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REFORM BAROMETER

REFORM TO PERFORM

SPRING 2016

2012 2013 2014 2015 **2016**

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Who are we?

BUSINESSEUROPE is the leading advocate for growth and competitiveness at 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

2015 was a challenging year for the EU, as it sought to deal with a number of complex issues including an influx of migrants, increased concerns regarding security linked to the tragic events in Paris, as well as further political and economic instability in Greece.

Against this background and continuing volatility in global financial markets we should welcome the fact that the EU economy continues to grow, albeit more slowly than we would have hoped, and aided by the tailwinds of continuing low oil prices and concerted policy action from the ECB.

We believe that many of EU's challenges can be more easily overcome if we have a strong economy providing rising living standards and fulfilling employment opportunities for all, and which in turn supports social cohesion and sound public finances.

But we will only secure a strong economic foundation if we step up the pace of reform path and undertake the further reforms needed to support long-term investment and innovation, and in turn promote the digital transformation of our economy. As part 1 of this report shows, despite important reforms in many Member States, important aspects of the EU's business environment ranging from the time and cost of starting a business, to excessive labour market regulations, to ease of trading across the internal market, fail to provide the platform for businesses to grow and invest that our major competitors offer. And as our special article notes, the need to rapidly address structural and fiscal challenges is made more urgent by the ongoing ageing of EU's population which, particularly in comparison to the US, places further pressure on our competitiveness.

The Commission's decision to launch a wide-ranging investment plan has therefore been welcomed by business. As we examine in detail, just over a year on from the launch of the plan, some progress has been made in agreeing a new fund (the EFSI) to use public funds to leverage private investment. And the Commission has launched important strategies in areas such as capital markets, energy and trade, setting out a number of key actions needed to breakdown investment barriers. But more efforts are needed as investment will only increase if policy-makers start turning words into actions in 2016 and agree to urgently implement the measures set out.

Implementation is also the keyword when we look at Member States' reform efforts. Part 2 demonstrates that despite the Commission identifying the key issues for reform in Member States, actual reform continues to lag, with only 20% of reform recommendations satisfactorily implemented according to BUSINESSEUROPE's members. This is despite the clear lesson from countries such as Spain, Ireland, Italy and Latvia that proper implementation of structural reforms can quickly reinforce business confidence and investment and support growth. Reform to Perform in 2016!

Emma Marcegaglia
President

Markus J. Beyrer
Director General

Executive Summary

The EU's slow economic recovery means we continue to lose ground in global markets

Whilst EU growth did pick up in 2015, the year nevertheless reinforced the post-crisis pattern of the recovery of the global economy being much stronger than that in the EU. Growth in the EU averaged just 1% between 2011 and 2015, as opposed to 2% in the US and Canada.

Employment remains more that 2.5 million lower in the EU compared to the beginning of the crisis in 2008, while over 3 million new jobs were created in the US in the same period.

Urgent action is still needed to improve the EU business environment and increase investment

Investment in the EU has failed to pick up as strongly as expected in the last 12 months due to rising geo-political and financial markets tensions impacting on confidence. FDI flows into the EU have been particularly volatile in recent years, and have fallen as a share of the global total. This reaffirms the need to take urgent action to improve the EU business environment.

One year on from the launch of the Commission's much needed investment plan, some concrete steps forward have been taken, in particular to quickly establishing the European Fund for Strategic Investment and ensure it can start lending, although continuing efforts are required to ensure it leads genuinely to additional investment.

The Commission has also launched a number of key strategies to improve the investment environment, but these now urgently need to be translated into concrete EU proposals able to increase business competitiveness. In particular:

1. The EU must rapidly implement its new **single market strategy** to achieve a truly integrated single market for goods and services and boost competition, innovation and growth. Fully realising the benefits of the digital economy alone could add more than €2 trillion a year to the EU GDP by 2030. At the same time, the EU must maintain the integrity of the Schengen area.

2. In addition to completing banking union, 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 (stock market capitalisation is presently 66% of GDP in the EU, compared to over 150% in the US).

3. The **energy markets union** must be completed to address energy price differentials with major competitors and improve energy security. Industrial energy prices remain almost 2½ times higher than in the US damaging competitiveness of companies operating in the EU.

4. Despite improvements in recent years, **administration requirements** are much higher in many Member States than in the US. Legislating less and better should be the golden rule. Regulation must be well designed, with a minimum of administrative burdens in order to support business start-ups and companies' expansion. Competitiveness proofing, including an SME test, must become an integral part of ex-ante impact assessment for all legislative proposals.

The ongoing ageing of the EU population reinforces the urgent need for competitiveness improvement to boost growth and strengthen public finances in a number of important areas:

- The **overall tax burden** in the EU remains over 50% higher than in the US and over 25% higher than in Japan. Further efforts are required by Member States to improve fiscal sustainability, through efforts to reduce public expenditure (whilst protecting investment), rather than tax rises, with population ageing emphasising the need to make pensions more sustainable.

- The tax burden on labour, which is almost 40% higher in the EU than in both the United States and Japan must be reduced to foster job creation and make work more attractive. Reforms are still required to ensure more open, dynamic and mobile **labour markets** which stimulate job creation and employment participation.

- Only 45% of EU adults aged over 25 participate in some sort of **learning**, compared to almost 60% in the US. Governments should prioritise education and ensure people of all ages have the knowledge and skills they need to succeed on labour markets.

- Businesses are increasingly concerned about a mismatch between the skills of the working population and the skills required by businesses. Education systems must better provide work relevant skills. Urgent action is particularly needed to address skill shortages in areas such as science, technology, engineering and maths.

- In order to mitigate the impact of population ageing on the labour market, reforms are required to encourage people to stay in the workforce, promote life-long learning, and ensure we properly integrate legal migrants into the workforce.

Member States must not allow 'reform fatigue' to set in

Our members consider that **88% of the Country Specific Recommendations for reform (CSRs) focus on the right issues** in EU Member States.

But **only 20% of the 2015 CSRs** assessed have been **satisfactorily implemented**.

Whilst the low implementation observed may be the result of the number of CSRs being reduced, we are concerned that 'reform fatigue' may be setting in as the EU economy starts to extend its recovery from economic crisis.

Implementation is uneven at country level. There are examples of countries, in particular Spain, Italy and Ireland, making strong reform progress, and it is important that such efforts are maintained, with governments making clear their commitments to fully implement reforms in order to increase legal certainty, which is essential to growth and prosperity. However, in other countries implementation is slowing or even in danger of being reversed in others.

Member federations are particularly concerned about a slowing in reform progress in the area of **innovation and skills**.

In terms of future reform priorities, tax reforms remains a key reform priority, alongside addressing skill mismatches. In addition, there has been a sharp increase in the numbers of member federations concerned about market integration and openness to trade and investment. The EU must press ahead with ambitious trade agreements, including TTIP.

