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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION on the economic policy of the euro area

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COUNCIL RECOMMENDATION

of …

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,

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[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.

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Whereas:

(1) After a very deep recession in 2020, the euro area economy is experiencing a solid and fast recovery. Gross domestic product (GDP) growth in the second quarter of 2021 surpassed expectations and, according to the Commission services' autumn 2021 economic forecast, the euro area's GDP is expected to have grown by 5,0 % in 2021. The euro area economy regained its pre-crisis GDP level in the last quarter of 2021. By the second quarter of 2021, seven euro area countries had already regained their pre-crisis GDP levels. Euro area annual GDP is forecast to grow by 4,3 % in 2022, but the recovery is expected to be uneven across countries and sectors. Domestic demand is the main driver of GDP growth, linked to the easing of restrictions related to the COVID-19 pandemic further to the vaccination rollout, gradual improvements in the labour markets, the drawdown of extra savings accrued during the lockdown periods, and strong investment growth benefitting from favourable financing conditions and support from NextGenerationEU, the recovery instrument established by Council Regulation (EU) 2020/2094[1]. As recommended, euro area Member States have taken action, individually and collectively within the Eurogroup, to ensure a policy stance that supports the recovery from the COVID-19 crisis. Going forward, the level of uncertainty remains high, with substantial risks including those related to the evolution of the pandemic, both within and outside the Union, and that level warrants close monitoring.

[1] Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis (OJ L I 433, 22.12.2020, p. 23).

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(2) In the course of 2021, strong domestic demand growth has met constraints on the supply side, including input scarcity and logistics disruptions. In addition, labour and skills shortages have become a growing concern in some sectors and some Member States. After several years of very low rates, inflation in the euro area has increased since the beginning of 2021, in particular on the back of base effects, surging energy prices and supply bottlenecks, suggesting a transitory phenomenon linked to the post-lockdown adjustment process. Inflation reached 4,9 % in the euro area in November 2021. According to the Commission services' autumn 2021 economic forecast, it is projected to decline to 2,2 % in 2022 and to 1,4 % in 2023.

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(3) In 2021, the European recovery strategy focused on putting NextGenerationEU and its largest instrument - the Recovery and Resilience Facility (RRF), established by Regulation (EU) 2021/241 of the European Parliament and of the Council[1] - into effect. By mid-November 2021, the Council had adopted the recovery and resilience plans of 22 Member States, including 18 euro area countries, following positive assessments by the Commission. Over the coming years, the effective implementation of reforms and investments under the RRF will have a deep positive impact on the functioning of the economies of the euro area Member States. Effective implementation of the RRF will foster upwards economic and social convergence across euro area Member States, given the key used to allocate its resources. The RRF has also reinforced confidence and contributes to supporting growth and macro-financial stability, thus balancing the policy mix and complementing the actions of the European Central Bank (ECB). Beyond supporting the recovery, the RRF aims to structurally transform the Member States' economies, in particular as regards achieving the green and digital transitions. The implementation of coherent investments and reforms under the RRF, together with the use of cohesion policy funds, aims to increase the euro area's resilience to future shocks, raise potential output in a durable manner, support employment and address social challenges. Furthermore, the issuance of euro-denominated debt by the Union to finance the RRF will add depth and liquidity to Europe's capital markets and contribute to strengthening the euro as an international currency. The issuance of green bonds under NextGenerationEU will further help to promote sustainable investment.

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[1] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

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(4) The implementation of the reforms and investments included in the recovery and resilience plans will give way to the disbursement of RRF funding and effectively contribute to the achievement of the euro area policy priorities, including those set out in the Council Recommendation of 13 July 2021 on the economic policy of the euro area[1]. Such implementation will concern, *inter alia*, strengthening national institutional frameworks, supporting high-quality public investment, and policy measures to support social cohesion and just green and digital transitions. Such implementation should help ensure a sustainable and inclusive recovery, sustain growth potential and enhance resilience. This is in line with the Commission's Communication of 24 November 2021 entitled 'Annual Sustainable Growth Survey 2022' and the four dimensions of competitive sustainability, namely environmental sustainability, productivity, fairness and macroeconomic stability.

