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NOTE

From: General Secretariat of the Council
To: Permanent Representatives Committee/Council

Subject: European Semester 2020
Recommendation on the economic policy of the euro area
- Approval of the contribution on the employment and social aspects

I. INTRODUCTION

On 17 December 2019, the Commission presented the Autumn Economic Package, including the Annual Sustainable Growth Strategy (ASGS), 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 28 January 2020 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 **recitals 1 and 12**. 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 28 January). The EPC-euro area format agreed on these modifications.

Changes in the Annex compared to the Commission proposal (doc. 15267/19) 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 recitals 1 and 12). The rest of the text will be discussed in the upcoming ECOFIN session, 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,

Whereas:

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

- (1) The euro area is continuing its expansion, but with interconnected risks to the outlook and uncertainty on the horizon. Moreover, the risk of a further prolonged period of low growth and inflation driven by anaemic productivity and ageing populations looms. While the output gap has turned positive since 2017 and stood at 0.7% of potential GDP in 2018, potential growth is set to remain below pre-crisis levels.³ Core inflation remained in the 1-1½ % range in 2018 and 2019 and is forecast to remain at some 1½% in 2020 and 2021. Labour market indicators continue to improve, although at a slower pace, and employment growth is projected to slow further and challenges in terms of job quality remain. Nominal wage growth has firmed, having reached some 2¼ % growth in 2018, after several years below 2.0%, [...] **is estimated [...]** at some 2½ % in 2019 and **is projected to return to [...]** to 2¼% in 2020-21. In spite of good labour market conditions, real wage growth has increased only slowly and remains low, at below 1% in 2018, **is estimated at around the same level in [...]** 2019 and projected at 0.7% and 0.8% for 2020 and 2021 respectively. The euro area current account surplus is projected to narrow, while remaining close to its peak. Deficit Member States narrowed or reversed their current account deficits, even if they continue to record large negative net international investment positions (NIIPs).⁴ At the same time, while some Member States narrowed their current account surpluses, they continue to run persistently high current account surpluses and therefore increase their NIIP. Current account balance dynamics in the euro area are affected by weakening external demand, especially for export-oriented Member States with high current account surpluses, which are highly dependent on foreign export demand. Favourable demand dynamics are also important, and large surplus countries would also contribute to rebalancing by strengthening the conditions that support wage growth, while respecting the role of social partners, as well as public and private investment.

³ All forecast figures in this document are from the European Commission Autumn 2019 forecast.

⁴ European Commission (2019), Alert Mechanism Report 2020, COM(2019) 651 final.

- (2) Increasing the growth potential while ensuring environmental and social sustainability and driving real convergence among euro area Member States requires structural reforms to enhance sustainable growth and investment in tangible and intangible capital to increase productivity. This would help particularly those Member States whose growth potential is clearly lower than the euro area average. This would also be necessary in order to prevent the euro area economy from falling into a protracted period of low potential growth and productivity, low price inflation and wage growth as well as rising inequality. Reforms and investment remain crucial to ensure the euro area relaunches its growth momentum, overcomes stronger pressures over the medium to long-term stemming also from deteriorating demographics, and facilitates the transformation towards a sustainable economy, helping the euro area and its member states to achieve the United Nations' Sustainable Development Goals.

- (3) The economic impact of climate change, one of the biggest systemic risks facing the world economy, financial systems and societies today, is beginning to be visible. Risks to the global economy from climate change and more broadly from environmental degradation are increasingly present, and these will have a widespread impact, including on the most vulnerable in our societies. If not accompanied by appropriate measures, there could be negative consequences on the resilience of our economies, on inclusiveness and on the long-term growth potential. In that context, investment and creating the regulatory and financial conditions for an orderly transition towards a sustainable economy would be essential. If tackled in the right way, environmental and climate challenges are also an opportunity to revitalise the European economy towards sustainable development. In that direction, the Commission has put forward a European Green Deal as Europe's growth strategy which will include a proposal for the first European Climate Law to enshrine the 2050 climate-neutrality target into law. At the same time, the green transition will need to take the impact on different parts of society into account. Investment to facilitate transformation towards a sustainable economy will need to be accompanied by carbon pricing, appropriate regulation in all sectors and investment in skills and support for job transitions to ensure that all citizens reap the benefits of technological change, particularly in the sectors and regions lagging behind in the digital and green transitions.

