
Annual Growth Survey 2019:
For a stronger Europe in the face of global uncertainty
INTRODUCTION

In 2019, Europe’s economy is set to continue expanding, providing jobs to a record number of people and lifting millions out of poverty and social exclusions. Structural reforms, investment and responsible fiscal policies implemented by the Member States, combined with decisive action at European level, including the Investment Plan for Europe, have contributed to the restored stability and greater prosperity enjoyed today in the European economy. Employment has risen to a record level of 239 million people and unemployment has fallen back to pre-crisis level, helping more than 10 million people out poverty or social exclusion over the past years.¹

Europe’s economy is now entering its sixth year of uninterrupted growth. Dispersion of growth rates across the euro area is the smallest in the history of the Economic and Monetary Union. Real convergence has resumed, with higher growth rates recorded in Member States with lower levels of GDP per capita. Robust growth and low interest rates have supported a continued decline in national government deficits, which in most cases have returned to pre-crisis levels. The investment gap brought about by the crisis is now nearly closed. After many difficult years, Greece successfully concluded its financial assistance programme, with its place at the heart of the euro area and European Union secured.

The growth of the economy, however, is not benefitting all citizens and countries in the same manner and remains vulnerable to global instability and medium to long-term challenges. The fundamentals for sustained growth in Europe are in place. Nevertheless, economic growth is projected to moderate and faces significant downside risks. Financing conditions remain supportive, but some tightening is expected as growth continues, inflation picks up and monetary policy gradually normalises. Concerns about the sustainability of public finances in countries with high debt could lead to increased financing costs across the economy, including in the banking sector. Some Member States are still experiencing high unemployment rates and household income below pre-crisis levels. Others suffer from underemployment or skill shortages. Productivity growth is subdued and diffusion of digital technologies is slow. Long-term challenges – such as population ageing, digitisation and its impacts on work, climate change and unsustainable use of natural resources – remain pressing. Additional risk factors include a faster tightening of monetary policy in the US and its potential ramifications on financial stability in emerging markets; continued geopolitical tensions impacting global trade and persisting uncertainties around the Union’s future relations with the United Kingdom.

Rising challenges and global uncertainty remind us that the current economic momentum offers an opportunity not to be missed. Renewed reform efforts, well-targeted investment and the reduction of debt levels, in line with the common European fiscal rules, are crucial to make the Union and its Member States stronger, more inclusive and resilient. Economic and fiscal policies must preserve macroeconomic stability, tackle high debt levels and create buffers against external or domestic shocks to mitigate employment and social

¹The 2019 draft Joint Employment Report accompanying the Annual Growth Survey provides a full picture of recent employment and social developments in the EU.
impacts. Investment and structural reforms need to focus even more on boosting potential growth.

A resilient and inclusive economy will allow the Union to leverage its strengths globally and champion the benefits of multilateralism and economic integration. The euro is a factor of stability and a shield in the face of growing risks to the global economic outlook. Yet, its architecture needs to be further strengthened. A fully integrated and well-functioning Single Market will also help shield Europe from future shocks and crises, while a genuine Capital Markets Union will unlock further funding for Europe’s growth. Swiftly equipping our Union with a long-term budget that reflects rapid developments in innovation, economic environment and geopolitics is also crucial to supporting structural change and make Europe stronger and more cohesive in the face of rising uncertainties, both at home and abroad. To reinforce the social dimension of the Union and foster upward convergence towards better living and working conditions, it is necessary to turn the principles proclaimed in the European Pillar of Social Rights into action, at both European and national levels.

1. FOUR YEARS ON: GROWTH, JOBS AND INVESTMENT DELIVERED

In 2014, Europe was just emerging from the worst financial and economic crisis in generations. Real economic output was only recovering to pre-crisis levels and a protracted period of low investment, along with other factors, weighed on productivity and competitiveness. High public deficits and other macroeconomic imbalances threatened the fragile recovery.

The social consequences of the crisis were deeply felt across the Union, with very high unemployment, in particular among young people, rising poverty and increasing social inequalities.

