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'I/A' ITEM NOTE

From:	Employment Committee and Social Protection Committee
To:	Permanent Representatives Committee (Part 1)/Council
Subject:	European Semester 2022 Recommendation on the economic policy of the euro area - Approval of the contribution on the employment and social aspects

I. INTRODUCTION

On 24 November 2021, the Commission presented the Autumn Economic Package, including the Annual Sustainable Growth Survey (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 7 December 2021 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 2 and recital 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 9 December 2021). The EPC-euro area format agreed on these modifications.

Changes in the Annex compared to the Commission proposal (set out in document 14146/21) 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 (recommendations 2 and recital 12). The rest of the text is currently under discussion in the ECOFIN *filière*, where it might undergo further modifications.

III. CONCLUSIONS

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

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) After a very deep recession in 2020, the euro area economy is experiencing a solid and fast recovery. GDP growth in the second quarter of 2021 surpassed expectations and, according to the Autumn 2021 economic forecast, the euro area's GDP is expected to grow by 5.0 % in 2021. The euro area economy is set to regain its pre-crisis GDP level in the last quarter of 2021. By 2021Q2, 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. Domestic demand is the main GDP growth driver, linked to the easing of restrictions 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 the policy support from NextGenerationEU. 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, uncertainty and risks remains high, including the evolution of the pandemic, both within and outside the EU.
- (2) In the course of the year, 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 Member States. After several years of very low rates, inflation in the euro area has picked up since the beginning of 2021, in particular on the back of surging energy prices and supply bottlenecks, suggesting a transitory phenomenon, linked to the post-lockdown adjustment process. Inflation has reached a ten-year high of 3.4% in the euro area in September 2021.

- (3) In 2021, the European recovery strategy has focused on putting NextGenerationEU, and its largest instrument the Recovery and Resilience Facility (RRF)³, into effect. By mid-November 2021, the Council had adopted the recovery and resilience plans of 22 Member States, including 18 euro area countries, after positive assessments by the Commission. Over the next years, the effective implementation of reforms and investments under the RRF will have a deep positive impact on the functioning of the euro area economies. Effective implementation of the Facility 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 European Central Bank (ECB)'s actions. Beyond supporting the recovery, the RRF aims at structurally transforming the Member States' economies notably to achieve 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 and to 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 contributes to strengthening the euro as an international currency. The issuance of green bonds under NextGenerationEU will further help promote sustainable investments.

³ 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.

- (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 the Council Recommendations on the economic policy of the euro area⁴. This will concern, *inter alia*, strengthening national institutional frameworks, supporting high-quality public investment, policy measures in support to social cohesion and to a just green and digital transition. This should help ensure a sustainable and inclusive recovery, sustain growth potential and enhance resilience. This is in line with the Annual Sustainable Growth Survey and the four dimensions of competitive sustainability, i.e. environmental sustainability, productivity, fairness, and macroeconomic stability⁵.
- (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 consistent mix between monetary and fiscal policies along with structural reforms and measures to maintain financial stability will continue to be essential for the good functioning of the euro area, in full compliance with the respective roles of the Member States and institutions under the Treaty.

⁴ Council Recommendation of 13 July 2021 on the economic policy of the euro area, OJ C 283, 15.7.2021, p. 1.

⁵ Annual Sustainable Growth Survey 2022, COM(2021)740

- (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 safeguard medium-term price stability. In July 2021, the ECB published its new monetary policy strategy. The new strategy adopts a symmetric 2 % inflation target over the medium term. The Governing Council also confirmed that the set of ECB interest rates remains its primary monetary policy instrument. In October 2021, the ECB launched a two-year-long investigation phase on a digital euro. The creation of a digital euro would require an intervention of the Union legislature on the basis of Article 133 TFEU. Issuing such a central bank digital currency could, inter alia, secure the continued supply of public money in digital form, support the digitalisation of the European economy and actively encourage innovation in retail payments⁶. Moreover, it would contribute to strengthening the international role of the euro and Europe's open strategic autonomy.
- (7) On 19 October 2021, the European Commission has re-launched the debate on the economic governance review to build broad-based consensus on how to enhance the effectiveness and transparency of the framework, tackle macroeconomic imbalances and address fiscal challenges in a transition and growth-friendly manner, taking into account the lessons learnt from the COVID-19 crisis.

⁶ See the October 2020 ECB "Report on a digital euro", available at https://www.ecb.europa.eu/pub/pdf/other/Report_on_a_digital_euro~4d7268b458.en.pdf.

- (8) The deficit of the general government in the euro area as a whole is projected to reach 7.1 % of GDP in 2021 but to fall to 3.9 % in 2022. The euro area fiscal stance, stemming from national budgets and the EU budget, is projected to remain supportive in 2021 and 2022 (1¾ % and 1 % of GDP, respectively). In 2022, public investment, both nationally- and EU-financed, will contribute to the supportive stance. As of November 2021, the 18 euro area national recovery and resilience plans approved by the Council so far will 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 COVID-19 shock, 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 the 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 the shock, a gradual, continuous and growth-friendly debt reduction will be a policy objective across a large part of the euro area.

- (9) In this context, improving the composition of public finances, including by promoting investment, the quality of budgetary measures and ensuring fiscal sustainability over the longer 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 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 OECD/G20 Inclusive Framework on base erosion and profit shifting (BEPS).

