EUROPEAN
COMMISSION

Brussels, 26.2.2020
COM(2020) 150 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP

2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176(2011)

{SWD(2020) 500-527 final}

1. INTRODUCTION

Europe is serious about leading the way towards competitive sustainability. Europe's prosperity and the well-being of its people ultimately depend on the policy actions taken in the coming years to address the long-term challenges transforming our economy and society.

The 2020 Annual Sustainable Growth Strategy has presented a new economic agenda and has set clear priorities for the coordination of economic and employment policies in the EU. Its aim of competitive sustainability fully reflects the ambition of the European Green Deal and rests on four dimensions: environmental sustainability, productivity gains, fairness and macroeconomic stability. An approach centred on these four dimensions allows exploiting synergies, addressing trade-offs and presenting solutions to ensure the economy works for people and the planet. The assessment presented in today's country reports will help to ensure the translation of these objectives into concrete policies at Member States' level.

Building the foundation of our future prosperity also provides responses to short-term challenges and the current slowdown in economic growth. The current low-growth environment underscores the importance of structural reforms that will enhance our potential growth and make our economies more productive. The European economy has the capacity to mobilise the financial resources to enable the necessary private and public investments in a sustainable manner. While debt reduction should be prioritised in high-debt Member States, those Member States in a favourable fiscal position have scope to further boost investment to raise economic growth and support the transition towards a greener and digital economy. Finally, a continued reduction of macroeconomic imbalances, both external and internal, will enhance the resilience of our economies.

We can only be successful as a continent if the Union and its Member States steer their policies in a single direction, putting sustainable development at the heart of our economic policy and actions. Translating the new economic agenda into effective national economic, social and fiscal policies across the Union will help Europe to achieve the United Nations Sustainable Development Goals. This will allow Europe to set a global example for how decisive policy action can lead to a more sustainable, prosperous, fair and secure future for all.

2. KEY NEW FEATURES IN THE EUROPEAN SEMESTER

To be successful, the new economic agenda needs to be turned into concrete policies, such as investment strategies, responsible fiscal policies and structural reforms that advance competitive sustainability in all its dimensions. The European Semester has a key role to play by coordinating and steering national efforts in the direction of long-term sustainable and inclusive growth. The country reports published today present a thorough analysis of the key socio-economic challenges of macro-economic relevance each Member State faces around the four dimensions of competitive sustainability. They will inform future policy recommendations, staying focused on the economic and employment policies needed to tackle the challenges within the four dimensions.

The 2020 country reports emphasise the challenges and opportunities for our economies arising from the green transition. These questions are analysed in a new section on environmental sustainability. Member States recently had to submit their National Energy and Climate Plans which will be key reference documents for implementing climate and energy policies in the Member States, including elements of macro-economic relevance that are monitored in the European Semester. The Commission will assess these plans in 2020. The country reports also contribute to the monitoring of the Sustainable Development Goals and bring attention to macro-economic and employment policies that can help to deliver them. Each country report includes a summary assessment of Member State progress relative to the SDGs overall as well as a dedicated annex setting out the performance with respect to the various specific goals.

The reports also zoom in on those regions and sectors most challenged by the transition towards climate neutrality. Based on this analysis, they will guide the use of the newly proposed Just Transition Fund. This is just the beginning. More work is needed and will be developed together with Member States, in line with the approach used for the programming of cohesion policy funds.

To successfully address the pressing socio-economic and environmental challenges of today and tomorrow, the European Semester of economic policy coordination will have to further evolve. In the coming years, work will need to continue to ensure that the various dimensions of the sustainable development agenda with macro-economic relevance are well integrated in the European Semester (see Box 1).

Box 1: Integrating the Sustainable Development Goals (SDGs) and environmental sustainability considerations in the European Semester

- **In line with the legal scope of the European Semester, the integration of SDGs focuses on their macro-economic dimension** and on how they can be achieved through economic, employment and social policies. The transformation to a sustainable economy is a defining challenge with implications for growth and jobs. Consequently, this macro-economic dimension takes a broader perspective and SDG-relevant policies and challenges are identified across the country reports in line with the Green Deal and the Annual Sustainable Growth Strategy. It does it consistently with the European Pillar of Social Rights, which is a compass for renewed convergence towards better working and living conditions in the EU and its Social Scoreboard, which monitors its implementation.

- **In line with the Green Deal and the Annual Sustainable Growth Strategy, environmental sustainability is being fully integrated in the Semester process.** The 2020 country reports reflect this new approach via a new dedicated section. This further contributes to the integration of the SDGs in the Semester. The new section on environmental sustainability provides a more comprehensive analysis of Member States' environmental and climate-related challenges, with a focus on those areas that interlink with economic and employment policies, including the social impact of these challenges and policies.

- **Each country report also includes a new annex setting out the individual Member State's SDG performance and the trend over the past five years.** Building on Eurostat's annual flagship publication on sustainable development (*Monitoring report on progress towards the SDGs in an EU context — 2019 edition*), the country reports reference available statistics to track Member States performance.

- **Going forward, further in-depth analysis to monitor the implementation of the SDGs and capture the transition to a climate-neutral and resource-efficient economy will be developed.** As a first step, the publication of Eurostat's annual flagship publication on SDG performance will be advanced in time to be ready at the outset of the next European Semester cycle The SDG-relevant information, which the Member States are invited to provide in their national reform programmes as of 2020, will complement this assessment of progress. The Commission is also working on expanding its toolkit to improve the analysis of the macroeconomic and social implications of the ecological transition in future Semester cycles. To this effect, a set of key indicators is being developed with the aim of being applied as of the next Semester cycle. The Commission will work closely with Member States and other stakeholders in its development.

The Commission has also launched an open debate on the economic governance framework. The economic governance review recently published[1] by the Commission assesses how the current framework has worked in the past. It also takes into account that the economic context has materially changed since the six- and two-pack reforms were adopted in 2011 and 2013 respectively as well as the broader ambition for a green and digital transformation of Europe, in line with the objectives of the European Green Deal. This has led the Commission to raise a number of issues for public debate to gather views on the functioning of surveillance so far and the possible ways to enhance the effectiveness of the framework in delivering on key objectives.

