BUSINESSEUROPE

REFORM BAROMETER SPRING 2018

THE EU ECONOMY 10 YEARS AFTER THE START OF THE CRISIS

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WHO ARE WE ?

BusinessEurope is the leading advocate for growth and competitiveness at the European level, standing up for companies across the continent and campaigning on the issues that most influence their performance.

A recognised social partner, we speak for all-sized enterprises in 34 European countries whose national business federations are our direct members.

WHAT IS THE REFORM BAROMETER ?

BusinessEurope's Reform Barometer looks at the global competitiveness performance of Europe on the basis of key indicators covering taxation and public finances, business environment, innovation and skills, access to finance and financial stability, and labour market. Based on a survey of BusinessEurope's member federations, the report evaluates the recommendations for structural reforms made under the European Semester, assesses progress in implementing them and identifies priorities for future reforms.

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FOREWORD

2018 marks 10 years since the start of the financial crisis. This year's Reform Barometer looks at how the EU has performed relative to its global counterparts in the years that followed the crisis, and in particular considers how well placed the EU is now to compete in the global economy compared to the eve of the crisis.

The global financial crisis has meant that developed economies across the globe have lost growth capacity as some firms have gone out of business, investment rates have fallen and industrial change has reduced demand for some skills, whilst creating shortages for others. At the same time, long-term challenges such as Europe's ageing population and the need to address global carbon emissions have become more pressing.

Whilst 2017 has been a strong year for the EU economy, it was nevertheless one of only three years over the last ten in which EU growth outperformed that of the USA. And whilst the USA economy is now 15% bigger than in 2007, by comparison, the EU is just 9% larger. Europe needs to ensure that it uses the present period of strong growth, which continues to be driven in part by temporary factors, notably the ECB's asset purchase programme, to put in place reforms to support our long-term competitiveness and ensure the sustainability of public finances. Our annual survey of Member Federations suggests that there remains a lack of urgency amongst the majority of Member States to put in place the growth-enhancing reforms recommended by the EU, and generally supported by our members, with only 22% of reforms implemented satisfactorily in 2017.

Whilst the EU has many world-class businesses, innovators and skilled workers, much more can be done to help raise growth and living standards. With the USA having recently put in place a major corporate tax reform which will significantly improve its attractiveness as an investment location, the EU needs to use all possible levers to improve its competitiveness. As well as making administrative requirements less onerous, the EU can also contribute by taking further steps to complete the single market, helping Member States address relatively low levels of R&D spending, reduce labour taxes and increase investment in key growth-enhancing projects such as infrastructure projects.

Most urgent is the need to address rapidly growing skill shortages which, despite the relatively recent recovery, are already at their highest in over 20 years, posing a real risk that the falls in unemployment seen in recent years will soon slow. As well as a fundamental drive to improve work-orientated learning for all age groups, broader efforts to ensure that regulation, collective-bargaining structures and the tax system all support employment creation must be a priority in 2018.

Emma Marcegaglia
President

Markus J. Beyrer
Director General

EXECUTIVE SUMMARY

PART 1: EU COMPETITIVENESS IN THE GLOBAL ECONOMY

In the 10 years since the crisis, the EU's recovery proceeded at a particularly slow pace compared to that of other major economies. In 2017, EU output was only 9% above pre-crisis levels, compared to 15% in the USA and 18% in Canada.

2017

In 2017, we have seen a strengthening of the EU's recovery, with growth surpassing 2%, and the creation of more than 11 million jobs since the height of the euro crisis in 2013.

Moreover, the recent strengthening of the **EU's recovery is underpinned by a number of temporary factors**, notably the ECB's expanded asset purchase programme. The underlying EU capacity for long-term growth, without reform, is only 1.3% and thus well below its current 'cyclical' growth of close to 2%.

1. LABOUR MARKET AND SKILLS

- While unemployment still remains high in several Member States, businesses increasingly report difficulties in hiring qualified workers; twice the pre-crisis share and the highest on record since 1985. There are indications of the emergence of a structural mismatch in EU labour markets.
- The average tax wedge is in Europe with 42% almost one third higher than in Japan and the USA (both about 32%), with barely any structural changes compared to 10 years ago.
- On the key OECD PISA education outcomes, the EU has made little progress in closing the structural difference in education performance with Japan, Canada and South Korea.

POLICY RECOMMENDATIONS

1. Urgent policy action is required to that avoid labour market mismatches increasingly act as a break on economic growth. Education and training systems need to be better tailored to labour market needs; more STEM graduates are needed as well as people with digital skills.

2. Reduce non-wage labour costs through targeted cuts in the tax wedge, which includes social security contributions, to stimulate demand by encouraging employers to hire more staff.

3. To ensure open, dynamic and mobile labour markets which help alleviating mismatches, reforms must be implemented to stimulate job creation, in particular for young people, and employment participation. Further development of the law through judicial decisions is not seen as a suitable solution for the fast-moving environment of digital technologies.

4. In order to maintain and increase global competitiveness, the labour market regulatory framework needs to be clear, simple and flexible.

5. Setting in motion a genuine partnership for labour market reforms: the EU's primary role is to provide information, incentives and know-how for Member States and social partners to design, implement and evaluate policies addressing structural labour market challenges.

6. Reforms are required to encourage people to stay in the workforce longer, make pension systems sustainable in the long term, and ensure we properly integrate legal migrants into the workforce.

2. BUSINESS ENVIRONMENT

- It remains **more difficult to do business in the EU** than in the USA 10 years after the crisis, with their relative positions in the World Bank's Doing Business Ranking essentially unchanged.

POLICY RECOMMENDATIONS

1. Achieve a truly integrated single market, in particular in the areas of digital economy, telecoms, energy and services.

2. Ensure that regulation, at EU and national level, is well designed and properly enforced, with a minimum of administrative burdens.

3. Energy prices must allow EU businesses to be competitive in international markets. Targeted measures (e.g. reforming taxes and levies, liberalising energy markets, etc.) to address the energy price differential with major competitors and to ensure energy security should be introduced.

4. Trans-European (and national) infrastructure must be expanded. Remaining regulatory, administrative and technical barriers in all modes of transport, and energy infrastructure, need to be removed to ensure access to adequate infrastructure facilities.

3. INNOVATION AND DIGITAL TRANSFORMATION

- **R&D intensity** remains much lower in the EU (2.0% in 2015) than in Japan (3.3%) and the USA (2.8%), also reflected in the low number of EU patent applications. China strongly increased its share of spending over the last decade (from 1.4% to 2.1%) and recently overtook the EU. An additional €150 bn a year would have to be invested to reach the EU's own 3% Europe 2020 target.

- Just as in 2007, the EU continues to lag behind its competitors in some key **metrics for digital communication, in particular broadband**. While in 2007, the availability of fixed broadband was of key concern, in 2016 (fast) fibre connections are much less prevalent in the EU, compared to Japan and South Korea.

POLICY RECOMMENDATIONS

1 EU Member States should increase R&D spending, and encourage higher private sector R&D spending, in order to reach the 3% commitment in the EU growth strategy. In particular in the post-2020 multi-annual financial framework the overall EU budget for R&D&I should be consistently scaled up.

2 Innovation policies must be more business-orientated to better capture the economic value from research & innovation investment. Targeted initiatives that stimulate private R&D investment and strike the right balance between direct and indirect R&D promotion via tax subsidies are needed. Incentives for cooperation between companies and research institutes in networks and clusters should be improved.

3 Adopt the latest technologies enabling businesses to compete globally. Achieving this will rely upon our digital infrastructure. This in particular when it comes to providing very high-capacity networks in order to launch 5G on a large scale.

4 Ensure a level playing field to eliminate barriers hampering cross-border e-commerce, prevent forced data localisation measures, and address legal fragmentation in the areas of consumer legislation, taxation, copyright and data protection rules.

4. ACCESS TO FINANCE AND FINANCIAL STABILITY

- In spite of recent progress, **non-performing loans (NPLs)** were with 4.4% in 2016 still well above the 1.3-1.4% seen in the USA and Japan.
- Euro-area businesses fund themselves to a larger extent via **bank lending** compared to the USA, where companies rely more on **capital markets**. Stock market capitalisation (as % of GDP) in the Euro-area is less than half that in the USA and almost two-fifths below that in Japan.
- While **venture capital (VC) investment** doubled in the EU in absolute terms since 2010, investment in the USA increased by almost 2.7 times, implying the gap between the EU and USA increased even further (2016: $18bn vs $83).
- Whilst **Euro-area banks** now feel more confident in **lending** again outside of the EU, their lending to other banks, institutions and firms within the Euro-area, but outside of their own Member State has continued to fall.

POLICY RECOMMENDATIONS

1 Reinforce and implement the Capital Markets Union proposals to ensure that the EU establishes a genuine single market in financial services, and develops complementary sources of finance to bank lending, in order to offset the consequences of banks deleveraging on companies' access to credit, in particular SMEs.

2 Following the publication of the comprehensive impact assessment on financial regulation, take action to ensure prudential rules strike the right balance between increasing financial stability and supporting companies' financing needs for investment and business activities.

3 Put a comprehensive banking union in place without further delay, including through making decisions on further development of a single resolution mechanism and, following asset quality reviews for all relevant banks, a deposit insurance scheme.

4 The introduction of higher capital requirements for NPLs could negatively affect the market price of these loans harming the development of a secondary markets and leading to significant reductions in banks' capital. The differences between EU countries' banking systems should be considered to ensure balanced actions when addressing still highlevels of NPLs in many European banks in a way which increases new lending and maintains financial stability.

5. TAXATION AND PUBLIC FINANCE

- While EU Member States made further progress in bringing down government **deficits**, there remains much more to be done to reduce EU public **debt levels** which are with 84% of GDP still well above the 58% in 2007 and the 60% Maastricht limit.
- Despite the recent focus on consolidation via expenditure reduction, **public expenditure** as a % of GDP remains with 46% of GDP in the EU well above the 37% in Japan and 36% in the USA.
- It is of concern that the **share of growth-friendly public spending** in overall spending has slightly fallen in the EU since the crisis (from 30.9% in 2007 to 30.4% in 2015), while in the USA the share of growth-friendly public spending increased in the same period (from 43.0% to 45.3%), further increasing the gap.

POLICY RECOMMENDATIONS

1. In all Member States, there is scope to make public finances growth-friendlier and more efficient, in particular by targeted reductions in non-productive public spending and by reductions in distortionary taxes that hamper growth. The efficiency of the fiscal rules must be improved, with more attention to the quality and composition of their public finances.

2. The proper implementation of the Stability and Growth Pact (SGP), drawing on built-in flexibility, remains essential to help Member States put their public finances on a sustainable footing. This is key in order to strengthen investors' trust in the Euro-area. But it is also essential that the SGP gives the fullest support possible to Member States who wish to orientate their budgets towards investment and growth-supporting expenditure.

3. Tax reforms should reduce taxation on labour and capital, including corporation tax, which are particularly damaging to growth and employment.

4. Member States should continue their efforts to ensure the administration of their tax systems becomes simpler, more transparent and user-friendly.

PART 2: STRUCTURAL REFORM PROGRESS - MEMBER FEDERATIONS' ASSESSMENT

- While our Member Federations believe that the EU's country-specific reform recommendations (CSRs) focus on the right reform objectives, Member States still demonstrate **unsatisfactory levels of implementation**. Only 22% of the CSRs assessed have been implemented appropriately according to our members, a slight increase compared to our previous assessment (17%).

