# OECD Economic Surveys: European Union and Euro Area 2025

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# OECD Economic Surveys: European Union and Euro Area 2025

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# Foreword

This Economic Survey was prepared by Jan Stráský, Martin Borowiecki, Federico Giovannelli, and Christian Gréus, with contributions from Alessandro Zona Mattioli, under the supervision of Mame Fatou Diagne. Research assistance was provided by Federico Giovannelli, administrative and editorial assistance by Robin Houng Lee and communication assistance by Laura Fortin and François Iglesias.

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## Basic statistics of the European Union, 2024

(Numbers in parentheses refer to the OECD average)

| | | | | | |
|---|---|---|---|---|---|
| **LAND, PEOPLE AND ELECTORAL CYCLE** | | | | | |
| Population (million, 2023) | 448.8 | | Population density per km² (2023) | 112.3 | (39.2) |
| Under 15 (%, 2023) | 14.6 | (16.9) | Life expect. at birth (years, 2023, OECD: 2022) | 80.4 | (80.6) |
| Over 65 (%, 2023) | 21.6 | (18.2) | Men (2023, OECD: 2022) | 77.4 | (78.0) |
| International migrant stock (% of pop., 2023) | 15.4 | (15.7) | Women (2023, OECD: 2022) | 83.4 | (83.2) |
| Latest 5-year average growth (%) | 0.1 | (0.4) | | | |
| **ECONOMY** | | | | | |
| Gross domestic product (GDP) | | | Value added shares (%, 2023) | | |
| In current prices (billion USD) | 19 398.3 | | Agriculture, forestry and fishing | 2.3 | (2.7) |
| In current prices (billion EUR) | 17 933.7 | | Industry including construction | 25.1 | (27.1) |
| Latest 5-year average real growth (%) | 1.1 | (1.7) | Services | 72.7 | (70.2) |
| Per capita (thousand USD PPP) | 59.1 | (59.0) | | | |
| **GENERAL GOVERNMENT** | | | | | |
| Expenditure (% of GDP, 2023) | 49.0 | (42.4) | Gross financial debt (% of GDP, 2023) | 88.8 | (110.5) |
| Revenue (% of GDP, 2023) | 45.5 | (37.8) | Net financial debt (% of GDP, 2023) | 50.4 | (67.0) |
| **EXTERNAL ACCOUNTS** | | | | | |
| Exchange rate (EUR per USD) | 0.92 | | Main exports (% of total merchandise exports, 2023) | | |
| PPP exchange rate (USA = 1) | 0.66 | | Machinery and electronics | 21.0 | |
| In per cent of GDP | | | Chemicals | 13.9 | |
| Exports of goods and services * | 50.7 | (30.5) | Transportation | 12.3 | |
| Imports of goods and services * | 46.2 | (30.1) | Main imports (% of total merchandise imports, 2023) | | |
| Current account balance | 0.7 | (-0.6) | Machinery and electronics | 21.2 | |
| | | | Fuels | 13.2 | |
| | | | Transportation | 12.5 | |
| **LABOUR MARKET, SKILLS AND INNOVATION** | | | | | |
| Employment rate (aged 15 and over, %) | 54.7 | (58.0) | Unemployment rate, LFS (aged 15 and over, %) | 5.9 | (4.9) |
| Men | 60.4 | (65.4) | Youth (aged 15-24, %) | 14.9 | (11.1) |
| Women | 49.3 | (51.0) | Long-term unempl. (1 year & over, %, 2023) | 2.1 | (1.0) |
| Participation rate (aged 15 and over, %) | 58.1 | (61.0) | Tertiary educational attainment (aged 25-64, %, 2023) | 37.3 | (41.0) |
| Average hours worked per year (OECD: 2023) | 1 601 | (1742) | Gross domestic expenditure on R&D (% of GDP, 2021) | 2.3 | (2.9) |
| **ENVIRONMENT** | | | | | |
| Total primary energy supply per capita (toe) | 2.8 | (3.7) | $CO_2$ emiss. from fuel combustion pc (tonnes, 2023) | 5.2 | (7.6) |
| Renewables (%) | 19.5 | (12.5) | Municipal waste per capita (tonnes, 2023) | 0.5 | (0.6) |
| Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2020) | 62.8 | (56.5) | | | |
| **SOCIETY** | | | | | |
| Income inequality (Gini coefficient, latest available) | 0.296 | (0.316) | Education outcomes (PISA 2022 score) | | |
| Relative poverty rate (%, 2022) | 10.6 | (11.7) | Reading | 469 | (476) |
| Median disposable household income (thousand USD PPP, 2022, OECD: 2021) | 30.6 | (30.0) | Mathematics | 472 | (472) |
| Public and private spending (% of GDP) | | | Science | 481 | (485) |
| Health care (2023) | 8.7 | (9.2) | Share of women in parliament (%, 2023) | 33.0 | (32.8) |
| Pensions (2021) | 10.4 | (9.9) | Net official development assistance (% of GNI, 2022) | 0.4 | (0.4) |
| Education (total spending, % of GDP, 2020) | 4.6 | (5.1) | | | |

Note: The year is indicated in parenthesis if it deviates from the year in the main title of this table (2024). Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.

* The figure refers to the average value of the EU and the OECD member countries, respectively. This includes total trade, i.e. intra- and extra- EU and OECD trade, respectively. In 2024, extra-EU exports accounted for 22.8% of GDP, while extra-EU imports accounted for 20.5% of GDP.

Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations, World Bank.

## Basic statistics of the euro area, 2024

(Numbers in parentheses refer to the OECD average)

| | | | | | |
|---|---|---|---|---|---|
| **LAND, PEOPLE AND ELECTORAL CYCLE** | | | | | |
| Population (million, 2023) | 347.8 | | Population density per km² (2023) | 146.3 | (39.2) |
| Under 15 (%, 2023) | 14.4 | (16.9) | Life expect. at birth (years, 2023, OECD:2022) | 81.1 | (80.6) |
| Over 65 (%, 2023) | 22.1 | (18.2) | Men (2023, OECD:2022) | 78.1 | (78.0) |
| International migrant stock (% of pop., 2023) | 16.7 | (15.7) | Women (2023, OECD:2022) | 84.0 | (83.2) |
| Latest 5-year average growth (%) | 0.2 | (0.4) | | | |
| **ECONOMY** | | | | | |
| Gross domestic product (GDP) | | | Value added shares (%, 2023) | | |
| In current prices (billion USD) | 16 240.7 | | Agriculture, forestry and fishing | 2.2 | (2.7) |
| In current prices (billion EUR) | 15 014.6 | | Industry including construction | 25.0 | (27.1) |
| Latest 5-year average real growth (%) | 0.9 | (1.7) | Services | 72.8 | (70.2) |
| Per capita (thousand USD PPP) | 61.2 | (59.0) | | | |
| **GENERAL GOVERNMENT** | | | | | |
| Expenditure (% of GDP, 2023) | 47.9 | (42.4) | Gross financial debt (% of GDP, 2023) | 94.7 | (110.5) |
| Revenue (% of GDP, 2023) | 45.4 | (37.8) | Net financial debt (% of GDP, 2023) | 57.5 | (67.0) |
| **EXTERNAL ACCOUNTS** | | | | | |
| Exchange rate (EUR per USD) | 0.92 | | Main exports (% of total merchandise exports, 2023) | | |
| PPP exchange rate (USA = 1) | 0.69 | | Machinery and electronics | 18.4 | |
| In per cent of GDP | | | Chemicals | 15.5 | |
| Exports of goods and services * | 49.3 | (30.5) | Transportation | 11.5 | |
| Imports of goods and services * | 44.9 | (30.1) | Main imports (% of total merchandise imports, 2023) | | |
| Current account balance | 3.0 | (-0.6) | Machinery and electronics | 19.5 | |
| | | | Fuels | 13.9 | |
| | | | Transportation | 13.7 | |
| **LABOUR MARKET, SKILLS AND INNOVATION** | | | | | |
| Employment rate (aged 15 and over, %) | 56.1 | (58.0) | Unemployment rate, LFS (aged 15 and over, %) | 6.3 | (4.9) |
| Men | 61.0 | (65.4) | Youth (aged 15-24, %) | 16.6 | (11.1) |
| Women | 51.5 | (51.0) | Long-term unempl. (1 year & over, %, 2023) | 2.2 | (1.0) |
| Participation rate (aged 15 and over, %) | 59.9 | (61.0) | Tertiary educational attainment (aged 25-64, %, 2023) | 38.6 | (41.0) |
| Average hours worked per year (OECD: 2023) | 1 600 | (1 742) | Gross domestic expenditure on R&D (% of GDP, 2021) | 1.9 | (2.9) |
| **ENVIRONMENT** | | | | | |
| Total primary energy supply per capita (toe, 2023) | 3.0 | (3.7) | $CO_2$ emiss. from fuel combustion pc (tonnes, 2023) | 5.3 | (7.6) |
| Renewables (%, 2023) | 23.1 | (12.5) | Municipal waste per capita (tonnes, 2023) | 0.5 | (0.6) |
| Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2020) | 51.8 | (56.5) | | | |
| **SOCIETY** | | | | | |
| Income inequality (Gini coefficient, latest available) | 0.297 | (0.316) | Education outcomes (PISA 2022 score) | | |
| Relative poverty rate (%, 2022) | 10.7 | (11.7) | Reading | 469 | (476) |
| Median disposable household income (thousand USD PPP, 2022, OECD: 2021) | 32.5 | (30.0) | Mathematics | 472 | (472) |
| Public and private spending (% of GDP) | | | Science | 481 | (485) |
| Health care (2023) | 9.0 | (9.2) | Share of women in parliament (%, 2023) | 34.2 | (32.8) |
| Pensions (2021) | 10.7 | (9.9) | Net official development assistance (% of GNI, 2022) | 0.4 | (0.4) |
| Education (total spending, % of GDP, 2020) | 4.6 | (5.1) | | | |

Note: Data refers to euro area member countries that are also members of the OECD (17 countries). The year is indicated in parenthesis if it deviates from the year in the main title of this table (2024). Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.

* The figure refers to the average value of the EA and the OECD member countries, respectively. This includes total trade, i.e. intra- and extra- EA and OECD trade, respectively. In 2024, extra-EA exports accounted for 27.8% of GDP, while extra-EA imports accounted for 25.2% of GDP.

Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations, World Bank.

# Executive summary

## Key messages

Russia's full-scale invasion of Ukraine and rising trade tensions have slowed down the economic recovery in Europe and emphasised the need to deepen structural reforms. The geopolitical challenges facing the EU will require robust policy responses from European institutions and national governments:

- Economic policy needs to support growth and make space for new spending needs, such as defence. Monetary policy should ensure the return to price stability.
- Reprioritising and optimising EU budget spending to provide sufficient resources for new challenges.
- A more integrated market for electricity would help lower electricity costs and improve competitiveness.
- Reducing the regulatory burden and removing internal market barriers is key to enhance innovation, business dynamism and productivity.

## The energy crisis and geopolitical tensions have weighed on growth

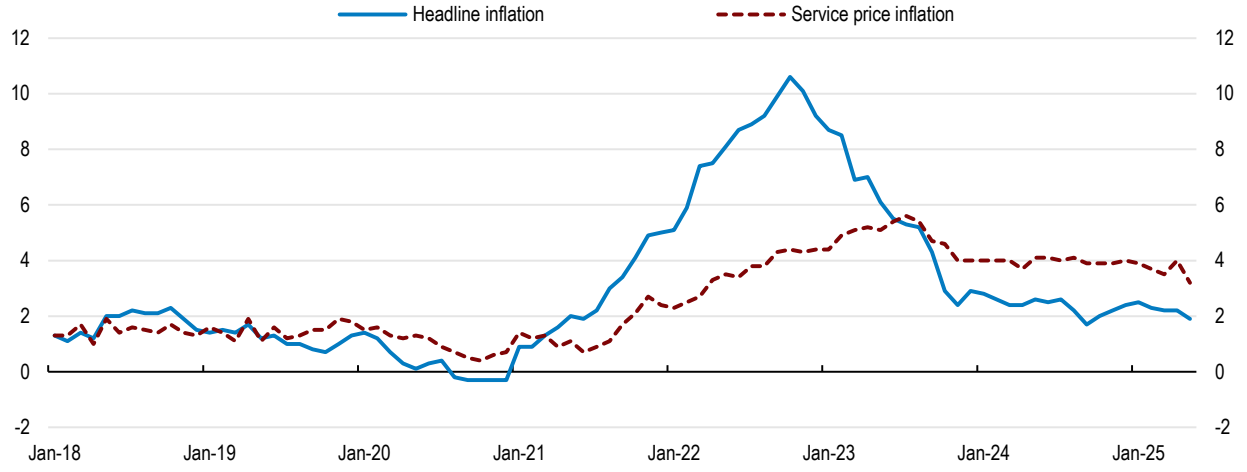
Russia's war of aggression against Ukraine and rising geopolitical and trade tensions continue to slow down the EU economy. Monetary policy needs to remain vigilant until inflation is durably reduced. Sluggish growth and considerable future spending needs require deepening structural reforms and carefully prioritising public spending.

**Economic recovery has been slow.** Despite strong policy responses to external shocks, aggregate demand remains subdued. Low confidence and precautionary motives hold back consumption and high uncertainty continues to weigh on business investment. Tight labour markets have supported private incomes, but labour demand has recently started to ease, partly reflecting the catch-up of real wages.

**Disinflation is progressing.** Headline inflation decreased swiftly following monetary policy tightening and services inflation started to ease (Figure 1). As services inflation needs to decrease further, monetary policy would do well to remain vigilant and data-dependent. There is merit in addressing the vulnerabilities in the non-bank financial sector through macroprudential measures, as needed.

### Figure 1. Inflation in services remains elevated

Euro area, y-o-y % changes




Source: Eurostat.

StatLink https://stat.link/4105y9

**Growth is projected to improve as private consumption strengthens.** The labour market will remain tight with labour shortages slowing down wage growth normalisation. Easing financial conditions will support private investment, while public investment will be boosted by spending from the Next Generation EU (Table 1). Worsening geopolitical and trade tensions could weigh on external demand and, in case of EU retaliation, reignite inflationary pressures.

**Fiscal policy should stay prudent.** To ensure long-term fiscal sustainability, fiscal tightening needs to continue. Additional spending on priority areas such as defence and innovation cannot be financed by debt in the long term and needs to be accompanied by reprioritisation of expenditures and accelerated structural reforms.

**Implementation issues in the new governance framework should be addressed** to ensure uniform and equal application of the rules. The strengthening of national fiscal councils should continue to enable effective discharge of responsibilities and improve compliance.

## Table 1. Growth is projected to strengthen

| | 2022 | 2023 | 2024 | 2025[1] | 2026[1] |
|---|---|---|---|---|---|
| Real GDP (% change) | 3.5 | 0.5 | 0.8 | 1.0 | 1.2 |
| Private consumption (% change) | 5.0 | 0.6 | 1.0 | 1.2 | 1.2 |
| Gross fixed capital formation (% change) | 2.0 | 1.8 | -1.8 | 1.9 | 2.5 |
| Harmonised index of consumer prices (% change) | 8.4 | 5.4 | 2.4 | 2.2 | 2.0 |
| Unemployment rate (% of labour force) | 6.8 | 6.6 | 6.4 | 6.4 | 6.2 |
| Fiscal balance (% of GDP) | -3.5 | -3.6 | -3.1 | -3.1 | -3.2 |
| General government debt, Maastricht definition (% of GDP) | 91.5 | 89.1 | 89.2 | 89.9 | 90.7 |

Note: Euro area countries that are also members of the OECD (17).
1. OECD estimates
Source: OECD Economic Outlook: Statistics and Projections database.

## Repurposing the EU budget for new challenges

To address new objectives and priorities, including enlargement, the new EU budget will need to involve both increasing the budgetary resources and re-prioritising existing spending in areas such as cohesion and agricultural policy.

**The EU budget is small and not sufficiently focused on European public goods.** A greater share of public investment could be co-ordinated and financed at the EU level, including defence procurement and cross-border infrastructure. To meet additional spending needs, EU countries will have to increase the EU budget's overall envelope and re-prioritise existing budget items.

**The financial burden of further EU enlargement under current budgetary rules is limited.** The cost of enlargement to Ukraine, Moldova and the Western Balkan countries, estimated in the range of 0.1% to 0.3% of EU Gross National Income (GNI), mainly comes from an increase in Common Agricultural Policy spending. The budgetary impact could be further reduced by the application of long transition periods, as done in previous enlargements.

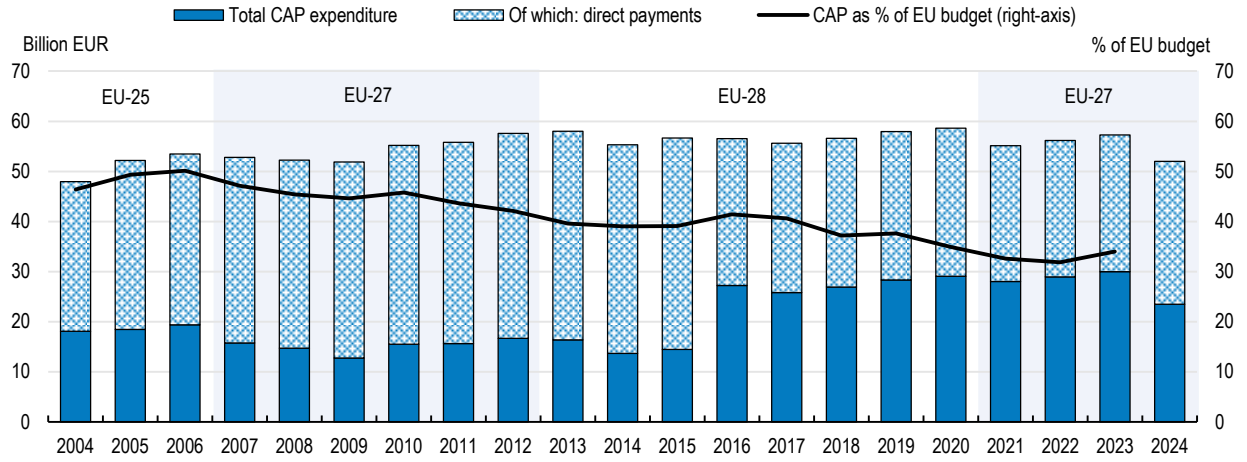
**Cohesion policy is complex and insufficiently targeted.** Many regions struggle to spend the cohesion funds, due to insufficient administrative capacities at national and regional levels, while the broad scope of cohesion policy complicates its evaluation. The cohesion policy targeting should further increase, while the new Competitiveness Fund, to come in 2028, needs to ensure efficient involvement of regional and local authorities.

**The distribution of direct payments under the CAP is uneven and could be more efficient.** Direct payments under Pillar 1 of CAP (Figure 2) often benefit other stakeholders than farmers and leave the variation of incomes over time unaddressed. Spending reviews, administrative simplification and national co-financing on all CAP spending would ensure more effective oversight, while releasing budget resources for new EU priorities.

**The control and prevention of corruption still poses challenges.** EU institutions should continue to coordinate national efforts to ensure public spending effectiveness and adopt the full 2023 anti-corruption reform package.

## Figure 2. Common Agricultural Policy spending mainly goes to direct payments

CAP expenditure




Note: Next Generation EU funds are excluded when calculating CAP's share of EU budget.
Source: European Commission, CAP expenditure database (accessed on 28-Jan-2025), https://agriculture.ec.europa.eu/data-and-analysis/financing/cap-expenditure_en#:~:text=2018%2D22%20average)-,CAP%20expenditure%20in%20the%20total%20EU%20expenditure,to%20about%2024.6%25%20in%202023

StatLink https://stat.link/3hz9lg

## Strengthening electricity markets

High energy costs reduce the EU's competitiveness, reflecting its dependence on fossil fuel imports. Lowering electricity costs requires structural reforms to lower electricity taxation, extend cross-border interconnections and strengthen competition to better align supply with demand.

**The EU aims to lower energy costs through electrification and the decarbonisation of electricity generation.** However, generous fossil fuel subsidies and relatively high electricity taxes reduce incentives for electrification. To further encourage electrification, reduced rates and exemptions for fossil fuels, including gas, need to be phased out. Taxation of fuels should be based on carbon content, with fossil fuels being taxed most heavily, to encourage the uptake of low-carbon electricity.

**Renewable support such as feed-in tariffs and production-based contracts for difference reduce the responsiveness of energy supply to demand.** Ensuring that state-aid goes to low-carbon technologies without distorting market price signals would help improve such supply flexibility. Raising the responsiveness of demand to energy prices will be essential as well.

**Further progress is needed to connect electricity grids between countries.** However, EU funding for cross-border grid investment is limited and the dominance of national interests in project selection of EU-funded cross-border grid investment is not optimal from an EU-wide perspective. To identify the most efficient investment, the EU Agency for the Cooperation of Energy Regulators (ACER) could be tasked to propose specific cross-border grid connection projects that meet cost-benefit analysis criteria. A more integrated electricity grid would allow countries to export their surplus energy, helping to ensure security of supply and lowering energy costs elsewhere. An integrated electricity grid also allows for smoother integration of renewables, helping to achieve climate targets more efficiently.

## Strengthening productivity and the Single Market

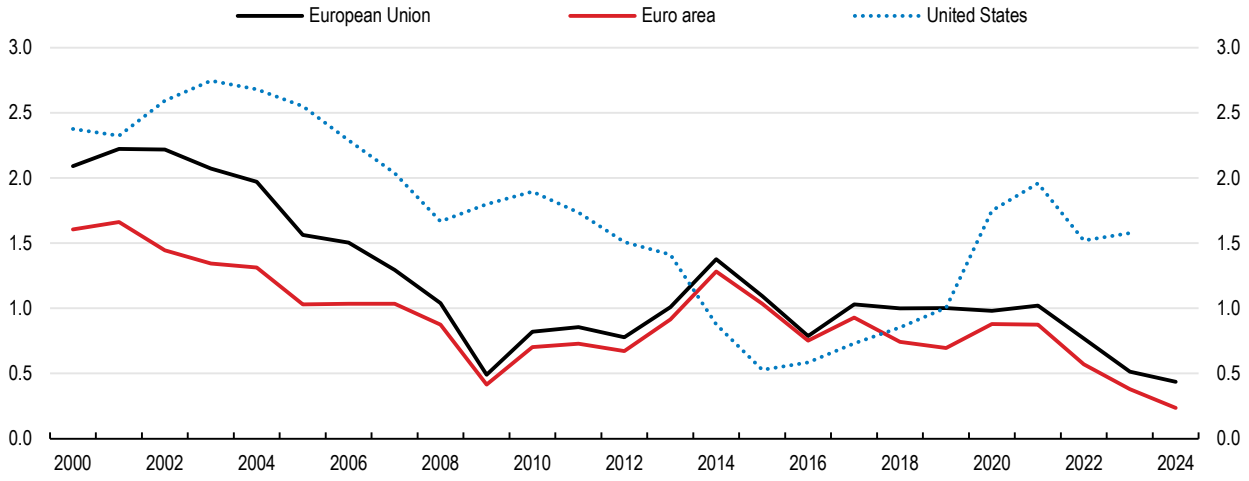
Long-term productivity growth has been weak, reflecting persistent internal market barriers (Figure 3). Higher productivity can be achieved through structural reforms to reduce internal market barriers, cut regulatory burdens, deepen capital markets, and strengthen competition to unleash business dynamism.

**Market integration remains particularly low in services**, where many EU countries have implemented the EU Services Directive in national law while foregoing the full potential of streamlining national services regulation. A fragmented Single Market puts European businesses at a disadvantage as firms operating in larger markets can more easily build economies of scale and tend to be more innovative and productive. Stronger productivity requires a more integrated Single Market for services with fewer regulatory roadblocks for companies to scale up and innovate.

**A growing regulatory burden is constraining business dynamism.** This reflects that recent regulation in digital sectors, including the General Data Protection Regulation, as well as sustainable reporting and due diligence rules were added to older ones, leading to a higher combined burden of regulations. Subjecting regulations to rigorous cost benefit analysis would help to reduce documentation requirements and reporting obligations.

## Figure 3. Productivity growth has been weak

Labour productivity growth, y-o-y % changes, five-year moving average




Note: Labour productivity is measured as real GDP per hour worked, USD PPP-adjusted.
Source: OECD Productivity database; and OECD calculations.

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**Capital markets remain underdeveloped.** This reflects limited long-term capital provided by institutional and retail investors. The failure of high savings to flow into productive investment is related to insufficient risk taking by the largely bank-based financial system. Bank savings products continue to benefit from tax benefits compared to bonds and equity in many countries, further entrenching banks' incumbent position. Stronger competition for savings products would help deepen long-term capital available for investment in young and innovative firms. At the same time, pension reforms that support a stronger uptake of private funded pensions would help expand the retail and institutional investor base.

**Despite recent harmonisation efforts of EU capital market regulation, supervisory practices differ across countries.** Convergence in supervisory practice and rules would help to reduce regulatory fragmentation and raise cross-border investment. Such convergence in national practice would constitute an incremental approach to capital market integration. Alternatively, a bigger push for a more unified European framework for supervision of capital markets could follow from the ambition to unify the Single Market for capital. This could be done by moving supervision of pan-European actors and infrastructures, such as pan-European stock exchanges, to the European level.

**Cross-border labour mobility is hampered by limited mutual recognition of qualifications and other barriers.** Service providers still face a wide array of barriers when they want to establish themselves in another EU country. Recognition procedures remain costly and lengthy, and the mutual recognition of qualifications is also not yet fully achieved. Removing unjustified and disproportionate restrictions on professional service providers would boost cross-border mobility. Another way of improving cross-border labour mobility is faster exchange of information on pension rights through the Electronic

Exchange of Social Security Information. There is also room to improve the Blue Card scheme, which aims to attract high-skilled workers to the EU.

**While the EU's science base is strong, a major weakness lies in the translation of science into breakthrough innovation.** However, EU public R&D spending is limited and not consistently directed at addressing this innovation deficit. Limited EU resources mean that the focus should be on raising the effectiveness of EU R&D support in encouraging innovation. This calls for rigorous evaluations of R&D programmes based on clear key performance indicators and for following up by closing under-performing programmes and shifting funding to well-performing programmes.

**Different national corporate laws increase operating costs for firms that want to scale up activities across the EU.** Such barriers to EU-wide business operation limit the contestability of markets. A common EU corporate law (28$^{th}$ regime) would support scaling up of innovative firms and strengthen business dynamism. Initially, such an EU corporate framework could establish common minimum requirements for business registration and bankruptcy.

**Unilateral national industrial policy entails risks for the Single Market.** The EU has simplified and temporarily relaxed state aid rules for clean technologies and energy-intensive manufacturing during the energy crisis and announced temporary simpler and more flexible state aid rules for strategic sectors until 2030. Such an approach to industrial policy has risks for the Single Market as countries with more fiscal space may provide excessive support. To protect the level playing field within the Single Market, state aid rules should not be relaxed.

| Main findings | Key recommendations |
|---|---|
| **Implementing prudent macroeconomic policies** | |
| Headline inflation has fallen strongly, but services inflation has been sticky. As inflation normalises, monetary policy will have to become more forward-looking. | Maintain a prudent monetary policy stance to ensure that inflation expectations remain firmly anchored and inflation returns to its medium-term target. |
| Financial stability risks are increasing in parts of the financial system with exposures to commercial and residential real estate and among non-bank financial institutions. | Address risks to macro-financial stability by using existing macroprudential tools and strengthen macroprudential supervision of non-bank financial institutions. |
| Spending pressures will increase due to population ageing, the need to increase defense capacity and the green and digital transitions. | Ensure implementation of prudent fiscal policy to rebuild fiscal buffers and prepare for long-term spending needs related to ageing and green transition. |
| The new governance framework provides for better fiscal policy, but it is untested and could be pro-cyclical under adverse shocks. Its implementation requires additional guidance and supporting policies. | Build credibility of the new governance framework through consistent implementation. |
| **Repurposing the EU Budget for new challenges** | |
| The EU's annual budget is small and could be increased to co-ordinate and finance more public investment at the EU level. | Refocus funds and allocate new resources to priorities best provided at EU level, such as innovation and cross-border infrastructure. |
| The Recovery and Resilience Facility (RRF) suffers from the risk of delays and non-completion of measures, while its top-down approach may not be suitable for regional development policy. | Design output-based budgeting instruments, using lessons from the RRF.<br>Take action to mitigate the risk of funding non-completed measures. |
| Almost 30% of the Cohesion Policy spending is channelled to EU regions with GDP per capita above 75% of the EU average. | Strengthen targeting of cohesion policy spending. |
| Despite mixed empirical evidence on the benefits of Common Agricultural Policy (CAP) payments for agricultural income and employment, direct payments still dominate CAP expenditure. | Free budget resources and improve spending efficiency of all CAP spending. |
| A strong anti-corruption and public integrity system ensures protection of the EU financial interest and allows citizens to rely on impartial institutions for a fair distribution of resources and a transparent business environment. The European Public Prosecutor's Office (EPPO) is key to investigate and prosecute crimes against the EU's financial interests, including corruption involving EU funds. It effectively handles cross-border cases involving sophisticated criminal organizations, for which national offices do not often have adequate resources. A broad PIF Directive assessment could consider expanding its scope regarding corruption offenses | Continue to coordinate national efforts to fight corruption and fraud, by speeding up trilogue negotiations for the adoption of the full 2023 anti-corruption package while also considering expanding the European Public Prosecutor Office's mandate. |
| **Strengthening electricity markets** | |
| Renewable support such as feed-in tariffs and production-based Contracts for Difference reduce supply flexibility. | Ensure that the EU state-aid framework targets government subsidies to low-carbon technologies without muting market price signals. |
| High electricity tax rates discourage electrification. | Phase out reduced rates and exemptions for fossil fuels by adopting the revision of the Energy Taxation Directive. |
| Cross-border electricity grid connections are limited. The dominance of national interests in project selection of EU funded cross-border grid investment introduces disincentives for most efficient investment. | Task ACER to propose specific cross-border grid connection projects that meet cost-benefit analysis criteria. |
| **Strengthening productivity and the Single Market** | |
| The regulatory burden is high. EU regulations are not always subject to a rigorous cost-benefit analysis. | Reduce the EU regulatory burden, including documentation requirements and reporting obligations for businesses.<br>Subject all EU regulatory proposals to a rigorous cost-benefit analysis. |
| Many existing barriers to market entry and exercise of professional services are unjustified and unnecessary. | Ensure that mutual recognition of qualifications is improved, and all unjustified and disproportionate restrictions on professional services are removed. |
| The EU Blue Card attracts fewer high-skilled workers than similar national schemes. National requirements for Blue Card eligibility differ. | Relax common requirements for EU Blue Card eligibility and facilitate Blue Card issuance for workers already covered by similar national schemes. |
| Different national corporate laws raise businesses' operating costs, limiting the contestability of markets. | Establish a common European Code of Business Law (28th regime) that includes business registration and insolvency. |
| EU-level public R&D spending is low and not consistently directed at addressing the innovation deficit. | Subject all R&D programmes to evaluations based on clear key performance indicators and follow up by closing under-performing programmes and shifting funding to well-performing programmes. |
| National industrial policy risks weakening the Single Market. | Enforce state aid rules to protect the level playing field within the Single Market. |

# 1 Implementing prudent macroeconomic policies

Jan Stráský and Christian Gréus

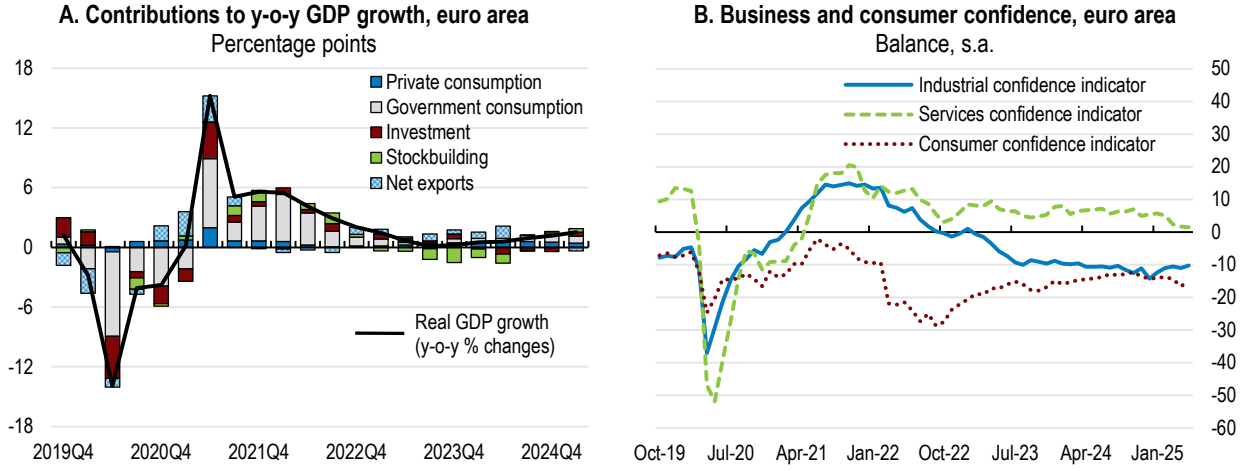
*Economic growth has been slow amid elevated uncertainty and growing trade and geopolitical tensions. Consumer and investor confidence is low and gross fixed capital formation has remained weak. Tight labour markets are gradually easing while growth will be supported by easing financial conditions. Monetary policy should remain vigilant until inflation durably returns to target, while macroprudential policy needs to stand ready to counter risks to financial stability not captured by the microprudential framework. Fiscal policy should make space for new spending priorities, such as higher defence expenditure by EU countries, while remaining prudent to ensure long-term sustainability and support disinflation. Next Generation EU spending needs to be accelerated and implementation issues in the new governance framework resolved.*

## 1.1. Economic recovery has been slow amid high uncertainty

### *1.1.1. Subdued domestic demand weighs on growth*

Economic recovery in the euro area continues, benefitting from strong policy responses to external shocks from both European institutions and national governments. The euro area has been resilient, supported by a strong labour market and stable financial sector. The post-Covid recovery has been stronger than previous recoveries, such as from the great financial crisis, but further shocks and long-term challenges underline the need to step up structural reforms. GDP growth slowed down in 2022 and stagnated in 2023, as the energy price shock triggered by Russia's war of aggression against Ukraine and the impact of higher interest rates weighed on the economy (Figure 1.1, Panel A). The euro area has returned to growth in 2024, when it expanded at an annual rate of 0.9% (1% in the EU). Moreover, GDP growth, in quarter-on-quarter terms, continued in 2025, at 0.3% in the first quarter, up from 0.2% in the previous quarter. However, consumption and investment only moderately contributed to aggregate demand, reflecting elevated uncertainty and weak confidence (Figure 1.1, Panel B). Short-term indicators suggest that GDP growth will continue to improve in the near term as stronger manufacturing and business activity is supported by expanding services activity. The consumer confidence indicator deteriorated sharply in April2025, driven by weak expectations of households about the general economy, and despite a partial rebound in May remains well below its long-term average.

**Figure 1.1. The GDP growth rebound was slow amid weak confidence**




Source: Eurostat National Accounts database; OECD Business Tendency Surveys database; and OECD Consumer Opinion Surveys database.

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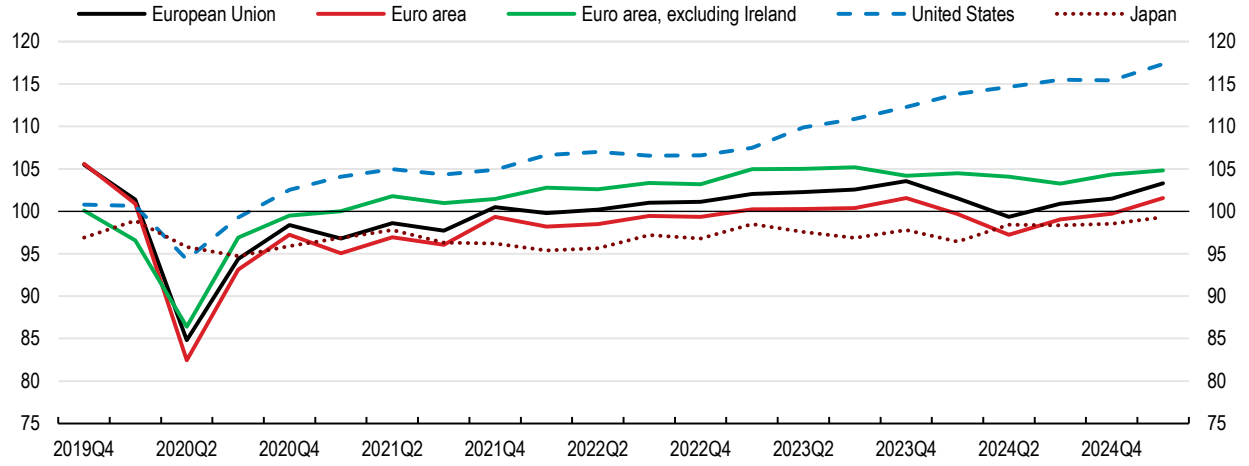
Real per capita consumption increased by 0.4% in the fourth quarter of 2024, after an increase of 0.7% in the third quarter. The rebound in real per capita consumption was supported by an increase in real incomes associated with declining headline inflation . The rebound has partly offset the effects of the recent inflation surge when consumption of goods fell below its pre-pandemic level at the beginning of 2023 and largely stagnated until the second quarter of 2024. Meanwhile consumption of services continued to rise at a very moderate pace. The inflationary shock has also reduced the real net wealth of households while the subsequent monetary policy tightening further encouraged saving. Empirical evidence suggests that the increase in the household saving rate between 2022Q2 and 2024Q2 can be largely attributed to rising real incomes and interest rates, together with negative wealth effects. Precautionary motives may have also explained increased savings, especially in 2022 after the start of Russia's war of aggression against Ukraine (Bobasu, Gareis and Stoevsky, 2024[1]). The household saving rate is likely to decrease only gradually, as the effects of monetary policy easing materialise, weighing on consumption in the near term. Moreover, bouts of uncertainty can further slow down or reverse this process.

Investment remains subdued, with elevated uncertainty, weak demand and still restrictive financial conditions weighing on businesses in both the euro area and the European Union (Figure 1.2). This may also reflect

long-standing structural issues such as regulatory burdens and a lack of business dynamism, particularly compared with the United States (see Chapter 4). Business investment grew robustly in the fourth quarter of 2024, amid a strong rebound in transport investment, while machinery and other equipment contracted. However, weak capital goods data and contracting industrial production point to stagnating investment in the first quarter of 2025. Housing investment remains similarly weak. Despite a stabilisation of building construction, residential building permits remained at low levels in the fourth quarter of 2024, pointing to a limited pipeline of projects (ECB, 2025[2]). In contrast to weak private investment, public investment was supported by disbursement of the Next Generation EU (NGEU) funds, and stood, as a share of GDP, at 3.3% in 2023, broadly in line with the levels seen before the euro area sovereign debt crisis. However, both private and public investment will need to step up further to meet new challenges, such as the green transition and the ramping up of defence capabilities.

## Figure 1.2. Investment is weak

Real gross fixed capital formation, index 2019 average = 100




Note: Data refers to euro area member countries that are also members of the OECD (17 countries) and to the 27 EU Member countries.
Source: OECD Economic Outlook: Statistics and Projections database.

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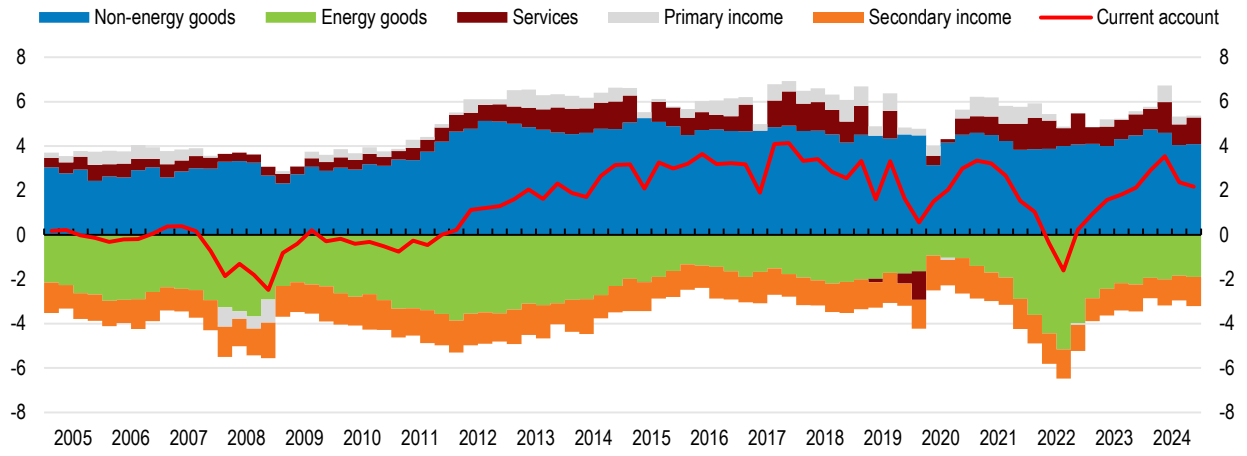
Net exports contributed positively to growth in 2024, despite a moderation in global trade at the end of the year. This was mainly driven by expanding services exports, while import growth remained limited. Trade in goods strengthened in the first months of 2025, partly reflecting front-loading amid growing trade frictions and elevated geopolitical tensions. The current account balance returned to surplus at the end of 2022, as the prices of energy imports gradually normalised (Figure 1.3). In the fourth quarter of 2024, the seasonally adjusted current account surplus was 2.2% of GDP. While the heterogeneity of current account positions across EU countries has increased, it remains below levels seen before the euro area sovereign debt crisis. Most countries have seen further current account improvements in 2024, and some, like Germany, Ireland and the Netherlands recorded strong increases in surpluses, while Greece and Slovakia faced a widening current account deficit (Eurostat, 2025[3]).

## Figure 1.3. The current account balance returned to surplus

Current account balance, % of GDP




Note: Data refers to the euro area including 20 countries as of 2013, while to euro area including 19 countries from 2005 to 2012.
Source: Eurostat Balance of Payments database; Eurostat International Trade by SITC database; Eurostat National Accounts database; and OECD calculations.

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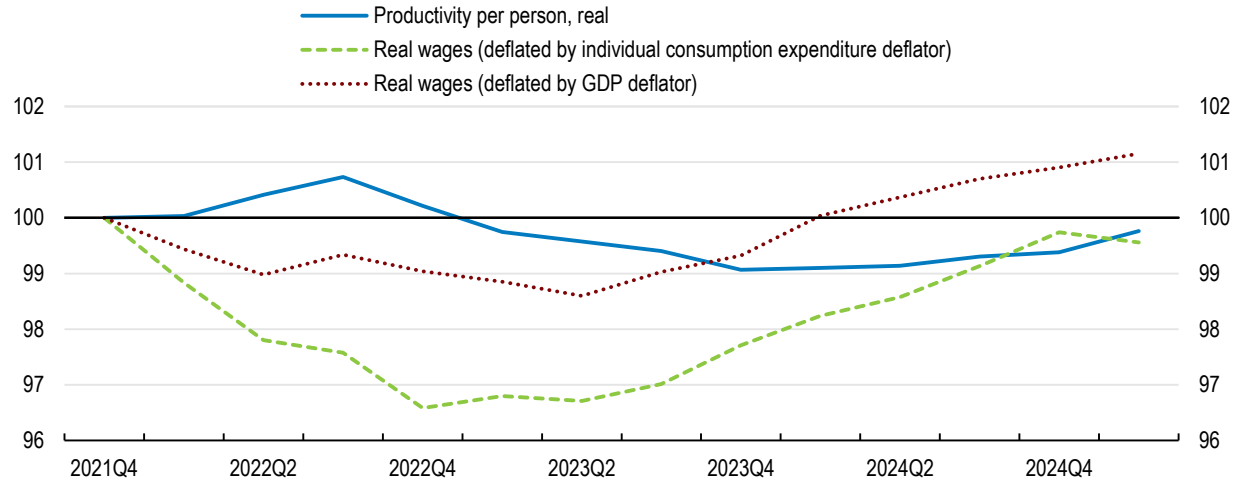
### *1.1.2. Tight labour markets are gradually easing*

Strong labour markets across the euro area supported household incomes, although this was only partially reflected in consumption. The unemployment rate stood at 6.2% in March 2025, close to a historic low, and the employment rate of people aged 20-64 in the EU reached a high of 75.9% in the fourth quarter of 2024. Employment growth since end-2019 has been stronger for women than men, while youth employment growth rebounded from the lows recorded during the pandemic. Those with tertiary degree benefited more than those with low to medium education. Employment growth has been broad-based across sectors, most notably in information and communication technologies and financial services, as well as in the public sector.

The labour market has been resilient following the pandemic. Unemployment remained low and employment has grown, despite weak economic growth and the strong monetary policy tightening. The surge in inflation at the onset of the energy crisis considerably reduced real wages, making labour cheaper relative to most other inputs and incentivising firms to hire or retain more workers. This initial effect has been gradually reversed, as strong nominal wage growth and ongoing disinflation allowed real wages to catch up broadly back to the level before the inflation surge (Figure 1.4). Catching up with past inflation has been an important driver of recent wage growth. Recent ECB estimates of augmented wage Phillips curve suggest a high degree of backward-lookingness, as workers sought to recoup their real wage losses and past inflation has become more important as a determinant of wage inflation. As the euro area's real wage gap is now broadly closed, wage setting could become more forward-looking again, further easing wage growth (Bates et al., 2025[4]). At the same time, many lower-income households are still affected by the drop in real incomes during the inflation surge and indicators of material and social deprivation as well as financial distress remain elevated (European Commission, 2024[5]).

## Figure 1.4. The real wage gap is closing

Euro area, index 2021Q4=100




Note: Labour productivity is measured as GDP per employee. Real wages are calculated as wages and salaries per employee and then deflated by the GDP and individual consumption expenditure deflators.
Source: Eurostat Labour productivity and unit labour costs database; Eurostat National Accounts database: and OECD calculations.

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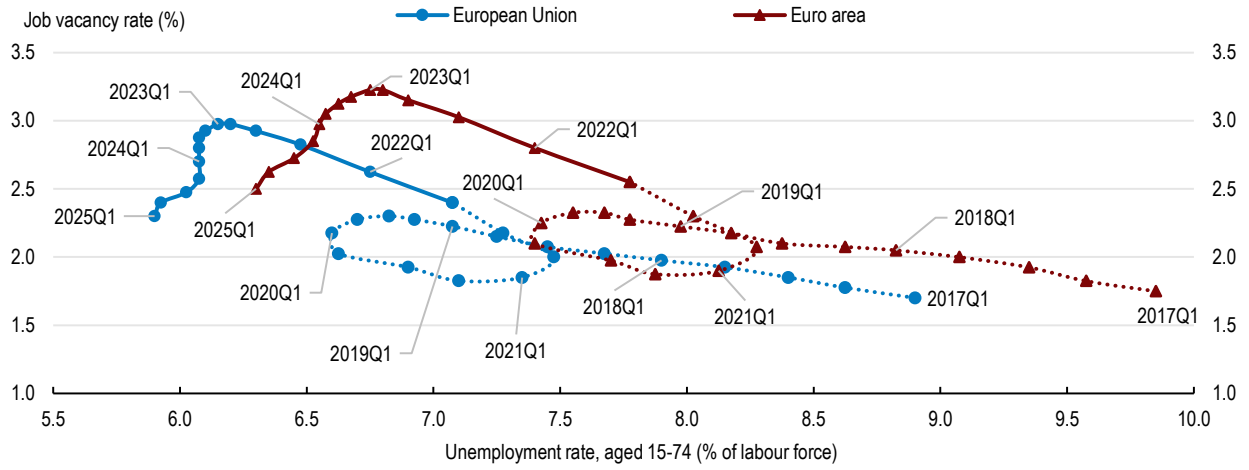
Other factors have helped ensure strong employment growth. Higher profit margins and lower average hours worked per employee made labour hoarding by firms affordable despite weak economic growth. Increased labour participation by women, older and highly educated workers as well as migration flows, including more than 4 million Ukrainian refugees benefitting from temporary protection in EU countries, helped alleviate labour shortages in some sectors. However, recent ECB research suggests that a key factor behind the decoupling of output and employment, at least until 2023, was the substitution of production factors by firms. Afterwards, the normalisation of energy and intermediate input prices as well as the catch-up of real wages made factor substitution less relevant, helping a realignment of employment dynamics and a recovery in productivity (Berson et al., 2024[6]).

Weak economic growth and resilient employment combined to yield a decline in labour productivity growth, even below its weak long-term trend. After declining by 0.9% per person in 2023, the fall in labour productivity reversed to 0.4% growth in annual terms in the fourth quarter of 2024. Productivity growth has been slow in the construction sector, while in some services, such as information and communication, productivity grew strongly. Conversely, employment growth was most prominent in the construction and professional services sectors and weak in the manufacturing sector, which tends to be more energy intensive. Recent weak productivity growth reinforces the long-term slowdown in labour productivity mainly driven by structural factors beyond the labour market, such as weak investment and a decline in technological innovation, which are discussed in Chapter 4.

Labour demand has been robust, but it recently started to ease. The ECB labour hoarding indicator started to weaken in 2024, as the proportion of firms that hoard workers decreased from 22% in the third quarter of 2023 to 16% in the second quarter of 2024 (Berson et al., 2024[6]). At the same time, the unemployment rate has remained low across the euro area, albeit with some country-level variation. Spain and Italy experienced the largest reductions in unemployment rates since January 2020, whereas Germany recorded a slight increase. Weakening labour demand coupled with a stable unemployment rate has resulted in a close-to-vertical Beveridge curve in 2023 and 2024, suggesting improved efficiency matching (Figure 1.5). It remains to be seen whether it will be possible to sustain this decrease in the vacancy-unemployment ratio needed to control inflation without at least a temporary increase in unemployment, in particular if productivity growth remains weak (Blanchard and Bernanke, 2024[7]). The ECB's wage tracker data up to April and information from contacts with companies point to gradually moderating wage growth throughout 2025. The easing of wage growth pressures is consistent with a decrease in labour compensation demands and cooling labour demand (ECB, 2025[2]).

## Figure 1.5. The Beveridge curve suggests improved labour matching




Note: Four-quarter moving average rates. Data refers to the euro area including 20 countries and to the 27 EU Member countries.
Source: Eurostat Job Vacancy Statistics database; Eurostat Labour Market Statistics database; and OECD calculations.

