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## I

*(Resolutions, recommendations and opinions)*

## RECOMMENDATIONS

## COUNCIL

## COUNCIL RECOMMENDATION

**of 9 July 2019**

**on the 2019 National Reform Programme of Belgium and delivering a Council opinion on the 2019 Stability Programme of Belgium**

(2019/C 301/01)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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, Belgium should ensure the full and timely implementation of the 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, measures to improve services will help address the first euro-area recommendation as regards resilient services markets, measures to improve the sustainability, efficiency and composition of public finances as well as using windfall gains to reduce public debt will help address the second euro-area recommendation as regards supporting investment, improving public finances, rebuilding fiscal buffers and measures to strengthen the effectiveness of labour market policies will help address the third euro-area recommendation as regards supporting successful labour market transitions.
- (3) The 2019 country report for Belgium was published on 27 February 2019. It assessed Belgium's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Belgium's progress towards its national Europe 2020 targets.
- (4) On 26 April 2019, Belgium submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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) Belgium is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme, the government plans a gradual improvement of the headline balance from a deficit of 0,7 % of gross domestic product (GDP) in 2018 to 0,0 % of GDP in 2022. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a balanced budgetary position in structural terms, is not planned to be achieved over the period covered by the 2019 Stability Programme. After having peaked at almost 107 % of GDP in 2014 and decreasing to 102 % of GDP in 2018, the general government debt-to-GDP ratio is expected to decline to 94 % by 2022 according to the 2019 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 2020 onwards have not been specified, which contributes to the projected deterioration of the structural balance in 2020 under unchanged policies according to the Commission 2019 spring forecast.
- (7) On 5 June 2019, the Commission issued a report prepared in accordance with Article 126(3) of the Treaty due to Belgium's non-compliance with the debt rule in 2018. The report concluded, following an assessment of all the relevant factors, that the current analysis is not fully conclusive as to whether the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 has been complied with.
- (8) In its 2019 Stability Programme, Belgium confirms the request made in its 2019 Draft Budgetary Plan to avail itself of the flexibility under the preventive arm pursuant to the 'Commonly agreed position on Flexibility within the Stability and Growth Pact' endorsed by the Council on 12 February 2016. Belgium requested a temporary deviation of 0,5 % of GDP from the adjustment path towards the medium-term budgetary objective in view of the implementation of major structural reforms with a positive impact on the long-term sustainability of public finances. The structural reforms refer to a pension reform, a 'tax shift', a reform of corporate income taxation, a labour market reform as well as a reform of the public administration. The Commission 2019 spring forecast

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 1.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

confirms that Belgium respects the minimum benchmark in 2019, providing a safety margin towards the 3 %-of-GDP deficit threshold. All the measures have now been fully legislated for, with the exception of the reform of the public administration. Given their nature, and in particular the tax shift and its corporate income tax reform, there are still uncertainties surrounding their short-term impact, particularly given their non-budgetary neutral nature, which has worsened the budgetary position. Nevertheless, the measures have enhanced the economy's growth potential, lowered the unemployment rate and reduced the risks of macroeconomic imbalances, thereby having a positive impact on debt sustainability in the medium to long term. On this basis, Belgium can currently be assessed as qualifying for the requested temporary deviation of 0,5 % of GDP in 2019, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester.

- (9) On 13 July 2018, the Council recommended Belgium to ensure that the nominal growth rate of net primary government expenditure <sup>(7)</sup> does not exceed 1,8 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. As Belgium qualifies for the requested temporary deviation of 0,5 % of GDP under the structural reform clause, the required structural adjustment for 2019 can be reduced to 0,1 % of GDP, corresponding to a nominal growth rate of net primary expenditure that does not exceed 2,8 % in 2019. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective over 2018 and 2019 taken together.
- (10) In 2020, in view of Belgium's general government debt ratio above 60 % of GDP and projected output gap of 0,1 %, 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. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement in 2020. Belgium is *prima facie* not forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. It would be important to use any windfall gains to further reduce the general government debt ratio. The medium- and long-term sustainability of Belgium's public finances continues to be at risk due to the combination of a high debt-to-GDP ratio and the projected rise in ageing costs, in particular those linked to pensions and long-term care. A set of pension reforms was legislated in 2015, leading to an increase of the statutory retirement age from 65 to 66 years as from 2025 and to 67 as from 2030. Moreover, age and seniority requirements to benefit from early retirement were also made stricter. Nevertheless public expenditure on pensions would still increase by 2,9 percentage points of GDP between 2016 and 2070, mostly during the next two decades. Furthermore, early retirement conditions for several large groups of civil servants remain more favourable than the standard conditions. Public spending on long-term care is projected to increase by 1,7 percentage points of GDP between 2016 and 2070, an above average increase starting from what is already one of the highest levels in the Union. The organisational fragmentation of long-term care, with competences currently spread across different administrative levels, challenges some dimensions of spending efficiency, hence the net impact of the recent transfer of responsibilities is not yet clear. Strengthening governance would help to achieve the intended efficiency gains. There might be room to optimise the care mix to increase the cost-efficiency of the long-term care system.
- (11) The composition and efficiency of public spending can be improved in order to create space for more public investment. In spite of a recent decrease, total expenditure as a share of GDP in Belgium remains among the highest in the euro area. The high level of public expenditure suggests that there is scope for a more spending-based fiscal adjustment. Given the high level of public expenditure, the outcomes of certain policies and the quality of certain public services raise questions of cost efficiency. Spending reviews and policy evaluations can help Belgium prioritise and improve the efficiency of public expenditure. Furthermore, spending reviews could be used to assess the efficiency of the indirect public support for business Research and Development, which is one of the highest in the Union, as a percentage of GDP and which continued to increase last year. Federal and regional authorities have recently expressed interest in integrating spending review in their budgetary mechanism.

<sup>(7)</sup> 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.

- (12) Budget coordination between entities is currently not sufficiently flexible to create room for public investment in large-scale projects. 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. There is still no formal agreement on annual targets at all levels of government, in spite of the cooperation agreement signed in 2013, complicating budget coordination. In contrast with the practice of previous Stability Programmes, when the Concertation Committee took note of the fiscal trajectory, all levels of government approved the overall fiscal trajectory presented in the 2018 Stability Programme and supported the achievement of the fiscal targets by 2020 for all government levels. Although this approval added credibility to the overall trajectory, there was no formal agreement on the annual fiscal targets at each level of government. A lack of agreement on the targets at each level of government may undermine the viability of the overall trajectory towards the medium-term objective. In addition, this prevents the public-sector borrowing requirements section of the High Council of Finance from effectively monitoring compliance with these targets. The 2019 Stability Programme contains only indicative overall and intermediary budgetary targets as elections took place at the federal level and at the level of the Regions and Communities on 26 May 2019.
- (13) Recent economic growth has resulted in jobs growth and employment is at the highest level in the past 10 years. Nevertheless, transitions from inactivity or unemployment to employment remain low and Belgium is not on track to achieving its Europe 2020 employment target of 73,2 %. Strong regional disparities in the labour market persist. Despite a steady decline over the last five years, youth unemployment is well above the Union's average in Brussels. Labour market participation is low for the low-skilled, people with a migrant background, older workers and people with disabilities, suggesting that both structural and group-specific factors hinder their integration in the labour market, while existing activation measures are not equally effective for all population groups. The employment rate of older workers (55-64 years) remains below the Union average and the gap with the Union average remains high for those over 60 years. People with a migrant background, in particular women, continue to experience higher unemployment, lower activity rates, higher in-work poverty and over-qualification. While some measures have been taken to support the integration of new arrivals and to tackle discrimination, a coordinated approach to address the challenges faced by people with migrant background is still lacking. To address low labour market participation, measures have been taken as part of the 'Jobs Deal' reform, but their impact remains to be assessed.
- (14) Important financial disincentives to take up employment remain. Although the tax shift reduced the labour tax wedge, it remains on average high for all wage earners, except for the very low wage earners (50 % of the average wage). Belgium remains the only Member State in which unemployment benefits are not limited in time, though they gradually fall. There are financial disincentives for beneficiaries of sickness and disability schemes and second earners to take up full-time employment. In particular, single parents (and to a lesser extent couples with children) face limited financial incentives to take up (full-time) employment due to a combination of costs and withdrawal of benefits. Moreover, coordination problems may arise due to the split of responsibilities for the social protection between the federal, regional and local levels. The social security system does not formally cover the self-employed for unemployment benefits, accidents at work and occupational diseases.
- (15) The decline in educational performance within compulsory education and the existence of significant disparities in the education system remain a concern. The percentage of young people not mastering basic skills can be improved in particular in the French Community where that percentage is above the OECD average. The gap in educational outcomes due to socioeconomic and migration background is high. Teachers need more support to deal with diversity and there remains a need to adapt teachers' continuous professional development. Reforms to improve educational outcomes and to tackle disparities need to be stepped up to boost knowledge-intensive, sustainable and inclusive growth and social inclusiveness. The implementation of the 'Pact for Excellence', the French Community's flagship school reform to improve basic skills, efficiency, governance and tackle inequalities, is progressing. Decrees on the organization of work of teachers, on the common core school curriculum, on the

status of school directors and the reinforcement of the knowledge of French for newcomer pupils have been adopted and will be applicable as from September 2020. The Flemish Community is implementing some reforms in secondary education as of 2019/2020, but early tracking of pupils remains a concern. The impact of these reforms and measures will also depend on their effective implementation and monitoring. The federal Parliament has also lowered the age of compulsory education from six to five years. Given the already high spending levels on education, reforms will need to be implemented with a stronger focus on increasing the efficiency and effectiveness of the system, and its capacity to deliver future-oriented and labour market relevant competences.

- (16) Skills mismatches and low job mobility hamper job and productivity growth. Despite several regional and federal measures taken to address skills shortages and increase activation, including as part of the 'Jobs Deal' reform, labour shortages are observed in several sectors, in particular in information and communication technologies, construction and health. The growth of the construction sector is held back by lack of skills and labour shortages. There are important needs in terms of re-skilling and upskilling the labour force in some sectors. Adult participation in education and training and job mobility are also low. Poor linguistic skills are an important issue, in particular in Brussels, where around 50 % of job offers require the knowledge of both French and Dutch, according to the 2019 National Reform Programme. Tertiary education attainment is high, but there are too few graduates in science, technology, engineering and mathematics (STEM). In 2016, Belgium ranked 26th in the Union for tertiary graduates in STEM education with a low rate of new entrants to related tertiary education fields, in particular for women. The overall implementation of the 'STEM Action Plan 2012-2020' in Flanders shows progress, but the number of STEM secondary graduates in technical and vocational paths has stagnated since 2010. The French Community has no STEM policy strategy and still needs to implement its recently adopted 'Strategy for Digital Education' for schools. Shortages of professionals with knowledge in entrepreneurship and in science, technology, engineering and mathematics hold back the development of start-ups. The overall level of digital skills is good, but not improving. The 2019 National Reform Programme highlights the agreement between Flanders and Wallonia and the planned agreement between Flanders and the Brussels-Capital Region to improve inter-regional labour mobility.
- (17) Research and development is concentrated in a few industries and there is insufficient diffusion of innovation to the rest of the economy, ultimately weighting on productivity growth. Publicly financed research appears to be below the Union average. In terms of Research, Development and Innovation, there are also regional and sub-regional disparities. The National Pact for Strategic Investment identifies the reinforcement of digitalisation as a promising avenue to boost productivity and the innovation capacity of Belgium. Doing so requires investments in digital infrastructure, including taking effective steps for the successful roll out of 5G, and human capital and entrepreneurial spirit as well as an accelerated take-up of digital technology, in particular by those firms that have been lagging behind so far.
- (18) The quality of road infrastructure is deteriorating after years of low public investment. At the same time, the maintenance of a large and dense network does not seem cost-effective for the regions and local authorities. Roads in Belgium are among the most congested in the Union. The rail infrastructure is dense and of good quality, but completing and upgrading it remains a challenge and there is congestion especially around Brussels and in access to the ports of Antwerp and Zeebrugge. Significant investments are planned in suburban rail infrastructure and signalling, but are being held back in particular by budgetary allocation rules across regions. Additionally, distortive incentives and barriers to competition and investment in domestic passenger railway services and intercity coach services constrain the supply and demand of alternative collective and low-carbon transport services. The increasing congestion is partly explained by the continuous increase of passenger cars, incentivised by toll-free roads, the company car deduction and low environmental taxation. High transaction taxes on immovable property and the company car scheme adversely affect mobility. The quality of rail services has decreased and the supply of urban and urban-rural public transport has room for improvement, in particular in Wallonia, where access to



employment is a major constraint to jobseekers. According to the 2019 National Reform Programme, important investments and reforms are underway in all regions, while at federal level, and in cooperation with the Regions, the completion of the network of suburban railways around Brussels is progressing. Belgium adopted the law to open domestic railway services, but the share of passenger transport provided under public service obligations with a directly awarded contract remains very high in Belgium. Private bus operators are not allowed to operate intercity coach services. Taxi regulations vary among local authorities. Although regions have developed their own mobility plans, complex coordination prevents a consistent vision for mobility within Belgium, and possibly with border cities and regions. The Rail Regulator has room to develop the scope of its regulating activities.

- (19) There are substantial investment needs to support the energy transition. Renovation of the old building stock, which predates the introduction of energy norms, will help to meet the 2020 and 2030 emission reduction targets. The roll-out of alternative fuel is rather low. There is a need for major investment in power generation, as well as interconnection capacity, smart grids storage and energy efficiency.
- (20) In spite of government efforts, the regulatory and administrative burden on firms remains heavy and weighs on entrepreneurship. Taxation has been alleviated for start-ups and small companies, but remains complex for financial investments. Belgium has reformed its company law code, reducing the number of legal forms for companies, facilitating legal electronic communication, reducing minimum capital requirements and, according to the 2019 National reform Programme, reforming the insolvency law to include in particular liberal professions. However, in spite of these efforts, there are long delays for building permits, costly property registration and lengthy judicial proceedings. Administrative justice is experiencing challenges due to a lack of resources and lengthy proceedings, causing important delays, in particular for building permits, but also for procurement procedures. Moreover, coordination in climate, energy, digital and transport policy is complex and can be improved. Cooperation between customs authorities and market surveillance authorities is sub-optimal increasing the risk that non-compliant goods enter the Union through the Belgian borders. Impact assessment could be better integrated in the policy-making process. The quality of digital public services for businesses is low. The lack of digitalisation of the justice system remains a serious challenge, in particular for data collection. Completing the digitalisation of justice is an important condition for further improvements of the quality of the justice system, such as updating business processes and better management of human and financial resources at courts.
- (21) Barriers to competition and investment in several business services hamper growth and productivity. Entry rates of new service providers are significantly below the Union average, while profit rates are above the Union average. The Commission restrictiveness indicator shows that the Belgian regulatory framework for accountants, tax advisors, architects and real estate agents is considerably more restrictive than the Union average. A recently adopted law has introduced stricter requirements for patent agents. The Federal Planning Bureau estimates that an ambitious reduction of the regulatory burden in legal, accounting and architectural services would increase labour productivity. The regulated fees of notaries for real estate transactions are significant, adding to the high registration taxes. Regions have unevenly reformed the crafts and trade professions. The retail sector still faces operational restrictions that hinder its productivity and discourage investment. The supermarket sector displays a sub-optimal level of competition, mainly due to high concentration and low entry and exit dynamics. According to the Retail Restrictiveness Indicator, Belgium is the sixth most restrictive Member State as regards the operational environment for retailers. The 2019 National Reform Programme highlights recent reforms in the Brussels-Capital Region to facilitate retail establishment. The telecoms market is characterised by a high level of concentration (further accentuated by recent takeovers) and weak competition. This is also illustrated by relatively high prices for fixed services compared to peer countries. In fixed networks, the retail market is characterised by geographically defined duopolies of the incumbent and cable network operators. This may create obstacles to the

provision of fixed-mobile convergent bundled services by some operators. The 2019 National Reform Programme highlights that the reform of economic law to improve compliance of competition law and the functioning of the Belgian Competition Authority by making procedures more efficient and reduce the risk of further disputes before the 'Cour des Marchés/Marktenhof' has been adopted. The Belgian competition authority has limited resources compared to the resources of competition authorities of other Member States.

- (22) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Belgium to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (23) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Belgium's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (24) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion <sup>(8)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Belgium take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1,6 % in 2020, corresponding to an annual structural adjustment of 0,6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. Continue reforms to ensure the fiscal sustainability of the long-term care and pension systems, including by limiting early exit possibilities from the labour market. Improve the composition and efficiency of public spending, in particular through spending reviews, and the coordination of fiscal policies by all levels of government to create room for public investment.
2. Remove disincentives to work and strengthen the effectiveness of active labour market policies, in particular for the low-skilled, older workers and people with a migrant background. Improve the performance and inclusiveness of the education and training systems and address skills mismatches.
3. Focus investment-related economic policy on sustainable transport, including upgrading rail infrastructure, the low carbon and energy transition and research and innovation, in particular in digitalisation, taking into account regional disparities. Tackle the growing mobility challenges, by reinforcing incentives and removing barriers to increase the supply and demand of collective and low emission transport.
4. Reduce the regulatory and administrative burden to incentivise entrepreneurship and remove barriers to competition in services, particularly telecommunication, retail and professional services.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Bulgaria and delivering a Council opinion on the 2019 Convergence Programme of Bulgaria**

(2019/C 301/02)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

- (2) The 2019 country report for Bulgaria was published on 27 February 2019. It assessed Bulgaria's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, 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 27 February 2019. The Commission's analysis led it to conclude that Bulgaria is experiencing macroeconomic imbalances. In particular, vulnerabilities in the financial sector are coupled with high indebtedness and non-performing loans in the corporate sector. While there is progress in addressing sources of the imbalances, the full implementation and monitoring of recent reforms of supervision and governance in the bank and non-bank financial sectors will be crucial.
- (3) On 24 April 2019, Bulgaria submitted its 2019 National Reform Programme and its 2019 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 <sup>(4)</sup>, 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 2019 Convergence Programme, the government, starting from a headline surplus of 2 % of gross domestic product (GDP) in 2018, aims at a deficit of 0,3 % of GDP in 2019 and a surplus of 0,4 % of GDP in 2020, 0,2 % in 2021 and 0,1 % in 2022. Based on the recalculated structural balance <sup>(5)</sup>, the medium-term budgetary objective — a structural deficit of 1 % of GDP in structural terms — continues to be overachieved throughout the programme period. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to decline gradually from 22,6 % of GDP in 2018 to 16,7 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 0,7 % of GDP in 2019 and 0,6 % of GDP in 2020, above the medium-term budgetary objective. Overall, the Council is of the opinion that Bulgaria is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (6) Tax revenues and tax compliance are improving and a number of initiatives are in place. However, tax collection does not seem to be improving everywhere at the same pace. This is particularly the case for labour-related taxes and social security contributions and in some categories of excise taxes. There is also evidence that undeclared work and illicit trade in fuels remain a challenge. Maintaining the efforts to improve tax collection and taking additional targeted measures to face the challenges in specific areas of the tax system is of paramount importance for reducing further the still large shadow economy.
- (7) The government has taken steps to improve the effectiveness of public expenditure. The World Bank completed a spending review covering a number of public institutions (ministries and municipalities) and two pilot studies, one on policing and firefighting and one on waste management, and also delivered a manual for future reviews by the government. In the 2018 medium-term fiscal strategy, the government introduced a number of performance indicators to assess the impact of spending in the different policy areas over time and to inform evaluation and planning of the budget. Following up on these initiatives is expected to raise the quality, efficiency and transparency of public spending, and consequently the quantity and quality of public goods.

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 7.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (8) State-owned enterprises suffer from weak corporate governance, which is also to a large extent reflected in their economic performance. A reform of the legal framework for the corporate governance of State-owned enterprises is under way in cooperation with the Organisation for Economic Cooperation and Development (OECD) and with the support of the Commission's Structural Reform Support Service. The reform aims to address the current weaknesses by aligning the national legislation with the OECD's corporate governance guidelines for state-owned enterprises. The adoption and effective implementation of the framework will ensure the continuity and will be critical for the success of the reform.
- (9) In a favourable economic environment, banks' capital and liquidity ratios improved on average. In parallel, non-performing loans by non-financial corporations declined although they remain high. The secondary market for non-performing loans has become more dynamic. On 30 May 2019 the BNB adopted a decision to implement the EBA Guidelines for the management of non-performing and restructured exposures. The follow-up measures resulting from the financial sector reviews have strengthened the banking sector, but some vulnerabilities remain. New regulatory initiatives in 2018 included the rules for large exposures and the identification of connected clients, an increase in the counter-cyclical capital buffer rate and the introduction of macro-prudential tools for borrower-based measures. Following up on legislative initiatives on related-party exposures, sustained supervisory efforts to limit loans to related parties and penalise infringements of collateral provisions are crucial to support sound business practices. Enhancing the bank resolution framework is another ongoing measure that will contribute to the resilience of the financial sector.
- (10) Completing the insolvency reform could help reduce the high outstanding private-sector debt and the still high share of non-performing loans. Some missing elements reduce the efficiency and effectiveness of the insolvency framework, resulting in slow and costly insolvency proceedings. At the same time, the absence of adequate monitoring tools prevents a proper analysis of current and new pre-insolvency and insolvency procedures and does not allow concrete bottlenecks or weak points to be identified. In October 2018, Bulgaria asked for assistance from the Commission's Structural Reform Support Service to help it advance the reform of the insolvency framework. This project identifies gaps in the insolvency framework and will produce a roadmap to address them. It is important to sustain the reform momentum and implement the forthcoming roadmap.
- (11) Bulgaria has adopted legislative amendments in 2018 and subsequently in May 2019 and is working towards a fully consistent transposition of the Directive (EU) 2015/849 of the European Parliament and of the Council <sup>(6)</sup> (Fourth Anti-Money Laundering Directive). Attention should be paid to the effective implementation of these measures. The authorities have still not finalised and notified the National Risk Assessment, which is a cornerstone to devising adequate national policies to combat money laundering and terrorist financing. Moreover, recent developments in the banking sector suggest that there is need to enhance the national supervision of international financial transactions and to ensure the effective enforcement of the anti-money-laundering (AML) framework. The risk of corruption needs to be better addressed, as it is a predicate offence to money laundering. The Bulgarian authorities will need to show concrete results and build a track record evidenced by final decisions in high level corruption cases. The use of financial investigation and financial profiling is limited.
- (12) Non-bank supervision is being reformed. The Financial Supervision Commission adopted an action plan for reforming non-bank financial supervision in September 2017, in cooperation with the European Insurance and Occupational Pensions Authority. The full and timely implementation and enforcement of the action plan, still ongoing, will contribute to adequate supervision of the non-banking financial sector. Amendments to secondary legislation are in place, aiming to improve the valuation rules and their application. Their effective implementation and enforcement would address remaining valuation issues that have been identified in the past. Lastly, group-level supervision remains a challenge for ensuring an adequate risk-based insurance supervision.

<sup>(6)</sup> Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141 5.6.2015, p. 73).

- (13) The car insurance sector presents some vulnerabilities. Well-specified rules on compensation would facilitate a more harmonised approach by judges when deciding on individual cases. In the longer term, such a methodology would help to reduce costs, volatility and underwriting risk in the motor third-party liability line of business. The sustainability of the sector would also benefit from improved pricing that takes into account clients' driving history. The Financial Supervision Commission has proposed a bonus-malus system, which is undergoing broad public debate. Lastly, the liquidity of the 'Green Card Bureau' has raised substantial concerns, mainly due to the non-payment of claims by one Bulgarian insurer. Strict compliance of all members with their obligations is crucial for the credibility and efficiency of the system.
- (14) Infrastructure suffers from major investment gaps. The coverage and quality of transport infrastructure have improved but remain below the Union average. The Trans-European Transport Network in Bulgaria is still incomplete. Moreover, greenhouse gas emissions from road transport have increased strongly over the last five years. There is a need for further development of rail and road sections and the respective European rail traffic management systems and intelligent transport systems. Bulgaria has low connection and treatment rates for urban waste water, high air pollution levels and landfilling rates for municipal waste and a recycling rate, considerably lower than the Union average. Investments to promote sustainable water management, resource efficiency and the transition to a circular economy are necessary. In addition, investment needs in the fields of energy and climate change mitigation and adaptation are significant. The high energy intensity of the economy and the slow progress towards meeting energy efficiency targets, in particular in the buildings sector, are holding back the productivity and competitiveness of businesses in the country. Efforts thus need to be stepped up to ensure that significant energy savings are achieved via targeted investments in the industrial, transport and buildings sectors. Increased investments in clean energy infrastructure (such as clean and low-carbon power generation, interconnections, and smart grids), in line with the priorities outlined in Bulgaria's draft national climate and energy plan, would further help improve the economy's overall competitiveness and people's quality of life.
- (15) Despite an increase in the public research budget in 2018, research and development (R & D) spending remains very low in both private and public sector. Private R & D investment is dominated by large multinational companies and concentrated in the capital region. The slow pace of implementing reforms and high fragmentation in the research, development and innovation system hampers the contribution of R & D investment to productivity and growth. A large number of universities and research institutes continue to perform poorly in high-quality scientific research. Science-business links remain very weak and the availability of human capital in the R & D system is a source of significant concern. Clusters and their potential in Bulgaria are underdeveloped as they often lack a critical mass. Further reforms, combined with efficient governance and more effective public investment can maximise the impact on productivity and improve the competitiveness of the economy. In addition, increasing the digitisation of companies and introducing new business models are critical for the country's productivity.
- (16) Public administration and e-government reforms continue to be slow and are yielding insufficient improvements while the business environment remains weak. A number of reform measures have been adopted, but their practical implementation is lagging behind. Institutional shortcomings, regulatory uncertainty, corruption, and an insufficient labour supply remain among the main obstacles to investment. Governance in the public sector could benefit from more transparency, clearer rules and a long-term perspective. Shortcomings are also apparent in the area of product testing and safety due to limited financial and human resources. Moreover, while the vast majority of measures included in the national procurement strategy have been adopted, their implementation requires continuous monitoring, control and assessment. The frequent use of direct awards and the high number of single bids represent a threat to the system's transparency and effectiveness. The public procurement sector's administrative capacity is an ongoing challenge, as are also the professionalisation of public buyers and aggregated purchases. The significant delay in the uptake of electronic procurement is preventing further improvement in the transparency and efficiency of public procurement processes.
- (17) The labour market has improved but challenges remain. The employment rate has reached the highest level since Bulgaria joined the Union and the unemployment rate is below the Union average. Despite these positive developments, some groups such as the low-skilled, young people, Roma and people with disabilities still face difficulties to find work. Specific measures are being implemented to support the long-term unemployed, who represented 3 % of the active population in 2018. A combination of effective and sustained outreach measures, active labour market policies and integrated employment and social services could improve disadvantaged groups' employability and chances of finding work.

- (18) Bulgaria's increasing skills shortages warrant significant investments. Young people might be more employable if the quality and effectiveness of traineeships and apprenticeships were improved. Moreover, the participation in upskilling and reskilling measures among the adult population is very low. Despite measures launched to encourage the development of digital skills, Bulgaria's level of basic digital skills (29 % of individuals possess basic digital skills against a Union average of 57 %) remains among the lowest in the Union.
- (19) Despite the ratification of the International Labour Organization's Convention concerning Minimum Wage Fixing and of several rounds of negotiations during 2018, employers and trade unions still have diverging views on the criteria to be applied when setting the minimum wage. There is scope for greater consensus about an objective and transparent wage-setting mechanism. Meanwhile, although the involvement of the social partners in the design and implementation of policies and reforms seems to have increased, continuous support for a reinforced social dialogue remains necessary.
- (20) Educational outcomes are still low and continue to be strongly influenced by parents' socioeconomic status. This reflects challenges relating to the quality and inclusiveness of the education and training system. Bulgaria invests insufficiently in education, particularly in pre-primary and primary education, two areas that are instrumental to creating equal opportunities from an early age. Participation in quality early childhood education and care is low, in particular for Roma and children from other disadvantaged groups. The rate of early school leaving is still high, with negative consequences for future employability and labour market outcomes. The labour market relevance of vocational education and training and the availability of dual vocational education and training remain insufficient. While some measures are underway, further efforts are needed to ensure that the skill set of higher education graduates can address short- and mid-term skills shortages in a consistent way. Some measures to retrain teachers and make the profession more attractive have been put in place. However, initial and continuous education programmes for teachers require further strengthening and efforts are still needed to improve the working conditions of education staff.
- (21) Bulgaria is still facing high income inequality and risk of poverty or social exclusion. Though decreasing, the rate of poverty or social exclusion in 2018 was 32,8 %, still well above the Union average. The social security system does not cover all people in employment and the social protection system is insufficient to tackle the significant social issues. This reflects the low level of social spending, the uneven availability of social services across the territory and the limited redistributive effects of the taxation system. In 2018, the income of the richest 20 % of population was 7.7 times higher than that of the poorest 20 %, still one of the highest in the Union. Despite some measures, the adequacy and coverage of the minimum income remain limited and an objective mechanism for regularly updating it is still missing. Social services are hampered by low quality and lack of an integrated approach towards active inclusion. Disparities in access to social services, healthcare and long-term care persist. This undermines their ability to provide comprehensive support for the most vulnerable, such as the Roma, children, the elderly, persons with disabilities and people living in rural areas. Part of the population has difficulty getting access to affordable housing. More efforts are therefore needed to foster active inclusion, promote the socioeconomic integration of vulnerable groups including the Roma, enhance access to quality services and address material deprivation.
- (22) The healthcare sector is still characterised by low public spending. People in Bulgaria face limited access to healthcare caused by an uneven distribution of limited resources and low health insurance coverage. Out-of-pocket payments are considerable, as they need to compensate for the low level of public expenditure. The low availability of general practitioners is constraining the delivery of primary care. There is a significant shortage of nurses with the number per capita among the lowest in the Union. Swifter and more effective implementation of the national health strategy would help tackle these weaknesses.

- (23) 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 the country. The November 2018 Cooperation and Verification Mechanism report noted that Bulgaria had continued its efforts to reform its judiciary and address shortcomings in the fight against corruption and organised crime, but that further efforts were needed in a number of areas. The Commission expects to assess progress again in early autumn 2019.
- (24) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Bulgaria to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (25) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Bulgaria's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 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 their compliance 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.
- (26) In the light of this assessment, the Council has examined the 2019 Convergence Programme and is of the opinion <sup>(7)</sup> that Bulgaria is expected to comply with the Stability and Growth Pact.
- (27) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Convergence Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendation (2) below,

HEREBY RECOMMENDS that Bulgaria take action in 2019 and 2020 to:

1. Improve tax collection through targeted measures in areas such as fuel and labour taxes. Upgrade the State-owned enterprise corporate governance by adopting and putting into effect the forthcoming legislation.
2. Ensure the stability of the banking sector by reinforcing supervision, promoting adequate valuation of assets, including bank collateral, and promoting a functioning secondary market for non-performing loans. Ensure effective supervision and the enforcement of the AML framework. Strengthen the non-banking financial sector by effectively enforcing risk-based supervision, the recently adopted valuation guidelines and group-level supervision. Implement the forthcoming roadmap tackling the gaps identified in the insolvency framework. Foster the stability of the car insurance sector by addressing market challenges and remaining structural weaknesses.
3. Focus investment-related economic policy on research and innovation, transport, in particular on its sustainability, water, waste and energy infrastructure and energy efficiency, taking into account regional disparities, and improving the business environment.

<sup>(7)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.



4. Strengthen employability by reinforcing skills, including digital skills. Improve the quality, labour market relevance, and inclusiveness of education and training, in particular for Roma and other disadvantaged groups. Address social inclusion through improved access to integrated employment and social services and more effective minimum income support. Improve access to health services, including by reducing out-of-pocket payments and addressing shortages of health professionals.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Czechia and delivering a Council opinion on the 2019 Convergence Programme of Czechia**

(2019/C 301/03)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, the Commission also adopted the Alert Mechanism Report, in which it did not identify Czechia as one of the Member States for which an in-depth review would be carried out.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

- (2) The 2019 country report for Czechia was published on 27 February 2019. It assessed Czechia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, the follow-up given to the recommendations adopted in previous years and Czechia's progress towards its national Europe 2020 targets.
- (3) On 30 April 2019, Czechia submitted its 2019 National Reform Programme and its 2019 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 <sup>(4)</sup>, 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) Czechia is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Convergence Programme, the government expects to move from a budgetary surplus of 0,3 % of gross domestic product (GDP) in 2019 to a deficit of 0,2 % in 2020, which is projected to gradually deteriorate to 0,5 % by 2022. Based on the recalculated structural balance <sup>(5)</sup>, the medium-term budgetary objective — which has been changed from a structural deficit of 1 % in 2019 to 0,75 % of GDP as of 2020 — continues to be overachieved throughout the programme period. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to gradually decline to 29,7 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Risks to the achievement of budgetary targets seem broadly balanced, with expected further growth in public wages and social transfers contrasting with a small reduction in total revenues as a share of GDP. Based on the Commission 2019 spring forecast, the structural balance is forecast to deteriorate to around -0,1 % of GDP in 2019 and -0,4 % of GDP in 2020, remaining above the medium-term budgetary objective. Overall, the Council is of the opinion that Czechia is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (6) Czechia faces medium risks for fiscal sustainability of public finances in the long term, mainly due to the costs of ageing. Pension expenditure is the main factor negatively affecting long-term sustainability, as it is expected to grow by around 2 percentage points of GDP by 2070. Long-term risks stem from unfavourable demographics combined with the capping of the statutory retirement age at 65 years. As a result, the old-age dependency ratio, comparing elderly people with the active population almost doubles, reaching approximately 50 % in 2070. Recent measures improve the adequacy of pensions. Alongside a more generous indexation of pension benefits, the government increased the basic pension amount and topped up pensions for older pensioners. However, these steps are not accompanied by policies that would improve sustainability. For example, the alignment between gains in life expectancy and the statutory retirement age is not automatic. Currently, any change to the retirement age (statutory and early retirement) needs to be proposed by the government and approved by the Parliament. Such measures can also be combined with labour market policies that support longer working careers and the participation of underrepresented groups. The projected increase in age-related public expenditure on healthcare amounts to 1,1 percentage points of GDP by 2070, which also reduces long-term fiscal sustainability. In this context, further consolidation of the hospital sector and investment in primary and integrated health and social care could improve the cost-effectiveness of the healthcare system.

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 12.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (7) The Czech National Bank can set recommendatory macro-prudential mortgage lending limits, but according to the current legislation, its sanctioning powers are limited since it lacks the formal authority to enforce them. While in general the Czech banks comply with the recommendations, binding legislative limits would likely increase the level of compliance among Czech banks, and other mortgage loan providers, ensuring financial stability and reduced risks for borrowers. A legislative proposal, amending the Act on the Czech National Bank, is still under discussion.
- (8) Despite slight improvements, corruption remains a concern for businesses and may hinder economic activity. On the positive side, the reforms introduced in 2017, including on public procurement, are currently being implemented and some pending measures were finally adopted by the government and sent to Parliament for further discussion. These include proposals for extending the role of the Supreme Audit Office to the regions and municipalities, and on nominations to the State-owned companies, an area open to conflict of interest and where regulation is essential. However, the proposals on protection of whistleblowers and on lobbying have not yet been adopted.
- (9) Czechia is enjoying strong labour market performance. Employment has risen steadily over the past seven years and unemployment has fallen considerably. Nonetheless, the labour market potential of women with young children, the low-skilled and people with disabilities remains underutilised. Against the background of labour shortages, there is clear scope for increasing their labour market participation. The employment gap and the gender pay gap 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. Low availability of affordable childcare, long parental leave entitlements, low use of flexible working arrangements and the lack of long-term care facilities still have a major impact on labour market participation. In 2017, only 6,5 % of children below the age of three were in formal childcare (compared to the Union average of 34,2 %). Although the low-skilled make up a small proportion of the population, their employment rate is well below that of the medium- and high-skilled. Similarly, the employment rate of people with disabilities remains low. Due to limited capacity, public employment services currently fall short of 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 would help boost the participation of disadvantaged groups.
- (10) Labour and demographic constraints in a manufacturing-intensive economy warrant more investment in education and training, including for employed adults, to ensure the country meets the challenges brought about by structural changes in the economy, such as future technological changes. Qualitative skills mismatches, including those due to future automation and robotisation, could arise, notably in the digital sector. The new jobs will require new competences and significant investment, particularly in higher vocational technical skills and digital skills, expected to be needed following the automation of current mechanical jobs. Although various initiatives to introduce a comprehensive skills strategy have taken place over recent years, these have not yet grown into a genuine comprehensive system.
- (11) Education outcomes continue to be strongly affected by the socioeconomic background of students. A reform to make education more inclusive was introduced in 2016 with the support of the European Social Fund. Its success will depend on the availability of sufficient and sustainable national funding, further teacher and teaching-assistant training, and an increase in public awareness of the benefits of inclusive education. While positive overall, the impact of the inclusive education reform on the participation of Roma children in mainstream education remains limited. Low investment, the limited attractiveness of the teaching profession and socioeconomic inequalities are holding back the level of education attained. There is a shortage of teachers due to low job prestige, low salaries compared to other professions despite recent increases, and limited career development opportunities. The teaching profession remains relatively unattractive for talented young people. Given this, the shortages of qualified teachers combined with expected unfavourable demographic developments indicate that it could become more challenging to recruit and retain teachers in the future.

- (12) Despite Czechia being a transit country, the completion of the European transport networks, including TEN-T corridors, is far from being finalised. Suburban transport infrastructure also remains deficient, limiting housing affordability and people's ability to commute to work. Weak transport links are also deterring business activity, particularly in remote regions. While the process of suburbanisation is ongoing in metropolitan areas, suburban transport networks are lagging behind, particularly for rail infrastructure. The country scores low in terms of low carbon aspects, particularly the percentage of renewable energy in transport and the take-up of electric vehicles. Furthermore, the planned growth of the recharging infrastructure for electric vehicles may not be sufficient to cater for future demand. More investment in sustainable transport could also reduce air and noise pollution, alleviating its impact on public health, especially in urban areas. Digital infrastructure is improving but the divide between urban and rural areas persists, as only 59 % of rural households are covered by fast broadband networks. Upgrading older networks based on copper infrastructure along with fixed wireless access solutions will not be sufficient for achieving the 2025 connectivity objectives. To address future connectivity needs, investment is needed in very high capacity networks (i.e. optical fibre) and appropriate demand-side measures.
- (13) The energy intensity of the Czech economy remains one of the highest in the Union as energy efficiency is improving only slowly, in particular in the buildings sector. Energy intensity is the highest in the industrial and residential sectors. Improving energy efficiency is an opportunity to increase Czechia's competitiveness, by reducing energy costs for households and businesses, developing cleaner industries and moving up the value chain. Coal dominates the power sector and is the largest source of carbon emissions, posing a substantial threat to local air quality. Greenhouse gas emissions from road transport have increased strongly the last 5 years. On climate adaptation and risk prevention, proper action is lacking as regards suitable prevention, preparedness and disaster resilience.
- (14) Administrative and regulatory burden may be hampering investment. Many Czech firms see the administrative and regulatory burden as a major obstacle to investment. Fast-changing legislation and complex administrative procedures remain major obstacles to doing business. The cost of enforcing contracts, frequent changes to the tax and labour regulations and difficulty in obtaining construction permits are potentially discouraging investment in the country. The degree of administrative burden also varies substantially among the regions. Recent proposals aim to reduce the complexity of planning procedures, particularly for large infrastructure projects. Furthermore, the government is preparing to draft a new construction law by 2021, with the involvement of social partners. Responsibility for market surveillance of products is spread over various organisations, suffers from overlaps and poses challenges for efficient coordination and effective cooperation.
- (15) Whilst improving in terms of transparency and provided training, public procurement practices still lag behind in terms of competitiveness, due to the high proportion of procedures with only one received bid, use of quality criteria and trust in public institutions. The vast majority of public procurement decisions continue to be based on the lowest price as the adoption of a strategic approach is still pending. There has been more emphasis on centralised procurement and on using shared expertise but their rollout is rather slow, despite their proven potential.
- (16) Czechia has not yet created a fully functioning innovation ecosystem based on domestic research and development. The country remains a moderate innovator at the Union level, despite an increase in research and development intensity. This performance may be linked to public investment lacking a fully coherent strategy to increase the modest research performance and improve cooperation between the private sector and academia. Productivity gains are mostly driven by large foreign companies, while domestic firms lag behind in terms of value added generation. Moreover, total factor productivity, an indicator of how efficiently capital and labour are being used in production, has been growing at a relatively slow pace. An increased focus on domestic innovation could boost productivity across the entire business spectrum, including for small and medium-sized enterprises.

- (17) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Czechia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (18) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Czechia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Czechia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Czechia, but also their compliance 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 2019 Convergence Programme and is of the opinion <sup>(6)</sup> that Czechia is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Czechia take action in 2019 and 2020 to:

1. Improve long-term fiscal sustainability of the pension and health-care systems. Adopt pending anti-corruption measures.
2. Foster the employment of women with young children, including by improving access to affordable childcare, and of disadvantaged groups. Increase the quality and inclusiveness of the education and training systems, including by fostering technical and digital skills and promoting the teaching profession.
3. Focus investment-related economic policy on transport, notably on its sustainability, digital infrastructure, and low carbon and energy transition, including energy efficiency, taking into account regional disparities. Reduce the administrative burden on investment and support more quality-based competition in public procurement. Remove the barriers hampering the development of a fully functioning innovation ecosystem.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(6)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Denmark and delivering a Council opinion on the 2019 Convergence Programme of Denmark**

(2019/C 301/04)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

- (2) The 2019 country report for Denmark was published on 27 February 2019. It assessed Denmark's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Denmark's progress towards its national Europe 2020 targets.
- (3) Denmark submitted its 2019 National Reform Programme on 15 March 2019, and its 2019 Convergence Programme on 10 April 2019. 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 <sup>(4)</sup>, 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 2019 Convergence Programme, the government plans a headline deficit of 0,1 % of gross domestic product (GDP) in 2019 and 2020. Based on the recalculated structural balance <sup>(5)</sup>, the medium-term budgetary objective — a structural deficit of 0,5 % of GDP — continues to be overachieved throughout the programme period until 2025. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to fall to 33,4 % in 2019 and to remain stable in 2020, before rising to 37,8 % of GDP by 2025. The macroeconomic scenario underpinning those budgetary projections is plausible over the programme period. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 0,9 % of GDP in 2019 and 1,0 % of GDP in 2020, above the medium-term budgetary objective. Risks relate to revenue shortfalls from volatile components, particularly the pension yield tax. Overall, the Council is of the opinion that Denmark is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (6) Denmark's research and innovation system is characterised by high levels of investment, a strong human resources base and scientific excellence. However, the research and innovation landscape in Denmark is concentrated in a relatively small number of players such as large firms and foundations mostly in the pharmaceutical and biotechnology sectors, which makes the research and innovation system potentially vulnerable to external shocks. Therefore, there appears to be room for improvement in investing in the scale-up of highly innovative companies.
- (7) Ensuring the supply of labour in times of demographic and technological changes and addressing labour shortages, in particular of skilled workers and ICT specialists, is key to fostering sustainable and inclusive growth in Denmark. Reforms and investments improving the attractiveness and thereby increasing the participation rates in vocational education and training is likely to have a positive impact on the supply of skilled workers. Continuous investments in adult and lifelong learning and digital skills could also help in addressing this challenge. Furthermore, it would be beneficial to focus on a better integration of marginalised and disadvantaged groups on the labour market. This relates in particular to young people with low educational attainment, people with a migrant background, people with reduced work capacity and disabilities. In addition, the educational performance of children with a migrant background remains a challenge.