- The most pressing concern to our members is the **slow pace of reform in the labour market**. Member States should step up their efforts to address in particular skills mismatches and design well-working labour supply measures. At the same time, federations remain very positive about reform progress in the area of financial stability and public finances.

- Our overall reform index consistently saw disappointing levels of implementation of CSRs during the post-crisis period. It is essential that Member States make use of the current positive economic climate **to implement structural reforms** in order to maintain sustainable economic growth in the long term, with the EU using all available tools to support Member States in their reform efforts.

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INTRODUCTION

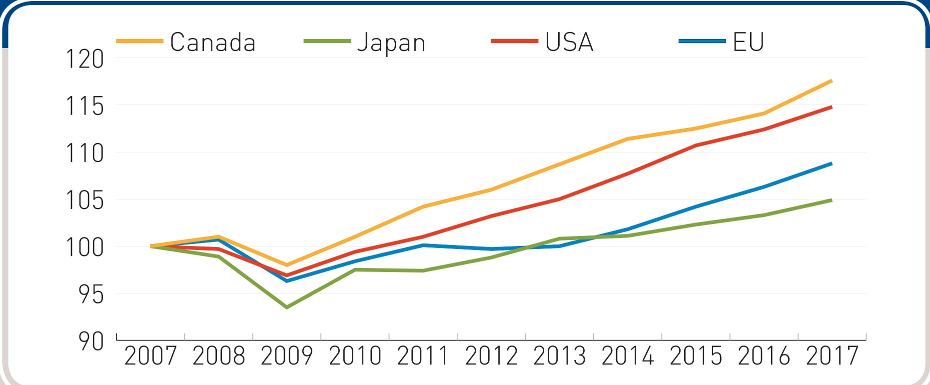
While we have seen a recent strengthening of the recovery, the EU economy lost ground with other leading economies over the past decade.

In 2017, we have seen a strengthening of the EU's recovery, with growth surpassing 2%, and the creation of more than 11 million jobs since the height of the euro crisis in 2013.

However, if we make a comparison to 10 years after the crisis, it is clear that the EU's recovery proceeded at a particularly slow pace compared to that of other major economies (graph 1). In 2017, EU output was 9% above pre-crisis levels, compared to 15% in the USA and 18% in Canada. While the USA only had a financial crisis-induced recession, the EU experienced a second **"double-dip" recession** related to the Euro-area sovereign debt crisis. It is during this period (beginning 2012) where the growth gap between the EU and USA emerges.

Even if we look at **GDP per capita growth**, the USA economy expanded with 6.5% at a faster rate than the EU with 5.1% during 2007 and 2017, despite the higher population growth we saw in the USA over the last decade[1]. It also implies that the EU continues to lag behind the USA when it comes to **GDP per capita levels**. In 2017, the USA produced 46% more per person than the EU in 2017, slightly up from 44% in 2007 (IMF data[2]). Finally, **GDP per hours worked** increased also more strongly in the USA than in the EU between 2007 and 2016[3].

Graph 1: The EU recovery lost ground from 2011



Real GDP, constant prices and national currency, 2007-17

Source: BusinessEurope calculations based on IMF data

[1] The population grew 2.7% in the EU vs 8.2% in the USA between 2007 and 2017
[2] On a purchasing power parity (PPP) basis
[3] By 9% vs 7%, slightly increasing the gap from 31% higher GDP/hours worked in the USA in 2007 to 33% in 2016

Moreover, it is also clear that the recent strengthening of the EU's recovery is underpinned by a number of temporary factors, notably the ECB's expanded asset purchase programme.

Against this background, this report considers the underlying strength of the EU economy 10 years after the financial crisis, and in particular the extent to which EU Member States have been undertaking the structural reforms needed to secure the recovery in the long term, once temporary support subsides.

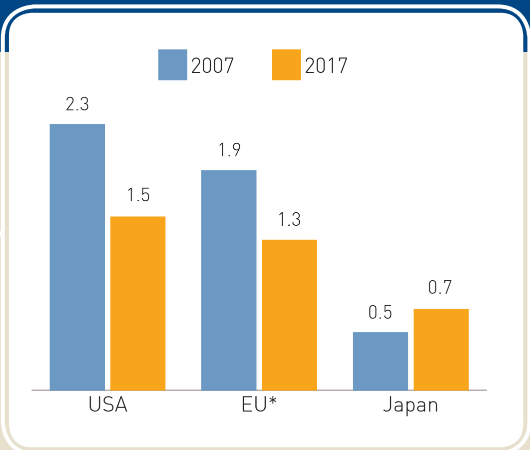
- The **first chapter** makes use of a number of quantitative indicators to benchmark the evolution of the EU's competitiveness vis-à-vis its key international trading partners in a number of areas crucial to businesses being able to provide the platform for growth, prosperity and employment creation (the overall business environment, innovation and digital transformation, access to finance and financial stability, labour market and skills, taxation and public finances).

- The **second chapter** considers the recent record, as judged by businesses in our Member Federations across the EU, of Member States implementing the key economic reforms agreed with the European Commission and Council.

The underlying **EU's capacity for long-term growth**, without reform, is only 1.3% and thus well below its current 'cyclical' growth of close to 2% (OECD estimate; graph 2). This compares to potential growth estimates of 1.5% in the USA and 0.7% in Japan. Alarmingly, potential growth fell strongly by 0.7-0.8 percentage points in both the EU and the USA over the last ten years[4]. The difference between the EU and the USA is even more pronounced when using the latest 2017 European Commission estimates which put potential growth at 1.6% in the EU, in contrast to 2.1% in the USA.

Graph 2: Potential growth has fallen and remains below that of the USA

Potential GDP growth estimates, 2007 and 2017



**EU weighted average of 23 countries*
Source: OECD

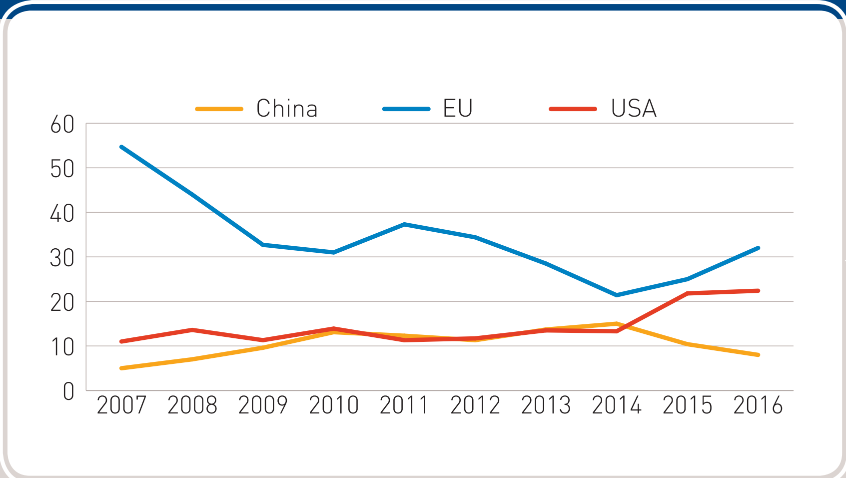
The willingness of those outside the EU to invest in the EU is also a key indicator of the competitiveness of our business environment. While the EU remains the largest global recipient of foreign direct investment (FDI) inflows, its importance has fallen in recent years. Its share of global FDI inflows has fallen by two-fifths from 55% in 2007 to 32% in 2016 (graph 3). The fall in the EU's share in global FDI occurred largely in the period up to 2013 and appears to have stabilised since then.

In particular the EU's attractiveness as an investment destination will be affected by changes in the international tax landscape. As the ECB points out: "lower USA corporate taxes [introduced via the

[4] It should be noted that the pre-crisis potential growth estimates have been recently revised by the OECD and thus do not reflect possibly excessive optimism in the time before the crisis.

Tax Cuts and Jobs Act effective since 1 January 2018] raise the tax attractiveness of the United States relative to other countries, which will influence corporations' incentives to invest"[5].

Graph 3: The EU's share of global FDI inflows have fallen by two-fifths between 2007-16



Foreign direct investment, net inflows in the EU, China and USA as a share of global FDI inflows, 2007-2016

Source: BusinessEurope calculations based on World Bank data

Finally, the EU's recent relative competitiveness weaknesses are reflected in a disappointing performance in relation to the development of significant high-growth firms[6]; while the USA has seen the creation of around 100 so-called "unicorn" firms since 2010, and China of 56, only 27 were created in the EU during that period[7].

I. LABOUR MARKET AND SKILLS

KEY OBSERVATIONS

- Whilst more than 11 million jobs were created since the peak of the euro crisis in 2013, the EU employment rate remains -7.6 percentage points below that in Japan and -2.4 percentage points below that in the USA.

- Even though unemployment rates are still too high in many Member States, businesses increasingly report difficulties in hiring qualified workers; twice the pre-crisis share and the highest on record since 1985. An analysis of the Beveridge curve suggests the emergence of a structural mismatch in EU labour markets during the crisis, where a given level of unemployment now comes along with a higher share of job vacancies.

[5] Ursel Baumann and Allan Gloe Dizioli. ECB Economic Bulletin, Issue 1 / 2018 – Boxes: "The macroeconomic impact of the US tax reform"
[6]i.e. recent tech start-up companies that managed to reach a $1 billion dollar market value as determined by private or public investment
[7]Data from Scenic Advisement, CB insights (cumulative series from October 2010 to October 2017)

- Comparing PISA 2006 and 2015 outcomes suggests that the EU has made little progress in closing the structural difference in education performance with Japan, Canada and South Korea. Within the EU, the number of adults with only a low level of basic skills in literacy and numeracy is also a concern.

- The average tax wedge is in Europe with 42% almost one-third higher than in Japan and the USA (both about 32%), with barely any structural changes compared to 10 years ago.

KEY POLICY RECOMMENDATIONS

1. Urgent policy action is required to avoid that labour market mismatches increasingly act as a break on economic growth in the coming years. To address serious skill shortages and mismatches, education and training systems need to be tailored to labour market needs. In particular, more STEM graduates (science, technology, engineering and maths) are needed as well as people with digital skills. A good way to develop digital skills is through e-apprenticeships - apprenticeships in digital and technical-based occupations and which use digital learning platforms.

2. Reduce non-wage labour costs through targeted cuts in the tax wedge that includes social security contributions to increase incentives for workers to enter the labour market and, at the same time, stimulate demand by encouraging employers to hire more staff. The tax burden on labour should be reduced to make work more attractive compared to welfare benefits, especially for low-income earners.

3. To ensure open, dynamic and mobile labour markets which help alleviating mismatches, reforms must be implemented to stimulate job creation, in particular for young people, and employment participation. The framework conditions on labour markets need to support new and more diverse career paths and smooth transitions between jobs, sectors and employment statuses, while respecting the diversity of industrial relations practices across Europe.

4. In order to maintain and increase global competitiveness, the labour markets' regulatory framework needs to be clear, simple and flexible. At the same time, labour markets need to ensure that increases in labour costs are consistent with rises in productivity growth. This means putting in place policies that can raise long-term productivity. European debates on wages should fully respect the fact that wage-setting is the competence of the social partners at national level in the context of diverse industrial relations systems.

