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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**

2017 European Semester: Country-specific recommendations

1. INTRODUCTION

The European economy has proven resilient in the face of significant challenges.

In 2016, both the EU and euro area economies grew by nearly 2%. Employment in the EU reached 232.9 million people, the highest number ever recorded. The European Commission's spring 2017 economic forecast¹ shows that public finances continue to improve: the general government deficit in the euro area, which was above 6% a few years ago, is expected to be 1.4% this year, and the debt-to-GDP ratio, after years of sharp increase, is expected to decrease slowly to go just below 90% next year. Economic growth is benefitting from the resilience of domestic drivers, supportive economic policies, including accommodative monetary policy and non-restrictive fiscal policies, a gradual improvement in world trade and the euro's relatively favourable exchange rate. However, economic developments remain burdened by weak underlying productivity and by the legacies of the crisis, including persistent inequalities and disparities across countries. Uncertainty stemming mostly from external factors remains high and potential growth needs to be boosted.

To strengthen the positive trends and convergence within the EU, economies need to be more competitive, resilient, inclusive and innovative.

This is the objective of the recommendations made under the European Semester of economic policy coordination. Reforms are made easier in a supportive environment and they are very necessary to sustain the current positive economic and social trends, as well as to support the modernisation of our economies. Well-designed and appropriately sequenced reforms, which also take into account distributional impacts, should serve to empower EU citizens and business to contribute to and benefit from growth, foster convergence and minimise any adverse effects of change. Implementing these reforms will also help to increase convergence within the EU and the euro area, also by strengthening their resilience.

Reforms need to take due account of the specific socio-economic situation and challenges in each Member State.

Significant labour market reforms have been adopted since 2010, notably in some of the countries hardest-hit by the crisis. These reforms have helped to increase the adjustment capacity of their economies, restore competitiveness and increase employment. Other reforms have sought to improve the business environment and the way financial and product markets function. Recently, attention has been increasingly paid to shifting taxation away from labour and to modernising social policies and labour market parameters to improve their functioning and deliver a fair distribution of the benefits of growth across society. However, further efforts have to be made, in particular in reforming product and

¹ See national programmes at:

https://ec.europa.eu/info/2017-european-semester-national-reform-programmes-and-stability-convergence-programmes_en and Commission Spring 2017 Economic Forecast of 11 May 2017 at: https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/spring-2017-economic-forecast_en

services markets and in modernising public administration, which are important areas for facilitating investment and for increased trade integration and competitiveness.

The reforms also need to ensure the longer term sustainability of the economic recovery and improve resilience to future economic and societal challenges. This requires more focus on reforms that facilitate investment in social infrastructure, education, early childhood education and care and lifelong learning. There is also a need for more reforms promoting research and innovation capacity and improving productivity. Such reforms could benefit catching-up Member States that are under increasing pressure to shift towards specialising in knowledge-intensive industries. They could also help countries with chronically low productivity growth. In addition, specific attention should be given to the overall efficiency of welfare and tax-benefit systems. In countries with excess savings and low investment, additional investment is needed to ensure future economic success, particularly given the ageing of the population.

There are still many restrictions that weigh on business activities. Inflows of foreign direct investments remain low and trade integration and diversification in some parts of the EU economy are still weak. Restrictions in professional services and disproportionate regulatory requirements and burdensome administrative procedures in some services sectors continue. The fragmentation and inefficiencies of public procurement markets persist. These factors continue to hamper trade integration in the internal market and slow down the value chain integration of businesses by imposing additional costs or restricting their access to markets. Boosting innovation and productivity and reducing disparities in economic performance across firms, sectors and regions creates space for dynamic wage developments and improvements in disposable household incomes.

Social priorities must be a key part of the reform efforts. As pointed out in the White Paper on the future of Europe and in the reflection paper on the social dimension of Europe by 2025, the recovery is still unevenly distributed across society and regions. Addressing the legacy of the crisis, from long-term unemployment to high levels of public and private debt, remains an urgent priority. Structural reforms are needed to foster social justice, mitigate income inequalities and support convergence towards better outcomes. Social priorities and consequences should be taken into account when designing and implementing the reform agenda.

To help address some of these issues and guide further convergence, the Commission has presented its proposal for a European Pillar of Social Rights. The aim of the pillar is to set out essential principles to support well-functioning and fair labour markets and welfare systems. The pillar is designed as a compass for a renewed process of convergence. The analysis and recommendations of the European Semester will reflect and promote the principles enshrined in the pillar by assessing, monitoring and comparing the progress made towards implementing them.

Benchmarking and exchange of best practices will be conducted in a number of areas. A social scoreboard will help to track progress.

The European Semester and country-specific recommendations provide annual guidance for the Member States' reforms. While the recommendations to the Member States are adjusted every year to reflect the progress made and the changing environment, they are firmly anchored in the wider priorities outlined in the Commission President's State of the Union address and the Annual Growth Survey. For the euro area countries, they also reflect the recommendations for the economic policy of the euro area. Coherence and consistency between the recommendations for the euro area and the country-specific recommendations is essential to ensure that the appropriate policy mix is achieved at euro area level and that spillovers within the euro area are appropriately reflected in the policy-making process. The wider and longer-term vision of the Europe 2020 strategy and the 2030 Sustainable Development Goals are important to guide action on an annual basis and are key to guide action on an annual basis and are fully integrated in the European Semester.

