

Brussels, 23.5.2022
COM(2022) 600 final

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE
EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF
THE REGIONS AND THE EUROPEAN INVESTMENT BANK**

2022 European Semester - Spring Package

{SWD(2022) 628 final} - {SWD(2022) 629 final} - {SWD(2022) 630 final} -
{SWD(2022) 631 final} - {SWD(2022) 632 final} - {SWD(2022) 633 final} -
{SWD(2022) 634 final} - {SWD(2022) 635 final} - {SWD(2022) 636 final} -
{SWD(2022) 637 final} - {SWD(2022) 638 final} - {SWD(2022) 639 final}

1. INTRODUCTION

The EU's decisive policy response following the COVID-19 pandemic supported the Union's resilience, as also shown under the current unprecedented geopolitical and economic environment. Coordinated policy action at EU and national levels cushioned the impact of the pandemic on Member States' economies and opened the way to a strong recovery. The EU economy reached its pre-pandemic output level in the autumn of 2021 and the outlook before Russia invaded Ukraine was for a phase of prolonged and robust expansion. However, Russia's war of aggression against Ukraine has created a new environment, exacerbating pre-existing headwinds to growth, which were previously expected to subside. Further hikes in commodity prices, renewed supply disruptions and heightening uncertainty are denting growth and imply significant downside risks. It also poses additional challenges to the EU economies related to security of energy supply and fossil fuel dependencies from Russia. The broadening inflationary pressures beyond energy prices, together with the large inflow of people fleeing the war, are having a direct impact on European societies. Yet, the EU economy is showing its resilience, being projected to keep expanding in 2022-2023. Residual tailwinds from re-opening dynamics, a still improving labour market and strong policy response to the pandemic shock still support growth. Short-term actions, including the temporary Support to mitigate Unemployment Risks in an Emergency (SURE), the Coronavirus Response Investment Initiative, REACT-EU or the State aid temporary framework, and the on-going roll-out of NextGenerationEU, with the Recovery and Resilience Facility (RRF) at its heart, have clearly paid off. At the same time, the growth projections are surrounded by exceptional uncertainty and subject to strong downside risks.

REPowerEU is the EU's plan to reduce Europe's dependence from Russian fossil fuels as soon as possible and well before 2030, by accelerating the European Green Deal. Based on the Commission package of 18 May¹, REPowerEU accelerates measures aimed at more affordable, secure and sustainable energy in the face of the emerging challenges. The case for reducing our dependence on fossil fuels from Russia has never been clearer. It should be based on a rapid transition away from all fossil fuels, as well as the strengthening of our social and economic resilience. The REPowerEU plan includes concrete measures to reduce the Union's energy dependence on all Russian fuels and speed up the implementation of the European Green Deal with new actions, building on the Fit for 55 package. The plan mobilises additional funding to further accelerate the decarbonisation of our economy and address remaining infrastructure gaps in the EU, including important cross-border links. It also includes measures to alleviate the impacts on firms and households of the energy supply disruptions linked to the Russian invasion. Measures to speed up permitting procedures will unlock the EU's potential in renewable energy, matched by actions to address the green skills shortage.

The European Semester and the RRF provide robust frameworks to ensure effective policy coordination and to address the current challenges. The four dimensions of the EU's competitive sustainability – environmental sustainability, productivity, fairness, and macroeconomic stability – will continue to guide policy action at European and national level. The country-specific recommendations adopted in the context of the European Semester provide guidance to Member States to respond adequately to persisting and new challenges and deliver

¹ COM(2022) 230

on their shared key policy objectives. This year they also include guidance for new dedicated REPowerEU chapters in the recovery and resilience plans (RRPs), to reduce the dependency on fossil fuels through reforms and investments in line with the REPowerEU priorities². The RRF will continue to drive Member States' reform and investment agendas for the years to come and is the main tool to speed up the twin green and digital transition and strengthen Member States' resilience, including through the implementation of national and cross-border measures under REPowerEU. The RRF also supports multi-country projects and reinforces cooperation between Member States. This is complemented by cohesion policy funds and other programmes³, which facilitate the delivery of key Union priorities for investment at national and regional levels, so that no region and no person is left behind. The 2022 European Semester cycle also provides updated and consistent reporting on progress towards the achievement of the Sustainable Development Goals (SDGs) across Member States. At Union level, whereas progress has been observed in past years with regard to almost all SDGs, more needs to be done, also in the context of the COVID-19 fallout and the current geopolitical and economic situation⁴.