5. Setting in motion a genuine partnership for labour market reforms: Rather than trying to solve labour markets challenges across the board at the European level, the European Union's primary role is to provide information, incentives and know-how for Member States and social partners to design, implement and evaluate policies really addressing the structural labour market challenges they face, in a way that is understood and acceptable to their societies.

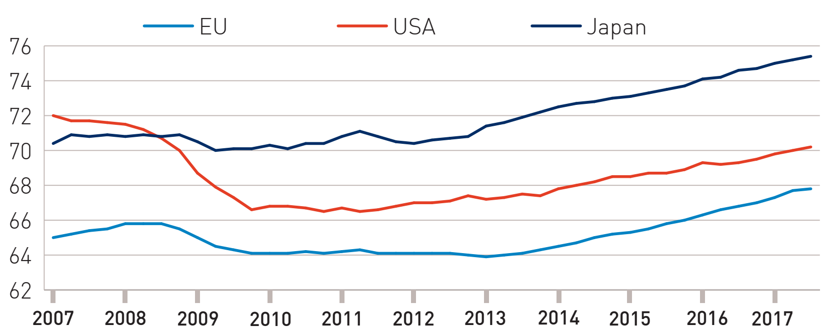
6

In order to mitigate negative impacts of population ageing on the labour market, reforms are required to encourage people to stay in the workforce longer, make pension systems sustainable in the long term, and ensure we properly integrate legal migrants into the workforce. Social protection systems need to become more effective and economically efficient, which means to focus social investments in areas where they can enhance growth (e.g. skills development, childcare), and to find the right balance between adequacy and sustainability of social safety nets.

The EU has seen strong job creation following the peak of the European sovereign debt crisis. Since the beginning of 2013 more than 11 million jobs were created[8].

However, the employment rate in the EU remains well below that of our major competitors[9] (graph 4) where job growth picked up earlier than in the EU[10]. In the USA, employment is now over 5 millions above pre-crisis heights, while it is 2.5 millions above its pre-crisis peak in the EU[11].

Graph 4: The EU's employment rate remains well below those in USA and Japan



Employment rate in %, 15-64 years old, seasonally adjusted, Q1 2007-Q3 2017

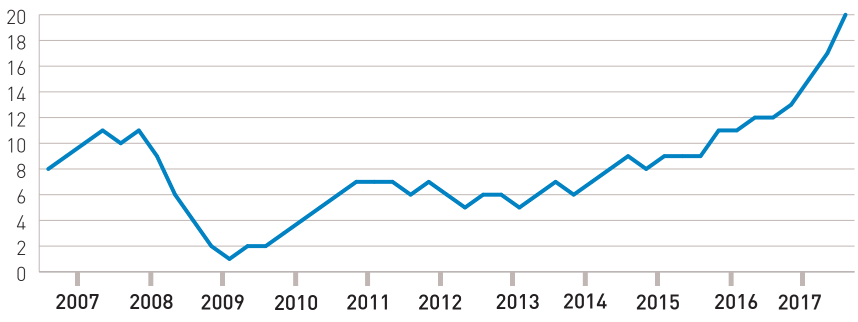
Source: Eurostat

Job growth in the EU has led to a gradual fall in unemployment since the beginning of 2013. While unemployment rates still remain too high in several Member States, business across the EU increasingly report difficulties in hiring qualified workers (graph 5). Whilst increasing skills shortages might be expected when the economy picks up, the share of industrial enterprises which indicate that insufficient labour limits their production is now twice the pre-crisis share and the highest on record since 1985.

[8] Comparing Q1 2013 and Q3 2017, seasonally adjusted data
[9] It remains -7.6 percentage points below that in Japan and -2.4 percentage points below that in the USA
[10] Employment growth in the USA started already at the end of 2009, thus three years earlier than in the EU
[11] In the USA the crisis started slightly earlier which means that pre-crisis heights were recorded in Q4 2007, in contrast to Q3 2008 in the EU.

Graph 5: Companies are increasingly concerned that a lack of labour hampers production

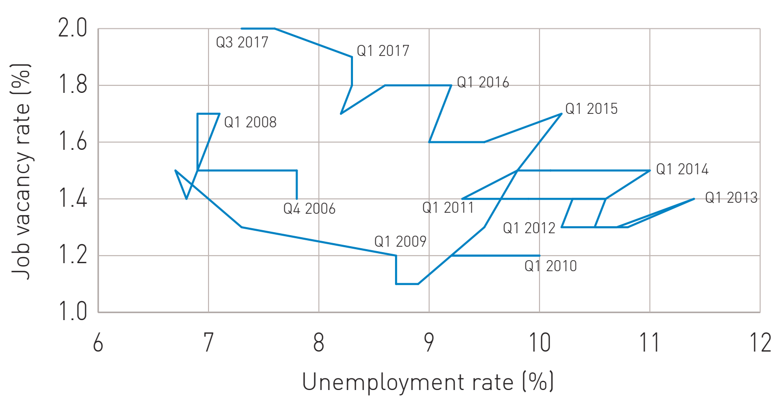
Share of industrial enterprises which indicate that insufficient labour limits production



Source: European Commission

The picture of a structural shift in skills shortages is supported when we look at data on the relationship between job openings and unemployment rates (the so-called Beveridge curve, graph 6). During the first phase of the crisis (until the end of 2009) we saw a movement down along the Beveridge curve, with higher unemployment coinciding with a reduction in vacancy rates. However, in the second phase (up to Q1 2013) there were further strong increases in the unemployment rate even though vacancy rates showed signs of improvement. This may have led to a permanent outward shift of the Beveridge curve, meaning that a given level of unemployment now comes along with a higher vacancy rate. While between the start of 2013 and the second half of 2017 EU unemployment almost returned back to pre-crisis level, job vacancies are with 2% in Q3 2017 well above the 1.5% in Q1-Q3 2007, despite a similar unemployment rate in both periods.

Graph 6: Outward shift of Beveridge curve suggests structural mismatch in EU labour markets, where a given level of unemployment comes along with higher job vacancies



The Beveridge curve for the EU (job openings vs unemployment rate)

Source: Eurostat

Against this background, urgent policy action is needed to avoid that labour market mismatches increasingly act as a break on economic growth over the coming years.

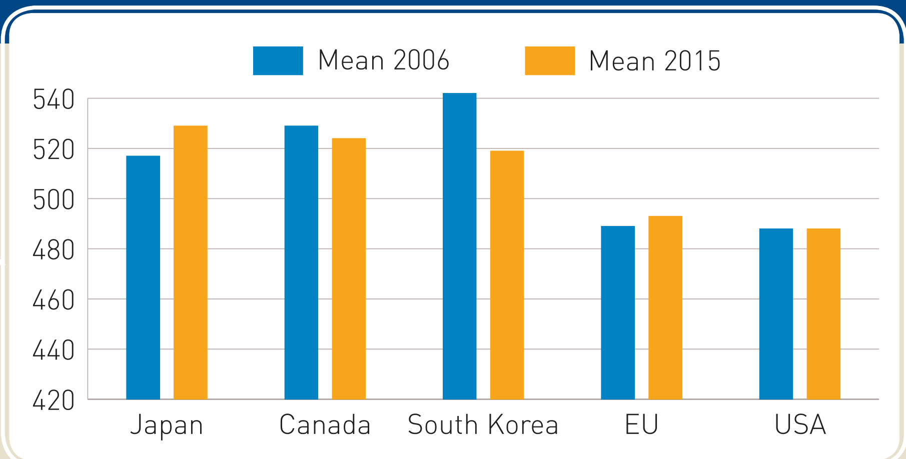
Well-functioning labour markets facilitate worker transition between jobs, encourage companies to hire and help match skills supply and demand. In contrast, excessive labour market rigidities make it hard for people to move between jobs, sectors and employment statuses, and may lead to a segmented labour market, reduce a country's attractiveness for both domestic and outside investors, and hamper employment creation as well as productivity and economic growth. It is thus important that labour market frameworks are simple, transparent and predictable, while providing for a variety of employment contracts and ensuring the attractiveness of these different contractual forms.

Many Member States are nowadays confronted with the challenge of ensuring clarity at national level on the way in which work opportunities in the context of new business models, such as platform work, qualify in terms of the pre-existing legal definitions of work and self-employment. In some Member States, a key priority is to improve the attractiveness of indefinite duration employment contracts. Both at European level and in the Member States, more work is needed to increase the coherence between EU and national policies aiming to increase the transparency, portability and/or transferability of social entitlements nationally and cross-border.

A high quality of education is also key for Europe's competitiveness and addressing mismatches as it ensures that workers have the necessary skills and knowledge throughout their working lives, especially in knowledge-intensive sectors. It is thus of concern that PISA results show that 15-year-old pupils in the EU underperform in comparison to their international peers (graph 7). In 2015, the (weighted) average mean PISA score was 493, slightly above that of the USA (488), but well below the scores of pupils in Japan (529), Canada (524) and South Korea (519). The result, comparing 2006 and 2015 outcomes, also suggests that the EU has made little progress in closing the structural difference in education performance with Japan, Canada and South Korea.

Graph 7: EU pupils underperform in education compared to their international peers

Overall mean score in PISA 2006 and 2015 (avg. science, reading and mathematics)



** Note: Reading score for USA from 2009 not 2006. EU26 for 2006 (excl. Malta and Cyprus). Weighted average score for the EU.*
Source: OECD PISA

As we have highlighted in previous editions, the comparably weak performance of EU pupils further underlines the importance of continuous education at the workplace.

In some systems, school-based learning is widely complemented by other forms such as workplace learning. Examples of this type of “dual system” can be found in Austria, Germany, Denmark, the Netherlands and Switzerland. One advantage of this practice is that it forms a series of public-private partnerships, allowing employers, in particular, and social partners to be involved in the development of vocational and educational training (VET) programmes, particularly apprenticeship schemes, in which they participate in defining and delivering the curricular programmes. Labour market needs and skills shortages can thus be addressed at an early stage.

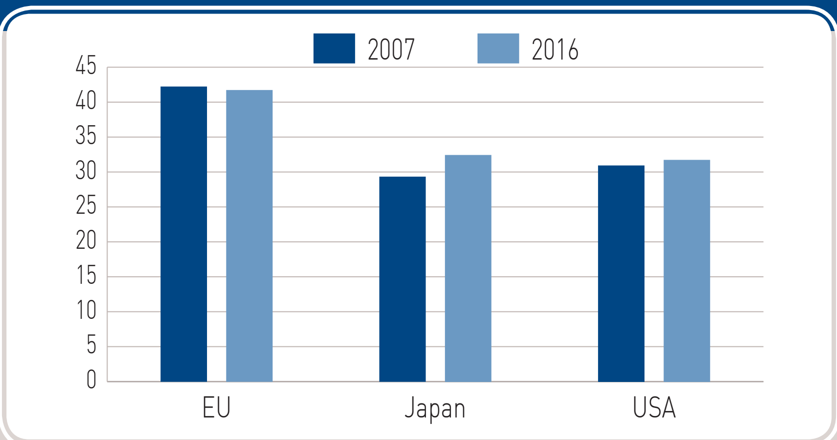
Education institutions should open up more to partnerships with companies, in particular to encourage the development of STEM skills. The quality of initial education needs to be ensured by governments and the right framework conditions should be put in place at national level to encourage governments, companies and workers to invest in continuing education on a cost-sharing basis. The role of the European Union should be to support Member States’ efforts to reform their education and training systems so as to better align them with labour market needs. This includes looking at how curricula can be adapted over a shorter time period.

