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

Delegations will find here attached the post EFC and EWG version of the draft Council recommendation on the economic policy of the euro area to be approved by Ecofin on 22 January 2019. The formal adoption of the text should take place after the endorsement by the European Council in March 2019.

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,

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 low compared to levels recorded in recent decades 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, while in other Member States labour supply is scarce. 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 Member States 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.

(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 whose growth potential is clearly lower than the euro area average. This is important for strengthening economic, social and territorial cohesion in the euro area.

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[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, inclusive 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. 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, taking into account fiscal space and spillovers across countries. Coordination of national fiscal policies based on 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 and low levels of public investment, supports 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. These can facilitate the operation of fiscal and 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, which has proven to be a major engine of growth and convergence between Member States, still holds considerable unexploited potential and progress is needed to deepen it, particularly in 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. There has been sustained progress in risk reduction, notably on non-performing loan (NPL) reduction and minimum requirement for own funds and eligible liabilities (MREL) build-up. 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 both to facilitate addressing legacy NPLs and to avoid their future build-up. The November 2016 banking package, which aims to further reduce risks by implementing internationally agreed norms on capital buffers, subordination of liabilities and liquidity in banks, preserving the balance of the Council compromise, is important for further progress towards risk reduction and thereby towards risk sharing. 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, including through the recent agreement on the operationalisation of a common backstop for the Single Resolution Fund, but it remains unfinished. There are limitations in the current set-up for liquidity provision in resolution and the lack of a common deposit insurance scheme and of a common backstop for the Single Resolution Fund, hampering 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 theother elements in the statement of Leaders of 14 December 2018. In December 2017 and May 2018, the Commission published a set of proposals setting further steps towards completing the EMU, including a European Investment Stabilisation 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. At the Euro Summit of 13–14 December 2018, decisions were taken on the Banking Union and the further development of the ESM, which leaders agreed will be the provider of the common backstop to the SRF at the latest by the end of the transition period. Work will proceed to prepare the necessary amendments to the ESM Treaty (including the common backstop to the SRF), based on the term sheet endorsed by Leaders. The backstop will be introduced earlier, provided that sufficient progress has been made in risk reduction to be assessed in 2020. Work will continue in the first half of 2019, in particular through the set-up of a High-Level Working Group on EDIS and further work on the set-up for liquidity provision in resolution. Work will also proceed on the design, modalities of implementation and timing of a budgetary instrument for convergence and competitiveness for the euro area, and ERM II Member States on a voluntary basis. The features of the instrument will be agreed in June 2019. The instrument will be adopted in accordance with the legislative procedure, as foreseen by the Treaties, on the basis of the relevant Commission proposal to be amended if necessary. All these reforms could 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, fully respecting the Union’s internal market.

(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 the quality of institutions, and pursue resilience-enhancing product and services market reforms. Reduce external debt and pursue reforms to boost competitiveness notably through productivity in euro area Member States with current account deficits or high external debt 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. While pursuing policies in full respect of the Stability and Growth Pact, support public and private investment and improve the quality and composition of public finances. Rebuild fiscal buffers, especially in euro area countries with high levels of public debt. Support and implement EU actions to combat Aggressive Tax Planning.

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 and anticipate this provided sufficient progress has been made in risk reduction. Pursue work on a European Deposit Insurance Scheme, with the setting up of a High Level Working Group. Strengthen the European regulatory and supervisory framework. Work further on solutions for overcoming limitations in the current set-up for liquidity provision in resolution. Promote orderly deleveraging of large stocks of private debt. Continue to swiftly reduce the level of non-performing loans in the euro area and prevent their build up, including by removing debt bias in taxation. Make ambitious progress on the Capital Markets Union.

5. Make swift progress on deepening the Economic and Monetary Union, building on the Statement of the Euro Summit of 14 December 2018, also with the perspective to strengthen the international role of the euro, taking into account the proposals of the Commission and the initiatives of Member States, while fully respecting the Union's internal market and in an open and transparent manner towards non-euro-area Member States.

Done at Brussels,

For the Council
The President