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#### NOTE

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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the economic policy of the euro area

#### I. INTRODUCTION

On 26 November 2015, the Commission presented the Autumn Economic Package, including the Annual Growth Survey (AGS), the Alert Mechanism Report (AMR), the draft Joint Employment Report (JER). In line with the Commission's Communication of 21 October 2015 on Completing the Economic and Monetary Union, the package also included a draft Council Recommendation on the economic policy of the euro area, with the aim to better integrate the euro area and national dimensions of EU economic governance.

The package reflects that the EU is experiencing a moderate recovery, but employment and social disparities still persist between and within Member States. Policies need to be oriented at consolidating the recovery and fostering upward economic and social convergence. Therefore, this year's priorities, reflected in the package in general and the euro area recommendation in particular, denote a strong emphasis on employment and social performance, such as a better consideration of investment priorities that extend to human capital and related social investment.

## **II. EURO AREA RECOMMENDATION**

In order to take account of this current economic context and of the revamped Semester process, and in particular the new timeline of the euro area recommendation, the Presidency considered it adequate to make proper use of the expertise of EPSCO and its preparatory and advisory committees. This approach is in line with the recurrent exercise in the context of the Country-specific recommendations and the developments in recent years to reinforce the social governance framework, also within the European Semester.

The Employment Committee (EMCO) and Social Protection Committee (SPC) were tasked by the Presidency to provide a contribution on the employment and social aspects of the draft euro area recommendation. Building on the contributions from a written consultation, the committee chairs submitted to the Presidency proposals for amendments.

On 1 December 2015, the Social Questions Working Party examined the employment and social aspects of the draft euro area recommendation, and more specifically Recommendation 2 (only indents i) to iv)), and the second half of recital 2. Cross-cutting areas of the recommendation were explicitly left for further joint analysis for the EPSCO and ECOFIN strands. In this discussion minor modifications were introduced in the above-mentioned parts of the draft Recommendation.

On 2 December, the Permanent Representatives Committee discussed the proposal and made minor amendments to the text. Changes compared to the previous version (doc. 14860/15) are marked in **bold**. The draft Explanatory Note can be found as an addendum to this document (doc. 14860/15 ADD1 REV1). The text of the draft Recommendation is annexed to this note.

The DE delegation maintains a general scrutiny reservation.

The Permanent Representatives Committee agreed to forward the draft recommendation of the euro area to the EPSCO Council with a view to the approval of its employment and social policy related aspects (recommendation 2 i) to iv) and the related part of recital 2 as well as a new recital 7A).

### III. CONCLUSIONS

The Council is invited to approve the above mentioned employment and social policy related aspects of the Euro area recommendation, annexed to this note, and the draft explanatory note set out in ADD 1 REV 1 to this note.

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Recommendation for a

## **COUNCIL RECOMMENDATION**

### **on the economic policy of the euro area**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 136 in conjunction with Article 121(2) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>1</sup>, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances<sup>2</sup>, and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Economic Policy Committee,

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

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

Whereas:

- (1) The economic recovery continues at a moderate pace in the euro area<sup>3</sup>. Sustaining and strengthening growth in the euro area requires continued policy efforts to support a balanced adjustment in the private and public sectors, improve the adjustment capacity and increase the economy's competitiveness and growth potential in the medium to long term. The pace of growth is hampered by legacies of the most recent economic and financial crises, including ongoing external rebalancing, high levels of public and private debt, high unemployment, as well as persistent structural rigidities in national labour and product markets. Investment remains weak on account of these factors but also of other bottlenecks, such as unfavourable business environments, public-administration inefficiencies as well as obstacles to access to finance.
- (2) The implementation of ambitious structural reforms that raise productivity and boost growth potential needs to be bolstered in line with the policy priorities set out in the 2016 Annual Growth Survey for all EU Member States<sup>4</sup>. If carried out jointly across Member States, structural reforms can offer benefits to the euro area as a whole through positive spillover effects, notably through trade and financial channels. Despite some progress with reforms to improve the resilience of labour markets, significant divergence persists across the euro area, especially as regards long-term and youth unemployment rates as well as poverty and social exclusion trends. Those Member States that pursued comprehensive labour market and social protection reforms prior to the crisis have been able to better support employment and preserve fairness during the economic downturn. Such reforms encompass flexible and reliable contractual arrangements **taking into account national practices**, comprehensive lifelong learning strategies, effective active labour market policies, and adequate and sustainable social protection systems. Also, reducing the tax wedge on labour, in particular for low-income earners, and ensuring equitable tax systems can improve outcomes.

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<sup>3</sup> Commission 2015 Autumn Economic Forecast.

<sup>4</sup> Annual Growth Survey 2016.