2. ECONOMIC AND EMPLOYMENT OUTLOOK

After the soft patch at the turn of 2021, the EU economy entered 2022 with the prospect of a vigorous expansion over this year and the next. Following the robust rebound in economic activity that started in spring last year and continued unabated through early autumn, the growth momentum in the EU slowed down under the impact of intensifying headwinds. The resurgence of the pandemic last autumn and the rapid spread of the new Omicron variant led to renewed strains on healthcare systems and prompted the reinstatement of restrictions, though generally of a milder or more targeted nature than in previous waves. Persistent logistic and supply bottlenecks, including shortages of semiconductors, some raw materials and metal commodities, weighed on production, as did the elevated prices of energy and labour shortages in many EU countries. Inflationary pressures started to curtail households' purchasing power. However, as supply conditions were expected to normalise and inflationary pressures to moderate, economic activity looked set to regain traction. A continuously improving labour market, large accumulated household savings, still favourable financing conditions, and the roll-out of the RRF were all set to sustain a prolonged and robust expansionary phase.

The Russian invasion of Ukraine has dented global economic expectations. The negative impact on the economic prospects acts through multiple channels. These include negative confidence effects, lower trade, tighter financing conditions and especially higher commodity prices, in turn bringing renewed disruptions in supply chains and additional stress on global logistics. Beyond these immediate consequences, Russia's invasion of Ukraine has led to a decoupling from Russia, including as regards trade and financial relations, the scale of which is difficult to fully apprehend at this stage. In parallel, the recent drastic pandemic containment measures applied in some parts of China could, if protracted, add to existing bottlenecks. The

² COM(2022) 231

³ Such as the Connecting Europe Facility, the Just Transition Mechanism, Horizon Europe and the EU Emissions Trading System Innovation and Modernisation Funds.

⁴ See Appendix 3 on EU-wide progress on SDG implementation and Eurostat's 2022 SDG Monitoring Report: <https://ec.europa.eu/eurostat/product?code=KS-09-22-019>.

new geopolitical environment calls for actions to achieve the EU's open strategic autonomy and reduce its dependency on energy and other strategic products and technologies.

While the Russian invasion of Ukraine has heightened uncertainty, the economic outlook still points to continued economic expansion in 2022 and 2023, showing the resilience of the EU economy. This reflects the comfortable starting position before the outbreak of the war and the crucial support provided by the full deployment of the RRF. According to the spring 2022 European Economic forecast, real GDP growth in the EU is set to slow from an estimated 5.4 % in 2021 to 2.7 % in 2022 and 2.3 % 2023. The employment rate for people aged 15-74 is forecast to increase from 72.5 % in 2021 to 73.5 % in 2022 and 74.2 % in 2023. Inflation is expected to be higher and remain elevated for longer than in the previous forecast, driven by war-induced commodity price increases and broadening price pressures. For 2022, it is projected at 6.8 % and 3.2 % in 2023. The new growth outlook is considerably less bright than projected before Russia's invasion of Ukraine, due to downside risks to the economic outlook in the context of Russia's aggression, unprecedented energy price hikes and continued supply chain disruptions. At the same time, the unprecedented nature and size of the new shocks makes all projections subject to considerable uncertainty.

Lower growth prospects and intensifying price pressures pose policy dilemmas. For much of the past two years, the combination of an accommodative monetary policy and strong fiscal support has allowed EU Member States to stabilise the economy in the face of the pandemic. The shocks unleashed by the war weigh predominantly on the supply side of the economy, exerting a drag on output growth while pushing up inflation to rates never seen since the introduction of the single currency. On its part, fiscal policy is called to mitigate the impact of rising energy prices, for vulnerable households in particular, being mindful of the measures' potential impact on inflation, the consistency with the long-term aim to reduce overall reliance on fossil fuels and shift fossil fuel imports away from Russia, as well as the need for prudence to maintain fiscal sustainability.