Next to targeted initiatives to improve education and training systems, labour mobility can also help in alleviating mismatches. On top of that, labour mobility is particularly important in a monetary union to ensure that different economies react optimally to a common monetary policy, as it can serve as an adjustment mechanism in response to asymmetric shocks. However, in the EU only around 0.3% of the population is moving from one country to another each year, comparing unfavourably with the USA where 3% of the population moves to another state each year[12].

In addition, the high tax burden across Europe has to be addressed. Both the OECD and the European Commission stress that high levels of labour taxation may have detrimental effects on employment by reducing incentives both for workers to enter the labour market (if net gains after taxes and benefits are small) and employers to hire more staff (if labour costs are very high). Looking at the 10-year comparison, the EU has made no progress in closing the gap with the USA. The average tax wedge in Europe is with 42% almost one-third higher than in Japan and the USA (both about 32%; graph 8).

In particular for low skilled/low-income earners as well as second-earners, high labour taxes are likely to have particularly strong negative consequences given that labour demand and supply tend to be more elastic for these groups. In this category, we see a similar overall picture as for average income earners, with the EU tax wedge on low-income earners amounting to 38% in 2016, compared to 31% in Japan and 29% in the USA.

Graph 8: The tax wedge on labour in the EU needs to come down



Tax wedge on average-income earners (single person), 2007 and 2016

Source: OECD

[12] CEPS, [Labour Mobility in the EU's Addressing challenges and ensuring ‘fair mobility’], July 2016.

II. BUSINESS ENVIRONMENT

KEY OBSERVATIONS

It remains more difficult to do business in the EU than in the USA 10 years after the crisis, with their relative positions in the World Bank's Doing Business Ranking essentially unchanged.

KEY POLICY RECOMMENDATIONS

1. Achieve a truly integrated single market, in particular in the areas of digital economy, telecoms, energy and services, in order to enhance job creation and economic growth.

2. Ensure that regulation, at EU and national level, is well designed and properly enforced, with a minimum of administrative burdens in order to support business start-ups and company' expansion. Competitiveness-proofing, including an SME test, must be an integral part of the ex-ante impact assessment for all legislative proposals.

3. Energy prices must allow EU businesses to be competitive in international markets. Targeted measures (e.g. reforming taxes and levies, liberalising energy markets, etc.) to address the energy price differential with major competitors and to ensure energy security should be introduced.

4. Trans-European (and national) infrastructure must be expanded. Remaining regulatory, administrative and technical barriers in all modes of transport need to be removed to ensure access to adequate infrastructure facilities. Energy infrastructures should be fully interconnected so as to further integrate the internal market.

A competitiveness-friendly business environment is crucial for company start-ups and expansion. Open markets with clear and properly enforced rules can promote competition, legal certainty and in turn productivity growth. In contrast, poorly designed regulation hampers competition and external competitiveness as companies waste time and financial resources on meeting burdensome regulatory requirements.

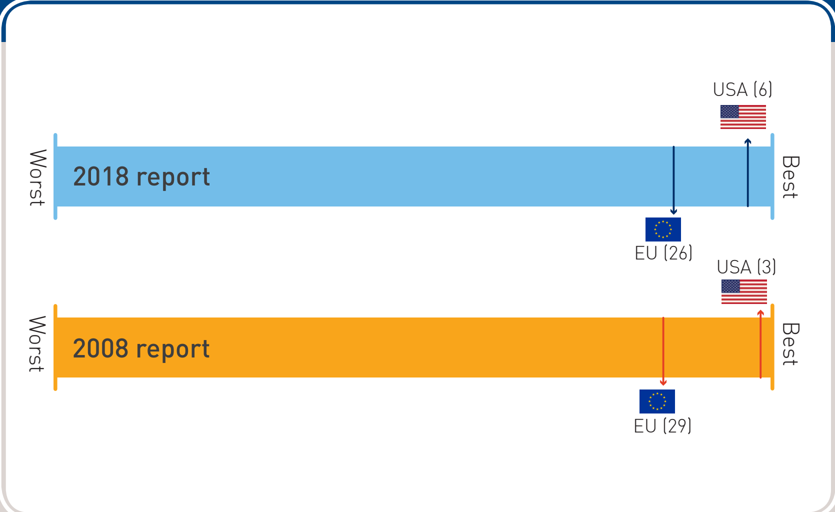
The World Bank Group's Doing Business Ranking provides a useful international benchmarking exercise by measuring aspects of business regulation and their implications for firm establishment and operations. The overall measure of the 'ease of doing business' ranking gives an indication of where it is easier for firms to do business.

Comparing the results of the 2008 and 2018 ranking (graph 9) indicates that it continues to be more difficult to do business in the EU than in the US, with little progress made in closing the gap. Both the EU and the USA have essentially maintained their relative international position over the last 10 years, with the EU ranking 26th and the USA 6th place in the latest ranking.

While the EU, alongside other economies, has made great progress in reducing both the cost and time of doing business over the last 10 years, it still takes about three times the cost and almost twice the time to set up a business in the EU compared to the USA.

Even though the overall position of the EU did not change much over the last 10 years in the Doing Business Ranking, there were some important changes within the EU. The biggest improvements in ranking took place in Poland (up 47 places, to 27th in 2018), Croatia (up 46, to 51st) and Greece (up 33, to 67th). In contrast, Belgium (down 33, to 52nd), Luxembourg (down 22, to 63rd) and the Netherlands (down 11, to 32nd) fell in their ranking. The EU countries currently ranking the highest are Denmark (3rd, up 2 places from 2008), the UK (7th, down 1) and Sweden (10th, up 4).

Graph 9: It remains more difficult to do business in the EU than in the USA



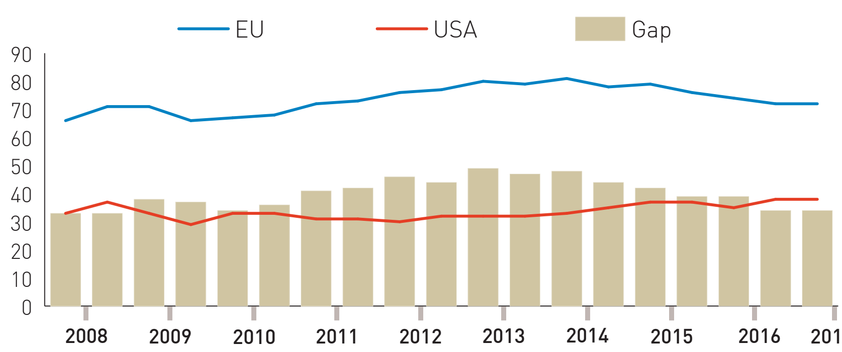
Ease of doing business ranking, 2008 and 2018 reports

Source: World Bank Doing Business Reports 2008 and 2018

Business competitiveness, especially in the manufacturing sector, also depends to a large extent on the secure supply of competitively priced energy. Yet, in the EU, retail prices for energy turn out to be significantly higher than in other major economies, in particular the USA. While average energy prices for EU industrial producers amounted to €72 per Kwh in the first semester of 2017, costs were with €38 only about half in the USA (graph 10). The gap between the EU and USA is about the same as 10 years ago, fluctuations between the periods were also influenced by bilateral exchange rate fluctuations.

Graph 10: Industrial energy prices remain about twice as high in the EU than in the USA

Average energy prices for industrial producers in the EU and USA, 1st semester 2008 to 1st semester 2017



Source: BusinessEurope calculations based on Eurostat, EIA and ECB. Methodology from European Commission Energy prices report 2014 & 2016. Does not include confidential rebates over the reference period.

III. INNOVATION AND DIGITAL TRANSFORMATION

KEY OBSERVATIONS

- The EU has failed to close the gap in R&D spending with the USA and Japan over the last decade. R&D intensity remains much lower in the EU (2.0% in 2015) than in Japan (3.3%) and the USA (2.8%), also reflected in the low number of patent applications. China strongly increased its share of spending over the last decade (from 1.4% to 2.1%) and recently overtook the EU. An additional €150 bn a year would have to be invested to reach the EU's own 3% Europe 2020 target.

- Just as in 2007, the EU continues to lag behind its competitors in some key metrics for digital communication, in particular broadband. While in 2007, the availability of fixed broadband was of key concern, in 2016 (fast) fibre connections are much less prevalent in the EU, compared to the leading countries Japan and South Korea.

KEY POLICY RECOMMENDATIONS

1. EU Member States should increase R&D spending, and encourage higher private-sector R&D spending, in order to reach the 3% commitment in the EU growth strategy. In particular in the post-2020 multi-annual financial framework the overall EU budget for R&D&I should be consistently scaled up.

2. Innovation policies must be more business-orientated to better capture the economic value from research and innovation investment. Targeted initiatives that stimulate private R&D investment and strike the right balance between direct and indirect R&D promotion via tax subsidies are needed. Regulation excessively focused on precaution and risk avoidance will stifle investment in innovation.

3. Incentives for cooperation between companies and research institutes in networks and clusters should be improved in order to facilitate the commercialisation of innovation.

4. The EU has significant work ahead when it comes to adopting the latest technologies enabling businesses to compete globally. Achieving this will rely upon our digital infrastructure. This is especially the case when it comes to providing very high-capacity networks in order to launch 5G on a large scale.

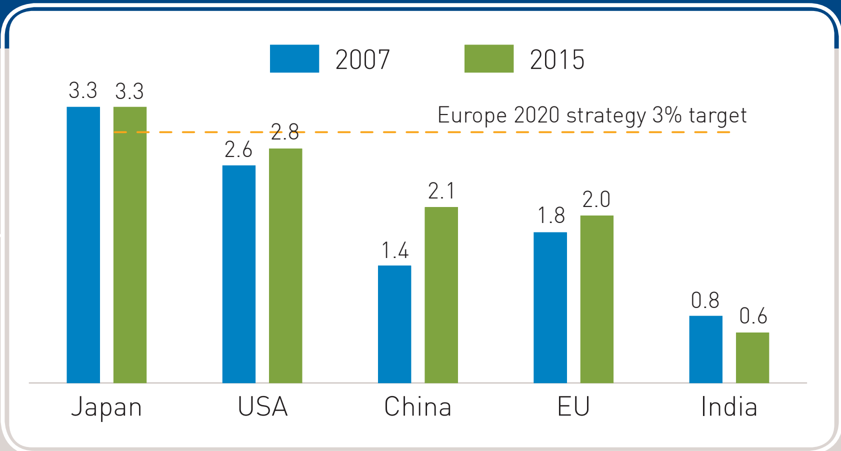
5. Ensuing a digital transformation will require a fully functioning digital single market. This means much more than simply investing in networks, with action needed to ensure a level playing field to eliminate barriers hampering cross-border e-commerce, to prevent forced data localisation measures, and to address legal fragmentation in the areas of consumer legislation, taxation, copyright and data protection rules.