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 16.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.



- (8) Despite high quality roads, road congestion is increasing, particularly around the large cities. In addition, there is a need to decarbonise the transport sector, which points to investment opportunities in sustainable transport infrastructure in order to decarbonise the transport sector and tackle road congestion, including the rollout of alternative fuel infrastructure. The outgoing government has put forward a plan to reduce congestion around larger cities. The adoption of that plan, which allocates DKK 112 billion (almost 6 % of GDP) from 2020 to 2030, is pending.
- (9) While the productivity level in the Danish economy remains among the highest in the Union, productivity growth has been declining for decades. Exporting companies show higher productivity growth than companies shielded from competition from foreign companies. While Denmark has taken measures to support productivity growth of companies in domestically oriented services sectors, productivity growth and competition in these sectors is still lagging behind. Denmark has implemented measures to enhance competition in the financial sector and has continued to implement the utilities strategy.
- (10) Following several years of high growth, housing prices appear overvalued, particularly in the main urban areas. Housing price increases moderated, however, in 2018. Furthermore, despite a continued decline, the ratio of household debt to disposable income remains the highest in the Union. The share of mortgage loans with variable interest rates and deferred amortisation is gradually decreasing, but is still high. New macroprudential measures seem to have curbed the increase in new mortgage loans with very high debt-to-income and loan-to-value ratios. The Danish authorities have in recent years also activated the countercyclical capital buffer and implemented measures to increase the resilience of banks, and they have adopted a property tax reform (effective from 2021) to put an end to the procyclical property tax system. Nevertheless, the combination of very high loan-to-income ratios, high debt with high interest rate sensitivity and overvalued housing prices pose risks to economic and financial stability and thus continuous monitoring is warranted.
- (11) Preventing money laundering and terrorism financing has become a priority for Denmark against the background of a large money-laundering scandal involving the largest financial institution in Denmark. The Danish Parliament has reached political agreements on strengthening the supervision and on a new anti-money-laundering package, encompassing a strategy to combat money laundering and terror financing. The strategy rests on eight pillars, which include strengthening cooperation between supervisors, the financial intelligence unit and other relevant stakeholders. However, challenges remain and the financial supervisor still needs to adopt additional measures and guidelines on how to strengthen supervision in these areas. Attention should be paid to the effective implementation of these measures, once adopted.
- (12) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Denmark to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (13) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Denmark's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 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 their compliance 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.

(14) In the light of this assessment, the Council has examined the 2019 Convergence Programme and is of the opinion <sup>(6)</sup> that Denmark is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Denmark take action in 2019 and 2020 to:

1. Focus investment-related economic policy on education and skills, research and innovation to broaden the innovation base to include more companies, and on sustainable transport to tackle road congestion.
2. Ensure effective supervision and the enforcement of the anti-money-laundering framework.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(6)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Germany and delivering a Council opinion on the 2019 Stability Programme of Germany**

(2019/C 301/05)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) and (2) below. In particular, investment measures and supporting wage growth will help address the first euro-area recommendation as regards euro-area re-balancing, and shifting taxes away from labour will help address the third euro-area recommendation as regards the functioning of the labour market.
- (3) The 2019 country report for Germany was published on 27 February 2019. It assessed Germany's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Germany'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 27 February 2019. The Commission's analysis led it to conclude that Germany is experiencing macroeconomic imbalances. In particular, the slowly declining current account surplus remains high and has cross-border relevance. The surplus slightly narrowed in 2018 in the context of a pick-up in domestic demand and is expected to continue to decline gradually in the coming years, while remaining above the threshold set in the Macroeconomic Imbalance Procedure. The surplus reflects a subdued level of domestic investment relative to savings in both the private and public sectors. Measures have been taken to boost private and public investment, which has increased substantially. This has contributed to a growth more driven by domestic demand. Nevertheless, as a share of gross domestic product (GDP), investment and consumption could have been expected to grow more given the favourable financing conditions, the public investment backlog, especially at municipal level, and the available fiscal space. Wage growth increased somewhat with the tightening labour market, yet real wage growth remains modest.
- (4) Germany submitted its 2019 National Reform Programme on 16 April 2019 and its 2019 Stability Programme on 17 April 2019. 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 <sup>(5)</sup>, 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) Germany is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans a budget surplus of between  $\frac{1}{2}$  and  $\frac{3}{4}$  % of GDP over 2019-2023. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective — a structural deficit of 0,5 % of GDP — continues to be overachieved throughout the programme period. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to fall below the 60 %-of-GDP Treaty reference value in 2019 and to gradually decline to 51 $\frac{1}{4}$  % in 2023. The macroeconomic scenario underpinning those budgetary projections is favourable. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 1,1 % of GDP in 2019 and 0,8 % of GDP in 2020, 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 2019 and 2020. At the same time, while respecting the medium-term budgetary objective, it would be important to use fiscal and structural policies to achieve a sustained upward trend in private and public investment, notably at regional and municipal levels.
- (7) Public and private investment increased robustly in 2018, but the investment ratio remains below the euro-area average. Public investment in 2018 grew by 7,7 % nominally and 3,8 % in real terms, but more efforts are still needed to clear the large investment backlog, particularly for investment in infrastructure and education. Real

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 19.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

public investment growth has been positive for the last three years, after a period of negative growth rates. Nominal investment at municipal level has grown by almost one fifth in 2018 alone. This reflects government efforts to boost investment. However, investment at municipal level remained lower than depreciation. Referring to KfW Municipal Panel 2019, the perceived investment backlog accumulated by 2018 was at 4 % of GDP. 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. Investment in public infrastructure is still held back by capacity and planning constraints at municipal level. Measures to overcome these constraints have been introduced, but have yet to show sustained tangible results. Moreover, there is scope to improve digital public services and public procurement. Private investment has increased noticeably, but not across all asset types. Equipment investment has grown robustly in response to record-high capacity utilisation. Housing investment continues to boom. However, the construction sector now reports capacity constraints and price increases. Non-residential construction has been increasing sluggishly in real terms, suggesting that essential infrastructure may not have kept up with the economy's needs.

- (8) Public expenditure on education, at 4,1 % of GDP in 2017, remained below the Union average of 4,6 %. Out of overall government expenditure, 9,3 % was spent on education, which is also below the Union average of 10,2 %. Spending on education and research remained at 9 % of GDP in 2017, falling short of the national target of 10 %. Even if education expenditure increased in real terms, the large investment backlog grew further due to demographic developments. Legislative changes allowing direct investment by the federal government in digital education in addition to the resources allocated by the Länder (*Digitalpakt*) are promising, but have yet to show results. Challenges such as growing student numbers, teacher shortages, digitalisation and further expansion of early childhood education and care will require appropriate public financing. Additional spending on education and on research and innovation is crucial for increasing Germany's potential growth and adapting to technological change.
- (9) Germany has made progress in recent years in increasing its research and development (R & D) intensity, mainly as a result of an increase in R & D spending by large companies, especially in medium/high-tech manufacturing sectors and in particular the automotive sector. The R & D intensity of small and medium-sized enterprises ('SMEs') is significantly below the Union average and continues to fall behind. SMEs tend to benefit less from cooperation with public research institutes than large companies. These two factors harm business innovation, which are on a long-term downward trend. Additional investment in R & D is essential not only to increase innovation capacity across the economy and boost productivity, but also to facilitate the transition to a low-carbon and circular economy, notably in relation to sustainable transport, green energy technologies, eco-innovation and recycling, and to further increase the performance of the public research sector and its contribution to these goals.
- (10) Digitalisation of the German economy is progressing slowly and SMEs remain slow adopters of digital technologies. Germany is lagging behind in deploying very high-capacity broadband (gigabit speeds) at national level, and particularly in rural areas, where stronger investment could improve productivity growth. Only 9 % of German households (in mid-2018) is covered by high-performance fibre-based access networks, compared with the Union average of 30 %. Instead, upgrading existing copper cable networks (vectoring) continued to be the incumbent's preferred technological solution. While many services rely on very high speed connectivity, 23 700 business parks were not connected to a fibre network in 2017 and 28 % of all companies lacked access to networks of at least 50 megabits. A lack of such connectivity holds back investment, especially by SMEs, many of which are located in rural and semi-rural areas. Public intervention in the deployment of ultrafast ( $\geq 100$  Mbps) broadband infrastructure in rural areas remains crucial, and different options going beyond subsidies could be explored. Performance in digital public services and in e-health is far below the Union average. Only 43 % of German internet users used e-government services in 2018 (compared to a Union average of 64 %). Regarding e-health, 7 % of Germans have used health and care services provided online (compared to a Union average of 18 %). E-prescription is used by 19 % of general practitioners (compared to a Union average of 50 %).
- (11) More investment in transport infrastructure and clean mobility solutions is needed in Germany to tackle mobility and air quality challenges, as well as to support climate change mitigation and adaptation. Greenhouse gas emissions from road transport have increased over the last five years. Air quality in Germany gives serious cause for concern, especially in urban areas where traffic accounts for about 60 % of harmful NO<sub>x</sub> emissions.

Freight transport could benefit from more developed inter-modality solutions. Cars remain by far the most commonly used means of transport for daily commuting and the average time spent in traffic jams is about 30 hours per year. Congestion and looking for parking spaces has been estimated to cost EUR 110 billion per year, or about 4 % of Germany's GDP. Although vehicles running on alternative fuels have seen the steepest increase in new registrations, the numbers remain low. Car sharing and ridesharing are still heavily underexploited. Considerable public and private investment will also be needed in view of new supply chains for batteries and critical raw materials.

- (12) Germany's electricity networks are slowly adapting to renewable production and significant investment in transmission and distribution grids remains necessary. Substantial delays in carrying out many projects have entailed considerable costs to German and European electricity networks and electricity markets. Of the 1 800 km of the grid projects identified in the 2009 Energy Network Expansion Act, only around 800 km had been implemented by the second quarter of 2018, in part because of public opposition. Delays in extending the grid will lead to higher congestion costs and result in more distortions in market functioning, both inside Germany and across borders. Investments in energy networks that promote sector coupling, diversification and an appropriate grid infrastructure are crucial for the flexibility of the energy system and for better integration across different sectors of the economy in view of the achievement of energy and climate targets.
- (13) Housing in Germany has become less affordable. Since 2015, both rents and house prices have grown faster than their long-term averages, in particular in large cities. In 2017, 20 % of the people aged 65 and over in Germany faced an excessive housing cost burden (i.e., the total housing cost represented more than 40 % of their disposable income), compared to 10 % of Europeans aged 65 and over. For the population with the lowest income, the housing cost overburden rate was 10 percentage points above the Union average of 35,3 %. The government reacted with certain measures, including a 'price brake' restricting rent increases (*Mietpreisbremse*), a support scheme to buy new property (*Baukindergeld*), as well as a change of basic law to enable the federal level to financially support the construction of social housing. Nevertheless, the completion of new dwellings remains considerably below demand and well below the government target of 375 000 per year. Further measures may be necessary, such as accelerating the construction of social housing, improving transport options, as well as reforming land-use and building regulation.
- (14) Germany has particularly benefited from integration in the internal market and plays an important role in its further development. However, barriers to competition in the business services sector in Germany remain high in comparison to other Member States. This concerns various areas, including regulated professions such as architecture, engineering, and legal services, where regulatory restrictions, such as reserve of activities and regulation on prices and fees, stifle competition. However, also unregulated business services face more restrictions to the general business environment compared to other Member States. Changes in the regulation of business services to increase competition would boost the efficiency and effectiveness of investment and economic activity.
- (15) After some improvements in previous years, there has been little progress over the past year to reform Germany's tax system to foster domestic private investment and growth. The tax system remains complex, distorts decision-making, e.g. on labour market participation, investment and financing, and could provide more effective incentives for investment and consumption. Most progress was recorded with labour taxation, but this is not yet visible in the data. There is still potential to reduce distortive taxation on labour through a tax shift away from labour to sources of revenue more supportive to inclusive and sustainable growth. The taxation of earnings from labour in 2018 (the tax wedge) remained among the highest in the Union, both for average and low-wage earners. Social security contributions of employees are particularly high compared to other countries, and social security contributions overall account for about two thirds of the tax wedge, while income tax accounts for one third. In turn, revenues from environmental taxes as a share of GDP are among the lowest in the Union. The cost of capital and the effective average corporate tax rate, which differ across regions, are among the highest in the Union. The effective average tax rate amounted to 28,8 % (national aggregate) as compared with a Union average of 20 %. Due to the interplay of the corporate income tax, the 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, estimated to be the third highest in the Union, according to 2017 data. Lowering the capital costs on equity could increase private investment and strengthen the relatively under-developed venture capital market.

- (16) The labour market remains strong, while the labour market potential of certain groups is underused. The employment rate for ages 20-64 reached 79,9 % in the fourth quarter in 2018, one of the highest in the Union. Unemployment sank to a record low of 3,2 % by the beginning of 2019. High job vacancy rate and labour shortages are becoming increasingly apparent and are restraining production significantly in some regions and sectors. Still, the labour market potential of certain groups, like women and people with a migrant background, is underused. At 46,7 %, Germany's percentage of female part-time work is very high. Taxes on labour in Germany remain relatively high, including for lower wage earners. The particular rules governing joint income taxation for married couples (*Ehegattensplitting*) mute the incentives for second earners to work, notably longer hours. People with a migrant background have a considerably lower employment rate than people with a native background, with a particularly high gap for women. Measures have been taken to support the integration of refugees in the labour market, but challenges remain, including their lack of proficiency in the German language, missing or non-transferable qualifications, caring responsibilities towards children and relatives, and lack of experience with informal rules on the German labour market.
- (17) The retirement of the baby boomer generation is affecting Germany more than other Member States. In the long-run, this demographic change will strain German public finances, could challenge the adequacy of pensions, and could degrade the currently limited share of the older population (aged 65 and above) at risk poverty or social inclusion. By 2040, the country is expected to be facing one of the largest increases in spending in relation to GDP on public pensions in the Union (up by 1,9 percentage points of GDP), while the public pension benefit ratio is expected to fall by 4,4 percentage points, to 37,6 %, according to the 2018 Ageing Report (European Commission, 2018d). Recent pension reforms increased benefit levels for certain groups, yet it is not clear that the achieved social benefits are commensurate to their considerable fiscal cost. The government also set two 'stop lines' (*doppelte Haltelinie*): a maximum pension contribution rate of 20 % and minimum income replacement rates of 48 % up to 2025. Retaining these limits is expected to require significant fiscal transfers, increasing further the burden on younger generations. In addition, the adequacy of the retirement income of low-income workers remains an issue.
- (18) Despite increasing labour shortages, real wage growth remains modest, while nominal earnings rose by 3,1 % in 2018. In addition, a concentration of employment growth in better paid full-time jobs and a reduction of the share of marginal part-time work in total employment contributed to overall wage growth in 2018, also slightly ahead of productivity growth. Collective bargaining coverage continued to decline (by 2 percentage points from 2016 to 2017), to 49 % in the west and 34 % in the east. There are significant differences in terms of coverage across sectors, with better coverage in the public sector and industry, while services have a much lower coverage. Low-paid workers have generally benefited from the minimum wage that has been introduced since 2015. Hourly wages at the very bottom of the wage distribution, notably the two lowest wage deciles, increased substantially. However, the share of low-paid workers, at 22,5 % in 2017, remains considerably above the Union average. The number of people employed only in mini-jobs fell by 6,8 % over 2010-2018 and employment subject to social insurance rose by around 18,1 % in the same period. Strengthening the conditions to promote wage growth would support domestic demand and contribute to euro-area rebalancing.
- (19) Upward social mobility in education is low in Germany. National sources confirm little progress in reducing the influence of socioeconomic background on educational outcomes. Germany has a good track record of integrating recently arrived migrants and refugees into education and training. However, people with a migrant background typically face bigger challenges than students with a native background (e.g., early school leaving rates and difficulty in finding apprenticeship places). Increasingly heterogeneous classrooms calls for strong efforts to reinforce the teaching profession, at a time of already considerable teacher shortage. The participation of employees in adult learning is a concern for future labour market performance of workers, in particular for the 6,2 million people who lack basic reading and writing skills.
- (20) Though the number of people at risk of poverty or social exclusion has fallen since its peak in 2014, challenges in equality of opportunities remain. In particular, the risk of poverty or social exclusion was, in 2017, 67 percentage points greater for the children of low-skilled parents than for the children of highly skilled parents. This gap is substantially higher than the average gap (53,9 percentage points) in the Union.

- (21) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Germany to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (22) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Germany's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Germany in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Germany, but also their compliance 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.
- (23) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion <sup>(7)</sup> that Germany is expected to comply with the Stability and Growth Pact.
- (24) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (2) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first euro-area recommendation. The fiscal policies referred to in recommendation (1) below contribute, inter alia, to addressing imbalances linked to the current account surplus,

HEREBY RECOMMENDS that Germany take action in 2019 and 2020 to:

1. While respecting the medium-term budgetary objective, use fiscal and structural policies to achieve a sustained upward trend in private and public investment, in particular at regional and municipal level. Focus investment-related economic policy on education; research and innovation; digitalisation and very-high capacity broadband; sustainable transport as well as energy networks and affordable housing, taking into account regional disparities. Shift taxes away from labour to sources less detrimental to inclusive and sustainable growth. 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 safeguard the long-term sustainability of the pension system, while preserving adequacy. Strengthen the conditions that support higher wage growth, while respecting the role of the social partners. Improve educational outcomes and skills levels of disadvantaged groups.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(7)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.



**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Estonia and delivering a Council opinion on the 2019 Stability Programme of Estonia**

(2019/C 301/06)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (2) and (3) below. In particular, measures focusing economic policy related to investment on the specified areas will help address the second euro-area recommendation as regards supporting investment.
- (3) The 2019 country report for Estonia was published on 27 February 2019. It assessed Estonia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the recommendations adopted in previous years and Estonia's progress towards its national Europe 2020 targets.
- (4) Estonia submitted its 2019 National Reform Programme on 30 May 2019 and its 2019 Stability Programme on 30 April 2019.
- (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 <sup>(5)</sup>, 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 2019 Stability Programme was submitted on a no-policy-change basis. The Programme envisages to move from a general government deficit of 0,6 % of gross domestic product (GDP) in 2018 to a deficit of 0,2 % of GDP in 2019, 0,3 % of GDP in 2020 and register a deficit of 0,7 % of GDP by 2022. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a deficit of 0,5 % of GDP in structural terms, is not planned to be achieved over the period covered by the 2019 Stability Programme. The general government debt-to-GDP ratio is projected to decline to 5,3 % of GDP by 2022. The macroeconomic scenario underpinning those budgetary projections is favourable. The measures needed to support the planned deficit targets have not been specified posing a risk to the revenue yield assumptions.
- (7) In view of the Commission autumn 2018 forecast, which projected a closer position to the medium-term budgetary objective in 2019, and consistent with the rules for unfreezing the required adjustment, the nominal growth rate of net primary government expenditure should not exceed 4,9 %, corresponding to an annual structural adjustment of 0,3 % in 2019. Based on the Commission 2019 spring forecast, there is a risk of significant deviation from that requirement in 2019.
- (8) In 2020, 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 2019 spring forecast under unchanged policies, there is a risk of significant deviation from that requirement in 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 24.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (9) Preventing money laundering has become a priority for Estonia against the background of large money-laundering scandals. Estonia has strengthened its anti-money-laundering framework and the proportion of non-resident deposits in the Estonian banking sector has significantly decreased. However, challenges remain. While the Estonian government introduced additional measures and guidelines on how to further strengthen the prevention in this area, a legislative initiative aiming at increasing the capacities of the anti-money-laundering supervision has not yet been adopted by the Estonian Parliament. Attention should be paid to the effective implementation of these measures, once adopted.
- (10) Skills shortages and mismatches are among the main obstacles to business investment and limit greater productivity gains. In recent years, Estonia has implemented comprehensive reforms but labour market trends and the decrease in the working-age population present long-term challenges to the education and training system. These challenges include a still high rate of early school leaving, incomplete reorganisation of the school network; the insufficient labour market relevance of higher education and vocational education and training; and the challenges linked to the ageing of teachers and the low attractiveness of the profession. Although participation in adult learning is improving, the upskilling and reskilling of the workforce is not occurring fast enough to keep up with labour market trends. The insufficient capacity to innovate is at the centre of the identified skills needs. In spite of the high percentage of information and communication technology specialists, there is limited digital skills training provided by enterprises. Improving the labour market relevance of the education and training system, including by investing in career guidance, tackling early school leaving and better anticipating skills needs, would help ensure that people are equipped with the rights skills. In addition, enhancing the working conditions of teachers, the quality of teaching and the education policies in response to demographic and economic trends would strengthen the capacity of the education and training system.
- (11) Despite improvements, poverty, social exclusion and income inequality remain high, particularly among older people. Around 42 % of those aged 65 and above were at risk of poverty and social exclusion in 2017 compared to the Union average of 15 %. Social benefits are still not effective in reducing poverty and the social safety net is weak. The provision of good quality and affordable social services is hampered by the weak coordination between the health and social care services and by the wide variation in municipalities' ability to identify the needs for social services and deliver them. Individuals also have to cover a large part of the costs of the services provided by the authorities. Estonia's public spending on long-term care was less than half of the Union average (0,6 % of GDP compared with 1,6 % of GDP in 2016). There are no preventive measures or a support system to alleviate the burden on informal carers. The proportion of people with unmet medical needs remains one of the highest in the Union (11,7 %) indicating problems with the accessibility and effectiveness of the healthcare system. These challenges point to the need to deliver affordable and good quality social and healthcare services in an integrated way and to develop a comprehensive long-term care framework. Investments supporting social inclusion, including in social infrastructure, would foster inclusive growth.
- (12) The gender pay gap at 25,6 % in 2017 remains among the highest in the Union and is slightly wider than the previous year. Moreover, the impact of parenthood on women's employment is well above the Union average (25,2 and 9,0 % respectively). Long parental leaves often lead to slower career progression for women. Women tend to work in lower-paid economic sectors and occupations even though their education level is higher than men's. Recent measures added flexibility to the parental leave and benefit system with a view to facilitating parents' return to the labour market. The use of childcare has been improving. However, factors such as economic activity, occupation, age, job experience or working time explain only part of the gender pay gap, leaving an unexplained gap of 20 % against the Union average of 11,5 %. Pay transparency could help to better understand the reasons behind this high gender wage gap. Continued investment in childcare and active labour market measures would help women's employment. Furthermore, engaging with the social partners and strengthening their capacity remain important in a broader context.

- (13) As a peripheral country with a low population density, a well-functioning and interconnected transport system is key for Estonia's economic activities and exports. Estonia's transport infrastructure faces some shortcomings in terms of connectivity and sustainability. Rail and intermodal transport remain underdeveloped. Moreover, greenhouse gas emissions from road transport have increased the last 5 years. Further innovative and sustainable solutions could help address congestion and public transport-related problems. Synchronising Estonia's electricity system with the continental European network is key to ensuring security of electricity supply in the entire Baltic region. Investment in infrastructure would help improve the competitiveness of the Estonian companies.
- (14) With low levels of investment in research and development, especially from the private sector, Estonia's productivity has been lagging behind. While in 2017 public expenditure on research and development was slightly below the Union average, business investment was only 0,61 % of GDP — about half the Union average. There is a low proportion of companies, in particular among small and medium-sized enterprises ('SMEs'), reporting research and innovation activities. Non-research and development innovation expenditure is declining and the collaboration between science and businesses is weak. Some of these factors are dragging down the country's innovation performance and productivity. More targeted investment in research, development and innovation, including in the digitalisation and automation of firms would increase Estonia's productivity and competitiveness. Better prioritisation of research topics in areas of relevance for the economy would do likewise. The Estonian authorities have designed and implemented several measures to address the shortcomings in the research and innovation system but their impact remains limited to date.
- (15) Challenges in the areas of resource and energy efficiency remain. Estonia's eco-innovation performance does not fully reflect the country's potential, and its composite eco-innovation score of 60 is 40 % below the Union average. Despite some improvements in recent years, Estonia performs about three times below the Union average in terms of resource productivity and the gap with the rest of the Union is widening. Only a small proportion of Estonian SMEs are taking actions to improve their resource efficiency and become greener. Furthermore, the economy is highly energy intensive, with energy consumption levels well above the Union average. All Estonian regions are lagging behind in improving resource and energy efficiency. At 0,4 % in 2017, Estonia was well below its national targets of 10 % share of renewable energy in transport. Fostering resource and energy efficiency, in particular in the buildings sector, and supporting the circular economy, including by increasing investment, would further contribute to a more competitive and sustainable economy.
- (16) Insolvency procedures in Estonia take around three years and the recovery rate is slightly above 40 %. This traps labour and financial resources in less productive firms. It undermines incentives to invest and provide financing to firms. Reforming the insolvency framework would be important with a view to shorten the duration of insolvency proceedings and increase the recovery rate for creditors. In particular, this could include encouraging the use of pre- and post- insolvency restructuring proceedings and preventing piece-meal liquidation of companies.
- (17) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Estonia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (18) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Estonia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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 2019 Stability Programme and its opinion <sup>(7)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Estonia take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4,1 % in 2020, corresponding to an annual structural adjustment of 0,6 % of GDP. Ensure effective supervision and the enforcement of the anti-money-laundering framework.
2. Address skills shortages and foster innovation by improving the capacity and labour market relevance of the education and training system. Improve the adequacy of the social safety net and access to affordable and integrated social services. Take measures to reduce the gender pay gap, including by improving wage transparency.
3. Focus investment-related economic policy on sustainable transport and energy infrastructure, including interconnections, on fostering research and innovation, and on resource and energy efficiency, taking into account regional disparities.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(7)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Ireland and delivering a Council opinion on the 2019 Stability Programme of Ireland**

(2019/C 301/07)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) and (3) below. In particular, focusing economic policy related to investment on the specified areas and introducing tax measures will help address the second euro-area recommendation as regards supporting investment, improving public finances and combating aggressive tax planning.
- (3) The 2019 country report for Ireland was published on 27 February 2019. It assessed Ireland's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 27 February 2019. The Commission's analysis led it to conclude that Ireland is experiencing macroeconomic imbalances. In particular, large stocks of public and private debt and net external liabilities make Ireland vulnerable to adverse shocks, but the flow variables have continued to improve. The stock of private debt remains high, but economic growth is continuing to help reduce it. The activities of multinationals continue to influence corporate debt. Household debt appears to be broadly in line with the fundamentals, although it is high compared with disposable income. Government debt is projected to remain on a downward trajectory, while the deficit is moving closer to a balanced position. House prices have been growing at a rapid pace for a number of years but have slowed down recently. House prices are largely driven by supply constraints, and there is no clear evidence of overvaluation. The stock of non-performing loans, although still high, has decreased further even if long-term arrears are falling at a slower pace.
- (4) Ireland submitted its 2019 National Reform Programme on 17 April 2019 and its 2019 Stability Programme on 29 April 2019. 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 <sup>(5)</sup>, 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) Ireland is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme, the government expects the headline balance to improve to 0,2 % of gross domestic product (GDP) in 2019 and to continue to gradually improve thereafter to 1,3 % of GDP in 2023. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a structural deficit of 0,5 % of GDP, is planned to be reached by 2020. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall to 61,1 % in 2019 and to continue declining to 51,6 % in 2023. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2020 onwards have not been sufficiently specified.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 27.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (7) On 13 July 2018, the Council recommended Ireland to achieve the medium-term budgetary objective in 2019. This is consistent with a maximum nominal growth rate of net primary government expenditure <sup>(7)</sup> of 7,0 % in 2019, corresponding to an allowed deterioration in the structural balance of 0,3 % of GDP. Based on the Commission 2019 spring forecast, Ireland is expected to comply with the recommended fiscal adjustment in 2019.
- (8) In 2020, Ireland should achieve its medium-term budgetary objective. Based on the Commission 2019 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure of 3,7 % <sup>(8)</sup>, corresponding to an annual structural adjustment of 0,7 % of GDP. Ireland is forecast to reach the medium-term budgetary objective. General government debt is forecast to remain on a firm downward path beyond the requirements of the debt rule. Overall, the Council is of the opinion that Ireland is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020. 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 important.
- (9) Public finances have further improved on the back of robust output growth, but the risks of revenue volatility remain, and there is scope for making revenue more resilient to economic fluctuations and adverse shocks. Limiting the scope and number of tax expenditures and broadening the tax base would improve revenue stability in the face of economic volatility. While Ireland has increased the lower value added tax rate on tourism activities, some recent tax measures have focused on cuts and reliefs. Moreover, Ireland has further potential to improve the way its tax system can support environmental objectives. Such efforts could include reducing fossil fuel subsidies and providing a stronger price signal to investors by committing to a schedule of increases in the carbon tax over the next decade.
- (10) The fight against aggressive tax planning is essential in making tax systems more efficient and fairer, as acknowledged in the 2019 Recommendation for the euro area. Spillover effects of taxpayers' aggressive tax-planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Ireland has taken measures against aggressive tax planning, but 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.
- (11) Long-term fiscal sustainability risks related to the cost of ageing remain. Spending on healthcare is projected to rise from 4,1 % of GDP in 2016 to 5,1 % in 2070, with a peak of 5,2 % in 2063. Though there are aspects of the healthcare system in Ireland that work well or have improved, the system is inefficient, struggles to meet demand and does not deliver coordinated, integrated care. In order to mitigate against the escalating pressures of demand, the Irish government approved the Sláintecare Implementation Strategy and set up the Sláintecare Programme Implementation Office to comprehensively reform and modernise Ireland's health and social care services over the next 10 years. The planned reform represents a credible vision for making the health system universally accessible and sustainable, meeting the demands of an ageing population and shifting care into the community, with a stronger focus on prevention. This is likely to have a positive impact in reducing the reliance on acute care, thereby making healthcare more cost-effective. However, implementation is endangered by the health system's difficulties in addressing the duplicate health insurance market and effectively managing its own budget, performance and workforce in the short term. Short-term costs will also need to be contained to fulfil the Sláintecare vision in the long run.

<sup>(7)</sup> Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and nondiscretionary 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.

<sup>(8)</sup> As in 2019, 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.



- (12) Despite past government efforts to contain spending on public pensions, the overall deficit of the pension system is expected to grow significantly in the long term as a result of pension expenditure rising from 5 % of GDP in 2016 to 6,6 % in 2070, with a peak of 7,5 % in 2053. A full and timely implementation of the presented roadmap for pension reform is key to making the Irish pension system more fiscally sustainable.
- (13) Increased investment in skills, education and training as well as in social inclusion are essential for improving Ireland's productivity and long-term inclusive growth. The tightening labour market and the emerging skills shortages and mismatches in certain sectors call for efforts to reach out to inactive groups of potential workers and to invest in under-tapped human capital. There is scope for promoting upskilling and better aligning education curricula and vocational training to labour market needs. The low percentage of the workforce with basic digital skills calls for further investment in workplace-based training and upskilling of the adult workforce. Investing in access to quality and affordable childcare and rolling out the National Childcare Scheme will help increase the rather low employment rate for women. The participation rate of people with disabilities in the labour market is among the lowest in Europe. The number of people living in households with low work intensity remains one of the highest in the Union, highlighting the scope for more integrated and targeted activation strategies to support this particular group.
- (14) Years of low investment after the economic bust are taking their toll on the availability of affordable and social housing and of appropriate infrastructure in the areas of clean transport and energy, water and ultrafast broadband, which in turn pose barriers to business investment. Moreover, greenhouse gas emissions from road transport have increased strongly in 5 years. Improved infrastructure, combined with spatial planning, could be a critical enabler for improving the housing supply, increasing private investment, boosting productivity growth, and ensuring balanced regional economic development. Future-proof connectivity and sufficient digital skills remain crucial for domestic companies to effectively utilise digital technology and for a thriving domestic information and communications technology sector. Significant challenges remain in relation to access to ultrafast broadband, in particular in rural areas. More infrastructure investment in clean energy, clean and public transport and water services as well as intensified efforts in the field of decarbonisation, energy efficiency, renewable energy and the circular economy would help Ireland in its transition towards a low-carbon and environmentally resilient economy.
- (15) While the launch of the National Development Plan could eventually lead to the provision of additional basic infrastructure, the weak capacity of the construction sector could become an obstacle to its timely delivery. Furthermore, diversifying maritime transport and energy connections with continental Europe could increase the resilience of the economy to external shocks. Ireland has so far failed to decouple its economic growth from the emissions of greenhouse gases and air pollutants. Greenhouse gas emissions have steadily risen, in particular in transport, agriculture, energy and the built environment. Lack of progress in this area will make it more difficult for Ireland to meet its Union obligations, while also increasing the cost of future action.
- (16) Persistent supply shortages, coupled with increasing demand, continue to fuel rises in property prices. Although prices did not seem overvalued in 2017, affordability is becoming a concern. Housing supply shortages are also affecting social housing due to insufficient investment and builds over the last decade. While demand for social housing is estimated at about 72 000 units, just 10 000 are planned for delivery in 2019. 17 000 households are to be assisted through Ireland's Housing Assistance Payment or Rental Accommodation Scheme, but this risks exacerbating rent increases in the private rental market where supply is already constrained. A large number of social homes are under-occupied, notably in the Dublin area, in part due to outdated succession practices. The inadequate mix in the types of social houses provided together with the very limited amount of affordable and cost-rental accommodation are factors further aggravating the situation. This is a major reason for a steady rise in the number of people and families living in emergency accommodation, with homelessness figures reaching new highs in February 2019.

- (17) Fostering the innovation-driven productivity of domestic firms is crucial to support more robust and resilient productivity growth in the country. Business research and development (R & D) expenditure continues to increase but it remains below the Union average and highly concentrated in the foreign-owned firms. There is scope to gear innovation policies to better support Irish small and medium-sized enterprises (SMEs). Indirect support (i.e. tax credits) remains the main instrument of public support for R & D in Ireland (accounting for 80 % of total public support). Stronger linkages between multinationals and domestic firms could help to improve the diffusion of innovation throughout the economy. In addition, closer cooperation between firms and public research centres would also increase the innovation potential.
- (18) Although the low levels of public R & D continue to cause concern (1,05 % of GDP compared to a Union average of 2 %), the recently adopted Future Jobs Ireland 2019 programme provides a promising framework to stimulate innovation and technological change and improve the productivity of SMEs. However, its full implementation will depend on a significant increase in public expenditure on research and innovation and the translation of the recently adopted programme into concrete policy measures. As it stands, this ambitious list of measures still lacks important details and precise implementation dates. For instance, for actions to be taken in 2019, no measures have been identified to increase the availability of long-term equity investment to support indigenous companies in scaling their business; the policy mix to incentivise SMEs to invest in new technologies combines tax credit and non-tax incentives to encourage SMEs to invest in innovation, but the relative magnitude of these measures remains unknown. Future Jobs Ireland 2019 does not include specific actions and deliverables to address the gap between Ireland and other Member States when it comes to rolling out future-proof broadband networks in line with Union 2025 Gigabit Society targets. The National Broadband Plan is expected to help address this gap.
- (19) Regional disparities in Ireland are significant and have been increasing over the last decade. Ireland has rather high regional economic disparities compared to other Member States in terms of GDP per capita. Between 2000 and 2016, GDP per capita in the Southern and Eastern region increased by 74 %, 63 percentage points more than in the Border, Midland and Western region, and the increase accelerated after 2012. By 2016, GDP per capita in the Southern and Eastern region was 2,6 times higher than in the Border, Midland and Western region. The Dublin area, with 40 % of Ireland's population, contributed by 62 percentage points to GDP growth between 2000 and 2016.
- (20) Regulatory barriers to entrepreneurship (in particular certain regulations related to commercial property and legal services) negatively affect firm entry and exit and thereby the productivity of indigenous Irish firms. Barriers to entry into retail markets represent a challenge. Ireland scores among the top five countries with the greatest number of procedural requirements as regards the establishment of retail outlets. Retailers face procedural obstacles which delay and increase the costs of opening new shops and may have a negative impact on market structure and dynamics.
- (21) The new Legal Services Regulation Act remains to be implemented, as the introduction of regulations continues to experience significant delays, even if preparatory consultations are ongoing. Allowing for direct professional access to barristers on contentious matters as well as allowing for legal persons to become partners in all types of legal practice remain uncertain possibilities. However, overly complex operation and management rules for multi-disciplinary practices are to be avoided. An ambitious implementation of open-ended reforms is a matter of top priority. 'Ambition 2.3' in the Future Jobs Ireland 2019 programme is supposed to tackle problems with the cost of legal services, but the only deliverable in 2019 is tentative and the timing is ambiguous. Delays in implementing this reform contribute to the high cost of legal services in Ireland, to the detriment of business, SMEs in particular, and individuals. Since legal services are an important input for other business services, restrictions in that sector contribute to the high cost of other services (e.g. insurance).

- (22) Non-performing loan ratios have continued to fall and were down by 4,4 percentage points to 5,5 % in the year up to the fourth quarter of 2018. Banks are well on track to meet their reduction targets, supported by portfolio sales, restructuring efforts and rising property prices. Long-term mortgage arrears (over two years past due) remain relatively high, helping to keep the non-performing loan ratio above the euro-area average. A number of initiatives and draft bills, such as the 'no consent, no sale' bill have been proposed to address the social and economic impact of non-performing loan resolution, including for vulnerable households. The credit register became fully functional for consumer loans in 2018 and will be crucial for assessing whether borrowers are capable of servicing their debts. Insolvency procedures and the use of in- and out-of-court options for arrears resolution remain limited. Further reducing long-term mortgage arrears while building on initiatives for vulnerable households, without creating undue obstacles for non-performing loans resolution, remains a challenge and requires continued monitoring.
- (23) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Ireland to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (24) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Ireland's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Ireland in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Ireland, but also their compliance 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 2019 Stability Programme and is of the opinion <sup>(9)</sup> that Ireland is expected to comply with the Stability and Growth Pact.
- (26) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (3) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the second euro-area recommendation. The fiscal policies referred to in recommendation (1) below contribute, inter alia, to addressing imbalances linked to high government debt,

HEREBY RECOMMENDS that Ireland take action in 2019 and 2020 to:

1. Achieve the medium-term budgetary objective in 2020. Use windfall gains to accelerate the reduction of the general government debt ratio. Limit the scope and number of tax expenditures, and broaden the tax base. Continue to address features of the tax system that may facilitate aggressive tax planning, and focus in particular on outbound payments. Address the expected increase in age-related expenditure by making the healthcare system more cost-effective and by fully implementing pension reform plans.
2. Provide personalised active integration support and facilitate upskilling, in particular for vulnerable groups and people living in households with low work intensity. Increase access to affordable and quality childcare.

<sup>(9)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

3. Focus investment-related economic policy on low carbon and energy transition, the reduction of greenhouse gas emissions, sustainable transport, water, digital infrastructure and affordable and social housing, taking into account regional disparities. Implement measures, including those in the Future Jobs strategy, to diversify the economy and improve the productivity of Irish firms — SMEs in particular — by using more direct funding instruments to stimulate research and innovation and by reducing regulatory barriers to entrepreneurship.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Greece and delivering a Council opinion on the 2019 Stability Programme of Greece**

(2019/C 301/08)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Greece 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').
- (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, Greece should ensure the full and timely implementation of the 2019 Recommendation for the euro area, as reflected in recommendations (1) and (2) below. In particular, reforms in line with the post-programme commitments and focusing economic policy related to investment in the specified areas will help address the euro-area recommendation.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Greece was published on 27 February 2019. It assessed Greece'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 27 February 2019. The Commission's analysis led it to conclude that Greece is experiencing excessive macroeconomic imbalances. The imbalances identified related in particular to the high public debt, the negative net international investment position, the high non-performing loans on banks' balance sheets and the still high unemployment rate. In addition, deep institutional and structural reforms initiated in recent years to modernise the economy and the State will require many years of sustained implementation for their impact to be fully felt.
- (4) Greece submitted its 2019 National Reform Programme on 26 April 2019 and its 2019 Stability Programme on 30 April 2019. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council <sup>(4)</sup>, 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 European Structural and Investment Funds to sound economic governance <sup>(5)</sup>.
- (6) Greece is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. It should also preserve a sound fiscal position which ensures compliance with the primary surplus target set by Council Implementing Decision (EU) 2017/1226 <sup>(6)</sup> of 3,5 % of gross domestic product (GDP) for 2018 and over the medium term. In spring 2018, the Council issued no country-specific recommendation to Greece in the context of the European Semester because pursuant to Article 12 of Regulation (EU) No 472/2013 of the European Parliament and of the Council <sup>(7)</sup> Greece was exempt from the monitoring and assessment under the European Semester at that time since it was subject to a macroeconomic adjustment programme. The post-programme framework for Greece entails the activation of enhanced surveillance together with Greece's integration to the European Semester framework of economic and social policy coordination, while maximising the synergies between the enhanced surveillance and European Semester processes.
- (7) In its 2019 Stability Programme, the government plans a headline surplus of between 1,1 % and 1,7 % of GDP over 2019-2022. The government set its medium-term budgetary objective — a budget surplus of 0,25 % of GDP in structural terms as of 2020. Based on the recalculated structural balance <sup>(8)</sup>, this medium-term budgetary objective is planned to be overachieved throughout the programme period and the general government debt-to-GDP ratio is expected to gradually decline to 153,3 % in 2022. The macroeconomic scenario underpinning those budgetary projections has been endorsed by an independent body and is favourable. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 1,9 % of GDP in 2019 and 0,8 % of GDP in 2020, above the medium-term budgetary objective. General government debt is forecast to remain on a downward path and to comply with the transitional debt rule in 2019 and with the debt rule in 2020. Overall, based on the Commission 2019 spring forecast and thus excluding the new measures adopted after its cut-off date, Greece was projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020. On the same basis, Greece was also considered to comply with the 3,5 % of GDP primary surplus target monitored under the enhanced surveillance framework.

<sup>(4)</sup> 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).

<sup>(5)</sup> COM(2014) 494 final.

<sup>(6)</sup> Council Implementing Decision (EU) 2017/1226 of 30 June 2017 amending Implementing Decision (EU) 2016/544 approving the macroeconomic adjustment programme of Greece (2015/1411) (OJ L 174, 7.7.2017, p. 22.).

<sup>(7)</sup> Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.5.2013, p. 1).

