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

Annual Growth Survey 2018

1. INTRODUCTION

Europe's economy is strengthening in a changing policy context. Growth is up, surpassing expectations, unemployment is down, investment is recovering and public finances are improving. Both the EU economy and the euro area economy have steadily grown over the past 18 quarters, as part of a recovery that has now reached all Member States. Employment is increasing, with a record 235.4 million people in jobs in the second quarter of 2017. 8 million additional jobs have been created in the EU – of which 5.5 million in the euro area – since the current Commission took office[1]**.** Unemployment stands at 7.5% in the EU and 8.9% in the euro area, the lowest levels in nine and eight years, respectively. Long-term and youth unemployment are also declining. Public finances have improved significantly and investment is slowly recovering. Structural policies have contributed to these positive trends, along with supportive macroeconomic policies.

This momentum presents the EU with a window of opportunity to reignite sustained economic and social convergence. While all Member States are showing positive growth, they are at varying points in their cycles and with respect to pre-crisis output and employment levels. 18.9 million people are still without a job, investment still remains too low, wage growth is subdued, labour market slack persists and core inflation is forecast to remain low. In some Member States, high debt levels remain a drag on growth. There is scope for supporting the continuation of the recovery, notably via structural reforms that create the conditions for boosting investment and increasing real wage growth in support of domestic demand, supporting internal and external rebalancing in the euro area.

Efforts need to continue on implementing reforms that are underway. At the same time, further structural reforms are needed to make Europe's economy more stable, inclusive productive and resilient. European economies and societies must become less vulnerable and more able to respond to shocks, and better prepared to adapt and take advantage of long-term structural changes. To achieve that, economic, financial and fiscal policies must ensure macroeconomic stability and minimise exposure to external or domestically generated shocks. Efficient and flexible product, labour and capital markets are instrumental to ensuring that resources are directed to their most productive use. Increased productivity depends on investment, innovation, education and a skilled labour force. People need to be empowered to harness opportunities over the entire course of their working lives and be able to rely on adequate social safety nets when needed. By mid-2018, Member States should have taken appropriate measures to implement the Council Recommendation on 'Upskilling Pathways: new Opportunities for Adults'[2], in line with the commitment made when it was adopted in December 2016.

Fiscal policies should strike the appropriate balance between ensuring the sustainability of public finances, in particular reducing debt ratios where they are high, and supporting the economic recovery. Low funding costs can incentivise governments to frontload high-quality investment programmes. Reducing high levels of debt and re-building fiscal buffers must continue to be a priority. Governments should improve the sustainability of their public finances, especially where debt ratios are high. This could be helped by closing

[1] Net employment change between 2014 Q3 and 2017 Q2.
[2] OJ C 484 of 24.12.2016.

tax loopholes or better targeting of spending. Improving the quality composition of public finances remains crucial.

The economic crisis has underlined the importance of improving and completing the architecture of the Economic and Monetary Union (EMU) for the benefit of the EU as a whole. Much has been done during the crisis, such as the creation of the European Fiscal Board and the establishment of national productivity boards. However, gaps persist, as outlined in the Commission's reflection paper on the deepening of the economic and monetary union[3]. The Commission will propose a comprehensive package of measures in December 2017, designed to make the EMU more resilient, democratic and efficient.

This Annual Growth Survey identifies the economic and social priorities for the European Union and its Member States for the year ahead. The 'virtuous triangle' of boosting investment, pursuing structural reforms and ensuring responsible fiscal policies is delivering results. This approach should continue, given the different stages of the economic cycle in which Member States find themselves. Structural reforms aimed at improving labour markets and social policies should help the workforce to acquire the skills needed and promote equal opportunities in the labour market, fair working conditions, increasing labour productivity to support wage growth, and sustainable and adequate social protection systems. The European Pillar of Social Rights, recently endorsed at the social summit in Gothenburg by a joint proclamation[4] of the EU institutions, should be used as a compass. Efficient and fair tax and benefits systems and effective, modern public institutions, facilitated where possible by eGovernment structures, play a key role in creating a balanced and comprehensive policy mix and should be prioritised.

