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(Resolutions, recommendations and opinions)

RECOMMENDATIONS

COUNCIL

COUNCIL RECOMMENDATION
of 13 July 2018

on the 2018 National Reform Programme of Belgium and delivering a Council opinion on the 2018 Stability Programme of Belgium

(2018/C 320/01)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Belgium as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Belgium should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (3) below.

The 2018 country report for Belgium was published on 7 March 2018. It assessed Belgium’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (1), the follow-up given to the country-specific recommendations adopted in previous years and Belgium’s progress towards its national Europe 2020 targets.

The 2018 Stability Programme was submitted to the Commission on 27 April 2018. In order to take account of their interlinkages, the two programmes are being assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (2), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Belgium is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2018 Stability Programme, the Government plans a gradual improvement of the headline balance from a deficit of 1.0% of GDP in 2017 to a surplus of 0.1% of GDP in 2021. The medium-term budgetary objective, set at a balanced budgetary position in structural terms, is planned to be reached by 2020. However, the recalculated structural balance (3) still points to a deficit of 0.2% in 2020. After having peaked at almost 107% of GDP in 2014 and decreasing to around 103% of GDP in 2017, the general government debt-to-GDP ratio is expected to decline to 94.6% by 2021 according to the 2018 Stability Programme. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been specified, which contributes to the projected deterioration of the structural balance in 2019 under unchanged policies according to the Commission 2018 spring forecast.

On 23 May 2018, the Commission issued a report under Article 126(3) of the TFEU, as Belgium did not make sufficient progress towards compliance with the debt reduction benchmark in 2017. Following an assessment of all the relevant factors, as there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium in 2017 and over 2016 and 2017 together, the report could not fully conclude as to whether the debt criterion as defined in the Treaty and in Council Regulation (EC) No 1467/97 (4) is or is not complied with. The Commission will reassess compliance with the debt reduction benchmark on the basis of the ex-post data for 2018 to be notified in Spring 2019.

The 2018 Stability Programme indicates that the budgetary impact of the security-related measures in 2017 is significant, and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure in 2017 amounted to 0.02% of GDP for security-related

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3. Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.
measures. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the severity of the terrorist threat is an unusual event, its impact on Belgium's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2017 has been reduced to take into account these additional costs.

(9) On 11 July 2017, the Council recommended Belgium to ensure that the nominal growth rate of net primary government expenditure (1) does not exceed 1.6 % in 2018, corresponding to an annual structural adjustment of 0.6 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Belgium's public finances. Following the Commission's assessment of the strength of the recovery in Belgium while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Belgium's 2018 Draft Budgetary Plan, no additional elements in that regard need to be taken into account. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2018 and over 2017 and 2018 taken together.

(10) In 2019, in view of Belgium's general government debt ratio above 60 % of GDP and projected output gap of 0.4 %, the nominal growth rate of net primary government expenditure should not exceed 1.8 %, in line with the structural adjustment of 0.6 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2019 and over 2018 and 2019 taken together. Belgium is prima facie not forecast to comply with the debt rule in 2018 and 2019. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.

(11) Sustainability of public finances remains a challenge. The pension reforms enacted in 2015 were a significant step to address risks related to the long-term of ageing. Yet the 2018 Ageing Report points to a larger than previously expected increase in age-related long-term expenditure for both pensions and long-term care. Pension expenditure is projected to increase by 2.9 percentage points of GDP in 2070, compared with an increase of 1.3 percentage points in 2060 (and a decrease of 0.1 percentage point of GDP on average for the Union) in the previous update. In this respect, the full implementation of the government’s reform roadmap could contribute to addressing those risks. In addition, expenditure on long-term care is projected to increase, going from an already above Union average level of 2.3 % of GDP to 4.0 % of GDP by 2070. The reduction of the fragmentation in the organisational landscape of long-term care, due to the distribution of competences across different administrative levels, has the potential to increase the efficiency of spending in this area.

(12) Effective budget coordination is essential in a federal Member State like Belgium, where a large part of the spending power has been devolved to sub-national governments. To improve internal coordination and to transpose the fiscal component of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the ‘Fiscal Compact’), the federal Government and the regional and community governments concluded a cooperation agreement in 2013, with the aim to define overall and individual multiannual fiscal paths, to be monitored by the High Council of Finance. An agreement on individual fiscal targets to be achieved by 2020 has been reached, which is a positive step. However, there is still no formal agreement on annual fiscal targets at all levels of government. Progress has been made in relation to establishing sufficient safeguards regarding the independence of the High Council of Finance.

(13) There is scope to give spending restraint a larger role in fiscal consolidation. Total public expenditure as a percentage of GDP is above the euro area average. Despite its potential to stimulate growth in the long run, public investment is low by European standards, particularly in relation to total public spending. Not only is the public capital stock low, the quality of public infrastructure has also been eroded. Spending reviews can

(*) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
Recent economic growth has been job-rich. Employment growth was robust in 2017 and the unemployment rate is now close to the pre-crisis level. Nevertheless, with regard to the employment rate of the population aged 20 to 64 (68.5% in 2017), Belgium is not on track to achieving its Europe 2020 target of 73.2%. Limited progress has been made on the participation in the labour market of disadvantaged groups, as inactivity and unemployment are largely concentrated among the low-skilled, people with a migrant background and older workers, suggesting that both structural and group-specific factors hinder integration in the labour market. In particular, people with a migrant background, which are a large share of the working-age population, continue to face unfavourable labour market outcomes and thus represent a significant untapped labour market potential. In 2016, the employment rate of non-EU born was 49.1%, which is more than 20 percentage points lower than for native born (the gap was even more pronounced for women). Activation measures could help people from disadvantaged backgrounds, but there is some evidence that those activation measures are not equally effective for all population groups. While some measures have been taken to help new arrivals integrate and to tackle discrimination, there is still a lack of coordination across policy domains and political levels to address the challenge of integrating people with a migrant background in the labour market. Strong regional disparities in labour market performance persist.

In spite of efforts to reduce the tax wedge on labour, disincentives to work remain high for some groups, such as single households earning the average wage and second earners. Despite previous measures, the tax wedge for a single household earning the average wage remained among the Union's highest in 2016. The unemployment trap for low-wage earners (67% of the average wage for a single household) is also one the Union's highest. High tax disincentives for second earners – mainly women – remain.

The vacancy rate is among the highest in the Union indicating major skills mismatches related to, among other factors, low mobility and, especially in the bilingual Brussels region, inadequate language skills. Participation in lifelong learning is low. More commitments by individuals and employers to continuous lifelong learning is important to enable people to handle employment transitions.
(19) Some progress has been made as regards equal opportunities to participate in quality education and vocational training as the Flemish and the French-speaking Communities are phasing in school reforms. However, despite good average performance in international comparison, long-standing high educational inequalities remain. Educational outcomes of 15 year-old pupils show significant variation linked to the socioeconomic background and migrant status. The performance differences between the Flemish and the French-speaking Communities as well as the underrepresentation of disadvantaged groups among top achievers in science, reading and mathematics are raising concerns. Wide performance gaps between schools go hand-in-hand with unequal educational opportunities. The proportion of tertiary education graduates is high. Yet, inequalities in access to quality education, skills shortages and regional disparities are seen. The proportion of graduates in science, technology and mathematics is one of the lowest in the Union and shortages in these fields could become a major barrier to growth and innovation. Teacher shortages are raising concerns, yet teacher training reforms progress slowly. There is a need to adapt teachers’ continuous professional development. Both the Flemish and the French-speaking Communities have embarked on major reforms of their education systems. The implementation of these reforms is planned over the next decade and beyond. However, at the end of 2017, Flanders took the decision to postpone the entry into force of key measures of these reforms by one year. The impact of the reforms and measures will very much depend on their effective implementation and monitoring.

(20) Only limited reforms have been undertaken to address the restrictive regulatory framework in services. Flanders abolished the Establishment Act for a selected number of craft professions. Nevertheless, regulation remains high in some professional services. As a result, competition is subdued in these sectors with low entry rates of new companies coming into the market. In the construction sector, horizontal authorisation schemes for access to the construction market are imposed and building permits remain complex despite measures adopted in recent years. The churn rates in the Belgian construction sector are substantially below the Union average, which may indicate that the sector suffers from insufficient competition. This also impacts the delivery of important infrastructure projects. There are also important restrictions in the area of rail and road transport services. The low productivity growth of the Belgian economy is largely driven by low productivity growth in the services sector. Regulatory restrictions also have adverse spill-over effects on users of these services, in particular the manufacturing sector. More in-depth structural reforms of key services sectors would help boost productivity growth, essential to ensure future growth as well as the sustainability of public finances.

(21) Also limited progress has been made in improving the functioning of the retail sector. Despite recent reforms, regulatory restrictions still weigh on the sector’s performance and deter investment. Prices for many product categories continue to be higher than in the neighbouring countries. More effort is needed to render the business environment competitive and investment-friendly to allow consumers enjoy a greater choice of products and lower prices. In April 2018, the Commission has proposed best practices to guide Member States’ reforms of the retail sector.

(22) Entrepreneurship performance in Belgium remains low, despite some reforms in the recent years and recent measures whose impact has yet to be assessed. Business dynamism is low, as the business creation rate remains among the lowest in Europe, far lower than the Union average, accompanied by a low destruction rate. Moreover, the administrative burden for firms remains heavy, characterised by complex procedures and a low level of regulatory certainty.

(23) Belgium is an average performer in digital public services. In contrast to its good overall position on development of its digital economy, it ranks only average in digital public services. Belgium’s federal structure poses specific challenges in establishing coherent and nationwide e-government services. Diverse systems that are not necessarily interoperable systems create friction losses. Serious concerns remain about the justice system in particular as regards delayed actions, digitalisation, and the reliability, comparability and uniformity of court data. The roll-out of initiatives to digitalise certain court services to all courts such as e-box or e-deposit are behind schedule. However, as long as this uniform coding system is not applied across all courts, data on the efficiency of court proceedings will remain of limited reliability and comparability.

(24) In spite of recent reforms, the Belgian tax system remains complex. The reform of the corporate income tax will lower statutory rates and contribute to simplifying the system. Nevertheless, many exemptions and distortionary incentives remain, as the rising trend in the total amount of tax breaks shows. The opportunity to shift taxes to more growth-friendly bases could be further used. Revenues from environment-related taxes are still among the
lowest in the Union. Indeed, there is considerable potential for a genuine ‘green’ tax shift dealing, inter alia, with the favourable treatment of company cars, which contribute to air pollution, congestion and greenhouse gas emissions.

(25) There has been limited progress in dealing with traffic congestion. Mobility suffers from insufficient public investment in infrastructure, distortive tax incentives and lack of competition in transport services, causing major congestion and hindering productivity growth. Road traffic congestion is worsening year by year deterring foreign investment and incurring high social, economic and environmental costs. The most urgent challenges are to complete and upgrade rail and road transport infrastructure especially around and inside Antwerp and Brussels. There are also substantial restrictions in the area of rail and road transport services. The authorities can encourage a more efficient use of existing infrastructure and a modal shift away from individual transport use towards more collective and low-emitting alternatives.

(26) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Belgium’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Belgium in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Belgium but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(27) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below:

HEREBY RECOMMENDS that Belgium takes action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.8 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. Pursue the envisaged pension reforms and contain the projected increase in long-term care expenditure. Pursue the full implementation of the 2013 Cooperation Agreement to coordinate fiscal policies of all government levels. Improve the efficiency and composition of public spending at all levels of government to create room for public investment, in particular by carrying out spending reviews.

2. Remove disincentives to work and strengthen the effectiveness of active labour market policies, in particular for the low-skilled, people with a migrant background and older workers. Pursue the education and training reforms, including by fostering equity and increasing the proportion of graduates in science, technology, engineering and mathematics.

3. Reduce the regulatory and administrative burden to incentivise entrepreneurship and increase competition in services, particularly retail, construction and professional services. Tackle the growing mobility challenges, in particular through investment in new or existing transport infrastructure and reinforcing incentives to use collective and low-emission transport.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Bulgaria and delivering a Council opinion on the 2018 Convergence Programme of Bulgaria

(2018/C 320/02)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Bulgaria as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Bulgaria was published on 7 March 2018. It assessed Bulgaria’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and Bulgaria’s progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that Bulgaria is experiencing macroeconomic imbalances. Vulnerabilities in the financial sector are coupled with high indebtedness and non-performing loans in the corporate sector, in a context of incomplete labour market adjustment.

(3) On 19 April 2018, Bulgaria submitted its 2018 National Reform Programme and its 2018 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time. Bulgaria’s 2018 National Reform Programme includes commitments both for the short and medium term and covers the challenges identified in the 2018 country report. In particular, it announces measures to strengthen banking and non-banking supervision, to improve the insolvency framework and to reduce remaining weaknesses identified in the 2016 stress-tests exercises. There are also measures to reinforce tax collection and tackle the shadow economy, to improve the targeting of active labour market policies, to increase social protection and to address various challenges in the healthcare and education sectors. Overall, the effective implementation of the 2018 National Reform Programme would underpin the correction of imbalances.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(5) Bulgaria is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the Government, starting from a headline surplus of 0.9 % of GDP in 2017, aims at a balanced budget in 2018 and a surplus of 0.3 % of GDP in 2019, 0.5 % in 2020 and 0.2 % in 2021. The medium-term budgetary objective — a structural deficit of 1 % of GDP — is planned to continue to be met with a margin throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to decline gradually from 25.4 % of GDP in 2017 to 19.4 % in 2021. The macro-economic scenario underpinning those budgetary projections is plausible. Based on the Commission 2018 spring forecast, the structural balance is forecast to remain in surplus but to decrease from 0.9 % of GDP in 2017 to 0.5 % of GDP in 2018 and remain at the same level in 2019. The structural balance is thus forecast to remain above the medium-term budgetary objective in both years. Overall, the Council is of the opinion that Bulgaria is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

(6) Increasing the efficiency of fiscal policy is of utmost importance. Tax revenues and tax compliance are improving but more as a result of a better economic outlook than of improved tax administration and collection. Efficiency of public spending in some sectors is very low. Reforms in the field of public finances management are important in this regard and the current economic and fiscal conditions are particularly favourable for such reforms. The economic performance of State-owned enterprises is weak compared with other countries in the region and with the private sector, and it is also a source of uncertainty and risk for public finances as the arrears of such companies represent contingent liabilities. Overall, corporate governance of State-owned enterprises remains a challenge and does not fulfil international standards. Additionally, reforms in this area are very important for the business environment.

(7) The soundness of the financial sector has continued to improve despite remaining vulnerabilities. Corporate non-performing loans are still high, although they have been reduced. Capital buffers are comfortable on average, thus providing space for a balance sheet clean-up. There has been notable progress in improving financial sector supervision, but some important measures are still to be fully implemented. Mitigating remaining risks associated with related-party exposures and improving asset valuation are key to further strengthening balance sheets and boosting the resilience of banks and insurance companies.

(8) The ineffectiveness of the insolvency framework is slowing the reduction in private sector indebtedness and the work-out of non-performing loans. Procedures are lengthy and the recovery rate is low. Some elements of a functioning framework are still lacking, in particular rules for debt discharge and for granting a second chance

to entrepreneurs within a reasonable timeframe following bankruptcy. The lack of data gathering and adequate monitoring tools prevents an assessment of the effectiveness of either older or new procedures, including for business restructuring.

(9) Levels of undeclared work remain high, which has considerable implications for fiscal revenue, labour conditions and the adequacy of income after retirement. Bulgaria has taken a number of recent measures that seek to improve the situation. These include one-day contracts in agriculture, improved cooperation between fiscal and labour authorities and increased efforts to raise awareness about the negative consequences for employees. Their efficiency will depend on effective implementation. Accelerating the transition to the formal economy is essential for achieving inclusive growth and ensuring fair working conditions for all.

(10) The labour market has improved but challenges persist. The employment rate has reached pre-crisis levels and the unemployment rate is below the Union average. However, the positive labour market developments are not equally benefiting the whole working-age population. The long-term unemployed, inactive young people, Roma and people living in poorer regions and rural areas continue to face significant difficulties in entering or re-entering employment. The ageing and shrinking population, combined with an activity rate below the Union average, leads to labour and skills shortages, thus weakening long-term prospects of the economy. A reinforced focus on upskilling and training would therefore be warranted. Labour market participation and employability could be fostered through a mix of effective outreach measures, active labour market policies and social services.

(11) Inequality of income and access to services (education, healthcare and housing), as well as the risk of poverty or social exclusion remain among the highest in the Union. In 2016, two-fifths of the population was at risk of poverty or social exclusion while the income of the richest 20% of households was almost eight times that of the poorest 20%. Spending on social protection is low, including on the general minimum income scheme, whose coverage and adequacy are limited, as well as its impact on reducing poverty and inequality. An objective mechanism to revise the level of benefits is lacking. In spite of recent improvements in the adequacy of social assistance benefits and minimum pensions, the social protection system does not provide sufficient levels of support to the most vulnerable or disadvantaged groups, such as Roma, children, the elderly, persons with disabilities and people living in rural areas. The provision of social services remains weak and their integration with labour market and other services is incomplete.

(12) The minimum wage is set without a clear and transparent mechanism and the percentage of workers at the minimum wage has increased more than twofold over the last six years. The lack of such a mechanism may put at risk the achievement of a proper balance between the objectives of supporting employment and competitiveness, while safeguarding labour income. In addition, it creates uncertainty that can adversely impact the predictability of business conditions. The Government has tabled proposals for a minimum wage setting mechanism addressing this shortcoming. However, there is no agreement between the social partners on this issue. Also, in its budget forecast, the Government included increases of minimum wage until 2020. In 2018, Bulgaria ratified the International Labour Organisation’s Convention concerning Minimum Wage Fixing. This could be a good basis for setting an objective mechanism.

(13) Limited access to healthcare caused by low public spending, uneven distribution of limited resources and low health insurance coverage remains a significant challenge. The low level of public expenditure needs to be compensated by high private spending, mainly in the form of out-of-pocket payments. The proportion of Bulgarians without health insurance is high in relation to the proportion pertaining in the majority of Member States. District-level differences in the distribution of doctors and the low number of nurses remain problematic. On a positive note, the number of doctors leaving Bulgaria has recently dropped. Measures like the National Health Strategy should be used to tackle these weaknesses.

(14) Despite recent measures to modernise the education system, educational outcomes are low and strongly influenced by socioeconomic status. Children from disadvantaged families, particularly Roma, do not enjoy equal opportunities. High levels of early school leaving have negative consequences for future employability and labour market performance. Providing ethnically mixed kindergartens, schools and classes remains a challenge for the
provision of quality inclusive mainstream education. Curricular reform seeks to improve educational outcomes and digital skills. However, the level of digital skills is still among the lowest in the Union and varies between different socioeconomic groups. Despite recent measures, the labour market relevance of vocational education and training remains insufficient. Higher education reform is underway, but addressing skills shortages is a challenge given the unbalanced profiles of graduates by sectors. Participation in adult learning is very low in spite of the need for upskilling. In a context of pronounced ageing among teachers, measures to address future shortages have started. Notwithstanding recent improvements, teacher education programmes require further strengthening.

(15) Many of the measures included in the National Public Procurement Strategy have been put in place. However, the national authorities should put more efforts to ensure their effective implementation. According to business and non-governmental organisations, the overall public procurement landscape has already begun to improve. However, transparency and corruption are still a matter of concern. The increased use of direct awards and the high number of single bids could significantly hamper the system's transparency and effectiveness. The first independent evaluation of the new control functions of the Public Procurement Agency is ongoing. Regular updates would be necessary to ensure further optimisation of the Agency's control functions. The remaining problems with the administrative capacity, including at the municipal level, call for further efforts on professionalisation and standardisation, and for serious consideration of the possibilities offered by central purchasing bodies. Aggregation of demand could also improve effectiveness and generate economies in the health procurement system. Finding a solution for the prevention of delays related to important public projects still necessitates further reflection.

(16) Structural shortcomings and high fragmentation in the research, development and innovation system limit its contribution to productivity and growth. Lower technology segments still dominate manufacturing and innovation is very low. The level of public as well as business spending on research and development is particularly low. The sluggish reforms hinder the move towards an innovation-oriented system. While there are many universities and research institutes, only a few of them are producing high-quality scientific output. Commercialisation of research remains a major weakness. The research funding system lacks competitive calls, international evaluation, and performance-based funding of research institutions. Public-private cooperation in research and development is weak. The flagship 'Sofia Tech Park' still faces a number of challenges, including: inefficient governance, unstable management, underutilised scientific infrastructure and a lack of long-term financial commitment from the Government. Structural transformation, combined with effective governance and a stable level of public research and innovation resources, can maximise the impact on productivity and growth and can support the transition of the economy to higher value added activities in line with the smart specialisation strategy.

(17) The business environment needs further improvement. While a number of reforms have been adopted, their practical implementation is lagging behind. Businesses are still concerned about corruption, institutional shortcomings and insufficient labour supply. Progress in public administration reform and e-government is slow. Governance in the public sector could benefit from more transparency, clearer rules and a long-term perspective. In addition, the role of social dialogue can further evolve, facilitated, when necessary, by public authorities. Shortcomings in infrastructure are reflected in the low effectiveness and performance of the transport sector. The rail passenger market has been suffering from a lack of effective competition. Well-targeted and effective measures to reduce air pollution have not been put in place.

(18) In 2017, Bulgaria continued its efforts to reform its judiciary and address shortcomings in the fight against corruption and organised crime. New elections to the Supreme Judicial Council confirmed the positive impact of constitutional and legislative reforms carried out in 2015 and 2016. Reforms of the criminal code have been adopted to improve the system of prosecution in high-level corruption cases and further reforms are under consideration. A law was adopted in early 2018 establishing a new unified anti-corruption authority to strengthen prevention and deterrence of high-level corruption. Under the Cooperation and Verification Mechanism, the Commission continues to monitor the judicial reform and the fight against corruption and organised crime in Bulgaria. These areas are therefore not covered in the country-specific recommendations for Bulgaria, but are relevant for the development of a positive business environment in Bulgaria.
In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Bulgaria's economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Bulgaria in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Bulgaria but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion that Bulgaria is expected to comply with the Stability and Growth Pact.

In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (2) and (3) below,

HEREBY RECOMMENDS that Bulgaria take action in 2018 and 2019 to:

1. Improve tax collection and the efficiency of public spending, including by stepping up enforcement of measures to reduce the extent of the informal economy. Upgrade the State-owned enterprise corporate governance framework in line with international good practices.

2. Take follow-up measures resulting from the financial sector reviews and implement the supervisory action plans in order to strengthen the oversight and stability of the sector. Ensure adequate valuation of assets, including bank collateral, by enhancing the appraisal and audit processes. Complete the reform of the insolvency framework and promote a functioning secondary market for non-performing loans.

3. Increase the employability of disadvantaged groups by upskilling and strengthening activation measures. Improve the provision of quality inclusive mainstream education, particularly for Roma and other disadvantaged groups. In line with the National Health Strategy and its action plan, improve access to health services, including by reducing out-of-pocket payments and addressing shortages of health professionals. Introduce a regular and transparent revision scheme for the minimum income and improve its coverage and adequacy.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of the Czech Republic and delivering a Council opinion
on the 2018 Convergence Programme of the Czech Republic

(2018/C 320/03)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify the Czech Republic as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for the Czech Republic was published on 7 March 2018. It assessed the Czech Republic’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and the Czech Republic’s progress towards its national Europe 2020 targets.

(3) On 30 April 2018, the Czech Republic submitted its 2018 National Reform Programme and its 2018 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

The Czech Republic is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the Government plans for a budgetary surplus in headline terms over 2018-2021. The medium-term budgetary objective — a structural deficit of 1.0 % of GDP — continues to be met with a margin throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to gradually decline to 29.9 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. Risks to the achievement of budgetary targets seem broadly balanced, with an expected rebound of public investment and further growth of public wages. Based on the Commission 2018 spring forecast, the structural balance is forecast to decline to around 0.9 % of GDP in 2018 and 0.2 % of GDP in 2019, remaining above the medium-term budgetary objective. Overall, the Council is of the opinion that the Czech Republic is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

The Czech Republic continues to display medium fiscal sustainability risks in the long term. While the costs of ageing pose a challenge for healthcare and long-term care, changes in the pension system warrant particular attention. Updated projections of age-related expenditure point to a higher increase than that indicated in the 2015 'Ageing Report'. Pension expenditure is expected to rise from 8.2 % of GDP in 2016 to 10.9 % of GDP in 2070. This expected higher increase in pension expenditure mainly reflects the capping of the statutory retirement age at 65 years. In fact, the alignment of life expectancy with the statutory retirement age is not automatic; instead, the cap is to be reviewed every five years by the Government, starting in 2019. Since it is left to the Government's discretion, the current pension expenditure projections do not take into account these retirement age reviews. Moreover, pension indexation is now more generous, taking into account 50 % of real-wage growth rather than the previous 33 % of real-wage growth. The impact of these changes on expenditure amounts to 2 percentage points of GDP in 2070. Further changes that are currently being discussed, such as an increase in the basic pension amount and higher pensions for older pensioners, also worsen the sustainability indicators. As regards public expenditure on health care, in the long-term it is projected to increase by 1.1 percentage points of GDP, above the estimated average increase of 0.9 percentage points for the Union. In this context, there are signs of inefficient use of resources in out-patient and in-patient care.

The new fiscal responsibility law in place since the beginning of 2017 has significantly strengthened the Czech Republic's fiscal framework and established an independent fiscal council. A draft law on independent audits is currently in the inter-service commenting procedure and aims to address the outstanding transposition of Council Directive 2011/85/EU (2).

The Czech National Bank can set recommendatory macro-prudential mortgage-lending limits, but its sanctioning powers are limited since it lacks the formal authority to enforce them. While the Czech banks comply with certain aggregate level limits, they have not fully adhered to the Czech National Bank's 2016 guidelines. Binding legislative limits would likely increase the level of compliance among Czech banks, ensuring financial stability and reduced risks for borrowers. A legislative proposal, amending the Act on the Czech National Bank, is expected to be discussed by the Parliament in 2018.

The Czech Republic continues to face challenges in improving the transparency and efficiency of public procurement and preventing corruption. While certain steps have been taken to improve the public procurement framework, the level of competition remains a concern, as nearly half of all public tenders result in a single-bid procedure. At the same time, the enactment of the obligatory use of electronic procedures has the potential to boost transparency and efficiency. The Czech authorities have invested in the the state-owned e-procurement platform ‘National Electronic Tool’, which should become increasingly user-friendly and reliable, in addition to private platforms serving the Czech market. There is still considerable scope for removing administrative barriers and tapping the potential of aggregated and strategic public procurement to get better value for public money.

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Both central and local authorities have started undertaking targeted initiatives to train staff involved in procurement procedures. Nonetheless, setting up joint procurement measures and acquiring specialist expertise in certain areas remain major challenges. In addition, corruption and bribery are ongoing concerns for businesses and the public. While several major reforms of the anti-corruption strategy were adopted, some areas remain unaddressed.

(10) While the performance of e-government remains below the Union average, relevant legislative measures have been adopted in order to ensure the increase of accessibility and availability of these services. Certain large-scale initiatives are expected to be introduced in 2018 but their success will depend on the ability of the authorities to raise awareness and provide user-friendly solutions.

(11) Certain administrative and regulatory burdens are holding back investment. These burdens mainly concern construction permits and tax complexity. It is acknowledged, however, that the authorities adopted an amendment to the Construction Act, which simplifies the building permit procedure by including the environmental impact assessment in the zoning decision or in the joint zoning and building permit. However, it remains unclear whether this could also streamline procedures for large infrastructure projects, since various other authorisations have not been included in this joint permit system. An amendment to the existing law regulating the construction of transport infrastructure is being discussed in the Parliament. While changes have been made to the tax system to improve tax collection, tax regulation and rates have moved up the list of concerns as problematic areas for doing business. The new Government has indicated possible changes in order to increase transparency and simplify the tax system, including the ongoing work to modernise the income tax legislation. Compliance costs have increased slightly and remain above the Union average. Although bringing in additional tax revenues, the ‘value added tax control statement’ has increased the time needed to comply with tax requirements. Despite the significant reduction in hours to comply with the Tax Code compared to the past, the Czech Republic is still at the higher end of the scale. Moreover, new reduced value added tax rates might add to the complexity of the value added tax system, especially for small and medium sized enterprises.

(12) While the Czech economy is shifting towards more knowledge-intensive activities, several bottlenecks still hamper the development of a well-performing research and innovation system. The increase of business R&D investment is primarily driven by foreign direct investments. R&D expenditure by domestic firms has declined over the last two years. Despite substantial public R&D investment, the Czech Republic underperforms in terms of the quality of its public science base. Policy measures were adopted to build links between academia and businesses, and improve the performance of the public science base, but the results to date have been limited and the reforms are yet to be fully implemented. Moreover, the governance of the research and innovation system remains fragmented.

(13) Quality inclusive education and training are of primary importance in view of increasing bottlenecks on the Czech labour market. Education performance continues to be strongly affected by the socioeconomic background of students. Inclusive education measures are still to be fully implemented, in particular for Roma children. Shortages of qualified teachers, combined with demographic projections, indicate that it could become more challenging to recruit and retain teachers. The planned new career system for teachers, which would have linked continuing professional development, career and salaries, was not adopted by the Parliament. Teachers’ salaries remain low compared with those of other workers with tertiary education, but further salary increases are envisaged in the next years. The teaching profession therefore remains relatively unattractive for talented young people. Finally, the success of the reform to make education more inclusive (introduced in 2016 with the support of the European Social Fund) will depend on the availability of sufficient and sustainable national funding, further teacher and teaching-assistant training, and raising public awareness of the benefits of inclusive education.

(14) The Czech Republic is experiencing strong labour market performance. Employment has risen steadily over the past six years and unemployment has fallen considerably. The potential of women, the low-skilled and disabled people remains nonetheless underutilised. Against the background of labour shortages, there is clear scope for increasing their labour market participation. Employment and gender pay gaps remain high despite recent measures that have made parental leave more flexible and increased the number of childcare facilities. The employment rate among women remains well below that of men. Motherhood still has a major impact on labour market participation, linked to the low availability of affordable childcare, long parental leave entitlements, low use of flexible working arrangements and the lack of long-term care facilities. In 2016, only 4.7 % of children below the age of three were in formal childcare. Although they make up a small proportion of the population, the employment rate of the low-skilled is well below that of the medium- and high-skilled. Similarly, the employment rate of disabled people is below the Union average, despite the record-low general unemployment rate and shortages in the labour market. This could motivate tapping into the unused potential of the disabled.
Due to limited capacity, public employment services currently fall short in providing jobseekers with personalised, continuous support. Increasing the outreach and activation capacities of public employment services, together with effective and well-targeted active labour market policies and individualised services, would help boost the participation of these groups. Upskilling initiatives (also covering digital skills) could improve labour market access.

