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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Delegations will find attached document COM(2019) 652 final.

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Strasbourg, 17.12.2019  
COM(2019) 652 final

Recommendation for a  
**COUNCIL RECOMMENDATION**  
**on the economic policy of the euro area**  
{SWD(2019) 631 final}

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<sup>1</sup>, 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<sup>2</sup>, 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) The euro area is continuing its expansion, but with interconnected risks to the outlook and uncertainty on the horizon. Moreover, the risk of a further prolonged period of low growth and inflation driven by anaemic productivity and ageing populations looms. While the output gap has turned positive since 2017 and stood at 0.7% of potential GDP in 2018, potential growth is set to remain below pre-crisis levels.<sup>3</sup> Core inflation remained in the 1-1½ % range in 2018 and is forecast to remain at some 1½% in 2019, 2020 and 2021. Labour market indicators continue to improve, although at a slower pace, and employment growth is projected to slow further and challenges in terms of job quality remain. Nominal wage growth has firmed, having reached some 2¼ % growth in 2018, after several years below 2.0%, and is projected at some 2½ % in 2019 and back to 2¼% in 2020-21. In spite of good labour market conditions, real wage growth has increased only slowly and remains low, at below 1% in 2018 and 2019 and projected at 0.7% and 0.8% for 2020 and 2021 respectively. The euro area current account surplus is projected to narrow. Deficit Member States narrowed or reversed their current account deficits, even if they continue to record large negative NIIPs.<sup>4</sup> At the same time, some Member States

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25.

<sup>3</sup> All forecast figures in this document are from the European Commission Autumn 2019 forecast.

<sup>4</sup> European Commission (2019), Alert Mechanism Report 2020, COM(2019) 651 final.

continue to run persistently high current account surpluses and therefore continue to increase their net international investment positions (NIIP). Current account balance dynamics in the euro area are affected by weakening external demand, especially for export-oriented Member States with high current account surpluses, which are highly dependent on foreign export demand.

- (2) Increasing the growth potential while ensuring environmental and social sustainability and driving real convergence among euro area Member States requires structural reforms to enhance sustainable growth and investment in tangible and intangible capital to increase productivity. This would help particularly those Member States whose growth potential is clearly lower than the euro area average. This would also be necessary in order to prevent the euro area economy from falling into a protracted period of low potential growth and productivity, low price inflation and wage growth as well as rising inequality. Reforms and investment remain crucial to ensure the euro area relaunches its growth momentum, overcomes stronger pressures over the medium to long-term stemming also from deteriorating demographics, and facilitates the transformation towards a sustainable economy, helping the euro area and its member states to achieve the United Nations' Sustainable Development Goals.
- (3) The economic impact of climate change, one of the biggest systemic risks facing the world economy, financial systems and societies today, is beginning to be visible. Risks to the global economy from climate change and more broadly from environmental degradation are increasingly present, and these will have an impact on the most vulnerable in our societies. If not accompanied by appropriate measures, there could be negative consequences on the resilience of our economies, on inclusiveness and on the long-term growth potential. In that context, investment and creating the regulatory and financial conditions for an orderly transition towards a sustainable economy would be essential. If tackled in the right way, environmental and climate challenges are also an opportunity to revitalise the European economy towards sustainable development. In that direction, the Commission has put forward a European Green Deal, as Europe's growth strategy which will include the first European Climate Law to enshrine the 2050 climate-neutrality target into law. At the same time, the green transition will need to take the impact on different parts of society into account. Investment to facilitate transformation towards a sustainable economy will need to be accompanied by investment in skills and support for job transitions to ensure that all citizens reap the benefits of technological change, particularly in the sectors and regions lagging behind in the digital and green transitions.
- (4) Mobilising public and private funds for investing in the green and digital transition can help to sustain growth in the short term and meet the long-term challenges facing our economies. While the digital revolution may entail opportunities in terms of productivity, growth and job creation, it may also raise challenges, in particular for less qualified workers, lacking skills to work with new technologies. Different speeds of transition to the digital economy among euro area Member States could prove a significant risk to convergence and macroeconomic stability. This could be reinforced by strong agglomeration effects, often benefiting large cities and winner-takes-all dynamics that are often present in the area of digital technologies, which can add to inequality and have adverse impact on convergence. Investments should

be geared towards generating research and innovations but also towards wider diffusion of innovations across the economy.