The policy guidance in this Annual Growth Survey builds on a broad range of inputs. It has been drawn up with the close involvement of public authorities and social partners. It builds on President Juncker's 2017 State of the Union address, the European Pillar of Social Rights, the White Paper on the Future of Europe[5] and the five subsequent reflection papers[6]. It takes into account discussions with the European Parliament, the Council, other EU institutions, national parliaments and social partners. The Annual Growth Survey is accompanied by a Recommendation for a Council Recommendation on the economic policy of the euro area[7], the Alert Mechanism Report[8], a Communication on the draft budgetary plans submitted by euro area Member States[9], a proposal to amend the employment guidelines[10] to ensure consistency with the European Pillar of Social Rights, and the draft Joint Employment Report.[11]

The European Pillar of Social Rights

On 17 November 2017, the European Parliament , the Council and the Commission endorsed the European Pillar of Social Rights in a proclamation signed at the social summit for fair jobs

[3] COM(2017) 291.
[4] Council document 13129/17.
[5] COM(2017) 2025.
[6] COM(2017) 206, COM(2017) 240, COM(2017) 291, COM(2017) 315, COM(2017) 358.
[7] COM(2017) 770.
[8] COM(2017) 771.
[9] COM(2017) 800.
[10] COM(2017) 677.
[11] COM(2017) 674.

and growth. The Pillar sets out 20 key principles and rights regarding equal opportunities and access to the labour market, fair working conditions and social protection and inclusion

The European Pillar of Social Rights expresses the principles and rights that are essential for fair and well-functioning labour markets and welfare systems in 21st century Europe. It is designed as a compass for renewed convergence towards better working and living conditions, taking direct inspiration from the existing wealth of good practices across Europe, and building on the strong body of law that exists at EU and international level.

The principles and objectives of the European Pillar of Social Rights will serve as a point of reference for the further implementation of the European Semester of policy coordination. They are already reflected in the draft Joint Employment Report and the proposal for new employment guidelines that accompany this Annual Growth Survey. The Commission will take this work forward in the analysis that will be included in the forthcoming country reports and the preparation of the country-specific recommendations in the 2018 European Semester cycle.

2. BOOSTING INVESTMENT TO SUPPORT THE RECOVERY AND TO INCREASE LONG-TERM GROWTH

Domestic demand is benefiting from the upturn in investment and improved conditions for consumption. Increased economic optimism among citizens and businesses suggests that the recovery is reaching firmer ground. Coupled with the drop in unemployment, the improved financial situation of households is supporting consumption growth. However, additional measures are needed to enable investment and increase future economic output, in particular by focusing on sustainable projects with longer term economic benefits.

Investments raising productivity are crucial to ensure future growth prospects. Targeted investment in areas such as infrastructure, education, training, health, research, digital innovation and the circular economy can increase both productivity and employment. However, there is a need to prevent the build-up of bubbles linked to the inefficient allocation of resources. As the economic crisis made clear, this is particularly important in the euro area, where economies are financially more integrated and are subject to greater spillover effects. Stronger micro- and macro-prudential supervision may help to achieve this.

More symmetric rebalancing within the euro area would help to improve the investment environment. While all countries should remove bottlenecks to investment, encouraging euro area countries with large current account surpluses to invest will help with rebalancing. Private investors require a climate of confidence and certainty to make investments. The renewed EU Industrial Policy Strategy[12] will encourage further private investment by incentivising the uptake of new digital and key-enabling technologies and reducing the current imbalance between risk and return.

Using reforms to support investment

Member States should continue reforms to encourage investment, leveraging public funding to mobilise private investment and improving the business environment. This

[12] COM(2017) 479.

would help strengthen economic resilience and have a positive impact on long-term economic convergence and the reduction of social disparities. Reforms should aim at improving the business environment, simplifying the tax system and making it more investment-friendly, making the public administration more efficient and addressing rigidities in product and labour markets.

Stronger and more efficient public institutions are crucial for building resilient economic structures that foster investment and growth, in full respect of the rule of law. The Investment Plan for Europe has shown that the use of EU funds is more effective in Member States with strong coordination and planning structures. These countries tend to be more successful in ensuring a stable pipeline of projects. Planning structures and coordination should be reinforced, while reducing the administrative burden for investors. Countries with more efficient institutions are also likely to suffer lower growth volatility and less severe output collapses. For example, an effective justice system supports business by facilitating contract enforcement and contributing to fight corruption. Corruption is a barrier to investment in some Member States, creating uncertainty in the business environment, slowing processes and potentially imposing additional costs. The rule of law and improvement in the independence, quality and efficiency of justice systems are crucial for a business friendly environment[13]. Effective insolvency frameworks enable restructuring and the winding down of unviable firms. Member States that need to do so should work to improve their institutions over time.