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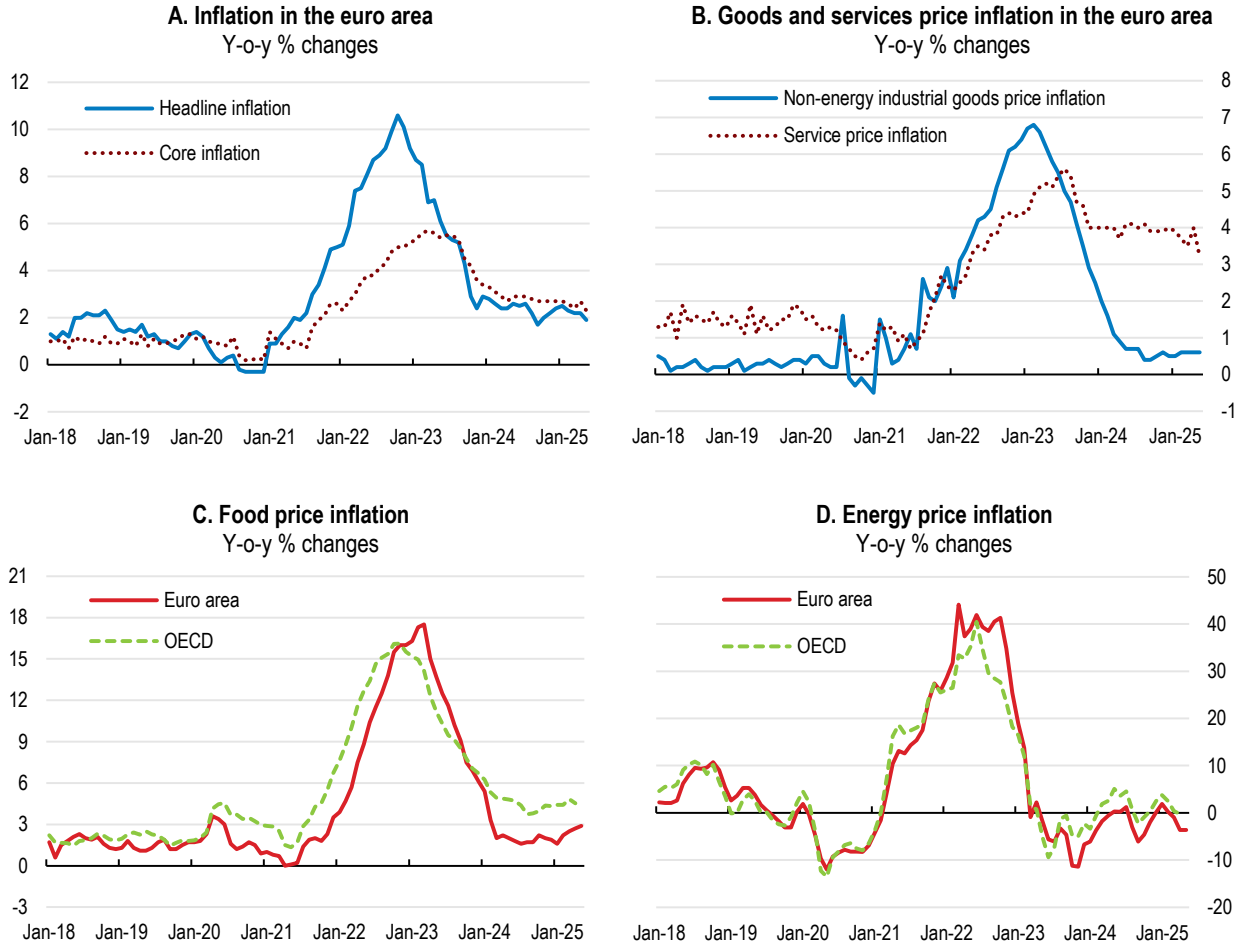
### *1.1.3. Headline inflation has declined, but services inflation remains elevated*

Disinflation remains incomplete, but inflation is decreasing towards the symmetric 2% medium-term target. The effects of a negative energy shock turned out to be mostly temporary, while inflation remained elevated in the services sector. Headline inflation decreased from a peak rate of 10.6% in October 2022 to 1.7% in September 2024, mainly driven by falling energy prices in the second half of 2023. Food and non-energy industrial goods continued to contribute to the fall in inflation, as domestic and global demand weakened in 2024. After a steady decline in the second half of 2024, headline inflation ticked up at the end of the year (Figure 1.6, Panel A). Annual headline inflation stood at 2.2% in April, unchanged from March and down from 2.3% in February 2025, primarily reflecting a decline in energy inflation partly due to favourable base effects, as past declines in energy prices fell out of the calculation. Services inflation increased to 4% annually in April (partly related to Easter), up from 3.5% in Marchand remains well above its long-term average of 1.9%. Non-energy industrial goods inflation, hovering around its long-term average, is adding to the underlying price pressures (Figure 1.6, Panel B). Food inflation in April increased to 3%, reversing its previous moderation (Figure 1.6, Panel C). Energy inflation stood at -3.6% in April, further down from -1% in March, reflecting downward base effect and a decline in transport fuel prices (Figure 1.6, Panel D). Although inflation dynamics need to be closely monitored, downside risks to inflation also exist, mostly related to the uncertainty surrounding trade tariffs. Factors limiting upside pressure on euro area prices include declining energy commodity prices, appreciation of the euro exchange rate, particularly against the US dollar, which dampens import price growth, as well as disinflationary effects of re-routing of exports from countries with overcapacity into the euro area.

Underlying inflation appears consistent with a sustained return of headline inflation to the target, as most measures of trimmed inflation remain between 2% and 3%. Import price inflation, with the exception of manufactured food prices, is moderate, while domestic cost pressures, still above their pre-pandemic average, continued to ease further in the fourth quarter (ECB, 2025[2]). At the same time, differences in inflation rates among euro area countries have narrowed, following the sharp increase in the inflation differentials during the energy crisis (European Commission, 2024[8]).

## Figure 1.6. Inflation is gradually decreasing




Source: OECD Price Statistics database; and Eurostat.

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### *1.1.4. Growth is projected to strengthen gradually, but uncertainty is high*

Growth is projected to improve moderately in 2025 and 2026, supported by easing financial conditions and benign energy and commodity prices but hampered by uncertainty. The labour market will remain tight, with labour shortages in many occupations and historically low unemployment slowing down wage growth normalisation. As disinflation continues, growing real disposable incomes will support consumption. Elevated uncertainty from trade tensions will weigh on private investment, while public investment will be supported by spending under the NGEU programme. The gradual pickup in domestic demand is projected to bring average annual growth of real GDP to 1% in 2025 and 1.2% in 2026 (Table 1.1). Growth in the European Union will follow a broadly similar profile and rebound to 1.2% and 1.4% in 2025 and 2026, respectively, on the back of stronger private consumption (Table 1.2).

Headline inflation is projected to moderate further, to 2.2% in 2025 and 2% in 2026, as employment growth stabilises and labour cost pressures gradually dissipate. Slower global trade growth and benign energy prices will limit the inflationary pressure from higher import prices. Core inflation is similarly projected to decline, at a slower pace reflecting still elevated services price inflation.

## Table 1.1. Macroeconomic indicators and projections for the euro area

| | 2021 | 2022 | 2023 | 2024 | 2025[1] | 2026[1] |
|---|---|---|---|---|---|---|
| | Current prices (EUR Billions) | Annual percentage change, volume (2021 prices) | | | | |
| Gross domestic product (GDP) | 12499.4 | 3.5 | 0.5 | 0.8 | 1.0 | 1.2 |
| Private consumption | 6394.1 | 5.0 | 0.6 | 1.0 | 1.2 | 1.2 |
| Government consumption | 2763.7 | 1.1 | 1.4 | 2.5 | 1.3 | 1.1 |
| Gross fixed capital formation | 2707.9 | 2.0 | 1.8 | -1.8 | 1.9 | 2.5 |
| Housing | 728.8 | 1.6 | -0.5 | -4.0 | . . | . . |
| Final domestic demand | 11865.7 | 3.4 | 1.0 | 0.7 | 1.4 | 1.5 |
| Stockbuilding[2] | . . | 0.5 | -0.9 | -0.3[1] | 0.1 | 0.0 |
| Total domestic demand | 11998.0 | 3.9 | 0.2 | 0.4 | 1.5 | 1.5 |
| Exports of goods and services | 6028.5 | 7.3 | -0.6 | 0.9 | 0.6 | 1.4 |
| Imports of goods and services | 5527.1 | 8.3 | -1.2 | 0.0 | 1.6 | 1.8 |
| Net exports[2] | 501.4 | -0.2 | 0.3 | 0.5[1] | -0.4 | -0.1 |
| *Memorandum items* | | | | | | |
| Potential GDP | | 1.5 | 1.3 | 1.3 | 1.2 | 1.1 |
| Output gap (% of potential GDP) | | 0.7 | -0.1 | -0.6 | -0.8 | -0.8 |
| Employment | | 2.8 | 1.6 | 1.1 | 0.9 | 0.6 |
| Unemployment rate (% of labour force) | | 6.8 | 6.6 | 6.4 | 6.4 | 6.2 |
| GDP deflator | | 5.1 | 5.9 | 2.9 | 2.3 | 2.0 |
| Harmonised index of consumer prices | | 8.4 | 5.4 | 2.4 | 2.2 | 2.0 |
| Harmonised index of core inflation[3] | | 3.9 | 4.9 | 2.8 | 2.2 | 2.0 |
| Household saving ratio, net (% of household disposable income) | | 7.0 | 7.7 | 9.1 | 9.0 | 8.7 |
| Current account balance (% of GDP) | | 1.1 | 2.7 | 3.6 | 3.1 | 2.8 |
| General government fiscal balance (% of GDP) | | -3.5 | -3.65 | -3.1 | -3.1 | -3.2 |
| Underlying general government fiscal balance (% of potential GDP) | | -4.1 | -3.9 | -3.2 | -3.0 | -3.0 |
| Underlying government primary fiscal balance (% of potential GDP) | | -2.6 | -2.5 | -1.7 | -1.4 | -1.4 |
| General government debt, Maastricht definition (% of GDP) | | 91.5 | 89.1 | 89.2 | 89.9 | 90.7 |
| General government net debt (% of GDP) | | 56.9 | 58.2 | 57.8 | 58.6 | 59.8 |
| Three-month money market rate, average | | 0.3 | 3.4 | 3.6 | 2.1 | 1.8 |
| Ten-year government bond yield, average | | 1.8 | 3.1 | 2.9 | 3.0 | 3.0 |

Note: Data refers to euro area member countries that are also members of the OECD (17 countries).
1. OECD estimates.
2. Contribution to changes in real GDP.
3. Index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook: Statistics and Projections database.

The uncertainty surrounding the outlook is considerable and the risks to projections are tilted to the downside (Table 1.3). Worsening trade tensions, such as the introduction of further US tariffs and possible EU countermeasures would weigh on external demand, while the tariffs already in place could trigger trade diversion flows towards the euro area. Trade retaliation measures by the EU could add to inflationary pressures. Financial stability risks continue to exist in the euro area, with pockets of financial vulnerabilities in the commercial real estate and non-banking financial sectors. On the upside, a stronger use of accumulated household savings could strengthen private consumption. In addition, a durable reduction of geopolitical uncertainty and trade tensions could hasten disinflation and help lift external demand.

Increasing global trade tensions and disruptions remain a significant concern. Although trade growth remained robust in the first quarter of 2025, reflecting strong front-loading of purchases ahead of tariffs, global trade is projected to expand at a weaker rate over the projection horizon. The standoff between the United States and its neighbours as well as China has intensified, as a first round of import tariffs was quickly followed by announced countermeasures. A proliferation in barriers to international trade and broader fragmentation of the global economy could add to the adverse impact of the tariff changes already announced. The negative impact would be magnified if policy uncertainty were to increase further or there was broad risk repricing and tightening of credit

standards in financial markets. Conversely, early agreements that would ease trade tensions between the EU and the US, along with renewed momentum in trade negotiations with other countries and regions, would help to improve policy certainty and growth prospects.

## Table 1.2. Macroeconomic indicators and projections for the European Union

| | 2021 | 2022 | 2023 | 2024 | 2025[1] | 2026[1] |
|---|---|---|---|---|---|---|
| | Current prices (EUR Billions) | Annual percentage change, volume (2021 prices) | | | | |
| Gross domestic product (GDP) | 22033.5 | 3.6 | 0.5 | 1.1 | 1.2 | 1.4 |
| Private consumption | 11349.1 | 4.8 | 0.4 | 1.3 | 1.5 | 1.5 |
| Government consumption | 4818.8 | 1.0 | 1.7 | 2.6 | 1.5 | 1.3 |
| Gross fixed capital formation | 4756.7 | 2.2 | 2.0 | -1.6 | 2.0 | 2.8 |
| Final domestic demand | 20924.6 | 3.3 | 1.0 | 0.9 | 1.6 | 1.7 |
| Stockbuilding[2] | . . | 0.6 | -1.3 | . . | . . | . . |
| Total domestic demand | 21225.2 | 3.9 | -0.3 | 0.7 | 1.8 | 1.7 |
| Exports of goods and services | 10877.1 | 7.4 | 0.4 | 1.1 | 0.8 | 1.5 |
| Imports of goods and services | 10068.8 | 8.2 | -1.2 | 0.4 | 1.8 | 2.1 |
| Net exports[2] | . . | -0.1 | 0.8 | . . | . . | . . |
| *Memorandum items* | | | | | | |
| Potential GDP | | 1.7 | 1.5 | 1.5 | 1.4 | 1.3 |
| Output gap (% of potential GDP) | | 0.8 | -0.2 | -0.7 | -0.8 | -0.7 |
| Employment | | 2.5 | 1.4 | 0.9 | 0.8 | 0.6 |
| Unemployment rate (% of labour force) | | 6.2 | 6.1 | 6.0 | 6.0 | 5.8 |
| GDP deflator | | 5.8 | 6.3 | 3.0 | 2.5 | 2.1 |
| Harmonised index of consumer prices | | 9.1 | 6.2 | 2.5 | 2.3 | 2.0 |
| Harmonised index of core inflation[3] | | 4.7 | 5.6 | 3.0 | 2.4 | 2.1 |
| Household saving ratio, net (% of household disposable income) | | 6.4 | 7.4 | 8.9 | 8.9 | 8.7 |
| Current account balance (% of GDP) | | 1.1 | 2.9 | 3.7 | 3.1 | 2.9 |
| General government fiscal balance (% of GDP) | | -3.4 | -3.6 | -3.2 | -3.2 | -3.2 |
| Underlying general government fiscal balance (% of potential GDP) | | -4.0 | -3.8 | -3.2 | -3.1 | -3.1 |
| Underlying government primary fiscal balance (% of potential GDP) | | -2.5 | -2.4 | -1.7 | -1.6 | -1.5 |
| General government debt, Maastricht definition (% of GDP) | | 86.0 | 84.1 | **84.5** | 85.2 | 86.1 |
| General government net debt (% of GDP) | | 52.1 | 58.3 | 53.5 | 54.3 | 55.3 |
| Three-month money market rate, average | | 1.0 | 3.9 | 3.8 | 2.4 | 2.1 |

Note: Data refers to European Union member countries that are also members of the OECD (22 countries).
1. OECD estimates.
2. Contribution to changes in real GDP.
3. Index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook: Statistics and Projections database.

## Table 1.3. Events that could lead to major changes in the outlook

| Risks | Possible outcomes |
|---|---|
| Further increases in trade fragmentation, could be accompanied by increases in policy uncertainty and broad risk repricing in financial markets. | Increased trade fragmentation would lower export demand and disrupt global supply chains. This would harm the euro area economy by adding to the downward pressures on corporate and household spending. |
| Disruptions in global energy markets and supply chains due to an escalation of conflict in the Middle East or elsewhere. | Higher energy prices would raise inflation, reduce real incomes and private consumption, and weigh on the competitiveness of domestic firms. Disruptions in global supply chains would harm production of tradables.<br>The need to finance further spending on defence would support growth but add to longer-term fiscal pressures. |
| The war in Ukraine ends in a durable negotiated settlement and geopolitical tensions decrease. | Confidence would rebound, spurring investment through reconstruction as well as private consumption. |

More broadly, deepening the network of EU trade partners and continuing support for a rules-based international order would help diversify trade flows and bolster resilience, while enhancing the EU's attractiveness as a base for global firms. The EU is currently negotiating and ratifying several important free trade agreements, including with

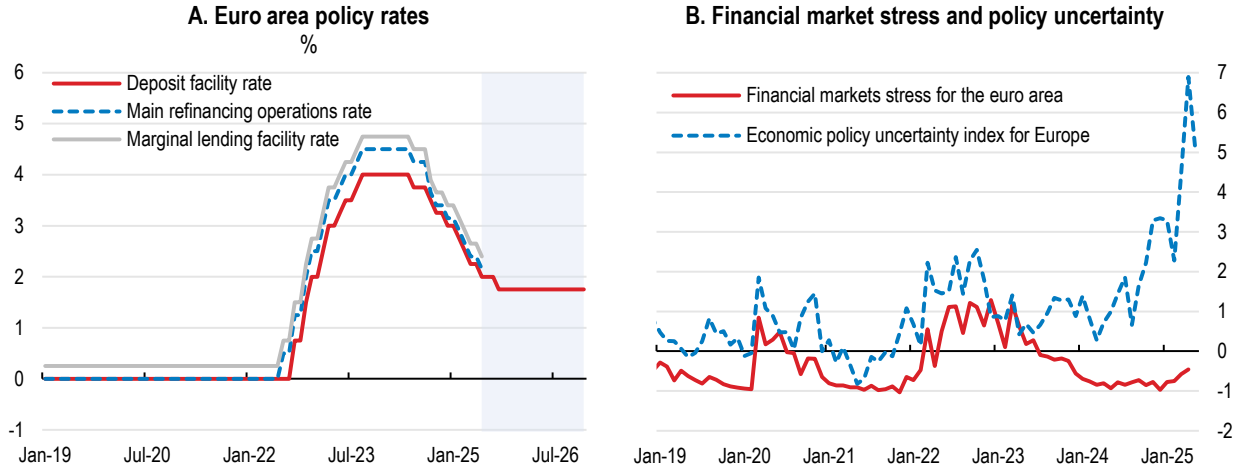
Mercosur, India, Indonesia, Australia, Mexico and Ukraine. With other countries, such as South Korea and Singapore, the EU is negotiating further digital trade agreements to remove unjustified barriers to digital trade. Preserving trade openness alongside efforts to expand free trade agreements is welcome.

## 1.2. Monetary policy is loosening amid elevated financial stability risks

### *1.2.1. The monetary policy stance has been relaxed*

After rapidly raising interest rates in 2022 and 2023, the ECB has started to reduce the degree of monetary policy restriction in 2024. In reaction to the inflation surge that started in 2021, the ECB raised interest rates by 450 basis points between July 2022 and September 2023. The ECB also continued to unwind the Asset Purchase Programme (APP) and Pandemic Emergency Purchase Programme (PEPP) portfolios and further reduced reinvestments from maturing securities, which added to the restrictiveness of the policy stance at the margin. As headline inflation in 2024 approached the medium-term target of 2%, the ECB decided to reduce the degree of monetary policy restriction, by further cutting interest rates, which are the primary tool for setting the policy stance. A series of 25 basis points cuts of policy interest rates in June, September, October and December 2024, as well as January, March and April 2025, brought the deposit facility rate down from 4% to 2.25%, amid market expectations for further cuts in 2025 (Figure 1.7, Panel A). To incentivise bidding in the weekly refinancing operations and limit volatility in short-term money markets as the ECB balance sheet normalises, the spreads between policy interest rates were reduced in September 2024, when both the rate on main refinancing operations (MRO) and the marginal lending facility rate were cut by 60 basis points. This resulted in a tighter, 15 basis points spread between the deposit facility rate and the MRO rate.

**Figure 1.7. The monetary policy stance has been relaxed amid increased uncertainty**




Note: Panel A, the shaded area refers to OECD EO117 projections. Panel B, the Financial markets stress for the euro area is the ECB composite indicator of systemic stress combining 15 mainly market-based financial stress measures; while the Economic policy uncertainty index for Europe, developed by Baker, Bloom, and Davis (2016), measures policy-related uncertainty by tracking the newspapers' coverage of economic policy-related uncertainty for 5 European economies (Germany, the United Kingdom, France, Italy, and Spain). The indicators are standardised to show the number of standard deviations above or below their average value over the period 2007-2024. A positive (negative) value indicates high (low) systemic stress in the financial markets. Data are shown up to May 2025.

Source: OECD Economic Outlook: Statistics and Projections database; Refinitiv; US Federal Reserve; and OECD calculations.

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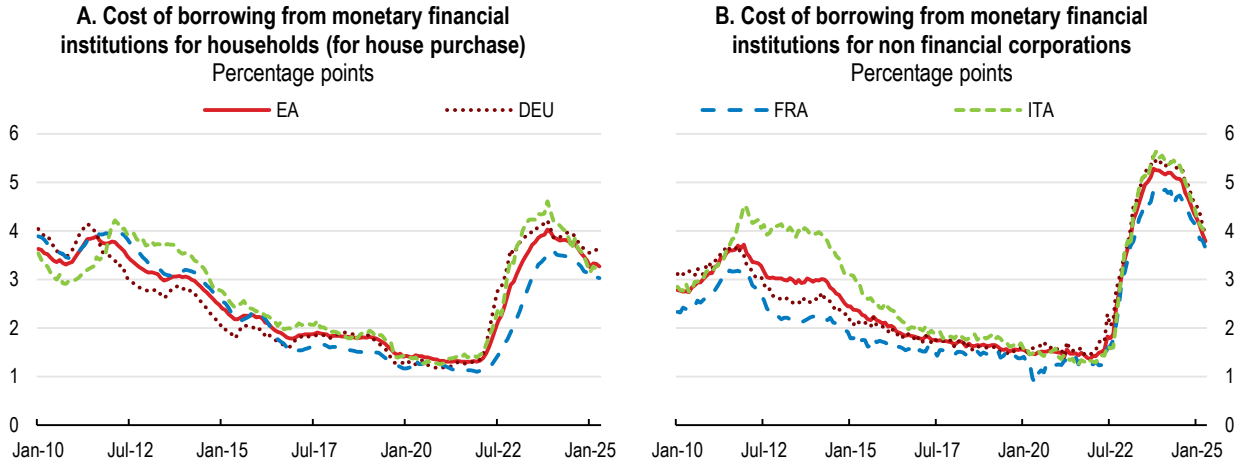
Financing conditions remain tight, in part reflecting the lagged effect of past rate hikes, but the policy interest rate cuts are gradually lowering borrowing costs for firms and households. The monetary policy stance has been transmitted smoothly to short-term market interest rates and lower bank lending rates. The average interest rate on new loans to firms declined to 3.9% in March and the average rate on new mortgages edged down to 3.3% (Figure 1.8). Bank lending to firms and households continued to grow, but annual growth rates remain far below historical averages reflecting still weak demand and tight credit standards. There has been a slight decrease in the net demand for loans of firms and a strong increase in net demand for housing loans by households, broad-based

across the euro area and mainly driven by declining interest rates. Consumer credit was similarly supported by declining interest rates and slowly improving consumer confidence. At the same time, credit standards for loans to firms tightened further in the first quarter of 2025, mainly reflecting higher perceived risks related to the economic outlook. Credit standards eased further for loans to households for house purchase, while tightening for consumer credit, after several quarters of easing (ECB, 2025[9]).

## Figure 1.8. Cost of borrowing has decreased




Note: Data are shown up to April 2025.
Source: European Systemic Risk Board (ESRB); and European Central Bank (ECB).

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Economic uncertainty increased markedly following the global inflation surge (Figure 1.7, Panel B). Apart from raising the policy interest rates, the ECB also clarified its monetary policy reaction function and the way it communicates its decisions. The three-pronged reaction function to support ECB decision-making in managing uncertainty involves the assessment of the inflation outlook, the most likely future path for inflation and the surrounding risks, developments in underlying inflation, and the strength of monetary policy transmission (Lane, 2024[10]). As monetary policy transmission is probably state-dependent and anticipating all the channels in real time is difficult, it is important to communicate effectively the uncertainty regarding the monetary policy stance. One option to do so would be to regularly and consistently use alternative scenarios to communicate uncertainty surrounding the projections or conduct regular sensitivity analysis of technical assumptions (Schnabel, 2024[11]).

### *1.2.2. Monetary policy should remain vigilant*

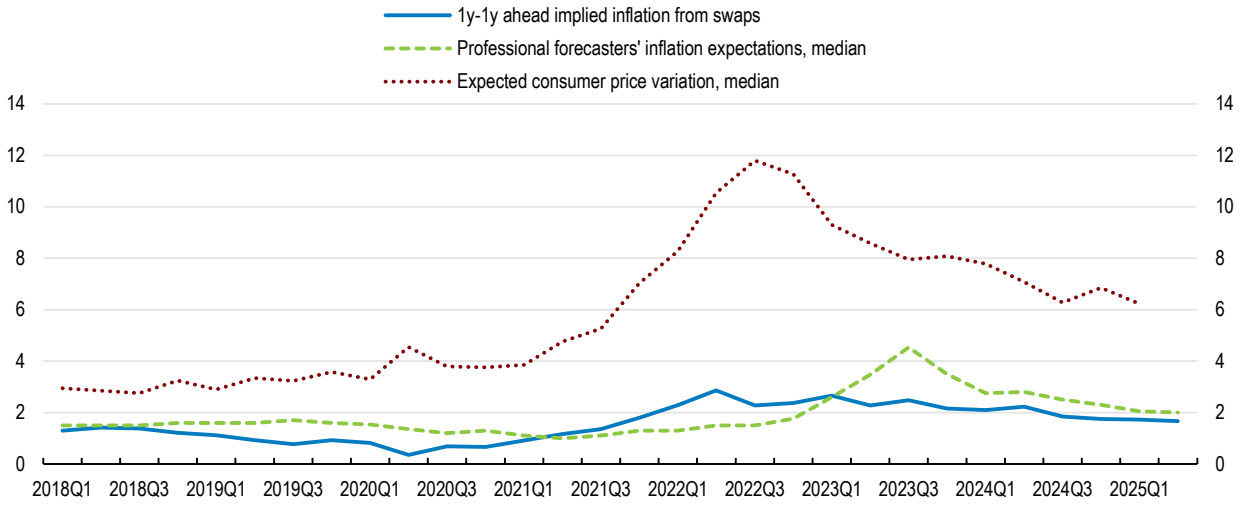
The shift from a high-inflation environment to a level of inflation consistent with price stability has implications for the conduct of monetary policy. In a high-inflation regime, during the inflation surge between 2021 and 2023, firms reacted to higher energy prices, supply-side bottlenecks and pent-up demand after the pandemic (Borio et al., 2023[12]). In addition, second-round effects pushed wage demands higher across firms. The frequency of price changes increased and as the changes were mostly upward, this led to a sharp increase in the common component of inflation. Monetary policy, which directly affects aggregate demand and the inflation expectations of consumers and firms, is powerful in counteracting such common shocks. The ECB has reacted with some delay, but the increase in policy rates during the high inflation episode has ultimately helped to stabilise prices and re-anchor inflationary expectations (Karadi et al., 2024[13]). However, in the coming regime of price stability, price shocks may mostly be independent of each other and mainly reflect relative price changes. Such shocks are less responsive to the tools of monetary policy. This is especially so when relative price shocks reflect supply-side or structural changes, such as permanently higher energy costs, the green transition or rising regulatory costs (Schnabel, 2024[14]).

In normal times, monetary policy may react less forcefully, using its credibility in fighting inflation. When relative price shocks dominate, inflation is mostly self-stabilising and the ECB's monetary policy might be more patient with moderate deviations of inflation from the target (Schnabel, 2024[14]). At the same time, the experience from the

recent inflation surge may shape future responses, if inflation expectations again become unanchored (Figure 1.9). If bondholders, price-setters and employees expect inflation more promptly in response to the next inflationary shock, the ECB may have to act decisively and quickly, despite the cost of doing so (Cochrane, Garicano and Masuch, 2024[15]).

### Figure 1.9. Inflation expectations have abated

Euro area, 12-month % change




Note: Data refer to the euro area aggregate and are based on the ECB Survey of Professional Forecasters (SPF) and refer to the inflation expectations for the next 12 months. Data on expected consumer price variation refer to the responses to the question "By how many per cent do you expect consumer prices to go up/down in the next 12 months?" contained in the European Commission Consumer opinion survey.
Source: Refinitiv; Eurostat. ECB Survey of Professional Forecasters; European Commission, Business and consumer surveys, https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/business-and-consumer-surveys_en; and OECD calculations.

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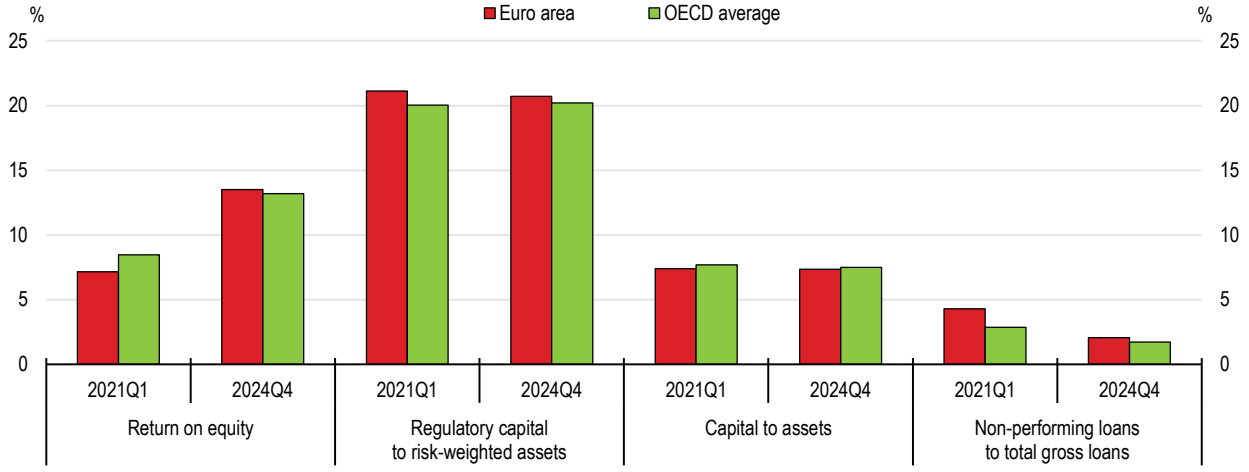
The ECB's monetary policy should remain vigilant and data dependent as disinflation progresses. As the estimates of a neutral policy interest rate, at which the inflationary risks are balanced and output is at potential, are of limited help in the presence of major shocks, the ECB's three-pronged reaction function discussed above is an appropriate tool for setting the monetary policy stance. At the same time, a recent ECB assessment of the unobservable neutral policy rate puts its econometric estimates between 1.75% and 2.25%, suggesting some room for further cuts and the output gap, which is estimated to be marginally negative, points in the same direction. In addition, recent research suggests that drivers of the neutral policy rate are partly cyclical, meaning that the rate increases when the economy recovers. After a decline during the pandemic crisis, the neutral rate has picked up recently, broadly coinciding with the rise of global and euro area interest rates (Christensen and Mouabbi, 2024[16]). Moreover, current short-term rates, both nominal and real, are below the historical levels prevailing before the global financial crisis and other data, such as the strong increase in net demand for housing loans recorded in the Bank Lending Survey suggest that the overall monetary and credit conditions have become less restrictive (ECB, 2025[9]). In the view of incomplete disinflation and the uncertainty surrounding the precise stance of monetary policy, it would be prudent for the ECB to remain vigilant when setting its monetary policy stance until price stability conditions are reliably achieved. After that, the ECB should maintain a small positive real short-term interest rate (Angeloni, 2024[17]).

## *1.2.3. Risks to financial stability are building up in the non-bank sector*

The banking sector in the euro area has been stable in recent years, enjoying strong aggregate capital and liquidity buffers, despite the gradual phasing out of funding form targeted longer-term refinancing operations. This reflects the successful implementation of the Basel III reforms designed to strengthen banks' resilience. To ensure a level playing field and not penalise banks that have duly prepared, this process should continue as planned by the

implementation of the remaining elements in all jurisdictions. The overall Common Equity Tier 1 ratio, at 15.9% at the end of 2024, was well above the minimum and combined buffer requirements. Despite some signs of deterioration, non-performing loans (NPLs) remain limited, while strong profitability of banks that continued in 2024 makes higher loan-loss provisions more affordable (Figure 1.10). Moreover, European banks benefit from effective supervision and a comprehensive regulatory framework, which helped them withstand the 2023 banking turmoil. However, as bank profitability may have peaked, macroprudential capital buffers should be kept at levels preserving resilience and existing borrower-based measures should also be maintained to ensure sound lending standards over the financial cycle (ECB, 2024[18]).

## Figure 1.10. The banking sector is well capitalised on aggregate




Note: Data refer to euro area member countries that are also members of the OECD (17 countries). 2024Q4 data for the euro area and OECD average is calculated on the basis of latest available quarter for the 17 euro area and OECD countries, ranging from 2023Q4 to 2024Q4.
Source: IMF Financial Soundness Indicators database.

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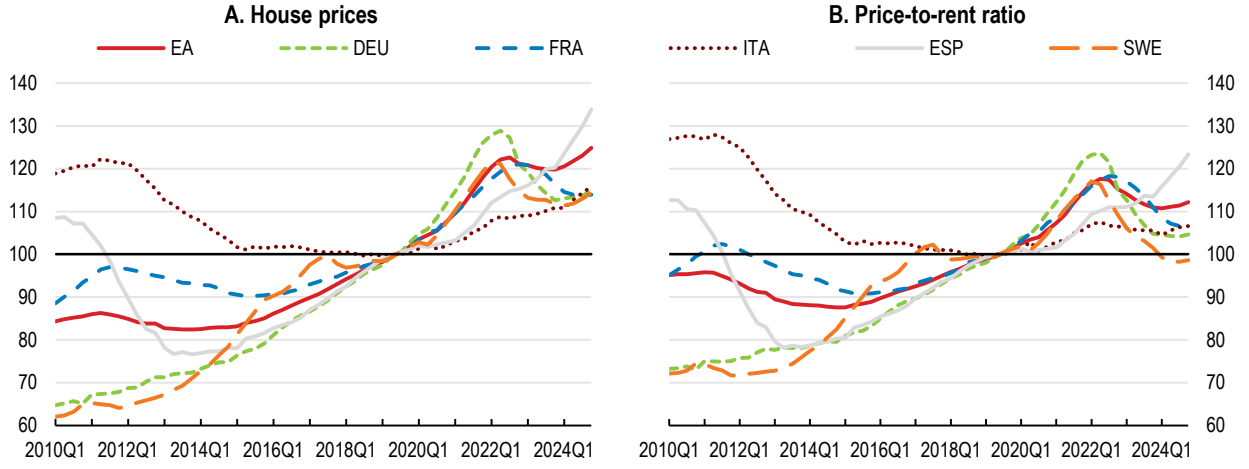
Credit risks are emerging in parts of the corporate sector that would affect both banks and non-bank lenders. Despite lower rates on new borrowing, interest costs continue to weigh on firms' profitability. Ongoing trade tensions are weighing on financing conditions for corporates with trade exposures to the US and could lead to periods of heightened financial market volatility. Data on bank loan defaults show that small and medium-sized enterprises (SMEs) and firms in the commercial real estate sector have the most fragile balance sheets. Insolvencies have been rising in the euro area, albeit from moderate levels, reflecting both the fading previous support and the effect of weak growth on firms' debt servicing ability. While conditions in the commercial real estate markets are stabilising, in line with less restrictive monetary policy, structural factors related to the shift to remote working and e-commerce, as well as the need for energy-efficiency investment, continue to weigh on the outlook. The exposures to commercial real estate are small but concentrated and banks with high exposures face elevated risks. At the same time, the deterioration of SME credit quality has been less pronounced, while being more widespread (ECB, 2024[18]).

Residential real estate prices in the euro area returned to growth in 2024, increasing by 1.3% and 2.6% year-on-year, respectively, in the second and third quarter of 2024. The orderly contraction in house prices masks significant differences among countries, with some not experiencing a decline in prices (Figure 1.11). Housing affordability has deteriorated in recent years, together with borrower capacity of households (European Commission, 2024[8]), but easier credit conditions and increasing demand for mortgage loans are expected to support price growth going forward. Household vulnerabilities have eased on aggregate, on the back of resilient labour markets and high savings rates, but interest costs are challenging for low-income cohorts. Although housing market adjustments have been orderly so far, risks are skewed to the downside (ECB, 2024[18]). Weaker growth and a softer labour market, especially in countries with elevated mortgage debt levels and overvalued property markets could trigger a housing market correction.

Non-banking financial institutions have been resilient so far, but the risks are building up. The sector's vulnerabilities, such as low liquidity and high leverage of some actors, require a comprehensive policy response at the EU level, to reduce both the macroprudential risks and the possibility of regulatory arbitrage (ECB, 2024[18]). For example, some types of open-ended investment funds have low liquid asset holdings and significant liquidity mismatches, which in the presence of an adverse market shock could lead to forced asset sales to cover sudden outflows of funds or margin calls on derivatives exposures. Similarly, the resilience of money market funds (MMFs) to liquidity shocks also needs to be strengthened by increasing the liquidity buffer requirements for private debt MMFs and making them more usable. Non-bank leverage should also be reduced to close potential gaps in the existing EU policy framework, starting with adopting the FSB minimum haircut framework for securities financing transactions (FSC, 2024[19]). Another concern is the widening gap in insurance protection caused by the growing frequency and severity of natural catastrophes linked to climate change. Recent proposals for EU-level solutions put forward by the ECB and the European Insurance and Occupational Pensions Authority (EIOPA) include a voluntary EU public-private reinsurance scheme to increase insurance coverage and an EU fund for public disaster financing (ECB and EIOPA, 2024[20]).

### Figure 1.11. House prices have stabilised in several countries

Index 2019=100, seasonally adjusted




Note: Latest observation refers to 2024Q4.
Source: OECD Price Statistics database; and OECD calculations.

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## 1.3. Fiscal policy should be prudent

### *1.3.1. Prudent fiscal policy is needed to reduce high debt levels*

Fiscal prudence is needed to ensure long-term fiscal sustainability and support the ongoing disinflationary process. In light of pressing needs for additional spending and investment in priority areas such as defence and innovation, expenditures should be reprioritised and structural reforms accelerated. While higher defence spending is needed, it cannot be financed by debt issuance in the long term and reprioritisation of fiscal spending is necessary to ensure fiscal sustainability. At the same time, gradual fiscal consolidation coupled with reforms and investments, partly funded by the Recovery and Resilience Facility (RRF) and other EU funds, could protect economic growth and boost potential output (European Commission, 2024[21]). To meet additional spending on agreed priorities, including European public goods and defence spending, EU countries could also increase the size of the EU budget or set up a common fiscal capacity, similar to that discussed in the 2021 *OECD Economic Survey of the Euro Area*. Such a decision would likely include a reduction in fiscal spending at the national level.

After strong fiscal expansion during 2020-2023, fiscal policy in the euro area is projected to tighten in 2024, and to a lesser extent in 2025 and 2026, with cumulative tightening of less than 1½ % of GDP over these three years

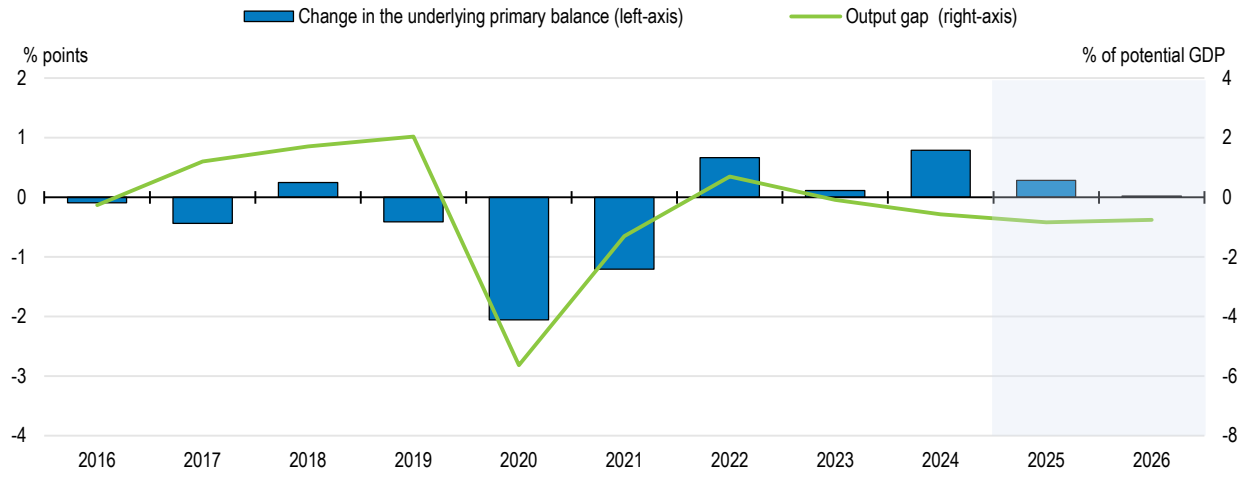
(Figure 1.12). The considerable fiscal impulse in 2020-2023 has not been offset, as the energy and income support measures have still not been fully rolled back. The constraints on fiscal policy were relaxed in March 2025 as the EU called for the coordinated use of national escape clauses for up to 1.5% of GDP for defence purposes, enabling additional spending of about EUR 650 billion (4.3% of euro area GDP) from 2025 to 2028. In addition, the Security Action for Europe (SAFE) instrument, if approved by the Council, will allow EU countries to borrow up to EUR 150 billion to facilitate the increase in defence spending.

The policy measures proposed in the ReArm Europe Plan aim at supporting EU's defence industry, stepping up defence spending and deepening the single defence market. They build on existing instruments established in the 2021-2027 Multiannual Financial Framework, such as the European Defence Fund, and other measures, including the Act in Support of Ammunition Production (ASAP), the European Defence Industrial Reinforcement through Procurement Act (EDIRPA) and the off-budget European Peace Facility. However, the successful implementation of the ReArm Europe plan would likely require an agreement to pool procurement and prioritise EU-made equipment (de Cordoue, 2025[22]), as well as expanding an integrated defence industrial base (Wolff, 2024[23]).

The high debt levels in many euro area countries were somewhat reduced between 2021 and 2023, partly reflecting favourable denominator effects from the high inflation episode, but primary deficits are set to continue. The euro area's fiscal position has been hit hard by the pandemic, but the debt-to-GDP ratio gradually decreased in recent years, from 98.5% in 2020 to 89.1% in 2023, reflecting reduced debt ratios in several euro area countries (Figure 1.13). However, in the coming years, the ratio is projected to increase again, to 91.7% in 2026, as ongoing primary deficits are only partly offset by a shrinking interest-growth rate differential (European Commission, 2024[8]). One reason for continuing headline deficits is rising debt servicing costs as maturing debt is rolled over at higher interest rates than on outstanding debt. A small impact on the primary balance also comes from the ongoing fiscal measures in response to the energy and inflation shock, which have been considerably reduced in 2024 and are projected to further decrease to 0.1% in both 2025 and 2026 (Ferdinandusse and Delgado-Téllez, 2024[24]).

## Figure 1.12. The fiscal stance is projected to tighten

Euro area fiscal stance measured by structural primary balance




Note: Data refer to euro area member countries that are also members of the OECD (17 countries). 2025 and 2026 represent projections.
Source: OECD Economic Outlook: Statistics and Projections database.

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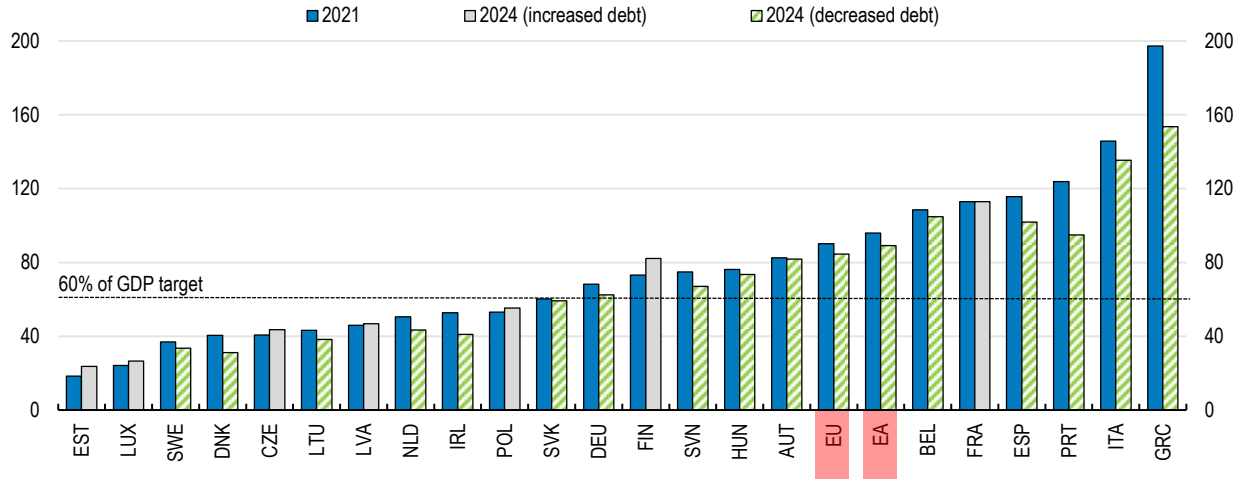
The favourable effects of the NGEU spending on debt-to-GDP ratios until 2031 are estimated at 7 to 8 ppt for the main recipients, Italy and Spain, and at about 3 ppt for the whole euro area (Bankowski et al., 2022[25]). The ECB's model-based simulations assume that the effects operate via a direct debt-increasing effect of RRF loans, a confidence channel affecting sovereign bond yields and risk premia, the demand driven stimulus from higher spending and the supply side effects from additional investment and reforms. However, the effects may be smaller than previously thought and occur later than expected. This is driven by delays in implementation, which have

reduced both budget outcomes and GDP and resulted in significantly lower potential GDP growth. At the same time, this implies that substantial resources will be deployed in the coming years, lifting the potential output gains (Bankowski et al., 2024[26]).

### Figure 1.13. Public debt has decreased in most countries, but it remains high

General government debt, Maastricht definition, as a percentage of GDP




Note: Data refer to the European Union and the euro area member countries that are also members of the OECD (22 and 17 countries respectively).
Source: OECD Economic Outlook: Statistics and Projections database.

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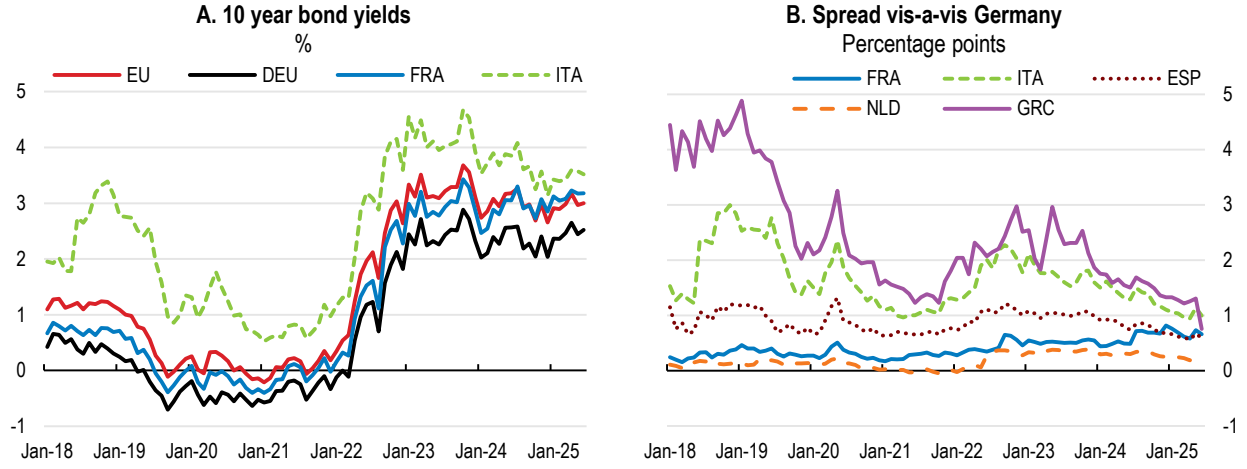
## *1.3.2. The NGEU spending is executed more slowly than planned*

The Next Generation EU (NGEU) programme agreed in reaction to the COVID-19 pandemic aims at fostering potential growth and transforming the economy. EU countries had applied for 733 billion euro under the NGEU by August 2024, which amounts to about 5.2% of EU GDP. Most of the funds, 650 billion euro are provided under the Recovery and Resilience Facility (RRF). Euro area countries are entitled to RRF funds of up to 532 billion euro and the ECB's Working Group on Public Finance estimates that some 489 billion euro, 295 billion in grants and 194 billion in loans will be spent, as some countries may not use their loan entitlements in full. The Commission had until November 2024 borrowed on financial markets more than 320 billion euro to pay out the NGEU funds. NGEU loans will be repaid by the borrowing countries, while the grants will be repaid through the EU budget. The repayment is guaranteed by the commitment by EU countries to provide up to 0.6% of gross national income (GNI) of additional budgetary "headroom", which seems sufficient under all plausible paths of future costs of servicing the debt (Bankowski et al., 2024[26]). The ECB estimates that the annual repayment cost of the RRF grants will peak at 26 billion euro in 2028 and steadily decrease afterwards. The financial burden will ultimately fall on EU taxpayers, either through agreeing on new EU own resources, which would imply less potential revenue for national budgets, or GNI-based national transfers to the EU budget (see Chapter 2). Hence, the EU countries should account for the NGEU repayments in their medium-term fiscal plans.

Sovereign borrowing costs have been growing in recent months, partly reflecting increased uncertainty regarding future growth and partly in anticipation that public spending will increase (Figure 1.14). For example, German yields on ten-year sovereign bonds stood above 2.5% in February from just above 2% at the beginning of December 2024. At the same time, recent auctions of government debt showed strong demand by investors, even as the ECB continues to reduce its sovereign bond holdings. However, a resurgence in inflation or downside surprises to economic growth could translate rapidly into falling asset prices with broader systemic effects. An increase in risk premia could also cause stress in sovereign bond markets amid high debt levels and substantial refinancing needs over the next two years (OECD, 2025[27]).

## Figure 1.14. Sovereign borrowing costs remain elevated




Source: LSEG; and OECD calculations.

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RRF expenditure has been lagging the initial indicative timeline and had a small impact on euro area GDP so far. In 2021-2023, there was a significant underspending of RRF funds compared to the original plans. The delay has occurred in most euro area countries and was mainly driven by the revision of national recovery and resilience plans in 2023 to include a RePowerEU chapter, limited administrative capacity and the effect of high inflation on already drafted procurement contracts (Dorrucci and Freier, 2023[28]). By April 2025, about a half of envisaged payments has been disbursed, 56% of grants and 38% of loans, pointing to a need for acceleration in the remaining life of the instrument. Similarly, only 30% of milestones and targets, both investments and reforms, have been assessed as fulfilled by the Commission so far, with an additional 23% reported as completed by EU countries (European Commission, 2025[29]). EU countries with weaker administrative capacity and large RRF allocations have experienced particularly long implementation delays. From the RRF progress reports submitted in the context of the European Semester, it also seems that delays have become increasingly frequent in 2022 and 2023 (ECA, 2024[30]), while the trend appears to have reversed in 2024. To improve the RRF implementation, the Commission should provide as needed additional guidance to national implementation bodies (see Chapter 2).

### *1.3.3. Implementation of the new governance framework should be strengthened*

The new fiscal rules adopted in April 2024 reformed both the preventive and the corrective arms of the Stability and Growth Pact (SGP). Most importantly, the new framework replaced multiple operational targets with a single indicator, net expenditure growth over the medium term. As discussed in the 2023 *Economic Survey of the EU and the euro area*, this is a positive change, which puts more emphasis on country-specific debt sustainability pursued through EU-endorsed medium-term fiscal-structural plans that set out national fiscal adjustment plans under a common framework. Such anchoring of the fiscal requirement on debt sustainability could also help make fiscal policy more counter-cyclical and improve national ownership.

Countries exceeding the 60% of GDP debt threshold or the 3% of GDP deficit threshold will have to comply with newly defined numerical safeguards strengthening fiscal adjustment. Countries with debt below the 60% of GDP and no plans to exceed it may only receive warnings and recommendations, unless they breach the 3% of GDP deficit threshold (Box 1.1). The possibility of a general escape clause is preserved in the new framework and a national escape clause was introduced. Although these provisions could in principle be used to address extraordinary spending needs, for example on defence, their use is conditional on preserving fiscal sustainability in the medium term.

## Box 1.1. New EU fiscal rules

The Stability and Growth Pact (SGP) constraining government deficits and debt in the EU consists of the preventive arm setting out the medium-term objective of fiscal sustainability and the corrective arm or excessive deficit procedure (EDP), which specifies adjustment requirements for countries with deficits above 3% of GDP or debts above 60% of GDP that are not falling fast enough. Each arm of the SGP corresponds to an EU regulation. The April 2024 reform of the SGP put in place a new preventive arm regulation and amended the existing EDP procedure.

In addition, Directive 2024/1265 updates the requirements for national budgetary frameworks, including new reporting requirements on climate change risks and the capacity and tasks of national independent fiscal institutions (IFIs). For example, the IFIs should have members appointed based on experience and competence, by transparent procedures. To ensure independence, the IFIs should have adequate and stable resources, timely access to all the relevant information and be subject to external evaluations. The Directive has to be transposed into national laws by end-2025.

### The new preventive arm

Each country submits a medium-term fiscal-structural plan (MTFSP), which in principle covers the period coinciding with the term of the national legislature and outlines a fiscal adjustment path, focussed on net expenditure, i.e. primary expenditure net of discretionary revenue measures, cyclical unemployment expenditure and one-off and temporary items. By the end of the adjustment period of four years at minimum, extendable to a maximum of seven years conditional on an additional set of investment and reform commitments, government debt must be on a plausibly downward path or staying below 60% of GDP over the 10-year period after the end of the adjustment, based on projections with unchanged policies. Over the same period, also based on projections with unchanged policies, the budget deficit should remain below 3% of GDP. The Commission verifies this forward-looking requirement at the time of endorsement of the plan, based on its debt sustainability analysis (DSA) methodology. A “plausibly downward path” means, in deterministic stress scenarios including pre-defined adverse assumptions about the evolution of interest rates, GDP and the primary fiscal balance, that debt is declining throughout the DSA period. In stochastic stress scenarios, a “plausibly downward path” means at least 70% probability that, after drawing 10 thousand randomised shocks from a predefined distribution, debt will decline during the DSA period. A working group has been established to review the existing DSA methodology.