In future cycles, the European Semester will be affected by the establishment of the Budgetary Instrument for Convergence and Competitiveness and the Convergence and Reform Instrument. For instance, the strategic policy priorities put forward by the euro area recommendation will be strengthened by the reforms and investments incentivised by the Budgetary Instrument for Convergence and Competitiveness.

The Commission will also set up a new rule of law mechanism, with an EU-wide scope annual reporting aimed at strengthening the rule of law culture. Good governance, effective institutions, independent and efficient justice systems, quality public administrations, effective insolvency frameworks, are important determinants of a Member State's business environment and can have an impact on investment decisions. Robust anti-corruption frameworks can also help to preserve the proper functioning of the internal market. Insights into the institutional and administrative performance of the Member States, including those related to the rule of law, which could create macroeconomic risks if unresolved, will therefore continue feeding into the European Semester and inform the macroeconomic assessment.

[1] COM (2020) 55 final, 5.2.2020.

3. MEMBER STATES POLICIES

The analysis provided in this year's country reports sets out the path for Member States to deliver on competitive sustainability and points towards the required structural reforms and important investments needs.

3.1 Environmental sustainability

The European Green Deal aims to make Europe the first continent to become climate neutral by 2050, with more resource-efficient growth. It outlines a comprehensive approach across all environmental and climate issues – addressing in particular challenges in the area of climate change, energy transition, biodiversity, pollution and circular economy – and across sectors, including mobility, industry and food systems. The ambition rests on both the EU and the Member States. National and EU economic policies need to internalise the environmental impact of existing production and consumption models and create the proper incentives to improve their sustainability. In June 2019[2], the Commission pointed out the remaining gaps between the combined proposed national contributions based on draft plans submitted by Member States, and the EU-wide targets set by legislation[3].

The green transition will require significant and targeted investment, both public and private, as well as deep structural reforms. Identifying key investment needs, preparing high impact investment projects and matching the projects with available sources of finance, and accompanying the projects with the right regulatory approach, will be key to deliver on this objective. The analysis presented in the country reports on structural reforms and the most significant investments needs, in areas such as energy, transport and buildings, including energy efficiency, can guide Member States' policy actions in line with the priorities agreed at EU level. The country reports also contain information on sources of funding at EU level.

Public financial support, including through the European Green Deal Investment Plan, can leverage private funds to scale up sustainable investment volumes. A greater share of spending on sustainable energy, climate and environmental action from the EU budget than ever before will crowd in private funding, with a key role for the European Investment Bank. The political agreement in December between the European Parliament and the Council on an

2 Commission's EU-wide assessment of the draft integrated national energy and climate plans, 18 June 2019, (COM(2019) 285 final).

3 The assessment showed that national plans, if implemented as foreseen in those drafts, would result in a substantial gap on aggregate: for both primary and final energy consumption, the contribution towards more efficient energy consumption fell short of the EU's targets. The Commission called on Member States to close those gaps in ambition in their final integrated National Energy and Climate plans, which the Member States were due to submit by 31 December 2019. To the extent possible, the content of the plans is already reflected in today's country reports.

EU-wide classification system for environmentally sustainable investments, or taxonomy, is an important step towards tackling climate change by enabling green investments to flow[4].

Green budgeting practices are an important tool to monitor the contribution of public finances to the European Green Deal. The explicit identification of expenditure and revenue policies in budgetary documents that contribute to climate action and other environmental goals can help fiscal policies to contribute to the green transition and increase coherence of policy goals and their monitoring. So far, only a few Member States (France, Finland, Ireland, and Italy) implement some green budgeting techniques in the framework of their budgetary processes. The approaches vary significantly and, apart from Italy, green budgeting practices are recent. In some cases the green budgeting information includes additional reporting elements, such as environmental impact assessments, a list of harmful subsidies, and information on greenhouse gas emissions and wellbeing indicators. Further development in all Member States would be necessary to strengthen the role of public finances in the transition to a climate-neutral, green, competitive and inclusive economy. The Commission will work with the Member States to screen and benchmark green budgeting practices.

The use of green taxation as a tool to change behaviour and generate revenue remains modest. Environmental taxes, as well as different forms of carbon pricing, are important policy instruments to achieve the required transition. A significant price on carbon dioxide emissions has been a key feature of Swedish climate policy since 2001[5] and now covers about 40% of Swedish greenhouse gas emission, helping Sweden to reduce greenhouse gas emissions in sectors not covered by the EU Emissions Trading System, while keeping the economy growing. Other Member States, including Ireland, Denmark, France, Finland, Slovenia, Estonia, Latvia, Poland and Portugal also apply a carbon tax. In Ireland all revenues from a recent price increase in the carbon tax (around EUR 90 million in 2020) will be fully allocated to climate-related spending. Part of them (EUR 6 million) will be used to establishing an Irish 'Just Transition Fund' for the Midlands – covering investment in retraining and reskilling and helping local communities and businesses to adjust to the low carbon transition.

The transition to a sustainable and climate-neutral economy needs to be fair and socially just, which requires regular monitoring. While fighting climate change and environmental degradation will benefit all in the long term, and provide opportunities for all in the medium term, not all population groups, regions and Member States have the same capacity to respond in the short term. Measures taken at national level are essential to mitigating negative impacts on specific groups and sectors and ensuring fairness. The EU budget will also provide a substantial contribution through all instruments directly relevant to the green transition. The Just Transition Mechanism, proposed by the Commission, will help ensure that no one is left behind, by providing additional support to regions and people most affected by the transition,

4 Commission's Action Plan: Financing Sustainable Growth (COM/2018/097 final)

5 Sweden introduced a carbon tax of SEK 250 (some EUR 23.50) per tonne. This has reached SEK 1,180 (some EUR 110) in 2017

especially those relying on solid fossil fuel extraction and use for energy purposes (coal, lignite, peat, oil shale) and greenhouse gas-intensive industries. Today's country reports include an analysis of the transition challenges and present the Commission services' preliminary views on the priorities for support by the Just Transition Fund. This will provide input for Member States when preparing their territorial Just Transition Plans that will identify eligible territories, detailing needs for economic diversification, employment creation, skills utilisation, local-based innovation and environmental rehabilitation as appropriate. The Commission will provide dedicated technical support to Member States for the drafting of the Transition Plans. Those plans will be drawn up by the Member States in dialogue with the Commission and will be consistent with their National Energy and Climate Plans (NECP).