The integration of financial markets still lags significantly behind other comparable economies. This is particularly critical for the euro area, where private risk-sharing is essential in the absence of intra-area exchange rates and significant public risk-sharing. Faster progress towards the completion of the Banking Union, where risk reduction goes hand in hand with risk sharing, is needed. Macro-financial stability would be significantly reinforced by the adoption of a common backstop to the Single Resolution Fund and a common deposit insurance scheme and of the regulatory measures proposed by the Commission in November 2016, and by a reduction in the stock of non-performing legacy assets from the crisis. Once completed, the Banking Union and Capital Markets Union will create the necessary conditions for more cross-border provision of financial services and a higher level of shock absorption in the euro area.

Stronger economic growth and country-specific actions have led to a significant improvement in the asset quality of banks in a number of Member States. The level of non-performing loans is generally receding, although it remains high in a number of Member States and continues to be an obstacle to bank profitability, in particular for medium and small sized banks. This in turn hinders the financing of the real economy. The action plan on non-performing loans agreed in July 2017 should be implemented urgently.

The Capital Markets Union holds significant potential to improve access to alternative, potentially cheaper sources of financing. It would foster shock absorption capacity in the euro area through cross-border ownership of financial assets. Its success will depend on the level of political commitment from the European Parliament and the Member States and on how market participants make use of the available financing and investment opportunities.

[13] The yearly EU Justice Scoreboard provides data on these elements in order to improve the effectiveness of national justice systems.

There is a need to ensure greater transparency with regard to capital flows. The Commission has recently proposed new transparency rules for intermediaries who design and promote tax planning schemes for their clients[14]. This will help to tackle tax avoidance. By the end of 2017, the EU should have a common list of non-cooperative jurisdictions, which will provide a stronger instrument to deal with third countries that refuse to play fair. The Commission will also continue to push for improvements in the international tax framework, to ensure the fair and effective taxation of companies globally and to safeguard Member States' tax bases.

Trade and investment that benefits all must be free, fair, mutually beneficial and based on a level playing field. The Commission is pursuing an ambitious set of trade negotiations to open new markets as key drivers of jobs and growth at home and to ensure that global trade is rules-based. Efforts are also underway to reform trade defence instruments to enable the EU effectively and rapidly to address unfair trade practices and market distortions. It has also proposed a European framework to screen foreign direct investment[15] on grounds of security or public order.

Investment that enhances environmental sustainability has the potential to boost productivity across the economy through enhanced resource efficiency and reduced input costs, whilst reducing external costs and impacts. Support for the transition towards a circular economy will create new jobs in innovative, maintenance and repair services and in designing and making new, more sustainable products. Potential specific areas include public procurement, investments in waste and water infrastructure, construction, critical raw materials, biofuels and biochemicals.

Making the most of EU and national budget opportunities

During the economic and financial crisis, with national budgets under severe strain, the EU budget proved to be a powerful instrument to support investment in cohesion, EU connectivity (transport, energy, digital sectors), innovation, environment and support to SMEs. In some Member States, it either was or still is the main source of investment. The European Fund for Strategic Investments (EFSI) has played a major role in catalysing private investments. This has shown how the EU budget can rapidly respond to emerging challenges and create substantial leverage[16]. At the same time, the rollout of these funds demonstrated that their real impact will not materialise unless other barriers are also addressed.

As of November 2017, the Investment Plan for Europe has already triggered an additional EUR 251.6 billion in investment across all 28 Member States. This represents 79.8% of the original EUR 315 billion target. The EFSI 2.0 Regulation will extend the lifetime of the Fund until the end of the current multiannual financial framework in 2020. It will increase the EU guarantee from EUR 16 billion to 26 billion and the European Investment Bank capital from EUR 5 billion to 7.5 billion. This should mobilise private and public investment of EUR 500 billion by 2020.

Public and private investments are crucial to increasing potential growth in the medium to long run. Physical and other infrastructures are needed to improve the business activities of firms and their productivity. A greater private sector contribution to human capital

[14] COM(2017) 335.
[15] COM(2017) 487.
[16] In September 2016, the Commission proposed a reinforcement and extension of the European Fund for Strategic Investments until 2020 (COM(2016) 597).

development and infrastructure projects would complement and leverage public sector support. For the future, there would be merit in establishing a financial framework conducive to investment and the mobilisation of private capital that also allows the combination of financial instruments and grants to help projects get off the ground.

Investments in high quality education, training, labour productivity growth and active labour market policies are crucial for empowering people and integrating them in the labour market, which remains the best vehicle out of poverty and social exclusion. It is essential to provide people with the right skills and support them through a changing labour market. The development of digital skills is particularly necessary.