Moreover, the reform has introduced additional constraints for the setting of the net expenditure path in the MTFSP, which apply to countries with debt above 60% of GDP or a deficit above 3% of GDP, namely:

- **A debt sustainability safeguard** requires the projected debt-to-GDP ratio to decrease over the adjustment period by a minimum annual average amount of 1 percentage point of GDP, for countries with debt ratios above 90%, and by ½ percentage point of GDP, for debt ratios between 60% and 90% of GDP.
- **A deficit resilience safeguard** requires that the structural deficit should eventually reach a level of no more than 1.5% of GDP. The improvement in the structural primary balance should reach 0.4 percentage point of GDP per year (or 0.25 percentage points per year if the adjustment period is seven years).
- **No backloading** requires that the annual fiscal adjustment must not increase during the adjustment period.

Fulfilment of these requirements is verified by the Commission and the Council of the EU, which can ask countries for revisions. Once a MTFSP is endorsed by the Council, the net expenditure path becomes the sole reference for assessing compliance with the EU fiscal rules. To allow for some flexibility, positive and negative deviations from the net expenditure path are accumulated in a notional control account. If the balance reaches 0.3% of GDP in one year or 0.6% of GDP cumulatively, countries with debt-to-GDP ratio above 60% and with a budgetary position not close to balance or in surplus are liable, after the Commission’s assessment, to the EDP for breach of the debt criterion, with the associated prescriptions and possible penalties.

The Regulation also provides for opinions on the macroeconomic forecast and assumptions underpinning the net expenditure path prepared by national independent fiscal institutions (IFIs), initially at the request of the government, and independently after 1 May 2032, provided they have built up sufficient capacity.

**Amendments to the Excessive Deficit Procedure**

The reform has left the EDP for breach of the deficit criterion broadly unchanged, although it provides more time to correct the excessive deficit than the one year usually recommended before the reform. Unless the deviation is assessed to be small and temporary, countries with deficits of more than 3% of GDP are required to implement a corrective net expenditure path and adjust their deficit by at least 0.5% of GDP per year, measured in terms of the structural primary balance in 2025-2027 and in terms of the overall structural balance afterwards. In addition, the Regulation makes a distinction, within a single legal procedure, between the deficit-based and debt-based EDP criteria. Where the excessive deficit procedure was opened on the basis of the debt criterion (see above), the corrective net expenditure path needs to be at least as demanding as the old one and remove the cumulated deviations of the control account by the time set by the Council.

The Regulation also modified the provisions on escalating the EDP, including the possibility of fines after the repeated failure by a country to take effective action to correct excessive deficits. The sanctions for non-compliance were substantially reduced from a minimum of 0.2% of GDP per year, as stipulated by the 2011 "six-pack" legislation, to 0.05% of GDP every six months. This change still needs to be harmonised with the "six-pack" legislation, which remains in place.

Source: European Commission (2024[31]); Pench (2024[32]); Darvas, Welslau and Zettelmeyer (2024[33]).

The Council adopted the net expenditure growth paths in national medium-term fiscal-structural plans (MTFSPs) for twenty-one EU countries and for the Netherlands a path consistent with the technical information, as recommended by the Commission. The net expenditure paths in some MTFSPs are higher than those in the prior guidance, reflecting differing macroeconomic and fiscal assumptions, including updated information on the macroeconomic outlook and on budget execution, which became available during the time between the prior guidance and the MTFSP and which the Commission acknowledged as justified (European Commission, 2024[31]). For five countries – Finland, France, Italy, Romania and Spain – the adjustment period has been extended from 4 to 7 years, as their reforms and investment commitments were assessed as supporting fiscal sustainability and improving growth and resilience. Except for Portugal and Finland, the adjustment required under the new framework, even taking into account the effect of numerical safeguards, seems less demanding than the requirements implied by the last medium-term objective (MTO) in the old framework (Darvas, Welslau and Zettelmeyer, 2024[33]). At the same time, the approved MTFSPs for some countries imply backloading of fiscal adjustment compared to the prior guidance, sometimes not fully protecting public investment (Box 1.2).

## Box 1.2. A preliminary assessment of the medium-term fiscal structural plans

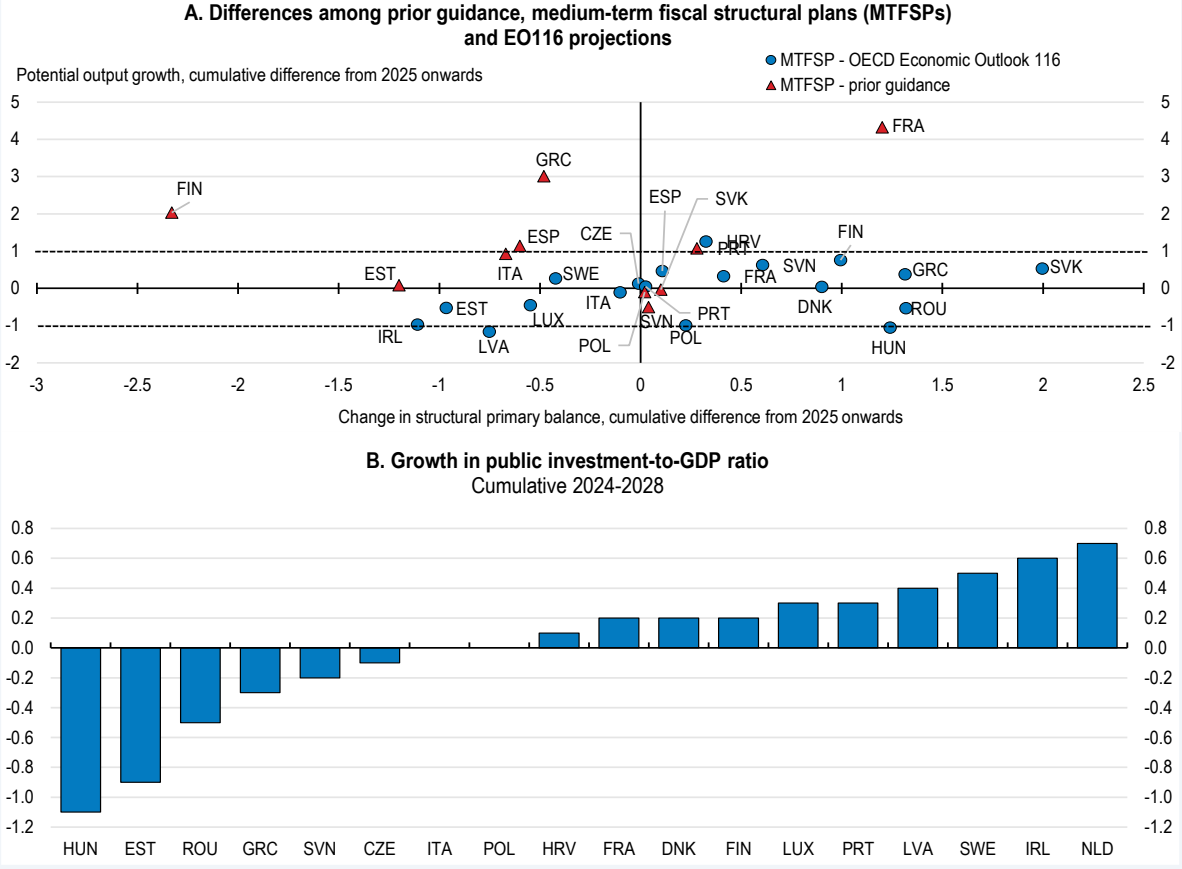
**Some national plans are more backloaded than the Commission's prior guidance**

The net expenditure growth path issued by the Commission in the prior guidance is for some EU countries different from the path set out in the national medium-term fiscal structural plans (MTFSPs) approved by the Council. For Estonia, Finland, Greece (until 2026), Italy (from 2027 onwards), and Spain (until 2029), the MTFSPs project a higher net expenditure growth than the prior guidance. On the other side, the MTFSPs of France, Portugal and Slovakia set out tighter fiscal policy constraints from 2025 onwards.

However, several factors may help explain these differences, in both directions. For example, some countries included in their MTFSPs a lower net expenditure path than implied by the Commission (Boivin and Darvas, 2025[34]). The difference comes from applying less than unitary revenue elasticity to nominal potential GDP in the Commission's formula for translating a structural primary balance (SPB) target into a net expenditure growth target and leads to more demanding fiscal effort. Another reason for differences in the net expenditure growth path could be differences in potential GDP growth projections. This can reflect either positive developments

since the preparation of the prior guidance or the national authorities having successfully justified their macroeconomic assumptions to the Commission. To assess these effects, Figure 1.15, Panel A plots the cumulative differences in potential GDP growth with cumulative changes in structural primary balance (SPB), both between the MTFSP and the prior guidance (in red) and between MTFSP and the EO116 data (in blue). In many cases, the differences in cumulative potential GDP growth lie within +/- 1 percentage point, which can be viewed as negligible. This is remarkably so for almost all countries when comparing MTFSPs to OECD projections in EO116. Only Croatia, Hungary and Latvia narrowly exceed this range. The differences in potential growth between the MTFSPs and the prior guidance are more substantial, partly reflecting more pro-cyclical nature of the Commission's estimates. This is the case notably for France, Greece and Finland, weakening the comparability of the projected changes in SPB. Leaving out these outliers, we can see that the MTFSPs for Spain and Italy involve smaller SPB adjustment than foreseen in the prior guidance, while the converse is true of Portugal and to a smaller extent of Slovakia, Slovenia and Poland. For many countries, the SPB adjustment projected in EO116 is smaller than the fiscal effort implied by the national MTFSPs.

## Figure 1.15. MTFSPs for some countries imply less consolidation than the prior guidance




Note: Panel A, horizontal lines at 1 and -1 indicate "negligible" difference in potential growth.
Source: OECD calculations based on the Commission's prior guidance, the MTFSPs approved by the Council and EO116.

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The aggregate euro area fiscal effort can be calculated for the countries where MTFSPs are available, which account for 51% of euro area GDP. The weighted average of annual changes in SPB suggests a reduction in fiscal effort under MTFSPs compared to that foreseen in the prior guidance (Table 1.4). Fiscal consolidation is shifted from 2024 to the subsequent years, partly reflecting new information on macroeconomic outlook and budget execution that became available between the prior guidance publication in June 2024 and the submission of the national plans in October and November. From 2026 onwards, the aggregate fiscal effort of the euro area set

out in the MTFSPs is roughly aligned with the one in the Commission's prior guidance. In addition, for the years 2024-2026 the fiscal consolidation assumed in the national plans is backloaded to 2025 and 2026, while being less strenuous in 2024.

### Table 1.4. Euro area fiscal effort under the new rules

Aggregate fiscal effort of the euro area as weighted sum of annual changes in the countries' SPBs

| Year | MTFSP | Prior Guidance | EO116 |
|---|---|---|---|
| 2024 | 1.01 | 1.34 | 1.29 |
| 2025 | 0.76 | 0.55 | 0.60 |
| 2026 | 0.53 | 0.55 | 0.43 |
| 2027 | 0.59 | 0.55 | |
| 2028 | 0.53 | 0.60 | |

Note: The column "MTFSP" refers to the aggregate fiscal effort of the euro area based on the national MTFSPs as adopted by the Council. The column "Prior Guidance" refers to the trajectories set out in the Commission's prior guidance. Countries with MTFSPs included in the table are Estonia, Finland, France, Greece, Italy, Portugal, Slovenia, Slovakia, Spain (accounting for around 51% of the euro area's GDP in 2023).
Source: European Commission, OECD, authors' calculations.

#### In most countries, growth of public investment is protected

During the euro area sovereign debt crisis, countries under macroeconomic programmes often implemented large fiscal adjustments that disproportionately cut public investment. The new economic governance framework aims to protect public investment, even in periods of necessary fiscal tightening. Comparing the average annual difference between growth in nationally financed public investment and growth in net expenditure shows that most countries plan a higher average annual growth in public investment than in net expenditure. However, Estonia, Greece and Hungary project in their plans a considerably lower annual growth in public investment than in net expenditure. In the case of Greece, the decrease comes after a surge in public investment to 3.8% of GDP in 2024. A similar point about declining public investment in some countries can be made by comparing cumulative changes in the ratio of public investment to GDP (Figure 1.15, Panel B).

Source: Boivin and Darvas (2025[34]); OECD EO116 database and authors' calculations.

The new framework could be further improved. For example, the new rules rely on bilateral exchanges with the Commission, albeit complemented by peer-reviews at a technical level, which entails risks of political pressure. This concern reinforces the need for uniform and equal application of the rules by the Commission. Another area of possible improvement is that the minimum adjustment requirement for countries breaching the 3% deficit benchmark could be pro-cyclical. Similarly to the previous framework, a country that is hit by an adverse output shock, which is not considered resulting from a severe economic downturn in the euro area or from exceptional circumstances outside government's control, but that results in a deficit exceeding 3% of GDP, may be asked to undertake additional fiscal adjustment. Such an outcome would depend on the initial requirements of the national MTFSP. If the national plan envisages fiscal adjustment of less than 0.5% of GDP per year, the EDP will effectively require a faster fiscal adjustment. It is also possible that the deficit resilience safeguard would imply a more ambitious medium-term consolidation target than the DSA requirements considered alone, for example for countries where ageing costs are increasing slowly or where GDP growth is projected to be strong (Darvas, Welslau and Zettelmeyer, 2024[33]). Another concern is the interplay of the provisions of the MTFSPs in the preventive arm and the operation of the EDPs, including the discretion enjoyed by the Commission and the Council around the benchmarks of the corrective arm (Pench, 2024[32]). While the discussions on a future code of conduct continue, additional guidance on how to resolve potential conflicts and interpret existing provisions would be useful.

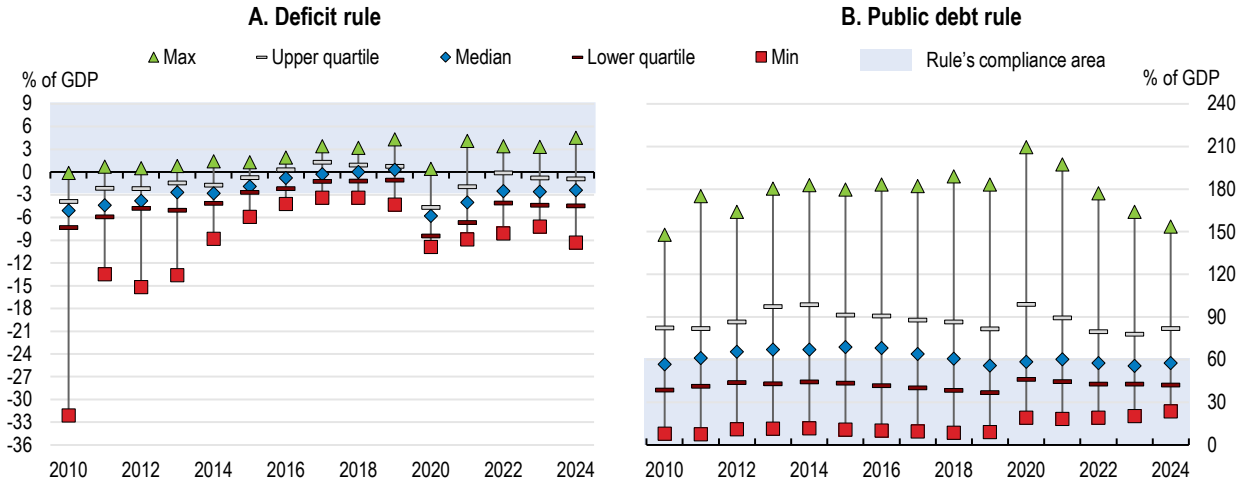
Another area of possible improvement relates to some details of the Commission's debt sustainability analysis (DSA) methodology. To assess fiscal sustainability, the Commission's DSA uses a baseline (no policy change) projection for the next 10 years and applies deterministic as well as stochastic scenarios covering a range of possible shocks derived from past data. The methodology is described in the Debt Sustainability Monitor 2023, while the files replicating the deterministic projections have been published and the code for stochastic projections has been shared with national authorities. In addition, to further improve transparency, the code for stochastic projections could also be made public, alongside the findings and recommendations of a new working group established to

review the DSA methodology. It would ensure that both the current methodology and its future modifications are disclosed, at a level that allows replication. Moreover, unlike the old framework, which required an annual decline in the debt-to-GDP ratio that was proportional to the initial debt level (the 1/20$^{th}$ excess debt rule), under the new framework countries with an estimated low volatility of debt-to-GDP ratio may be required to target only a small reduction in their debt ratio, even if their debt level is high (Cottarelli, 2024[35]). While the 1/20$^{th}$ excess debt rule was a source of pro-cyclicality in the old framework, the implied speed of debt reduction under the new framework may in some cases be too slow.

### *1.3.4. Empowered fiscal councils and redesigned sanctions could improve compliance*

While the track record of the new system still needs to be established, it remains to be seen whether partial compliance present in the old system will be resolved. Compliance with the EU fiscal rules has been imperfect in the past and the average numerical deviations from the rules non-negligible (Figure 1.16). In addition to uniform application of the rules, well-resourced and effective national independent fiscal institutions (IFIs) could help improve compliance and ownership in the new framework. The reform incrementally strengthened the minimum safeguards for IFIs independence, for example adequate as well as stable funding and timely access to necessary information. The reform also introduces an extensive comply-or-explain requirement for governments on all the tasks introduced in the updated Budgetary Frameworks Directive. This is welcome as it could help increase the effectiveness of national IFIs by enabling a regular dialogue with government on fiscal policy issues (Horvath, 2018[36]). However, the IFIs remain vastly heterogeneous in terms of size, capacity and challenges they face (Figure 1.17). For example, less than a third of EU IFIs has access to legally protected stable funding and the deadlines for complying with IFIs information requests are mostly non-existent (EFB, 2024[37]). To ensure effective discharge of responsibilities under the new fiscal governance framework, national IFIs should be strengthened and the differences in their capacities reduced. To facilitate this, the Commission should systematically monitor effective compliance by EU countries with the IFIs independence safeguards (Network of EU IFIs, 2019[38]; ECA, 2019[39]).

## Figure 1.16. Compliance with fiscal rules has been partial




Note: Data refer to the 27 EU Member countries.
Source: Eurostat; and OECD calculations.

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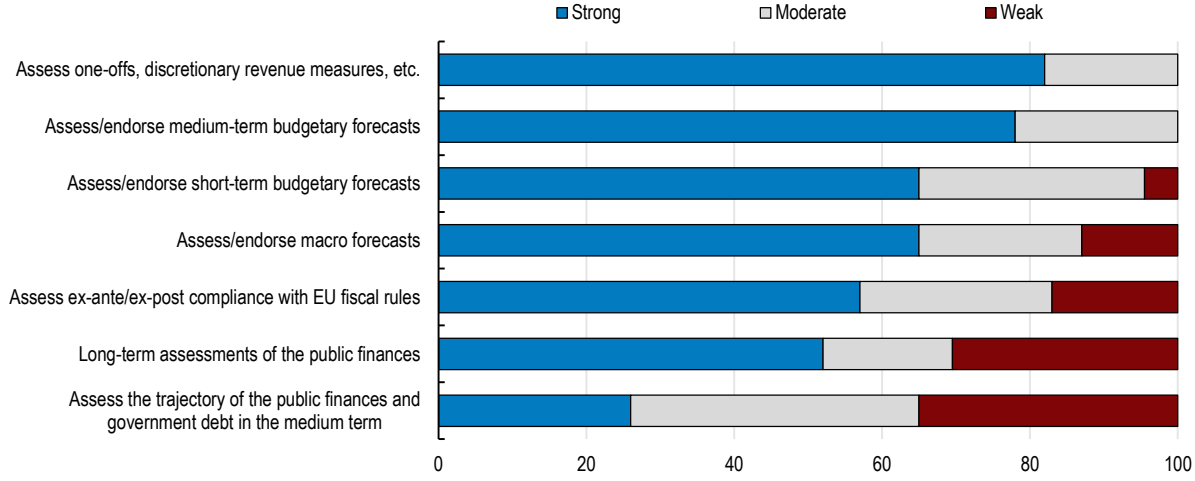
## Figure 1.17. The IFIs vary in their capacity

Shares of the level of IFIs capacity by type of task, %




Note: Based on the survey responses of 29 IFIs from 25 EU countries. The category 'strong' includes IFIs that reported having sufficient or complete capacity, and the category 'weak' includes all IFIs that reported having minor or no capacity to carry out the proposed tasks.
Source: Network of EU IFIs (2022).

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Sanctions for rules violations were not effective under the old rules and likely will not be in the future (Kirchsteiger and Larch, 2025[40]; OECD, 2023[41]). While the deficit-based EDP has been partly effective in reducing both large deficits and surpluses, this seems more related to increases in sovereign borrowing costs than the possibility of sanctions (Pench, 2024[32]). Under the new rules, sanctions were reduced, to limit their macroeconomic effect, and became more automatic, but the incentives for the Commission and the Council to avoid them remain in place. In any case, enforcement proceedings could provide a useful signal to markets even if fines ultimately do not materialise. A scale of escalation steps, set out by the Commission based on the extent of deviation from the agreed path, would help markets to reprice the risks gradually.

## Table 1.5. Past recommendations on macroeconomic policies

| Main recommendations of the 2023 Survey | Action taken since 2023 |
|---|---|
| Maintain a restrictive monetary policy stance, as needed and depending on data, to ensure inflation expectations remain firmly anchored and inflation decreases durably towards its medium-term target. | The ECB continued to tighten its monetary policy stance in 2023, increasing its policy rates by cumulative 200 basis points that year. Starting in June 2024, the ECB began to dial back the degree of monetary policy restriction. The balance sheet normalisation continues in parallel. |
| Continue to use macroprudential policy, including countercyclical capital buffers, to bolster resilience of the banking sector. | The ECB promoted further build-up of releasable capital buffer requirements in internal policy recommendations and in its publications, resulting in increased average rates of countercyclical capital and systemic risk buffers. The ECB also enhanced the methodology to assess capital buffers for other systemically important institutions starting in January 2025. |
| Implement prudent fiscal policy, consistent with the return of inflation to target, while ensuring that income support for high energy prices is temporary and targeted and preserves energy saving incentives. | Support measures related to the energy crisis were largely removed by end-2024.<br>EU countries were allowed to use national escape clause in the new fiscal framework to increase their defence capabilities by 1.5% of GDP per year from 2025 to 2028. |
| Refocus fiscal rules on debt sustainability and multiannual expenditure plans. | A new EU fiscal framework based on net expenditure as single operational indicator was adopted in April 2024. The required fiscal effort is tailored to national conditions using debt sustainability analysis. |

## Table 1.6. Main findings and recommendations (key recommendations in bold)

| Main findings | Recommendations |
|---|---|
| **Ensure that monetary policy is not relaxed prematurely** | |
| Headline inflation has fallen strongly, but services inflation has been sticky. As inflation normalises, monetary policy will have to become more forward-looking. | **Maintain a prudent monetary policy stance to ensure that inflation expectations remain firmly anchored and inflation returns to its medium-term target.** |
| **Address emerging vulnerabilities in the financial sector** | |
| Financial stability risks are increasing in parts of the financial system with exposures to commercial and residential real estate and among non-bank financial institutions. | **Address risks to macro-financial stability by using existing macroprudential tools and strengthen macroprudential supervision of non-bank financial institutions**.<br>Develop additional macroprudential tools, for example to address liquidity mismatches in investment funds. |
| **Continue fiscal consolidation while protecting public investment** | |
| Spending pressures will increase due to population ageing, the need to increase defense capacity and the green and digital transitions. | **Ensure implementation of prudent fiscal policy to rebuild fiscal buffers and prepare for long-term spending needs related to defence, ageing and the green transition.**<br>Within the limits of prudent fiscal policy, provide flexibility for defence spending, as needed. |
| The new governance framework provides for better, more counter-cyclical fiscal policy, but it is untested and despite the progress made it preserves some pro-cyclicality under adverse shocks. Its implementation requires additional guidance and supporting policies. | **Build credibility of the new governance framework through consistent implementation.**<br>Fully disclose the Commission methodology on debt sustainability analysis and the outputs of the new working group.<br>Strengthen the national IFIs by systematically monitoring countries' compliance with the IFI's independence safeguards. |

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EURO

# 2 Repurposing the EU budget for new challenges

Jan Stráský and Federico Giovannelli

*The EU budget needs to address objectives and priorities such as innovation and productivity as well as prospects of enlargement. Hence, the next Multiannual Financial Framework will likely have to involve both increasing the overall budgetary envelope and re-prioritising existing spending. In addition to reinforcing administrative capacity, cohesion policy spending would benefit from better prioritisation and more targeting at less developed regions. At the same time, the approach of the Recovery and Resilience Facility may not be the most suitable for regional policy and should be used with caution. Spending on agriculture is still dominated by direct payments that are not effective in protecting incomes and employment. More efficient and better administered CAP spending would free up resources in the EU budget for other priorities. Further strengthening the anti-corruption framework would help protect the EU financial interests and safeguard the EU budget from corruption and misappropriation.*

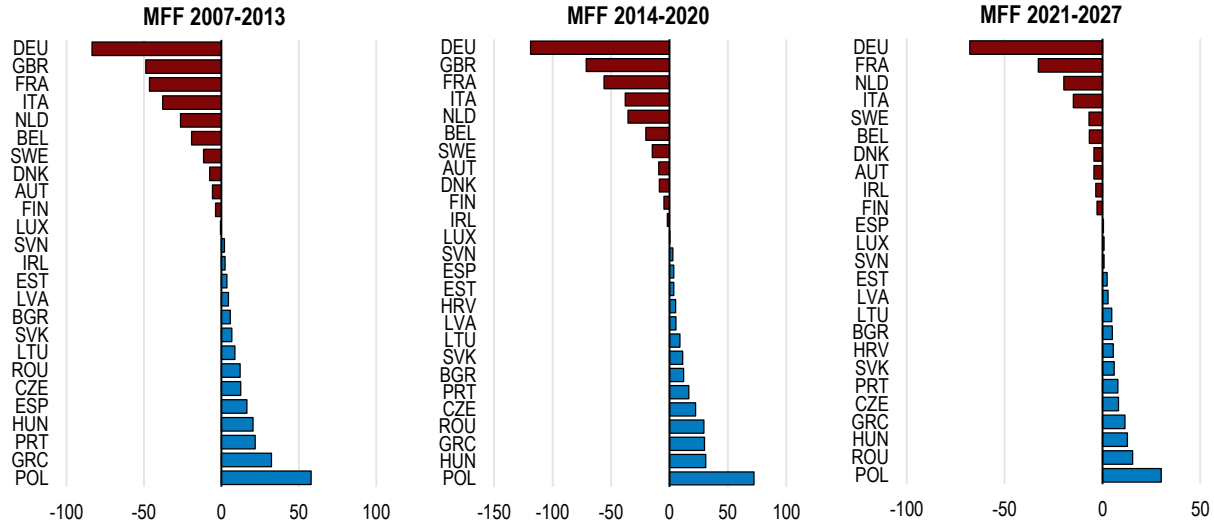
## 2.1. The EU budget remains limited

There is a growing need to reform the EU budgetary rules, reviewing both the budget size and the spending priorities. The EU budget is not sufficiently focused on public goods that are best provided at the EU level, as Cohesion Policy and Common Agricultural Policy (CAP) spending together represent more than 60% of the budget. Yet, a greater share of public investment could be co-ordinated and financed at the EU level, including spending on cross-border infrastructure, green R&D and public procurement for defence, as discussed in Chapter 4 and in the 2023 *OECD Economic Survey of the EU and the Euro Area*. Instead, budget resources are set to shrink. The Recovery and Resilience Facility (RRF) will expire in 2026, sharply reducing funding channelled into areas such as energy, decarbonisation and the digital transition. At the same time, the debt issued under the NGEU programme will have to be repaid starting from 2028, with interest payments already accruing.

The EU's annual budget is small, at about 1% of EU GDP or 0.89% of EU Gross National Income (GNI) in 2023. In addition, the Next Generation EU (NGEU) grants in 2023 amounted to just under 0.4% of EU GNI. Over the years, the distribution of net contributions to the EU budget has reflected differences in population and income. This measure, which does not capture cross-country spillovers and broader benefits of EU membership, has remained broadly stable, except for the departure of the United Kingdom (Figure 2.1).

### Figure 2.1. The distribution of net recipients has remained broadly unchanged

Net fiscal receipts from the EU budget, billion EUR




Note: Difference between EU budget receipts (excluding NGEU and European public administration costs) and contributions. The "rebate" ad hoc mechanism for the United Kingdom is deducted from its contributions. MFF 2021-2027 only includes data up to 2023. Expenditure that appears to go only to a Member State may benefit several or all of them given strong spillovers of EU expenditure, or provide a European public good.
Source: European Commission; and OECD calculations.

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EU countries unanimously agree on the overall envelope for annual EU spending. During the Multiannual Financial Framework (MFF) 2021-2027, the so-called own resources ceiling for each year is 1.4% of EU GNI, excepting NGEU debt service. The own resources of the EU budget comprise traditional own resources, such as customs duties and levies, a value added tax-based own resource and the non-recycled plastics packaging waste own resource and the GNI-based own resource. As the EU's budget must be balanced each year, the GNI-based own resource, which is a uniform fraction of national GNI collected by the EU as needed, acts as a balancing item after all other own resources and other revenue are deducted. It currently represents about 59% of EU budget revenues (EPRS, 2023[1]). Since it is the agreed size of expenditures that effectively determines the revenue, one could argue that there is a little difference between financing through the GNI-based own resource and other own resources determined by the underlying revenue base and specific formulas. However, designating new own resources could better align the budget to EU objectives and priorities and reduce net balance considerations of EU countries (the so-called *juste retour*). For example, the non-recycled plastic packaging waste own resource, while not increasing overall revenue

of the EU budget (since the balancing GNI-based contributions are reduced correspondingly), still incentivises national recycling policies (Buti, Darvas and Steinbach, 2024[2]). Moreover, to repay NGEU debt, the own resources decision (Council Decision 2020/2053) established a separate own resource ceiling of 0.6% of GNI up to 2058, which will have to be met either by new own resources or increased national contributions (see Chapter 1). In June 2023, the Commission amended its proposal for new own resources comprising 30% of proceeds from the ETS, 75% of revenues from the Carbon Border Adjustment Mechanism and additional transfers based on a new common consolidated corporate tax base (CCCTB), which would expand the existing revenue by about 0.2% of EU GNI (Bankowski et al., 2024[3]) and which the Council of the EU has not yet approved.

To meet additional spending on strategic priorities, including European public goods and defence spending, EU countries could decide to increase the EU own resources in line with the Commission's June 2023 proposal or set up a common fiscal capacity, similar to that discussed in the 2021 *OECD Economic Survey of the Euro Area*. For example, the Security Action for Europe (SAFE) instrument proposes an EU budget instrument to effectively contribute to defence financing. The next EU budget will also entail reprioritisation of current spending and reallocation of resources in support of competitiveness priorities. A new European Competitiveness Fund is to establish an investment capacity for commonly agreed EU public goods and multi-country investment projects with a strengthened policy steering mechanism (European Commission, 2025[4]).

### *2.1.1. Transition periods and built-in caps could help contain the cost of enlargement*

Following the Russian war of aggression against Ukraine and the sharp increase in geopolitical risk, EU enlargement has come to the fore again. While Moldova and Ukraine opened accession negotiations in 2024, progress of the Western Balkan countries has been slow. Support for administrative and institutional capacity building, already provided through the Instrument for Pre-Accession Assistance, could be reinforced by involving candidate countries in the European Semester process and the European Green Deal (Darvas and Grabbe, 2024[5]).

Estimating the budgetary cost of enlargement is difficult, as many relevant factors are not known. However, the existing studies suggest that, at least under current budgetary rules, the financial burden of further EU enlargement would be limited, in the range of 0.1% to 0.3% of EU GNI. This cost is mainly coming from an increase in the Common Agricultural Policy spending of up to 25% (Rubio et al., 2025[6]). Although the EU candidate countries are poorer than the EU average and more dependent on agriculture, recent quantitative assessments of the financial implications of enlargement agree that the hypothetical size of the new EU budget would be below 1.4% of EU GNI, the maximum level of own resources agreed for the MFF 2021-2027. For example, using population and GDP data and projections from 2020 and modelling reallocation of cohesion spending towards new EU regions, the inclusion of Ukraine, Moldova, Georgia and the six Western Balkan countries would increase the overall size of the current MFF budget from 1.12% of EU GDP to 1.23% (Darvas and Lopez, 2024[7]). Similarly, using the 2021 data and keeping the annual expenditure for all existing EU members constant, the accession of Ukraine, Moldova and the Western Balkans would increase the EU budget to 1.3% of the expanded EU's GDP (Lindner, Nguyen and Hansum, 2023[8]). The impact on net positions would be modest, as many net beneficiaries have already experienced a reduction in net transfers from the EU budget since 2021. Most net payers would need to contribute an additional 0.1% of their GDP to the EU budget. However, these estimates do not include the cost of future reconstruction of Ukraine.

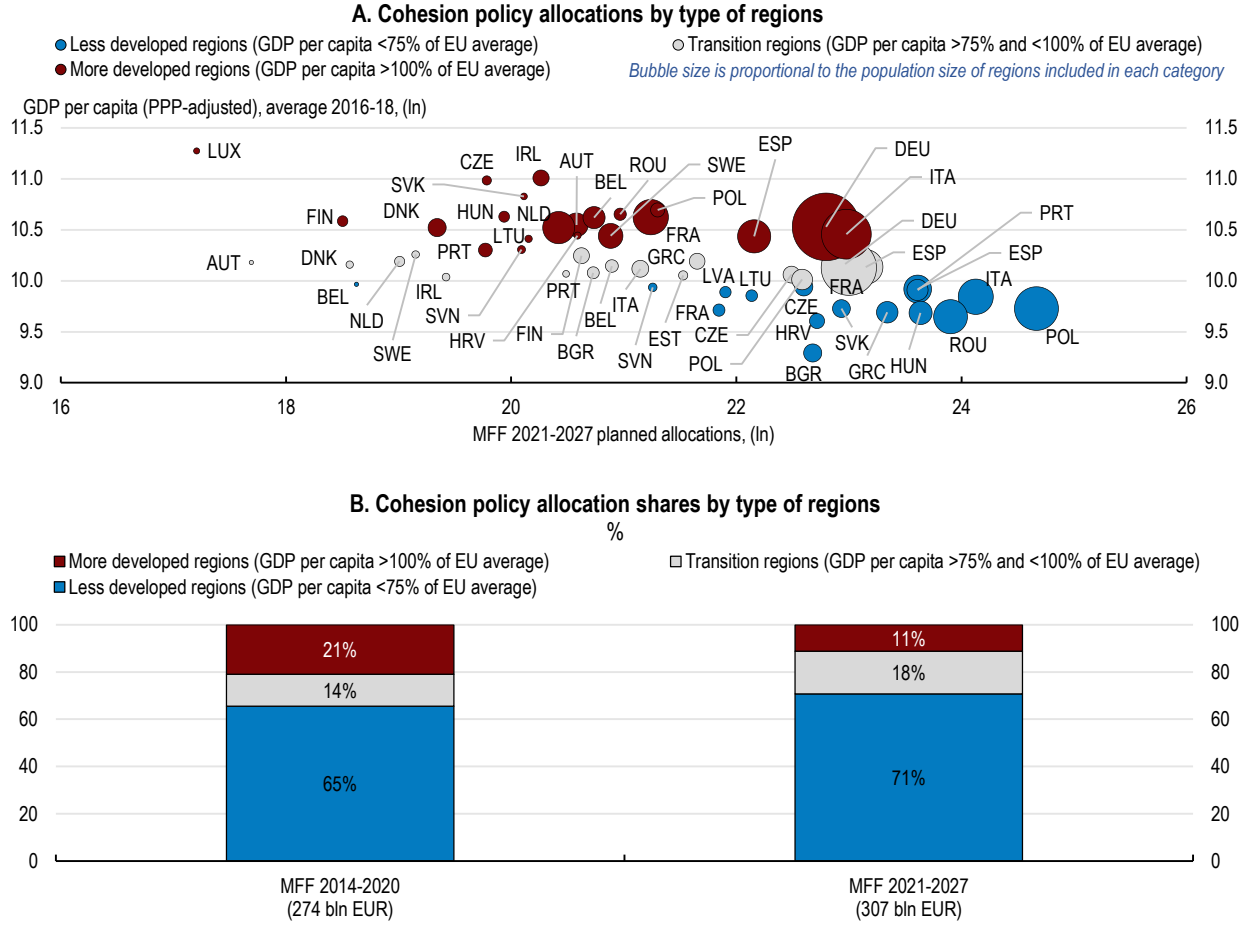
The budgetary impact under current financing rules could be further reduced by the introduction of long transition periods. For example, in the 2004 enlargement to Central and Eastern Europe, the EU phased in direct payments under the CAP to the new members over 10 years, starting at 25% of the final level, and the same practice of staggering direct payments over 10 years was followed in 2007 for Bulgaria and Romania and in 2013 for Croatia (Matthews, 2024[9]). Moreover, under the Common Provisions Regulation (CPR), there are caps limiting the amount any EU country can receive in cohesion funds. For the current MFF, cohesion funds going to any EU country cannot exceed 2.3% of national GDP or 107% of the national allocation in the previous programming period. The CPR also provides a safety net for cohesion policy funds for current beneficiaries, meaning that national allocations in 2021-2027 cannot be less than 76% of funds received in the previous MFF (Lindner, Nguyen and Hansum, 2023[8]). At the same time, extending the European Green Deal and other EU programmes to candidates, for example by increasing funding for the Western Balkans Growth Plan under the next MFF, could increase financing needs prior to the EU accession.

## 2.2. EU spending should become more targeted

### *2.2.1. Cohesion policy needs a sharper focus and better prioritisation of challenges*

The EU allocates almost a third of the Multiannual Financial Framework (MFF) to cohesion policy. For the 2021-2027 MFF period, structural and investment funds in the EU budget amount to EUR 392 billion, of which EUR 378 billion is allocated to cohesion policy including European Territorial cooperation. Together with national cofinancing, cohesion policy spending from the European Regional Development Fund (ERDF), European Social Fund Plus (ESF+), Cohesion Fund and Just Transition Fund sums up to EUR 527 billion (European Commission, 2024[10]). Importantly, Cohesion Policy funds are not limited to less developed regions (Figure 2.2). While most cohesion funds have gone to areas with GDP per capita below 75% of the EU average, the EU has since 2007 distributed funds across all EU regions, including the wealthiest (Box 2.1).

**Figure 2.2. Targeting of cohesion policy spending is improving but could be further strengthened**




Note: For all MFFs data refer to EU financing only (excluding national co-financing). In Panel A and Panel B, MFF 2021-2027 data refer to planned allocations over the whole budgetary period for the following funds: European Regional Development Fund (ERDF) and European Social Fund plus (ESF+). The data does not include payments to Outermost or northern sparsely populated regions and payments of Interregional funds, which form a part of the European Regional Development Fund (EDRF). In Panel B, MFF 2014-2020 data refer to allocations over the whole period for the following funds: European Regional Development Fund (ERDF) and European Social Fund (ESF).
Source: Open Data Platform for the European Structural and Investment Funds; Eurostat; and OECD calculations.

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### Box 2.1. Cohesion policy in the 2021-2027 Multiannual Financial Framework

In the 2021-2027 Multiannual Financial Framework, cohesion policy comprises four funds. The European Regional Development Fund (ERDF) and the European Social Fund Plus (ESF+) are the two largest instruments with initial allocations under the MFF 2021-2027 of EUR 309 billion. The EDRF aims at reducing economic disparities between regions, while also funding projects in the areas of innovation and competitiveness, climate neutrality and social inclusion. The ESF+ aims more specifically at reducing unemployment, promoting social inclusion and supporting workers training. Funds from the ERDF and ESF+ are distributed among three categories of regions, classified according to their GDP per capita in purchasing power parity terms relative to the EU average in 2018, "less developed regions" with GDP below 75%, "transition regions" with GDP between 75% and 100%, and "more developed regions" with GDP above 100% of the EU average. The initial allocations under the MFF 2021-2027, excluding payments to Outermost or northern sparsely populated regions and Interregional funds, amount to EUR 217 billion or 71% of the total to less developed regions, EUR 56 billion (18%) to transition regions and EUR 34 billion (11%) to more developed regions.

The other two funds are considerably smaller and more targeted. The Cohesion Fund supports investment in transport and environment infrastructure in EU countries with Gross National Income below 90% of the EU average and does not have any sub-national allocation key. The Just Transition Fund (JTF) supports regions and territories most affected by the green transition. Support from the Just Transition Fund can be allocated to specific territories in all EU countries based on factors such as industrial emissions and employment in fossil-fuel intensive sectors. Furthermore, a small subset of funds from the ERDF, about 3% of total cohesion policy spending, is reserved for projects that cut across regions and EU countries, under the name of Interreg.

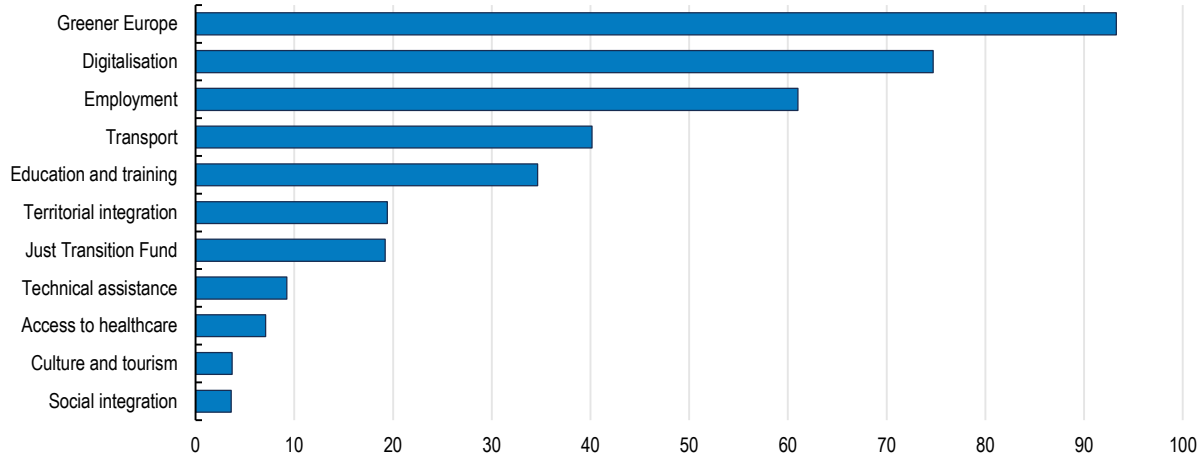
All cohesion policy spending is regulated by the Common Provision Regulation (CPR) and falls under shared management between the Commission and EU countries. The CPR sets the broad policy goals as well as common rules for allocation and implementation of the funds. EU countries and their regions are in charge of designing the specific programmes involving consultations with a range of stakeholders. Importantly, all cohesion policy is co-financed from national resources, with co-financing rates differing according to programmes and categories of regions.

Source: European Commission (2024[10]) and Redeker, Bischof and Lang (2024[11]).

Many regions struggle to spend the available funds due to considerable administrative burden and capacity constraints at the national and subnational level. Cohesion policy is complex and incorporates priorities that are not directly related to the objectives of reducing economic disparities and fostering social cohesion specified in the Treaty on the Functioning of the European Union (TFEU). For example, regional innovation and competitiveness were introduced in 2007 under the Lisbon Strategy and benchmarks for the digital transition and climate investment were added in 2014 (Figure 2.3). In addition, cohesion policy is sometimes used to address short-term spending needs triggered by unforeseen events, such as migration and the energy crisis (Schwab, 2024[12]). This broad scope undermines the effectiveness of cohesion policy, complicates its evaluation and burdens regional and national managing authorities. One way forward would be to ensure cohesion policy spending focuses on items with long-term growth benefits, such as education and training, innovation and infrastructure. For example, minimum standards for education capacities, medical services and elderly care, as well as transport and communication could be defined and cohesion funds targeted to provide them everywhere in Europe (Krieger-Boden, 2018[13]). In addition, cohesion spending could encourage cross-border collaboration under the Interreg programme or be channelled into Integrated Territorial Investments, which can be used to foster cooperation across municipalities in countries that lack legal frameworks to do so.

## Figure 2.3. What does Cohesion Policy finance?

Multiannual financial framework (MFF) 2021-27 by purpose, billion EUR




Note: Data refer to the following funds: the Cohesion Fund, European Regional Development Fund, European Social Fund Plus and Just Transition Fund.

Source: Open Data Platform for the European Structural and Investment Funds; and OECD calculations.

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Improvements in institutional quality and administrative capacities at national and regional levels are needed to ensure efficient use of cohesion funds. The Cohesion Policy framework emphasises accountability and protection of the EU's financial interest but leads to significant administrative burdens. Beneficiaries often hire specialist consultants to navigate the application and payment process. The new simplified payment schemes still require upfront work by managing bodies, which falls more heavily on low-capacity regions (Berkowitz, Storper and Herbertson, 2025[14]). Subnational governments often lack the skills and resources to carry out robust monitoring and evaluation, as even commissioning such work requires capacity for contracting and oversight (Mason, Nathan and Overman, 2023[15]). Reducing the number of instruments and harmonising implementation and reporting rules would help alleviate the administrative burden. Moreover, additional training for staff, improved policies to recruit and retain talent as well as stronger partnerships with intermediate bodies and beneficiaries would help improve the implementation of various Cohesion Policy programmes (OECD, 2020[16]).

Empirical evidence is mixed, but many studies show that cohesion policy has a positive impact on regional GDP growth, or, a usually less pronounced, impact on regional employment and productivity, often with substantial cross-country heterogeneity (Bachtrögler, Fratesi and Perucca, 2020[17]; Crescenzi and Giua, 2020[18]). Other studies find positive effects conditional on further determinants, such as human capital or institutional quality (Rodríguez-Pose and Garcilazo, 2015[19]). Moreover, research on opportunity zones in the United States and regions in the United Kingdom shows that the economic benefits of place-based policies are greater in distressed areas, suggesting that targeting more economically deprived regions may enhance both equality and the return on cohesion spending (Bartik, 2020[20]; Di Cataldo and Monastiriotis, 2020[21]). For example, cohesion policy spending in the wake of the 2008 financial crisis effectively protected public investment in many Southern European countries, while supporting GDP growth (OECD, 2020[22]). However, there is also growing evidence that cohesion spending is insufficiently targeted, leading to slowdown in convergence in vulnerable regions (Diemer et al., 2022[23]). First, inequality within regions seems to be a more important driver of the overall inequality in Europe than inequality across regions. Second, although cohesion policy spending raises average incomes in the targeted regions, these gains seem to accrue more strongly to higher-income households (Redeker, Bischof and Lang, 2024[11]). Using combined data from 260 national household surveys covering 231 European regions, the authors show that place-based funds tend to boost labour incomes of the highly skilled.

Although this would be politically challenging, a greater share of cohesion funding could be focused on less developed regions with a GDP per capita of less than 75% of the EU average. For example, spending under the ERDF and the ESF+ programmes currently allocated to transition and more developed regions, with GDP above 75% of the EU average, could be redirected towards less developed regions or into an EU-level investment instrument

targeting cross-border infrastructure projects, in addition to other instruments such as the Connecting Europe Facility (CEF), and other EU-wide priorities. Such targeting would keep regions in most EU countries eligible for cohesion funds. If cohesion spending under the current MFF were to be redirected fully towards NUTS-2 regions that contain at least one NUTS-3 region with GDP below the 75% threshold, Denmark, Finland and Sweden would become not eligible for it.

### *2.2.2. The experience with the Recovery and Resilience Facility is mixed*

The Commission has proposed a new approach to the EU budget, built around a plan for each country with key reforms linked to investments, and focusing on joint priorities, including promoting economic, social and territorial cohesion (European Commission, 2025[24]). The approach seems inspired by the national Resilience and Recovery Plans. However, the approach used to implement the Recovery and Resilience Facility (RRF) may not be the best one for regional development policy. On the one hand, the RRF supported the implementation of structural reforms by combining complementary reforms and investments in a single plan, significantly advancing the implementation of country-specific recommendations under the European Semester. On the other hand, the RRF did not bring the administrative simplification that was hoped for and sufficient involvement of regional and local authorities in its implementation (European Commission, 2024[25]). However, Cohesion Policy so far relied on multi-level governance, involving national, regional and local authorities in identifying regional priorities.

Hence, the lessons from the RRF need to be applied carefully in the context of Cohesion Policy, for several reasons. While policy execution may be accelerated, the approach may fail to identify the best local development strategies. In addition, there is the issue of conditionality, which should in principle be addressed to the same level of government as the policy support. Regions may benefit from a cash-for-reforms approach similar to that of the RRF, provided that such conditions and recommendations can be acted upon by the regional level of government. The recommendations under the European Semester, which are mainly directed at national governments responsible for systemic reforms, such as labour market or pension reforms, may not be most suitable for this purpose, as the regions may lack the policy levers to implement them.

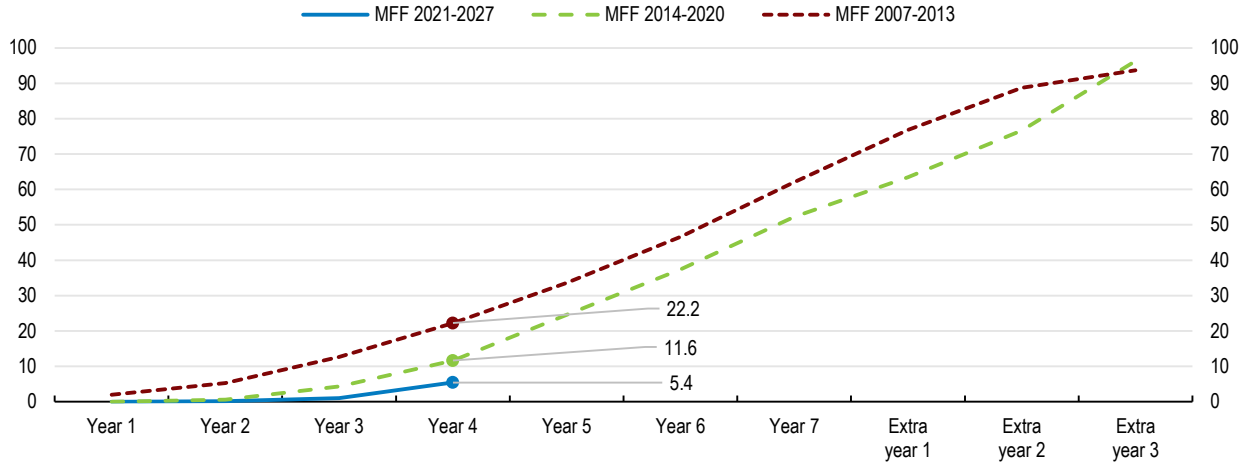
Another concern is how to implement output-based budgeting. The RRF Regulation and the implementation guidance do not require reporting on results, also because of the short life of the programme, which will end in 2026. However, a full ex post evaluation is planned for 2028. Hence, milestones and targets under RRF are defined as measures of progress towards a reform or an investment, which is not the same as achievement of measurable results that are sometimes beyond the control of government and slow to materialise. Although the data on milestones and targets are closely monitored, there is only limited reporting on common indicators monitoring progress towards the RRF's objectives (ECA, 2023[26]). At the same time, national recovery plans are rather heterogenous: some include many result indicators, while others, such as those of Germany and France, rely heavily on input indicators (Darvas and Welslau, 2023[27]). To improve effectiveness, the EU should use its existing policies and the RRF experience to continue developing performance-based instruments, focused on achieving results. For example, common output and results indicators for regional policy formulated in Regulation (EU) 2021/1058 on the European Regional Development Fund and the Cohesion Fund could be useful in designing harmonised result indicators for EU countries.

The problems with absorbing the RRF funds can to some extent be explained by supply-side bottlenecks and effects of higher-than-expected inflation in the initial years of the programme as well as the need to include the RePowerEU chapter in the national plans in 2023. Aside from these shocks, the RRF spending, currently at 47% of the total, was slowed down by limits on the administrative capacity to spend, which are similar to those under Cohesion Policy. The need to administer performance-based spending under the RRF and cost-based spending under Cohesion policy in parallel may have exacerbated the low absorption rates in the current MFF (Figure 2.4). In some EU countries, the absorption may have suffered from the lack of administrative resources for tenders and procurement. To address these difficulties, efforts to improve national administrative capacities, for example by improving public procurement, permitting procedures and digitalisation of public administration, should continue (European Commission, 2024[28]). In addition to the delays in the absorption of RRF funds, there are also risks to the completion of agreed measures in the second half of the programme when actions shift from reforms to investment, further increasing the risk of delays. Moreover, the RRF Regulation does not specify a procedure for the recovery of funds paid out for achieved milestones and targets if measures are not completed (ECA, 2024[29]). To address these risks,

the Commission should provide additional support and guidance to address any remaining uncertainties identified by EU countries. Together with national authorities, the Commission could also identify the RRF projects most at risk of non-completion by 2026 and agree actions to overcome the delays to mitigate the risk of funding measures that will eventually not be completed. These actions and lessons from the RRF implementation should also be reflected in further efforts by the Commission to design instruments based on financing not linked to costs (ECA, 2024[29]). Another option for improving the RRF approach to delivery of EU funding would be a stronger role for multi-stakeholder Monitoring Committees responsible for oversight and evaluation of cohesion policy spending, in which Commission representatives participate as observers (Zeitlin, Bokhorst and Eihmanis, 2023[30]).