(5) Appropriately supportive and mutually reinforcing economic policies have ensured effective macroeconomic stabilisation, and contained the impact on labour market outcomes, mitigating risks of scarring and supporting a rapid economic recovery. A sound mix of monetary and fiscal policies along with structural reforms and financial policies will continue to be essential for the proper functioning of the euro area, in full compliance with the respective roles of the Member States and institutions under the Treaty.

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[1] OJ C 283, 15.7.2021, p. 1.

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(6) The ECB's monetary policy measures aim to ensure the smooth functioning of different financial market segments and keep the monetary transmission channels intact, and ultimately to safeguard medium-term price stability. In July 2021, the ECB published its new monetary policy strategy, which adopts a symmetric 2 % inflation target over the medium term. The ECB's Governing Council also confirmed that the setting of ECB interest rates remains its primary monetary policy instrument. In October 2021, the ECB launched a two-year-long investigation phase regarding the possible issuance of a digital euro. The creation of a digital euro would require intervention by the Union legislators, and the Commission intends to make a legislative proposal on the basis of Article 133 of the Treaty. Depending on its design, such a central bank digital currency could, *inter alia*, offer a supply of public money in digital form, support the digitalisation of the European economy and actively encourage innovation in retail payments. Moreover, it could contribute to strengthening the international role of the euro and the Union's open strategic autonomy.

(7) On 19 October 2021, the Commission adopted a communication entitled 'The EU economy after COVID-19: implications for economic governance', re-launching the debate on the economic governance review to build broad-based consensus on how to enhance the economic governance framework, tackle macroeconomic imbalances and address fiscal challenges in a transitional and growth-friendly manner, taking into account the lessons learnt from the COVID-19 crisis.

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(8) The deficit of the general government in the euro area as a whole was projected to reach 7,1 % of GDP in 2021 but to fall to 3,9 % in 2022. The euro area fiscal stance, according to the Commission services' autumn 2021 economic forecast, was projected to remain supportive in 2021, with an expansion above 1,75 % of GDP, and in 2022, with an expansion close to 1 % of GDP. In 2022, public investment, both nationally-financed and Union-financed, will contribute to that supportive stance. As of November 2021, the 18 euro area national recovery and resilience plans approved at that time by the Council are to provide large-scale financial support to euro area Member States of up to EUR 262 billion in grants and EUR 139 billion in loans in the period to 2026. Coordination of national fiscal policies, in full respect of the Stability and Growth Pact, is crucial for the effective response to the economic shock caused by the COVID-19 crisis, a sustainable recovery, and the proper functioning of the Economic and Monetary Union (EMU). While the general escape clause will remain active in 2022, it is expected to be deactivated as of 2023. With the economic recovery taking hold, fiscal policy is pivoting from temporary emergency measures to targeted recovery support measures. The increase in government debt ratios from 85,5 % of GDP in 2019 to 100 % of GDP in 2021 has reflected the combined effects of the contraction in output and the necessary policy reaction to the very large COVID-19 shock. However, as debt ratios were already high in some euro area Member States before that shock, a gradual, continuous and growth-friendly debt reduction will be a policy objective across a large part of the euro area.

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(9) In this context, improving the composition of public finances, including by promoting investment, improving the quality of budgetary measures and ensuring fiscal sustainability over the medium and long term, including in view of climate change and the green and digital transitions, appear particularly relevant. Green budgeting, spending reviews, well-functioning public investment management schemes, and effective public procurement frameworks can improve the transparency and effectiveness of public finances and create fiscal space for additional public investments. Reforms for more efficient and fairer revenue policy have become even more fundamental in the aftermath of the COVID-19 crisis. There is still scope to make the tax systems in the euro area more growth- and environment-friendly, in particular by addressing distortions and reducing the tax wedge on labour, which remains high in most euro area Member States. Measures addressing aggressive tax planning, tax avoidance and tax evasion can make tax systems more efficient and fairer, while supporting the recovery and increasing revenue. Globalisation has made it necessary to adjust the taxation framework to fit an increasingly digitalised economy. An agreement on reforming global taxation to address the tax challenges arising from the digitalisation of the economy and to limit harmful tax competition has been reached within the Organisation for Economic Co-operation and Development and G20 Inclusive Framework on Base Erosion and Profit Shifting.

