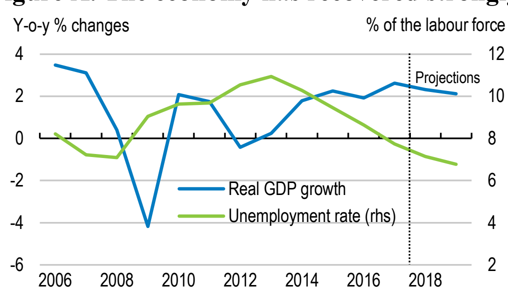
Executive summary

- *The economy is expanding supported by accommodative macroeconomic policies*
- *Policies to pursue stronger growth and make it more inclusive are needed*

Economic conditions keep improving…

The EU economy is finally growing robustly. After years of crisis, the European economy has robustly expanded in 2017 (Figure A), helped by very accommodative monetary policy, mildly expansionary fiscal policy and a recovering global economy. GDP growth is projected to remain strong in 2018 and 2019 by the standards of recent years.

Figure A. The economy has recovered strongly



Source: OECD (2018), *OECD Economic Outlook: Statistics and Projections* (database).

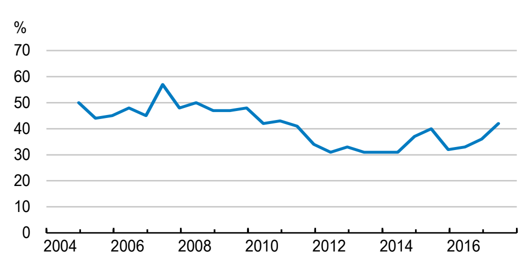
StatLink http://dx.doi.org/10.1787/888933747432

…but important challenges remain

With an expansion underway, attention needs to shift to Europe's long-term challenges. Wellbeing disparities, the UK vote to exit the EU, low potential growth, an ageing population and continuous technological developments are all important challenges. To further strengthen the confidence of all its citizens (Figure B), the European Union needs to focus on policies that support a stronger and more inclusive growth.

Figure B. Citizens' trust in the EU is recovering

% of population claiming they tend to trust the EU, as an institution



Source: European Commission, Public Opinion in the European Union, Standard Eurobarometer Survey.

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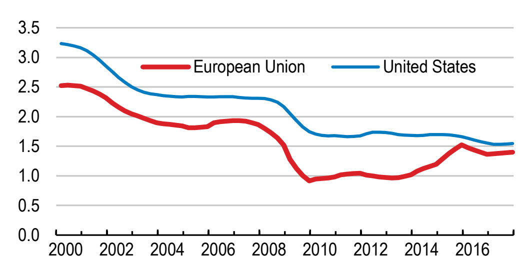
Bringing everyone on board to revive the European project. Income inequality in EU countries is on average lower than in other OECD countries. At the same time, the crises have left a legacy of social problems and discontent. Unemployment remains above pre-crisis levels in many countries and real wages fell sharply in some countries hard hit by the crisis and stagnated or barely grew in others. Youth unemployment, at about 16% on average, remains high and there are still too many youth left behind.

Improving long-term growth is key to make growth more inclusive

Potential growth has fallen substantially since the financial crisis (Figure C). Sustained improvements in living standards are held back by weak productivity and investment in many countries. The EU can lift the EU's low growth potential by creating the right incentives and conditions to support national reforms. Across Europe there is ample scope for reforms to boost competition, encourage innovation and business dynamism and make growth more inclusive. It is in good times that countries can best afford the adjustment costs of such reforms.

Figure C. The EU's potential output growth is low

As a percentage of potential GDP



Source: OECD (2018), *OECD Economic Outlook: Statistics and Projections* (database).

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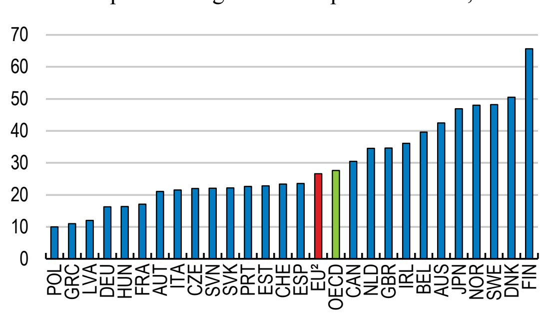
Deepening the Single Market is a key EU lever to enhance prosperity. A dynamic and large single market, that stimulates competition and efficiency, is the EU's main asset for spurring productivity, investment and economic growth. However, the single market remains fragmented, with barriers in key areas, including services, transport, finance, energy and digital markets. Removing unnecessary barriers to competition and cutting red tape can help to improve economic dynamism, facilitating firm entry and exit, reallocation of resources across firms and technological diffusion. New efforts to complete the single market by creating new business opportunities would also stimulate business investment, which is increasing but remains below pre-crisis.