### Figure 2.4. Absorption of cohesion funds is slow

Fraction of cohesion funds spent at year-end under the last three Multiannual Financial Frameworks, %




Source: Open Data Platform for the European Structural and Investment Funds; and OECD calculations.

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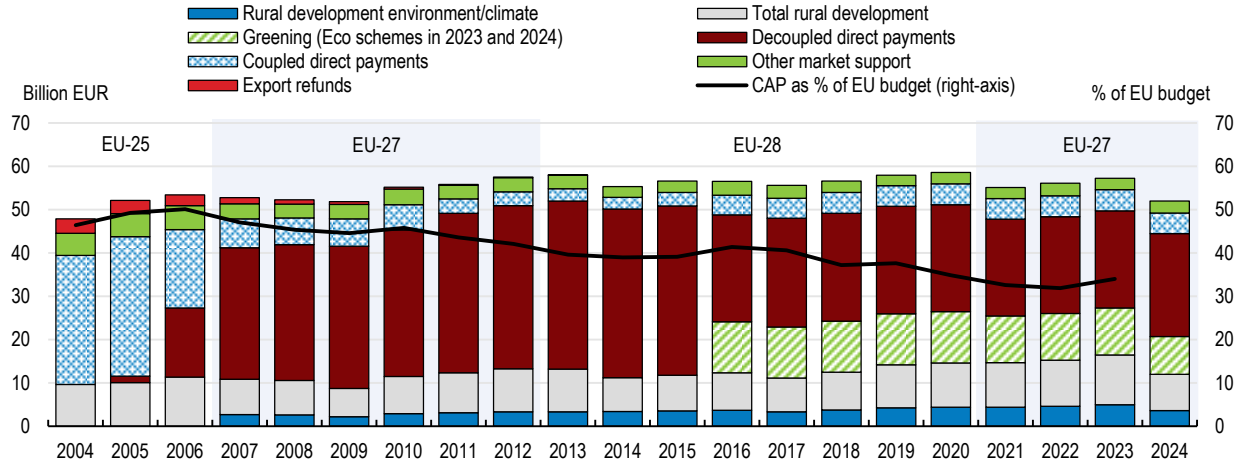
## *2.2.3. Spending on agriculture should be rationalised*

The Common Agricultural Policy (CAP) covers multiple objectives including income support for farmers, a stable supply of affordable food, tackling climate change and protecting biodiversity and the environment (Figure 2.5). The absolute budget figure for the CAP more than doubled between 1990 and 2010, partly reflecting the 2004 Eastern enlargement of the EU, but remained relatively stable since then. At the same time, CAP expenditures as a share of the total EU budget declined sharply from 62% in 1990 to 32% in 2021. The latest CAP reform was fully implemented in January 2023. The new delivery model applied in the period 2023-2027 has brought both pillars of the CAP under a single strategic planning process centred around the national CAP Strategic Plans (Box 2.2).

## Figure 2.5. Income support through direct payments still dominates CAP expenditure

CAP expenditure by broad category, EUR billion




Note: Next Generation EU funds are excluded when calculating CAP's share of EU budget.
Source: European Commission, CAP expenditure database (accessed on 28-Jan-2025).

StatLink https://stat.link/72vwzn

Empirical evidence on the effects of CAP direct payments is mixed. Although direct payments seem to have limited positive effect on the level or stability of farm income, their contribution to broader resilience capacities is more doubtful (Sauer and Antón, 2023[31]). Even the farm income stabilisation feature is not fully effective, as direct payments were found to be capitalised in the value of land and land rents, hence benefiting other stakeholders than farmers (Varacca et al., 2022[32]). Moreover, direct payments are not designed to deal with variation of income over time. Payments are made to farmers when prices are low, but also when prices are high. Moreover, the payments are not targeted to farms that experience the greatest income variability (Severini, Tantari and Di Tommaso, 2016[33]). The literature does not agree on the impact of CAP payments on agricultural employment. Some studies find a positive impact, depending on the type of payment, while others find a negative impact; see (Bojnec and Fertő, 2022[34]) and (Schuh et al., 2019[35]) for reviews. Generally, the identified effects tend to be small (OECD, 2023[36]).

Direct payments under Pillar 1 should be targeted to the achievement of specific objectives rather than provided as a general entitlement to farmers. Such targeted payments could be linked to specific needs and identified market failures, such as risk management, competitiveness and the provision of public goods, including climate change adaptation and mitigation. For example, the CAP crisis measures, including the agricultural reserve, could be beefed up and the eligibility for certain emergency aid programmes made conditional on producers' participation in risk mitigation schemes (Mahé and Bureau, 2016[37]). Similarly to the cohesion spending, to reduce inequality both between and within countries, the CAP support needs to be re-directed from the richest to the poorest EU countries and from the richest to the poorest farm households within a country (Marino, Rocchi and Severini, 2024[38]). Given the dependence of many farms on direct payments as a major source of income, transitional provisions could be made for the continuation of the support during the next programming period, before phasing it out. Moreover, the existing rule for returning unused Pillar 1 funds to the EU at the end of each year should be replaced by a multi-year rule (Grethe and Chemnitz, 2023[39]).

The EU could reduce and rationalise the CAP spending in several ways. Notably, following the mid-term review of the current MFF, the EU countries decided to redeploy EUR 1.1 billion from the CAP and cohesion funds to other programmes. Although the national CAP budgets were not reduced as EU countries agreed instead to reduce the operating costs funded by the EU budget, the drive to improve ex ante and ex post assessment of CAP expenditures should continue. It is welcome that the Commission will undertake the first biannual review of the national CAP Strategic Plans in 2025 and in case of a significant deviation from a milestone will be able to enforce a specific remediation action plan or withhold payments. However, such a corrective process is unlikely to be applicable before 2027, when the current MFF ends (Guyomard et al., 2024[40]). Other possible policy tools include a robust monitoring, reporting and verification system at the farm level and an EU-wide benchmarking system to increase the harmonisation of sustainability metrics and indicators (OECD, 2023[41]).

## Box 2.2. The EU's Common Agricultural Policy between 2023 and 2027

### The CAP remains focused on direct payments

For the 2021-2027 financing period, EUR 387 billion in funding has been allocated to the CAP. This represents 32% of the EU budget excluding Next Generation EU funding (19% of the budget including the NGEU). 75% of funds, EUR 291 billion, are allocated to the European agricultural guarantee fund (EAGF, the first pillar of the CAP), which mainly provides direct income support to agricultural producers. A small share of 5% of Pillar 1 funds is also used to intervene in certain agricultural markets in case of adverse price shocks. Until 2003, direct payments to farmers were based on production volumes. Since then, such payments based on production were reduced and replaced by payments based on eligible hectares.

The remaining EUR 96 billion, which includes the NGEU top-up of EUR 8.1 billion, are allocated to the European fund for rural development (EAFRD, the second pillar of the CAP), which finances rural development activities as well as environmental and climate objectives. It requires national co-financing of at least 40% by EU countries.

About 95% of the CAP budget is implemented under so-called shared management. The EU Commission monitors the work of national agencies and is accountable for the use of EU funds, while EU countries are responsible for making payments and carrying out checks on recipients. The remaining 5% is implemented under direct management by the Commission.

### The new delivery model

To increase national responsibility and accountability, EU countries were asked to develop CAP Strategic Plans (CSP) outlining their proposed interventions for 2023-2027. The 28 CSPs (one for each EU country, except for Wallonia and Flanders in Belgium) include the ambition of the European Green Deal and the Farm to Fork Strategy to dedicate 40% of total CAP spending to climate action. For example, a third of all direct payments under Pillar 1 have since 2015 been subject to compulsory agricultural practices beneficial for the climate and environment (green direct payments). In addition, all direct payments to farmers are subject to meeting certain environmental and public health standards. Furthermore, as of 2023, a quarter of the direct payments is dedicated to eco-schemes providing stronger incentives for environmental-friendly farming practices, such as organic farming. Greater subsidiarity allows EU countries and regions to better take account of local conditions and decide how to tailor CAP interventions to maximise their contribution to EU objectives. This programming approach is applied to interventions under both CAP pillars, not only to rural development interventions, as previously.

The key governance challenge of the new model is to ensure that the incentives and targets at the national level are also transmitted at the farm level, because required changes at the EU level will only be achieved with changes in actual farming practices. This will depend on several factors, including the improvement of monitoring and evaluation systems and the availability of data.

Source: OECD (2023[36]) and OECD (2023[42]).

At the same time, the rationalisation will require a simplification of the CAP for both beneficiaries and administrations and a reduction of the associated administrative burden. The evidence from the CAP implementation at national level suggests improvements are needed in the application phase, in the implementation phase, as well as in the monitoring and control phase. In the application phase, it is mainly the number of application requirements and the lack of clear communication with beneficiaries. In the latter phases, the main issue is the overlap of processes and reporting requirements, together with the lack of proportionality of checks and the perceived lack of transparency (European Commission, 2025[43]). However, the efficiency benefits of simplification need to be weighed against the possibility of compromising the effects of interventions.

National co-financing is another accountability mechanism that could help rationalise the CAP, which already exists in Pillar 2 of CAP spending and in other EU spending such as the cohesion spending. Requiring co-financing for direct payments under Pillar 1 would ensure that agricultural funds are used more efficiently, while releasing budget resources for new EU priorities or returning funds to national budgets. When local taxpayers fund a fraction, say,

50% of a specific agricultural or rural development programme, they have a material interest in ensuring value for money. In addition, national spending must be approved through a budgetary process under the control of the Ministry of Finance, providing oversight by non-agricultural interests on how agricultural funds are used. Such oversight is missing under the current rules where EU funds earmarked for agriculture are primarily allocated by Ministries of Agriculture (Matthews, 2016[44]).

## 2.3. Protecting the EU budget by strengthening the anti-corruption framework

Protecting the EU financial interests and safeguarding the EU budget from corruption and misappropriation is crucial. In this regard, fighting corruption is among the top priorities of the Commission, as it is an important determinant of economic growth, efficient allocation of resources, as well as economic and social equality. A strong anti-corruption and public integrity system ensures that citizens rely on impartial institutions that create rules and conditions for a fair distribution of resources and the creation of a dynamic and transparent business environment, hence attracting investment and strengthening economic growth (OECD, 2023[45]; OECD, 2022[46]; OECD, 2024[47]). To this end, the Commission has continued to put in place several initiatives and measures to tackle corruption, such as the proposal for an anti-corruption package, the review of the anti-fraud architecture, the adoption of the new Anti-Money Laundering legislation, and the establishment of an EU-wide independent ethics body, ultimately aiming to protect the EU's financial interest and to ensure a transparent and accountable allocation of resources. However, the control and prevention of corruption still poses challenges and perceptions vary across EU countries (Figure 2.6).

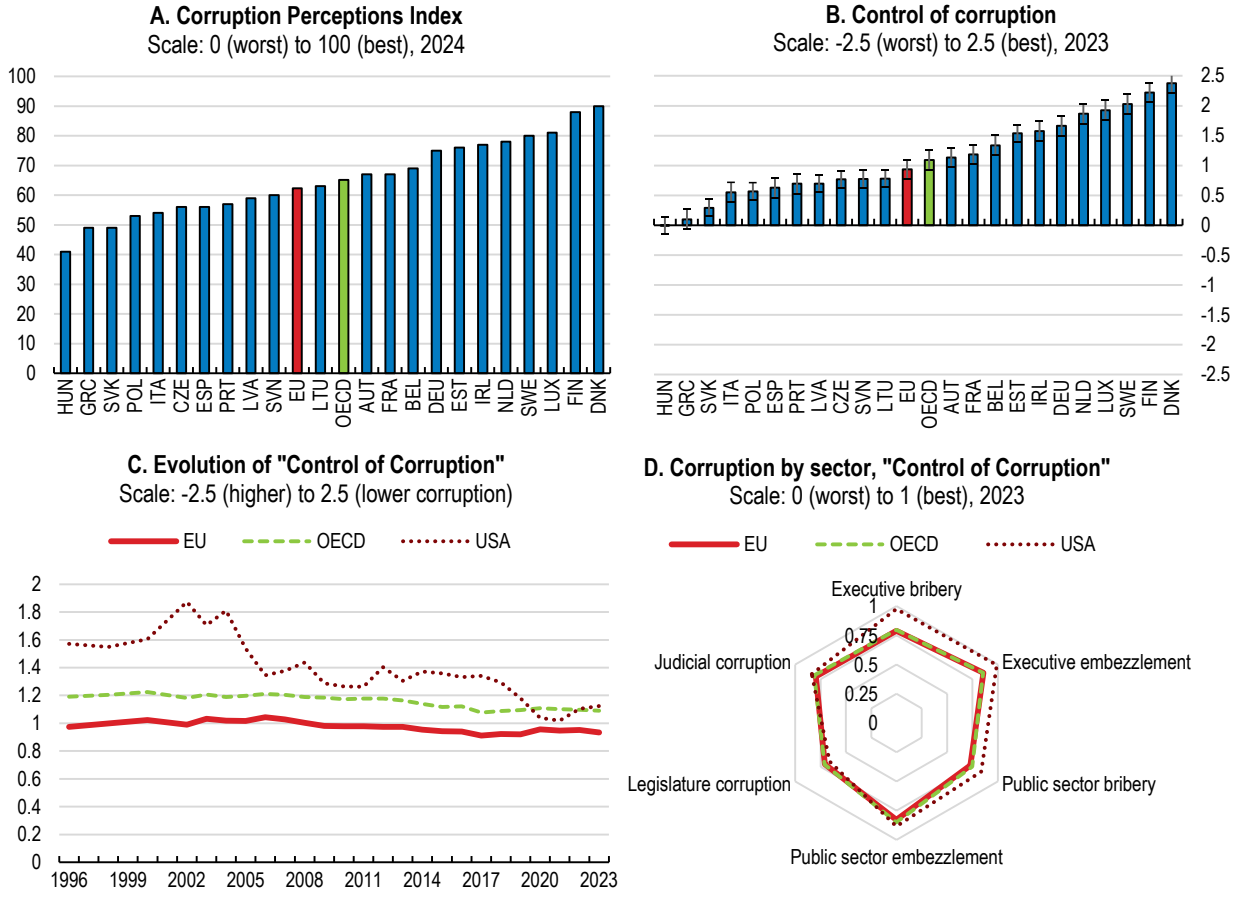
The Commission launched its latest anti-corruption package proposal in May 2023. The package includes a proposal for a Directive on combating corruption through criminal law and the establishment of a dedicated sanction regime to target "corruption worldwide" under the Common Foreign and Security Policy (CFSP). More importantly, the Directive foresees anti-corruption rules applying to both the private and public sectors in a single legal instrument for the first time (Council of the EU, 2024[48]; European Parliament, 2024[49]). The proposal seeks to update the EU anti-corruption framework and make it more effective, building on the already existing instruments, such as the Framework Decision 2003/568/JHA on Corruption in the Private Sector, the 1997 Convention on Combating Corruption against Officials of the EU or EU Member States, and the Directive on the fight against fraud to protect the Union's financial interests by means of criminal law (the "PIF Directive"). All in all, the new Directive aims to align the legislation on forms of corruption and harmonise penalties across countries, by also strengthening prevention and enforcement tools, as discussed in the *2023 OECD Economic Survey of the European Union and euro area* (OECD, 2023[50]; Eucrim, 2024[51]).

In January 2024, the Parliament's Committee on Civil Liberties, Justice and Home Affairs adopted its opinion on the package. Compared to the original Commission's proposal, the opinion suggested to make penalties stricter and broaden the scope of the criminal liability, such as the extension of the definition of "national official" to include any individual performing public service duties and the classification of members of the EU Parliament as "high-level officials" to be subject to more severe rules (European Parliament, 2025[52]; European Parliament, 2024[49]; European Parliament, 2024[53]). The Parliament also proposed amendments for more detailed measures on conflict of interest, lobbying and "revolving doors", additional categories of offences, and mandatory national anti-corruption strategies to be reviewed periodically in consultation with a varied range of stakeholders. Subsequently, the Council adopted its opinion in June 2024, narrowing the scope of the Commission's proposal. For example, the Council required to limit the "abuse of function" offence to the public sector only and to make its criminalisation optional. Moreover, the Council emphasised the importance of granting institutional and administrative autonomy to EU countries, for example where the proposed Directive requires the establishment of specialised bodies for the prevention and repression of corruption, as well as of respecting the national constitutional principles on privileges and immunities where the Directive asks for appropriate procedures to lift them (Council of the EU, 2024[54]).

In January 2025, the newly elected Parliament confirmed the opinion adopted in 2024, opening the way to "trilogue" negotiations on the anti-corruption Directive. Given the different views of the two co-legislators, the Council and the Parliament, the Commission should steer trilogue negotiations as close to the original proposal as possible to avoid restricting its scope and compromising the original aim of the reform, namely optimising and

strengthening the existing EU anti-corruption legislative framework. At the same time, success of the reform hinges on cooperation of EU countries.

## Figure 2.6. Corruption perception across EU countries varies but could be reduced further




Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project.

Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Project, V-Dem Dataset v12.

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Another positive feature of the anti-corruption reform package is the alignment to the principles of the United Nations Convention Against Corruption (UNCAC), such as the recognition of the corruption crimes agreed internationally under the UNCAC (European Commission, 2025[55]). The UNCAC is a legal anti-corruption instrument to which the EU, recognised as a state party, committed in 2008, whose membership involves a two-phase implementation review. The first phase started in 2023 and covers the implementation of important articles of the UNCAC on criminalisation and law enforcement, as well as international cooperation (European Commission, 2020[56]). The finalisation of the first phase of the review is expected in 2025 with a report including recommendations on how to comply with UNCAC standards. Afterwards, the second phase of the review process will start, with a focus on prevention measures and cross-border asset recovery (United Nations, 2024[57]).

In parallel to the review process, the EU and UNODC established the Anti-Corruption Dialogue held annually since 2022. The initiative provided an opportunity to discuss possible synergies, including staff exchange, and share good practices in the fight against corruption (European Commission, 2023[58]; European Commission, 2024[59]). The Commission, the UNOCD and other international organisations, including the OECD, also cooperate in the framework of the EU Network against corruption, established by the EU in 2023 to discuss corruption issues and solutions with various stakeholders in the EU, as well as in the Anti-corruption partnership Forum, aiming to foster information exchange among and reduce administrative burden for reviewed countries (Eucrim, 2023[60]; United

Nations, 2024[57]). It is important that the Commission continues its partnership with the UNODC and concludes the UNCAC implementation review, with the ultimate aim to improve the EU legal anti-corruption framework by introducing good practices and international standards that may currently be lacking.

In the area of protection of the EU's financial interests, the 2023 anti-corruption package proposal foresees a possible amendment of the 2017 PIF Directive, by tightening penalties for both natural and legal persons, increasing the spectrum of aggravating and mitigating circumstances, and extending statutes of limitation (Eucrim, 2023[61]; European Union, 2017[62]). The proposal also includes plans for a generic assessment of the PIF Directive to evaluate the possible extension of its scope in terms of corruption offences. Currently, there are several infringement procedures ongoing, mainly in relation to the non-conformity of transposition of the definition of criminal offences, sanctions and limitation periods provided by the PIF Directive. To protect the financial interests of the European Union by means of criminal law and to create the basis for potential future amendments stemming from the new anti-corruption package, EU countries should complete and speed up the correct transposition of the 2017 PIF Directive.

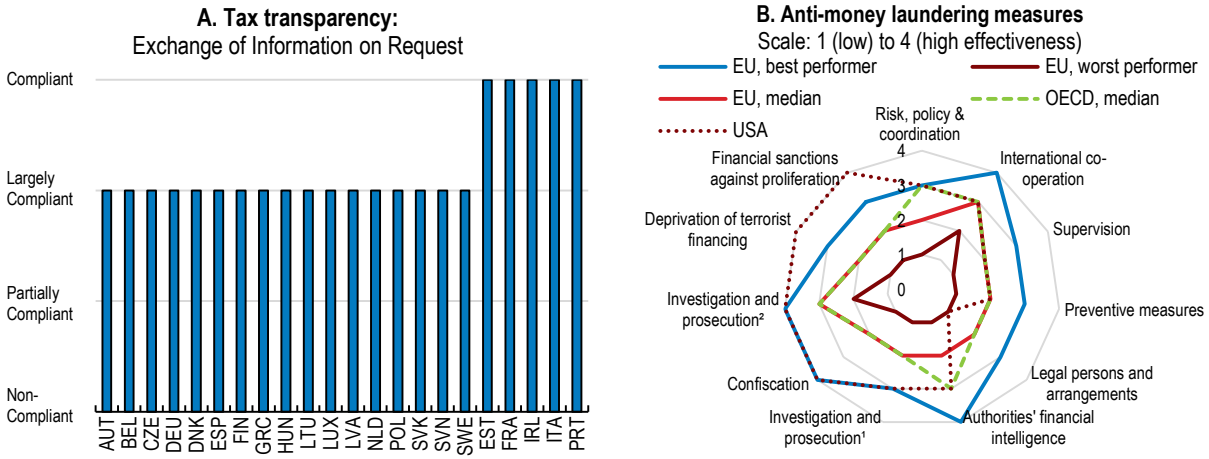
The rules established by the PIF Directive lay the foundations for the competences of the European Public Prosecutor's Office (EPPO). The EPPO is responsible for investigating and prosecuting crimes affecting the EU's financial interests, including corruption cases that damage the EU budget and misappropriation of EU funds (EPPO, 2025[63]). Twenty-four EU countries have joined the EPPO so far, with two of them in 2024 (i.e., Poland and Sweden). EPPO membership is not mandatory for EU countries but bilateral cooperation has been established with non-participating EU countries (i.e., Denmark, Hungary and Ireland). Cooperation has also been established with non-EU countries, such as Switzerland, the United Kingdom and the United States (Council of the EU, 2024[64]). The EPPOs' global perspective is particularly important since national investigation and public prosecutor's offices do not often have adequate resources to deal with sophisticated criminal organisations. The EPPO also cooperates closely with the European Union agencies for criminal justice cooperation (Eurojust) and for law enforcement cooperation (Europol), as well as with the European Anti-Fraud Office (OLAF), which conducts administrative investigations into fraud, corruption and any other illegal activity affecting the EU budget.

In 2024, the EPPO processed more than 6500 crime reports, an increase of 56% compared to 2023, with active investigations into damages estimated at more than 24 billion euro, of which 53% related to cross-border VAT fraud and 11% to the Next Generation EU funding (EPPO, 2025[65]; EPPO, 2025[66]). The discussion whether EPPO's competences should be extended, notably to crimes that have a cross-border nature, has been inconclusive so far. The Directive on the violation of the Union restrictive measures, which entered into force in 2024, makes explicit reference to the need for "Member States, Europol, Eurojust, the European Public Prosecutor's Office and the Commission, within their respective competences", to cooperate to fight the criminal offences set in the Directive. The Directive is a step forward for the implementation and enforcement of EU sanctions, for instance in the context of Russia's war of aggression against Ukraine. The Parliament's call for extending EPPO's current competencies to these violations were so far not successful (Eucrim, 2024[67]; European Parliament, 2024[68]; European Union, 2024[69]). Given the EPPO's effectiveness and expertise in the investigation and prosecution of cross-border crimes**,** trilogue negotiations for the adoption of the anti-corruption reform package should further assess the EPPO's area of intervention and consider extending it, especially in view of a possible extension of the scope of the PIF Directive (see above).

For the preparation of the next MFF, commencing in 2028, strengthening the EU's anti-fraud framework is a priority for the new Commission to further protect the EU budget, recognising the central role of the EPPO and OLAF (European Commission, 2024[70]). In this regard, the Commission is currently reviewing the EU anti-fraud architecture, for instance by assessing the necessity to amend the mandate of OLAF to make EU law enforcement more effective in EU countries, by ensuring that the EPPO has the necessary support and resources to perform its activities and by strengthening the Commission's cooperation with the EPPO to speed up the recovery of EU funds. The review also foresees the possible development of a framework for timely and effective information exchange among EU's bodies ensuring the protection of the EU's financial interests, such as the EPPO and OLAF, as well as Eurojust and Europol. In this context, the application of the 2021 Conditionality Regulation also remains a priority. More specifically, this legal instrument makes the payments from the EU budget to countries conditional to the respect of the 'rule of law' principles, such as the non-arbitrary use of power and the independence of the judicial system.

The Commission recently finalised the adoption of other important reforms in the area of protecting the EU's financial interests. In 2024, the comprehensive reform on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CTF) was adopted, as a result of trilogue negotiations following the Commission proposal in 2021 discussed in the *2023 OECD Economic Survey of the European Union and euro area* (OECD, 2023[50]). The application of the new rules, including the transposition of the new Directive (6th AML Directive) and the Regulation, will be gradual and should be completed by July 2027 (Figure 2.7). The adopted package has broader scope than the Commission's proposal. For instance, the AML rules will also regulate professional football clubs and football agents. According to a recent study of the Commission, the sport sector is one of the highest risk areas of corruption (European Commission, 2024[71]). In addition, the new AML Authority will have a double role, both in terms of supervision and facilitation of the cooperation among EU financial intelligence units (FIUs). Compared to the initial proposal, the Authority staff resources were doubled.

## Figure 2.7. There is scope to strengthen Anti-Money Laundering measures




Note: Panel A summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdictions' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows results from the ongoing second round when available, otherwise first round results are displayed. Panel B shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing.

Source: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

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To further improve EU's financial interests safeguards, an amendment (recast) of the Financial Regulation was adopted in September 2024 (European Union, 2024[72]). It extends the scope of the Early Detection and Exclusion System (EDES), the EU's debarment tool to detect early and exclude entities putting at risk its financial interests from EU funding, for specific reasons such us breach of obligations relating to the payment of taxes, bankruptcy, fraud and corruption. According to the new rules, the system will also apply to EU funds disbursed under shared management with member states (representing around 75% of EU programmes) for the most serious misconducts such as corruption, fraud and terrorist offences, for programmes adopted or financed as of 1 January 2028. Previously, EDES only applied to EU funds under direct or indirect management, covering only 24% of the EU budget. As in the past, also with the new measure, the obligation of national authorities to exclude EDES-debarred entities from funding only applies to EU funds allocation, but not to funding from national budget. Exclusion from national funding remains at the countries' discretion, despite the European Parliament's recommendation to the contrary. Moreover, the publication of EDES's exclusion decisions is considered an additional measure when facts are serious enough and significantly harm EU's finances, but this should be balanced against the need to protect investigations, individuals, and proportionality (Council of the EU, 2024[73]). In practice, the publication of information contained in the EDES list is not permitted if this compromises the confidentiality of an investigation, where this concerns a

natural person, or is disproportionate in terms of damage caused. However, the new Regulation remains unclear on how such criteria, namely "the seriousness of the conduct or its impact on the financial interests of the Union", should be assessed and identified. Clearer rules and guidance should be provided on how exception criteria set by the Financial Regulation should be interpreted and applied to publication of information on the EDES list.

Measures have also been taken to strengthen public integrity in EU institutions. Following the December 2022 corruption scandal allegedly involving some Members of the European Parliament (MEP), measures were adopted to tighten existing internal rules on transparency and lobbying. These were followed by even more stringent rules, adopted in September 2023, on MEP's asset declarations and lobbying activity with a potential direct impact on EU's decision-making processes (European Parliamen, 2024[74]) (Atlantic Council, 2024[75]). More importantly, in May 2024 an EU-wide independent ethics body was established, as a result of an EU inter-institutional agreement (European Union, 2024[76]) (European Commission, 2023[77]) (European Commission, 2023[78]). The new body will develop, update and promote a common code of conduct to ensure ethical behaviour across the EU institutions (Eucrim, 2024[79]). However, the body will only be able to issue non-binding opinions on ethics-specific cases, which may be raised exclusively on the own initiative of one of the founding institutions. The body does not have power to enforce integrity rules, nor the possibility to recommend sanctions for misbehaviour. As these powers remain in the hands of the EU institutions themselves, it is possible that the credibility of the new body and its ability to strengthen EU's institutional integrity be weakened (Transparency International, 2024[80]). To make the EU integrity system stronger and more credible, EU institutions should extend the competencies of the new independent ethics body to include oversight and enforcement powers.

As announced in the aftermath of the above-mentioned scandal, the Parliament in 2023 tasked the EU Special Committee on Foreign Interference to identify and assess existing shortcomings in the Parliament's rules regarding transparency, integrity, accountability and anti-corruption, with the aim to make proposals for reforms in these areas (European Parliament, 2023[81]) (European Parliament, 2023[82]) (European Parliament, 2022[83]). This is welcome and results and follow-up actions from the inquiry should be published. The need to further strengthen public integrity in the EU institutions is also reflected in the Parliament's opinion on the Commission's proposal for the new anti-corruption reform package, where stricter integrity rules for its members have been proposed (see above).

## Table 2.1. Past recommendations on agricultural and anti-corruption policies

| Main recommendations of the 2023 Survey | Action taken since 2023 |
|---|---|
| **Ramp up mitigation in agriculture** | |
| Introduce an internal carbon price for all budget and planning preparations. | No action taken. |
| Remove support for the agricultural use of drained peatlands. | No action taken. |
| Gradually withdraw direct payments for high livestock numbers. | No action taken. While new rules to reduce harmful emissions from large pig and poultry farms were adopted in 2024, direct payments remain to be paid per hectare. |
| Make payments under the agri-environmental schemes conditional on achieving emission reductions. | No action taken. |
| **Strengthen the anti-corruption framework** | |
| Continue to coordinate national efforts to fight corruption and fraud. Align minimum standards across countries and strengthen prevention measures. | The Commission launched its latest anti-corruption package proposal in May 2023. The package is a further step to strengthen and coordinate the fight against corruption in the EU. Trilogue negotiations on the anti-corruption Directive has started in 2025. Additionally, the European Commission continues to monitor the anti-corruption framework in EU Member States via the Annual Rule of Law Report.<br>The Commission continued to provide support to both Eurojust, the EU agency competent to coordinate investigations and prosecutions of cross-border serious crimes, including fraud and corruption, and the EPPO, the EU body in charge of investigating and prosecuting crimes affecting the Union's financial interests, including fraud and corruption that damage or may damage the Union budget. |
| Ensure that information on beneficial ownership of companies and on persons/entities representing risks to the Union's financial interest can be accessed by users pursuing anti-money laundering and anti-fraud objectives, while determining sufficient protection of personal data in compliance with the Charter of Fundamental Rights. | The new AML Directive (AMLD6) includes specific access rules for persons with legitimate interest to access the beneficial ownership information held in the interconnected registers, to protect the Union's financial interests and to address vulnerabilities of public procurement procedures to corruption. |
| Extend the Early Detection and Exclusion System's (EDES) scrutiny to economic operators that are under shared management. | The amended Financial Regulation, adopted in September 2024, extends the scope of the Early Detection and Exclusion System (EDES) to also include EU funds under shared management with member states for the most serious misconducts, for programmes adopted or financed as of 1 January 2028. |
| Accelerate the establishment of an EU-wide independent ethics body and strengthen rules on transparency and lobbying regulating the activity of Members of Parliament. | In May 2024 an EU-wide independent ethics body was established, as a result of an EU inter-institutional agreement. The new body will develop, update and promote a common code of conduct to ensure ethical behavior across EU institutions. The body does not have power to enforce integrity rules, nor the possibility to recommend sanctions for misbehaviour. |

## Table 2.2. Main findings and recommendations (key recommendations in bold)

| Main findings | Recommendations |
|---|---|
| **Ensure sufficient budgetary resources** | |
| The EU's annual budget is small and could be increased to co-ordinate and finance more public investment at the EU level. | **Refocus funds and allocate new resources to priorities best provided at EU level, such as innovation and cross-border infrastructure.** |
| The cost of enlargement could be reduced, if needed. | As in the 2004 enlargement, limit the budgetary impact using transition periods and financing caps defined in the spending policies. |
| **Improve the efficiency of budget spending** | |
| Cohesion policy is complex, and its broad scope undermines its effectiveness. | Focus cohesion spending on items with long-term growth benefits.<br>Improve quality and capacities of institutions administering cohesion policy in the regions, while simplifying procedures and adapting programmes to regional needs. |
| The Recovery and Resilience Facility (RRF) suffers from the risk of delays and non-completion of measures, while its top-down approach may not be suitable for regional development policy. | **Design output-based budgeting instruments, using lessons from the RRF.**<br>**Take action to mitigate the risk of funding non-completed measures.**<br>Provide additional guidance to facilitate the RRF implementation. |
| **Re-allocate budget spending to new challenges and priorities** | |
| Almost 30% of the Cohesion Policy spending is channelled to EU regions with GDP per capita above 75% of the EU average. | **Strengthen targeting of cohesion policy spending.** |
| Despite mixed empirical evidence on the benefits of Common Agricultural Policy (CAP) payments for agricultural income and employment, direct payments still dominate CAP expenditure. | Improve monitoring and evaluation systems to ensure that national targets are transmitted to the farm level.<br>**Free budget resources and improve spending efficiency of CAP spending.** |
| **Strengthen the anti-corruption framework** | |
| A strong anti-corruption and public integrity system ensures protection of the EU financial interest and allows citizens to rely on impartial institutions for a fair distribution of resources and a transparent business environment. The European Public Prosecutor's Office (EPPO) is key to investigate and prosecute crimes against the EU's financial interests, including corruption involving EU funds. It effectively handles cross-border cases involving sophisticated criminal organizations, for which national offices do not often have adequate resources. A broad PIF Directive assessment could consider expanding its scope regarding corruption offenses. | **Continue to coordinate national efforts to fight corruption and fraud, by speeding up trilogue negotiations for the adoption of the full 2023 anti-corruption package while also considering expanding the European Public Prosecutor Office's mandate.** |
| The new EU-wide ethics body does not have enforcement and sanctioning powers, which remain with EU institutions, weakening its credibility and ability to strengthen institutional integrity. | Extend the competences of the new independent ethics body to include oversight and enforcement powers. |

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# 3 Strengthening electricity markets

Martin Borowiecki

*The EU aims to enhance energy security, lower energy costs and decarbonise the economy through electrification, and the decarbonisation of electricity generation. Electricity costs are high, reflecting high taxation and weak competition. Generous fossil fuel subsidies and relatively high electricity taxes reduce incentives for electrification. Lower electricity costs could also be achieved through a more integrated Single Market for electricity. This would require structural reforms to reduce internal market barriers and strengthen competition to better align supply with demand. A more integrated Single Market for electricity would also help reducing the costs of decarbonisation.*

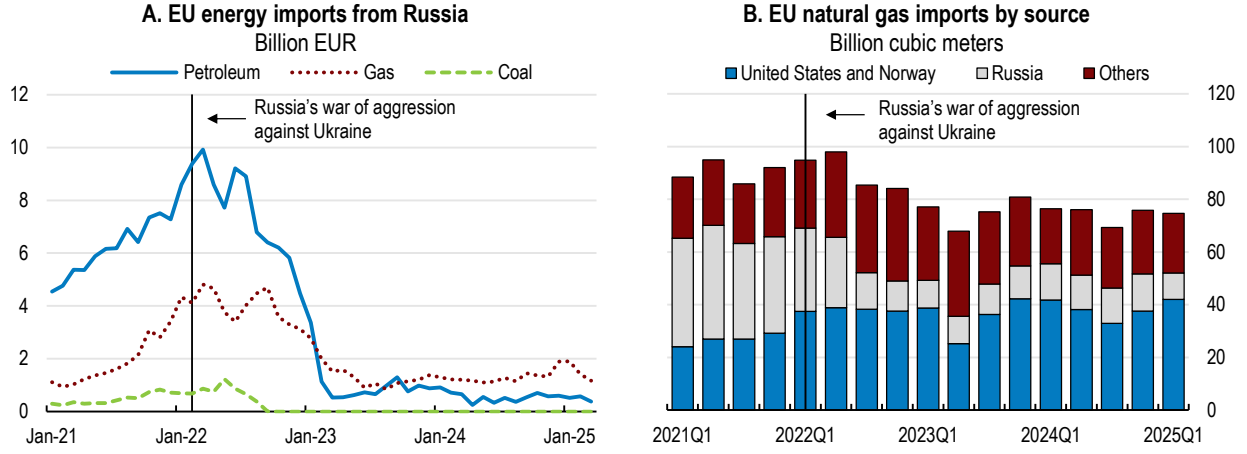
## 3.1. Lowering electricity costs is a key challenge

Well-functioning and integrated electricity markets will be important to lower the costs of electricity and support the competitiveness of the EU industry. However, entry barriers, including regulatory ones, hamper competition in electricity markets, which could help lower electricity costs. Taxation of electricity is relatively high compared to fossil fuels, reducing incentives for electrification. Higher demand and supply flexibility is also needed for a decarbonised energy system with a high share of variable renewable energy. Moreover, a lack of European planning and funding creates additional disincentives for investment in cross-border electricity connections. This Chapter discusses policies to further integrate the Single Market for electricity with a view to lowering electricity costs, enhancing energy security and accelerating the energy transition.

## 3.2. Market integration has helped coping with the energy crisis

The EU has no rich fossil fuel resources and relies heavily on energy imports. This became evident following Russia's war of aggression against Ukraine when the EU introduced a coal and oil embargo on Russia, and Russia significantly reduced pipeline gas flows to the EU (Figure 3.1, Panel A). Global energy markets were instrumental to help replace Russian fossil fuel imports with imports from other countries. However, this adjustment came at a high cost as cheaper Russian gas was replaced by more expensive liquefied natural gas (LNG) from Norway and the United States (Panel B).

### Figure 3.1. Russian fossil fuel imports were replaced quickly




Note: Panel B, "Others" include Algeria, Azerbaijan, Libya and the United Kingdom.
Source: Eurostat; and Bruegel based on ENTSOG, GIE and Bloomberg.

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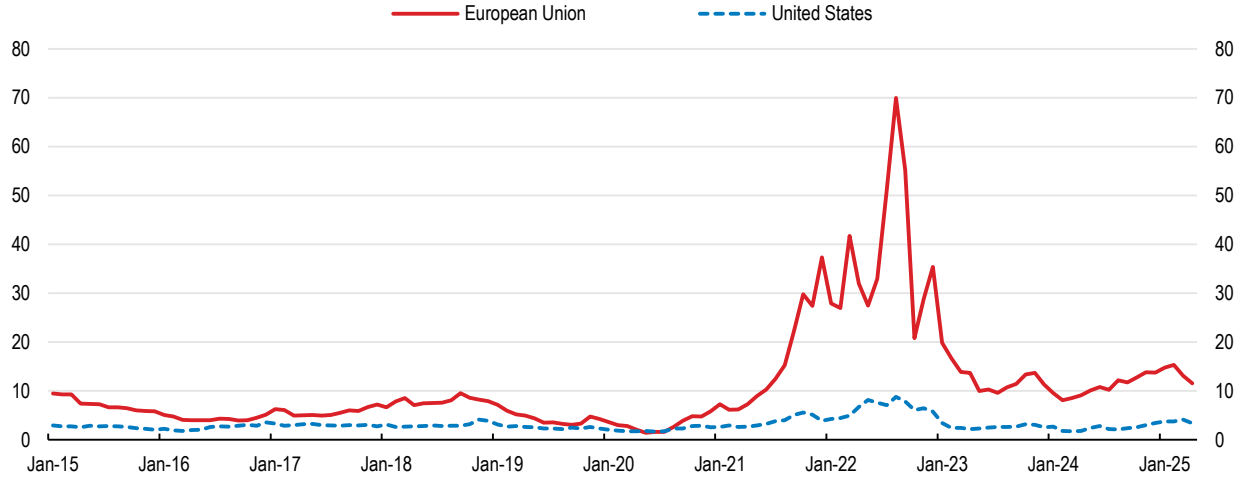
During the energy crisis that followed, the EU internal energy market proved successful in shifting scarce energy volumes across EU countries. Since then, energy prices have fallen from their historic heights although they remain above pre-pandemic levels (Draghi, 2024[1]). A lingering concern is the reduced competitiveness of EU industry due to relatively high energy prices. EU wholesale gas prices were almost five times those in the United States in 2024 (Figure 3.2).

Higher gas prices directly translate into higher electricity prices because gas fired electricity-generating plants are often the plants that ensure that total electricity supply meets total electricity demand and they have the highest marginal cost (Box 3.1). As a result, EU industrial retail electricity prices were roughly twice as high as before the energy crisis in 2024 (Figure 3.3). High electricity prices will eventually encourage investment in cheaper energy sources. In the meantime, gas remains an important price setter and is projected to remain so at peak hours over the next decade (Gasparella, Koolen and Zucker, 2023[2]).

## Figure 3.2. Wholesale gas prices remain relatively high

Gas prices, USD per Metric Million British Thermal Unit (MMBtu)




Source: IMF.

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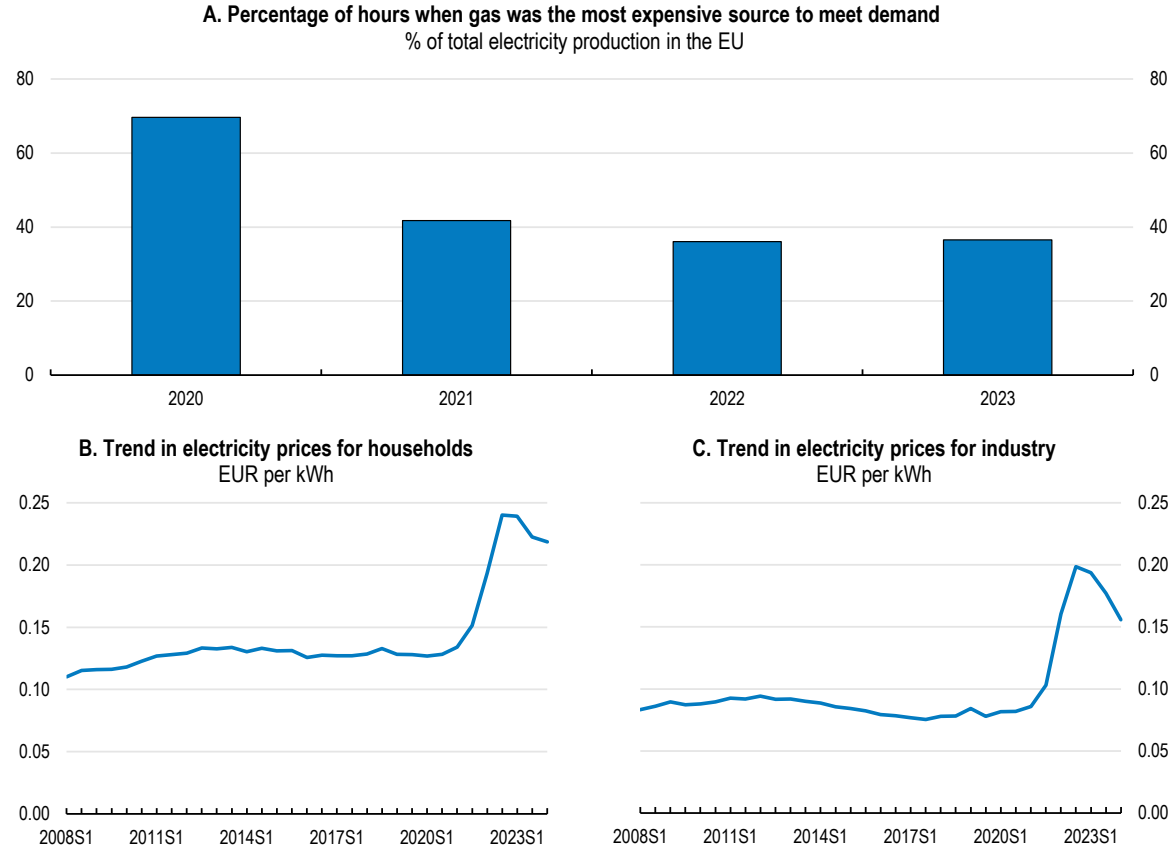
## Figure 3.3. High gas prices translate into higher electricity prices




Note: Panel A, prices refer to day-ahead wholesale electricity prices. Panel B, consumption from 2 500 kWh to 4 999 kWh (band DC). Panel C, consumption from 500 MWh to 1 999 MWh (band IC).

Source: ACER calculations based on ENTSO-E transparency platform; Eurostat Electricity prices components for household consumers database; and Electricity prices for non-household consumers database.

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### Box 3.1. Setting of wholesale electricity prices

In wholesale electricity markets, prices are set according to the electricity production cost of the last unit needed to meet demand (i.e., merit order model and marginal cost pricing). The cheapest electricity is bought first, next offers in line follow. Once demand is met, producers receive the price asked for by the last unit of electricity that was bought. In 2023, gas-produced electricity set the electricity price 37% of the time (ACER, 2024[3]). This means that wholesale electricity prices are sensitive to price swings of gas as seen during the energy crisis.

#### 2023 reform of the electricity market

In response to the energy crisis, in 2023 the EU introduced reforms to the wholesale electricity market as discussed in more detail in the last *Survey* (OECD, 2023[4]). Emphasis was put on stronger uptake of long-term contracts to reduce dependence on more volatile short-term markets. These include commercial power purchase agreements (PPAs) between energy producers and industry, and government production-based subsidy schemes, notably Contracts for Difference (CfDs).

To encourage the uptake of PPAs:

- To raise demand, EU countries can provide state guarantees to reduce the financial risks associated with PPAs for medium-sized companies that want to buy PPAs, as well as intermediaries who bundle demand from multiple small consumers, such as small and medium-sized enterprises. These companies often lack a strong investment grade credit rating that banks require for credit lines. In addition, the EU will provide EUR 0.5 billion (0.002% of EU GDP) in guarantees for the European Investment Bank until 2027 to counter-guarantee PPAs undertaken by companies under the Action Plan for Affordable Energy.
- Electricity providers, which are often large dominant incumbents, are subject to more stringent requirements to hedge against price risks, which is expected to increase the supply of PPAs.
- Renewable energy providers participating in a public tender also need to reserve a share of the generation for sale through a PPA to hedge against price risks. This should also raise the supply of PPAs.

The EU also encourages the use of CfDs:

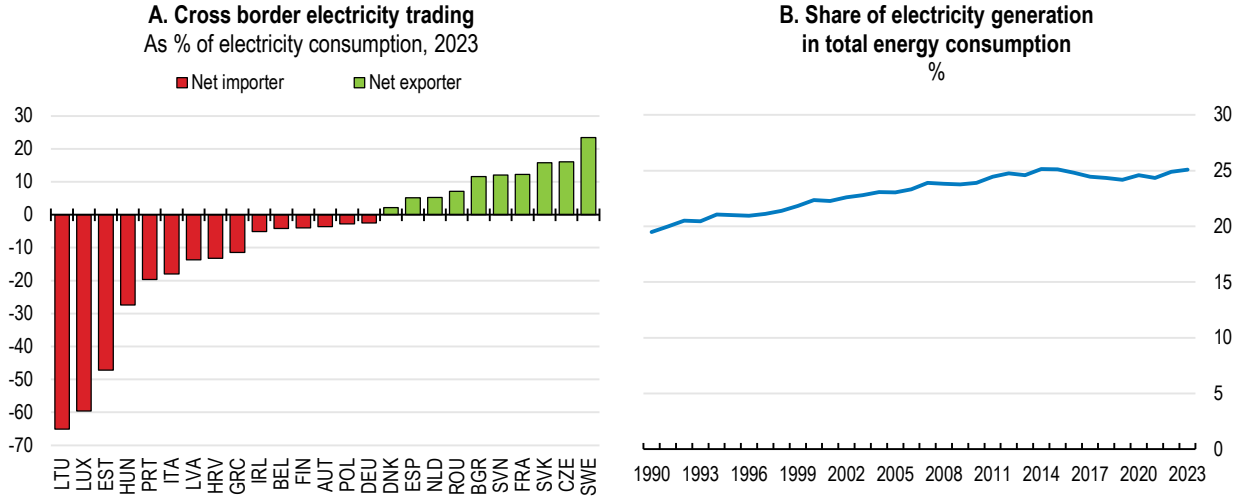
- Governments guarantee electricity providers a minimum price or strike price for electricity produced, which effectively moves some of the financial risk to the public sector. In return, a price caps limits providers' revenues as any revenue above the price cap needs to be paid back to the government.
- Providing long-term income stability through production-based CfDs reduces incentives to enter market-based long-term PPAs. Trade-offs between these markets need to be carefully examined (see below).
- EU countries can apply CfDs only to mature, low-carbon technologies with low operational costs and high capital expenses, such as solar, wind, geothermal, hydro, and nuclear energy, including historic nuclear power. Support is not allowed for emerging low-carbon technologies that are at early stages of their market development (European Parliament and European Council, 2024[5]).

## 3.3. Well-functioning and integrated markets are important for electrification

Liberalisation of national electricity markets in the 1990s led to the establishment of the Single Market for electricity (Box 3.2). The aim was to lower energy prices for consumers through increased competition and consumer choice. Reforms included the liberalisation of supply by reducing barriers to entry, regulated third party access and the unbundling of transmission networks and generation. Separation of generation from networks led to the establishment of wholesale electricity markets. Independent Transmission System Operators (TSOs) now own the transmission grid in EU most countries. In some, but not all markets, there is a distinction between the TSOs and the market operators, i.e., they provide generation firms access to the transmission grid so that they can participate in wholesale electricity markets. The joint ownership and operation of grids under the umbrella of TSOs is a major difference to other electricity markets such as the United States.

Interconnected grids and European electricity exchanges allow countries to export their surplus electricity, helping to lower costs elsewhere, although countries which produce cheap electricity could see domestic prices rise (Figure 3.4, Panel A). The integrated EU electricity grid also helps to balance out production surpluses and deficits across countries by taking advantage of economies of scale. Interconnected electricity markets also allow for smoother integration of renewable intermittent sources of electricity (such as solar and wind) (Panel B). However, interconnection capacity among EU countries is still limited (see below). Further market integration would require extending interconnections between countries.

## Figure 3.4. Electricity trade helps meeting growing electricity demand




Source: Fraunhofer Institute for Solar Energy Systems (ISE); Eurostat; and OECD calculations.

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The EU's climate targets influence the EU's Single Market for electricity. The main objective of the EU's climate policy is to achieve net zero greenhouse gas (GHG) emissions by 2050. In addition, there are several intermediate targets for 2030: A 55% reduction in EU GHG emissions (compared to 1990), 42.5% of EU energy consumption produced from renewable resources, and a 11.7% reduction in the EU's energy consumption through higher energy efficiency (compared with the energy consumption forecasts for 2030 made in 2020). Greenhouse gas emission targets are climate targets while objectives related to renewable energy sources and energy efficiency are energy targets. Although they all contribute to climate mitigation, they also serve other energy policy goals such as energy security, fuel diversification, reduction of import dependency and competitiveness.

The EU has the Emission Trading System (ETS) at its disposal to reduce overall GHG emissions. The ETS carbon price of currently around EUR 80 per tonne of $CO_2$ is set to rise, which will eventually support decarbonisation by making fossil fuels even more expensive than low-carbon electricity. In contrast, the EU does not have economic instruments to meet its renewable target. Here, EU countries are responsible. To achieve national renewables targets, EU countries provide generous state aid for renewables. However, such unilateral state aid may have consequences for the Single Market.

Under the Temporary Crisis and Transition Framework, the EU has temporarily relaxed its state aid regime to accelerate the rollout of renewable energy and energy storage during the energy crisis. In 2025, the EU announced a simplification of state aid rules for clean technology and energy-intensive manufacturing until 2030 to incentivise national investment in these areas aligned with EU priorities. The new state aid framework would build on the experience of the Temporary Crisis and Transition Framework (European Commission, 2024[6]; European Commission, 2025[7]). However, this stance, together with stronger use of national industrial policy, could lead to a relaxation of state aid rules and have implications for the level playing field in the Single Market as countries may give preference to their own sectors and firms. Unilateral industrial policies also endanger EU productivity by slowing down the relocation of energy-intensive industry to locations in the EU where such production is more competitive. Hence, the EU should refrain from relaxing state aid rules except in emergency situations. Instead, a more European approach for industrial policy is needed (Chapter 4).

### Box 3.2. The EU's electricity wholesale market

The EU's wholesale electricity market is divided into several zones, with a uniform price in each zone (so-called zonal pricing). Zones are usually defined by transmission constraints, or where transmission links are most likely to be congested, although also for political reasons. Germany, for instance, is a unique zone despite its relatively large size, often leading to north-south congestion.