Outline

PART 1
EU COMPETITIVENESS IN THE GLOBAL ECONOMY

Introduction

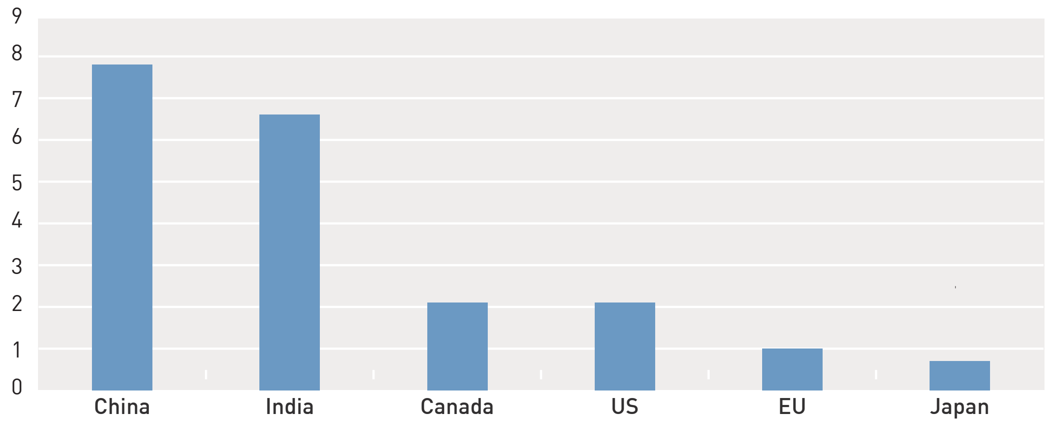
2015 saw a gradual continuation of the EU economic recovery, with 2015 GDP growth expected to be around 1.9%. But underlying this recovery were a number of temporary factors, notably further falls in oil prices and the ECB's expanded asset purchase programme. In addition, the relatively low euro effective exchange rate supported Euro-area members' exports. The clear danger is that when those temporary factors subside, the EU will have difficulties in maintaining strong growth rates. This report considers to what extent Member States have been undertaking the structural reforms needed to 'lock in' the recovery for the long term.

Whilst EU growth did pick up in 2015, the year nevertheless reinforced the post-crisis pattern of the recovery of the global economy, and particularly that of the US, being much stronger than that in the EU (US GDP growth is estimated to have been 2.5% in 2015). As figure 1 illustrates, growth in the EU averaged just 1% between 2011 and 2015, as opposed to 2% in the US and Canada. While the EU cannot be expected to match the growth of developing countries, the comparisons with China and India, where growth was almost 8% and 7% respectively over the 4 years are nevertheless important.

In sum, it is clear that while the EU has been occupied with crisis management, other major economies have pressed ahead in driving growth in recent years, differences in growth performance have clearly had repercussions on labour markets, with employment more that 2.5 million lower in the EU compared to the beginning of the crisis in 2008, while over 3 million new jobs were created in the US in the same period.

Figure 1 **While the EU conducted crisis management, other economies pressed ahead**

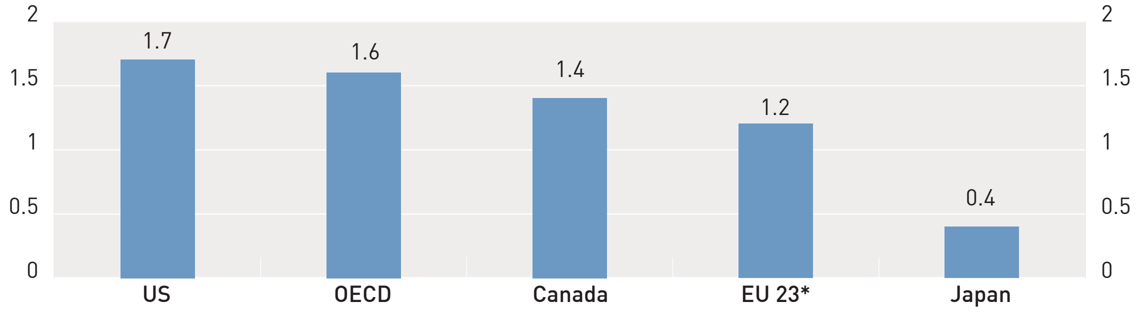
Average real GDP growth from 2011 and 2015, %



Source: BUSINESSEUROPE calculations based on IMF data (2015 est.)

More worrying is the fact that underlying growth prospects for the EU appear limited at present. Whilst EU labour productivity growth is only slightly below the levels seen in the US (0.8% and 1.3%, respectively), productivity gains in the EU have arisen primarily through employment falls. This low underlying productivity growth is reflected in the relatively low estimates for potential growth in the EU which further illustrates the need for structural reforms (fig. 2).

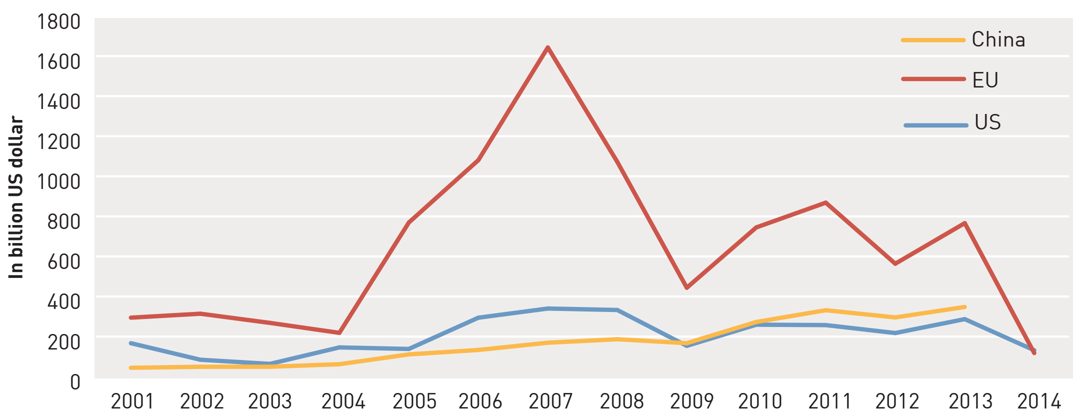
Figure 2 **Potential growth in the EU is estimated to be low**
Potential GDP growth estimates, 2015-17 average, in %



Source: OECD Economic Outlook November 2015

Despite the EU's relatively poor recent growth record, it remains the major global destination for global FDI inflows. But as figure 3 illustrates, these inflows have been particularly volatile in recent years, with the EU's overall share of inward FDI having fallen as China, in particular, has become a more important destination. As we consider in more detail in Annex 1, further efforts to deliver the Commission's investment plan, particularly to break down policy barriers to business investment, are required to enable the EU as a whole to benefit from a sustained increase in investment.

Figure 3 **Significant fall in investment inflows into the European Union in 2014**
Foreign direct investment, net inflows



*Source: United Nations, *note: no data for China for 2014*

Annex 1 summary: The Commission's investment plan for Europe 1 year on

A good start for the plan...

EU investment, in common with other major economies, declined significantly following the financial crisis. But while investment as a share of GDP has rebounded strongly in the US and Japan, EU investment is increasing very slowly, and remains below its long-term average.

Given investment is the basis for our future competitiveness, growth and jobs, we welcome the European Commission's decision to launch the investment plan for Europe in Autumn 2014.

As Annex 2 considers in depth, since the launch of the plan, the European Fund for Strategic Investment (EFSI) has been quickly established. According to the EIB, 145 transactions in 22 Member States have been signed off, drawing on €6.7 bn of EIB financing and €2.3 bn from the EIF, resulting in total investment of €61.5 bn.

Important steps have also been made by the Commission in setting out the policy barriers that need to be addressed in many important areas such as trade, capital markets, energy and the digital economy, if EU investment is to increase.

... But further concrete measures now urgently need to reduce investment barriers

Nevertheless, business investment has clearly been impacted by the inter-related factors of rising geo-political tensions slowing emerging market growth and increasing financial market instability. The Commission is now forecasting lower investment levels in the coming years than it was doing 12 months ago.