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(10) The swift and forceful policy response at national and Union level, including through NextGenerationEU, has been effective in mitigating the impact of the crisis on households and firms. Thanks to that coordinated action, divergences have widened less than initially expected, and long-run scarring effects have been mitigated. Policy support, including through short-time work schemes and other job retention measures, has helped keep businesses in activity throughout the crisis and has limited the rise in the unemployment rate and the drop in disposable income. Although increasing, insolvency rates have remained contained in 2021 despite the gradual lifting of support measures. Labour markets are also showing gradual improvement, with the employment rate at 72,1 % in the second quarter of 2021, compared to the pre-COVID-19 peak of 72.9 % in the fourth quarter of 2019. The accelerated adoption of digital technology throughout the COVID-19 crisis could have a positive impact on productivity if sustained over time. Still, that crisis has had substantial territorial, sectorial and distributional implications, which will require reallocations both within and across countries and sectors, with substantial transition costs for workers and companies.

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(11) Although the rise in bankruptcies has remained limited so far, the COVID-19 crisis has left many firms with weaker balance sheets, which might constrain their ability to finance investment projects in the near term and compromise their repayment capacity. As the recovery takes hold, support should be gradually phased out and made more targeted. Making less use of debt instruments would limit contingent liabilities and help preserve businesses' investment capacity. Timely withdrawal of policy support measures is a balancing act involving supporting investment and employment and avoiding failures of viable businesses, without inhibiting the orderly exit of unviable businesses over the medium-term. In this context, improving access to finance for companies, strengthening firms' balance sheets and enhancing the capacity and efficiency of insolvency frameworks is crucial. National insolvency regimes differ substantially across the euro area, and capacity-enhancing actions will be needed to facilitate an effective administration and judicial system. Improving insolvency frameworks can also contribute to sounder balance sheets in the banking sector, with a positive impact on credit supply. Directive (EU) 2019/1023 of the European Parliament and of the Council[1] on restructuring and insolvency, which seeks to introduce minimum standards across Member States on preventive restructuring and debt discharge for entrepreneurs, is to be transposed into national law by 17 July 2022. Moreover, the integration of the Union's capital markets is key to providing companies with alternative sources of funding to complement bank lending. Progress in the Capital Markets Union can improve access to finance for euro area businesses, mobilise long-term investments in new and in green technologies and infrastructure, promote equity investment and remove cross-border barriers to investment, including by harmonising certain aspects of substantive law on insolvency proceedings.

[1] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) (OJ L 172, 26.6.2019, p.18).

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(12) While employment is recovering rapidly, some sectors, specific categories of workers and regions are set to be impacted in the long-term by the COVID-19 crisis and by the strong push for greening the economy and accelerating digitalisation. Young people have been particularly affected, as well as low-skilled people and people with a migrant background. The new jobs being created could be different from those jobs lost due to that crisis. Some groups, including women, still experience structural challenges in labour market integration. Supply chain bottlenecks and surging energy prices may slow down the rebound of employment in certain sectors. Policy measures that facilitate job transitions and labour market re-integration will therefore be key to supporting adjustment and mitigating the social impact, in particular in light of the green and digital transitions. The Commission put forward Recommendation (EU) 2021/402[1] on an effective active support to employment following the COVID-19 crisis, inviting Member States to develop coherent policy packages combining measures that aim to bridge skill shortages and help individuals to successfully navigate the green and digital transitions. Such packages would consist of three components: (i) time-limited and well-designed hiring and transition incentives and support to entrepreneurship; (ii) upskilling and reskilling opportunities linked to labour market needs; and (iii) enhanced support by employment services. Meanwhile, for the cohesiveness of the euro area, social protection remains fundamental in the wake of the health and economic crises to ensuring fair green and digital transitions. The European Pillar of Social Rights remains the compass for employment, skills and social policy action, fostering upward economic and social convergence and better working and living conditions in the Member States. The European Pillar of Social Rights Action Plan, adopted in March 2021, sets three Union headline targets on (i) employment, (ii) adult learning and (iii) poverty reduction by 2030, to which relevant policy actions will contribute. Those targets were welcomed by Union leaders at the 8 May 2021 Porto Social Summit and in the European Council on 24–25 June 2021.