3.2 Productivity growth

Productivity growth remains a challenge, even more so in the light of demographic change. Labour productivity growth continues to slow down, with considerable differences across and within Member States. In 2018, labour productivity growth ranged from 6% in Poland to -1.1% in Luxembourg. Differences are even more pronounced at regional level and productivity growth has been higher, on average, among bigger firms than SMEs.

There are multiple causes for this weak performance. An important factor relates to the availability and quality of production inputs. Insufficient investment in capital equipment, and in education and training, relatively obsolete production technologies, the ageing of the labour force, insufficient labour market integration of women and people with a migrant background and skills shortages or mismatches are holding back potential growth. For instance, in Czechia, the employment rate has reached 80% and labour shortages have become a serious matter of concern. In Bulgaria, a significant share of the investment effort aims at replacing machinery and equipment, which are well below state-of-the-art levels. Moreover, new technologies are only slowing reaching other firms than those in the technological frontier, stalling the overall efficiency of most firms, particularly SMEs.

The green and digital transformations offer challenges but also opportunities for Europe's economy to grow, for its companies to develop new business models and better products and services. Currently the digital transformation of Europe's economy is hampered by a low performance in many Member States on key framework conditions. There are a number of conditions that determine the robustness and sustainability of the digital economy eco-system. These include digital skills and infrastructure, funding for innovation, the availability of data, cybersecurity and public services fit for the digital age. For example, Germany, Greece, Hungary, Romania and Italy lag behind in the e-Government domain while Portugal and Czechia improved considerably. In digital skills, large economies like France, Spain, Poland and Italy are not improving at the pace technological change requires. Only Denmark and Sweden have a strong digital intensity levels in their enterprises, while the rest of Member States do not reach 10% of their companies with high levels of digitisation in their

companies. To complement efforts at national levels, the Commission has set out a vision of a digital society that works for all.

Innovation and new technologies are critical to achieve the objectives of the European Green Deal. The EU's share in the worldwide investment in R&D is diminishing. China has now overtaken the EU both in relative and absolute terms. In fact, in 2019, the Council asked all Member States in its country-specific recommendations to address aspects related to research and innovation. Boosting productivity, in order to achieve competitive sustainability, will not be possible without research and innovation playing a key role in the transformation of Europe's socio-economic systems, including by taking measures to further integrate the Single Market for goods and services. The upcoming new Industrial Strategy for Europe will help to create the environment for such innovation. A new initiative to take the European Research Area to the next level will also be an important contributor. The transition to a climate-neutral economy will require new production and consumption models driven by technological and social innovations. Increasing resource productivity as well as ensuring well-functioning European research and innovation systems are key in this respect.

Stimulating private research and innovation is a key challenge in Europe. In several Member States, R&D efforts are increasingly concentrated in a limited number of firms while innovation expenditure in SMEs declines. This trend contributes to widening the productivity gap between technology leaders and most other firms. Country reports show that Member States have a role to play. For instance, in Sweden, a good technology base and business environment have allowed a start-up to scale up, with the support from the European Fund for Strategic Investments, in order to become one of the first European producers of batteries for electric cars. In Czechia, investments in the automation of carmakers have increased their productivity ushering the adoption of advanced digital technologies. Unfortunately, improvements of business environments are slow, in particular, for access to sufficient R&D and innovation financing. The establishment of the Capital Markets Union can greatly facilitate the access of innovative firms to external financing. Ways to improve SMEs' access to finance will also be addressed in the Commission's upcoming SME strategy.

Significant divergence among Member States impedes Europe's economy from achieving its full potential for digital services. Member States differ significantly in their progress towards digitalising their economies**.** This may prompt commercial and industrial users to delay the roll-out and uptake of digital technologies. Widespread deployment of 5G networks should be pursued without delay as it will help Europe to seize the opportunities offered by the green and digital revolutions [6].

Productivity growth relies strongly on human capital. This requires high quality education and training systems, including vocational education, that equip all learners with key

[6] National processes for assigning spectrum in the 5G pioneer bands are expected to be finalised in a number of Member States, in view of the legal obligation to allow the use of these bands by the end of the year.

competences and the professional skills needed in a rapidly changing labour market. Yet, the persistently high share of underachievers in basic skills, highlighted in the most recent PISA results, is an important bottleneck for skills development and later employability. In its country-specific recommendations, the Council has repeatedly asked Member States to increase investment in skills to meet the demands of qualified labour.

Policies to foster productivity need to be tailored to national circumstances and National Productivity Boards can bring in such country-specific knowledge. A large number of the existing Productivity Boards has been appointed only recently and it is, therefore, too early to provide a comprehensive assessment of their impact. It is encouraging to see that National Productivity Boards are already established in a majority of euro area Member States and the number of Boards is steadily growing. Fourteen euro-area and four non-euro area Member States have now set up their own Productivity Board.

3.3 Fairness

The green and digital transitions and demographic change will require reforms of social protection systems and labour markets while ensuring fair working conditions and adequate social protection. These reforms are needed to ensure that Europe remains the home of the world's most advanced welfare systems, investing in its human capital and supporting innovation and competitive entrepreneurship. The Just Transition Mechanism, together with the European Social Fund Plus, will be key in ensuring that no one is left behind.

The European Pillar of Social Rights[7] is the European answer to those fundamental ambitions. Delivering on the Pillar – our strategy to ensure the transitions are just and socially fair – is all the more important against the backdrop of prospects of a prolonged period of slower growth in the EU, even if the employment and social situation has continued to improve, as indicated by the social scoreboard[8].