Today, Europe has largely turned the page on the economic and financial crisis. Europe's economy is now entering its sixth year of uninterrupted growth. This solid economic growth has been accompanied by a recovery in investment, stronger consumer demand, improved public finances and continued job creation, although at different pace across countries. The dispersion of growth rates among euro area

Graph 1 - GDP Growth Dispersion in the euro area (2000-2018). Source: European Commission

* Calculations since 2015 without Ireland.
countries fell to its lowest level since the start of the Monetary Union (see graph 1).²

**Microeconomic performance has also improved over recent years.** The productivity gap with the United States has stabilised and EU manufacturing production has increased considerably. Europe’s manufactured goods and services have remained attractive in the global market place, despite falling demand from emerging markets and higher oil prices. Digital connectivity across Member States has expanded by over 40 % since 2014.

On taking office, President Juncker put forward an ambitious agenda for "Jobs, Growth, Fairness and Democratic Change". Jobs, growth and investment featured right at the top of the 10 priorities presented. Since then, the three main pillars for the EU’s economic and social policy have been a coordinated boost to investment, a renewed commitment to structural reforms, and the pursuit of responsible fiscal policies. In line with the Integrated Guidelines,³ these elements have formed a virtuous triangle, which has helped reinforce the recovery and support the economic growth.

The Investment Plan for Europe has helped significantly to deliver on the promises made in 2014.⁴ It has already increased EU GDP by 0.6 % and it is set to contribute by a further 0.7 % by 2020. It has facilitated the channelling of public and private investment into projects that ensure long-term growth. Complementing national actions to improve access to finance, the Juncker Plan has boosted and diversified the availability of financial instruments during the recovery. It is estimated that its operations have already supported the creation of more than 750 000 jobs, and this figure is set to rise to 1.4 million by 2020.

Progress made towards ensuring sound fiscal policies and structural reforms was essential to reduce debt levels and stimulate the creation of more and better jobs. Under the European Semester, structural reforms have supported inclusive growth and employment,

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² Also see the 2017 Annual Report of the European Central Bank (April 2018), which also highlights how in 2017 differences in growth rates across the euro area, measured in standard deviations in gross value added, were the lowest since 1998 (1998: 1.47σ vs. 2017: 0.75σ).


⁴ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank. Investment Plan for Europe: stocktaking and next steps, COM/2018/771 final.
while facilitating the reduction of macro-economic imbalances. The mainstreaming of the European Pillar of Social Rights in the European Semester since 2018 has further supported this process. Fiscal discipline has safeguarded financial stability in many Member States. Public finances are now on a sounder footing, although in high-debt countries fiscal buffers need to be rebuilt more firmly. The quality of public spending improved, also thanks to investment recovering. Better conditions for businesses, including measures to lighten administrative burden or make the tax systems more efficient, have also been essential to create the right regulatory environment and promote a climate of entrepreneurship and job creation. Progress at national and EU level in areas like services, infrastructure, broadband, energy, transport, circular economy, labour market reforms, healthcare, education, research, training and innovation created new opportunities for jobs and growth.

All these developments promoted inclusive growth and contributed to substantial improvements in labour market and social conditions. The employment rate of people aged 20-64 rose to 73.2 % in the second quarter of 2018, the highest level ever reached in the EU (see graph 2). With the current trend, the EU is well on track to reach the Europe 2020 target of 75% in 2020. In parallel, as a result, the unemployment rate has recently dropped to 6.8 %, back to pre-crisis level. Long-term unemployment and youth unemployment are also declining. Yet they remain high in a number of Member States. On the back of improved labour market conditions, the number of people at risk of poverty or social exclusion, at 113 million people in 2017, has dropped for the first time below pre-crisis levels. Still, in-work poverty is high and rising in several Member States. The risk of poverty or social exclusion remains a challenge in particular for children, people with disabilities and people with a migrant background.

2. KEY CHALLENGES LOOKING AHEAD

Despite the progress made, external risks and challenges are increasing, requiring a stronger and united European response. From the rise of China in the global value-chain to the disruption by the US of the post-war economic order through growing trade protectionism, the EU will have to rise to the challenge of an uncertain and rapidly changing global environment.

A prosperous future depends on Europe’s ability to address persisting vulnerabilities, provide answers to longer-term challenges and withstand increasing global risks. Globalisation has supported economic growth but has not brought the same benefits to all. Some regions and sectors have struggled to make the most of market integration and
technological innovation. High levels of income inequality persist, despite supportive economic conditions.

In several Member States, sluggish reform momentum, low productivity growth and high debt levels weigh on the growth potential of the economy. Population ageing, digitisation and climate change put mounting pressure on our workforce, social welfare systems and industry, compelling us to innovate and reform to sustain high living standards.

