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From: General Secretariat of the Council
To: Permanent Representatives Committee/Council
Subject: European Semester 2019
Recommendation on the economic policy of the euro area
- Approval of the contribution on the employment and social aspects

I. INTRODUCTION

On 21 November 2018, the Commission presented the Autumn Economic Package, including the Annual Growth Survey (AGS), the Alert Mechanism Report (AMR) and the draft Joint Employment Report (JER). Like the previous year, 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.

II. EURO AREA RECOMMENDATION

The committee chairs (EMCO and SPC, EPC-euro area format) cooperated on a coordinated input. Accordingly, the EMCO and SPC held a joint meeting on 29 November to analyse and discuss the employment and social aspects of the recommendation.

The employment and social aspects of the euro area recommendation are contained in **recommendation 3** and **recital 7**. The committees discussed these parts and agreed to a few modifications to the Commission text . The EMCO and SPC chairs presented these modifications to the EPC-euro area format (teleconference on 30 November). All agreed on the additions in recital 7. In recommendation 3, however, the EPC-euro area format did not include the reference to poverty and social inclusion. The reference to adequate and sustainable social protection systems is in the second sentence of the recommendation 3.

Changes in the Annex compared to the Commission proposal (doc. 14445/18) are marked by **bold** and deletions by [...].

The text in the annex to this note corresponds to the modifications agreed by the EPC-euro area format, however regarding only the parts under EPSCO competence (recommendation 3 and recital 7). The rest of the text is currently under discussion in the ECOFIN committees, where it might undergo further modifications.

III. CONCLUSIONS

The Permanent Representatives Committee is invited to recommend to the Council (EPSCO) the approval of the employment and social policy related aspects of the euro area recommendation, annexed to this note.

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 policies¹, 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 imbalances², 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,

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

Whereas:

- (1) The euro area is entering its sixth year of uninterrupted economic growth and the negative output gap is closing, but risks to the outlook are increasing and growth is expected to moderate. Potential growth remains significantly below pre-crisis levels and country divergences persist resulting from notable differences in economic resilience across Member States. Real wage growth is still moderate and has been trailing behind productivity developments. Nominal wage growth and core inflation are picking up with continued employment growth, but pockets of labour underutilisation or high unemployment remain in some Member States. The euro area has recorded a large current account surplus over the past five years linked to the dynamics of the euro-area exports and improved competitive position while country divergences continue to be significant on the external side. Member States that recorded large external deficits for a long time still have large negative net international investment positions that represent vulnerabilities, as they are generally mirrored by large stocks of private or government debt. An appropriate deleveraging pace, a supportive growth and inflation environment, continued reforms to increase productivity are crucial for successful rebalancing in the euro area.³ Favourable demand dynamics are also important, and large surplus countries would also contribute to rebalancing by strengthening the conditions that support wage growth, as well as public and private investment.
- (2) Increasing long-run growth potential and overcoming national and regional disparities requires further increases in labour participation rates, growth-enhancing structural reforms and investment in tangibles and non-tangibles to increase productivity and innovation, in particular in those Member States where it is clearly lower than the euro area average. This is important for strengthening economic, social and territorial cohesion in the euro area.

³ European Commission (2018), Alert Mechanism Report 2019.

- (3) Consistency and balance in the macroeconomic policy mix of the euro area, including monetary, fiscal and structural policies, is crucial to ensure robust and sustainable economic growth. In recent years, the European Central Bank resorted to unconventional monetary policy tools to bring inflation back towards its medium-term inflation objective, while supporting growth and job creation. Against the backdrop of a gradual normalisation of monetary policy, appropriately differentiated fiscal policies and focus on structural reforms are needed to continue supporting growth in the short and long term.
- (4) The strengthening of fiscal sustainability of the euro area and its Member States requires differentiated national policies in full respect of the Stability and Growth Pact and should take into account fiscal space. Coordination of national fiscal policies in accordance with the common fiscal rules is essential for the proper functioning of the Economic and Monetary Union (EMU). The common fiscal rules are geared towards pursuing debt sustainability at the national level, while providing room for macroeconomic stabilisation. The euro area fiscal stance remained on average broadly neutral over 2015-2018 and based on the Commission forecast it is projected to become slightly expansionary in 2019 in spite of output being above potential. Rebuilding fiscal buffers is especially important in Member States with still high levels of public debt. Doing so would also reduce their vulnerability to shocks and allow for the full functioning of automatic stabilisers in the next downturn. Increasing public investment, in particular in Member States with fiscal space, would support growth and rebalancing.

- (5) Fiscal structural reforms remain crucial for improving fiscal sustainability and strengthening the economic growth potential. Better functioning national fiscal frameworks, well-managed spending reviews and effective and transparent public procurement can strengthen the efficiency and effectiveness of public expenditure and the credibility of fiscal policies. Improving the composition of national budgets, on both revenue and expenditure sides, including shifting resources towards investment, would increase the growth impact of public budgets and raise productivity in the longer term. Simplifying and modernising tax systems and addressing tax fraud, evasion and avoidance, namely through measures against Aggressive Tax Planning are essential to making tax systems more efficient and fairer. Ensuring that tax systems favour the deepening of the single market, and encourage competition between firms is key in improving the business environment in and the resilience of the euro area and Member States' economies. The Common Consolidated Corporate Tax Base would be instrumental in this endeavour.
- (6) Structural and institutional features of labour and product markets and well-functioning public administrations are important for the resilience of euro-area Member States. Resilient economic structures prevent shocks from having significant and long-lasting effects on income and labour supply. This can facilitate the operation of monetary policy and contain divergences, creating conditions for sustainable and inclusive growth. Better coordination and implementation of structural reforms, in particular those prescribed in the country-specific recommendations, can create positive spillovers between Member States and strengthen the positive effects across the euro area. Reforms that increase competition in product markets, promote resource efficiency and improve the business environment, and quality of institutions, including an effective justice system, foster economic resilience of the euro area and Member States. The Single Market still holds considerable unexploited potential and progress is needed to deepen it, particularly in financial services, digital activities, energy and transport, ensuring timely implementation and better enforcement of legislation.

