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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	European Semester 2021 Recommendation on the economic policy of the euro area - Approval of the contribution on the employment and social aspects

I. INTRODUCTION

On 17 September 2020 the Commission presented its Communication on the 2021 Annual Sustainable Growth Strategy (ASGS) earlier, while the rest of the Autumn Economic Package, including the Alert Mechanism Report (AMR) and the draft Joint Employment Report (JER) was presented on 18 November 2020. Like the previous year, the Autumn Economic 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 1 December 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 **recommendations 1 and 2** and **recitals 4, 8, 9, 13 and 14**. 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 3 December 2020). The EPC-euro area format agreed on these modifications.

Changes in the Annex compared to the Commission proposal (set out in document 13060/20) 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 <u>only the parts under EPSCO competence</u> (recommendations 1 and 2 and recitals 4, 8, 9, 13 and 14). The rest of the text is currently under discussion in the ECOFIN *filière*, where it might undergo further modifications.

III. <u>CONCLUSIONS</u>

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

ANNEX

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[1], 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[2], 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) As a result of the COVID-19 pandemic, the euro area economy experienced a sudden and deep recession in the first half of 2020 and remains vulnerable to the persisting health crisis. The COVID-19 crisis has produced a series of large demand and supply side shocks translating into an expected decline of GDP by 7.8% in 2020. The recovery in 2021 is now projected to be slower than previously expected and a large output gap of some -7.0% of potential GDP in 2020 will not close by the end of 2021. Considerable uncertainty prevails over the economic outlook, related to the evolution of the pandemic and behavioural changes by economic agents. Prompt action at the national and Union level, including through the Next Generation EU (NGEU) package, has decisively helped to offset some of the negative consequences of the shock and stabilise markets. Both private consumption and investment took a severe hit, affecting in turn negatively prices and wages. The labour market outlook has also taken a turn for the worse, interrupting seven years of improvements. However, owing to the successful implementation of ambitious policy measures in all Member States – such as short-time work schemes and other support policies to avoid mass lay-offs and large income losses – the increase in unemployment has been mitigated by a decline in activity rates as discouraged workers left the labour market combined with a drop in total hours worked.

(2) The COVID-19 crisis is increasing the economic divergences across euro area Member States. Several factors are driving these divergences, including: the intensity and timing of the initial COVID-19 shock; the relative size and economic importance of contact-intensive sectors (e.g., tourism and hospitality) and the differences in fiscal space available. These differences impact confidence, investments and growth prospects as well as regional disparities that pre-existed but may be exacerbated. Over the longer-term, the current COVID-19 crisis risks having permanent negative effects on potential growth and income gaps due to lower human and physical capital (both tangible and intangible). That could translate into even lower growth in labour productivity and incomes.

(3) The fast and forceful reaction by the Union, including Next Generation EU (NGEU), which comprises the Recovery and Resilience Facility (RRF), has boosted market confidence and showed unity of Member States on a coordinated effort to restart economic growth and strengthen economic and social resilience. A number of new instruments for the Union and the euro area were also already agreed immediately. These instruments already provide a safety net for workers (through the European Instrument for Temporary Support to mitigate Unemployment Risks in an Emergency - SURE)[3], for businesses (through a scheme by the European Investment Bank) and for Member States in order to stabilise sovereign's funding costs, including through the European Stabilisation Mechanism's Pandemic Crisis Support Instrument.[4] The Union policy response also included the activation of the general escape clause of the Stability and Growth Pact and a temporary framework to use the flexibility under EU state aid rules.[5] The cohesion policy funds were redirected where most needed through the Coronavirus Response Investment Initiative Plus (CRII and CRII+).[6]

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3 OJ L 159, 20.5.2020, p. 1–7

