europe 2020 strategy has always provided the long-term perspective in the drive for jobs and growth. The key principles of the Europe 2020 strategy remain as valid as ever. They set the direction of the country-specific recommendations and they have also provided a basis for the multiannual financial framework and the European Structural and Investment Funds. Table 2 attached to this Communication provides an overview of progress made towards the targets of the Europe 2020 Strategy.

Removing barriers to financing and supporting public and private investment

Financing opportunities need to be ensured for a wider range of businesses. In many Member States, high levels of private debt and the high ratio of non-performing loans still prevent stronger recovery in credit. The Capital Markets Union should be used by the Member States as a tool to develop European markets for SME asset-backed securities, so that improved financing conditions together with credit growth can be felt by a large number of businesses. In addition, the markets for other forms of capital market financing, such as venture capital, should be further developed, including by reviewing the regulatory environment in the Member States. The Commission recommends action in this area to Germany, Cyprus, Portugal and Slovenia.

The cleaning up of bank balance sheets helps to create the conditions for better access to finance. Banks have made substantial progress in adjusting their balance sheets and most banking institutions are well capitalised and liquid. However, the banking sector in some countries is still recording a high share of non-performing loans and bad assets. If unaddressed, these weaknesses may result in subdued credit growth. Moreover, the protracted refinancing of non-performing debt implies that fewer resources are available for new projects, resulting in suboptimal credit allocation. In certain countries, reforms in the insolvency framework may help to speed up the resolution of bad debt, contributing to a more rapid clean-up of bank balance sheets, including by creating better conditions for the securitisation of non-performing loans. For these reasons, the Commission has recommended further action to reduce non-performing loans, including with the help of insolvency framework reforms, to countries such as Bulgaria, Ireland, Croatia, Italy, Cyprus, Portugal and Slovenia.

Unlocking investment goes well beyond increasing financing. Investment has so far failed to emerge as a strong driver of the recovery. Where available, for example in Germany, Member States should use their fiscal space to increase public investment in areas conducive

to growth, such as infrastructure, education and research. At the same time, Member States are encouraged to ensure an environment that is conducive to productive investment. A stocktaking exercise of the national barriers to investment by the Commission shows that the highest number of barriers is related to bottlenecks, such as the low degree of efficiency and transparency of public administration, ineffective judicial systems and weaknesses in the business environment. These include high regulatory and administrative burden, the lack of a predictable regulatory framework and sector-specific regulations (involving cumbersome and lengthy approval procedures), which can hamper investment in large infrastructure projects.

There are remaining inefficiencies in taxation systems, public procurement, judicial systems and insolvency frameworks. For example, the Commission recommends to Hungary to remove distortive sector-specific taxes and to Latvia, Lithuania, Poland, Romania and Slovakia to improve tax compliance. Italy should reduce the length of civil justice proceedings by enforcing reforms and through effective case management and should improve the framework for insolvency and debt collection. Belgium could simplify the tax system and remove distortive tax expenditures. In addition, reforms are necessary to enable access to increased and more diversified sources of funding and there is a need to extend priorities beyond traditional infrastructure to include more intangible items, human capital and related social investment. Increasing the responsiveness of labour and product markets also plays a role. Progress also means reinforcing the single market, identifying a stable pipeline of projects, both national and cross-border, and ensuring coordination and planning at all levels of the administration. In parallel, the Commission is taking initiatives to unlock the full potential of investment in Europe by implementing the Investment Plan for Europe and further reinforcing the Single Market.

Improving the business environment and productivity

Long-term growth is dependent on productivity increases. This requires the EU to increase its investment in areas such as technology, innovation and human capital. A subdued level of investment over several years has produced a significant accumulated lag, especially in information and communication technologies (ICT). Productivity and competitiveness would benefit from structural reforms that would enable a more efficient allocation of resources, the faster adoption of new technologies, the promotion of a more circular economy and the introduction of innovative business models.

A more business- and employment-friendly regulatory environment would encourage private investment. Improving public administration practices, eliminating corruption, introducing transparency, light and predictable regulations contribute to increasing competitiveness, growth and job creation. For example, the Commission recommends to France to continue its simplification programme, to Italy to implement the reform of the public administration and to Austria to reduce administrative and regulatory barriers for investments, in particular in the area of services.