- (4) Mobilising public and private funds for investing in the green and digital transition can help to sustain growth in the short term and meet the long-term challenges facing our economies. While the digital revolution may entail opportunities in terms of productivity, growth and job creation, it may also raise challenges, in particular for less qualified workers, lacking skills to work with new technologies . Different speeds of transition to the digital economy among euro area Member States could prove a significant risk to convergence and macroeconomic stability. This could be reinforced by strong agglomeration effects, often benefiting large cities and winner-takes-all dynamics that are often present in the area of digital technologies, which can add to inequality and have adverse impact on convergence. Investments should be geared towards generating research and innovation but also towards wider diffusion of innovations across the economy.

- (5) A more coordinated investment strategy coupled with a stronger reform effort at euro area level would be instrumental to support sustainable growth and respond to the long-term challenges such as the climate transition and technology transformation. The Budgetary Instrument for Convergence and Competitiveness, would provide financial support to euro area Member States for the implementation of proposals which should as a rule consist of packages of reforms and investments. InvestEU, which will also contribute to the Sustainable Europe Investment Plan, also aims to trigger additional investment to further foster innovation and job creation in the EU, including by financing sustainable infrastructure. Cohesion policy funds, which play a crucial role in supporting our regions and rural areas, also play a role in the climate and technological transition by promoting sustainable development. The European Investment Bank already dedicates 25% of its total financing to climate investment, and has announced its intention to double this share. To achieve the Union's sustainability objectives, it would be essential to carry out investment projects at national and sub-national level that cover climate adaptation and mitigation, energy transition, decarbonisation or the circular economy. Investment in network industries and infrastructure can help improve the euro area's competitiveness and foster the transition to more sustainable transport. In addition, investments in intangible assets such as research and development, and skills are also key to prepare the euro area for the challenges ahead.

- (6) The effects of the economic expansion over the last years have not been felt evenly within Member States and across regions and countries. While disposable income levels have recently risen, they remain below pre-crisis levels in several euro area Member States. The number of people at risk of poverty and social exclusion is declining in most Member States, and is now 5 million below the 2012 peak, but remains above 2008 levels in the euro area. Following a period of increased divergences, some Member States have converged towards the highest performers in GDP-per-capita over the past few years. However, the share of income held by the highest income levels has slowly increased in the past decade, and large divergences remain between Member States. In order to promote upwards convergence within and across Member States, it would be important to promote policies that aim at increasing both efficiency and equity, in line with the Sustainable Development Goals. They result in better macroeconomic outcomes with more equally shared benefits for society at large, that also help boost the cohesion of the euro area.
- (7) Consistency and balance in the macroeconomic policy mix of the euro area, including monetary, fiscal and structural policies, are crucial to ensure robust, inclusive and sustainable economic growth and to respond effectively to persistent low inflation, a weakening outlook and risks to long-term growth. The European Central Bank is maintaining an accommodative monetary policy to help inflation edge towards its medium-term inflation objective, while supporting growth and job creation. Fiscal policy needs to complement the monetary policy stance, as do structural reforms across different sectors, including those necessary to complete the architecture of the Economic and Monetary Union (EMU).

- (8) Coordination of national fiscal policies in full respect of the Stability and Growth Pact, while taking into account available fiscal space and spillovers across countries, supports the proper functioning of the EMU. The euro area fiscal stance is expected to be broadly neutral to slightly expansionary in 2020 and 2021. At the same time, national fiscal policies remain insufficiently differentiated. The pursuit of prudent fiscal policies by Member States with high levels of public debt would put public debt on a downward path, reduce vulnerability to shocks, and allow for the full functioning of automatic stabilisers in the event of an economic downturn. On the other hand, further boosting investment and other productive spending in Member States with a favourable budgetary situation would support growth in the short and medium term, while also helping to rebalance the euro area economy. If downside risks were to materialise, fiscal responses should be differentiated, aiming for a more supportive stance at the aggregate level, while ensuring full respect of the Stability and Growth Pact. Country-specific circumstances should be taken into account and pro-cyclicality avoided, to the extent possible. Member States should stand ready to coordinate policies in the Eurogroup.