The EU's capacity to innovate is fundamental to its ability to attract and retain high-quality, high-productivity jobs, and take forward the digital transformation that is needed across all sectors to ensure we are able to compete successfully in the global economy. Measuring innovation capacity and technological readiness is a complex exercise, but R&D investment, patent registrations and access to (fast) broadband networks provide useful pointers in assessing both our current and future capability.

Regarding R&D spending, the EU has failed to close the gap with the USA and Japan over the last decade. R&D intensity remains much lower in the EU (2.0% in 2015) than in Japan (3.3%) and the USA (2.8%), while China now overtook the EU in terms of spending (2.1%) (graph 11). It is also well below its own 3% target set in the Europe 2020 Strategy, for which to reach an additional €150 bn a year needs to be invested.

Graph 11: EU spending on R&D remains well below USA and Japanese levels

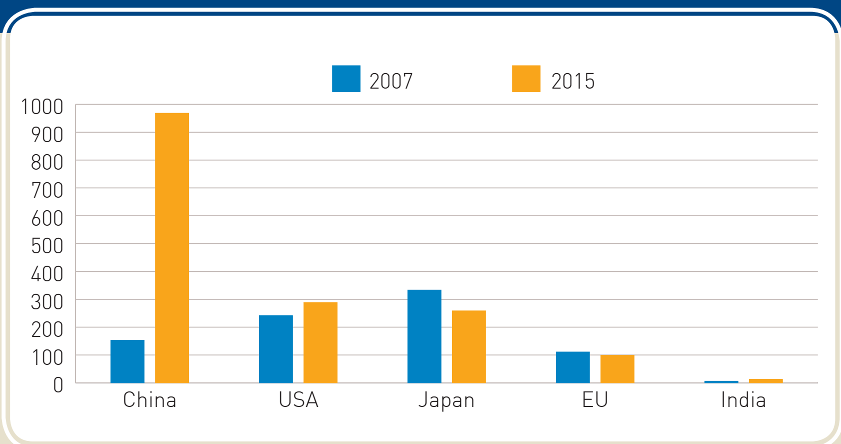
R&D intensity as % of GDP in 2007 and 2015



Source: World Bank

Patent applications provide an alternative measure of innovation performance, although companies will use many different methods to protect intellectual property (IP), hence such data should be treated with caution. As shown in graph 12, in the USA 2.6 times the number of patents were filed in 2015, compared to the EU, while Japan received 2.3 times as many patent applications. China, which saw a strong increase in the number of patent applications over recent years, received almost 9 times as many patent applications as the EU, where we have seen a slight decline in applications since 2007.

Graph 12: Instead of gradually closing the patent gap the EU is falling further behind



Total number of patent applications, in thousands

Source: WIPO

Finally broadband as an enabler for economic and social growth has become a key priority of the 21st century.

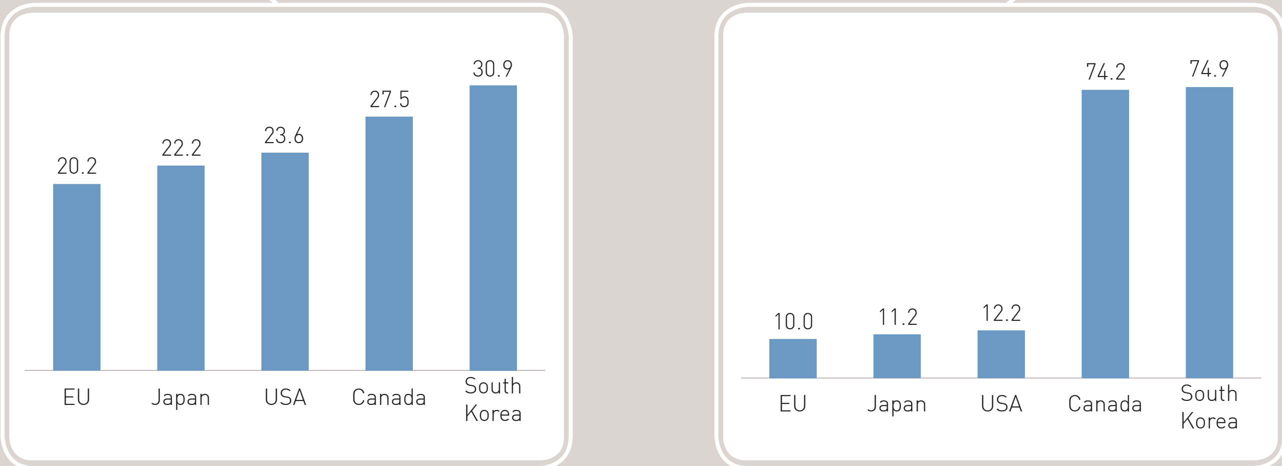
Just as in 2007, the EU continues to lag behind its competitors in some key metrics for digital communication. Looking back at 2007, the availability of fixed broadband was of key concern. As graph 13 (left panel) illustrates, the EU was lagging strongly behind other major economies with regards to broadband subscriptions. A decade later, the focus has shifted more from the general availability of broadband connections to the speed of connections as a key competitiveness indicator. As illustrated in the right panel of the graph, it is thus of concern that (fast) fibre connections are much less prevalent in the EU, USA and Canada, compared to the leading countries Japan and South Korea.

Graph 13: The EU needs to make further effort to increase fast broadband connections

Broadband indicators

a) Fixed broadband subscriptions (per 100 people), in 2007, %

b) Fibre connections in total broadband, in 2016, %



Source: OECD

IV. ACCESS TO FINANCE AND FINANCIAL STABILITY

KEY OBSERVATIONS

- While the Euro-area as a whole has made progress in reducing non-performing loans (NPLs) since the heights in 2012, NPLs were with 4.4% in 2016 still well above the 1.3-1.4% seen in the USA and Japan.

- Euro-area businesses fund themselves to a larger extent via bank lending compared to the USA, where companies rely more on capital markets. Stock market capitalisation (as % of GDP) in the Euro-area is less than half that in the USA and almost two-fifths below that in Japan.

- While we have seen a doubling of venture capital investment in the EU in absolute terms since 2010, investment in the USA increased by almost 2.7 times, implying the gap between the EU and USA increased even further (2016: $18bn invested in the EU vs $83 in the USA).
- Whilst Euro-area banks now feel more confident in lending again outside of the EU, their lending to other banks, institutions and firms within the Euro-area, but outside of their own Member State has continued to fall.

KEY POLICY RECOMMENDATIONS

1. Reinforce and implement the Capital Markets Union proposals to ensure that the EU puts in place a genuine single market in financial services, and develops complementary sources of finance to bank lending, in order to offset the consequences of bank's deleveraging on companies' access to credit, in particular SMEs.

2. Following the publication of the comprehensive impact assessment on financial regulation, take action to ensure prudential rules strike the right balance between increasing financial stability and supporting companies' financing needs for investment and business activities.

3. A full banking union must be put in place, with rapid agreement and implementation of an EU deposit insurance scheme, alongside the existing supervision and resolution pillars, needed to address the continued fragmentation of EU savings and credit markets. Member States have now implemented the bank recovery and resolution directive and are creating harmonised deposit insurance systems. In addition, further asset quality reviews of all banks are necessary before establishing a common system.

4. The introduction of higher capital requirements for non-performing loans (NPLs) could negatively affect the market price of these loans harming the development of a secondary market and leading to significant reductions in banks' capital. The differences between EU countries' banking systems should be considered to ensure balanced actions when addressing still high levels of NPLs in many European banks in a way which increases new lending and maintains financial stability.

Access to finance on reasonable terms is a pre-condition for companies to thrive and make the investment necessary to drive growth and maintain competitiveness. In order to both provide stability and meet the different financing needs of companies, and in particular of SMEs, finance needs to be available through a variety of different channels.

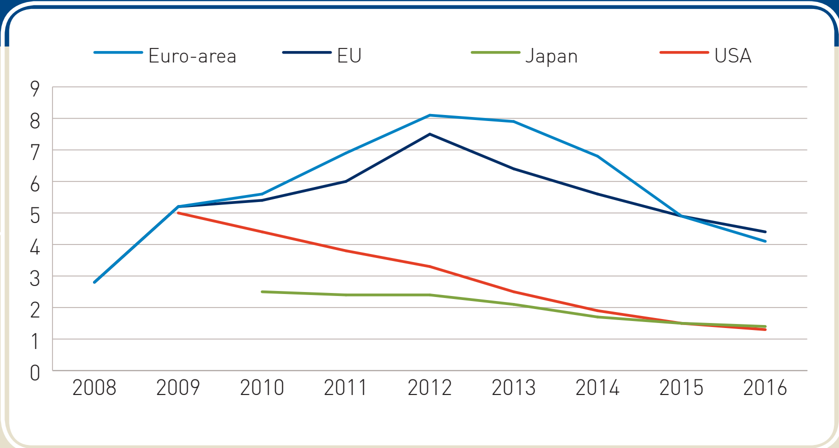
Financial instability, as illustrated during the crisis, impacts negatively on access to finance, confidence and growth, precluding companies from taking on new investment. The negative feedback loop between sovereign and bank financial positions we saw building up from 2010, which led to political uncertainty and financial market instability, has become less acute since 2012, following strong European Central Bank (ECB) action and the banking union. However, both the legacies of the financial crisis and the increasingly stringent prudential regulation of banks continue to impact upon bank lending to businesses, especially to SMEs, and in those countries that were hit the hardest by the crisis.

One particular supply constraint on bank lending may be the continuing high volumes of non-performing loans (NPLs) that banks continue to hold on their balance sheets in a number of Euro-area Member States. While the Euro-area as a whole has made progress in reducing NPLs since the heights in 2012, when the ratio of NPLs to gross loans amounted to more than 8%, NPLs were with 4.4% in 2016 still well above the 1.3-1.4% seen in the USA and Japan (graph 14). In addition, the ratio of NPLs varies significantly across Euro-area Member States, ranging from 0.9 to 48.7%.

The ECB has estimated that if the capital tied up to support NPLs could be deployed to support new lending then 'total credit volume' in the Euro-area could increase by at least 2.5% overall, and at least 6% in the six Member States with the highest concentration of NPLs[13].

Graph 14: While NPLs have gradually been reduced across Europe, ratios still remain above those in the USA and Japan

Bank non-performing loans to total gross loans (%)



Source: World Bank Group

A key project for the period ahead will be to reinforce and implement the Capital Markets Union proposals to ensure that the EU establishes a genuine single market in financial services, and develops complementary sources of finance to bank lending.