<sup>(8)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (8) The Stability Programme and Commission 2019 spring forecast do not incorporate new permanent measures announced and adopted shortly after their respective submission and cut-off dates. The Commission estimates the fiscal impact of these measures to exceed 1,0 % of GDP in 2019 and subsequent years. It is also assessed that the adoption of these new measures poses a risk for the agreed primary surplus target, as monitored under the enhanced surveillance framework and set by Implementing Decision (EU) 2017/1226. Moreover, the new measures are expected to reduce the structural balance, raising concerns on the achievement the medium-term budgetary objective in 2020. But, a reassessment will be carried out in autumn 2019, and will include a revision of the applicable benchmark for the net expenditure growth rate in 2020. While general government debt is forecast to remain on a downward path, some risks could be posed to compliance with the debt reduction benchmark. This will have to be reassessed in autumn as a result of these newly adopted measures.
- (9) Following its successful completion of the financial assistance programme under the European Stability Mechanism, Greece is subject to a post-programme surveillance framework integrated into the European Semester and is subject to enhanced surveillance in accordance with Regulation (EU) No 472/2013. The activation of enhanced surveillance for Greece under Commission Implementing Decisions (EU) 2018/1192 <sup>(9)</sup> and (EU) 2019/338 <sup>(10)</sup> acknowledges the fact that over the medium term, Greece needs to continue adopting measures to address the sources or potential sources of macroeconomic imbalances, while implementing structural reforms to support a robust and sustainable economic growth. Greece made a commitment in the Eurogroup of 22 June 2018 to continue all key reforms adopted under the programme until they are fully completed. Greece also committed to implementing specific actions related to fiscal and fiscal-structural policies, social welfare, financial stability, labour and product markets, privatisation and public administration. Greece is subject to quarterly reporting on progress with implementing its commitments under enhanced surveillance, where a favourable report can, on a six monthly basis, pave the way for the release of debt-relief measures worth 0,7 % of GDP per annum. The release of the first tranche of policy-contingent debt measures worth EUR 970 million was agreed by the Eurogroup in April 2019. The third Enhanced Surveillance report assessing Greece's progress with the implementation of its commitments was published on 5 June 2019.
- (10) Reforms that improve the business environment and the quality of institutions, in particular the efficiency of the justice system, would foster economic resilience in Greece, improve payment discipline and should have a significant impact on investment decisions and attracting businesses. Despite recent improvements, the Greek judicial system still faces challenges and displays inefficiencies, as the time to reach a decision is often too long and backlogs weigh on the productivity of courts. Further targeted action in this area is therefore critical, also to facilitate the smooth functioning of the financial system as well as help unlocking investment potential.
- (11) Several years of underinvestment have led to major investment gaps in Greece. Increasing growth-enhancing investment will be instrumental in underpinning longer-term growth and reducing regional disparities. Reforms in the financial sector favouring the expansion of the supply of credit will play a key role in supporting investment. The 2019 country report identified priority areas for public and private sector investment.
- (12) Higher investment in education and training is crucial to improve Greece's productivity and long-term inclusive growth and address barriers to growth in innovative sectors. The Greek education system faces several challenges with inadequate resources, low autonomy, underachievement in basic (including digital) skills and persisting skills mismatches. At all levels, accountability and monitoring, which are necessary for quality improvement of the education system, are largely missing. Promoting quality and inclusive education and training, establishing closer links between education and labour market needs, improving the attractiveness of vocational education and training, and increasing participation in lifelong learning are important for underpinning sustainable growth.

<sup>(9)</sup> Commission Implementing Decision (EU) 2018/1192 of 11 July 2018 on the activation of enhanced surveillance for Greece (OJ L 211, 22.8.2018, p. 1).

<sup>(10)</sup> Commission Implementing Decision (EU) 2019/338 of 20 February 2019 on the prolongation of enhanced surveillance for Greece (OJ L 60, 28.2.2019, p. 17.).

- (13) Despite recent improvements, the share of long-term unemployed, which represented 70 % of the unemployed in Greece in 2018, is very high, and high youth unemployment and low labour market participation of women are also a matter of concern. Interventions should focus on improving employment prospects, promoting labour market participation, and fostering conditions for job creation. Effective social dialogue and responsible social partnership in Greece can support the environment for the implementation and ownership of sustained reforms, resulting in a better functioning of the labour market.
- (14) Whilst reforms have been initiated, Greece is characterised by high income inequality and has one of the lowest impact of social transfers on reducing the risk of poverty in the Union (15,83 % in 2017 versus an Union average of 33,98 %). Investments should focus on enhancing access to inclusive, affordable and high quality social services, as well as on developing day-care centres. Supporting the most deprived and promoting the social integration of children at risk of poverty, of persons with disabilities, of migrants and refugees, while paying attention to geographic disparities would improve social inclusion in Greece.
- (15) Greece initiated a far-reaching reform of the primary healthcare system in 2017, which is crucial to ensure access and requires continued investment through the deployment of local healthcare units (the 'TOMYS').
- (16) The Greek transport system faces significant challenges. It is largely road-based and heavily dependent on oil, with all main connections rotating around the Athens– Thessaloniki route. Transport costs are still high while the quality of service, safety standards and penetration of intelligent transport systems remains low. New investment is needed to increase multimodal transport and promote regional integration and urban development.
- (17) Treatment of solid waste and urban and industrial wastewater is the main area needing additional investment in order to align the country's environmental protection standards with the rest of the Union. The management of solid waste continues to be a major structural challenge, with Greece still relying heavily on landfilling and mechanical-biological treatment instead of more modern techniques. In addition, the proportion of municipal waste that is recycled is only about a third of the Union average. Investments are also needed to improve water treatment, combat ground water salinisation, and support measures to prevent flooding and restore the natural flow of rivers.
- (18) Underdeveloped infrastructures increase energy costs for businesses and households and form a barrier to the uptake of renewable energy. Greece faces a particular challenge here with the electricity connectivity of islands and the connection with neighbouring countries. Further development of commercial gas infrastructure would help grow the market. The reform of both the gas and electricity markets should strive to take advantage of these new infrastructure opportunities.
- (19) The digital transformation of the economy and society remains challenging, with low access to high-speed broadband networks and digital skills well below the Union average. Greece particularly needs to invest in information and communication technology, also to make up for the investment slump during the crisis. Insufficient higher speed broadband connectivity creates major bottlenecks for dynamic export oriented businesses. The investment in innovation and people's skills is insufficient to promote productivity growth, and the lack of digital skills among the population at large is impeding them from finding employment and hindering the development of innovative businesses.
- (20) Renewed 'smart specialisation' strategies at national and regional level, and additional measures to address the most pressing weaknesses of the research and innovation system, are needed to stimulate market-oriented investment in research and development (R & D), which remains low and weighs on Greece's growth potential. Advances in scientific excellence are hindered by the low intensity of public R & D, a lack of a performance-based funding system and weak science-business links. Higher investment is also needed to boost the low levels of technological development, reflected in the very low number of patents compared with other Member States, and to fully tap into the potential of start-ups and scale-ups.



- (21) As a crosscutting theme, investment in the regeneration of deprived urban areas, islands and highlands is needed to counter the loss and deteriorated quality of the country's physical and human capital during the economic crisis. Sustainable redevelopment of disadvantaged and/or deindustrialised areas in the Athens-Piraeus and Thessaloniki conurbations and in some principal peripheral urban centres is a specific short to medium-term priority. Longer-term priorities include developing sustainable productive activities, upgrading mobility and security systems, energy efficiency and renewable energy, environmental protection and improving resilience to natural risks and socio-economic crises. Interventions should also target the social inclusion, the integration of migrants, the acquisition of skills to reduce unemployment, and cultural activities to increase the attractiveness of deprived areas. Addressing these challenges through integrated urban renewal strategies would maximise the chances of achieving the best economic, social and environmental outcomes.
- (22) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Greece to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the administrative capacity for the management of the Funds is an important factor for the success of investment.
- (23) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Greece's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 National Reform Programme. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Greece, but also their compliance 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.
- (24) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion <sup>(1)</sup> that Greece is expected to comply with the Stability and Growth Pact.
- (25) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (2) below. Those recommendations also contribute to the implementation of the first four of the euro-area recommendations,

HEREBY RECOMMENDS that Greece take action in 2019 and 2020 to:

1. Achieve a sustainable economic recovery and tackle the excessive macroeconomic imbalances by continuing and completing reforms in line with the post-programme commitments given at the Eurogroup of 22 June 2018.

<sup>(1)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

2. Focus investment-related economic policy on sustainable transport and logistics, environmental protection, energy efficiency, renewable energy and interconnection projects, digital technologies, R & D, education, skills, employability, health, and the renewal of urban areas, taking into account regional disparities and the need to ensure social inclusion.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Spain and delivering a Council opinion on the 2019 Stability Programme of Spain**

(2019/C 301/09)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, measures to improve productivity will help address the first euro-area recommendation as regards productivity improvements for euro area rebalancing, using windfall gains to reduce public debt and focusing economic policy related to investment in the specified areas will help address the second euro-area recommendation as regards rebuilding buffers and supporting investment, and measures to improve skills and employability will help address the third euro-area recommendation as regards the functioning of the labour market.
- (3) The 2019 country report for Spain was published on 27 February 2019. It assessed Spain's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 27 February 2019. The Commission's analysis led it to conclude that Spain is experiencing macroeconomic imbalances. A large stock of internal and external debt, both public and private, and high unemployment, in the context of weak productivity growth, are still vulnerabilities with a cross-border relevance. The reduction of private-sector debt is progressing, but deleveraging needs remain sizeable. Despite continued robust gross domestic product (GDP) growth, the government debt as a share of GDP remains high. The unemployment rate has continued its rapid decline, but remains very high and the high degree of labour market segmentation between temporary and open-ended contracts impedes faster labour productivity growth. After a strong reform momentum between 2012 and 2015, an evolving political context over the past year has contributed to another year of limited progress in implementing country-specific recommendations of previous years. The present favourable economic situation provides a window of opportunity to address pending reform needs with a view to making the Spanish economy more resilient and raising its productivity growth.
- (4) On 30 April 2019, Spain submitted its 2019 National Reform Programme and its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) The 2019 Stability Programme reports on actions taken to implement the preventive and corrective tools set out in Spain's Stability Law. However, it does not set out plans to make the enforcement of these tools automatic and to review the Stability Law's expenditure rule, with a view to strengthening its contribution to fiscal consolidation, especially during economic upturns. In the area of public procurement, to improve the efficiency of public spending as well as to help prevent irregularities, the ambitious implementation of the Law on public-sector contracts adopted in 2017 will be instrumental. In particular, it is important that the new governing structure, in particular the Independent Office for Regulation and Supervision, can effectively perform the tasks allocated to it, and that the comprehensive National Public Procurement Strategy be swiftly adopted — with the active involvement of contracting authorities and entities at national, regional and local levels. Finally, a number of spending reviews are due in 2019 and the implementation of the recommendations stemming from them should help increase the efficiency of public spending.
- (6) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for 2014-2020. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council <sup>(5)</sup>, 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.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 33.

<sup>(5)</sup> 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).

- (7) Following the timely and durable correction of the excessive deficit and Council Decision (EU) 2019/1001 <sup>(6)</sup> to abrogate the excessive deficit procedure, Spain is in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. It projects the general government balance to increase from – 2,5 % of GDP in 2018 to – 2,0 % of GDP in 2019 and to reach a balanced budget in 2022. Based on the recalculated structural balance <sup>(7)</sup>, the medium-term budgetary objective of a balanced budgetary position in structural terms is not planned to be achieved over the time horizon of the 2019 Stability Programme. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to decrease from 97,1 % in 2018 to 95,8 % in 2019, before reaching 88,7 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Risks to the achievement of the fiscal targets set in the 2019 Stability Programme mostly pertain to the revenue side, where there is large uncertainty about the yield or chances of adoption of many of the revenue measures.
- (8) On 13 July 2018, the Council recommended Spain to ensure that the nominal growth rate of net primary government expenditure <sup>(8)</sup> does not exceed 0,6 % in 2019, corresponding to an annual structural adjustment of 0,65 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.
- (9) In 2020, in view of Spain's general government debt-to-GDP ratio, which is above the 60 %-of-GDP Treaty reference value, and projected positive output gap of 2,0 % of GDP, nominal net primary government expenditure should not grow in 2020, 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, with inflation projected to stay below 2 % in 2019 and 2020 and remaining slack in the labour market (high unemployment rate and a very high share of involuntary part-time work, temporary employees as well as in-work poverty). 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 0,9 %, appears appropriate. According to the Commission 2019 spring forecast, under unchanged policies, there is a risk of a significant deviation from the required fiscal adjustment in 2020. In addition, Spain is not projected to comply with the requirements of the transitional debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. It would be important to use any windfall gains to further reduce the general government debt ratio.
- (10) Employment growth remains robust in Spain. Unemployment continues to fall but it remains well above the Union average, especially for young people and for the low-skilled people. Gender gaps in employment and in the length of working careers remain wide. These represent untapped potential not least given the rapidly ageing population.
- (11) While progressively reduced, the still widespread use of temporary contracts, including in sectors less prone to seasonal or cyclical activity, ranks amongst the highest in Europe and may hinder Spain's growth potential and social cohesion. Young people, the low-skilled and third-country nationals are those most affected, often suffering from lower entitlements to social benefits and higher poverty risks. Temporary contracts are often very short and provide weak incentives for both workers and employers to invest in training, which in turn hinders productivity growth. Moving from a temporary contract to a permanent one remains difficult and, barriers to mobility of labour reduce opportunities for jobseekers and hamper its efficient allocation across the country.

<sup>(6)</sup> Council Decision (EU) 2019/1001 of 14 June 2019 abrogating Decision 2009/417/EC on the existence of an excessive deficit in Spain (OJ L 163, 20.6.2019, p. 59).

<sup>(7)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(8)</sup> 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.

- (12) Spain has strengthened the support to the long-term unemployed, who still represented 6,4 % of the active population in 2018. Recent initiatives seek to make young people employable through counselling and career guidance, but public employment services still handle a low share of job vacancies and further efforts are needed to improve their use in job search and placement. In particular, in some regions, engagement with employers is weak and profiling tools to better match jobseekers with employers' needs are still in an initial phase. Partnerships between public employment services and social services are progressing, but cooperation is still limited in some regions. Increased investment in modern public employment services together with support to labour mobility could contribute to improve the employability and adaptability of workers and smoothens labour market transitions, thus improving Spain's productivity and long-term inclusive growth.
- (13) Efforts to reinforce labour inspectorates in order to fight against the abuse of temporary contracts are bearing some fruit and the share of open-ended contracts in net employment growth is increasing. However, employers continue to make an extensive use of short-term contracts. Past evidence shows that the numerous incentives to support job creation are having limited effects in promoting quality employment. Spain launched a new evaluation with the view to simplifying the system, but results are not available yet. Recruitment competitions to reduce the share of fixed-term employment in the public sector at all levels of government need to be speed up to reach the target of 8 % by the end of the 2020 recruitment competitions. While the setting-up of tripartite round tables is a good step towards greater involvement by the social partners in policy design, there is room for deeper and more timely consultations.
- (14) Though decreasing, the proportion of people at risk of poverty and social exclusion as well as income inequality remains above the Union average. In-work poverty rates are high amongst temporary or low-skilled workers, or non-EU-born. The child poverty rate, although declining, remains very high. The capacity of social transfers other than pensions to reduce poverty remains among the lowest in the Union, especially for children. Social spending as a share of GDP in Spain for households with children in Spain is one of the lowest in the Union and is poorly targeted, despite a recent small increase in the means-tested child allowance. Despite a positive trend, there are still significant gaps in the coverage of people with severe and moderate dependency. National unemployment assistance remains fragmented, with multiple schemes that target different groups of jobseekers. Recent measures improving the coverage and protection of income assistance for older long-term unemployed (aged 52 or above) may, at the same time, weaken incentives to work within this particular group. Meanwhile, regional minimum income schemes present wide disparities in access conditions, coverage and adequacy across regions and their limited portability between regions reduces incentives for labour mobility. As a result, a number of people in need do not receive support. The launch of the Universal Social Card system will make the social benefits system more transparent and thus allow for a better targeting. While the economic recovery continues to curb poverty, the situation calls for investment in social inclusion policies and social infrastructure (e.g. social housing) in order to attain inclusive growth. In addition, Spain faces specific territorial cohesion challenges, such as acute depopulation and ageing in certain rural areas. Actions promoting entrepreneurship, digitalisation and the social economy can help respond to those challenges, as part of integrated territorial development strategies.
- (15) During the crisis, the Spanish pension system played an important role in maintaining the living standards of the elderly, who face a lower risk of poverty. Projections in the 2018 Ageing Report and Pension Adequacy Report indicate that the 2011 and 2013 reforms helped to ensure the sustainability and relative adequacy of pensions in the long term. However, a continuation of the relinking of pension increases to inflation (as decided in 2018 and 2019) and the postponement of the sustainability factor would require compensatory measures to ensure the sustainability of the pension system in the medium to long term. Moreover, action would be needed to address both the main challenge of the adequacy of future retirees' incomes and the length and completeness of their working careers in a context of high unemployment and widespread use of temporary contracts and part-time employment.

- (16) Spain's innovation performance and productivity growth are hampered by subdued levels of investment in research and development and by skills mismatches. Research and development expenditure in the business sector in Spain is only half the level of the Union average, particularly for large firms, with significant regional disparities. That divergence is reinforced by the low and falling execution rate of the public budget for research and development, particularly of loans. Skills shortages and mismatches are another important barrier to the development and use of advanced technologies, in particular by small and medium-sized firms. Employment in high technology sectors and knowledge intensive services is well below the Union average in many Spanish regions. While regional innovation strategies for smart specialisation are being developed and the governance of national research and innovation policy is being streamlined, national-regional coordination in the design, implementation and evaluation of policy remains weak. Improving Spain's innovation performance requires significant investments to foster entrepreneurship and start-ups and help them grow and to promote the competitiveness of all firms and their adaptation – including through digitalisation – to higher added-value activities with the aim of expanding their presence in international markets. It also requires a stronger focus on public-private partnerships, cooperation between academia and business and technology transfer, particularly in favour of small and medium-sized companies, a strengthened governance of research and innovation policy across government levels, and a closer alignment of research and development infrastructure and projects to regional and national innovation strategies.
- (17) Although improving, the early school leaving rate remains very high in Spain, with significant regional disparities. There is scope to improve educational outcomes which vary greatly across regions. Both factors negatively affect the long-term potential for productivity growth. Efforts to reform the education system have stalled. Firms report difficulty in finding the skills needed to embrace innovation, in particular as regards specialists in information and communication technologies. Spain approved measures to upgrade the dual vocational education and training system, which could play a key role in providing the skills and qualifications required to absorb innovation, but enrolment in those systems remains moderate. Spain's rate of tertiary education attainment is above the Union average but tertiary graduates face difficulties in finding adequate jobs. Developing human capital through all levels of education and training, including higher education and vocational training, and greater cooperation between education and business with a view to mitigating existing skills mismatches, could boost labour market access of young graduates. It could also provide firms with the skills and qualifications required to enhance their innovation capacity and to take full advantage of the growth potential offered by digitalisation. Retraining workers in digital skills would also allow Spanish companies to remain competitive in an increasingly digitised economy. All those actions would contribute to the reduction of regional disparities.
- (18) The restrictiveness and fragmentation of regulation within Spain are preventing firms from benefiting from economies of scale and is holding back productivity. The Law on Market Unity remains an important tool to address these issues. Implementing that Law more decisively and removing identified restrictions on services in particular for certain professional services, such as civil engineers, architects and legal services, would improve growth opportunities and competition. As in other fields where regions are key actors for the successful implementation of reforms, a stronger and sustained coordination between national and regional authorities could make policies in this area more effective.
- (19) Incomplete connections for freight transport by rail and limited integration with the Union's electricity and gas markets prevent Spain from fully benefitting from the Union Single Market. For this reason, Spain also needs to invest further in electricity interconnections with the rest of the Union to achieve the target of at least 10 % of its installed electricity production capacity by 2020. Investment is also needed to allow for greater use of rail for freight transport, including cross-border connections with France and Portugal and connections to ports and logistic hubs.

- (20) Significant investment gaps also remain in the area of natural resources management to ensure a more sustainable development model. Reducing energy consumption in buildings, and developing smart grids and renewable electricity storage would help to better manage the demand. Additional efforts should promote sustainable transport and the circular economy. Certain areas of Spain are amongst the most exposed in Europe to climate change, with the existing water resources under pressure and requiring further infrastructure investments to improve water management, such as wastewater treatment, addressing leaks in the networks and water supply. In spite of a steady progress in recent years, Spain still needs to fulfil certain requirements of the Union's water law. Progress in meeting all these objectives would bring environmental, economic and social benefits to Spain.
- (21) For all identified investment gaps, account should be taken of specific regional disparities in investment needs. Territorial disparities in GDP per head are moderate but they remain wider than before the crisis, mostly due to the asymmetric impact of labour shedding across regions. The widest regional disparities are currently identified in labour and social outcome indicators, where most Spanish regions underperform relative to the Union average. Other socioeconomic indicators present wide territorial disparities, such as innovation, entrepreneurship, and competitiveness. Economic policy related to investment should take due account of regional disparities in investment needs.
- (22) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Spain to make the best use of those funds in respect of the identified sectors, taking into account regional disparities and the special situation of the outermost region of the Canary Islands. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (23) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Spain's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (24) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion <sup>(9)</sup> is reflected in particular in recommendation (1) below.
- (25) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first, second and third euro-area recommendations. Fiscal policies referred to in recommendation (1) contribute inter-alia to address imbalances linked to high government debt,

HEREBY RECOMMENDS that Spain take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 0,9 % in 2020, corresponding to an annual structural adjustment of 0,65 % of GDP. Take measures to strengthen the fiscal and public procurement frameworks at all levels of government. Preserve the sustainability of the pension system. Use windfall gains to accelerate the reduction of the general government debt ratio.

<sup>(9)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.



2. Ensure that employment and social services have the capacity to provide effective support. Foster transitions towards open-ended contracts, including by simplifying the system of hiring incentives. Improve support for families, reduce fragmentation of national unemployment assistance and address coverage gaps in regional minimum income schemes. Reduce early school leaving and improve educational outcomes, taking into account regional disparities. Increase cooperation between education and businesses with a view to improving the provision of labour market relevant skills and qualifications, in particular for information and communication technologies.
3. Focus investment-related economic policy on fostering innovation, resource and energy efficiency, upgrading rail freight infrastructure and extending electricity interconnections with the rest of the Union, taking into account regional disparities. Enhance the effectiveness of policies supporting research and innovation.
4. 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 the principles of that Law and by improving cooperation between administrations.

Done at Brussels, 9 July 2019.

*For the Council*

*The President*

M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of France and delivering a Council opinion on the 2019 Stability Programme of France**

(2019/C 301/10)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, measures to use windfall gains to reduce public debt, to rationalise public expenditure and to focus economic policy related to investment in the specified areas will help address the second euro-area recommendation as regards rebuilding fiscal buffers, improving public finances and supporting investment. Measures to simplify the tax system and reduce regulatory restrictions will help address the first euro-area recommendation as regards the business environment. Finally, measures to improve employability will help addressing the third euro-area recommendation as regards the functioning of the labour market.
- (3) The 2019 country report for France was published on 27 February 2019. It assessed France's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 27 February 2019. The Commission's analysis led it to conclude that France is experiencing macroeconomic imbalances. The imbalances identified relate in particular to high public debt and weak competitiveness dynamics in a context of low productivity growth.
- (4) On 26 April 2019, France submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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) France is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2019 Stability Programme, the government plans the headline deficit to increase from 2,5 % of gross domestic product (GDP) in 2018 to 3,1 % of GDP in 2019 and to gradually decline thereafter to 1,2 % of GDP in 2022. The planned increase of the headline deficit in 2019, which is confirmed by the Commission 2019 spring forecast, is mainly due to the one-off deficit-increasing impact of the transformation of the tax credit on employment and competitiveness into a permanent reduction of employers' social contributions. Based on the recalculated structural balance <sup>(6)</sup>, 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 2019 Stability Programme. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to increase from 98,4 % of GDP in 2018 to 98,9 % of GDP in 2019 and to decline thereafter to 96,8 % 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 2020 onwards have not been specified.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 39.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology

- (7) On 5 June 2019, the Commission issued a report under Article 126(3) of the Treaty, as the 2019 Stability Programme planned a headline deficit in breach of the 3 %-of-GDP Treaty reference value in 2019 and, based on notified data, the transitional debt rule was prima facie not complied with in 2018. The report concluded that, following an assessment of all the relevant factors, the deficit and debt criteria as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as currently complied with.
- (8) On 13 July 2018, the Council recommended France to ensure that the nominal growth rate of net primary government expenditure <sup>(7)</sup> does not exceed 1,4 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.
- (9) In 2020, in view of France's general government debt ratio above 60 % of GDP and projected output gap of 0,7 %, the nominal growth rate of net primary government expenditure should not exceed 1,2 %, 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. According to the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement in 2020. France is prima facie not forecast to comply with the transitional debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. It would be important to use any windfall gains to further reduce the general government debt ratio.
- (10) Efforts to consolidate government finances have only modestly reduced the public expenditure ratio, which at 56 % in 2018, remained the highest in the Union. A steady decrease in public debt will depend on the government's ability to curb its spending. Since 2017, the government has rolled out a renewed fiscal consolidation strategy over the five-year presidential term. Its success will depend on meeting planned expenditure targets defined for the central and local governments and for the healthcare system.
- (11) Expenditure on healthcare has steadily increased over time. Total expenditure was estimated at 11,5 % of GDP in 2017, the highest level among the Member States adhering to the Organisation for Economic Cooperation and Development (OECD). A new reform of the healthcare system was announced in the autumn of 2018 and a draft law was presented on 13 February 2019. Its success will depend on the set up of a clear legal and organizational framework that provides the right incentives and fosters collaboration between public and private actors. The announced reform of the healthcare system does not include a revision of the growth norm for healthcare expenditure (*Objectif National de Dépenses d'Assurance Maladie*, ONDAM). This spending norm covers a third of social security spending. Although this objective has been met since 2010, the ONDAM target has already been increased three times since 2017. It was increased for 2018-2020, from an initial target of 2,1 % growth to a revised target of 2,3 % in the budget law for 2018, and was further increased up to 2,5 % in the social security budget act for 2019. This will reflect to some extent the additional expenses to be incurred by 'Ma santé 2022'.
- (12) At local level, public spending exceeded the planned growth target in 2017. Since 2014, the public expenditure of the local government in France is guided by an expenditure norm indicating yearly non-binding growth targets for both operating public expenditure and financing needs at local level (*Objectif d'évolution de la Dépense Locale*). In 2018, this expenditure norm was accompanied by legally binding contract agreements between the State and 71 % of the 322 biggest local authorities, valid in 2018-2020. The limited reduction in the number of municipalities, however, might hamper compliance with the expenditure norm. The territorial reform of 2014- 2016 reduced the number of regions by half, but the number of municipalities only slightly decreased and remained above 34 000, by far the highest in the Union.

<sup>(7)</sup> 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.

- (13) Implementing the renewed fiscal consolidation strategy rolled out by the government for the five-year presidential term also requires the still not fully defined 'Public Action 2022' programme to be carried out. That programme aims to deliver substantial efficiency gains for government spending while improving the functioning of the national public administration. The government has given clear priority to methodological and process-related aspects, but has not focused on *ex-ante* and across-the-board quantification of potential savings. While this approach may stem from a complex reform process and the need to smoothen the public debate over sensitive issues, it also makes it difficult to assess in quantitative terms the overall strategy and its contribution to fiscal consolidation. In particular, it is not clear how exactly and with what timing the reform programme — including the Ministries' transformation plans that include a wide set of varied measures — would contribute with concrete actions to the very specific objective of reducing the expenditure-to-GDP ratio by 2022. Overall, available information shows partial adherence to the guidance for spending reviews agreed in 2016 by the Eurogroup.
- (14) Sustainability risks for general government debt remain high in the medium term. The high general government debt and structural general government deficit pose sustainability challenges, especially in the medium term. A fiscal effort that translates into a decisive improvement in France's structural primary balance would be essential to avert such risks. Reducing the general government debt ratio would also improve growth prospects and the resilience of the French economy.
- (15) The planned pension reform could help to decrease the general government debt over the medium term and therefore reduce debt sustainability risks. The budgetary equilibrium of the pension system is highly dependent on macroeconomic assumptions. According to the latest annual report by France's Pensions Advisory Council (*Conseil d'orientation des retraites*), pension expenditures were at 13,8 % of GDP in 2018 and are projected to reach 13,8 % in 2022, before remaining in a range between 11,8 % and 13,8 % by 2070 depending on the growth rate assumed for the evolution of GDP and employment over time. More than 40 different pension schemes co-exist in France. These schemes apply to different groups of workers and functions according to different sets of rules. A draft law is expected by the end of the year to progressively unify the rules of these schemes, with a view to simplifying the functioning of the pension system in particular to improve its transparency, fairness and efficiency.
- (16) The employment rate continued to increase and reached 71,3 % in 2018. The unemployment rate further declined, reaching 9,1 % in 2018, but remains well above the Union average (6,8 %) and the euro area average (8,2 %). In addition, the French labour market remains highly segmented. Almost 85 % of new hires are on temporary contracts and the transition rate to permanent contracts is among the lowest in the Union. Involuntary part-time work is also very high, at 42,3 % of total part-time work in 2018. The planned reform of the unemployment benefit system (*Unédic*) is aimed to tackle labour market segmentation by reducing incentives for hiring on very short-term contracts and recalls, and to reduce the debt of the system. Negotiations between social partners on the unemployment benefits system began in the autumn of 2018. The aim was to i) reduce the debt of the system, ii) review the incentives for the unemployed to take up work and iii) find an incentive mechanism to reduce incentives to hiring on very short-term contracts. However, social partners did not find an agreement on a new set of rules. The reform is now in the hands of the government, which is committed to announcing which measures will be retained by the summer 2019.
- (17) Labour market conditions for vulnerable groups remain comparatively more difficult than for other groups. The employment rate for non-EU-born people, at 57,5 % in 2018 (against 73,1 % of those born in France), is one of the lowest in the Union. Evidence shows that people with a migrant background tend to be disadvantaged during the recruitment process. Their geographical concentration in poor neighbourhoods is also a matter of concern. Inhabitants of the most deprived areas (such as *Quartiers prioritaires de la politique de la ville*), including people with a migrant background, continue to face difficulties on the labour market, with an unemployment rate of 24,7 % in 2017. Despite some policy action, the impact of socioeconomic and migrant background on educational performance remains high and hampers labour market integration.

- (18) Low-skilled and young people also remain at a disadvantage in the labour market. The unemployment rate of the low-skilled declined in 2017 for the first time since 2008, but at 16,2 % in 2018, it remains well above pre-crisis levels. Youth unemployment (ages 15-24) decreased by 1,6 percentage points in 2018 to 20,7 %, but is still well above the Union average of 15,2 %. The unemployment rate of low-skilled young people is still very high, at 35,6 % in 2018. Effective active support to find employment, including intensive job counselling and recruitment support, access to upskilling actions, innovative measures to reach out to the most vulnerable young people not in education, employment or training and firmer action on discriminatory practices, are all key to fostering equal opportunities on the labour market. The outermost regions are confronted with additional challenges and deserve particular attention.
- (19) As labour market conditions improve, several indicators point to skills mismatches. While unemployment and under-employment remain high, shortages of skilled workers are increasing, especially in specific sectors. Skill shortages and lack of competencies are key factors explaining unfilled job vacancies. According to data from France's *Pôle Emploi*, in 2017, out of 3,2 million registered job vacancies, 150 000 were cancelled due to the lack of candidates. Evidence suggests that, during the crisis and the subsequent recovery, an increase in skill mismatches contributed to unemployment declining at a slower rate and to higher long-term unemployment. Labour market outcomes of initial vocational education and training are improving. The government introduced a comprehensive set of actions in 2018 to increase access to initial and continuous training and revise the governance and financing of the vocational education and training system. Complementing these reforms, the skills investment plan (*Plan d'investissement dans les compétences*) aims to train and provide intensive guidance to 1 million young people not in employment, education or training and to 1 million low-qualified jobseekers over the period 2018-2022.
- (20) Overall, the French social protection system is effective in reducing inequality and poverty. The proportion of people at risk of poverty and social exclusion has further decreased to an historical low of 17,1 % in 2017, compared to an average of 22,4 % in the Union. However, income inequality remains well above the pre-crisis level. Moreover, upwards transition across income quantiles has gone down, especially for the lowest quintile. Some groups, among which single-parent families and people born outside the Union face an increased risk of poverty and social exclusion. Counselling for minimum income beneficiaries is not always sufficient, with wide territorial discrepancies. Further and better coordinated investments in social inclusion, as envisaged by the national strategy against poverty presented in September 2018, could help to tackle these challenges. While the performance of the health system is good overall, regional disparities in access to services could benefit from further investment, especially in the outermost regions.
- (21) Despite recent initiatives, France has not been able to reduce its gap with the Union's innovation leaders according to the European Innovation Scoreboard. Investment in research and development has remained stable and new companies have difficulty growing. Overall, France is not on track to meet its total research and development intensity target of 3 % for 2020 and the level of research and development investment from the business sector is still far below the 2 % target. Public expenditure on research and development is above the Union average and includes a wide range of direct and indirect support schemes to business research and innovation efforts, including the research and development tax credit scheme (*Crédit d'Impôt Recherche*), which is one of the most generous among OECD countries. However, the overall performance of the research and development and innovation ecosystem does not yet match the large amount of public support. While the existing tools, including the *Crédit d'Impôt Recherche*, were recently evaluated, a comprehensive evaluation of the overall policy mix would help feed the implementation of future policy. The Innovation Council (*Conseil de l'innovation*), set up in July 2018, is tasked with supervising the simplification measures, which include better coordination between regional, national and European support to innovation. Closer links between science and business, in particular through knowledge transfer schemes, could also help spread innovation, as France continues to score below the Union average for public research and development financed by businesses. Support to competitiveness clusters (*pôles de compétitivité*) has been renewed for a fourth phase (2019-2022) and priority will be given to clusters organisations

well connected with others structures at local level, focused on national industrial priorities and with a track record in Union projects. The Innovation and Industry Fund (*Fonds pour l'innovation et l'industrie*), financed through privatisations, will also help to provide funding for artificial intelligence. Timely development of related technologies, such as the internet of things, 5G networks, high performance computing and, more generally, the data economy, will be one of the keys to the success of these initiatives. Major differences among regions also exist in terms of regional investment in research and development and innovation performance. Several rural regions or regions in industrial transition rank below the Union average. The outermost regions are at the low end of the scale.

- (22) At present, France is performing well in energy and climate mitigation policy and remains on track to reach its 2020 greenhouse gas reduction target. However it needs to step up significantly its investment efforts to reach its 2020 renewables and energy efficiency targets, as well as its more ambitious 2030 climate and energy targets, in particular in the deployment of renewables and the energy efficient refurbishment of the building stock. As more than half of the current funding for those investments is publicly driven, economic and regulatory conditions would have to make the financing of projects more viable for the private sector in order to tap into significant investment opportunities. Accelerating the penetration of renewables in the heating and cooling sector represents a particularly large untapped potential. High investment needs also concern energy efficiency in buildings. This is particularly the case for the renovation of the housing sector, which accounts for a large share of the total climate investment gap, as the majority of the housing stock is old and contains 7 to 8 million thermal sieves (representing around 20 % of the total number of housing). The percentage of building stock reported to satisfy high-energy efficiency standards is lower for firms in France (25 %) than in the Union as a whole (39 %) in 2017. Significant regional differences prevail in the energy sector. Energy intensity is decreasing in almost all regions, but at differing paces, and considerable differences exist in the penetration of renewable energy. Additional investments in inter-connections could contribute to greater integration of the internal Union energy market, while introducing more competition and facilitating the deployment of renewable energy, in particular with the Iberian Peninsula.
- (23) The 2018 national circular economy roadmap (*Feuille de Route pour l'Économie Circulaire*) is an ambitious policy framework for resource efficiency, whose implementation will hinge on ensuring the corresponding investments. Although the contribution of recycled materials to the overall material demand (circular material use rate) is well above the Union average (19,5 % versus 11,7 % in 2016), recycling rates for municipal waste are still slightly below the Union average (41,8 % versus 46,4 % in 2016). In this regard, the adoption of a law on the circular economy will be a step forward, including for a wider use of secondary raw materials, in particular plastics. New resource-efficient business models and production processes, including industrial symbiosis, need to be further promoted, in particular among small and medium-sized businesses. This can be facilitated by the development of innovative financial instruments and funding for eco-innovation.
- (24) Investments to improve connectivity, especially in more disadvantaged areas, could help address inequalities in France. France scores below the Union average for access to fast broadband network, and fast broadband take-up is low (20 % of households against 41 % in the Union on average in 2018). The use of mobile broadband services is also still below the Union average. Broadband coverage varies greatly across regions and remains limited in a few rural areas and outermost regions France's plan for ultra-fast broadband (*Plan France Très Haut Débit*) and related measures are expected to significantly contribute to the country reaching its connectivity targets. It will be essential to closely monitor the implementation of these measures, particularly in areas with poor coverage, given the predominantly decentralised approach and potential bottlenecks if not enough skilled workers are available to roll out the network.

- (25) Despite ongoing efforts to increase certainty for taxpayers (*Loi pour un État au service d'une société de confiance*, ESSOC law) and simplify the system, the French tax system continues to be complex, which weighs on the business environment. The tax code encompasses multiple rates systems and tax expenditures (tax credit, exemptions, tax reductions). This complexity often aims to achieve specific policy goals, like alleviating the tax burden on the most vulnerable households and incentivising or correcting specific behaviours. However, it risks resulting in a loss of readability, thus increasing compliance costs and legal uncertainty detrimental to France's attractiveness while creating loopholes.
- (26) Streamlining tax expenditures and reducing the number of small taxes could help further simplify the tax system. Total tax expenditure is estimated at 4 % of GDP in 2019. Unlike the previous multiannual framework, the current budgetary framework (2018-2022) does not provide a spending limit for tax expenditures. It sets instead a non-binding target of 28 % for the ratio of tax expenditures to the sum of net tax revenues and tax expenditures. While the budget law for 2018 planned a tax spending ratio below the target (28 %) set in the 2018-2022 multiannual budgetary framework, this ratio is set to increase in the future (25,5 % at the end of 2018 and 26 % in 2019).
- (27) The 2019 budget tables a decrease of the overall amount of tax expenditures below EUR 100 billion, putting an end to a five-year period of constant increases in volume. Between 2018 and 2019, however, the number of tax expenditures has increased from 457 to 474. In 2018, the Court of Auditors recommended streamlining the existing tax expenditures and pointed their lack of control and evaluation. Efforts to discontinue taxes which bring limited revenue or that are inefficient should be pursued. In the budget law for 2019, 26 taxes yielding low revenues have been cut, 20 were eliminated in 2019 for a total amount of EUR 132 million and 6 are to be eliminated in 2020 for a total amount of EUR 208 million. The elimination of small taxes is expected to continue in 2020 at the same pace.
- (28) Other taxes on production continue to weigh on businesses. Taxes on production stood at 3,1 % of GDP in 2016, higher than Italy (1,4 %), Spain (1,0 %) and Germany (0,4 %). Such taxes have different tax bases (turnover, added value, salaries, land and buildings) and can increase the overall cost of production. This could have a negative impact on competitiveness in particular for the manufacturing sector. The 2019 budget law cuts only one tax on production (*forfait social*) levied at national level and worth EUR 660 million per year (once fully implemented in 2020).
- (29) Despite progress and the adoption of ambitious reforms, barriers to entry persist and competition in business services and regulated professions remains low. The new OECD intra-EEA services trade restrictiveness index shows that the level of regulatory restrictiveness in France is higher than the European Economic Area (EEA) average in sectors such as accounting, legal services and distribution services. Main barriers arise in the form of restrictive authorisation requirements, reserves of activities, shareholding and voting rights requirements. In the retail sector, France has carried out a number of reforms to reduce the regulatory burden. However, a number of operational restrictions still affects the efficiency of retail businesses and puts them at a disadvantage compared to e-commerce. The 2019 National Reform Programme details new measures to strengthen competition in a few specific services sectors (such as driving schools, property management companies and the sales of automotive spare parts). On 4 April 2019, the Competition Authority presented its opinion to ease restrictions on the distribution of medicines while maintaining a high level of public health protection.
- (30) Barriers in services have led to low competition, high profit margins and prices, harming the competitiveness of the whole economy. Churn rates are lower in key business services in France compared to the rest of the Union. The lack of competition in services combined to high labour costs have helped to keep prices high, in particular in real estate transactions, housing, catering and legal and accounting services. Since the costs of these services are also borne by other firms using them as inputs, they represent an additional factor weighing on France's competitiveness, including on industry.



- (31) The PACTE law (*loi relative à la croissance et la transformation des entreprises*) aims to support the growth and transformation of firms. It will reduce the number of thresholds firms face as they grow, although remaining thresholds have become broader in scope and more costly to overcome. It also introduces a five-year transition period before considering that a threshold has been reached and encourages small and medium-sized businesses to use incentives and participation schemes for employees linked to a firm's performance. Finally, it provides simplified procedures to start or register businesses and introduces new rules to help entrepreneurs get a second chance. It also reduces the time and costs of insolvency procedures, in particular for small and medium-sized businesses, including by making them more predictable. According to the French administration's own estimates, the potential impact of the PACTE law on GDP is an increase of 0,32 % by 2025 and by 1 % in the longer term. Its full and timely implementation remains key to reap the benefits of this reform.
- (32) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow France to make the best use of those funds in respect of the identified sectors, taking into account regional and territorial disparities and the special situation of the outermost regions.
- (33) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of France's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (34) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion<sup>(8)</sup> is reflected in particular in recommendation (1) below.
- (35) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first and second euro-area recommendations. Fiscal policies referred to in recommendation (1) contribute inter-alia to address imbalances linked to high government debt,

HEREBY RECOMMENDS that France take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary expenditure does not exceed 1,2 % in 2020, corresponding to an annual structural adjustment of 0,6 % of GDP. Use windfalls gains to accelerate the reduction of the general government debt ratio. Achieve expenditure savings and efficiency gains across all sub-sectors of the government, including by fully specifying and monitoring the implementation of the concrete measures needed in the context of Public Action 2022. Reform the pension system to progressively unify the rules of the different pension regimes, with the view to enhance their fairness and sustainability.

<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

2. Foster labour market integration for all job seekers, ensure equal opportunities with a particular focus on vulnerable groups including people with a migrant background and address skills shortages and mismatches.
3. Focus investment-related economic policy on research and innovation (while improving the efficiency of public support schemes, including knowledge transfer schemes), renewable energy, energy efficiency and interconnections with the rest of the Union, and on digital infrastructure, taking into account territorial disparities.
4. Continue to simplify the tax system, in particular by limiting the use of tax expenditures, further removing inefficient taxes and reducing taxes on production. Reduce regulatory restrictions, in particular in the services sector, and fully implement the measures to foster the growth of firms.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Croatia and delivering a Council opinion on the 2019 Convergence Programme of Croatia**

(2019/C 301/11)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 2019 country report for Croatia was published on 27 February 2019. It assessed Croatia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, the follow-up given to the country-specific 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 27 February 2019. The Commission's analysis led it to conclude that Croatia is experiencing macroeconomic imbalances linked to high levels of public, private and external debt in a context of low potential growth. However, imbalances have been narrowing over recent years supported by robust nominal growth and a prudent fiscal policy. The negative net external position has been improving due to continued current account surpluses. Public debt has declined significantly since its 2015 peak. Private-sector debt reduction is ongoing, though its pace is set to abate as credit growth and investment recover. The financial sector is well capitalised and profitable, but the share of non-performing loans, although declining, remains high. Policy action has been stepped up, but thorough implementation of structural measures remains crucial for strengthening the resilience of the economy. Despite some progress, issues with the completeness, accuracy and timeliness of economic and government finance statistics remain.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 44.