- (9) Fiscal structural reforms remain crucial for improving fiscal sustainability, strengthening growth potential and allowing for effective counter-cyclical fiscal policies in the event of a downturn. Well-functioning national fiscal frameworks, together with regular and thorough spending reviews and effective and transparent public procurement can strengthen the efficiency and effectiveness of public expenditure and improve the credibility and quality of fiscal policies. Improving the composition of national budgets, on both the revenue and expenditure sides, including shifting resources towards public investment in the context of well-designed investment strategies and developing green budgeting tools, would increase the growth impact of public budgets, raise productivity and begin meeting the urgent long-term challenges of the transition towards green and digital economies. Simplifying and modernising tax systems and addressing tax fraud, evasion, and avoidance, namely through measures against Aggressive Tax Planning, taking account of the on-going discussions at the OECD Inclusive Framework on the remaining BEPS issues, are essential to making tax systems more efficient and fairer. The ease with which mobile resources can move within the euro area is one of the foundations of the internal market but also increases the scope for tax competition. Coordination among Member States is therefore essential to address profit-shifting and harmful tax practices and avoid an overall race to the bottom in terms of corporate taxation. Working towards an agreement for a Common Consolidated Corporate Tax Base as well as an agreement on the OECD Inclusive framework on the remaining BEPS issues to review profit allocation among countries and ensure minimum effective taxation could be instrumental in this endeavour. The tax burden in the euro area is relatively high and skewed towards labour, with property or environmental taxes representing a very small share of tax revenues. The two latter, however, can be less detrimental to growth and labour supply and demand. An increased use of environmental taxes can contribute to sustainable growth by incentivising “greener” behaviour by consumers and producers. Taxation would need to take better into account the climate dimension and address emissions and carbon leakage more consistently. Promoting worldwide coordinated action would further increase the effectiveness of these measures. Therefore, in order to help transitioning towards a green economy, fostering the design of budgetary policies conducive to environmental commitments and a review of the Energy Taxation Directive will be proposed, as well as a WTO-compliant Carbon Border Adjustment Mechanism, if needed to avoid carbon leakage.

- (10) Structural and institutional reforms that increase competition in product markets, promote resource efficiency, improve the business environment and the quality of public administrations, including the effectiveness of justice systems, are important for the resilience of euro-area Member States. Resilient economic structures and appropriate policies prevent shocks from having significant and long-lasting effects on income and labour supply and can facilitate the operation of fiscal and monetary policy and contain divergences, particularly in downturns, creating more favourable 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 across Member States. In that respect, the National Productivity Boards can play an important role in increasing the reform ownership and improving implementation. Reforms are also needed to face urgent long-term challenges such as the climate transition and technological transformation. Deepening Single Market integration, which has proven to be a major engine of growth and convergence between Member States can also contribute to fostering productivity growth.
- (11) 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. It is designed as a compass to promote upward convergence towards better working and living conditions. Stronger and more inclusive economies and societies can in turn foster the resilience of the Union and the euro area. Reforms and investment in skills, job transitions and more effective social protection are also important to accompany a just and fair transition towards a green and digital economy. The full implementation of the pillar at all levels with due regard for respective competences will be essential to promote upward convergence.

- (12) Reforms that increase labour market participation, **tackle youth and long-term unemployment**, promote quality job creation, support successful labour market transitions, reduce segmentation and promote social dialogue can help boost inclusive growth, improve economic resilience and automatic stabilisation, reduce inequalities, and address poverty and social exclusion. Individualised job transition support, training and requalification are key to promote the timely reinsertion of job-seekers. **Active labour market policies should be well integrated with social policies and promote active inclusion in the labour market and in society.** Access to high-quality education and training throughout the life cycle requires adequate investment in order to improve human capital and skills, also in light of the digital and green transition. This contributes to improving employability, productivity, innovation capacity and wages in the medium and longer term, increasing the resilience of the euro area. Employment protection legislation needs to provide for fair and decent working conditions for all workers, especially in view of emerging atypical forms of employment bringing along new opportunities but also challenges related to job security and social protection. 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 can importantly foster labour market participation, safeguarding the long-term sustainability of European welfare systems. A shift away from labour taxation could usefully focus in particular on low income and second earners. Social partners' involvement in employment, social and economic reforms is crucial to strengthen ownership and support reform implementation. **Similarly, the involvement of civil society organizations is beneficial. It is important that collective agreements contribute to the objectives of these recommendations in full respect of the social partners' autonomy.**