Policy-makers now need to urgently implement many of the ideas set out in strategy papers and start taking concrete steps to improve Europe's business environment, notably to complete the single market, particularly for capital, digital and energy and reduce regulation.

The EFSI must support financially sound projects that cannot find private funding alone and resist any pressure to fund projects unnecessarily and crowd out private lending.

I. TAXATION AND PUBLIC FINANCES

KEY POLICY RECOMMENDATIONS

1 **Member States must demonstrate their commitment to sustainable public finances, focusing primarily on reductions in current public expenditure which protect investment, rather than tax rises. Improving public administration efficiency and management can help maintain services whilst reducing expenditure.**

2 **We support the increased flexibility in the Commission's approach regarding the enforcement of the Stability and Growth Pact. This must be accompanied by proper enforcement by the Commission and Council to ensure compliance with the SGP rules.**

3 **Tax reforms should reduce taxation on labour and capital which are particularly damaging to growth and employment.**

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

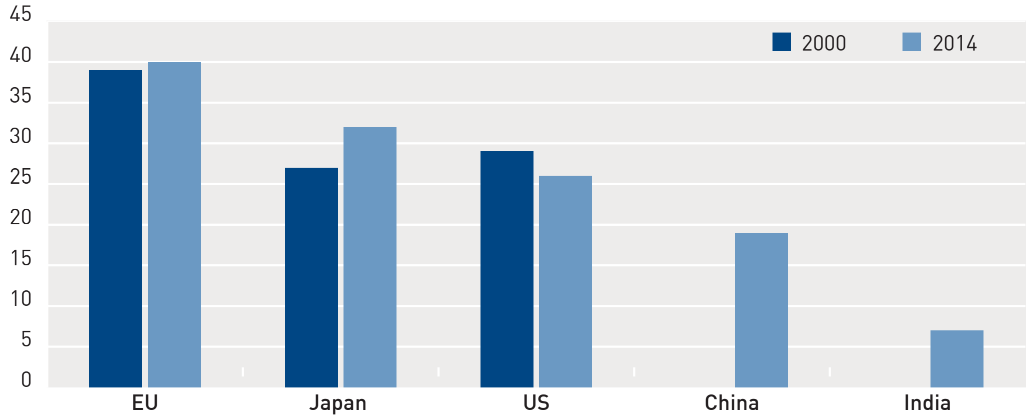
Sustainable public finances are of key importance for long-term growth. Falling confidence in governments' ability to repay debt can lead to a vicious cycle whereby increased borrowing levels lead to higher borrowing costs, and in turn require higher taxation.

EU Member States are making gradual progress in bringing down deficits which decreased to -2.5% in 2015, compared to -6.7% in 2009. In addition, public debt is expected to have peaked at 88.6% in 2014 and to have come down slightly to 87.8% in 2015. We welcome the fact that since 2012, Member States have pursued fiscal consolidation mainly via expenditure cuts rather than tax hikes (total public expenditure in the EU came down from 49% of GDP in 2012 to 48.2% in 2014). It is important that Member States remain committed to fiscal reforms by adhering to EU budgetary rules, drawing on the flexibility embedded within the Stability and Growth Pact.

In order to achieve a more growth-friendly composition of fiscal policies, while at the same time reducing still high debt ratios, it is essential that Member States lower the tax burden in a budget-neutral way and cut expenditure in unproductive areas. Unfortunately, there has been virtually no progress made in reducing the tax burden in the EU over the last year. As figure 4 demonstrates, the overall tax burden remains more than 50% higher in the EU than in the US and over 25% higher than in Japan. To some extent this includes policy choices linked to the European social model, including the provision of public healthcare. However, many Member States are at, or approaching, the point where tax levels are 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.

Figure 4 **Overall tax burden in the EU is higher than elsewhere**

Total tax burden as % of GDP, 2014 (including social security contributions)



Source: AMECO and Heritage Foundation for China and India

II. BUSINESS ENVIRONMENT

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 the EU's global competitiveness and support reindustrialisation.

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 companies' expansion. Competitiveness-proofing, including an SME test, must be an integral part of the ex-ante impact assessment for all legislative proposals.

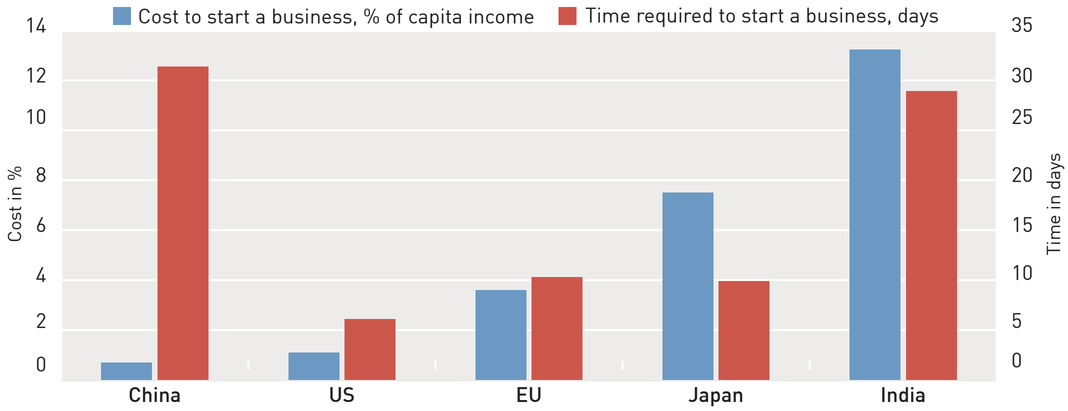
3 Energy prices must allow EU businesses to be competitive in international markets. Targets and measures to address the energy-price differential with major competitors and to ensure energy security should be introduced and taken into account in any EU energy and climate policy initiatives.

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 competitive-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.

The time and cost of starting a business, and of getting operating licences, are key indicators of the overall ease of doing business in an economy. While significant progress has been made over the last decade, administrative hurdles and costs to start up a business continue to vary considerably across the EU, indicating that there is still significant scope to improve. In particular, it continues to cost over three times more to start a business in the EU than in the US, while it takes almost twice the time to start a business in the EU (fig 5). The European Commission has estimated that the reduction of administrative burdens under the Action Programme for Reducing Administrative Burdens could lead to an increase of 1.4% in EU GDP, the equivalent to €150 billion.[1]

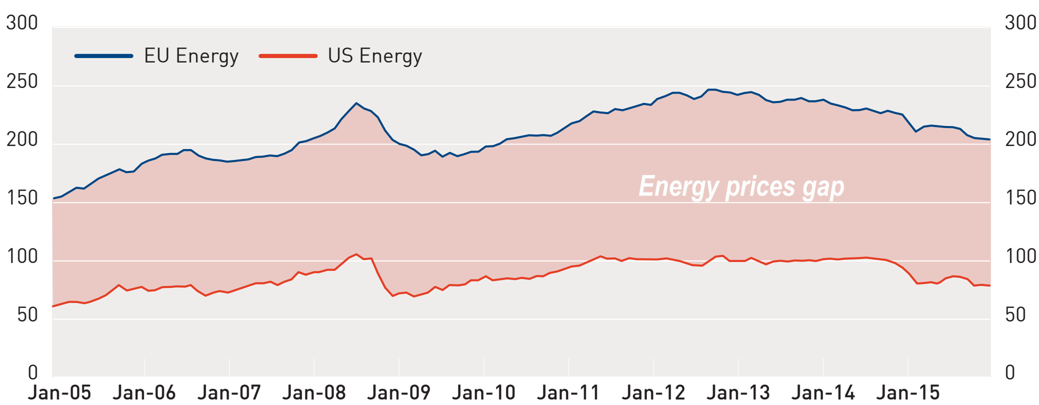
Figure 5 **Still scope for the EU to reduce administrative burdens**
Cost and time to start a business in 2015



Source: World Bank

A cornerstone for business success, in particular in the manufacturing sector, is the secure supply of competitively priced energy. However, as figure 6 shows, even with the recent fall in oil prices, industrial electricity prices in the EU remain on average over 2½ times higher than those in the US. It is imperative for Europe to combine climate action with better cost-efficiency in order to ensure that excessive energy prices compared to its partner economies do not hamper EU production. This includes better cooperation between EU Member States to build a common energy market.