(15) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of the Czech Republic's economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to the Czech Republic in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in the Czech Republic but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(16) In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion (1) that the Czech Republic is expected to comply with the Stability and Growth Pact, HEREBY RECOMMENDS that the Czech Republic take action in 2018 and 2019 to:

1. Improve the long-term fiscal sustainability, in particular of the pension system. Address weaknesses in public procurement practices, in particular by enabling more quality-based competition and by implementing anti-corruption measures.

2. Reduce the administrative burden on investment, including by speeding up permit procedures for infrastructure work. Remove the bottlenecks hampering research, development and innovation, in particular by increasing the innovation capacity of domestic firms. Strengthen the capacity of the education system to deliver quality inclusive education, including by promoting the teaching profession. Foster the employment of women, the low-skilled and disabled people, including by improving the effectiveness of active labour market policies.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

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(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Denmark and delivering a Council opinion on the 2018 Convergence Programme of Denmark

(2018/C 320/04)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Denmark as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Denmark was published on 7 March 2018. It assessed Denmark's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and Denmark's progress towards its national Europe 2020 targets.

(3) On 24 April 2018, Denmark submitted its 2018 National Reform Programme and its 2018 Convergence programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (4), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review

and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(5) Denmark is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the Government plans to achieve a headline deficit of 0.7% of GDP in 2018 and to continue to meet the medium-term budgetary objective — a structural deficit of 0.5% of GDP — throughout the programme period until 2025. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to fall to 35.6% in 2018 and to continue declining to 34.2% in 2020, before rising to just under 40% by 2025. The macroeconomic scenario underpinning those budgetary projections is plausible over the programme period. Based on the Commission 2018 spring forecast, the structural balance is forecast to reach a surplus of 0.3% of GDP in 2018 and 0.9% of GDP in 2019, somewhat above the target of the 2018 Convergence Programme and above the medium-term budgetary objective. Overall, the Council is of the opinion that Denmark is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

(6) Ensuring labour supply in times of demographic changes and addressing the emerging shortages of labour in certain sectors is a condition for sustainable growth in Denmark. Reforms to increase participation and completion rates in vocational education and training and measures to better develop digital skills levels are likely to increase the supply of skilled workers. Furthermore, measures to better include marginalised and disadvantaged groups on the labour market would be beneficial in this respect. This applies to young people with low educational attainment, people with reduced work capacity and disabilities and people with a migrant background. The recent job-integration measures started off slowly but appear to be improving the situation for newly arrived refugees. The integration of children with a migrant background in the education system remains a key challenge, resulting in a lower education performance on average compared to other children.

(7) High productivity growth is fundamental to support economic growth, maintain the relatively high level of welfare in Denmark and ensure the country’s competitiveness. Although Denmark’s productivity level is high compared to other Member States, productivity growth has been declining for a long time and there is a broad range of possible impediments to productivity growth (also identified by the Danish Productivity Board and Competition Authority). Domestically oriented services in particular have been characterised by sluggish productivity where the Government only took limited measures in 2017 to increase competition and where some parts, like mortgage banks, are not exposed to foreign competition. Weak competition in several domestically oriented services sectors (e.g. in retail, finance, distribution of utilities, transport and wholesale pharmaceuticals) is still weighing on productivity, investments and job creation.

(8) Following several years of substantial increases in housing prices, overvaluation risks are emerging, particularly in the main urban areas. The European Systemic Risk Board issued a warning to eight Union countries, including Denmark, pointing to medium-term vulnerabilities in the residential real estate sector due to increasing housing prices combined with high household debt. Households continued to reduce their debt in 2017, but debt remains among the highest in the Union (as a percentage of GDP) and above what is warranted by economic fundamentals and prudential thresholds, according to Commission estimates. Moreover, the proportion of mortgages with very high loan-to-income levels has been increasing strongly since 2013, particularly in and around Copenhagen. The Danish authorities have adopted several new macroprudential measures to further restrict risky loan taking (effective from 2018 and 2020) and introduced a property tax reform (effective from 2021) to address regional imbalances in housing prices. Nevertheless, the combination of very high loan-to-income ratios, high debt with high interest rate sensitivity and potentially overvalued housing prices is increasing the risk of a price correction that could hurt the real economy and the banking sector.

(9) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Denmark’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Denmark in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Denmark but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.
In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion (1) that Denmark is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that Denmark take action in 2018 and 2019 to:

1. Increase competition in domestically oriented services sectors, for instance in the distribution of utilities and in the financial sector.

Done at Brussels, 13 July 2018.

For the Council  
The President  
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Germany and delivering a Council opinion on the
2018 Stability Programme of Germany
(2018/C 320/05)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4)
thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of
budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018
European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights,
proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities
of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November
2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism
Report, in which it identified Germany as one of the Member States for which an in-depth review would be
carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation
on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On
14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3)
(‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in
the economic and monetary union, Germany should ensure the full and timely implementation of the
Recommendation for the euro area, as reflected in recommendations (1) and (2) below.

(3) The 2018 country report for Germany was published on 7 March 2018. It assessed Germany’s progress in
addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up

Germany submitted its 2018 National Reform Programme on 30 April 2018, and its 2018 Stability Programme on 19 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (¹), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Germany is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2018 Stability Programme, the Government plans a budget surplus of between 1 and 1½ % of GDP over 2018-2021. The medium-term budgetary objective — a structural deficit of 0.5 % of GDP — continues to be met with a margin throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline to 53 % in 2021. While the Stability Programme lists and describes several planned measures of the March 2018 coalition agreement, amounting to around broadly 1½ % of GDP over the period 2018-2021, those are not yet included in the Stability Programme's projections as they are not yet adopted. The macroeconomic scenario underpinning those budgetary projections, which has not been endorsed by an independent body, is plausible (²). Based on the Commission 2018 spring forecast, the structural balance is forecast to register a surplus of around 1.2 % of GDP in 2018 and 1.0 % of GDP in 2019, above the medium-term budgetary objective. General government debt is forecast to remain on a firm downward path. Overall, the Council is of the opinion that Germany is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019. At the same time, while respecting the medium-term objective, there remains scope to use fiscal and structural policies to achieve a sustained upward trend in public and private investment in particular on education, research and innovation.

Real public investment increased robustly in 2015-2017. This trend reflects the Government's efforts to strengthen investment. Public investment is picking up, but as a proportion of GDP the increase is still modest, and a significant backlog at municipal level, estimated at 4 % of GDP, remains. The public capital stock is still declining as a proportion of GDP, due to negative net investment at municipal level (around EUR 6 billion annually in 2010-2016). Clearing the investment backlog at municipal level would require additional annual public investment of 0.3 % of GDP over the next decade. Investment as a percentage of the capital stock in the government sector, and public investment as a percentage of public expenditure are below the euro-area average. A service agency set up to support public investment at municipal level became operational in 2017, but additional efforts are needed to address the investment backlog. Together with the favourable budgetary position this indicates that there is scope to increase investment at all levels of government, in particular at regional and municipal levels.

Despite some improvements in recent years, Germany’s tax system remains inefficient, in particular because it is complex and distorts decision-making, e.g. on investment, financing and labour market participation. Germany places a relatively strong emphasis on direct taxes to raise revenues and there is potential to reduce distorting direct taxation or for a shift towards less distorting taxes on property, inheritance and consumption. The levels of taxes and social contributions on income from employment were the sixth highest in the Union in 2015. The cost of capital and the effective average corporate tax rate, which differ across regions, are among the highest in the Union (28.2 % as a national aggregate, as compared with a Union average of 20.9 %). Due to the interplay of corporate income tax, local trade tax and the solidarity surcharge, the corporate tax system is complex, involves high tax administration costs and distorts the level and location of investments. In addition, the corporate income tax distorts financing decisions, with a bias towards debt financing. This bias is the seventh highest in the Union. Lowering the capital costs on equity could strengthen private investment and the relatively under-developed venture capital market. Furthermore, loss carry-forward provisions remain relatively strict, limiting the amount to 60 % of taxable income for a given year.

Regulation in Germany is still highly restrictive, especially as regards business services, regulated professions and administrative formalities for the cross-border provision of services. Key restrictions concern inter alia legal form and shareholding. Churn rates in key business services sectors such as legal, accounting, architectural and engineering activities are below the Union average, while gross operating rates in those sectors are above average, suggesting lower competitive pressures. Because of services’ role as intermediate inputs, less restrictive regulation of services increases productivity in downstream service-intensive industries.

Germany’s labour market performance has been very strong. Unemployment fell to a record low of 3.6 % in the fourth quarter of 2017 and employment reached 79.8 %. The level of youth unemployment (6.8 % in 2017) is among the lowest in the Union. Germany is experiencing increasing shortages of skilled labour, while certain groups’ labour market potential remains under-used. The proportion of people working part-time, particularly women and those with a migrant background and caring responsibilities, is among the highest in the Union. For women, key factors include disincentives to work longer hours, coupled with a lack of sufficient childcare and all-day school facilities. Specific tax rules, particularly for second earners and low-wage workers, and the lock-in effects of the mini-job earning threshold of EUR 450 generated further disincentives to work longer hours. Germany has one of the highest tax wedges on low earners, most of whom are women. The high rate of
women working part-time is accompanied by one of the widest gender gaps in part-time employment in the Union (37.5 % versus Union average of 23.1 %). This contributes to a very wide gender pay gap in Germany.

(14) Nominal wage growth remained moderate in 2017, at 2.4 %, despite record low unemployment and high job vacancy rates. This relatively subdued rate is partly due to slow productivity increases in services, low collective bargaining coverage in some sectors and a reduction in structural unemployment. The reaction to the pick-up in inflation was limited, with real wage growth declining from 1.8 % in 2016 to 0.7 % in 2017. Collective agreements from early 2018 may lead to some wage acceleration; developments in this area are worth monitoring. The proportion of low-wage earners remains high and there is scope for increases in the number of hours worked in lower wage deciles. Increased immigration did not prevent wage growth in lower wage segments. The introduction of the statutory general minimum wage in 2015, and its subsequent rise in 2017, increased wages at the bottom of the distribution. On top of wage increases, social partners are focusing on working time flexibility in the current round of wage negotiations.

(15) Germany has a solid social protection system overall. However, the at-risk of poverty rate for the total population rose steadily until 2015 before the trend was slightly reversed in 2016. Income inequality has also begun to decline in 2015, showing a modest reduction in the S80/S20 ratio owing to an improvement in the incomes of poorer households. The recent improvement of in-work poverty in 2016 was also modest and only benefitted men.

(16) Germany can improve the attachment of older workers to the labour market, which would increase old-age income, boost potential output, help adapt to a tight labour market, and reduce the need for precautionary savings for old age. Fiscal sustainability risks are currently low, due in large part to a relatively high primary surplus. Still, Germany is expected to have one of the largest increases in pension expenditure in the Union up to 2070 according the 2018 Ageing Report. At 17.6 % in 2016, the risk of poverty in old age (i.e. above 65) was above the Union average of 14.7 %. The future deterioration of pension adequacy in the statutory first pillar is expected to increase the risk of poverty in old age, particularly for low-wage earners, people with atypical contracts and those with interruptions in their employment histories. The gender pension gap is one of the widest in the Union. At the same time, while the employment rate for workers aged 60-64 (58.4 % in 2017) was among the highest in the Union, the employment rate for workers aged 65-69 was in the middle third of Member States (16.1 %).

(17) Socio-economic background remains a considerable determinant of educational outcomes and labour market integration. In science, it contributes to a performance difference of three years of schooling between the lowest and highest social quartiles according to the Programme for International Student Assessment in 2015. National data confirm the substantial correlation also for primary education. Particular challenges exist for students with a migrant background. Compared with native-born students, they are much more likely to underachieve in basic skills and leave school early or drop out of university. Also the labour market potential of people with a migrant background is not fully used. In 2017, the employment rate among non-Union nationals (aged 20-64) was more than 27 percentage points, lower than that for German nationals (32 percentage points lower in the case of female non-Union nationals). The participation of employees in adult learning is a concern for future labour market performance of workers, in particular for the low-skilled adult population of 7.5 million people who lack basic reading and writing skills.

(18) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Germany's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Germany in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Germany, but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion (1) that Germany is expected to comply with the Stability and Growth Pact.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
(20) In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (2) below,

HEREBY RECOMMENDS that Germany take action in 2018 and 2019 to:

1. While respecting the medium-term objective, use fiscal and structural policies to achieve a sustained upward trend in public and private investment, and in particular on education, research and innovation at all levels of government, in particular at regional and municipal levels. Step up efforts to ensure the availability of very high-capacity broadband infrastructure nationwide. Improve the efficiency and investment-friendliness of the tax system. Strengthen competition in business services and regulated professions.

2. Reduce disincentives to work more hours, including the high tax wedge, in particular for low-wage and second earners. Take measures to promote longer working lives. Create conditions to promote higher wage growth, while respecting the role of the social partners. Improve educational outcomes and skills levels of disadvantaged groups.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Estonia and delivering a Council opinion on the 2018 Stability Programme of Estonia

(2018/C 320/06)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Estonia as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (’Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Estonia should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendation (1).

(3) The 2018 country report for Estonia was published on 7 March 2018. It assessed Estonia’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Estonia’s progress towards its national Europe 2020 targets. The Commission’s analysis led it to conclude that Estonia is not experiencing macroeconomic imbalances.

(4) On 26 April 2018, Estonia submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) Estonia is currently in the preventive arm of the Stability and Growth Pact. The Government plans to move from a general government deficit of 0.3 % of GDP in 2017 to a surplus of 0.2 % of GDP in 2018, 0.5 % of GDP in 2019 and move towards a balanced budget thereafter. Its medium-term budgetary objective is a structural deficit of 0.5 % of GDP. According to the 2018 Stability Programme, the recalculated (2) structural deficit is projected to amount to 0.8 % of GDP in 2018, 0.4 % of GDP in 2019 and remaining in a slight deficit thereafter. The general government debt-to-GDP ratio is projected to remain below 9 % of GDP in 2018 and 2019, declining to 5.3 % of GDP by 2022. The macroeconomic scenario underpinning those budgetary projections is favourable. Negative risks for the revenue yield assumptions primarily relate to some of the measures which are not well specified, affecting all years of the programme horizon.

(7) For 2018, Estonia was recommended to remain at the medium-term budgetary objective. This is consistent with a maximum nominal growth rate of net primary government expenditure (3) of 6.1 %, corresponding to an allowed deterioration in the structural balance by 0.2 % of GDP. Based on the Commission 2018 spring forecast, there is a risk of some deviation from that requirement in 2018. In 2019, in view of Estonia’s projected output gap of 2.7 % of GDP and with projected GDP growth below to the estimated potential growth rate, the nominal growth rate of net primary government expenditure should not exceed 4.1 %, in line with the structural adjustment of 0.6 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Based on the Commission 2018 spring forecast under unchanged policies, there is a risk of some deviation from that requirement in 2019 and over 2018 and 2019 taken together. Overall, the Council is of the opinion that Estonia needs to stand ready to take further measures to ensure compliance in 2018 and 2019.

(8) Providing a more adequate social safety net supported by better service provision remains a major challenge for Estonia. Estonia spends less on social protection (around 16 % of GDP) than the Union average (around 28 % of GDP). The impact of social transfers on reducing poverty is improving but still weak and below the Union average. Estonia still has a high at-risk-of-poverty rate, particularly for people with disabilities, jobless households and older people, especially those living alone. Income inequality at 5.6 % in 2016 remains higher than the Union average (5.2 % in 2016) despite recent improvements. Some steps are being taken to provide adequate family benefits for larger families, which has further reduced relative poverty among children. The level of minimum income benefit was increased, accompanied by incentives to return to work. The payment of an allowance of EUR 115 to persons with low pensions and living alone was the first step in addressing the very high at-risk-of-poverty rate of this group. The at-risk-of-poverty-or-social-exclusion gap between people with disabilities and those without (20.9 % in 2016) was also higher than the Union average (10.1 %). Financing of long-term care services does not match the needs of the ageing population. The impact of ongoing administrative reform on the delivery of high-quality services remains to be seen.

(9) The gender pay gap remains one of the highest in the Union at 25.3 % although it is reducing. Work-life balance is being promoted by the recent changes to the parental leave and benefit system. These changes are expected to give women an incentive to return to work earlier and thereby contribute to lowering Estonia’s gender pay gap. The changes will be implemented between 2018 and 2020. The proposal on the second stage of parental leave reform is being discussed. Continued engagement with social partners and strengthening their capacity, financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

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(2) Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

(3) Net primary government expenditure comprises total government expenditure excluding interest expenditure. Expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
in light of very low membership rates, remain important in this context and beyond. Amendments to the Gender Equality Act to improve wage transparency have yet to be adopted and, once adopted, will only apply to the public sector entities. A tool to analyse wage differences between genders is not expected to be developed before 2019.

Estonia's slow productivity growth is linked to its moderate performance on research, technology and innovation. With less than 0.5 % of Estonian companies reporting research activities in 2016, business R&D intensity is only 0.7 % of GDP — half the Union average of 1.3 %. In addition, several indicators measuring innovation — such as small and medium-sized companies creating new products and processes or innovating in-house — have declined significantly in recent years. While the economy has some high value added and knowledge-intensive activities, business R&D intensity, science-business links, and companies' innovation and technological capacity remain low. Public sector expenditure on research, technology and innovation has traditionally been above the Union average. However, insufficient priority-setting in public research poses challenges. Estonia has put in place several measures to boost the economy's research and innovation performance, but it is a challenge to maximise their impact.

In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Estonia's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Estonia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Estonia but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below, HEREBY RECOMMENDS that Estonia take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Improve the adequacy of the social safety net, in particular for older people and people with disabilities. Take measures to reduce the gender pay gap, including by improving wage transparency in the private sector.

2. Promote research and innovation, in particular by providing effective incentives for broadening the innovation base.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÓGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION

of 13 July 2018

on the 2018 National Reform Programme of Ireland and delivering a Council opinion on the 2018 Stability Programme of Ireland

(2018/C 320/07)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Ireland as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) ('Recommendation for the euro area').

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Ireland should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendations (1) and (2).

(3) The 2018 country report for Ireland was published on 7 March 2018. It assessed Ireland’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Ireland’s progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that Ireland is experiencing macroeconomic imbalances. In particular, large stocks of private and public debt and net external liabilities constitute vulnerabilities. However, the improvements have been substantial. Strong productivity growth

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in past years led to improved competitiveness and to a positive current account balance entailing a rapid reduction in the high stock of net foreign liabilities. Strong economic growth continues to support private deleveraging. However, the stock of private debt remains high, although the strong influence of the activities of multinational companies needs to be taken into account when evaluating corporate debt, while household debt appears broadly in line with fundamentals. Government debt is projected to remain on a downward trajectory, and the deficit is moving closer to balance. House prices are growing at a rapid pace, albeit from likely undervalued levels, which is also strengthening households’ balance sheets. Banks are well recapitalised and their profitability is improving gradually. The stock of non-performing loans, although remaining high, continues to decrease. Policy action addressing these vulnerabilities has been taken, but some measures will take time to generate the expected effects.

Ireland submitted its 2018 National Reform Programme on 18 April 2018, and its 2018 Stability Programme on 30 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Ireland is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2018 Stability Programme, the Government expects the headline deficit to decline slightly to 0.2 % of GDP in 2018 and to continue to gradually improve thereafter, turning into a surplus of 0.4 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0.5 % of GDP — is expected to be met from 2019 onwards. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall to 66 % in 2018 and to continue declining to 58.7 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been sufficiently specified.

On 11 July 2017, the Council recommended Ireland to ensure that the nominal growth rate of net primary government expenditure does not exceed 2.4 % in 2018, corresponding to an annual structural adjustment of 0.6 % of GDP. At the same time, the Council stated that consideration should be given to achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Ireland’s public finances. Based on the Commission 2018 spring forecast, there is a risk of some deviation from the recommended fiscal adjustment in 2018 and over 2017 and 2018 taken together.

In 2019, Ireland should achieve its medium-term budgetary objective. This is consistent with a nominal growth rate of net primary government expenditure (2) which does not exceed 5.3 % (2), corresponding to an annual structural adjustment of 0.1 % of GDP. Based on the Commission 2018 spring forecast, the structural balance is forecast to reach a deficit of 0.4 % of GDP in 2019, above the medium-term budgetary objective. Ireland is forecast to comply with the transitional debt rule in 2018 and the debt rule in 2019. Overall, the Council is of the opinion that Ireland needs to stand ready to take further measures to ensure compliance in 2018 and is projected to comply with the provisions of the Stability and Growth Pact in 2019. In view of the difference between measurements of GDP and domestic output in Ireland and the associated impact on the debt-to-GDP ratio, Ireland’s current cyclical conditions and the heightened external risks, the use of any windfall gains to further reduce the general government debt ratio would be prudent.

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2. Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out. The expenditure benchmark for Ireland reflects an adjustment to correct for a distortion to the 10-year reference rate of potential growth caused by the exceptionally high surge in real GDP growth in 2015. Following the approach taken by the Irish authorities in their Budget 2017 calculations, the Commission has taken the average of potential growth rates in 2014 and 2016.
3. As in 2018, the expenditure benchmark reflects an adjustment to correct for a distortion to the 10-year reference rate of potential growth caused by the exceptionally high surge in real GDP growth in 2015.
Public finances have further improved on the back of robust output growth, yet risks of revenue volatility remain, and there is scope for making revenue more resilient to economic fluctuations and adverse shocks. Limiting the scope and the number of tax expenditures, and broadening the tax base would improve revenue stability in the face of economic volatility. However, some recent tax measures have focused on cuts and reliefs, and seem to have further increased reliance on highly pro-cyclical sources of revenue. Moreover, Ireland has further potential to improve the way its tax system can support environmental objectives.

As indicated in the 2018 euro-area recommendation, the fight against taxpayer's aggressive planning strategies is essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spill-over effects of taxpayers' aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. The high level of royalty and dividend payments as a percentage of GDP suggests that Ireland’s tax rules are used by companies that engage in aggressive tax planning. Limited application of withholding taxes on outbound (i.e. from Union residents to third-country residents) royalty and dividend payments made by companies based in Ireland may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. Furthermore, companies may use certain provisions in bilateral tax treaties between Ireland and some other countries to overrule the new tax residence rule put in place in Ireland in 2015 and further analysis of this issue is warranted. The outcome of the consultation undertaken by Ireland following the Independent Review of the Corporation Tax Code will be relevant for the design of the announced tax reforms. The Commission takes note of recent positive steps announced or adopted (i.e. steps taken to tackle aggressive tax planning domestically; possible defensive measures against listed non cooperative jurisdictions). Based on recent exchanges, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

Long-term fiscal sustainability risks related to the cost of ageing remain. Ireland has introduced some significant efficiency measures such as a cost-saving agreement with the pharmaceutical industry, a financial management system and activity-based funding. Some measures have also been taken to improve the availability of primary healthcare. However, the Irish healthcare system is costly and faces many challenges, which are compounded by a rapidly ageing population. Moreover, primary and community care services are not yet capable of alleviating the mounting pressure on capacity and costs within hospital care. The planned move towards universal healthcare needs to be supported by multi-year budgeting and better expenditure control. In addition, it has to be informed by the findings from a comprehensive spending review of the effectiveness and efficiency of the health sector. In addition, strengthening the gatekeeper role of primary care for Ireland's overburdened hospitals should be considered. Despite a wide range of reforms to contain public pension expenditure, the overall pension system deficit is expected to grow significantly in the long term. A timely implementation of the presented roadmap for pension reform is key to strengthening the fiscal sustainability of the Irish pension system.

Years of low investment following the economic bust are taking their toll on the availability of appropriate infrastructure in the areas of transport, clean energy, water services, housing and telecommunications. Persistent supply shortages, coupled with increasing demand, continue to fuel property price increases. Although prices did not seem overvalued in 2016, affordability is a concern. If not addressed, constraints limiting the supply of housing could contribute to imbalances building up. Combined with spatial planning, improved infrastructure is a critical enabler for an appropriate housing supply response, the enhancement of private investment, productivity growth and a balanced regional economic development. Moreover, infrastructure investment in clean energy, clean and public transport and water as well as intensified efforts in the field of renewable energy and the circular economy will be essential for Ireland to succeed in its transition towards a low-carbon and environmentally resilient economy. The National Development Plan 2018-2027 and the National Planning Framework, which are part of the ‘Ireland 2040 Strategy’, will be strong steps in the right direction once acted upon and implemented in close coordination with stakeholders.

Existing climate change mitigation efforts will not enable Ireland to achieve its Europe 2020 climate goals domestically. Only limited progress has been achieved in decarbonising key parts of the economy, mainly in agriculture, road transport and the residential sector. This will make it necessary for Ireland to use available
Ensuring inclusive growth remains a challenge in Ireland. Unemployment fell to 6.7% in 2017 but certain groups are still largely detached from the labour market and socially excluded. The social protection and taxation systems are very effective in curtailing poverty and inequality, and Ireland has taken measures to incentivise employment by tapering the withdrawal of benefits and supplementary payments. Ireland’s persistent high at-risk-of-poverty-or-social-exclusion rate is linked to the high proportion of people living in households with low work intensity (almost twice the Union average and highest in the Union — 18.2% versus 10.5% in 2016). This is particularly prevalent for single-parent households. Almost three quarters of people who are not working in Ireland are inactive. Both the overall and child at-risk-of-poverty-or-social-exclusion rates fell slightly in 2016 but remain higher than the Union average. As a result, Ireland needs to complete the implementation of its Action Plan for Jobless Households, including by improving the integrated support to people furthest from the labour market. The supply of social housing requires continued attention to meet ambitious targets and high demand.

Access to affordable, full-time and quality childcare remains a challenge. According to the Organisation for Economic Co-operation and Development, childcare costs in Ireland — relative to wages — were in 2015 the highest in the Union for lone parents and the second highest in the Union for couples. The high costs of childcare can act as a barrier to accessing paid employment, particularly in low-income households, including single-parent households. This has a negative effect on women’s employment rate, which stood in 2016 at 65.4%, close to the Union average. A law on the Single Affordable Childcare Scheme is nearing finalisation in Parliament. Implementation delays are already becoming apparent. The quality of childcare provision has also been promoted in particular through initiatives to ensure robust staff qualifications.

The differences between the employment rates of low, medium and highly skilled workers were among the highest in the Union in 2016 and the employment rate of low-skilled labour is 10 percentage points lower than before the economic crisis. As a consequence and linked to the change in economic activity, skills mismatches and skills shortages are becoming more evident in several areas. This accentuates the need to accelerate upskilling and reskilling policies and measures. Ireland has in particular a low level of participation in lifelong learning among low-skilled people in employment, which makes them vulnerable to changes in labour demand. Ireland has overall one of the lowest levels of digital skills in the Union, which is in stark contrast to the high proportion of science, technology, engineering and mathematics graduates leaving the Irish higher education system. Ireland also has one of the lowest employment rates of people with disabilities in the Union.

Productivity growth in Ireland is mainly driven by multinational companies. The productivity performance gap between these firms and Irish indigenous firms — mostly small and medium-sized enterprises — is increasing. The high international mobility of some of the multinationals and current uncertainties may put the sustainability and resilience of the Irish economy at risk in the longer term. Recent research has revealed that Irish-owned firms draw limited spill-overs and benefits in terms of productivity growth, innovation and export performance from the activities of multinationals in Ireland. However, Irish firms that carry out R&D efforts do benefit from spill-overs from multinationals. Public-sector incentives to carry out R&D and increasing the availability of skilled workers to Irish small and medium-sized enterprises would foster the diffusion of new technologies in those firms. In addition and as repeatedly indicated by the Irish National Competitiveness Council, ensuring the
competitiveness of Irish firms requires limiting the growth of certain inputs and of legal costs in particular. Barriers in the market for legal services continue to represent a challenge, hampering competition and raising costs for service recipients. These affect mostly small businesses as they increase litigation costs. No implementing regulations are as yet in place for the new Legal Services Regulation Act. Public consultations, which are a pre-requisite to implementing legislation, are experiencing significant delays.

(18) Even if Ireland’s financial sector is on the way to a sustained recovery, legacy issues still create constraints. Although Ireland continued to make progress in reducing non-performing loans, their ratio to total gross loans (11.2% in September 2017) remains among the highest in the Union. Debt overhang, market concentration and heightened uncertainty in some exporting sectors weigh on the demand for credit by small and medium-sized enterprises which remains subdued. It is crucial to reduce the long-term arrears, of which those overdue for more than two years account for around 60% of total mortgages in arrears in 2017. Reducing long-term arrears could also help address the problem of debt overhang, which reduces the incentives for corporations, and small and medium-sized enterprises in particular, to put credit into more productive uses. Although its 2017Q4 Report on Residential Mortgage Arrears and Repossessions noted that approximately 87% of restructured mortgages are meeting the arrangements, the Central Bank of Ireland has highlighted that restructures involving a temporary payment reduction are particularly prone to re-defaults. The viability of repossessions and write-offs as last resort options could be improved and complemented by a strong consumer protection framework safeguarding the positive developments in secondary market loan sales and the durability of loan restructuring solutions.

(19) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Ireland’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Ireland in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Ireland but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(20) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below.

(21) In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below,

HEREBY RECOMMENDS that Ireland take action in 2018 and 2019 to:

1. Achieve the medium-term budgetary objective in 2019. Use windfall gains to accelerate the reduction of the general government debt ratio. Limit the scope and the number of tax expenditures, and broaden the tax base. Address the expected increase in age-related expenditure by increasing the cost-effectiveness of the healthcare system and by pursuing the envisaged pension reforms.

2. Ensure the timely and effective implementation of the National Development Plan, including in terms of clean energy, transport, housing, water services and affordable quality childcare. Prioritise the upskilling of the adult working-age population, with a focus on digital skills.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
3. Foster the productivity growth of Irish firms, and of small and medium enterprises in particular, by stimulating research and innovation with targeted policies, more direct forms of funding and more strategic cooperation with foreign multinationals, public research centres and universities. Promote faster and durable reductions in long-term arrears by the use of secondary markets, building on initiatives for vulnerable households and, where necessary, using write-offs of non-recoverable exposures.

Done at Brussels, 13 July 2018.

For the Council

The President

H. LÖGER
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Spain and delivering a Council opinion on the 2018 Stability Programme of Spain

(2018/C 320/08)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Spain as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (Recommendation for the euro area)

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Spain should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (3) below.

(3) The 2018 country report for Spain was published on 7 March 2018. It assessed Spain’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Spain's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission's analysis led it to conclude that Spain is experiencing macroeconomic imbalances. In particular, large stocks of external and internal debt, both public and private, in a context of high unemployment, continue to constitute vulnerabilities with cross-border relevance. The external rebalancing is advancing, thanks to the current account surpluses recorded since 2013, which are underpinned by structural improvements in trade performance. However, net external liabilities remain high.