(7) The European Pillar of Social Rights sets out twenty principles to foster equal opportunities and access to the labour market, fair working conditions and social protection and inclusion. Reforms that promote labour market participation, support **successful labour market** transitions, **promote quality job creation** and reduce segmentation can help boost **inclusive** growth, improve economic resilience and automatic stabilisation, reduce inequalities, [...] **address poverty and social exclusion**, and help face the challenges of a changing economy. Individualised support for job searching, training and requalification can result in effective and timely activation. Access to high-quality education and training **throughout the life cycle** is vital and requires adequate investment in human capital and skills, notably for the low skilled. Such reforms and investments improve employability, innovation, productivity, and wages in the medium and longer term, increasing resilience of the euro area and promoting social inclusion and mobility within Member States and across the euro area. The tax burden in the euro area is relatively high and skewed towards labour; a shift away from labour to tax bases that are less detrimental to growth, such as property, consumption or environmental taxes, could strengthen labour supply and demand. Employment protection legislation needs to provide for fair and decent working conditions for all workers especially in view of emerging new forms of employment and new types of contracts that bring along new opportunities but also challenges related to job security and social protection coverage. Effective and sustainable social protection systems are also crucial to ensure adequate income and access to quality services. Pension reforms and work-life balance policies are also key to foster labour-market participation. Unnecessary restrictions on job, sectoral and geographical mobility may hamper reallocation within Member States and across the euro area. Social partners' involvement in employment, social and related economic reforms is crucial.

(8) While the robustness of the euro area financial sector has increased since the crisis, vulnerabilities remain to be addressed. Private sector debt remains elevated, and tax systems still feature a debt bias. Substantial increases in sovereign bond yields risk eroding banks' capital risking negative spillovers across the euro area. The need to adapt banks' business models, the low interest rate environment and increasing competition from other forms of finance continue to exert pressure on banks' profitability. Non-performing loan (NPL) ratios are falling as a share of total loans and at a higher rate in Member States with the highest stocks. Nonetheless, national NPL ratios that remain far above the euro area average require further sustained efforts. In March 2018 the Commission presented a risk-reduction package to address legacy NPLs and avoid their future build-up which should be fully adopted by Parliament and the Council. Adoption by the end of 2018 of the November 2016 banking package, which further reduces risks by implementing internationally agreed norms on capital buffers and liquidity in banks, remains crucial for the completion of the Banking Union. Following serious breaches of anti-money laundering rules, the Commission proposed reinforcing the European Banking Authority and supervisory cooperation to strengthen the enforcement of the regulatory framework in this area. Significant progress has been made in establishing the Banking Union, but it remains unfinished. The lack of a common deposit insurance scheme and of a common backstop for the Single Resolution Fund hampers the ability of the Banking Union to sever the link from banks to sovereigns.

- (9) Strengthening the architecture of the EMU requires completing the Banking Union and the Capital Markets Union as a matter of priority, but also action on all the elements of the Commission roadmap for the EMU for the period until 2024. Given the common monetary policy and a decentralised fiscal policy, more risk sharing is needed considering the achieved progress on risk reduction. In December 2017 and May 2018, the Commission published a set of proposals setting further steps towards completing the EMU, including a European Investment Stability Function and a Reform Support Programme (proposed under the Multi Annual Financial Framework). The proposals build on the reflection paper on the deepening of EMU of May 2017 and the Five Presidents' Report of June 2015. In line with the agreement of euro area Finance Ministers in June 2018, political decisions and concrete steps are to be taken on the Banking Union, including beginning political negotiations on the European Deposit Insurance Scheme and to further strengthen the **European Stability Mechanism**, which leaders agreed should be the provider of the backstop to the Single Resolution Fund. All these reforms will contribute to strengthening the international role of the euro, making it more commensurate to the euro area global economic and financial relevance. It is important that they are discussed in an open and transparent manner towards non-euro area Member States.
- (10) The **Employment Committee** and the **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 2019–2020 to:

1. Deepen the Single Market, improve the business environment, and pursue resilience-enhancing product and services market reforms. Reduce external debt and pursue reforms to boost productivity in euro area Member States with current account deficits and strengthen the conditions that support wage growth respecting the role of social partners and implement measures that foster investment in euro area Member States with large current account surpluses.

2. Rebuild fiscal buffers in euro area countries with high levels of public debt, support public and private investment and improve the quality and composition of public finances in all countries.
3. Shift taxes away from labour and strengthen education **and training** systems and investment in skills, as well as the effectiveness of active labour market policies that support **successful labour market** transitions. **Promote quality job creation and address** labour market segmentation and ensure adequate **and sustainable** social protection systems across the euro area.
4. Make the backstop for the Single Resolution Fund operational, set up a European Deposit Insurance Scheme and strengthen the European regulatory and supervisory framework. Promote orderly deleveraging of large stocks of private debt. Swiftly reduce the level of non-performing loans in the euro area and prevent their build up, including by removing debt bias in taxation.
5. Make swift progress on completing the Economic and Monetary Union, also with the perspective to strengthen the international role of the euro, taking into account the Commission proposals, including those concerning the financial sector as well as the Reform Support Programme and the European Investment Stabilisation Function under the proposal for the 2021-2027 Multiannual Financial Framework.

Done at Brussels,

For the Council

The President