Better harnessing digital technologies to adapt to rapid technological change. An important factor for future growth will be the ability of EU economies to reap the benefits of digitalisation. Several countries lag behind in the quality of digital infrastructure: use of advanced digital tools falls short in many countries (Figure D). A better designed EU regulatory framework could encourage greater investment in high quality network infrastructure. This should be accompanied by strong national efforts to develop the right digital skills among people of all ages and educational attainment. The EU could support the development of digital skills by establishing common definitions of skill needs and helping countries develop data tools to monitor skill gaps.

Figure D. Use of advanced digital tools falls short in many countries

% of enterprises using cloud computed services, 2017[1]



1. Or latest available year.
2. Unweighted average across European Union members that are also members of the OECD (22 countries), plus Lithuania.
Source: OECD (2018), *ICT Access and Usage by Businesses* (database); see figure 23 for details.

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Creating inclusive labour markets to raise living standards and potential growth. With the recovery maturing, some central European countries are already facing labour shortages. Now is the time to build on national reforms to ensure that women, youth, older workers and migrants are integrated in the labour market. Making it much easier to hire skilled workers from outside the EU, by simplifying the eligibility requirements and procedures for the EU Blue Card, would also help. Swiftly integrating refugees would improve both their wellbeing and expand the labour force and help address EU citizens' concerns. Labour mobility between EU countries has increased in recent years but still remains relatively low. To a large extent, this reflects Europe's linguistic and cultural diversity, which is an asset. But policy-induced barriers also inhibit movement. These include difficulties in having professional qualifications recognised and different social security systems. Even if the EU has rules to coordinate social security systems to ensure the portability of social security rights.

A reformed EU budget could enhance growth and make it more inclusive

The approaching negotiations for the next multiannual financial framework provide an opportunity to rethink the EU budget. The EU budget is already stretched and there are new financing needs. Reforming the budget has become even more urgent with Brexit: the UK departure will lead to a gap of about 7% of the annual budget after 2020. If not addressed this shortfall could lead to significant cuts in some crucial European programmes.

Financing new priorities and filling the UK gap will require higher member states' income-based contributions, new sources of revenue coming from taxation, a reallocation of spending or a combination of these measures. Additional funding could come from eliminating the system of special reductions that some of the largest net contributor countries benefit from. Although politically difficult, cohesion funding should be focussed more tightly on lagging regions, which would more effectively address regional divides. Reforms have reduced the weight of agriculture in the

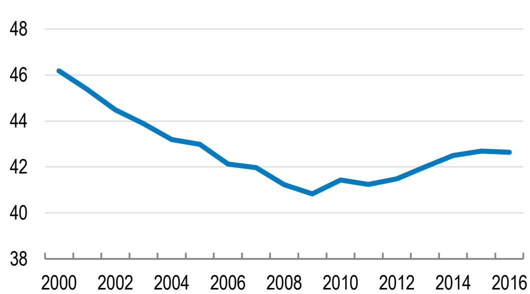
EU budget to 37%. However, about 27% of the support to producers is still linked to production and should be phased out. Spending on R&D, which only accounts for 13% of the EU budget, should be significantly increased given Europe's low growth potential and the evidence of the value added of EU-level R&D support compared to national programmes. The EU could better support those who lose out from globalisation and are displaced by technological change through a reformed and better funded European Globalisation Adjustment Fund. Increased funding for programmes with a strong apprenticeship component and job-placement support such as "Erasmus Pro" could help less qualified workers, especially youth.

Narrowing regional divides

The EU's record on reducing regional income disparities is mixed. Average regional disparities in GDP per capita have declined over the last decade. But progress on regional convergence came to a halt with the crisis and has not resumed since (Figure E).

Figure E. Convergence in regional GDP per capita came to a halt with the crisis

Population-weighted coefficient of variation[1], %



1. The graph shows disparities in GDP per capita (in PPS) between NUTS-2 EU regions.
Source: European Commission (see figure 14).
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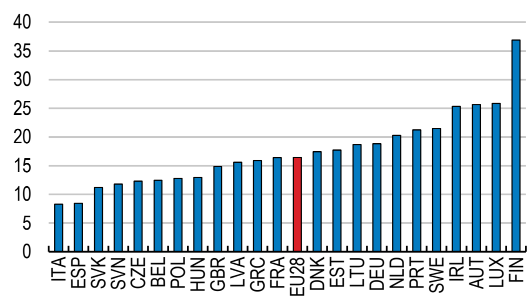
Making the best of cohesion policy to reduce regional divides. To further support income convergence, cohesion spending should focus on items with long-term growth benefits and clear spillovers across borders, including human capital, innovation and transport, energy and digital networks. There is too much focus on spending the funds and not enough on the quality of investment. Higher co-funding rates could encourage greater spending effectiveness.