Private sector debt reduction is also progressing, supported by favourable growth conditions, but deleveraging needs persist. A healthier financial sector is supporting economic activity. Despite the strong nominal GDP growth, government debt as a share of GDP is only slowly decreasing. The unemployment rate has continued its rapid decline, but remains very high and the high degree of labour market segmentation impedes faster labour productivity growth. Following the strong reform momentum between 2012 and 2015, progress on the implementation of recommendations has become more limited. The present economic situation provides a window of opportunity to address pending reform needs with a view to making the Spanish economy more resilient and raising productivity growth.

(4) Spain is currently in the corrective arm of the Stability and Growth Pact. In its 2018 Stability Programme, Spain plans to correct the excessive deficit by 2018, in line with Council Decision (EU) 2017/984 giving notice to Spain to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit (1). The general government balance is planned to continue improving and to reach a 0,1 % of GDP surplus in 2021. The 2018 Stability Programme incorporates all the measures included in the draft budget law submitted to Parliament on 3 April 2018 as well as additional measures announced by late April 2018. The medium-term budgetary objective of a balanced budgetary position in structural terms is not planned to be reached within the time horizon of the 2018 Stability Programme. The 2018 Stability Programme projects the government debt-to-GDP ratio to decline to 97,0 % in 2018, 95,2 % in 2019, and 89,1 % in 2021. The 2018 Stability Programme’s macroeconomic assumptions are plausible. Overall, the planned achievement of the headline deficit targets continues to rely on the strong economic outlook and on government expenditure growing by less than nominal GDP. Risks to the achievement of the fiscal targets relate to both stronger revenue growth and more contained expenditure increases than those projected in the Commission 2018 spring forecast, and to the possible materialisation of further contingent liabilities.

(5) In Decision (EU) 2017/984, the Council requested Spain to put an end to the excessive deficit situation by 2018 and, in particular, to reduce the general government deficit to 4,6 % of GDP in 2016, 3,1 % of GDP in 2017 and 2,2 % of GDP in 2018. This improvement in the general government balance was deemed consistent with a deterioration of the structural balance by 0,4 % of GDP in 2016, and a 0,5 % of GDP improvement in both 2017 and 2018, based on the updated Commission 2016 spring forecast. Spain reached a headline deficit of 3,1 % of GDP in 2017, as required in Council Decision (EU) 2017/984. The Commission 2018 spring forecast projects the headline deficit to decline to 2,6 % of GDP in 2018, 0,4 % of GDP above the headline deficit target in the 2018 Stability Programme and that set by the Council. Compared to the 2018 Stability Programme, the Commission 2018 spring forecast projects lower growth in government revenues and somewhat higher expenditure. In the Commission 2018 spring forecast, the structural balance is forecast to deteriorate by 0,3 % of GDP in 2018, against the backdrop of deficit-increasing measures included in the draft budget law for 2018 that reached Parliament on 3 April 2018, and to improve only slightly in 2019. Hence, the fiscal effort in 2018 as well as cumulated over 2016-2018 is not expected to be ensured. While the economic expansion is supporting the deficit reduction, it is not being used to structurally strengthen the public finances. Accordingly, in its Opinion on the updated 2018 Draft Budgetary Plan of Spain, the Commission concludes that the Plan is broadly compliant with the provisions of the Stability and Growth Pact, as the Commission 2018 spring forecast projects that the excessive deficit will be corrected in a timely manner, but is expansionary.

(6) For 2019, should a timely and durable correction of the excessive deficit be achieved, Spain would be subject to the preventive arm of the Stability and Growth Pact and to the transitional debt rule. In view of Spain’s general government debt ratio above 60 % of GDP and projected positive output gap of 2,3 % of GDP, nominal net primary government expenditure (2) should fall by at least 0,3 % in 2019, in line with the structural adjustment of 1,0 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. At the same time, there are signs that idle capacity in the economy is underestimated. In 2019, Spain is still expected to record one of the highest unemployment rates in the Union, which is set to contain wage pressures, especially in the private sector, and in turn inflation is expected to remain well below 2 %. This points to remaining slack in the labour market. In addition, even if the Commission’s assessment of the

(2) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
In addition, in Decision (EU) 2017/984, the Council also requested Spain to take measures to improve its fiscal framework, with a view to increasing the automaticity of mechanisms to prevent and correct deviations from the fiscal targets and to strengthening the contribution of the Stability Law's spending rule to fiscal consolidation. However, the 2018 Stability Programme does not report plans to reinforce the domestic spending rule. Neither does it report measures to increase in the law the automaticity of the corrective and preventive mechanisms. The Council also requested Spain to take measures to improve its public procurement policy framework. Spain has made progress with the adoption of a new law on public sector contracts in November 2017. However, the new legislation can only improve the efficiency and transparency of public procurement if it is swiftly and ambitiously implemented by setting up the new governance structure and enhancing control mechanisms of procurement procedures at all levels of government. In particular, the forthcoming National Public Procurement Strategy should specify the ex-ante and ex-post controls to be carried out by the new structures. In June 2017, the Government commissioned the independent fiscal authority to carry out a spending review on selected public sector subsidies. The Commission monitors the implementation of the review, which is expected to be completed by early 2019.

On 27 April 2018, Spain submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Employment has continued to grow at a robust pace in Spain, supported by the effects of past labour market reforms and wage moderation. The unemployment rate continues to fall, but it remains well above the country's pre-crisis levels and ranks among the highest in the Union. This entails considerable untapped skills potential, in particular for young unemployed people. The proportion of unemployed people who have been without a job for more than a year is decreasing but still accounts for 44.5 % of all unemployed people. Spain adopted a set of policy initiatives to extend the individual support to the long-term unemployed and to help young people enter the labour market and improve their employability, in particular by increasing the number of Youth Guarantee beneficiaries. The effectiveness of these measures also depends on the capacity of regional public employment and social services to deliver personalised support to jobseekers, which is only slowly improving. There is also scope for greater cooperation with employers, in particular by increasing the percentage of vacancies handled by the employment services and by better profiling and matching of jobseekers with employers' needs. At the same time, efforts to improve the coordination between employment and social services, which has seen some progress in 2017, should be maintained.


The plausibility of the output gap does not flag the output-gap estimates based on the commonly agreed methodology as implausible, it indicates a rather wide range of plausible output-gap estimates for Spain. On this basis, an annual structural adjustment of 0.65 % of GDP, corresponding to a maximum growth rate of net primary government expenditure of 0.6 %, appears appropriate. According to the Commission 2018 spring forecast, under unchanged policies, there is a risk of a significant deviation from the required fiscal adjustment in 2019. In addition, Spain is not projected to comply with the requirements of the transitional debt rule in 2019. Overall, the Council is of the opinion that Spain needs to stand ready to take further measures to ensure compliance in 2018 and that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.
The proportion of employees on temporary contracts is among the highest in the Union, and mostly comprises young and low-skilled workers. Temporary contracts are often short term and rarely serve as a stepping stone to a permanent contract. Their widespread use, including in sectors less prone to seasonal or cyclical activity, may impede faster productivity growth and is often associated with lower entitlements to social benefits and higher risks of poverty. While open-ended contracts have increased as a percentage of net employment growth in the last two years, further action is needed to incentivise transitions from temporary contracts into open-ended ones. The system of recruitment incentives remains fragmented and does not effectively aim to promote open-ended employment. Spain adopted a plan to reduce the reliance on fixed-term employment in the public sector, but its implementation is just beginning and needs to speed up to meet the 8% target set for 2019. Labour inspectorates’ greater capacity and effectiveness in fighting the abuse of temporary contracts has resulted in an increased number of them being converted into permanent contracts, but does not seem to discourage employers from continuing to use them extensively. The tripartite round table set up at the beginning of 2017 to discuss quality of employment has not yet made specific proposals. The involvement of social partners in policy design has increased recently but there is still room for further improvement.

Economic growth and job creation are helping to reduce the share of people at risk of poverty and social exclusion, which nevertheless remains above the Union average, as well as income inequality. In-work poverty is a concern especially amongst households with members employed on temporary or part-time contracts. The child poverty rate, although declining, remains very high. The impact of social transfers other than pensions on reducing poverty is below the Union average and decreasing. Income guarantee schemes are marked by large disparities in access conditions across regions, and by the fragmentation of multiple national schemes that target different groups of jobseekers and are managed by different administrations. As a result, a number of people in need do not receive support. Further to the recent study assessing the effectiveness of the national and regional income guarantee schemes, no action plan has been agreed yet. The launch of a Universal Social Card system should make the social benefits granted more transparent and facilitate participation in associated activation measures, although it will not directly address the weaknesses of the existing schemes. The effectiveness of family benefits is also low and coverage is uneven. The Spanish pension system plays an important role in maintaining the quality of life of older people, who as a result face a significantly lower risk of poverty than younger generations. Relative to wages, current pensions are among the highest in the Union. Projections in the forthcoming 2018 Ageing Report and Pension Adequacy Report (1) indicate that the 2011 and 2013 reforms helped to ensure sustainability and relative adequacy of pensions in the long term. However, the increases in pensions and the postponement of the sustainability factor proposed during the adoption process of the draft 2018 budget call into question the commitment to these reforms. At the same time, they do not address the main challenge to income adequacy of future retirees, which is rather related to high unemployment and segmentation in the labour market.

Addressing weaknesses in Spanish firms’ innovation capacity could improve their productivity. Innovation performance and productivity growth are hampered by persistently subdued levels of investment in research and development, which make reaching the national Europe 2020 research and development intensity target of 2% very unlikely. This trend is reinforced by the low and falling execution rate of the public budget for research and development. While governance of national research and innovation policy is being streamlined, partly through the new State Agency for Research, national-regional coordination in the design, implementation and evaluation of policy remains weak. Developing an evaluation culture to systematically assess the effectiveness of support programmes and policies would allow policy learning and create synergies across levels of government.

The limited innovation capacity of Spanish firms is also explained by skills mismatches, which negatively affect the long-term potential for productivity growth. Under-qualification and over-qualification at work are widespread in Spain. Despite having improved markedly over the last decade, early-school-leaving rates are well above the Union average. Together with educational outcomes, they vary greatly across regions and may affect equality of opportunities. Targeted programmes to address these disparities have so far only had limited effects. The National Social and Political Pact on Education, aimed at an in-depth reform of the education system, is still in the negotiation phase. In the meantime, the professional development of teachers is to be supported by replacing temporary employment contracts and increased resources for their training. At the same time, tertiary graduates in particular face difficulties in finding adequate, stable jobs in the labour market. Greater cooperation

between education and business could boost labour market access of young graduates, while providing firms with the skills required to enhance their innovation capacity. In this context, the proposal for a new national digital strategy acknowledges the need to improve digital skills. Challenges relate to the low number of specialists in information and communication technologies, as well as to promoting the role of the education system in advancing digital skills. Retraining workers in digital skills would also allow Spanish companies to remain competitive in an increasingly digitised economy.

(15) Regulatory disparities in the business environment also play a role in keeping productivity growth restrained. In the current context, regulatory disparities and restrictions in the business environment contribute to keeping mark-ups high, reducing the geographical mobility of companies and workers, and restraining productivity growth. The Law on Market Unity, which aimed to meet this challenge, has been implemented only in part. The monitoring of the implementation of that Law at regional and local level must be improved and the role of the sectoral conferences strengthened. That Law introduced the principle that compliance with certain requirements in one part of the territory would allow businesses to operate in the whole territory. In several judgments published in 2017, the Constitutional Court held that this principle is void in the absence of common or equivalent minimum standards for access to or exercise of an economic activity. In light of these judgments, establishing consistent common or equivalent standards throughout the territory could help fulfill the objectives of that Law. In addition, cooperation between the different levels of government should be improved at all stages of the implementation to more effectively tackle the adverse effects of fragmentation on businesses. The work of the Committee for Better Regulation, which was set up to ensure that the legislation was aligned with the Union acquis on services, should be accelerated. Restrictions affecting certain regulated professions such as civil engineers and architects were also highlighted in the Services Package adopted in January 2017, and no specific measures to address them have been taken so far.

(16) More generally, improvements in the quality of institutions could boost trust in the Spanish economy and amplify the gains from measures adopted to increase productivity growth. Progress has been made in the transparency of party financing, and disclosure of assets and conflicts of interest. The business environment has also benefited from progress in the fight against corruption, although concerns still remain in this area. Perceptions of the independence of the justice system have also improved amongst citizens and businesses. Efforts to further improve the effectiveness of the justice system are under way and should be continued. Though some progress has been made in this broad area, the challenge of fostering trust in institutions across all levels of government remains.

(17) Further enhancing the transport, energy and water infrastructure would foster territorial cohesion, better integration in the common market and productivity growth. Cross-border transport and energy connections, as well as the water infrastructure, face investment gaps. Better use could be made of passenger and freight rail infrastructures. The different gauges coexisting in Spain, Portugal and France are a critical barrier to better rail connectivity, although new sections using the internationally prevalent standard gauge have been completed recently. Shortcomings are also found in freight railway connections between the main harbours on the Atlantic and Mediterranean coasts and in-land industrial areas. Insufficient connectivity also impedes closer integration in the Union electricity and gas markets. Further infrastructure investment is needed to improve water management, for example to treat wastewater, reduce leaks in the networks and improve water supply. This would bring environmental, economic and social benefits to Spain.

(18) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Spain’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Spain in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Spain but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below:

HEREBY RECOMMENDS that Spain take action in 2018 and 2019 to:

1. Ensure compliance with Council Decision (EU) 2017/984 giving notice under the excessive deficit procedure, including through measures to enforce the fiscal and public procurement frameworks at all levels of government. Thereafter, ensure that the nominal growth rate of net primary government expenditure does not exceed 0.6% in 2019, corresponding to an annual structural adjustment of 0.65% of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.

2. Ensure that employment and social services have the capacity to provide effective support for jobseekers, including through better cooperation with employers. Foster transitions towards open-ended contracts. Improve family support and increase the effectiveness of income guarantee schemes, by addressing coverage gaps, simplifying the system of national schemes and reducing disparities in access conditions to regional ones. Reduce early school leaving and regional disparities in educational outcomes, in particular by better supporting students and teachers.

3. Increase public investment in research and innovation and systematically carry out evaluations of support policies in this area to ensure their effectiveness. Increase cooperation between education and businesses with a view to mitigating existing skills mismatches. Further the implementation of the Law on Market Unity by ensuring that, at all levels of government, rules governing access to and exercise of economic activities, in particular for services, are in line with principles of that Law and by improving cooperation between administrations.

Done at Brussels, 13 July 2018.

For the Council
The President
H. Löger
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of France and delivering a Council opinion on the 2018 Stability Programme of France
(2018/C 320/09)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified France as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (Recommendation for the euro area).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, France should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendations (1) and (2).

(3) The 2018 country report for France was published on 7 March 2018. It assessed France's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and France's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission's analysis led it to conclude that France is experiencing macroeconomic imbalances. In particular, vulnerabilities stem from high public debt and weak competitiveness dynamics in a context of low productivity growth. The risk of an adverse effect on the French economy and, given its size, of negative spillovers to the economic and monetary union, is particularly important.

(4) On 25 April 2018, France submitted its 2018 National Reform Programme and its 2018 Stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) Following the timely and durable correction of the excessive deficit and Council Decision (EU) 2018/924 (2) to abrogate the excessive deficit procedure, France is in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2018 Stability Programme, the Government plans a gradual improvement of the general government balance from − 2.6 % of GDP in 2017 to + 0.3 % of GDP in 2022. The medium-term budgetary objective — a structural deficit of 0.4 % of GDP — is not planned to be achieved over the period covered by the 2018 Stability Programme. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to decrease from 97.0 % in 2017 to 89.2 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not be sufficiently specified.

(7) On 11 July 2017, the Council recommended France to ensure that the nominal growth rate of net primary (3) government expenditure does not exceed 1.2 % in 2018, corresponding to an annual structural adjustment of 0.6 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission’s assessment of the strength of the recovery in France while giving due consideration to its sustainability challenges, carried out in the context of its opinion on France’s 2018 Draft Budgetary Plan, no additional elements in that regard need to be taken into account. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2018.

(8) In 2019, in view of France’s general government debt ratio above 60 % of GDP and projected output gap of 0.6 %, the nominal growth rate of net primary government expenditure should not exceed 1.4 %, in line with the structural adjustment of 0.6 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. According to the Commission 2018 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement in 2019, and over 2018 and 2019 taken together. France is prima facie not forecast to comply with the transitional debt rule in 2018 and 2019. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.

(9) The level of public expenditure in France is the highest in the Union. The expenditure ratio is projected to reach 56.0 % of GDP in 2018, 10.6 percentage points higher than the Union average. While the consolidation strategy in recent years has mainly benefited from declining interest rates and cuts in public investment, the low interest rate environment is unlikely to prevail in the medium term and the cut in productive investment could harm future economic potential. The spending reviews since 2014 did not render significant savings and efficiency

(3) Net primary government expenditure comprises total government expenditure excluding interest expenditure. expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
The unemployment rate declined from 10.4% in 2015 to 9.4% in 2017 and is forecast to decrease further in the coming years, while the employment rate rose to 70.6% in 2017. However, labour market conditions for young people, low-skilled workers and people with a migrant background (both first and second generation) remain relatively more difficult. In 2017, only 55.6% of non-EU-born people (aged 20-64) were in employment, which is 17.0 percentage points lower than the figure for those born in France. Inhabitants of most deprived areas (Quartiers de la politique de la ville), including people with a migrant background, continue to face difficulties on the labour market. Notwithstanding policy action, the impact of socioeconomic and migrant background on educational performance is comparatively high and hampers labour market integration. There is also evidence of discriminatory practices in the labour market. Effective active employment support, including language training, intensive job counselling and recruitment support, and firmer action on discriminatory practices, are key to fostering equal opportunities on the labour market.

The 2016 law on labour, modernising social dialogue and securing professional pathways aims to improve firms’ capacity to adjust to economic cycles and reduce the share of workers on temporary contracts. While more people are being recruited on open-ended contracts, labour market segmentation remains a challenge and the transition to more open-ended forms of employment should be fostered. In this context, it is important to finalise the implementation of the ongoing ambitious reform programme, which includes the recently adopted reform of the labour law, the planned overhaul of the unemployment benefit system, and the reform of the vocational education and training system, including apprenticeships.

The gradual implementation of measures to reduce the labour tax wedge have improved France’s cost competitiveness since 2013, but accumulated past losses have not yet been fully recovered. At the average wage, in 2016, France still had one of the highest employers’ social contribution rates as a proportion of total labour costs in the Union. Existing policy measures to reduce labour costs are expected to be further consolidated and strengthened as of 2019, with the announced conversion of the tax credit for competitiveness and employment (CICE) into a generalised reduction of social contributions for employers and the introduction of further rebates for lower wages to foster employment of the low-qualified.

Since 2013, the French minimum wage has followed its indexation rule, without any ad hoc hikes. As a result, it has grown more slowly than reference wages (1.23% in 2017, compared to 1.31% for average wage), in a context of weak inflation and subdued wage growth. While the minimum wage, as compared with the average wage, is high in international terms, the cost of labour at the minimum wage has been significantly curtailed by reductions of social contributions. Such reductions will be intensified and made permanent as of 2019. While the indexation of the minimum wage is important to preserve workers’ purchasing power, the current mechanism (unique in the Union) might limit wage adjustments to changing conditions, with potential negative consequences for competitiveness. A group of independent experts assesses the minimum wage annually and provides non-binding opinions on its development. In 2017, the group recommended revising the indexation rule, for example by limiting it to inflation indexation only.
The current initial vocational education and training system does not sufficiently support labour market integration in particular because a significant proportion of students is driven towards pathways with limited employment prospects. Moreover, French students in vocational education and training achieve much lower educational outcomes than the Union average, while those in general education perform much better. In this context, measures to foster apprenticeships, which are associated with better employment prospects, along with measures to improve school-based results, are essential to support youth employment and promote equality of opportunity. At the same time, improving access to continuous training for the low-qualified workers and jobseekers and promoting the achievement of higher qualifications, backed by appropriate training guidance, are also important. Reflecting these challenges and in particular the need to improve the governance of the system, ensure labour market relevance, quality and access to training and secure labour market transitions, the Government presented on 27 April 2018 a draft law reforming the apprenticeship and continuous vocational education and training system. Moreover, the 2018 National Reform Programme confirms the intention to implement a EUR 14 billion investment plan for skills and opens the way for a complementary reform of the school-based initial vocational education.

Overall, the social protection system delivers good results. Income inequalities after transfers are below the Union average and, despite a recent increase, the number of people at risk of poverty and social exclusion remains relatively low. However, some groups, in particular single-parent families, people not born in the Union and people living in deprived urban areas face a higher risk of poverty. Access to adequate housing for people living in poverty remains a matter of concern. Despite recent improvements, social housing shortages remain in some areas.

Despite ongoing reforms to reduce the tax burden on companies and support productive investment, the French tax system continues to be characterised by a high level of complexity, with tax expenditures, inefficient taxes and taxes on production forming barriers to a well-functioning business environment. The high number of tax expenditures (tax credit, exemptions, tax reductions) puts an additional burden on businesses, and SMEs in particular, in the form of increased compliance costs and uncertainty. It also creates additional control costs for the tax administration. Tax expenditures will increase further in number and in value under the 2018 Budget Law and are set to reach EUR 99.8 billion in 2018 (4.2 % of GDP) in 2018, as compared with EUR 93 billion in 2017. In addition, around 192 taxes yielding low revenue (less than EUR 150 million a year) have been identified, but only a very limited number have been eliminated since 2014 (1). Finally, France has very high taxes on production in the Union (2) (3.1 % of GDP in 2016) which consist mainly of capital and labour taxes for which companies are liable as a result of engaging in production and regardless of their economic performance.

Market services accounted for more than 50 % of value added, 40 % of employment and 20 % of the manufacturing industry's value added in exports in 2016. However, while competition in market services has an impact across the whole economy, it is still hampered by regulatory requirements and administrative burden, which also impede firms' ability to grow. If sufficiently ambitious and fully implemented, reforms in the area of services could have a significant positive economic impact. In prioritising reform efforts, it is important to take into account the economic importance and performance of the services subsectors. An indicator-based approach used to identify priority reforms in the services sectors highlights a number of business services (architectural and engineering activities, legal and accounting activities, administrative and support services), retail trade, accommodation and food services, and health. In the specific area of professional services, the Growth, Activity and Equal Economic Opportunities Act (the 'Macron law') of 6 August 2015 eased restrictions in a limited number of professions, mostly legal professions. There remains scope for further reforms in professional services. Further reforms could target specific entry and exercise restrictions (e.g. reserves of activity, voting rights restrictions, shareholding restrictions, multidisciplinary restrictions and numerus clausus restrictions), which are considered excessive. Reforms to address key impediments to firms' growth could include removing threshold effects linked to size-related criteria in regulations and reducing the administrative burden on businesses. Finally, improving France's coverage with fast broadband would enhance its ability to benefit from the digital economy.

According to the European Innovation Scoreboard, France's innovation performance remains below that of Union innovation leaders, despite the relatively high level of public support. In particular, improving the efficiency of public support schemes including the tax credit for research and development (Crédit d'Impôt Recherche) would

(1) Inspection Générale des Finances (2014), Les taxes à faible rendement.
(2) Taxes on production are to be understood as 'other taxes on production' according to EUROSTAT (D29 category).
stimulate better innovation output. In this respect, the results of ongoing evaluations need to be fed into improvements to the design of public support for innovation. Knowledge transfer between public research and businesses remains a challenge and this limits the commercial exploitation of research results. Compared with other Union countries, France's performance is low in public-private co-publications and public R&D financed by businesses. There is some potential to strengthen transfer mechanisms between academia and industry by simplifying partnership research and incentivising researchers' mobility.

(20) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of France's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to France in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in France, but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(21) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below.

(22) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below,

HEREBY RECOMMENDS that France take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.4 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. Implement expenditure savings in 2018 and fully specify the objectives and new measures needed in the context of Public Action 2022, for them to translate into concrete expenditure savings and efficiency gains measures in the 2019 budget. Progressively unify the rules of the different pension regimes to enhance their fairness and sustainability.

2. Pursue the reforms of the vocational education and training system to strengthen its labour market relevance and improve access to training, in particular for low-qualified workers and jobseekers. Foster equal opportunities and access to the labour market, including for people with a migrant background and people living in deprived areas. Ensure that minimum wage developments are consistent with job creation and competitiveness.

3. Simplify the tax system, by limiting the use of tax expenditures, removing inefficient taxes and reducing taxes on production levied on companies. Reduce the regulatory and administrative burden to increase competition in the services sector and to foster firms' growth. Step up efforts to increase the performance of the innovation system in particular by improving the efficiency of public support schemes and strengthening knowledge transfer between public research institutions and firms.

Done at Brussels, 13 July 2018.

For the Council

The President

H. LÖGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Croatia and delivering a Council opinion on the 2018 Convergence Programme of Croatia

(2018/C 320/10)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Croatia as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Croatia was published on 7 March 2018. It assessed Croatia’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the recommendations adopted in previous years and Croatia’s progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that Croatia is still experiencing excessive macroeconomic imbalances, although they are being reduced. Vulnerabilities are linked to still high levels of public, private and external debt, all largely denominated in foreign currency. The level of non-performing loans remains high, in particular for non-financial corporations. Croatia’s potential growth remains insufficient to enable a durable adjustment and overall there has been little progress in implementing policy measures to address the chronically low labour utilisation and slow productivity growth. Competitiveness and investment remain hindered by a restrictive business environment and the fragmentation of the public administration weighs on efficiency in public services.

(3) On 26 April 2018, Croatia submitted its 2018 National Reform Programme and its 2018 Convergence Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014–2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Croatia is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. Starting from a general government surplus of 0.8 % of GDP in 2017, the 2018 Convergence Programme plans the headline balance to fall into a deficit of 0.5 % of GDP in 2018 and then to gradually improve to a surplus of 0.5 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 1.75 % of GDP — is planned to continue to be overachieved throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to fall from 78.0 % of GDP in 2017 to 75.1 % in 2018 and to continue declining to 65.9 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. However, the planned budgetary targets appear cautious. The Commission 2018 spring forecast projects the general government balance at 0.7 % and 0.8 % of GDP in 2018 and 2019, respectively.

On 11 July 2017, the Council recommended Croatia to remain at its medium-term budgetary objective in 2018. Based on the Commission 2018 spring forecast the structural balance is forecast to stand at – 0.3 % of GDP in 2018 and at – 0.6 % of GDP in 2019, remaining above the medium-term budgetary objective. Croatia is forecast to comply with the debt rule in 2018 and 2019. Overall, the Council is of the opinion that Croatia is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

The planned adoption of key legislation to improve Croatia’s fiscal framework is long overdue. Flaws in the design of the numerical fiscal rule make it ineffective for fiscal policy planning and the role of the Fiscal Policy Commission as an independent body is still weak. Croatia’s still high level of public debt and its exposure to currency risks mean that sound debt management practices remain essential. In 2017, the debt management function was strengthened and a debt management strategy was produced, which requires regular updates. The introduction of a property tax already legislated was postponed with no indication of whether and when it would be implemented. This leaves Croatia with a low proportion of revenue from recurrent taxation of immovable property. A recurrent property tax would create scope for improving the overall growth-friendliness of revenue collection, while ensuring a stable and predictable source of revenue for local government units.

The Croatian labour market continued to recover in 2017. Still, employment and activity rates remain substantially below the Union average, hampering potential growth. To date, the statutory pensionable age is 62 years for women and 65 years for men. The convergence and increase of the statutory retirement age is slow, with both sexes stipulated to reach a pensionable age of 67 only in 2038. In addition, older workers can benefit from many pathways to early retirement and the pension system includes a number of special pension schemes providing more favourable conditions for retirement. The care responsibilities of women contribute further to their low labour market participation. The resulting low average duration of working lives implies low current and future pension adequacy and risks of old-age poverty. The announced measures to encourage longer working lives have not yet been implemented.

Even though the social dialogue structure in Croatia is in place, the actual interaction between the authorities and stakeholders in the policy preparation process is limited and has been mostly confined to the provision of written feedback on the Government-proposed measures. In addition, the fragmentation of trade unions limits their overall capacity to engage in social dialogue.

Despite recent improvements, the share of the population at risk of poverty or social exclusion remains high, with marked territorial disparities across counties. The elderly, the low-skilled and people with disabilities are

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particularly affected. The social protection system displays shortcomings in effectiveness and fairness. Social benefits have a limited poverty reduction capacity. Lack of coordination across institutions and lower fiscal capacity of poorer local government units leads to an uneven provision of social benefits.

(11) Croatia performs below Union average in education investment, early childhood education and care, basic skills, tertiary educational attainment and labour market relevance of vocational education and training in education. Croatia has launched the implementation of several reforms outlined in the strategy on education, science and technology. The reform of school curricula is likely to have a positive impact on the quality of Croatia's education, if it is implemented in full and consistently with the other actions in the strategy. The labour market relevance of vocational education and training programmes appears limited, as suggested by the fact that more than half of registered unemployed are vocational education and training graduates. Better coordination between public authorities and employers is needed to improve the identification of skills needs. The adult education system aiming to help inclusion in the labour market is characterised by a large and unevenly distributed number of providers across the country, and learning programmes that are not properly assessed. Participation in adult education and educational programmes offered as part of active labour market policy measures are critically low.

(12) The territorial fragmentation of Croatia's public administration and the wide distribution of competences across levels of government weigh on the efficiency of public service provision and public expenditure. Many small local units lack adequate financial and administrative capacity to carry out decentralised functions. Indicators of public administration efficiency show performance below the Union average, which hinders the design and implementation of public policies and a more efficient use of European Structural and Investment Funds. The planned reduction of the number of local branch offices of the central administration and the streamlining of the system of state agencies have been further postponed. Lack of coherence in the wage-setting frameworks in the public administration and public services impede equality of treatment and government control over the public wage bill. The planned legislation for their harmonisation has been further postponed to mid-2018. The authorities have taken the first steps to integrate some functions among hospitals in order to improve efficiency in service provision and access to healthcare. However, an ineffective model of the health system's financing results in accumulation of debts, especially related to inpatient care.

(13) State-owned enterprises maintain their large presence in the economy. Measures to improve their governance have advanced slowly, and they continue to operate at low levels of productivity and profitability. New legislation governing the management and disposal of state assets has been adopted.

(14) November 2017 saw the finalisation of an independent asset quality review of the Croatian Bank for Reconstruction and Development. Given the bank's importance for implementing the Union financial instruments and the Investment Plan for Europe as well as its increasing engagement in direct lending, the review's findings should be used to strengthen the bank's supervisory and regulatory framework and governance.

(15) Administrative burden and parafiscal charges continue to weigh on the business environment. Reduction of the administrative burden has been progressing steadily, but at a modest pace. Cuts in parafiscal charges have been limited and transparency is low, as neither regular updates of the registry nor impact assessments of the planned cuts have been conducted.