- (5) A more coordinated investment strategy coupled with a stronger reform effort at euro area level would be instrumental to support growth and respond to the long-term challenges such as the climate transition and technology transformation. The Budgetary Instrument for Convergence and Competitiveness, to be included in the Reform Support Programme, would provide financial support to euro area Member States for the implementation of reform and investment packages. InvestEU, which will also contribute to the Sustainable Europe Investment Plan, also aims to trigger at least EUR 650 billion in additional investment to further foster innovation and job creation in the EU, including by financing sustainable infrastructure. Cohesion policy funds, which play a crucial role in supporting our regions and rural areas, also play a role in the climate and technological transition by promoting sustainable development. The European Investment Bank already dedicates 25% of its total financing to climate investment, and has announced its intention to double this share. To achieve the Union's sustainability objectives, it would be essential to carry out investment projects at national and sub-national level that cover climate adaptation and mitigation, energy transition, decarbonisation or the circular economy. Investment in network industries and infrastructure can help improve the euro area's competitiveness and foster the transition to more sustainable transport. In addition, investments in intangible assets such as research and development and skills would be key to prepare the euro area labour market for the challenges ahead.
- (6) The effects of the economic expansion over the last years have not been felt evenly within Member States and across regions and countries. While disposable income levels have recently risen, they remain below pre-crisis levels in several euro area Member States. The number of people at risk of poverty and social exclusion is declining in most Member States, and is now 5 million below the 2012 peak, but remains above 2008 levels in the euro area. Following a period of increased divergences, some Member States have converged towards the highest performers in GDP-per-capita over the past few years. However, the share of income held by the highest income levels has slowly increased in the past decade, and large divergences remain between Member States. In order to promote upwards convergence within and across Member States, it would be important to promote policies that aim at increasing both efficiency and equity, in line with the Sustainable Development Goals. They result in better macroeconomic outcomes with more equally shared benefits for society at large, that also help boost the cohesion of the euro area.
- (7) Consistency and balance in the macroeconomic policy mix of the euro area, including monetary, fiscal and structural policies, are crucial to ensure robust, inclusive and sustainable economic growth and to respond effectively to persistent low inflation, a weakening outlook and risks to long-term growth. The European Central Bank is maintaining an accommodative monetary policy to help inflation edge towards its medium-term inflation objective, while supporting growth and job creation. Fiscal policy needs to complement the monetary policy stance, as are structural reforms across different sectors, including those necessary to complete the architecture of the Economic and Monetary Union (EMU).
- (8) Coordination of national fiscal policies in full respect of the Stability and Growth Pact, while taking into account available fiscal space and spillovers across countries,

supports the proper functioning of the EMU. The euro area fiscal stance is expected to be broadly neutral to slightly expansionary in 2020 and 2021. At the same time, national fiscal policies remain insufficiently differentiated in light of the available fiscal space in Member States. The pursuit of prudent fiscal policies by Member States with high levels of public debt would put public debt on a downward path, reduce vulnerability to shocks, and allow for the full functioning of automatic stabilisers in the event of an economic downturn. On the other hand, further boosting investment and other productive spending in Member States with a favourable budgetary situation would support growth in the short and medium term, while also helping to rebalance the euro area economy. In case of a worsening outlook, achieving a supportive fiscal stance at the aggregate level that focuses on productive spending, while pursuing policies in full respect of the Stability and Growth Pact, taking into account country-specific circumstances and avoiding pro-cyclicality to the extent possible, is important to sustain growth in the short term.

- (9) Fiscal structural reforms remain crucial for improving fiscal sustainability, strengthening growth potential and allowing for effective fiscal policies in the event of a downturn. Well-functioning national fiscal frameworks, together with regular and thorough spending reviews and effective and transparent public procurement can strengthen the efficiency and effectiveness of public expenditure and improve the credibility and quality of fiscal policies. Improving the composition of national budgets, on both the revenue and expenditure sides, including shifting resources towards investment by setting up public investment strategies, would increase the growth impact of public budgets, raise productivity and begin, meeting the urgent long-term challenges of the green and digital economies. 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. The ease with which mobile resources can move within the euro area increases the scope for tax competition. Coordination among Member States is therefore essential to address profit-shifting, excessive tax competition and an overall race to the bottom in terms of corporate taxation. An agreement for a Common Consolidated Corporate Tax Base as well as an agreement to review profit allocation among countries and ensure minimum effective taxation would be instrumental in this endeavour. The tax burden in the euro area is relatively high and skewed towards labour, with property or environmental taxes representing a very small share of tax revenues. The two latter, however, can be less detrimental to growth and labour supply and demand and can contribute to sustainable growth by incentivising “greener” behaviour by consumers and producers. Taxation would need to take better into account the climate dimension and address emissions and carbon leakage more consistently. Therefore, in order to help transitioning towards a green economy, fostering the design of budgetary policies conducive to environmental commitments and a review of the Energy Taxation Directive will be proposed, as well as a Carbon Border Adjustment Mechanism if needed to avoid carbon leakage and keep the level playing field with third countries firms.
- (10) Structural and institutional reforms that increase competition in product markets, promote resource efficiency, improve the business environment and the quality of public administrations, including the effectiveness of justice systems, are important for the resilience of euro-area Member States. Resilient economic structures prevent shocks from having significant and long-lasting effects on income and labour supply and can facilitate the operation of fiscal and monetary policy and contain