Europeans need affordable, accessible and quality services. Services such as childcare, out-of-school care, education, training, housing, health services and long-term care are essential for ensuring equal opportunities for all. Adequate social housing and other housing assistance are also essential. This also entails protecting vulnerable people against unjustified forced eviction and foreclosures, as well as tackling homelessness.

3. STRUCTURAL REFORMS FOR INCLUSIVE GROWTH, UPWARD CONVERGENCE AND COMPETITIVENESS

Structural reforms are essential to enable the economy to deal with shocks, adapt to longer term structural changes and improve social outcomes. In many countries, the economic crisis exposed the lack of appropriate structures and adaptability to allow shocks to be absorbed smoothly and to pave the way to a swift economic recovery. Structural reforms should take account of distributional effects on different societal groups and regions. This will help to make economies more resilient and competitive and allow them to get back to long term growth with positive social and economic outcomes and convergence.

The adequate sequencing and packaging of structural reforms is fundamental to reduce their short term costs, and maximise their long term benefits, in terms of increased productivity and growth potential. Some structural reforms might have short-term demand costs and distributional effects which should be taken into account in their design and implementation. The overall effectiveness of labour market reforms and product market reforms tends to be improved if they are part of a well-designed package. Moreover, reforms of the public administration and the business environment have minimum short term costs and can be effective at any point of the economic cycle, which strengthens the case for pursuing them. Building integrity and transparency in public administrations, including the implementation of effective corruption prevention, are crucial to delivering high quality services for businesses and citizens.

A new tool to support structural reform efforts

The Structural Reform Support Programme (SRSP) finances tailor-made, on-request technical support to Member States to help them with their reform efforts. It has a budget of EUR 142.8 million for the period from 2017 to 2020 and helps Member States carry out the reforms that they consider necessary to make their economies more competitive and investment-friendly. The support is available to all EU Member States, is demand-driven and requires no co-financing. The programme is implemented by the Commission's Structural Reform Support Service (SRSS), in cooperation with other Commission services. The SRSS has so far supported 15 Member States to carry out over 150 support projects. Under the SRSP 2018 cycle, the SRSS has received 444 requests for support from over 20 Member States, leading to a substantial excess demand for the SRSP budget of EUR 30.5 million for 2018.

The technical support covers reforms in the areas of governance and public administration, public financial management, the business environment, labour markets, health and social services, the financial sector and access to finance. It draws on a good practice from across the European Union, as well as expertise from international organisations, the private sector and the Commission. Practical support and guidance is given throughout the reform process, from preparation to design, through to implementation and evaluation of reforms. It helps implement reforms listed under economic adjustment programmes and for priorities identified in the economic governance process, notably in the country-specific recommendations under the European Semester, as well as actions related to the implementation of Union law.

Ensuring greater convergence and inclusion is particularly relevant for euro area Member States. Reforms that increase competition in product markets, improve the business environment and enhance the quality of institutions foster economic resilience in euro area Member States. Further integration in the single market has proven to be a major engine of growth. Narrowing competitiveness gaps also requires stronger growth fundamentals and faster productivity growth in the lagging countries. Faster real wage growth in the euro area as a whole would help to sustain domestic demand.

Resilience and convergence

As highlighted in the Five Presidents' Report and echoed in the reflection paper on the deepening of the EMU, convergence towards more resilient economic structures in Member States is an essential element for long term success of the EMU. Recent years have shown how the lack of resilience in one or several euro area economies can have significant and persistent effects on income and employment in the countries concerned, in other countries and in the euro area as a whole. This is particularly the case for countries that have accumulated vulnerabilities over the past.

The economy's capacity to cushion the effects of a shock is influenced by the degree of risk-sharing through financial markets. In this respect, the Single Market has proven to be a major engine of convergence and can help increase resilience, acting as a buffer against unpredictable shocks. A well-capitalised banking sector and a fully-fledged Capital Markets Union are essential to strengthening shock absorption capacity. Properly functioning labour market institutions and competitive products and services markets can also help respond to shocks and to long term structural changes affecting our societies. Governments can also support the adjustment through efficient and effective spending and revenues, creating fiscal space in good times.

Real convergence of living standards and income levels is central to achieving the Union’s objectives of economic and social cohesion and full employment. In the first ten years of EMU, significant growth in real income occurred and the euro area members with initial lower living standards caught up in terms of GDP per capita. This was adversely affected by the crisis that started in 2008 (Figure 1). The situation has improved in recent years, although only very moderately if one considers only the original euro area members. Unemployment rates also became more even across euro area countries before the crisis hit, but showed stronger differences after the crisis (Figure 2). Since 2013, unemployment rates started again to vary less across countries, but differences still remain above pre-crisis levels.