Transmission System Operators allocate electricity capacity across zones, while cross-zonal volumes are traded at European electricity exchanges (so-called market coupling). The day-ahead market is most important for spot price setting, with national balancing markets providing ancillary services for the stabilization of the electricity grid.

The coupling of day-ahead wholesale electricity markets allows prices in every market and cross-border trades to be simultaneously determined. Market coupling also ensures that existing cross-border transit capacity is used more efficiently to send electricity from low- to high-price zones, reducing cross-country differentials in wholesale electricity prices.

Integrated and liquid day-ahead markets have supported cross-border electricity trade, which accounted for 10% of EU final electricity consumption in 2023. In contrast, balancing and future markets remain underdeveloped. On days when enough cross-zonal transit capacity is available, electricity prices across zones tend to converge. However, this is not often the case (ACER, 2024[3]). Hence, the EU aims to increase inter-zonal transit capacity to achieve a more integrated energy market.

Two European bodies were established in the 2010s to develop a rulebook for cross-border electricity trade and supervise it. The EU Agency for the Cooperation of Energy Regulators (ACER) supervises cross-border trade and surveils national wholesale and retail markets, including third-party access, cross-border capacity allocation, congestion management, and system balancing. The European Network of Transmission System Operators for Electricity (ENTSO-E) – itself not an EU agency, is tasked to develop legally binding electricity market and network codes, in accordance with the framework guidelines defined by ACER:

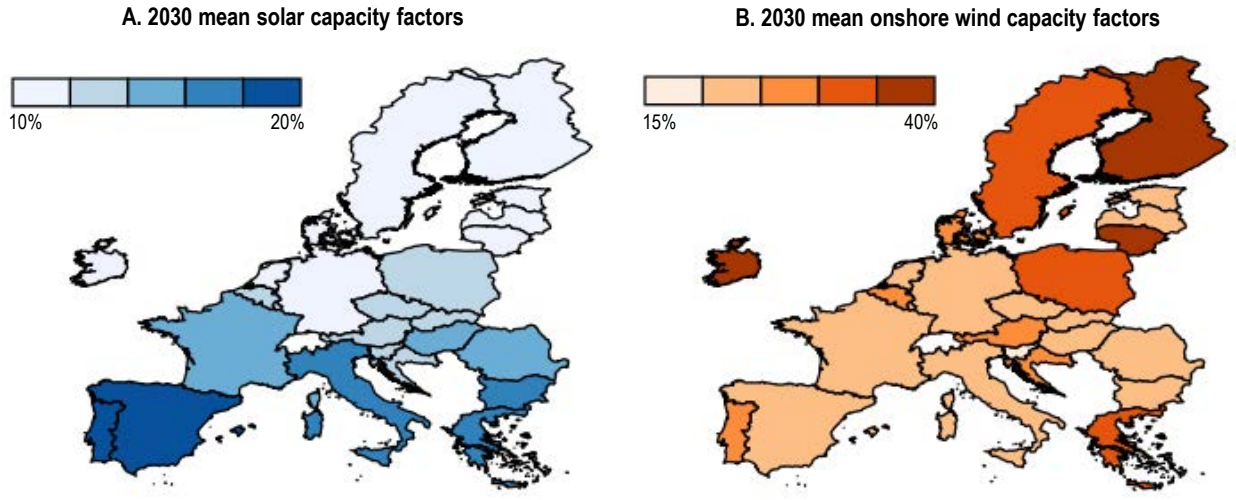
- Market rules for short-term wholesale electricity markets: Day-ahead and intraday capacity allocation, congestion management, electricity balancing, and forward capacity allocation.
- Operational codes to monitor and operate the EU-wide interconnected electricity grid.
- Grid connection codes for the integration of renewables, distributed generation, and demand response.

Source: IEA (2020[8]) and OECD (2022[9]).

National renewable targets also make it difficult to find market-based solutions that minimise abatement costs. For instance, if countries are not on track to meet the renewable energy target for 2030, additional investment in renewables will be needed. Such investment will not be driven by abatement cost considerations, but by the impetus to expand renewables to reach the target. Importantly, national renewable targets hamper EU-wide optimisation of the renewable fleet as they ignore cost advantage in energy rich regions (Figure 3.5). As a result, countries are encouraged to expand relatively inefficient solar production in Northern Europe, or wind production in non-coastal regions with less wind (ENTSO-E, 2024[10]).

A more cost-efficient approach would entail pricing all emissions and letting market forces determine the appropriate location with lowest abatement costs to reduce emissions, as discussed in the last *Survey* (OECD, 2023[4]). Carbon pricing leaves the decision on when and where to cut emissions to those who know best about their abatement costs. Support for new technologies and decarbonisation may still be necessary due to market failures. Nonetheless, a more European approach is needed for an EU-wide optimization of low-carbon energy. For instance, EU-wide competitive auctions for renewables could achieve an optimisation of the renewable fleet that reflects cost advantages of energy-rich regions (see below).

## Figure 3.5. Solar and wind potential differ across countries




Note: Capacity factor refers to electricity produced at realistic wind or solar conditions, relative to the amount produced if the plants would in each hour have operated at their peak capacity. The figures are based on the assumptions for installed renewable capacities in 2030 reported to ENTSO-E.
Source: Bruegel (Zachmann et al., 2024[11]) based on ENTSO-E's European Resource Adequacy Assessment 2023.

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Well-functioning electricity markets, including for renewables, are important. The energy transition will have positive impacts, and more integrated markets will help lower electricity costs (IEA, 2024[12]). In the short run, however, there will be transition costs. This reflects the cost of transitioning to a low-carbon energy system with high investment in production assets, networks and flexibility mechanisms. Therefore, in addition to more integrated markets, it is important to develop more efficient renewable technologies to decarbonise in a more cost-efficient way.

However, government support, notably through CfDs, benefits mostly mature technologies, notably solar, wind, geothermal, hydro, and nuclear energy (Box 3.1). The technology bias in subsidies hinders more efficient renewable technologies from entering the market, such as innovative wind energy solutions, or energy storage technologies, to name a few. This calls for more competitive markets and innovation, less state aid for mature technologies, and stronger support for new technologies. A way forward would be to ensure that the EU state-aid framework targets government subsidies to low-carbon technologies that are not yet competitive, as recommended in the last *Survey* (OECD, 2023[4]).

There is also a trade-off between industrial policy and productivity. On the one hand, some forms of national industrial policy can have positive cross-border spillovers if they are motivated by well-defined market failures such as decarbonisation and support for new technologies. However, design and implementation of such policies should be considered carefully through a cost-benefit analysis, including Single Market implications (Millot and Rawdanowicz, 2024[13]; OECD, 2024[14]). On the other hand, some EU countries with high energy prices want to maintain energy-intensive industries, whereas they could only be competitive in regions with low energy prices such as southern Spain or northern Sweden (Zachmann et al., 2024[11]). Unilateral industrial policy may bind resources in uncompetitive firms, harming competition and hindering industry's adjustment to structural change. Some energy-intensive production may be kept in the EU due to security of supply concerns. However, production may have to happen in locations in the EU with lower energy costs. Instead, better integrated energy markets will be key to lower energy prices and support EU productivity, which the Commission is working on (see below).

## 3.4. Towards a more integrated market for electricity

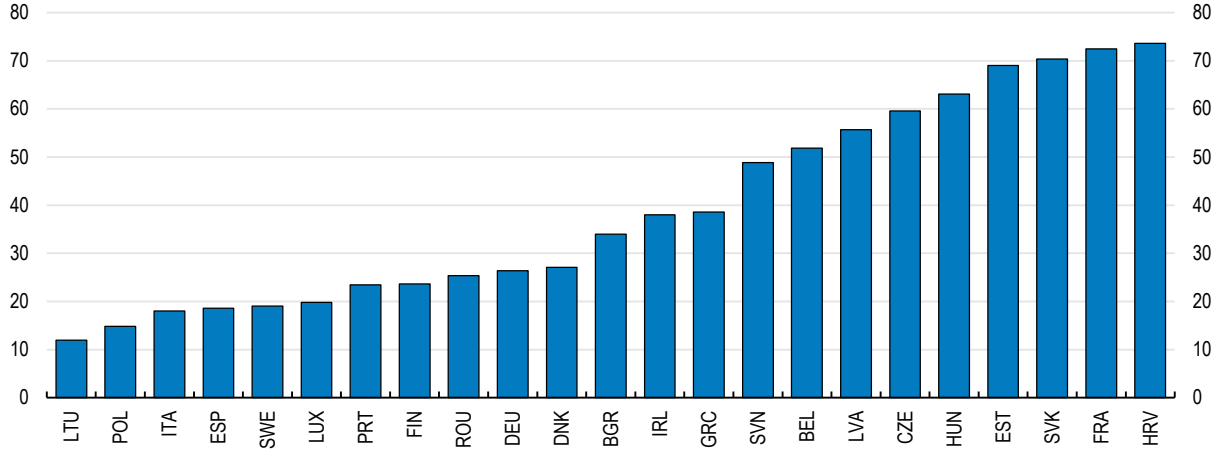
### *3.4.1. Enhancing competition to lower electricity costs*

Competition in retail markets remains low in many EU countries (Figure 3.6). Low competitive pressures mean that developments of the wholesale market, notably price decreases due to cheaper renewable energy, are not passed through to lower retail prices for consumers (ACER, 2022[15]; European Court of Auditors, 2023[16]). This is a sign that markets are not properly functioning. National electricity regulation in some countries still inhibits entry of foreign energy producers and retailers, and smaller distributed producers, such as rooftop solar cells. For example, only seven EU countries provide smaller distributed producers access to electricity markets, balancing and congestion management services, as mandated by European legislation (ACER, 2023[17]). The EU's Directive on Common Rules for the Internal Market for Electricity requires EU countries to develop a regulatory framework that enables market participation of such actors.

The EU should fully enforce competition in electricity markets to avoid that national electricity regulation is used by EU countries to distort the playing field in favour of national incumbents. The EU, together with the EU Agency for the Cooperation of Energy Regulators (ACER), could provide technical guidance to EU countries on the correct implementation of the EU Directive on Common Rules for the Internal Market for Electricity that guarantees all energy producers and retailers access to electricity markets. The EU could also consider infringement action when progress is insufficient.

#### Figure 3.6. Competition in electricity markets is low in many EU countries

Market share of the largest company-generator in the electricity market, %, 2022




Source: Eurostat Energy market indicator database.

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Retail electricity markets remain fragmented along national lines. This reflects to some extent regulated retail electricity prices, but also other barriers such as access to grids for retailers (Figure 3.7 and Figure 3.8) (IEA, 2020[18]). Regulated retail prices, often below market prices, poorly reflect market demand, making cost recovery difficult and discouraging investment in new low-carbon electricity generation. The EU requires countries to phase out retail price regulation except if it is time-limited and for energy-poor or vulnerable households. Further market integration requires stronger price signals. This entails phasing out regulated retail prices. Instead, energy poverty can be better addressed by targeted income support such as social transfers and tax credits to vulnerable households as discussed in the last *Survey* (OECD, 2023[4]).

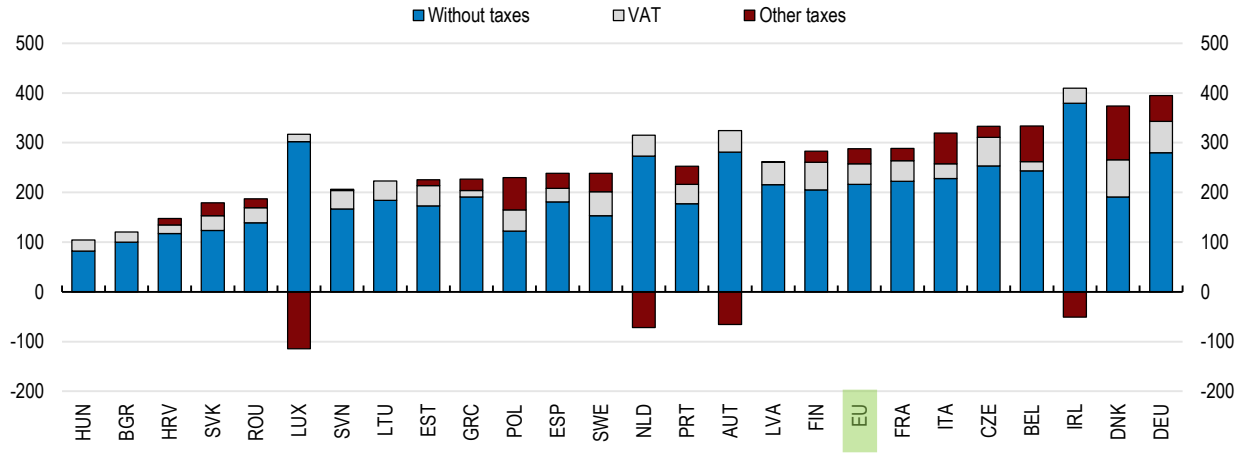
To support the electrification of the economy, the EU should phase out reduced rates and exemptions for fossil fuels as discussed in the last *Survey* (OECD, 2023[4]). High electricity tax rates compared to gas discourage the switch from gas to electricity (Figure 3.9 and Figure 3.10). Energy taxes are levied by governments on most forms of energy, notably mineral oils, but also gas, coal and electricity. The current EU's Energy Taxation Directive sets a minimum excise duty rate for electricity at approximately the same level as natural gas, irrespective of carbon content. In

practice, electricity is taxed more because gas benefits from fossil fuel subsidies such as reduced tax rates in many EU countries, although not all electricity is generated using low-carbon energy sources and low-carbon electricity benefits from a lower net effective energy tax rate due to subsidies for solar, wind and nuclear power (OECD, 2024[19]).

Nonetheless, net effective energy tax rates for gas continue to be relatively low and are only marginally higher than for low-carbon electricity, discouraging the switch from gas to low-carbon electricity. The European Commission proposed to reform EU-wide minimum energy tax rates for energy products. According to the proposal, exemptions and reduced rates for fossil fuel should be phased out, and taxation of fuel would no longer be based on volume but on energy content and environmental performance, with fossil fuels being taxed most heavily. The reform would also encourage the uptake of low-carbon electricity.

## Figure 3.7. Retail prices for electricity differ across EU countries

Electricity prices for households, EUR per MWh, 2024




Note: Electricity prices for household consumers in the consumption bands 2.5 MWh-5 MWh (band DC). "Other taxes" is negative when the environmental tax allowances' amount is higher than the amount of the environmental tax itself, and includes price support provided to electricity consumers during the energy crisis.
Source: Eurostat Electricity prices components for household consumers database.

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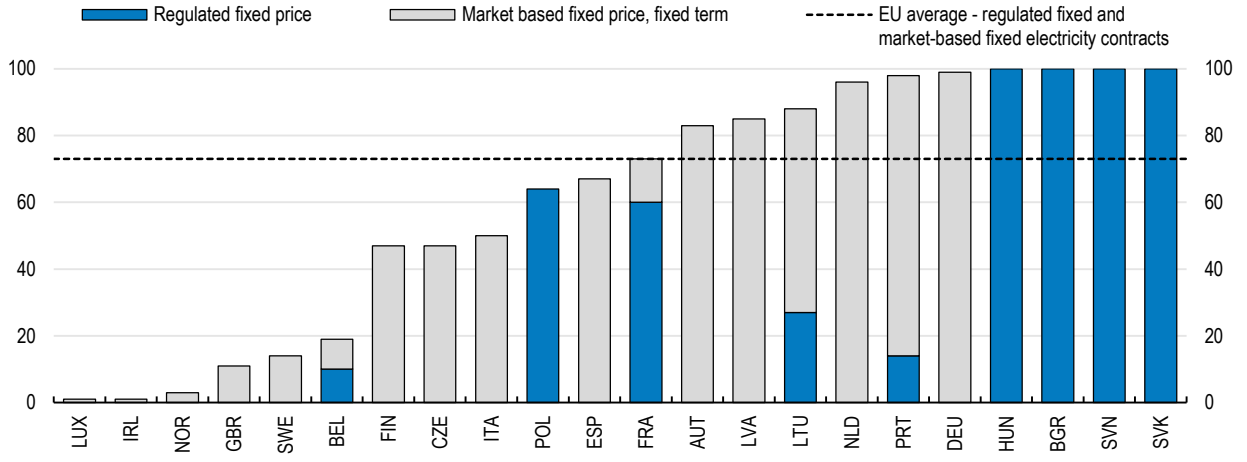
## Figure 3.8. Regulated and fixed price contracts are frequent

Share of household regulated and fixed price electricity contracts, %, 2023




Note: Regulated fixed prices are fixed prices regulated by law. Market based fixed price, fixed term contracts are private contracts between retailers and consumers that set a fixed price for electricity for a fixed term.
Source: ACER based on data provided by National Regulatory Authorities.

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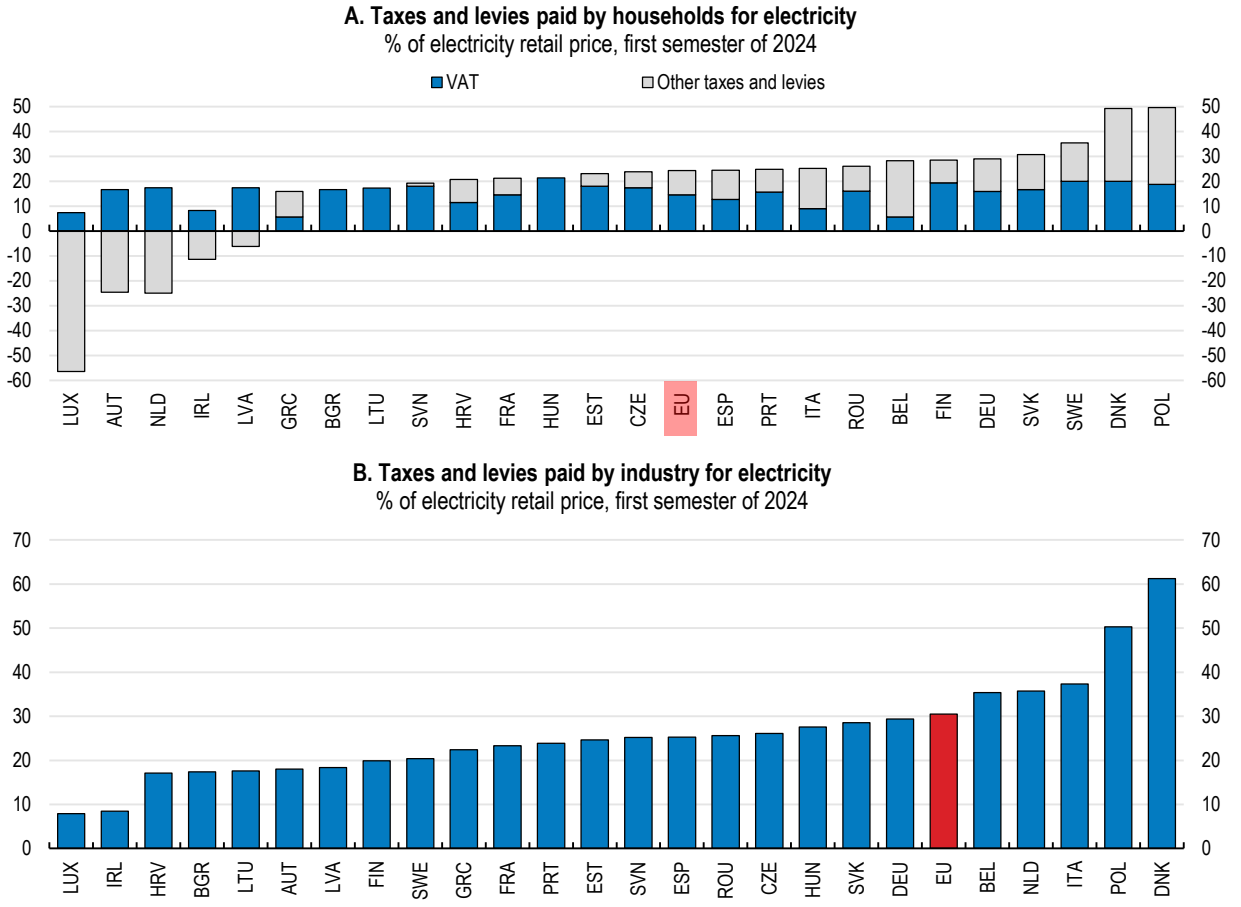
## Figure 3.9. Taxes and levies account for a high share of retail electricity costs




Note: Panel A, consumption from 2 500 kWh to 4 999 kWh (band DC). Panel B, consumption from 500 MWh to 1 999 MWh (band IC). "Share of other taxes and levies" is negative when the energy tax allowances' amount is higher than the amount of the energy tax itself.
Source: Eurostat Electricity prices components for household consumers database; and Electricity prices for non-household consumers database.

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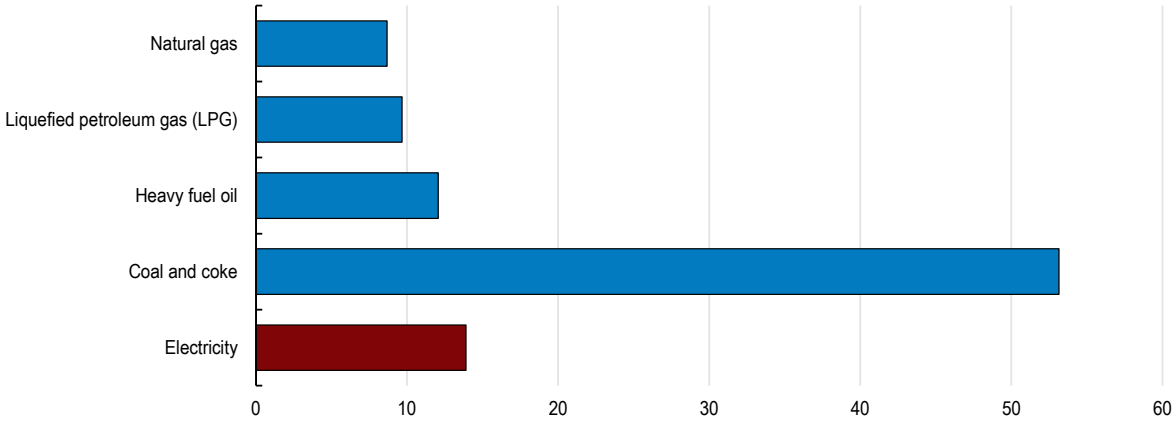
## Figure 3.10. Electricity taxation is high compared to fossil fuel taxation

Taxes by energy product, EUR per MWh, situation at 1 January 2025




Note: Data refer to taxes applied to energy products for non-business use.
Source: European Commission, Taxes in Europe database (TEDB); and OECD calculations.

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### *3.4.2. Strengthening markets for low-carbon energy sources*

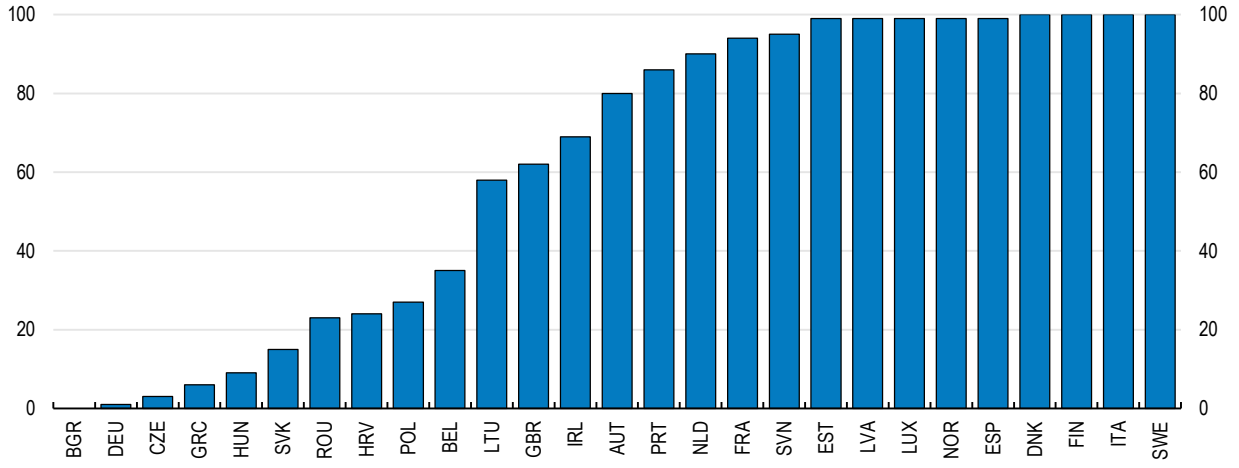
The expansion of low-carbon energy sources such as renewables can help decarbonise electricity production and reduce the EU's dependence on gas and oil imports. On the demand side, the electrification of final energy consumption is behind schedule due to the unequal uptake of electric vehicles and heat pumps. This reflects that fossil fuels still benefit from tax advantages compared to electricity, but also high costs of electric vehicles and heat pumps. Hence, a key challenge for the energy transition is to synchronise supply and demand. However, the current setup of electricity markets discourages supply and demand flexibility.

Higher demand flexibility is needed for a decarbonised energy system with a high share of intermittent renewable energy (IEA, 2024[20]; IEA, 2020[21]). However, regulated retail prices reduce the responsiveness of consumers to adjust their demand to changing supply. In addition, consumer pricing in most EU countries still involves flat rates that do not change over time (Figure 3.8). As a result, around three quarters of EU households do not adjust their consumption to price changes, although it also protects final consumers from the volatility of wholesale electricity prices. Exposing consumers to real-time electricity prices can encourage efficiency, energy savings, and lower on average electricity prices as shown for industrial consumers in Germany (Hirth, Khanna and Ruhnau, 2022[22]; Ruhnau et al., 2023[23]). It can also encourage more frequent changes of electricity providers and hence enhance competition.

In this regard, the EU requires its member states to ensure that the national regulatory framework enables suppliers to offer fixed-term, fixed-price electricity supply contracts but also dynamic electricity price contracts. Specifically, final customers who have a smart meter installed can request to conclude a dynamic electricity price contract. In Spain, for instance, the installation of smart meters has helped to raise the uptake of dynamic pricing schemes among households (ACER-CEER, 2024[24]). Already since 2009, the EU set the target for the roll-out of smart meters to cover at least 80% of the electricity end-users by 2020. However, the deployment of smart meters is behind schedule in many EU countries (Figure 3.11).

#### Figure 3.11. The rollout of smart meters is behind schedule in many EU countries

Roll-out of smart meters among households, %, 2023




Source: ACER based on data provided by National Regulatory Authorities.

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EU countries are subsidising the expansion of domestic renewable energy production. Electricity levies (or charges) finance the costs of energy policies linked to the transition of the electricity sector, such as those supporting renewable energy. Electricity levies differ from general energy taxation, which is discussed above. Over 70% of new renewable capacity installed in 2023 and 2024 involved renewable support, including through feed-in tariffs, feed-in premiums and Contracts for Difference auctions, where producers receive a subsidy from the government when the wholesale price is below the strike price (IEA, 2023[25]). This moves some the financial risk to the public sector to incentivize the rollout of renewable energy. If wholesale electricity prices are too low, or the cost of capital too

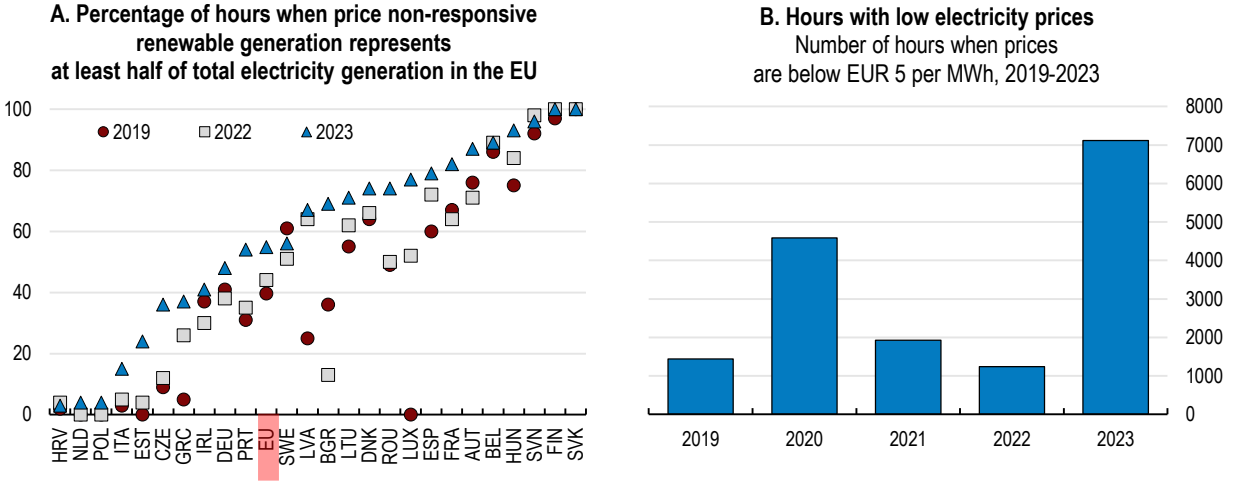
high due to market failures, public support becomes necessary to maintain this level of capacity. In this sense, government support provides investors with long term price certainty to cover high capital costs of renewables.

However, government intervention may reduce supply flexibility. A growing share of the energy mix is subsidised, with production decoupled from wholesale market price developments. In 2023, already half of the EU's electricity supply was provided by such subsidised renewable and nuclear generation (Figure 3.12, Panel A). Production subsidies, such as feed-in tariffs and production-based CfDs, mute price signals for producers and have contributed to more frequent production surpluses or deficits, and overall higher price volatility. For instance, episodes of low and even negative prices have become more frequent as periods of high renewable generation meet low demand, such as on weekends in summer, reducing investment incentives in renewables (Panel B).

A stronger role of market prices is called for to raise supply responsiveness to demand. In this regard, EU state aid rules require since 2022 that beneficiaries of state support measures should not be incentivised to offer their output below their marginal costs. Also, state aid should not be provided for production in any periods when wholesale electricity prices are negative. There are efficient, non-production based CfD designs that allow price support to provide long-term investment incentives without muting the market price signal. These include, for instance, 2-way production-independent CfDs with a strike price set based on competitive tendering. Hence, the EU state-aid framework should target government subsidies to low-carbon technologies without distorting the functioning of the market. Another important barrier to higher supply flexibility is limited energy storage capacity.

Moving to stronger local price signals (or locational pricing) that reflect local scarcity (or abundance) of electricity is economically efficient because generators have stronger price signals as to where to invest in generation and storage. A more efficient distribution of electricity would also dampen price volatility resulting from renewables (Cevik, 2025[26]). Hence, ACER should review the current EU bidding zones with a view to improving locational price signals. Another approach would be to include a stronger locational price element in network tariffs as proposed by the Commission (European Commission, 2025[27]).

## Figure 3.12. Renewable subsidies make generation non-responsive to price changes




Source: ACER calculations based on ENTSO-E transparency platform (actual generation per type), European Network of Transmission System Operators for Electricity (ENTSO-E) and regulation on wholesale energy market integrity and transparency (REMIT) data.

StatLink https://stat.link/wyv5fb

Private risk markets such as long-term contracts remain underdeveloped. Even in the most liquid risk market, Germany, market liquidity for contracts longer than one year is low and almost non-existent beyond three years (ACER, 2024[3]). A market with long term contracts could develop, but in current circumstances, producers have no incentives to participate in such a market. This is a competition issue and reflects that national incumbents that dominate energy markets in most countries are both electricity producers and retailers at the same time. Hence, they are naturally protected against financial risks because they benefit from wholesale or retail profits (Ambec, Crampes and Tirole, 2023[28]). A way to enhance risk markets is to encourage risk insurance for electricity providers in the form of long-term contracts.

Contracts for Difference auctions can help incentivise investment in new technologies for which markets do not yet exist or when risks are too high for the private sector, such as carbon capture. An alternative approach to support carbon capture technologies is to extend the EU's Emission Trading System to carbon removals as discussed in the last *Survey* (OECD, 2023[4]).

Security of supply will also require stronger market integration. However, little coordination happens between EU countries when it comes to actual investment. A strict national approach to renewable support neglects dependencies among countries. Such externalities require a more regional or European approach to investment in energy supply. For instance, EU-wide or joint cross-border competitive auctions for renewable capacity could achieve an EU-wide optimisation of the renewable fleet that reflects cost advantages of energy-rich regions. The EU has already started such auctions in the case of hydrogen (European Commission, 2025[29]). The EU could support such projects with funding from Important Project of Common European Interest. This should be based on rigorous cost-benefit analysis (Chapter 4).

EU countries grant priority network access and dispatching, and limited balancing responsibilities for small renewable energy installations and larger historic renewable installations. Dispatching refers to a short-term change in how a power plant is utilised and comes at the behest of a transmission system operator to prevent bottlenecks in the electricity grid. In periods of high demand, priority is granted to national renewable plants (such as hydro, geothermal and biomass), discouraging imports of electricity, even if it can be imported at lower prices. This constitutes a barrier to the Single Market. All renewable producers should be subject to the same responsibilities and liabilities as conventional energy producers, including taking part in short-term balancing. Hence, priority dispatch for all renewable producers should be phased out and technology-neutral balancing requirements for renewable producers should be mandated.

Permitting times for renewable installations are lengthy as discussed in more detail in the last *Survey* (OECD, 2023[4]). To shorten permitting times, the EU proposed in 2023 to designate renewable projects as of overriding public interest (European Commission, 2023[30]). Since then, several EU countries such as Germany and Spain have introduced an overriding public interest principle for renewable installations, which was followed by double-digit increases in the volume of permits issued for onshore wind (OECD, 2023[31]; OECD, 2023[32]). However, lengthy permitting times often reflect legitimate environmental concerns. They also result from a technology bias of renewable support towards technologies that require agricultural land and other used land, creating tensions with local populations. A better focus on distributed energy production could ease these tensions, such as installation of solar photovoltaic capacity on unused rooftops in urban areas.

### *3.4.3. Bolstering investment in electricity grids*

Barriers to the deployment of renewables include underinvestment in grids, notably local distribution networks, and lengthy planning and permitting processes (Box 3.3). Permitting times for new grid connections are on average longer than for new renewable installations, which leads to bottlenecks. Moreover, stronger European planning and funding is needed to incentivise investment in cross-border electricity connections.

Grid investment is regulated and needs to be approved by national Ministries. The regulatory framework is very short-term oriented because grid connections are approved only for existing power installations. Moreover, permitting times for new electricity grid connections are on average longer than for new renewable installations, which leads to bottlenecks (ENTSO-E, 2024[33]). Hence, there is a need for a more anticipatory regulatory framework for grid investment. For instance, national authorities could approve grid connections before planned renewable installations are built, as suggested by the Commission (European Commission, 2025[27]). The Commission should provide guidance to EU countries to fasten the permitting process of grid installations for instance by granting permits for connections to planned power installations. Priority should be given to cross-border grid connections, such interconnections in the North Sea and between France and Spain, which would strengthen connections between energy-rich and energy-poor regions in the EU.

Network tariffs accounted for 17% of the average EU household's electricity bill in 2023 (Eurostat, 2024[34]). Network tariffs are expected to rise to finance the sizeable grid investment needs, which are projected to increase from 0.5% of GDP in 2024 to 0.6% of GDP per year until 2030 (European Commission, 2022[35]). Higher network tariffs, however, will discourage the switch from gas to electricity. Reducing the cost of capital for network companies

could help lowering investment costs and thus network tariffs. One solution would be to apply a faster rate of depreciation to provide higher returns early on for investors, which could lower risk premia and capital costs (ENTSO-E, 2024[36]). The Commission announced it will provide guidance to EU countries as to how they can use their public budget to lower network charges in compliance with state aid rules, which is welcome (European Commission, 2025[27]). Another solution is prolonging the cost recovery period for grid expansions.

### Box 3.3. Adapting Regulatory Frameworks to the Characteristics of Renewable Energy

Accelerating the transition to renewable energy requires significant reforms to the national and sub-national regulatory frameworks for energy markets. Whilst important reforms have been adopted at EU level, EU countries have been slow to implement change. The Commission initiated infringement decisions against 26 of the 27 EU countries in September 2024 for failure to transpose the Renewable Energy Directive, for instance.

- Distributed Generation: Renewable electricity often involves decentralised, variable, and geographically dispersed installations, unlike traditional centralised power. Outdated regulatory frameworks, initially introduced for conventional fossil fuel generated electricity, create barriers for innovative business models and hinder renewable deployment. To accelerate progress, regulations must be updated to support distributed systems. The EU's Directive on Common Rules for the Internal Market for Electricity requires EU countries to develop a regulatory framework that enables market participation of such actors, but its implementation has been slow (see above).
- Technology-specific Challenges: Regulatory frameworks need to be tailored to the unique features of renewable energy segments. For example, utility-scale solar installations typically face extensive spatial planning and environmental assessment procedures, unlike smaller rooftop or solar car park installations, which warrant streamlined permitting due to their simpler integration into existing grids. Solar energy production on agricultural land requires tailored local regulations to maintain agricultural land classification.
- Local Regulatory Challenges: In most EU countries, sub-national and local authorities are responsible for local permitting procedures, spatial planning rules, and regulations for local distribution system operators such as private solar rooftops. These rules influence the ease of entry as well as the integration of distributed generation into local grids. Efficient permitting procedures, clear spatial planning guidelines, and operational rules for local distribution system operators are essential for renewable energy deployment.

Source: (OECD, 2025[37]).

There are trade-offs between competitiveness and decarbonisation when it comes to network tariffs. Currently, energy-intensive firms pay lower network costs than households in some countries such as Austria, France, and Germany. In contrast, costs between industry and households are more equally distributed in other countries such as the Netherlands (Heussaff and Zachmann, 2025[38]). Lowering energy costs for industry can support competitiveness. However, it introduces an uneven level playing field to the Single Market. It also reduces households' incentives to invest in electrification such as electric vehicles and heat pumps. The EU announced to provide guidance to harmonise network tariff methodologies to limit distortions to the level playing field in the Single Market, which is welcome (European Commission, 2025[27]).

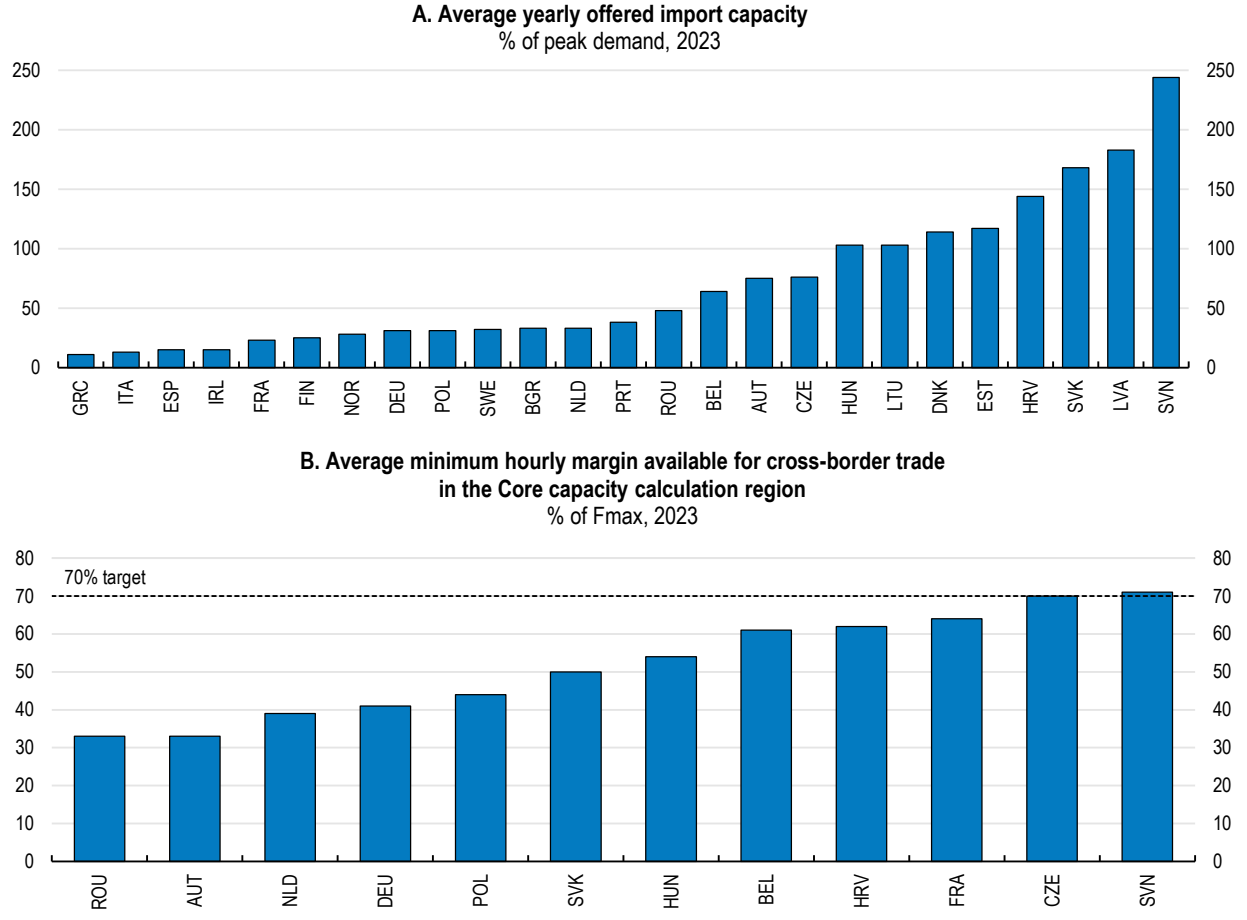
The EU's integrated electricity grid allows countries to export their surplus energy, helping to ensure security of supply and lowering energy costs elsewhere. Overall, cross-border electricity trade is estimated to have lowered consumers' electricity bill by 0.2% of GDP in 2021 (ACER, 2022[15]). Another advantage of an integrated electricity grid is its size, which helps to balance out production across countries, allowing for smoother integration of renewables. This allows to achieve climate targets in a more efficient way without compromising energy security.

However, further progress is needed to connect electricity grids between countries (Figure 3.13, Panel A). The investments announced or underway in new cross-border grids for 2030 only cover about a quarter of the needed EUR 6 billion annual investment (or 0.03% of EU GDP) (ENTSO-E, 2022[39]). Underinvestment in cross-border grids

reflects that these projects are often not commercially viable due to regulatory differences across countries and disagreement over cost-sharing arrangements. Overcoming such differences involves higher costs and risks, which national government are not willing to do either. EU funding could overcome such barriers. But the central EU funding vehicles for cross-border grid investment, the Connecting Europe Facility, has an annual budget of less than EUR 1 billion (0.006% of EU GDP). Hence, the EU should reallocate funds to the Connecting Europe Facility to ensure sufficient funding is available for cross-border grid connections for which private funding is not available. This should be done based on cost-benefit analysis.

The EU's ten-year network development plan identifies borders that should be prioritised for connections based on a cost-benefit analysis (ENTSO-E, 2025[40]). Such EU-wide priorities can receive EU funding. However, projects are proposed and selected with strong involvement of national grid operators, the owners of network infrastructure. National grid operators may have different priorities for grid expansion than a Pan-European grid operator would have. The European Network of Transmission System Operators for Electricity (ENTSO-E) and the EU Agency for the Cooperation of Energy Regulator (ACER) have a more European perspective on investment needs, but they cannot propose projects. The dominance of national interests in project proposal and selection introduces disincentives for most efficient investment in cross-border networks from a European perspective. ACER could be tasked to propose specific cross-border projects that meet cost-benefit analysis criteria.

## Figure 3.13. Cross-border grid connections are limited




Note: Panel B, Fmax indicates the maximum flow on critical network elements, respecting operational security limits.
Source: ACER calculations based on ENTSO-E and JAO Auction Tool data.

StatLink https://stat.link/fv4m5n

To open national markets to trade and competition, the EU requires countries to increase the utilization of their existing electricity cross-border capacity to 70% by 2025. However, progress on reaching this target is behind

schedule in most countries (Figure 3.13, Panel B) (ACER, 2024[41]). This reflects that national transmission system operators have the discretionary power to apply derogations to soften cross-border capacity targets. In practice, these derogations constitute a major barrier to trade and competition as they reduce access to domestic markets for foreign electricity producers and retailers. Although ACER is responsible for monitoring the fulfilment of cross-border capacity targets, it does not have powers to enforce such targets. Non-discriminatory access to the EU electricity network is fundamental for more market integration. Hence, ACER should receive powers to enforce cross-border capacity targets, for instance, by overriding national derogations to cross-border capacity targets.

## Table 3.1. Past recommendations on energy

| Main recommendations of the 2023 Survey | Action taken since 2023 |
|---|---|
| Revise the Energy Taxation Directive to introduce minimum tax rates for fossil fuels based on energy content and environmental performance, and broaden the energy tax base by phasing-out exemptions and reduced rates for fossil fuels. Announce clear time paths for the evolution of minimum tax rates for fossil fuels. | No action taken. |
| Ensure that the EU state-aid framework allows government subsidies only for renewable technologies that are not yet competitive. | No action taken. |
| Ensure that EU countries phase out regulated retail electricity prices by fully implementing the EU Directive on Common Rules for the Internal Market for Electricity. | No action taken. |
| Increase investment in cross-border grid connections by diverting EU funds to the Connecting Europe Facility. | The Connecting Europe Facility has received a budget reinforcement worth EUR 50 million in 2024. This allowed the selection of a greater number of cross-border projects for grants. |
| In the longer-term, consider reforms to the wholesale electricity market pricing system, including a stronger reliance on long-term contracts. | No action taken. |

## Table 3.2. Main findings and recommendations (key recommendations in bold)

| Main findings | Recommendations |
|---|---|
| **Enhance competition to lower prices** | |
| Renewable support such as feed-in tariffs and production-based Contracts for Difference reduce supply flexibility. | **Ensure that the EU state-aid framework targets government subsidies to low-carbon technologies without muting market price signals.** |
| High electricity tax rates discourage electrification. | **Phase out reduced rates and exemptions for fossil fuels by adopting the revision of the Energy Taxation Directive.** |
| Entry barriers hamper competition in electricity markets. | Provide technical guidance to EU countries to accelerate the implementation of the EU Directive on Common Rules for the Internal Market for Electricity granting market access to all energy producers and retailers. Consider infringement action if progress is insufficient. |
| Regulated retail prices discourage energy savings. | Ensure that EU countries phase out regulated retail electricity prices by fully implementing the EU Directive on Common Rules for the Internal Market for Electricity. |
| **Strengthen markets for low-carbon energy sources** | |
| National renewable targets hamper EU-wide optimisation of the renewable fleet. National renewable auctions do not reflect the cost advantages of energy-rich regions. | Establish EU-level or cross-border competitive auctions for renewables, as is already the case for hydrogen. |
| Countries grant priority access and dispatching for some domestic renewable energy, reducing capacity for cross-border trade. | Phase out priority dispatch for all renewable producers by revising the Electricity Directive. |
| **Bolster investment in electricity grids** | |
| Cross-border electricity grid connections are limited.<br>The dominance of national interests in project selection of EU funded cross-border grid investment introduces disincentives for most efficient investment. | **Task ACER to propose specific cross-border grid connection projects that meet cost-benefit analysis criteria.**<br>Reallocate funds to the Connecting Europe Facility to spur cross-border grid connections. |
| Most countries still discriminate against foreign electricity producers and retailers when allocating their existing cross-border transit capacity. | Empower ACER to override national derogations of cross-border capacity targets. |
| Permitting times for new grid connections are on average longer than for new renewable installations, which leads to bottlenecks. | Provide guidance to EU countries to grant permits for grid connections to power installations that are still in planning. |

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# 4 Strengthening productivity and the Single Market

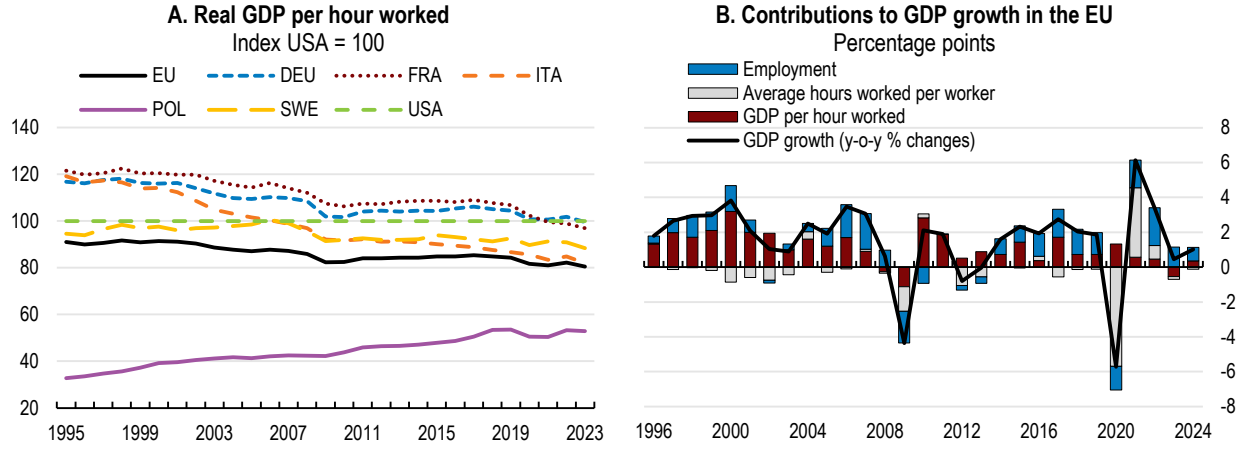
Martin Borowiecki, Federico Giovannelli and Jan Stráský

*Productivity growth in the EU has been weak, reflecting persistent internal market barriers, rigid labour markets and a largely bank-based financial system. The latter fails to channel high saving rates into investment in young innovative firms. As a result, the EU lags behind the United States and increasingly China in innovation and adoption of new technology. Higher productivity can be achieved through a more integrated Single Market for capital, labour and services. This will require structural reforms to reduce internal market barriers and cut regulatory burden to strengthen competition and unleash business dynamism.*

## 4.1. Strengthening productivity remains a key challenge

Since 2000, economic growth in the European Union has been driven by employment gains while labour productivity growth has weakened. As a result, the EU's productivity gap vis-à-vis the United States has widened (Figure 4.1). While productivity growth has been stronger in some EU countries such as Sweden and Poland, many others have seen weak productivity growth. Going forward, population ageing, and the expected shrinking of the working age population implies that employment-driven growth will be more difficult to sustain, leaving the EU more reliant on improvements in productivity (André, Gal and Schief, 2024[1]).

### Figure 4.1. Productivity growth has lagged behind




Source: OECD National Accounts database; OECD Productivity database; and OECD calculations.