The fast-changing economy requires flexible allocation of resources. Qualitative aspects of the reforms are important for success. An efficient allocation of resources towards more productive firms would increase productivity and growth rates. Furthermore, it would increase investment by more efficient firms, strengthening the long-term growth potential of Member States' economies. Reforms in product, services and labour markets take time to deliver

results but they trigger this reallocation of resources, activating investment and modernising the productive base of the EU economy.

Growth potential would be increased by improving the performance of business services. The number of restrictions in services sectors remains high in many EU Member States, with detrimental impact on investment, growth and employment. The contribution of the business services sector to the productivity of manufacturing and other sectors is essential for the modernisation of EU economies. The range, level and number of restrictions prevailing in business services and regulated professions, especially in engineering, accounting, architecture and legal services, warrant special attention. In this regard, the Commission proposes recommendations to Member States, including Belgium, Germany, Luxembourg and Austria. Stepping up reforms to reduce regulatory barriers in the retail and construction sectors would also have a considerably positive impact in several Member States.

There is a need for much closer cooperation between business and academia. Innovation is a driver for modernising the economy, increasing productivity, attracting investment and supporting economic growth. Creating conditions for innovation requires a combination of financial incentives, supportive regulatory frameworks and a stronger link between business and academia. The link between academia, research and business innovation needs to be strengthened in many Member States, such as the Czech Republic, Denmark, Estonia, Spain and Portugal. The Commission recommends to Belgium to foster investment in knowledge-based capital and boost its general innovation capacity. Estonia and Latvia should promote private investment in research, development and innovation.

Adapting public finances to make them more supportive of growth

The current aggregated euro area fiscal stance is broadly appropriate. Overall, the fiscal policy stance in the euro area is expected to become slightly expansionary in 2016. When assessed against the double objective of the long-term sustainability of public finances and the need to support the economic recovery, in particular to shift from external to domestic sources of economic growth, the expected fiscal policy stance in the euro area on aggregate this year can be assessed as broadly appropriate in the context of persistently very low inflation. At the same time, the fiscal stance in individual Member States does not always strike the right balance between the two objectives above.

The Commission has also taken a number of steps under the Stability and Growth Pact. First, the Commission recommends that **Cyprus, Ireland and Slovenia** should now exit the excessive deficit procedure. This would leave six Member States under the corrective arm after this Semester round, down from 24 Member States in 2011. Second, the Commission adopted reports for **Belgium, Italy and Finland** under Article 126(3) TFEU, in which it reviews their compliance with the debt criterion of the Treaty. While these countries appear to be at variance with the debt reference value, and the benchmark pace of reduction towards it, the reports, after analysing the relevant factors, suggest that the Stability and Growth Pact should be considered as currently complied with. For Italy, the Commission will review its assessment of the relevant factors in a new report by November as further information on the resumption of the adjustment path towards the medium-term budgetary objective for 2017 becomes available.

As regards **Portugal** and **Spain**, the Commission recommends to the Council to recommend a durable correction of the excessive deficit in 2016 and 2017 respectively, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction. In line with its duty to monitor the implementation of the excessive deficit procedure under Article 126 of the Treaty, the Commission will come back to the situation of these two Member States in early July.

Fiscal policy remains important in strengthening the recovery. Deficit levels have been successfully reduced in some Member States and the policy focus should mainly be on further progress with the implementation of structural reforms to lift the medium-term growth potential. At the same time, further consolidation efforts are still needed in a number of Member States to set public debt ratios firmly on a downward path, especially in those countries with high debt, where vulnerability to financial market swings may be more accentuated.

Revenue and expenditure sides of public finances can be made more conducive to growth and fairness. In the current context, striking an appropriate balance between the different components of public finances is crucial to preserving their growth-friendliness. On the revenue side, although some decisive steps have been taken, Member States could still step up efforts to make tax systems fairer, more transparent and effective in providing the much-needed incentives for job creation. Building on the progress made on fighting tax evasion and improving tax administration, further efforts are needed to make tax systems fairer and more effective, to address disincentives to employment creation, to prioritise growth-friendly expenditure and to preserve productive public investment. The Commission makes recommendations in this regard to Member States such as Italy, Poland and Sweden. On the expenditure side, Member States should target both higher efficiency and the performance of individual expenditure sources. Enhanced efficiency may create room to reduce overall expenditure, while still safeguarding the provision of adequate levels of social services and public goods. The ageing population calls for reforms in long term care, pensions and health care that ensure the sustainability and/or the adequacy of the social security systems in Member States such as Malta, Austria and Slovenia.