The differences in economic structures help to explain these developments in real convergence. Those parts of the euro area with more efficient product and labour markets and public administrations fared better throughout the crisis. A more vigorous and sustained process of appropriately sequenced structural reforms addressing long term structural changes would reinforce the resilience of economies. Resilient economic structures are needed to support real convergence and make it sustainable over time. They should be accompanied by policies that support productivity and potential growth over the medium to long term, as well as appropriate macroeconomic policies.

Figure 1 – Variation in real GDP per capita, EA17 and EA10[(1)]

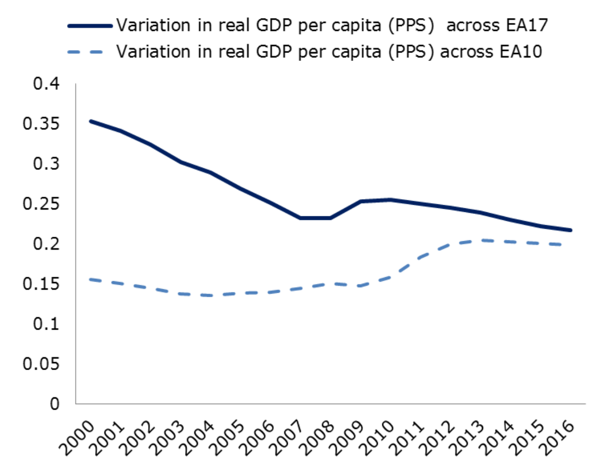
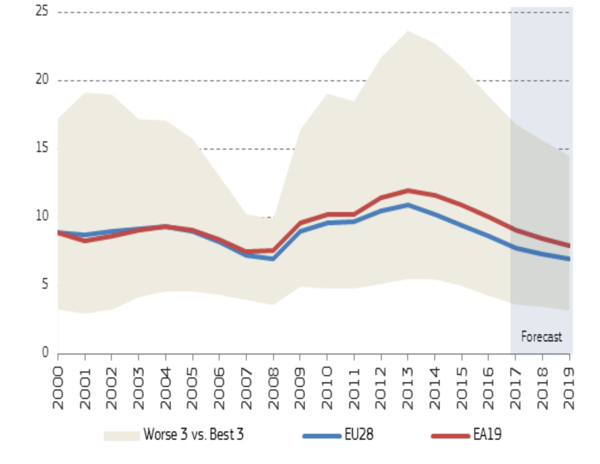


Figure 2 – Variation in unemployment rates, EU 28 and EA19



Notes: (1) Figures excluding Ireland and Luxembourg.

__Promoting well-functioning labour markets and modern welfare systems__

Globalisation and technological progress are changing the way we live and work. They are creating new opportunities to increase productivity, foster entrepreneurship, create jobs and improve living standards. At the same time, they are transforming an increasing number of economic sectors, business patterns and the labour market itself, with more transitions between employment forms and statuses. Labour markets are showing signs of skills polarisation, with the potential for income polarisation and weaker social cohesion. The impact of the changes is often hardest felt locally, leading to a need for targeted public interventions. There has been an increase in the use of more flexible and non-standard forms of employment. This may represent an opportunity for companies to adjust their business cycles and for individuals to adjust their career patterns towards their desired work-life balance. However, it also raises questions about job security, earnings, working conditions and could lead to exclusion from social protection. It is therefore of paramount importance to have in place labour and social protection legislation that responds to these new realities in the labour market.

The impact of the crisis has coincided with longer-term structural drivers of change. While working lives are becoming longer and career paths less linear, the difficulties faced by younger generations in joining the labour market pose a new challenge. The employment of younger workers has stagnated over the last decade. In 2016, 6.3 million young people aged 15-24 were not in employment, education or training. Intergenerational fairness is becoming a real concern. Without further action, there may be a detrimental impact on output growth, competitiveness, the sustainability of welfare systems, future generations' pension entitlements, their access to healthcare and their future welfare.

Social partners are essential stakeholders in the reform process. The timely and meaningful involvement of social partners in the design, sequencing and implementation of reforms can improve ownership, impact and delivery. New forms of social dialogue, collective organisation and bargaining need to be developed to meet the challenges posed by new forms of work.

Equal opportunities and access to the labour market

The unemployment rate in Europe is now close to its pre-crisis level. Poverty and social exclusion have started to come down. However, the recovery is still not reaching all parts of society and the economy. Most Member States are taking steps to narrow the gender labour income gap, better integrate disadvantaged groups into the labour market and raise the quality of jobs and of the working environment.