The Commission recently set out the road towards an Action Plan to implement the European Pillar of Social Rights[9] and started a first-stage consultation of social partners on fair minimum wages[10]. While there is no one-size fits all, social justice and social progress are foundations of the European social market economy. In 2019, minimum wages increased in almost all Member States that have national statutory levels; Italy and Cyprus are discussing proposals to introduce a statutory minimum wage by law. Despite the moderate wage growth in recent decades in some Member States, the situation of low-wage workers has worsened and wage inequalities have increased. About one in six workers in the EU earns a

7 Inter-institutional Proclamation on the European Pillar of Social Rights (2017/C 428/09).

8 See the Commission's proposal for a Joint Employment Report 2020 (COM/2019/653 final).

9 A strong social Europe for just Transitions (COM/2020/14 final).

10 First phase consultation of Social Partners under Article 154 TFEU on a possible action addressing the challenges related to fair minimum wages (C(2020) 83 final).

low wage. This share has been on a rising trend[11]. In-work poverty has also increased from 8.1% to 9.6% between 2005 and 2018.

Unemployment levels continue to differ considerably across Member States. Labour market segmentation is a challenge in several Member States, often associated with negative consequences on working conditions and feelings of insecurity. Workers with a temporary contract experience much higher risk of poverty than those with a permanent job (16.2% vs 6.1% in 2018). Some groups, such as young people, the low skilled, people with disabilities and people with a migrant background, also remain at a disadvantage in the labour market.

A number of Member States are taking actions to improve their working conditions and promote the labour market integration of vulnerable groups. For instance, following agreement among social partners, Portugal adopted measures to tackle labour market segmentation and promote permanent employment. Slovenia took measures to foster activation and improve the social security of unemployed people. Cyprus reformed its labour inspectorate and adopted an action plan with the aim to fight undeclared work and bring it to the formal economy, including preventive measures on top of deterring ones.

Over recent years, the employment and pay gaps between men and women remained stable at a high level[12]. Women continue to experience lower employment rates, to work fewer hours, to earn less and to have more discontinuous careers. This also has a negative impact on their pension entitlements. Spain introduced parental leave of 16 weeks for each parent. It will replace the maternity and paternity leaves as of 2021. In Ireland, the 2020 Budget is to finance, among others, a programme to help women who are inactive due to care responsibilities get back into the workforce. In most Member States, parenthood has a negative impact on employment rates of women, while the opposite occurs for men. Several Member states are taking action to improve access to affordable and quality care services, but challenges persist.

Investment in education and skills is crucial to adapt to structural changes, especially those of the green and digital transitions and of demographic change. Equal access to high-quality education and training from an early age is also essential to promote equality of opportunities and to foster inclusion, including of underrepresented groups such as Roma, people with a migrant background and persons with disabilities. Yet, socio-economic background is still the most important determinant of young peoples' education outcomes. Several Member States are implementing measures to increase the inclusiveness of education and training and to modernise research institutions. Slovenia introduced measures amongst others to reinforce adult learning, and in Ireland, the review of the National Training fund was combined with additional funding to reinforce the assessment of skills gaps[13]. Finland put

[11] It rose on average in the EU from 16.7% to 17.2% between 2006 and 2014, with significant increases in some countries.

[12] The Commission will adopt a Gender Equality Strategy in March 2020 and address the pay gap by way of a legislative proposal on pay transparency later in 2020.

[13] The Commission will present the "Skills Agenda" in March 2020 with targets and initiatives to address the challenges posed by the twin transitions.

forward a continuous learning reform starting in 2020, which will increase the chances to combine work and studies in a flexible manner and support learning at the work place.

Poverty and social exclusion continue declining on the back of good labour market conditions. Still, income inequality has increased in recent years and stabilised at historically high levels, which risks limiting growth and threatening social cohesion. In a rapidly changing world of work, adequate social protection needs to be ensured for all. Last year, Ireland extended invalidity and unemployment benefits to the self-employed. Italy introduced a regulatory framework for working conditions and social protection for workers on digital platforms, introducing a minimum standard of protection. In a context of demographic change, ensuring equal access to quality healthcare, as well as strengthening long-term care, will be increasingly important. A number of Member States are seeking ways to reinforce prevention services and foster accessible, efficient and cost-effective care provision.

Reforming tax and benefits systems can contribute to sustainable and inclusive growth. Rebalancing the tax structure, for instance by moving the tax burden away from labour to less distortive taxes, such as environmental taxes, can boost economic growth, encourage employment, reduce inequalities and contribute to an environmentally sustainable economy. Several Member States continue reforming the tax system and in particular reducing labour taxation. France, Italy, Netherlands, Greece and Slovenia are lowering the tax burden on labour by reducing personal income taxes or social security contributions. Several of these labour tax reductions are financed by relying more on less detrimental taxes.

Progress in reforming health care and long-term care systems varies among the Member States. A fiscally sustainable, efficient, affordable and accessible provision of quality health care services contribute to preserving and restoring good health for all, thereby contributing to a productive and resilient work force. Moreover, there is scope for improvement in providing fiscally sustainable, efficient and adequate long-term care. For a number of Member States, the country-specific recommendations identified healthcare and/or long-term care systems as requiring particular attention. Cyprus, Lithuania, Latvia, Slovakia have made some progress in addressing the recommendations. Only limited progress has been made for Belgium, Bulgaria, Ireland, Hungary, Malta, Austria, Portugal, Romania and Finland and no progress in the case of Czechia and Slovenia.

Social dialogue plays a key role in the successful design and implementation of reforms. Collective bargaining, as well as a broader involvement of social partners and civil society, is particularly important at a moment when policy makers are developing comprehensive strategies to achieve a fair and just green and digital transition and to cope with demographic change. In particular, over the past years, there has been some progress in social partners' participation in policymaking in Estonia, Latvia, Portugal, Slovenia and Spain.