Figure 6 **Relatively high energy prices are harming EU competitiveness**
Average energy prices for industrial producer in the EU and US from Jan 2005-Nov 2015, US=100 in January 2013



Source: European Central Bank, US Federal Reserve and European Commission Energy prices report 2014

[1] European Commission Memo on The High Level Group on Administrative Burdens, 19 September 2013

III. INNOVATION AND AND DIGITAL TRANSFORMATION

KEY POLICY RECOMMENDATIONS

1 Innovation policies must be more business orientated, with targeted initiatives that stimulate private R&D investment (e.g. tax incentives supporting access to finance). Incentives for cooperation between companies and research institutes in networks and clusters should be improved in order to facilitate the commercialisation of innovation.

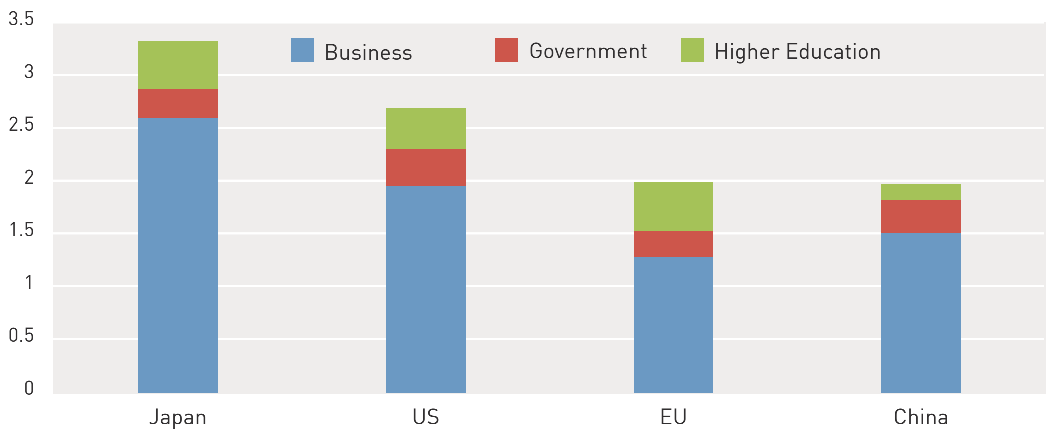
2 The EU has significant work ahead when it comes to adopting the latest technologies enabling businesses to compete globally. This is especially the case when it comes to providing basic infrastrucuture as well as innovation and R&D to develop its digital economy.

3 Ensuing a digital transformation will required 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 address legal fragmentation in areas of consumer legisation, taxation, copyright and data protection rules.

The EU's innovation and technological capability is fundamental to our 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, broadband access and patent registrations provide useful pointers in assessing both our current and future capability

Overall, the EU's R&D spending in relation to the size of its economy was, at around 2% in 2012, well below rates seen in the US (2.7%) and Japan (3.3%) (figure 7) and a percentage point behind the 3% target in the EU growth strategy (Europe 2020).

Figure 7 **EU spending on R&D is well below US & Japanese levels**
R&D intensity as % of GDP in 2012

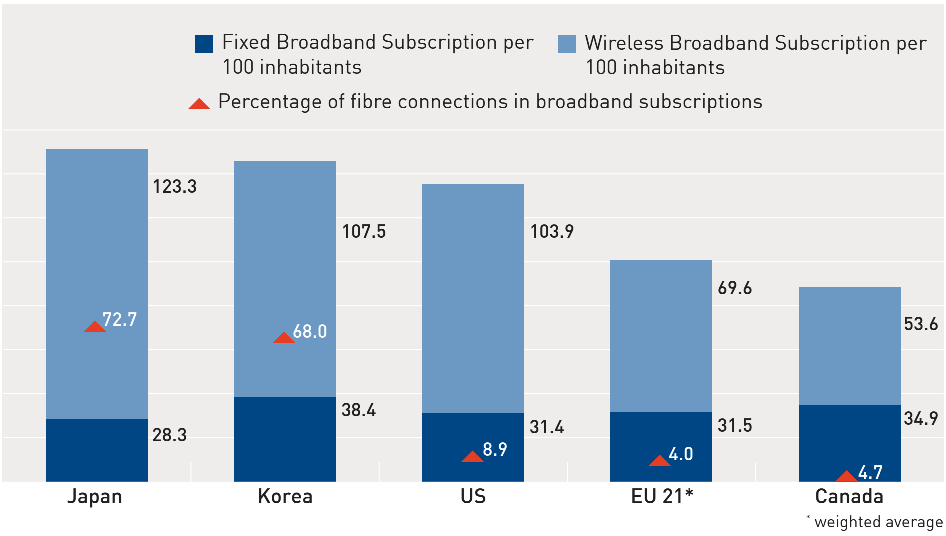


Source: Eurostat

Similarly, investment levels in broadband infrastructure are substantially lower in the EU compared to other large economies. In 2013, investment in broadband infrastructure on a per-capita basis was €90 in the EU, compared to €226 in Canada, €226 in Japan and €178 in the US. In fact, the EU is the only economy where per-capita investment fell between 2008 and 2013.

In line with this, the EU is lagging behind other major economies with regards to wireless broadband subscriptions and to a somewhat lesser extent when it comes to fixed subscriptions (fig 8), even though there has been some progress made in the EU over the last year, with total subscriptions increasing by 11%, while increasing by 8% in Japan and 4% in the US. Fibre connections, enabling quicker connections and disconnections than traditional copper lines, are much more common in Japan (73%), Korea (68%) and the US (9%) than in the EU (4%).

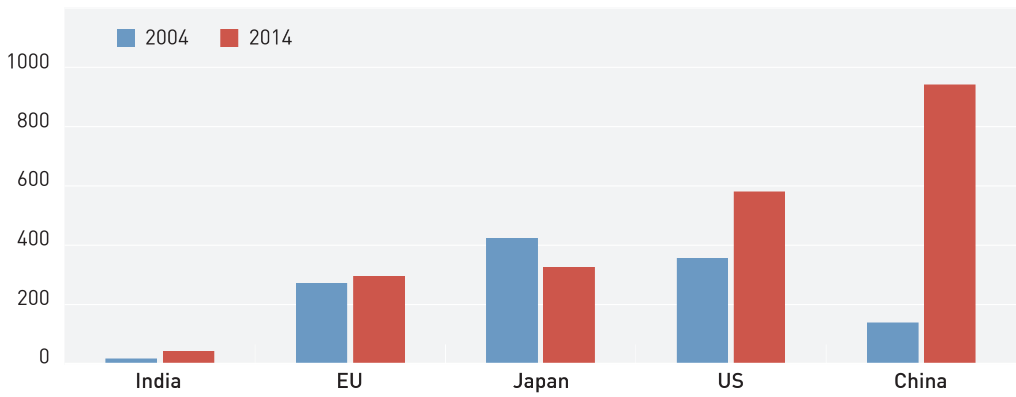
Figure 8 **The EU lags behind in the development of (fast) broadband connections**
Fixed and wireless broadband subscriptions per 100 inhabitants and fibre connections in %, 2014



Source: OECD Broadband Portal

The failure to invest in R&D and digital infrastructure appears to be impacting on innovation output, at least when looking at total patent applications as a proxy. Clearly, the patent gap with the US has grown over the last 10 years, whilst China has risen from very low levels (about half of those in the EU) to application numbers now three times exceeding those in the EU (fig 9).