3. LINKING THE EUROPEAN SEMESTER, THE RRF AND REPOWEREU – KEY OBJECTIVES FOR THE 2022 COUNTRY-SPECIFIC RECOMMENDATIONS

The RRF is the central tool to deliver the EU policy priorities under the European Semester and, in combination with REPowerEU, to address newly emerged challenges. The Facility, with its strong performance-based monitoring system, is providing important financial support for the implementation of key reforms and investments, entailing a fiscal and reform impulse financed by the Union. One year on from its introduction, major progress has been made, triggering positive spillover effects across the EU while supporting convergence, in particular across the euro area. Implementing the ambitious RRs is key to foster the twin transition and increase Member States' resilience. In line with the RRF Regulation, national RRs cover all or a significant subset of the relevant country-specific recommendations. The European Semester and the RRF will therefore continue to be closely interlinked to ensure complementarity in the policy priorities they are set to achieve, by avoiding overlaps and minimising the administrative burden. Russia's invasion of Ukraine has altered the geopolitical

and economic context. The Versailles Declaration⁵ called for further decisive steps towards building European sovereignty, by reducing EU's strategic dependencies, increasing the security of supply notably in the area of critical raw materials and phasing out our fossil fuel dependencies from Russia. The RRF will play a central role in mobilising and steering available resources at European level to achieve these objectives, as also outlined under REPowerEU.

As announced in the 2022 Annual Sustainable Growth Survey this year's spring Package reintroduces country reports and country-specific recommendations (CSRs). The country reports provide a snapshot of the existing and newly emerging challenges along the four dimensions of competitive sustainability, as well as the individual Member States' resilience to tackle these challenges, as also reflected in the resilience dashboards developed by the Commission⁶. The country reports take stock of the implementation of past country-specific recommendations and of the measures included in the RRP that will largely drive Member States' reform and investment agendas until 2026⁷. The reports identify key outstanding or newly emerging challenges, not sufficiently covered by commitments undertaken in the RRP, which are the basis for this year's CSRs. This 'gap analysis' and the related recommendations notably take into account the need to reduce our energy dependencies following Russia's invasion of Ukraine, in line with the REPowerEU priorities, and to address the related socio-economic implications.

Given the encompassing nature of the RRP, targeted new country-specific recommendations address a limited number of additional reform and investment challenges⁸. Member States should primarily focus on the timely implementation of the RRP. Therefore, the Commission proposes to the Council to address to all Member States with an approved RRP: a recommendation on fiscal policy, including fiscal-structural reforms where relevant; a recommendation on the implementation of the RRP and the cohesion policy programmes; a recommendation on energy policy in line with the objectives of REPowerEU; where relevant, an additional recommendation on outstanding and/or newly emerging structural challenges, based on the gap analysis. The scope of the recommendations is larger for Member States that do not have approved RRP.

The RRF is a powerful tool to achieve the objectives of REPowerEU. The RRF offers an existing monitoring and reporting framework under which Member States could report also progress made in reaching the objectives of REPowerEU, in full synergy with the implementation of existing and updated national energy and climate plans⁹ and the European Semester. Member States are strongly encouraged to put forward additional investments and reforms and reinforce existing measures to foster the EU's energy security and decrease reliance on Russian fossil fuels. To that effect, Member States are invited to propose a dedicated

⁵ <https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf>

⁶ The resilience dashboards, developed by the Commission, aim to provide a holistic assessment of resilience in the EU and its Member States. They assess resilience as the ability to make progress towards policy objectives amidst challenges. See: https://ec.europa.eu/info/strategy/strategic-planning/strategic-foresight/2020-strategic-foresight-report/resilience-dashboards_en

⁷ See Appendix 2 on the EU-wide progress in the implementation of the country-specific recommendations.

⁸ See Appendix 1 on the overview of thematic areas covered in this year's proposals for country-specific recommendations.

⁹ Member States will update national energy and climate plans in 2023 in line with REPowerEU, the relevant country specific recommendations and eventual modifications of RRP.