The Commission has taken concrete steps to improve and support the implementation and ownership of reforms by the Member States. As in previous years, the recommendations are based on a comprehensive multi-level dialogue with the European Parliament, national parliaments, Member States' public authorities, social partners, civil society and other key stakeholders. For the first time, the Commission consulted the Member States on the draft country reports published in February,² thus strengthening common understanding of the key economic and social priorities. The Commission also holds regular consultations with social partners at EU and national levels and has invited Member States to pay greater attention to the contribution of national social partners. This includes involving them more closely in the elaboration of National Reform Programmes and consulting them on key milestones of the Semester. In its proposals for this year's country-specific recommendations, the Commission also focuses on the issues that require the most urgent attention.

2. OVERALL PROGRESS IN REFORMS AND CORRECTING IMBALANCES

The experience of the past few years confirms that the Member States are committed to pursuing structural reforms actively. The evolution of progress towards implementing each country-specific recommendation can be seen most clearly by looking at the whole period since its adoption. The large majority of reforms have seen substantive progress, while the pace and depth with which they have been implemented by Member States varies. To facilitate Member States' ownership of reforms and contribute to their improved implementation, the

² See https://ec.europa.eu/info/publications/2017-european-semester-country-reports_en

Commission has shifted focus towards key priority issues of macro-economic and social relevance. Over recent cycles of the European Semester, recommendations have become more focused on reform steps that can be implemented within 12-18 months. While this is important to produce momentum and initiate first steps, this timeframe is limiting for a true assessment: experience shows that reforms often happen incrementally over a longer period of time and their impact needs to be measured over several years.

Around two thirds of the country-specific recommendations issued until 2016 have been implemented with at least ‘some progress’. Since 2011, the Council has annually issued a set of recommendations to each Member State. The targeted reforms are often far reaching and require time to prepare and implement in line with national practices. Governments, national parliaments, social partners, other stakeholders and individual citizens need to invest time, hold discussions and carry out analysis to come to the best outcomes for the issues addressed by the recommendations. These generally require compromise solutions that strike a balance between different economic, social, institutional and political considerations.

Progress in implementing the recommendations from previous years is considerably greater than for those made less than one year ago. This confirms that implementing reforms takes time and that it is important to assess the process over the medium term and not only the short term perspective. From a multiannual perspective, reform progress has been greatest in the policy areas that concern fiscal policy and fiscal governance and in financial services. This largely reflects the efforts made in overcoming the economic and financial crisis, as the high debt and deficit levels had to be addressed and the financial sector stabilised. Significant measures have been taken in many countries to improve the sustainability of pension systems. Areas in which progress has been slower are health and long-term care, broadening the tax base, improving the business environment, access to finance and competition in services. Some of these are longer-term priorities that will become more pressing due to increasing demographic challenges and could be heightened if growth remains moderate. Since the start of the European Semester in 2011, the pace of progress - as assessed one year after the adoption of the recommendations - has been slightly decreasing. This might partly be because politically easier reforms were done first and because of the greater sense of urgency during the crisis. Yet, this trend has been halted with the implementation of the 2016 country-specific recommendations.

Figure 1: Implementation of country-specific recommendations: yearly assessment in each consecutive year since 2011