Improved public procurement practices can make a significant contribution to improve the quality of public expenditure and to introduce incentives for innovation and cost-effectiveness. In addition, Member States should focus on the sources of expenditure that will raise productivity capacity in the future and will have strong positive spill-overs on the wider economy – such as education, research and development, transport and communications. For example, Ireland should prioritise government capital expenditure in R&D and in public infrastructure. The Netherlands also needs to increase efforts to shift public spending towards R&D.

Member States should address the high tax wedge on labour. In particular, this concerns Belgium, the Czech Republic, Germany, France, Latvia, Lithuania and Hungary. The high tax wedge weighs on labour costs and reduces the net take-home pay of employees, hindering both labour demand and labour supply. In spite of some reforms to reduce labour taxation in a number of Member States, the tax wedge on labour remains high in some EU countries, especially on low-income earners.

Labour market reform efforts have brought initial positive results. Labour market conditions continue to improve, with employment growing and unemployment falling at a moderate pace. The EU has also witnessed resilient activity rates amid increases in the participation rate of women and older workers, which is a positive development. Recent labour market reforms in many Member States, such as more flexible work arrangements, improved active labour market policies and decentralised wage bargaining have contributed to higher labour market flexibility and the better alignment of wages to productivity developments, thereby underpinning labour demand. Reform efforts are still needed in a number of countries to improve the functioning of their labour markets. For example, Belgium should ensure that wages can evolve in line with productivity. France and Romania should ensure that minimum wage developments are consistent with the objectives of promoting employment and competitiveness. Finland should ensure targeted and sufficient active labour market measures.

Labour markets need to strike the right balance between flexibility and security. The persistence of unemployment is likely to continue weighing on the efficiency of labour market matching, welfare dependency and low-skills traps. In spite of rising skills demands on the labour market, low-qualified workers tend not to take part in lifelong learning. The situation of young people and of the long-term unemployed was flagged as requiring particular attention by the Council¹³.

There is a need to improve the capacity to create jobs and thereby to tackle high levels of unemployment. This is crucial to boost job creation, address distortions such as high levels of structural unemployment, segmentation, skills mismatches, and to improve social cohesion. Some Member States also need to adapt the role that public employment services play and to enhance the promotion of job creation, also by promoting entrepreneurship and self-employment. The availability of a wide range of well-targeted and designed active labour market policies is also important in reaching higher employment rates. Hungary should facilitate the transition from the public works scheme to the primary labour market. Long-term unemployment needs to be tackled by combining effective social assistance with measures to enhance the chances of finding employment, in particular in Bulgaria, Spain and Portugal. The labour market participation of older workers and women also needs to be promoted in countries such as the Czech Republic, Germany, Austria and Slovakia. The segmentation of labour markets should be reduced by promoting more permanent types of employment in the Netherlands, Poland and Portugal.

Investing in human capital contributes to greater convergence. Structural and long-term unemployment is fuelled, in part, by the high number of persons who are not employable because they have not acquired sufficient and relevant skills. These skill gaps and mismatches put a brake on Europe's innovation capacity and competitiveness. For example, the Commission recommends to the United Kingdom to address skills mismatches and provide for skills progression and to France to reform apprenticeship and vocational training, with emphasis on the low skilled. Member States need to engage in a process of evidence-based scrutiny of their education and training systems and reforms to improve educational

¹³ Council documents 15107/15 and 6154/16.

outcomes, especially in Hungary and Slovakia, and make more efficient use of public expenditure. Several countries face a problem in including vulnerable groups in mainstream education, particularly Roma, but also other groups such as students with a migrant background.