(16) The anti-corruption action plan 2017-2018 needs to be fully implemented in order to deliver on the objectives of the anti-corruption strategy 2015-2020. Several key elements still require improvement, particularly asset and conflict-of-interest disclosures, raising awareness of whistle-blowing reporting channels, and an effective control of risks in public procurement, which remains vulnerable to corruption due to a large share of in-house contracting by state-owned entities.

(17) Restrictive regulation in goods and services markets, in particular a high number of exceedingly regulated professions hampers competition. Easing regulation has been slow against the background of strong resistance from interest groups.

(18) Lengthy court proceedings and sizeable backlogs continue to weigh on the quality and efficiency of the justice system and consequently the business environment. The observed decrease in backlogs was mainly driven by a lower inflow of new cases rather than faster resolution of cases. Despite improvements, electronic communication in litigation and insolvency proceedings remains underused.
Some targeted efforts to reform the national science and innovation system are in the making via Croatia’s smart specialisation strategy. Policy responsibilities in support of science and innovation appear uncoordinated, which weakens the implementation of the policy strategy. Similarly, major universities have highly fragmented governance structures and rigid administrative rules. Cooperation between research institutions and the business sector is weak. There is no systematic monitoring and evaluation of the impact of research and innovation policies in place, preventing proper priority setting. The tertiary education system could benefit from incentives to encourage quality and labour market relevance.

In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Croatia’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Croatia in previous years. It has taken into account not only their relevance for a sustainable fiscal and socioeconomic policy in Croatia, but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion (1) that Croatia is expected to comply with the Stability and Growth Pact.

In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below:

HEREBY RECOMMENDS that Croatia take action in 2018 and 2019 to:

1. Strengthen the fiscal framework, including by strengthening the mandate and independence of the Fiscal Policy Commission. Introduce a recurrent property tax.

2. Discourage early retirement, accelerate the transition to a higher statutory retirement age and align pension provisions for specific categories with the rules of the general scheme. Deliver on the reform of the education and training system to improve its quality and labour market relevance for both young people and adults. Consolidate social benefits and improve their poverty reduction capacity.

3. Reduce the territorial fragmentation of the public administration, streamline the functional distribution of competencies and enhance the capacity to design and implement public policies. In consultation with social partners, introduce harmonised wage-setting frameworks across the public administration and public services.

4. Improve corporate governance in state-owned enterprises and intensify the sale of state-owned enterprises and non-productive assets. Significantly reduce the burden on businesses arising from parafiscal charges and from cumbersome administrative and legislative requirements. Enhance competition in business services and regulated professions. Reduce the duration of court proceedings and improve electronic communication in courts.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Italy and delivering a Council opinion on the 2018 Stability Programme of Italy
(2018/C 320/11)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Italy as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (Recommendation for the euro area).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Italy should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (4) below.

(3) The 2018 country report for Italy was published on 7 March 2018. It assessed Italy’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Italy’s progress towards its national

Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission's analysis led it to conclude that Italy is experiencing excessive macroeconomic imbalances. In particular, high government debt and protracted weak productivity dynamics imply risks with cross-border relevance, in a context of a high but decreasing stock of non-performing loans and high though declining unemployment. The need for action to reduce the risk of adverse effects on the Italian economy and on the economic and monetary union, given the size and cross-border relevance of Italy's economy, is particularly important.

(4) On 16 May 2018, Italy submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) Italy is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. The 2018 Stability Programme submitted by the outgoing Government is based on a trend scenario assuming unchanged legislation. The headline deficit is projected by the Italian authorities to improve from 2,3 % of GDP in 2017 to 1,6 % in 2018, 0,8 % in 2019, and a broadly balanced budgetary position by 2020. The medium-term budgetary objective, set at a balanced budgetary position in structural terms, is planned to be reached by 2020 and maintained in 2021, whereas the recalculated (2) structural balance points to a small structural deficit (0,2 % of GDP) in both years. After having slightly decreased in 2017 (to 131,8 % of GDP, from 132,0 % in 2016), the general government debt-to-GDP ratio is projected in the 2018 Stability Programme to decrease by one percentage point of GDP to 130,8 % in 2018, reaching 122,0 % in 2021 also thanks to projected privatisation proceeds of 0,3 % per year over 2018-20. However, privatisation targets have been underachieved in recent years. Based on a no-policy change assumption, the Commission 2018 spring forecast expects lower real GDP growth and a higher deficit for 2019 than the 2018 Stability Programme. In fact, the Commission forecast does not incorporate a VAT hike (0,7 % of GDP) legislated for as a 'safeguard clause' to achieve the budgetary targets in 2019.

(7) On 23 May 2018, the Commission issued a report prepared in accordance with Article 126(3) of the TFEU due to Italy's prima facie non-compliance with the debt rule in 2016 and 2017. The report concluded, following an assessment of all the relevant factors, that the debt criterion as defined in the Treaty and in Council Regulation (EC) No 1467/97 (2) should be considered as currently complied with, and that opening of an excessive deficit procedure is thus not warranted, having regard in particular to Italy's ex-post compliance with the preventive arm in 2017. The Commission will reassess compliance on the basis of the ex-post data for 2018 to be notified in Spring 2019.

(8) The 2018 Stability Programme indicates that the budgetary impact of the exceptional inflow of refugees and the protection against seismic risks is significant and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure in 2017 amounted to 0,16 % of GDP for the exceptional inflow of refugees and 0,19 % of GDP concerning protection against seismic risks. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees and the seismic risks are unusual events, their impact on Italy's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2017 has been reduced to take into account these additional costs.


(2) Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

(9) On 11 July 2017, the Council recommended Italy to ensure a nominal rate of reduction of net primary government expenditure \((\text{NPE})\) by at least 0.2 % in 2018, corresponding to an annual structural adjustment of 0.6 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission's assessment of the strength of the recovery in Italy while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Italy's 2018 Draft Budgetary Plan, a fiscal structural effort of at least 0.3 % of GDP is required for 2018, without any additional margin of deviation over one year. This corresponds to a nominal rate of growth of net primary government expenditure not exceeding 0.5 %. Taking that into account in the overall assessment, based on the Commission 2018 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2018.

(10) In 2019, in view of Italy's general government debt ratio above 60 % of GDP and projected output gap of 0.5 %, the nominal growth rate of net primary government expenditure should not exceed 0.1 %, in line with the structural adjustment of 0.6 % of GDP stemming from the matrix of requirements under the Stability and Growth Pact. Under unchanged policies, there is a risk of a significant deviation from the requirement in 2019 and for 2018 and 2019 taken together. Italy is prima facie not forecast to comply with the debt rule in 2018 and 2019. Moreover, at around 130 % of GDP, Italy's high public debt ratio implies that large resources are earmarked to cover debt servicing costs, to the detriment of more growth-enhancing items including education, innovation and infrastructure. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.

(11) Italy's old-age pension expenditure, at around 15 % of GDP, is now among the highest in the Union. Implicit liabilities arising from population ageing were curbed by past pension reforms, improving Italy's long-term sustainability also by gradually adjusting retirement age to life expectancy. However, both the 2017 and the 2018 budgets contained provisions that partially reversed those reforms. Italy has a larger share of population above 65 than the Union average. This is projected to further increase over time, worsening Italy's old-age dependency ratio. Hence, pension expenditure is projected to increase over the medium term. The high share of old-age pensions in public spending also restrains other social spending, including to fight poverty, and growth-enhancing spending items like education, whose share in expenditure has been declining since the early 2000s. While respecting the principles of fairness and proportionality, sizeable savings could be achieved by intervening on the high pension entitlements not matched by contributions.

(12) Italy's tax system weighs heavily on capital and labour, which has adverse effects on economic growth. Despite the recent extension of targeted tax incentives, the tax burden on the production factors is still among the highest in the Union, discouraging investment and employment. There is room to reduce it in a budgetary neutral way, by shifting towards tax bases less detrimental to growth, such as property and consumption. The recurrent property tax on first residences was repealed in 2015, including for wealthier households. In addition, property cadastral values are largely outdated, and a reform to align them with current market values is still pending. The number and size of tax expenditures, in particular in the case of the reduced value added tax rates, are particularly high and their streamlining has been further postponed despite being required by national legislation. There is also scope to reduce the burden on compliant firms and households by reducing the complexity of the tax code and increasing the overall level of tax compliance. The extension of mandatory electronic invoicing to all private sector transactions from 2019 is a positive step in this direction. However, legal thresholds for cash payments have been increased, which could discourage the use of electronic payments whose compulsory nature may improve tax compliance. Italy's National Institute of Statistics estimates that the shadow economy amounts to about 12.6 % of GDP in 2015 but no strategic action has been planned to tackle this challenge. About 15.9 % of total employment is partially or completely undeclared, with peaks nearing 50 % in some sectors.

\(\text{NPE}\) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
Investment declined sharply during the crisis and has not yet returned to its 2007 level. Despite increasing in 2017 the level of investment is still low compared to other Union countries. Private investment has been particularly low, held back by structural factors. These include a less favourable business environment, financial constraints related to underdeveloped capital markets, impaired bank-lending and a lack of high-skilled people due to, among other reasons, brain drain and limited lifelong learning. Intangible assets, such as research and development, innovation and training of workers, are vital for productivity and economic growth and can help explain differences in productivity across countries. However, investment in such assets remains below the Union average. This is due to the large number of micro-firms, Italy's lack of specialisation in knowledge-intensive sectors, limited digitisation and digital skills. At the same time, overall public spending in research and development has been reduced. Financing of small and medium-sized companies continues to be highly dependent on the banking sector, and lending remains subdued despite financing costs at historically low levels. There are also major regional differences in investment in research and development, in the take-up of recent policy incentives for innovative firms and in the quality of education. Based on the current evaluation of the results of the different industrial measures put in place under 'Finance for Growth' and 'Industry/Enterprise 4.0' initiatives, it would seem appropriate to set-up a long-term policy framework to sustain investment that is capable of strengthening the different factors that support innovation, such as credit availability, strong research basis, high education and suitable skills. It would also seem appropriate to consider existing differences in regional industrial and education systems.

Corruption remains a major challenge for Italy's business environment and public procurement. Italy improved its anti-corruption framework by revising its statute of limitations, extending the protection of whistle-blowers to private-sector workers and better aligning the offence of corruption among private parties with international standards. While the adopted reform of the statute of limitations does not stop prescription terms after a first-instance conviction, as recommended by the Council of Europe's Group of States against Corruption, it may reduce the scope for abusive criminal litigation as a delaying tactic by lawyers at higher instances. As such, it may alleviate a long-standing concern that corruption cases get time-barred after first-instance conviction. Repression of corruption could be improved by increasing the efficiency of criminal justice. In 2014, Italy had the largest number of incoming and pending criminal cases in the Union at second and third instance, also due to one of the highest rates of Cassation appeals. This resulted in one of the longest criminal trial lengths. Incentivising expedited procedures and discouraging abuses of the trial could help make criminal justice and the fight against corruption more effective. Moreover, the National Anti-Corruption Authority has a key role in the implementation of the new anti-corruption framework.

Increasing the quality of the Italian public administration would have a positive impact on the business environment and investment and firms' ability to exploit innovation opportunities. The great regional variation in administrations' responsiveness towards firms suggests that entrepreneurs in specific areas face bigger obstacles when doing business. In 2015, a comprehensive enabling law reforming the public administration was adopted, with the potential to improve efficiency for the benefit of the economy. By the end of 2017, the implementation of the reform was completed and now requires enforcement, in particular in regions with the lowest performances. On publicly-owned enterprises, the reform aims to ensure a better alignment between rules governing publicly-owned enterprises and privately-owned entities. The declared objectives are to: rationalise publicly-owned enterprises via mergers, consolidations of non-profitable ones and privatisations; increase the efficiency of the remaining enterprises; and avoid future proliferation of non-essential publicly-owned
enterprises. The enforcement of the new framework is key to achieve these objectives. In addition, local public services are sheltered from competition (in and for the market), impacting on efficiency, quality of services and leading to consumers’ dissatisfaction. The 2015 public administration reform also envisaged a new framework reforming the management of local public services. However, in November 2016, the Constitutional Court declared the procedure followed to adopt some legislative decrees unconstitutional, including the one on local public services. As the deadline of the decree expired in November 2016, a new legislative initiative is needed.

(17) Improvements to business environment would facilitate entrepreneurship, while better framework conditions for competition would favour a more efficient allocation of resources and productivity gains. The 2015 annual competition law was adopted in August 2017 and needs to be properly implemented. However, significant barriers to competition persist in certain sectors, such as professional services, local public transport, rail and retail sectors. Increasing competitive processes to award public service contracts and concessions for access to public goods would positively impact the quality of services. In the area of public procurement, the benefits of the recent reform will depend on the reform's timely completion, a consistent application of the plans for e-procurement and aggregation and the actual activation of the central aggregation body for policy coordination (Cabina di regia per gli appalti pubblici).

(18) Market confidence in Italian banks has increased following measures taken in 2017 to deal with several weaker banks. On the back of the improved economic conditions and supervisory pressure, progress has been made with reducing non-performing loans, but the legacy stock still remains high. This constrains banks’ profitability and their ability to internally generate capital. The pace at which non-performing loans are being disposed of, which includes deepening the secondary market for non-performing loans, needs to be maintained in order to further strengthen financial stability and credit extension to the real economy. Further balance sheet restructuring and consolidation, including for small and second-tier banks, should also be supported. This includes addressing banks’ structurally low profitability through comprehensive cost-cutting and business model optimisation.

(19) Whereas the various corporate governance reforms are ongoing, full implementation of the reforms of the large cooperative and small mutual banks reforms would underpin the overall health of the banking sector. The insolvency and foreclosure frameworks remain insufficiently supportive of swiftly working out and restructuring non-performing loans. Promptly adopting and implementing the necessary legislative measures for the insolvency reform would help address structural weaknesses. Measures adopted in 2016 to accelerate collateral enforcement by banks are not yet being used. The framework for out-of-court collateral enforcement is still not fully applicable to households and only recently to companies.

(20) Despite progress due to several policy measures adopted over the last years, access to finance remains an important barrier to investment and finance for growth, particularly for small and medium-sized companies. Firms’ financing remains predominantly bank-based, while the capital market is underdeveloped as compared to other Union countries. The share of equity financing among small and medium-sized companies is particularly low, compared to the Union average. The introduction of the ‘allowance for corporate equity’ was an important reform, but the reference rate was subsequently reduced, muting its beneficial impact. Boosting market-based access to finance for firms would be an essential ingredient in diversifying firms’ financing sources in order to support investment and growth.

(21) Labour market institutions have been substantially reformed in recent years. Labour market conditions continue to improve, as headcount employment increased by 1.2 % in 2017 to over 23 million people, back to pre-crisis levels. The employment rate (age 20-64) rose to over 62 % last year, albeit largely driven by temporary jobs. However, this is still considerably below the Union average. The unemployment rate fell to 11.2 % in 2017 but the total hours worked is still considerably lower than before the recession. Despite improvements, long-term and youth unemployment remain high, posing risks to social cohesion and growth. At 20.1 % in 2017, the proportion of young people not in employment, education or training was still among the highest in the Union, with wide and persistent regional differences.
(22) Bargaining at firm or territorial level remains limited, also due to the prevalence of small firms in Italy. This may prevent wages from adapting swiftly to local economic conditions. At the end of February 2018, Confindustria and the three major Italian trade unions (Cgil, Cisl and Uil) signed a framework agreement, stressing the role of second-level bargaining, by increasing legal certainty through setting clearer rules for the representation of social partners at negotiations. The tax rebates on productivity-related wage increases set by second-level agreements were strengthened in 2017, but their effectiveness is difficult to evaluate. While the total number of collective agreements is on the rise, only a small share of them is signed by the main trade unions and employers’ associations.

(23) The reform of active labour market policies outlined by the Jobs Act made little progress in 2017. Training and re-qualification are particularly important in the light of the increased flexibility in the Italian labour market and the growing share of temporary contracts. Generally binding service standards have not yet been implemented, and employment services lack staff and adequate monitoring, although the new Budget law for 2018 allocated additional financial and human resources for Public Employment Services to the regions. Increasing the number of staff and ensuring that they are sufficiently qualified for employment services and social services, is also critical for the correct implementation of the anti-poverty scheme introduced in 2018 and for the Youth Guarantee, which aims to provide young people in need with an adequate job or training offer in a timely manner.

(24) The proportion of women participating in the labour market, although on the rise, remains one of the lowest in the Union. The impact of the recent measures, centred on non-means-tested cash payment per child birth, has not been assessed by the Italian authorities. Evidence suggests that these cash transfers may not be effective to increase women's participation in the labour market. In addition, they are unlikely to increase the birth rate, which has been stagnating at very low levels over the last 20 years. A comprehensive strategy to reconcile family life and work is missing. These shortcomings are reflected by the lack of gender balanced design of parental leave, flexible working arrangements and the insufficient supply of adequate, affordable and quality childcare and care services.

(25) Introducing measures to raise human capital and skills would help improve employability and meet future labour market needs. The overall quality of schooling in Italy is improving, but wide regional differences persist. The proportion of students leaving school without a diploma remains above the Union average, particularly among foreign-born students (30,1% compared with the Union average of 19,4%). Implementation of the school reform is broadly on track, and vocational education and training are improving. Tertiary education, severely underfunded with public spending accounting for less than 0,4% of GDP, is characterised by high drop-out rates and prolonged study periods. As a consequence, educational attainment is one of the lowest in the Union (26,9% of the population aged 30 to 34). The participation rate in adult learning programmes is increasing but it still remains among the lowest in the Union, especially for low-skilled adults. Upskilling and reskilling should be fostered, while employers should be encouraged to provide more learning opportunities for the workforce. The implementation of the comprehensive national ‘skills strategy’ launched in October 2017 will be crucial.

(26) Unlike the Union trend, the rate of people at risk of poverty or social exclusion has continued to increase and at 30% in 2016 it was well above the Union average. This especially affects children, temporary workers and migrants. Income inequality is high and rising. In 2016, the income of the top 20% of households was 6,3 times higher than that of the poorest 20%. This ratio is even higher for people of working age, as the redistributive impact of pensions is excluded. The introduction of a new permanent scheme to tackle poverty (Reddito di Inclusione) represents a major step forward in social policies. Designed as a universal transfer for people meeting certain conditions of poverty, the scheme is expected to increase the currently low impact of social benefits on poverty reduction. The scheme is based on solid governance mechanisms and will be subject to systematic evaluation. Importantly, it also envisages a substantial reinforcement of the country's understaffed social services. Closer co-operation between social services and public employment services, as well as the allocation of sufficient resources, will be crucial for the smooth implementation of the reform. The scheme incorporates the former unemployment assistance scheme (ASDI), as a first step towards rationalising social spending. Italy's health care system provides universal coverage and the health of the population is good overall; nevertheless, self-reported unmet needs for medical care are high, and differences between regions in the organisation and quality of care delivery persist. Italy has made some efforts to ensure appropriate access to healthcare, including by revising and expanding the minimum statutory benefit package of care services.
In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Italy’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Italy in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Italy but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below.

In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below.

**HEREBY RECOMMENDS** that Italy take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 0.1% in 2019, corresponding to an annual structural adjustment of 0.6% of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. Shift taxation away from labour, including by reducing tax expenditure and reforming the outdated cadastral values. Step up efforts to tackle the shadow economy, including by strengthening the compulsory use of e-payments through lower legal thresholds for cash payments. Reduce the share of old-age pensions in public spending to create space for other social spending.

2. Reduce the length of civil trials at all instances by enforcing and streamlining procedural rules, including those under consideration by the legislator. Achieve more effective prevention and repression of corruption by reducing the length of criminal trials and implementing the new anti-corruption framework. Ensure enforcement of the new framework for publicly-owned enterprises and increase the efficiency and quality of local public services. Address restrictions to competition, including in services, also through a new annual competition law.

3. Maintain the pace of reducing the high stock of non-performing loans and support further bank balance sheet restructuring and consolidation, including for small and medium-sized banks, and promptly implement the insolvency reform. Improve market-based access to finance for firms.

4. Step up implementation of the reform of active labour market policies to ensure equal access to effective job-search assistance and training. Encourage labour market participation of women through a comprehensive strategy, rationalising family-support policies and increasing the coverage of childcare facilities. Foster research, innovation, digital skills and infrastructure through better-targeted investment and increase participation in vocational-oriented tertiary education.

Done at Brussels, 13 July 2018.

*For the Council*

*The President*

H. LÖGER

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(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Cyprus and delivering a Council opinion on the 2018 Stability Programme of Cyprus

(2018/C 320/12)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Cyprus as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Cyprus should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1), (3) and (5) below.

(3) The 2018 country report for Cyprus was published on 7 March 2018. It assessed Cyprus’ progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Cyprus’ progress towards its national

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Cyprus submitted its 2018 National Reform Programme on 19 April 2018 and its 2018 Stability Programme on 30 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Cyprus is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2018 Stability Programme, the Government plans a budgetary surplus in nominal terms of 1.7 % of GDP in 2018 and slightly below 2.0 % of GDP over the programme period. The medium-term budgetary objective, set at a balanced budgetary position in structural terms, is planned to be reached over 2018-2021. After having decreased to around 97.5 % of GDP in 2017, the general government debt-to-GDP ratio is expected to increase to 105.6 % in 2018 and to steadily decline thereafter, reaching 88 % by 2021, according to the 2018 Stability Programme. The macroeconomic scenario underpinning those budgetary projections is plausible. The risks associated with the macroeconomic assumptions presented in the Stability Programme are to the downside, mainly linked to the high stock of non-performing loans in the financial sector.

On 11 July 2017, the Council recommended Cyprus to remain at the medium-term budgetary objective in 2018. This is consistent with a maximum nominal growth rate of net primary government expenditure (2) of 1.9 % in 2018, corresponding to an allowed deterioration in the structural balance by 0.4 % of GDP. Based on the Commission 2018 spring forecast, the structural balance is projected to register a surplus of 0.8 % of GDP in 2018 and 0.5 % of GDP in 2019, above the medium-term budgetary objective. Cyprus is forecast to comply with the transitional debt rule in 2018 and the debt rule 2019. Overall, the Council is of the opinion that Cyprus is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019. At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues.

Despite recent efforts on e-government services, regulatory quality and staff mobility, inefficiency in the public administration remains a challenge and has an impact on the business environment. Key legislative proposals aiming to address the issue remain pending. These include draft laws on the reform of the public administration and of local governments. Shortcomings in the governance framework for State-owned entities might facilitate the build-up of public contingent liabilities and hinder investment capacity in key utilities, such as telecoms and energy. The containment of the public-sector wage bill has been a significant factor in fiscal consolidation in Cyprus. Yet, the current collective agreement limiting the growth of public-sector wages expires in 2018 and a more permanent solution is still lacking.

A national anti-corruption strategy and action plan were adopted in December 2017. The existing anti-corruption body remains inadequately resourced, but the Government is considering the establishment of a new independent agency. Various legislative initiatives, such as draft laws on whistle-blower protection, lobbying and asset declarations, are currently under parliamentary scrutiny and, if adopted, would also help to strengthen the national anti-corruption framework.


(2) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
As indicated in the 2018 euro-area recommendation, the fight against aggressive tax planning strategies is essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spill-over effects of taxpayers' aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. The high levels of dividend and interest payments (relative to GDP) suggest that Cyprus' tax rules are used by companies that engage in aggressive tax planning. The absence of withholding taxes on outbound (i.e. from Union residents to third-country residents) dividend, interest and, in many cases, royalty payments by Cyprus-based companies to third-country residents may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. The absence of such taxes, together with the corporate tax residency rules, may facilitate aggressive tax planning. While notional interest deduction regimes help to reduce the debt equity bias, they can also be used for tax avoidance purposes, if there are no effective anti-abuse rules. The Commission takes note of recent positive steps that have been announced or adopted (i.e. the announced review of corporate tax residency rules, planned changes on transfer pricing provisions). Based on recent exchanges, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

Inefficiencies in the justice system continue to affect contract enforcement and the swift resolution of civil and commercial cases. Cumbersome civil procedures and weak enforcement of court decisions weigh on banks' incentives to use the insolvency and foreclosure frameworks to reduce their stock of non-performing loans. A series of reforms have started to address the most critical problems in the justice system, in particular low digitalisation of courts and the lack of lifelong training for judges.

Use of the new insolvency and foreclosure frameworks remains limited, undermining efforts to reduce non-performing loans. A stakeholders' working group was set up to review the implementation and performance of the frameworks. Some administrative measures have been taken to reduce the backlog in the issuance of title deeds. However, backlogs remain high and a structural solution to address the inadequacies of the property transaction system (i.e. the issuance and transfer of title deeds) is still lacking.

The high level of non-performing loans remains the key vulnerability of the banking sector and affects credit supply. Banks still face impediments in enforcing their claims on defaulted borrowers and weak repayment discipline remains problematic. In 2017, non-performing loans decreased, albeit unevenly across banks, as a result of debt restructuring through write-offs and debt-to-asset swaps. Uncertainties remain over the sustainability of banks reduction plans, as loan re-defaults and re-restructuring remain high and banks' direct exposure to the property market increases. These factors point to the need for swift implementation of a more comprehensive strategy to accelerate the clean-up of banks' balance sheets, having regard to social consequences for vulnerable groups and carefully designed incentives to strengthen repayment discipline. As part of this strategy, legislative amendments to allow for the effective enforcement of claims and to facilitate the sale of loans appear necessary, including on borrower protection and the introduction of electronic auctions. In addition, the governance and administrative capacity of insurance and pension-fund supervision remain weak. The Government intends to table legislative proposals to address this issue in the course of 2018.

Implementation of the action plan for growth has led to some progress in the areas of strategic investments, entrepreneurship and better regulation. However, some important reforms have stalled, in particular as regards the granting of licences authorising investment projects. Access to finance has improved, thanks to some improvements in collateral requirements, but it remains a key issue, in particular for small and medium-sized enterprises. Financial support measures are based mainly on grants. Alternative sources of finance such as venture capital, equity funding and crowdfunding, remain marginal for Cypriot businesses. Privatisation efforts, aimed at attracting productivity-enhancing foreign investments, are in many cases on hold and only a few privatisation projects are gradually advancing (e.g. the Larnaca port).

Employment is on the rise and unemployment is falling fast, although it remains high among young people and the long-term unemployed. Efforts to improve the administrative capacity of the public employment services continue. However, providing services to employers, securing customer categorisation, personalised guidance and activation, including for recipients of guaranteed minimum income, remain a challenge. The proportion of young
people (aged 15-24) not in employment, education, or training is still one of the highest in the Union. Outreach measures and timely, tailor-made assistance for young people are limited, as confirmed by their low numbers in relevant activation schemes.

(16) The modernisation of the education sector has advanced but important challenges remain. Recent positive developments include a thorough revision of school curricula and the implementation of a new appointment system for teachers. Cyprus' education spending is above the Union average, demonstrating a strong commitment to education, training and lifelong learning. However, educational achievements remain poor and early school leaving, while well below the Union average, has increased significantly. Participation in vocational education and training is low, the reform of the teacher evaluation system is still pending and a high proportion of tertiary graduates continue to work in occupations that do not necessarily require an academic degree.

(17) Cyprus has made substantial progress on healthcare by adopting legislation to establish the new National Health System. The new system seeks to improve access, introduce universal health coverage, reduce the high level of out-of-pocket payments and increase the efficiency of care delivery in the public sector. Before the system becomes fully functional in 2020, there are major implementation challenges and investment needs. Efforts should continue towards safeguarding against possible cost overruns, modernising and improving the efficiency of healthcare providers, including primary healthcare, introducing e-Health and setting up a National Medicines Organisation. The level of long-term care is low and remains a challenge given the ageing population.

(18) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Cyprus' economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Cyprus in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Cyprus but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion (1) that Cyprus is expected to comply with the Stability and Growth Pact.

(20) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (5) below,

HEREBY RECOMMENDS that Cyprus take action in 2018 and 2019 to:

1. Adopt key legislative reforms to improve efficiency in the public sector, in particular as regards the functioning of the public administration and the governance of State-owned entities and local governments.

2. Step up efforts to improve the efficiency of the judicial system by revising civil procedures, increasing the specialisation of courts and setting up a fully operational e-justice system. Take measures to fully operationalise the insolvency and foreclosure frameworks and ensure reliable and swift systems for the issuance of title deeds and the transfer of immovable property rights.

3. Accelerate the reduction of non-performing loans by implementing a comprehensive strategy, including legislative amendments allowing for the effective enforcement of claims and facilitating the sale of loans. Integrate and strengthen the supervision of insurance companies and pension funds.

4. Prioritise the implementation of key elements of the action plan for growth, in particular fast-tracking strategic investments, and take additional measures to improve access to finance for small and medium-sized enterprises. Improve the performance of State-owned enterprises including by resuming the implementation of privatisation projects.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
5. Complete reforms aimed at increasing the capacity and effectiveness of the public employment services and reinforce outreach and activation support for young people who are not in employment education or training. Complete the reform of the education and training system, including teacher evaluation and actions to increase the capacity of vocational education and training. Take measures to ensure that the National Health System becomes fully functional in 2020, as planned.

Done at Brussels, 13 July 2018.

For the Council

The President

H. LÖGER
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Latvia and delivering a Council opinion on the 2018
Stability Programme of Latvia

(2018/C 320/13)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4)
thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of
budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018
European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights,
proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of
the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November
2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the
Commission also adopted the Alert Mechanism Report, in which it did not identify Latvia as one of the Member
States for which an in-depth review would be carried out. On the same date, the Commission also adopted
a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed
by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on
the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in
the economic and monetary union, Latvia should ensure the full and timely implementation of the Recommenda-
tion for the euro area, as reflected in recommendations below, in particular recommendations (1) and (2).

(3) The 2018 country report for Latvia was published on 7 March 2018. It assessed Latvia’s progress in addressing
the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the
country-specific recommendations adopted in previous years and Latvia’s progress towards its national Europe
2020 targets.

(4) Latvia submitted its 2018 National Reform Programme on 11 April 2018 and its 2018 Stability Programme on
16 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the
same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Latvia is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans a deterioration of the headline balance from a deficit of 0.5 % of GDP in 2017 to a deficit of 0.9 % of GDP in both 2018 and 2019 before improving to 0.4 % of GDP in 2020 and 2021. This path is expected to be consistent with the medium-term budgetary objective of a structural deficit of 1 % of GDP and the allowed deviations based on the pension reform and the structural reform clause for the healthcare sector. The recalculated structural balance deficit is estimated to increase from –1.2 % of GDP in 2017 to –1.7 % of GDP in 2018 and then decrease to –1.5 % of GDP in 2019. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to decrease from 40.1 % of GDP in 2017 to 36 % of GDP by 2021. The 2018 Stability Programme's GDP growth projections appear to be markedly favourable for 2018 and plausible for 2019, as compared to the Commission forecast. Risks to the budgetary position are tilted to the downside linked to the optimistic forecast of the yield of tax compliance-improving measures.