Slow starts of projects at the beginning of the programming period (Figure F) lead to a back-loading of investment resulting in poor project quality. Reducing the burden of administration is a must to make cohesion policy more effective and reduce slow starts. Creating a single-rule book for EU funding could help.

Figure F. Slow use of structural funds is common

Spending as a % of planned investment[1]



1. 2014-20 programming period, as of end 2017.
Source: European Commission (2018), Cohesion Open Data Portal for the European Structural and Investment Funds (https://cohesiondata.ec.europa.eu/).
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Climate change is a global challenge that requires all countries to act decisively

Over 90% of Europeans see climate change as a serious problem. Under the Paris agreement, the EU and its member states committed to reducing greenhouse-gas (GHG) emissions by at least 40% by 2030 from 1990 levels. Policy must be strengthened, even more so to meet the objective of "significantly less than 2°". The EU emission trading system (ETS) has not played as great a role as it could in driving low-carbon investments. The recession, extensive promotion of renewables and other measures have generated a large surplus of allowances and a low carbon price. The ETS will need to be tightened further and taxation increased on the use of fossil fuel outside electricity generation. Bringing all emissions, notably transport, into the ETS could make room to progressively replace most other climate policies. Working through price incentives would increase coherence and lower overall costs. Supporting policies, ranging from smart grids and other infrastructure, through energy labelling and information provision, will remain necessary.

MAIN FINDINGS	KEY RECOMMENDATIONS
Reforming the EU budget to foster more inclusive growth	
There are new priorities to support more inclusive growth that need to be financed and the departure of the UK will lead to a financing gap. The burden of financing the EU budget does not reflect countries ability to pay.	Consider enhancing the efficiency of spending and increasing revenues, and reassess how the European budget is financed. Phase out production-based payments in the Common Agricultural Policy. Increase research and development (R&D) spending.
Reducing regional divides by making cohesion policy more effective	
There is a significant productivity gap between less developed regions and the rest.	Prioritise cohesion funding to less developed regions.
Multiple objectives are reducing the effectiveness of cohesion policy, scattering resources and making evaluating its effectiveness very difficult.	Better target cohesion funding on spending with long-term growth benefits (human capital, innovation and network infrastructure), and to projects with clear spillovers across borders.
There is too much focus on spending structural and cohesion funds and not enough on the quality of investment.	Consider increasing national co-financing rates to encourage better project selection taking into account the relative impact of the project and the EU added value.
The overwhelming amount of regulation, with frequent rule changes makes cohesion policy difficult to manage and control.	Create a “single rule book” for EU funding programmes. Use e-government and e-procurement more often.
Leveraging the single market to improve long-term growth and living standards	
Business services experience many administrative and regulatory barriers.	Simplify administrative formalities for the establishment and provision of cross-border services, and provide guidance on implementing EU legislation.
European energy markets are too fragmented; high market concentration and weak competition remain an issue, investment is insufficient and final energy prices are high for citizens and businesses.	Pursue the planned cross-border co-operation on power system operation and trade, including interconnection capacity calculations and reserve margins.
A shortage of workers with the right digital skills is constraining investment and productivity.	Develop tools to help member states monitor digital skill needs. Set EU standards for the monitoring of digital skills and task content of occupations.
Eliminating barriers to people working and supporting intra-EU mobility	
The EU is relatively weak at attracting highly skilled foreign workers.	Make effective the proposed simplification of eligibility and procedures for the EU Blue Card for high-skilled labour migrants.
Intra-EU labour mobility is weak owing to linguistic differences, slow recognition of qualifications and barriers to access regulated professions among others.	Increase spending on mobility programmes such as Erasmus+, and facilitate access irrespective of socio-economic background. Foster the harmonisation of professions’ curricula at the EU level. Make the electronic European professional card available to all sectors.
Methods to circumvent labour and tax laws persist.	Step up efforts at the EU level to coordinate the design and organisation of joint cross-border labour and tax control activities.
Better protecting EU citizens in the face of change	
The effectiveness of the European Globalisation Adjustment Fund is reduced by a complex and slow approval process.	Revise application requirements and procedures to speed the use of the Fund and expand eligibility to workers affected by other shocks, such as automation.
Over 90% of Europeans see climate change as a serious problem. To meet the EU 2030 greenhouse-gas emission targets without excessive costs, policy needs to be tightened, with more attention given to cost-effectiveness.	Increase the price of greenhouse gas emissions and consider bringing all fuel use, including transport, into the EU Emissions Trading System (ETS). Increase minimum tax rates on fossil fuel use that falls outside the ETS, especially where tax rates are currently low or zero.