3.4 Economic stability

In the current low interest rate environment, Member States continue to have very different positions in terms of debt and sustainability challenges. Government deficits in the EU have, on average, started rising again, reversing the declining trend of recent years.

National fiscal policies remain insufficiently differentiated. Current high levels of public debt are a source of vulnerability in some Member States and a constraint on governments delivering macroeconomic stabilisation when needed. In Italy, Belgium, Spain and France debt ratios have not declined, in spite of the supportive economic and financing conditions over recent years. Member States with high levels of public debt should make swift process to reduce debt, while re-prioritising expenditure to provide room for additional investment. This should create space for counter-cyclical fiscal policy in case of a downturn. On the other hand, further boosting investment and other productive spending in Member States with a favourable budgetary situation would support growth in the short and medium term, while also helping to rebalance the euro area economy. Some Member States with ample fiscal space are now using some of it. Specifically, the Netherlands and Germany plan to increase investment with the view to raise economic growth, adding additional support to the transition towards a greener economy.

Well-designed and well-functioning national fiscal frameworks are a cornerstone of sound public finances in the EU. Member States have strengthened their national fiscal frameworks over recent years, in particular in response to Union law requirements and recommendations. For instance, Lithuania and Poland have continued to reform their budgetary processes to improve expenditure management. Hungary streamlined the national system of numerical fiscal rules and harmonised the calculation of debt ratios. In several Member States, reflections take place how to improve further the framework, as in France, where the National Assembly made recommendations related to the design of the medium-term budgetary framework. Nevertheless, there is still scope to improve the design of the frameworks, as also recommended by the European Court of Auditors[14].

Member States are still struggling to get back to their pre-crisis public investment levels. The majority of Member States displayed a more growth-friendly budget composition before or at the onset of the crisis. In particular, public investment spending remains at historically low levels and the ratio of public investment to GDP is projected to increase only marginally, especially in the euro area. Increasing the growth potential requires structural reforms to enhance sustainable growth and investment in tangible and intangible capital to increase productivity. This would be particularly important for those Member States whose growth potential is clearly lower than the euro area average. Notwithstanding the weakness in foreign trade and heightened uncertainty about trade policies, the current account of the European Union will remain in surplus. This means that Europe generates ample savings to finance its economic transformation provided that those savings are appropriately channelled to the right investment in the Member States.

Spending reviews are becoming regular exercises across the EU and can be an important tool to improve the quality of public finances. Some are conducted on an annual basis (e.g. in Germany), others span over a multi-year horizon (e.g. in Finland, France, Ireland and Portugal). They also differ in scope of expenditure. Some reviews are comprehensive

14 European Court of Auditors (2019), "EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application". Special Report 22/2019.

while others target key sectoral policies such as education and healthcare (e.g. in Latvia, Lithuania and Slovakia) or very specific items (police force in Malta, business incentives in Germany and government subsidies in Spain). While some reviews have yielded savings, outcomes in terms of efficiency gains are not always clear. The production of regular and independent evaluations, improved links with budgetary planning and expanding the coverage to subnational spending can help enhance the usefulness of spending reviews. Increasing competition in public procurement can also contribute to improving the quality of public expenditure.

Fighting tax evasion and aggressive tax planning is essential to maintain sound public finances and avoid distortion of competition between firms and between Member States. Certain features of some Member States' tax systems (i.e. Ireland, Cyprus, Luxembourg, Hungary, Malta and the Netherlands), may be used by companies that engage in aggressive tax planning. Aggressive tax planning practices in one Member State, have spillover effects, both on other companies and on other Member States, including tax revenue losses and distortions of the playing field among companies. Member States, whose tax base is eroded, have to raise revenue from other taxes or have lower revenues for growth-enhancing reforms, redistribution and investment.

Demographic change and high government debt pose significant challenges for ensuring the quality and sustainability of public finances. In a medium- to long-term perspective, more than half of the Member States face either medium or high sustainability risks. For several countries, risks are due to a significant projected stock of public debt, in particular in Belgium, Spain, France, Italy, and Portugal. Moreover, challenges are related to the projected increases in age-related public spending. In some cases, sustainability-enhancing pension reforms have been reversed, adding to the future fiscal challenge in Italy and Romania. Progress in reforming pension systems was muted among the Member States for which the Council adopted pension-related country-specific recommendations in 2019.Policy challenges thus remain for Belgium, Czechia, Germany, Ireland, Spain, France, Italy, Luxembourg, Malta, Austria, Poland, Romania, Slovenia and Slovakia.

Banking sector resilience strengthened in 2019, supported by the economic conditions and the measures to mitigate remaining challenges. Overall, banking sector capitalisation has remained solid, with the average solvency ratio at EU level reaching 18.8% in the second quarter of 2019. The need to adapt banks' business models, the low-interest-rate environment and increasing competition from other forms of finance is a challenge for many Member States that continues to exert pressure on banks' competitiveness and profitability(e.g. Greece, Germany, Ireland, Portugal and Luxembourg). .The process of balance sheet repair has further advanced, as the stock of legacy non-performing loans has continued to decline. The non-performing loans ratio at EU level decreased to 2.9% in the second quarter of 2019), down by a half percentage point, compared to one year earlier. While asset quality has strengthened in all Member States, in particular in those Member States with the highest ratio of non-performing loans, the ratio is still above 7% in Greece, Cyprus, Portugal, Italy, Bulgaria and Croatia. Diversifying income sources to further support banks profitability has remained challenging, in particular for smaller credit institutions.

The fight against money laundering and terrorist financing is essential to protect the integrity of the EU economic and financial system. Weaknesses in the application of the anti-money laundering framework across the EU can be exploited to launder the proceeds of illicit activities. Member States where legislation is not up to speed with EU standards, supervision is not sufficient, financial intelligence is underused and prosecutions are limited represent weak links within the EU framework. Recent money laundering scandals have shown the importance of strict application of the rules.

4. ADDRESSING MACROECONOMIC IMBALANCES

Macroeconomic imbalances can adversely affect the economy of a particular Member State, the euro area, or the Union as a whole[15]. The Macroeconomic Imbalances Procedure aims at detecting and preventing their emergence at an early stage to ensure that the Member States concerned take appropriate action to correct them.