- (3) On 18 April 2019, Croatia submitted its 2019 National Reform Programme and its 2019 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 to some extent 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<sup>(4)</sup>, 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) 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 0,2 % of gross domestic product (GDP) in 2018, the 2019 Convergence Programme plans the headline balance to deteriorate to -0,3 % of GDP in 2019 and then to gradually improve to a surplus of 0,8 % of GDP in 2022. Based on the recalculated structural balance<sup>(5)</sup>, the medium-term budgetary objective - which has been changed from a structural deficit of 1,75 % of GDP in 2019 to 1 % of GDP as of 2020 - is planned to continue to be overachieved throughout the programme period. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to fall from 71,6 % of GDP in 2019 to 68,5 % in 2020 and to continue declining to 62 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. However, the planned budgetary targets appear cautious. The Commission 2019 spring forecast projects the general government balance at 0,1 % and 0,5 % of GDP in 2019 and 2020, respectively. Based on the Commission 2019 spring forecast the structural balance is forecast to stand at -0,8 % of GDP in 2019 and at -0,5 % of GDP in 2020, remaining above the medium-term budgetary objective. Croatia is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that Croatia is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (6) In December 2018, the Croatian Parliament adopted the Fiscal Responsibility Act. It aims to reinforce the set-up and mandate of the Fiscal Policy Commission and lay down numerical fiscal rules, including a structural budget balance rule. In March 2019, the mandate of the State Audit Office was strengthened through the introduction of sanctioning mechanisms for cases of non-compliance with its recommendations and a broadening of the scope of its audits. The fiscal framework will be further strengthened with the adoption of the amended Budget Act. This is expected to improve budgetary planning, collection of fiscal data and the criteria for the issuance of government guarantees.
- (7) The territorial fragmentation of Croatia's public administration affects its efficiency and exacerbates regional disparities. Many small local governments often lack adequate financial and administrative resources to provide the services under their remit. This creates wide disparities in public service provision between financially and administratively strong and weak local units across Croatia. At the central government level, the authorities have taken steps towards the simplification of the cumbersome state agencies system, but the legal framework introducing a higher degree of homogeneity across the system is pending. It is planned to devolve the responsibilities of branch offices of the central administration operating at local level to the counties' administration.
- (8) The healthcare system has accumulated further debt in 2018, which poses a risk for public finances. Financing of the system relies on contributions by the working population and state budget transfers, though the latter have been consistently below full cost coverage. The financial situation of the healthcare system is expected to improve due to the increase in the health insurance premium introduced in 2019 and the excise duties on tobacco in December 2018. The ongoing functional integration of hospitals and actions aimed at improving primary care could lead to increased efficiency in spending, but implementation is proceeding slowly.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (9) The wage-setting framework lacks consistency across the public administration and public services, which affects equality of treatment and hinders central control over the public wage bill. New legislation on wage setting for civil servants has been postponed several times. The aim of the law is to achieve greater harmonisation across the public administration through the introduction of common wage grids and job complexity coefficients, based on more consistent job descriptions and competence frameworks. Croatia has a social dialogue framework, but working methods and procedures need to improve for a genuine social dialogue. The fragmentation of the trade unions also weakens the effectiveness of social dialogue.
- (10) In 2018, the unemployment rate continued its rapid decline. Youth unemployment also decreased considerably, but remains high. However, activity and employment rates in Croatia remain low, with early retirement and care responsibilities playing an important role in inactivity. Access to employment needs to improve, for example by anticipating and providing appropriate skills. Many drivers of inactivity are still present and the current measures to help people enter the labour market appear to be insufficient. The capacity of labour market institutions remains limited and cooperation between employment services, social services and other relevant stakeholders is weak. An important package of pension system reforms entered into force in 2019. The main objectives of the reform are threefold: i) to address design inconsistencies, which have resulted in unfair treatment of certain cohorts of pensioners; ii) to improve the adequacy of the pension system by extending working lives; and iii) to strengthen the institutional setup and performance of the second pension pillar.
- (11) Socioeconomic differences are an important determinant of educational attainment in Croatia. The country performs below the Union average when it comes to education, in particular early childhood education and care, basic skills, tertiary educational attainment, adult participation in learning, and the labour market relevance of vocational education and training. Croatia is implementing the curricular reform as a pilot project, but the reform will achieve its full potential only if it is implemented in full and accompanied by training of teachers.
- (12) Despite still relatively high unemployment, labour shortages are affecting some sectors of the economy, mainly because of skills gaps. Improving digital skills could raise productivity and close some skills gaps. The limited labour market relevance of vocational education and training contributes to low employment rate among graduates. Student participation in programmes that include work-based learning is low. The establishment of the Regional Centres of Competences and the experimental programme in dual education should improve the quality of vocational education and training and facilitate the identification of skills needs. Participation in adult education programmes, offered as part of measures to help people find work or training, is low. This is especially true of those most in need of education, such as low-qualified and unemployed persons.
- (13) The proportion of the population at risk of poverty or social exclusion is declining, but remains above the Union average. This risk mainly concerns the elderly and people with disabilities. The capacity of social benefits to reduce poverty remains weak compared to the Union average. The authorities have taken steps to improve the recording of social benefits provided at the local level by harmonising their classification. This should result in a better overview of the benefits provided across the territory, which could then be used to improve the effectiveness of the social protection system in reaching those most in need.
- (14) The transport network is unbalanced, with railway infrastructure lagging significantly behind, resulting in low quality of service and barriers to workers' mobility. Public transport in smaller cities lacks adequate infrastructure. Greenhouse gas emissions from road transport have increased significantly over the last five years. The share of renewable energy sources in the transport sector is far below the 2020 target of 10 %. Additional efforts and investments are needed to effectively reduce the high proportion of fossil fuel-powered cars, promote intermodality and more generally curb rising greenhouse gas emissions from the transport sector.
- (15) Croatia's high energy intensity could be decreased by investments in energy efficiency and smart energy systems. Particular attention could go to reducing the energy consumption in buildings and improving the energy efficiency of district heating networks. Investments in wind and solar have considerable potential too, as have renewables in heating and cooling. Their promotion would also enable Croatia's islands to increase self-reliance in energy, in line with the 'Clean Energy for EU islands' initiative. In addition, Croatia is particularly vulnerable to climate risks, especially floods and forest fires.

- (16) Investments could also promote the transition to a circular economy. They are needed to support separate waste collection and recycling as alternatives to landfilling, develop alternatives to raw materials and increase demand for recycled content and raise public awareness of sustainable consumption practices and behaviour. In addition, significant investment is also necessary to ensure the collection and treatment of wastewater in agglomerations above 2 000 population equivalent. Investment in water networks could reduce leakage of drinking water and fulfil unmet quality requirements.
- (17) Research and innovation capacities and the uptake of advanced technologies need investment to strengthen innovation performance and foster productivity growth, which is being hampered by fragmented and inefficient research and innovation policies. Croatia's 2016-2020 'smart specialisation' strategy (RIS3) aims to foster innovation, overcome fragmentation in the system and ensure that research and development activities are organised around key economic priorities, but its implementation is expected to accelerate further. Investment could support collaboration between universities and businesses, to enable the transfer of technology and commercialisation of research outcomes and could strengthen governance.
- (18) Measures to improve corporate governance in State-owned enterprises have slowly progressed. A new Code of Corporate Governance was adopted and mid-term planning and performance reporting were mandated. Still, the combination of State-owned enterprises' heavy presence in many sectors and their low profitability and weak productivity continue to weigh on the economy. In 2018, the list of companies of special interest was further reduced and more companies are now formally eligible for sale, but there is no clear privatisation strategy in place. The authorities' efforts appear to focus on disposing of the large remaining stock of minority shares and activating non-productive assets. Corruption is perceived to be widespread and growing. Effective tools to prevent and sanction corruption are lacking, in particular at local level. There remains a need to enhance oversight and sanctioning mechanisms for appointees to local public companies.
- (19) Excessive administrative and legislative requirements and parafiscal (non-tax) charges burden businesses, particularly smaller ones. The identification of administrative burden has been completed, allowing the authorities to proceed with the implementation of warranted relief measures. Cuts in parafiscal charges have been lagging. The high number of overly regulated professional services hampers competition. There has been progress in certain sectors, most notably taxi services, but excessive restrictions remain in place for many economically important professions.
- (20) Despite progress, substantial backlogs and lengthy proceedings in civil and commercial courts reduce legal certainty, while inefficiencies in criminal justice hamper the fight against economic and financial offences. The perception of independence of the judiciary has further deteriorated. Amendments to the law on the State Judicial Council were adopted in 2018. With the exception of the High Commercial Court, the continued reduction in backlogs was mainly due to a decline in the incoming caseload. Electronic communication is being tested in some courts but has yet to be extended nationally.
- (21) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations and in particular in the areas covered by Annex D to the 2019 country report. This would allow Croatia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity to manage these funds is an important factor for the success of these investments. The institutional setup for public procurement requires strengthening to improve compliance and enable strategic procurement to achieve policy objectives and ensure efficient public spending.
- (22) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Croatia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Croatia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Croatia, but also their compliance with Union rules and guidance. This reflects the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

- (23) In the light of this assessment, the Council has examined the 2019 Convergence Programme and is of the opinion <sup>(6)</sup> that Croatia is expected to comply with the Stability and Growth Pact.
- (24) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Convergence Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below. Fiscal policies referred to in recommendation (1) contribute, inter alia, to address imbalances linked to high government debt,

HEREBY RECOMMENDS that Croatia take action in 2019 and 2020 to:

1. Reinforce the budgetary framework and monitoring of contingent liabilities at central and local level. Reduce the territorial fragmentation of the public administration and streamline the functional distribution of competencies.
2. Deliver on the education reform and improve both access to education and training at all levels and their quality and labour market relevance. Consolidate social benefits and improve their capacity to reduce poverty. Strengthen labour market measures and institutions and their coordination with social services. In consultation with the social partners, introduce harmonised wage-setting frameworks across the public administration and public services.
3. Focus investment-related economic policy on research and innovation, sustainable urban and railway transport, energy efficiency, renewables and environmental infrastructure, taking into account regional disparities. Increase the administration's capacity to design and implement public projects and policies.
4. Improve corporate governance in State-owned enterprises and intensify the sale of such enterprises and non-productive assets. Enhance the prevention and sanctioning of corruption, in particular at the local level. Reduce the duration of court proceedings and improve electronic communication in courts. Reduce the most burdensome parafiscal charges and excessive product and services market regulation.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(6)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Italy and delivering a Council opinion on the 2019 Stability Programme of Italy**

(2019/C 301/12)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.



- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (5) below. In particular, measures in the area of public administration, justice and competition will help address the first euro-area recommendation as regards resilient product markets and the quality of institutions; focusing economic policy related to investment in the specified areas and using windfall gains to reduce public debt will help address the second euro-area recommendation as regards supporting investment and rebuilding buffers; measures to improve employability and shift the tax burden away from productive factors will help address the third euro-area recommendation as regards the functioning of the labour market, and measures to improve banks' balance sheets will help address the fourth euro-area recommendation as regards the reduction of non-performing loans.
- (3) The 2019 country report for Italy was published on 27 February 2019. It assessed Italy's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 27 February 2019. 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. 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 significant.
- (4) On 19 April 2019, Italy submitted its 2019 National Reform Programme and its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time. Italy's 2019 National Reform Programme only partly addresses the structural issues raised by the 2018 country-specific recommendations, and details on the few new commitments it contains, as well as on the timeline for their implementation, are often missing. However, its reform strategy builds on major reforms already in the pipeline in different areas, showing broad continuity compared to past National Reform Programmes.
- (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 <sup>(5)</sup>, 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. In its 2019 Stability Programme the government expects the headline deficit to increase from 2,1 % of gross domestic product (GDP) in 2018 to 2,4 % in 2019, and to gradually decline thereafter to 2,1 % in 2020 and 1,5 % by 2022. These projections assume a VAT hike (1,3 % of GDP in 2020 and 1,5 % of GDP from 2021) legislated for as a 'safeguard clause' to achieve the budgetary targets from 2020. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective – which has been changed from a balanced budgetary position in structural terms in

<sup>(4)</sup> OJ C 136, 12.4.2019, p. 48.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

2019 to a surplus of 0,5 % of GDP in structural terms as of 2020 – is not planned to be reached within the programme period. After having increased in 2018 (to 132,2 % of GDP, from 131,4 % in 2017), the general government debt-to-GDP ratio is projected in the 2019 Stability Programme to increase by 0,4 percentage point of GDP to 132,6 % in 2019, and to decline to 128,9 % by 2022. These projections assume privatisation proceeds of 1 % of GDP in 2019 and 0,3 % in 2020. The macroeconomic scenario underpinning those budgetary projections is plausible. However, in recent years the VAT hikes legislated for as ‘safeguard clauses’ have been systematically repealed without adequate alternative financing measures, and privatisation targets have been underachieved. Based on unchanged policies, the Commission 2019 spring forecast expects lower nominal GDP growth and a higher government deficit for 2020 than the ones expected in the 2019 Stability Programme. The Commission forecast does not incorporate the VAT hike legislated for as a ‘safeguard clause’ in 2020.

- (7) On 5 June 2019, the Commission issued a report prepared in accordance with Article 126(3) of the Treaty due to Italy’s non-compliance with the debt rule in 2018. The report concluded, following an assessment of all the relevant factors, that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as not complied with, and that a debt-based excessive deficit procedure is thus warranted.
- (8) Following the request made in the revised 2019 Draft Budgetary Plan, the 2019 Stability Programme confirms that the budgetary impact of the collapse of the Morandi bridge in Genoa and of exceptionally adverse weather conditions that occurred in 2018 was significant and provides adequate evidence of the scope and nature of these additional budgetary costs. In particular, the 2019 Stability Programme indicates that the 2019 budget comprises exceptional expenditure amounting to about 0,2 % of GDP in relation to an extraordinary maintenance programme for the road network and a preventive plan to limit hydrogeological risks. Due to the direct link with the collapse of the Morandi bridge in Genoa and the adverse weather conditions of 2018, the specific treatment of expenditure for extraordinary road-maintenance and hydrogeological risk prevention could be considered in application of the ‘unusual event clause’. According to the Commission, the eligible additional expenditure in 2019 amounts to 0,18 % of GDP for these 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 collapse of the Morandi bridge in Genoa and the exceptionally adverse weather conditions are considered 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. A final assessment, including on eligible amounts, will be made in spring 2020 on the basis of observed data for 2019 as provided by the Italian authorities.
- (9) On 13 July 2018, the Council recommended Italy to ensure that the nominal growth rate of net primary government expenditure <sup>(7)</sup> does not exceed 0,1 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019. That conclusion would not change even if the budgetary impact of the extraordinary maintenance programme for the road network following the collapse of the Morandi bridge in Genoa and of a preventive plan to limit hydrogeological risks following exceptionally adverse weather conditions were subtracted from the requirement of the preventive arm of the Stability and Growth Pact in 2019.

<sup>(7)</sup> 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) In 2020, in view of Italy's general government debt ratio above 60 % of GDP and projected output gap of -0,1 %, the net primary government expenditure should decline by 0,1 % in nominal terms, in line with the structural adjustment of 0,6 % of GDP stemming from the matrix of requirements under the Stability and Growth Pact. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from the requirement in 2020. Italy is *prima facie* not forecast to comply with the debt rule in 2019 and 2020. Moreover, at around 132 % 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 2019 to comply with the provisions of the Stability and Growth Pact. It would be important to use any windfall gains to further reduce the general government debt ratio.
- (11) Italy's tax system continues to weigh heavily on the factors of production, to the detriment of economic growth. The high tax burden on labour and capital discourages employment and investment. The 2019 budget has lowered taxation on self-employed workers and small businesses. However, it has also temporarily raised the tax burden on firms at aggregate level, in particular on financial institutions. Tax bases less detrimental to growth, such as property and consumption, are underused, leaving room to shift the tax burden away from labour and capital in a budgetary neutral way. The recurrent property tax on first residences was repealed in 2015, including for wealthier households. In addition, land and property values (or 'cadastral' values), which serve as the basis for calculating property tax, 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 rates for value added tax, are high, and their streamlining has been systematically postponed in recent years. There is also scope to alleviate the burden on compliant firms and households by reducing the complexity of the tax code and increasing the overall level of tax compliance. In particular, the VAT gap (the difference between theoretical VAT revenues and those actually collected) is among the highest in the Union. One of the reasons for this is the high level of tax evasion, which is especially related to omitted billing and invoicing. The mandatory electronic transmission of receipts for all commercial transactions with final consumers is a positive step in remedying the gap. However, legal thresholds for cash payments have been increased in recent years, which could discourage the use of electronic payments. Encouraging electronic payments instead could raise incentives to issue bills and invoices and thus improve tax compliance.
- (12) Italy's expenditure on pensions, at around 15 % of GDP in 2017, is among the highest in the Union, and is expected to increase in the medium term due to the worsening old-age dependency ratio. The 2019 budget and the decree law implementing the new early retirement scheme in January 2019 backtrack on elements of past pension reforms, worsening the sustainability of public finances in the medium term. These new provisions will further increase pension expenditure in the medium term. Between 2019 and 2021, the new early retirement scheme ('quota 100') will allow people to retire at the age of 62 if they have paid 38 years of contributions. In addition, the scope of the existing provisions for early retirement has been extended, including by suspending until 2026 the indexation to life expectancy of the required minimum contribution, which past pension reforms had introduced. For those provisions, the 2019 budget earmarked funds worth 0,2 % of GDP in 2019 and 0,5 % of GDP in 2020 and 2021, but additional costs are also expected in the following years. The high public spending for pensions restrains other social and growth-enhancing spending items like education and investment, and limits margins to reduce the overall high tax burden and the high public debt. Furthermore, broadening the possibility for early retirement might negatively affect labour supply, in a context where Italy is already lagging behind the Union average for the participation of its older workers (55-64) in employment, thereby hampering potential growth and worsening the sustainability of public debt. To limit the increase in spending on pensions, previously adopted pension reforms to curb implicit liabilities arising from population ageing should be fully implemented. Furthermore, savings could be achieved by intervening on the high pension entitlements not matched by contributions, while respecting the principles of fairness and proportionality.

- (13) Despite the economic slowdown, employment continued to increase in 2018, albeit at a slightly slower pace than in the previous year. The number of persons in employment reached 23,2 million at the end of the year, exceeding pre-crisis levels. The employment rate (20-64 years) rose to 63 % last year, but is still far below the Union average (73,2 %). Moreover, regional gaps are substantial and the labour market remains segmented, with the share of temporary contracts having further increased in 2018. The unemployment rate declined to 10,6 %. Long-term and youth unemployment remain high, weighing on potential growth and social cohesion. Inactivity is prevalent among women, the low-skilled and young people. Moreover, the share of young people (15-24) neither in employment nor in education or training, at 19,2 % in 2018, is the highest in the Union. Involuntary part-time is also widespread, pointing to persisting slack in the labour market.
- (14) Income inequality and risk of poverty are high, with wide regional and territorial disparities. In 2017, 28,9 % of the population was at risk of poverty or social exclusion, above both the pre-crisis levels and well above the 2017 Union average (22,4 %). Children, especially those with a migrant background, are particularly affected. In-work poverty is high and rising, in particular among temporary workers and people with a migrant background. The self-employed, who represent 20,8 % of the workforce (against the Union average of 13,7 %), are generally less protected against social risks than employees. Access to affordable and adequate housing is also a challenge and the provision of social services remains underdeveloped and fragmented. The impact of social transfers on reducing poverty and inequality reduction is one of the lowest in the Union. The anti-poverty scheme introduced in 2018 has been replaced by a new major scheme (citizenship income), which keeps an active inclusion approach, subject to certain conditions. The considerable administrative burden on employment and social services represents a challenge for the implementation of the reform. Its actual impact will depend on how effective policies are in getting people into work or training, the extent to which personalised social services are provided and on controls. In particular, the actual capacity to reach out to those most in need will influence the impact on the reduction of poverty and social exclusion. The outcome of the health system is overall good, despite below-Union average spending. Nevertheless, the provision of healthcare largely varies across regions, affecting access, equity and efficiency, and could be improved through better administration and by monitoring the delivery of standard levels of services. More home and community-based care and long-term care is key to provide support to people with disabilities and other disadvantaged groups.
- (15) Undeclared work is widespread in Italy, especially in the southern regions. According to the estimates of the National Institute of Statistics, the unobserved economy was worth about EUR 210 billion (12,4 % of GDP) in 2016. Around 37,2 % of it is attributable to undeclared work. This affects in particular vulnerable groups, such as migrants, women and minors. The new Labour Inspectorate Agency, operational since 2017, devoted particular attention to the phenomenon of '*caporalato*' in the agriculture sector, characterised by a high incidence of irregularity and by a risk of labour exploitation, especially for irregular migrants. A close monitoring of the measures recently adopted as well as additional steps are needed to tackle and prevent undeclared work and labour exploitation and to ensure fair and safe working conditions. Finally, it is important to ensure that the operationalisation of the citizenship income maximises the incentives to regular work and the transformation of undeclared work into regular employment, both through close monitoring and positive incentives.
- (16) Improving public employment services, by providing more resources and better quality services, is crucial for implementing the reform on the new citizenship income scheme. In this context of the new citizenship income scheme for low-income earners and unemployed persons, effective active labour market policies are an important tool for reducing labour market frictions and incentivising people to look for a job. In this respect, it is critical that employment services be equipped with sufficient and qualified staff. Effective job search assistance aiming to enhance training and upskilling is crucial to improve labour mobility and provide workers with the right skills

for future labour market challenges and an increasingly challenging and competitive working environment. Some steps to make active labour market policies more effective have been recently taken, such as the definition of monitoring indicators and minimum standards, the adoption of a strategy for the long-term unemployed and the development of a qualitative profiling tool. Nonetheless, the overall efficiency of public employment services and their capacity to find jobs for people remain weak, performance varies widely between regions and integration with social and educational policies is limited. Cooperation with employers is also weak.

- (17) The gender employment gap in Italy remains one of the highest in the Union and the employment rate of women, albeit slightly increasing, is substantially lower than the Union average (53,1 % against 67,4 % in 2018). Investment in care services and women's participation in the job market remains insufficient, as well as measures to promote equal opportunities and adequate work-life balance policies. However, a comprehensive strategy to promote women's participation in the labour market is still missing. While the compulsory paternity leave was marginally extended from 4 to 5 days, the parental leave system remains inadequate. This, together with underdeveloped childcare and long-term care services, tends to prevent women with children or other family members in need of care from working. In 2017, only 28,6 % of children under three years of age were in formal early childhood education, well below the Union average. Investment in childcare, health and long-term care should take into account the wide geographical disparities in the availability of services. Furthermore, a high tax wedge for second earners reduces the financial incentive for women to take up work. Higher labour-force participation of women, as much as higher participation rates in general, could foster economic growth by lifting labour supply, alleviate poverty and mitigate the social and financial risks rising from population aging.
- (18) The initially envisaged reform of the collective bargaining framework aimed to bring wages and salaries more in line with economic conditions at the regional and firm level. In March 2018, Confindustria signed a framework agreement with the three major Italian trade unions (Cgil, Cisl and Uil) in order to expand second-level bargaining. Moreover, the agreement increases legal certainty by setting clearer rules for the representation of social partners at negotiations and establishes an improved algorithm for setting wage minima. The first implementation agreement on representativeness, health and work safety was signed at end of 2018 by the employers' association and the three major trade unions.
- (19) Investment in education and skills is crucial to promote smart, inclusive and sustainable growth. Italy's sluggish productivity trend is affected by the weaknesses of the education and training system and the weak demand for high skills. Improving the quality of the education and training system is a major challenge. The school drop-out rate (early school leaving) remains well above the Union average (14,5 % versus 10,6 % in 2018) and there are wide regional and territorial disparities in educational outcomes. While the share of funding allocated to primary and secondary education is broadly in line with the Union average, further efforts to attract, effectively recruit and motivate teachers could contribute to improve learning outcomes. The recruitment system is too knowledge-based rather than skills-based, while the training component is limited. Moreover, Italian teachers' salaries remain low compared to international standards and relative to workers with tertiary education. Salary increases are slower than among international peers and career prospects are more limited, based on a single career pathway. Furthermore, promotions are based exclusively on seniority rather than merit. This results in a very low attractiveness of the teaching profession for highly qualified persons and discouragement of the teaching staff, which in turn has a negative impact on the learning outcomes of students. The apprenticeship system was gaining momentum in recent years, but adopted measures have scaled it down. Italian students and adults are amongst

the worst performers in the Union in key competences and basic skills. Adult participation in learning is very limited and decreasing, in a context where the employment gap between the high- and low-skilled is among the highest in the Union. Upskilling is particularly needed for digital skills. So far there has been limited progress in developing digital skills and infrastructure. Investment in human capital is a pre-requisite for boosting public and private investment and current measures to boost digital skills and adult learning lack a comprehensive approach. Basic and advanced digital skill levels are below the Union average – only 44 % of individuals between 16 and 74 years have basic digital skills (57 % in the Union).

- (20) Weak investment in skills is slowing down Italy's transition to a knowledge-based economy, holding back productivity growth and limiting the potential to improve non-price competitiveness and GDP growth. Education gaps also help to explain the lower productivity of Italy's micro and small firms compared to peer countries. Tertiary education is underfinanced and understaffed, and the scope of vocational-oriented higher education is limited despite high employability rates. The proportion of university graduates remains low (27,9 % of the population aged 30 to 34 in 2018) and is coupled with a relatively low availability of tertiary graduates, especially in scientific and technical fields, targeted investments in skills are a pre-requisite to boost both public and private investment, particularly in intangibles. There is a need to boost studies in fields relevant to knowledge-intensive sectors and to strengthen specific skills, such as digital and financial ones.
- (21) The adoption by smaller firms of strategies to increase productivity, such as product, process and organisational innovation, remains limited, particularly in southern Italy. Investment in intangibles has been considerably below the Union average since the early 2000s. Business expenditure on research and development is almost half the average level of the euro area. Public support for business expenditure on research and development remains low, although it is improving thanks to the increased role of tax incentives. Public expenditure on research and development is also below the euro area average. Low innovation could also slow down the transition to a green economy. Improving Italy's innovation performance requires further investment in intangibles, as well as a stronger focus on technology transfer, taking into account regional weaknesses and the size of the firms. Some measures have been recently announced in the budget to promote innovative technologies. Public support for business expenditure on research and development can be improved through a balanced mix of direct and indirect measures and an in-depth assessment of the existing temporary tax incentives, to make the most efficient ones permanent. Measures to support knowledge (such as technological clusters) and cooperation among firms help smaller firms in particular to tackle these difficulties and increase their low productivity.
- (22) Investment is needed to raise the quality and sustainability of the country's infrastructure. In the transport sector, Italy has not delivered on its infrastructure investment strategy (*Connettere l'Italia*). Very limited progress has been made in implementing the planned investments in rail, road and sustainable urban mobility. This is due to administrative delays, spending inefficiencies, incomplete implementation of the Code on procurement and concessions and litigation. The Union transport scoreboard shows that the quality of Italy's infrastructure is below the Union average. The state of repair is a clear source of concern, as shown by the collapse of the Morandi bridge in Genoa. The government has prioritised maintenance and safety with a plan to monitor the maintenance status of all infrastructure and the creation of a new agency in charge of safety of rail and road

infrastructure. In this respect, for 2019 Italy was granted an allowance of EUR 1 billion under Union fiscal rules for an investment plan to secure road infrastructure similar to the Morandi bridge. Investing in sustainable transport and infrastructure is also a way of tackling environmental challenges. Sustained green investment is needed to achieve the ambitious 2030 Union energy and climate targets. The Integrated National Energy and Climate Plan is a key source of guidance to establish investment needs in the area of decarbonisation and energy. Investments are needed to improve the energy infrastructure, which would contribute to a more resilient, clean, secure and flexible energy system, while enhancing market integration and reducing price gaps. The Italian electricity grid is not yet sufficiently equipped to cope with increased exchanges across borders and to cope with the magnitude of variable renewables as projected for 2030. Investment in prevention for hydrogeological and seismic risks is needed to reduce emergency expenditure, including for infrastructure. For 2019, Italy was granted an allowance of EUR 2,1 billion with respect to Union fiscal rules to ensure prevention against major hydrogeological risks. Lastly, insufficient effective investment is being made in waste management and water infrastructure in southern Italy, while scarcity and drought risks continue. The fragmentation of the sector, together with the weak credit profile of smaller operators, remains a barrier to investment. Investment, including in climate change response, environmental sustainability and risk prevention as well as rural connectivity would also contribute to address regional disparities. In rural areas, the broadband network is also less advanced. On ultrafast (100 Mbps and above) broadband coverage, Italy still lags behind (only 24 % compared to the Union average of 60 %) and ranks near the bottom (27<sup>th</sup>) with a still very moderate growth rate. Both ultrafast broadband coverage and take-up show results much below the Union averages.

- (23) The weak capacity of the public sector, especially at the local level, to administer funding represents an investment barrier across sectors, due to complex procedures, the overlapping of responsibilities and poor management of public employment. Inadequate skills in the public sector constrain the capacity to assess, select and manage investment projects. This also undermines the implementation of Union funds, where Italy lags behind compared to the Union average. The lower quality of governance in southern Italy seriously limits its spending and policy-making capacity. Improving the administrative capacity is a pre-condition for the effective delivery of public investment and the use of Union funds, with positive spillovers on private investment and GDP growth. Such improvements could give more impact to investments in broadband, transport, water management and the circular economy, especially in southern Italy. The latter lags behind mainly in terms of intangible investment. The improvement of administrative capacity of central and local bodies would have positive impact on the planning, evaluation and monitoring of investment projects, as well as on identifying and addressing possible bottlenecks.
- (24) Increasing the efficiency of Italy's public administration and its responsiveness to business would have a positive impact on the business environment, investment and the ability of firms to exploit innovation opportunities. In 2015, a comprehensive enabling law reforming the public administration was adopted. The reform tackled most sources of inefficiency such as the length and complexity of procedures, the lack of transparency, the ineffective management of public employment, the inefficient management of public-owned enterprises, and low digitalisation. By the end of 2017, most of the reform was implemented and enforcement is ongoing, supported by the new 'Concretezza' law. However, inconsistent planning, scarce financial resources and insufficient coordination are delaying the implementation of digital public services in key areas like online payment systems, which would help reducing complexity and increasing transparency. The high average age and low average digital skills of public employees are further slowing down the process. Nevertheless, when clear goals and effective enforcement are combined, results are evident as was the case for the rapid development of the electronic market for public administrations and e-invoicing. The 2015 public administration reform also envisaged a new framework reforming the management of local public services. However, in November 2016 Italy's Constitutional Court declared the procedure followed to adopt a number of legislative decrees, including the one on local public services, unconstitutional. A new legislative initiative is thus needed to promote the efficiency and quality of local public services, including by prioritising competitive bids over in-house solutions or direct grants.

- (25) The update to Economic and Financial Document 2018 (NADEF 2018) identified project preparation and quality improvement of the project cycle as critical factors for relaunching effective investment spending in Italy. In the same document, the constitution of a specific grant fund for project preparation and project review of key infrastructure projects was reported. Another grant fund was foreseen for preparation of smaller projects implemented by local bodies. However, implementing decrees on both funds have not been issued yet, and the allocation assigned to these funds may be lower than the one initially presented in the DEF 2018. In the budget law for 2019, the creation of a '*Centrale per la progettazione*' is mentioned but this body is not operational yet and its creation seems to require a longer-term effort. In terms of functionality, it is not clear how the *Centrale per la progettazione* will interact with municipalities and other local bodies.
- (26) Improvements to the business environment would facilitate entrepreneurship, and better framework conditions for competition would favour a more efficient allocation of resources and productivity gains. The 2015 annual competition law, adopted in August 2017, needs to be properly implemented. Moreover, significant barriers to competition persist in certain sectors, such as business services and retail. Improving the quality of the regulatory framework would ensure a level playing field for both innovative platforms and traditional operators, unleashing the full potential of the collaborative economy and fairer competition in all sectors. Increasing competitive processes to award public service contracts and concessions for access to public goods would positively affect the quality of services. Lack of regulatory stability in the public procurement system could jeopardise some key benefits of previous reforms and contribute to defer investment. Market surveillance of products is spread over various organisations, has many overlaps and lacks systems for efficient coordination. This reduces the effectiveness of controls in preventing unfair competition from non-compliant business.
- (27) The low efficiency of Italy's civil justice system remains a source of concern. In 2017, the time needed to resolve civil and commercial litigious cases in Italy was still the highest in the Union at all instances. While the length of proceedings showed an increase in first instance compared to 2016, past reforms are starting to positively affect trial length at higher instances, but there is still room to limit abuses of the trial and ensure a more efficient functioning of courts. At the Supreme Court of Cassation, a high number of incoming cases coupled with lower clearance rates of its tax section negatively affects the Court's efficiency and raises concerns about the tax justice system at first and second instance. Overall, adequate enforcement of simpler procedural rules could help to decisively speed up civil trials. In this regard, a reform to streamline the civil procedure has been announced, but has not yet been presented to the Parliament. Other challenges are the still limited and inconsistent use of the inadmissibility filter for appeals in second instance, the numerous vacancies for administrative staff, and the remaining differences across courts in the effectiveness of case management.
- (28) Italy has recently made some progress in improving its anti-corruption framework, including through better protection for whistle-blowers, a stronger role of the National Anti-corruption Authority in implementing it, and a new anti-corruption law of January 2019. The latter aims to boost the detection and repression of corruption through stricter penalties, better investigation techniques and a leniency scheme for those who denounce corruption. The law also suppresses prescription terms after a first-instance conviction, but only as of 2020. The latter is a long-awaited positive step in line with international standards. However, the repression of corruption remains ineffective in Italy, mainly because the length of criminal proceedings remains excessive in the absence of a much-needed reform of the criminal trial, including the appeal system to avoid abuse of litigation. Moreover, gaps persist in the prosecution framework for specific offences, such as embezzlement of public money.



- (29) Italian banks have continued to make good progress in repairing their balance sheet despite renewed market pressure. However, due to their high exposure to the sovereign bonds, market volatility has adversely affected their capital positions, putting pressure on funding costs and making their access to unsecured wholesale funding more difficult. Continued reduction of the legacy stock of non-performing loans and unlikely-to-pay loans remains warranted especially for small and second-tier banks, in order to further safeguard financial stability and strengthen credit extension to the economy. Having banks, especially smaller ones, advance on meeting regulatory funding requirements would also boost the system's resilience to external shocks. Addressing banks' structurally low profitability by increasing efficiency and business model optimisation is also important. A timely implementation of the insolvency reform decrees would help accelerate the still slow foreclosure and collateral enforcement procedures and further boost the resilience of the banking sector. Any compensation granted by the State to shareholders and retail holders of subordinated debt of banks subject to past administrative liquidation procedures should be strictly targeted at addressing the social effects of past mis-selling. Governance in the banking system should be further improved, by promptly completing the 2015 reform of the large cooperative banks after legal clarity has been established.
- (30) Bank credit remains the dominant source of corporate financing. However, smaller and innovative firms still struggle to access credit, especially in southern Italy. The capital market is underdeveloped in comparison to other Member States, also due to factors constraining demand, such as low financial education, fear of losing control over the business and burdensome administrative requirements. Several measures were introduced in the last few years to improve access to finance, mostly focusing on the bank credit channel, although market-based measures such as mini-bonds, the alternative investment market, venture capital and direct public support also helped smaller and innovative firms to gain access to finance. The abolition of the allowance for corporate equity by the 2019 budget may reduce incentives for firms to use equity financing. Effectively boosting non-bank access to finance requires taking into account the needs of smaller and innovative firms as well as the capacity of investors to evaluate investment projects. Diversifying financing sources would better protect firms' investment from shocks in the banking sector, while supporting innovation and growth.
- (31) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Italy to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (32) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Italy's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (33) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion<sup>(8)</sup> is reflected in particular in recommendation (1) below.
- (34) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (5) below. Those recommendations also contribute to the implementation to the first four euro-area recommendations. Fiscal policies referred to in recommendation (1) contribute inter-alia to address imbalances linked to high government debt,

<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Italy take action in 2019 and 2020 to:

1. Ensure a nominal reduction of net primary government expenditure of 0,1 % in 2020, 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. Fight tax evasion, especially in the form of omitted invoicing, including by strengthening the compulsory use of e-payments including through lower legal thresholds for cash payments. Implement fully past pension reforms to reduce the share of pensions in public spending and create space for other social and growth-enhancing spending.
2. Step up efforts to tackle undeclared work. Ensure that active labour market and social policies are effectively integrated and reach out in particular to young people and vulnerable groups. Support women's participation in the labour market through a comprehensive strategy, including through access to quality childcare and long-term care. Improve educational outcomes, also through adequate and targeted investment, and foster upskilling, including by strengthening digital skills.
3. Focus investment-related economic policy on research and innovation, and the quality of infrastructure, taking into account regional disparities. Improve the effectiveness of public administration, including by investing in the skills of public employees, by accelerating digitalisation, and by increasing the efficiency and quality of local public services. Address restrictions to competition, particularly in the retail sector and in business services, also through a new annual competition law.
4. Reduce the length of civil trials at all instances by enforcing and streamlining procedural rules, including those under consideration by the legislator and with a special focus on insolvency regimes. Improve the effectiveness of the fight against corruption by reforming procedural rules to reduce the length of criminal trials.
5. Foster bank balance sheet restructuring, in particular for small and medium-sized banks, by improving efficiency and asset quality, continuing the reduction of non-performing loans, and diversifying funding. Improve non-bank financing for smaller and innovative firms.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Cyprus and delivering a Council opinion on the 2019 Stability Programme of Cyprus**

(2019/C 301/13)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (5) below. In particular, measures to decrease the administrative burden will help address the first euro-area recommendation as regards the business environment and productivity improvements for euro-area rebalancing; focusing economic policy related to investment on the specified areas will help address the second euro-area recommendation as regards supporting investment; tax measures and measures to improve skills will help address the third euro-area recommendation as regards the fight against aggressive tax planning and the functioning of the labour market; and measures to improve the functioning of the asset management company will help address the fourth euro-area recommendation as regards the reduction of non-performing loans.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Cyprus was published on 27 February 2019. It assessed Cyprus's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Cyprus'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 27 February 2019. The Commission's analysis led it to conclude that Cyprus is experiencing excessive macroeconomic imbalances. In particular, it is essential that the Member State tackle the high stocks of private, public and external debt and non-performing loans.
- (4) Cyprus submitted its 2019 National Reform Programme on 15 April 2019 and its 2019 Stability Programme on 30 April 2019. 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 <sup>(5)</sup>, 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) Cyprus is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the general government balance, which turned into a deficit of 4,8 % of gross domestic product (GDP) in 2018 and thereby exceeded the Treaty reference value of 3 % of GDP, is projected to reach a surplus in nominal terms of 3,0 % of GDP in 2019 and above 2,0 % of GDP over the programme period. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a balanced budgetary position in structural terms, is planned to be reached over 2019-2022. After having increased to around 102,5 % of GDP in 2018, the general government debt-to-GDP ratio is expected to decrease to 95,7 % in 2019 and to continue to steadily decline thereafter, reaching 77,5 % by 2022, according to the 2019 Stability Programme. The macroeconomic scenario underpinning those budgetary projections is plausible. The risks associated with the macroeconomic and budgetary assumptions presented in the Stability Programme are tilted to the downside, mainly linked to external developments, as well as the potential fiscal impact of Court rulings on past fiscal reforms and the financing needs of public hospitals during the first years of the national health system. The Commission 2019 spring forecast projects the general government balance to register a surplus of 3,0 % of GDP in 2019 and 2,8 % of GDP in 2020. Based on the Commission 2019 spring forecast the structural balance is forecast to stand at 1,1 % of GDP in 2019 and at 0,7 % of GDP in 2020, remaining above the medium-term budgetary objective. Cyprus is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that Cyprus is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (7) On 5 June 2019, the Commission issued a report prepared in accordance with Article 126(3) of the Treaty, as, based on notified data, the headline deficit was in breach of the 3 %-of-GDP Treaty reference value in 2018. The report concluded that further steps leading to a decision on the existence of an excessive deficit should not be taken. Inefficiencies in the public administration and local governments remain a challenge despite some progress with e-government services. This has an impact on the business environment. Key legislative proposals 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, which has been a significant factor in fiscal consolidation in Cyprus, warrants continuation.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 55.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (8) The fight against aggressive tax planning is essential in making tax systems more efficient and fairer, as acknowledged in the 2019 Recommendation for the euro area. Spillover effects of taxpayers' aggressive tax-planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Cyprus has taken measures against aggressive tax planning, but the high levels of dividend and interest payments (relative to GDP) indicate that Cyprus's tax rules may be 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. The Notional Interest Deduction scheme needs to be closely monitored to prevent any misuse for aggressive tax planning. Finally, the Scheme for Naturalisation of Investors in Cyprus by Exception and Residence by Investment Scheme give access to a low personal tax rate on income from foreign financial assets and do not require an individual to spend a significant amount of time in the jurisdiction offering the scheme. They have been listed by the OECD as having a potentially high risk for being misused to circumvent the automatic exchange of financial accounts.
- (9) Significant measures were implemented in the context of a comprehensive non-performing loans strategy. This led to a marked reduction in non-performing loans in the banking sector, mainly due to the sale and wind-down of the Cyprus Cooperative Bank and the transfer of its non-performing loans portfolio to a State-owned asset management company. Furthermore, the law on the sale of loans was improved and a law on the securitisation of loans was adopted. In order to maximise the proceeds from the sale of assets and ultimately help reduce private debt, it is essential for the State-owned asset management company to have an effective governance structure, a highly specialised management, operational independence from the Cypriot State, and well-defined targets in line with the commitments made by the government in the context of the State aid decision on the sale of the Cyprus Cooperative Bank, which was approved by the European Commission. Furthermore, it is important to set up an adequate supervisory framework for the credit-acquiring companies as the number of credit-acquiring companies, including the State-owned asset management company, has increased and more non-performing loans portfolio sales are planned in the future. The governance and administrative capacity of insurance and pension fund supervisors remains weak. The integration of these supervisors should be swiftly finalised. More generally, the supervisory framework for the capital markets has to be strengthened, given the relatively sizeable cross-border activities of the non-bank financial services companies and the exponential growth of licensed firms in recent years.
- (10) Employment is rising, unemployment is falling and the public employment services' short-term capacity to facilitate active support to employment has been improved. However, the long-term sustainability of the public employment services' capacity is still an issue, as the additional staff were recruited for only two years. In 2018 the proportion of young people not in education, employment or training was among the highest in the Union. The low efficiency of the public employment services and their limited rollout and participation in activation for helping people find work remain a challenge. Therefore, there is scope for reinforcing the outreach and activation support for access to employment, in particular for young people and the long-term unemployed. This includes promoting self-employment and the social economy as well as modernising labour market institutions and services to help people gain skills that better match labour market needs.
- (11) Skills shortages and mismatches are among the main obstacles to business investment, highlighting the need to invest more in training of unused and under-used labour potential, better aligning education curricula to labour market needs, and investing in matching vocational education infrastructure. Progress on crucial education and training reforms, such as improving the appointments and evaluation of teachers, is uneven. Educational achievements remain low, as does participation in early childhood education and care, which has become less affordable for households as their income during the crisis fell at a faster rate than childcare costs. Continuing efforts to modernise the education and training system at all levels will help to improve educational outcomes and increase the potential for sustainable growth in Cyprus. Revising the vocational and training curricula is a promising step in reducing the skills mismatches in the labour market. However, prevalent skills mismatches for tertiary graduates and low participation in adult learning, especially of the low qualified, indicate the need for enhanced upskilling and reskilling measures.