4 https://www.consilium.europa.eu/media/44011/20200508-pcs-term-sheet-final.pdf

5 OJ C 91I, 20.3.2020, p. 1–9, OJ C 112I, 4.4.2020, p. 1–9, OJ C 164, 13.5.2020, p. 3–15, OJ C 218, 2.7.2020, p. 3–8.

6 OJ L 99, 31.3.2020, p. 5–8.

(4) The implementation of well-designed policies in the context of NGEU and its main instrument, the RRF, will support Member States in embarking on growth-enhancing reforms and increase the level and quality of investments, consistent with serving the objectives of resilience and the green and digital twin transitions. It should help build human capital, support workers' successful job transitions which, alongside the cohesion policy funds, will be essential to ensure cohesion, foster **employment and** productivity**,** and enhance economic and social resilience. EU growth objectives, and national structural challenges, including those identified in the 2019 and 2020 country-specific recommendations, are key. The Annual Sustainable Growth Strategy (ASGS[7]), which promotes these objectives, puts forward seven flagship initiatives: (1) Power up, (2) Renovate, (3) Recharge and Refuel, (4) Connect, (5) Modernise, (6) Scale-up, (7) Reskill and upskill. Those flagships represent common challenges that call for coordinated investments and reforms. Member States should channel investments, implement reforms and integrate further their value chains in these flagship areas. The proposed Recovery and Resilience Facility Regulation provides, among others, that euro area Member States' Recovery and Resilience Plans shall be consistent with the challenges and priorities identified in the Council recommendation on the economic policy of the euro area. This consistency should be taken into account in the assessment of the Recovery and Resilience Plans.

(5) The euro area requires a policy mix that is supportive, coordinated, comprehensive and consistent to cushion the impact of the COVID-19 pandemic. The aim is to limit any negative long-term impact on the labour market, to reduce significant economic and social divergences, to address imbalances and other macro-significant risks and, more broadly, to avoid negative consequences on potential economic growth over the medium term. The mutual consistency of the three core dimensions of the euro area policy mix – monetary, fiscal and structural – is essential to ensure a supportive aggregate policy stance for the euro area.

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7 COM/2020/575 final

(6) The timely European Central Bank (ECB) monetary policy interventions aimed at keeping the monetary transmission channels intact and safeguarding medium-term price stability. The ECB announced substantial additional purchases of public and private sector assets, which will amount to EUR 1470 billion under the Asset Purchase Programme (APP, EUR 120 billion until the end of 2020)[8] and the Pandemic Emergency Purchase Programme (PEPP, EUR 1350 billion until at least mid-2021).[9]

(7) The fiscal stance is forecast to be highly expansionary in 2020 and to remain supportive in 2021 at both euro area and national level. Coordination of national fiscal policies, in full respect of the Stability and Growth Pact, is crucial for the effective response to the COVID-19 shock and the proper functioning of the Economic and Monetary Union (EMU). On 20 March 2020, the Commission concluded that the EU economy was experiencing a severe economic downturn and the conditions to activate the general escape clause of the Stability and Growth Pact were met. This conclusion was endorsed by the finance ministers of the Member States.[10] Member States introduced sizeable budgetary measures to contain the pandemic and provide support to individuals and businesses particularly affected including exceptional liquidity support, mainly via guarantees provided to companies and to banks to ensure the flow of credit. Further coordinated fiscal support will be provided at the EU level, notably through the RRF.

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8 OJ L 157, 15.6.2016, p. 28–32.

9 OJ L 91, 25.3.2020, p. 1–4.

10 https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

(8) The economic fallout from COVID-19 is having a large negative impact on public finances. When health and economic conditions allow, a refocusing of fiscal policies towards achieving prudent medium-term fiscal positions, including by phasing out support measures to firms and citizens, will contribute to ensuring fiscal sustainability in the medium term. This should be done in a way that mitigates the social and labour-market impact of the crisis **and contributes to social sustainability**. Reforms aimed at improving the composition of national budgets and at ensuring fiscal sustainability over the longer term, including in view of climate change and health challenges, appear particularly relevant. Improving the composition of national budgets, especially through spending reviews and effective public procurement frameworks, can create much-needed fiscal space. Green budgeting practices can also help address the challenges of climate mitigation and environmental protection. Adequate, efficient and inclusive health and social protection systems offer much-needed protection to those in **[…]** need, play a key role as automatic stabilisers and should preserve fiscal sustainability. Similarly, reforms that strengthen the functioning of labour, capital, products and services markets – through appropriate implementation and sequencing – increase potential output, while avoiding a negative short-term impact on aggregate demand.