Social protection systems have been put to the test. Social protection, including pensions and services such as healthcare, child care and long-term care, remain essential for balanced and inclusive growth. They can support longer working lives, increase employment and reduce the gender gap. Promoting social dialogue and the involvement of social partners in the development of employment and social policies should facilitate the implementation and increase the effectiveness of such policies. Reforms need to promote a modernisation of social protection and the promotion of activation policies, combining flexibility, security, adequacy and sustainability. This also requires enhancing the capacity of unemployment benefit and social assistance to ensure adequate incomes, quality enabling services and effective activation. This can be achieved by broadening coverage and adequacy and also by ensuring sustainable financing and improving the targeting of social protection spending, as recommended, for example, to Italy. Balanced and inclusive growth can also be enhanced by reforms aiming at ensuring accessible, effective and sustainable health systems.

5. CONCLUSION

The set of country-specific recommendations has been prepared by the Commission, with reference to the euro area recommendations and in the light of bilateral dialogue with the Member States after the publication of the country reports and after examination of the national reform programmes and the stability or convergence programmes. The challenges identified and the recommendations proposed are those that the Commission considers to be the most urgent and necessary to keep Member States, and the European Union as a whole, on the path of reforms, job creation and growth.

The Commission calls on the Council to endorse the proposed approach for the 2016-2017 country-specific recommendations and related decisions under the Stability and Growth Pact, and on Member States to implement them fully and in a timely manner. The Commission will continue to engage with stakeholders at all levels to ensure broad ownership and effective follow-up and implementation.

TABLE 1 - OVERVIEW OF ISSUES COVERED IN THE COUNTRY-SPECIFIC RECOMMENDATIONS FOR 2016-2017

Policy areas	AT	BE	BG	CY	CZ	DE	DK	EE	ES	FI	FR	HR	HU	IE	IT	LT	LU	LV	MT	NL	PL	PT	RO	SE	SI	SK	UK	
Fiscal policy & fiscal governance																												
Long-term sustainability of public finances, inc. pensions																												
Reduce the tax burden on labour																												
Broaden tax bases																												
Reduce the debt bias																												
Fight against tax evasion, improve tax administration & tackle tax avoidance																												
Financial services																												
Housing market																												
Access to finance																												
Private indebtedness																												
Employment protection legislation & framework for labour contracts																												
Unemployment benefits																												
Active labour market policies																												
Incentives to work, job creation, labour market participation																												
Wages & wage setting																												
Childcare																												
Health & long-term care																												
Poverty reduction & social inclusion																												
Education																												
Skills & life-long learning																												
Research & innovation																												
Competition & regulatory framework																												
Competition in services																												
Telecom, postal services & local public services																												
Energy, resources & climate change																												
Transport																												
Business environment																												
Insolvency framework																												
Public administration																												
State-owned enterprises																												
Civil justice																												
Shadow economy & corruption																												

TABLE 2 - PROGRESS TOWARDS EUROPE 2020 STRATEGY TARGETS

Europe 2020 strategy targets for the EU	2010 data	Latest available data	In 2020, based on recent trends
1. Increasing the employment rate of the population aged 20-64 to at least 75%	68.6%	70.1% (2015)	Target uncertain to be met
2. Increasing combined public and private investment in R&D to 3% of GDP	1.93%	2.03% (2014)	Target unlikely to be met
3a. Reducing greenhouse gas emissions by at least 20% compared to 1990 levels	14.3% reduction	23% reduction (2014)	Target likely to be met
3b. Increasing the share of renewable energy in final energy consumption to 20%	12.8%	16% (2014)	Target likely to be met
3c. Moving towards a 20 % increase in energy efficiency	5.6% increase (for primary energy consumption)	15.7% increase (2014)	Target likely to be met
4a. Reducing school drop-out rates to less than 10%	13.9%	11.2% (2014)	Target likely to be met
4b. Increasing the share of the population aged 30-34 having completed tertiary education to at least 40%	33.8%	38.7% (2015)	Target likely to be met
5. Lifting at least 20 million people out of the risk of poverty and social exclusion	1.4 million increase (compared to the 2008 base year)	4.5 million increase (2014)	Target unlikely to be met

For country-specific information, please see:

<http://ec.europa.eu/eurostat/web/europe-2020-indicators/europe-2020-strategy/headline-indicators-scoreboard>