The 2019 Alert Mechanism Report identified 13 Member States for an in-depth review to assess whether they are or may be at risk of being affected by imbalances.[16] Those 13 countries are the same as already identified a year ago as experiencing imbalances or excessive imbalances. The results of this cycle's in-depth reviews are included in the country reports for the Member States concerned. The analysis looks at the gravity of the imbalances, their evolution and policy responses. Relevant spillovers and systemic cross-border implications of imbalances are also taken into account.

4.1. Progress with correcting the macroeconomic imbalances in the EU and the euro area

Macroeconomic imbalances have been gradually correcting amid favourable economic conditions. Following a widespread post-crisis deleveraging process, a number of imbalances and unsustainable trends have been corrected, notably large current account deficits, excessive credit growth fuelling house prices and, generally, strong unit labour costs implying cost competitiveness losses. However, despite progress with deleveraging, private, public, and external debt stocks remain at high levels and take more time to be corrected. In addition, pockets of vulnerabilities in the financial sector persist in some cases.

The rebalancing of external positions remains incomplete. Only few Member States currently have a current account deficit, but a number of Member States with large stocks of external debt need to maintain prudent current account positions and avoid competiveness losses. At the same time, large current account surpluses have persisted in some Member States (e.g. Germany, Netherlands), causing the euro area to register a surplus of 3.3% of GDP. This means that over recent years, the European economies have consistently generated more savings than investments, and accumulated assets vis-a-vis the rest of the world. Weak export demand has recently contributed to some narrowing of current account surpluses, and

15 Article 2 of Regulation (EU) No 1176/2011.

16 COM(2019) 651 final.

to the widening of current account deficits in some cases. In the current context, rebalancing of both current account deficits and surpluses could help overcome the low-inflation, low-interest-rate environment, and to reduce the dependency on foreign demand. In many net-debtor countries, reforms to boost competitiveness and reduce external debt are needed. In net-creditor countries, the window for financing further public and private investment at low interest rates should be seized. Strengthening the conditions that support wage growth would also contribute to rebalancing.

The resilience of the EU banking sector has improved, but some challenges remain. Capitalisation ratios have stopped growing from levels above regulatory standards. Profitability in the banking sector has improved considerably over past years. Non-performing loans ratios have recorded a major reduction over recent years, notably in countries that accumulated large stocks of non-performing loans in past years (e.g., Cyprus, Italy, Portugal). Nonetheless, challenges remain in a number of Member States still characterised by relatively low capitalisation and profitability and high non-performing loans ratios. The outlook of low-for-long interest rates and weakening economic growth is adding to those challenges.

House prices continue displaying sustained growth rates, with decelerations observed in Member States where evidence of overvaluation is stronger. In a growing number of countries, house prices are above peaks recorded since the mid-2000s, and are possibly overvalued. However, the growth in house prices has recently moderated where the strongest growth in house prices was recorded in some EU countries that so far have shown only limited evidence of overvaluation (e.g., Hungary, Ireland, Portugal).In contrast, prices often decelerated in countries where overvaluation concerns are stronger and household debt is high, including Sweden. In some countries, strong growth rates of house price growth are accompanied by a sustained growth of new mortgage credit.

Cost competitiveness conditions are becoming less favourable in a number of Member States. Unit labour costs have been growing at a fast pace in some Member States due to high wage and low productivity growth. In some central and eastern European and Baltic countries, continuously strong growth in unit labour costs reflects tight labour markets and skill gaps. In the euro area, while unit labour cost growth has been higher in many net-creditor countries than in net-debtor ones, this difference in growth rates is narrowing since 2016, becoming therefore less supportive of symmetric rebalancing.

4.2. Implementing the macroeconomic imbalances procedure

Imbalances or excessive imbalances have been identified in 12 out of the 13 Member States for which an in-depth review was carried out, with the gravity of imbalances narrowing in a number of cases. The 2020 in-depth reviews have found that 9 Member States are experiencing *imbalances* and that 3 are experiencing *excessive imbalances*. One Member State identified with imbalances last year has reached sufficient progress in economic outcomes and policy response so that an exit from the MIP appears justified. In most other Member States, some progress was recorded in correcting macroeconomic imbalances. At this stage, this did not justify a revision of their status from the viewpoint of

the identification and assessment of their imbalances. Appendix 3 summarises the findings from the in-depth reviews by Member State.

Bulgaria, identified with *imbalances* in 2019, is found to experience *no imbalances*. Important progress has been made in strengthening financial sector governance and addressing outstanding regulatory issues. Moreover, corporate debt has fallen and the non-performing loans (NPL) ratio has declined, although it remains elevated among corporates.[17]

In most other Member States identified with imbalances in 2019, vulnerabilities have continued to gradually moderate, but challenges remain on the economic and policy outlook:

- In **Germany** and the **Netherlands**, despite some correction and amidst some policy progress, large current account surpluses persist. **Spain**, **Portugal, Ireland** and **Croatia** are characterised by a combination of vulnerabilities linked to high private, government and foreign debt. These stock imbalances started receding with the recovery, particularly in Ireland, where determined policy action was taken. Policy action stalled somewhat in Croatia and Spain. In **France**, government debt is not yet declining and, despite some policy progress, productivity growth remains subdued. In **Sweden,** notwithstanding the recent correction, house prices remain at historically high levels, while household debt keeps growing; despite progress, policy gaps remain. In **Romania**, vulnerabilities linked to cost competitiveness losses and a widening current account deficit persist in context of a strongly expansionary fiscal policy, and would aggravate if current trends are not reversed.