(9) The COVID-19 crisis is reinforcing the importance of reforms for more efficient and fairer public revenue systems. As the tax wedge on labour in the majority of euro area Member States remains high, these **reforms** include shifting the tax burden towards tax bases that are less detrimental to labour supply **and demand**, productivity, investment and growth, while taking into account the related distributional impact. An increased use of environmental taxation and/or other forms of pricing of externalities can contribute to sustainable growth by incentivising “greener” behaviours. Measures addressing aggressive tax planning and tax avoidance, both internationally and in the Union, can make tax systems more efficient and fairer. Moreover, globalisation and digitalisation of the economy have created a disconnect between where value is created and where taxes are paid. Work is ongoing within the OECD framework to reach a global-consensus based solution to address tax challenges arising from the digitalisation of the economy.

(10) Frontloading reforms that tackle investment bottlenecks and supply-side constraints is of particular relevance considering the high-level of uncertainty brought by the COVID-19 shock and its detrimental effect on investment. Measures that accelerate the absorption of EU funds and an effective and efficient utilisation of resources are essential, in particular in Member States lagging behind in that respect and where EU funds finance a significant share of investments. Reforms that reduce the administrative burden for firms (e.g., digitalisation of public administrations, including electronic identification, judicial reforms) and prevent the misuse of funds (e.g., corruption, fraud and anti-money laundering[11]) can improve the business environment and help boost investment, job and firm creation.

[11] 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.

(11) The COVID-19 crisis has led to substantial revenue losses for many firms and poses risks to corporate solvency across the euro area. Effective insolvency frameworks play a crucial role in supporting viable firms undergoing temporary problems and providing for the orderly exit of non-viable firms. Improving insolvency frameworks can also help address the likely increase in non-performing loans and maintain credit to the economy by facilitating the cleaning up of bank balance sheets and spur cross-border investment over the longer term. In this context, the Restructuring and Second Chance Directive (2019/1023)[12] was adopted to introduce minimum standards across Member States in the national solvency legislation in order to ensure that preventive restructuring frameworks are available to debtors in financial difficulty, to provide procedures leading to a discharge of debts incurred by over-indebted entrepreneurs, and to increase the efficiency of all types of insolvency procedures. It is important to proceed with the transposition and the implementation of the directive. The European Commission also announced in the Capital Markets Union action plan of September 2020[13] work towards minimum harmonisation or increased convergence in targeted areas of core non-bank insolvency. Beyond this, there is scope for Member States to further assess the efficiency and effectiveness of their insolvency frameworks in line with international best practices and address the remaining deficiencies.[14]

12 OJ L 172, 26.6.2019, p.18-55.
13 COM(2020)590 final.
14 The Eurogroup identified a number of principles including early identification of debt distress and availability of early restructuring procedures. See https://www.consilium.europa.eu/en/meetings/eurogroup/2016/04/22/

(12) Further deepening the single market in goods and services, and adapting the euro area to the digital era, can be a major engine of growth, convergence and resilience. The common currency and the single market have been working in tandem to create better conditions for economic stabilisation and long-term growth. The COVID-19 crisis has boosted the use of digital tools, highlighted the importance of the digital single market and has accelerated the use of digital and cashless payment methods. However, the single market remains incomplete, especially in the area of services and more specifically in retail trade and professional services. The single market has the potential to limit price rigidities that hamper both the monetary policy transmission mechanism and economic resilience. The single market helps with the mobility of production factors, which allows sectors, regions and Member States to minimise economic costs (e.g., unemployment) in response to shocks. To achieve further integration of the single market for goods and services, it is necessary to remove all remaining unnecessary restrictions, enhance market surveillance mechanisms and take measures to guarantee the administrative capacity in order to achieve these objectives.