In 2019, Latvia should achieve its medium-term budgetary objective, taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms for which a temporary deviation is granted. This is consistent with a maximum nominal growth rate of net primary government expenditure of 6.0 % in 2018, corresponding to an allowed deterioration in the structural balance by 0.3 % of GDP. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from the medium-term budgetary objective in 2018. However, as a result of the better-than-expected outcome for 2017, such risk may be lower in 2018. At the same time, the plausibility tool based on the Commission 2018 spring forecast indicates a high degree of uncertainty surrounding the estimate of output gap for Latvia based on the common methodology. If confirmed, these factors will be considered in the ex-post assessment for 2018 in spring 2019.

Income inequality in Latvia is high. The ratio of incomes of the richest 20 % of households to that of the poorest 20 % stood at 6.3 in 2017, among the highest in the Union, as the redistribution through the tax-benefit system is lower. Latvia's tax system has been overhauled and personal income tax progressivity increased; however, the tax wedge on low-wage earners remains relatively high and discourages formal employment. The tax reform is limited in terms of shifting taxation to sources less detrimental to growth and achieving the stated policy objective of increasing the tax revenue share in GDP. The low share of tax revenue in GDP limits the resources for sustainable development of public services and social inclusion. The revenue potential of property and capital taxation is underused relative to other Union countries. Despite some progress in fighting tax evasion, tax compliance remains a serious challenge.


\(^{(2)}\) Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

\(^{(3)}\) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
(10) Weaknesses in the social safety net are reflected in the high proportion of people at risk of poverty or social exclusion and indicate challenges on minimum income, pensions and the inclusion of people with disabilities. Poverty rates among people with disabilities and the elderly have been increasing in recent years and are among the highest in the Union. The minimum income level reform, announced in 2014, has not been implemented which negatively affects the poorest households. The adequacy of social assistance benefits increased only slightly and remains low. Minimum old-age pensions have not been increased since 2006. The share of people facing severe housing deprivation is among the highest in the Union and social housing is scarce.

(11) The labour market is tightening due to adverse demographic developments and emigration. While employment growth is becoming constrained by falling labour supply, employment opportunities vary between regions and skill levels. Curriculum reform in vocational education and training aimed at aligning education with contemporary skills requirements has progressed. However, further efforts are needed to fully implement the reform and increase participation in both initial and continuous vocational education and training. The implementation of the new work-based learning approach has started, with the involvement of social partners and companies. However, few students are enrolled in the scheme. Adult participation in learning has increased only slightly and the involvement of the unemployed in active labour market measures is lower than in most other Member States. This is of concern in the context of a high unemployment rate among the low-skilled. In a broader context, strengthening social partners’ capacity is important to foster their engagement.

(12) Reforms have been taking place in the health system. The increased funding for healthcare is expected to address some access restrictions linked to the annual service limits and long waiting times. However, public financing for healthcare remains well below the Union average and efficiency-increasing measures are still to be implemented, including effective prevention measures, streamlining of the hospital sector, strengthening primary care and targeting quality management. Health outcomes are relatively poor and timely access to affordable healthcare for everyone remains a concern. The high out-of-pocket payments and the division of health services into two baskets ('full' and 'minimum') risks lowering access for some groups and leading to adverse health outcomes.

(13) Weaknesses in regulatory quality and low public administration efficiency and effectiveness are detrimental to the business environment. In 2017, the Government adopted an ambitious reform plan for a leaner and more professional public sector, aiming to improve efficiency through reductions in staff and centralisation of support functions, while strengthening performance-based payment and increasing transparency. This plan is however limited to the central administration, despite the fact that significant efficiency gains could also be achieved at municipality level. State-owned enterprises, which account for a sizeable share of the economy, are coordinated at government level. While companies owned by central government are subject to a centralised corporate governance framework, ports and enterprises owned by municipalities remain outside this mechanism.

(14) Corruption continues to hamper Latvia’s business environment, and the prevention of conflicts of interest remains rigid and formalistic. The delay in legislating on whistle-blower protection is detrimental to the accountability and efficiency of public administration. Regulation of the insolvency process has been significantly strengthened over the recent years, limiting the opportunities for abuses. However, the Council for the Judiciary encouraged investigating accusations of past abuses in the insolvency system by reviewing certain cases. It has recommended improving the judges’ qualifications assessment and reviewing the available disciplinary measures.

(15) Latvian banks serving non-resident clients are exposed to a high risk of involvement in money laundering. This creates challenges for the integrity, and can damage the reputation, of the financial system of Latvia and negatively affect investment and economic growth. The anti-money laundering framework has recently been strengthened; continuous efforts would be needed to achieve sustainable improvement. Latvia has recently adopted a law aimed at significantly limiting the exposure of the Latvian financial sector to money-laundering risks. Key elements are enhancing the exchange of information between financial institutions and law enforcement agencies and curbing transactions with shell companies. The consequences of the law and its effectiveness will need to be monitored.

(16) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Latvia’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Latvia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal
and socioeconomic policy in Latvia but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(17) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1).

HEREBY RECOMMENDS that Latvia take action in 2018 and 2019 to:

1. Achieve the medium-term budgetary objective in 2019, taking into account the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted. Reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance.

2. Improve the adequacy of minimum income benefits, minimum old-age pensions and income support for people with disabilities. Increase the labour market relevance of vocational education and training, and foster upskilling of low-skilled workers and jobseekers. Increase the accessibility, quality and cost-effectiveness of the healthcare system.

3. Strengthen the efficiency of the public sector, in particular with regard to local authorities and state-owned enterprises. Strengthen the accountability of public administration by protecting whistle-blowers, preventing conflicts of interest and following-up on the results of the ongoing assessment of past insolvency proceedings.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Lithuania and delivering a Council opinion on the 2018 Stability Programme of Lithuania

(2018/C 320/14)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Lithuania as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Lithuania should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendation (1).

(3) The 2018 country report for Lithuania was published on 7 March 2018. It assessed Lithuania’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Lithuania’s progress towards its national Europe 2020 targets.

(4) Lithuania submitted its 2018 National Reform Programme on 26 April 2018 and its 2018 Stability Programme on 30 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) Lithuania is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans to maintain a headline surplus of 0.6 % of GDP from 2018 to 2020, before it is projected to decrease to 0.3 % of GDP in 2021. The medium-term budgetary objective — a deficit of 1 % of GDP in structural terms — is planned to be met throughout the programme period. In 2016 and 2017, Lithuania was also granted a temporary deviation linked to the implementation of the systemic pension reform and of the structural reforms. These deviations are carried forward for a period of three years. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to fall from 39.7 % of GDP in 2017 to 35.3 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned surplus targets from 2019 onwards have not been sufficiently specified.

(7) On 11 July 2017, for 2017 the Council recommended Lithuania to remain at its medium-term budgetary objective in 2018, taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms for which a temporary deviation was granted. This is consistent with a maximum nominal growth rate of net primary government expenditure (2) of 6.4 % in 2018, corresponding to an allowed deterioration in the structural balance by 0.6 % of GDP. Based on the Commission 2018 spring forecast, Lithuania’s structural deficit is forecast to stand at 0.7 % of GDP in 2018 and 0.6 % of GDP in 2019. The structural balance is thus forecast to remain above the medium-term budgetary objective in both years. Overall, the Council is of the opinion that Lithuania is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

(8) Revenues from environmental and recurrent property taxes remain below the Union average. Lithuania has undertaken a reform of its property tax system, which introduces an element of progressivity into the system, and abolished excise duty exemptions for coal and coke used for heating purposes. However, scope remains to broaden the tax base to sources that are less detrimental to growth. Although Lithuania has made progress in recent years on improving tax collection, its value added tax gap is still among the widest in the Union. Lithuania is taking further steps to combat tax evasion and improve tax compliance, and recently implemented measures are showing positive early results. Further increasing tax compliance would raise budget revenues and contribute to improving the fairness of the tax system.

(9) With the introduction of a new pension indexation formula in 2018, which links pensions to the wage bill growth, the share of public pension expenditure in GDP is projected to stay flat until 2040. This would ensure the fiscal sustainability of the Lithuanian pension system. However, this is largely driven by a decline in the benefit ratio since the total wage bill is projected to increase at a slower pace than wages due to the rapidly shrinking working-age population. This raises concerns about pension adequacy, which is already among the lowest in the Union. It is also unclear how this reform will work in practice since the Government is legally obliged to propose measures in the event of a falling replacement ratio. If the replacement ratio were kept unchanged, total pension expenditure as a share of GDP would increase by almost 45 % by the end of the 2040s, putting a strain on public finances. It is therefore important to clarify legal uncertainties over pension legislation and to ensure the long-term fiscal sustainability of the pension system while addressing its low adequacy.


(2) Net primary government expenditure comprises total government expenditure excluding interest expenditure. expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
The labour market is tightening quickly as a result of robust economic growth, but also due to adverse demographic developments and emigration, leading already to skills shortages. Such a situation demands an education and training system able to provide everybody with the relevant skills. While the reforms launched over the past year are a step in the right direction, it is important that Lithuania implements these reforms to improve the outcomes of its education and training system. The financing and accreditation rules in Lithuania’s tertiary education are helping to increase the number of people with tertiary education, but at the same time have contributed to concerns about its quality, fragmentation and labour market relevance. The ongoing university consolidation, if complemented by changes to accreditation and financing rules, should help address the current challenges. In addition, persistent demographic pressures have affected the efficiency of the education system and made more urgent the need to provide equitable access to quality and inclusive education. To address the below-average performance of Lithuania’s pupils in basic skills, reforms are needed in teachers’ initial training, careers and working conditions, complemented by other quality-focused reforms.

The low participation of adults in learning in Lithuania indicates that adult learning remains underdeveloped and is not enabling the economy to benefit from skills upgrading, innovation and better integration of the disadvantaged into the labour market (for example older, unemployed or inactive adults). Despite investment in infrastructure, the content of the vocational education and training curriculum is often outdated, while alignment with the needs of local and regional labour markets could be more developed. Work-based learning is still at the initial phase and could be expanded. Active labour market policy measures contain a larger training offer, but this offer could be enhanced further. The recent reforms and measures taken in this field have not had significant results so far. In a broader context, strengthening social partners’ capacity is important to foster their engagement.

Challenges in healthcare outcomes persist; these are having a negative impact on productivity, competitiveness of the economy and quality of life. The delivery of health services remains too hospital-centric, leaving room for further strengthening of primary care. Further rationalisation of resources together with measures to improve quality of both hospital and primary care are key to making healthcare more effective. Disease prevention and health promotion policies should curb risk behaviours more strongly and rapidly. However, the scale of such policies remains small, while cross-sectoral collaboration is underdeveloped and accountability for results is not sufficiently embedded at municipality level. High reliance on out-of-pocket payments, a low level of health spending and an inefficient allocation of resources are limiting the efficiency of the healthcare system.

The high proportion of people at risk of poverty or social exclusion, together with high income inequality, remain major challenges for Lithuania that hinder its prospects for economic growth. They also threaten social cohesion and could fuel emigration. Despite continued economic growth, the elderly, people with disabilities, children, single-parent households and the unemployed face the highest risk of poverty and social exclusion. The corrective power of the Lithuanian tax and benefit system is one of the lowest in the Union. While some significant initial steps were taken to fight poverty and income inequality, the country still has a long way to go to converge towards the Union poverty and income inequality averages. The relatively high tax wedge on low income earners may limit their incentive to work and increase the risk of poverty and inequalities. Levels of poverty and inequality could be lowered by incentivising labour market participation, in particular among people from vulnerable groups and low income earners, and by increasing the corrective power of the tax and benefit system supported by better collection of taxes. Such measures could also increase social fairness.

After being subdued since 2012, productivity growth rebounded in 2017, alleviating pressures on cost competitiveness. However, this improvement is largely driven by the private sector. Only limited progress has been made in improving the efficiency of public investment. In particular, the efficiency of public R&D expenditure and the cooperation between businesses and science remain low. Moreover, public investment in R&D dropped significantly in 2016. Fragmented coordination and governance of research and innovation policy lead to inefficiencies and prevent businesses from fully benefiting from the variety of support schemes. Further progress in the ongoing reform of the organisation and funding of the public research sector should help achieve better use of the available resources.
Lithuania made progress in strengthening its corruption prevention framework by adopting legislation on lobbying and whistle-blower protection for both public- and private-sector workers. However, implementing the legislation remains a challenge. Corruption in the health sector still raises concerns, despite the commendable results of the Government’s ‘clean hands’ programme.

In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Lithuania’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Lithuania in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Lithuania but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion that Lithuania is expected to comply with the Stability and Growth Pact.

Hereby recommends that Lithuania take action in 2018 and 2019 to:

1. Improve tax compliance and broaden the tax base to sources less detrimental to growth. Ensure the long-term sustainability of the pension system while addressing the adequacy of pensions.

2. Improve the quality, efficiency and labour market relevance of education and training, including adult learning. Improve the performance of the healthcare system by a further shift from hospital to outpatient care, strengthening disease prevention measures, including at local level, and increasing the quality and affordability of care. Improve the design of the tax and benefit system to reduce poverty and income inequality.

3. Stimulate productivity growth by improving the efficiency of public investment, ensuring efficient governmental coordination of research and innovation policy and addressing gaps and inefficiencies in public measures supporting science-businesses cooperation.

Done at Brussels, 13 July 2018.

For the Council
The President
H. Löger
COUNCIL RECOMMENDATION
of 13 July 2018

on the 2018 National Reform Programme of Luxembourg and delivering a Council opinion on the 2018 Stability Programme of Luxembourg

(2018/C 320/15)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Luxembourg as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (Recommendation for the euro area).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Luxembourg should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (2) below.

(3) The 2018 country report for Luxembourg was published on 7 March 2018. It assessed some progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Luxembourg’s progress towards its national Europe 2020 targets.

(4) On 30 April 2018, Luxembourg submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) Luxembourg is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans a decrease in the headline surplus from 1.5 % of GDP in 2017 to 1.1 % of GDP in 2018, followed by an almost steady increase thereafter, reaching a surplus of 2.4 % of GDP in 2022. The medium-term budgetary objective — a structural deficit of 0.5 % of GDP — continues to be met with a margin throughout the programme period. According to the 2018 Stability Programme, the government debt-to-GDP ratio is expected to remain well below the 60 %-of-GDP Treaty reference value. The macroeconomic scenario underpinning those budgetary projections is favourable for the period up to 2020 and plausible thereafter. Based on the Commission 2018 spring forecast, the structural balance is forecast to register a surplus of 0.8 % of GDP in 2018 and 0.3 % of GDP in 2019, lower, in particular for 2019, than in the 2018 Stability Programme, but still above the medium-term budgetary objective. Overall, the Council is of the opinion that Luxembourg is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

(7) Luxembourg's economy is continuing to grow healthily and has performed better than the euro area average since the 2009 global recession. The financial sector remains the key driver of economic growth and continues to be sound and profitable. This is reflected in strong surpluses in both the services balance and the overall current account balance. The external sector relative contribution to real GDP growth represented 61 % on average in 2013-2016, despite recurrent negative trade balances. Luxembourg is a net creditor to the rest of the world, and at the end of 2016, gross external assets and liabilities reached EUR 10.5 trillion. The national authorities have further implemented macroprudential and oversight measures and concerned financial intermediaries are adjusting to the changing national and Union policy framework.

(8) As indicated in the Recommendation for the euro area, the fight against aggressive tax planning strategies is essential to prevent distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spill-over effects of taxpayers' aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Despite the size of its financial sector, the high level of dividend, interest and royalty payments as a percentage of GDP suggest that the country's tax rules are used by companies that engage in aggressive tax planning. The majority of foreign direct investment is held by 'special purpose entities'. The absence of withholding taxes on outbound (i.e. from Union residents to third-country residents) interest and royalty payments and the exemption from withholding taxes on dividend payments under certain circumstances may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. The Commission takes note of the positive steps taken by Luxembourg (for example the adoption of a patent box regime compliant with international rules). Based on recent exchanges with the Luxembourg authorities, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

(9) The Luxembourg authorities have, for several decades, actively sought to diversify the economy, by developing selected sectors, including the information and communication technologies industry and the space sector. Given the country's high labour costs, activities with higher added value offer the potential to unlock alternative sources of growth. The successful diversification of Luxembourg's economy therefore depends, to a large extent, on sectors that are less sensitive to labour cost levels. These are largely based on research and innovation, which tend to be technology- and knowledge-intensive. This strategy has been recently strengthened. Large public investment projects, including R&D and market regulations, among other measures, are being implemented to develop these priority sectors. Between 2000 and 2016, Luxembourg has increased its public R&D expenditure fivefold,

Concerns remain about the long-term sustainability of public finances due to the projected increase in ageing costs. Luxembourg has a high projected increase in the proportion of the old-age population that will be dependent by 2070 and, according to the 2016 projections of the General Inspectorate of the Social Security, the operational balance of the pension system will be running a deficit by 2023. Nevertheless, past and current surpluses of the pension system have been saved and accumulated reserves would maintain the viability of the system for a further 20 years. According to the 2018 Ageing Report, age-related costs are expected to increase by 13 percentage points of GDP between 2016 and 2070, exceeding the sustainability thresholds and particularly driven by pensions (8.9 percentage points of GDP). Expenditure on long-term care as a proportion of GDP is one of the highest among Member States. In spite of the reform adopted in 2017, such expenditure is projected to increase by 3 percentage points from the current level by 2070.

The employment rate of older people remains particularly low and further measures are needed to improve their employability and labour market opportunities. This is also important to ensure the long-term sustainability of public finances. Early retirement schemes encouraging workers to leave employment remain widespread, with 59.2% of newly attributed pensions being early old-age pensions. A law suppressing one early retirement scheme was passed in December 2017 but its net impact on the average effective retirement age and on expenditure is uncertain as it eases conditions on other early retirement schemes. This poor labour market outcome can also be partly attributed to financial disincentives to work, which are comparatively high for this group. Encouraging the employment of older workers requires a comprehensive strategy including measures to help workers remain in active employment for longer. The ‘Age Pact’, a draft law submitted to Parliament in April 2014, which aims to encourage firms with more than 150 employees to hire and retain older workers through age management
measures, is still pending in Parliament. As regards education, Luxembourg needs to address the strong impact of students' socioeconomic background on their education outcomes. This is also important to respond to the strong demand for highly specialised skills.

(14) Real estate prices have continued to rise. This may undermine Luxembourg's ability to attract and retain a skilled labour force, a large proportion of which is made up of non-nationals. House price pressures emerge from a fundamental supply and demand mismatch. On the supply side, insufficient land availability and lack of incentives for private owners to sell land or buildings seem to represent a bottleneck to the creation of new housing. Further work is needed to encourage housing investment, by increasing incentives to promote real estate sales, improving administrative procedures to grant building permits and providing affordable social housing. The recently adopted tax reform on capital gains on real estate sales and the update of the social housing programme is unlikely to increase the house supply, given the continuous trend towards higher prices. On the demand side, high population and employment growth push prices up. The housing market situation also exacerbates the problem of traffic congestion and pollution. In addition, the increase in house prices has repercussions on household indebtedness, raising concerns about the sustainability of household debt. Household indebtedness has rapidly increased over the last 10 years to reach an estimated 165% of disposable income in 2016, reflecting real estate inflation, as around 80% of household debt stems from mortgage loans. However, Luxembourg has already introduced relevant macroprudential measures to reduce significantly potential risks to financial stability. Following the proposals of the national systemic risk committee, the Government has also recently presented a draft law providing a framework for borrower-based measures, to avoid a build-up of household vulnerability, although this draft law still needs to be approved by Parliament.

(15) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Luxembourg's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Luxembourg in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Luxembourg but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(16) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion (1) that Luxembourg is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that Luxembourg take action in 2018 and 2019 to:

1. Increase the employment rate of older people by enhancing their employment opportunities and employability while further limiting early retirement, with a view to also improving the long-term sustainability of the pension system.

2. Further reduce regulatory restrictions in the business services sector.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Hungary and delivering a Council opinion on the 2018 Convergence Programme of Hungary

(2018/C 320/16)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Hungary as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Hungary was published on 7 March 2018. It assessed Hungary’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (2), the follow-up given to the country-specific recommendations adopted in previous years and Hungary’s progress towards its national Europe 2020 targets.

(3) On 30 April 2018, Hungary submitted its 2018 National Reform Programme and its 2018 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (3), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Hungary is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2018 Convergence Programme, the Government plans a deterioration of the headline deficit from 2.0 % in 2017 to 2.4 % in 2018 and a gradual improvement thereafter to 0.5 % of GDP by 2022. The medium-term budgetary objective — a structural deficit of 1.5 % of GDP — is planned to be met by 2020. Based on the recalculated structural balance ( ), the medium-term budgetary objective would be reached by 2022. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to decline gradually to slightly below 60 % by the end of 2022. The macroeconomic scenario underpinning those budgetary projections is favourable, which poses notable risks to the implementation of the deficit targets.

The 2018 Convergence Programme indicates that the budgetary impact of the security-related measures in 2017 is significant, and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure in 2017 amounted to 0.17 % of GDP for security-related measures. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the severity of the terrorist threat are unusual events, their impact on Hungary's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2017 has been reduced to take into account these additional costs.

On 12 July 2016, the Council recommended Hungary to achieve an annual fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2017 unless the medium-term budgetary objective was respected with a lower effort. Based on 2017 outturn data Hungary was found to be in significant deviation from the adjustment path toward the medium-term budgetary objective. In line with Article 121(4) TFEU and Article 10(2) of Regulation (EC) No 1466/97, the Commission issued a warning to Hungary on 23 May 2018 that a significant deviation from the adjustment path toward the medium-term budgetary objective was observed in 2017. On 22 June 2018, the Council adopted a subsequent Recommendation ( ) confirming the need for Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure ( ) does not exceed 2.8 % in 2018, corresponding to an annual structural adjustment of 1 % of GDP. Based on the Commission 2018 spring forecast, there is a risk of a deviation from the recommended effort.

In 2019, in view of Hungary's general government debt ratio above 60 % of GDP and projected output gap of 2.3 %, the nominal growth rate of net primary government expenditure should not exceed 3.9 %, in line with the structural adjustment of 0.75 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from that requirement in 2019. Overall, the Council is of the opinion that significant further measures will be needed as of 2018 to comply with the provisions of the Stability and Growth Pact, in light of a strongly deteriorating fiscal outlook, in line with the recommendation addressed to Hungary on 22 June 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective.

The overall employment rate has improved significantly and the favourable economic trend provides an opportunity to reintegrate in particular unemployed people into the labour market. The gender employment gap is wide, especially in the 25-39 age group, which can in part be explained by a limited supply of good quality childcare. The level of participation in childcare for children under the age of 3 is well under the Barcelona target and the Union average. Although the public work scheme remains the main active labour market policy, the number of participants in it having decreased significantly represents a positive development. Nonetheless, the scheme remains insufficiently focused and its effectiveness in reintegrating participants into the open labour market continues to be limited considering the labour market situation. Active labour market policies which focus more on upskilling and reskilling are under-developed.

The proportion of people at risk of poverty and social exclusion has decreased to 26.3 % in 2016 but remains above the Union average. Children in general are more exposed to poverty than other age groups. The level of minimum income benefits is below 50 % of the poverty threshold for a single household, making it among the

( ) Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

( ) Council Recommendation of 22 June 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Hungary (OJ C 223, 27.6.2018, p. 1).

( ) Net primary government expenditure comprises total government expenditure excluding interest expenditure. expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
lowest in the EU. The adequacy of unemployment benefits is very low; the maximum duration of 3 months ranks as the shortest in the EU, and represents only around a quarter of the average time required by job seekers to find employment. In addition, the levels of payment are among the lowest in the EU.

(11) The Hungarian social dialogue structures and processes remain underdeveloped and do not allow for a meaningful involvement of social partners in policy design and implementation. The deficiencies in stakeholders' engagement and the limited transparency have an impact on the evidence base for and quality of policy making, creating uncertainty for investors and slowing down convergence.

(12) Measures have been implemented to improve the tax system, but some problems remain. Although decreasing, the tax wedge on labour, especially for certain low-income groups, is still high in Union comparison. The overall complexity of the tax system, coupled with the continued presence of distortive sector-specific taxes, remains a weakness. Measures against taxpayer's aggressive planning strategies are essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spillover effects of taxpayer's aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Hungary records relatively high capital inflows and outflows through special purpose entities, which are disconnected from the real economy. The absence of withholding taxes on outbound (i.e. from Union residents to third-country residents) dividend, interest and royalty payments made by companies based in Hungary may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. The Commission takes note that Hungary acknowledges that outbound payment may lead to aggressive tax planning if misused. Based on recent exchanges, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

(13) Regulatory barriers in services, and retail trade in particular, impact on the sector's performance and hamper the efficient reallocation of resources, productivity and innovation. There is a continuous trend to entrust certain services to state-owned firms specifically created for these purpose, to the detriment of open competition. Unpredictability of the legal framework is a further problem, especially in the retail sector, which in recent years has been faced with frequent changes to regulations. As the proposed regulations are often tailored to turnover or floor size, they mainly affect foreign retail chains. This increases uncertainty among business operators and can deter investment. A stable regulatory environment favourable to competition is needed. Restrictive regulation of professions remains high in Hungary, in particular with respect to key professions like accounting and legal services.

(14) Concerns remain regarding preventing and prosecuting corruption. According to several indicators, Hungary's exposure to corruption appears to have increased over the past years and the risks of corruption could negatively affect the country's growth potential. The functioning of the prosecution service is of crucial importance to fight corruption and money laundering and while measures to fight low-level corruption appear to have been applied with some success, there is not enough focus on starting investigations into high-level cases. Limited transparency and restrictions on access to information further hinder measures to prevent corruption. Significant steps have been taken regarding public procurement, but there is scope to further improve transparency and competition in tendering processes. This could be achieved inter alia through making data gained from the e-procurement system publicly accessible.

(15) Education outcomes for basic skills are significantly below the Union average, especially for children from disadvantaged socioeconomic background. Pupils are streamed early into different types of schools, with wide gaps in education outcomes and employment paths. Disadvantaged children, including Roma children, tend to be concentrated in vocational secondary schools which are characterised by poorer levels of basic skills and higher dropout rates, and people who leave these schools receive lower wages on average. The early school leaving rate increased to 12.4% on average, and is particularly high among Roma children. These challenges are especially pressing in the context of quality and inclusive education. The shrinking pool of applicants and high drop-out rates in tertiary education will further limit attainment rates at a time when the demand for highly-skilled workforce is growing.

(16) Despite ongoing efforts to improve public health, poor health outcomes, aggravated by unhealthy lifestyles, persist, having a negative impact on human capital. Low levels of healthcare spending, coupled with an inefficient allocation of resources, limit the effectiveness of the Hungarian healthcare system. This, together with a high reliance on out-of-pocket payments, has negative equity implications for the timely access to affordable, preventive and curative healthcare of good quality. Shortage of healthcare workers also hampers access to care, although recent salary increases have mitigated this challenge. Ongoing reform efforts are focused on tackling
excessive use of hospital care services, a key cause of which is that primary care providers are not appropriately equipped to act as effective gatekeepers. Further rationalisation of hospital resources use, together with targeted investments to strengthen primary care services, would enable the reduction of disparities in access to care, drive efficiency gains and effectively improve health outcomes.

(17) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Hungary’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Hungary in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Hungary but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input for future national decisions.

(18) In the light of this assessment, the Council has examined the 2018 Convergence Programme and its opinion (1) is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Hungary take action in 2018 and 2019 to:

1. In 2018, ensure compliance with the Council recommendation of 22 June 2018 with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective. In 2019, ensure that the nominal growth rate of net primary government expenditure does not exceed 3.9 %, corresponding to an annual structural adjustment of 0.75 % of GDP.

2. Continue simplifying the tax system, in particular by reducing sector-specific taxes. Improve the quality and transparency of the decision-making process through effective social dialogue and engagement with other stakeholders and by regular, adequate impact assessments. Reinforce the anti-corruption framework, strengthen prosecutorial efforts and improve transparency and competition in public procurement inter alia through further developing the e-procurement system. Strengthen competition, regulatory stability and transparency in the services sector, in particular in retail.

3. Unlock labour reserves through improving the quality of active labour market policies. Improve education outcomes and increase the participation of disadvantaged groups, in particular Roma, in quality and inclusive mainstream education. Improve the adequacy and coverage of social assistance and unemployment benefits.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Malta and delivering a Council opinion on the 2018 Stability Programme of Malta

(2018/C 320/17)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Malta as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (2) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Malta should ensure the full and timely implementation of the Recommendation on the economic policy for the euro area, as reflected in the recommendations below, in particular recommendation (1). The 2018 country report for Malta was published on 7 March 2018. It assessed Malta’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and Malta’s progress towards its national Europe 2020 targets.

(3) On 13 April 2018, Malta submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Malta is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans to maintain a surplus in headline terms over 2018-2021. The medium-term budgetary objective — a balanced budgetary position in terms of GDP — continues to be met with a positive margin throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to remain below the 60 %-of-GDP Treaty reference value and to gradually decline from 50,8 % of GDP in 2017 to around 36 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible for 2018-2019 and favourable for 2020-2021. Based on the Commission 2018 spring forecast, the structural balance is forecast to register a surplus of 0,6 % of GDP in 2018 and 1,1 % of GDP in 2019, above the medium-term budgetary objective. Overall, the Council is of the opinion that Malta is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019. At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues.

As indicated in the 2018 euro area recommendation, the fight against aggressive tax planning strategies is essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spillover effects of taxpayers’ aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. The absence of withholding taxes on outbound (i.e. from Union residents to third-country residents) dividends, interest and royalty payments made by Malta-based companies may lead to those payments avoiding tax altogether, if they are also not subject to tax in the recipient country. While Malta’s new Notional Interest Deduction regime will help to reduce the debt equity bias, insufficient anti-abuse rules, combined with a relatively high rate and a stock-based regime, may provide opportunities for tax avoidance. The existence of some provisions in bilateral tax treaties between Malta and other Member States, coupled with Malta’s tax system, where a company that is resident but not domiciled in Malta is taxed on source and remittance basis, may be used by companies to engage in tax avoidance practices. The Commission takes note of Malta’s commitment to fight against taxpayers aggressive tax planning. Based on recent exchanges, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

The long-term sustainability of public finances in Malta remains a challenge. This is entirely driven by the budgetary impact of ageing-related costs, such as healthcare, long-term care and pensions. The pension system faces the dual challenge of achieving sustainability while ensuring adequate retirement incomes. The long-term sustainability prospects for pension expenditure have improved, mainly thanks to a more positive assessment of Malta’s long-term growth potential. However, the measures introduced in the 2016 budget had only a limited impact on long-term sustainability of the pension system, which therefore remains a significant challenge. In addition, despite the introduction of measures to improve pension adequacy, the gender coverage gap in pensions remains high. The performance of the health system has improved and waiting times are being reduced. However, challenges remain in the redistribution of resources and activities from hospital to primary care. The institutional setting of primary healthcare provision puts pressure on both hospital and emergency care. Hospital and primary care are not well coordinated and emergency care remains inefficiently used. Access to innovative medicines remains a challenge, also in budgetary terms. Initiatives were undertaken to cater for growing demand in the long-term care system, such as incentivising community-based and home care.