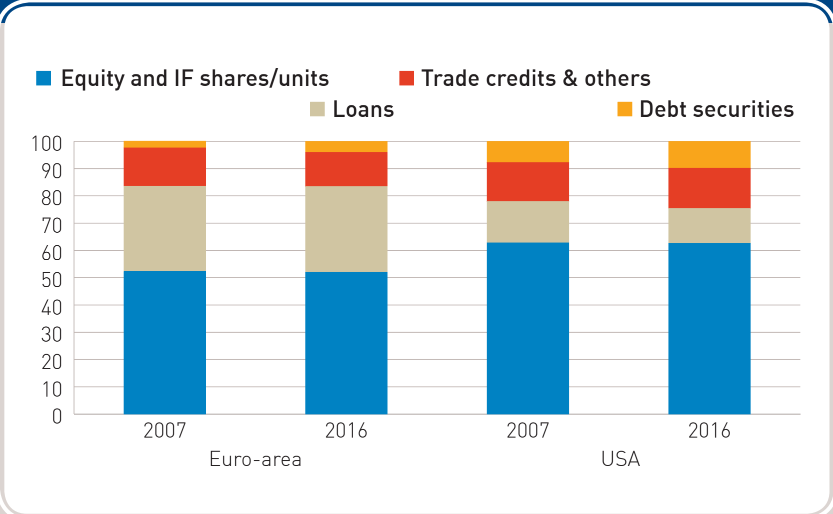
Graph 15 illustrates that businesses in the Euro-area fund themselves to a much larger extent via bank lending, with loans making up over 31% of total liabilities of non-financial firms, in contrast to only 13% in the USA. In the USA, firms fund themselves to a greater extent via capital markets. First, equity and investment fund shares/units make up 63% of firm liabilities in the USA but only 52% in the EU. Second, debt securities such as bonds amount to 10% in the USA, but only 4% in the Euro-area.

Moreover, as graph 15 illustrates the structure of liabilities of non-financial firms since the financial crisis is largely unchanged despite several EU policy initiatives to diversify firm funding sources following the crisis. In the USA, companies marginally reduced their share of funding via loans (from 15% in 2007 to 13% in 2016) and at the same time very slightly increased the share of debt securities (8% to 10%). Whilst the Euro-area has seen an increase in the absolute value of corporate bond issuance (amount doubled), this remains just 4% of overall funding (from 2.5% in 2007), with the overall structure of financing broadly unchanged[14]. The key question is whether the increase in debt securities in the EU is a structural shift or rather a temporary phenomenon related to the current low interest rate environment.

[13] Keynote speech by Vítor Constâncio. (Feb, 2017) "Resolving Europe's NPL burden: challenges and benefits"
[14] Overall, total liabilities of Euro-area non-financial firms as a share of GDP are with 293% slightly below the share in the USA (316%) in 2016. Compared to 2007, the share of liabilities increased slightly in both economies (274% in the Euro-area and 291% in the USA)

One area where we have seen strong increases is the market for sustainable finance[15]. According to the rating agency Standard and Poor's[16], green bonds are expected to grow by 30% this year. The global market would thus increase to $200 bn, with a significant share of $60 bn in Europe. The significant growth of sustainable investment products shows that market mechanisms and voluntary commitments are the right tools. Regulatory policy interventions in this functioning market should therefore be avoided.

Graph 15: Euro-area businesses fund themselves to a larger extent via bank lending compared to the USA, where companies rely more on capital markets



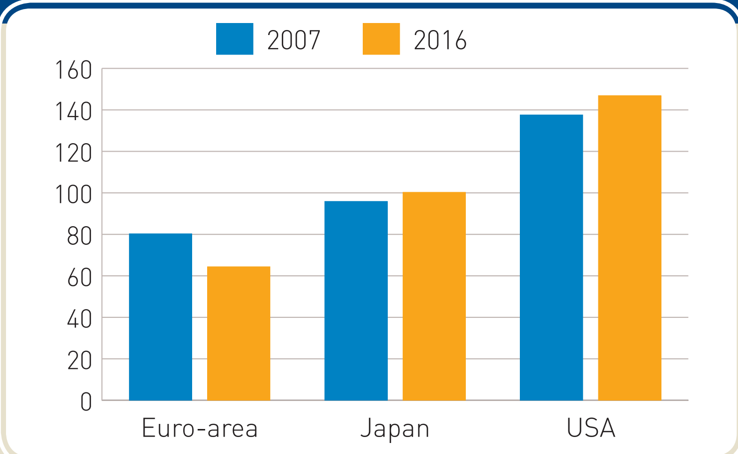
Main liabilities of non-financial firms as % of total liabilities

Source: OECD

If we were to look at absolute values, the differences in size of market-based financing between the Euro-area and USA are even more pronounced when it comes to listed equities, given that in Europe a large share of equity is unlisted. As illustrated in graph 16, stock capitalisation is in the Euro-area with 64% well below that in the USA (147%), and fell somewhat since the crisis to 64% (possibly due to valuation losses).

Graph 16: Stock market capitalisation (as % of GDP) in the Euro-area is less than half that in the USA and almost two-fifths below that in Japan

Market capitalisation of listed domestic companies (% of GDP)



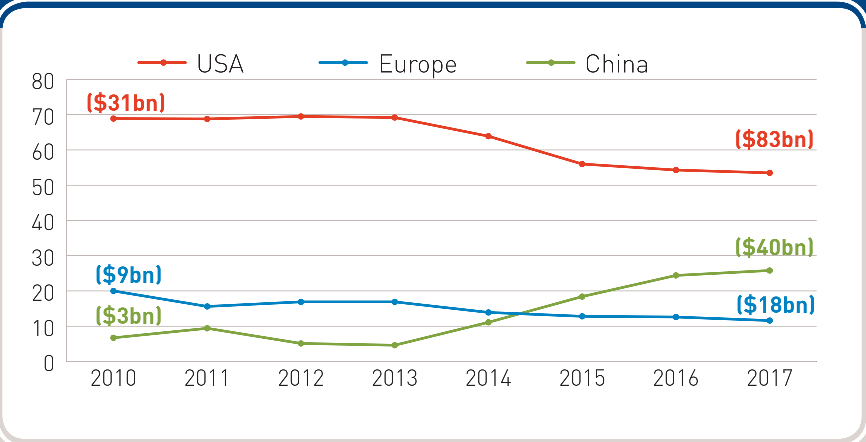
Source: World Bank Group

[15] Issuance skyrocketed in 2017 to $155 bn, up from a mere $13 bn in 2013, according to the Climate Bonds Initiative.
[16] "Green Bond Issuance Is Expected To Shoot Up Further", 29 January 2018

Expanding the financial support channels can help companies to avoid credit shortfalls and obtain better credit conditions, while at the same time contributing to financial stability by diversifying the risk between banks and other financial institutions.

Venture capital (VC) can also be an important source of finance, in particular for growth companies. In terms of global shares, we have seen a strong increase in China since 2010, which implied that the respective shares of the EU and USA have fallen (graph 17). While we saw a doubling of VC investment in the EU in absolute terms since 2010, investment in the USA increased by almost 2.7 times, implying the gap between the EU and USA increased even further (2016: $18bn invested in the EU vs $83 in the USA).

Graph 17: EU strongly lags behind the USA for venture capital financing and was recently overtaken by China



Venture capital invested in Europe, the USA and China as a share of global total. Absolute amounts in brackets for 2010 and 2017

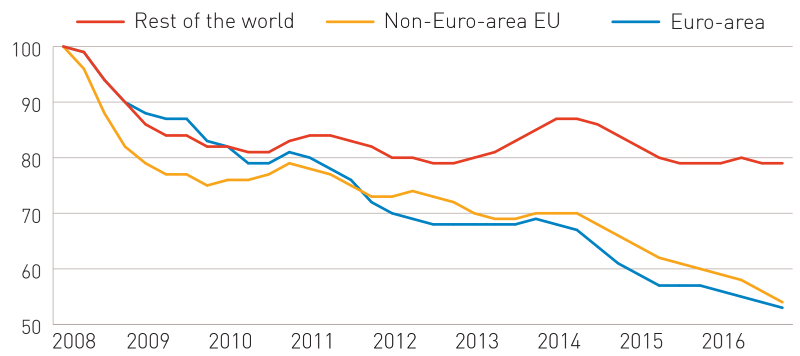
Source: KPMG, Venture Capital Pulse

Deepening the Economic and Monetary Union and in particular completing the banking union is likely to be a key topic for discussion amongst EU policy-makers in 2018. EU leaders will need to make firm decisions to strengthen our common currency. In particular, a full banking union must be put in place, with rapid agreement and implementation of an EU deposit insurance scheme, alongside the existing supervision and resolution pillars, needed to address the continued fragmentation of EU savings and credit markets.

Graph 18 illustrates this fragmentation by showing the claims held by Euro-area banks in different countries. As is well known, following the financial crisis, banks across the globe reduced their international lending, and Euro-area banks were no exception to this. But whilst Euro-area banks now feel more confident in lending again outside of the EU, their lending to other banks, institutions and firms within the Euro-area, but outside of their own Member State has continued to fall, despite the first steps being put in place to complete the banking union. As the European Central Bank has pointed out, greater cross-border banking can increase financial stability and competition in the banking sector, ultimately improving the availability of finance for firms to invest - meaning completing the banking union really is a priority in 2018.

Graph 18: Intra-Euro-area bank lending continues to fall despite banking union

Cross-border bank claims of Euro-area banks by destination country



Source: BusinessEurope calculations from Bank of International Settlements data

V. TAXATION AND PUBLIC FINANCES

KEY OBSERVATIONS

- It is positive to observe that EU Member States made further progress in bringing down government deficits, but there remains much more to be done to reduce EU public debt levels which are with 84% of GDP still well above the 58% in 2007 and the 60% Maastricht limit.
- Despite the recent focus on consolidation via expenditure reduction, public expenditure as a % of GDP remains with 46% of GDP in the EU well above the 37% in Japan and 36% in the USA.
- It is of concern that the share of growth-friendly public spending in overall spending slightly fell in the EU since the crisis (from 30.9% in 2007 to 30.4% in 2015), while in the USA the share of growth-friendly public spending increased in the same period (from 43.0% to 45.3%), further increasing the gap between both economies.

KEY POLICY RECOMMENDATIONS

1. In all Member States, there is scope to make public finances growth-friendlier and more efficient, in particular by targeted reductions in non-productive public spending and by reductions in distortionary taxes that hamper growth. Efficiency of the fiscal rules must be improved, with more attention to the quality and composition of public finances.

2. The proper implementation of the Stability and Growth Pact (SGP), drawing on uilt-in flexibility, remains essential to help Member States put their public finances on a sustainable footing. This is key in order to

strengthen investors' trust in the Euro-area. But it is also essential that the SGP gives the fullest support possible to Member States who wish to orientate their budgets towards investment and growth-supporting expenditure.

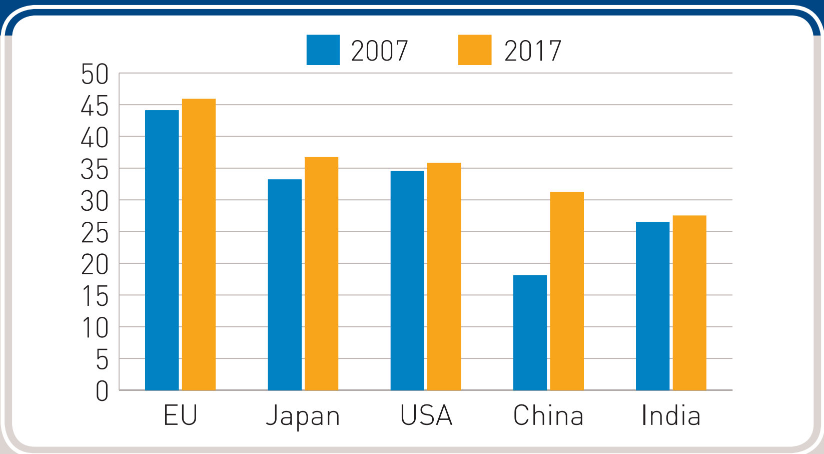
3. Tax reforms should reduce taxation on labour and capital, including corporation tax, which are particularly damaging to growth and employment.