(13) Reforms and investment that improve labour market integration and transitions, with particular attention to digital and green jobs, are essential to increase economic and social resilience and support the recovery. The immediate national and Union crisis measures limited the negative economic and social impact on workers. At the same time, a number of long-standing reforms have become even more urgent now: effective active labour market policies, including individualised support, improving the quality and inclusiveness of education and training systems to strenghen educational outcomes from an early age, strong re- and up-skilling measures and investment in adult education and training and in online learning platforms, addressing skills shortages, increasing the employment prospects of the most vulnerable segments of the working population, including the young and long-term unemployed, as well as closing the gender gap**s**. Fostering quality job creation and improving working conditions, notably by ensuring adequate minimum wages and addressing labour market segmentation **and barriers to labour mobility**, are key to support a sustainable and inclusive recovery. Social dialogue and collective bargaining play an important role in the successful design and implementation of policies.

(14) Access to adequate, inclusive and sustainable health and social protection systems, which function as automatic stabilisers in the crisis, is important for economic and social resilience. These help to maintain **social cohesion**, decent living standards and good population health, which is fundamental to a productive labour economy, through the entire economic cycle **and address poverty and social exclusion**. Investments to support health reforms and resilient health systems need to remain a priority for Member States. The implementation of the European Pillar of Social Rights[15] is key to guide policies. In the face of the crisis, the need to ensure adequate social protection coverage for all, both in terms of quality health- and long-term care**,** as well as in terms of income replacement for all workers, including those under atypical contracts and the self-employed, has become even more important. Many Member States have adopted temporary income support and social assistance measures in favour of vulnerable groups with very low incomes and workers not entitled to unemployment benefits. Measures have been taken with regard to benefits, eligibility conditions and additional in-kind services. Strengthening of the adequacy and coverage of social protection systems needs to be done in a way that ensures the long-term sustainability of public finances and intergenerational fairness.

15 Interinstitutional Proclamation on the European Pillar of Social Rights OJ C 428, 13.12.2017, p.10-15.

(15) Significant progress has been achieved in recent years, but the economic fallout from the pandemic has put renewed pressure on the financial sector. Euro area banks entered the current crisis with stronger loss-absorption capacities compared to before the onset of the global financial crisis. Combined with monetary and fiscal policy measures, this has avoided a tightening of market financing conditions, beyond the initial phase of the crisis, and ensured the continued credit provision to the private sector. The crisis is likely to put further pressure on banks' already low profitability levels and non-performing loan ratios, and on the non-bank financial sector, which experienced outflows and valuation losses that have been only partly recovered. This could hamper the provision of credit, which is essential for the recovery. The swift and sizeable policy interventions have supported confidence and helped to preserve macro-financial stability. To mitigate risks it is crucial to sever the feedback-loop between corporate sector vulnerabilities and financial sector risks and to address structural weaknesses in order to strengthen profitability. Government loan guarantee schemes help protect companies and the banking sector, but also constitute contingent liabilities for Member States' budgets. In the absence of an effective system that distinguishes viable from non-viable businesses, prolongation of insolvency moratoria and forbearance of non-performing loans entails difficult decisions as it might lead to misallocation of funds and increase the losses under an eventual bankruptcy.

(16) The completion of the EMU architecture remains essential. Filling the remaining gaps could further increase the euro area's stability and resilience and would strengthen the international role of the euro, which has remained broadly stable in recent years. Beyond its short-term stabilisation function and its role in supporting the recovery, Next Generation EU has the potential to impact the EMU in the longer term. Increasing the euro area's resilience to future shocks as well as through the sizeable issuance of euro-denominated debt, including green and social bonds, will add depth and liquidity to the market for high-quality euro-denominated debt securities, and can in this way strengthen the euro as an international reserve currency. Nonetheless, important elements are still missing in EMU, such as a complete Banking Union and Capital Markets Union. Strengthening the Banking Union remains crucial in order to ensure financial stability, reduce financial fragmentation and protect lending to the economy in times of crisis. Finalising the work on the ESM package of reforms is a priority, including the introduction of a backstop for the Single Resolution Fund. This backstop should be made operational and be anticipated, provided sufficient progress has been made with risk reduction. There should be further work on solutions for overcoming limitations in the current set-up for liquidity provision in resolution. Completing the Capital Markets Union is a key priority, as demonstrated by the new action plan of September 2020. A strong and resilient EMU will also be important to strengthen the international role of the euro and ensure the Union's economic and financial autonomy on which the Commission will put forward a communication, while fully respecting the Union's internal market and pursued in an open and transparent manner towards non-euro area Member States.