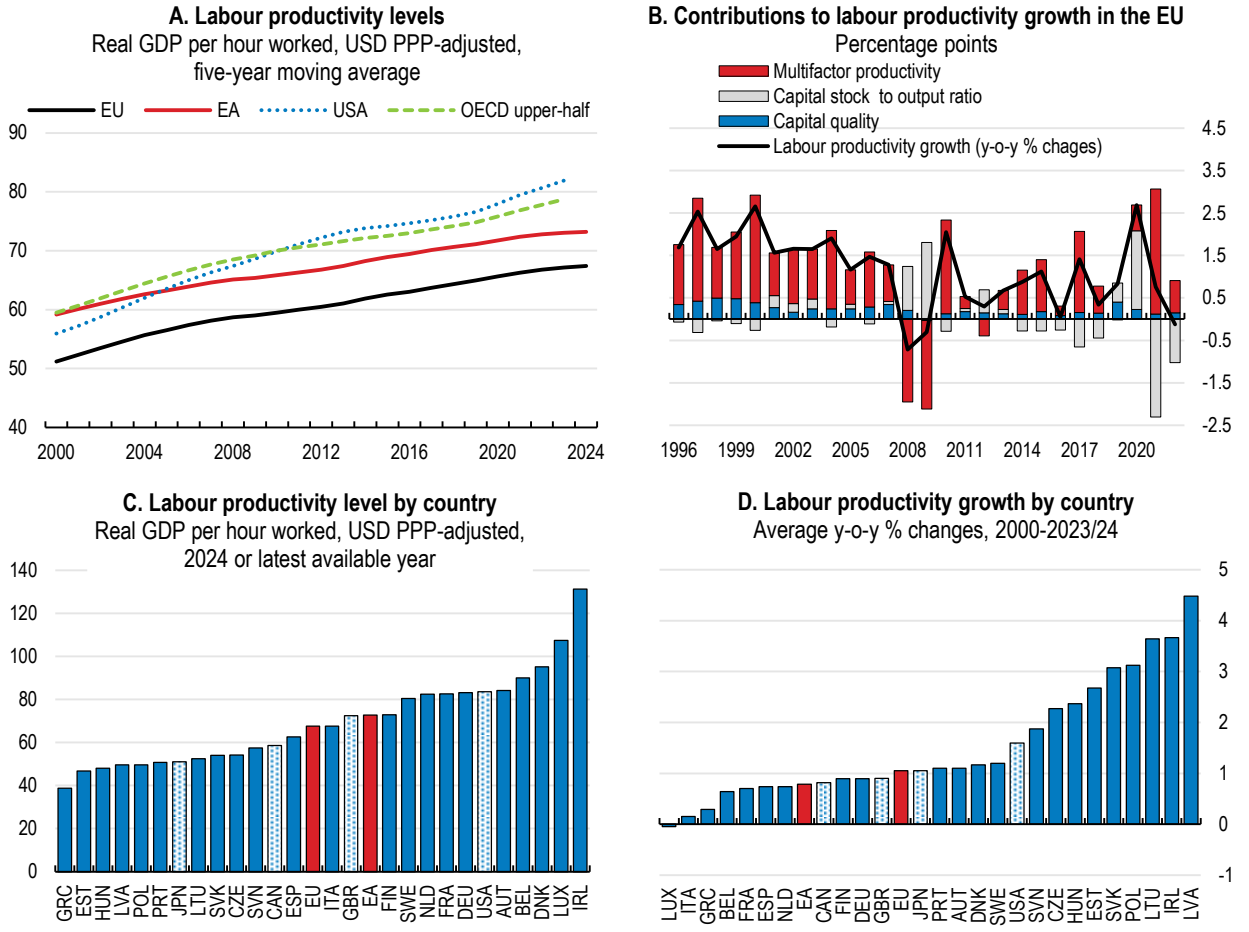
StatLink https://stat.link/cnmfwd

At the same time, high energy costs, global trade tensions as well as protectionist industrial policies raise risks to competitiveness. Some of the EU's challenges are attributable to areas where the Single Market is not fully integrated yet. Limited market integration denies the scope for economies of scale of the type US and Chinese firms can benefit from (Letta, 2024[2]; Draghi, 2024[3]). Unduly restrictive regulatory barriers to firm entry and competition still prevail in many countries and sectors, hampering market integration and productivity growth (European Commission, 2023[4]; European Commission, 2023[5]). Similarly, a largely bank-based financial system, segmented along national lines, fails to channel high saving rates into investment in young innovative firms as well as in intangible capital-intensive sectors (Demmou, Stefanescu and Arquie, 2019[6]). As a result, the EU lags behind the United States and increasingly China in innovation, especially in high-tech sectors such as artificial intelligence (AI) (Fuest et al., 2024[7]). In addition, despite the relatively high skills of Europeans, Europe is missing skilled labour where it is most needed, reinforcing the need to improve labour mobility. This Chapter will review policies to strengthen productivity and will focus on Single Market policies. A deeper, more integrated Single Market can be achieved through structural reforms that reduce internal market barriers.

## 4.2. Productivity growth has been weak

Weak productivity developments reflect a significant decline in multifactor productivity growth, or how efficiently labour and capital are used, and, since the global financial crisis, weaker capital accumulation (Figure 4.2, Panel A and B). EU labour productivity growth has been half a percentage point lower annually than in the United States since 2000. Euro area productivity performance has been weaker still, reflecting weak productivity growth in the largest euro area economies. In contrast, some northern as well as central and eastern European Member States saw stronger productivity growth, with the latter reflecting ongoing convergence. Nonetheless, productivity levels remain relatively low in central and eastern Europe (Panel C and D).

## Figure 4.2. Productivity growth has slowed



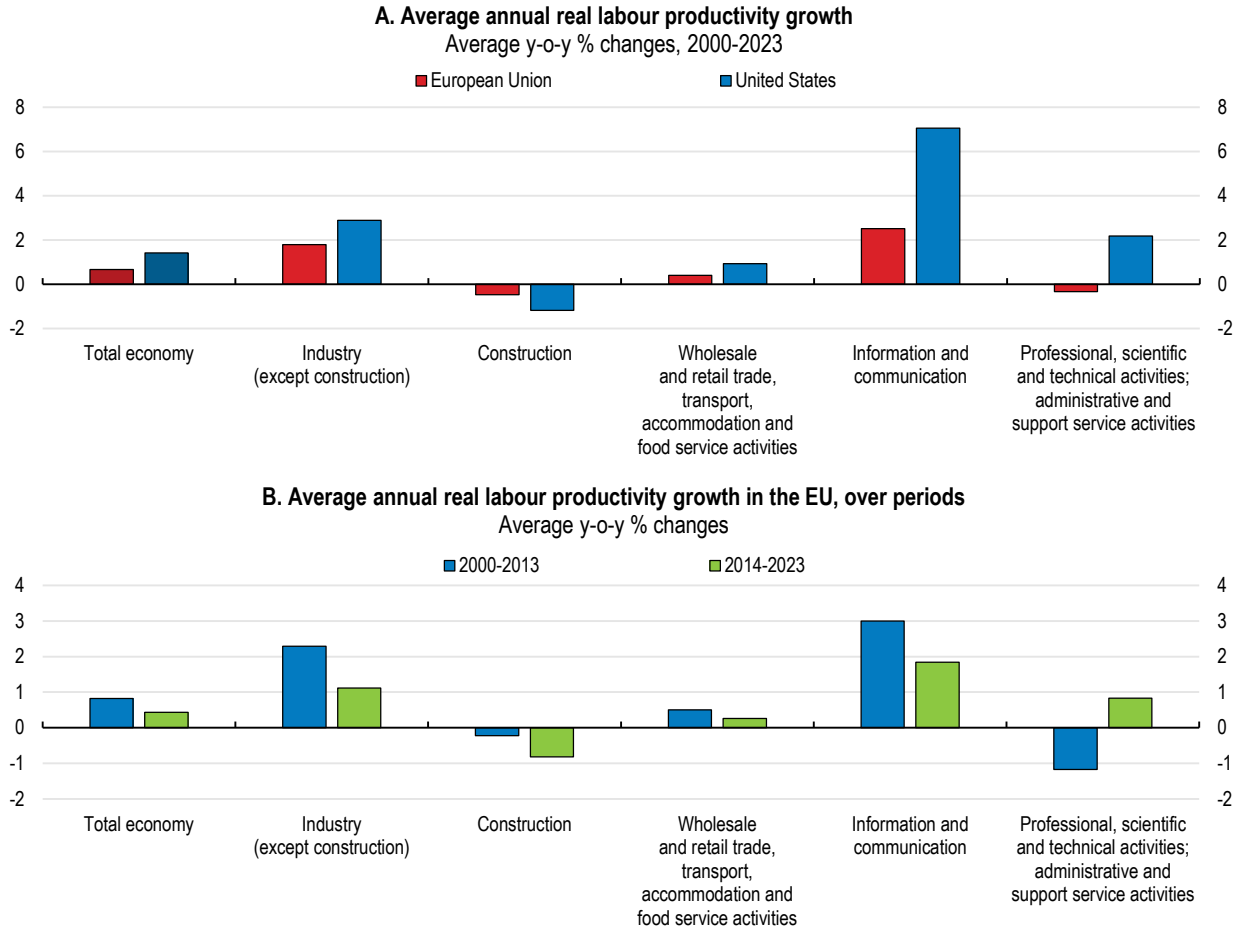

Note: Labour productivity is measured as real GDP per hour worked, USD PPP-adjusted. In Panel A, OECD average weighted by the number of hours worked. In Panel B, the EU aggregate includes 14 EU countries plus Norway, namely AUT, BEL, DEU, DNK, ESP, FIN, FRA, GRC, IRL, ITA, LUX, NLD, NOR, PRT, and SWE.

Source: OECD Productivity database; and OECD calculations.

StatLink https://stat.link/tw5hka

The productivity slowdown has been broad-based across sectors, although industry structure can partly explain productivity differences (Figure 4.3). Compared to the United States, a noticeable development has been weaker productivity growth in information and communication as well as professional services, two sectors that heavily use digital technologies. This also reflects a greater ability of US firms to create and use digital technologies as well as their bigger size (van Ark, O'Mahony and Timmer, 2008[8]; Schivardi and Schmitz, 2019[9]). In contrast, the EU has failed to reap the benefits of digital technologies, which reflects that many European companies are too small and constrained by regulation to fully exploit new technology (see below).

## Figure 4.3. The productivity slowdown has been broad based across sectors




Note: Labour productivity is measured as real value added per employee, chain-linked volumes 2015.
Source: Eurostat; BEA; and OECD calculations.

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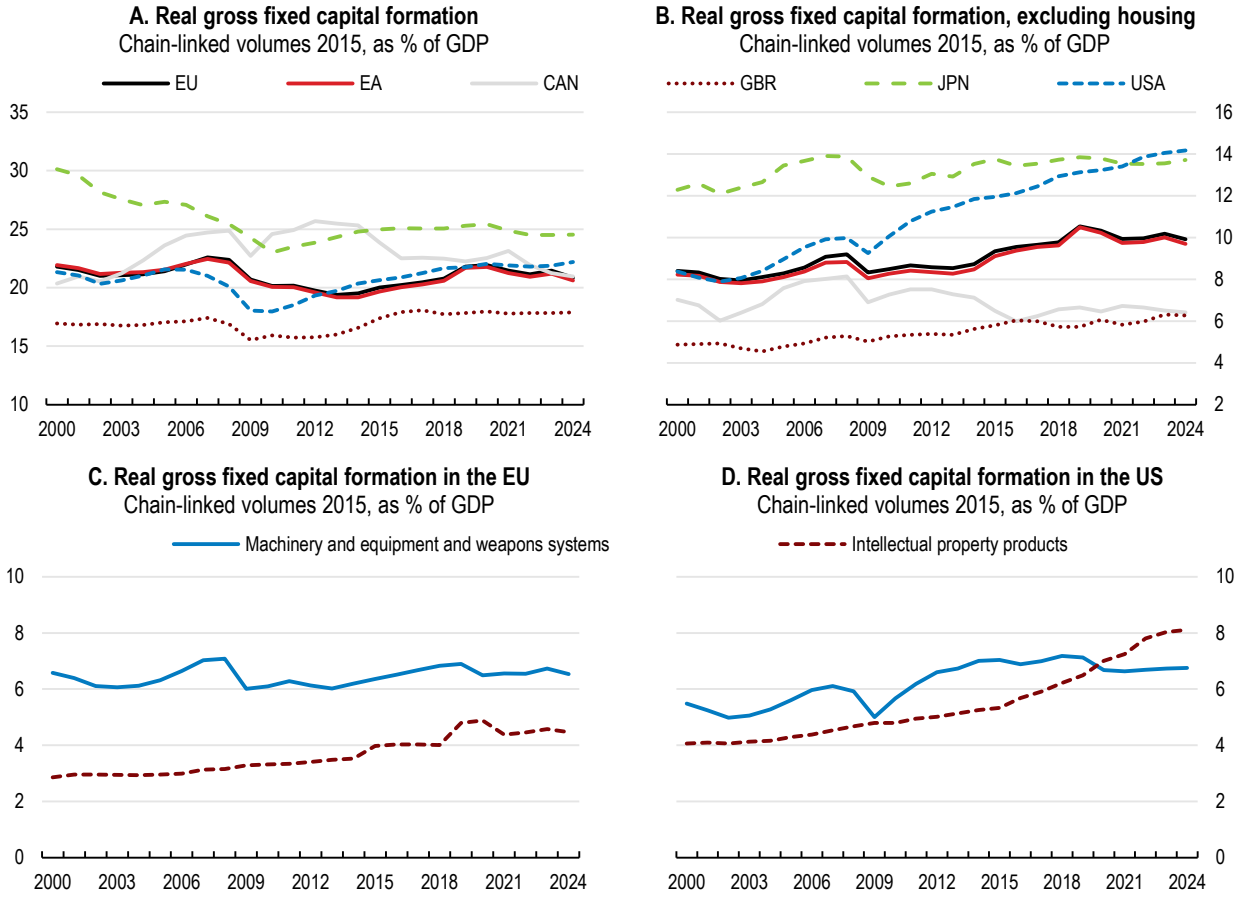
Overall, investment is relatively high as a share of GDP, reflecting high residential investment (Figure 4.4, Panel A). In contrast, productivity-enhancing investment, excluding housing, has expanded less dynamically than in the United States since the early 2000s and investment rates started to diverge significantly between the EU and the United States after the financial crisis (Panel B). The divergence was mainly driven by lower spending on intellectual property products, notably business R&D and information technologies, and encompasses all sectors but is particularly stark in the information and communication technology sector (Panel C and D) (IMF, 2024[10]; EIB, 2024[11]; OECD, 2025[12]). This reflects higher business R&D spending by US high-tech firms as well as their bigger size (Pinkus et al., 2024[13]). In contrast, business R&D spending in the EU is concentrated in medium-tech sectors such as the automotive sector.

## Figure 4.4. Investment in business R&D and information technologies is relatively low




Note: In Panel C and Panel D, machinery and equipment and weapons systems include transport equipment, ICT equipment (i.e. computer hardware and telecommunications equipment) and other machinery and equipment and weapons systems; while intellectual property products include computer software and databases, research and development and mineral exploration and evaluation.
Source: OECD National Accounts database; and OECD calculations.

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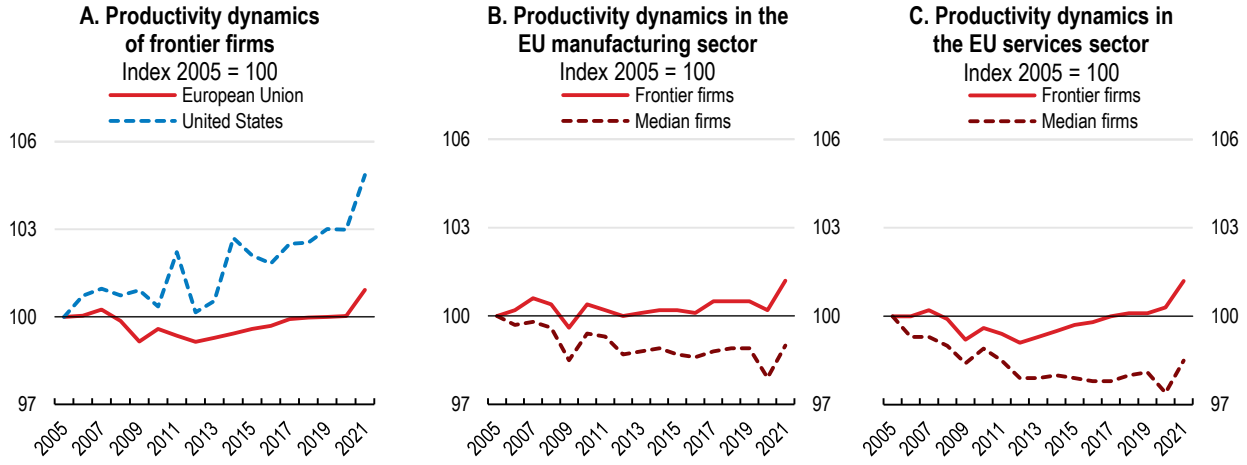
Productivity growth of the most productive EU firms (or frontier firms) was slower than those of US frontier firms across all sectors since 2005, and especially so in information and communication technology (IMF, 2024[10]). While the EU is not specialised in ICT, a concern is weaker productivity developments in important medium to high-technology sectors, including in the automotive sector and advanced machinery, reflecting lower innovation activity (Modery et al., 2021[14]). Lower innovation activity and specialisation in medium-tech sectors has contributed to the EU lagging the United States and, increasingly, China in innovation in frontier technologies such as artificial intelligence (Filippucci, Gal and Schief, 2024[15]; Fuest et al., 2024[7]; OECD.AI, 2024[16]). A factor behind weak innovation is low investment in young innovative firms.

The labour productivity growth of EU firms has also proven less resilient to economic shocks and rebounds from such shocks have been slower than for US firms. Labour productivity levels of frontier US firms stood 1.7% higher in 2014 than before the financial crisis in 2007. In contrast, labour productivity levels of frontier EU firms were 0.9% lower in 2014 than in 2007. Similarly, labour productivity of US frontier firms rose 1.9% above pre-pandemic levels by 2021. That is more than double the 0.9% rise in labour productivity of frontier EU firms (Figure 4.5, Panel A). The weaker productivity rebound of EU frontier firms may also reflect weaker business dynamism (see below).

## Figure 4.5. Productivity has rebounded slowly following economic shocks




Note: Panels A, B and C, calculations based on the methodology of Andrews et al. (2016[17]). Average labour productivity across 2-digit NACE Rev2 sectors using firm-level data. Labour productivity is defined as value added per employee between firms at the top 5% of the productivity distribution (EU "frontier") and at the median (EU "medium performer") within each detailed 2-digit NACE Rev2 sector across 20 EU countries for which firm level data is available. The median firm is in 99% of all EU sectors a small and medium-sized enterprise. Manufacturing refers to NACE Rev2 sectors 10-33 and services to NACE Rev2 sectors 45-82 (excluding the financial sector 64-66).
Source: OECD calculations using the Orbis firm-level financial accounts database by Moody's/BvD (2024).

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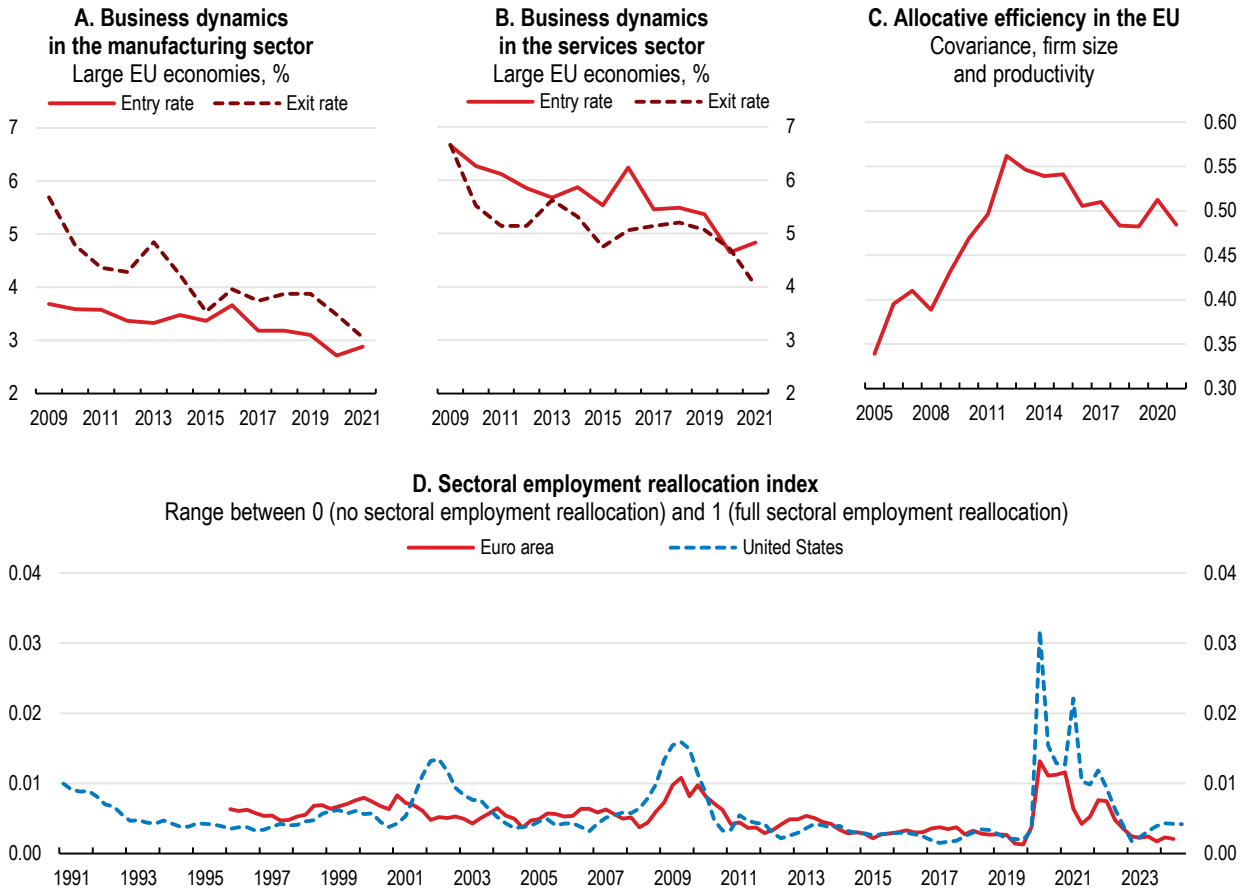
Weaker productivity growth can also be traced back to declining labour productivity growth of small and medium-sized enterprises (SMEs, or the median firm) in the EU manufacturing sector since the financial crisis (Figure 4.5, Panel B). The fall in labour productivity of SMEs (or the median firm) in EU services was even more pronounced (Panel C). In contrast, service sector firms at the productivity frontier have continued to perform more strongly than other firms since the financial crisis, pointing to a slowdown in the diffusion of innovation and best management practices across firms (Andrews, Criscuolo and Gal, 2016[17]; André and Gal, 2024[18]). Other factors behind the growing productivity dispersion in services may include weak competition, winner-takes-all markets, and limited services market integration that denies EU firms the scope for economies of scale that US firms can benefit from.

Weak productivity developments also reflect an increasingly inefficient allocation of resources across firms (ECB, 2024[19]). The reallocation of labour to more productive firms (or allocative efficiency) within a sector has improved between 2000 and the financial crisis. Since then, however, allocative efficiency has weakened. Similarly, entry and exit rates of firms in Europe have declined (Figure 4.6, Panel A to C) (Cho et al., 2024[20]; Calvino, Criscuolo and Verlhac, 2020[21]; Calvino and Criscuolo, 2019[22]). More generally, job reallocation across sectors is also weaker during crises in the EU compared to the United States (Panel D). Much of this rising misallocation stems from rigid labour markets and persistent barriers to firm entry and competition that prevent capital and labour from reaching the most productive companies. Lengthy and inefficient insolvency proceedings may also keep unproductive businesses alive, further weakening productive reallocation. This may also have made the EU economy more vulnerable to economic shocks, which implied long-lasting effects on the structure and sectoral allocation of output.

Reducing regulatory barriers holding back productive firms from growing, and improving insolvency procedures for a faster exit of unproductive businesses, could help revive productivity growth and strengthen the Single Market (Zona Mattioli and Borowiecki, 2025[23]). Such reforms will also be important to raise the capacity of the EU economy to adjust to economic shocks. In addition, reforms that leverage new technologies such as AI will help to revive productivity growth (Filippucci, Gal and Schief, 2024[15]).

## Figure 4.6. Business dynamism has weakened




Note: Panels A and B, based on OECD DynEmp data for France, Germany, Italy and Spain. Average firm entry and exit rates in percentage of the business population based on firms with at least two persons employed. Entry is defined as the reported birth year in the micro-data when this year is prior to the sample period; otherwise, it is defined as the first year with positive employment. Exit is defined as the last year with positive employment. Large EU economies refer to the unweighted average of Germany, France, Italy and Spain. Panel C, allocative efficiency is the within-industry covariance between firm size and firms' labour productivity following Olley and Pakes (1996). Firm size is defined as employment and labour productivity as value added per employee. The larger the (positive) covariance between firm size and productivity, the higher the share of employment that goes to more productive firms and the higher the industry productivity. All decompositions are computed within each 2-digit NACE Rev2 sector. The chart shows the employment-weighted average across sectors. Panel D, the reallocation index is calculated using year-over-year growth rates of employment from SIC industry classification.

Source: Garcia-Cabo Herrero et al., (2023) Sectoral shocks, reallocation, and labor market policies, European Economic Review, https://doi.org/10.1016/j.euroecorev.2023.104494; OECD calculations using the 2024 vintage of the Orbis firm-level financial accounts database by Moody's/BvD; and OECD DynEmp - Measuring job creation by start-ups and young firms.

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## 4.3. The Single Market is key for productivity

An important policy lever of the EU to raise productivity growth is by strengthening the Single Market. Market integration has raised intra-EU trade, competition, and investment, and hence economic growth more broadly (Kierzenkowski et al., 2016[24]; in 't Veld, 2019[25]; Felbermayr, Gröschl and Heiland, 2022[26]). A larger market offers firms the opportunity to exploit economies of scale. Lower barriers to mobility of labour and capital and the forceful application of competition policies raise the contestability of markets. This, in turn, is beneficial for business dynamism and innovation, and allows efficiency gains through reallocation towards the most productive firms. In addition, lower trade barriers and the harmonisation of legislation and standards reduces costs for businesses (Sondermann and Lehtimäki, 2020[27]). The proper functioning of the Single Market entails competition policy, innovation policy, energy policy, transport policy, telecommunication policy, and trade policy. In addition, the EU is

responsible for capital market integration and cross-border banks. Taxation is mainly the domain of EU countries, although the EU sets minimum tax rates for value added tax (VAT) and energy, including transportation and heating fuels. The EU also encourages cooperation between EU countries to combat tax evasion. For example, the Directive on Administrative Cooperation aims to strengthen the automatic exchange of tax information, and the OECD/G20's Pillar Two have been transposed in EU law.

In the 1990s, the EU's Single Market for goods was furthered through extensive deregulation. EU countries opted for the Single Market for goods as the inefficiencies of fragmented national markets outweighed the regulatory costs of the Single Market. Since then, however, a growing body of EU regulation has added to the regulatory costs of the Single Market. This reflects that regulation in digital sectors, including the General Data Protection Regulation of 2016, as well as sustainable reporting and due diligence rules of 2024, to name a few, have not been subjected to rigorous economic impact assessments. Recent regulations were added on top of older ones, leading to a higher combined burden of regulations that does not incentivise firms to invest and raise productivity. When it is well-conceived, EU regulation can reduce compliance costs for businesses operating within the Single Market compared to the costs of adhering to 27 different national laws. Hence, to reduce the regulatory cost of the Single Market, the EU should ensure proper economic impact assessment of regulations.

Liberalisation of services markets happened later than for goods markets. The Services Directive established a single regulatory framework for the Single Market for services in 2006, covering around two-thirds of services activity within the EU or 45% of EU GDP. This includes retail, construction, and tourism. Services outside the scope of the Directive benefit from EU specific regulation, including financial services, network services (energy and telecommunications), and transport services. To strengthen labour mobility, the Professional Qualifications Directive creates rules to facilitate the recognition of qualifications between EU countries.

Despite progress in the Single Market for services, however, market integration remains lower than for goods. EU countries have retained a large room for manoeuvre in the implementation of the Services Directive. This reflects that some services are not tradeable, cultural and language barriers (Parsons and Smith, 2022[28]; Jacobs, Parsons and Moland, 2024[29]) but also that the aim of the Services Directive is not to fully harmonise national regulations. Instead, it aims at removing disproportionate, discriminating or unjustified barriers.

However, some EU countries are far less ambitious in the implementation of the Services Directive than others. Mutual recognition of qualifications remains limited for professional services, hindering cross-border labour mobility and the provision of services. As a result, cross-country differences persist in regulations for professional services, retail, telecommunication, and transport services, among other sectors (Letta, 2024[2]). Such barriers to entry and growth protect the rents of incumbents, constrain the entry of young innovative firms and hamper efficient reallocation of resources to the most productive firms (Sorbe, Gal and Millot, 2018[30]).

Importantly, a fragmented Single Market puts European businesses at a disadvantage as firms operating in larger markets can more easily build economies of scale and tend be more innovative and productive (Draghi, 2024[3]). The EU needs a more integrated Single Market with fewer regulatory roadblocks for companies to scale up and innovate. As EU countries have a key role in implementing Single Market Law, the EU could help facilitate closer collaboration between EU countries to help identify best practice that reduces burdens and drive consistent approaches across the Single Market (see below).

In 2025, the EU announced a simplification of state aid rules for clean technology and energy-intensive manufacturing until 2030 to support national industrial policy in these areas. Specifically, the proposed new Clean Industrial State Aid Framework aims to make state aid rules simpler and more flexible to incentivise national investment in areas aligned with EU priorities (Box 4.1). The new state aid framework would build on the experience of the Temporary Crisis and Transition Framework, which temporarily loosened state aid rules during the COVID-19 pandemic and the energy crisis using the flexibility foreseen in the Treaty to remedy serious economic disturbances.

However, these simpler and more flexible state aid rules for strategic sectors, together with stronger use of national industrial policy, could result in a relaxation of state aid rules, which can have implications for competition and the level playing field in the Single Market (OECD, 2023[31]). For instance, countries with more fiscal space may provide excessive support, putting at risk the integrity of the Single Market. This increased flexibility may also weaken incentives for greater coordination across national-level initiatives in line with EU objectives (Hodge et al., 2024[32]; Piechucka, Sauri-Romero and Smulders, 2024[33]). To protect the Single Market, the EU should refrain from a

continued relaxation of state aid rules. The existing EU legal framework, particularly the 2022 Guidelines on State aid for climate, environmental protection and energy, already allows for green subsidies justified by environmental externalities and climate protection. If the EU engages in industrial policy, a European scope and stringent cost-benefit analysis can be most efficient (see below).

Industrial policy has been partly motivated by the perceived need to increase economic security and resilience in the context of geopolitical fragmentation, and substantial intensification of industrial policy action globally. However, there are trade-offs between efficiency and resilience. On the one hand, protection of national incumbents may slow down productivity and structural change. On the other hand, economic security and resilience are important in the context of growing geopolitical risks, such as in security of supply of critical materials. Some forms of national industrial policy can have positive cross-border spillovers if they are motivated by well-defined market failures such as support for security, new technologies and decarbonisation. This requires non-distortive industrial policy that fosters innovation and competition, avoids favouring incumbents, and emphasises policy evaluation. Hence, design and implementation of such policies should be considered carefully through a cost-benefit analysis and follow-up evaluations, including Single Market implications (Millot and Rawdanowicz, 2024[34]). Moreover, the existing state aid framework already allows support for industrial policy in cases of well-defined market failures, such as new technologies. A way to minimise the trade-off between industrial policy and productivity would be to finance industrial policies from EU funds.

Industrial policy can pose risks to third countries by distorting markets, harming innovation, and raising prices. These risks grow when competition is limited and protectionism rises, potentially undermining market contestability and the rules-based trading system. In this regard, industrial policy need not restrict competition. The EU should aim to continue supporting international cooperation and rules-based trade (Millot and Rawdanowicz, 2024[34]).

Industrial policy is mostly national and not aligned with EU priorities. Despite the EU's strategy to support decarbonisation and innovation (Box 4.1), most EU countries continue providing environmentally harmful fossil fuel subsidies such as tax exemptions and deductions for diesel. Public subsidies are also mostly allocated to firms operating in low and medium-technology sectors, with the exception of the Nordic countries (EIB, 2025[35]). The focus on national priorities comes with the risk of spreading support too thinly over too many sectors and underfunding EU priorities such as security and the energy transition.

National industrial policy also fails to take advantage of the economies of scale of the Single Market. For instance, some countries include environmental conditions in their support for electric vehicles, while others subsidise Chinese vehicles which already received subsidies in China. These disparities give inconsistent signals to car manufacturers.

To better align national spending with EU objectives, the Commission announced a new Clean Industrial Deal in February 2025 (Box 4.1) (European Commission, 2025[36]). The Commission also proposed a new Competitiveness Coordination Tool to coordinate with EU countries on investment in selected key areas of strategic importance and of common European interest. Higher levels of EU funding for such investment, including the announced Competitiveness Fund, aim to enhance alignment between national and European policy objectives. However, previous experience with the Net-Zero Industry Act suggests that prioritisation could be strengthened, with about 50 sectors deemed as strategic (European Commission, 2023[37]).

### Box 4.1. The European Commission's roadmap for productivity and competitiveness

The 'Competitiveness Compass' of January 2025 is a set of proposed measures to raise productivity and competitiveness and follows up on the recommendations of the Draghi report (Draghi, 2024[3]). It includes, among other things, the following policy proposals:

- In the next multiannual financial framework starting in 2028, a new **European Competitiveness Fund** will be formed, funded from the EU budget. The Fund will establish an EU-level investment capacity that will support national investment in EU strategic priorities to enhance European competitiveness, including research and innovation, energy-intensive manufacturing, and strategic technologies such as AI, clean tech, biotech and space, in return for EU countries' commitment to reforms.
- **Innovation policy:** The Commission proposes the establishment of a European Code of Business Law or "28th legal regime" that co-exists with national corporate law. In addition, measures to strengthen venture capital for start-ups include the European Investment Bank's scale-up TechEU investment programme and the European Tech-Champions Initiative 2.0. The EU Startup and Scaleup Strategy will address barriers faced by startups, including access to finance, markets, talent, infrastructure and harmonised innovation policy. The European Innovation Act will address the regulatory framework applicable to innovative companies, in particular startups and scale-ups, to reduce administrative burden. A European Research Area Act will focus on aligning EU R&D funding with strategic EU priorities. The AI Continent strategy and the EU Cloud and AI Development Act aim to encourage private investment in AI infrastructure.
- **Competition policy:** The Commission announced that it will simplify state aid rules for clean technology and energy-intensive manufacturing to incentivise investment until 2030 (Draft Clean Industrial State Aid Framework or CISAF). CISAF is currently in public consultation and sets out the conditions under which state aid for certain investments supporting the objectives of the Clean Industrial Deal will be considered compatible with the Single Market and state aid rules, notably in clean technology and energy-intensive manufacturing. It is planned to be adopted for June 2025, after closing the public consultation, and will build on the experience of the Temporary Crisis and Transition Framework (TCTF), which loosened state aid rules during the COVID-19 pandemic and the energy crisis. As in the TCTF, the proposed state aid rules would ease standard requirements, like the mandatory bidding process to allocate state aid for less mature clean technologies such as hydrogen. In addition, mandatory open tenders would not be required anymore for state aid supporting investment in the decarbonisation of energy-intensive manufacturing, with view to accelerating the use of state aid by EU countries. The Commission will also revise guidelines for assessing mergers, giving more weight to investment considerations to ensure that innovation and resilience in strategic sectors are given adequate weight. Competition policy will also promote a simpler and faster assessment of Important Projects of Common European Interest (IPCEIs), although further details were not announced. A Digital Networks Act will aim to enhance harmonisation of national spectrum assignment, giving greater weight to investment considerations vis-à-vis competition concerns.
- **Industrial policy and decarbonisation:** Under the "Clean Industrial Deal", the Commission proposes to establish an Industrial Decarbonisation Bank, aiming for EUR 100 billion (or 0.6% of EU GDP) in funding from the EU budget, funded by budgetary reallocations from the Innovation Fund, parts of EU ETS revenues and the investment programme InvestEU. The Bank will be placed within the governance of the future Competitiveness Fund (see above). It also announced an increase in the amount of financial guarantees that InvestEU can provide to support investments so as to mobilise up to EUR 50 billion (or 0.3% of EU GDP) (European Commission, 2025[36]). The Clean Industrial Deal also includes the sharpened use of trade defence instruments in sectors exposed to unfair global competition, and public procurement rules with EU content requirements. The Commission will also recommend EU countries to incentivise energy investment via depreciation rules and tax credits. The industrial action plan for

the automotive sector encourages more competitive and resilient automotive supply chains, stronger uptake of electric vehicles and autonomous driving. It will also grant car producers more flexibility to meet $CO_2$ emission targets in the coming three years without changing the actual targets (European Commission, 2025[38]). A forthcoming review of the Carbon Border Adjustment Mechanism will look into extending carbon levies on non-EU importers further into downstream sectors.

- **Energy policy:** The Action Plan for Affordable Energy will provide EUR 0.5 billion in guarantees for the European Investment Bank to counter-guarantee long-term power purchase agreements undertaken by companies. The Commission will provide EU countries with recommendations to lower electricity taxation and guidance on network tariffs with a view to lowering them for industry. The Plan also includes measures to facilitate permitting of renewable projects and electricity grids. EU countries are encouraged to use contracts for difference auctions to allocate renewable capacity, thus providing a government-guaranteed price floor and price cap for renewable energy, while the Commission will advocate for an EU-wide auction framework for hydrogen and other new clean technologies. A review of the Emission Trade System in 2026 will analyse whether to include carbon removals to compensate for emissions in hard to abate sectors, including energy-intensive industry and agriculture.
- **Trade policy and economic security:** Trade diversification with a wide range of countries and regions will be pursued through classical free-trade agreement such as the EU-Mercosur Agreement and the EU-Mexico Global Agreement, among others, as well as new types of trade instruments, such as the Clean Trade and Investment Partnerships and the Sustainable Investment Facilitation Agreements. The Economic Security Strategy from 2023 identified ten technologies critical for the EU's economic security, including AI, quantum technologies, and biotechnologies, and proposed increased scrutiny for foreign investment under the EU foreign subsidies regulations, export controls and outward investment monitoring. The Security Strategy also supports risk assessments related to the resilience of supply chains, critical infrastructure, technology leakage and economic coercion. The Critical Raw Materials Act facilitates shorter permitting processes for rare earths, such as lithium, and envisages joint purchases, stockpiling and import diversification of rare earths.
- **Reducing red tape:** Between 2024 and 2029, the objective is to reduce administrative burdens on businesses by 25% in terms of costs, and 35% for SMEs, starting with a review of sustainable finance reporting and due diligence rules. Companies will only have to report on their direct suppliers and business customers. Smaller EU companies will be exempted from the carbon border tax. There will also be a push for stronger digitalisation of business procedures, including moving reporting online.
- **Reducing internal market barriers:** The Single Market Enforcement Taskforce will be reinforced to tackle more effectively the most significant barriers within the Single Market that hinder the EU's competitiveness.
- **Deepening capital markets:** In early 2025, the Commission presented a Strategy on a Savings and Investments Union with measures to mobilise private savings for long-term investment and ease access to equity finance, including via a blueprint savings and investments account and actions to strengthen the uptake of private and occupational pensions, and more unified EU supervision of capital markets such as larger stock exchanges and post-trade financial infrastructure. These efforts complement ongoing work aimed at the harmonisation of insolvency frameworks, and the harmonisation of tax frameworks for cross-border investment.

Source: European Commission (2025[39]).

The EU's state aid framework allows supporting national industrial policy in line with EU objectives, notably through the Important Projects of Common European Interest (IPCEI). These projects support investment in advanced technologies, R&D, innovation, first industrial deployment and key infrastructure, provided they have a European relevance and do not cover mass production or commercial activities. EU countries are in the driving seat as they propose projects to the Commission. The Commission ensures through competition analysis that any potential

distortions of competition are minimised. More generally, industrial policy should not protect incumbents from competition, which would be negative for productivity (Millot and Rawdanowicz, 2024[34]).

## 4.4. Deepening the Single Market

### *4.4.1. Reducing the regulatory burden*

When it is well-conceived, EU regulation can reduce compliance costs for businesses operating within the Single Market compared to the inefficiencies of fragmented national regulations. There also seems to be a positive international impact as EU product standards have in many fields become global standards, reducing compliance costs for businesses.

However, a growing regulatory burden is constraining business dynamism. In Germany, for instance, the total costs of bureaucracy incurred by the corporate sector is estimated at 0.7% of GDP per year. More than half of the costs of red tape in Germany are related to EU legislation (Falck et al., 2024[40]). In the EU, about 61% of firms surveyed by the European Investment Bank identified regulatory frameworks as a major barrier to long-term investment, and about 86% of firms employ staff to deal with regulatory compliance with an associated cost of 1.8% of turnover. Regulatory costs increase to 2.5% of turnover for SMEs (EIB, 2025[35]; EIB, 2024[41]). Recent years have seen new EU legislative acts for money laundering and sustainable reporting, due diligence rules, data protection, policing of online content, AI, and digital services. This suggests that the combined burden of all regulations has increased.

In response, the European Commission has proposed to simplify sustainable finance reporting and due diligence rules, and exempt smaller companies from the carbon border tax (European Commission, 2025[39]). To effectively reduce the combined burden of all regulations (and directives), the European Commission has announced a review of the entire body of EU legislation that has grown over the past decade to simplify and streamline documentation requirements and reporting obligations (European Commission, 2025[42]). The proposed Omnibus Simplification Package, announced in early 2025, aims at streamlining corporate sustainability reporting and the Carbon Border Adjustment Mechanism (CBAM), among other things, while maintaining the EU's sustainability goals (European Commission, 2025[43]).

The European Commission announced it aims to reduce administrative burden for businesses by a quarter, and for SMEs by 35%, by 2029 (European Commission, 2025[42]). In 2021, the Commission already adopted the "one in, one out" approach offsetting new EU regulations by equivalently reducing the number of existing regulations (European Commission, 2021[44]). To flank the "one in, one out rule" and support burden reduction efforts, the Commission has announced a suite of new tools, including implementation dialogues with stakeholders and reality checks with practitioners in companies.

To better manage the flow of new rules and avoid unnecessary burdens in the first place, all regulatory proposals (and directives) should be accompanied by rigorous cost-benefit analysis as discussed above, including a list of reporting obligations. Currently, cost-benefit analysis of draft legislation is not rigorous as it typically does not provide a clear comparison of all policy options in terms of effectiveness and efficiency, making a solid comparison of options and justification of the preferred set of measures difficult (European Commission, 2024[45]). The total net economic cost of new regulation should be less than zero for the coming years to reduce the combined regulatory burden that has grown over the past decade. Given their key role in the EU legislative process, the Council of the EU and the European Parliament need to contribute to the burden reduction effort by assessing the impacts, including costs and benefits, of their substantive amendments.

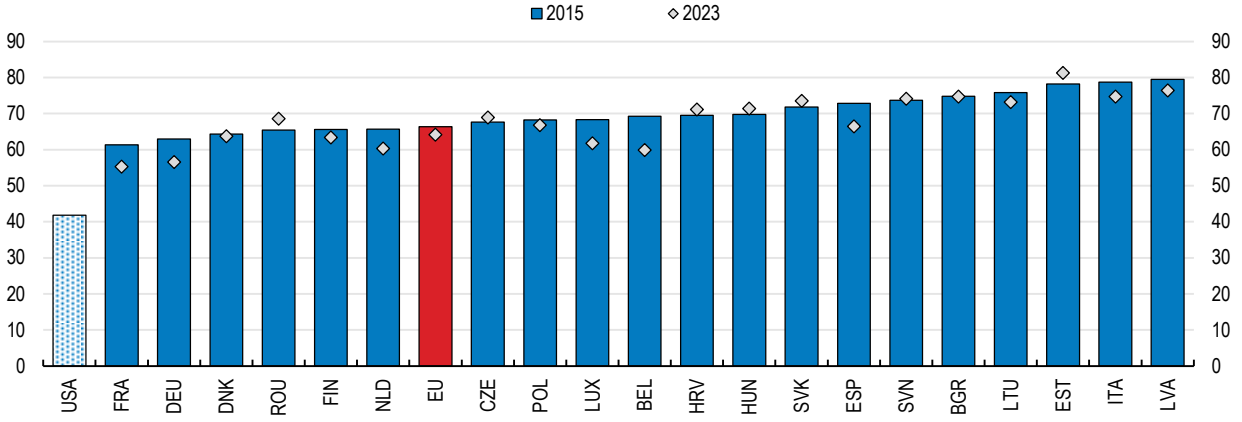
The EU Corporate Sustainability Due Diligence Directive introduced due diligence obligations on large companies, requiring them to carry out human rights and environmental due diligence in their own operations and supply chains. Beyond the Directive, a range of other EU laws integrate due diligence expectations, often with OECD standards as the basis, while differing on some aspects. Such differences can increase compliance costs for businesses. Effective international coordination and exchange among policy makers is important to reduce compliance costs and duplication.

The growing body of regulation is also constraining the predominantly smaller European companies to fully exploit new technology (Figure 4.7). The General Data Protection Regulation (GDPR) governs how the personal data of EU residents may be processed and transferred. The Digital Services Act ensures, notably, policing of online content, and the AI Act sets out a clear set of risk-based rules for AI developers and deployers regarding specific uses of AI (European Parliament and European Council, 2024[46]). Part of this regulatory trend in digital technologies reflects a stronger emphasis on consumer protection than on innovation. While consumer protection is important, compliance costs for businesses are high. For instance, the GDPR is estimated to have reduced profitability for smaller high-tech firms by up to 12% in addition to its costs in terms of lower innovation, although it has facilitated services trade (Frey and Presidente, 2024[47]; Frey, Presidente and Andres, 2024[48]; EBRD, 2024[49]).

Moreover, the national implementation of the GDPR has led in some instances to diverging rules across EU countries, adding to compliance costs. For instance, national rules differ with regard to the processing of biometric data or data concerning health. An additional factor behind higher compliance costs is diverging interpretations of the GDPR by national data protection authorities (European Commission, 2022[50]). The European Commission acknowledged in 2024 the compliance costs for SMEs and called for intensified efforts to support SMEs' compliance with GDPR, including through guidelines and compliance tools provided by data protection authorities (European Commission, 2024[51]).

## Figure 4.7. European companies are on average smaller than those in the United States

Share of employment accounted for by companies with less than 250 employees




Note: Data for the United States refer to employees only in 2015, the latest year for which data is available.
Source: OECD Structural business statistics by size class and economic activity (ISIC Rev. 4) database; and OECD calculations.

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The EU AI Act will be fully applicable in 2026. A structured set of AI guidelines is important for both advancing the technology and ensuring that risks for workers and consumers are appropriately addressed. An AI regulatory framework also helps develop a market by creating trust. However, it is important that the EU remains vigilant that the AI Act does not result in an overly restrictive framework, so that the AI related productivity gains in areas such as autonomous vehicles, education, and health are not unduly hampered. Other countries are following a more hands-off approach, where AI technologies are regulated after they are being introduced. In the United Kingdom, for instance, sectoral regulators issue AI-specific guidance to regulated entities in line with the government's voluntary guidance (Department for Science, 2024[52]). Similarly, the EU's well established sectoral standards organisations could help understand the economic effects of AI based on accurate, up-to-date information about its actual capabilities, laying the ground for regulation grounded in experience (Kilian, Ebel and Jäck, 2025[53]).

In this regard, the OECD recommends reviewing and adapting AI regulatory frameworks to encourage innovation and competition (OECD, 2024[54]). As AI is still a new technology, regulations must be crafted pragmatically to minimise unintended consequences while incentivising innovation. Hence, more agile regulatory frameworks are needed as new AI models have the potential to be deployed for countless purposes, many not initially foreseen in development. There was an impact assessment of the AI Act but not about reporting obligations and reporting

requirements. The Commission has already committed itself to reviewing the AI Act in 2029. This is welcome as the upcoming review offers an opportunity to assess costs and benefits of reporting obligations and reporting requirements. A similar review should be conducted for the General Data Protection Regulation.

Digitising administrative procedures can create greater efficiency and effectiveness while raising public trust in the EU. Half of EU citizens perceive the EU bureaucracy as burdensome and about a third of EU citizens ask for more digital services and more user-friendly e-government services (European Commission, 2023[55]). Only seven EU countries provide e-government services above the OECD average, with Estonia and Demark at the top, while most others are digital laggards (OECD, 2025[56]).

The Commission's Your Europe online portal provides access to national electronic procedures for businesses, including requesting business permits, registering employees for pension and social security, paying social security contributions, and declaring corporate tax. It is the Commission's most visited online portal, with 32 million visitors in 2023. Time spent by businesses on administrative procedures from other countries has fallen from an average 2 ½ hours to four minutes when they use the portal.

The EU plans to further ease business registration in 2025 with an EU-wide company certificate, the reduction of certified translations, and fully implementing the once-only principle where citizens and businesses will need to provide their data only once to public administrations. That once-only principle is currently being rolled out with the establishment of the Once-Only Technical System. When the onboarding of some 80.000 national authorities across the EU will be completed, users of online procedures will be able to request that documents needed for the procedure are transferred directly from the authority that issued it to the authority requiring it. The Once-Only Technical System has been proven to reduce costs and time for businesses by half.

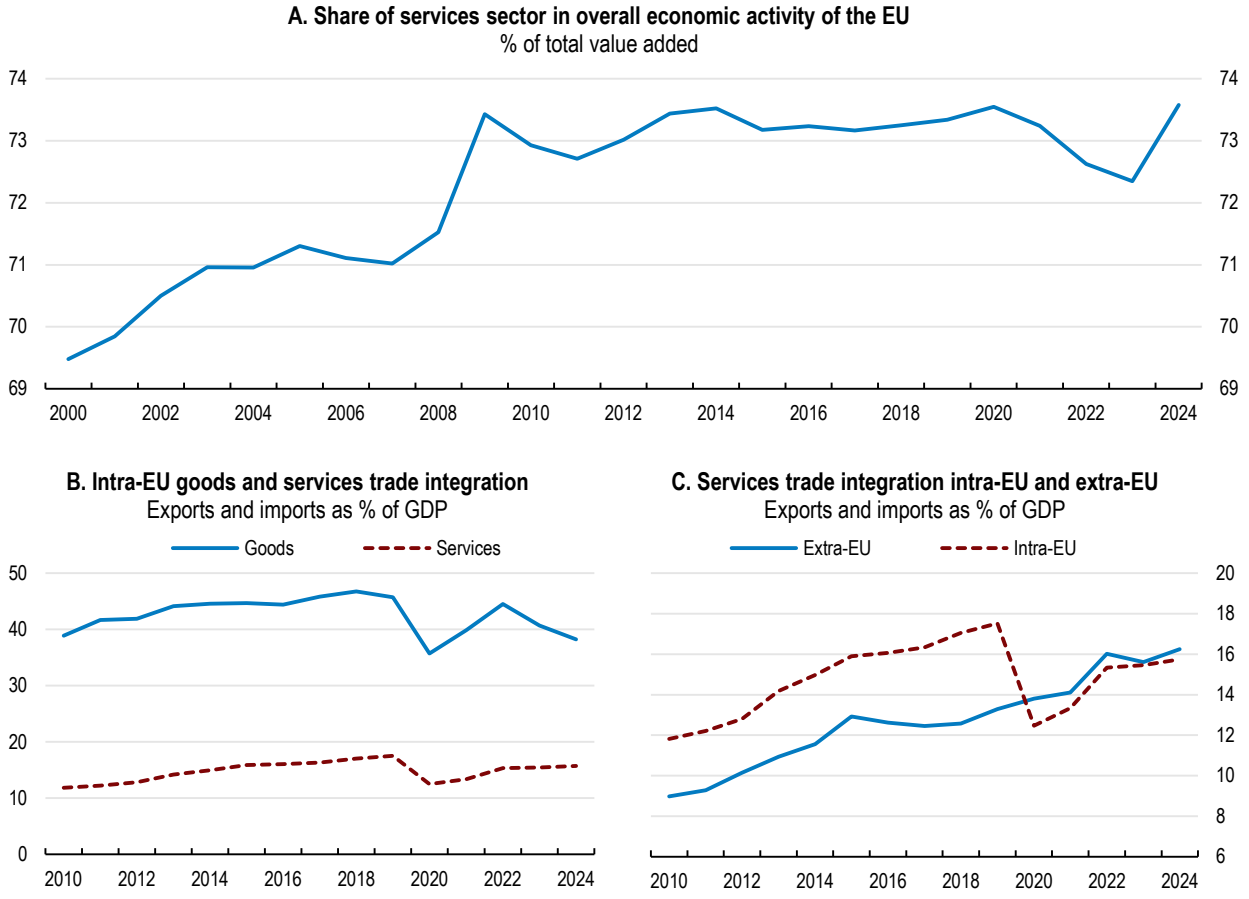
However, while about 60% of national administrative procedures that EU countries are required to make available online are fully available online, only about 20% are also accessible for cross-border users, including the transmission of documents from another country (European Commission, 2023[57]). Thus, there is a need to make more procedures available online, especially for cross-border users. Eventually, the EU should ensure that EU countries post all administrative processes online by default to encourage the uptake of e-government services and reduce compliance costs.

### *4.4.2. Bolstering market integration of services*

The Single Market offers EU businesses the scope for economies of scale of the type US and Chinese firms benefit from. However, the level of European integration, especially in services, remains insufficient. Intra-EU trade in services accounts for only about 16% of GDP compared with more than 42% for goods in 2023 with no sign of catching up, although presumably many services are less suited to trade than goods. This comes despite the much larger size of the EU services market (Figure 4.8, Panel A and B). Similarly, cross-border establishments accounted for only 10% of output (less net exports) in services in 2018. What is more, extra-EU trade in services has surpassed intra-EU trade in services since the departure of the United Kingdom from the Single Market in 2020 (Panel C). This reflects the relative importance of EU-UK trade in financial and IT services. There is a need to step up efforts towards further deepening the Single Market in services to boost productivity.

Progress in reducing internal market barriers in service sectors has been slow over the past decade. As a result, more regulated services sectors such as retail and professional services show lower market integration (Figure 4.9). Firms in legal services face the highest regulatory barriers, while retail sectors saw an increase in barriers (European Commission, 2021[58]; European Commission, 2022[59]). Overall, 60% of regulatory barriers present in 2002 were still present in 2022 (European Commission, 2022[60]). This reflects that many EU countries implemented the EU Services Directive in national law with limited ambition, and thus foregoing the full potential of streamlining national services regulation (OECD, 2025[61]). As a result, rules differ across countries, including legal form requirements and territorial restrictions on retail. Such fragmentation increases the administrative costs and procedural times for businesses, and denies businesses the scale benefits of the Single Market (European Parliamentary Research Service, 2019[62]; European Parliamentary Research Service, 2023[63]). To reduce internal market barriers, the EU should introduce common rules and Single Market clauses in EU legislation, and closely monitor transposition of EU legislation in EU countries.