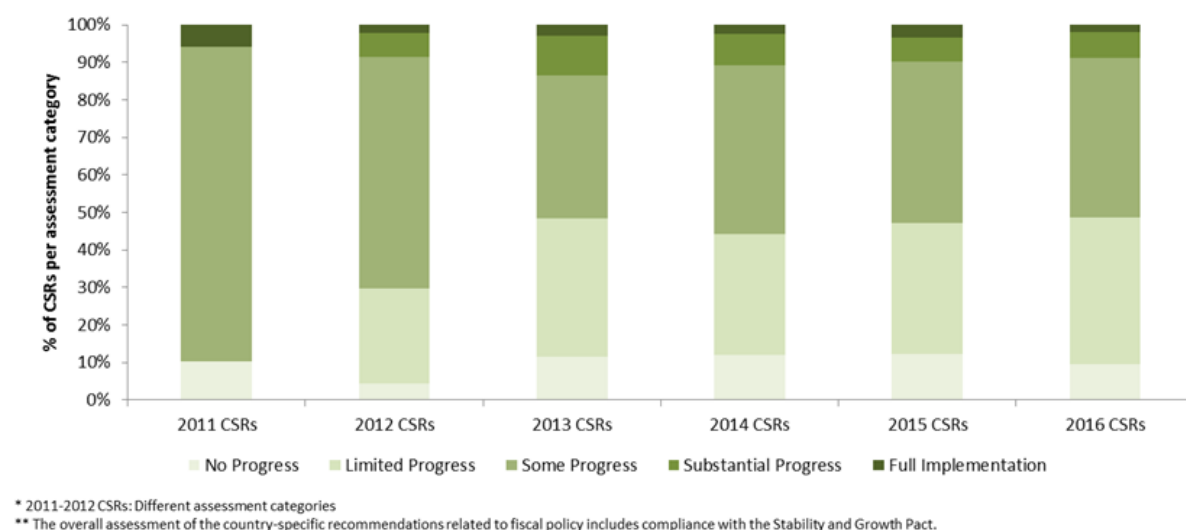
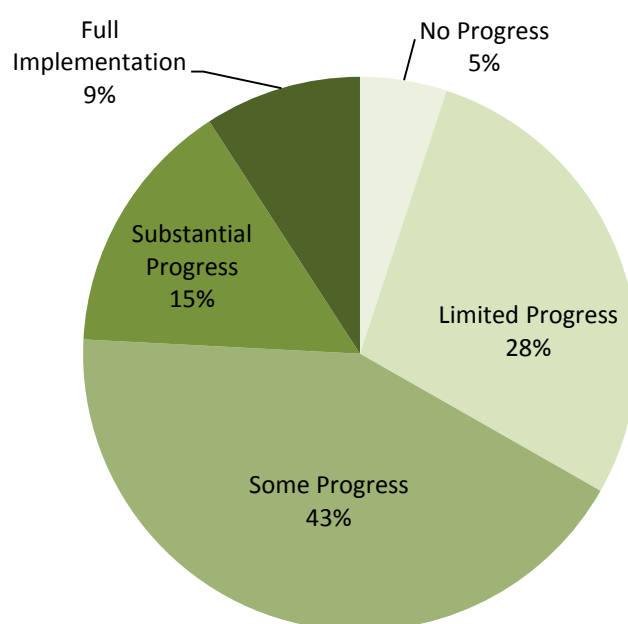


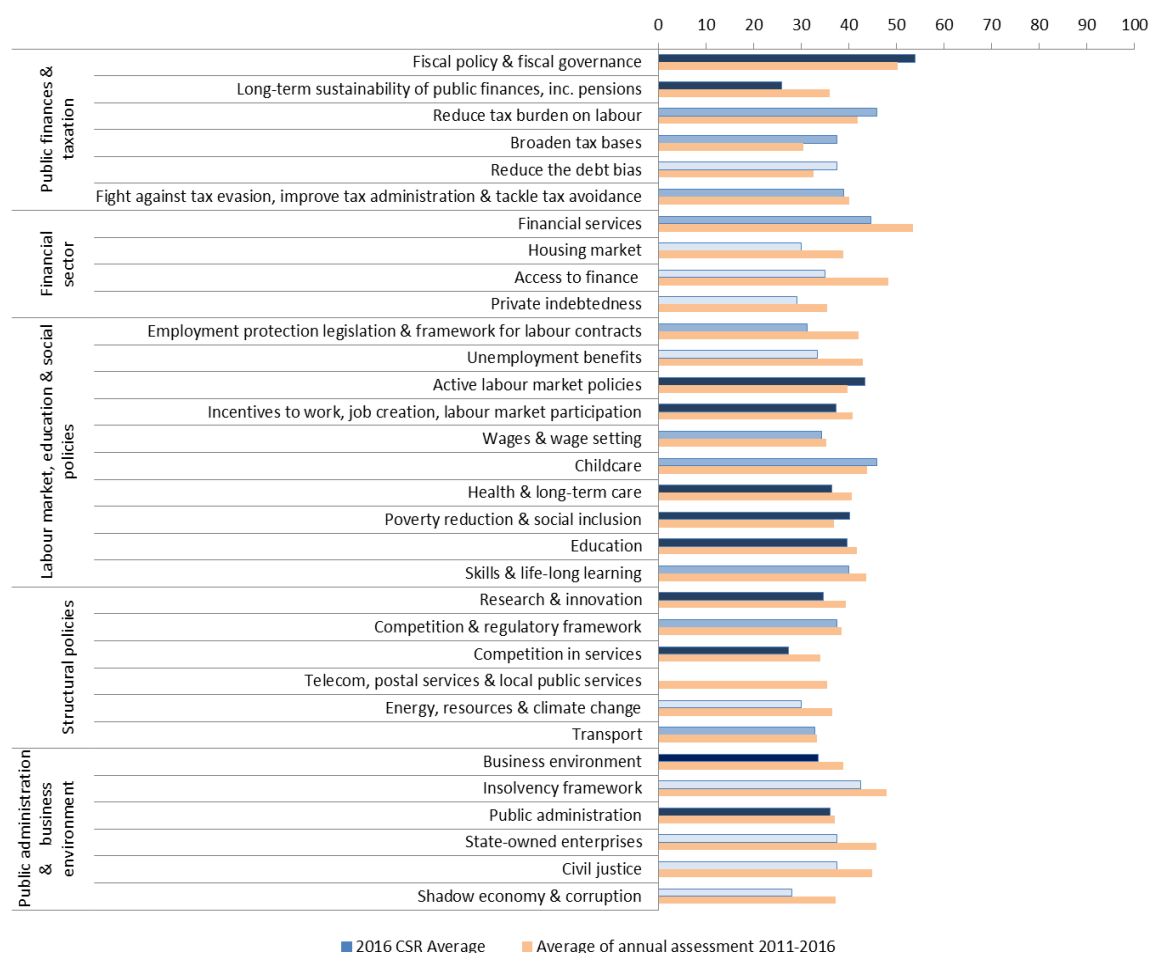
Figure 2: Overall implementation of 2011-2016 CSRs to date (multiannual assessment)