- Cyprus, Greece and Italy are identified, as in 2019, to be experiencing **excessive imbalances**. In **Cyprus** significant vulnerabilities remain, despite progress in past years. NPLs were reduced considerably in 2018 and progress since then is taking place at lower pace. Government and private debt are declining and are set to further fall. However, the current account deficit widened in a context of an already highly negative net international investment position. Policy progress is mixed, with some reform commitments still pending. In **Greece** very significant vulnerabilities remain, relating to government debt, NPLs and the external sector, in a context of still low growth potential and high unemployment. Progress is however visible in a number of areas. Policy commitments monitored under the enhanced surveillance programme are broadly on track. In **Italy,** government debt to GDP ratio is still on the rise, although government plans are becoming more conducive to debt reduction. Potential growth, albeit improving, remains insufficient to ensure a fast reduction of debt. Action to implement the reform agenda has resumed. In all three Member States, sustained reform efforts are needed to rebalance the economy. They will be closely monitored by the Commission.

[17] The commitments of Bulgaria in the context of the ERM II participation will be assessed by the Commission and the ECB in their respective areas of competence in due course.

The Commission will continue reviewing developments and policy measures taken by all Member States with imbalances or excessive imbalances in the framework of specific monitoring. The Council participates in those reviews and has supported the conclusions of the specific monitoring reports.[18]

5. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS AND PROGRAMMING OF COHESION POLICY FUNDS

While Member States continued to make progress with the implementation of the country-specific recommendations, the level of reform implementation differed across Member States. From a multiannual perspective, the level of implementation has remained broadly stable over the past years. In particular, Member States have made at least some progress with the implementation of more than two-thirds of all the country-specific recommendations since the start of the European Semester in 2011. In terms of policy areas, Member States have made most progress in financial services, followed by progress with legislation, governing labour law and employment protection. At the same time, progress has been particularly slow on broadening the tax base, and on reforming health and long-term care.

Amid the high uncertainty surrounding the economic outlook, timely and effective implementation of reforms that boost growth potential is key to address the economy's longer-term challenges. As regards the Council recommendations adopted in 2019, reform implementation has been strong in financial services and active labour market policies. Nonetheless, it has remained low in addressing recommendations, such as competition in services and long-term sustainability of public finances. The Commission has taken measures to ensure that the assessment process of implementation of the country-specific recommendations is more transparent and the multilateral review discussions on recommendations is enhanced. Overall, the uncertain economic outlook calls for reinvigorated reform implementation.

The implementation of investment-related economic policies takes time. Country-specific recommendations regarding investment-related economic policies have been issued for the first time last year. Member States have been recommended to focus their policies on specific areas, supported by national public and private resources as well as by EU funds. Progress with the implementation needs to be analysed with a long-term perspective. Member States should focus their policies on specific areas, supported by national public and private resources as well as by EU funds. On the use of EU funds, indications are positive: for the current European Structural and Investment Funds programming period (2014-2020), the Commission carried out a performance review in 2019, showing that EUR 21.4 billion of the performance reserve[19] had been released. Despite the non-discretionary character of the performance review, on average, three quarters of the cohesion policy performance reserve

[18] Council conclusions on the Alert Mechanism Report 2020, adopted on 18 February 2020 (ST 6145/20).

[19] The performance reserve, set aside in the overall ESI Funds allocation (6% of the budget or about EUR 26 billion), is released to those priorities which have achieved their 2018 milestones set in the performance framework.

amounting to EUR 15.9 billion went to areas related to the investment CSRs. For the amounts linked to programmes and priorities that did not achieve their performance milestones, the Commission services have invited the Member States to take due account of the investment CSRs in their reallocation proposals. Member States started submitting the corresponding re-programming proposals in autumn 2019 for Commission's assessment and adoption.

Box 2: State of play on the programming of cohesion policy funds

In many Member States, public investments are heavily dependent on EU funds. At the time of programming, the cohesion policy funds for the 2014-2020 programming period took into account the investment-relevant CSRs. Those CSRs are directed towards areas of strategic European importance. For the 2021-2027 cohesion policy programming, the Commission proposed to establish an even stronger link to the European Semester. In its 2019 Semester cycle, it put forward investment guidance for cohesion policy funds and proposed CSRs on investment-related policies for all Member States, which the Council adopted.

After the publication of the country reports in February 2019, events were held in all Member States in spring 2019 marking the start of the informal dialogue on programming for the 2021-2027 period. The Commission's aim is to adopt all programmes as soon as the relevant legislation is in place. In shared management, this will also depend on the Member States' readiness to prepare and discuss their draft programmes.

6. WORKING TOGETHER WITH THE MEMBER STATES AND THE EUROPEAN PARLIAMENT

Trust and cooperation between the Commission, the Council and the Member States are essential for the effectiveness of the European Semester. The Commission offers multiple opportunities to exchange views with all stakeholders, including engaging in regular meetings with social partners, civil society, the European Parliament and national Parliaments. In the case of the European Parliament, Members of the Commission stand ready to come to the European Parliament before each key stage of the European Semester cycle. Before the adoption of today's package, Members of the Commission engaged with the Parliament in meetings of the Parliament's EMPL and ECON committees. The Commission also holds regular meetings with social partners and civil society organisations both in Brussels and in Member States. Over the years, these efforts to establish an open and fruitful dialogue have helped develop an increasingly common understanding of the European and national policy challenges and responses.

In line with efforts undertaken in the past, the Commission is committed to a genuine policy dialogue with the Member States and to ensuring its policy recommendations are part of the national policy process, including by strengthening the involvement of national parliaments and social partners at national level. These exchanges take place through technical and political missions in each Member State and bilateral meetings twice a year in Brussels. In addition, national authorities are consulted on the analytical content of the country reports before their publication. As a new feature, this year the Commission has reached out to the national authorities to select a topic of common interest for deeper analysis in the country reports. Most national authorities directed their interest towards topics of relevance to the green and digital transitions and their impacts on the economy, industry and

workforce, a strong sign of alignment of interest and priorities with the new economic agenda of the Commission. The Commission also aims to help Member States step up their reform efforts through the Structural Reform Support Programme, which provides technical support to all EU Member States, at their request, to help them design and implement growth-enhancing reforms. This includes as well reform challenges highlighted in the country-specific recommendations.