<table>
<thead>
<tr>
<th>Box: Main risks and challenges</th>
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<tr>
<td>✓ <strong>Persisting vulnerabilities</strong>: Low productivity growth; persisting income inequality and slow reduction in poverty; regional and territorial disparities; high public and private debt and other remaining macroeconomic imbalances, notably within the euro area.</td>
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<tr>
<td>✓ <strong>Short-term challenges</strong>: Rising protectionism and geo-political tensions affecting trade relations; instability on emerging markets; skills mismatches and emerging labour shortages in some countries and sectors; migration; slow diffusion of new digital technologies; gradual withdrawal of central bank stimulus; loss of reform momentum/risk of reform reversals and aggravation of fiscal imbalances.</td>
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<td>✓ <strong>Medium/long-term challenges</strong>: Tapping the growth potential of digitisation; the impacts of technological transformations on workers and specific sectors; the impacts of demographic changes and the role of migration; mitigation of and adaptation to climate change; sustainable use of natural resources.</td>
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Macro-financial stability and sound public finances remain a precondition for sustainable growth. The implementation of structural reforms and the recreation of fiscal room for manoeuvre are mutually reinforcing in this respect: reforms that boost growth lead to lower debt levels, while the reduction of debt can create space for investment and growth. While all countries should remove bottlenecks to investment, encouraging euro area countries with large current account surpluses to invest will help with rebalancing.

**Coping with potential future shocks requires long-overdue progress in deepening the Economic and Monetary Union.** The focus needs to be on urgently completing the Banking Union – including the establishment of a backstop for the Single Resolution Fund – and creating a meaningful central stabilisation function to cope with large asymmetric shocks while keeping strong incentives for structural reforms at national level. The Commission has made several concrete proposals to achieve that – most of which now await adoption by the Parliament and Council. Global economic uncertainties are impacting business and consumer confidence as well as the economic outlook. This is raising the cost of delayed action and is strengthening the case for consolidating the international role of the euro. A strong economy will allow the EU to leverage its strengths globally, promoting multilateralism.

**Increasing protectionism and trade tensions on the world stage have also magnified the importance of a well-performing Single Market.** To mitigate these threats, it is essential to swiftly carry out pending reforms of capital and energy markets and the digital economy,

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5 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. The Single Market in a changing world. A unique asset in need of renewed political commitment, COM/2018/772 final.
undertake credible enforcement actions and continue product and service market reforms at national level. Adopting proposed EU measures\textsuperscript{6} to strengthen labour mobility by establishing clear and fair rules is key to ensure the internal market benefits citizens more broadly. An agreement on harmonised rules for a consolidated corporate tax base would remove cross-border tax obstacles and benefit business in the Single Market.

Over the last two decades, total factor productivity in the euro area has lagged behind major global competitors (see graph 3). Boosting productivity is crucial to sustaining economic growth. In particular, it can allow the EU to remain competitive, support wage growth, create quality jobs and promote upward convergence in living standards. Higher productivity growth would also enable the EU to expand its contribution in global value chains.

There are considerable differences in productivity performance across EU firms, regions and sectors. In particular, productivity growth in most service sectors is failing to keep pace with manufacturing and with international competition. This significantly affects EU competitiveness, as 9 of every 10 newly created jobs have been in service sectors. In most Member States, the most productive firms have increased their productivity, whereas the least productive firms are stagnating. This suggests that technological diffusion from the most innovative firms to the rest of the economy has slowed down. Improving allocative efficiency would help shift capital and labour from less to more productive firms, reducing the dispersion and increasing productivity overall. Since productivity is a driver of wage growth, this would also have an upward effect on wages.

To thrive, increasingly digitised and globalised economies require greater and smarter investments in skills and education. Digitisation offers important benefits but also entails challenges for workers and employers. The ongoing technological shift is translating into fast restructuring even in traditional industries, which calls for a better-qualified workforce and upskilling. Even now, skills mismatches are considerable, with 40 % of EU employers reporting difficulties in recruiting people with the right skills. On average in the EU, the employment rates of low-educated workers are almost 30 percentage points lower than for high-educated workers. More than 60 million adults lack necessary literacy, numeracy and digital skills.