Since the adoption of last year's country-specific recommendations, Member States have made most significant progress in the areas of fiscal policy and fiscal governance, as well as in active labour market policies. Steps have been taken in taxation policies (reducing the tax burden on labour), the labour market and social policies (notably poverty reduction, social inclusion and childcare) and financial services. The areas showing least progress include the long-term sustainability of public finances, competition in services and the business environment. The overall

picture that emerges is that Member States continue to make efforts to implement reforms, but the degree of progress ranges between ‘limited’ and ‘some’ for most policy areas identified in the 2016 country-specific recommendations. This means that there is still work to do before the reforms are fully implemented and deliver results for citizens and companies.

Figure 3: Assessment of progress on 2016 country-specific recommendations by policy area



Addressed to 1-5 Member States

Addressed to 6-10 Member States

Addressed to 11+ Member States

The correction of macroeconomic imbalances continues, reflecting progress in implementing relevant reforms, but it remains largely asymmetric across the EU, in the sense that it is countries with external deficits or debt that have made further progress. At the same time, large current account surpluses persist in some other countries. The ensuing persistent current account surplus of the euro area reflects aggregate demand dynamics that continue to lag behind economic activity. Moreover,

core inflation has been at historically low levels. This provides a challenging environment for countries that need to reduce domestic and foreign debt. As a result, private and public debt deleveraging is progressing at a slow and uneven pace, hampered by low nominal growth. Boosting price and non-price competitiveness would help external rebalancing in the euro area. Member States with current account deficits or high external debt can contribute to the euro area rebalancing by introducing measures that help raise productivity. Those with large current account surpluses can contribute to the euro area's rebalancing by structural reforms and other measures that make it easier to channel excessive savings into domestic demand. This can be done, in particular by strengthening investment and promoting stronger wage growth. The current environment of low interest rates also provides additional opportunities to do this, notably in countries with significant fiscal space.

A number of imbalances remain to be addressed. Levels of private, public and external debts remain very high in some countries. Keeping these debts on a solid declining path is essential to reduce vulnerabilities, also in view of a foreseen recovery in inflation and interest rates. Capital buffers in the financial sector have been strengthened, but challenges arise from low profitability, coupled with high levels of non-performing loans. Labour market conditions are improving across the board, although persistently high unemployment and inequality remain sources of social distress and weigh on economic performance in some Member States. In a growing number of Member States, challenges are linked to strong house price movements.

In February 2017, the Commission identified imbalances in 12 Member States; appropriate follow-up forms part of the country-specific recommendations, where challenges identified in the macroeconomic imbalance procedure are referred to. In-depth reviews were carried out for 13 Member States. It was concluded that Finland is no longer experiencing imbalances, while six are experiencing imbalances (Germany, Ireland, Spain, the Netherlands, Slovenia and Sweden) and six are experiencing excessive imbalances (Bulgaria, France, Croatia, Italy, Cyprus and Portugal). For Cyprus, Italy and Portugal, the Commission announced in February that it would review its assessment, taking into account the level of ambition of their National Reform Programmes.

Box 1. Assessment of National Reform Programmes of Italy, Cyprus and Portugal

In February 2017, the Commission announced that Italy, Cyprus, and Portugal were experiencing excessive imbalances and that, in the light of persistent structural weaknesses emerging from the analysis in the in-depth reviews, it would review this assessment in May. The Commission has continued to monitor developments in these three countries, notably the policy commitments outlined in their National Reform Programmes, which they submitted in April.

Cyprus's programme details the policy initiatives envisaged over the short and medium term to tackle other economic and structural challenges. These will be addressed notably by making the public sector more efficient, making the functioning of the insolvency framework function better, streamlining the issuance and transfer of title deeds and modernising the justice system. The programme also presents policy measures to improve competitiveness and remove barriers to investment, in particular by continuing to implement the action plan for growth. Although many reform commitments appear sufficiently ambitious to tackle Cyprus's challenges, details of when they will be adopted and implemented are generally lacking.

Italy's 2017 reform programme presents short and medium term commitments, in continuity with previous such programmes. Measures to be taken by mid-2017 include final adoption of the pending laws on competition, reform of criminal process and the statutes of limitation, and implementation of the anti-poverty law. Measures related to firm-level bargaining, tax shift and privatisation are also planned. Over the medium term, the programme targets in particular public finance, taxation, the labour market, the banking and the credit system, competition, the public administration and the justice system, and investment. Although many reform commitments appear sufficiently ambitious to tackle Italy's challenges appropriately, their credibility hinges on being implemented in practice.