## Figure 4.8. Intra-EU trade in services remains relatively low




Note: In Panels B and C, intra-EU and extra-EU trade integration refers to import and export volumes as a share of GDP. Data refer to the EU changing members' composition, EU27 from 2010 to 2012, EU28 from 2013 to 2019 and EU27 from 2020 to 2024.
Source: Eurostat; and OECD calculations.

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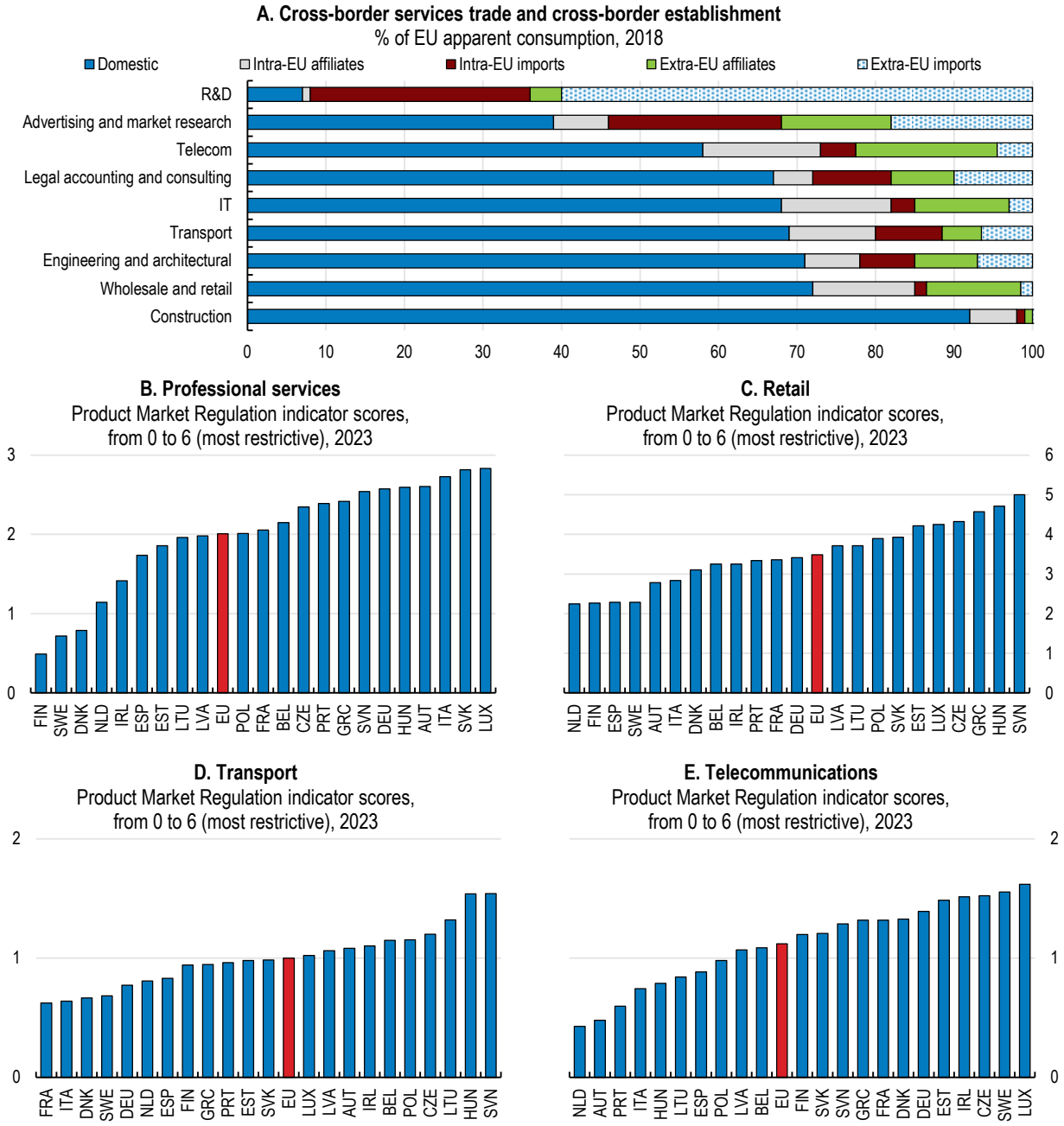
Closer collaboration and sharing of evidence on regulatory costs (and benefits) between EU countries and the European Commission could ensure consistency and minimise burdens. However, only a minority of EU countries assess impacts of legislative proposals to inform their negotiating position. Moreover, since implementation of EU law is largely within the purview of EU countries, they are well placed to anticipate and flag to the Commission any potential challenges related to implementation, helping to keep proposals practical from the outset. Sharing evidence across EU countries can help identify best practice that reduces burdens and drive consistent approaches across the Single Market. This could also help avoid cases of gold plating, i.e., when countries introduce stricter regulations than required by EU rules, running against the objective of a Single Market. Yet, there are no specific information sharing mechanisms in place for transposition and only a handful of EU countries actively use each other's or the Commission's impact assessments to inform the transposition of EU directives (OECD, 2025[61]). The Commission should establish information sharing mechanisms for transposition to identify best practice and advocate for consistent application of such best practice across the Single Market.

Overall, there have been many initiatives to remove barriers to competition in the Single Market over the past years with limited impact. This may partly reflect a focus on soft prevention measures rather than enforcement by infringement action. The Single Market Enforcement Taskforce's work on document requirements for the cross-border recognition of qualifications is an example for the prevention approach (European Commission, 2024[64]). More recently, the Commission proposed the establishment of Single Market offices in EU countries (European Commission, 2023[65]).

## Figure 4.9. Market integration is lower in more regulated services sectors




Note: In Panel A, apparent consumption refers to production plus imports minus exports. The Product Market Regulation (PMR) indicator is a composite index that encompasses a set of indicators that measure the degree to which policies promote or inhibit competition in areas of the product market where competition is viable.

Source: European Commission (2022), "30 years of single market – taking stock and looking ahead"; and OECD Product Market Regulation database.

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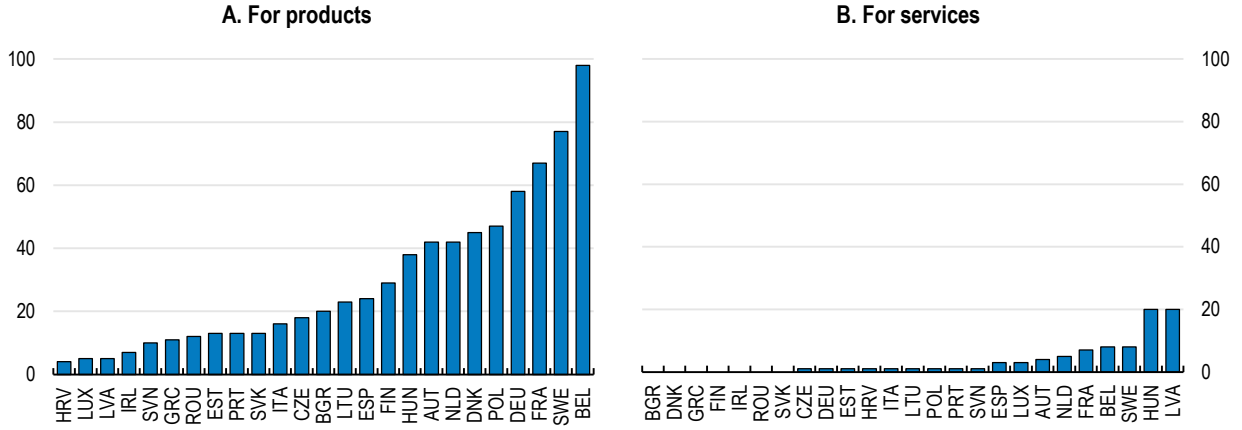
However, a question is whether new preventive initiatives will make a difference. Arguably, prevention is easier and less confrontational to prevent the creation of barriers as opposed to demanding EU countries to dismantle them. In general, however, EU countries seem to have low incentives to further reduce barriers, which may reflect lower infringement enforcement action by the Commission over the past decade (see below). Together with continued prevention, stepping up enforcement action via infringement procedures would contribute to putting the Single Market at the top of policy priorities.

The European Commission plans the establishment of a European Code of Business for smaller companies (European Commission, 2025[66]), following recommendations by Draghi (2024[3]) and Letta (2024[2]). Such a common corporate regime would harmonise rules for smaller businesses operating in the different EU countries under a so-called "28th regime", and it would co-exist with national corporate business law. However, company size thresholds would penalise firm growth. Ideally, such a corporate structure could establish common EU-wide rules for all companies, irrespective of size, that are more attractive than national rules for business registration, insolvency, cross-border investment and cross-border trade of company shares, significantly reducing compliance costs.

The reporting framework for internal market barriers under the Services Directive is weak. Reporting obligations for EU countries only concern a limited number of barriers to business establishment. This includes restrictions on legal form or shareholders, minimum tariffs and number of employees. The limited scope of reporting requirements is reflected in a relatively low number of notifications, and national measures of other types, such as authorisation regimes, are often not notified so that the Commission and other EU countries or stakeholders cannot scrutinise those measures on compliance with Single Market law (Figure 4.10). Another factor that complicates public scrutiny is that there is no single notification entry point for EU countries as in the case of goods. All this leads to underreporting of internal market barriers.

## Figure 4.10. Reporting of internal market barriers in services is low

Number of national regulation drafts notified to the Commission, 2024 reporting period




Note: 2024 reporting period goes from 1 October 2023 to 30 September 2024.
Source: EC Single Market Scoreboard.

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A relatively straightforward way to raise reporting is to extend reporting requirements for barriers in goods markets to services. Importantly, business as well as other relevant local stakeholders should be alerted on time and have access to an easy online mechanism for comments on national legislation at an early stage. Currently, only few EU countries, like Denmark and Spain, consult stakeholders early in the policy process, before a broader policy direction has been set with legal draft legislation. Early consultations can help identify challenges and explore the right tools, including non-regulatory alternatives.

Moreover, few countries publish feedback on consultations, which could signal that comments are being given due consideration (OECD, 2021[67]). The lack of meaningful stakeholder consultation early on leads to more burdensome regulation. Announcements on laws and regulations should be also made in English to allow foreign companies to comment. Hence, reporting requirements for national services regulation should be tightened and a single online access point for stakeholder comments on national legislation should be established, as in the case of goods. Consultations on national services legislation should occur early, with the European Commission's "Have Your Say" portal as a useful example.

The existing reporting framework for internal market barriers under the Services Directive does not provide details for a proper proportionality assessment (European Parliament, 2024[68]). This means that EU countries do not have

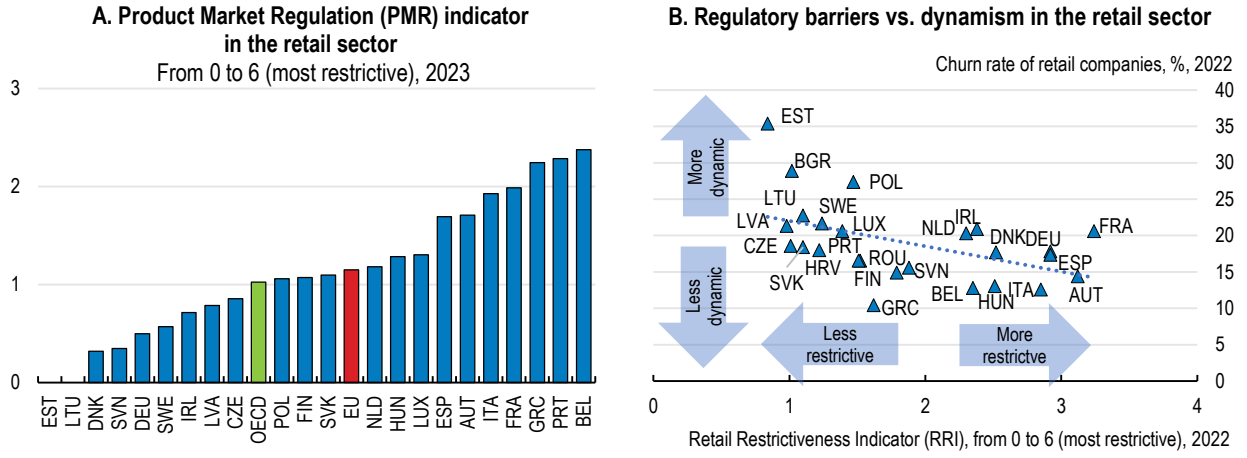
robust guidance as to how to assess whether national rules are properly justified, proportionate and non-discriminatory. The Commission could provide a template for proportionality assessments that EU countries could apply to national draft laws or regulations, as it already does in the case of professional services. Hence, proportionality assessments should be made mandatory for notifications of national regulatory barriers to services and conducted by EU countries. Such assessments should also include economic impact assessments. The Commission could provide guidance to EU countries where necessary (OECD, 2022[69]). For instance, impact assessments including a cost-benefit analysis of national regulations would be useful and relatively inexpensive (see below).

### *4.4.3. Removing internal market barriers in retail*

Within the Single Market, retailers are confronted with restrictions on establishment and day-to-day operations (Figure 4.11) (European Commission, 2018[70]). Restrictions to retail establishment amount to major entry barriers and include requirements regarding the shop's size and location or the procedure to obtain a specific authorisation. Restrictions on day-to-day operations include restrictions on shop opening hours, sales promotions and distribution channels, sourcing of products, and retail specific taxes (European Commission, 2018[70]). Most of these restrictions are present in all EU countries, although some countries are more restrictive than others (Figure 4.12). Since 2018, only few countries have reduced regulatory restrictions, while their level has either remained unchanged or even increased in most other cases (European Commission, 2025[71]). This is despite the positive impacts of reforms on market dynamics, consumer choice and prices. Denmark and Finland, for instance, have introduced higher establishment thresholds and removed certain floor caps. Such reforms are likely to have a positive impact on consumer choice and prices (European Commission, 2018[70]).

The EU's Service Directive prohibits some barriers on retail establishment such as economic needs tests and requires EU countries to evaluate the justification and proportionality of some others such as territorial restrictions, and the conditions for granting an establishment authorisation. However, EU countries often do not sufficiently assess the justification and proportionality of national restrictions to establishment and day-to-day operations of retailers. Thus, the European Commission should ensure that freedom of establishment as well as the relevant provisions of the Services Directive are well-implemented and enforced by EU countries.

## Figure 4.11. Regulatory barriers in retail are high




Note: Panel A, the OECD PMR indicator is a composite index consisting of indicators that measure the degree to which policies promote or inhibit competition in product markets where competition is viable. Panel B, the Commission's RRI shows the level of regulatory restrictions in the retail sector. The churn rate indicates the sum of birth rate and death rate of companies in the retail sector.
Source: OECD Product Market Regulation database; European Commission, Retail Restrictiveness Indicator; and Eurostat Business Demography database.

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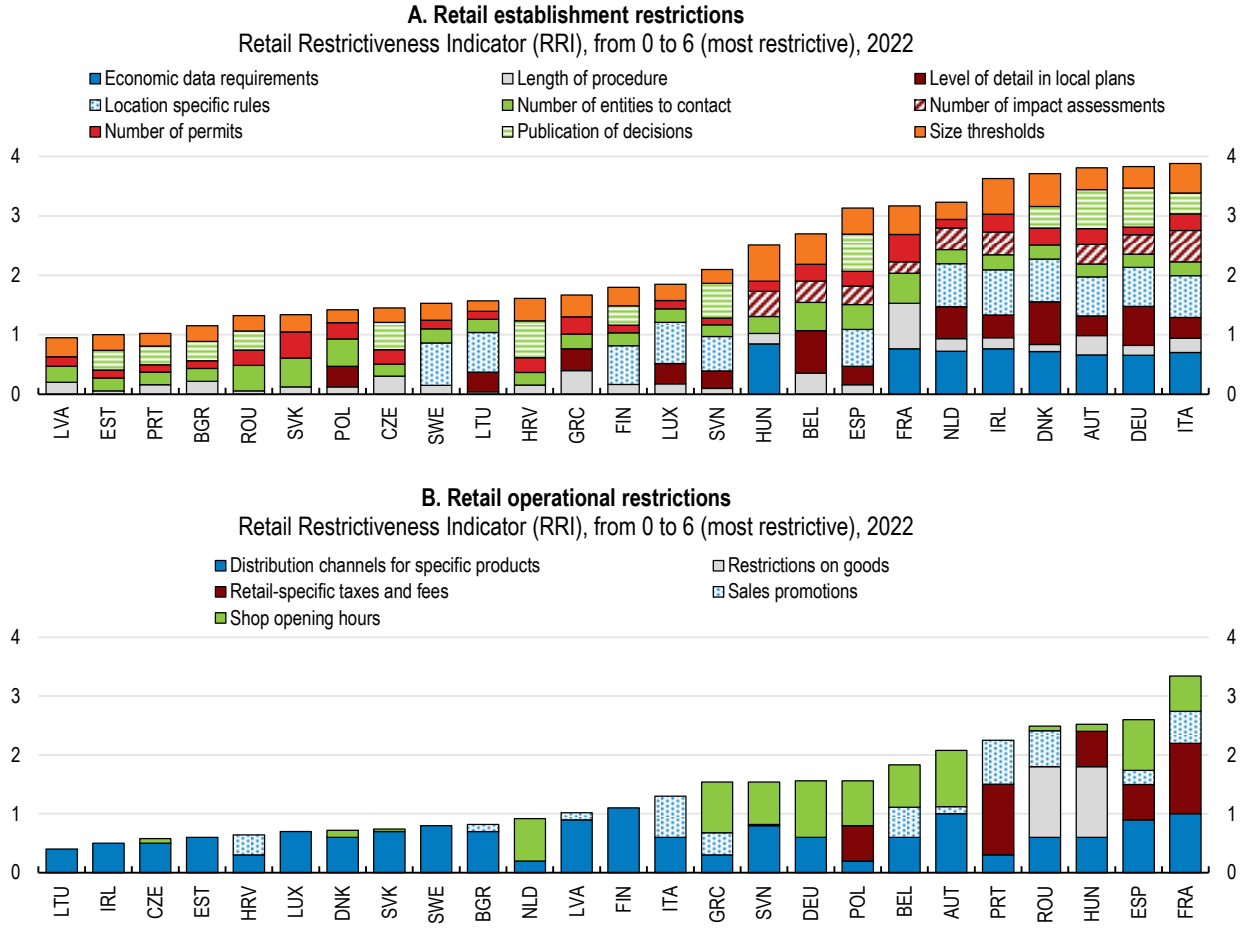
## Figure 4.12. Regulatory restrictions differ across EU countries




Note: The EC Retail Restrictiveness Indicator (RRI) shows the level of regulatory restriction in the retail sector across the EU.
Source: European Commission, Retail Restrictiveness Indicator (RRI); and OECD calculations.

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Territorial supply constraints are a major non-regulatory barrier for retailers set up by large brand manufacturers, which often oblige retailers to buy stock from their national distributors (EuroCommerce, 2024[72]). This has a negative impact on competition and prices as retailers cannot seek the best price and offers EU-wide (European Commission, 2020[73]). The Commission updated the Vertical Block Exemption Regulation in 2022 to provide more clarity when territorial supply constraints resulting from agreements between companies constitute a barrier to the Single Market (European Commission, 2022[74]).

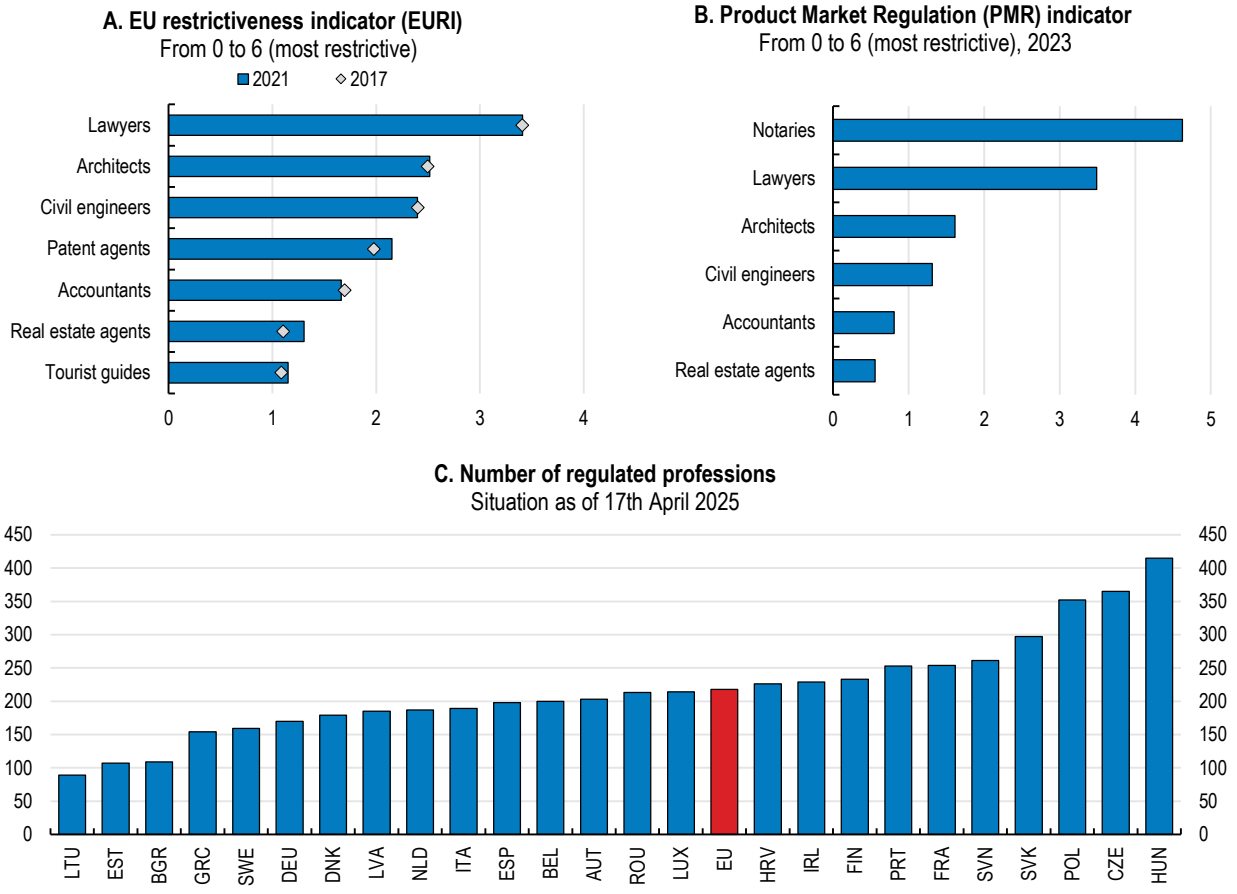
In addition, the Commission is constantly monitoring such anti-competitive practices. A recent example is the Mondelēz case, one of the largest global producers of chocolate and biscuits, which was fined by the Commission in 2024 for having prevented retailers from freely sourcing their products in EU countries with lower prices. The Commission also announced in March 2025 that it was carrying out new investigations in the drinks and personal care sector. Measures such as the whistle-blower tool, allowing individuals to alert the Commission about anti-competitive behaviour anonymously, can help alert about anti-competitive behaviour but they are not sufficient (European Commission, 2024[75]). Continued enforcement of competition rules will be important to tackle the misuse of territorial supply constraints.

However, territorial supply constraints occur also beyond the scenarios captured by competition law, i.e., when the company has a dominant market position or in case of an anti-competitive agreement. To identify such scenarios, the Commission launched a fact-finding exercise in September 2024 to map the occurrence of such restrictions in the different EU countries. As part of this exercise, the Commission also organised a stakeholder dialogue. The Commission should use the findings of this exercise and propose concrete measures in the upcoming Single Market Strategy.

### *4.4.4. Lowering barriers to professional services*

Professional services providers continue facing a wide array of barriers when they want to establish themselves in another EU country. The recognition of professional qualifications is subject to heavy documentary requirements in many EU countries and requirements differ significantly across EU countries (European Commission, 2025[76]). This reflects that EU countries are competent to regulate professions, within the limits of non-discrimination and proportionality. Many professional service providers are also subject to a relatively high number of prior checks on their qualifications, which are lengthy procedures often lasting several months. As a result, recognition procedures remain costly and lengthy, and the mutual recognition of qualifications is also not yet fully achieved (European Commission, 2020[77]). Such restrictions negatively affect intra-EU labour mobility as regulated professions represent about 22% of the EU labour force (Figure 4.13). The Commission observed little progress in removing restrictions on professional service providers since 2017, with the level of restrictive regulations still being high for certain categories, notably lawyers, architects and engineers (European Commission, 2021[78]).

**Figure 4.13. Stringency of professional services regulations remains high for certain categories**




Note: Panel A, The EU restrictiveness indicator (EURI) measures the level of regulatory restrictiveness on a scale from 0 (least restrictive) to 6 (most restrictive) for the cross-border provision of services and the right of establishment for seven groups of professional services with a high share in EU firms' intermediate consumption (the value of the goods and services consumed as inputs by a process of production) or cross-border mobility. Panel B, the OECD Product Market Regulation (PMR) indicator is a composite index that encompasses a set of indicators that measure the degree to which policies promote or inhibit competition in areas of the product market where competition is viable.
Source: EC Single Market Scoreboard; OECD Product Market Regulation database; and EC Regulated Professions database.

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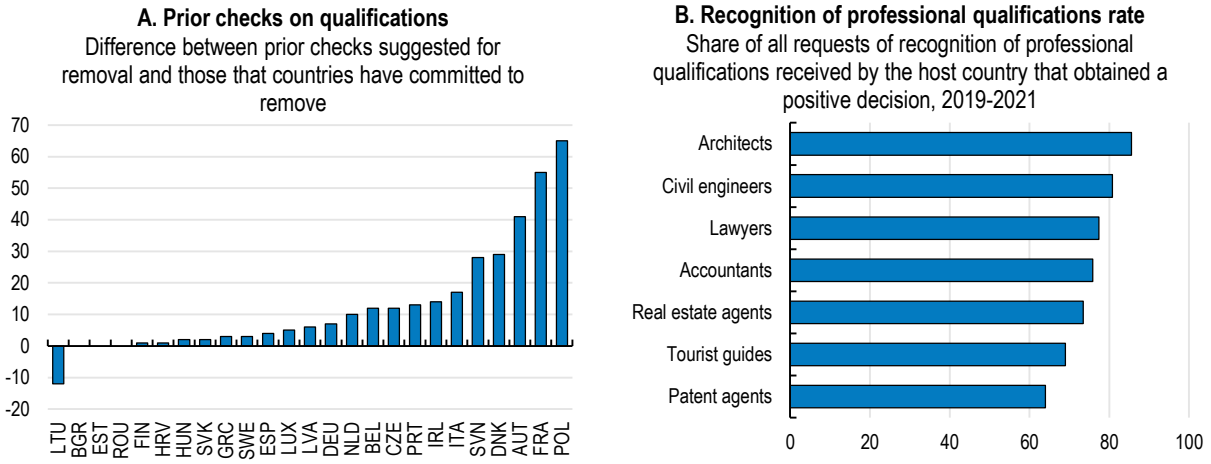
Countries can introduce restrictions on professional services providers based on public interest ground such as public security and public health. These restrictions need to be proportionate, i.e., they must be suitable and necessary to achieve the desired end. A positive development has been the 2018 Proportionality Test Directive,

which requires EU countries to assess the proportionality of draft regulations for professions (European Commission, 2023[65]). The Commission provides EU countries with a standardised framework to assess the proportionality of such regulations. Furthermore, EU countries are encouraged to involve independent bodies, such as competition authorities, to ensure the objectivity and independence of proportionality tests. In certain countries this is already in place, with positive results. For example, the Italian competition authority and the Council of State in Luxembourg are requested to express opinions on the proportionality of new legislations regulating professions (European Commission, 2022[79]).

However, the Commission concluded in 2024 that a significant proportion of the prior checks of qualifications of professional services providers who intend to provide temporary services in another EU country raise doubts as to their justification and proportionality. Although EU countries committed to removing many of them, they proceed at different speeds (Figure 4.14) (European Commission, 2024[64]). Given the slow and uneven progress, the European Commission launched infringement procedures in December 2024 against 22 EU countries covering more than 250 professions. This is welcome and the Commission should follow up on the enforcement action to ensure that all unproportionate restrictions are removed.

## Figure 4.14. Progress in removing prior checks on qualifications is slow




Source: EC Single Market Enforcement Taskforce (SMET) Report 2022-2023; and EC Single Market Scoreboard.

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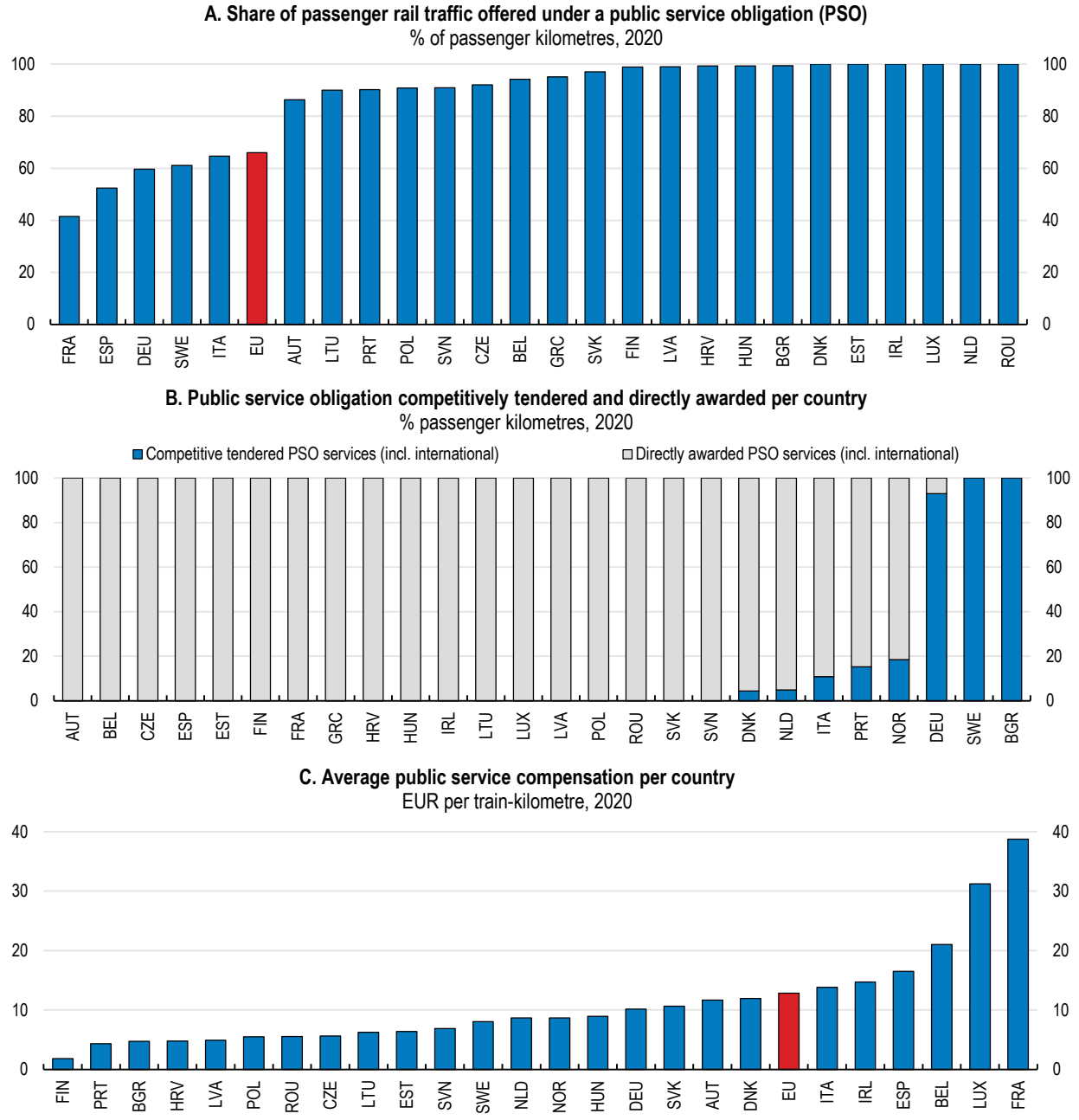
### *4.4.5. Further liberalising network sectors*

Market liberalisation of the rail sector is in progress. National incumbents still accounted for 86% of all commercial passenger rail transport in 2020 (European Commission, 2023[80]). Market liberalisation in freight is more advanced, with about half of all volumes carried by competitors (non-incumbents) in 2020. The high market share of national incumbents in passenger rail transport reflects that domestic services were only liberalised in 2020, ten years after the liberalisation of cross-border services. Still, many EU countries directly awarded as much as 100% of train kilometres for national incumbents under public service contracts in 2020, without a competitive tender (Figure 4.15, Panel A and B).

The lack of competition has led to generous public service compensations per passenger kilometre for national incumbents (Panel C). This comes despite the EU's Fourth Railway Package, which requires that all public service contracts must be allocated via competitive tendering since 2024. However, data on competitive tendering for 2024 is not available yet, although the low share of competitively tendered domestic rail services in 2020 suggests that progress has been slow. The Commission should continue monitoring the liberalisation of the rail market and ensure that public service contracts are allocated via competitive tendering.

## Figure 4.15. The rail market is still dominated by national incumbents




Source: European Commission, Rail Market Monitoring (RMMS).

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The main barriers to further passenger rail market integration are of a technical nature. National signalling systems are still in place while the switch to the common European signalling system has been behind schedule (European Commission, 2023[81]). A faster transition to the European system would allow trains to run on all the lines. This, together with harmonised qualification and language requirements for drivers, would significantly reduce technical barriers for cross-border trains.

For cross-border connections, there is discrimination against foreign competitors when it comes to access to path slots, notably in about 13 EU countries where the infrastructure operator and the railway operator are not fully separated (European Commission, 2023[80]). Such integration within a holding company creates the wrong

incentives for competition. To ease access to cross-border path slots, the Commission proposed to switch from national path slot allocations to a more integrated scheme across countries. The EU should implement such a cross-border system of path slot allocations and ensure non-discrimination against competitors in access to path slots, both within EU countries and across borders.

Other barriers to entry include high track charges, high costs of rolling stock and ticketing. The EU aims to reduce costs of rolling stock by standardisation, setting EU-wide basic requirements for most common vehicle types that can be used in different EU countries. This is complemented by a unique EU-wide authorization process for rolling stock. However, the lack of secondary market for rolling stock may discourage market entry. The absence of an appropriate single digital booking and ticketing regulation is also a significant barrier to entry. The Commission is currently preparing an initiative that aims to enable ticketing solutions for passengers across different operators and borders.

Broadband prices tend to be lower and broadband services of higher quality in the EU compared to the United States (OECD, 2024[82]). This reflects a sound EU pro-competition framework, which in turn incentivises investment (OECD, 2021[83]). However, the Single Market for telecommunication remains in some respects fragmented. For instance, there are 27 different spectrum policies with sometimes lengthy spectrum assignment processes, inconsistent approach on spectrum assignment conditions and diverging licensing costs across countries (European Commission, 2023[84]). The lack of a consistent approach on licensing conditions, including spectrum caps or reservations, results in fragmentation and legal uncertainty. This may impair operators' ability to expand their footprint across borders in the EU.

To harmonise regulation across EU countries, the European Electronic Communication Code of 2018 mandated common spectrum licensing conditions, such as licence duration, among many other regulatory measures (European Commission, 2018[85]). The Code is intended to be reviewed in 2025. With regards to spectrum management, well-designed and transparent licensing regimes encourage investment and foster innovation in mobile networks (OECD, 2022[86]). Hence, the EU should further enhance coordination of spectrum assignment policies, including harmonising license conditions such as the duration of licences and licensing costs.

### *4.4.6. Strengthening Single Market law and competition enforcement*

Enforcement of Single Market law has weakened over the past decade. Between 2010 and 2023, the number of infringement cases opened by the Commission dropped by 47%, while the number of cases it referred to the European Court of Justice fell by 53%. In 2023, the Commission referred on average three cases per EU country to the Court of Justice, down from an average of 11 cases per EU country in 2000. The fall in infringement cases was not associated with a proportionate drop in complaints from citizens and businesses about low compliance with EU rules (Kelemen and Pavone, 2023[87]; European Commission, 2024[88]). To encourage stronger compliance with EU rules, enforcement should be strengthened. This entails stronger use of infringements procedures, and, in damaging instances, may entail a suspension of related national law at the onset of the infringement procedure. This should be followed by an in-depth investigation as under EU Competition Law where Member States have the right of appeal. An alternative would be a fast-track procedure to the Court of Justice.

The competition authority faces new challenges to competition that require reprioritisation of budget and staff. The Digital Markets Act and the Foreign Subsidy Regulation - two new instruments that came into force in 2023, saw a redeployment of staff from other competition instruments such as merger control and antitrust. This reduced resources for competition enforcement. At the same time, the EU continues to examine a relatively high number of mergers, which is welcome as they might otherwise not be examined by national competition authorities (OECD, 2024[89]). Over the past decade, merger control has focused on the very few notified merger transactions that threaten the proper functioning of the internal market, with 9 prohibitions out of a total 3 760 merger decisions adopted since 2015. This means that the Commission approved about 97% of all notified transactions, including 4.3% of merger cases approved with ex-post remedies. Competitive markets are essential to promote productivity and innovation, especially in view of rising industry concentration over the past decade (Calligaris et al., 2024[90]; Calligaris et al., 2025[91]). Thus, given limited resources, the competition authority should re-assess its priorities and, if needed, its resources should be bolstered. Prioritisation will also be important to address new competition challenges arising in digital markets and to respond to national industrial policy (Nicoletti, Vitale and Abate, 2023[92]).

The Proportionality Test Directive encourages EU countries to involve independent competition authorities in the proportionality assessment of national professional services regulations. For instance, the Italian competition authority is required to provide an opinion on the proportionality of the draft legislation (European Commission, 2022[79]). More generally, national competition authorities could play a more relevant role in assessing the anticompetitive stance of restrictions targeted under the Services Directive. Hence, the Commission should strengthen the role of competition authorities in the Services Directive, similarly as under the Proportionality Test Directive.

## 4.5. Towards more integrated financial markets

### *4.5.1. Deepening capital markets*

Capital markets remain relatively underdeveloped, limiting access to funding for innovative companies for which bank lending is less suitable (Figure 4.16, Panel A). Underdeveloped capital markets reflect a lack of deeper pools of long-term capital provided by retail and institutional investors such as pension funds, hampering effective financial intermediation. This is despite the high saving rate of European households, with savings mostly kept in bank deposits with low returns (Panel B and C). The failure of high savings to flow into productive investment may be due to insufficient risk-taking by a largely bank-based financial system. Thus, shifting savings from bank deposits to long-term investment, including retail investment and pension assets, would help channel more capital to innovative firms and secure better returns. Another important element is improved financial literacy, as addressed by the Commission's Strategy for a Savings and Investments Union.

In addition to efforts at the EU level, multi-country initiatives can enhance market integration in areas where EU legislation has limited reach—such as taxation, which remains largely under national jurisdiction. EU countries can coordinate their actions to help advance the creation of a Savings and Investments Union, complementing EU-level initiatives (see below).

While in most EU countries, private pensions and owner-occupied residential property benefit from lower marginal effective tax rates, taxation on other forms of savings follows different approaches (OECD, 2018[93]). Many EU countries still favour bank deposits with generous tax advantages compared to corporate bonds, shares or investment funds. For instance, Austria, Finland and Luxembourg provide tax relief on deposits in a tax-favoured savings account, up to a specified limit. In France, Livret A bank savings accounts are exempt from tax up to a deposit limit of EUR 22 950 in 2025. Similar tax exemptions for bank accounts at the holding stage apply in Austria, Belgium, Hungary, Luxembourg, Spain and Sweden. In other countries, like Sweden, retail participation in capital markets is encouraged via savings and investments accounts with favourable tax treatment.

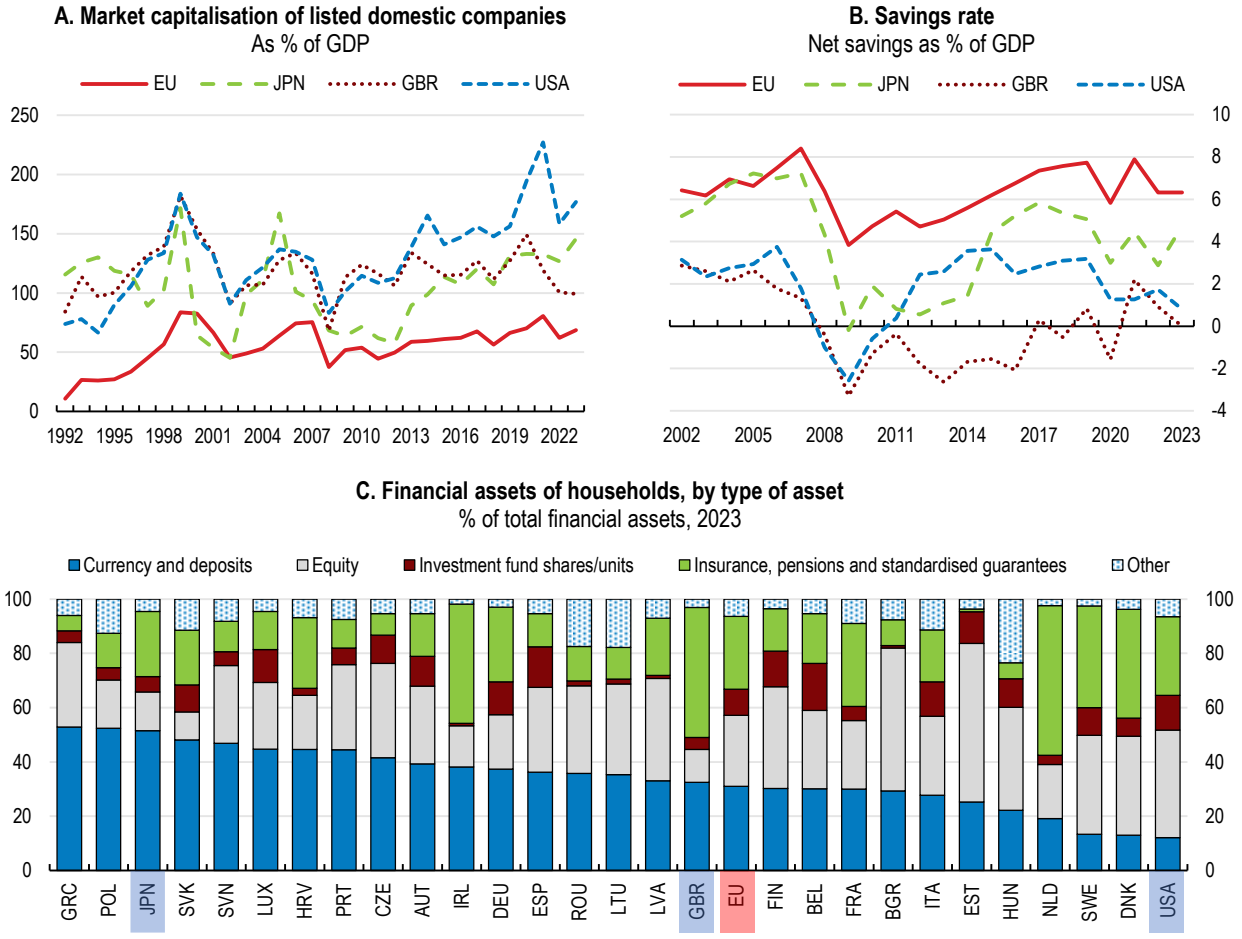
While banks indirectly benefit from those tax advantages, they often do not offer other financial products of competitors, which may prevent broader retail participation in capital markets. This also constitutes a major entry barrier, entrenching banks' incumbent position. In 2023, the Commission highlighted that more competition is needed in the distribution of retail investment products (European Commission, 2023[94]). In 2025, it announced a blueprint for tax-favoured savings and investments accounts as an alternative to bank savings to strengthen retail investment in capital markets (European Commission, 2025[95]). This initiative aims to build financial wealth and investment capital but may also increase competition in financial service offerings. To support entry in financial markets, the EU should encourage banks to offer financial products other than their own, for instance by introducing a blueprint for investment accounts. It will also be important to advocate for tax reforms by EU countries with a view to aligning the tax treatment of bank savings products with retail investment products.

There has been some progress on financial integration recently. EU countries agreed on simplifying withholding tax procedures, which will make cross-border transactions more tax efficient, although there is a long transition period until 2030 and EU countries with smaller capital markets can opt out. The European single access point will provide information on all EU listed firms for retail investors and the European consolidated tape will provide access to information on actual trading conditions, which is currently dispersed at different trading venues. At the same time, the Listing Act lowers prospectus requirements for listings. However, the Eurogroup acknowledged in 2024 that there has been little progress in reducing fragmentation of national regulatory and insolvency frameworks, while risk capital for scale ups remains limited (Eurogroup, 2024[96]).

Mobilising of household savings will be key. The pensions system, and particularly private funded pensions systems, can contribute to providing sufficient long-term capital to support productive investment (Figure 4.17). However, private funded pension systems remain underdeveloped in most EU countries, with the notable exception of some northern European countries. Denmark, the Netherlands, and Sweden, for instance, have introduced such private funded pension systems. They are organised as occupational pension plans where employers provide employees with pension plans as negotiated in collective bargaining agreements. Another option is auto-enrolment in occupational pension schemes as in Italy, Lithuania and Poland (European Commission, 2021[97]).

In this regard, in March 2025, the Commission announced forthcoming measures to encourage EU countries to promote auto-enrolment in occupational pension schemes based on best practice, and enhance the EU framework for occupational and personal pensions (European Commission, 2025[95]). In the longer term, pension reforms that support a stronger uptake of occupational pensions would help expand the retail and institutional investor base. As EU countries are responsible for pension systems, the EU could advocate for technical standards and reforms via the Eurogroup and the European Semester based on identified best practice.

## Figure 4.16. Capital markets remain relatively underdeveloped




Source: European Capital Markets Institute (ECMI); OECD National Accounts database; Eurostat Financial Balance Sheets database; OECD Financial Statistics database; and OECD calculations.

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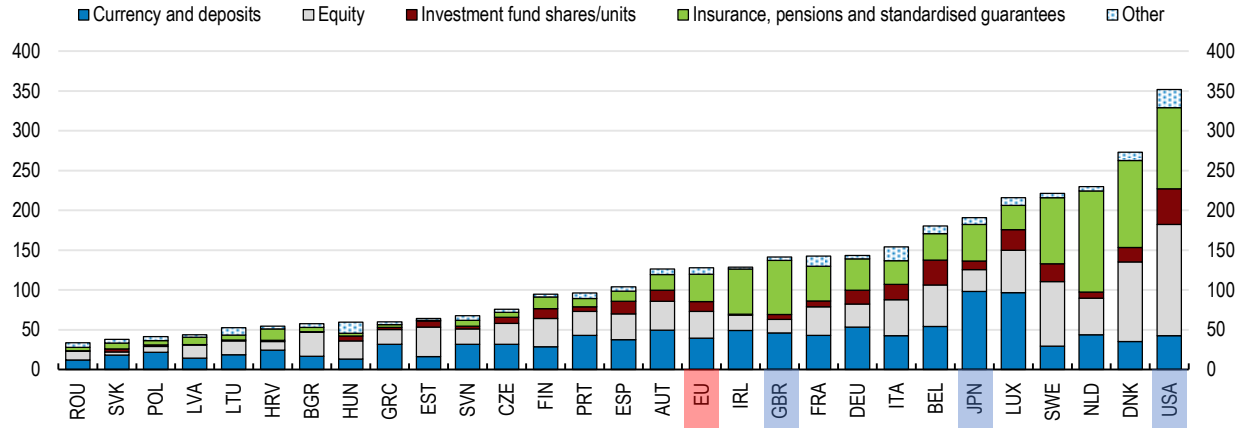
## Figure 4.17. Private funded pensions systems remain underdeveloped in most EU countries

Household financial assets per capita, by type of asset, thousands PPP-adjusted, 2023




Source: Eurostat Financial Balance Sheets database; OECD Financial Statistics database; OECD National Accounts database; and OECD calculations.

StatLink https://stat.link/6vjzex

Retail participation in capital markets is relatively low. EU households still hold a third of their assets in low-return bank deposits, compared to only 12% in the United States where households invest more in equity and investment funds with higher returns (Figure 4.16, Panel C above). Only Denmark, the Netherlands and Sweden – countries with large private funded pension systems, have a higher share of household assets hold in equity and investment funds. To broaden the retail investment base, the EU could collect best practices and advocate for reforms via the Eurogroup and the European Semester. Such an exercise could draw on the successful experiences in countries that offer tax incentives for retail investment, including tax deductions for private pension savings, such as in Denmark and Sweden (Box 4.2).

In this regard, the Commission proposed to introduce an EU-wide blueprint for investments accounts based on existing best practice, accompanied by a recommendation addressed to EU countries on the tax treatment of such investment accounts (European Commission, 2025[95]). Another factor behind low retail participation is low investor confidence following financial market boom and bust cycles in the 2000s. Hence, financial stability and consumer protection will be key to raise investor confidence. This entails reinforcing supervision (see below).

### Box 4.2. Private funded pension systems in Denmark and Sweden

Almost all OECD Member States offer tax incentives for private pension savings (OECD, 2018[98]). Denmark and Sweden are successful examples where tax incentives for private pension savings and employer matching contributions have led to a strong uptake of private pension saving products.

The Danish and Swedish private funded pension systems date back to the 1990s. They are mostly organised as occupational pension plans that are negotiated as part of collective bargaining agreements. Importantly, employers provide contributions, which are, like other parts of salaries, fully tax deductible as expenses.

As in most OECD countries, pension savings contributions are tax exempt. In contrast, returns on investment are taxed. Returns on investment are however not subject to progressive income tax rates but rather to lower fixed tax rates of 15.3% and 15% in Denmark and Sweden, respectively. In comparison, other capitals gains are taxed at 27% in Denmark (up to 8 170 EUR a year and above that at 42%), and 30% in Sweden. To avoid early withdrawals, Sweden provides tax relief on contributions conditional on people not retiring before a certain age. In Denmark, a fixed tax rate of 60% applies to withdrawals before retirement age, although many occupational plans do not offer this opportunity of early withdrawal.

Source: OECD (2018[98]).

Low retail participation also reflects the small size and high costs of European investment funds (European Securities and Markets Authority, 2023[99]). The growth of investment funds is to some extent hampered by the fragmented regulatory landscape across the EU, including marketing registration requirements. This results from different national markets with national rules, but also national preferences and institutions. Fragmentation also reflects that the EU law regulating investment funds is a Directive, where countries have considerable room to introduce rules besides EU minimum standards. As a result, setting up an EU-wide fund has become economically unviable. The EU requires countries to remove such local requirements on cross-border funds (European Commission, 2019[100]). Despite this, EU countries maintained and even strengthen their requirements (Investment Company Institute, 2023[101]). Hence, the EU should ensure marketing registration requirements for cross-border investment funds are harmonised, for instance through regulations. Doing so would support the growth of investment funds and reduce costs for retail investors.

Preferential tax treatment of national bank savings products still poses a formidable challenge to the development of EU-wide savings and investment products. For instance, the EU introduced in 2022 the Pan-European Pension Product (PEPP) to pool private pension savings across EU countries. However, its uptake has been disappointing due to tax disadvantages compared to national bank saving products such as life insurance and private pension products, among other barriers (European Insurance and Occupational Pensions Authority, 2024[102]). The European Commission announced a review of the PEPP Regulation to increase its attractiveness and uptake (European Commission, 2025[95]). The differential tax treatment of long-term retail investment hinders cross-border portability. One way forward would be for a group of countries to test harmonised taxation rules for long-term investment products. For instance, Spain and six other EU countries (Estonia, France, Germany, Luxembourg, the Netherlands, and Portugal) have launched the European Competitiveness Laboratory in March 2025 to work on harmonisation of aspects related to long-term savings products, among other things. The initiative is open to all other EU countries. Cost-benefit analysis of investment tax frameworks by the European Commission would be useful and relatively inexpensive.