Effective active labour market policies are important to reduce youth and long term unemployment. Member States should help those out of work by providing support for job search, training and re-qualification, while protecting those unable to participate. The mobility of workers across jobs, sectors, and locations should be promoted, while ensuring the full respect of existing rights. Member States should also work towards more effective and tailor-made public employment services. The Commission will propose a number of new initiatives, including the creation of a new European Labour Authority.

Member States need to help people build the skills needed in the labour market. Proficiency in basic skills has stagnated or declined in most Member States. Among adults, poor basic skills remain a cause for concern and act as a drag on the economy. For example, while 90% of all jobs require digital skills, 44% of Europeans are estimated to be lacking them. Too many people, especially the low qualified, are out of work or in precarious work. Participation in adult learning has stagnated. Europe's competitiveness and global economic stature depend on a qualified and skilled workforce. Improvements in the quality and relevance of training and qualifications are needed.

Quality education and training must be accessible to all. Academic achievement remains strongly linked to socio-economic background. Efforts should be made to ensure equal opportunity and access to education and training to ensure social inclusion and better economic outcomes. This requires investment in both initial and continuing education and training, especially in Member States where gaps exist in educational outcomes and access to education, notably for disadvantaged groups. It also requires a more ambitious approach to cooperation with Member States, as outlined in the Communication on 'Strengthening European Identity through Education and Culture'[17]. Furthermore, in line with the New Skills Agenda for Europe[18], there is a need to upgrade vocational training and strengthen work-based learning, including through quality apprenticeships. Recognising skills acquired outside formal education and training and support for adults should also be made easier.

Job creation and fair working conditions

Dynamic and inclusive labour markets are essential for creation of good quality jobs, social inclusion, incentivising entrepreneurship and supporting labour market transitions. Innovative forms of work should go hand in hand with adequate job security and accessible social protection. Member States should ensure fair and equal treatment regarding working conditions. An appropriate balance between flexibility and security in the labour

[17] COM(2017) 673.
[18] COM(2016) 381.

market requires addressing labour market segmentation, including by fostering the transition towards open-ended forms of employment.

The demand for labour should also be supported by shifting the tax burden away from labour. Targeted labour tax reductions can specifically contribute to the inclusion of groups at the margins of the labour market, such as low-income earners and the long-term unemployed, while limiting revenue losses.

Promoting work-life balance is crucial for gender equality and increased female labour market participation. Ensuring access to quality services for all, such as childcare and early education, is important. Taxation systems that do not penalise second-earners and the provision of suitable family leave and flexible working arrangements for parents and carers also improve work-life balance.

Barriers to employment should be reduced, especially for disadvantaged groups, including single parent households, people with disabilities, ethnic minorities, refugees and migrants. Labour market integration efforts must be combined with social integration support, such as childcare, access to healthcare and housing, along with the removal of obstacles such as discrimination on the labour market. Better complementarity between labour market and social integration systems will help all vulnerable groups, generate increased prosperity for all and create stronger social cohesion. An adapted work environment for people with disabilities is also needed, as well as targeted financial support to help them participate fully in the labour market and society as a whole.

Short-term efforts to integrate refugees and migrants in the labour market should be replaced by comprehensive, longer term strategies to upskill them and integrate them in the labour market. Access to education and training improve their prospects of gaining employment, earning a decent wage and being included in society. This also improves the host country's growth prospects and will enable the EU to capitalise on the potential of refugees and their families and their strong motivation to be active members of society.

Growth in real wages, as a result of increased productivity, is crucial to reduce inequalities and ensure high standards of living. More dynamic wage developments, when translated into greater domestic demand, would support further the ongoing economic expansion.

Social protection and inclusion to tackle inequality and poverty

Social protection systems should provide adequate and well-targeted income support, foster labour market participation and ensure equal access to quality services. Addressing inequalities, including through the design of national tax and benefit systems, should be a priority. The distributional impact of reforms must be taken into account when designing and implementing structural policies. Member States should provide the unemployed with adequate benefits for a reasonable duration that does not constitute a disincentive to work. In some Member States, there is a need to develop more progressive tax and benefit systems that are in general more universal and better means-tested, where necessary. Social protection systems should ensure the right to minimum income benefits for people lacking sufficient resources and promote social inclusion by encouraging all to participate in the labour market and in society.

Social protection and labour market policies must also adapt to evolving forms of employment and increased labour mobility. More than half of independent workers in Europe are not covered by unemployment benefits. Social protection systems should adapt to new ways of working and ensure that entitlements are portable from one job to the next, make it easier to cumulate contributions from multiple jobs, and secure transitions between jobs.