The 2017 reform programme for Portugal presents a medium term economic and social strategy in continuity with the 2016 programme. The measures proposed aim to raise the skills level of the labour force; address labour market segmentation, improve the business environment and increase the competitiveness of Portuguese firms; tackle corporate debt and unemployment; modernise the public administration and improve social protection. Although many reform commitments appear sufficiently ambitious to tackle Portugal's challenges appropriately, the document lacks details as well as concrete implementation plans in some key areas such as reducing private and public debt. Portuguese authorities provided further details on measures and timing in a letter on 14 May 2017.

As a result of these assessments, and taking into account all the available information, the Commission has concluded that there are currently no analytical grounds for stepping up the macroeconomic imbalance procedure, provided that these Member States swiftly and fully implement the reforms set out in their country-specific recommendations. The Commission will continue to monitor these three countries, as it does all countries with excessive imbalances, notably through 'specific monitoring'.

The Commission has strengthened the monitoring of policy implementation under the macroeconomic imbalance procedure. In line with the decision taken last year to streamline the categories of Member States under the macroeconomic imbalance procedure, the process of 'specific monitoring' has been applied to all countries with imbalances or excessive imbalances. The depth of the monitoring process reflects the scope of the challenges and the severity of the imbalances. The

aim is to contribute to a swifter and more comprehensive policy response to the imbalances identified by intensifying dialogue between the Commission and the national authorities.

3. KEY OBJECTIVES OF THE 2017-2018 RECOMMENDATIONS

The overall objective of the recommendations is to deliver more jobs and faster growth, while taking account of social fairness considerations. The recommendations are chosen following broad policy analysis and engagement with key stakeholders. They are based on the issues identified in the Annual Growth Survey, the macroeconomic imbalance procedure, surveillance under the Stability and Growth Pact, country visits, Member States' consultations, the Tripartite Social Summit, the annual convention for inclusive growth with civil society, and the euro area recommendations.

The challenges vary considerably across Member States. In some Member States, for instance those experiencing excessive imbalances, the challenges identified require comprehensive and sometimes urgent policy action, In others where economic performance is overall satisfactory and challenges are more specific, more targeted policy action is recommended. These differences are reflected in the number of recommendations addressed to each Member State and in their scope and formulation. The Member States are expected to take action to address all of the challenges identified by the comprehensive analysis in the country reports published in February, even if these are not reflected in the country-specific recommendations. Particular attention should be paid to sequencing the reforms appropriately and to taking accompanying measures where relevant, based on the assessment of the distributional impacts of the reforms.

Labour market

Many Member States have implemented reforms to strengthen the performance of labour markets, but further efforts are necessary to address high levels of unemployment. Past reforms are bearing fruit in terms of creating jobs and improving labour market conditions. However, youth and long-term unemployment remain urgent priorities and more efforts are needed to promote resilient and inclusive labour markets. These include tackling labour market segmentation and increasing the effectiveness of active labour market policies (for example in Belgium, Bulgaria, Ireland, Italy, Lithuania, Hungary, Portugal and Romania) and social policies (for example in Bulgaria, Lithuania and Spain). Likewise, there is a need to develop collective bargaining systems that are more conducive to creating jobs and to raising productivity growth. In some countries that are at or close to full employment, real wage increases could accelerate, with related positive effects on aggregate

consumption. This could contribute to reducing large current account surpluses in Germany and the Netherlands.

Labour market segmentation is hampering productivity and the development of human capital. Structural changes in employment have resulted in an increase in temporary forms of employment. New forms of employment can increase work opportunities and boost business development. However, they may also limit access to social protection, training and employment services, weaken job security and undermine the objective of creating quality jobs.

More needs to be done to improve participation in the labour market. Despite continuous increases in the labour market participation of women and some measures to improve work-life balance, gender employment gaps and gender pay gaps remain significant. The Commission therefore continues to propose that Member States act in this area. Additional efforts are also needed to improve the integration of migrants and people with a migrant background into the labour market (for example in Belgium, France, the Netherlands, Austria and Finland).

A combination of pension reforms, labour market policies, lifelong learning and health policies is required to support a more active older population. Older workers have seen their labour market participation increase but in many countries their employment rates remain low. In view of the ageing population and higher dependency ratios, getting older people involved in the labour market is crucial to ensuring that the social protection systems are sustainable and adequate. Remaining active and healthy is also important for the well-being of older people. This is why the Commission has proposed a number of recommendations in these areas where action has been more limited and where the challenges are more pressing (for example in Germany, Croatia, Luxembourg, Austria, Poland and Slovenia). Member States have successfully undertaken relevant reforms of their healthcare systems. However, there are Member States where healthcare performance, sustainability and accessibility are hampered by persistently low funding, inefficient allocation of resources, over-reliance on hospital care, large out-of-pocket payments and staff shortages. A number of recommendations address these issues (for example in Latvia, Austria and Romania).

The contribution of social dialogue is important. It is crucial to ensure that social partners are empowered to play their role fully in collective bargaining in line with national practices. Besides a well-functioning social dialogue, the involvement and constructive engagement of social partners in the design and implementation of relevant policies and reforms is essential to increase their ownership and effectiveness.