REPowerEU chapter in their RRP, in line with the respective Guidance issued on 18 May¹⁰. In this context, the newly issued CSRs in 2022 in the area of energy will become particularly relevant for the reforms and investments included in the REPowerEU chapters. When assessing the additional chapter and any other targeted modifications to address new CSRs, the Commission will take into account all analytical information on the Member State available in the context of the European Semester and consider the measures already included in RRP as well as cohesion policy programmes for 2021-2027.

4. GOING BEYOND THE RRP – OVERVIEW OF IDENTIFIED COMMON CHALLENGES

While Member States should proceed with the implementation of their RRP, a number of outstanding challenges persist and new ones have arisen, including as a result of the invasion of Ukraine, impacting the four dimensions of competitive sustainability. Member States thus face both common and country-specific challenges that require policy action, as reflected in the country-specific recommendations.

4.1 Energy and environmental sustainability

Accelerating decarbonisation will reduce our dependence on fossil fuels while also helping reach our 2030 climate goals as set in the European Climate Law¹¹. The invasion of Ukraine exposed the EU's dependency on fossil fuel imports. It reinforces the environmental, economic and security case for scaling up renewable energy and reducing energy consumption. With a 22% share of gross final energy consumption from renewable sources, based on the most recent data, the EU exceeded by 2 percentage points its 2020 target, but more effort is now necessary. In its Fit for 55 package of July 2021, the Commission proposed to increase the 2030 renewables target from at least 32% to at least 40% of the EU's overall energy mix, and to increase the energy efficiency target to achieve 9% reduction in energy consumption by 2030 compared to baseline projections. Given the urgent need to make the EU less dependent on Russian fossil fuels, as part of its REPowerEU Plan, the Commission tabled legislative amendments to increase the 2030 renewable target to at least 45% and the energy efficiency 2030 target to at least -13%.

Reducing energy consumption and increasing the share of renewables require mobilising higher levels of public and private investment. Previous estimates of additional investment needs for the green transition of EUR 520 billion per year¹² are likely to be at the lower end of the actual needs, as a result of the need to frontload the energy transition in the wake of the Russian invasion of Ukraine. Public and private investment in energy should focus on reducing energy consumption in line with the energy efficiency first principle¹³, supporting energy-poor households, empowering active consumer participation in the energy transition, increasing the

¹⁰ C(2022) 3300

¹¹ Regulation (EU) 2021/1119.

¹² Box 2 in European Commission, "The EU economy after COVID-19: implications for economic governance", COM(2021) 662 final.

¹³ The energy efficiency first principle is one of the key pillars not only to meet EU's climate objectives but also to reduce dependence on fossil fuels from abroad and increase security of supply and the use of renewable energy. It should be applied by taking utmost account of cost-efficient energy efficiency measures in shaping energy policy and making relevant investment decisions.

share of renewable energy and promoting sustainable mobility and industry decarbonisation, while direct and indirect subsidies to fossil energies should be phased out as a matter of priority. Investments in research and innovation will be crucial to speed up the green transition. Investment in energy infrastructure, including in a cross-border context, will also be needed to diversify sources of energy supply, with a focus on clean energy, and to ensure energy security. In particular, development of cross-border interconnectors will contribute to increasing security of supply as they give Member States access to additional and more diversified energy sources and increase the flexibility and resilience of their energy markets. Member States need to mobilise all available public and private funding sources to finance these investments, including by allocating a higher share of ETS revenues. New infrastructure and network investments related to gas can play a role in diversifying energy supplies and increasing security of supply. They are recommended to be future-proof where possible, in order to facilitate their long-term sustainability through future repurposing for sustainable fuels.