4. Member States should continue their efforts to ensure the administration of their tax systems becomes simpler, more transparent and user-friendly.

Sustainable public finances are of key importance for long-term growth. The financial crisis illustrated that falling confidence in a government's ability to repay debt can lead to a vicious cycle whereby increased borrowing levels lead to higher borrowing costs, and in turn require higher taxation.

Public expenditure as a % of GDP remains with 46% of GDP in the EU well above the 37% in Japan and 36% in the USA (graph 19). Expenditure ratios slightly increased across economies since the crisis so that the gap remains largely unchanged.

Graph 19: EU public expenditure ratios are well above those seen in other economies



Public expenditure as % of GDP

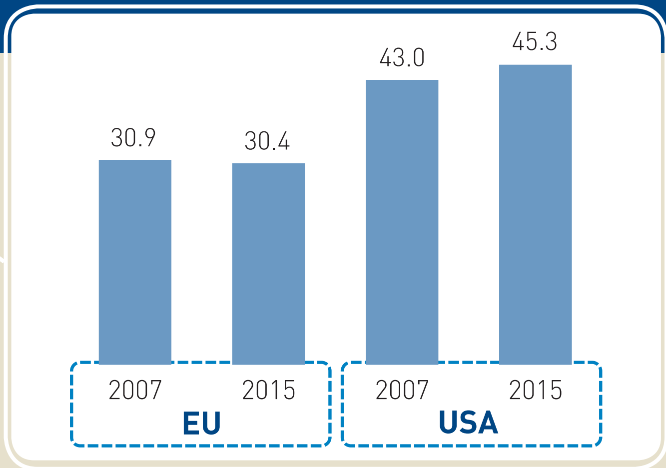
Source: IMF

To some extent, the bigger role of the state in Europe relates to policy choices made at national level to ensure sustainability and adequacy of social protection systems, including the provision of public healthcare, pensions and welfare systems. However, ultimately higher public expenditure needs to be financed by higher taxes which, at a certain level, can be harmful for growth by weakening incentives for both investment and workers to enter the labour market. Progress towards fiscal sustainability therefore needs to ensure greater efficiency of the public sector and quality of public finances, with special attention to growth-enhancing investment, while avoiding tax increases.

It is of concern that the share of growth-friendly public spending in overall spending slightly fell in the EU since the crisis (from 30.9% in 2007 to 30.4% in 2015; graph 20). In contrast, in the USA the share of growth-friendly public spending increased in the same period (from 43.0% to 45.3%), further increasing the gap between both economies. All EU Member States should therefore review the composition of their public expenditure to make it more supportive of growth.

Graph 20: The US spends a much higher share on growth friendly items than the EU

Share of growth-friendly public spending in overall spending in 2007 and 2015, in %



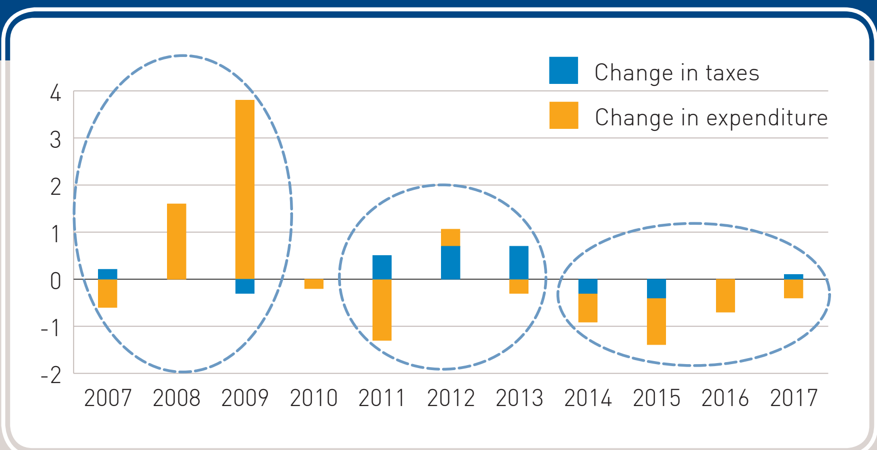
Expenditure assumed to be growth-enhancing: education, R&D, health, transport and communications

Source: Eurostat, OECD COFOG database and Bureau of Economic Analysis

The proper enforcement of the Stability and Growth Pact (SGP) remains essential to help Member States put their public finances on a stronger footing, and in particular bring down debt levels below the Maastricht threshold of 60% of GDP. However, it is also essential that the SGP offers the fullest support possible to Member States who wish to orientate their budgets towards investment and growth-supporting expenditure.

While the optimal approach can vary depending on a number of factors, including country differences, studies have found that consolidation via expenditure reductions rather than via tax hikes (i.e. an increase in government revenue) may be more effective[17]. As graph 21 illustrates this has been the case since 2014, when the focus in the EU was more on expenditure reductions than on tax increases. It stands in contrast to the period between 2011 and 2013 when we saw an excessive focus on deficit reductions via tax increases.

Graph 21: Since 2014 fiscal consolidation came mainly via expenditure cuts rather than tax hikes



Change in government revenue and expenditure compared to the previous year, in percentage points

Source: BusinessEurope calculations based on Ameco database

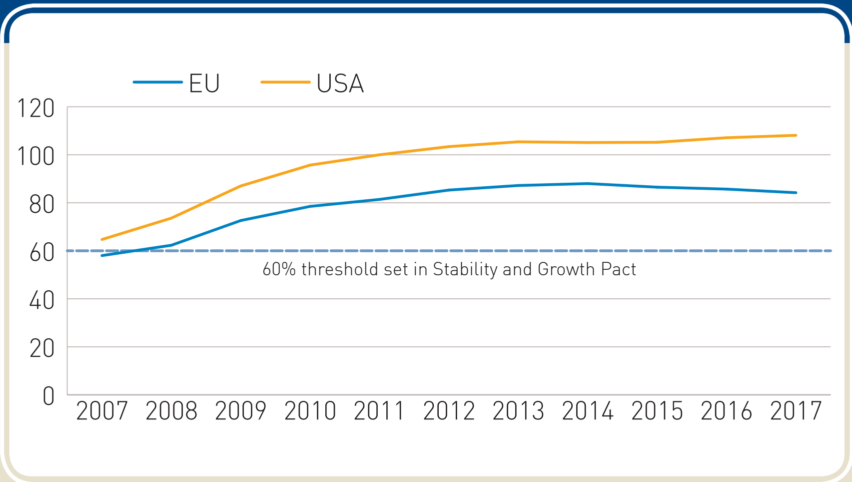
[17] See for example: Maria Grazia Attinasi and Luca Metelli (2016), "Is fiscal consolidation self-defeating? A panel-VAR analysis for the euro area countries", European Central Bank

Against this background, it is positive to observe that EU Member States made further progress in bringing down government deficits, from a high -6.6% in 2009 (-6.3% in the Euro-area) to an expected -1.2% in 2017 (-1.1% in the Euro-area)[18].

However, there remains much more to be done to reduce EU public debt levels which, whilst lower than in the USA, are with 84% of GDP still well above the 58% in 2007 and the 60% Maastricht limit (graph 22)[19].

Graph 22: The EU's public debt ratio is below that of the US, but still well above the 60% limit set out in the Stability and Growth Pact

Gross public debt as % of GDP



Source: IMF

[18] See for example: Maria Grazia Attinasi and Luca Metelli (2016), "Is fiscal consolidation self-defeating? A panel-VAR analysis for the euro area countries", European Central Bank
[19] According to European Commission estimates, public debt ratios were 89.3% in the EU in 2017, compared to 65% in 2007

PART 2: STRUCTURAL REFORM PROGRESS - MEMBER FEDERATIONS' ASSESSMENT

As Part 1 of this report demonstrates, a failure to take structural reforms forward has had a significant impact on Europe's competitiveness and in turn on its economic performance. The potential benefits from reform are huge with the OECD[20] suggesting for example that "if countries were to move to best practice in product and labour market policy settings, aggregate output in the Euro-area could rise by more than 6% by 2025". Such an improvement would almost halve the per capita gap with the USA by 2030.

In contrast, if we fail to deliver on growth, this would threaten the sustainability of our European social model and make it difficult to uphold our current welfare state system.

Against that background, this chapter analyses the results of a survey of BusinessEurope Member Federations regarding reform effort over the year 2017, linked to the European Semester. In particular, federations commented on the appropriateness of each of the Commission's country-specific recommendations (CSRs) and on their government's efforts to implement them. Detailed answers by Member Federations on individual country recommendations can be found on BusinessEurope's website.

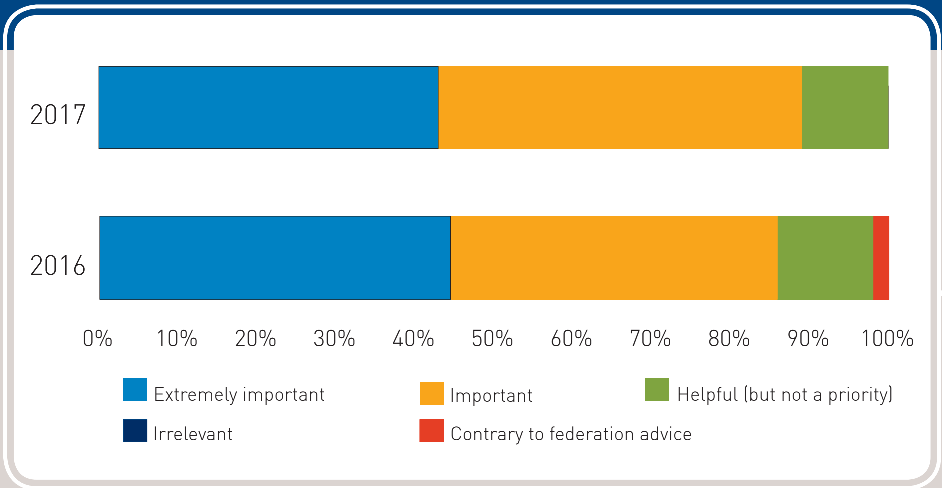
I. COUNTRY-SPECIFIC RECOMMENDATIONS

According to the results of our survey, the Commission has continued to provide accurate and ambitious country-specific recommendations to EU Member States. BusinessEurope Member Federations believe that **89% of the CSRs** (a slight increase compared to 85% last year) **they have analysed focus on the right issues for reform in EU Member States**. The remaining 11% of CSRs are seen as helpful, but not a priority, meaning that there are no CSRs which are not supported by our Member Federations.