HEREBY RECOMMENDS that euro area Member States take action, individually, including through their Recovery and Resilience Plans, and collectively within the Eurogroup, in the period 2021–2022 to:

1. Ensuring a policy stance which supports the recovery

As the health emergency persists, fiscal policies should remain supportive in all euro area Member States throughout 2021.

Policy measures should be tailored to country-specific circumstances and be timely, temporary and targeted. As downside risks continue to materialise, Member States should continue coordinating actions to effectively address the pandemic, sustain the economy and support a sustainable recovery.

When the epidemiological and economic conditions allow, phase out support measures to firms and citizens in a way that mitigates the social and labour-market impact of the crisis, and pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

Member States should pursue reforms that strengthen the coverage, adequacy, and sustainability of health and social protection systems **for all**.

Member States should pay particular attention to the quality of budgetary measures. Improve public financial management, including notably investment and green budgeting and public procurement frameworks. Make use of spending reviews to better focus public expenditure on recovery and resilience needs.

2. Further improving convergence, resilience and sustainable and inclusive growth

Mitigate the risk of further divergence and enhance economic and social resilience in the euro area by implementing reforms that strengthen productivity and employment, ensure a smooth allocation of resources and improve the functioning of markets and public administration, and by increasing the level of public and private investment to support the recovery consistent with fair and inclusive green and digital transitions.

Further integrate the single market for goods and services, including digital, by removing unnecessary restrictions, enhancing market surveillance and guaranteeing sufficient administrative capacity.

Ensure effective active labour market policies and support to job transitions, notably towards the green and digital economy. Foster fair working conditions, address labour market segmentation **and strengthen inclusion.** Ensure the effective involvement of social partners in policy making, strengthen social dialogue and collective bargaining. Strengthen inclusive education and training systems and investment in **skills**, addressing skills shortages.

Continue working on a global consensus-based solution to address the tax challenges arising from the digitalisation of the economy within the OECD framework, and stand ready to move ahead with action at the EU level by June 2021. Make further progress to combat Aggressive Tax Planning, lower the tax wedge and support a shift in taxation towards carbon pricing and environmental taxation.

3. Strengthening national institutional frameworks

Pursue and frontload reforms to address bottlenecks to investments and to ensure the efficient and timely use of EU funds, including of the Recovery and Resilience Facility. Strengthen the effectiveness and digitalisation of public administration, including justice and health systems, as well as public employment services. Reduce the administrative burden for firms and improve the business environment. Put in place effective frameworks to counter fraud, corruption, and money laundering.

Promote concrete actions to increase the efficiency, effectiveness and proportionality of insolvency frameworks, to work out non-performing exposures and ensure an efficient allocation of capital.

4. Ensuring macro-financial stability

Maintain the credit channels to the economy and measures to support viable companies as long as necessary during the emergency of the unprecedented crisis.

Keep sound bank sector balance sheets, including by continuing to address non-performing loans, in particular through the development of secondary markets for non-performing loans.

5. Completing the EMU and strengthening the international role of the euro

Make progress on deepening the Economic and Monetary Union to increase the resilience of the euro area by completing the Banking Union and Capital Markets Union and through initiatives implementing digital finance, retail finance and sustainable finance policies.

Increase the efficiency, proportionality and overall coherence of the bank crisis management and depositor insurance framework, including robust Banking Union safety nets as short-term priorities.

Progress in these areas will contribute to enhancing the international role of the euro and promote better Europe's economic interests globally while fully respecting the Union's internal market.

Done at Brussels,

For the Council

The President.