Cumbersome administrative procedures hamper the deployment of renewable energy projects. Stakeholders have repeatedly signalled administrative procedures in several Member States as a key bottleneck for the deployment of renewable energy projects and related infrastructure, impacting investor certainty, project planning and overall project approval rates. Efforts should in particular focus on the complete transposition of the Renewable Energy Directive and on rigorous application of the Recommendation on accelerating permitting procedures adopted on 18 May. Member States should also identify without delay 'renewables go-to areas', as set out in the proposed amendment of the Renewable Energy Directive, and tackle remaining barriers to renewable energy deployment and related infrastructure. New renewable energy and energy infrastructure projects should benefit from simplified planning and permitting procedures. In this regard, the Commission has since March 2022 been also working with Member State authorities in the framework of the Single Market Enforcement Taskforce in tackling permitting-related barriers. Member States will also need to focus on addressing bottlenecks related to labour shortages and make available additional upskilling and reskilling opportunities, including for relevant permitting authorities at national, regional and local levels, as part of their broader efforts in ensuring the availability of skills necessary for the objectives of the Green Deal, including the Renovation Wave.

Concerns regarding raw material availability underscore the need and urgency to advance our transition towards a circular economy. Together with a strategic rethinking of the sourcing of raw materials, in particular rare earths necessary for the twin transitions, including considering sustainable extraction and processing of raw materials in the EU, scaling up circular and innovative solutions will enhance the availability of raw materials and contribute to reducing energy demand¹⁴. Circular economy, resource efficiency and waste management measures have environmental, climate and economic benefits. They should be prioritised by those Member States whose current policies in these areas do not yet reach their full potential. This calls for putting in place stronger regulatory frameworks to promote the circular economy, with incentives for innovative practices.

¹⁴ In the area of critical raw materials, relevant efforts are ongoing and will be scaled up, as announced in the REPowerEU plan (COM(2022)230).

4.2 Productivity

Ensuring a well-functioning Single Market remains key for productivity growth, economic prosperity and convergence. The combined effect of the COVID-19 crisis and Russia's invasion of Ukraine have aggravated supply chain disruptions and businesses will need to diversify their supply chains to manage risks related to raw material prices, quality and supplies. Ongoing containment measures and protracted labour shortages can also drag on economic activity and dent the functioning of critical supply chains for longer than expected. Since a well-functioning Single Market is the EU's main source of productivity growth, job creation and resilience, any distortions within and barriers to the Single Market, that constrain the free movement of persons, goods, services and capital, need to be tackled. This requires a constant effort by Member States addressing bottlenecks to foster investments, including in transport infrastructure, and stability of supply chains through all the ecosystems. Actions are needed to mitigate the impact on viable EU businesses of both the energy price hike and the risks that stem from the Russian invasion of Ukraine on supply chain disruptions, logistics, and investments. Exploiting the diversity of the EU regions and helping all regions to unlock their full potential will contribute to a more integrated, buoyant and resilient the Single Market. A more integrated Single Market will improve EU companies' ability to raise capital across the EU, therefore encouraging long-term investments to support innovation and finance the green and digital transitions. Further progress in completing the Capital Markets Union and the Banking Union is also important in that regard.

Ambitious reforms aimed at improving the business environment, administrative capacities and institutional resilience need to accompany additional investments. In order to implement productivity-enhancing structural reforms and large-scale investments, there is a need for a comprehensive policy approach, geared towards improving administrative capacities and adequate framework conditions at national and subnational levels. A number of Member States still face the challenge to improve the business environment, including regulated professions, efficient public administration, public procurement, access to finance, and reducing the administrative burden for businesses, in particular for small and medium enterprises (SMEs). In addition, continued efforts to strengthen the Rule of Law, in particular independent, quality and efficient justice systems and well-functioning anti-corruption frameworks, are essential for the soundness of Member States' institutional resilience and a good business environment.

Research and Innovation (R&I) remains a vital tool to boost Member States' competitiveness, and instrumental for the twin transitions and for EU's open strategic autonomy. In the current context, effective and well-coordinated research and innovation instruments together with further efforts to bridge the gap between innovation and market are crucial to accelerate the green and digital transitions and reduce fossil fuel dependence in all EU countries and regions. While the substantial set of R&I reforms and investments included in the RRP should significantly contribute to strengthening Member States' R&I systems, several countries will need to take further actions to strengthen their innovation landscape and tackle the challenges they face in the R&I field. Such actions include improving science-business linkages, facilitating knowledge transfers, producing excellence, fostering business innovation including through support of SMEs, start-ups and social enterprises, expanding the regional base of their national R&I public and private ecosystem and attracting talent. In doing so, suitable financial

allocation, coupled with clearly articulated research and innovation objectives and funding targets are instrumental.