Figure 9 **The EU has failed to close the gap of international patent applications**
Total number of patent application, in thousands



Source: WIPO

IV. ACCESS TO FINANCE AND FINANCIAL STABILITY

KEY POLICY RECOMMENDATIONS

1 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, consider whether further action is required to ensure prudential rules strike the right balance between increasing financial stability and supporting companies' financing needs for investment and business activities.

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

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 SME's, finance needs to be available through a variety of different channels.

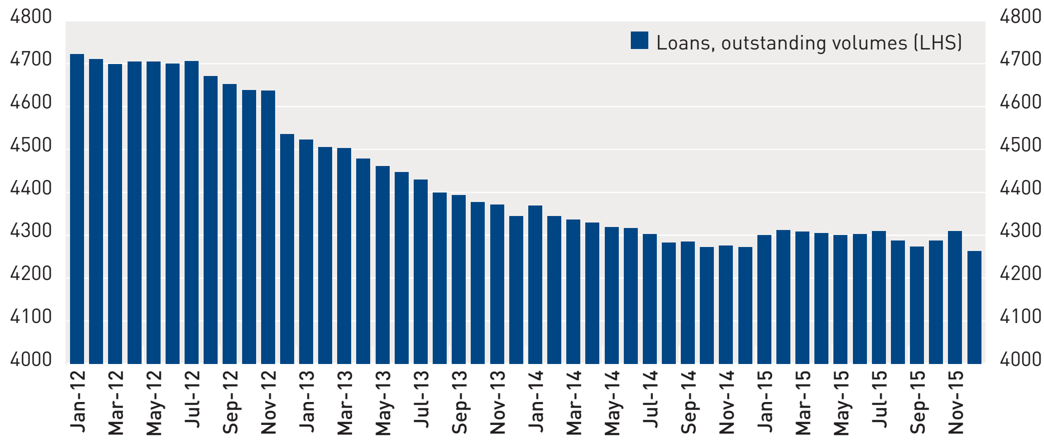
Financial instability, as illustrated during the crisis, impacts negatively on access to finance, confidence and growth, precluding companies from taking on new investment. The negative feedback loop between sovereign and bank financial positions we saw build from 2010, which led to political uncertainty 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 hardest hit by the crisis.

While we have recently seen a gradual convergence, (albeit with a few exceptions), towards lower interest rates on business loans across the Euro Area, access to finance remains a key concern for business. BUSINESSEUROPE supports the full implementation as agreed by Member States of the Bank Resolution and Recovery Directive. In the context of precautionary recapitalisations, resolution authorities should carefully assess the opinion of imposing losses on junior creditors on a case-by-case basis, given the risk of a flight of investors which could further hamper EU bank funding.

Although reinforced prudential rules and strengthened supervision restored confidence in financial institutions and made them more resilient, it also put back bank lending under pressure. In particular, with the demand for finance picking up in line with a gradually improving economic outlook, insufficient finance remains a risk to firms' investment. It will therefore be particularly important that following the publication of the comprehensive impact assessment on financial regulation, we consider whether further action is required to ensure prudential rules strike the right balance between increasing financial stability and supporting companies' financing needs for investment and business activities.

As figure 10 illustrates, despite the increasing involvement of the ECB the volume of bank loans remains around the same level as during the first quarter of 2014 and is about 9% below the levels we have seen in 2012.

Figure 10 **Bank lending to business shows no signs of recovery**
Bank loans to Euro Area non-financial corporations, outstanding billion Euros, Jan 2012 – Nov 2015

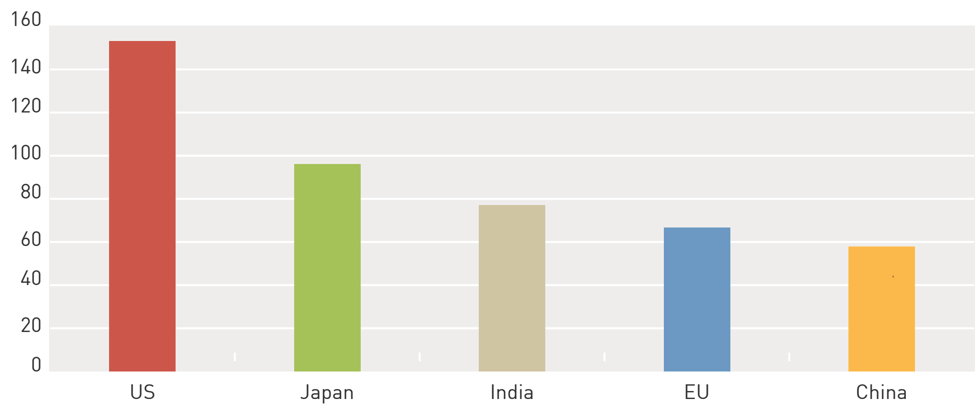


Source: European Central Bank

To prevent any shortfall of funding, it should be made easier for businesses to tap non-bank financing. Traditional bank loans still makes up around 80% of business financing in the euro area and in the UK, and only 20% of borrowing by European enterprises comes from capital markets. In the US, it is the opposite situation. This is reflected in the low stock market capitalisation of the EU with around 66% of GDP compared with about 151% in the US (fig 11). Similarly, the outstanding stock of corporate bonds increased from €633 bn in 2007 to €1051 bn in 2014 in the Euro-area, whereas it increased from €4327 bn to €6461 bn in the US during the same period. Clearly, EU businesses, and SMEs in particular, face more difficult requirements to access capital markets and strong regulatory disincentive when it comes to securitization, in comparison with the United States.

Expanding the financial support channels can help companies to avoid credit rationing and obtain better credit conditions, while at the same time contributing to financial stability by diversifying the risk between banks and other financial institutions. For example, venture capital can be an important source of finance, in particular for growth companies. However, in the EU venture capital investment is still a far less important source of finance than in the US. Whereas in 2014 the EU accounted for only 12.1% of global venture capital investment, the US made up 60%.[2] Rapid progress in implementing the Capital Markets Union is required to address many of these issues.

Figure 11 **Stock market capitalisation as a % of GDP**
Total stock market capitalisation of listed public companies in 2014



Source: World Bank

[2] Source: Ernst & Young. (Jan 2015), "Venture Capital Insights – 4Q14".

V. LABOUR MARKET & SKILLS

KEY POLICY RECOMMENDATIONS

1 To ensure open, dynamic and mobile labour markets, reforms focusing on stimulating job creation, in particular for young people, and employment participation, smoother labour market transitions, and better allocation of labour based on employers' needs must be implemented.