- (13) The robustness of the euro area financial sector has increased since the crisis, though vulnerabilities remain to be addressed. High corporate and household debt levels, to which the debt bias in many national tax systems contributes, can be a source of risk. 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 . There has been steady progress in risk reduction, notably on non-performing loan (NPL) reduction. Nonetheless, where NPL ratios remain high they require further sustained efforts, and all Member States should put in place appropriate policies to prevent the build-up of NPLs. In March 2018, the Commission presented a risk-reduction package both to facilitate addressing legacy NPLs and to avoid their future build-up. As part of the legislative measures on NPLs, a Regulation was adopted in April 2019,⁵ which introduces a 'statutory prudential backstop' in order to prevent the risk of under-provisioning of future NPLs; further progress should be made to continue tackling the issue of NPLs, in particular by progressing with the draft Directive on NPLs secondary markets. Progress has already been achieved to improve the existing framework on anti-money laundering. However, as highlighted in the Commission reports issued in July 2019⁶, a more comprehensive approach to fighting money laundering and the financing of terrorist activities is needed in the Union to address structural shortcomings identified. This requires, in particular, considering ways to increase harmonisation, and improve supervision and enforcement of the rules, through EU action.

⁵ Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures OJ L 111, 25.4.2019, p.4.

⁶ Communication COM (2019) 360 final from the Commission to the European Parliament and the Council of 24 July 2019 towards better implementation of the EU's anti-money laundering and countering the financing of terrorism framework.

- (14) Strengthening the Banking Union has been a priority undertaking, since 2013, in order to ensure financial stability, reduce financial fragmentation and protect lending to the economy in times of crisis. This has continued to progress, including through the agreement on the ESM legal framework on the common backstop for the Single Resolution Fund, but further strengthening is necessary. In this connection, the Euro Summit tasked the Eurogroup to continue to work on the ESM package of reforms, pending national procedures, and to continue work on all elements of the further strengthening of the banking union, on a consensual basis. A High Level Working Group (HLWG) was set up to work on a roadmap for beginning political negotiations on a European Deposit Insurance Scheme (EDIS). It is important to move forward to unlock the Banking Union's benefits in terms of private risk sharing, financial stability and economic growth, while reducing opportunities for arbitrage between Member States. Ultimately, it should ensure Europe's financial and economic sovereignty. This calls for continuing to work without delay, on all elements including those discussed in the High Level Working Group on EDIS, and with the same level of ambition. The work on the ESM package of reforms should be finalised, including the introduction of a backstop for the SRF. The backstop for the SRF should be made operational and this should be anticipated, provided sufficient progress has been made in risk reduction. There should be further work on solutions for overcoming limitations in the current set-up for liquidity provision in resolution. Finally, the Commission delivered on all of the actions announced in the Capital Markets Union Action Plan of 2015. However, legal, tax and regulatory obstacles to the establishment of a Capital Markets Union remain, and renewed efforts are needed to overcome them, in particular as regards the rules on access to finance, certain insolvency and tax divergences, and to achieve high, effective and convergent supervisory standards.