Investments in digital technologies, people and their skills are drivers of our digital transformation. According to the Digital Economy and Society Index (DESI), the progress of Member States in rolling-out 5G networks and in digitalising the public and private service sector is mixed. However, progress in digital is closely interlinked with other enabling factors such as R&I, finance, labour market and education and training reforms, as well as the need of clear investment signals to facilitate the integration of digital solutions in relevant sectors (e.g. energy, mobility, health). Investments in digital infrastructure and technologies are valuable enablers for the green and digital transformation of our economies and societies and need to be complemented by investing in digital education, in people and their skills, including in support to upskilling and reskilling, with a strong focus on addressing regional disparities, including by addressing the challenges of brain drain, the urban-rural divide and depopulation in particular regions. This will also contribute to stimulating productivity gains by European business and will incentivise businesses, in particular SMEs to move towards a greater digitalisation of their activities and contribute to the economic recovery in general.

4.3 Fairness

The European Pillar of Social Rights is the overall guiding framework to ensure fairness in the EU; its full implementation is crucial to achieving upward social and economic convergence. The RRP include a wide range of reforms and investments that will contribute to support a broader participation in the labour market, productivity gains through education, reskilling and upskilling measures, as well as social inclusion and resilience. Together with cohesion policy funds and the Just Transition Mechanism, the RRF is supporting a fair and inclusive recovery in the EU in line with the European Pillar of Social Rights. The Commission's Action Plan to further implement the Pillar proposed new EU headline targets on employment, skills and poverty reduction by 2030¹⁵, as well as a revised Social Scoreboard, all welcomed in the 2021 Porto Social Summit. Member States are in the process of setting national targets in line with the ambition of the EU headline targets. The implementation of the Pillar, and its monitoring via the Social Scoreboard, has been integrated in the European Semester cycle and is reflected in the analyses that underpin the relevant country-specific recommendations.

The COVID-19 pandemic has affected different population groups and regions unevenly and revealed underlying vulnerabilities and inequalities. Thanks to a prompt policy response, overall income inequalities and the risk of poverty or social exclusion remained broadly stable between 2019 and 2020 in most Member States. However, the mid-term effects of the pandemic on poverty and inequality remain uncertain. The COVID-19 crisis has disproportionately hit some regions, sectors and population groups that were already facing worse employment and social conditions, notably: the youth, low-skilled and temporary workers, persons with disabilities, people with a migrant background and the Roma. It also broadened educational inequalities and skill gaps and has shown the importance of ensuring access to quality education at all levels, as well as adequate coverage by social safety nets and short-time work schemes,

¹⁵ By 2030: an employment rate of at least 78% of the population aged 20-64; at least 60% of all adults to participate in learning every year; at least 15 million fewer people at risk of poverty or social exclusion.

including those supported by the European Social Fund and SURE, which helped preserve employment. The access to, adequacy and effectiveness of social benefits vary among Member States, pointing to inefficiencies in the social protection systems. Increasing the availability of affordable and social housing is warranted in a number of Member States. The pandemic has also highlighted how essential it is to have effective, resilient and sustainable healthcare systems. Several Member States still face the challenge of improving the resilience, quality and accessibility of their healthcare and long-term care systems, including the need to address shortages in the health workforce, while ensuring their long-term fiscal sustainability.

The recent energy and food price rises hit the poorest households the hardest. The increases of fossil fuel, electricity and commodity prices, already noticeable in the second half of 2021, have been further aggravated with the invasion of Ukraine. They weigh particularly on the most vulnerable households, who have to spend a higher share of their disposable income on basic goods, such as energy and food. The Commission Communication on Energy Prices¹⁶ includes a “toolbox” that the EU and its Member States can use to address the immediate impact of energy prices increases, and further strengthen resilience against future shocks. Short-term national measures include emergency income support to households, State support for companies, and tax reductions. The “toolbox” was complemented in the REPowerEU Communication with additional guidance on interventions in price setting. The implementation of the RRP, the REPowerEU plan, cohesion programmes, as well as accompanying policies that take into account distributional and social impacts, are currently even more necessary to ensure a fair green transition for all citizens and territories¹⁷. Supporting policies should be temporary and targeted to the most vulnerable in order for them to be most effective, while maintaining incentives to reduce the consumption of fossil fuels and containing their budgetary impact.