2 In order to maintain and increase global competitiveness, 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.

3 Reduce non-wage labour costs through targeted cuts in employers' social security contributions can play an important role in stimulating demand by encouraging employers to hire more staff. The tax burden on labour should be reduced to make work more attractive, especially for low-income earners, compared with welfare beneficiaries.

4 To address serious skill shortages and mismatches which risk acting as a brake on economic growth in the EU, education and training systems need to be tailored to labour market needs.

5 In particular, more STEM graduates (science, technology, engineering and maths) are needed over the next years as well as people with good e-skills developed, for example, through e-apprenticeships.

6 In order to mitigate the impact of population ageing on the labour market, reforms are required to encourage people to stay in the workforce, promote life-long learning, and ensure we properly integrate legal migrants into the workforce.

Persistent and high unemployment continues to affect many European economies in the aftermath of the financial crisis and underlines the difficulties European labour markets face as a result of underlying structural weaknesses.

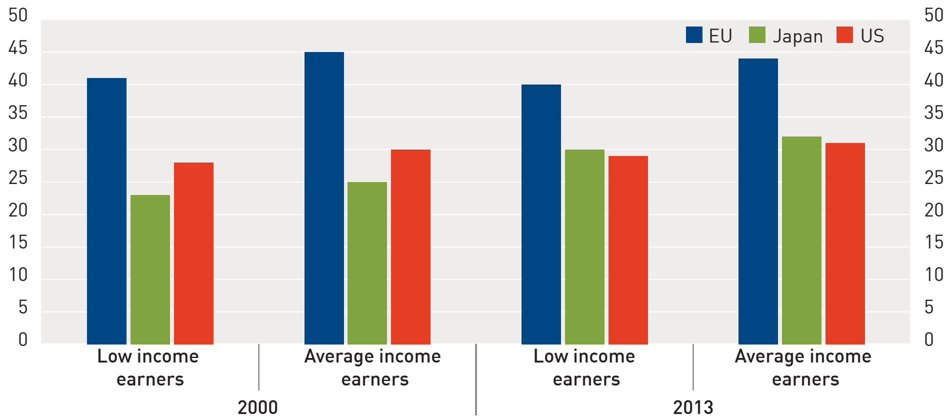
Well-functioning and flexible labour markets facilitate workers' transition between jobs and help match skills supply and demand. In contrast, excessive labour market rigidities reduce a country's attractiveness for both domestic and outside investors, and hamper employment creation as well as productivity and economic growth. Labour mobility is even more important in the case of a monetary union to assure that different economies react optimally to a common monetary policy, as it can serve as an adjustment mechanism in response to asymmetric shocks. Despite the efforts to increase the cross-borders mobility among European workers, the share of the EU workforce that moved to another member state was only 0.2% in 2012, while the same figure for the US indicates that 2.7% of the workforce moved cross-border. In 2013, only just over 8 million EU citizens worked and lived in another Member State, representing just 3% of the total EU labour force.[4]

In addition to facilitating labour mobility, 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).

[3] European Commission, "Labour Mobility within the EU" Memo, September 2014
[4] European Parliamentary Research Service, "Implementation Appraisal on EURES Labour Mobility Package", June 2015

Given that labour demand and supply tends to be more elastic for low-skilled/low-income earners as well as second-earners, high labour taxes will have particularly strong negative consequences for these groups. Thus it is a clear concern that the average tax wedge on average income earners is almost 40% higher in the EU compared to the US and Japan (fig 12). Reducing the tax wedge must be a key priority to enhance economic growth in the EU.

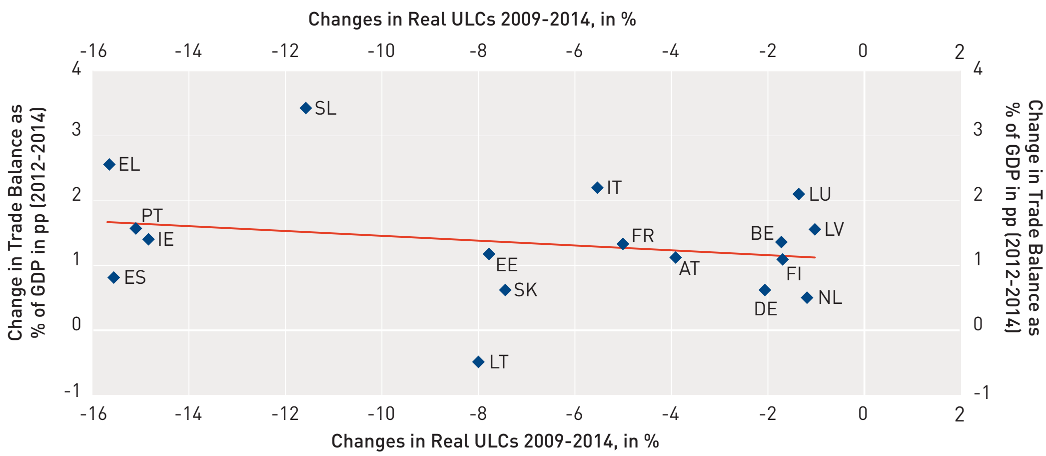
Figure 12 **The tax wedge on income earners in the EU needs to come down**
Tax wedge on low and average income earners (single person), 2000 and 2013



Source: OECD

Finally, reducing excessive labour costs will also help Member States in improving their international competitiveness. As figure 13 illustrates Euro Area members that allowed their unit labour costs (ULCs) to strongly rise in the pre-crisis period have recently made progress in reducing ULCs and see positive effects in their trade balance.

Figure 13 **Countries where adjusted ULCs show improved export performance**
Changes in real unit labour costs (2009-14) and in net exports (2012-14), in %



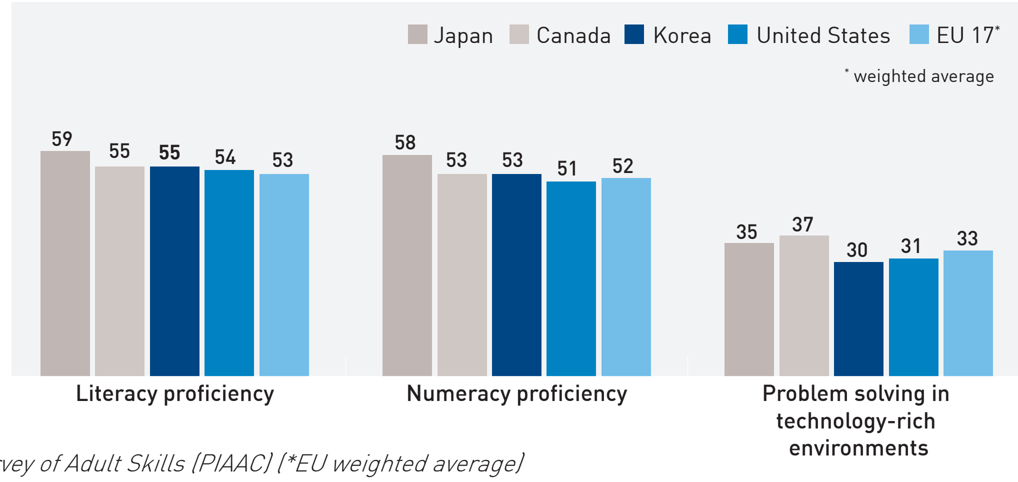
Source: BUSINESSEUROPE calculations based on Eurostat & European Commission AMECO Database

Therefore, it is important that Member States continue to implement structural reforms in the labour market to ensure competitiveness. This should include reducing the tax wedge on labour, shifting taxation in a way that will not create market distortions and promote economic growth, as well as realizing more efficient collective bargaining structures and allowing more flexibility in wages schemes and contractual terms.