[1] Commission Recommendation (EU) 2021/402 of 4 March 2021 on an effective active support to employment following the COVID-19 crisis (EASE) (OJ L 80, 8.03.2021, p. 1).

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(13) Member States have designed ambitious reform and investment plans, with the financial and policy support of the RRF, and their implementation is key. Increasing the quality of institutions, in particular by strengthening administrative capacity, will be key to ensuring a swift absorption of the related funds while avoiding duplication of and interference with other Union instruments. Member States can improve the framework conditions for private investment by improving the business environment. Preserving and strengthening supply chain resilience in the single market by detecting and addressing supply shortages and bottlenecks, in addition to open markets, convergence in standards, and greater diversification, circularity and resource efficiency, will be key to ensuring the smooth functioning of the single market. The Council Recommendation of 13 July 2021 on the economic policy of the euro area, which calls for further integration of the single market for goods and services, including the digital single market, by removing unnecessary restrictions, enhancing market surveillance and guaranteeing sufficient administrative capacity, remains relevant.

(14) As a result of previous reforms, the banking sector has shown overall resilience when faced with severe economic stress. The extensive policy support in the trough of the crisis and the solid recovery recorded in 2021 have so far attenuated concerns about weaker corporate balance sheets. However, it is possible that euro area banks will experience some deterioration in asset quality. Timely monitoring of risks, proactive engagement with debtors and active management of non-performing loans, together with strengthened profitability and a robust regulatory framework, are important to maintain the stability of the banking sector and its ability to finance the economic recovery.

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(15) The economic size and integration of the euro area, as well as the actions put in place to respond to the COVID-19 crisis, have been stabilising factors globally throughout that crisis. Given the interconnectedness of the economies, in the coming years euro area Member States will need to deliver the investments and reforms agreed to emerge stronger from the crisis, while further deepening the EMU to increase its resilience to future shocks and its ability to stand stronger on the international scene. Developments in advanced and emerging market economies have direct repercussions on the euro area through a number of channels, including as regards health and vaccination policy, monetary policy trajectories, financial flows, global value chains and trade. The constraints in global supply chains that arose in the wake of the recovery further testify to the growing global economic interconnectedness. Meanwhile, the euro area current account surplus has continued its gradual decline and reached, in 2020, a level close to that suggested by fundamentals. However, it is forecast to rise from 2,6 % to 3,4 % between 2020 and 2023. Strengthening the international role of the euro, which remained broadly stable in recent years, including through developing a digital euro, could enhance the economic and financial autonomy of the euro area and the Union, and improve global financial stability.

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(16) The deepening of the EMU remains essential. The Banking Union and the Capital Markets Union are mutually reinforcing projects to promote growth, safeguard financial stability and support a genuine EMU. Filling the remaining gaps would further increase the euro area's stability and resilience, help the euro area economies thrive, and strengthen the international role of the euro. Completing the Banking Union - together with the timely ratification of the amending agreements to the Treaty establishing the European Stability Mechanism[1] and to the Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund, done at Brussels on 21 May 2014 - and the Capital Markets Union remains essential. That completion will also support the green and digital transitions, which require important investments. The Euro Summit of 25 June 2021 reiterated the commitment to the completion of the Banking Union and invited the Eurogroup in inclusive format to agree, without delay and on a consensual basis, on a stepwise and time-bound work plan on all outstanding elements. It also called for rapid implementation of the Capital Markets Union 2020 Action Plan, set out in the Commission's Communication of 24 September 2020 entitled 'A Capital Markets Union for people and businesses-new action plan', in line with the priorities set out in the Council Conclusions of 3 December 2020 on that Action Plan. The Council Recommendation of 13 July 2021 on the economic policy of the euro area, which calls for completing the EMU and strengthening the international role of the euro, remains relevant,

[1] Treaty Establishing the European Stability Mechanism between the Kingdom of Belgium, the Federal Republic of Germany, the Republic of Estonia, Ireland, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Grand Duchy of Luxembourg, Malta, the Kingdom of The Netherlands, the Republic of Austria, the Portuguese Republic, the Republic of Slovenia, the Slovak Republic and the Republic of Finland, signed at Brussels on 2 of February 2012.