As labour markets recover, we observe employment shifts due to digital, green, geopolitical and demographic transformations, leading to labour shortages. For many employers, the overlapping digital, green and geopolitical transformations are likely to lead to profound changes in operations and in business models. Labour shortages are appearing in many Member States, particularly in sectors such as construction, healthcare and information and communication technologies. Equipping the labour force with the right skills remains a major challenge not only to address labour shortages but also to unlock investments by firms and enable the green and digital transitions. This further highlights the role of effective active labour market policy measures and public employment services, labour-market relevant education and training, and qualified teachers and trainers in increasingly knowledge-intensive labour markets and societies, as highlighted in the Recommendation on Effective Active Support to Employment (EASE). In the context of labour shortages and persistent employment gaps, increasing the labour market participation of women, including by enhancing access to early childhood education and care, and underrepresented groups, such as persons with disabilities migrants and the Roma, still represents a major opportunity for inclusive and sustainable growth and equality.

Russia’s invasion of Ukraine has made millions of people flee their country to safety. These people, mainly women and children, need support via the social, education and health systems of

¹⁶ COM(2021) 660 final.

¹⁷ See: Commission proposal for a Council Recommendation on ensuring a fair transition towards climate neutrality https://ec.europa.eu/commission/presscorner/detail/en/ip_21_6795

the Member States¹⁸. The wave of displaced persons from Ukraine has been followed by an unprecedented wave of solidarity across Europe. On 4 March 2022, the Temporary Protection Directive was triggered for the first time, granting displaced persons from Ukraine the right to legally stay in the EU, as well as access to early childhood education and care, education and training, labour market, healthcare, housing and social welfare¹⁹. It is essential that the lives of displaced people are not paused during the war so that they can continue with their education and are able to work and acquire new skills. This requires that Member States provide assistance addressing the immediate needs of people fleeing Ukraine, but they also need to equip the national administrations in their efforts to support displaced persons in accessing healthcare, childcare, housing, social protection, engaging in education and training, and finding jobs. To financially support Member States in hosting those fleeing Ukraine, the Commission undertook a number of initiatives as of March 2022²⁰ and will continue providing assistance as part of a coordinated EU effort.

Member States' continued reforms and investments will be crucial to support quality job creation, skills development and smooth labour market transitions, as highlighted by the Commission proposal on Employment Guidelines. The Guidelines provide steering on how to modernise labour market institutions, education and training as well as social protection and health systems, with a view to making them more inclusive and fair. They also integrate specific guidance aimed at addressing increasing skills and labour shortages, and achieving socially just green and digital transitions. In 2022, the Commission proposes to align the Employment Guidelines to better reflect the post-COVID environment, most recent policy initiatives and relevant policy elements in relation to Russia's aggression against Ukraine.

4.4 Macroeconomic Stability

Coordinated policy action cushioned the impact of the pandemic on the EU economies and opened the way to a robust recovery in 2021. The general escape clause of the Stability and Growth Pact, coupled with the State aid temporary framework, enabled large-scale fiscal support in all Member States. In parallel, the EU mobilised its budget, in particular with SURE, to mitigate the impact of the crisis on workers and companies. The roll-out of NextGenerationEU, including the RRF, is providing a strong impetus to the recovery. The fiscal stance in the EU as a whole – including public expenditure financed by grants from the RRF and other EU funds²¹ – is

¹⁸ Most arrivals are recorded in Poland, followed by other EU Member States neighbouring Ukraine, but some resettlement towards other EU countries is expected. See: Communication on 'Welcome those fleeing the war in Ukraine' of 23 March 2022.

¹⁹ See: Council Implementing Decision (EU) 2022/382 of 4 March 2022 establishing the existence of a mass influx of displaced persons from Ukraine within the meaning of Article 5 of Directive 2001/55/EC, and having the effect of introducing temporary protection (OJ L 71, 4.3.2022, p. 1).