[20] "Economic Challenges and Policy Recommendations for the Euro Area". Better Policies Series, 2014

Assessment of the 2017 country-specific recommendation objectives

Member Federations' assessment of the appropriateness of individual CSRs



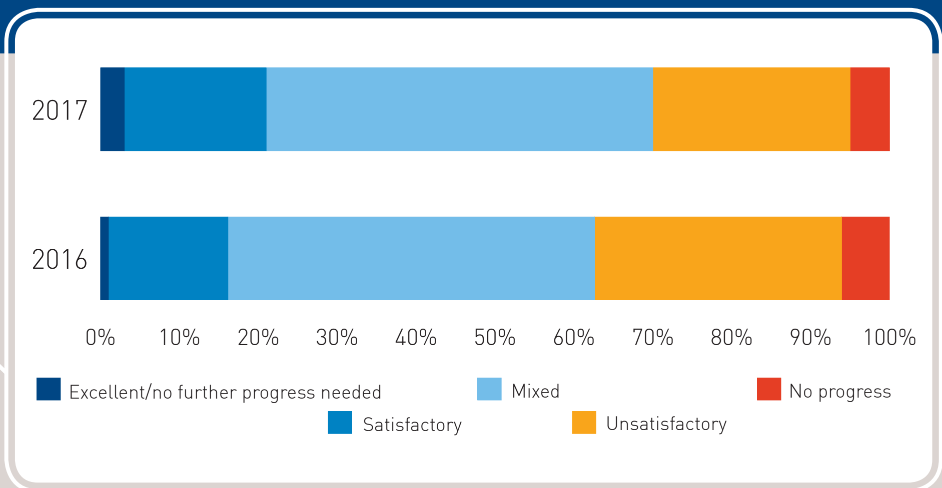
Source: BusinessEurope survey of Member Federations

However, despite the importance of these recommendations, our Member Federations conclude that **only 22% of the 2017 CSRs assessed are satisfactorily implemented**, a small increase compared to the 17% figure observed twelve months ago. When considering the additional proportion of CSRs where mixed (i.e. some) progress has been identified, the figure jumps to 70% (compared to 63% last year). While the proportion has fallen from last year, still more than one quarter of CSRs saw no or little progress according to our members.

It is important to see the different drivers behind these figures, as strong uneven implementation between Member States remains. There are examples of countries making strong reform progress, in particular in Poland, Belgium and Portugal, where the pace of reform implementation has picked up significantly compared to last year. However, in some countries, reform implementation has fallen, notably in the Netherlands, Slovenia and Hungary.

Progress in implementing the 2017 country-specific recommendations

Member Federations' assessment of Member States' efforts to implement recommendations



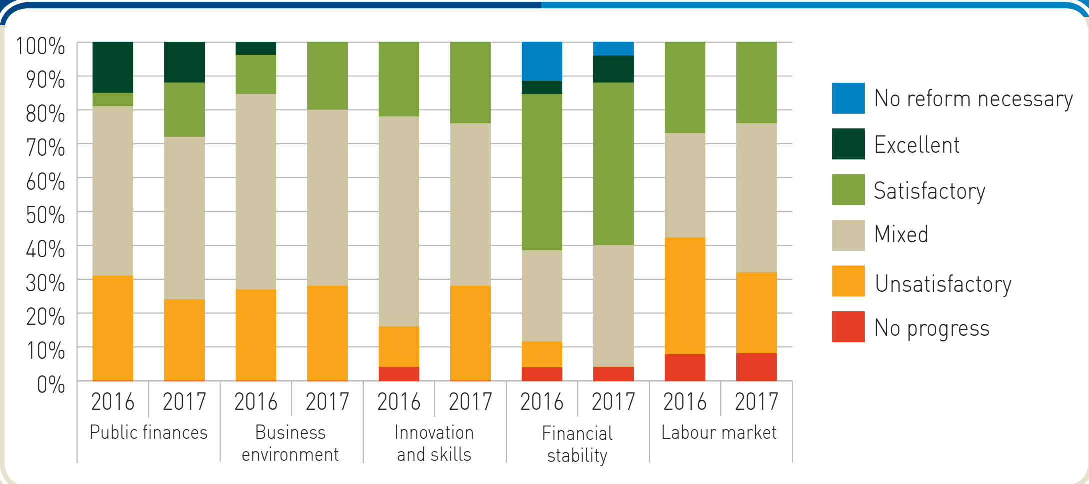
Source: BusinessEurope survey of Member Federations

II. PROGRESS BY AREA

In addition to assessing reform effort in implementing the country-specific recommendations, BusinessEurope Member Federations have assessed reform progress in five broad policy areas that are important for long-term growth and which also correspond to the areas analysed in Part 1 of this report.

Reform progress by main policy areas

Member Federations' assessment of reform progress by main areas



Source: BusinessEurope survey of Member Federations

- The most pressing concern remains the slow pace of reform in the labour market according to our members, despite a small improvement compared to last year. More efforts are demanded by our federations in 2018 in this area, in particular by addressing skills mismatches and designing well-working labour supply measures (see chapter 3).
- Business federations are increasingly worried about the slow pace of reform in the areas of innovation and skills and the business environment, with a significant rise in the proportion of federations considering reform in these areas to be unsatisfactory.
- At the same time, federations remain very positive about reform progress in the area of Financial stability and public finances.

III. REFORM PRIORITIES FOR 2018

We have also surveyed our Member Federations regarding future reform priorities, with the results summarised in the following chart:

Reform priorities for 2018

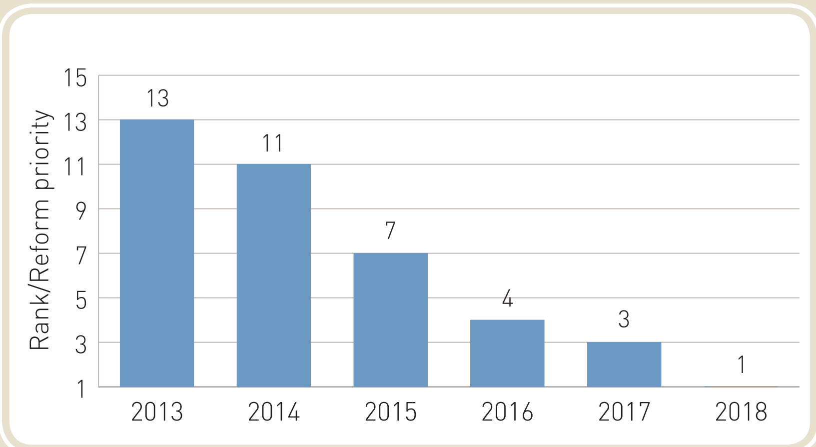
	Difference from 2017
1. Labour market mismatches and labour mobility	**+2**
2. Tax reforms	**=**
3. Pension and healthcare reforms	**+1**
4. Business environment	**-3**
5. Public sector efficiency	**+1**
6. R&D and innovation	**-1**
7. Bank lending conditions	**+4**
8. Public investment	**-1**
9. Labour supply measures	**+3**
10. Active labour market policies	**+1**

Member Federations' assessment of priorities for reform in 2018

Source: BusinessEurope survey of Member Federations

- Our members have highlighted the need for reform in the labour market as a key priority for 2018. In particular, measures to improve labour market mobility can help ensure that workers are able to maximise the use of their training and specialist skills in their jobs. The graph below clearly shows that over the last years, our members assigned an increasing importance to reform in the area of labour market mismatches and mobility. While in 2013, this area was only placed 13th in our priority ranking, it now is the key priority for reform to our members in 2018.

Long-term development of 'Labour Market Mismatches and Mobility' as a key reform priority



Member Federations' assessment of priorities for reform in 2013-2018

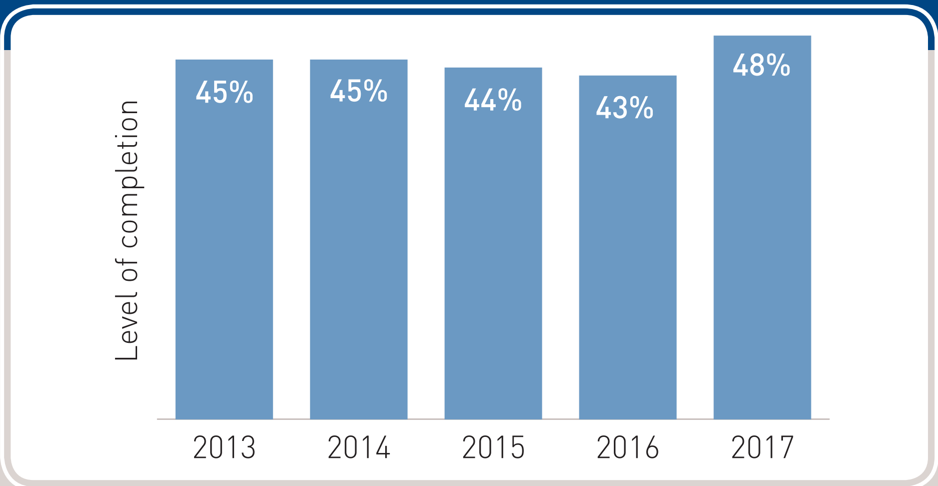
Source: BusinessEurope survey of Member Federations

IV. REFORM PROGRESS OVER THE YEARS

To see whether members have assessed their country's reform progress differently over the past years, we have constructed a reform index, using simple averages[21] of their assessment of each country-specific recommendation, to see whether there has been an increase or decrease in reform momentum.

Based on our overall index, we consistently see that over the post-crisis period, there has been a disappointing level of reform implementation. Member States will need to step up their efforts and make use of the current positive economic climate to implement structural reforms in order to maintain sustainable economic growth in the long term.

Long-term progress in implementing the country-specific recommendations

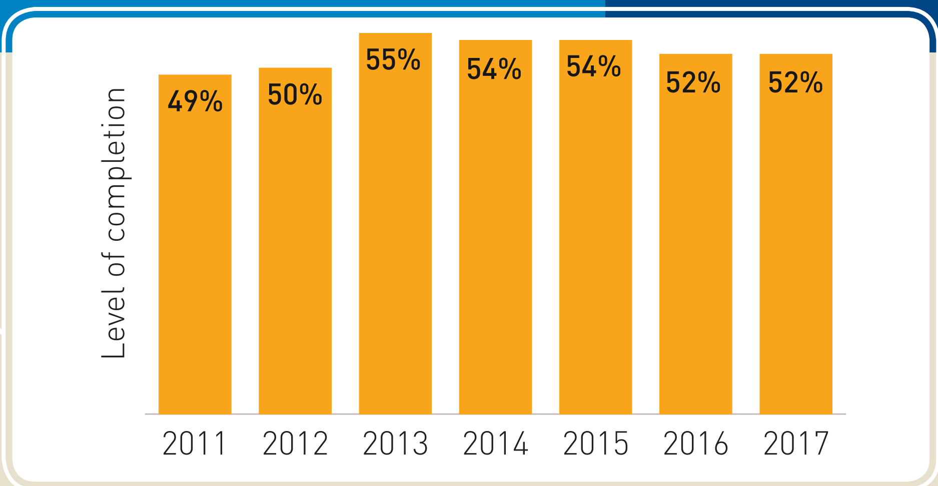


Member Federations' long-term assessment of Member States' efforts to implement CSRs

Source: BusinessEurope survey of Member Federations

Long-term progress by area

Member Federations' long-term assessment of reform progress by main areas



Source: BusinessEurope survey of Member Federations

[21] For this chapter, we have allocated different scores to the responses (1=excellent, 0.75=satisfactory, 0.5=mixed, 0.25=unsatisfactory, 0=no progress) to calculate a simple average score on the level of completion of each country-specific recommendation for each year in both graphs bove.

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Norway	Poland	Portugal	Rep. of San Marino	Serbia	Slovak Republic
Slovenia	Spain	Sweden	Switzerland	The Netherlands	Switzerland
Turkey	Turkey	United Kingdom			

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