- (12) Cyprus has made 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. Preserving long-term sustainability of the system, including ensuring the financial and operational autonomy of public hospitals, as planned, remains crucial. Measures aimed at modernising and improving the efficiency of healthcare providers, including primary healthcare, introducing e-health and setting up a National Medicines Organisation would further strengthen the healthcare system. The level of long-term care is low and remains a challenge given the ageing population.
- (13) Cyprus's weak environmental performance is a major concern, and the country remains vulnerable to climate change. Cyprus needs to significantly improve its waste management system and the circular economy. Waste generation remains significantly higher than the Union average and has increased since 2014. The current facilities for waste treatment do not achieve high recycling rates, and the lack of economic instruments such as landfill taxes makes recycling economically unattractive. Water management, in particular in urban areas, is characterised by inefficiencies. Water scarcity, in combination with over-abstraction of groundwater, is the main challenge for Cyprus. On urban wastewater, there is a considerable amount of wastewater that is still discharged without collection or treatment — only around half of the total waste water undergoes secondary treatment. Droughts and water scarcity are major concerns, and an insufficient policy response might affect the Cyprus's rural economy and tourism. Therefore, sustainable management and an efficient use of its natural resources, along with stricter enforcement of environment and climate legislation, are essential for Cyprus to mitigate adverse climate change effects, preserve and restore its natural environment and ensure sustainable economic growth in the long term.
- (14) Cyprus can make much better use of its renewable energy sources — particularly solar — and address current energy inefficiencies. The renewable energy share in Cyprus was 9,72 % in 2017, with the 2020 target being 13 %. Residential and commercial buildings constructed with no or low levels of thermal protection, particularly in urban settings, are a substantial source of energy inefficiency. Framework conditions for investing in the renewable energy sector have improved, and several measures have been introduced, including installations of photovoltaic systems and support schemes for small and medium-sized enterprises (SMEs) and households. However, Cyprus has not yet taken full advantage of its considerable potential in renewable energy generation, in particular from solar sources. The reliance on roads for inland transport creates a number of policy challenges, most notably the struggle to reduce air pollution and greenhouse gas emissions, and also leads to severe congestion in urban areas during peak hours and on roads to and from ports. With a 2,7 % share in 2016, Cyprus is also lagging behind in the use of renewable energy sources in transport and may have difficulties reaching the binding 10 % target by 2020.
- (15) Investing in the digital economy and in improving workers' digital skills is essential for bolstering productivity. Cyprus ranks at the low end in the European Commission's 2019 Digital Economy and Society Index (DESI). Only 50 % of Cypriots between 16 and 74 years of age have basic digital skills, and ICT specialists still represent a lower proportion of the workforce compared to the Union as a whole (2,3 % versus 3,7 %), hampering the potential of the digital economy. There is a low level of online interaction between public authorities and citizens, with only 50 % of Cypriots interacting online. E-commerce is improving, but is still below the Union average.
- (16) Cyprus remains a moderate innovator, with innovation performance having declined since 2010. Public and private research and development expenditure levels are among the lowest in the Union, thus hindering the capacity of the research centres and the business sector to innovate. The interaction between academia and businesses is also very limited. Increasing the capacity of the business sector to innovate and boosting access to finance and investments that focus on well-defined areas of smart specialisation are crucial to improve Cyprus's competitiveness and that of its SMEs in particular.
- (17) The administrative burden is high, especially for initiating strategic investments. There is scope to significantly simplify the procedures for obtaining permits for strategic investments, and the relevant legislation is still pending.

- (18) Implementation of the action plan for growth has led to some progress in entrepreneurship and access to finance for SMEs. However, financial support measures for SMEs are still based mainly on grants and banking finance supported by Union and/or national funds. Alternative sources of finance such as venture capital, equity funding and crowdfunding remain marginal for Cypriot businesses. Better coordination of business support could improve uptake. Privatisation efforts to attract productivity-enhancing foreign investments are in many cases on hold, and only a few privatisation projects are gradually advancing.
- (19) Persisting inefficiencies in the justice system continue to affect contract enforcement and prevent the swift resolution of civil and commercial cases and the investigation of serious crimes. Cumbersome and outdated civil procedure rules 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 the outdated civil procedures rules, the low specialisation and digitalisation of courts, the clearance of the large backlog of cases and the lack of lifelong training for judges; but progress remains slow. The reform should be in line with the commitments undertaken by the government in the context of the State aid decision on the sale of the Cyprus Cooperative Bank, which was approved by the European Commission. Improved insolvency and foreclosure frameworks were adopted in 2018. Decisive implementation of the new laws together with ensuring an efficient judicial system and stricter enforcement of judgments should help improve the debt repayment discipline. A national anti-corruption strategy has been in place since December 2017 and has been reinforced by the approval of a national horizontal action plan against corruption by the Council of Ministers in May 2019. Draft laws for the establishment of a new independent anti-corruption agency and whistle-blower protection have been submitted to the parliament but are yet to be adopted. These laws would help to strengthen the national anti-corruption framework. The anti-corruption reforms should be accelerated through the swift implementation of the anti-corruption Action Plan. The independence of the prosecution has to be safeguarded and the capacity of law enforcement should be strengthened.
- (20) Despite some efforts to reduce the backlog in the issuance of title deeds, the backlog remains high. A structural solution to address the inadequacies of the property transaction system (i.e. the issuance and transfer of title deeds) is still lacking. This is essential to facilitate foreclosure procedures and enable liquidation of collaterals.
- (21) The programming of Union Funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Cyprus to make the best use of those funds in respect of the identified sectors, taking into account territorial disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (22) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Cyprus's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Cyprus in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Cyprus, but also their compliance 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.
- (23) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion <sup>(7)</sup> that Cyprus is expected to comply with the Stability and Growth Pact.
- (24) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (5) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first, third and fourth euro-area recommendations,

<sup>(7)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Cyprus take action in 2019 and 2020 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. Address features of the tax system that may facilitate aggressive tax planning by individuals and multinationals, in particular by means of outbound payments by multinationals.
2. Facilitate the reduction of non-performing loans including by setting up an effective governance structure for the State-owned asset management company, taking steps to improve payment discipline and strengthening the supervision of credit-acquiring companies. Strengthen supervision capacities in the non-bank financial sector, including by fully integrating the insurance and pension-fund supervisors.
3. Complete reforms aimed at increasing the effectiveness of the public employment services and reinforce outreach and activation support for young people. Deliver on the reform of the education and training system, including teacher evaluation, and increase employers' engagement and learners' participation in vocational education and training, and affordable childhood education and care. Take measures to ensure that the National Health System becomes operational in 2020, as planned, while preserving its long-term sustainability.
4. Focus investment-related economic policy on sustainable transport, environment, in particular waste and water management, energy efficiency and renewable energy, digitalisation, including digital skills, and research and innovation, taking into account territorial disparities within Cyprus. Adopt legislation to simplify the procedures for strategic investors to obtain necessary permits and licences. Improve access to finance for SMEs, and resume the implementation of privatisation projects.
5. Step up efforts to improve the efficiency of the judicial system, including the functioning of administrative justice and revising civil procedures, increasing the specialisation of courts and setting up an operational e-justice system. Take measures to strengthen the legal enforcement of claims and ensure reliable and swift systems for the issuance and transfer of title deeds and immovable property rights. Accelerate anti-corruption reforms, safeguard the independence of the prosecution and strengthen the capacity of law enforcement.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Latvia and delivering a Council opinion on the 2019 Stability Programme of Latvia**

(2019/C 301/14)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, focusing economic policy related to investment on the specified areas and measures to improve skills will help address the first euro-area recommendation as regards productivity improvements for euro-area rebalancing and tax measures will help address the third euro-area recommendation as regards the functioning of the labour market.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Latvia was published on 27 February 2019. It assessed Latvia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 2019 National Reform Programme on 15 April 2019 and its 2019 Stability Programme on 17 April 2019. 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 <sup>(5)</sup>, 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) Latvia is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans an improvement of the headline balance from a deficit of 1,0 % of gross domestic product (GDP) in 2018 to a deficit of 0,5 % of GDP in 2019 and 0,4 % of GDP in 2020 and 0,2 % of GDP in 2021. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a deficit of 1 % of GDP in structural terms, is planned to be reached in 2019, taking into account the allowance linked to the implementation of the structural reforms for which a temporary deviation is granted. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to decrease to 33,1 % of GDP by 2022. The 2019 Stability Programme's GDP growth projections appear to be plausible. Risks to the budgetary position are balanced.
- (7) On 13 July 2018, the Council recommended that Latvia achieve its 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. This is consistent with a maximum nominal growth rate of net primary government expenditure <sup>(7)</sup> of 4,8 % in 2019, corresponding to an improvement in the structural balance by 0,2 % of GDP. Based on the Commission 2019 spring forecast, Latvia is expected to be close to its medium-term budgetary objective, taking into account the allowance linked to the implementation of the structural reforms for which a temporary deviation is granted. Thus, the current assessment indicates a risk of some deviation in 2019. At the same time, projected nominal growth rate of net primary government expenditure would currently point to a risk of a significant deviation from the requirement in 2019. If the structural balance is no longer projected to be close to the medium-term budgetary objective, taking into account the allowance linked to the implementation of the structural reforms for which a temporary deviation is granted, in future assessments an overall assessment would need to take into account a possible deviation from the requirement.
- (8) In 2020, in view of Latvia's projected output gap of 1,3 %, the nominal growth rate of net primary government expenditure should not exceed 3,5 %, 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. Based on the Commission 2019 spring forecast under unchanged policies, Latvia is expected to be close to its medium-term budgetary objective. Thus, the current assessment indicates risk of some deviation in 2020. At the same time, the projected nominal growth rate of net primary government expenditure would currently point to a risk of a significant deviation from the requirement in 2020. If the structural balance is no longer projected to be close to the medium-term budgetary objective, in future assessments an overall assessment would need to take into account a possible deviation from the requirement. Overall, the Council is of the opinion that Latvia needs to stand ready to take further measures as of 2019 to comply with the provisions of the Stability and Growth Pact.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 60.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(7)</sup> 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.

- (9) The tax revenue as a share of the gross domestic product of Latvia is low compared with the Union average and limits to some extent the delivery of public services, in particular healthcare, and social inclusion. Capital and property are relatively undertaxed and the freezing of the values used to calculate land and property taxes will reduce their revenue further. At the same time, the tax burden on labour remains high for low-wage earners relative to the average of the Union, despite having been reduced. The share of the shadow economy appears to have declined over the past years by different estimates. Nevertheless, the share of under-reported economic activity is higher in Latvia than in other Baltic States. In particular, underreporting of salaries ('envelope wages'), particularly in the construction sector, accounts for a large share of the shadow economy.
- (10) Following the closure of its third largest bank due to allegations of money laundering, Latvia tightened the regulation concerning non-resident clients. As a result, non-resident deposits, which are the main source of money laundering risk in Latvia, have significantly decreased since May 2018, but challenges regarding fighting money laundering remain. Moreover, Latvia has come up with a detailed action plan for improving its anti-money-laundering and counter-terrorist financing strategy. The main priorities listed in the action plan include enhancing risk-based supervision, ensuring the required human resources for the supervisory authorities, and ensuring effective information exchange and collaboration among the investigative authorities and with the private sector. Attention should be paid to the effective implementation of these measures, once adopted. Finally, law enforcement and judicial authorities' capacity also need to be increased.
- (11) Latvia faces challenges on delivering on several of social protection and inclusion principles of the European Pillar of Social Rights. Income inequality in Latvia is high, as the redistribution through the tax-benefit system is low. The adequacy of social benefits remains low and the impact of social transfers on poverty and inequality reduction is limited. The poverty risk among the elderly and people with disabilities is relatively high and increasing due to benefits not keeping pace with wage growth. The at-risk-of-poverty or social exclusion rate for the elderly was 49,0 % in 2018 (Union average: 18,2 % in 2017) and for people with disabilities 40,7 % in 2017, (Union average: 29,3 % in 2017). The State social security benefit for people with disabilities and minimum old-age pensions, have not been revised since 2006. The minimum income level reform, announced in 2014, has not been implemented, which negatively affects the poorest households. Access to long-term care also remains weak. Investments are thus required to address social exclusion, including food and material aid for the most deprived. Moreover, investments, including infrastructure, are needed to improve access to childcare, long-term care, employment and other social services, and to enable integration of health and social services, including the transition from institutional to community-based care. The share of people facing severe housing deprivation is among the highest in Europe (15,2 % versus 4,0 % in average in 2017 in the Union) and social housing is scarce. Investment is needed to improve the provision of affordable housing.
- (12) While overall employment rates are high and increasing, headcount employment is negatively affected by the adverse demographic developments and emigration. In addition, employment varies between regions and skill levels. Older people with outdated skills encounter more difficulties. The low level of digital skills among the labour force limits the use of digital technologies by businesses and the potential for innovation. Adult participation in learning and the involvement of the unemployed in active labour market measures is lower than the average of the Union.
- (13) The education system faces a challenge to consolidate resources while improving quality and efficiency. While Latvia's education system performs well in terms of learning achievement, access to quality education remains dependent on the place of residence and type of school. Curriculum reform in vocational education and training aimed at aligning it with new skills requirements has progressed and the vocational school environment is significantly improved. However, attractiveness remains low with enrolment rates and the employment rate of recent graduates below the average of the Union.

- (14) Ensuring skills supply is one of the main areas where demand for investment remains significant. Matching investment, including through infrastructure, is required to improve the quality, effectiveness and labour market relevance of education and training, and to promote lifelong learning, notably flexible upskilling and reskilling opportunities. Investment are also needed to improve access to employment, including to improve outreach and coverage of active labour market policies, enhance the workability of workforce, as well as sectoral and regional labour mobility. In a broader context, strengthening social partners' capacity is important in promoting the fair working conditions and delivering on the European Pillar of Social Rights.
- (15) Low public spending for healthcare and unhealthy lifestyle choices are the main reasons for the population's poor health outcomes. The recently increased funding for healthcare addresses some of the access restrictions linked to the annual service limits and long waiting times. However, public financing for healthcare remains well below the Union average. Timely and equal access to healthcare is limited. This leads to high self-reported unmet needs for care due to high out-of-pocket payments, especially for vulnerable groups, as well as inequality of opportunities. Reforms to boost efficiency and quality in healthcare are progressing but are in an early phase and should be accelerated, including effective prevention measures, streamlining of the hospital sector, strengthening primary care and targeting quality management. In addition, Latvia faces health workforce shortages, especially of nurses, which hamper the delivery of public healthcare and pose risks to the success of the health reforms. If the division of health services into two baskets ('full' and 'minimum') comes into effect, it risks further limiting equitable access to healthcare and leading to adverse health outcomes. Matching investments in healthcare, including infrastructure, are needed to increase the accessibility, affordability and quality of healthcare in order to improve the population's health status and ensure healthier and longer working lives.
- (16) Latvia invests little in research and development and its investment gap in innovation is important. In 2017, Latvia's share of expenditure on research and development was among the lowest in the Union and has been rather stable over the past decade. Moreover, research funding relies almost entirely on Union funds. As a result, Latvia is a moderate innovator with some strong points, such as its information, communications and technology infrastructure but its performance lags behind in human resources, in public-private sector cooperation and in investment in intellectual property.
- (17) Important investment gaps also remain to address regional disparities. Significant economic differences persist between Riga and Latvia's other regions. While Latvia as a whole is converging with the Union, the gap in economic performance between the capital region and the other regions has not narrowed since Latvia's accession to the Union. The competitiveness and quality of public services differs considerably among the different Latvian regions, influencing their territorial attractiveness. Investment needs should therefore address significant regional differences in mobility and digital infrastructure, in particular the last mile connections. Gaps in connectivity in the Trans-European Transport Network and with peripheral and border regions are still extremely pronounced having a negative impact on Latvia's economic activities and exports. Investments gaps also exist to complete the Rail Baltica project and the key electricity infrastructure projects that form part of the Baltic energy market interconnection plan. Additionally, investment in resource efficiency is also needed in order to speed up Latvia's energy transition. More efforts are needed to improve overall energy efficiency, in particular in the residential and transport sectors.
- (18) The recent adoption of the whistleblower law marks a positive step and the country's anti-corruption body has also gathered momentum recently thanks to it uncovering a number of high profile corruption cases. Nevertheless, government decision-making is still perceived to be influenced by favouritism and the procurement process as susceptible to corruption due to lack of transparency, in particular in municipalities and State-owned and municipal enterprises. Amendments in the Competition Law entering into force in January 1, 2020, will limit the ability of State-owned and municipal enterprises to adversely affect competition with their activities. Legislative amendments on conflict of interest regime may give rise to abuses. The recently adopted Code of Ethics does not cover politically appointed persons.

- (19) Public services have not been adjusted to the declining and ageing population. The declining population and urbanisation leave infrastructure and public services underused in the rural areas. Public administration, education, healthcare services require strategies to preserve access to quality services in scarcely populated and dwindling areas, while ensuring greater efficiency. A general administrative territorial reform to be implemented by December 2021 has been recently announced. A timely implementation of this reform could contribute to enhancing the accountability and efficiency of the public sector, all the more in light of the operational programme for Union funds, which is to be approved by the year 2020.
- (20) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Latvia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (21) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Latvia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (22) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion <sup>(8)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Latvia take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 3,5 % in 2020, corresponding to an annual structural adjustment of 0,5 % of GDP. Reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance. Ensure effective supervision and the enforcement of the anti-money-laundering framework.
2. Address social exclusion notably by improving the adequacy of minimum income benefits, minimum old-age pensions and income support for people with disabilities. Increase the quality and efficiency of education and training in particular of low-skilled workers and jobseekers, including by strengthening the participation in vocational education and training and adult learning. Increase the accessibility, quality and cost-effectiveness of the healthcare system.
3. Focus investment-related economic policy on innovation, the provision of affordable housing, transport, in particular on its sustainability, resource efficiency and energy efficiency, energy interconnections and digital infrastructure, taking into account regional disparities.
4. Strengthen the accountability and efficiency of the public sector, in particular with regard to local authorities and State-owned and municipal enterprises and the conflict of interest regime.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Lithuania and delivering a Council opinion on the 2019 Stability Programme of Lithuania**

(2019/C 301/15)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (2) and (3) below. In particular, investment measures will help address the second euro-area recommendation as regards supporting investment and education measures will help address the third euro-area recommendation as regards the functioning of the labour market.
- (3) The 2019 country report for Lithuania was published on 27 February 2019. It assessed Lithuania's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 2019 National Reform Programme on 10 May 2019 and its 2019 Stability Programme on 30 April 2019. 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 <sup>(5)</sup>, 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 2019 Stability Programme, the government plans to achieve a headline surplus of 0,4 % of gross domestic product (GDP) in 2019 and 0,2 % of GDP in 2020, before it is projected to decrease further to 0,1 % of GDP in 2021. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a deficit of 1 % of GDP in structural terms, is overachieved throughout the programme period. In 2017, Lithuania was also granted a temporary deviation linked to the implementation of the structural reforms. This deviation is carried forward for a period of three years. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to fall from 34,2 % of GDP in 2018 to 32,9 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned surplus targets from 2020 onwards have not been sufficiently specified. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a deficit of 1 % of GDP in 2019 and 0,9 % of GDP in 2020, in compliance with the medium-term budgetary objective. 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. Overall, the Council is of the opinion that Lithuania is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (7) In June 2018, the government adopted a set of legislative acts to implement a comprehensive package of six structural reforms covering the key areas of education, health, taxation, informal economy, pensions and innovation.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 64.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (8) Lithuania has continued to take measures to combat the shadow economy and improve tax compliance. While these measures have shown encouraging results, overall tax compliance remains low. Lithuania still has one of the largest VAT gaps in the Union. Further increasing tax compliance would raise revenues and make the tax system more fair. No measures were taken to broaden the tax base to sources less detrimental to growth. Environmental and property taxes remain below the Union average and there are no changes envisaged to car taxation or the road-use tax for private passengers.
- (9) Since 2018, public pensions are automatically indexed to the wage bill growth. This is expected to reduce public pension expenditure from 6,9 % of GDP in 2016 to 5,2 % in 2070. However, due to the projected fall in employment, pension adequacy is set to decrease because pension benefits would not keep pace with wage growth. The pension benefit ratio — which expresses the average pension in terms of the average wage — is expected to steadily decline from what is already one of the lowest levels in the Union. Current legislation states that when the benefit ratio declines, the government needs to propose corrective measures. Due to uncertainty over the precise nature and timing of such future measures, they are not accounted for in the Ageing Report projections. They do, however, represent a risk to the sustainability of public finances. If the total benefit ratio were kept unchanged until 2070, pension expenditure would increase to 7 % of GDP instead of decreasing to 5,2 % as projected. There is, therefore, uncertainty about how pension legislation will be applied in practice and what its consequences would be for fiscal sustainability and pension adequacy over time.
- (10) 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 inclusive economic growth. Despite continued economic growth, many members of Lithuanian society (e.g. the elderly, people with disabilities, children, single-parent households and the unemployed) face a particularly high risk of poverty and social exclusion. While the social safety net has been improved in recent years, the overall corrective power of the Lithuanian tax and benefit system and social protection expenditure as a share of GDP remain among the lowest in the Union. Some first steps were taken to address the high level of poverty and income inequality, such as the introduction of the 'amount of minimum consumption needs', the increase in the universal child benefit and the indexation of old-age pensions. However, the persistently high levels of poverty and inequality show that the country still has a long way to go to converge towards the Union average levels of social security and that investment to address social exclusion is needed. Active inclusion strategies for vulnerable groups are more effective when they combine better adequacy of minimum income and pension schemes, labour market activation and enhanced provision of social services, including childcare and social housing.
- (11) The labour market has become tight as a result of employment growth, but also due to adverse demographic developments, including emigration. To mitigate the effect of the shrinking working-age population, investment in human capital and enhanced access to the labour market for all are needed. In the face of the persistent skills' shortages and mismatches, it is important that Lithuania speed up the reforms to improve the quality and efficiency at all education levels and ensure equitable access to quality and inclusive education and training. Demographic decline has put the school network under pressure. The demographic shift calls for strategies to preserve access to high-quality education for all while ensuring the efficiency of the school network and supporting teachers affected by school consolidation. Significant steps are still required to consolidate the higher education network, comprising more than 40 State-owned and private universities and colleges. Vocational education and training providers need to modernise the curricula as well as improve their responsiveness to the needs of local and regional labour markets. Effective and easily accessible adult learning, reskilling and upskilling measures, together with the provision of social services, could bring more people into the labour market. Participation in adult learning remains low, at 6,6 % in 2018, well below the Union average of 11,1 %. The Lithuanian economy has potential to benefit from investment in skills upgrading, including digital skills, innovation and better integration of the disadvantaged into the labour market (for example persons with disabilities, and older, unemployed or inactive adults). In a broader context, strengthening the capacity of the social partners is important to foster their engagement.
- (12) Weak health outcomes and low investment in healthcare are persisting challenges. There remains significant potential to rationalise the use of resources through a further shift from inpatient to outpatient care. The



consumption of hospital services continues to be high, with high rates of hospitalisations for chronic diseases coupled with relatively low bed occupancy rates. Further rationalisation of hospital resources use, together with targeted investments to strengthen primary care services, including in the healthcare workforce, are necessary to drive efficiency gains and improve health outcomes. The quality of care remains one of the main reasons for poor health outcomes. Measures to improve the quality of care are fragmented, with very low take-up of accreditation in the primary care sector and a lack of application of the accreditation system in hospitals. Investment in disease prevention measures is particularly low. Moreover, steps taken to strengthen disease prevention measures at local level lack an overarching vision and are impaired by a lack of systemic cooperation between public health offices and primary care. Lastly, low levels of health spending coupled with relatively high informal payments and high out-of-pocket payments have negative implications for equity of access to healthcare.

- (13) Some measures have been taken in the fight against corruption, but an integrated registry of interest declarations is still missing. Implementing legislation to the whistleblowers' protection law was adopted in 2018, and a new law regulating lobbying is under discussion. Irregularities persist in addressing corruption in the healthcare system.
- (14) Investment as a share of GDP in Lithuania remains below both the averages in the Union and in other Baltic countries. The level of innovation and the technology absorption capacity of businesses in Lithuania is low. Higher investment levels in research and innovation are needed, especially in the private sector. This would boost productivity, which, despite a recent pick-up, remains well below the Union level. The shortage of information and communication technology specialists points to the need to invest in digital skills which support competitiveness, innovation and Lithuania's capacity to absorb technology, and foster the shift toward more knowledge-based and higher value added economy.
- (15) The economy is relatively resource-intensive, with high dependency on imports of energy and materials. Resource productivity is low while energy consumption is high, especially in the residential and transport sectors. More investment in energy efficiency, in particular in the buildings sector and domestic energy generation from renewable sources would help to 'green' the economy and put it on a more sustainable growth path, while also reducing dependency on energy imports.
- (16) Lithuania still suffers from low international accessibility in terms of rail, road, maritime and air transport and needs to be integrated further with the rest of Europe. Better transport connectivity would increase the economy's productivity and allow it to take full advantage of the internal market. Transport sector performance is far below the Union average in terms of the extent of the TEN-T road and rail networks, research and innovation investment in the transport sector, sustainability aspects and road safety. Rail traffic is dominated by East-West flows, while the North-South axis remains underdeveloped. Significant investments are therefore needed to develop a sustainable, climate-resilient, smart, secure and intermodal TEN-T network and its accessibility, as well as to promote sustainable urban mobility. Moreover, greenhouse gas emissions from road transport have increased strongly over the last five years. The synchronisation of Lithuania's electricity system with the continental European network is key to ensuring the security of the electricity supply in the entire Baltic region.
- (17) Regional disparities in Lithuania are wider than the Union average and have been widening over the past two decades. The benefits of Lithuania's speedy economic convergence are heavily concentrated in the two metropolitan areas. Predominantly rural regions, which cover most of the territory and host nearly 55 % of the population, are experiencing strong population declines compounded by decreasing access to quality public services. Significant socioeconomic disparities within the country show that certain regions have distinct investment needs. Increasing links between adjacent territories within Lithuania, including transport and digital connections, also remains a challenge.

- (18) To improve the efficiency of public investment, the Lithuanian authorities updated the rules for preparing and selecting investment projects financed from the State budget. Since 2018 all new investment projects should be screened with a cost-benefit analysis and fulfil additional selection criteria. While this is an important first step, more is needed to maximise the impact of public investment on increasing the long-term growth potential and addressing growing regional disparities. The authorities have started the revision of the State budgeting system with the objective of lengthening the time horizon for budgeting and strengthening the link between expenditure and the overall economic goals. It is crucial to ensure that the new strategic investment planning system is ready for the 2021-2023 budgeting process and the start of the new Union funding cycle in 2021.
- (19) Lithuania has no single strategy for research and innovation. The landscape is characterised by fragmented policies and a proliferation of support schemes that lack synergies. The existence of several implementing agencies that do not take a concerted approach to supporting the research and innovation policy mix adds to a complex governance system that appears to restrict users' access to the panoply of available instruments. This state of affairs is particularly harmful for science-business cooperation and hampers innovative activity. The new division of responsibility for research and innovation policy between the Ministry of Economics and Innovation and the Ministry of Education and Science is not yet conducive to a coherent policy framework with synergetic support schemes, as would be available through a one-stop shop for potential beneficiaries.
- (20) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Lithuania to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (21) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Lithuania's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (22) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion <sup>(7)</sup> that Lithuania is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Lithuania take action in 2019 and 2020 to:

1. Improve tax compliance and broaden the tax base to sources less detrimental to growth. Address income inequality, poverty and social exclusion, including by improving the design of the tax and benefit system.
2. Improve quality and efficiency at all education and training levels, including adult learning. Increase the quality, affordability and efficiency of the healthcare system.

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<sup>(7)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

3. Focus investment-related economic policy on innovation, energy and resource efficiency, sustainable transport and energy interconnections, taking into account regional disparities. Stimulate productivity growth by improving the efficiency of public investment. Develop a coherent policy framework to support science-business cooperation and consolidate research and innovation implementing agencies.

Done at Brussels, 9 July 2019.

*For the Council*

*The President*

M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Luxembourg and delivering a Council opinion on the 2019 Stability Programme of Luxembourg**

(2019/C 301/16)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, focusing economic policy related to investment in the specified areas and tackling outbound payments will help address the second euro-area recommendation as regards supporting investment and aggressive tax planning, and measures to improve participation of the older people in the labour market will help address the third euro-area recommendation as regards ensuring an adequate and sustainable social protection system.
- (3) The 2019 country report for Luxembourg was published on 27 February 2019. It assessed Luxembourg's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Luxembourg's progress towards its national Europe 2020 targets.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 68.

- (4) On 30 April 2019, Luxembourg submitted its 2019 National Reform Programme and its 2019 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<sup>(5)</sup>, 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 2019 Stability Programme, the government plans a decrease in the headline surplus from 2,4 % of gross domestic product (GDP) in 2018 to 1,0 % of GDP in 2019, followed by an almost steady increase thereafter, reaching a surplus of 2,2 % of GDP in 2023. Based on the recalculated structural balance<sup>(6)</sup>, the medium-term budgetary objective – which has been changed from a structural deficit of 0,5 % of GDP in 2019 to a surplus, in structural terms, of 0,5 % of GDP as of 2020 – is overachieved throughout the programme period. According to the 2019 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 throughout the period covered by the 2019 Stability programme, except for 2023 when it is plausible. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 0,9 % of GDP in 2019 and 0,5 % of GDP in 2020, lower, in particular for 2020, than in the 2019 Stability Programme, but still above or in line with the medium-term budgetary objective. 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. Overall, the Council is of the opinion that Luxembourg is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (7) In spite of recent reforms, Luxembourg's age-related spending (pension-related, healthcare and long-term care costs) is expected to increase markedly in the long term. Assuming no policy changes are made to the current system, this could put at risk the sustainability of public finances in the long term. This is despite the current low level of public debt and the accumulated reserves of the social security system, which are expected to ensure the system's viability until 2041. Recommendations on this challenge have been addressed to Luxembourg since 2011 but limited progress has been made to date. In its 2018 report, the government's pensions working group discussed various ways to improve the long-term sustainability of the pensions system, including gradually increasing the contribution rate, raising the pensionable age to take account of longer life expectancy and encouraging phased retirement. The report suggests a multi-pronged strategy of calibrated reforms to guarantee the long-term sustainability of the system while minimising the impacts on both the economy and pensioners. Projected increases in age-related expenditure also threaten the long-term sustainability of the healthcare and long-term care systems. More than three quarters of long-term care expenditure comes from public sources. The long-term care insurance system should remain financially stable until 2030 if the contribution rate is gradually raised from 1,4 % to 1,7 %, according to an analysis carried out in 2013 by the General Inspectorate of Social Security, in order to keep costs in line with the proportion of dependent people. However, the impacts in terms of long-term fiscal sustainability are not yet clear. To sustain social cohesion and public finances in the long term, demographic policies would need to concur with education and training policies, taking a holistic approach to considering both the challenges and opportunities of changes in demography as well as in the digital economy, given the expected impact of population ageing on labour supply in the near future. Labour shortages have recently emerged in certain sectors, which could hinder productivity growth and reduce the long-term growth potential.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (8) Despite an overall good labour market performance, the employment rate is stagnating and specific groups still face particular difficulties on the labour market. In particular, the employment rate of older people remains particularly low, and further measures are needed to improve their participation in the labour market. Early retirement schemes encouraging workers to leave employment remain widespread, with 57,5 % of newly attributed pensions being early old-age pensions in 2017. In 2018, the government abrogated one of the pre-retirement schemes allowing people to retire from the age of 57, but the effect of this reform was weakened by relieving restrictions on other pre-retirement schemes. Low old-age activity rates also largely result from financial disincentives to work stemming from the tax-benefit system which are comparatively high for this age group. Encouraging the employment of older workers requires a comprehensive strategy including measures to help them 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.
- (9) While Luxembourg remains committed to improving the regulatory environment for the business services sector, regulatory barriers are still high in several sectors, such as legal, accounting, architecture and engineering services, according to the Commission's restrictiveness indicator (7). The OECD's Intra-EEA Services Trade Restrictiveness Index published in December 2018 also confirmed that Luxembourg's level of regulatory restrictiveness vis-à-vis other Member States is higher than the Single Market average for these sectors.
- (10) Luxembourg's economic model features strong performances consistent with robust and sustained creation of qualified employment. This is supported by high productivity levels, largely reflecting efficiency gains from participation in global markets, in particular in the financial sector. However, productivity growth has stagnated in recent years, hampered by low levels of business investment in innovation and digital integration. Luxembourg's strategy to diversify its economy, by developing key knowledge-intensive sectors in a transition to a data-driven economy, exhibits strong potential to stimulate high value-added investment and boost productivity growth. In that context, public investment remains high and focused on those sectors, including a strong Information and Communication Technology sector. However, this has not helped to stimulate private investment in innovation and digitalisation. Increased investment in research and innovation, as well as in digital integration, especially in firms and specifically in small and medium-sized enterprises, is important for improving productivity growth and further diversifying Luxembourg's economy. Developing a coherent and integrated national framework for research and innovation policies and support instruments, including prioritisation based on robust assessment of expected economic impacts, is essential to enabling Luxembourg to exploit the full potential of its innovation eco-system.
- (11) Increased investment in skills, in particular information and communication technology skills, employability, education and training, including a better alignment of education curricula to labour market needs and fostering technological and digital transformations, is important for improving Luxembourg's productivity, employment and long-term growth potential, and for fostering equal opportunities.
- (12) Air pollution and traffic congestion at peak times still constitute major problems for Luxembourg, from both a competitiveness and environmental point of view. In addition, the CO<sub>2</sub> emissions from road transport contribute to climate change. According to the 2017 national projections submitted to the Commission, it is expected that in the absence of additional measures, Luxembourg will miss its 2020 greenhouse gas emission reduction target by 3 percentage points and its 2030 target by 20 percentage points. The number of cross-border workers, who currently represent about 45 % of Luxembourg's labour force, the low taxation of transport fuel and high house prices stimulate increased car use and are an obstacle to improving air quality and traffic conditions. Meanwhile, the use of alternative fuels in new passenger cars sold in Luxembourg has increased over the past few years.

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(7) SWD(2016) 436 final

- (13) Insufficient housing supply may negatively affect Luxembourg's attractiveness. Its strong housing demand remains driven by population growth, favourable financing conditions and a large cross-border workforce. Housing supply and investment appear insufficient, constrained by insufficient land availability and low housing density, largely due to a lack of incentives for landowners to build new housing or to sell. The supply of social housing also appears insufficient and points to a need for significant investment to alleviate rising tensions in the housing market. In that regard, policy measures set out in the governmental programme for 2018-2023 aim at increasing housing supply. These include changes to urban planning laws to increase building areas and develop affordable and social housing.
- (14) The fight against aggressive tax planning is essential to make tax systems more efficient and fair as acknowledged in the 2019 Recommendation for the euro area. Spillover effects of taxpayers' aggressive tax planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Luxembourg has taken measures against aggressive tax planning, but the high level of dividend, interest and royalty payments as a percentage of GDP indicates that the country's tax rules may be 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 specific circumstances may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction.
- (15) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Luxembourg to make the best use of those funds in respect of the identified sectors.
- (16) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Luxembourg's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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 2019 Stability Programme and is of the opinion <sup>(8)</sup> that Luxembourg is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Luxembourg take action in 2019 and 2020 to:

1. Increase the employment rate of older workers by enhancing their employment opportunities and employability. Improve the long-term sustainability of the pension system, including by further limiting early retirement.
2. Reduce barriers to competition in regulated professional business services.
3. Focus economic policy related to investment on fostering digitalisation and innovation, stimulating skills development, improving sustainable transport, and increasing housing supply, including by increasing incentives and lifting barriers to build.
4. Address features of the tax system that may facilitate aggressive tax planning, in particular by means of outbound payments.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Hungary and delivering a Council opinion on the 2019 Convergence Programme of Hungary**

(2019/C 301/17)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 2019 country report for Hungary was published on 27 February 2019. It assessed Hungary's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Hungary's progress towards its national Europe 2020 targets

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 72.



- (3) On 30 April 2019, Hungary submitted its 2019 National Reform Programme and its 2019 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 2014-2020. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council<sup>(4)</sup>, 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) Hungary is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Convergence Programme, the government plans an improvement of the headline deficit to 1,8 % of gross domestic product (GDP) in 2019 from 2,2 % in 2018. The deficit is planned to continue gradually improving thereafter to 1,2 % in 2021 and to reach a balanced budgetary position in 2023. Based on the recalculated structural balance<sup>(5)</sup>, Hungary would be close to its medium-term budgetary objective — which has been changed from a structural deficit of 1,5 % of GDP in 2019 to 1,0 % of GDP as of 2020 — in 2022 and would achieve it in the following year. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to decline gradually to below 60 % by the end of 2022. The macroeconomic scenario underpinning those budgetary projections is plausible for 2019 and markedly favourable from 2020, which poses risks to the implementation of the deficit targets. At the same time, the measures needed to support the planned deficit targets from 2020 onwards have not been sufficiently specified.
- (6) On 22 June 2018, the Council found in accordance with Article 121(4) of the Treaty on the Functioning of the European Union that a significant observed deviation from the adjustment path towards the medium-term budgetary objective occurred in Hungary in 2017. In view of the established significant deviation, on 22 June 2018 the Council issued a Recommendation<sup>(6)</sup>, recommending that Hungary take the necessary measures to ensure that the nominal growth rate of net primary government expenditure<sup>(7)</sup> did not exceed 2,8 % in 2018, corresponding to an annual structural adjustment of 1,0 % of GDP. On 4 December 2018, the Council adopted Decision (EU) 2018/2028<sup>(8)</sup>, establishing that Hungary had not taken effective action in response to its Recommendation of 22 June 2018, and issued a revised Recommendation<sup>(9)</sup>. In the Recommendation of 4 December 2018, the Council asked Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3,3 % in 2019, corresponding to an annual structural adjustment of 1,0 % of GDP. On 14 June 2019, the Council adopted Decision (EU) 2019/1003<sup>(10)</sup>, establishing that Hungary had not taken effective action in response to the Council Recommendation of 4 December 2018. Moreover, based on 2018 outturn data, Hungary was found to be in significant deviation from the recommended adjustment in 2018.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(6)</sup> 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).

<sup>(7)</sup> 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.

<sup>(8)</sup> Council Decision (EU) 2018/2028 of 4 December 2018 establishing that no effective action has been taken by Hungary in response to the Council Recommendation of 22 June 2018 (OJ L 325, 20.12.2018, p. 29).

<sup>(9)</sup> Council Recommendation of 4 December 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Hungary (OJ C 460, 21.12.2018, p. 4).

<sup>(10)</sup> Council Decision (EU) 2019/1003 of 14 June 2019 establishing that no effective action has been taken by Hungary in response to the Council Recommendation of 4 December 2018 (OJ L 163, 20.6.2019, p. 64).

- (7) In line with Article 121(4) of the Treaty and Article 10(2) of Regulation (EC) No 1466/97, the Commission issued a warning to Hungary on 5 June 2019 that a significant deviation from the adjustment path towards the medium-term budgetary objective was observed in 2018. On 14 June 2019, the Council adopted a subsequent Recommendation<sup>(11)</sup> 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 3,3 % in 2019, corresponding to an annual structural adjustment of 1,0 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a deviation from that Recommendation in 2019.
- (8) In its Recommendation of 14 June 2019, the Council recommended Hungary to take the measures necessary to ensure that the nominal growth rate of net primary government expenditure does not exceed 4,7 % in 2020, corresponding to an annual structural adjustment of 0,75 % of GDP. This would put Hungary on an appropriate adjustment path towards the medium-term budgetary objective. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a deviation from that requirement in 2020. Overall, the Council is of the opinion that significant further measures will be needed as of 2019 to comply with the provisions of the Stability and Growth Pact, in line with the Council Recommendation of 14 June 2019, with a view to correcting the significant observed deviation from the adjustment path towards the medium-term budgetary objective.
- (9) The overall employment rate has improved significantly amid strong economic expansion but has not benefited all groups equally. The gaps in employment and wages between skills groups and men and women remain wide in comparison with the Union average. The gender employment gap is wide partly due to the limited supply of good quality childcare. Labour market outcomes for various vulnerable groups, including Roma and people with disabilities, are weak. Despite its reduction, the Public Works Scheme, which is not effective in leading participants to the jobs in the primary labour market, remains sizeable. Other policies to help unemployed or inactive people find work or training are insufficiently targeted. Developing digital skills could help improve employability. Recent measures are designed to get more retired workers back into jobs and to increase their number over time. Hungary's overall poverty situation has been improving since 2013. The duration of unemployment benefits is the shortest in the Union, at a maximum of three months, which is well below the average amount of time needed to find a job.
- (10) The share of people at risk of poverty and social exclusion is falling. There has been a clear shift from social benefits towards work-related family support and in-kind benefits, which are however not sufficiently targeted to the poor. While home-ownership subsidies have expanded, there has been no improvement in the supply of social housing.
- (11) Education outcomes are below the Union average and show wide territorial disparities. Early school leaving is higher and the tertiary education attainment rate lower than the Union average. The education system hinders social mobility. Pupils are streamed early into different types of schools, with wide gaps in education outcomes and employment paths. The proportion of primary schools with majority Roma participation increased from 10 % in 2008 to 15 % in 2017. The impact of recent measures targeting the even distribution of disadvantaged pupils across schools is limited by the exemption of non-state schools from the requirement to take disadvantaged pupils. Disadvantaged children tend to be concentrated in vocational secondary schools where poorer levels of basic skills, higher dropout rates and lower pay and career prospects are more prevalent. The low participation of disadvantaged groups, in particular Roma, in quality education is a missed opportunity to build up human capital. The shortage of teachers also remains a challenge. Teachers' salaries have risen in recent years but are still relatively low, compared to other tertiary education graduates. The low number of students participating in higher education is not in line with the strong demand for highly skilled workers and the wage premium of tertiary graduates, which is the highest in the Union. Hungarian higher education institutions have the lowest financial autonomy in the Union. In addition, the April 2017 amendment of the Higher Education Act, which set additional requirements for international universities to operate in Hungary, raised further concerns over academic freedom. In 2018, the internationally highest ranked Hungarian university signalled its intention to leave the country because of the regulatory uncertainty created by this amendment.

<sup>(11)</sup> Council Recommendation of 14 June 2019 with a view to correcting the significant observed deviation from the adjustment path towards the medium-term budgetary objective in Hungary (OJ C 210, 21.6.2019, p. 4).