Some progress has been made in improving cross-border cooperation. However, the Malta Financial Services Authority still appears understaffed and concerns remain on its capacity to supervise a large cross-border financial system, in particular its non-bank segment. In addition, while the services sector (in particular, the online gaming industry) has significantly contributed to the country's sustained economic growth, this may create challenges to the financial system's integrity, calling for a strong anti-money laundering framework. Malta has recently transposed the 4th Anti Money Laundering Directive: the effectiveness of its implementation remains to be assessed. In addition, following the transposition of the Directive into national law, Maltese authorities have recently presented an integrated strategy to fight money laundering and terrorist financing. Among other actions, a National Coordinating Committee on Combating Money Laundering and Funding of Terrorism, composed of representatives from government and other relevant national authorities has been set up. However, challenges remain on ensuring proper implementation and effective enforcement of the recently adopted regulatory framework.

In the context of strong economic growth and reforms supporting female employment and up-skilling of the workforce, Malta's labour market outcomes have further improved. However, high gender employment gaps and the low labour market participation of women above the age of thirty and people with disabilities continue to be a challenge. The design of paternity leave and parental leave remains relatively weak but is important for gender-balanced caring responsibilities and greater support for women to work. Labour shortages are growing and skills mismatches persist. A substantial share of the Maltese labour force still has low qualifications, while the reliance on foreign labour to address the labour and skills shortages is increasing. The policy initiatives being implemented in the areas of labour market, skills and social inclusion are expected to continue further, but need to be informed by outcome-based monitoring and evaluation.

At 18.6 % in 2017, the early school leaving rate remains the highest in the Union and with little improvement compared to the previous year. Malta also has the highest early school leaving rate for people with disabilities, which is at 50 %, double the Union average. Moreover, learning outcomes are strongly influenced by socio-economic background, type of school and disability status. The gap in science performance between students from the bottom versus the top performing schools is among the highest in the Union and 1.5 times the average of the Organisation for Economic Co-operation and Development. The share of low achievers in maths, science and reading is the fourth highest in the Union. A comprehensive approach to improve educational quality and reduce inequalities in educational outcomes between social groups and different school types is needed.

Robust economic growth has increased pressure on infrastructure and natural resources. In particular, the road transport sector faces major infrastructure and long-term sustainability challenges. Insufficient transport infrastructure and rising congestion costs are a barrier to investment. The increase in the number of vehicles and in traffic leads to rising greenhouse gas emissions and negatively affects air quality. They may also negatively impact tourism, which represents an important pillar of Malta's economy. Therefore, the need to tackle the infrastructure gap goes hand in hand with the need for clean transport solutions. In 2016, the Government adopted a National Transport Strategy with a 2050 horizon and an Operational Transport Master Plan to 2025. It also announced a EUR 700 million project to upgrade the road network. Together, these measures are expected to reduce the economic costs of congestions by less than 20 %. Increasing economic activity may exacerbate existing infrastructure bottlenecks, putting even more pressure on environmental resources. In addition, the plan fails to set a clear target for the reduction of greenhouse gas emissions from transport and does not propose an effective monitoring system for implementation of the measures reported (besides a five-year review cycle). It is thus important to set targets and implement measures to substantially reduce congestion and greenhouse emissions from transport by 2025, allowing for periodic monitoring of progress.

The challenges created by the country's size and island status make the need to move towards a more circular economy particularly compelling. Smart investment can help to reduce pressure on the island's vulnerable natural resources. For instance, if not addressed, difficulties with disposal of construction and demolition waste might reduce the quality of environment and the country's attractiveness as a tourist destination. While Malta has remained in the bottom group for eco-innovation performance (26th in the Union in 2016 from 18th in 2013, according to the Eco-innovation index), it has the potential to mobilise investment to generate or adopt
innovative solutions to improve resource and energy efficiency in construction, as well as the management of waste and waste water. In particular, improvements are needed in the management of waste alongside investment in recycling facilities for construction and demolition waste and the implementation of controls to prevent illegal landfill or dumping at sea of construction and demolition waste.

(13) The justice system continues to face challenges with regard to its efficiency and a strengthened legal and institutional framework to fight corruption is necessary to ensure a high quality business environment. Governance shortcomings in the anti-corruption framework may adversely affect the business climate and weigh negatively on investment. The effectiveness of Malta’s efforts to fight corruption needs to be further improved, especially with regard to the investigation and prosecution of corruption. Improving the governance framework is crucial to preserving Malta’s reputation and attractiveness as an international investment destination.

(14) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Malta’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Malta in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Malta, but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(15) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion (1) that Malta is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Malta take action in 2018 and 2019 to:

1. Strengthen the overall governance framework by enhancing the national supervision of internationally oriented financial businesses licensed in Malta, by ensuring the effective enforcement of the Anti-Money Laundering framework and by continuing to step up the fight against corruption.

2. Ensure the sustainability of the healthcare and the pension systems, including by increasing the statutory retirement age and by restricting early retirement.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

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(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION  
of 13 July 2018  

on the 2018 National Reform Programme of the Netherlands and delivering a Council opinion on  
the 2018 Stability Programme of the Netherlands  

(2018/C 320/18)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified the Netherlands as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, the Netherlands should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (2) below.

(3) The 2018 country report for the Netherlands was published on 7 March 2018. It assessed some progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and the Netherlands’ progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that the Netherlands is experiencing macroeconomic imbalances. In particular, the Netherlands shows the largest three-year average current account surplus in terms of GDP among euro area Member States. The surplus suggests a suboptimal allocation of resources, leaving opportunities for increased growth and welfare. Private debt is high, specifically the stock of household mortgages and multinational enterprises’ debt. The long household balance sheets increase the vulnerability to financial shocks.

The Netherlands submitted its 2018 National Reform Programme on 30 April 2018 and its 2018 Stability Programme on 26 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

The Netherlands is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans a decrease in the general government surplus from 1.1% of GDP in 2017 to 0.3% of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0.5% of GDP — continues to be met throughout the programme period. According to the 2018 Stability Programme, the government debt-to-GDP ratio is projected to fall to 44.0% of GDP in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2018 spring forecast, the structural balance is projected to decline from a surplus of 0.5% of GDP in 2017 to a deficit of 0.1% of GDP in 2018 and 0.3% of GDP in 2019, above the medium-term budgetary objective. General government debt is forecast to remain on a firm downward path and below the Treaty reference value. Overall, the Council is of the opinion that the Netherlands is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019. At the same time, while respecting the medium-term objective, there remains scope to use fiscal and structural policies to raise public and private investment in research, development and innovation.

The Netherlands has an efficient research and development sector and the country’s high-performing education system and scientific base provide a sound basis for boosting innovation and growth capacity through education and research and development activities. Substantial additional investment has been announced which could help to stabilise public and private research and development intensity. Whether the Netherlands will reach its Europe 2020 targets, in particular on investment in research and development and renewable energy, remains uncertain.

A key challenge in addressing high household indebtedness lies in the housing market, where the rigidities and distortive incentives that have built up over decades shape the patterns of housing financing and sectoral savings. Since 2012, a series of measures has been implemented that partly address this. In 2017, the Government announced plans to accelerate the reduction in mortgage interest tax deductibility starting in 2020. Yet, the lack of a well-functioning middle segment on the rental market encourages households to buy rather than rent, leading to high debt-to-income ratios and financial vulnerability at a young age. The social housing sector is one of the largest in the Union, but housing is not always occupied by those really in need. High-income households stay in social housing, given that social housing corporations do not increase rents as fast as they legally could. While the Government has announced its intention to support the supply of affordable housing on the private rental market, concrete plans for such support have not been communicated yet.

As indicated in the Recommendation for the euro area, the fight against aggressive tax planning strategies is essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spill-over effects of taxpayers’ aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. The high level of dividend, royalty and interest payments made via the Netherlands suggests that the country’s tax rules are used by companies that engage in aggressive tax planning. A large proportion of the foreign direct investment stock is held by ‘special purpose entities’. The absence of withholding taxes on outbound (i.e. from Union residents to third-country residents) royalties and interest payments may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. The lack of some anti-abuse rules, especially in the case of hybrid

entities, may also facilitate aggressive tax planning. The Commission acknowledges the Netherlands' commitment to fight aggressive tax planning as set out in the reform agenda on taxation, including withholding taxes on royalty, interest and dividend payments in case of abuse or payments to low-tax jurisdictions, is a positive step to decrease aggressive tax planning and should be implemented swiftly and monitored closely. Based on recent exchanges with the Dutch authorities, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

(10) Despite low unemployment and high job vacancy rates, nominal wage growth was moderate at 1.5% in 2017. This is below the level that could be expected based on inflation, productivity and unemployment. Moderate wage growth can be partly linked to slow increases in productivity, remaining labour market slack and increased labour market segmentation. In 2017, the Government adopted several fiscal measures, which reduce the tax burden on labour and aid at increasing the net disposable household income of those who work. Further boosting net disposable household income by creating the conditions to promote wage growth and reforming the second pillar of the pension system to make it more transparent, inter-generationally fairer and more resilient to shocks would support domestic demand and contribute to euro area rebalancing.

(11) The recent growth in employment can be largely attributed to an increase in the number of people employed on temporary contracts and of the self-employed. The high and increasing percentage of temporary contracts as well as the rapid increase in self-employment without employees is observed in the context of great differences in applicable labour regulations, labour protection, as well as differences in tax and social security legislation. Although some measures have been taken and additional ones have recently been announced, some of these factors still create financial incentives for employees to start working as self-employed or favour hiring them under a temporary contract. In addition, the enforcement of measures to tackle bogus self-employment has been suspended until 2020. Self-employed are more often under-insured against disability, unemployment and old age. This could affect the sustainability of the social security system in the long run.

(12) Despite a labour market that performs well overall, there is still untapped labour potential. In particular the high number of part-time working women and the employment situation of people with a migrant background remain an important challenge. The employment rate for non-EU-born migrants is 20.6 percentage points lower than for people born in the Netherlands with an even larger gap for non-EU-born women.

(13) The rise in recent years in the household saving rate was partly due to higher saving in the second pillar of the pension system (mandatory supplementary private schemes), to which the regulatory environment contributed. An appropriate intra- and inter-generational distribution of costs and risks beyond the adopted rules on indexation and financial buffers (financial assessment framework) would help households to allocate their financial means in more growth-friendly ways. The Government has confirmed its intention to substantially reform the second pension pillar in order to improve the coverage and to create a more transparent, more flexible and actuarially fairer system. With respect to fiscal sustainability, the 2018 Ageing Report points to a medium risk to fiscal sustainability in the long term, as long-term care expenditures are projected to increase from 3.5% to 6.0% of GDP by 2070.

(14) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of the Netherlands' economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to the Netherlands in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in the Netherlands but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(15) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion (1) that the Netherlands is expected to comply with the Stability and Growth Pact.

(16) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (2) below.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
HEREBY RECOMMENDS that the Netherlands take action in 2018 and 2019 to:

1. While respecting the medium-term objective, use fiscal and structural policies to raise public and private investment in research, development and innovation. Take measures to reduce the debt bias for households and the remaining distortions in the housing market, in particular by supporting the development of the private rental sector.

2. Reduce the incentives to use temporary contracts and self-employed without employees, while promoting adequate social protection for the self-employed, and tackle bogus self-employment. Create conditions to promote higher wage growth, respecting the role of the social partners. Ensure that the second pillar of the pension system is more transparent, inter-generationally fairer and more resilient to shocks.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Austria and delivering a Council opinion on the 2018 Stability Programme of Austria
(2018/C 320/19)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Austria as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the recommendation on the economic policy of the euro area (2) (recommendation for the euro area).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Austria should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (2) below.

(3) The 2018 country report for Austria was published on 7 March 2018. It assessed Austria’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and Austria’s progress towards its national Europe 2020 targets.

(4) Austria submitted its 2018 National Reform Programme on 25 April 2018, and its 2018 Stability Programme on 21 March 2018. To take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Austria is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2018 Stability Programme, the Government expects that the headline balance will improve from a deficit of 0.7 % of GDP in 2017 to a surplus of 0.4 % of GDP in 2022. The medium-term budgetary objective — a structural deficit of 0.5 % of GDP as of 2017 — is projected to be met in 2019. According to the Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 78.1 % of GDP in 2017 to 62.2 % of GDP in 2022. The macroeconomic scenario underpinning those budgetary projections is favourable for 2018 and plausible afterwards. The main risks underlying the medium-term budgetary planning are discretionary policy measures envisaged as of 2020, such as the announced reform of the personal income tax, whose net budgetary effects are not yet fully specified.

The Stability Programme indicates that the budgetary impact of the exceptional inflow of refugees and security-related measures is significant and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure in 2017 amounted to 0.03 % of GDP for the exceptional inflow of refugees while no further cost was incurred for security-related measures. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees as well as the severity of the terrorist threat are unusual events, their impact on Austria’s public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2017 has been reduced to take into account additional refugee-related costs.

On 11 July 2017, the Council recommended Austria to ensure that the deviation from the medium-term budgetary objective in 2018 is limited to the allowance linked to the budgetary impact of the exceptional inflow of refugees and security-related measures. This is consistent with a maximum nominal growth rate of net primary government expenditure of 3.3 % in 2018, corresponding to an allowed deterioration in the structural balance by 0.2 % of GDP. Taking into account the granted allowances, the Commission 2018 spring forecast points to a risk of some deviation from that requirement in 2018 and over 2017 and 2018 taken together.

In 2019, Austria should achieve its medium-term budgetary objective, taking into account the allowance linked to unusual events for which a temporary deviation is granted. This is consistent with a maximum nominal growth rate of net primary government expenditure of 2.9 %, corresponding to an improvement in the structural balance by 0.3 % of GDP. Based on the Commission 2018 spring forecast, under unchanged policies, Austria would be at risk of a significant deviation from the requirement in 2019, due to the deviation over 2018 and 2019 taken together. At the same time, Austria is projected to be within a distance of 0.1 % of GDP from its medium-term objective in 2019. In addition, Austria is forecast to comply with the debt rule in 2018 and 2019. Overall, the Council is of the opinion that Austria needs to stand ready to take further measures to ensure compliance in 2018 and that the necessary measures should be taken in 2019 to comply with the provisions of the Stability and Growth Pact.

According to the 2018 Ageing Report, the projected increase in pension, healthcare and long-term care expenditures points to a medium risk to fiscal sustainability in the medium and long term. Austria’s public expenditure on pensions is above the Union average (13.8 % compared to 11.2 % of GDP in 2016) and expected to increase further by 2070 (0.5 % compared to -0.2 % of GDP). Recent reforms have successfully provided incentives to retire later. However, without an increase in the statutory retirement age, the further accumulation

of benefit entitlements during the extended working lifetime does not improve long-term sustainability. At 60, the statutory retirement age of women is among the lowest in the Union. The statutory retirement age of women will only gradually adjust as of 2024, achieving harmonisation with the male statutory retirement age only as of 2033. Overall, increasing the statutory retirement age and restricting early retirement would contribute to pension sustainability in an ageing demographic context.

Public healthcare expenditure is above the Union average (7% compared to 6.8% of GDP in 2016) and expected to increase more than the Union average (1.3% versus 0.9% of GDP), which would raise public healthcare expenditure to 8.3% of GDP by 2070. Expenditure on long-term care is projected to double from 1.9% to 3.8% of GDP by 2070. The introduction of expenditure ceilings through the 2017 Financial Equalisation Law and the reform strengthening primary healthcare and reducing the reliance on the hospital sector have started to address the sustainability issue. The persistently high number of health insurance agencies provides an indication of potential further savings in governance and administrative costs. In addition, more effective public procurement (e.g. Union-wide tendering, the use of award criteria other than price and cross-regional tender aggregation) would help improve quality and cost-efficiency. In the area of long-term care, recent policy measures such as the decision to abolish the recourse to private assets of people to finance inpatient long-term care are expected to increase, rather than contain, expenditure.

The 2017 Financial Equalisation Law has contributed to streamlining the fiscal relations among the different levels of government by initiating task-oriented financing, simplifying the distribution of intergovernmental transfers, and assigning an own source of revenue to the States. However, despite these reform efforts, the fiscal framework continues to be opaque and the significant mismatch between expenditure and revenue-raising responsibilities persists, providing weak incentives for increasing efficiency at subnational level.

Despite the 2016 tax reform, the tax burden on labour remains high and is set to gradually increase over time if tax brackets are not indexed to inflation. Higher income earners saw a relatively large benefit from the reform compared to lower income earners, and the tax burden for low-income earners remains high. The tax reform also benefited men more than women. Sources of revenue deemed less detrimental to growth, such as recurrent property taxes, appear to be underutilised, mainly because of a largely outdated tax base. Revenues from recurrent property taxes in Austria are low, amounting to 0.2% of GDP compared to the Union average of 1.6% of GDP in 2016. Shifting the tax burden from labour to less detrimental sources of revenue could help address this problem.

The labour market performs well, however challenges for specific groups (e.g. women and people with a migrant background) remain. Despite an overall high employment rate for women, labour market outcomes in terms of full-time employment remain rather poor. The rate of female part-time employment (age 20-64), at 47.9% in 2017, remains one of the highest in the Union (Union average: 31.1%). The issues related to access to formal childcare, including in particular outside the urban area, contribute to this outcome. The high share of women in part-time work, which is largely the result of women performing important unpaid tasks such as caring for children and relatives, as well as lower hourly earnings, contribute to a persistently high gender pay gap. The latter has a direct impact on women's accumulation of pension rights, resulting in a large pension gap.

Learning outcomes for disadvantaged students have not improved. A wide performance gap remains between students with and without a migrant background. National testing in 2016 confirmed that around one-quarter of 8th grade pupils do not or only partially meet educational standards in German. Recent international testing also confirmed a widening gap in reading for those from a lower socioeconomic or migrant background. Comparing the 2012 and 2015 results of the Programme for International Student Assessment (PISA), the proportion of low achievers increased in all three core areas surveyed, i.e. mathematics, reading and science. Austrian-born pupils outperform first generation migrants by a level equivalent to almost three years of schooling.

While productivity is high in Austria, productivity growth has been lacklustre over recent years despite Austria's considerable efforts, such as by investing in R&D and improving the framework for start-ups. The remaining levers to support productivity growth relate to the digitalisation of businesses, company growth and competition in services. Austria has significant access barriers and restrictive rules on the exercise of business services and
regulated professions. These include specific shareholding requirements, extensive reserved activities and interdisciplinary restrictions. Continued efforts to reduce burdens and the planned evaluation of Austria’s Trade Licence Act (Gewerbeordnung) are important instruments to address this issue.

(17) More competition in the service sector would help address Austria’s challenges in spreading digital technologies and business models, in particular among micro, small and medium-sized enterprises. Digitalisation of these enterprises is particularly important in Austria as they form the backbone of the Austrian economy. Initiatives such as ‘KMU Digital’ and ‘AT: net’ and the implementation of the Digital Roadmap Austria are key. A further issue concerns the scaling-up of companies and in particular of highly innovative companies. Later stage funding, such as in the forms of venture capital and access to public capital markets for scale-ups, is a bottleneck. High-growth companies are crucial for the diffusion of new technologies and business models, including digital ones, and thus for productivity growth.

(18) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Austria’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Austria in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Austria but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Austria take action in 2018 and 2019 to:

1. Achieve the medium-term budgetary objective in 2019, taking into account the allowance linked to unusual events for which a temporary deviation is granted. Ensure the sustainability of the health and long-term care and the pension systems, including by increasing the statutory retirement age and by restricting early retirement. Make public services more efficient, including through aligning financing and spending responsibilities.

2. Reduce the tax wedge, especially for low-income earners, by shifting the tax burden to sources of revenue less detrimental to growth. Improve labour market outcomes of women. Improve basic skills for disadvantaged young people and people with a migrant background. Support productivity growth by stimulating digitalisation of businesses and company growth and by reducing regulatory barriers in the service sector.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION

of 13 July 2018

on the 2018 National Reform Programme of Poland and delivering a Council opinion on the 2018 Convergence Programme of Poland

(2018/C 320/20)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (¹), and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (²), the Commission also adopted the Alert Mechanism Report, in which it did not identify Poland as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Poland was published on 7 March 2018. It assessed Poland’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (³), the follow-up given to the country-specific recommendations adopted in previous years and Poland’s progress towards its national Europe 2020 targets.

(3) On 26 April 2018, Poland submitted its 2018 National Reform Programme and its 2018 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (⁴), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(5) Poland is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the Government plans a gradual improvement of the headline balance from a deficit of 1.7 % of GDP in 2017 to 0.7 % of GDP in 2021. The medium-term budgetary objective, a deficit of 1.0 % of GDP in structural terms, is not expected to be reached by 2021, i.e. in the Convergence Programme horizon. The recalculated structural balance \(^1\) points to a deficit of 1.3 % of GDP in 2021. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to decrease from 50.6 % of GDP in 2017 to 50.4 % of GDP in 2018 and to 46.0 % by 2021. The macroeconomic scenario underpinning those budgetary projections is cautious in 2018 and plausible thereafter.

(6) On 11 July 2017, the Council recommended Poland to ensure that the nominal growth rate of net primary government expenditure \(^2\) does not exceed 3.7 % in 2018, corresponding to an annual structural adjustment of 0.5 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. The Commission has carried out a qualitative assessment of the strength of the economic conditions in Poland while giving due consideration to its sustainability challenges. On that basis, it is concluded that no additional elements need to be taken into account. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from that recommended adjustment in 2018.

(7) In 2019, in view of Poland's projected output gap of 1.5 % of GDP, the nominal growth rate of net primary government expenditure should not exceed 4.2 %, in line with the structural adjustment of 0.6 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from that requirement in 2019. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact.

(8) In the medium and long term, Poland will face expenditure pressures in several areas, in particular related to population ageing, which necessitate new mechanisms to assess the efficiency and effectiveness of public spending and to facilitate a reallocation of resources. To this end, the Government has started work on reforming the budgetary process, in particular to strengthen the medium-term budgetary framework, and incorporate spending reviews into the budgetary process. Poland is the only Member State without a fully-fledged independent fiscal council and with no known plans to create one, even though existing independent institutions cover some of the functions typically fulfilled by fiscal councils. The 2018 country report finds that Poland made no progress in limiting the extensive use of reduced rates for value added tax. However, the Polish Ministry of Finance is working on simplifying how applicable rates are assigned to goods and services.

(9) The performance of the Polish labour market has been strong in recent years and employment rates have continued to increase. However, the participation of some groups in the labour force, especially women, the low-skilled and older people, has remained low in comparison to other Member States. Several recent policy measures have tended to lower the incentive to work, especially for women and older people. The Polish social protection system provides insufficient incentives to take up work. While the child benefit has reduced poverty and inequality, it has already had a negative effect on the participation of parents, mostly women, in the labour market as its size and limited means-testing offset work incentives built into other social benefits. Further hampering women’s participation in the labour market is the fact that the formal childcare enrolment rate for children under the age of three remains among the lowest in the Union. The limited support made available to people providing long-term care prevents them from entering the labour market. Lowering the statutory retirement age has encouraged some older workers to exit the labour force. Migration from non-EU countries is helping to meet the increase in demand for labour.

(10) A complementary route to support both participation in the labour force and the innovative capacity of the economy is to equip pupils and adults with adequate skills and competences that support employment in

\(^1\) Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

\(^2\) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
a rapidly changing labour market. The rate of adult’s participation in education and training is much lower than the Union average. This, combined with certain weaknesses in digital skills, as well as in literacy and numeracy skills, particularly among adults with below-tertiary education, is hampering their employability. To what extent recently introduced and still planned policy measures, such as changes in the organisation of general education, vocational education and higher education, will have an impact on skill levels is not yet known.

(11) Poland has continued taking measures to address labour market segmentation by limiting the possibility to abuse temporary employment, increasing social security contributions on some non-standard labour contracts and introducing a minimum hourly wage for some of these contracts. The number and share of permanent contracts has been rising since the end of 2016, however the share of temporary contracts still remains among the highest in the Union. Some further legislative changes relevant for labour market duality might be included in the reformed Labour Code. Social protection coverage of workers who are self-employed and have certain non-standard contracts emerges as a potential issue, especially from the perspective of adequacy of their future pensions. Several measures have been introduced since 2015 to improve social protection coverage of the self-employed and those employed with atypical contracts.

(12) The average age of retirement has increased in recent years, reflecting past reforms, such as withdrawing early retirement options and a gradual increase of the statutory retirement age. A continuation of an increase in the effective retirement age is crucial for medium-term economic growth, and to ensure the adequacy and fiscal sustainability of the pension system. However, the recent lowering of the statutory retirement age to 60 for women and to 65 for men goes in the opposite direction. In contrast, the retirement age of male and female judges of ordinary courts was aligned to 65, which is in line with the request by the Commission. The special social insurance system for farmers, being subsidised to a cost close to 1 % of GDP, is among the reasons for low labour mobility and hidden unemployment in agriculture.

(13) Better access to healthcare and an increase in its effectiveness are needed in order to improve health outcomes in Poland. Self-reported unmet needs for medical care rank among the highest in the Union, and waiting times for certain interventions are particularly long. The number of hospital beds is relatively high and not optimally distributed geographically. Outpatient and primary healthcare are generally underdeveloped, with doctors having incentives to refer investigations and treatment to specialist providers. Tackling these issues is particularly challenging, given that the level of public funding and the number of doctors and nurses in certain specialisations in Poland are well below the Union average. In 2017, some efforts were made to distribute healthcare resources more efficiently, but the effects of these measures are yet to be seen.

(14) Increasing the economy’s capacity to innovate is crucial for enabling Poland to move up in the global value chain, thus sustaining the potential to improve living standards. This requires policy action on many fronts in a gradual process of several years. The key relevant policy areas include building trust in the regulatory environment, providing incentives for business expenditure on R&D, strengthening the science base including through reforms of tertiary education and encouraging a strong flow of knowledge and close cooperation between business and research institutions. The latter also involves ensuring favourable conditions for the commercialisation of research, developed and supported by public funding. Several policy measures have already been implemented in these areas, and further ones are planned by the Government.

(15) The fast pace of regulatory change and the limited use of public and social consultations on a number of key laws are weighing on the quality of legislation and increasing uncertainty for business. Guaranteeing the rule of law and the independence of the judiciary are also essential in this context. It is recalled that in December 2017, the Commission presented to the Council a reasoned proposal to determine that there is a clear risk of a serious breach by Poland of the rule of law. Legal certainty and trust in the quality and predictability of regulatory, tax and other policies and institutions are important factors that could allow an increase in the investment rate. Solid ex-ante and ex-post impact assessments and well designed and exercised social and public consultations could help improve the quality of legislation, limit the need for subsequent amendments and in this way increase the predictability of the regulatory environment. This could also help to limit possible negative side effects of new laws in the short term, such as for instance the temporary increase in administrative burdens resulting from a change in tax regulations.
(16) The road network has developed rapidly thanks to Union funding, but the road fatality rate is still among the highest in the Union. Moreover, cities face growing mobility challenges, such as congestion and air pollution created by the increasing passenger car fleet and the large share of old cars. The current incentives to use collective, low emission and active transport modes are insufficient to address these challenges. The implementation of Union-co-financed railway projects continues to face major bottlenecks mainly due to the limited capacity of the construction sector and the institutional weaknesses of the railway infrastructure manager. Although the Government plans an update of a relevant strategic document, insufficient information is currently available on a strategic vision for the long-term development of the transport networks in all modes beyond 2023. Their respective roles would be clearly identified and attributed in this document. In addition, despite investments in recent years, bottlenecks and deficiencies in energy networks and infrastructure persist.

(17) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Poland’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Poland in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Poland but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(18) In the light of this assessment, the Council has examined the 2018 Convergence Programme and its opinion (1) is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that Poland take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.2 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Take steps to improve the efficiency of public spending, including by improving the budgetary process.

2. Take steps to increase labour market participation, including by improving access to childcare and by fostering labour market relevant skills, especially through adult learning, and remove remaining obstacles to more permanent types of employment. Ensure the sustainability and adequacy of the pension system by taking measures to increase the effective retirement age and by reforming the preferential pension schemes.

3. Strengthen the innovative capacity of the economy, including by supporting closer collaboration between business and research institutions. Improve the regulatory environment, in particular by ensuring effective public and social consultations in the legislative process.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Portugal and delivering a Council opinion on the 2018 Stability Programme of Portugal

(2018/C 320/21)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Portugal as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the Economic and Monetary Union, Portugal should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (3) below.

(3) The 2018 country report for Portugal was published on 7 March 2018. It assessed Portugal’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Portugal’s progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that Portugal is experiencing macroeconomic imbalances. In particular, the large stocks of net external liabilities, private and public debt, and a high proportion of non-performing loans constitute vulnerabilities in a context of low productivity growth. A prudent current account position and the maintenance of competitiveness gains are required to ensure the adjustment of net external liabilities. Private debt ratios continue to

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On 27 April 2018, Portugal submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time. The 2018 Stability Programme projects a solid downward path of the public debt-to-GDP ratio. Portugal’s 2018 National Reform Programme includes commitments both for the short and medium term and covers the challenges identified in the 2018 country report. In particular, it announces measures in the areas of qualifications and innovation, which can boost productivity and increase the value of Portuguese exports. The strategy presented to reduce non-performing loans together with the action to promote firm capitalisation contribute to reduce the indebtedness of the Portuguese economy and clean up banks’ balance sheets. Overall, the effective implementation of the submitted programmes would underpin the correction of imbalances.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Portugal is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2018 Stability Programme, Portugal plans to attain a headline deficit of 0.7 % of GDP and 0.2 % of GDP in 2018 and 2019, respectively, and a further improvement to a surplus of 1.4 % of GDP by 2021. Those plans do not include the potential deficit-increasing impact of bank support measures from 2019 onwards. It is planned that the medium-term budgetary objective — a structural surplus of 0.25 % of GDP — is to be achieved by 2020. The 2018 Stability Programme projects the general government debt-to-GDP ratio to reach 122.2 % in 2018 and 118.4 % in 2019, which would then be at 107.3 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible for 2018 but favourable for the following years. At the same time, the measures needed to support the planned deficit targets from 2018 onwards have not been sufficiently specified.