divergences, particularly in downturns, creating more favourable conditions for sustainable and inclusive growth. Better coordination and implementation of structural reforms, in particular those prescribed in the country-specific recommendations, can create positive spillovers across Member States. In that respect, the National Productivity Boards can play an important role in increasing the reform ownership and improving implementation. Reforms are also needed to face urgent long-term challenges such as the climate transition and technological transformation. Deepening Single Market integration, which has proven to be a major engine of growth and convergence between Member States can also contribute to fostering productivity growth.

- (11) The European Pillar of Social Rights sets out twenty principles to foster equal opportunities and access to the labour market, fair working conditions and social protection and inclusion. It is designed as a compass to promote upward convergence towards better working and living conditions. Stronger and more inclusive economies and societies can in turn foster the resilience of the Union and the euro area. Reforms and investment in skills, job transitions and more effective social protection are also important to accompany a just and fair transition towards a green and digital economy. The full implementation of the pillar at all levels with due regard for respective competences will be essential to promote upward convergence.
- (12) Reforms that increase labour market participation, promote quality job creation, support successful labour market transitions, reduce segmentation and promote social dialogue can help boost inclusive growth, improve economic resilience and automatic stabilisation, reduce inequalities, and address poverty and social exclusion. Individualised job transition support, training and requalification are key to promote the timely reinsertion of job-seekers. Access to high-quality education and training throughout the life cycle requires adequate investment in order to improve human capital and skills, also in light of the digital and green transition. This contributes to improving employability, productivity, innovation capacity and wages in the medium and longer term, increasing the resilience of the euro area. Employment protection legislation needs to provide for fair and decent working conditions for all workers, especially in view of emerging atypical forms of employment bringing along new opportunities but also challenges related to job security and social protection. Effective and sustainable social protection systems are also crucial to ensure adequate income and access to quality services. Pension reforms and work-life balance policies can importantly foster labour market participation, safeguarding the long-term sustainability of European welfare systems. A shift away from labour taxation could usefully focus in particular on low income and second earners. Social partners' involvement in employment, social and economic reforms is crucial to strengthen ownership and support reform implementation.
- (13) The robustness of the euro area financial sector has increased since the crisis, though vulnerabilities remain. Corporate and household debt remains high in several countries, and in many cases, national tax systems still feature a debt bias. 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' competitiveness. There has been sustained progress in risk reduction, notably on non-performing loan (NPL) reduction. Nonetheless, where NPL ratios remain rather high they require further sustained efforts, and all Member States should put in place appropriate policies to prevent the build-up of NPLs. In March 2018, the

Commission presented a risk-reduction package both to facilitate addressing legacy NPLs and to avoid their future build-up. As part of the legislative measures on NPLs, a Regulation was adopted in April 2019,<sup>5</sup> which introduces a ‘statutory prudential backstop’ in order to prevent the risk of under-provisioning of future NPLs; further progress should be made to continue tackling the issue of NPLs, in particular by progressing with the draft Directive on NPLs secondary markets. As highlighted in the Commission reports on anti-money laundering issued in July 2019<sup>6</sup>, a more comprehensive approach to fighting money laundering and the financing of terrorist activities is needed in the Union to address structural shortcomings identified. This requires, in particular, a better enforcement of the rules and better supervision through more unified EU action.