Social protection systems and inequality

Social protection systems must provide enabling services to all and adequate income support to those in need, while fostering employment and participation in the labour market for those who can. An appropriate balance is needed between adaptability and security, including an adequate level, coverage and duration of social protection. Reforms that make work pay are also needed to encourage transitions into employment.

Income inequality and poverty need to be addressed when designing policy reforms and monitoring their implementation. As outlined in the Annual Growth Survey and further supported by the analysis in the country reports, critical new socio-economic developments have been identified in some Member States. These concern income inequalities or socio-economic inequalities in education and health outcomes. These need to be considered when designing economic policies. In addition, Member States with the greatest levels of inequality tend to have higher poverty rates. Tackling income inequality and poverty requires a comprehensive set of preventive and mitigating policies. These include equal access to education and health care, improved labour market opportunities and earnings prospects, affordable quality services and well-designed tax and benefit systems.

Tax and benefit systems combined, through the progressiveness of tax systems, good tax collection and the provision of adequate social benefits, can contribute to steering employment and reducing income inequalities and poverty. While the design of national tax systems is a prerogative of the Member States, experience shows that a low tax progressivity, combined with poor tax collection and a weak social safety net, is damaging to society and economic growth. In this context, a number of recommendations have been made to improve the adequacy and coverage of safety nets (for example regarding minimum income) and the transparency and coordination of social benefits.

Education

Better skills are essential for improving people's prospects in the labour market and sustaining innovation and productivity growth. Workers who are low-skilled have lower employment rates and make up a large proportion of the long-term unemployed. Investing in skills and supporting transitions from lower-skilled to higher-skilled employment and career opportunities is also crucial to mastering technological progress, sustaining productivity growth and addressing ageing. Reforms need to include steps to up- or re-skill the population with basic skills and improve the labour market relevance of education, vocational education and training, tertiary education and life-long learning. Efforts should also focus on reducing inequalities in access to quality education, in particular for disadvantaged groups such as Roma and students with a migrant background. All these measures also highlight the important role of the social partners in providing high-skill, high-productivity work and lifelong learning opportunities. Recommendations concerning education-

related issues are proposed this year for Austria, Belgium, Bulgaria, Spain, France, Lithuania, Cyprus, Croatia, Hungary, Austria, Romania, Slovakia and the United Kingdom.

Financial sector

Fixing remaining vulnerabilities in the banking sector would help to support the recovery and strengthen the financing of European business. While the process of repairing bank balance sheets has progressed in Member States over recent years, high levels of non-performing loans, inefficiencies in business models and overcapacity weigh on banks' profitability and limit their ability to provide lending to the real economy. The Commission has presented a comprehensive legislative package to reduce risks further and strengthen the resilience of the EU banking sector in particular. The Commission will also present a mid-term review of the Capital Markets Union action plan in June 2017.

High levels of non-performing loans are a legacy of the overlending before the crisis and a result of the protracted period of sluggish growth since then. The pick-up in economic growth and domestic policy actions have helped put the level of these loans on a decreasing path in some Member States (Ireland, Croatia and Slovenia). However, in a number of other countries, the recovery itself continues to be hindered by the constrained bank lending resulting from the high level of bad loans. Decisive policy actions in these countries to promote the resolution of these loans could help to break such vicious circles.

There is a need to act both on the high level of existing non-performing loans and on preventing their renewed build-up in the future. With economic and financial systems that are highly interconnected in the EU, high ratios of non-performing loans in several Member States have broader spillover effects. Although policy tools are largely in the hands of Member States, an EU-level strategy could promote a more comprehensive approach and concerted action at both national and European level. The euro area recommendation calls for an effective area-wide strategy to address viability risks within the banking sector.

Effective insolvency frameworks, notably including effective out-of-court restructuring, are crucial for supporting the workout of non-performing loans and increasing recovery rates. These measures include increasing transparency and disclosure, strengthening data infrastructures to ease transactions, and servicing by and sale to specialised non-bank institutions. To deal with large existing stocks of non-performing loans, options should be considered for facilitating accelerated balance sheet repair. These should include more proactive use of supervisory powers, as well as making it easier to sell such assets. The Commission has recommended taking measures to Bulgaria, Ireland, Italy, Cyprus, Portugal and Slovenia.

Economic stability and the implementation of reforms have contributed to the recovery in investment, which has exceeded pre-crisis levels in some Member States. However, further efforts are needed to increase the stocks of capital equipment, intangible capital and infrastructures and to compensate for the investment gap accumulated since the outbreak of the crisis. The Commission's assessment of the progress made in addressing national barriers to investment and the priority reforms underway confirms that a significant proportion of country-specific recommendations in these areas are not fully implemented. Member States should take advantage of the favourable prevailing macroeconomic conditions to step up public investment in order to accelerate the pace of reforms and create opportunities for private investment. At the same time, Member States, in particular those with fiscal space, should sustain the upward trend in public investment.