Wide regional and territorial disparities remain a key issue of concern. The EU has been a unique convergence machine, helping to ensure greater cohesion within and between Member States in an enlarged Union. Yet, in many EU countries, some regions are lagging

behind. While the poorest regions have become more prosperous since 2010, their economic gap with richer regions has widened. Technological change and the energy transition could increase this gap, unless suitable measures are taken to boost regional competitiveness (e.g., creating incentives for the adoption of new technologies and re-training of the workforce, addressing demographic decline). In this respect, investment undertaken through EU cohesion policy has a strong role to play, alongside national reforms geared towards boosting potential growth, inclusiveness and good governance. The Commission’s proposals for the new Multiannual Financial Framework promote stronger links between structural reforms needs identified in the context of the European Semester and European investment in the Member States, with the aim of fostering competitiveness and cohesion.

**Even if income inequality is lower within the EU than in other developed economies, it remains above pre-crisis levels.** The European Pillar of Social Rights aims to ensure convergence towards better working and living conditions. Reforms are crucial in this respect, including the development of inclusive and growth-friendly social protection schemes, fairer tax-benefit systems and labour market institutions that effectively combine flexibility and security. As new forms of work emerge, including platform and own-account work, social protection traditionally geared to covering workers in full-time open-ended contracts will need to be modernised and adapted. In a globalised world, the ability of a single government to tax the top of the income and wealth owners has become increasingly limited. Ensuring fairer taxation, including of the digital economy in line with proposed EU measures, is a precondition for more inclusive growth.

**Europe’s ageing population is a challenge for pension, healthcare and long-term care systems.** The ratio between the number of people aged 65 and over and those aged 15-64 is projected to increase from 28.8 % in 2015 to 35.1 % in 2025 and to over 50 % in 2050. This has important implications for future economic growth and distribution of resources: it will require additional measures to ensure both fiscal sustainability and adequate coverage. The situation of young people is especially concerning, as they may face a double burden: having to pay higher contribution rates while working, and receiving lower pensions after retirement. A more dynamic and inclusive labour market and reformed welfare systems could mitigate the social and public finance risks related to population ageing.

### 3. Setting the Right Priorities for a Prosperous Future

Europe needs to take a long-term view and increase its socio-economic resilience in order to reinforce its ability to weather shocks and grasp new opportunities. The steady growth Europe is experiencing today provides the right environment to tackle the pending and urgent reforms needed to confront the challenges we face.

Making the appropriate policy choices today is key to delivering higher and fairer growth, better jobs and a stronger capacity to smoothen the impacts of global economic cycles. A consistent set of priorities is essential to guide national reform plans and complement efforts made at EU level. The key to a prosperous future remain (1) delivering high-quality investment; (2) focusing on reforms that increase productivity growth,
inclusiveness and institutional quality; and (3) continuing to ensure macro-financial stability and sound public finances.

**Delivering high-quality investment**

**Investment provides the engine for growth and job creation.** Member States need to continue fostering an environment that is favourable to growth-enhancing investment. Well-targeted public and private investment should go hand in hand with a well-designed set of structural reforms. It should build or upgrade strategic infrastructure, strengthen human capital for tomorrow’s competitiveness and improve working and living conditions. It should also help deliver on the EU’s objective of moving towards a low-carbon, circular economy, in support of long-term sustainability. Investment that enhances environmental sustainability has in fact the potential to boost productivity across the economy through greater resource efficiency and reduced input costs.

**There are significant investment gaps in research and innovation,** including in digital infrastructure and intangible assets. The rise of digital technologies is profoundly changing the dynamics of innovation. Network effects and the complexity of the innovation process are increasing. Innovation benefits are concentrated in a handful of leading companies that have achieved strong productivity growth rates. To ensure broader innovation-driven productivity gains, wider diffusion and uptake of innovation is needed across the EU. Investment should support stronger science-business linkages, with a greater focus on spreading innovation and creating new markets, expanding digital infrastructure (e.g. broadband and digitalisation of small and medium-sized enterprises) and developing the right set of skills.

**Investment in education, training and skills is crucial to increasing productivity and sustaining employment in the context of rapid change and digitisation.** Member States should equip young people with skills that are relevant to labour market needs, while enabling and encouraging lifelong learning. They should pay particular attention to adaptability of the workforce, especially the low-skilled, to ensure the optimal uptake of technological progress. Particular attention is also needed to addressing inequalities in access to quality education and training, which persist in most Member States.