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HEREBY RECOMMENDS that euro area Member States take action, individually, including through the implementation of their recovery and resilience plans, and collectively within the Eurogroup, in the period 2022–2023 to:

(1) continue to use and coordinate national fiscal policies across Member States to effectively underpin a sustainable and inclusive recovery. Maintain a moderately supportive fiscal stance in 2022 across the euro area, taking into account national budgets and the funding provided by the Recovery and Resilience Facility. Gradually pivot fiscal measures towards investments that promote a sustainable and inclusive recovery, consistent with the green and digital transitions, paying particular attention to the quality of budgetary measures. Reflecting the degree of uncertainty, keep fiscal policy agile in order to be able to react to the evolution of the COVID-19 pandemic. Differentiate fiscal policies taking into account the strength of the recovery, ensuring fiscal sustainability and enhancing investments, while bearing in mind the need to reduce divergences.

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(2) promote policies that tackle aggressive tax planning, tax evasion and tax avoidance to ensure fair and efficient tax systems. Work to limit harmful tax competition including through the implementation of the global consensus-based solution to address the tax challenges arising from the digitalisation and globalisation of the economy. Lower the tax wedge on labour and promote a shift from labour taxation towards taxes that are less distortive. Transition from emergency to recovery measures in labour markets by ensuring effective active labour market policies: (i) supporting job transitions, in particular towards a green and digital economy; (ii) combining measures tackling skills shortages, strengthening upskilling and re-skilling, providing targeted hiring incentives; and (iii) enhancing the capacity of public employment services to address labour market mismatches. Strengthen inclusive quality education and training systems. Promote labour market integration of young people, women, and vulnerable groups, ensure adequate working conditions and address labour market segmentation, develop and adapt where needed social protection systems and strengthen access in order to address challenges emerging from the COVID-19 crisis and those related to the green and digital transitions. Ensure the effective involvement of social partners in policy making, strengthen social dialogue and promote collective bargaining. Ensure sharing of, and convergence towards, good practices in labour market and social policies that increase economic and social resilience.

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(3) monitor the effectiveness of policy support packages for companies, focus on a more targeted support for the solvency of viable firms that have come under stress during the COVID-19 crisis, and make greater use of equity-type instruments. Increase the capacity of insolvency frameworks to deal effectively and in a timely manner with bankruptcy and debt restructuring, maximise the preservation of value and promote an efficient allocation of capital in the real economy and cross-border investments. Make swift progress in deepening the Capital Markets Union, on which the Commission has made legislative proposals with a focus on supporting the financing of the economy, enhance investment opportunities for firms and individuals, and remove unwarranted cross-border barriers to investments in the single market.

(4) continue to strengthen national institutional frameworks and pursue reforms to address bottlenecks to investment and reallocation of capital, and ensure the efficient and timely use of Union funds. Reduce the administrative burden for firms and improve the business environment. Strengthen the effectiveness and digitalisation of public administration. Improve public financial management, including through green budgeting and by improving the effectiveness of public investment management frameworks, and make use of spending reviews to improve the composition and quality of public finances, in particular quality of public investments and investment in people and skills, and to better focus public expenditure on recovery and resilience needs.

(5) ensure macro-financial stability, and maintain the credit channels to the economy, continuing to address non-performing loans through, amongst others, monitoring asset quality, timely and pro-active engagement with distressed debtors, in particular viable ones, and the further development of secondary markets for non-performing loans. Continue to work on completing the Banking Union, by means of a step-wise and time-bound work plan on all outstanding elements needed and with the same level of ambition, and on strengthening the international role of the euro. Continue to support exploratory work on the possible introduction of a digital euro.

Further steps in deepening the EMU should take into account the lessons learnt from the Union's comprehensive economic policy response to the COVID-19 crisis. Progress in deepening the EMU should be pursued in full respect of the Union's internal market and in an open and transparent manner towards non-euro area Member States.

Done at …,

For the Council
The President

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