Portugal’s 2018 Stability Programme indicates that the budgetary impact of the large-scale wildfires that occurred in 2017 was significant and provides adequate evidence of the scope and nature of these additional budgetary costs. In particular, the 2018 Stability Programme indicates that the 2018 budget comprises exceptional expenditure amounting to about 0.07 % of GDP in relation to preventive measures to protect the national territory against wildfires. The 2018 Stability Programme sets out expenditure related to the emergency management, classified as one-off measures, and to prevention. Due to the integrated nature of these expenditures and due to the direct link with the large-scale wildfires of 2017, the specific treatment of wildfire-prevention expenditure could be considered in application of the ‘unusual event clause’. According to the Commission, the eligible additional expenditure in 2018 amounts to 0.07 % of GDP for preventive measures. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the unprecedented large-scale wildfires are considered unusual events, their impact on Portugal’s public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. A final assessment, including on eligible amounts, will be made in spring 2019 on the basis of observed data for 2018 as provided by the Portuguese authorities.

On 11 July 2017, the Council recommended Portugal to ensure that the nominal growth rate of net primary government expenditure (1) does not exceed 0.1% in 2018, corresponding to an annual structural adjustment of at least 0.6% of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission’s assessment of the strength of the recovery in Portugal while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Portugal’s 2018 Draft Budgetary Plan, no additional elements in that regard need to be taken into account. Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from that recommended adjustment in 2018 and over 2017 and 2018 taken together.

In 2019, in view of Portugal’s general government debt ratio above 60% of GDP and projected output gap of 1.3% of GDP, the nominal growth rate of net primary government expenditure should not exceed 0.7%, in line with the structural adjustment of 0.6% of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2019 and over 2018 and 2019 taken together. At the same time, Portugal is forecast to comply with the transitional debt rule in 2018 and 2019. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.

Ensuring public debt sustainability hinges on sustainable fiscal consolidation via a structural improvement in public finances, to be achieved through stronger revenue collection and expenditure controls. To enhance expenditure controls, effective enforcement of the commitment control law, strict and timely implementation of the budget framework law and continued spending review and rationalisation efforts are key. Budgetary planning and implementation continue to be a considerable challenge particularly in the health sector, where late payments (arrears) remain very high, which also points to weaknesses in accounting control and managerial practices. For sustainable fiscal consolidation, high and rising ageing costs should be addressed. In the medium term, higher ageing-related fiscal risks are expected to relate largely to the costs of financing pensions, while health-related costs will increase pressure in the long term. Steps to improve the medium-term sustainability of the pension system, together with a comprehensive strategy to tackle the health-related costs of ageing, would help to address those risks.

In a similar vein, controlling expenditure, managing debt and improving the overall financial sustainability of state-owned enterprises could contribute significantly to the structural improvement of public finances. Although overall net income continues to be negative, the operational results of state-owned enterprises have generally improved in recent years, except in the health sector, where they have worsened. Total non-consolidated debt of public corporations included in general government also remains high, at 18.3% of GDP at the end of 2017. Measures to improve the monitoring of state-owned enterprises are being rolled out, but their impact remains to be seen. An ongoing debt management and recapitalisation plan for state-owned enterprises should reduce indebtedness and lower interest costs, but good incentives could be reinforced by ensuring a predictable and transparent framework for limited budgetary transfers.

The recovery of the Portuguese labour market continues, in line with strengthened economic performance. The economy added more than 150,000 jobs in 2017 and the employment rate (20-64 year olds) increased up to 73.4% in 2017, back to pre-crisis levels. The unemployment rate dropped considerably and is now below the euro area average. The long-term unemployment rate has also fallen rapidly, although it remains relatively high. Besides ongoing active labour market policies, exemptions on social security and a public employment service model of personalised support for job seekers, Portugal is also implementing one-stop shops for employment in 2018. This could play a major role in ensuring wider coverage of activation measures. Poverty and inequality indicators have also improved further. The ‘at-risk-of-poverty or social exclusion’ rate is coming closer to the

(1) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
Despite a significant increase in the number of permanent jobs in 2017, the proportion of temporary employees remained stable at 22 %, still one of the highest levels in the Union. In 2017, around 82 % of temporary employees were in this situation involuntarily. While more people are moving from temporary to permanent jobs, temporary contracts remain the norm for unemployed people finding a job. Moreover, the (already wide) wage gap between temporary and permanent employees grew during the crisis. Measures to promote the creation of permanent jobs (e.g. Contrato-Emprego) and exemptions from social contributions in return for recruiting people belonging to vulnerable groups proved effective but had limited coverage. Some aspects of employment protection legislation and cumbersome court procedures may still discourage recruitment on open-ended contracts. However, no action is currently planned to review the legal framework for dismissals. The Government is planning measures to address labour market segmentation through tripartite discussion with social partners.

The overall skills level of the adult population remains among the lowest in the Union, hampering the country's innovation potential and competitiveness. This includes digital skills: in 2017, only 50 % of citizens aged 16-74 possessed basic or above basic digital skills (against a Union average of 57 %). Programmes are being rolled out in this regard (in particular Qualifica and the national digital competences initiative Incode 2030), but their effectiveness in upgrading workers' basic (numeracy, literacy and digital) skills and ultimately raising productivity will depend on the coverage and quality of the training offered, going beyond the recognition of skills. While evidence suggests that recent minimum wage increases (amounting to a cumulative rise of 18,3 % since 2014) have not harmed the employment rate among low-skilled workers, the substantial rise in the number of employees covered, up to 20,4 % in the third quarter of 2017, resulted in increasing wage compression. This threatens to reduce the skills wage premium, in particular between low- and medium-skilled workers, thus lowering incentives for the low-skilled to invest in education and training. The Government is closely monitoring minimum wage developments together with social partners.

Early school leaving remains higher than the Union average, but it is on a long-term downward trend, partly thanks to measures being implemented to encourage educational success and reduce drop-out rates. Educational outcomes continue to improve, but there are equity concerns as proportions of low achievers differ significantly between the bottom and the top socio-economic quartiles. Attainment in tertiary education (age 30-34) decreased from 34,6 % in 2016 to 33,9 % in 2017, far below the national target of 40 % by 2020. Despite the high employability of science, engineering, technology, and mathematics graduates, there is low student uptake in these fields.

Despite the positive developments in the Portuguese Research & Innovation system in the last years, in particular in terms of quantity and quality of human resources and scientific production, overall significant bottlenecks remain in creating a culture and the enabling conditions for stronger academia-business cooperation. These include barriers to knowledge and technology transfer, commercialisation of research outputs as well as research career tracks that do not sufficiently incentivise researchers to explore the avenues of ‘entrepreneurial research’ and the opportunities for collaboration with industry. Further raising the awareness and clarity of intellectual property in the relation between academia and business could contribute to reduce the time of execution of contractual objectives, the economic monetisation of scientific knowledge as well as their economic potential.

A comprehensive strategy for a faster reduction of non-performing assets is being implemented. This has helped to reduce the ratio of non-performing loans from 17,2 % of gross loans at the end of 2016 to 13,3 % in the fourth quarter of 2017. Corporate non-performing loans are a particular concern, as they account for about two-thirds of the total stock of non-performing loans; the ratio of corporate non-performing loans remains high, at 25,2 % of gross loans. Resolving bad assets is key to freeing up credit supply for new investments and sustainable growth. However, procedures for insolvent firms and thin secondary markets for bad assets remain significant impediments to reducing the ratio of non-performing loans. Although capital increases, together with the ongoing efforts to reduce costs, and some more recent positive developments regarding non-performing loans, are improving financial sector prospects, profitability remains low, exposure to sovereign debt high and capital buffers weak.
Access to finance remains a major challenge for the Portuguese economy. Obtaining stable access to finance, and in particular to equity capital, is considered to be one of the major challenges for Portuguese enterprises, further exacerbated by the deleveraging pressures. In relative terms, alternative sources of finances remain of little relevance. In recent years, new programmes and credit lines have been launched, along with further simplifications in the business environment, but there is still room for improvement. At the same time, though decreasing, non-performing loans and corporate debt remain high and improvements in the allocation of capital towards more productive firms would be beneficial for the investment environment.

Despite progress in introducing administrative simplification for cross-cutting matters impacting the daily lives of citizens and businesses, sector-specific regulatory and administrative barriers still impede investment and an efficient allocation of resources. A revamp of procedural workflows by shortening deadlines for decision-making, derogating from the tacit-approval principle in very limited cases only and replacing authorisation schemes requiring the submission of multiple documents by 'responsible declarations' are much needed sector-specific reforms in this regard. Administrative charges in the construction sector should be brought into proportion with actual costs. While competition in public procurement remains limited, the revised Public Procurement Code aims to promote transparency, competition and better management of public contracts. The implementation of the new rules should be monitored, including the impact of the stricter rules on the use of direct awards. Even though the Portuguese justice system continues to improve its efficiency, the length of proceedings in administrative courts remains a challenge. Moreover, corruption and lack of transparency are still perceived by businesses as areas of concern. While progress has continued as regards prosecuting corruption, efforts to improve the culture of integrity in public institutions have not so far shown sufficient results.

Regulatory reforms have been scarce since the financial assistance programme, halting or at times even reversing reforms agreed in that context. Corporate groups are banned from providing several professional services. By-laws regulating certain professional business services, in particular legal services, are less ambitious than the framework law in decisive respects, such as legal form, shareholding, management, advertising and multidisciplinary practices. A reform of the authorisation and registration of construction service providers has been scarcely complemented by an easing of controls for installation services and building controls.

In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Portugal's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Portugal in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Portugal but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input for future national decisions.

In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion is reflected in particular in recommendation (1) below.

In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below.

HEREBY RECOMMENDS that Portugal take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 0.7 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. Strengthen expenditure control, cost effectiveness and adequate budgeting, in particular in the health sector with a focus on the reduction of arrears in hospitals. Improve the financial sustainability of state-owned enterprises, in particular by increasing their overall net income and by reducing debt.

2. Promote an environment conducive to hiring on open-ended contracts, including by reviewing the legal framework in consultation with social partners. Increase the skills level of the adult population, including digital literacy, by strengthening and broadening the coverage of the training component in adult qualification programmes. Improve higher education uptake, namely in science and technology fields.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
3. Increase the efficiency of insolvency and recovery proceedings and reduce impediments to the secondary market for non-performing loans. Improve access to finance for businesses. Reduce the administrative burden by shortening procedural deadlines, using more tacit approval and reducing document submission requirements. Remove persistent regulatory restrictions by ensuring a proper implementation of the framework law for highly regulated professions. Increase the efficiency of administrative courts, inter alia by decreasing the length of proceedings.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER
COUNCIL RECOMMENDATION  
of 13 July 2018  
on the 2018 National Reform Programme of Romania and delivering a Council opinion on the  
2018 Convergence Programme of Romania  

(2018/C 320/22)  

THE COUNCIL OF THE EUROPEAN UNION,  

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,  

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,  

Having regard to the recommendation of the European Commission,  

Having regard to the resolutions of the European Parliament,  

Having regard to the conclusions of the European Council,  

Having regard to the opinion of the Employment Committee,  

Having regard to the opinion of the Economic and Financial Committee,  

Having regard to the opinion of the Social Protection Committee,  

Having regard to the opinion of the Economic Policy Committee,  

Whereas:  

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Romania as one of the Member States for which an in-depth review would be carried out.  

(2) The 2018 country report for Romania was published on 7 March 2018. It assessed Romania’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (2), the follow-up given to the country-specific recommendations adopted in previous years and Romania’s progress towards its national Europe 2020 targets.  

(3) Romania submitted its 2018 National Reform Programme on 10 May and its 2018 Convergence Programme on 14 May 2018. To take account of their interlinkages, the two programmes have been assessed at the same time.  

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (‘ESI Funds’) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (3), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.  

(5) Romania is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the Government plans a headline deficit of 2.95% of GDP in 2018, and its gradual reduction thereafter, to 1.45% of GDP in 2021. The medium-term budgetary objective, a structural deficit of 1% of GDP, is not expected to be reached by 2021, which is the end of the programme horizon. The recalculated structural balance is expected to reach -2.1% in 2021. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to remain below 40% by 2021. The macroeconomic scenario underpinning those budgetary projections is favourable. Moreover, the measures needed to support the planned deficit targets have not been sufficiently specified.

(6) On 16 June 2017, the Council decided in accordance with Article 121(4) of the Treaty on the Functioning of the European Union (‘TFEU’) that a significant observed deviation from the medium-term objective occurred in Romania in 2016. In view of the established significant deviation, on 16 June 2017 the Council recommended Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure (*) does not exceed 3.3% in 2017, corresponding to an annual structural adjustment of 0.5% of GDP. On 5 December 2017, the Council found that Romania had not taken effective action in response to the Council recommendation of 16 June 2017 and issued a revised recommendation. In the new recommendation the Council asked Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.3% in 2018, corresponding to an annual structural adjustment of 0.8% of GDP. On 22 June 2018, the Council (**) found that Romania had not taken effective action in response to the Council recommendation of 5 December 2017. Moreover, based on 2017 outturn data Romania was found to be in significant deviation from the recommended adjustment in 2017.

In line with Article 121(4) TFEU and Article 10(2) of Regulation (EC) No 1466/97, the Commission issued a warning to Romania on 23 May 2018 that a significant deviation from the adjustment path toward the medium-term budgetary objective was observed in 2017. On 22 June 2018, the Council (**) adopted a subsequent Recommendation confirming the need for Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.3% in 2018, corresponding to an annual structural adjustment of 0.8% of GDP. Based on the Commission 2018 spring forecast, there is a risk of a deviation from that recommendation in 2018.

(7) For 2019, the Council on 22 June 2018 recommended Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 5.1%, corresponding to an annual structural adjustment of 0.8% of GDP. Based on the Commission 2018 spring forecast, there is a risk of a deviation from that requirement in 2019. In addition, the Commission 2018 spring forecast projected a general government deficit of 3.4% and 3.8% of GDP for 2018 and 2019, above the 3%-of-GDP Treaty reference value. Overall, the Council is of the opinion that significant further measures will be needed as of 2018 to comply with the provisions of the Stability and Growth Pact, in light of a strongly deteriorating fiscal outlook, in line with the recommendation addressed to Romania on 22 June 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective.

(8) Romania’s budgetary planning regularly ignores the prescriptions of its fiscal framework despite the need for responsible fiscal policy-making. Romania’s fiscal responsibility law transposes the Fiscal Compact into national legislation. Its rules are well designed but are recurrently overlooked in practice. In 2016 the structural deficit increased above the medium-term objective, in breach of the deficit rule. Both the 2017 and 2018 budgets targeted a headline deficit of close to 3% of GDP, implying a deterioration of the structural balance against the rule. The two budget amendments undertaken in 2017 were not compliant with the rules prohibiting increases of the headline and primary deficit ceilings and increases in personnel and total government expenditure during the ongoing fiscal year respectively. Furthermore, as in earlier years, in 2017 the update of the fiscal strategy was provided to Parliament long after the statutory deadline, thus failing to provide a longer-term perspective to budgetary planning.

(*) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.


(**) Council Recommendation of 22 June 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Romania (OJ C 223, 27.6.2018, p. 3).
(9) Tax compliance remains low, in particular for the value added tax. In the past year, Romania achieved limited progress in addressing the repeated country-specific recommendation to strengthen tax compliance and collection. As regards the value added tax, the difference between theoretically expected and actually collected revenues remains very high. To improve compliance, the authorities introduced split payments. This is optional except for insolvent companies and taxpayers with significant outstanding value added tax's liabilities. However, the measure has yet to deliver significant results. The introduction of electronic cash registers connected to the tax administration’s information technology system is still pending implementation.

(10) The health of the financial sector has further improved, but some developments need monitoring. The banking sector is well capitalised and asset quality has improved. However, several ongoing legislative initiatives, which risk adversely affecting non-performing loan disposal and credit and investment, warrant close monitoring. The recent reduction in the contributions to the pre-funded second pillar pension funds eased short-term fiscal concerns but could have negative implications for the development of capital markets.

(11) The labour market has been tightening due to employment growth along with a reduction of the labour force due to demographic ageing and emigration. Romania has at the same time substantial unused labour potential, and several groups such as young people, Roma, the long-term unemployed and people with disabilities have difficulties in accessing the labour market. In the past year, Romania made little progress addressing the country-specific recommendation to strengthen targeted activation policies and integrated public services, focusing on those furthest away from the labour market. Despite increased financial incentives for mobility schemes, participation in active labour market policies has remained very low, and the administrative burden has been high. Public work programmes of local interest have done little to provide relevant skills and support transitions into standard employment. There is no case management for the long-term unemployed and recipients of social assistance. Cooperation among public employment services and social and education service providers and external providers respectively has been limited.

(12) The risk of poverty or social exclusion has been very high. Families with children, people with disabilities, Roma, and the rural population have been particularly affected. High income inequality persists, also due to the low impact of the tax-benefit system on mitigating market income inequality. The social reference index, which provides a reference when calculating the most important social benefits, has not been updated since 2008. The minimum inclusion law, scheduled for entry into force in 2018, would have increased the coverage and adequacy of social assistance. However, its entry into force was postponed by more than a year. The lower retirement age for women results in lower pension entitlements, aggravating old-age poverty and the gender employment gap.

(13) The involvement of social partners in the design and implementation of economic and social reforms has been very limited. The views of social partners are frequently not taken into account even when they converge. Romania's collective bargaining framework is not conducive to a well-functioning system of industrial relations. Social dialogue is characterised by a low level of collective bargaining, especially at sectoral level and low membership of trade unions and employers' organisations. High representativeness thresholds and the vague definition of sectors are among the key obstacles to more effective social dialogue. Legislative amendments to improve the framework have progressed little so far.

(14) In the past few years, the minimum wage has been repeatedly increased in a discretionary manner. Since 2015, the net minimum wage has risen by more than 60%. In 2017, around 30% of workers earned the minimum wage, implying a highly compressed wage distribution. A proposal for an objective mechanism for minimum wage increases has been endorsed by social partners but not been applied by the Government.

(15) The supply of skills is not keeping up with the needs of the economy. Low attainment levels in basic skills and digital skills have an adverse impact on competitiveness, employment and convergence. Participation in adult learning has been very low. A mechanism to match active labour market policies with the demand for skills is not yet in place, and the capacity to anticipate future skills needs and estimate the expected impact of new technologies is weak. Vocational education and training remains a second choice option and is not sufficiently aligned with labour market needs and regional or sectoral specialisation strategies.

(16) The weak performance of the education system contributes to the high inequality of opportunity and weakens Romania's long-run growth prospects. The provision of and access to quality inclusive mainstream education is a challenge, in particular for Roma and children in rural areas. The monitoring methodology to tackle school
The poor quality of infrastructure, including in the transport, waste and wastewater sectors, limits Romania's growth prospects. Public investment is characterised by low efficiency particularly in project preparation and prioritisation. The general condition and reliability of road, rail and waterways infrastructure remain poor and the reform of the transport sector is progressing very slowly. Progress in waste management reform is slow too, while the solid waste and wastewater sectors are facing challenges alike. The transport masterplan and the national waste management plan are intended to provide a stable roadmap for investments and strengthen administrative capacity in the sectors, but the alignment of project preparation with strategic planning has been limited so far. Romania achieved limited progress in addressing a country-specific recommendation to strengthen project prioritisation and preparation in public investment.

Efficient and transparent public procurement remains pivotal to addressing key policy challenges to Romania, including efficient public spending, the fight against corruption, and fostering innovation and sustainable and inclusive growth. Romania made some progress in addressing the country-specific recommendation to implement the public procurement strategy, but the plan is not yet fully implemented. At the same time, enhancing the efficiency and strategic use of public procurement, effective audit and fraud control still remain challenges. The sustainability of measures taken and the irreversibility of reforms need continued monitoring. Efficiency and transparency challenges associated with public procurement apply in particular to the large healthcare infrastructure investments in the regional hospitals for Iași, Cluj and Craiova.

State-owned enterprises have a key role in critical infrastructure sectors such as energy and rail transport. However, their operational and financial performance is weaker than that of private-sector counterparts. The corporate governance of State-owned enterprises has been substantially weakened lately, reversing progress made on country-specific recommendations from 2015 and 2016. Not only has implementation of the new legislation been hesitant, but there are ongoing attempts to exempt a number of companies from its scope. Furthermore, the publication of financial data on State-owned enterprises has been delayed. As a result, key conditions for promoting the efficient use of public resources are being impaired, and space is allowed for distorted investment decisions. In February 2018 the Constitutional Court called on Parliament to revise the above exemptions.
Developments throughout the past year have largely brought into question the irreversibility and sustainability of Romania’s substantial progress on reforming its judicial system and tackling high-level corruption. Judicial independence is being challenged and pressure being put on the judicial institutions and on the legal framework for fighting corruption, while progress on remaining challenges is being further held back. The implementation of the 2016-2020 national anti-corruption strategy developing further measures to prevent and fight corruption is progressing at technical level but more tangible political support is needed, as corruption and governance issues in the public sector persist at all levels and are among the top challenges for the business environment.

Under the Cooperation and Verification Mechanism, the Commission continues to monitor the judicial reform and the fight against corruption in Romania. These areas are therefore not covered in the country-specific recommendations for Romania but are relevant for the development of a positive socio-economic environment in the country.

In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Romania’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Romania in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Romania but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

In the light of this assessment, the Council has examined the 2018 Convergence Programme and its opinion (1) is reflected in particular in recommendation (1) below:

HEREBY RECOMMENDS that Romania take action in 2018 and 2019 to:

1. Ensure compliance with the Council recommendation of 22 June 2018 with a view to correcting the significant deviation from the adjustment path toward the medium-term budgetary objective. Ensure the full application of the fiscal framework. Strengthen tax compliance and collection.

2. Complete the minimum inclusion income reform. Improve the functioning of social dialogue. Ensure minimum wage setting based on objective criteria. Improve upskilling and the provision of quality mainstream education, in particular for Roma and children in rural areas. Improve access to healthcare, including through the shift to outpatient care.

3. Increase the predictability of decision-making by enforcing the systematic and effective use of regulatory impact assessment and stakeholder consultation and involvement in the design and implementation of reforms. Improve the preparation and prioritisation of large infrastructure projects and accelerate their implementation, particularly in the transport, waste and waste water sectors. Improve the transparency and efficiency of public procurement. Strengthen the corporate governance of State-owned enterprises.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Slovenia and delivering a Council opinion on the
2018 Stability Programme of Slovenia
(2018/C 320/23)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Slovenia as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (Recommendation for the euro area).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Slovenia should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendation (1).

(3) The 2018 country report for Slovenia was published on 7 March 2018. It assessed Slovenia’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Slovenia’s progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that Slovenia is not experiencing macroeconomic imbalances.

(4) Slovenia submitted its 2018 National Reform Programme on 13 April 2018 and its 2018 Stability Programme on 26 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Slovenia is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. The 2018 Stability Programme was submitted by a caretaker Government and is based on a no-policy-change assumption. Accordingly, the Government expects that the headline surplus will improve to 0,4 % of GDP in 2018 and then reach 0,9 % of GDP in 2021. The medium-term budgetary objective — a surplus of 0,25 % of GDP — is not planned to be achieved by 2021, under a no-policy-change scenario. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to fall to 69,3 % of GDP in 2018 and continue to fall to 58,3 % of GDP in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible.

On 11 July 2017, the Council recommended Slovenia to ensure that the nominal growth rate of net primary government expenditure (2) does not exceed 0,6 % in 2018, corresponding to an annual structural adjustment of 1,0 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission’s assessment of the strength of the recovery in Slovenia while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Slovenia’s 2018 Draft Budgetary Plan, a fiscal structural effort of at least 0,6 % of GDP is required for 2018, without any additional margin of deviation over one year. This corresponds to a nominal rate of growth of net primary government expenditure not exceeding 1,5 %. Taking that into account in the overall assessment, based on the Commission 2018 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2018.

In 2019, in view of Slovenia’s general government debt ratio above 60 % of GDP and projected positive output gap of 4,1 % of GDP, the nominal growth rate of net primary government expenditure should not exceed 2,2 %, in line with the structural adjustment of 1,0 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. At the same time, there are strong signs that the idle capacity in the economy is underestimated, with inflation expected to reach 2 % in 2019, underemployment above the pre-crisis level and investment picking up following a strong contraction over the crisis years. In addition, the plausibility tool also indicates that there is a high degree of uncertainty surrounding the output gap estimates based on the common methodology. On that basis, an annual structural adjustment of 0,65 % of GDP, corresponding to a maximum growth rate of net primary government expenditure of 3,1 %, appears appropriate. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2019 and for 2018 and 2019 taken together. Slovenia is forecast to comply with the transitional debt rule in 2018 and the debt rule in 2019. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact.

The Government has presented proposals to reform the healthcare system. The draft Healthcare and Health Insurance Act, which is the central piece of the reform and will ensure the financing of the health system in the long term, was put to the Economic and Social Council for consultation in December 2017 but was not adopted before the elections, making its prospects for adoption uncertain. A draft Long-Term Care Act is currently being drawn up to make long-term care a new pillar of social security complementary to other social security systems (healthcare, social care, and pension security). It remains uncertain how Slovenia will increase cost-effectiveness, (1) Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(2) Net primary government expenditure comprises total government expenditure excluding interest expenditure. expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
accessibility and quality of care in the future. In 2017, proposals to amend the Medical Practitioners Act, the Health Services Act, the Patient Rights Act and the Act Determining Intervention Measures to Ensure the Financial Stability of Public Healthcare Institutions were adopted and need to be implemented to ensure accessibility and quality care. Initial steps have been taken to implement the National Health Care Plan for 2016-2025. Family medicine outpatient clinics are gradually being introduced, a health technology assessment system is planned to be established by 2020 and eHealth solutions will improve monitoring nationwide. In addition, the benefits from better coordinated public procurement in healthcare are expected to help procurement to become more cost-efficient.

In July 2017, the Economic and Social Council unanimously adopted a document called ‘Starting points for the modernisation of the Pension and Disability Insurance System in the Republic of Slovenia’. It outlines various measures on how adequate pensions and a sustainable and transparent pension system could be achieved. However, a concrete action plan to adopt those measures is still missing and despite an agreement between social partners and the Government to adopt the reform by 2020, the phase-in period for the reform has not yet been outlined. Challenges remain in: ensuring the long-term sustainability and adequacy of the pension system by adjusting the statutory retirement age and promoting later retirement; boosting the coverage of the supplementary pension schemes; appropriately addressing changing career paths and reducing old-age poverty risks.

Economic growth continued and labour market and social trends improved further. The rate of people at risk of poverty or social exclusion decreased but remains above the Union average for the elderly, and in particular for women. Employment continued to rise and unemployment further decreased. However, there are signs of labour shortages in a number of vocational occupations. Long-term unemployment remains above pre-crisis levels and still represents almost half of all unemployment. Challenges persist in particular for older workers as their activity and employment rates remain among the lowest in the Union. Slovenia's society is ageing rapidly which means the working-age population and labour supply are shrinking. In response to this trend, the government has prepared an 'Active Ageing Strategy', but concrete action plans are still lacking.

The ageing population emphasises the need to increase participation in adult learning which has been falling since 2010 and is especially low among low-skilled and older workers. Improving skills through lifelong learning would increase the chances of employment, especially for low-skilled and older workers. The employment rate of low-skilled workers improved, but remains below pre-crisis levels and the Union average. Evaluation of active labour market policies shows that most programmes are performing well, however expenditure in this field and the participation rate of unemployed people in the programmes both remain limited. While the 2013 labour market reform clearly helped certain vulnerable groups enter employment, temporary employment remains an issue.

Measures have been adopted to improve funding options for firms in Slovenia and to provide them with alternatives to bank credits. However, reliance on bank credit presents a continued funding challenge, in particular for small and medium-sized enterprises, for which access to finance remains a growth barrier. Current measures have not yet resulted in improved financing, particularly for innovative firms. There are only a small number of high-growth enterprises in Slovenia and these lack sufficient support to scale up. Venture capital, as one form of equity financing, is growing but from a very low level. Innovative companies would also benefit from more efficient public research which is currently hindered by difficulties in attracting domestic and foreign talent and a lack of performance-based funding. The level of private investment in Slovenia remains relatively low compared to peer countries meriting focussed efforts to further improve the framework conditions for investment, particularly in areas yielding strong potential to increase productivity.

Businesses are held back by the still high regulatory and administrative burden. Red tape is considered to be one of the most problematic factors in terms of doing business in Slovenia. This mainly relates to uncertainty and complexity of tax procedures but is not limited to this area as it still takes about a year for commercial cases to be heard by a court. Slovenia has created a tool to help reduce administrative burden and is progressing with implementing this. A significant part of this implementation has not yet been carried out.
(15) Equally, Slovenia has only started to address its high level of restrictive regulation in certain service sectors. Reforms have been carried out to liberalise the professional requirements for architects and civil engineers, but other issues identified by Commission’s services remain unaddressed. Reforms would also benefit Slovenian manufacturing firms which depend on competitive services inputs.

(16) Efficient public procurement is key to cost control and quality improvements in Slovenia’s health sector. Expanding centralised procurement as well as other forms of procurement aggregation such as joint procurement between hospitals, is crucial to ensuring good quality supplies of innovative products at competitive prices.

(17) Slovenia struggles with inefficiency in public procurement. Competition between bidders is comparatively low, as indicated by the low number of bids received per tender and by the high ratio of negotiated procedures without prior call. The latter also reduces transparency. Professionalisation of those involved in procurement is low and there are few safeguards against corruption and collusion among bidders. In particular, the independence of the National Review Commission is limited, as a result of the procedure for appointing its members. While economic crime and corruption are estimated by the authorities to have caused significant damage in the past years, some anti-corruption reforms are still pending.

(18) Slovenia still has high state involvement in the economy, in particular in the financial sector. The previously published plans for privatisation have been implemented slowly. Proceeding with privatisations would increase the viability of the companies in the long run and would lower the risks for public finances.

(19) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Slovenia’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Slovenia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Slovenia but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(20) In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below;

HEREBY RECOMMENDS that Slovenia take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 3.1% in 2019, corresponding to an annual structural adjustment of 0.65% of GDP. Adopt and implement the Healthcare and Health Insurance Act and the planned reform of long-term care. Ensure the long-term sustainability and adequacy of the pension system, including by increasing the statutory retirement age and by restricting early retirement. Increase the employability of low-skilled and older workers through lifelong learning and activation measures.

2. Develop alternative sources of financing for fast-growing companies. Lower the barriers for market entry through the revision of Product Market Regulation and limiting administrative burden. Enhance competition, professionalisation and independent oversight in public procurement. Carry out the privatisations in line with to the existing plans.

Done at Brussels, 13 July 2018.

For the Council

The President

H. LÖGER

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(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Slovakia and delivering a Council opinion on the 2018 Stability Programme of Slovakia

(2018/C 320/24)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Slovakia as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Slovakia should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendation (1).