- (12) Health outcomes lag behind most other Member States, reflecting both unhealthy lifestyles and the limited effectiveness of healthcare provision. The prevalence of smoking, alcohol use disorder and obesity is one of the highest in the Union. Hungarians are among the most likely in the Union to suffer premature death due to bad air quality. The number of avoidable deaths is one of the highest in the Union, partly due to inadequate screening and primary care management. There are significant socioeconomic disparities in access to quality care. Public spending on healthcare is below the Union average, and citizens rely on out-of-pocket payments to access quality care, which risks further widening the socioeconomic health divide. The system remains strongly hospital-centred, with weaknesses in primary care, in particular early detection and prevention of chronic diseases. A sizeable shortage of healthcare staff, in particular general practitioners and nurses, thwarts access to care in poorer areas.
- (13) Increasing research and innovation capacities could improve Hungary's modest innovation performance and increase productivity. The low level of intellectual asset accumulation is reflected in the low number of patent, trademark and design applications, the small number of innovative businesses and the low level of internationalisation by small and medium-sized enterprises. Smaller firms are especially reluctant to innovate, hindering their involvement in global value chains. Business R & D is concentrated in a few large, mainly foreign-owned companies and benefits from generous government support. Supporting science-business cooperation would contribute to better innovation performance and technology transfer. The quality of public science is suffering from inefficient R & D policies and underfunding as public sector R & D expenditure is well below the Union average. Recent policy measures aiming to cut the funding and limiting the independence of academic and research fora are creating uncertainty in those fora, which may result in the emigration of top research talent and risk a persistent decline in research quality.
- (14) Weak local public transport connectivity and high commuting costs are contributing to unemployment in disadvantaged areas. The poor condition of the road and rail networks hampers mobility and reduces travel safety, with more than half of the road network in bad condition, especially in disadvantaged regions. Transport networks are centred on Budapest, while local networks and transversal connections through the country are not well developed. Road congestion is a growing challenge and a barrier to productivity in Hungary's urban areas. Moreover, greenhouse gas emissions from road transport have increased strongly in the last 5 years.
- (15) Energy efficiency in the residential sector remains weak. The electricity network needs to be prepared for the growing role of decentralised renewable electricity generation. Half of Hungary's territory is significantly exposed to climate change risks including drought and floods, which create the need for investment in water management on the main rivers. Air pollution and water quality remain a concern. The main sources of pollution are residential solid fuel combustion, agriculture and transport emissions. The circular economy is still in an initial phase, recycling of municipal waste is underdeveloped and economic instruments are insufficient to address Hungarian environmental challenges.
- (16) Concerns remain over the prevention and prosecution of corruption. Several indicators suggest that Hungary's exposure to corruption has increased in recent years. Corruption risks and favouritism distort the allocation of resources as these are not channelled to the most productive firms. The functioning of the prosecution service is of crucial importance to fighting corruption. While measures to fight low-level corruption appear to have been applied with some success, there are still no signs of determined action to prosecute corruption involving high-level officials or their immediate circle when serious allegations arise. Accountability for decisions to close investigations is a matter of concern, as there are no effective remedies to contest such decisions. The prevention of corruption is further hindered by public institutions applying restrictions, including dissuasive fees for access to information.

- (17) The independence, efficiency and quality of the justice system are crucial to attracting business and enabling economic growth. Checks and balances, which are crucial to ensuring judicial independence, are seen to be under further pressure within the ordinary courts system. The National Judicial Council faces increasing challenges in counter-balancing the powers of the President of the National Office for the Judiciary. Questions have been raised regarding the consequences of this for judicial independence. With regard to the Administrative Courts Law, it is noted that the government tabled a bill withdrawing the Act on the entry into force and transitional rules for the administrative courts on 30 May 2019.
- (18) The public procurement framework has improved in recent years but obstacles to competition remain. These include the use of procedures with limited publicity and systemic irregularities in the tendering processes, in particular related to inadequate selection and award criteria and unequal treatment of tenderers. While some indicators show improvements, the number of procedures with a single bidder are still high. The effective use of e-procurement could further increase efficiency and transparency.
- (19) Hungary's social dialogue structures and processes remain underdeveloped and do not allow for meaningful involvement of the social partners in policy design and implementation. The deficiencies in stakeholder engagement and limited transparency undermine the evidence base for, and the quality of, policymaking. This results in frequent and unpredictable changes in regulations and discourages high-value-added investments.
- (20) Measures have been taken to further improve the tax system but some challenges remain. The tax burden on labour has decreased but remains high for low-income earners. Sector-specific taxes and a large number of small taxes complicate the tax system and raise compliance costs, in particular for smaller firms.
- (21) Regulatory barriers and State involvement in product markets hinder the selection of efficient enterprises and limit competition. The authorities continue to entrust certain services to State-owned firms or private firms specifically created for these purposes. Certain tailor-made legislation and measures and ad hoc exemptions from competition scrutiny hinder the functioning of the market and hamper investment. The unpredictability of the legal framework is a further problem, especially in the retail sector, which in recent years has faced frequent changes to regulations. Legislation imposing an additional special authorisation for modifications to the use or design of retail premises has been introduced in the past year. Regulation of professions also remains restrictive. The lack of competition in these sectors may become detrimental to innovation and efficiency.
- (22) The fight against aggressive tax planning is essential in making tax systems more efficient and fairer. Spillover effects of taxpayers' aggressive tax-planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Hungary has taken measures against aggressive tax planning, but records relatively high capital inflows and outflows through special-purpose entities, which have no or little effect on 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.
- (23) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Hungary to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

- (24) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Hungary's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 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 their compliance 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 2019 Convergence Programme and its opinion <sup>(12)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Hungary take action in 2019 and 2020 to:

1. Ensure compliance with the Council Recommendation of 14 June 2019 with a view to correcting the significant deviation from the adjustment path towards the medium-term budgetary objective.
2. Continue the labour market integration of the most vulnerable groups, in particular through upskilling, and improve the adequacy of social assistance and unemployment benefits. Improve education outcomes and increase the participation of disadvantaged groups, in particular Roma in quality mainstream education. Improve health outcomes by supporting preventive health measures and strengthening primary healthcare.
3. Focus investment-related economic policy on research and innovation, low-carbon energy, transport infrastructure, and waste management and energy and resource efficiency, taking into account regional disparities. Improve competition in public procurement.
4. Reinforce the anti-corruption framework, including by improving prosecutorial efforts and access to public information, and strengthen judicial independence. Improve the quality and transparency of the decision-making process through effective social dialogue and engagement with other stakeholders and through regular, appropriate impact assessments. Continue simplifying the tax system, while strengthening it against the risk of aggressive tax planning. Improve competition and regulatory predictability in the services sector.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(12)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Malta and delivering a Council opinion on the 2019 Stability Programme of Malta**

(2019/C 301/18)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (2) and (3) below. In particular, focusing economic policy related to investment on the specified areas and tax measures will help address the second euro-area recommendation as regards supporting investment and combating aggressive tax planning.
- (3) The 2019 country report for Malta was published on 27 February 2019. It assessed Malta's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Malta's progress towards its national Europe 2020 targets.
- (4) Malta submitted its 2019 National Reform Programme on 16 April 2019 and its 2019 Stability Programme on 30 April 2019. 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 <sup>(5)</sup>, 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) Malta is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans a decrease in the headline surplus from 2 % of gross domestic product (GDP) in 2018 to 0,9 % of GDP in 2019, followed by a marginal increase to 1,0 % of GDP in 2020 and further to 1,1 % of GDP in 2021 and 2022. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective — a balanced budget in structural terms — continues to be overachieved 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 46 % of GDP in 2018 to around 33 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 0,6 % of GDP in 2019 and 0,8 % of GDP in 2020, 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 2019 and 2020. 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.
- (7) The increase in age-related spending represents a risk to the long-term sustainability of public finances. Age-related public spending in the pension and healthcare systems is expected to increase significantly compared to other Member States, indicating a risk of rising debt in the long term. Several measures aim to increase the adequacy of pensions also through strengthening incentives for private pension savings and voluntary occupational retirement pensions. Ongoing efforts have helped to increase the supply of labour and prolong working lives, with a positive impact on employment rates for women and older workers. In 2018, the government made adjustments to include contributions made after pensionable age and allowed self-employed and part-time working pensioners under 65 years to pay contributions proportionate to their earnings, thereby promoting longer working lives. However, the statutory retirement age, gradually increasing from its current level at 63 years, is set to remain unchanged

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 76.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

after 2027 at 65 years despite a projected further growth in life expectancy. The Pension Strategy Group established in 2018 is expected to publish a report by December 2020, outlining recommendations for improving the adequacy and sustainability of the pension system. With regard to healthcare, measures to decentralise services from hospitals to primary care and to improve the provision of long-term care services are ongoing. Current plans to expand the capacity of public-hospital outpatient care can help in tackling long waiting times for certain specialties. Nevertheless, other measures to reduce unnecessary referrals to specialists and redirect inappropriate use of emergency care to outpatient care have so far not been fully utilised, thereby preventing improvements in the efficiency of the system from being made. A new concept for primary-care centres and investments to gradually expand the use of e-health are carried out with a view to decentralising services from hospitals to primary-care level. Reflecting increasing demand for long-term care, new types of community-based and home care services were introduced in 2017-2018. Despite their potential, the impact of the measures in the area of pensions and healthcare on fiscal sustainability has yet to materialise.

- (8) In the last decade, Malta experienced a pronounced shift towards the services sector, with a strong focus on internationally oriented areas such as financial services, tourism and remote gaming. The expansion of the services sector contributed to fuel economic growth and to develop a large surplus in the current account. At the same time, the increasing reliance on sectors that are considered vulnerable to financial integrity risks creates challenges to the governance framework, putting pressure on the supervisory and enforcement capacity. In particular, the size of the financial and the gaming sector, the efforts to attract crypto-currency operators require an effective anti-money-laundering enforcement. The recent increase in the human and budgetary resources of the Financial Intelligence Analysis Unit as well as the enhancement of its procedures and processes are positive steps. Governance shortcomings, particularly in the fight against corruption, may also adversely affect the business environment and weigh negatively on investment. In particular, there is a risk of conflict of interest at various levels of government. Furthermore, the police's Economic Crimes Unit is currently understaffed. In this context, it is important to couple a strengthened legislative framework with timely and thorough implementation. Improving the governance framework and ensuring effective implementation is a key element in preserving Malta's attractiveness and protecting the economy from reputational risks.
- (9) The insurance sector is exposed to risks of passive supervision, where cooperation between domestic and external supervisors is essential. In contrast to the banking sector, the supervision of subsidiaries in the insurance sector are subject to home supervision, i.e. insurance companies registered in Malta and writing business in other countries are under the direct supervision of the Maltese regulator. However, the supervisory capacity has not been sufficiently strengthened yet. In addition, the complexity of insurance business models and products, coupled with the increased appetite for establishing and expanding specialised insurance vehicles, calls for stringent supervision.
- (10) Reforms aimed at continuing to improve the independence of the judiciary and the justice system are ongoing. This includes, in particular, the establishment of a new prosecution service, independent from the Attorney General and the police, as also recommended by the Council of Europe's Commission for Democracy through Law (the Venice Commission) in an opinion on Malta adopted in December 2018. Moreover, a strengthened governance framework, including effective judicial and anti-corruption enforcement, is a prerequisite to obtaining the full benefits of investment.
- (11) The proportion of innovative enterprises is still lagging behind. Research and innovation performance need to be strengthened by smart specialisation so that this may contribute to growth in productivity. Malta has not yet formulated a coherent, comprehensive and long-term competitiveness strategy for moving the domestic economy up the value chain. Given Malta's specialisation in fast-growing services and its aspirations for block-chain technology, it is critical to invest even more in administrative and supervisory capacity. In addition, increasing Malta's innovation performance will require further investments in intangible assets, including research and development (R & D), addressing skills deficits and gaps and facilitating science-business links, all within more effective governance of the research and innovation system.



- (12) Malta needs to promote the shift towards a more sustainable and resource-efficient economy, for example by investing in the untapped potential for energy efficiency and renewables, the water-management cycle, waste management, tackling the growing emissions from air conditioning, climate action and sustainable mobility, which will contain emissions from road transport. Due to limited transport and commuting alternatives to driving as well as high car penetration, road congestion is one of the weakest aspects of Malta's business environment and remains a major challenge. Moreover, greenhouse gas emissions from road transport have increased over the last 5 years. The share of renewables in the energy mix has increased to 7,2 % in 2017, slightly above the 2017/2018 indicative trajectory level of 6,5 %. However, Malta's final energy consumption is continuously increasing. Further investments across sectors are needed in the short term in order to meet the 2020 national renewable energy and energy efficiency targets. R & D funding or support measures should be implemented to develop new/improved technologies addressing environment and climate change. The environmental and social costs of the housing boom require closer monitoring. Circular economy principles should be applied to the disposal of construction waste to limit its environmental impact. The economic and social consequences of the increase in the cost of housing require attention.
- (13) The employment rate in Malta, now above Union average, is still increasing. A special emphasis in this regard could benefit people with disabilities. The gender employment gap remains the largest in the Union and women's participation in the labour market declines after 40 years of age, largely due to caring responsibilities. More labour market support for unemployed informal carers could address this gap. The increasing reliance on foreign labour to address the labour and skills shortages creates social and sustainability challenges. Policy initiatives in the areas of the labour market, skills and social inclusion could benefit from better monitoring and evaluation.
- (14) Malta invests relatively high amounts in education and training; and, while overall participation and attainment have increased, this is not yet reflected in better outcomes for all. The investment strategy would benefit from further focus on correcting social disadvantage, to be in line with the European Pillar of Social Rights principle on quality and inclusive education. Measures taken over the last decade have led to a reduction in early school leaving, but the rate is still one of the highest in the Union. Recent measures also seek to improve the inclusiveness of tertiary education, but attainment at this level remains below the Union average and results in skills challenges. Participation in adult learning is increasing but is still low for the low-skilled and the inactive.
- (15) The fight against aggressive tax planning is essential in making tax systems more efficient and fairer, as acknowledged in the 2019 Recommendation for the euro area. Spillover effects of taxpayers' aggressive tax-planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. Malta has taken measures against aggressive tax planning, but the high level of royalty and dividend payments as a percentage of GDP indicates that Malta's tax rules may be 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) 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 Notional Interest Deduction regime will help to reduce the debt equity bias, the scheme's anti-abuse rules, combined with a generous rate and a stock-based regime, warrant close monitoring to prevent any misuse for aggressive tax planning. Although the Malta Individual Investor Programme and the Malta Residence and Visa Programme do not automatically grant residence for tax purposes, income may, if certain requirements are met, be exempt under the 'non-dom' regime without substantial physical presence requirements, provided that income is not remitted to Malta. They may facilitate aggressive tax-planning practices and have been listed by the OECD as having a potentially high risk for being misused to circumvent the automatic exchange of financial accounts.
- (16) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Malta to make the best use of those funds in respect of the identified sectors.

- (17) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Malta's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Malta in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Malta, but also their compliance 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 2019 Stability Programme and is of the opinion (7) that Malta is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Malta take action in 2019 and 2020 to:

1. Ensure the fiscal sustainability of the healthcare and pension systems, including by restricting early retirement and adjusting the statutory retirement age in view of expected gains in life expectancy.
2. Address features of the tax system that may facilitate aggressive tax planning by individuals and multinationals, in particular by means of outbound payments. Strengthen the overall governance framework, including by continuing efforts to detect and prosecute corruption. Continue the ongoing progress made on strengthening the anti-money-laundering framework, in particular with regard to enforcements. Strengthen the independence of the judiciary, in particular the safeguards for judicial appointments and dismissals, and establish a separate prosecution service.
3. Focus investment-related economic policy on research and innovation, natural resources management, resource and energy efficiency, sustainable transport, reducing traffic congestion and inclusive education and training.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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(7) Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of the Netherlands and delivering a Council opinion on the 2019 Stability Programme of the Netherlands**

(2019/C 301/19)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) and (3) below. In particular, investment measures and measures supporting wage growth will help address the first euro-area recommendation as regards euro area rebalancing, tax measures will help address the second euro-area recommendation as regards fight against aggressive tax planning, and reducing the debt bias for households will help address the fourth euro-area recommendation as regards reducing the debt bias in taxation.
- (3) The 2019 country report for the Netherlands was published on 27 February 2019. It assessed the Netherlands' progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 27 February 2019. The Commission's analysis led it to conclude that the Netherlands is experiencing macroeconomic imbalances. In particular, the high stock of private debt and the large current account surplus constitute sources of imbalances, with cross-border relevance. Supported by economic growth, the private debt-to-GDP ratio has continued its downward trend both for corporate and households debts, although it is still high. Nevertheless, nominal household debt is slowly increasing on the back of rising house prices.
- (4) On 29 April 2019, the Netherlands submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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 Netherlands is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans a decrease in the general government surplus from 1,5 % of gross domestic product (GDP) in 2018 to 0,0 % of GDP in 2022. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective — a structural deficit of 0,5 % of GDP — continues to be overachieved throughout the programme period. According to the 2019 Stability Programme, the government debt-to-GDP ratio is projected to fall from 52,4 % of GDP in 2018 to 44,6 % of GDP in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2019 spring forecast, the structural balance is projected to decline from a surplus of 0,8 % of GDP in 2018 to 0,7 % of GDP in 2019 and 0,2 % of GDP in 2020, 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 the Netherlands is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020. At the same time, while respecting the medium-term budgetary objective, it would be important to use fiscal and structural policies to support an upward trend in investment.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 80.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

- (7) With respect to fiscal sustainability, the projected increase in public expenditure on long-term care points to medium risks in long-term sustainability. In 2015, the government moved a large part of the long-term care system to the municipal domain to improve its efficiency and lower public expenditures. The impact of this reform on fiscal sustainability needs to be monitored.
- (8) As of November 2018, the funds of the Deposit Guarantee Fund, an independent legal entity, have been moved from a segregated account in the Dutch central bank to an account with the Treasury. The Dutch Deposit Guarantee Fund was being built up gradually and had so far accumulated around EUR 1 billion, with an additional EUR 4 billion to be paid by banks by 2024, which should have been invested in a diversified portfolio of low-risk assets in line with Directive 2014/49/EU of 16 April 2014 of the European Parliament and of the Council (7) (the Deposit Guarantee Scheme Directive). The transfer of the account of the fund reduces the gross debt level, but has no effect on the public deficit. Following this transfer, the Treasury will be able to use the funds for the financing of government expenditures, but will have to make the funds available in case there is a need to make pay-outs to depositors or finance interventions in accordance with its legal mandate, which may have an impact on financial stability.
- (9) Dutch households combine large illiquid assets in housing and pensions with high household debt. Long balance sheets make households vulnerable to financial and economic shocks. High household debt is explained by generous tax relief on mortgage interest payments, but also by a lack of a well-functioning middle segment on the rental market and high compulsory pension savings. 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 addresses this. The announced acceleration of the reduction in mortgage interest tax deductibility has been put into law and will start in 2020. Despite this, the tax relief on mortgage payments remains generous and continues to result in a substantial debt bias for households. At the same time, the private rental market, as the only non-subsidised segment, remains underdeveloped accounting for 13 % of total dwellings. 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.
- (10) While the pension system performs well on pension adequacy and fiscal sustainability, it has drawbacks in terms of intergenerational fairness, transparency of pension rights and flexibility. Moreover, occupational pension contributions are high and fluctuate depending on how pension funds perform. As such it may affect household spending in a pro-cyclical way. A reform of the pension system could, over the life cycle, lead to lower compulsory pension contributions and more stable consumption (or 'consumption smoothing'). The government has the intention to substantially reform the second pension pillar in order to improve coverage and create a more transparent, more flexible and actuarially fairer system. A simultaneous reform of housing market institutions and the pension system has the potential to shorten household balance sheets, and make the household sector less vulnerable to financial and economic shocks with beneficial effects for macroeconomic resilience and economic growth.
- (11) Despite low unemployment, high job vacancy rates and growing shortage of workers, nominal wage growth has remained moderate so far (1,1 % in 2017 and 2,4 % in 2018). Wages in collective agreements increased on average by 2,1 % in 2018, while public wages increased at a faster rate (by 3 % in the second half of 2018). Furthermore, wage agreements were reached leading to a nominal increase of 7 % in two years for all civil servants in central government. Additional funding has been provided to increase the salaries of primary school teachers. In addition, the government adopted several fiscal measures which reduce the tax burden on labour and aim to increase the net disposable household income of those who work. Further boosting disposable household income by strengthening the conditions that support 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 help to rebalance the euro area.

(7) Directive 2014/49/EU of 16 April 2014 of the European Parliament and of the Council on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).

- (12) The fight against aggressive tax planning is essential to make tax systems more efficient and fair as acknowledged in the 2019 Recommendation for the euro area. Spillover effects of taxpayers' aggressive tax-planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. The Netherlands has taken measures against aggressive tax planning, but 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 announcement of the reform agenda on taxation, including withholding taxes on royalty, and interest payments in case of abuse or payments to low-tax jurisdictions, is a positive step to decrease aggressive tax planning and should be monitored closely.
- (13) Growth in employment in recent years has mainly been due to temporary employment and self-employment, although job growth for employees with permanent contracts has recently outpaced job growth for temporary employment. Nevertheless, the share of flexible employment remains high and represents a substantial share of the labour market. The high percentage of temporary contracts and the rapid increase in self-employment without employees is observed in the context of great differences in applicable labour regulations, labour protection, and in the differences in tax and social security legislation. A package of measures has been adopted (Law on labour market in balance, '*Wet Arbeidsmarkt in Balans*') to make it easier to hire permanent employees and make flexible contracts less flexible. The implementation of these measures (which should enter into force in 2020) should be closely monitored. Moreover, measures have been announced to ease the obligation of employers to continue to pay salaries for two years in case of illness. However, no other concrete measures have been adopted so far. Therefore, some of these institutional factors still create financial incentives for employees to start working as self-employed or favour of the use the status of self-employed without employees. The self-employed are more often under-insured against disability, unemployment and old age, which could affect the sustainability of the social security system in the long run. In addition, the enforcement of measures to tackle bogus self-employment has been suspended until 2020.
- (14) Despite a labour market that is performing well overall, fostering equal opportunities regarding employment and active inclusion remains an important challenge, in particular for people with a migrant background, for those operating at the margins of the labour market and for those who are economically inactive. In addition, there is still untapped labour potential, in particular among the high number of part-time working women.
- (15) Technical and digital skills and qualified professionals are crucial for the Dutch economy's capacity to innovate and for productivity growth. This points to the need to invest more in training, including training in digital skills, and to promote flexible upskilling and reskilling opportunities. Improving society's capacity to innovate also requires investments to support education in science, technology, engineering and mathematics. Moreover, increased investment in skills, education and training is crucial to improving access to the labour market and the employability of those at the margins of the labour market, while fostering equal opportunities and active inclusion.
- (16) While the research and development investment intensity for the Netherlands rose to over 2 %, it is still well below the 2,5 % national target and the level of top performers. In terms of productivity, the Netherlands is one of the best performing countries in many sectors. Continued productivity growth is therefore highly dependent on innovation. Additional investment in research and development, and innovation, especially in the private sector, would support this.
- (17) The energy transition and the reduction of greenhouse gas emissions require substantial investments to ensure a more sustainable and resource efficient economic development. The Netherlands is likely to overachieve its 2020 targets in the field of greenhouse gas reductions, while reaching the 2030 targets will require additional measures. The 2020 primary energy efficiency and renewable energy targets will not be reached without additional measures. The Dutch target for renewable energy by 2023 as defined by the Dutch Energy Agreement target should be within reach thanks to investments in off-shore wind farms. By the end of 2019, the government aims at adopting a National Energy and Climate Plan which will provide an overview of its investment needs until 2030 for the different dimensions of the Energy Union, including renewable energy, energy efficiency, security of supply, and climate mitigation and adaptation.

- (18) Congestion remains a challenge in the Netherlands, which is a dense and well equipped country and a key player in Union logistics with the biggest Union port in Rotterdam and one of the biggest airports in Schiphol. The issue has been alleviated with additional infrastructure works but it still remains an issue with high social costs and hours wasted stuck in traffic.
- (19) The programming of Union funds for the period 2021-2027 could help address some of the needs identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow the Netherlands to make the best use of those funds in respect of the identified sectors.
- (20) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of the Netherlands's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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 2019 Stability Programme and is of the opinion <sup>(8)</sup> that the Netherlands is expected to comply with the Stability and Growth Pact.
- (22) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (3) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first and fourth euro-area recommendations. Fiscal policies referred to in recommendation (3) contribute inter-alia to addressing imbalances linked to the current account surplus,

HEREBY RECOMMENDS that the Netherlands take action in 2019 and 2020 to:

1. Reduce the debt bias for households and the distortions in the housing market, including by supporting the development of the private rental sector. Ensure that the second pillar of the pension system is more transparent, inter-generationally fairer and more resilient to shocks. Implement policies to increase household disposable income, including by strengthening the conditions that support wage growth, while respecting the role of social partners. Address features of the tax system that may facilitate aggressive tax planning, in particular by means of outbound payments, in particular by implementing the announced measures.
2. Reduce the incentives for the self-employed without employees, while promoting adequate social protection for the self-employed, and tackle bogus self-employment. Strengthen comprehensive lifelong learning and upgrade skills in particular of those at the margins of the labour market and the inactive.
3. While respecting the medium-term budgetary objective, use fiscal and structural policies to support an upward trend in investment. Focus investment-related economic policy on research and development in particular in the private sector, on renewable energy, energy efficiency and greenhouse gas emissions reduction strategies and on addressing transport bottlenecks.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Austria and delivering a Council opinion on the 2019 Stability Programme of Austria**

(2019/C 301/20)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.



- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (3) below. In particular, focusing economic policy related to investment on the specified areas will help address the second euro-area recommendation as regards supporting investment, while the recommendation to shift taxes away from labour addresses the third euro-area recommendation regarding functioning of the labour market.
- (3) The 2019 country report for Austria was published on 27 February 2019. It assessed Austria's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the recommendations adopted in previous years and Austria's progress towards its national Europe 2020 targets.
- (4) On 24 April 2019, Austria submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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) Austria is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme, the government expects that the headline balance will improve from a surplus of 0,1 % of gross domestic product (GDP) in 2018 to 0,3 % of GDP in 2019 and incrementally reduce to a balanced budget position in 2023. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective – a structural deficit of 0,5 % of GDP – continues to be overachieved throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 73,8 % of GDP in 2018 to 59,8 % of GDP in 2023. The macroeconomic scenario underpinning those budgetary projections is favourable. The risks underlying the medium-term budgetary planning appear to be moderate and mainly concern the announced implementation of cost savings in the public administration that are to be used to finance the planned reform of the personal and corporate income tax.
- (7) On 13 July 2018, the Council recommended Austria to achieve the medium-term budgetary objective in 2019, 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 <sup>(7)</sup> of 2,9 %, corresponding to an improvement in the structural balance by 0,3 % of GDP. Based on the Commission 2019 spring forecast, the structural balance is forecast to improve from – 0,1 % of GDP in 2019 to 0,0 % of GDP in 2020, above the medium-term budgetary objective. Austria is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that Austria is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 84.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(7)</sup> 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.

- (8) Austria faces medium fiscal sustainability risks in the long term. These risks are due to the projected increase in public expenditure on healthcare, long-term care and pensions. While coverage of healthcare services is generally high in Austria, public healthcare expenditure is projected to increase by 1,3 percentage points to 8,3 % of GDP by 2070 and hence more than the Union average of 0,9 percentage points. Public 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 Primary Health Care Reform, aimed at reducing the excessive reliance on the hospital sector, have started to address the sustainability issue. The recently adopted Social Security Organisation Act may entail savings in governance and administrative costs but will generate upfront costs. Quality and cost-efficiency would be further helped by more effective public procurement (e.g. Union-wide tendering, the use of award criteria other than price, and aggregating tenders across regions) and a wider use of e-health solutions. In the area of long-term care, recent policy measures — such as the decision to abolish the obligation on patients to use their own private assets to fund long-term inpatient care — are expected to increase, rather than contain, expenditure.
- (9) Pension spending would peak in 2036, at a level of 1,2 percentage points of GDP above the 2016 reference point. Past reforms have successfully provided incentives to retire later (the effective exit age from the labour market increased by an estimated 1,5 years for men and by 1 year for women between 2014 and 2017). However, closing the gap between the statutory and the effective retirement age remains a challenge and longer working lives should be promoted. In addition, adjusting the minimum age for both early and statutory retirement would help improve long-term sustainability more effectively in the context of an ageing society. Introducing an automatic link between the statutory retirement age and gains in life expectancy in the future could reduce public pension expenditure. Such a reduction is estimated to 2,4 percentage points of GDP in 2016-2070, thus offsetting the increase that would be the result of an unchanged policy.
- (10) Austria's fiscal federalism leads to a significant mismatch in expenditure and revenue-raising responsibilities at subnational level. Rather than relying on tax autonomy, subnational budgets are fed by a complex system of tax sharing and intergovernmental transfers. This hampers both fiscal transparency and political accountability, and provides few incentives for efficient public spending. The 2017 Intergovernmental Fiscal Relations Act has introduced a series of changes to streamline the fiscal relations between the different levels of government. The changes include simplifying the distribution of shared taxes, assigning an own source of revenue to the *Länder*, and agreeing on further reforms for a more transparent allocation of legislative and executive responsibilities between levels of government. As for the latter, the *Kompetenzbereinigungspaket* constitutes a first step towards the disentangling responsibilities as it re-allocates shared policy areas to either (exclusively) the federal or the *Länder* level, and reduces mutual rights of assent. However, the law affects only a limited number of policy areas.
- (11) Austria's tax structure is characterised by a high burden on labour (payroll taxes and social security contributions). The burden is set to increase over time, as long as tax brackets are not indexed to inflation. At 55,3 % in 2017, the share of labour taxes in total tax revenue was one of the highest in the Union (average: 49,7 %). Recent reforms, such as reductions in social security contributions for low-income earners and employers as well as the tax relief for working parents provided by the new Family Bonus plus, have helped lower the labour tax wedge. There remains scope for shifting the tax mix towards sources that support more inclusive and sustainable growth. In particular, recurrent property taxes are found to be relatively growth-friendly and progressive, as higher-income earners are likely to possess more housing wealth. However, due to a largely outdated tax base, revenue from recurrent property taxes in Austria remains low and well below the Union average. A revaluation of the tax base would help generate more revenue and address fairness issues that arise when land/real estate values are decoupled from market prices. Effective, well-designed wealth-related taxes could also make the tax system fairer, especially against the background of Austria's striking wealth inequality and in the absence of inheritance and gift taxes. Finally, environmental taxes help internalise negative externalities of resource use and polluting activities related to health and climate. In this context, the preferential tax treatment such activities currently enjoy should be reconsidered.

- (12) The labour market is improving; however, the untapped potential of human capital is hampering productivity and long-term growth with changes particularly required for women, low-skilled workers, older workers and people with a migrant background. Despite an overall high employment rate for women (Austria 71,7 % versus Union 67,4 % in 2018), the number in full-time employment remains rather low. Female part-time employment is well above the Union average (Austria 47,6 % versus Union 30,8 % in 2018) and is mainly related to insufficient childcare facilities and a high share of women performing unpaid care tasks. The current design of childcare services provision and family-related leave do not sufficiently contribute to equal opportunities for men and women on the labour market. Further investment in affordable full-time childcare services and all-day schools would help more women work full-time, better use the labour market potential of women, and improve productivity and long-term inclusive growth. Female part-time employment also explains an important share of the unadjusted gender pay gap, which remains visibly above the Union average (Austria 19,9 % versus Union 16,0 % in 2017). Other important drivers of this gap are the over-representation of women in low-paid sectors, segregation related to the choice of education, under-representation of women in management and supervisory positions, and career breaks. Overall, the substantial gender gap in pension income (Austria 40,5 % versus Union 35,2 %, in 2017), is largely the result of these gender-specific income inequalities generated during working life. Moreover, marginally employed people, a majority of whom are women, are not covered by unemployment benefit. High unemployment rates among the low-skilled point to underused labour market potential. More than 44 % of all unemployed have completed only basic schooling (up to lower secondary school, 'Pflichtschule'). Active labour market policies encouraging more people to work or look for a job, including lifelong learning opportunities, remain crucial for realising the labour potential of workers with a migrant background and low-skilled adults. The involvement of social partners in the decision-making process for these policies, despite being traditionally strong, has been challenged.
- (13) Shortages of skilled labour point to the need to invest more in general education and training. 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 showed that the level of basic skills poses a challenge, as around one-quarter of 8th grade pupils do not or only partially meet educational standards in German. Results for those with a weak socioeconomic and/or migrant background have hardly improved in national testing. Recent international testing also confirmed a widening gap in reading for those from a lower socioeconomic or migrant background. In the Programme for International Student Assessment, Austrian-born pupils outperform first generation migrants by a level equivalent to almost three years of schooling. Recent education reforms partly undermine previous reform efforts and are not in line with Union and OECD best practice. In this context, the expansion of all day schooling has slowed, and tracking and streaming in general school is being intensified. Investment is required to address unequal education outcomes due to socioeconomic or migrant background. While Austria performs above average in the Union with regard to the digital skills of its citizens, it is falling behind the top performing countries. There is a growing lack of skilled IT workers in the economy, as increasing demand is not met by a sufficient supply of computing graduates.
- (14) Austria is a country that invests heavily in research and development, with ambitious national targets. However, the scientific and innovation outputs are not at the level of those of Union's 'Innovation Leaders' <sup>(8)</sup>. Increased investment in research and development does not translate entirely into innovation outcomes and productivity growth. In particular, Austria performs poorly on employment in fast-growing innovative firms. Research and development investment would be more effective if it was translated fully into excellent science and ground-breaking innovation. To do so, more and better links between science and business should be enabled and cooperation on smart specialisation priorities between different regions and with other countries should be encouraged. In addition, further investment could generate major productivity gains and innovation outcomes including into eco-innovation, the innovation capacity of small and medium-sized enterprises ('SMEs') and in complementary intangible assets.

<sup>(8)</sup> As defined by the European Innovation Scoreboard 2018 – *Innovation leader*: SE, DK, FI, NL, UK, LU *Strong innovator*: DE, BE, IE, AT, FR, SI.

- (15) While Austria performs better than the Union average in overall progress with digitalisation, it does not reach the level of Union's 'Innovation Leaders'. This concerns the use of digital technologies but also their development. Austria's information and technology sector is comparatively small and has not been subject to the same growth as similar sectors in the 'Innovation Leader' countries. Additionally, rural areas lack high-speed connectivity, which increases the divide in digitalisation and innovation capacities between regions. Significant gaps also exist as regards digital infrastructure in schools, for example for the coverage of wireless local area networks. Austria has introduced some funding programmes to improve high-speed internet connectivity across the country. A relaunch of Austria's overall digitalisation strategy offers an opportunity to adopt targets and indicators and also to monitor progress on the necessary public and private investment in digitalisation.
- (16) Increasing energy efficiency and the share of renewable energy resources would strengthen Austria's sustainable growth potential and help meet the country's climate and energy targets for 2030. However, additional efforts will be needed to reach these targets. Moreover, public investment in research and development in the area of environment and energy is below the Union average. Improving energy efficiency and the use of renewable energy in SMEs would help reduce energy consumption. Investment in building renovation, renewable electricity generation and sustainable mobility could provide a significant boost to the Austrian economy. A transition towards a circular economy requires an overall strategy and increased investment by businesses.
- (17) Despite a recent uptick linked to the favourable economic climate, Austria has not yet managed to rekindle total factor productivity growth and to leave behind the decade-long stagnation in this key driver of economic growth and competitiveness. Levers to support productivity growth relate to the digitalisation of businesses, company growth and competition in services. While Austria's larger businesses are adopting digital technologies and business models at a good pace, its smaller businesses lag behind. Digitalisation of smaller firms, including micro-enterprises, is particularly important, as they form the backbone of the Austrian economy. The considerable take-up of the programme 'KMU Digital' shows demand and interest among SMEs in getting advice on digitalisation. Prolonging and expanding this programme would help, as well as further policy focus on business digitalisation under Austria's overall digitalisation strategy.
- (18) Structural challenges remain for starting and scaling-up businesses in Austria, and in particular highly innovative companies. Austria lags behind comparable Member States as regards employment in fast-growing innovative firms. This points to a need to improve the conditions for scaling up innovative businesses, which remains hindered by factors such as a venture capital landscape that is less developed and diverse than in 'Innovation Leader' countries. Later-stage funding, such as in the forms of venture capital and access to public capital markets for scale-ups, is a bottleneck. The newly created SME segment on the Vienna Stock Exchange is a step in the right direction. High-growth companies are crucial for spreading new technologies and business models, including digital ones, and thus for productivity growth.
- (19) 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. Regulatory barriers, notably as regards the daily operation of shops, contribute to the relatively weak development of Austria's retail sector. A high administrative burden remains a pressing concern for Austria's businesses. Continued efforts to reduce burdens and the planned evaluation of Austria's Trade Licence Act (*Gewerbeordnung*) are important instruments to improve the business environment. More competition in the service sector would also help address Austria's challenges in spreading digital technologies and business models.
- (20) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Austria to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

- (21) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Austria's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Austria in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Austria, but also their compliance with Union rules and guidance. This reflects the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (22) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion <sup>(9)</sup> that Austria is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Austria take action in 2019 and 2020 to:

1. Ensure the sustainability of the health, long-term care, and pension systems, including by adjusting the statutory retirement age in view of expected gains in life expectancy. Simplify and rationalise fiscal relations and responsibilities across layers of government and align financing and spending responsibilities.
2. Shift taxes away from labour to sources less detrimental to inclusive and sustainable growth. Support full-time employment among women, including by improving childcare services, and boost labour market outcomes for the low skilled in continued cooperation with the social partners. Raise the levels of basic skills for disadvantaged groups, including people with a migrant background.
3. Focus investment-related economic policy on research and development, innovation, digitalisation, and sustainability, taking into account regional disparities. Support productivity growth by stimulating digitalisation of businesses and company growth and by reducing regulatory barriers in the service sector.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(9)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Poland and delivering a Council opinion on the 2019 Convergence Programme of Poland**

(2019/C 301/21)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

- (2) The 2019 country report for Poland was published on 27 February 2019. It assessed Poland's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Poland's progress towards its national Europe 2020 targets.
- (3) Poland submitted its 2019 National Reform Programme on 26 April 2019 and its 2019 Convergence Programme on 29 April 2019. 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 <sup>(4)</sup>, 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 2019 Convergence Programme, the government plans a slight deterioration of the headline balance from a deficit of 0,4 % of gross domestic product (GDP) in 2018 to 0,6 % of GDP in 2022, with a deficit of 1,7 % of GDP in 2019 and a surplus of 0,2 % of GDP in 2020. The recalculated structural balance, at a deficit of 1,1 % of GDP, will come close to the medium-term budgetary objective, set at a structural deficit of 1,0 % of GDP, in 2022. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to decrease from 48,9 % of GDP in 2018 to 40,6 % by 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the operational details of some of the measures needed to support the planned deficit targets from 2020 onwards have not been sufficiently specified.
- (6) The 2019 Convergence Programme indicates that Poland implemented drought-related compensatory measures and that their budgetary impact in 2018 was significant. The Convergence Programme provides adequate evidence of the scope and nature of these additional budgetary costs. The specific treatment of drought-related expenditure could be considered in application of the 'unusual event clause'. According to the Commission, the related eligible additional expenditure in 2018 amounted to 0,07 % of GDP. The provisions set out in Articles 9(1) and 10(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the exceptionality of the drought is considered an unusual event, its impact on Poland'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 2018 has been reduced to take into account these additional costs.
- (7) On 13 July 2018, the Council recommended Poland to ensure that the nominal growth rate of net primary government expenditure <sup>(5)</sup> does not exceed 4,2 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from that recommended adjustment in 2019.

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 88.

<sup>(4)</sup> 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).

<sup>(5)</sup> 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.

- (8) In 2020, in view of Poland's projected output gap of 2,0 % of GDP, the nominal growth rate of net primary government expenditure should not exceed 4,4 %, 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. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement in 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact.
- (9) Poland achieved significant progress in increasing tax compliance. At the same time, the country enjoyed strong economic growth, the labour market was buoyant and the share of labour contracts being subject to social security contributions has been gradually increasing. All those factors contributed to an increase in public revenue. A part of the increased revenue is of cyclical nature and may fade when the macroeconomic environment worsens. At the same time, over recent years, public spending increased as a share of GDP. Several new categories of expenditure are of a permanent nature and may not be easy to change in the near future. Moreover, going forward Poland's public finances will face pressures for higher spending, in particular due to population ageing. These factors amplify the need for new tools to strengthen expenditure management, including a regular assessment of the effectiveness and efficiency of spending. While in 2018 Poland continued to work to improve the budgetary system, the overall reform is complex and will be applied in stages over several years. Whereas overall the fiscal framework is strong and independent institutions cover some of the functions typically fulfilled by fiscal councils, Poland remains the only Member State without an independent fiscal council. While Poland made no progress in limiting the extensive use of reduced value added tax rates, the government launched a reform which has the potential to make the rates less complex and less error-prone.
- (10) Until 2017, the average age of retirement was increasing, reflecting past reforms such as the withdrawal of early retirement options and a gradual increase of the statutory retirement age. In 2018, the average retirement age decreased both for men and for women, reflecting lowering of the statutory retirement age in late 2017. A continued increase in the effective retirement age is crucial for labour market participation and thus economic growth, given the decline in the working age population. It is also crucial to ensure the adequacy of future pensions, prevent poverty at old age and hence also to improve the fiscal sustainability of the pension system. The lowering of the statutory retirement age to 60 for women and to 65 for men in autumn 2017 will have a significant negative impact on future pension benefit levels and introduces a significant gap between men and women in this regard. Existing preferential pension schemes imply fiscal costs and reduce the mobility of workers between sectors. The special social insurance system for farmers, subsidised at a cost of around 0,8 % of GDP, is hampering labour mobility and contributing to hidden unemployment in agriculture.
- (11) The favourable macroeconomic environment has helped the strong performance of the Polish labour market in recent years. Employment rates have continued to increase, while the unemployment rates, after several years of decline, stabilised at a historical low of below 4 % in 2018. However, the participation of some groups in the labour force, especially the low-skilled, persons with disabilities and their carers and older people, has remained low in comparison to other Member States. The Polish social benefit system provides insufficient incentives to take up work. The child benefit has reduced poverty and inequality, but it has had a negative effect on the participation of parents, mostly women, in the labour market due to its size and design. The enrolment rate for children under the age of three in formal childcare remains among the lowest in the Union. In addition, long-term care is mostly provided by family members without almost any institutional support, which prevents carers from working. The lowered statutory retirement age has encouraged some older workers to exit the labour force. Migration from non-Union countries has been helping to meet the increase in demand for labour, but there are signs that a continued inflow of migrant workers may be difficult to achieve.
- (12) Between 2015 and 2017, Poland took measures to tackle 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. While the share of temporary contracts has been declining since 2015, thanks to the measures taken and due to the shortages of workers, and this process accelerated during 2018, it still remains among the highest in the Union. Further legislative changes addressing this issue were not pursued as the reform of the labour code was finally not implemented. The adequacy of future pensions of workers who are self-employed and those who have certain non-standard contracts emerges as a potential issue.