When it comes to education, OECD analysis (fig 14), shows that the EU adult population lags behind the leading global performers in each of the key areas of literacy, numeracy, and problem-solving in technological-rich environments. Among the 15-years old in the EU, the share of underachievement in reading (17.8% across the EU), maths (22.1%) and science (16.6%) remains well above the ET 2020 benchmark of 15%, according to the OECD PISA 2012 study.

Figure 14 **Adult skills need to be improved in the EU**

Literacy, Numeracy and Problem-solving Skills of Adult Population (16-65 years), Converted scores out of a 100, 2012

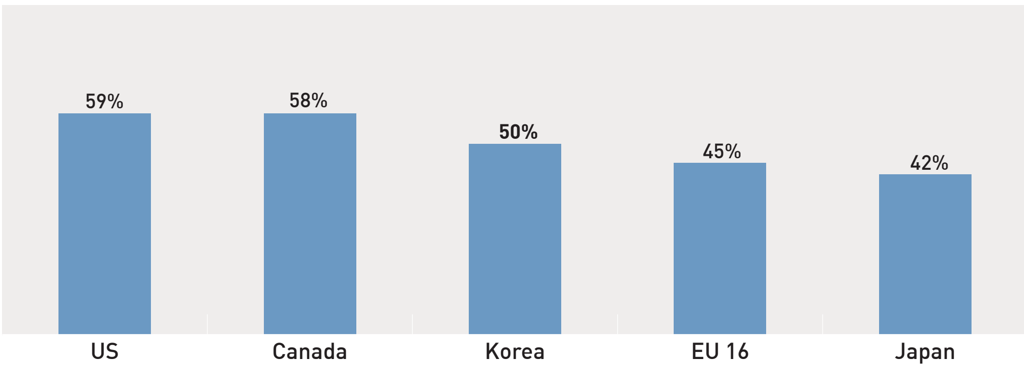


*Source: Survey of Adult Skills (PIAAC) (*EU weighted average)*

Whilst weakness in adult skills may to a large extent reflect failures in school education, adult education also has a strong role to play in addressing such concerns. However, overall participation rates in formal and non-formal education and learning of 25-64 year olds in the EU are well below the levels observed across the Atlantic (see figure 15). In particular in the light of an ageing population it is imperative to ensure that older people are able to adapt to a fast changing technological market.

Figure 15 **The EU depicts low participation rates in education and learning**

Participation in formal and non-formal education and learning of 25-64 year olds during the previous 12-month period, 2012



*Source: Education at a Glance - OECD 2014 (*EU weighted average)*

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.

Summary Annex 1 Demographic change: Is the EU sufficiently prepared ?

Annex 1 considers the implications of population ageing on the EU economy, and in particular on growth, the labour market and public finances. **We find that whilst the US and other global economies will also experience population ageing, the phenomenon will be less acute, raising the spectre of the EU losing further ground in terms of competitiveness. In particular:**

- In the EU the old-age dependency ratio will increase from 29% at present to 54% in 2050, whereas in the US the ratio is expected to increase from only 22% to 37%.
- The strong shift in the distribution of the population will also have significant fiscal implications via a shrinking tax base due to fewer people working and at the same time increasing age-related expenditure (expected to increase from 19% of GDP in 2015 to 26% in 2050 in the EU, while comparative expenditure in the US increases from 13% in 2015 to only 18% of GDP in 2050).

A number of key policy actions are urgently required to enable the EU to address the challenge of population ageing whilst maintaining rising living standards for all:

- Promoting **better and higher quality education** and skills throughout people's working lives will be essential in light of the declining working population.
- Member State must do more to **encourage older workers to stay in the workforce**, while **immigration**, when properly managed, can also play an important role in addressing the increasing dependency ratio.
- Population ageing makes the need to **consolidate public finances** now more acute. In particular, Member States need to **make pensions more sustainable.**
- Member States must **improve the efficiency of health and long-term care provision** including by building strong partnerships with the private sector, in order to keep health care costs under control.
- Overall, **strong growth** is essential to help pay for the additional costs of population ageing.

PART 2
STRUCTURAL REFORM PROGRESS - MEMBER FEDERATIONS' ASSESSMENT

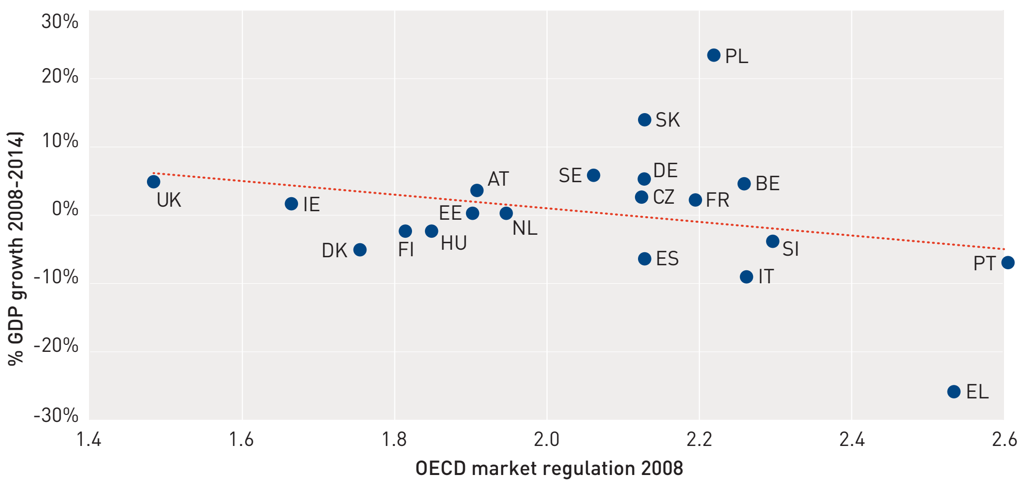
As Part 1 of this report demonstrates, a failure to take forward structural reforms has had a significant impact on Europe's competitiveness and in turn on its growth and employment performance.

A recent OECD study highlights the potential benefit of structural reforms to long-term growth in the Euro Area.[5] Analysis suggests 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 half the per capita gap with the United States by 2030.

Further demonstrating the importance of reforms to put in place a supportive business environment, figure 16 shows that countries that entered the crisis in 2008 with better-regulated product and labour markets according to the OECD have in general seen slightly higher post-crisis growth rates.

Figure 16 **Countries with less rigid market regulation show higher growth rates**

Correlation between average. OECD product and labour market regulation in 2008 and 2010-14 GDP growth



Source: OECD & Eurostat

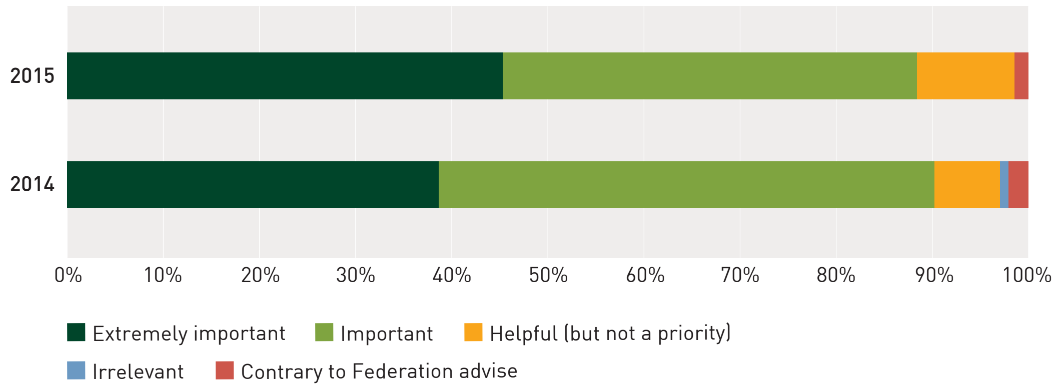
This chapter analyses the results of a survey of BUSINESSEUROPE member federations regarding reform effort over the year, linked to the European Semester.