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7 Currently, at 2.03 %, the EU is far from achieving the overall target of investing 3 % of GDP on research and development and continues to lag significantly behind other advanced economies such as the United States (2.79 %), Japan (3.29 %) and South Korea (4.23 %).
The current economic growth should translate into a frontloading of investment in the modernisation and decarbonisation of Europe’s industry, transport and energy systems. Infrastructure investments in these fields should meet the evolving needs of the future and facilitate the insertion of EU firms in international value chains within and beyond the Single Market. Continued decoupling of energy and resource use from economic growth is needed to achieve the EU’s 2030 climate and energy targets, in line with commitments under the Paris Agreement. Investing into a low-carbon, circular economy, including through innovation, is one of the keys for Europe to remain globally competitive and raise productivity without compromising living standards. Upgrading of transport infrastructures, including investments into smart, sustainable and safe mobility, including zero-emission mobility, remains a challenge in a number of Member States. Targeted investments in residential construction, coupled with simplified national regulations, are needed to make housing more affordable and curb energy consumption.

Private investment, sourced from well-functioning and integrated capital markets, needs to be more fully exploited. As the EU finalises the delivery on its action plan on building a capital market union, Europe’s full diversity of capital markets ranging from global hubs to

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regionally integrated networks and local initiatives should be further developed to finance businesses, and promote decarbonisation and the transition to a more sustainable economy.

The Commission’s proposals for the next EU Multiannual Financial Framework fully support the delivery of more and better investment by national authorities and the private sector. As mentioned earlier, the Commission intends to ensure more effective links between the European Semester and EU funding for 2021-2027 (see box below). Moreover, the new InvestEU Programme⁹ will bring together under one roof the multitude of EU financial instruments available to support investment. This will make EU funding for strategic investment projects in Europe simpler, more efficient and more flexible. By reinforcing existing practices in the context of the next Multiannual Financial Framework, EU programmes will be used in a coherent manner to maximise the added value of EU financing and support reforms at national level in the context of the European Semester, with the ultimate objective to efficiently deliver on EU policy priorities.

**Box: A greater alignment of the European Semester and EU cohesion funding**

Addressing the challenges identified in the context of the European Semester is key to boosting investment and making it more effective in achieving greater socio-economic and territorial cohesion across the EU. At the same time, investment is in some cases needed to support the implementation of country-specific recommendations. Formal links already exist between EU cohesion funding and the coordination of economic policies through the European Semester. Creating even greater synergies and complementarity between them can deeply benefit both processes.

To achieve this, the 2019 European Semester will have a stronger focus on assessing investment needs to guide programming decisions for 2021-2027. The analysis in the 2019 country reports will look at investment needs in each country, including – where relevant – sectoral and regional dimensions. Based on this analysis, a new annex to the country report will identify those investment needs that are relevant for the European Regional Development Fund, the European Social Fund Plus and the Cohesion Fund during the 2021-2027 period. This will provide a solid analytical input to the programming dialogue with Member States.

Building on the country reports, the Commission also intends to identify, as part of its proposals for the 2019 country-specific recommendations, priority areas for public and private investment to further facilitate the implementation of growth-enhancing reforms.

**Focusing reforms efforts on productivity growth, inclusiveness and institutional quality**

High-quality investment must go hand in hand with the appropriate set of structural reforms. A forward-looking approach to growth calls for renewing the focus of national reform efforts on three key areas: productivity growth, inclusiveness and institutional quality.

Higher productivity growth should be a central objective of national reforms. Broader and faster uptake of productivity-enhancing technologies requires targeted measures to promote relevant investment (e.g. tax incentives), skills development and stronger links between education and training systems and businesses. Advanced digital technologies such

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as high-performance computing, cybersecurity and artificial intelligence are now sufficiently mature to be deployed and scaled up. This has the potential to create new sources of revenues and jobs if the right incentives for companies are in place.

**Member States should take both collective and individual responsibility in the Single Market to release its untapped potential.** Together with innovation and diffusion of technology, well-functioning product and services markets are a key driver of productivity growth, as they enable a more efficient allocation of resources. While some Member States have a favourable business environment, others need deeper reforms to facilitate entry and exit in markets for goods and services. Reforms are particularly needed in the energy, telecommunication, transport, business services and retail markets. There are still protected rent-seeking behaviours that delay the introduction of innovations and new business models, including the collaborative and circular economy. In many cases, insolvency frameworks are not effective enough to unlock resources for new businesses.