- (13) A quality education and training system that takes the life-long perspective, supported by sufficient investment, could be one crucial factor supporting future growth prospects in Poland. Equipping people with skills and competences that are needed to find employment in a rapidly changing labour market is of crucial importance to encourage both participation in the labour force and the innovative capacity of the economy. The rate of the participation of adults in education and training is much lower than the Union average and vocational training in enterprises is underutilised. This, combined with certain weaknesses in digital skills, as well as in literacy and numeracy skills, particularly among adults with no higher education, is hampering their employability. The insufficient quality of teacher training and some gaps in their skills are likely to have a negative impact on the quality of education. There are also weaknesses in the quality assurance system of the higher education. Despite recent reforms in vocational education and in higher education, the effective coordination of adult learning is still lacking and the impact of different policy measures on the quality of the education and training provided and the skill levels is not clear.
- (14) Poland's long-term economic prospects depend on developing the economy's capacity to innovate. However, Poland still ranks low in terms of innovation, with low-tech sectors representing an important share in the country's economic structure and with important regional disparities in innovation performance. While some measures have been taken to improve science-business cooperation, a number of financial and non-financial obstacles persist. In particular, complex administrative procedures and limited skills of academics in managing joint public-private research and development (R & D) projects remain key barriers. The clusters and formalised corporate networks, especially between small and medium-sized enterprises and large firms, play a limited role in diffusing innovative solutions. The 2018 higher education reform improves some aspects of the Polish scientific landscape, but only partially addresses important issues such as the fragmentation of the research sector, researchers' wages or the internationalisation of Polish science. Gross domestic expenditure on R & D remained at about half of the Union average in 2017, with important regional disparities.
- (15) Health outcomes have continued to improve but remain below the Union average with males faring worse in life expectancy than females by 7,9 years in 2017 while the gap between the highest and lowest educated Poles was 10 years in 2016. Access to and the effectiveness of the healthcare system is affected by low spending and staff shortages. The number of practising doctors and nurses relative to population size is among the lowest in the Union with quarter of the medical staff above retirement age. Unmet needs for medical services declined in 2017, but remain among the highest in the Union and the waiting times for certain procedures have increased substantially since 2010. Poland has developed maps of healthcare needs, but they have not yet become tools for supporting decisions on the purchasing of health services and investments. The healthcare system remains overly hospital-based and primary and ambulatory care remain underdeveloped. Long-term care system is weak, lacking standardised services and a coherent strategic approach. Most long-term care is provided by informal carers, often family members with little institutional support. In 2017, Poland's public healthcare expenditure totalled 4,7 % of GDP, well below the Union average of 7 % of GDP. Poland plans to gradually increase this expenditure in the coming years. However, this may be difficult to achieve, given that the recently announced plans to increase social transfers to medium- and high-income households will limit fiscal space in the future.
- (16) While infrastructure in Poland has improved significantly, some sectors still exhibit important connectivity gaps. Road investments that are to be completed by 2024 according to the national road construction programme will be concentrated mainly in the eastern part of Poland, leaving some northern regions less connected. There are still important gaps in the Trans-European Transport Network Railways, and investment in rail is proceeding slower than investment in roads. The road fatality rate is still among the highest in the Union. 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. Greenhouse gas emissions from road transport have increased strongly over the last five years. The current incentives to use collective, low-emission and active transport modes are insufficient to tackle these challenges. Fixed internet connectivity in Poland remains one of the lowest in the Union, with ultra-fast broadband available mainly in big cities.

- (17) The Polish economy is among the least carbon-efficient in the Union. Poor insulation of public and private buildings contributes to higher energy consumption and energy poverty. Poland also has the most air-polluted cities in the Union, especially in the southern and central regions. Investing in higher energy efficiency, in particular in the buildings sector, increasing the share of low-carbon intensive and cleaner energy production, and supporting lower emissions from transport, would reduce the dependency on fossil fuels and limit air pollution, while reducing social costs and improving the quality of life. The current legislative environment, including the gas stock-piling act, the electricity price freeze act and on-shore wind farms regulations, may hamper investments in electricity and gas markets and affect the competitiveness of Poland's energy sector and energy-intensive industries in the long term.
- (18) The quality of new and revised legislation, and a stable and predictable business environment are of high importance for sustaining favourable economic conditions and supporting the increase in private investment. The unstable regulatory framework and other barriers to the expansion of firms are negatively affecting investment activity and productivity. Establishing an effective dialogue with all stakeholders would help improve the quality of legislation and — by limiting the number of revisions needed — would contribute positively to the stability of the business environment. Therefore, strengthening the role of consultations of social partners and public consultations — by ensuring a sufficient length of time for consultations, improving the uptake of the stakeholders' opinions gathered in the process, and minimising the number of laws exempted from consultations — would substantially help to minimise the administrative burden resulting from frequent changes in the law, increase investment and promote sustainable economic growth in the long term. 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. These concerns are the subject of a judgement and on-going procedures which are pending before the Court of Justice of the European Union. Legal certainty and trust in the quality and predictability of regulatory, tax and other policies and institutions are important factors for the investment environment.
- (19) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Poland to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (20) In recent years, the State role strongly expanded in banking, insurance and energy sectors. Increased State ownership presents a new challenge to competition and the regulatory and governance framework. The quality of governance and the independence of regulators and supervision is therefore becoming increasingly important given potentially conflicting interests and stronger financial-sovereign links.
- (21) In the light of this assessment, the Council has examined the 2019 Convergence Programme and its opinion <sup>(6)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Poland take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4,4 % in 2020, corresponding to an annual structural adjustment of 0,6 % of GDP. Take further steps to improve the efficiency of public spending, including by improving the budgetary system.

<sup>(6)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.

2. Ensure the adequacy of future pension benefits and the sustainability of the pension system by taking measures to increase the effective retirement age and by reforming the preferential pension schemes. Take steps to increase labour market participation, including by improving access to childcare and long-term care, and remove remaining obstacles to more permanent types of employment. Foster quality education and skills relevant to the labour market, especially through adult learning.
3. Strengthen the innovative capacity of the economy, including by supporting research institutions and their closer collaboration with business. Focus investment-related economic policy on innovation, transport, in particular on its sustainability, digital and energy infrastructure, healthcare and cleaner energy, taking into account regional disparities. Improve the regulatory environment, in particular by strengthening the role of consultations of social partners and public consultations in the legislative process.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Portugal and delivering a Council opinion on the 2019 Stability Programme of Portugal**

(2019/C 301/22)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, focusing economic policy related to investment on the specified areas and using windfall gains to reduce public debt will help address the second euro-area recommendation as regards supporting investment and rebuilding buffers. Measures to reduce labour market segmentation, improve skills and the effectiveness of the social safety net will help address the third euro-area recommendation as regards the functioning of the labour market and social protection systems. Measures to reduce the regulatory burden will help address the first euro-area recommendation as regards business environment and productivity improvements for euro-area rebalancing. Increasing the efficiency of insolvency and recovery proceedings will help address the fourth euro-area recommendation as regards the reduction of non-performing loans.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Portugal was published on 27 February 2019. It assessed Portugal's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 27 February 2019. 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 share of non-performing loans constitute vulnerabilities in a context of low productivity growth. Policy gaps remain, in particular in terms of implementing the measures outlined to reduce non-performing loans and to improve the business environment. The adoption and implementation of several reform plans, including fiscal-structural reforms to strengthen the sustainability of public finances, will need to be monitored.
- (4) On 30 April 2019, Portugal submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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) Portugal is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2019 Stability Programme, Portugal plans to attain a headline deficit of 0,2 % of gross domestic product (GDP) in 2019, a surplus of 0,3 % of GDP in 2020 and a further improvement to a surplus of 0,7 % of GDP by 2022. Those plans only partially include the potential deficit-increasing impact of bank support measures from 2020 onwards. Based on the recalculated structural balance, the medium-term budgetary objective — which has been changed from a structural surplus of 0,25 % of GDP in 2019 to a balanced budgetary position in structural terms as of 2020 — is planned to be achieved in 2020. The 2019 Stability Programme projects the general government debt-to-GDP ratio to reach 118,6 % in 2019 and 115,2 % in 2020; the ratio would then be at 103,7 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible for 2019 and 2020 and favourable for the following years. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been sufficiently specified.
- (7) The 2019 Stability Programme does not provide information on the budgetary impact of the exceptional expenditure in relation to preventive measures to protect the national territory against wildfires, following the large-scale wildfires that occurred in 2017. However, in a letter dated 9 May 2019, the Portuguese authorities have provided adequate evidence of the scope and nature of these additional budgetary costs. In particular, the letter indicates that the 2018 budget implementation comprises exceptional expenditure amounting to about 0,04 % of GDP in relation to preventive measures to protect the national territory against wildfires. The letter of 9 May 2019 sets out expenditure related to the emergency management, classified as one-off measures, and expenditure related 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 0,04 % 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. Therefore, the required adjustment towards the medium-term budgetary objective for 2018 has been reduced to take into account these additional costs.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 92.

<sup>(5)</sup> 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).

- (8) On 13 July 2018, the Council recommended Portugal to ensure that the nominal growth rate of net primary government expenditure <sup>(6)</sup> does not exceed 0,7 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from that recommended adjustment in 2019.
- (9) In 2020, Portugal should achieve its medium-term budgetary objective, taking into account the allowance linked to unusual events for which a temporary deviation is granted. Based on the Commission 2019 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure of 1,5 %, corresponding to an annual structural adjustment of 0,5 % of GDP. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement in 2020. At the same time, Portugal is forecast to comply with the transitional debt rule in 2019, as a result of the allowed annual deviation of 0,25 %, but is *prima facie* not projected to comply with the debt rule in 2020. Overall, the Council is of the opinion 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 important.
- (10) Strengthening Portugal's fiscal sustainability hinges on continued growth-friendly fiscal consolidation. There is, however, scope to improve the quality of public finances and to make expenditure more growth-friendly by supporting investment (see below). Despite having increased in 2018, public investment has remained very low compared with Union standards and consistently below the government's own targets. Enforcing the commitment control law, implementing the budget framework law in a strict and timely manner and continuing rationalisation efforts remain crucial to improving expenditure control and making spending more efficient. Recent stand-alone bottom-up expenditure reviews in specific sectors have led to overall limited efficiency savings. To achieve higher efficiency gains, expenditure reviews should instead become a regular feature of Portugal's budget framework. Moreover, deeper reforms to increase efficiency and a clear top-down focus on containing overall expenditure, are still needed. This should largely build on a strategy for public administration reform aimed at better aligning public employment levels with the need to deliver effective services, which includes supporting staff reallocation and retraining, and promoting individual performance and the attractiveness of the public service for highly skilled staff.
- (11) Portugal's public finances are under continuous pressure from adverse demographic trends, notably the ageing population, with negative consequences, especially for the sustainability of the pension and health systems. While the past reforms improved the long-term sustainability of the pension system, ongoing special pension increases and early retirement reforms have entailed further increases in pension spending on top of the underlying upward trend driven by ageing. The overall sustainability of the pension system may be negatively affected if there are no adequate compensatory measures. In the health sector, cost-effectiveness continued to be promoted in 2018, including through an increased reliance on centralised purchasing and a greater use of generics and biosimilars. At the same time, persistently high hospital arrears result from inadequate budgetary planning and implementation and weaknesses in accounting control and managerial practices. Temporary decreases in hospital arrears in 2018 have essentially resulted from sizeable extraordinary clearance measures. A new programme for 2019 aims to structurally address hospital arrears by introducing a new governance model for public hospitals, in combination with a substantial increase in their annual budgets. This programme's ability to slow down the accumulation of hospital arrears in the short term and thereby lead to a structural reduction of their overall stock crucially hinges on its timely and effective implementation.
- (12) Increasing the net incomes of State-owned enterprises and reducing their debt would help to make Portuguese public finances more sustainable. The authorities are planning the net incomes of State-owned enterprises as a whole to approach a level close to balance in 2019, which means a delay compared with earlier announcements aiming at a similar outcome already in 2018. Moreover, measures to ensure adherence to initial activity plans and efforts to ensure more timely, transparent and comprehensive monitoring were delayed and have been slow in translating into corrective action where needed. In particular, a sufficient level of *ex-ante* transparency regarding the financing of State-owned enterprises through recapitalisations and loans has not been ensured.

<sup>(6)</sup> 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.

- (13) Despite the ongoing implementation of some measures to decrease labour market segmentation, such as the reinforcement of the labour inspectorate and the launch of an integration programme for precarious workers in the public service, the proportion of temporary workers in Portugal still exceeds the Union average. More specific measures agreed between the government, employers and employees representatives aimed at further reducing labour market segmentation and precariousness and promoting collective bargaining are still to be approved by Parliament and materialise into concrete legislation.
- (14) Improved labour market conditions have resulted in fewer people at risk of poverty or social exclusion. Despite this improvement, income inequality remains high and the impact of social transfers on poverty reduction is limited. While income inequality in Portugal is decreasing, it still remains significantly higher than the Union average. The adequacy of the minimum income scheme is among the lowest in the Union, providing incomes of only 40 % of the national poverty threshold. Unless reviewed, the low effectiveness of social transfers could be severely tested in the event of a future economic slowdown, with the vulnerable people particularly affected.
- (15) The low qualification level of workers is an obstacle to investment and productivity growth. About 50 % of the population aged 25-64 has low educational attainment levels, well above the Union average of 22 % in 2018. The low availability of skilled staff is an important obstacle to investment that companies report. For adult learning in particular, there is scope to further engage the low qualified (whose participation in learning is below the Union average) and to extend targeted public incentives to small and medium-sized enterprises to train their staff. Digital skills are a particular challenge, with 50 % of the Portuguese population lacking basic digital skills compared to a Union average of 43 %. Investment in education and training, including infrastructure, is key to improving employability and social mobility.
- (16) Measures to increase enrolment in higher education, such as a significant increase in scholarships, are ongoing as part of efforts to increase the number of higher education graduates. Among 30- to 34-year-olds in Portugal, 33,5 % have completed higher education, which is still below the Union average of 40,7 %. The persistency of these low shares, in particular for graduates in information and communication technologies, the natural sciences, mathematics and statistics may have negative consequences for Portugal's productivity growth and capacity to innovate. While the government is trying to address the issue by increasing the number of study places in these fields and implementing a review of the higher education system, more efforts are needed.
- (17) The ratio of non-performing loans in the financial system remains relatively high at 9,4 %. Nevertheless, most banks made substantial progress in meeting the targets to reduce non-performing loans and the overall non-performing loans stock decreased by 50 % between the peak, in June 2016, and December 2018. The secondary market for distressed assets gained momentum while banks also accelerated write-offs and non-performing credit cures. The breakdown of non-performing loans continues to show a steady high proportion (65 %) of corporate non-performing loans. Over the past few years, the authorities have implemented a number of legal and institutional reforms for insolvency and debt enforcement. However, the average length of insolvency proceedings remains persistently high, as does the number of pending court cases. The legal and judicial frameworks are heavily affecting the recovery process and the prospects for efficient repossession of collateral. The long average duration of recovery proceedings weighs on the prices applied by the market to non-performing assets.
- (18) Reforms aimed at administrative simplification have been mostly limited to across-the-board implementation of dematerialisation of procedures and the once-only principle. Achievements in administrative modernisation should be complemented by more substantial administrative simplification. Priority should be given in particular to limiting the number of documents that have to be submitted and either replacing authorisation schemes with simple declarations of compliance with applicable conditions or, for the more sensitive sectors, simplifying authorisations by reducing decision times and adopting tacit approval. The streamlining of procedures for specific sectors is still lacking. Excessive administrative charges remain in place, notably in the construction sector. Additionally, shortcomings in planning and monitoring public procurement hinder competition. The performance of public procurement could be improved by introducing structured and quantified planning and ensuring closer supervision of the execution phase of contracts. Despite a significant reduction in direct awards between 2017 and 2018, their use remains high.

- (19) In the context of the financial assistance programme, Portugal has made an effort to reduce the regulatory burden for highly regulated professions, notably with the introduction of the 2013 framework law. In some cases, however, this progress was halted or even reversed with the adoption of bylaws for the individual professions and the introduction of a ban on corporate groups. Regulatory and administrative restrictions on business and professional services prevail, raising concerns about competition, price levels, innovation and the quality of services. So far, no reform plans have been announced in response to the Commission's recommendations on regulation of professional services, or in response to the 2018 Organisation for Economic Cooperation and Development (OECD) Competition Assessment Review on Portugal's self-regulated professions (in cooperation with the Portuguese Competition Authority).
- (20) The conditions for firms to access finance have been improving over the last few years and the proportion of firms reporting access to finance as main constraint to investment is now in line with the Union average. The Portuguese authorities launched and strengthened several initiatives in this area, such as the Capitalizar programme and other programmes targeting specific types of companies or sectors. However, Portuguese firms tend to rely heavily on their own resources to finance investment, and an insufficient amount of bank loans ends up in firms with higher productivity. The low level of capital invested per worker represents a major obstacle to upgrade the productive structure of the Portuguese economy. In this context, it is important that productive investment increases while being gradually rechannelled towards firms with growth potential and in sectors with high productivity profiles. Although other sources of financing, such as venture and equity capital, have been increasing over the last few years, they remain markedly lower than the Union average.
- (21) The justice system is becoming more efficient but continues to face critical challenges with lengthy proceedings and a high backlog of cases, in particular in the administrative and tax courts. While efforts to crack down on corruption continue, preventing corruption remains an issue due to the lack of a coordinated strategy and fragmented responsibilities.
- (22) Investment in research and development (R & D) has recently picked up again but remains insufficient to upgrade the Portuguese national research and innovation system. After years of decline, the share of spending on R & D in relation to GDP increased recently and, in 2017, business R & D intensity slightly surpassed the public research and development intensity. Little progress has been made to upgrade Portugal's economic structure to higher shares of value-added in high-tech manufacturing and in knowledge-intensive services. Promoting investment in intangible assets, including R & D as well as managerial skills, financial literacy and digital skills, in order to enable firms to grow, increase their innovation capacity and enter export markets offers Portugal significant potential to boost investment and productivity growth.
- (23) Insufficient maritime and railway connections make it difficult for export-oriented businesses to fully benefit from the potential of the single market. Due to its geographical location, Portugal is a natural maritime entry point, especially for the transatlantic routes. Timely investments in the new container terminals in Sines (Terminal Vasco da Gama), Leixões and Barreiro and the finalisation of the ongoing investment projects in the other main Portuguese ports (Viana do Castelo, Leixoes, Aveiro, Figueira da Foz, and Setubal) would increase the cargo-handling capacity of those ports. Railways are still widely underused in the connections to Spain (both East-West and North-South corridors). Developing a comprehensive Iberian plan, which includes identifying the intermediate steps, terminals, interconnections needed to benefit from the Spanish network upgrade and developing the International Union of Railways gauge, would help boost Portugal's international rail performance.
- (24) Investments in resource efficiency and climate-change mitigation and adaptation would help to achieve long-term sustainable growth. Anticipating the adverse effects of climate change, such as floods and forest fires, remains a challenge in Portugal. Challenges remain to achieve the 2020 energy efficiency target, and the latest data for 2017 show that energy consumption is increasing. There is still a wide margin to improve energy efficiency in buildings and reduce energy consumption in business. Better cross-border energy connectivity could enable more competition and facilitate the deployment of renewable energy.
- (25) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Portugal to make the best use of those funds in respect of the identified sectors, taking into account regional disparities and the special situation of the outermost regions. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.



- (26) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Portugal's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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 2019 Stability Programme and its opinion <sup>(7)</sup> is reflected in particular in recommendation (1) below.
- (28) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first, second and fourth euro-area recommendations. The fiscal policies referred to in recommendation (1) below contribute, inter alia, to addressing imbalances linked to high government debt,

HEREBY RECOMMENDS that Portugal take action in 2019 and 2020 to:

1. Achieve the medium-term budgetary objective in 2020, taking into account the allowance linked to unusual events for which a temporary deviation is granted. Use windfall gains to accelerate the reduction of the general government debt ratio. Improve the quality of public finances by prioritising growth-enhancing spending while strengthening overall expenditure control, cost efficiency and adequate budgeting, with a focus in particular on a durable reduction of arrears in hospitals. Improve the financial sustainability of State-owned enterprises, while ensuring more timely, transparent and comprehensive monitoring.
2. Adopt measures to address labour market segmentation. Improve the skills level of the population, in particular their digital literacy, including by making adult learning more relevant to the needs of the labour market. Increase the number of higher education graduates, particularly in science and information technology. Improve the effectiveness and adequacy of the social safety net.
3. Focus investment-related economic policy on research and innovation, railway transport and port infrastructure, low carbon and energy transition and extending energy interconnections, taking into account regional disparities.
4. Allow for a swifter recovery of the collateral tied to non-performing loans by increasing the efficiency of insolvency and recovery proceedings. Reduce the administrative and regulatory burden on businesses, mainly by reducing sector-specific barriers to licensing. Develop a roadmap to reduce restrictions in highly regulated professions. Increase the efficiency of administrative and tax courts, in particular by decreasing the length of proceedings.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(7)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Romania and delivering a Council opinion on the 2019 Convergence Programme of Romania**

(2019/C 301/23)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Romania as one of the Member States for which an in-depth review would be carried out.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

- (2) The 2019 country report for Romania was published on 27 February 2019. It assessed Romania's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(3)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Romania'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 27 February 2019. The Commission's analysis led it to conclude that Romania is experiencing macroeconomic imbalances. In particular, vulnerabilities are linked to diminishing cost-competitiveness and a widening current account deficit in a context of an expansionary fiscal policy and an unpredictable business environment. Recent legislative initiatives create risks for the functioning of the financial sector and may harm private investment.
- (3) Romania submitted its 2019 National Reform Programme on 9 May 2019 and its 2019 Convergence Programme on 8 May 2019. 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 <sup>(4)</sup>, 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 2019 Convergence Programme, the government plans a headline deficit of 2,8 % of gross domestic product (GDP) in 2019, and its gradual reduction thereafter, to 2,0 % of GDP in 2022. Based on the recalculated structural balance <sup>(5)</sup>, the medium-term budgetary objective, set at a structural deficit of 1 % of GDP, is not planned to be achieved over the programme horizon. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to remain below 40 % by 2022. 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 22 June 2018, the Council found in accordance with Article 121(4) of the Treaty that a significant observed deviation from the adjustment path towards the medium-term budgetary objective occurred in Romania in 2017. In view of the established significant deviation, on 22 June 2018 the Council issued a Recommendation <sup>(6)</sup>, recommending that Romania take the necessary measures to ensure that the nominal growth rate of net primary government expenditure <sup>(7)</sup> did not exceed 3,3 % in 2018 and 5,1 % in 2019, corresponding to an annual structural adjustment of 0,8 % of GDP in each year. On 4 December 2018, the Council adopted Decision (EU) 2018/2020 <sup>(8)</sup>, establishing that Romania had not taken effective action in response to its Recommendation of 22 June 2018, and issued a revised Recommendation <sup>(9)</sup>. In the Recommendation of 4 December 2018, the Council asked Romania to take the necessary measures to ensure that the nominal growth rate of net

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 98.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(6)</sup> 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).

<sup>(7)</sup> 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.

<sup>(8)</sup> Council Decision (EU) 2018/2020 of 4 December 2018 establishing that no effective action has been taken by Romania in response to the Council Recommendation of 22 June 2018 (OJ L 323, 19.12.2018, p. 16).

<sup>(9)</sup> Council Recommendation of 4 December 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Romania (OJ C 460, 21.12.2018, p. 1).

primary government expenditure does not exceed 4,5 % in 2019, corresponding to an annual structural adjustment of 1,0 % of GDP. On 14 June 2019, the Council adopted Decision (EU) 2019/1002 <sup>(10)</sup>, establishing that Romania had not taken effective action in response to the Council Recommendation of 4 December 2018. Moreover, based on 2018 outturn data, Romania was found to be in significant deviation from the recommended adjustment in 2018. In line with Article 121(4) of the Treaty and Article 10(2) of Regulation (EC) No 1466/97, the Commission issued a warning to Romania on 5 June 2019 that a significant deviation from the adjustment path towards the medium-term budgetary objective was observed in 2018. On 14 June 2019, the Council adopted a subsequent Recommendation <sup>(11)</sup>, 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 4,5 % in 2019, corresponding to an annual structural adjustment of 1,0 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a deviation from that Recommendation in 2019.

- (7) In its Recommendation of 14 June 2019, the Council recommended Romania to take the measures necessary to ensure that the nominal growth rate of net primary government expenditure does not exceed 5,1 % in 2020, corresponding to an annual structural adjustment of 0,75 % of GDP. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a deviation from that requirement in 2020. In addition, the Commission 2019 spring forecast projected a general government deficit above the 3 %-of-GDP Treaty reference value in 2019 and in 2020. Overall, the Council is of the opinion that significant further measures will be needed as of 2019 to comply with the provisions of the Stability and Growth Pact, in light of a strongly deteriorating fiscal outlook, in line with the Council Recommendation of 14 June 2019, with a view to correcting the significant observed deviation from the adjustment path towards the medium-term budgetary objective.
- (8) Romania's budgetary planning regularly ignores the provisions of the national fiscal framework. The national structural deficit rule requires compliance or convergence with the medium-term budgetary objective of a structural deficit not exceeding 1 % of GDP. In 2016 Romania departed from the medium-term budgetary objective and has been on a divergent path since then, in breach of the national deficit rule. The two 2018 budget amendments adopted in autumn 2018, departed once again from several auxiliary rules prohibiting increases in deficit and expenditure ceilings during the ongoing fiscal year. The 2019 budget, adopted by the government in February 2019 and approved by the Parliament in March, again departed from multiple fiscal rules, including the structural deficit rule. Moreover, as in previous years, the authorities did not send an update of the medium-term fiscal strategy to Parliament by the statutory August deadline, thereby undermining its guiding role. Also, as in previous years, the authorities did not comply with the requirement to sign a statement that the 2019 budget and the fiscal strategy respect the fiscal rules and principles of fiscal responsibility.
- (9) Tax compliance remains low. As regards value added tax, the difference between theoretically expected and actually collected revenues remains very high. The large informal economy represents an additional challenge for tax compliance, while the high levels of undeclared work deprive the State budget of significant resources. Furthermore, the prevalence of cash payments facilitates tax evasion. In the past year, Romania has achieved limited progress in addressing the repeated country-specific recommendation to strengthen tax compliance and collection. The introduction of electronic cash registers connected to the tax administration's IT system is progressing rather slowly. The tax administration is taking steps to set up a risk assessment system for auditing taxpayers.
- (10) After several years of continued efforts to consolidate the financial sector, financial stability was again strained in 2018 by a set of government and parliamentary legislative initiatives. The tax on banks' assets adopted by the government via an emergency ordinance at the end of December 2018, without impact assessment or stakeholder consultation, raised a number of serious concerns related to its negative impact on banks' prudential situation, the conduct of monetary policy and ultimately investment and economic growth. The manner of its adoption and

<sup>(10)</sup> Council Decision (EU) 2019/1002 of 14 June 2019 establishing that no effective action has been taken by Romania in response to the Council Recommendation of 4 December 2018 (OJ L 163, 20.6.2019, p. 62).

<sup>(11)</sup> Council Recommendation of 14 June 2019 with a view to correcting the significant observed deviation from the adjustment path towards the medium-term budgetary objective in Romania (OJ C 210, 21.6.2019, p. 1).

its provisions have had a significant adverse effect on the exchange rate, the government's ability to borrow on the market and ultimately on stakeholders' perception of operational risks. While some controversial aspects of the tax were amended in March 2019, the changes were again adopted via a government emergency ordinance and without an impact assessment. The most challenging aspects of the bank tax on total assets were removed. However, under the new formulation the tax may distort credit incentives, which could result in a misallocation of credit to the economy. The potential implications of these changes for monetary policy transmission should be assessed. Several legislative initiatives adopted by Parliament at the end of 2018, although declared unconstitutional by the Constitutional Court in March 2019, have put additional strain on the banking sector and reinforced the overall perception of an unpredictable legal framework. Past experience shows that such initiatives could be put forward again by the legislature.

- (11) The new pension law, adopted by Parliament in December 2018, is likely to pose risks to the sustainability of public finances. The pension point, i.e. the main parameter used for pension indexation, is set to increase by 15 % in September 2019 and by 40 % in September 2020. The pension law would change several parameters used to calculate pension benefits. In particular, the pension point value is set to rise, as the indexation factor for existing pensions would no longer converge towards prices but would instead remain permanently composed of wages and prices. Moreover, the contributory period used to calculate a person's pension will be shortened, leading to higher pension expenditure for new pensions. However, the abolishment of the correction index for new pensions (which used to partly link the first pension to wages) will mitigate the overall pension expenditure increase caused by the other parameters. Some structural challenges that affect pension adequacy remain unaddressed. The effective average retirement age is close to the Union average, but is not equal between women and men. Coupled with shorter contributory periods for women, this results in a considerable pension gender gap.
  
- (12) The reform of the pension system introduced in 2008 has been gradually rolled back. After repeated postponements of the scheduled increases in contributions to the second-pillar pension funds, which should have reached 6 % of gross wages by 2016, contributions were reduced to 3,75 % of gross wages as of 2018. Second-pillar pension funds were further weakened by a set of measures adopted by the government via an emergency ordinance at the end of 2018. Contributions to these funds were made optional after a minimum contributory period of five years. The minimum capital requirements for second-pillar pension-fund management companies were increased significantly, triggering a risk of exits by fund management companies from the Romanian market. The administrative fees levied on gross contributions were also significantly cut, thus potentially affecting the financial results of fund management companies and increasing the likelihood of market exits. This could have negative implications for the development of the local capital market and the pool of institutional investors, as well as depriving the economy of a much needed source of long-term investment. Furthermore, the weakening or undoing of the second pillar will result in less diversified retirement income and expose pensions to higher political and demographic risks. In March 2019, via an emergency ordinance, the government maintained the new minimum capital requirements for fund management companies, but postponed the deadline for paying the entire additional capital until December 2019. In May 2019 the government significantly decreased the minimum capital requirements for pension-fund management companies, which partly offset the increase decided in December 2018. Other provisions in the December 2018 emergency ordinance that endanger the viability of second-pillar pension funds remain unchanged.
  
- (13) Challenges linked to the quality and inclusiveness of the education and training system have a negative impact on Romania's inclusive growth potential. Although the budget increased in 2019, spending on education remains one of the lowest in the Union, particularly at levels of education that are key to preventing early school leaving (which remains high), ensuring equal opportunities and tackling inequalities later in life. Participation in quality early education and care remains below the Union average, partly due to lack of facilities. This has implications for the labour-market participation of women as well as the early acquisition of skills. Modernisation of the school network and optimisation to address demographic trends is lagging behind, with 10 % of schools being overcrowded, while 58 % have excess capacities. The acquisition of basic and digital skills faces significant challenges. Teachers' abilities to apply a learner-centred approach are not sufficiently developed. Rural-urban disparities persist and vulnerable groups, including the Roma, continue to have limited access to high-quality, inclusive education.

- (14) The labour market has been under increasing pressure, as the unemployment rate (4,2 % in 2018) is very low, while the labour force is declining and skills shortages persist. Women's activity rate, particularly for the young and middle-aged, is low. This is mainly due to personal and family responsibilities and the low participation of children aged 0-3 in formal childcare. Active labour market policies provide a limited response to labour market needs, with measures focused mainly on financial incentives rather than on tailor-made and comprehensive approaches. The delay of the planned reform for the public employment service remains a significant barrier for modernised service-delivery to employers and the unemployed. Upskilling and integrated services delivery is also weak. Skills are not evolving in line with the needs of expanding economic sectors, with 81 % of employers having difficulties filling job vacancies. The ICT sector is growing, while the number of Romanians aged 20-29 holding a degree in science, technology, engineering or maths fell between 2014 and 2016. At present there is no global or sector-level assessment of skills needs, and the forecasting of skills remains unused, hampering the adaptation of the education and training system to labour market needs. The roll-out of dual vocational education and training to address skills shortages has started. However, vocational education and training is still considered a second-rate option by students and parents, and the relatively low employment rate for recent vocational education and training graduates indicates that labour market relevance is a challenge. Higher education is not sufficiently aligned with the labour market. Although tertiary educational attainment has doubled over the decade, it remains low.
- (15) Despite recent improvements, poverty and income inequality remain high, and regional disparities are deepening. One in three Romanians is still at risk of poverty and social exclusion, with particular groups such as children, the Roma, people with disabilities and the elderly being more affected. Social services have insufficient quality and coverage, and uneven geographical distribution, not correlated with communities' specific needs. Only around 20 % of administrative territorial units have licensed social services. Services are usually concentrated around richer or urban areas, while needs are more pressing in poorer, rural areas and regions. The limited integration of employment, education, health and social services does not allow for the sustainable inclusion of various disadvantaged groups. People with disabilities are given only limited support for independent living and accessing employment. The situation of the Roma community shows very little progress. Housing deprivation is the highest in the Union and is detrimental to social inclusion. Housing policies are being decentralised without a strategic framework, and poor communities often lack financial resources. The social reference index used as a basis for most social benefits has not been updated since 2008 and has also depreciated considerably in relation to the minimum wage. As a result, poverty rates for people with low and very low work intensity have increased by half since 2010. Furthermore, social security for atypical workers is inadequate. One in three atypical workers is at risk of severe material deprivation. Daily and seasonal workers do not have formal access to social security rights covering unemployment, maternity leave, accidents and occupational injuries. The implementation of the minimum inclusion income reform initiated in 2016, which would increase the coverage and adequacy of social assistance, was further postponed to 2021.
- (16) Social dialogue is characterised by low collective agreement coverage, in particular at sectoral level, also due to the current definition of sectors. The authorities have initiated plans to revise the definitions of economic sectors but no agreement has yet been reached. Beyond the collective bargaining framework, the timely and meaningful involvement of social partners on policy issues and reforms is limited. Most social dialogue takes place formally, within the Economic and Social Council and the Social Dialogue Committees. However, despite the established framework of dialogue and consultations, the stability and the role of these institutions has weakened over the last year.
- (17) After years of moderate wage growth, Romania is experiencing one of the fastest rates of wage growth in the Union. This is driven by government policies increasing public and minimum wages, record-low unemployment rate and structural labour supply shortages. The minimum wage continues to be set in a non-systematic manner, without an objective mechanism. Consecutive increases over the years resulted in one in three employees earning the minimum wage in 2017, a rate almost four times higher than in 2011.
- (18) The healthcare system faces many challenges. Low funding, inefficient use of public resources and the lack of reform limit the effectiveness of the health system. Continued emigration has resulted in a sizeable shortage of doctors and nurses. Health infrastructure and the prevalence of informal payments remain sources of concern. Access to healthcare services for those living in rural areas and vulnerable groups is limited. These factors in turn

have a negative impact on people's health, which remains below the Union average despite recent improvements. Improvements in community care are much needed but are delayed. The pilot project for setting up community care centres has started with a delay, impacting the roll-out of integrated care services. The long-term care sector is not ready to deal with a rapidly ageing population. There are very few at-home and day-care services, mainly concentrated in areas with higher income. Coverage and public spending on long-term care are among the lowest in Union and access to long-term care, rehabilitation and palliative care is poor.

- (19) The quality of infrastructure, including in the transport, energy, waste and wastewater sectors remains poor and limits Romania's growth prospects. Despite significant public investment after Romania joined the Union, its physical infrastructure remains underdeveloped. The general condition and reliability of the road and rail networks are very poor. The infrastructure is not keeping up with the traffic demand generated by an expanding economy. The road network is among the least developed in the Union, and the reform of the railway sector is lagging behind. Greenhouse gas emissions from road transport have increased strongly over the last five years. Moreover, heavy underinvestment in maintenance has reduced train speed and affected delivery times of rail freight transport. Urban transport suffers from chronic underfinancing, poor sector organisation and the weak administrative capacity of local providers. In addition, energy, waste, water and wastewater infrastructure and energy interconnections continue to show deficiencies. The waste management system continues to be characterised by very low recycling of municipal waste and very high landfill rates. Challenges remain to achieve the energy efficiency target, in particular there is still a wide margin to improve energy efficiency in buildings.
- (20) Romania's overall innovative capacity remains low and its future competitiveness is challenged by the large productivity and innovation gap between foreign-owned and domestic firms. Romania's investment in research and development is the lowest in the Union (0,5 % of GDP), and public research and development expenditure further declined from 0,32 % of GDP in 2011 to 0,21 % of GDP in 2017, impeding any capacity building. As a consequence, the quality of the public science base remains very low and science-business links underdeveloped. As the number of tertiary graduates in science, technology, engineering and mathematics has also further declined, skills shortages pose a great challenge to the innovative potential of the Romanian economy. Digitalisation is a key challenge if Romanian innovation and competitiveness are to improve. Romania scores poorly on many components of the Digital Economy and Social Index, including digital public services, digital skills of the overall population and digitalisation of businesses.
- (21) Romania achieved limited progress in addressing a country specific recommendation to strengthen project prioritisation and preparation in public investment. The Ministry of Finance is in charge of preparing a priority list of public investment projects above RON 100 million (EUR 21 million) and monitoring their implementation, but the projects are managed by the line ministries. The list of priority projects currently includes 136 projects, mostly in the transport area. Most of these priority projects could be co-financed by Union funds. The uptake of Union funds is held back by factors like limited administrative capacity to prepare, prioritise and implement large investment projects. Even though recently large infrastructure projects are being prepared and sent to the European Commission for approval, some important projects such as the Sibiu-Pitești motorway (ensuring the connectivity with the TEN-T Rhine-Danube and Orient-East Mediterranean corridors) are still missing and implementation in general continues to lag behind. Moreover, the absorption of Union funds has so far been driven by projects prepared for the previous programming period, whereas a pipeline of new projects for the current period is yet to be fully developed.
- (22) Efficient public procurement is key to achieving important policy objectives in Romania, including efficient public spending, the modernisation of public administration and promoting innovation, sustainable and inclusive growth. Romania has made limited progress in addressing the country-specific recommendation to improve the transparency of public procurement. The efficiency of public procurement continues to be an issue, while the irreversibility of certain measures, notably the streamlining of the *ex-ante* control, is at stake. The national public procurement strategy stresses the importance of a unitary *ex-ante* control performed by the National Agency for Public Procurement. Recurrent legislative initiatives risk undermining the achievement of the objectives in the strategy. The predictability and stability of the public procurement legislation remain important challenges and the national public procurement strategy is not fully implemented.

- (23) The conduct of public policy making has become increasingly unpredictable, weighing on the business environment. A recent example is the adoption through government emergency ordinance of a set of far-reaching measures affecting the functioning of the banking sector, the second-pillar pension-fund managers, and energy and telecommunication companies, without stakeholder consultation or impact assessment. Regulatory impact assessments remain a formality, while their quality and actual use vary substantially across sectors. There is only limited quality control of regulatory impact assessments and policy design. There is no sustainable policy monitoring mechanism with a transparent reporting system and *ex-post* evaluations. Important legislative initiatives are often announced just before adoption. The involvement of stakeholders in designing and implementing reforms is weak, and genuine dialogue rarely exists, although the institutional structures for it are available. Cumbersome administrative procedures particularly affect small and medium-sized businesses. For example, burdensome administrative procedures for setting up businesses as well as regulatory requirements imposed on services providers, including regulated professions, impede further market development. The adoption of relevant legislation on human resource management in public administration is still delayed. High fragmentation of responsibilities and resources affects the consistency and availability of public services provided, especially at local level. National and regional strategies for different public services are not well translated into integrated measures at regional and local level. Funding of public services is uneven across the country and often does not correspond to local needs. Factors like a unified strategic approach per type of service, existing gaps and needs to develop new services are overlooked. Local authorities' revenues lack stability and predictability. Limited action has been taken to improve the balance between responsibilities to be decentralised and the allocation of financial resources to allow local authorities to deliver quality services. Additional actions are needed to increase administrative capacity at local level.
- (24) State-owned enterprises have a key role in critical infrastructure sectors such as energy and rail transport. Their economic and financial performance has recently improved, on the back of a favourable macroeconomic environment. However, transparency and disclosure of financial and operational results have not improved and corporate governance rules continue to be only sparsely applied. Specific examples include the repeated appointment of interim boards, departing from the spirit of the law, and the non-use of enforcement tools available under the legislation for non-compliant companies. Risks that the legislation on State-owned enterprises could be substantially weakened have not abated. This amounts to a reversal of progress made on country-specific recommendations from 2015 and 2016. As a result, key conditions for promoting the efficient use of public resources are being impaired, and space is allowed for distorted investment decisions. The transfer of the ownership of several of the larger State-owned enterprises to the new Sovereign Development and Investment Fund will require a thorough implementation of strong corporate governance rules both for the Fund and for the companies in its portfolio.
- (25) Developments throughout the past year have raised concerns with regard to the rule of law and strengthened previous serious concerns regarding the irreversibility and sustainability of Romania's earlier progress on reforming its judicial system and tackling high-level corruption. These issues are the subject of monitoring under the Cooperation and Verification Mechanism. Amendments to three justice laws are now in force and contain a number of measures weakening the legal guarantees for judicial independence. These are likely to undermine both the effectiveness of daily work by judges and prosecutors and public confidence in the judiciary. Pressure is being put on judicial institutions and on individual magistrates, including by setting up a specialised prosecution section for crimes allegedly committed by magistrates. Ongoing steps to amend the criminal code and the criminal procedure code would have a negative impact on the effectiveness of criminal investigations and trials and also reduce the scope of corruption as an offence. Further concerns relate to the processes for dismissing and appointing high-level magistrates. Recent announcements suggest that measures related to the reform of the justice system may be reconsidered.
- (26) 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 developing a positive socioeconomic environment in the country.