Regulatory changes are slow. Over the past decade, a common rulebook for capital markets has been developed. However, the regulatory process is lengthy, taking two to three years for a regulatory change as it involves the entire EU legislative process. Markets perceive this as too slow and bureaucratic, especially in case of changing framework conditions such as market circumstances, emerging risks, and technological innovations (European Securities and Markets Authority, 2024[103]). One way forward could be a more responsive regulatory approach. In the United Kingdom, for instance, the Financial Conduct Authority has the powers to develop and adjust technical rules and reporting requirements in light of changing market circumstances, resulting in more agile market regulation without compromising consumer protection. More generally, stronger cooperation between ESMA and the Commission will be important to deal with these technical rules in an efficient way.

The past decade has seen an upsurge in new EU legislative acts. The resulting common European rulebook for trading and consumer protection was needed to address pre-financial crisis vulnerabilities and adapt to innovations in capital markets. However, it has also increased the regulatory burden. In response, the European Commission has decided to simplify sustainable finance reporting and due diligence rules as discussed above (European Commission, 2025[39]). To effectively reduce compliance costs, the EU and ESMA should continue reviewing the entire body of capital market legislation that has grown over the past decade, with a view to simplify and streamline technical requirements and reporting obligations.

Despite recent harmonisation efforts of EU capital market regulation, supervisory practices differ, and national authorities interpret EU laws differently. Fragmentation along national lines is not conducive for the Single Market. Convergence in supervisory practice and rules would help reducing regulatory fragmentation and improving cross-border investment. Such convergence in national practice would constitute an incremental approach to capital market integration. For instance, there is room to improve supervisory consistency between different national supervisors. To improve consistency of rules, more timely cooperation and joint supervisory work is needed among national authorities and ESMA, notably for larger, cross-border firms. This could take the form of mandatory supervisory colleges (Eurogroup, 2024[96]; European Securities and Markets Authority, 2024[103]). Hence, the EU could make supervisory colleges mandatory to enhance supervisory convergence. A question, however, is whether incremental changes will be sufficient to achieve a fully unified Single Market for capital.

Making sure that capital markets fulfil the function of a truly unified Single Market for capital, and provide better financial intermediation, might require a bigger push for more harmonised supervision. A single European framework for supervision of capital markets follows from the bigger ambition to truly unify the Single Market for capital. Moreover, recent geopolitical tensions that have resulted in increased capital inflows to the EU pose a challenge for supervision, but also a big opportunity in terms of Single Market and deeper capital markets. Going forward, continued geopolitical tensions might make it more attractive for companies and investors to seek safe havens in places where there is predictability, such as the EU.

However, making European capital markets more attractive requires a bigger push for simplification and efficiency. In the banking sector, for instance, the EU went for a unified approach to supervision and established a single European supervisor for larger banks following the financial crisis. This led to tangible benefits such as simplified supervision and rules. In capital markets, a more European framework could provide similar benefits of simplification, especially in cases where there are European-wide risks or where markets provide pan-European services (European Securities and Markets Authority, 2024[103]). A first step would be EU supervision of larger, systematic market actors and infrastructures with European dimension. This includes large pan-European stock exchanges, large pan-European asset managers, and large post-trade infrastructure. Hence, to unify supervision and spur deeper capital market integration, the supervision of such providers of EU-wide financial market services could be moved to ESMA.

### *4.5.2. Completing the Banking Union*

Since 2010, the EU banking sector has undergone significant integration with the establishment of the ECB's Single Supervisory Mechanism (SSM), the application of a single EU rulebook, and the Single Resolution Mechanism (SRM). EU banks can operate across the EU through subsidiaries and branches, benefiting from a harmonized regulatory framework. Despite this progress, there are few large, cross-border banks in the EU. Barriers to cross-border banking include a lack of common deposit insurance, and ring-fencing measures applied to each legal entity of the banking group by EU countries. These barriers reduce the scope of economies of scale. As a result, EU banks often do not match the scale of their bigger US counterparts (ECB, 2018[104]). To maintain the banking sector's strength, further market integration should be accompanied by a continued strong focus on financial stability and supervision.

A positive development has been the setting up of the bank resolution framework. However, it has been rarely used as EU countries prefer to handle bank failures at the national level via insolvency proceedings (Buckingham et al., 2019[105]). The hesitancy to use the resolution framework reflects higher and stricter bail-in capital requirements from creditors and investors compared to national insolvency proceedings. The Commission has proposed a package of reforms to the EU's resolution framework to improve the application of the resolution tools for smaller and mid-sized banks, and to better protect depositors and reduce risks to public finances.

A resolution framework with a stronger financial backstop of the Single Resolution Fund (SRF) could provide a bigger budget for orderly bank resolutions and support cross-border bank expansion. However, the amended European Stability Mechanism (ESM) Treaty, which would make the ESM a backstop to the SRF, is currently pending ratification in one country (Italy). To support cross-border banks, the EU should ensure that the resolution framework is complemented by a stronger financial backstop of the SRF. This entails ratifying the new European Stability Mechanism (ESM) Treaty and implementing it.

Another barrier is a lack of an EU-wide deposit insurance scheme. This means that national sovereign safety nets remain the ultimate backstop for banks in times of crisis. However, national safety nets cement the sovereign-bank nexus that amplified the euro area crisis more than a decade ago. Hence, EU countries should agree on a common deposit insurance system. A way forward would be a step-by-step approach, agreeing on common injection of liquidity in a first step, and tackling loss absorption later on (ECB, 2024[106]). Importantly, a deposit insurance scheme needs to be complemented with strong market discipline to mitigate adverse incentives and a robust burden-sharing framework between countries (see below).

Deepening the banking union requires reducing regulatory barriers that continue to hinder cross-border consolidation and competition. The overall supervisory framework for international banking groups is European, with the ECB's SSM supervising international banking groups. However, national competent authorities can impose local capital and liquidity buffers on national units of banking groups and limit intragroup cross-border transactions.

Such ring-fencing measures limit cross-border flows of capital and liquidity within a single banking group. A common deposit insurance scheme would render such ring-fencing measures unnecessary.

But waiving local capital and liquidity buffers would also require a robust and clearly defined burden-sharing framework between countries in times of crisis to ensure financial stability if a banking group encounters distress. This includes, for instance, the conclusion of intragroup support agreements, and making further steps to improve the credibility of single-entry point resolution strategies. Without such a harmonised crisis management framework, a premature easing of capital and liquidity requirements could potentially introduce financial stability risks.

In this regard, the Eurogroup statement of June 2022 provides a clear outline for advancing on the Banking Union, with strengthening the crisis management and deposit insurance framework as the next step. Another possibility is for banks to rely more extensively on branches. In this regard, the ECB's suggests facilitating the use of branches embedded in the European Regulation on the Societas Europaea and the Cross-border Merger Directive (ECB, 2021[107]). Other barriers include overly restrictive transparency and due diligence requirements that hamper securitisation.

## 4.6. Boosting labour mobility

The European Commission projects labour supply to fall starting from the late 2020s despite expected increases in participation rates of older workers due to pension reforms (European Commission, 2024[108]; European Commission, 2024[109]). Declines in the EU's working age population are likely to exacerbate labour shortages (European Commission, 2023[110]). The productivity impact of population ageing is not clearcut as labour shortages, and the resulting wage increases, may lead to a stronger uptake of labour-replacing new technology (André, Gal and Schief, 2024[111]). Nonetheless, making better use of existing skills and attracting global talent will be key for productivity and economic growth. This entails both measures to attract talent from outside the EU and to enhance cross-border mobility within the EU.

The EU has developed rules to harmonise EU countries' entry and residence conditions for certain categories of non-EU nationals, including highly qualified workers, seasonal workers, and intra-corporate transferees. EU rules also regulate admission and rights of non-EU students and researchers, family reunification, and procedures for obtaining long-term residence permits.

Currently, labour force growth depends largely on immigration (Figure 4.18). The inflow of more than four million displaced persons from Ukraine, under temporary protection until March 2026, has contributed to some extent to reducing labour shortages in low-wage sectors in several countries, notably Czechia, Denmark, Germany, the Netherlands, Poland, and the United Kingdom (UNHCR, 2025[112]). But more needs to be done to attract talent to ease labour shortages. High-skilled non-EU job seekers can apply for the EU Blue Card scheme, which applies to all EU countries except Denmark and Ireland and offers an easier route to EU long-term residence status, as the periods spent in different EU countries may be cumulated. Even so, the uptake of the Blue Card is low with 89 thousand in 2023, and could be enhanced as it continues to exist alongside more attractive national schemes, which tend to offer lower salary thresholds and quicker processing times.

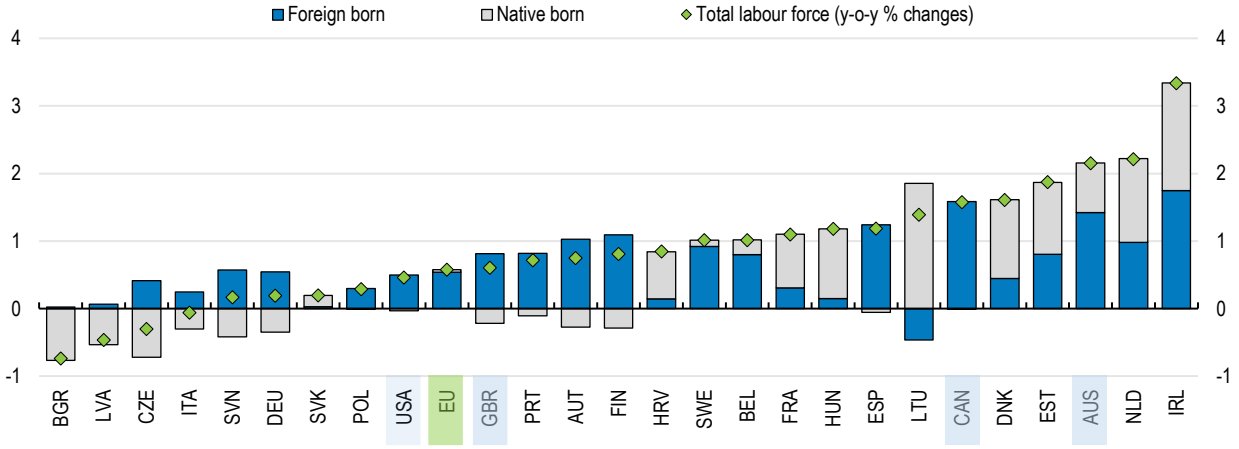
In 2021, a Directive revised the EU Blue Card scheme, which had to be transposed by November 2023, making the scheme more attractive by reducing the minimum job offer duration, relaxing restrictions on changing employers and expanding eligibility to highly skilled applicants with relevant professional experience but not a diploma. These adjustments are welcome and could even be taken further. For example, lower salary threshold requirements could help alleviate the existing skills shortages in less-skilled occupations, such as healthcare, construction and agriculture, which display high and increasing vacancies in many OECD countries (Causa et al., 2025[113]).

However, delays in transposition in some EU countries together with substantial cross-country differences in the minimum salary requirements and the eligibility of applicants with professional experience but no relevant educational qualifications risk ongoing fragmentation, lengthy procedures and hence preference for national schemes. To address these issues, the EU countries could align their EU Blue Card-related salary thresholds and other conditions to the extent possible with those of their national schemes (OECD, 2021[114]). Uptake could be also strengthened by easier access to the EU Blue Card for workers already covered by similar national schemes.

Apart from high-skill migration, which is supported by the EU Blue Card, labour migration from abroad can support employers to address shortages at all skills levels. For instance, the Single Permit Directive was recently revised to make access to the procedures to obtain a single permit easier and faster. This recast, together with the Blue Card Directive recast, aim at making the EU more attractive for workers from abroad. A broader approach focusing on areas with labour shortages would help and requires more detailed analysis of actual needs of the labour market.

## Figure 4.18. Labour force growth depends largely on migration

Foreign-born/native-born contribution to labour force growth, 2020-2024 (annual average), percentage points




Note: Foreign (native) born contribution indicates the absolute change in the number of foreign (native) individuals in the labour force, divided by the absolute change in the total number of individuals in the labour force. The sum of the foreign and native components equals the total labour force growth. Data refer to the labour force aged 15 and over for all countries except the United States and the United Kingdom for which data refer to the age group 16 and over.

Sources: Eurostat Labor Force Statistics (EU); Australian Bureau of Statistics Labor Force Statistics (AUS); Statistics Canada Labor Force Statistics (CAN); Office for National Statistics Labor Force Survey (GBR); and US Bureau of Labor Statistics Current Population Survey (USA); and OECD calculations.

StatLink https://stat.link/09cjbm

To facilitate intra-EU labour mobility for EU citizens, the Directive on mutual recognition of professional qualifications allows for automatic recognition of some qualifications obtained in another EU country. Automatic recognition is to be applied for seven professions, including doctors and nurses. In addition, the directive allows for automatic recognition based on professional experience in the craft, commerce or industry sectors. In addition, EU professional cards became available in 2016 for five professions (nurses, pharmacists, physiotherapists, mountain guides and real estate agents) to help professionals get their qualifications validated more quickly.

However, service sector providers still face a wide array of barriers when they want to establish themselves in another EU country or deliver services on a temporary cross-border basis. Recognition procedures remain costly and lengthy, and the mutual recognition of qualifications remains limited, leading to market restrictions and limiting cross-border mobility. This reflects that EU countries are competent to regulate professions, within the limits of non-discrimination and proportionality, including the qualifications required to access specific professions (see above).

Another barrier to within-EU labour mobility are difficulties to transfer pension rights across borders. The EU has established the Electronic Exchange of Social Security Information system to accelerate the transfer of pension rights across EU countries. Improving cross-border labour mobility will require faster exchange of information on pension rights through this system. Another way to strengthen labour mobility is to extend the portability period for unemployment benefits from three to six months, where a legislative proposal to this effect is currently being negotiated between the European Council and the European Parliament, and better monitoring of working conditions of posted workers as discussed in the last *Survey* (OECD, 2023[31]).

The number of cross-border workers and postings returned to pre-pandemic levels and continued to grow in 2023. The estimated number of cross-border workers (with Portable Document A1) stood at 3.6 million, which is 19% higher than in 2022. Similarly to previous years, Austria, France and Germany were the main destination countries

for workers coming predominantly from France, Germany, Italy and Poland (European Commission, 2025[115]). However, posting of workers remains a lengthy and burdensome process. Since 2023, the Single Market Enforcement Taskforce works on reducing administrative burden by EU countries, such as prior declarations. In 2024, the Commission proposed to establish a multi-lingual online declaration system for declarations of posting of workers, which is currently being negotiated by the European Council and the European Parliament (European Commission, 2024[116]). This is welcome, as the online declaration portal will considerably reduce the time firms spend on declarations and increase the transparency of postings. At the same time, by facilitating effective and targeted inspections, it will contribute to the protection of rights of posted workers.

Some EU countries, including Germany, Austria and Denmark, to name a few, have reimposed internal border controls in 2024 in the context of fighting irregular migration and have considered prolonging them. Frontex, the EU's border agency, recorded a 40% drop year-on-year in irregular border crossings in 2024, despite a switch in migration routes from the Balkans route to entries via the eastern Mediterranean and the Canaries (Frontex, 2024[117]). The fall in irregular border crossings may reflect stronger border controls, and levels of irregular border crossing are arguably still high despite the recent fall. However, there are trade-offs between border controls and the Single Market. Making border controls more permanent than in the spirit of Schengen will have repercussions on labour mobility. Border checks affect cross-border commuters (1% of the EU labour force), although some countries have a significantly higher share such as Austria, Belgium and Luxembourg (European Commission, 2024[118]). EU countries can in case of a threat to their internal security or public policy, in reasoned cases and proportionally, suspend Schengen for six months at a time. The EU should ensure that internal border controls are temporary and proportional.

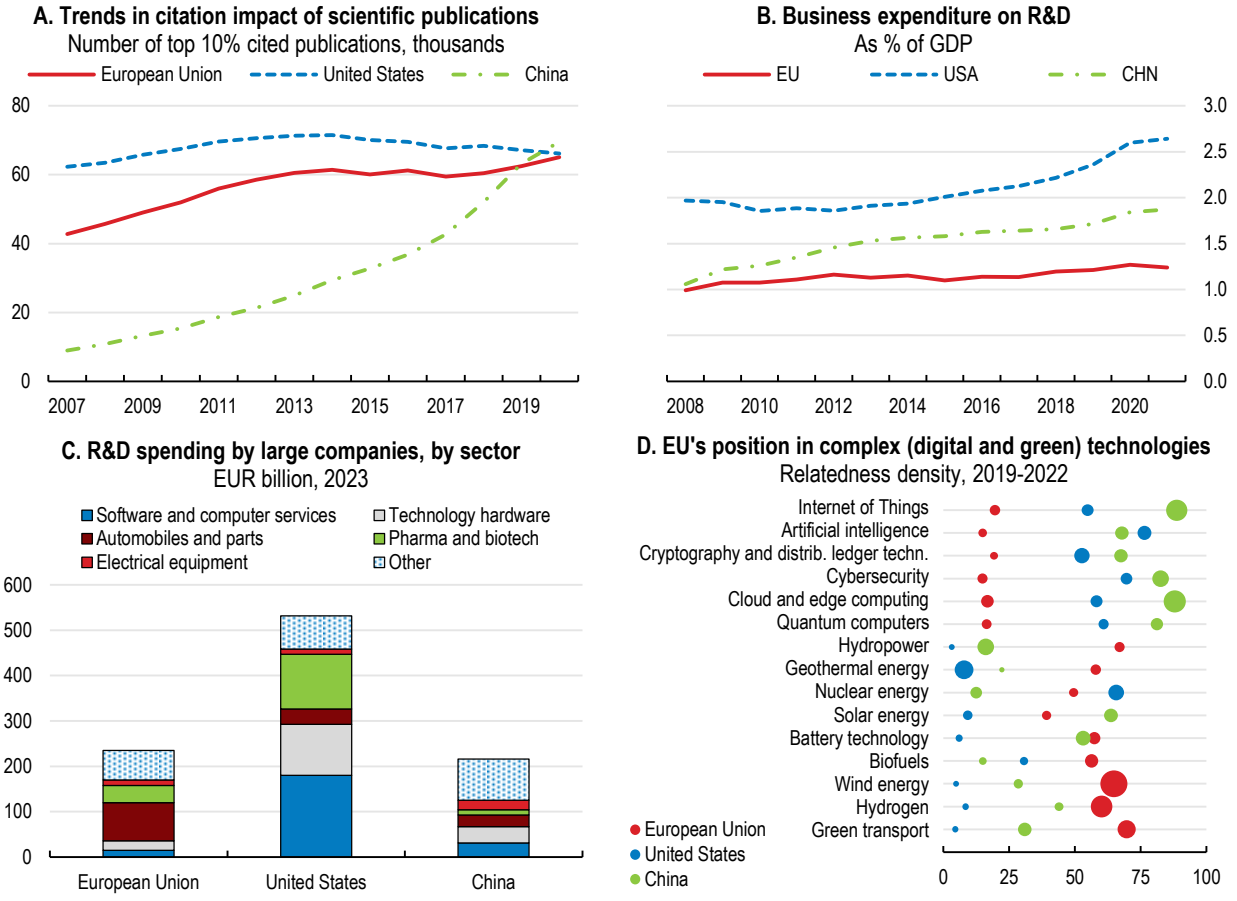
## 4.7. Supporting innovation

### *4.7.1. Creating the right framework conditions for innovative companies*

Europe is losing ground in innovation vis-à-vis the United States and China. The European Research Council has been successful in fostering basic research, although there is a need to continue fostering excellent basic research given growing competition from other countries. While the EU's science base is strong, a major weakness lies in the translation of science into breakthrough innovation (Figure 4.19, Panel A). Private R&D spending is relatively low and taking place in a handful of incumbent companies that have not changed over the past decades. This has led to an over-specialisation in the medium-tech segment where competition is growing fiercer, notably in the automotive sector (Panel B and Panel C). As a result, the EU lags the United States and, increasingly, China in innovation in frontier technologies (Panel D) (Fuest et al., 2024[7]; European Commission, 2024[119]). In contrast, support for breakthrough innovation is limited and the fragmented Single Market hampers the scaling up of high-tech start-ups that can challenge incumbents. Entry and exit barriers, stringent labour market regulations, and different national investment tax and insolvency frameworks increase operating and hiring costs for businesses and investors.

Capital markets can provide the finance for companies to commercialise their innovative ideas and rapidly scale up their investment. However, European stock markets remain unattractive for companies to raise capital. Initial public offering volumes have fallen over the past decade (European Securities and Markets Authority, 2024[103]). To encourage stock exchange listings, the EU has relaxed disclosure requirements and research investment rules under the Listings Act. Nonetheless, shallow and fragmented capital markets fail to provide the necessary liquidity and scale, resulting in a higher equity risk premium compared to the United States (OECD, 2024[120]; Fratto et al., 2024[121]). The costs of not having deeper and more integrated capital markets are particularly high for innovative firms. These firms rely on equity finance because debt-based bank finance is less suitable for their high risk, high reward innovation activities. A stronger participation of retail and institutional investors, such as pension funds, could deepen capital markets and lower the equity risk premium, making it cheaper to raise equity through initial public offerings.

## Figure 4.19. The science base remains strong while innovation is weak




Note: In Panel D, on the x-axis, "relatedness density" measures how easily a country can build comparative advantage in a particular technology, depending on how closely related it is to other technologies the country is already strong in. Higher values show a higher relatedness density for a given technology. On the y-axes, technologies are ranked according to how advanced they are, ranging from green transport (less technologically advanced) to Internet of Things (more technologically advanced). The size of the bubble captures the degree of specialisation that each country reports in a given technology field, as measured by the revealed comparative advantage (RCA).

Source: OECD (2023), OECD Science, Technology and Innovation Outlook 2023: Enabling Transitions in Times of Disruption, OECD Publishing, Paris, https://doi.org/10.1787/0b55736e-en; 2024 EU Industrial R&D Investment Scoreboard; Di Girolamo et al. (2023), The global position of the EU in complex technologies, European Commission, Directorate-General for Research and Innovation, Publications Office of the European Union, Luxembourg, https://data.europa.eu/doi/10.2777/454786; and OECD calculations.

StatLink https://stat.link/zg3doy

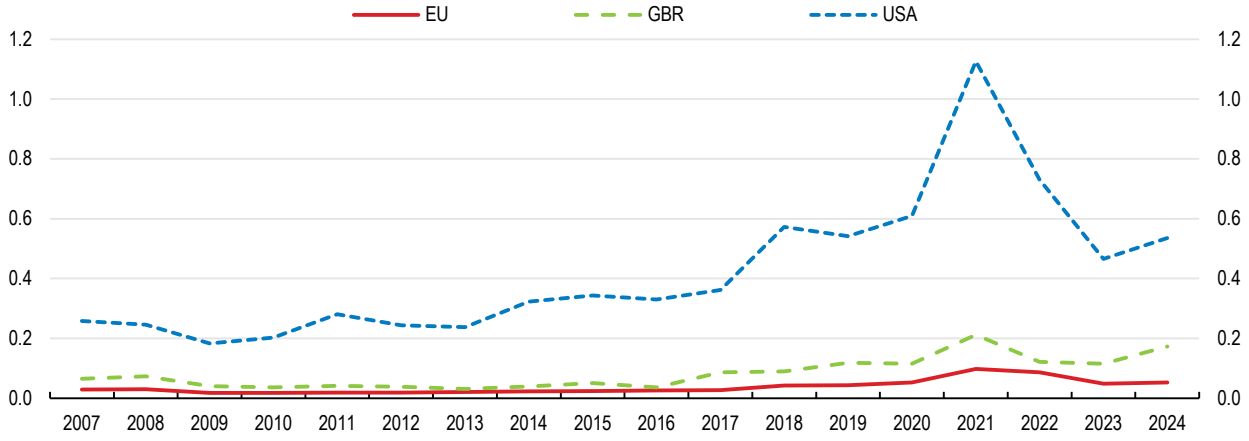
Venture capital investment is relatively low, further limiting financing options for innovative young firms for which bank financing is less suitable (Figure 4.20). A concern is limited private risk capital to finance the transition from startup phase to the growth phase of companies. This reflects shallow capital markets that reduce listing options for venture-backed start-ups, and thus exit options for their investors (Arnold, Claveres and Frie, 2024[122]). As a result, the EU has only 11% as many large venture-backed companies as the United States (Fratto et al., 2024[121]). A concern for policy is that the scarcity of risk capital pushes EU companies to seek funding and stock market listings abroad. The EU, together with ESMA and the financial sector should foster the development of an EU-wide market segment for high-tech start-ups with sufficient size and liquidity to attract private investors. Common supervision and trading rules for such pan-European trading venues could facilitate their development (see above).

Public involvement in the venture capital market is strong. The European Investment Fund (EIF) plays a major role in the venture capital market with its European Investment Fund (EIF), accounting for 15% of total venture capital raised in the EU over the past decade (Fratto et al., 2024[121]). In addition, EU budgetary support of about 0.02% of EU GDP a year is provided for high-tech start-ups via the EU's InvestEU programme and the European Innovation Council. The proliferation of EU financial instruments is not optimal as it complicates the funding landscape for

start-ups (Demertzis, Pinkus and Ruer, 2024[123]). The Commission should simplify its portfolio of investment instruments and introduce common application requirements to ease access for start-ups. Importantly, an independent cost-benefit analysis needs to establish whether public investment programmes deliver value added in terms of innovation.

## Figure 4.20. Venture capital remains relatively low

Venture capital investments, as % of GDP




Note: Data refer to European Union member countries that are also members of the OECD (22 countries).
Source: OECD Venture capital investments (market statistics) database; and OECD calculations.

StatLink https://stat.link/tkoq60

Corporate frameworks remain largely national, raising operating costs for companies that want to scale up activities across the EU. Such barriers to EU-wide business operation limit the contestability of markets and reduce the supply of scale ups for investors. In response, the Commission proposed the establishment of a European Code of Business Law for smaller companies as discussed above. With the Societas Europaea (SE), such a European corporate structure already exists. However, its uptake has been limited to large publicly listed industrial firms. This reflects the high minimum capital requirement of EUR 120 000 to be incorporated and the lengthy formation process as firms still need to follow national regulations (Biermeyer, 2021[124]).

To attract companies into the scheme, such a 28th corporate regime would need to lower the minimum capital required to be incorporated and ensure EU-wide common regulation, starting, for example, with business registration and insolvency rules. Importantly, company size thresholds should be avoided in order not to penalise firm growth. Hence, the Commission should establish a European corporate framework with common requirements for business registration and bankruptcy.

There are roughly 400 different national insolvency proceedings across the EU. From an investor's perspective, collecting information about EU countries' insolvency proceedings is costly and assessing liquidation values of cross-border investments difficult (European Commission, 2022[125]). The high number of insolvency proceedings also impairs the levelling of the playing field among businesses in EU. Hence, as a first step, the EU should ensure that EU countries reduce the number of insolvency procedures with the objective to have only one insolvency procedure per country. Thereafter, the different national insolvency proceedings could be unified (see below).

National insolvency proceedings also continue to differ in terms of efficiency. This reflects differences in definitions of insolvency, recovery times and rates, and ranking of claims. For instance, the time to recover assets during insolvency proceedings ranged from half a year to 7 years across the EU in 2019. Lengthy insolvency procedures keep unproductive firms alive, hampering efficient allocation of capital to more productive firms (Adalet McGowan, Andrews and Millot, 2017[126]). In addition, the recovery rate for creditors was on average 40% of the amount outstanding at the time of the default, although this rate varied between 7% in Poland and 95% in Denmark in 2019 (European Banking Authority, 2020[127]). Such cross-country differences impair cross-border investment.

In 2022, the Commission proposed to harmonise insolvency proceedings (European Parliamentary ResearchService, 2023[128]). This includes recovery rates and the ranking of claims for a more predictable distribution of recovered value among creditors. However, a common definition of insolvency is still missing. The Commission and EU countries should adapt and implement a harmonised framework for insolvency, preferably through regulations to avoid divergent implementation across countries. This entails a common ranking of claims and a common definition of insolvency, which could include pre-insolvency procedures. Specifically, creditors should be allowed to initiate restructuring to distinguish temporary distress from insolvency and enable the timely restructuring of temporarily distressed firms. In addition, priority should be given to new financing over unsecured creditors in the event of restructuring to facilitate capital injections and internal reorganisation (André and Demmou, 2022[129]). Monitoring of progress towards full harmonisation will be important. In this regard, the Commission should ensure that national authorities share data on the number and duration of insolvency procedures, where claims are being paid, and the ranking of claims.

### *4.7.2. Improving effectiveness of innovation policy*

EU-level public R&D spending is relatively low as a share of GDP and not consistently directed at addressing the innovation deficit (Figure 4.21, Panel A). Limited EU-level funding means that the focus should be on raising the effectiveness of EU public R&D support in supporting innovation. This requires rigorous cost-benefit analysis and other forms of impact evaluations of individual EU programmes based on clear output indicators, such as scientific breakthroughs leading to innovative start-ups.

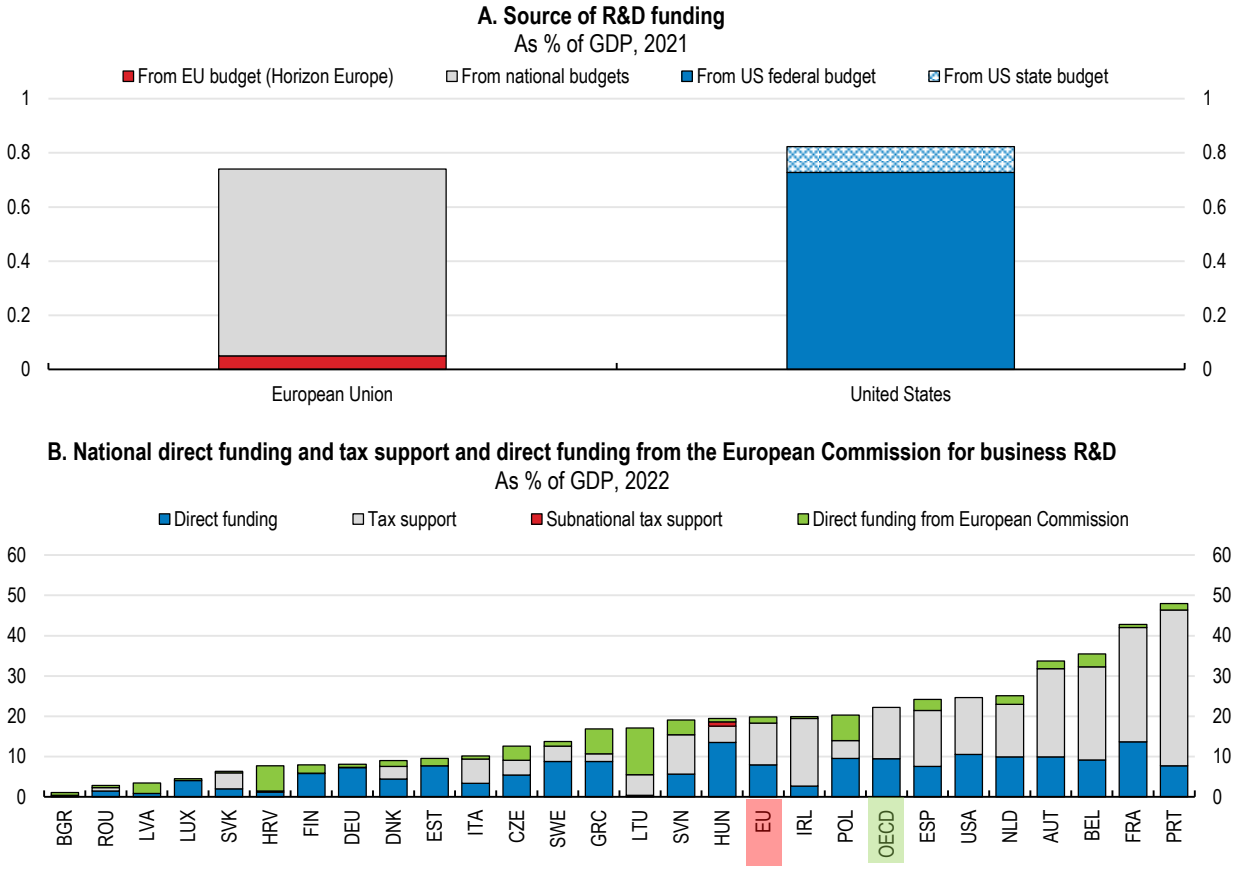
The Commission has a long tradition in programme evaluations, although key performance indicators for programmes under Horizon Europe, the EU's framework R&D programme, were only introduced in 2020 (European Commission, 2023[130]). Before that, evidence on the direct benefits of the individual programmes were not always available, and underperforming programmes were never closed, leaving less budgetary space for well-performing programmes. Hence, the EU should subject all R&D programmes to evaluations based on clear key performance indicators and follow up by closing under-performing programmes and shift funding to well-performing programmes. If this is ensured, existing EU budgetary resources should be re-directed towards support for R&D and innovation coordinated at the EU level as recommended in the last *Survey* and committed to by the Commission (OECD, 2023[31]).

The relative role of EU funding for business R&D is similar, with about 10% of total support for business R&D in the EU attributable to the Commission (OECD, 2025[131])(Figure 4.21, Panel B). The role of EU-level R&D support also varies across countries and is higher in central and eastern European countries. EU-level funding can complement national funding to avoid duplicate efforts, scale up and foster R&D and innovation. Hence, the interaction with national programs should be acknowledged and accounted for in evaluations of R&D programmes, where possible.

EU budget resources devoted to breakthrough innovation are limited. The European Innovation Council (EIC), the EU's funding instrument for deep-tech breakthrough innovation that was established as recently as 2021, accounts for only about 10% of the Horizon Europe budget (European Commission, 2024[132]). The EIC features both an open, bottom-up element, where researchers and companies submit their proposals, accounting for over half its funding, and a challenge-based element, where funding is provided in pre-defined key areas such as quantum technologies, clean tech and biotech. Following international best practice, the EIC has programme managers that help both define early-stage challenge topics and develop the portfolio of activity taken forward by these projects. Topics for EIC challenges are informed by both policy priorities and emerging opportunities with consultation involving the EU countries.

However, the EIC's limited budget is reflected in a limited number of 10 programme managers (compared to 100 at the US Defense Advanced Research Projects Agency in early 2025). In addition, the programming process is lengthy. This reflects the limited budget, but also that a new call within a Challenge cannot be signed off without the approval of every EU country in the European Council. This approach stands in contrast to best international practice of support for breakthrough innovation in the United States, or support for early stage research by the European Research Council (Fuest et al., 2024[7]). Hence, opportunities to give the EIC more autonomy should be explored. For instance, the EIC and its programme managers could receive a broader mandate in which they can initiate and execute calls once a topic for a challenge is agreed on, and therefore speed up processes.

## Figure 4.21. EU-level public R&D spending is relatively low




Source: European Commission, 2024, based on Eurostat and OECD; Bureau of Economic Analysis of the United States (BEA); OECD R&D Tax Incentives database, https://oe.cd/rdtax; OECD Research and Development Statistics, https://oe.cd/rds; and OECD calculations.

StatLink https://stat.link/y2hob8

The EU has the ambition to better align public R&D funding with investment in new strategic technologies such as AI (European Commission, 2025[39]). However, such a focus disregards the strengths of the European innovation system, which lie in advanced manufacturing, biotechnology, and clean technology (European Commission, 2024[132]). Another impediment to investment in strategic technologies is limited EU-level funds for R&D (see above). Public R&D spending is fragmented along national lines and not consistently directed towards EU priorities. Public procurement accounts for 14% of EU GDP and could provide an important impetus for new technology but it remains entirely national (European Court of Auditors, 2023[133]). All these factors reduce the scope for a better alignment of public R&D support with EU strategic objectives.

Several countries have established organisations to support high risk, high reward technological breakthroughs in precisely defined strategic areas. An example is the US Defense Advanced Research Projects Agency (DARPA), which supports breakthrough innovation in defence with a relatively large budget of USD 4.3 billion, or 28% of the EU's annual R&D budget (Defense Advanced Research Projects Agency, 2024[134]). In comparison, the EIC has a relatively small annual budget of USD 1.7 billion (EUR 1.5 billion). In addition, there are several other US agencies dedicated to breakthrough innovation, including the Intelligence Advanced Research Projects Activity (IARPA) focusing on AI, and the Advanced Research Projects Agency-Energy (ARPA-E).

DARPA has funded technologies such as the internet and the global positioning system (GPS), to name a few. It has a high degree of autonomy and organisational flexibility to recruit experts from science, technology, and the venture capital industry. Importantly, its programme managers have significant leeway and budgets to pursue radical innovations and open calls. Calls are based on excellence and novelty, often benefitting new players. Accountability is strong as programmes are constantly evaluated based on clear quantifiable goals and trackable metrics, allowing

to terminate unsuccessful projects early on (Azoulay et al., 2019[135]). However, while the EIC has many of these elements in place, such a system cannot be easily adapted to conditions in the EU with its national procurement markets that fail to serve as first buyer of new technologies as in the United States. Private investment for deep tech could partly compensate for public procurement, and the EIC aims to de-risk and crowd in private investment. Deeper and more integrated capital markets, including venture capital, would support this (see above).

### *4.7.3. Ensuring industrial policy does not harm the Single Market*

Industrial policy is mostly national, which poses a challenge to the level playing field in the EU. To better align national spending with EU objectives, the Commission announced a new Clean Industrial Deal in February 2025. The Clean Industrial Deal will provide incentives for the decarbonisation of industry. Simpler state aid and public procurement rules will apply to strategic sectors including clean tech and energy-intensive manufacturing (European Commission, 2025[36]).

However, these new state aid rules for strategic sectors could result in a less stringent state aid framework which would not prevent fiscally stronger EU countries from providing excessive support. This reflects that some EU countries with high energy prices may want to maintain energy-intensive industries, whereas they could be only competitive in regions with low energy prices and high potential for renewables such as southern Spain or northern Sweden (Zachmann et al., 2024[136]). Such a national approach, together with relaxed state aid rules, may have implications for the Single Market and costs for the EU economy in the form of lower productivity. The reason is that unilateral industrial policy risks binding resources in uncompetitive firms, harming competition and hindering industry's adjustment to structural change. Hence, the EU's decarbonisation goal could be in conflict with its productivity goal. Instead, better integrated energy markets will be key to lower energy prices and support EU productivity. The Commission is working towards better integrated energy markets, which is welcome (Chapter 3).

A related issue is the lack of EU funds for industrial policy. Instead, the EU has state aid rules at its disposal to steer national spending towards EU objectives, notably under Important Projects of Common European Interest (IPCEI). IPCEI involve at least four EU countries and support investment in strategic EU objectives such as economic security and resilience, innovation in clean technology or new clean energy infrastructure.

There might be a trade-off between economic efficiency and resilience. The Commission ensures through state aid assessment that IPCEI address market failures, any potential distortions to the Single Market are limited and outweighed by the positive effects in terms of contribution to the objective of common European interest. In return, IPCEI can benefit from state aid of up to 100% of the funding gap, i.e., the difference between the positive and negative cash flows over the lifetime of the investment, discounted to their current value.

The Joint European Forum for IPCEI identifies potential new IPCEI based on cost-benefit analysis and provides guidelines for evaluation of IPCEI by EU countries. However, IPCEI are not subject to rigorous evaluations based on common key performance indicators, including an assessment of the costs and benefits of different policy options, as discussed in the last *Survey* (OECD, 2023[31]). Industrial policy needs to be carefully applied to those areas where markets fail, particularly in new technology, to crowd-in private investment. In this regard, it is welcome that the EU ensures that such policy interventions do not harm competition and the Single Market. Importantly, the EU should also ensure that the costs of policy intervention are limited, and its returns are high. To ensure the efficient use of public resources, a strong emphasis should be placed on evaluation and the regular reassessment of IPCEI (Box 4.3) (Millot and Rawdanowicz, 2024[34]). Hence, the EU should subject IPCEI to rigorous evaluations based on common measurable key performance criteria, and halt support if performance criteria are not met.

### Box 4.3. Industrial policy design

Effective industrial policies aim to enhance domestic business performance by addressing market failures, fostering innovation, and supporting sustainable, inclusive growth through well-designed and implemented strategies:

- Clear objectives and strategic coordination: Policies should set clear objectives based on well-defined market failures, with coordinated government action.
- Evidence-based design and evaluation: Decisions should rely on rigorous assessments, with regular reviews to adjust ineffective measures.
- Balancing horizontal and targeted approaches: Broad business policies (e.g., R&D tax credits, competition policy) may be complemented by targeted support for strategic sectors and technologies.
- Encouraging competition and innovation: Policies should promote competition and innovation, avoiding protectionism.
- Using demand-side instruments such as public procurement, regulatory standards, and consumer incentives.
- Ensuring transparency and accountability: Competitive selection, clear benchmarks, and sunset clauses help prevent inefficiencies and policy capture.
- International cooperation: Policies should align with international trade rules and encourage international cooperation.

Source: Millot and Rawdanowicz (2024[34]), Criscuolo et al. (2022[137]), OECD (2025[138]).

More generally, prioritisation is missing with about 50 sectors deemed as strategic under the EU's Net-Zero Industry Act, the predecessor of the Clean Industrial Deal (European Commission, 2023[37]). The EU's new Clean Industrial Deal from February 2025 does not provide a list of strategic sectors, although it identified clean-tech as strategic and announced it would extend industrial policy support to additional sectors, notably energy-intensive industries (European Commission, 2025[36]). To identify potential IPCEI with the highest value added to achieve EU objectives, EU countries and the Commission work together in the Joint European Forum for IPCEI (JEF-IPCEI) since October 2023. Targets are also set on an aggregate level, such as meeting 40% of domestically produced key components of clean tech products on the EU market, but not at a technology or sector level. Missing prioritisation in the Clean Industrial Deal and measurable targets make it impossible to identify IPCEI with the highest value added to achieve EU objectives. Thus, the EU should publish a list of strategic sectors and introduce clear measurable sectoral output targets to improve accountability.

With financing provided by EU countries, previous IPCEI often involved larger EU countries with sufficient fiscal resources to support them (Government of Sweden, 2021[139]). This created the risk that the level playing field within the Single Market will be undermined as large countries attract investment. The EU has addressed this issue by encouraging countries to use Recovery and Resilience Facility funds to support IPCEI, although this solution is only temporary. To avoid harming the Single Market, the EU could top up IPCEI support for projects aligned with EU objectives with highest returns, such as early-stage technology development and cross-border energy infrastructure. This will require first and foremost the capacity to conduct rigorous cost-benefit analysis to identify projects where EU support can provide clear value added with limited costs of intervention (see above). If this is ensured, funding for EU industrial policy could be freed up from lower EU spending on agricultural and cohesion policy (Chapter 2).

## Table 4.1. Past recommendations on productivity and the Single Market

| Main recommendations of the 2023 Survey | Action taken since 2023 |
|---|---|
| Promote the Capital Markets Union by reviewing the regulatory burden on institutional investors. | As part of the 2020 Capital Market Union plan, the Commission reduced administrative burdens for institutional investors and asset managers, improved cross-border access to information, and advanced the supervisory data strategy to cut reporting costs. The February 2025 EU sustainability framework proposes to simplify sustainable reporting, with further measures for a Savings and Investments Union proposed in March 2025. |
| Complete the Banking Union by addressing all outstanding issues in a holistic manner. Harmonise the use of national deposit guarantee schemes and the rules for resolution of banks. | In June 2022, eurozone Finance Ministers prioritised completing the Banking Union, focusing on reforming the crisis management and deposit insurance (CMDI) framework. The CMDI framework review, proposed by the Commission in April 2023 and currently in negotiation, seeks to improve resolution tools for small and medium-sized banks and enhance the use of industry-funded safety nets. Interinstitutional negotiations are currently ongoing. Other projects, like the European Deposit Insurance Scheme (EDIS) and market integration, would be re-assessed after CMDI reform.<br>In April 2024, the ECON Committee of the European Parliament adopted a draft report on the Commission's 2015 EDIS proposal, introducing a liquidity-only EDIS. This involves a European liquidity support fund combined with mandatory loans from national deposit guarantee schemes (DGS) in case of shortfall of national resources. The Parliament will decide on further action on EDIS.<br>Progress on EDIS and the Banking Union is part of the Commission's new mandate. As outlined in the Savings and Investments Communication in March 2025, the Commission will deliver a 2026 report evaluating ways to improve the Single Market in banking. |
| Continue efforts to reduce occupational entry barriers.<br>Reduce the costs of posting workers by introducing a common EU declaration system and harmonized documentation requirements, including exemptions.<br>Consider extending the unemployment benefit duration to six months when moving to a different EU country. | In 2024, the Subgroup Common Training Frameworks was established to create common training frameworks, foster cooperation among EU countries, map educational and regulatory requirements, and provide expertise on national requirements.<br>The Commission took enforcement action against non-compliant national laws on professional qualifications recognition, including the December 2024 package targeting 22 Member States for imposing unjustified prior checks on qualifications for temporary services provision.<br>In 2023, the Commission recommended simplifying the recognition of qualifications for third-country nationals to attract them to the EU and support their labour market integration. It provides guidelines for faster recognition of qualifications for regulated professions and labour migration.<br>The Commission's November 2024 proposal for a Regulation on a public interface connected to the Internal Market Information System aims to create a multilingual interface for declaring posted workers, with voluntary participation from EU countries. The proposal is under discussion by the European Council and European Parliament.<br>The Commission's proposal to revise the Regulation on coordinating social security schemes includes extending the transfer of unemployment benefits for job search in another EU country up to 6 months. The proposal is under discussion by the European Council and European Parliament. |
| Protect the Single Market and avoid relaxing the state-aid rules further.<br>Improve the governance of the Important Projects of Common European Interest framework and speed up the approval process. | The Commission will publish a Single Market Strategy in 2025.<br>Since 2023, the Commission has launched initiatives to enhance the effectiveness of IPCEI procedures:<br>A Code of Good Practices for transparent, faster design and assessment of IPCEI was published in May 2023, with guidance and templates for EU countries.<br>In June 2023, the Commission revised the General Block Exemption Regulation, enabling EU countries to grant aid for smaller IPCEI-related R&D projects without prior notification to the Commission. If conditions on cross-border collaborations and result sharing are met, aid intensity can reach 60% for SMEs, and such IPCEI-related projects could be linked as 'associated partners' to the IPCEI. Several workstreams, especially in the JEF-IPCEI, aim to enhance SME participation in IPCEI.<br>DG COMP has published standardised project templates on its dedicated IPCEI website to provide guidance, clarify information needs and assessment criteria, with more templates in development. |

| | |
|---|---|
| | In October 2023, the Joint European Forum for IPCEI (JEF-IPCEI) was established. It covers the entire lifecycle of IPCEI from identification, design, assessment to implementation. Within the identification workstream, the JEF-IPCEI prioritises strategic technologies for the EU that could be relevant candidates for future IPCEIs. It aims to enhance IPCEI transparency and efficiency by streamlining preparation and implementation of IPCEI and developing best practices.<br>In April 2025, the IPCEI Design Support Hub was announced. It will offer technical support, and streamline IPCEI processes for EU countries. |
| Re-direct existing EU budgetary resources towards support for green R&D, innovation and early-stage support coordinated at the EU level. | The EU directs funding towards green R&D and innovation through the 35% climate mainstreaming target for Horizon Europe under the current Multi-annual Financial Framework. |
| Ensure that the EU state-aid framework allows government subsidies only for renewable technologies that are not yet competitive. | No action taken. |
| Increase investment in cross-border grid connections by diverting EU funds to the Connecting Europe Facility. | The Connecting Europe Facility has received a budget reinforcement worth EUR 50 million in 2024. This allowed the selection of a bigger number of cross-border projects for grants. |

## Table 4.2. Main findings and recommendations (key recommendations in bold)

| Main findings | Recommendations |
|---|---|
| **Remove internal market barriers** | |
| The regulatory burden is high. EU regulations are not always subject to a rigorous cost-benefit analysis. | **Reduce the EU regulatory burden, including documentation requirements and reporting obligations for businesses.**<br>**Subject all EU regulatory proposals to a rigorous cost-benefit analysis.** |
| Countries often do not report internal market barriers under the Services Directive. National regulations on services are often not subject to proper economic impact assessments. | Tighten reporting requirements for national services regulation under the Services Directive.<br>Make economic impact assessments by EU countries mandatory for notifications of national services regulations under the Service Directive. |
| Many barriers to market entry and the practice of professional services persist.<br>Territorial supply constraints by large brand manufacturers are a major non-regulatory barrier for retailers. | Ensure that the Services Directive is well implemented and enforced across EU by Member States, notably as regards the justification and proportionality of retail restrictions. |
| Many existing barriers to market entry and exercise of professional services are unjustified and unnecessary. | **Ensure that mutual recognition of qualifications is improved, and all unjustified and disproportionate restrictions on professional services are removed.** |
| Only about a fifth of national administrative procedures that countries are required to make available online are online and accessible for cross-border users through the Commission's Your Europe online portal. | Ensure all relevant national administrative procedures for businesses are available online and accessible through the Commission's Your Europe online portal, including for cross-border users. |
| Enforcement of Single Market law has weakened over the past decade. | Increase the use of infringements procedures to enforce Single Market law, while continuing with preventive measures. |
| Different national spectrum assignment policies hamper market integration in telecommunication. | Further harmonise spectrum assignment policies across EU countries, including the duration of spectrum licences and fees. |
| Competition in commercial passenger rail transport is low. There is evidence of discrimination against foreign competitors when it comes to access to path slots for trains. | Ensure that public rail service contracts are allocated via competitive tendering. Move from national path slot allocations for trains to a cross-border path slot allocation. |
| **Deepen financial markets** | |
| The institutional and retail investor base is shallow. Competition for retail savings and investment products is low. | Encourage banks to offer financial products other than their own, for instance by introducing a blueprint for investment accounts. |
| Rules for investment funds differ, hindering growth of cross-border investment funds. | Introduce common marketing registration requirements for cross-border investment funds. |
| There is a lack of common supervision of pan-European financial services providers and infrastructures.<br>Capital market supervisory practices differ, and national authorities interpret EU laws differently. | Consider moving the supervision of large pan-European stock exchanges, large pan-European asset managers, and large post-trade infrastructure to ESMA.<br>Extend ESMA's mandate to include mandatory supervisory colleges to enhance supervisory convergence. |
| International banking groups are still treated as national units by national regulators, hampering cross-border capital flows within banking groups. | Introduce a common deposit insurance system.<br>Establish a robust burden-sharing framework between EU countries, for instance by facilitating intragroup support agreements and improving on single-entry point resolution strategies. |
| **Boost labour mobility** | |
| The EU Blue Card attracts fewer high-skilled workers than similar national schemes. National requirements for Blue Card eligibility differ. | **Relax common requirements for EU Blue Card eligibility and facilitate Blue Card issuance for workers already covered by similar national schemes.** |
| Administrative processes for cross-border postings are cumbersome. The recognition of pension benefits in another EU country is lengthy. | Establish an online portal for the declaration of posting of workers.<br>Accelerate the exchange of information on pension rights through the Electronic Exchange of Social Security Information. |
| **Support innovation** | |
| Different national corporate laws raise businesses' operating costs, limiting the contestability of markets.<br>There are more than 400 national insolvency proceedings in the EU. | **Establish a common European Code of Business Law (28th regime) that includes business registration and insolvency.**<br>Introduce a common EU insolvency framework. |
| EU-level public R&D spending is low and not consistently directed at addressing the innovation deficit. | **Subject all R&D programmes to evaluations based on clear key performance indicators and follow up by closing under-performing programmes and shifting funding to well-performing programmes.**<br>Provide the European Innovation Council and its programme managers with a broader mandate in which they can initiate and execute calls, and therefore speed up processes. |
| National industrial policy risks weakening the Single Market.<br>Important Projects of Common European Interest (IPCEI) are not subject to rigorous evaluations based on clear, common key performance criteria. | **Enforce state aid rules to protect the level playing field within the Single Market.**<br>Subject IPCEI to rigorous evaluations based on measurable, common key performance criteria, and halt support if performance criteria are not met. |

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# OECD Economic Surveys: European Union and Euro Area 2025

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Russia's war of aggression against Ukraine and rising trade tensions continue to slow down the European economy. Despite strong policy responses to external shocks, the near-term outlook is clouded by elevated uncertainty. Disinflation is progressing, but monetary policy should remain vigilant. Fiscal policy needs to make space for new spending needs, such as defence, but to ensure medium-term sustainability, fiscal prudence must continue. The new EU budget will need to involve both increasing budgetary resources and re-prioritising existing spending in areas such as cohesion and agricultural policy. A more integrated electricity market can help lower electricity costs and boost competitiveness through expanded cross-border interconnections, reduced electricity taxation, and stronger competition. Furthermore, enhancing productivity requires a more integrated Single Market with fewer regulatory barriers for firms to scale, compete, and innovate. Deeper capital markets will also be important for innovation and productivity. A strong state aid framework is vital to maintain a level playing field for productive firms to grow and drive structural change. Improving labour mobility will further support productivity.

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