Member States should ensure the sustainability and adequacy of pension systems for all. This requires ensuring equal opportunities for all workers, including the self-employed, to acquire pension rights, including in supplementary schemes. Most Member States have reformed their pension systems but more efforts are needed to complement enacted reforms. Flanking policies should be adopted to ensure that reforms are not reversed. Retirement incomes can be boosted by extending working lives, linking the retirement age to life expectancy, avoiding early exit from the labour market and supporting other complementary means of retirement incomes. Member States should put in place measures to ensure the sustainability of public pension systems, even under adverse conditions.

Reforms of health care and long-term care systems need to be pursued to enhance their cost-effectiveness, ensure their fiscal sustainability and ensure quality, affordable access. Expenditure on health care and long-term care is set to increase due to population ageing and non-demographic cost drivers such as technological progress in treatments and pharmaceuticals. Policy actions are therefore needed to enable people to stay healthy for longer, by making health systems and long-term care more cost-effective and ensuring timely access to affordable preventive and curative healthcare of good quality.

Innovation and competitiveness

Designing product and services markets for the future

New production technologies and services are changing European industry and its ability to grow and compete globally. They create jobs and deliver higher productivity and value to consumers, benefiting the wider economy. The future of Europe's industry depends on its ability to adapt and innovate by investing in new technologies and embracing digitisation and decarbonisation. Competitiveness will be dependent on the ability to move towards more sustainability and resource-efficiency and the ability to exploit the advantages of digital technologies. The business environment as a whole needs to enable innovation and support job creation.

Structural reforms that strengthen labour and product markets and support innovation are instrumental for making EU economies more competitive and resilient. Well-functioning labour and product markets enable adjustments through smoothly adjusting prices and promote innovation-driven competitiveness with positive effects on long term growth and social outcomes.

Particular attention needs to be given to the diffusion of new technologies among small and medium-sized companies. Their difficulties in taking up new technologies and gaining access to fresh capital are more acute in a globalised, technology-driven economy. Member States can play a role through better functioning public administration, improving business environments, forward-looking policies on skills, labour mobility and regional development, as well as empowering consumers. In addition, the conditions for the consolidation and scaling up of start-ups are critical for the renewal of the EU's production base in the economic recovery.

Business services are becoming increasingly important for the competitiveness of businesses. The demand for these services is growing and they provide an increasing share of the value added incorporated in manufactured goods. Opening up business services to more competition would benefit the EU economy as a whole, as manufacturing sectors relying on a higher proportion of business services perform better in terms of productivity growth than other manufacturing sectors.

Increased competition in distribution services would allow consumers to benefit more from innovation and new technologies. Competitive retail services should allow consumers to grasp more benefits from digitisation, more efficient value chains, increased choice and lower prices. Adequate enforcement of consumer rights and product safety legislation would support the delivery of these benefits.

The further reduction of restrictions in the services markets would improve productivity and competitiveness and lead to job creation. Regulatory and administrative obstacles persist in the services sector. In business services, construction, real estate and tourism, Member States still have disproportionate requirements to reserve activities, impose stringent conditions on corporate forms and shareholding structures, or require complex authorisation requirements. Reducing restrictions in the services markets, including collaborative models, would lead to stronger competition, higher productivity, cheaper services and greater choice for consumers and more jobs, notably for young qualified professionals.

The EU internal market provides a springboard for European companies to expand their business globally. The highest rates of job creation can be found in information and communication, administrative and support services and professional, scientific and technical activities. 85 % of these new jobs are created in small and medium-sized enterprises. Defence is also a sector where a true single market can make a fast and tangible difference. This means encouraging industrial competition, fostering productivity growth, cross-border access and collaboration between SMEs along the value chain, specialisation, economies of scale for suppliers, optimised production capacity, lower production costs and security of supply.

4. RESPONSIBLE FISCAL POLICIES TO SUPPORT SUSTAINABILITY AND CONVERGENCE

Fiscal policy to be tailored to country-specific circumstances

Following substantial fiscal adjustment efforts during the crisis, the improvement in the state of public finances has been supported further by the recovery. However, persisting high levels of public debt in several Member States have not yet been resolved. Affected Member States are likely to face higher financing costs once monetary policy accommodation is reduced, especially in the euro area. These higher financing costs would require additional fiscal efforts to contain an increase in debt ratios. It is time to take action to prevent even higher debt financing costs in the future and to build up fiscal buffers to help our economies to be more resilient to shocks and to create space for increased investment. The EU economic governance framework provides clear rules for the Member States, while at the same time allowing for flexibility where it is needed and justified.