- (27) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Romania to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (28) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Romania's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Romania in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Romania, but also their compliance 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.
- (29) In the light of this assessment, the Council has examined the 2019 Convergence Programme and its opinion <sup>(12)</sup> is reflected in particular in recommendation (1) below.
- (30) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1), (2), (3) and (5) below. The fiscal policies referred to in recommendation (1) below contribute, inter alia, to addressing imbalances linked to competitiveness and the external position,

HEREBY RECOMMENDS that Romania take action in 2019 and 2020 to:

1. Ensure compliance with the Council Recommendation of 14 June 2019 with a view to correcting the significant deviation from the adjustment path towards the medium-term budgetary objective. Ensure the full application of the fiscal framework. Strengthen tax compliance and collection.
2. Safeguard financial stability and the robustness of the banking sector. Ensure the sustainability of the public pension system and the long-term viability of the second-pillar pension funds.
3. Improve the quality and inclusiveness of education, in particular for Roma and other disadvantaged groups. Improve skills, including digital, in particular by increasing the labour market relevance of vocational education and training and higher education. Increase the coverage and quality of social services and complete the minimum inclusion income reform. Improve the functioning of social dialogue. Ensure that the minimum wage is set on the basis of objective criteria, consistent with job creation and competitiveness. Improve access to and cost-efficiency of healthcare, including through the shift to outpatient care.
4. Focus investment-related economic policy on transport, in particular on its sustainability, low-carbon energy and energy efficiency, environmental infrastructure as well as innovation, taking into account regional disparities. Improve the preparation and prioritisation of large projects and accelerate their implementation. Improve the efficiency of public procurement and ensure the full and sustainable implementation of the national public procurement strategy.
5. Ensure that legislative initiatives do not undermine legal certainty by improving the quality and predictability of decision-making, including by appropriate stakeholder consultations, effective impact assessments and streamlined administrative procedures. Strengthen the corporate governance of State-owned enterprises.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILĂ

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<sup>(12)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Slovenia and delivering a Council opinion on the 2019 Stability Programme of Slovenia**

(2019/C 301/24)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, the Commission also adopted the Alert Mechanism Report, in which it did not identify 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 21 March 2019. On 9 April 2019, the Council adopted the recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (3) below. In particular, reducing regulatory restrictions will help address the first euro-area recommendation as regards resilient product and services markets, and focusing economic policy related to investment in the specified areas will help address the second euro-area recommendation as regards supporting investment.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Slovenia was published on 27 February 2019. It assessed Slovenia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Slovenia's progress towards its national Europe 2020 targets.
- (4) Slovenia submitted its 2019 National Reform Programme on 15 April 2019 and its 2019 Stability Programme on 26 April 2019. 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 <sup>(5)</sup>, 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) Slovenia is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme, the government expects that the headline surplus will increase to 0,9 % of gross domestic product (GDP) in 2019 and then reach 1,2 % of GDP in 2022. Based on the recalculated structural balance, the medium-term budgetary objective – which has been changed from a structural surplus of 0,25 % of GDP in 2019 to a structural deficit of 0,25 % of GDP from 2020 – is planned to be achieved by 2021 <sup>(6)</sup>. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is projected to continue to fall to 65,4 % of GDP in 2019 and to 54,7 % of GDP in 2022. The macroeconomic scenario underpinning those budgetary projections is favourable.
- (7) On 13 July 2018, the Council recommended Slovenia to ensure that the nominal growth rate of net primary government expenditure <sup>(7)</sup> does not exceed 3,1 % in 2019, corresponding to an annual structural adjustment of 0,65 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.
- (8) In 2020, Slovenia should achieve its medium-term budgetary objective. Based on the Commission 2019 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure of 4,0 %, corresponding to a structural adjustment of 0,5 % of GDP. Based on the Commission 2019 spring forecast under unchanged policies, Slovenia is forecast to be close to its medium-term budgetary objective in 2020. Thus, the current assessment indicates a risk of some deviation in 2020. While the projected nominal growth rate of net primary government expenditure would currently point to a risk of some deviation from the requirement in 2020, it would point to a risk of significant deviation from the requirement over 2019 and 2020 taken together. If the structural balance is no longer projected to be close to the medium-term budgetary objective, in future assessments an overall assessment would need to take into account a possible deviation from the requirement. Slovenia is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken in 2019 and that Slovenia needs to stand ready to take further measures as of 2020 to comply with the provisions of the Stability and Growth Pact.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 103.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(7)</sup> 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 4-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.

- (9) Population ageing will increasingly strain Slovenia's healthcare and long-term care systems. The financing for the healthcare system is not adapted to face the expected cost increases from population ageing. To date Slovenia has not adopted comprehensive measures to ensure quality, accessibility and long-term fiscal sustainability of healthcare in Slovenia. A draft long-term care act is being drawn up as part of Slovenia's active ageing strategy. However, it remains still unclear how the envisaged measures will improve cost-effectiveness, accessibility and quality of care except that public procurement in healthcare is expected to become more cost-efficient through improved coordination. Investments in health and long-term care structures and equipment could help easing future pressure on the care systems.
- (10) Challenges regarding the long-term sustainability and adequacy of the pension system are becoming increasingly pressing as the Slovenian population is ageing faster than the population of most other Member States. In the document 'Starting points for the modernisation of the Pension and Disability Insurance System in the Republic of Slovenia', adopted in 2017 by the Economic and Social Council, it was foreseen by the social partners and the previous government to adopt a reform by 2020 and the National Reform Programme 2019-2020 mentions the possibility of an overhaul of the pension system to support the medium to long-term sustainability of the system and appropriate levels of pensions. It also sets the objective of extending working lives and providing better opportunities for exploiting the human resources of older workers, but it does not specify how and when to achieve this objective. Adjusting the statutory pension age in line with increased life expectancy and promoting later retirement would make the system more sustainable. Ensuring adequate pensions remains a challenge, as some pension recipients are still at or below the poverty line. Almost 70 % of all self-employed people in Slovenia choose to pay social security contributions at the minimum level entitling them to the minimum old-age pension only. The adequacy of pensions could be further improved by boosting the coverage of the supplementary pension schemes, appropriately addressing changing career paths and by reducing old-age poverty risks.
- (11) Employment continued to rise and unemployment fell further in 2019. At the same time, long-term unemployment remains above pre-crisis levels and still represents almost half of all unemployment. Challenges persist in particular for low-skilled and older workers as their activity and employment rates remain among the lowest in the Union. Their participation in adult learning is very low. Evaluation of policies to encourage people into work or training shows that most existing programmes are performing well. However, spending in this field, and the participation rate of low-skilled and older unemployed people in the programmes remain limited. Therefore, investments in efficient measures to increase the employability of low-skilled and older workers, including in digital skills, is of particular importance. Increasing the employment rate of older workers will also help ease pressures on the pension system. While the 2013 labour market reform clearly helped certain vulnerable groups enter employment, temporary employment remains an issue. The rate of people at risk of poverty or social exclusion decreased but remains above the Union average for the elderly.
- (12) Signs of labour shortages are emerging in more and more sectors of the economy. A mismatch between the skills young people acquire during their education and the skills sought by employers appears to contribute to such shortages. Together with deficiencies in the functioning of the ecosystems for innovation, these shortages hinder industrial transformation in the priority areas of the smart specialisation strategy as defined in consultation with stakeholders. Developing digital skills in the future workforce is crucial to meet the needs of the economy.
- (13) Some measures have been or will be adopted to improve funding options for firms in Slovenia and to provide them with alternatives to bank loans. However, Slovenia's businesses still heavily rely on bank loans and cash flow to meet their funding needs. Access to equity from private markets remains low. Venture capital provision is growing, but from a very low level. The market capitalisation of the stock exchange in Ljubljana is low and continues to shrink. The limited and underdeveloped capital market, combined with unfavourable framework conditions including the low financial literacy of smaller firms, hampers the inflow of equity and venture capital into the country. The difficult access to equity presents a growth barrier for innovative companies but also for established businesses which could benefit from a change in funding.

- (14) Slovenian businesses are held back by the country's still high regulatory and administrative burden. This burden is considered a key problem for doing business in Slovenia. It relates to issues such as permits, reporting requirements, tax procedures and often lengthy commercial court proceedings. Difficulties in prosecuting economic and financial crime also impact the business environment. Slovenia has created tools to reduce administrative burden, including the SPOT portal ('Slovenska poslovna točka') and the 'Single Document', which address several of the identified burdens. However, many of the burden-reduction measures are still pending and the impact of some that have been implemented has been below expectations. Slovenia has also carried out some reforms to liberalise restrictive professional requirements. Nevertheless, some parts of the Commission's recommendations from 2017 remain unaddressed, in particular as regards lawyers and real estate agents.
- (15) Despite some progress made, there are weaknesses regarding competition and transparency in public procurement in Slovenia, as indicated notably by the high ratio of contracts arranged through negotiated procedures (without a call). The safeguards against corruption and collusion among bidders, notably in procurement by local administrations and by State-owned enterprises, remain weak. Independent oversight of public procurement lacks sufficient legal safeguards against external pressure or interference, particularly regarding the disciplinary procedures and the proposal for appointing members of the National Review Commission. An action plan to increase the professionalisation of those involved in procurement has been put in place, but professionalisation is still low. 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.
- (16) Despite the partial privatisation of 75 % minus one share of Slovenia's largest bank, Nova Ljubljanska Banka, State involvement in the economy is still high, including in the financial sector. The previously published plans for privatisation have been implemented slowly. Proceeding with privatisations would increase the viability of companies in the long run and lower the risks for public finances as well as the risk of distorting competition and resource allocation. Further sales of shares in listed companies would also help develop Slovenia's capital market.
- (17) The research, development and innovation ecosystem requires improvements to become fully functioning and support measures often lack coherence. Limited support for business education and technology transfer, and, more generally, weak cooperation between science and business, hinder the creation and scaling up of innovative companies. Most small and medium-sized enterprises in Slovenia have a low innovation capacity and the share of innovative companies in Slovenia is indeed decreasing and below the Union average. Slovenia's slow digital transformation limits productivity growth. There are discrepancies in the innovation performance between Slovenia's eastern and western regions, which hinder cooperation and networking. Slovenia is reversing its progress towards the 2020 research and development spending target at the same time as an increase in investment into research, development and innovation would strengthen the country's growth potential. Slovenia attracts a low share of international students at all levels of post-secondary education, especially at the doctoral level while international mobility of researchers and mobility between academia and industry remain limited.
- (18) For the period until 2030, Slovenia has set out objectives in terms of energy infrastructure, energy efficiency and renewables in its draft national energy and climate plan, which all require appropriate investments. In particular, Slovenia's economy is more carbon intensive than the Union average, and the share of renewables in total energy production is stagnating. The development of renewable energy sources other than wood and hydropower is particularly slow. Slovenia's industry, services and residential sector all account for higher shares of total final energy consumption than the Union average. Moreover, existing energy storage capacity is underdeveloped and so fails to address the needs deriving from non-integrated local production of renewable energy sources.

- (19) Transport has become the biggest source of CO<sub>2</sub> emissions: its share of total emissions is above the average share of this sector in the Union. Slovenia's heavy reliance on road transport creates problems of high energy and carbon intensity, as well as air pollution and road accidents. There is significant scope for improvement in rail infrastructure as well as in low carbon energy and sustainable transport in general, which could help reducing these negative effects. Important investment gaps also remain in the area of natural resources to ensure a more sustainable development model. Slovenia's economy depends on its natural environment, which is deteriorating. High dependence on imported raw materials, coupled with low recycling rates, hinder the transition to a circular economy. The state of the urban wastewater sector system, including collection and treatment infrastructure, does not fully meet Union requirements. Substantial parts of Slovenia's economy are vulnerable to natural disasters, in particular floods.
- (20) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Slovenia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (21) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Slovenia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance with Union rules and guidance. This reflects the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (22) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion <sup>(8)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Slovenia take action in 2019 and 2020 to:

1. Achieve the medium-term budgetary objective in 2020. Adopt and implement reforms in healthcare and long-term care that ensure quality, accessibility and long-term fiscal sustainability. Ensure the long-term sustainability and adequacy of the pension system, including by adjusting the statutory retirement age, restricting early retirement and other forms of early exit from the labour market. Increase the employability of low-skilled and older workers by improving labour market relevance of education and training, lifelong learning and activation measures, including through better digital literacy.
2. Support the development of equity markets. Improve the business environment by reducing regulatory restrictions and administrative burden. Improve competition, professionalisation and independent oversight in public procurement. Carry out privatisations in line with the existing plans.
3. Focus investment-related economic policy on research and innovation, low carbon and energy transition, sustainable transport, in particular rail, and environmental infrastructure, taking into account regional disparities.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Slovakia and delivering a Council opinion on the 2019 Stability Programme of Slovakia**

(2019/C 301/25)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (2) to (4) below. In particular, measures to tackle corruption and improving the justice system will help address the first euro-area recommendation as regards quality of institutions, focusing economic policy related to investment in the specified areas will help address the second euro-area recommendation as regards supporting investment, and measures to improve skills will help address the third euro-area recommendation as regards functioning of the labour market.
- (3) The 2019 country report for Slovakia was published on 27 February 2019. It assessed Slovakia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, 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 2019, Slovakia submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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) Slovakia is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government expects the headline balance to improve from a deficit of 0,7 % of gross domestic product (GDP) in 2018 to a balanced budget in 2019 and to remain unchanged out to 2022. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective — which has been changed from a structural deficit of 0,5 % of GDP in 2019 to 1 % of GDP as of 2020 — is planned to be achieved in 2020. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 47,5 % in 2019 to 44,4 % by 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 been fully specified. The budget includes a non-specified category of expenditure called budgetary reserves (totalling 0,7 % of GDP), which reduces predictability in budget implementation.
- (7) On 13 July 2018, the Council recommended Slovakia to ensure that the nominal growth rate of net primary government expenditure <sup>(7)</sup> does not exceed 4,1 % in 2019, corresponding to an annual structural adjustment of 0,5 % of GDP. In view of the Commission autumn 2018 forecast, which projected a closer position to the medium-term objective in 2019, and consistent with the rules for unfreezing the required adjustment, the nominal growth rate of net primary government expenditure should not exceed 4,6 %, corresponding to an annual structural adjustment of 0,3 % in 2019. Based on the Commission 2019 spring forecast, there is a risk of significant deviation from the recommended fiscal adjustment over 2018 and 2019 taken together.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 107.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(7)</sup> 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.



- (8) In 2020, Slovakia should achieve its medium-term budgetary objective. Based on the Commission 2019 spring forecast under unchanged policies, this is consistent with a maximum nominal growth rate of net primary government expenditure of 4,6 %, corresponding to a structural adjustment of 0,3 % of GDP. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement over 2019 and 2020 taken together. Slovakia is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact.
- (9) Slovakia's public finances face medium fiscal sustainability risks in the long term. According to the Commission's 2018 Fiscal Sustainability Report, a cumulated improvement of 2,5 percentage points of GDP in the structural primary balance would be required to stabilise the debt-to-GDP ratio over the long term, relative to the no-policy-change scenario. This is due to the projected increase in pension and healthcare expenditure that is driving up ageing costs (joint contribution of 1,8 percentage points of GDP). As birth rates are low while life expectancy in Slovakia is expected to increase further, the old-age dependency ratio (comparing elderly people with the active population — the share of the population in work of training) is projected to almost triple by 2060. And, while in 2016 there were only about three inactive people above 65 for every ten employed persons, this is projected to rise to more than seven for every ten employed by 2060 (economic old-age dependency ratio). Introducing automatic adjustments of the retirement age to life expectancy had gradually improved the long-term sustainability of the pension system. This was seen as an important tool to ensure intergenerational fairness and long-term sustainability. Concerns over the long-term fiscal sustainability of the pension systems have heightened following the adoption by Parliament on 28 March 2019 of a constitutional amendment instituting retirement age caps (64 for men and women without children, with half a year reductions for women for each of the first three children) which implies that the automatic adjustments linked to life expectancy will not be applied any more once the cap is reached. According to Slovakia's Fiscal Council, the cap will bring an additional expenditure increase of 1,6 % of GDP, from 8,6 % in 2016 to 11,4 % in 2070 compared to the increase to 9,8 % projected in the 2018 Ageing Report. This will significantly increase sustainability risks. No counterbalancing measures have been put forward at this moment and the impact on old age income and poverty has not been calculated.
- (10) Despite some progress in fighting tax evasion, tax compliance remains a challenge and the VAT compliance gap was more than twice the Union average in 2016. While measures planned under the Third Action Plan are expected to bring positive results, some of them are still pending implementation. For instance, the introduction of electronic tax returns is likely to reduce the administrative burden on taxpayers, but a failure to implement all planned measures risks diminishing the overall effect. At the same time, a structured framework of policy measures can help to reduce frequent changes in the tax code and encourage its simplification. Finally, the revenue potential of environmental and property taxation is underused relative to other Member States.
- (11) Positive developments in the labour market continue, marked by increasing employment and historically low levels of unemployment. There has been good progress in implementing the Action plan for the long-term unemployed, which has helped reduce the number of long-term unemployed by one third over two years. Nevertheless, the long-term unemployment rate remains above the Union average, affecting in particular low-skilled people, young people and Roma. In contrast to falling unemployment rates, reports of skilled labour shortages have become a major issue. Severe regional disparities in the labour market continue to be observed, with higher unemployment concentrated in three regions of eastern Slovakia and labour shortages concentrated in the western part of the country. Continued capacity building for employers and trade unions is needed to promote their more active involvement.
- (12) The range and effectiveness of policies to improve employability is limited. Training and requalification programmes have been strengthened, but are still insufficient and do not target fully the long-term unemployed and disadvantaged groups. The education system does not sufficiently contribute to socioeconomic development and is underfunded at all levels. The low quality of educational results, the participation of Roma in inclusive mainstream education as of early childhood and the effective integration of pupils from socioeconomically disadvantaged backgrounds in education and training (given the increasing early school leaving rate) are pressing challenges. Educational results and the level of basic skills remain weak by international standards,

strongly affected by the pupils' socioeconomic background. Ensuring the Slovak population is equipped with better sets of skills for a changing economy and society is a challenge. Despite progressive salary increases until 2020, the teaching profession remains unattractive and faces increasing shortages. In addition, the quality and relevance of initial training and opportunities for professional development of teachers are limited. Current measures to foster equity and inclusive education have so far fallen short of expectations, and no real progress on desegregation of Roma students was observed. The government has adopted the 'National reform plan for education and upbringing' (2018–27) and the first Action Plan (2018-19) (together with an estimated budget), as well as new legislation on quality assurance in higher education. It will be crucial that these measures are effectively implemented and monitored to see if they bring the expected results.

- (13) The low employment rate for women reflects the fact that long parental leave is rarely taken up by men and is further accentuated by limited access to and low availability of affordable childcare and long-term care facilities. For children under the age of three in particular, the overall enrolment rates in childcare are extremely low. The government adopted a new decision on mandatory participation in early childhood education and care from the age of five, with effect from 2020. However, further investment and encouraging attendance in childcare and pre-school facilities is needed.
- (14) Even though the share of people at risk of poverty or social exclusion is below the Union average, levels are considerably higher in a number of districts in Southern and Eastern Slovakia. A considerable bottleneck exists in access to high-quality and inclusive education, where the regional disparities translate into particularly pronounced early school leaving rates. Other bottlenecks concern access for disadvantaged groups, in particular for Roma, as well as people with disabilities and people that suffer from homelessness and housing exclusion, to healthcare, long-term care, social housing and other essential services. An integrated approach is essential in order to foster social inclusion for these groups.
- (15) Reforms aimed at improving the cost-effectiveness of the healthcare system are gaining momentum, although the degree of implementation has varied across different care areas. Policy measures carried out in the context of the health spending review achieved some positive results, mainly following a series of cost containment measures in the areas for pharmaceuticals and medical devices. However, there is still room for increasing efficiency and delivering better-value care by strategically reallocating resources between areas of care. Health service delivery remains excessively reliant on hospitals, which, despite regular debt relief, continue to accumulate debt and struggle to fund the investments required to improve efficiency and quality of care. While strengthening primary care is key to reducing avoidable use of hospital services, the low number of general practitioners and the limited scope of services offered in primary care act as a bottleneck to improving the efficiency of the health system. As the government has initiated measures to tackle health workforce shortages, it will be important to fit these efforts into a longer-term strategy aimed at gradually decentralising services from acute care, strengthening primary care and reinforcing preventive services.
- (16) A fragmented research system undermines the effectiveness of public research and development (R & D) investment in raising scientific research quality and does not attract private funding. Research and innovation policy suffers from ineffective coordination among ministries and other actors, leading to delays and failures of major reforms. The suboptimal transformation process of the Slovak Academy of Sciences raised concerns about the continuity of its operations, which led to the collapse of the whole process. A lack or failure of targeted measures, together with limited engagement by research institutions and limited research capacity, all contribute to low private R & D expenditure. Overall, business R & D remains one of the lowest in the Union and is centred on medium/high-tech manufacturing, areas dominated by multinational firms. Measures to stimulate knowledge transfer, strengthen innovative capacities in industry and improve cooperation between businesses and academia are advancing slowly.

- (17) To increase Slovakia's productivity and maintain the convergence process, sustained investment efforts are also needed in digital and transport infrastructure, and energy efficiency. There is a need to improve basic fixed broadband and 4G coverage and take-up of ultrafast broadband. Investing into energy efficiency, in particular in the buildings sector, and environmental technology can be a source of green growth and will help preserve scarce environmental resources. In addition, to allow less developed regions to catch up and become more knowledge-based, competitive and productive, more strategic investment is needed to fill in the infrastructure gaps and to improve transport networks. Slovakia is lagging behind with regard to completing both the core road and railway network under the Trans-European Transport Network, such as in the Rhine-Danube corridor. Weaknesses in the transport network could be tackled by enhancing the interconnectivity, multimodality and interoperability of the existing public and urban transport network, and by promoting sustainable modes of transport.
- (18) A heavy administrative and regulatory burden may negatively affect investment and innovation, especially for small and medium-sized enterprises ('SMEs'). Despite government efforts, administrative burden is not being reduced enough and the Slovak business environment is losing ground in international comparisons. Quality of legislation and lack of predictability are a concern for businesses. These challenges should be addressed by the full deployment of Slovakia's Better Regulation Strategy (RIA2020) and the strengthening of the Better Regulation Centre and analytical capacities within the State administration. The Slovak professional services sector remains highly regulated. The restrictiveness of regulation is above the weighted Union average for lawyers, patent agents, civil engineers, architects, accountants, tourist guides and estate agents.
- (19) The government is substantially reforming public procurement practices by overhauling the legal framework to simplify procedures and reduce transaction costs. A new focus on professionalisation is welcome; however, general benefits are only emerging slowly. In the context of distrust towards public institutions, public buyers need to make more effort to regain confidence from businesses, media and the public at large. This hinders the introduction of much needed novel practices. Efforts to increase the use of quality criteria need to be stepped-up to achieve better value for money and improve strategic use of public procurement.
- (20) Slovak public administration still faces inefficiencies and bottlenecks caused in particular by ineffective cooperation between government departments. The lack of capacity and strategic planning as well as administrative inefficiencies hamper a smooth delivery of ESI Funds. As a result, Slovakia lost EUR 120 million of funding from the 2014-2020 period, while distribution of funds to final beneficiaries remains low. In addition, sub-optimal preparation of projects funded by ESI Funds led to delayed investment and resulted in tight deadlines for public procurement procedures, increasing the risk of irregularities.
- (21) Corruption continues to pose a challenge and there has been only limited determination to prosecute high-level corruption cases. Efforts to combat corruption are hindered by organisational and procedural weaknesses at the police and prosecutor's level, and weak protection for whistle-blowers. Also, improving the effectiveness of the justice system, including its independence, remains a challenge. Despite some improvements in terms of efficiency and quality, concerns about the independence of the judiciary persist and the delay in the process for appointing judges to the constitutional court could affect the functioning of the justice system.
- (22) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Slovakia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening Slovakia's administrative capacity for the management of these funds is an important factor for the success of this investment.

- (23) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Slovakia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (24) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion <sup>(8)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Slovakia take action in 2019 and 2020 to:

1. Achieve the medium-term budgetary objective in 2020. Safeguard the long-term sustainability of public finances, in particular that of the healthcare and pension systems.
2. Improve the quality and inclusiveness of education at all levels and foster skills in line with labour market needs. Enhance access to affordable and quality childcare and long-term care. Promote integration of disadvantaged groups, in particular Roma.
3. Focus investment-related economic policy on healthcare, research and innovation, transport, in particular on its sustainability, digital infrastructure, energy efficiency, competitiveness of SMEs, and social housing, taking into account regional disparities. Increase the use of quality related and lifecycle cost criteria in public procurement operations.
4. Continue to improve the effectiveness of the justice system, focusing on strengthening its independence, including on judicial appointments. Increase efforts to detect and prosecute corruption, in particular in large-scale corruption cases.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Finland and delivering a Council opinion on the 2019 Stability Programme of Finland**

(2019/C 301/26)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area <sup>(3)</sup> ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

<sup>(3)</sup> OJ C 136, 12.4.2019, p. 1.

- (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 2019 Recommendation for the euro area, as reflected in recommendations (3) and (4) below. In particular, focusing economic policy related to investment on the specified areas will help address the second euro-area recommendation as regards supporting investment, and measures to contain household indebtedness will help address the fourth euro-area recommendation as regards reducing private debt.
- (3) The 2019 country report for Finland was published on 27 February 2019. It assessed Finland's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 <sup>(4)</sup>, the follow-up given to the recommendations adopted in previous years and Finland's progress towards its national Europe 2020 targets.
- (4) On 4 April 2019, Finland submitted its 2019 National Reform Programme and its 2019 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 <sup>(5)</sup>, 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) Finland is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, which was submitted on a no-policy-change basis by the previous government shortly before the general elections in April, the government plans a headline balance of  $-0,3\%$  of gross domestic product (GDP) in 2019, up from  $-0,7\%$  of GDP from 2018. According to the Government, the balance is projected to improve further in 2020 to  $0\%$  and, thereafter, to worsen again to  $-0,1\%$  in 2021 and  $-0,3\%$  in 2022. Based on the recalculated structural balance <sup>(6)</sup>, the medium-term budgetary objective, set at a structural deficit of  $0,5\%$  of GDP, is forecast on a no-policy-change basis to continue to be overachieved throughout the programme period, taking account of the allowances in 2019 linked to the implementation of the structural reforms for which a temporary deviation is granted. The general government debt-to-GDP ratio, which peaked at  $63,4\%$  in 2015, declined to  $58,9\%$  in 2018. According to the 2019 Stability Programme, the debt ratio will continue to decrease and reach  $57,4\%$  of GDP in 2021. It is projected to increase again in 2022 to  $57,7\%$  of GDP. 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 cost of ageing and higher inflation.
- (7) On 13 July 2018, the Council recommended Finland to achieve the medium-term budgetary objective in 2019, taking account of the allowances linked to the implementation 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 <sup>(7)</sup> of  $2,9\%$  in 2019, corresponding to an allowed deterioration in the structural balance by  $0,2\%$  of GDP. According to the Commission 2019 spring forecast, Finland is expected to be at its medium-term budgetary objective in 2019 taking account of the granted allowance linked to the structural reform clause.

<sup>(4)</sup> OJ C 320, 10.9.2018, p. 112.

<sup>(5)</sup> 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).

<sup>(6)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>(7)</sup> 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.

- (8) In 2020, in view of Finland's projected output gap of 0,8 %, the nominal growth rate of net primary government expenditure should not exceed 1,9 %, 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. According to the Commission 2019 spring forecast under unchanged policies, Finland is projected to be at risk of some deviation in 2020. Overall, the Council is of the opinion that Finland is projected to comply with the provisions of the Stability and Growth Pact in 2019 and needs to stand ready to take further measures to ensure compliance with the provisions of the Stability and Growth Pact in 2020.
- (9) Due to the ageing population and declining workforce, spending on pensions, health and – especially – social care (long-term care) is projected to increase in the coming decades. According to the 2018 Fiscal Sustainability Report, the projected increase in ageing costs would require a fiscal consolidation amounting to 2 % of GDP to stabilise the debt-to-GDP ratio in the long term. The preparations for a reform of regional government, health and social services, designed to address these challenges and to ensure equal access and reduce waiting times, were discontinued due to the resignation of the Government on 8 March 2019. The ratio of self-declared unmet medical needs in Finland remains above the Union average. In particular, people outside the workforce are having difficulties getting the necessary medical care due to long waiting lists.
- (10) Amid a shrinking working-age population and rising levels of vacancies, the Finnish labour market is tightening. At the same time, activity and employment rates in Finland are lower than in the other Nordic countries and structural unemployment remains at 7 % in 2018. This partly reflects inactivity and unemployment traps hindering a better use of the labour force. The barriers to getting people back to work include the complex benefits system and the combination of different types of allowances. Benefits are phased out rapidly as income increases, which creates the risk that taking up work might not be sufficiently financially rewarding. Uncertainty surrounding the level of benefits and the time to reinstate them reduces the attractiveness of short-term or part-time work. The basic income experiment, the preliminary results of which were published in February 2019, provides some information for revising the social security system to combine benefits more effectively with earnings.
- (11) Investments in active inclusion, especially of groups furthest from the labour market, are necessary to increase the participation rate now that activity and employment rates are close to pre-crisis levels. Comprehensive reforms aiming at fostering labour market participation could bring about better opportunities in the labour market for some groups. This concerns people with a migrant background, women at childbearing age, low-skilled men, people partially able to work and persons with disabilities. Some services for the unemployed and inactive are dispersed among separate authorities and providers. Helping these groups to join and remain in the labour market requires tailor-made and integrated activation and rehabilitation services and policies. Long caretaking responsibilities for women contribute to the gender employment gap and the gender pay gap. The government initiated a process to reform family leave, but did not carry it through.
- (12) Ensuring the supply of labour in times of demographic and technological change is key to fostering sustainable and inclusive growth in Finland. Investing in skills, especially those relevant to the labour market, would help meet the challenges created by structural change in the economy. Technological change calls for continuous training and reskilling of the workforce through flexible ways of learning, including by focusing on adult learning, education and training. This should increase occupational mobility, reducing skills mismatches and helping to meet future labour market needs.
- (13) Finland is at risk of missing the 2020 municipal waste recycling target of 50 %. In particular, municipal waste is increasingly incinerated (60 % in 2017 compared to 55 % in 2016).

- (14) While public spending on research and development is now stabilising, Finland experienced the sharpest decline of all the Member States since 2009 in private-sector investment in research and development. Despite an improvement in the macroeconomic situation in recent years, private-sector investment in research and development has not recovered yet. A higher intensity of investment in research and development is a key factor enabling structural change to favour knowledge-intensive sectors of the economy and strengthen long-term growth potential. In addition, cooperation between higher education institutions and the business sector remains one of the key bottlenecks to stimulating innovations and bringing them to the market.
- (15) With a dispersed population, transport bottlenecks may prevent people from moving to find jobs. Strategic investment in the transport infrastructure may improve labour mobility and thereby strengthen the functioning of labour markets. In parallel, as transport costs have a relatively high impact on the final price of products in Finland compared to other Member States, infrastructure interconnections could enhance access to markets abroad.
- (16) Strategic investment in decarbonising energy-intensive industries and the transport sector would help achieve long-term economic and climate goals. Finland is a leader in clean energy innovation and private research and development spending in this area. Further investment in some of its clean energy programmes by 2021, as committed, would help Finland meet its carbon neutrality objectives. Besides Finland's ambitious objectives for increasing the share of biofuels, electrification is a cost-efficient option for decarbonising the transport sector, given the advanced decarbonisation of power generation.
- (17) Low interest rates and the improved economic outlook have increased the overall volume of lending, especially through housing companies (which provide a distinctive form of home ownership). In parallel, consumer credit is increasing rapidly and a rising share of this lending is granted by foreign banks, financial institutions other than credit institutions, small-loan companies and peer-to-peer lending. Household debt therefore remains at a historically high level (67 % of GDP in 2017). The debt is predominantly at a variable rate, which constitutes a risk if interest rates rise in the medium term. The Finnish Financial Supervisory Authority has adopted a number of measures to contain the increase in the indebtedness of households. However, no active reduction of the debt burden is expected soon, especially as interest rates remain low and consumer confidence is still relatively strong.
- (18) At this stage, Finland does not have a comprehensive (i.e. collecting both positive and negative information on debtors) credit registry that covers its major banks. The lack of this can prevent banks having a clear overview of households' overall indebtedness. Some preparatory work for the setting up of a registry of this kind has been carried out in the last year.
- (19) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Finland to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (20) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Finland's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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 2019 Stability Programme and its opinion <sup>(8)</sup> is reflected in particular in recommendation (1) below,

<sup>(8)</sup> Under Article 5(2) of Regulation (EC) No 1466/97.



HEREBY RECOMMENDS that Finland take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1,9 % in 2020, corresponding to an annual structural adjustment of 0,5 % of GDP. Improve the cost-effectiveness of and equal access to social and healthcare services.
2. Improve incentives to accept work and enhance skills and active inclusion, notably through well-integrated services for the unemployed and the inactive.
3. Focus investment-related economic policy on research and innovation, low carbon and energy transition and sustainable transport, taking into account regional disparities.
4. Strengthen the monitoring of household debt and establish the credit registry system.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of Sweden and delivering a Council opinion on the 2019 Convergence Programme of Sweden**

(2019/C 301/27)

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 <sup>(1)</sup>, 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 <sup>(2)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> OJ L 306, 23.11.2011, p. 25.

- (2) The 2019 country report for Sweden was published on 27 February 2019. It assessed Sweden's progress in addressing the country-specific recommendation adopted by the Council on 13 July 2018 <sup>(3)</sup>, 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 27 February 2019. 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 high household debt has continued to grow as a share of GDP. There was a correction of house prices in the second half of 2017 and since then they have gradually stabilised. Nevertheless, valuation indicators suggest that house prices remain high relative to fundamentals. Although the banking sector appears adequately capitalised, a disorderly correction would negatively affect the financial sector given the large exposure to household mortgages. In such a case, there could also be negative spill-overs to neighbouring countries given the systemic financial interlinkages. Structural bottlenecks for housing supply persist and construction output has weakened. Although steps have been taken in recent years in the macro prudential field to address mortgage debt growth, the impact so far appears limited. Key policy gaps remain, particularly in relation to tax incentives for home ownership and the functioning of housing supply and the rental market.
- (3) Sweden submitted its 2019 National Reform Programme on 26 April 2019 and its 2019 Convergence Programme on 29 April 2019. 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 <sup>(4)</sup>, 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) Sweden is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Convergence Programme, the government plans to achieve a surplus of 0,6 % of gross domestic product (GDP) in 2019, which is expected to strengthen further over the programme horizon. Based on the recalculated structural balance <sup>(5)</sup>, the medium-term budgetary objective — a structural deficit of 1 % of GDP — is planned to be overachieved throughout the programme period. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to fall to 34,5 % in 2019 and to continue declining to 28,2 % in 2022. Sound public finances and a stable economic growth 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 2019 spring forecast, the structural balance is forecast to register a surplus of 0,5 % of GDP in 2019 and 0,6 % of GDP in 2020, above medium-term budgetary objective. Overall, the Council is of the opinion that Sweden is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.
- (6) Household debt has continued to rise from already high levels. Household debt grew by 5,5 % in 2018, reaching about 88 % of GDP and 186 % of disposable income, which is among the highest in the Union. This was driven mainly by higher mortgage borrowing linked to high house prices, coupled with structural distortions favouring mortgage-financed property purchases. Sweden has implemented several macro-prudential measures in recent years, including a strengthened repayment rule for high debt-to-income mortgages in force since March 2018,

<sup>(3)</sup> OJ C 320, 10.9.2018, p. 116.

<sup>(4)</sup> 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).

<sup>(5)</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

and a decision to raise the countercyclical capital buffer for banks from September 2019. However, the policy steps taken so far appear to have had limited overall impact on the growth of mortgage lending and no policy action has been taken to reform the tax incentives for home ownership and mortgage debt.

- (7) While house prices declined in late 2017 and have since been broadly stable, this follows a long period of strong price rises, and valuations remain well above economic fundamentals. Key issues include tax incentives favouring home ownership and mortgage debt, and accommodative credit conditions coupled with still relatively low mortgage repayment rates. Despite a significant increase in new construction over the past five years, a shortage remains, particularly of affordable homes around major cities. New housing supply failed to reach projected near-term needs, estimated at about 90 000 new homes per year for 2018-2020. This shortage is linked to structural inefficiencies, such as 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. The housing stock is not used efficiently. 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 housing shortage makes it harder for people to change jobs and can contribute to intergenerational inequality. The Swedish authorities are continuing to gradually implement the '22-point plan' to increase residential construction and improve the efficiency of the housing sector. So far, there have been no concrete policy steps to liberalise tight rental market regulations and revise the capital tax on owner-occupied homes, although in January 2019 the new government announced plans to introduce reforms in these areas, subject to preparatory inquiry work.
- (8) Labour shortages are emerging in some sectors, such as in construction, education and information and communication technologies. Ensuring a supply of specialist human capital is vital to support research and development investment as well as digitalisation. Investing in education and skills, including digital skills, will help to address those challenges. So far, the educational outcomes have improved somewhat, but there is a large and increasing educational performance gap between different social groups. Demographic developments will lead to an increase in the number of pupils, exacerbating the present shortage of teachers. The situation of non-Union migrants and their descendants and the effects of recently adopted programmes deserve closer monitoring, as the school integration of foreign-born pupils, and the sustainable inclusion of the low-skilled and non-Union migrants (in particular women) into the labour market remain a challenge.
- (9) Maintaining investments in transport infrastructure can contribute to improved labour mobility, regional cohesion and housing market and foster Sweden's long-term productivity growth. The government has announced considerable investments in transport infrastructure through the national plan for infrastructure 2018-2029 to upgrade the different transport modes (in particular railway and road). The plan contains major investments to develop the railway system, promoting the switch in goods transport from roads to railways, thus also helping to reduce emissions. Maintaining high levels of investment in research and development, favourable framework conditions and a broader innovation base are key to securing Sweden's position as innovation leader. Sweden's innovation model has traditionally relied on a limited number of large, globally active, technology companies. It would be important to create an environment that also nurtures the innovation potential of SMEs and start-ups. Sweden's innovation capacity could also be further improved by increased collaboration between academia and SMEs.
- (10) Preventing money laundering has become a priority for Sweden against the background of an evolving money laundering scandal related to one of the largest financial institutions in the country. The Swedish and Estonian financial supervisors have started a joint investigation, together with their Latvian and Lithuanian counterparts. While Sweden's anti-money-laundering framework has been strengthened in 2017, when the money laundering act entered into force, continued work to identify and correct any remaining deficiencies of the framework remain important. Challenges remain and the supervisor still needs to adopt additional measures and guidelines on how to strengthen supervision in this area. Attention should be paid to the effective implementation of these measures, once adopted.

- (11) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Sweden to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (12) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Sweden's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme, the 2019 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 their compliance 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.
- (13) In the light of this assessment, the Council has examined the 2019 Convergence Programme and is of the opinion that Sweden is expected to comply with the Stability and Growth Pact.
- (14) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 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 2019 and 2020 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 investment in residential construction where shortages are most pressing, in particular by removing structural obstacles to construction. Improve the efficiency of the housing market, including by introducing more flexibility in rental prices and revising the design of the capital gains tax.
2. Focus investment related economic policy on education and skills, maintaining investment in sustainable transport to upgrade the different transport modes, in particular railways, and research and innovation, taking into account regional disparities.
3. Ensure effective supervision and the enforcement of the anti-money-laundering framework.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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**COUNCIL RECOMMENDATION****of 9 July 2019****on the 2019 National Reform Programme of the United Kingdom and delivering a Council opinion  
on the 2018-2019 Convergence Programme of the United Kingdom**

(2019/C 301/28)

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 <sup>(1)</sup>, 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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council <sup>(2)</sup>, 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.

<sup>(1)</sup> OJ L 209, 2.8.1997, p. 1.

<sup>(2)</sup> 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 (OJ L 306, 23.11.2011, p. 25).

- (2) The 2019 country report for the United Kingdom was published on 27 February 2019. It assessed the United Kingdom's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and the United Kingdom's progress towards its national Europe 2020 targets.
- (3) On 23 April 2019, the United Kingdom submitted its 2019 National Reform Programme and its 2018-2019 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (4) On 29 March 2017, the United Kingdom notified the European Council of its intention to leave the European Union. When the United Kingdom leaves the European Union, it will become a third country. As there is uncertainty over the date and terms of the United Kingdom's withdrawal, as well as the United Kingdom's future relations with the Union, this Recommendation does not speculate on the possible economic implications of different scenarios. In the event that the United Kingdom leaves the Union on the basis of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community <sup>(3)</sup> ('the Withdrawal Agreement'), which has been agreed by the government of the United Kingdom and which the European Council endorsed on 25 November 2018, Union law, including the European Semester, will continue to apply to and in the United Kingdom, for the duration of the transition period established by the Withdrawal Agreement.
- (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 <sup>(4)</sup>, 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 until 2019-2020. In its 2018-2019 Convergence Programme, the government expects the headline deficit to increase from 1,2 % of gross domestic product (GDP) in 2018-2019 to 1,4 % of GDP in 2019-2020 and to fall to 1,1 % of GDP in 2020-2021. 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 fall from 85,5 % in 2018-2019 to 83,8 % in 2019-2020 and to 82,9 % of GDP in 2020-2021. 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 <sup>(5)</sup> in a number of areas pose a risk to the achievement of the planned deficit path.
- (7) On 13 July 2018, the Council recommended the United Kingdom to 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. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the requirements of the preventive arm in 2019-2020.

<sup>(3)</sup> OJ C 66 I, 19.2.2019, p. 1.

<sup>(4)</sup> 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).

<sup>(5)</sup> 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.

- (8) In 2020-2021, in view of the United Kingdom's general government debt ratio above 60 % of GDP and projected output gap of 0,3 %, the nominal growth rate of net primary government expenditure should not exceed 1,9 %, 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 2020-2021. The United Kingdom is projected to comply with the transitional debt rule in 2019-2020, as a result of the allowed annual deviation of 0,25 %, and with the debt rule in 2020-2021. Overall, the Council is of the opinion that the United Kingdom needs to stand ready to take further measures as of 2019-2020 to comply with the provisions of the Stability and Growth Pact.
- (9) The United Kingdom has long been the G7 economy with the lowest capital investment as a share of GDP. Investment also fell particularly sharply during the financial crisis, and a post-crisis recovery in private investment has stalled. The United Kingdom's research and development investment intensity has been around 1,7 % of GDP for the past decade, below the Union average. Through its Industrial Strategy, the United Kingdom has set a whole-economy target of 2,4 % of GDP by 2027 and 3 % of GDP in the longer term. Research and development investment is concentrated in a limited number of companies and regions. These broad-based shortfalls in both physical and human capital are a root cause of the United Kingdom's relatively low and stagnant labour productivity.
- (10) The United Kingdom has a persistent housing shortage. A post-crisis recovery in house building has lost momentum. Capacity constraints are emerging while residential construction remains below what is required to meet estimated demand. House prices and rents remain high, especially in areas of high housing demand, with signs of overvaluation. Significantly fewer young adults now own their own homes. The government is implementing a range of measures to boost housing supply. At the same time, the amount and location of land available for new housing remains limited by tight regulation of the land market, particularly around big towns and cities.
- (11) Major investment is needed to modernise and expand infrastructure networks while bringing down project costs and greenhouse gas emissions. There are growing capacity pressures in road, rail and aviation networks. The United Kingdom needs to deliver significant new and greener energy generation and supply capacity. The United Kingdom's infrastructure development has tended to be costly and slow. After decades of public under-investment, the government is starting to deal with the infrastructure deficit through its National Infrastructure Strategy, but it will be challenging to secure the amount of outside funding required in the government's projections in a cost-effective manner.
- (12) Although unemployment is low, real wages remain below their pre-crisis peak. The high proportion of low-skilled employees has limited career progression prospects, weighing on productivity and contributing to high levels of in-work poverty. There is scope to improve the effectiveness of the education and training systems in basic and technical skills. The government is making reforms to both classroom and work-based training, but overall registrations for the new twin-track system are far fewer than expected.
- (13) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of the United Kingdom's economic policy and published it in the 2019 country report. It has also assessed the 2018-2019 Convergence Programme and the 2019 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 their compliance 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.



(14) In the light of this assessment, the Council has examined the 2018-2019 Convergence Programme and its opinion <sup>(6)</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that the United Kingdom take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1,9 % in 2020-2021, corresponding to an annual structural adjustment of 0,6 % of GDP.
2. Focus investment-related economic policy on research and innovation, housing, training and improving skills, sustainable transport and low carbon and energy transition, taking into account regional diversity.

Done at Brussels, 9 July 2019.

*For the Council*  
*The President*  
M. LINTILÄ

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<sup>(6)</sup> Under Article 9(2) of Regulation (EC) No 1466/97.





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