[5] OECD, Economic Challenges and Policy Recommendations for the Euro Area, Better Policies Series, 2014

1. COUNTRY-SPECIFIC RECOMMENDATIONS – IMPLEMENTATION PROGRESS

BUSINESSEUROPE member federations continue to believe that the Country-Specific Recommendations (CSRs) focus predominately on the right issues. Our Members consider that 88% of the CSRs focus on the right issues for reform in EU Member States (fig 17).

Figure 17 **Assessment of the 2015 Country-Specific Recommendations objectives**
Member federations' assessment of the appropriateness of individual CSRs



Source: BUSINESSEUROPE survey of member federations

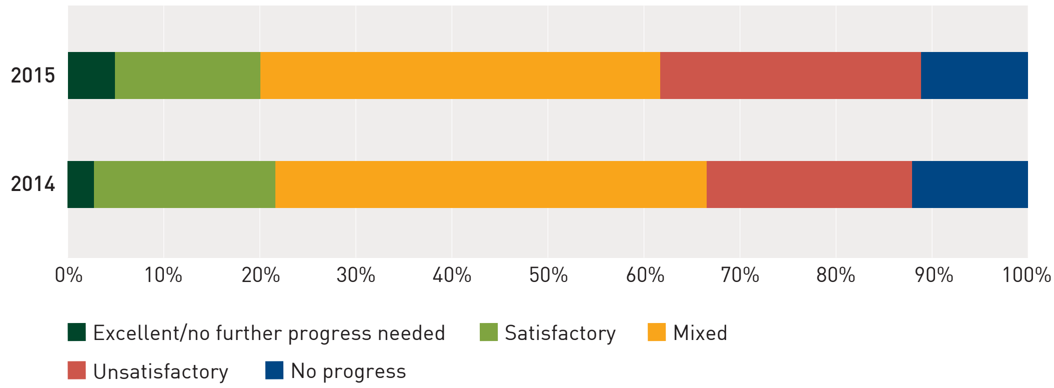
But member federations continue to observe that implementation of the CSRs is unacceptably poor, with members indicating that only 20% of the 2015 CSRs assessed have been satisfactorily implemented (fig 18). This does raise concerns that 'reform fatigue' may be setting in as the EU economy starts to extend its recovery from economic crisis.

In addition, for those countries who did implement CSRs, it is essential to maintain the reforming attitude, passing the reforms that are yet to be approved, and allowing the changes already established to play out so as to see the expected results. It is crucial to contribute to legal certainty and predictability, qualities well needed in the current environment to allow growth and prosperity.

When taking into account the additional proportion of CSRs where mixed (i.e. some) progress has been identified, the figure increases to 61%. But this still leaves 39% of CSRs where progress has been either unsatisfactory or nil.

Looking in more detail at country level, we see a strong picture of uneven implementation. There are examples of countries making strong reform progress, in particular in Spain, Italy and Ireland. In these countries it will be important to maintaining reform momentum and ensure that reforms are fully implemented and properly evaluated. However, in some countries, notably Greece, Portugal and Slovenia the pace of implementation has fallen.

Figure 18 **Progress in implementing the 2015 Country-Specific-Recommendations**
Member federations' assessment of the appropriateness of Member States' efforts to implement recommendations

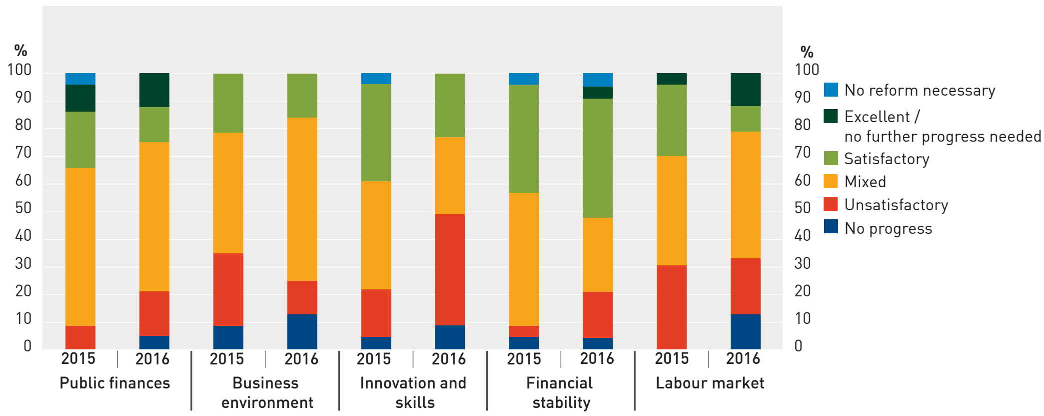


Source: BUSINESSEUROPE survey of member federations

2. 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 correspond to the areas analysed in Part 1 of this report (fig 19).

Figure 19 **Reform progress by main policy areas**
Member Federations' assessment of reform progress by main areas



Source: BUSINESSEUROPE survey of member federations

- Against an overall background of slowing reform, member federation are particularly concerned about reform progress in the area of innovation and skills, with a strong rise in the proportion of federations considering reform progress in these areas to be unsatisfactory.

- Financial stability continues to be an area where members are most satisfied with reform progress, although even here there are signs of reform fatigue.

3. PRIORITIES FOR 2016

We have also surveyed our member federations regarding future reform priorities, with the results summarised in figure 20.

Figure 20 **Reform priorities rank for 2016**
Member federations' assessment of priorities for reform in 2016

	Difference from 2015
1 Tax reforms	+1
2 Business Environment	-1
3 Pension and healthcare reform	+1
4 Labour market mismatch and labour mobility	+3
5 R&D and Innovation	+4
6 Active labour market policies	0
7 Public sector efficiency	-4
8 Public investment	0
9 Wage bargaining and wage-setting policies	+4
10 Consolidation of public expenditures	-6

Source: BUSINESSEUROPE survey of member federations

- Tax reforms continue to be a key priority for BUSINESSEUROPE members, with businesses pointing to the importance of both sound public finances and a lower overall tax burden in supporting growth.

- Businesses are becoming increasingly urgent to see more reforms to support R&D and innovation. Businesses are increasingly concerned about a mismatch between the skills of the working population and the skills required to by businesses to drive growth. As well as ensuring that education systems provide work-relevant skills, measures to improve labour market mobility can also help ensure that workers are able to maximise the use of their training and specialists skills in their jobs.

BUSINESSEUROPE

BUSINESSEUROPE is the leading advocate for growth and competitiveness at 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.

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Denmark	Denmark	Estonia	Finland	France	Germany
Germany	Greece	Hungary	Iceland	Iceland	Ireland
Italy	Latvia	Lithuania	Luxembourg	Malta	Montenegro
Norway	Poland	Portugal	Portugal	Rep. of San Marino	Serbia
Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Switzerland
The Netherlands	Turkey	Turkey	United Kingdom		

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