Fiscal policy needs to be tailored to country-specific circumstances. This must be done in compliance with the Stability and Growth Pact and must take into account the need for stabilisation and sustainability. In Member States with sustainability risks, the gradual consolidation in line with EU fiscal rules should aim for a fiscal stance that both strengthens the ongoing recovery and ensures the sustainability of public finances. Particular attention needs to be paid to the composition of both expenditure and revenue. Member States with fiscal space could make use of it to lift potential growth and domestic demand, notably through investment.

With core inflation forecast to stay low, there is scope for higher growth without triggering inflationary pressures. Moreover, the euro area's largely positive external balance indicates room for further expanding private investment and consumption. Low funding costs make it also worthwhile for governments to frontload investment programmes through new lending, especially where public investments are at historical lows and there are identified needs.

Against these considerations, a broadly neutral fiscal stance would be appropriate for the euro area as a whole in 2018. The economic situation is expected to improve further, therefore strengthening the case for the reduction of public debt and rebuilding fiscal buffers, especially in highly indebted countries. However, in order to strengthen the growth potential of the euro area economies, public investment should be safeguarded and even increased in some Member States.

More efficient and fairer taxation and better quality of public spending

Improving the quality of public finances, in particular their composition and the better use of public procurement, is essential for the delivery of efficient public spending. Reforms in public administration can achieve fast and significant cost savings. Adaptation to a changing environment may require a fundamental transformation of the role, purpose, organisation and service delivery. The EU public procurement package[19] sets clear priorities to support procurement in practice and support investment in the EU. It presents a mechanism for large infrastructure projects and a recommendation on the professionalisation of public buyers. Measures must be in place to prevent corruption and collusion between suppliers and address firmly instances of unfair procurement.

Efficient and fair tax systems are an intrinsic part of sustainable public finances. Greater transparency and higher efficiency can help restore public trust in tax systems and improve tax collection. Fair and growth-friendly tax systems can reduce inequalities and poverty, encourage employment, support private investment and improve the business environment. Ensuring a level playing field is critical to address the issue of some multinational companies operating profitably in the single market while paying disproportionately little tax. Key EU-level action includes the adoption of legally binding anti-abuse measures, increased tax transparency, and initiatives on the reform of the VAT system and a common consolidated corporate tax base (CCCTB). The Commission has also launched a new agenda for the fair and efficient taxation of the digital economy. The fight against tax evasion and avoidance calls for a coordinated approach through EU initiatives and national policies.

Ambitious, comprehensive and regular spending reviews can be instrumental for improving the quality and composition of public expenditure. Spending reviews help achieve or maintain responsible fiscal policies and contribute to a more growth-friendly budget composition by offering a critical review of public expenditure trends and identifying smarter, more effective ways of spending taxpayers' money. While such initiatives are becoming more widespread in the Member States, there is significant room to improve the way in which they are conducted and, more importantly, their transformative effect on the spending side of public finances.

A stronger focus on the composition and efficiency of public spending is also important to deliver better on key policy priorities of the EU. For example, Member States have agreed to coordinate better their spending on defence, which would also allow for efficiency

[19] COM(2017) 572.

gains. The current dispersed system affects the interoperability of defence equipment. It can also lead to a lack of preparation and readiness of armed forces and gaps in defence capabilities.

5. NEXT STEPS

Member States should take account of the priorities identified by the Commission in this Annual Growth Survey in their national policies and strategies to promote growth, job creation and social inclusion and protection, notably in the definition of their national reform programmes. They should do so while accelerating the implementation of their reform agendas, making full use of the policy and funding instruments that are available to them at the EU level.

The Commission will continue the dialogue established with Member States in the context of the European Semester, with a view to reaching a common understanding of the most pressing challenges in the forthcoming country reports and the identification of the areas for priority action in the next round of country-specific recommendations. Member States should ensure that national social partners and national parliaments are fully involved in the reform process.

For the euro area Member States, the recommendation to the Council on the economic policy of the euro area sets out the specific areas for action by all euro area countries, with a view to putting in place a coordinated and comprehensive approach to the further development of the euro area for the benefit of all of its members, bringing benefits for each of them individually and for the common currency area as a whole.

With the recent proclamation on the European pillar of social rights, the basis has been set for the consolidation of a common approach to the protection and development of social rights across the European Union, which should be reflected in the measures pursued by all Member States. In the coming weeks, the Commission will complement this with a package of proposed measures on deepening the economic and monetary union, with the objective of providing a solid basis on which the future prosperity of Europe can be developed.