**Further reforms are needed to strike the right balance between flexibility and security on the labour market.** Labour legislation and social systems should provide security to all types of workers, facilitate transitions between jobs and statuses, foster mobility and flexibility, while better tackling labour market segmentation and in-work poverty. More effective active labour market policies and public employment services are key in this respect. In some Member States, tax and policy incentives aimed at broadening participation of women in the labour market could also create important avenues for productivity gains.

**Inclusiveness should also be at the core of reform efforts, ensuring that productivity gains benefit all citizens.** This requires a stronger focus on quality education, training and adult learning, notably for the low-skilled (see dedicated box); appropriate and innovative design of tax-benefits systems and continued or improved access to quality healthcare, childcare and long-term care services.

**Wage growth, resulting from increased productivity, can reduce inequalities and support upward convergence of living standards.** Real wage developments continued to trail behind productivity in 2017 on average, following a longer-term trend. In a context of declining collective bargaining coverage, policies enhancing the institutional capacity of social partners could be beneficial in countries where social dialogue is weak or has been negatively affected by the crisis.

**Tackling poverty and inequalities also requires inclusive and efficient tax-benefit systems.** National reforms of tax-benefit systems should focus on the adequacy of benefits and coverage as well as optimising incentives for labour market participation. In a number of Member States, combating tax fraud, evasion and avoidance remains essential to ensuring fair burden sharing between taxpayers and securing tax revenues for investment in high-quality public service. Across the EU, corporate tax avoidance alone is estimated at EUR 50-70 billion per year.

**Member States should further promote activation and social inclusion policies and universal access to affordable and quality care services.** Policy action is particularly
needed to foster participation by non-standard workers and the self-employed in social security schemes. Wider access to high-quality care services (e.g. childcare or long-term care) would ensure more opportunities for women to enter or stay in employment and reduce the risk of poverty and social exclusion among children and vulnerable groups. More efficient policies to integrate migrants in the labour market would support their wider social integration. To ensure fiscal sustainability and maintain universal access to quality healthcare, Member States need to increase cost-effectiveness by investing in innovation, improving the integration of healthcare at the primary, specialised outpatient and hospital care levels and strengthening links with social care to meet the needs of an ageing population. A greater focus on prevention is also warranted to underpin these efforts.

**Well-performing public institutions contribute to higher growth and are a precondition for the successful delivery of other reforms.** Empirical analyses show that better institutional quality is generally associated with higher productivity. This includes elements related to the effectiveness of the public administration, the degree of digitisation of public services, the quality and stability of the regulatory environment, the fight against corruption and respect for the rule of law. All these aspects can have an impact on investment decisions and could be improved by sharing and implementing EU best practices more widely. Member States should also focus more systematically on the quality of governance and actively address shortcomings.

**The rule of law, effective justice systems and robust anti-corruption frameworks are crucial to attracting business and enabling economic growth.** This relates in particular to the independence and efficiency of court systems as well as a comprehensive approach to fighting corruption, which combines prevention, effective prosecution and sanctions. This needs to be coupled with transparency and integrity in the public sector, effective legal protection of whistle-blowers, the presence of independent media and more engagement with civil society. In some Member States, stronger law enforcement needs to be complemented by sound prevention policies and incentives to use of electronic payment systems or digital solutions to tackle the shadow economy.

**Today’s still favourable economic growth provides optimal conditions for successfully implementing reforms, yet in some countries reform efforts are losing momentum.** To support and incentivise the continued implementation of reform efforts at national level, the Commission has proposed the creation of the Reform Support Programme. This new EU budgetary tool for 2021-2027 is set to provide financial incentives for reforms and increased technical assistance, building on the success of and high demand for the current Structural Reform Support Programme.

**Ensuring macroeconomic stability and sound public finances**

**Macroeconomic imbalances in the EU have declined, but vulnerabilities persist.** A global reassessment of risks in international financial markets could prompt investors to re-assess

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legacy risks such as high debt levels, remaining weaknesses in banking sectors and limited fiscal policy space in some Member States. A further correction of large stock imbalances therefore requires further reductions in high private and public debt and additional strengthening of the financial sector. This will help create the necessary fiscal space to ensure long-term sustainability, build capacity to deal with future crises and free up funds for future investment.