The rate of public investments in education, infrastructure and research and innovation should grow in those countries where there is room to increase public expenditure. Improved public infrastructure with an impact on productivity, such as broadband networks, communications or innovation, are needed in a number of Member States. Investment in public housing, education, health and social services is needed in many others. In all cases, applying procurement procedures transparently and appropriately should help to maximise efficiency in the use of public sector budget resources.

However, the speed and strength of the recovery hinges on a more determined upturn in private investment. The implementation of the Investment Plan for Europe is helping to ensure optimal use of public investment and is acting as a catalyst of private investment. This reinforces the impact of the European Structural and Investment Funds in many parts of Europe. Structural reforms are helping to create a business environment that is conducive to encouraging private sector investments in Member States. Administrative reforms have been accelerated in countries where they were most needed. However, much more work remains to be done. A stable pipeline of projects in key sectors is still being developed.

Further efforts are needed to improve the effectiveness of justice systems and to prevent and fight corruption. These are key issues in a number of Member States, hampering investment, efficient resource allocation, economic performance and growth. Addressing these challenges is essential for improving business confidence and the investment climate, enhancing the efficiency of public spending, promoting fairness and supporting economic, social and territorial cohesion. The situation calls for continued, persistent and coherent action particularly in the sectors that remain most vulnerable to corruption: public procurement, public administration, the business environment, healthcare. Remaining challenges include: fragmented corruption prevention frameworks and inadequate control mechanisms; gaps in the anti-

corruption legal framework or enforcement of existing anti-corruption rules; insufficient initiatives on whistleblowing and letterbox companies; insufficient prosecution of high-level corruption; informal payments in healthcare; lack of competition and transparency in public procurement operations.

Product and services markets

Reforms in product and services markets are still making insufficient progress in most countries. Reforms should be undertaken in Member States that have not tackled them yet. In most cases, reforms have been tabled or announced but they still need to be stepped up, enacted and implemented with resolve. Where reforms have been adopted and are in the process of being implemented, measures must be taken to ensure the implementation is unwavering and, most importantly, to consolidate the reforms to avoid potential backtracking.

Reforms are particularly important in business services and retail distribution, given the impact that these sectors have on the productivity of other services and manufacturing sectors. Specific sectoral initiatives have been launched in these areas and in past Semester cycles it has been recommended that Member States introduce reforms in these sectors. Finding complementary ways to implement these measures and reforms alongside other efforts to increase competition in these markets will be essential for fostering productivity growth in the service sectors as well as in other sectors using these services as inputs. This would help improve competitiveness across primary and user sectors. Greater competition and lower prices of professional services would be of particular benefit for SMEs. These reforms should also allow for the development of new business models and innovation.

Public finance

Public finances are expected to continue improving in both the euro area and the EU as a whole. Benefiting from the ongoing moderate economic expansion and exceptionally low interest rates, the general government deficit and debt continued to decline in 2016 in the euro area and the EU (deficit respectively at 1.5% and 1.7% of GDP, and debt respectively at 91.3% and 85.1% of GDP). The general government deficit is expected to continue to decline in both areas in 2017 and 2018, and to reach in 2018 1.3% of GDP in the euro area and 1.5% in the EU, under a no-policy-change assumption. General government debt is also projected to continue declining in 2017 and 2018 in the euro area and the EU. It is forecast to reach, in the euro area, 90.3% in 2017 (84.7% in the EU) and 88.8% in 2018 (83.6% in the EU). These are the lowest levels since 2012. Debt reduction can be ascribed mainly to primary surpluses, reduced interest expenditure, real GDP growth (albeit modest) and the expected rise in inflation.

After several years of budgetary consolidation, the fiscal policy stance in the euro area and the EU remained broadly neutral in 2016 and is set to remain so in 2017. With the proposed country-specific recommendations, the fiscal adjustment required for Member States under the preventive arm not yet at their medium-term budgetary objective is consistent with the Stability and Growth Pact. For Member States under the corrective arm, the proposed recommendations reiterate the need to comply with the requirements of the Excessive Deficit Procedure. Setting public debt ratios firmly on a downward path is especially important in those countries with high debt and where vulnerability to financial market swings may be more accentuated. Overall, these adjustments to comply fully with the Pact would imply a slightly restrictive aggregate fiscal stance for the euro area as a whole in 2018.

Within the existing rules of the Stability and Growth Pact, euro area Member States that have fiscal scope are therefore recommended to use it to support domestic demand, notably investment in infrastructure, research and innovation.

This would strengthen their growth potential and lead to a better distribution of the fiscal adjustment across the euro area. It would also contribute to achieving a broadly more appropriate fiscal stance for the area as a whole in 2018. This would be important to strike the right balance between attaining public finance sustainability and safeguarding the ongoing recovery in economic activity and in employment. Moreover, when taking policy measures to achieve the recommended budgetary adjustments under the preventive arm of the Pact, Member States should consider the need to support the recovery and the potential impact on employment. In carrying out its future assessments, the Commission stands ready to use its margin of appreciation in cases where the impact of large fiscal adjustment on growth and employment is particularly significant. In that context, it will make use of any updated information regarding the projected position in the economic cycle of each Member State and work closely with the Council to that effect. This is consistent with the approach already set out by the Commission in its Communication of January 2015 on making the best use of the flexibility within the rules of the Stability and Growth Pact and in its Communication of November 2016 on a positive fiscal stance for the euro area.