- (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 this 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 in spite of the gradual lifting of support measures. Labour markets are also showing gradual improvements, with **the** employment **rate** back at 72.1 % in the second quarter of 2021, compared to the pre-COVID peak of 72.9 % in the fourth quarter of 2019. The accelerated adoption of digital technology throughout the crisis could have a positive impact on productivity if sustained over time. Still, the COVID-19 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.

- (11) Although the rise in bankruptcies has remained limited so far, the pandemic 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 between supporting investment and employment, and avoiding failures of viable businesses on the one hand, without inhibiting the orderly exit of the unviable ones over the medium-term, on the other. 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. The Directive on restructuring and insolvency⁷, which seeks to introduce minimum standards across Member States on preventive restructuring and debt discharge for entrepreneurs, will have to be transposed into national law by 17 July 2022. Moreover, the integration of EU capital markets is key to provide companies with alternative sources of funding to complement bank lending. Progress in the Capital Markets Union (CMU)⁸ can improve access to finance for euro area businesses, mobilise long-term investments in green, new technologies and infrastructure, promote equity investment and remove cross-border barriers to investment, including by harmonising certain aspects of substantive law on insolvency proceedings.

⁷ 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.

⁸ During the Euro Summit on 25 June 2021, EU leaders underlined their political support for the capital markets union (CMU) and called for rapid implementation of the CMU action plan.

- (12) While employment is recovering rapidly, some sectors, specific categories of workers and regions are set to be durably impacted by the crisis and by the strong push for greening the economy **and accelerating digitalisation. Young people have been particularly affected, as well as the low-skilled and people with a migrant background.** The new jobs being created may be different from the jobs that have been lost due to the 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 support adjustment and mitigate social impacts in particular in the light of the twin transition. The Commission put forward a recommendation on an Effective Active Support to Employment following the COVID-19 crisis (EASE)⁹, which invites Member States to develop coherent policy packages combining measures aimed at bridging the skill shortages and help individuals to successfully navigate the green and digital transitions. These 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 and with a view to ensuring fair twin transitions.

⁹ 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.

The European Pillar of Social Rights¹⁰ 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 EU headline targets on (i) employment, (ii) adult learning, and (iii) poverty reduction by 2030¹¹, to which policy actions recommended below will contribute. These targets have been welcomed by the EU leaders in the 8 May 2021 Porto Social Summit and the European Council on 24-25 June 2021.

- (13) Member States have designed ambitious reform and investment plans, with the financial and policy support of the RRF whose implementation is key. Increasing the quality of institutions, in particular by strengthening administrative capacity, will be key to ensure a swift absorption of the related funds while avoiding duplications and interference with other EU 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, alongside open markets, convergence in standards, greater diversification, circularity and resource efficiency, will be key to ensure the smooth functioning of the Single Market. The 2021 Council Recommendation on the economic policy of the euro area, of 13 July 2021, which calls for further integrating 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.

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

¹¹ The EU committed to the following EU headline targets by 2030: at least 78% of the 20-64 population should be in employment; at least 60% of people aged 25-64 should participate in learning activities each year; and the number of people at risk of poverty or social exclusion should decrease by at least 15 million compared to 2019.

- (14) The banking sector has shown its overall resilience when faced with severe economic stress, thanks to previous reforms. 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. Still, euro area banks might experience some deterioration in asset quality. Timely monitoring of risks, proactive engagement with debtors and active management of non-performing loans is important to maintain their ability to finance the economic recovery.
- (15) The economic size and integration of the euro area, as well as the actions put in place to respond to the crisis, have been stabilising factors globally throughout the COVID-19 crisis. Given the interconnectedness of the economies, euro area Member States will in the coming years need to deliver the investments and reforms agreed to emerge stronger from the crisis, while further deepening the institutional setup of the euro area to increase its resilience to future shocks and stand stronger on the international scene. Economic and financial developments in advanced and emerging market economies have direct repercussions on the euro area through a number of channels, including through health and vaccination policy, monetary policy, 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 continued its gradual decline and recorded a level close to that suggested by fundamentals. 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.

- (16) The deepening of 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 Economic and Monetary Union. 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 Agreement to the ESM Treaty, and the Capital Markets Union remains essential. This 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 CMU Action Plan in line with the priorities set out in the Council Conclusions of 3 December 2020. The 2021 Council Recommendation on the economic policy of the euro area, of 13 July 2021, which calls for completing the EMU and strengthening the international role of the euro, remains relevant.

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. Keep fiscal policy agile in order to be able to react if pandemic risks re-emerge. Differentiate fiscal policies taking into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. Once economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

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 the 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.

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 pandemic, and make greater use of equity-type instruments. Take actions to increase the capacity of insolvency frameworks to deal effectively and timely with bankruptcy and debt restructuring, maximize the preservation of value and promote an efficient allocation of capital and cross-border investments. Make progress in deepening the Capital Market Union, including by swiftly agreeing on the Commission legislative proposals to support the financing of the economy and to enhance investments opportunities for firms and individuals and remove 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 effective public investment management frameworks, and make use of spending reviews to improve the composition of public finances, in particular quality of public investments, 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, through a step-wise and time-bound work plan, and on strengthening the international role of the euro. Continue to support exploratory work on the possible introduction of a digital euro.

Done at Brussels,

For the Council

The President