7. NEXT STEPS

The European Semester offers the Commission, Member States, social partners and stakeholders the opportunity to engage in a permanent dialogue with one another throughout the year. The country reports published with this Communication draw on in-depth exchanges with governments, national authorities and stakeholders at both technical and political level, including bilateral meetings held in December 2019. Their findings will be presented in the capitals of the Member States, and will be followed up in further bilateral and multilateral meetings. Throughout the year, European Semester Officers continue their engagement with key stakeholders in Member States. Commission Vice-Presidents and Commissioners will visit Member States to seek the views of parliaments, governments, social partners and other stakeholders on the analysis and conclusions of the country reports. The Commission will also discuss the summary findings of the country reports with the European Parliament.

In the light of the challenges identified, the Member States will present their economic and social priorities in their national reform programmes by mid-April. They will also present their multiannual strategies for sound public finances, in the form of stability (for euro area Member States) and convergence (for non-euro area Member States) programmes. In their final National Energy and Climate Plans submitted under the Energy Union Governance Regulation, Member States set out how they plan to meet their energy and climate targets. To provide an appropriate and sustainable response to the challenges, the Commission recommends that those programmes would be prepared with the involvement of all key stakeholders, such as social partners, regional and local authorities, and civil society organisations as appropriate.

APPENDIX 1 INTEGRATED SURVEILLANCE OF MACROECONOMIC AND FISCAL IMBALANCES

	Macroeconomic Imbalances Procedure (MIP)[20]	Stability and Growth Pact[21] (MTO: medium term objective / EDP: excessive deficit procedure)	Comments
AT		Preventive arm Achieving MTO; subject to debt rule[22]	
BE		Preventive arm Not at MTO; subject to debt rule	
BG		Preventive arm Achieving MTO	
CY	Excessive Imbalances	Preventive arm Achieving MTO; subject to debt rule	
CZ		Preventive arm Achieving MTO	
DE	Imbalances	Preventive arm Achieving MTO	
DK		Preventive arm Achieving MTO	
EE		Preventive arm Not at MTO	
EL	Excessive Imbalances	Preventive arm Subject to transitional debt rule[23]	Since Greece was exempt from submitting Stability Programmes while it was under the programme, the assessment of year 2019 is conducted in the absence of an MTO.
IE	Imbalances	Preventive arm Not at MTO	
ES	Imbalances	Preventive arm Not at MTO; subject to transitional debt rule	
FR	Imbalances	Preventive arm Not at MTO; subject to transitional debt rule	
HR	Imbalances	Preventive arm	

[20] Both the 'imbalances' and 'excessive imbalances' categories entail specific monitoring, to be modulated depending on the severity of the challenges.

[21] The achievement of the MTO and the applicability of the (transitional) debt rule refer to 2019 based on the Commission 2019 autumn forecast.

[22] Debt rule: If the 60% reference for the debt-to-GDP ratio is not respected, the Member State concerned will be put in the Excessive Deficit Procedure, after taking into account all relevant factors and the impact of the economic cycle, if the gap between its debt ratio and the 60% reference is not reduced by 1/20th annually (on average over three years).

[23] Transitional debt rule: each Member State in the Excessive Deficit Procedure is granted a three-year period following the correction of the excessive deficit for meeting the debt rule. This does not mean that the debt rule does not apply during this period as Member States should make sufficient progress towards compliance during this transitional period. A negative assessment of progress made towards compliance with the debt benchmark during the transition period could lead to the opening of an Excessive Deficit Procedure.

		Achieving MTO; subject to debt rule	
HU		Preventive arm (SDP[24]) Not at MTO; subject to debt rule	
IT	Excessive imbalances	Preventive arm Not at MTO; subject to debt rule	
LT		Preventive arm Not at MTO	
LU		Preventive arm Achieving MTO	
LV		Preventive arm Not at MTO	
MT		Preventive arm Achieving MTO	
NL	Imbalances	Preventive arm Achieving MTO	
PL		Preventive arm Not at MTO	
PT	Imbalances	Preventive arm Not at MTO; subject to transitional debt rule	
SI		Preventive arm Not at MTO; subject to debt rule	
SE	Imbalances	Preventive arm Achieving MTO	
SK		Preventive arm Not at MTO	
RO	Imbalances	Preventive arm (SDP) Not at MTO	
FI		Preventive arm Not at MTO	
UK		Preventive arm Not at MTO; subject to transitional debt rule	

[24] The Significant Deviation Procedure aims to give Member States the opportunity to correct a deviation from their medium-term objective (MTO) or the adjustment path towards their MTO.

APPENDIX 2: PROGRESS TOWARDS EUROPE 2020 TARGETS

Europe 2020 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%	73.8% (Q3 2019)	Target unlikely to be met
2. Increasing combined public and private investment in R&D to 3% of GDP	1.93%	2.12% (2018)	Target unlikely to be met
3a. Reducing greenhouse gas emissions by at least 20% compared to 1990 levels	14.3% reduction	23% reduction (2018)	Target likely to be met
3b. Increasing the share of renewable energy in final energy consumption to 20%	12.5%	18% (2018)	Target likely to be met
3c.Moving towards a 20 % target in energy efficiency	5.7% (for primary energy consumption)	4.6% (distance to 2020 target for primary energy consumption)	Target unlikely to be met
4a. Reducing school drop-out rates to less than 10%	13.9%	10.6% (2018)	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%	40.7%	Target likely to be met
5. Lifting at least 20 million people out of the risk of poverty and social exclusion	1.4 million increase (compared to the 2008 base year)	7.1 million decrease (compared to the 2008 base year) in 2018	Target unlikely to be met

APPENDIX 3 - FINDINGS FROM IN-DEPTH-REVIEWS BY MEMBER STATE

	Outcome of 2019 IDRs	Outcome of 2020 IDRs
No imbalances	-	BG
Imbalances	BG, DE, ES, FR, HR, IE, NL, PT, RO, SE	DE, ES, FR, HR, IE, NL, PT, RO, SE
Excessive imbalances	CY, EL, IT	CY, EL, IT