**Credible actions to achieve agreed fiscal objectives, in line with the common European rules, remains essential.** In many countries, debt remains high, reducing the room for absorbing negative income shocks. As the economy continues to grow, the time is ripe to build up the fiscal buffers needed to cope with the next downturn and mitigate potential employment and social impacts. A number of Member States have reduced their public debt and achieved or exceeded their medium-term budgetary objective, creating scope for higher public investment to support potential growth. However, several others continue to shoulder high levels of public debt, which constrain their ability to invest for the future. These countries have also made less progress in reducing public debt over recent years. They should use the current economic expansion to build up buffers; further strengthen their public finances, in particular in structural terms; and prioritise expenditure on items that foster resilience and growth potential. The Stability and Growth Pact provides clear rules to ensure responsible fiscal policies.

**Improving the quality and composition of public finances is important for ensuring macroeconomic stability and a crucial element of Member States’ fiscal policy.** On the revenue side, efficient tax systems that provide incentives for investment and growth should be established. Efforts are also needed on the expenditure side, through spending reviews and by prioritising expenditure that fosters long-term growth and equity.

**Ensuring long-term sustainability of public finances is also key.** People today lead longer healthy lives, but demographic change is also exerting increasing pressure on welfare systems. Pension reforms aimed at adapting the balance between working life and retirement and supporting complementary retirement savings remain essential. Implementing such reforms is often politically difficult and their reversal should be avoided, as this could jeopardise fiscal sustainability, reduce growth potential and intergenerational fairness. Improved governance of public procurement could also greatly contribute to more efficient public spending in several Member States.

**Financial sector’s resilience has improved, but efforts to reduce non-performing loans and strengthen supervisory frameworks need to continue.** While some Member States made substantial progress reducing the stock of non-performing loans, in others more efforts are needed, including on insolvency. The adoption of the measures presented by the Commission in March 2018,\(^\text{11}\) in accordance with the action plan to tackle non-performing

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\(^\text{11}\) The package includes a proposal for a directive on credit servicers, credit purchasers and the recovery of collateral, a proposal for a regulation amending the capital requirements regulation and a blueprint on the set-up of national asset management companies.
loans in Europe, will support these developments. The opportunities provided by technological developments and a fully integrated market within a completed Banking Union need to be further exploited. Macro-prudential frameworks need to be adapted to address risks of overheating and prevent new imbalances from building up. National supervisory frameworks and their coordination should be improved further to ensure full implementation of EU rules against money laundering and adequate risk prevention and management by banks.

**CONCLUSIONS AND NEXT STEPS**

The EU and its Member States need decisive and concerted policy action to deliver on the promise of inclusive and sustainable growth in the future, all the more so in light of rising global uncertainty. Europe needs to increase its growth potential and economic and social resilience, thus reinforcing its ability to weather shocks and turn long-term challenges into opportunities.

Member States should take account of the priorities identified by the Commission in this Annual Growth Survey in their national policies and strategies, particularly when drawing up their national reform programmes. They should do so while accelerating implementation of their reform agendas and key reforms highlighted in the country-specific recommendations. They should make full use of the policy and funding instruments available to them at EU level to foster growth-enhancing investment. It will be particularly important to ensure even greater synergies between priorities established through the coordination of economic and social policies at EU level and funding from the EU budget, in line with the Commission’s proposals for the next Multiannual Financial Framework.

The Commission will continue the dialogue established with Member States under the European Semester. Its aim is to reach a common understanding of the most pressing challenges in the forthcoming country reports and identify the areas for priority action in the next round of country specific recommendations. The establishment of National Productivity Boards could benefit national debates on how to boost productivity by providing high-quality and independent analysis and enhancing national ownership of reforms. Member States should ensure that social partners and national parliaments are fully involved in the reform process. Their involvement, along with a broader engagement with civil society, is fundamental to improving ownership and legitimacy of reforms and bringing about better socio-economic outcomes.

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13 Currently, thirteen Member States have appointed a National Productivity Board: Cyprus, Finland, France, Greece, Ireland, Lithuania, Luxembourg, the Netherlands, Portugal and Slovenia. Three non-euro area Member States have appointed a National Productivity Board: Denmark, Hungary and Romania.