(3) The 2018 country report for Slovakia was published on 7 March 2018. It assessed Slovakia’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Slovakia’s progress towards its national Europe 2020 targets.

(4) On 25 April 2018, Slovakia submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Slovakia is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the Government plans to improve the headline deficit to 0,8 % of GDP in 2018, and gradually further to 0,0 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0,5 % of GDP — is expected to be reached in 2020. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 49,3 % in 2018 to 43,3 % by 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been fully specified. The budget includes a non-specified category of expenditure called budgetary reserves which represents a non-negligible share (0,7 % of GDP) and can be used for ad hoc operations, thus reducing predictability in budget implementation.

On 11 July 2017, the Council recommended Slovakia to ensure that the nominal growth rate of net primary government expenditure (2) does not exceed 2,9 % in 2018, corresponding to an annual structural adjustment of 0,5 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission's assessment of the strength of the recovery in Slovakia while giving due consideration to its sustainability challenges, no additional elements in that regard need to be taken into account. Based on the Commission spring 2018 forecast, there is a risk of a significant deviation from that recommendation in 2018.

In 2019, in view of Slovakia's projected output gap of 1,2 % of GDP, the nominal growth rate of net primary government expenditure should not exceed 4,1 %, in line with the structural adjustment of 0,5 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Under unchanged policies, Slovakia would be at risk of significant deviation from that requirement in 2019, due to the deviation over 2018 and 2019 taken together. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to ensure compliance with the provisions of the Stability and Growth Pact.

Slovakia’s public finances still face risks in the long term. Healthcare expenditure continues to pose a risk to the long-term sustainability of public finances as increasing the cost effectiveness of healthcare in Slovakia remains a challenge. In the long term, public expenditure on healthcare is projected to increase by 1,2 percentage points of GDP, above the average estimated increase of 0,9 percentage points for the Union. The pension system has seen a gradual improvement in its long-term sustainability due primarily to the automatic increase in the retirement age, which has reduced the projected age-related spending increases in the long term.

Although some steps have been taken to improve the cost effectiveness of the healthcare system, in particular through the implementation of the Value for Money spending review, the potential to rationalise the use of resources remains significant. Plans for a far-reaching healthcare reform allowing the streamlining of services, better hospital resource management and more efficient care system are showing no signs of progress. The consumption of hospital services continues to be high, with high rates of hospitalisation for chronic diseases and discharge rates above the Union average, coupled with relatively low bed occupancy rates. While strengthening

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(2) Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
the primary care sector can ease the high burden put on hospitals, the system suffers from a shortage of general practitioners, which is exacerbated by their uneven geographical distribution. The age composition of general practitioners also raises concerns for their future supply. Lastly, several provisions aimed at enhancing the cost effectiveness of the health system such as the full introduction of a diagnosis-related group payment system and the effective operationalisation of the e-health system are still in their development phase. They are likely to face further delays and implementation challenges in the future.

(11) Fiscal revenues are increasing on the back of swift economic growth and efforts are ongoing to improve tax compliance and close Slovakia's high value added tax gap. While fiscal incentives promoting R&D were increased, property taxation remains a weak revenue source. A rolling programme of spending reviews for all key areas of public spending is proving to be an effective and rigorous tool for improving cost effectiveness in government spending.

(12) Positive developments in the labour market continue, marked by increasing employment and historically low levels of unemployment. Nevertheless, the long-term unemployment continues to be one of the highest in the Union, affecting particularly disadvantaged groups such as low-skilled workers, young people and marginalised Roma. As a result of the improving labour market conditions, reports of skilled labour shortages in some sectors of the economy have started to appear. Regional disparities in the labour market are pronounced, with higher unemployment concentrated in eastern Slovakia and labour shortages concentrated in the western part of the country. Slovakia has started to implement its action plan on the integration of the long-term unemployed, supported by the European Social Fund. The plan introduces in particular personalised services, social counselling, and a new basic profiling system. However, implementation has not yet yielded significant structural improvements. Gaps persist in cooperation with private partners and non-governmental organisations to alleviate caseloads in public employment services, while individualised counselling is at an early stage. In addition, the rough segmentation of the long-term unemployed does not fully serve as a tool for subsequent referral to activation measures. Training and requalification programmes have been strengthened but are still insufficient and their targeting of the long-term unemployed and disadvantaged groups remains limited. In addition, adult participation in learning is still very low and second-chance education for disadvantaged groups is underdeveloped. The eligibility criteria for unemployment benefits are strict and the duration of benefits is short. This results in low coverage of the short-term unemployed receiving unemployment benefits.

(13) The gender employment gap and gender pay gap are well above the Union average. The low employment rate of women of childbearing age reflects the fact that long parental leave is rarely taken up by men, accompanied by a low take-up of flexible working arrangements and limited affordability and access to childcare facilities. Particularly for children under the age of three, the enrolment rates in childcare are extremely low.

(14) The education system does not sufficiently contribute to the socioeconomic development of Slovakia, and is underfunded at all levels. The quality of educational outcomes, the participation of Roma in inclusive mainstream education and the effective integration of students from socioeconomically disadvantaged backgrounds in education and training are pressing challenges. Educational outcomes and the level of basic skills remain weak by international standards and are profoundly impacted by students' socioeconomic background. Early school leaving is low but increasing and regional disparities in dropout rates are pronounced. Despite plans to annually increase teacher salaries by 6% until 2020, the teaching profession is still unattractive, in part due to limited initial training and professional development opportunities. The implementation of measures to increase the participation of Roma pupils in inclusive mainstream education is extremely weak due to inadequate financial support and monitoring as well as insufficient training of teachers on intercultural issues.

(15) Public administration is still burdened by inefficiency and bottlenecks caused by poor inter-ministerial cooperation and weak political neutrality of the civil service. Implementation of the Civil Service Act has been slowly taking off, but its impact on improving human resource management remains to be seen. On the management of Union funds, administration capacity and efficiency is still limited and staff turnover remains high, in part linked to the political cycle. This is nevertheless being addressed by strengthening the coordinating role of the Office of the Deputy Prime Minister which acts as a stabilising factor on continuity and institutional expertise in implementing organisations.
ESI Funds are pivotal in addressing key challenges to improve competitiveness, growth and jobs in Slovakia. Slovakia suffered from a loss of EUR 26 million of funding for research and innovation in 2017 mostly due to problems in applying selection criteria and selecting evaluators, as confirmed by the verifications carried out. If appropriate measures are not taken to accelerate implementation, there is a high risk that another part of the funding allocation will be lost. While the project selection rate has now exceeded half of the total allocation for the current programming period, implementation on the ground resulted in payments to beneficiaries amounting only to 11% of the allocation.

The low effectiveness of public administration also translates to other sectors, including energy and the environment. Recycling rates are very low and air quality remains relatively poor. Sustainable forest management is an increasing challenge. The energy sector suffers from overregulation and energy policies are not fully in line with the climate and energy objectives of the Union.

Slovakia has taken important steps towards achieving a well-functioning system of public procurement. Efforts have been made to introduce quality award criteria. Mandatory electronic tools for conducting public procurement procedures should be in place by October 2018. While not optimally efficient, comprehensive prior verifications have been carried out on all projects funded through the ESI Funds. Nevertheless, a satisfactory performance has not yet been achieved in the areas of internal controls, transparency, digitisation, professionalisation, strategic and environmentally sustainable public procurement. This is reflected in Slovakia's scores related to anti-competitive practices, which remain somewhat above the Union average, despite some improvement. Moreover, there are still only limited signs of commitment to fighting corruption. More than half of businesses perceive corruption as widespread in public procurement managed by national authorities.

Corruption, complex administrative procedures, excessive and fast-changing business regulations and concerns about the governance of several regulatory bodies heavily affect the quality of Slovakia's business environment. While Slovakia lost some ground in some international comparisons, it has identified a number of measures to improve the quality of the business environment and boost investment. Slovakia has also strengthened its framework for regulatory impact assessment, extending its use in recent years. Finally, RIA (Regulatory Impact Assessment) 2020, a new strategy for better regulation has been recently adopted. High regulatory barriers remain in the business services sector with levels of restrictiveness higher than the Union average for architects, engineers, tax advisers, lawyers, patent agents, real estate agents and tourist guides. Recommendations to address the regulatory barriers were made in the Commission Communication of 10 January 2017 on reform recommendations for regulation in professional services. However, Slovakia has reported no progress in addressing those restrictions.

Overall, no progress has been achieved in stepping up the fight against corruption. Corruption perceptions remain high and prosecutions for such offences have fallen further. The perception of corruption has further deteriorated in the wake of the murder of an investigative journalist and his findings on a wide range of high-level corruption cases. The proportion of high-level cases prosecuted is extremely low. The lack of accountability for police and public prosecutors has not been resolved and hinder the fight against corruption and investigations of sensitive corruption cases.

Improving the effectiveness of the justice system, including the independence, remains a challenge for Slovakia, despite some improvements in efficiency. Concerns about the independence of the judiciary persist, including the appointment processes for judges at all levels of the judiciary.

Although boosting innovation can trigger competitiveness and facilitate the transition to a knowledge-based economy, Slovakia's capacity to innovate remains moderate, with a business R&D intensity which is very low (0.40% of GDP in 2016). While Slovakia has a large medium/high-tech manufacturing sector, the dominant multinational companies have so far shown only limited interest in carrying out R&D activities and the percentage of small and medium-sized enterprises innovating in-house was much lower in Slovakia (13.9%) than in the Union as a whole (28.8%) in 2016.

Public investments in research and innovation increased strongly between 2009 and 2015 due to the use of the ESI Funds. The full potential of these investments has not been realised due to inefficiencies in Slovakia's research environment. Despite the strengthened role of the Office of the Deputy Prime Minister for coordination of research, development and innovation, the overall governance of policy in this area is weak. The fragmented
nature of the system and the weak governance framework, with responsibilities split among several ministries and implementing agencies, which are often poorly coordinated, leads to a regular postponement of reforms. Measures to stimulate knowledge transfer, strengthen research capacities in industry, and improve the cooperation between businesses and academia are advancing only slowly.

(24) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Slovakia’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Slovakia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Slovakia but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(25) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (*) is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that Slovakia take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2019, corresponding to an annual structural adjustment of 0.5% of GDP. Implement measures to increase the cost effectiveness of the healthcare system and develop a more effective healthcare workforce strategy.

2. Reinforce activation and upskilling measures, including quality targeted training and individualised services for disadvantaged groups, in particular by delivering on the action plan for the long-term unemployed. Foster women’s employment, especially by extending affordable, quality childcare. Improve the quality and inclusiveness of education, including by increasing the participation of Roma children in mainstream education from early childhood onwards.

3. Increase the use of quality-related and lifecycle cost criteria in public procurement operations. Tackle corruption, including by ensuring enforcement of existing legislation and by increasing accountability at the level of police and prosecution. Improve the effectiveness of the justice system, in particular by safeguarding independence in judicial appointment procedures. Reduce the fragmentation of the public research system and stimulate business innovation, including for small and medium-sized enterprises.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(*) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Finland and delivering a Council opinion on the 2018 Stability Programme of Finland

(2018/C 320/25)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify Finland as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area (3) (‘Recommendation for the euro area’).

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Finland should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendation (3).

(3) The 2018 country report for Finland was published on 7 March 2018. It assessed Finland’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (4), the follow-up given to the country-specific recommendations adopted in previous years and Finland’s progress towards its national Europe 2020 targets.

(4) On 13 April 2018, Finland submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Finland is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2018 Stability Programme, the Government plans a headline balance of -0.6% of GDP in 2018, unchanged from the previous year. According to the Government, the balance is projected to improve in 2019 and, thereafter, reach a small surplus in 2020 and 2021. The medium-term budgetary objective — a deficit of 0.5% of GDP in structural terms — was over-achieved in 2017. However, the recalculated structural deficit (2) is projected to be marginally larger, at 0.6% of GDP in 2018-2019 and to decrease thereafter. The general government debt-to-GDP ratio peaked at 63.6% in 2015 and declined to 61.4% in 2017. According to the 2018 Stability Programme, the debt ratio will continue to decrease and reach 56.7% of GDP in 2021. The macroeconomic scenario underpinning those budgetary projections appears to be broadly plausible. The main risks to the budgetary projections relate to the possible larger-than-expected upfront costs of the planned social and healthcare services reform.

The 2018 Stability Programme recalls that the costs related to the exceptional inflow of refugees increased and that this budgetary impact was significant in 2015-2016. According to the 2017 Stability Programme, the costs were projected to decrease by 0.15% of GDP in 2017. This figure was not confirmed in the 2018 Stability Programme and has therefore not been taken into account by the Commission. In addition, in 2017, Finland was granted a temporary deviation of 0.5% of GDP from the required adjustment path towards the medium-term budgetary objective to take account of major structural reforms, in particular, the 2017 pension reform and the Competitiveness Pact, with a positive impact on the long-term sustainability of public finances. In 2017, Finland was also granted a temporary deviation of 0.1% of GDP to take account of national investment expenditure in projects co-financed by the Union. As regards the latter deviation, one of the eligibility criteria is that total public investment does not decrease. Outturn data for 2017 showed a decline in public investment in 2017 compared to the previous year, while investment linked to Union funds is estimated to have remained stable. Thereby, Finland is no longer considered eligible for a temporary deviation of 0.1% of GDP in relation to national investment expenditure in projects co-financed by the Union in 2017. The remaining temporary deviations from the adjustment path towards the medium-term budgetary objective are carried forward so that they cover a period of three years. Therefore, the temporary deviations under the unusual events and structural reform clauses amount to 0.67% of GDP in 2018 and 0.5% of GDP in 2019.

The Council recommended Finland to ensure that the deviation from the medium-term budgetary objective in 2018 is limited to the allowance linked to the budgetary impact of unusual events (granted in 2016) as well as the allowances related to the implementation of structural reforms and investments (granted in 2017). This is consistent with a maximum nominal growth rate of net primary government expenditure of 1.9% in 2018, corresponding to an allowed deterioration in the structural balance by 0.1% of GDP. Based on the Commission 2018 spring forecast, there is a risk of some deviation from the recommended fiscal adjustment in 2018. However, as a result of the better-than-expected outcome for 2017, the distance from the medium-term objective is currently forecast to be less than the granted allowances linked to the unusual events and the structural reform clauses. If confirmed, this shall be taken into account in the ex-post assessment for 2018.

In 2019, based on the Commission 2018 spring forecast, Finland should ensure that the deviation from the medium-term budgetary objective in 2019 is limited to the allowance linked to the budgetary impact in relation to the implementation of the structural reforms for which a temporary deviation was granted in 2017. This is consistent with a maximum nominal growth rate of net primary government expenditure of 2.9%, corresponding to an allowed deterioration in the structural balance by 0.2% of GDP. Under unchanged policies, Finland is forecast to comply with the requirement for 2019. Finland is also forecast to comply with the debt

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(2) Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.
Due to an ageing population and a declining workforce, expenditure on pensions, health and long-term care is projected to increase from 22% of GDP in 2016 to 24% of GDP by 2030. The administrative reform and the reform of the social and healthcare services, currently under discussion in the Parliament, aim at reducing expenditure growth in this area. Other objectives would be to ensure equal access to healthcare and reduce waiting times for patients, especially in less favoured or remote areas. The ratio of self-declared unmet medical needs is above the Union average. In particular, people outside the workforce are experiencing difficulties getting the necessary medical care. A new level of regional public administration, i.e. counties, will take care of Finland’s social and healthcare services from 2020. The reform will pool resources to allow their more effective use at county level. Higher use of digital and electronic services should also increase productivity. Finally, social and primary healthcare services would be available from both public and private social and health centres. This would give patients more freedom of choice, while competition between service providers is expected to yield cost savings. Achieving these ambitious objectives will also depend on the choices made during the implementation phase of the reform.

Inactivity and unemployment traps remain an obstacle to a more extensive use of the labour force. A significant inactivity trap results from the benefits system and the combination of its different types of allowances. Social assistance and the housing allowance form a substantial component of this trap. These and other benefits are phased out very rapidly as income increases, which creates the risk that taking up work might not be sufficiently financially rewarding. The complexity of benefit rules combined with administrative practices are deemed to result in significant unemployment traps or ‘bureaucratic traps’. Uncertainty surrounding the level of benefits and the time to reinstate them reduces the attractiveness of short-term or part-time work. Finally, despite a recent pick-up in new home construction, the lack of affordable housing in growth centres could be an additional impediment to labour mobility. The ongoing basic income experiment, whose first results are expected in 2019, is likely to provide some information for revising the social security system. A reform of the parental leave system has been explored to increase the employment rate of women of child-bearing age and to promote gender equality. A real-time income register is currently under preparation and could provide an opportunity to improve the efficiency of public services and level the benefits effectively.

Wage-setting practices are changing and moving towards sectoral and local level bargaining. Since firms often face very different constraints, this should allow more wage differentiation between firms, ensuring that real wage increases are in line with productivity growth while supporting better employment outcomes. Under the most recent wage agreements concluded in late 2017 and early 2018, organised employers have more opportunities to carry out local bargaining. For non-organised employers some obstacles persist. Some first positive results have been observed, as the current status of the recent wage negotiations points to an outcome with a broadly neutral impact on cost competitiveness. In practice, despite the absence of formal coordination on wage agreements, a Finnish model seems to be emerging, linking pay rises in the non-tradable sector with the increases agreed in the tradable sector.

As activity and employment gradually return to pre-crisis levels, the lower employability of the unemployed and the inactive is likely to become a major concern that could slow down recovery of the labour market, thereby undermining the long-term sustainability of Finland’s welfare society. The situation requires adequate and integrated activation and rehabilitation services to the unemployed and the inactive. At the same time, the resources devoted to public employment services, in particular to counselling activities, are below the Union average. Services for the unemployed, especially for those with lower employment prospects, are dispersed among a number of separate providers. Integration or better coordination would help produce a seamless services chain (a one-stop-shop for the unemployed/inactive). Continued efforts are needed to ensure the re-entry of the
inactive into the labour market, especially those in the 25-49 age group and persons with a migrant background. The migrant population could partly offset the existing decline in the working-age population, provided that they are well integrated into the labour market and in Finnish society. Finally, labour shortages are increasing, likely reflecting ongoing structural changes in the economy, such as population ageing. This suggests a need for continued investment in adult learning and vocational training to enable occupational mobility and reduce skills mismatches.

(15) The Government has implemented measures to promote entrepreneurship and start-ups and it has also improved the availability of loans and export guarantees for small and medium-sized enterprises. Also, the unemployed are now allowed to receive unemployment benefits during the first months when starting a business. This scheme is most likely to be successful if combined with training and coaching, while its short duration can limit its impact. Also, some weaknesses remain in the social protection of entrepreneurs and the self-employed and the risk of poverty for the self-employed in Finland is high relative to employees.

(16) Household debt remains at a historically high level (67% of GDP in 2016). The debt is predominantly at a variable rate, which constitutes a risk should interest rates rise in the medium term. Consumer credit is increasing rapidly and a rising share of this lending is granted by foreign banks, by financial institutions other than credit institutions, by small-loan companies and by peer-to-peer lending. The Finnish Financial Supervisory Authority has adopted a number of measures to contain the increase in the indebtedness of households. However, no active deleveraging is expected soon, especially as interest rates remain low and consumer confidence is strong. The lack of a comprehensive (collecting both positive and negative information on debtors) credit registry can prevent banks from having a clear overview of households’ overall indebtedness.

(17) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Finland’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Finland in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Finland but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(18) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion (1) is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Finland takes action in 2018 and 2019 to:

1. Achieve the medium-term budgetary objective in 2019, taking into account the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted. Ensure the adoption and implementation of the administrative reform to improve cost-effectiveness and equal access to social and healthcare services.

2. Improve incentives to accept work and ensure adequate and well-integrated services for the unemployed and the inactive.

3. Strengthen the monitoring of household debt including by setting up a credit registry system.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 5(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of Sweden and delivering a Council opinion on the 2018 Convergence Programme of Sweden

(2018/C 320/26)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (2), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Sweden as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Sweden was published on 7 March 2018. It assessed Sweden’s progress in addressing the country-specific recommendation adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and Sweden’s progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission’s analysis led it to conclude that Sweden is experiencing macroeconomic imbalances. In particular, overvalued house price levels coupled with a continued rise in household debt poses risks of a disorderly correction. The already high household debt remains on an upward path. House prices have been growing at fast and virtually uninterrupted pace for about 20 years. Negative growth was recorded in the last quarter of 2017. Still, valuation indicators suggest that house prices remain very high relative to fundamentals. Although banks appear adequately capitalised, a disorderly correction could also affect the financial sector as banks have a growing exposure to household mortgages. In such a case, there could be spill-overs to neighbouring countries given the systemic financial interlinkages. In recent years measures have been taken to rein in mortgage debt growth and increase housing construction. However, policy steps implemented so far have not been sufficient to address overvaluation in the housing sector, and key policy gaps remain, particularly in relation to tax incentives for home ownership as well as the functioning of the housing supply and the rental market.

On 27 April 2018, Sweden submitted its 2018 National Reform Programme and its 2018 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

Sweden is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the government plans to achieve a surplus of 1.0% of GDP in 2018 and to continue to meet the medium-term budgetary objective — a structural deficit of 1% of GDP — throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to fall to 37.3% in 2018 and to continue declining to 29.0% in 2021. Economic growth and sound public finances are set to be the main drivers behind the declining general government debt-to-GDP ratio. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2018 spring forecast, the structural balance is forecast to show a surplus of 0.7% of GDP in 2018 and a surplus of 1.0% of GDP in 2019, above the medium-term budgetary objective. Based on its assessment of the 2018 Convergence Programme and taking into account the Commission 2018 spring forecast, the Council is of the opinion that Sweden is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

Household indebtedness has continued to rise from already high levels. Household debt grew by 7.0% in 2017, reaching about 86% of GDP and 184% of disposable income – among the highest levels in the Union. After falling somewhat in 2016, the average debt-to-disposable-income ratio for new mortgage borrowers rose again in 2017 to 411%, a new high. The growth in household debt is driven mainly by higher mortgage borrowing, linked to high house prices and structural distortions favouring mortgage-financed property investment. Debt levels are unevenly distributed, with lower-income and younger households facing particularly high debt loads relative to their incomes. Sweden has implemented several macroprudential measures in recent years. Steps taken include setting loan-to-value limits, adjusting banks’ risk-weight floors, and introducing a formal mortgage amortisation rule in June 2016. A new strengthened amortisation requirement for high-debt-to-disposable-income mortgages came into force in March 2018. Sweden has also adopted legislation to strengthen the legal mandate of macroprudential authority (Finansinspektionen). The new mandate is operational from February 2018, allowing the authority to respond in a more timely manner with a wider range of potential measures to the risks associated with growing household debt. Macroprudential policy steps taken so far appear to have had limited impact on mortgage lending growth. Gradually limiting the tax deductibility of mortgage interest payments or increasing recurrent property taxes would help curb household debt growth, but the Government has made no progress on this.

In 2017, Sweden's economy grew strongly by about 2.4%, fuelled by robust domestic demand. Investment, driven by housing investment, grew by 6.0% (year-on-year) in the first three quarters, making a particularly strong contribution. Despite a sharp rise in new construction in recent years, there is still an ongoing supply shortage, particularly of affordable homes around major cities. Lack of available and affordable housing can also limit labour market mobility and the effective integration of migrants into the labour market and contribute to intergenerational inequality.

After two decades of rapidly rising house prices, the housing market experienced a gradual decline in autumn 2017, but prices remain above fundamentals. Key drivers include tax incentives favouring home ownership and mortgage debt, and continued accommodative credit conditions coupled with still relatively low mortgage amortisation rates. In addition, the housing shortage is linked to structural inefficiencies, including limited competition in the construction sector due to barriers to entry for small and foreign firms and the ability of large developers to control land resources. There are also barriers to an efficient usage of the existing housing stock. In the rental market, below-market rents create lock-in and ‘insider/outsider’ effects. In the owner-occupancy market,

capital gains taxes reduce homeowner mobility. The Swedish authorities are continuing to gradually implement the 22-point plan to increase residential construction and improve the efficiency of the housing market. However, no significant policy action has been taken to introduce more flexibility in setting rental prices or to revise the design of the capital gains tax.

(9) The advanced economy needs highly skilled workers; corresponding labour shortages are emerging in sectors such as construction, education, health, science, engineering and information and communication technologies. In this context, challenges remain, such as integrating people with a migrant background, especially women, into the labour market. The employment rate of non-EU born women is considerably lower than for the overall population. The educational performance gap between pupils from different socioeconomic backgrounds is widening. The integration of newly arrived migrant pupils into the school system warrants close monitoring, as does the growing shortage of teachers.

(10) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Sweden’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Sweden in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Sweden but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(11) In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion (1) that Sweden is expected to comply with the Stability and Growth Pact.

(12) In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Convergence Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendation (1) below.

HEREBY RECOMMENDS that Sweden take action in 2018 and 2019 to:

1. Address risks related to high household debt by gradually reducing the tax deductibility of mortgage interest payments or increasing recurrent property taxes. Stimulate residential construction where shortages are most pressing, in particular by removing structural obstacles to construction, and improve the efficiency of the housing market, including by introducing more flexibility in setting rental prices and revising the design of the capital gains tax.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LÖGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.
COUNCIL RECOMMENDATION
of 13 July 2018
on the 2018 National Reform Programme of the United Kingdom and delivering a Council opinion
on the 2018 Convergence Programme of the United Kingdom

(2018/C 320/27)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (1), and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission also adopted the Alert Mechanism Report, in which it did not identify the United Kingdom as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for the United Kingdom was published on 7 March 2018. It assessed the United Kingdom’s progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 (3), the follow-up given to the country-specific recommendations adopted in previous years and the United Kingdom’s progress towards its national Europe 2020 targets.

(3) On 29 March 2017, the United Kingdom notified the European Council of its intention to leave the European Union. Unless a ratified Withdrawal Agreement establishes another date or the European Council, in accordance with Article 50(3) of the Treaty on European Union and in agreement with the United Kingdom, unanimously decides that the Treaties cease to apply at a later date, all Union primary and secondary law will cease to apply to the United Kingdom from 30 March 2019, 00:00h (CET). The United Kingdom will then become a third country. Negotiations are on-going in order to ensure an orderly withdrawal, including a transition period until the end of 2020 during which Union law will continue to apply to and in the United Kingdom.

(4) On 30 April 2018, the United Kingdom submitted its 2018 National Reform Programme and its 2018 Convergence Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (1), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) The United Kingdom is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2017-2018 Convergence Programme, the Government expects the headline deficit to fall from 2.2 % of GDP in 2017-2018 to 1.8 % of GDP in 2018-2019 and to 1.7 % of GDP in 2019-2020. The Convergence Programme does not include a medium-term budgetary objective. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to broadly stabilise around 85.5 % from 2017-2018 to 2019-2020 before falling to 84.8 % of GDP in 2021-2022. The macroeconomic scenario underpinning those budgetary projections is plausible. While the measures needed to support the planned deficit targets are overall well specified, growing pressures on government expenditure in a number of areas pose a risk to the achievement of the planned deficit reduction.

(7) On 11 July 2017, the Council recommended the United Kingdom to ensure that the nominal growth rate of net primary government expenditure (2) does not exceed 1.8 % in 2018-2019, corresponding to an annual structural adjustment of 0.6 % of GDP. At the same time, the Council stated that consideration should be given to achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of the United Kingdom’s public finances. Based on the Commission 2018 spring forecast, there is a risk of some deviation from the requirements of the preventive arm in 2018-2019.

(8) In 2019-2020, in view of the United Kingdom’s general government debt ratio above 60 % of GDP and projected output gap of 0.4 %, the nominal growth rate of net primary government expenditure should not exceed 1.6 %, in line with the structural adjustment of 0.6 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Under unchanged policies, the United Kingdom is forecast to comply with the requirement in 2019-2020. The United Kingdom is prima facie projected to comply with the transitional debt rule in 2018-2019 and in 2019-2020 as a result of the allowed annual deviation of 0.25 %. Overall, the Council is of the opinion that the United Kingdom needs to stand ready to take further measures as of 2018-2019 to comply with the provisions of the Stability and Growth Pact.

(9) Annual net housing supply continues to increase amid a range of government initiatives to stimulate the housing market and a cyclical recovery. However, it remains far below estimates of demand and the United Kingdom continues to face a major challenge in delivering sufficient housing. This is linked to very strict and complex regulation of the land market. Shortages of housing and high housing costs are particular issues in areas of high and growing demand, such as in and around urban centres. The Government recognises the problem and has set ambitious objectives to increase supply in the coming years. At the same time, the Government has reaffirmed its commitment to limiting development around urban centres. Home ownership has fallen significantly for younger people, contributing to intergenerational inequality.

(10) Labour productivity is low and stagnant. Large parts of the economy perform comparatively poorly on the main drivers of productivity — skills, investment and efficient business processes. The United Kingdom’s road, rail and aviation networks also have significant and growing capacity pressures.

(11) Although headline labour market figures continue to be positive across most metrics, there are ongoing concerns about the quality of some employment. This is related to issues with skills development, certain atypical forms of work, earnings, productivity, labour market participation and working-age poverty. There have been significant policy announcements and developments on all of these issues. Coherence in these related policies is paramount.


(2) Net primary government expenditure comprises total government expenditure excluding interest expenditure. expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.
On skills, much of the focus thus far has been on apprenticeships and reforms to technical education. A focus on quality for both could provide a sustainable multiplier effect for the society as well as the economy. The United Kingdom is among those Member States that already meet over two-thirds of the draft criteria in the European Framework for Quality and Effective Apprenticeships, and therefore setting and monitoring quality targets, e.g. via graduate tracking, is feasible. Resources commensurate with those earmarked for apprenticeships and the new T-Levels for school leavers are needed for lifelong learning options, particularly for those trapped in entry-level employment.

(12) Social protection and inclusion issues also need attention going forward. Childcare reforms are being rolled out, but more provision may be needed, particularly for children under three. The impact of some welfare reforms and cutbacks are yet to be fully felt, particularly for in-work families.

(13) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of the United Kingdom’s economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to the United Kingdom in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in the United Kingdom, but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input for future national decisions.

(14) In the light of this assessment, the Council has examined the 2018 Convergence Programme and its opinion (1) is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that the United Kingdom take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.6 % in 2019-2020, corresponding to an annual structural adjustment of 0.6 % of GDP.

2. Boost housing supply, particularly in areas of highest demand, including through additional reforms to the planning system.

3. Address skills and progression needs by setting targets for the quality and the effectiveness of apprenticeships and by investing more in upskilling those already in the labour force.

Done at Brussels, 13 July 2018.

For the Council
The President
H. LOGER

(1) Under Article 9(2) of Regulation (EC) No 1466/97.