- (14) The establishment of the Banking Union has progressed, including through the agreement on the operationalisation of a common backstop for the Single Resolution Fund, but it remains unfinished. A High Level Working Group was set up to continue technical work towards the launching of the political negotiations for establishing a European Deposit Insurance Scheme (EDIS). This work needs to be completed given the significance of EDIS for the steady-state Banking Union and within the broader EMU architecture, which calls for addressing all the relevant elements to favour the stability and efficiency of the European banking sector. Finally, the Commission delivered on all of the actions announced in the Capital Markets Union. However, concrete support on specific legislative files has sometimes been lacking and renewed efforts are needed to remove the legal, tax and regulatory obstacles to the establishment of a Capital Markets Union, in particular as regards the rules on access to finance, insolvency, supervision and tax divergences, and to achieve a more effective EU supervision. The role and functioning of national government bond markets needs to be assessed also to address the so-called bank-sovereign nexus.
- (15) Strengthening the architecture of the EMU requires delivering on the actions identified in the Statement of the Euro Summit of December 2019 as a matter of priority, but also on Commission proposals setting further steps towards completing the EMU. The June 2019 Communication on Deepening Europe’s Economic and Monetary Union: Taking stock of four years after the Five Presidents’ Report presents the state of play and outline areas where reform efforts should focus in the short and medium term. There has been some progress on the economic union, with a political agreement on the Budgetary Instrument for Convergence and Competitiveness for the euro area. Discussions on improving the European Stability Mechanism’s toolkit and revising its Treaty are ongoing. However, there have been no discussions in the Council on a euro area fiscal stabilisation function nor reforming the governance of the euro area. The Commission intends to propose a European Unemployment Benefit Reinsurance Scheme in order to better protect citizens in cases of economic shocks.

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

<sup>6</sup> 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.



- (16) Completing the EMU would result in better macroeconomic outcomes. An incomplete EMU impedes financial integration. This limits financing opportunities for much-needed investment to foster an inclusive, productive, sustainable and stable economy. An incomplete EMU also hinders the smooth transmission of monetary policy across the euro area and limits Europe's ability to determine its economic destiny. In addition, the lack of a central fiscal stabilisation function significantly weakens the euro area's counter-cyclical fiscal capacity. Additionally, the move towards intergovernmental solutions has not been matched by appropriate accountability at EU level. Therefore, improvements in the governance of the euro area bodies would be instrumental to increase democratic accountability. Strengthening the EMU is key to enhance the clout of Europe in the world, to develop the international role of the euro and to contribute to an open, multilateral and rules-based global economy. It is important that discussions continue to be held in an open and transparent manner towards non-euro area Member States, fully respecting the Union's internal market.

HEREBY RECOMMENDS that euro area Member States take action, individually and collectively within the Eurogroup, in the period 2020–2021 to:

1. In euro area Member States with current account deficits or high external debt, pursue reforms to boost competitiveness and reduce external debt. In euro area Member States with large current account surpluses, strengthen the conditions that support wage growth, while respecting the role of social partners, and implement measures that foster public and private investment. In all Member States, foster productivity by improving the business environment and the quality of institutions, enhance resilience by improving the functioning of goods and services markets especially by deepening the Single Market. Support a fair and inclusive transition towards a competitive green and digital economy through tangible and intangible investment, both public and private.
2. In Member States with high debt levels, pursue prudent policies to put public debt credibly on a sustainable downward path. In Member States with a favourable fiscal position, use it to further boost high-quality investments. In case of a worsening outlook, deliver a supportive fiscal stance at the aggregate level, while pursuing policies in full respect of the Stability and Growth Pact, taking into account country-specific circumstances and avoiding pro-cyclicality to the extent possible, and stand ready to coordinate policies in the Eurogroup. Improve the effectiveness of national fiscal frameworks and the quality of public finances and adopt growth-friendly tax and other relevant budgetary measures that foster a sustainable economy. Support and implement EU actions to combat Aggressive Tax Planning and address a race to the bottom in corporate taxation.
3. Strengthen education and training systems and investment in skills. Increase the effectiveness of active labour market policies that support labour market integration and successful labour market transitions, including to more digital and green jobs. Promote participation in the labour market, including that of women, and shift taxes away from labour, in particular for low-income and second earners. Foster quality job creation, fair working conditions and address labour market segmentation. Improve access to adequate and sustainable social protection systems. Enhance the effectiveness of social dialogue and promote collective bargaining.

4. Complete the Banking Union by starting political negotiations on the European Deposit Insurance Scheme, taking steps to improve crisis management and making provisions for liquidity in resolution and the backstop for the Single Resolution Fund operational. Strengthen the European regulatory and supervisory framework, including by reinforcing the supervision and enforcement of anti-money laundering rules. Promote orderly deleveraging of large stocks of private debt including by removing debt bias in taxation. Continue to enable the swift reduction of the level of nonperforming loans by banks in the euro area and prevent their build up. Renew efforts to complete the Capital Markets Union.
5. Make ambitious progress on deepening the Economic and Monetary Union, delivering swiftly on the actions identified in the Statement of the Euro Summit of December 2019 and advancing on all other aspects with the perspective to strengthen the international role of the euro and to project Europe's economic interests globally. Deepen the Economic and Monetary Union and enhance its democratic accountability while fully respecting the Union's internal market and in an open and transparent manner towards non-euro area Member States.

Done at Strasbourg, 17.12.2019

*For the Council  
The President*