In order to find resources to finance medium-to-long term investment projects, Member States should focus on enhancing the composition of their public finances. Close attention should be paid to an appropriate allocation of public revenues and expenditures across the various policy areas, resulting in a combination that can be more conducive to growth. Further efforts are needed to improve the efficiency and effectiveness of public taxation and expenditure at all levels of government. This may be instrumental in containing further the overall cost of the public sector, and may provide space to support policies that help boost growth and productivity and social inclusion, for example by investing in social infrastructure and upgrading workers' skills. Business activity and social fairness would both benefit from the provision of an effective, well-functioning public administration and an adequate level of social services and public goods.

Box 2. Update on surveillance under the Stability and Growth Pact

Based on the assessment of the 2016 Stability and Converge Programmes, the Commission has also taken a number of steps under the Stability and Growth Pact.

The Commission recommends that the excessive deficit procedure is closed for Croatia and Portugal. This would leave only four Member States under the corrective arm of the Pact.

The Commission adopted reports for Belgium and Finland under Article 126(3) TFEU, in which it reviews their compliance with the debt criterion of the Treaty. In both cases, the conclusion is that the debt criterion should be considered as currently complied with. In the case of Belgium, additional fiscal measures are to be taken in 2017 to ensure broad compliance with the adjustment path towards the MTO in 2016 and 2017 together. In the case of Finland, it is noted that the swift adoption and implementation of structural reforms increasing productivity and supply of labour are key to enhance growth prospects in the medium term and improve fiscal sustainability.

Furthermore, the Commission addressed a warning to Romania on the existence of a significant deviation from the adjustment path toward the medium-term budgetary objective in 2016 and recommends the Council to adopt a recommendation for Romania to take appropriate measures in 2017 with a view to correcting this significant deviation. It is the first time that this procedure of the EU economic governance framework is applied. It provides the authorities the opportunity to take corrective action in order to avoid the opening of an excessive deficit procedure.

Based on the assessment of the 2017 Stability Programmes, the Commission takes a favourable view of the flexibility requests of Lithuania and Finland. In the case of Finland, flexibility is granted in view of the planned implementation of major structural reforms, notably the Competitiveness Pact and the pension reform, and investment. In the case of Lithuania, flexibility is granted in view of the planned implementation of reforms raising the sustainability of the pension system through a reinforced indexation and a gradual increase of the pensionable service.

4. CONCLUSION

Structural reforms, together with the better use of public budgets, are indispensable to lift the EU economy to its full potential. The set of recommendations put forward by the Commission draws on both the European and national perspectives. The recommendations follow up on the EU and euro area priorities outlined in the Annual Growth Survey and the recommendations for the economic policy of the euro area. They also build on a thorough dialogue with the Member States, through the country reports, bilateral discussions and visits, and the

reform agenda, as outlined in the National Reform Programmes and Stability or Convergence Programmes. The recommendations address the most pressing challenges that hinder the creation of more jobs or faster growth.

The Commission calls on the Council to endorse the proposed approach for the 2017-2018 country-specific recommendations and related decisions under the Stability and Growth Pact. It also calls 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. The Commission is also available to provide on-request reform support to the Member States through the newly set-up Structural Reform Support Service and through the best use of the European Structural and Investment Funds.

TABLE 1 – POLICIES COVERED IN THE 2017 COUNTRY-SPECIFIC RECOMMENDATIONS

Broad Category	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
Public finances & taxation	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 sector	Financial services																											
	Housing market																											
	Access to finance																											
	Private indebtedness																											
Labour market, education & social policies	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																											
Structural policies	Research & innovation																											
	Competition & regulatory framework																											
	Competition in services																											
	Telecom, postal services & local public services																											
	Energy, resources & climate change																											
	Transport																											
Public administration & business environment	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%	71.1% (2016)	Target likely to be met
2. Increasing combined public and private investment in R&D to 3% of GDP	1.93%	2.03% (2015)	Target unlikely to be met
3a. Reducing greenhouse gas emissions by at least 20% compared to 1990 levels	14% reduction	22% reduction (2015)	Target likely to be met
3b. Increasing the share of renewable energy in final energy consumption to 20%	12.9%	16.7% (2015)	Target likely to be met
3c. Moving towards a 20% increase in energy efficiency (i.e. a primary energy consumption target of 1483 Mtoe)	11.7% above the primary energy consumption target of 1483 Mtoe	3.1% above the primary energy consumption target of 1483 Mtoe (2015)	Target likely to be met
4a. Reducing school drop-out rates to less than 10%	13.9%	10.7% (2016)	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%	39.1% (2016)	Target likely to be met
5. Lifting at least 20 million people out of the risk of poverty and social exclusion	0.45 million increase (compared to the 2008 base year)	1.7 million increase (compared to the 2008 base year, 2015)	Target unlikely to be met

Sources: European Commission; European Environment Agency.