- (3) An appropriate design and swift implementation of reforms can help in addressing existing imbalances in the euro area and to prevent the build-up of new ones. The thematic discussions by the Eurogroup, with increased focus on benchmarking, pursuing best practices and peer pressure, can contribute to promoting convergence towards best performance. The Eurogroup should therefore further strengthen the thematic discussions on reforms in areas that are essential for the functioning of EMU and regularly monitor the implementation of reforms by euro area Member States as well as the progress made with the correction of imbalances in the context of the Macroeconomic Imbalances Procedure.
- (4) Fiscal policies are a matter of vital common interest in the Economic and Monetary Union. Responsible national fiscal policies that respect the common fiscal rules are essential to ensure debt sustainability and allow the fiscal stabilisers to operate and cushion country specific shocks. In addition, in light of the spillovers between euro area Member States, it is essential also to achieve an appropriate fiscal stance at the level of the euro area as a whole and to avoid pro-cyclical fiscal policies. This calls for a reinforcement of the coordination of fiscal policies within the euro area in full respect of the Stability and Growth Pact. In this context, the broadly neutral aggregate fiscal stance in the euro area expected in 2016 appears appropriate in light of the overall macroeconomic conditions and downside risks to growth. As regards 2017, based on the forecast of a gradually closing output gap, fiscal policies should balance the need of avoiding pro-cyclicality and reducing public debt to restore fiscal buffers. This should be reflected in the preparations of the up-dated Stability Programmes in Spring 2016, taking into account the latest economic and fiscal developments. The composition of fiscal strategies is not yet sufficiently growth-friendly. As highlighted in the recommendations to the euro area Member States in summer 2015<sup>5</sup>, Member States should hold thematic discussions on improvements in the quality and sustainability of public finances.

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<sup>5</sup> OJ C 272, 18.8.2015, p. 98.

- (5) The Banking Union needs to be fully implemented. First, the Bank Recovery and Resolution Directive must be fully transposed by 30 November 2015 as required for all 28 Member States. Second, as regards bank resolution, appropriate bridge financing arrangements need to be put in place without delay so that the Single Resolution Fund (SRF) will be able to face any potential financing needs as of 1 January 2016. In addition, a fiscally neutral backstop to the SRF should be agreed as soon as possible during the transition period. Finally, as part of the further development of the Banking Union, the Commission has proposed on 24 November 2015 the creation of a European deposit insurance scheme for the euro area Member States<sup>6</sup>.
- (6) Financial market conditions remain overall favourable in the euro area, against the background of an accommodative monetary policy stance. However, the still weak economic fundamentals and high leverage in the private sector continue to weigh on demand for bank lending and thereby economic growth. Banks' balance sheets remain under pressure from high levels of non-performing loans, hampering lending activity. Diverse and sometimes inadequate insolvency regimes in the EU contribute to delaying the reduction of private sector debt, holding back investment.

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<sup>6</sup> COM(2015) 586 final, 24.11.2015.

(7) Notwithstanding the recent achievements in strengthening the EMU architecture, work must continue to complete it. The Five Presidents' Report of June 2015 maps the way ahead to complete EMU by 2025 at the latest<sup>7</sup>. On 21 October 2015, the European Commission adopted a first set of follow-up proposals to the report<sup>8</sup>. The euro area Member States should take collective ownership and move ahead in a timely way with the implementation of the short and medium term initiatives towards the completion of Economic and Monetary Union. With a view to further facilitate convergence across the euro area, the proposals include measures to strengthen the euro area dimension of the European Semester by, inter alia, earlier publication of the euro area recommendations, with a view to identify common challenges early in the process and to inform the formulation of Country Specific Recommendations for the euro area Member States to be adopted later in the European Semester,

**(7A) The Employment Committee and Social Protection Committee have been consulted on the employment and social aspects of this recommendation.**

HEREBY RECOMMENDS that euro area Member States take action, individually and collectively, within the Eurogroup in the period 2016-2017 to:

1. Pursue policies that support the recovery, foster convergence, facilitate the correction of macroeconomic imbalances and improve adjustment capacity. To this end, Member States, particularly those with large stocks of private and foreign debt, should implement reforms that enhance productivity, foster job creation, raise competitiveness and improve the business environment. Member States with large current account surpluses should implement as a priority measures that help channelling excess savings toward the domestic economy and thereby boost domestic investment.

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<sup>7</sup> Completing Europe's Economic and Monetary Union, Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz.

<sup>8</sup> [http://ec.europa.eu/priorities/economic-monetary-union/docs/single-market-strategy/communication-emu-steps\\_en.pdf](http://ec.europa.eu/priorities/economic-monetary-union/docs/single-market-strategy/communication-emu-steps_en.pdf)

2. Implement reforms that combine (i) flexible and reliable labour contracts that promote job quality and smooth labour market transitions and avoid a two-tier labour market; (ii) comprehensive lifelong learning strategies; (iii) effective policies to help the unemployed re-enter the labour market, (iv) adequate and sustainable social protection systems that contribute effectively and efficiently throughout the life cycle both to social inclusion and labour market integration and, (v) open and competitive product and services markets. Reduce the tax wedge on labour, particularly on low-earners, in a budgetary-neutral way to foster job creation.
3. Maintain the planned broadly neutral fiscal stance in 2016. With a view to 2017, reduce public debt to restore fiscal buffers while avoiding pro-cyclicality, in full respect of the Stability and Growth Pact. Differentiate the fiscal effort by individual Member States taking into account their respective position vis-à-vis the requirements under the SGP and their stabilisation needs, as well as spillovers across euro area countries. To this end, discuss the euro area fiscal stance in time for the preparation and presentation of the Stability Programmes and the Draft Budgetary Plans.
4. Facilitate the gradual reduction of banks' non-performing loans and improve insolvency proceedings for businesses and households. In Member States with large stocks of private debt, promote an orderly deleveraging, including by facilitating the resolution of unviable private debt.

Done at Brussels,

*For the Council*

*The President*

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