- (15) Strengthening the architecture of the EMU requires delivering on the actions identified in the Statement of the Euro Summit of December 2019 as a matter of priority, while continuing discussions on other aspects. The June 2019 Communication on Deepening Europe's Economic and Monetary Union: Taking stock of four years after the Five Presidents' Report presents the state of play and outlines the Commission view on areas where reform efforts should focus in the short and medium term. There has been some progress on the economic union, with a political agreement on the features of a Budgetary Instrument for Convergence and Competitiveness for the euro area. An agreement in principle, subject to completion of national procedures, was reached on further developing the European Stability Mechanism and revising its Treaty. There has been no consensus in the Council on a euro area fiscal stabilisation function nor on reforming the governance of the euro area.
- (16) Deepening the EMU would result in better macroeconomic outcomes. An incomplete EMU impedes financial integration. This limits financing opportunities for much-needed investment to foster an inclusive, productive, sustainable and stable economy. An incomplete EMU also hinders the smooth transmission of monetary policy across the euro area and limits Europe's ability to determine its economic destiny. If agreed, a central fiscal stabilisation function would complement the capacity of euro area Member States to conduct counter-cyclical fiscal policy. The Council notes the Commission intention to propose a European Unemployment Benefit Reinsurance Scheme in order to better protect citizens in cases economic shocks. Strengthening the EMU, together with sound policies at the national and European levels, is key to enhance the clout of Europe in the world, to enhance the international role of the euro and to contribute to an open, multilateral and rules-based global economy. It is important that discussions continue to be held in an open and transparent manner towards non-euro area Member States, fully respecting the Union's internal market.

- (17) 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 2020–2021 to:

1. In euro area Member States with current account deficits or high external debt, pursue reforms to boost competitiveness and reduce external debt. In euro area Member States with large current account surpluses, strengthen the conditions that support wage growth, while respecting the role of social partners, and implement measures that foster public and private investment. In all Member States, foster productivity by improving the business environment and the quality of institutions, enhance resilience by improving the functioning of goods and services markets especially by deepening the Single Market. Support a fair and inclusive transition towards a competitive green and digital economy through tangible and intangible investment, both public and private.
2. While pursuing policies in a manner that fully respects the Stability and Growth Pact, support public and private investment and improve the quality and composition of public finances. In Member States with high public debt levels, pursue prudent policies to put public debt credibly on a sustainable downward path. In Member States with a favourable fiscal position, use it to further boost high-quality investments, while preserving the long-term sustainability of public finances. If downside risks were to materialise, fiscal responses should be differentiated, aiming for a more supportive stance at the aggregate level, while ensuring full respect of the Stability and Growth Pact. Country-specific circumstances should be taken into account and pro-cyclicality avoided, to the extent possible. Member States should stand ready to coordinate policies in the Eurogroup. Improve the effectiveness of national fiscal frameworks and the quality of public finances and adopt growth-friendly tax and other relevant budgetary measures that foster a sustainable and inclusive economy. Support and implement EU actions to combat Aggressive Tax Planning and avoid a race to the bottom in corporate taxation.

3. Strengthen education and training systems and investment in skills. Increase the effectiveness of active labour market policies that support labour market integration and successful labour market transitions, including to more digital and green jobs. Promote participation in the labour market, including that of women **and vulnerable groups**, and shift taxes away from labour, in particular for low income and second earners. Foster quality job creation, fair working conditions, **promote work-life balance**, and address labour market segmentation. Improve access to adequate and sustainable social protection systems. Enhance the effectiveness of social dialogue and promote collective bargaining.

4. Follow up on the Euro Summit statement of 13 December 2019 to further strengthen the Banking Union, with a view to its completion, by continuing to work, without delay, and with the same level of ambition, on all elements, including those discussed in the High Level Working Group on EDIS. Finalise the work on the ESM package of reforms, including the introduction of a backstop for the SRF. Make the backstop for the SRF operational and anticipate this, provided sufficient progress has been made in risk reduction. Work further on solutions for overcoming limitations in the current set-up for liquidity provision in resolution. Strengthen the European regulatory and supervisory framework, including by ensuring consistent and effective supervision and enforcement of anti-money laundering rules. Promote orderly deleveraging of large stocks of private debt including by reducing debt bias in taxation. Continue to enable the swift reduction of the level of nonperforming loans by banks in the euro area and prevent their build up. Renew efforts to deepen the Capital Markets Union.

5. Make ambitious progress on deepening the Economic and Monetary Union, in particular by delivering swiftly on the actions identified in the Statement of the Euro Summit of December 2019, including as regards the Budgetary Instrument for Convergence and Competitiveness (BICC), and discussing other aspects. Progress in this area will also enhance the international role of the euro and project Europe's economic interests globally, and should fully respect the Union's internal market and be pursued in an open and transparent manner towards non-euro area Member States.

Done at Brussels

For the Council

The President