²⁰ On March 8, the Commission adopted the Cohesion's Action for Refugees in Europe (CARE) proposal, allowing the swift reallocation of available funding from the 2014-20 Cohesion policy (ESF, ERDF) and the Fund for European Aid to the most Deprived (FEAD). The 2022 envelope of the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) can also be used by Member States to address the needs of those fleeing Ukraine. The Commission proposed to increase by EUR 3.4 billion the total pre-financing from the REACT-EU to Member States welcoming people displaced from Ukraine. These funds will complementing existing thematic funds such as the Asylum, Migration and Integration Fund (AMIF) and the Border Management and Visa Instrument (BMVI). As of 13 April, the Commission introduced a new a simplified financing procedure under 2014-2020 cohesion policy to cover for basic needs of persons granted temporary protection as a result of the war in Ukraine.

²¹ Excluding COVID-19 temporary emergency measures.

estimated to have been broadly neutral in 2020 and expansionary by close to 1% of GDP in 2021.

Discretionary policy measures, including higher investment, contribute to an expansionary fiscal stance in 2022 for the EU as a whole. This expansionary stance in 2022 is estimated at around 1¾% of GDP. The composition of discretionary measures has evolved over time in the face of emerging challenges, including in particular policies to mitigate the impact of higher energy prices on firms and households, and measures for the support of those fleeing Russia's military aggression against Ukraine. The discretionary fiscal measures that have been adopted since autumn 2021 to reduce the impact of high energy prices are currently estimated at 0.6% of the EU GDP in 2022. These include temporary reductions in indirect taxes on energy products, subsidies to energy production, subsidies to energy consumers, social transfers (directly linked to energy consumption) to vulnerable households and regulated prices at retail level. While most of these measures have been announced as temporary, the associated costs would rise accordingly should they be prolonged in time or widened in scope in the absence of offsetting measures. Moreover, it is important to note that the impact on public finances from the increase in energy prices goes beyond the discretionary measures taken. The deceleration in economic activity that results from the energy price shock is set to lead to a slowdown in tax and social contribution collections. This, together with possible higher public expenditure stemming from adjustments to inflation of wages, social benefits and other outlays, impacts the government deficit and debt. In order to contain budgetary costs, maximise their economic and social impacts, and maintain incentives for the green transition, the policy measures aimed at addressing the increase in energy prices should be temporary and targeted at vulnerable households, for whom the energy bill represents a significant part of their consumption basket, as well as at specifically exposed industries. These measures should also be accompanied by incentives to increase energy efficiency and reduce fossil energy consumption.

Fiscal policy should be prudent in 2023, while standing ready to react to the evolving economic situation. The specific nature of the macroeconomic shock imparted by Russia's invasion of Ukraine, as well as its long-term implications for the EU's energy security needs, call for a careful design of fiscal policy in 2023. Based on the spring 2022 forecast, which projects GDP growth to remain in positive territory over the forecast horizon albeit amid high uncertainty and downside risks, a broad-based fiscal impulse to the economy in 2023 does not appear warranted. Fiscal policy should combine higher investment with controlling the growth in nationally-financed primary current expenditure, while allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine. Full and timely implementation of the RRP is key to achieving higher levels of investment. Moreover, Member States' fiscal plans for next year should be anchored by prudent medium-term adjustment paths reflecting fiscal sustainability challenges associated with high debt-to GDP levels that have increased further due to the pandemic. To reduce risks from climate change, Member States are encouraged to systematically consider its implications in budgetary planning, alongside with policies and tools that help prevent, reduce and prepare for climate-related impacts in a fair way. Green budgeting practices in the Member States should be continued and encouraged to ensure coherence of public expenditures and revenues with environmental goals.

Fiscal policies should continue to be appropriately differentiated across Member States (see also Box 1). High-debt Member States should ensure prudent fiscal policy, in particular by

limiting the growth of nationally-financed current expenditure below medium-term potential output growth, taking into account continued temporary and targeted support to households and firms (subject to State Aid rules) most vulnerable to energy price hikes and to people fleeing Ukraine. Low/medium-debt Member States should specifically ensure that the growth of nationally-financed current expenditure is in line with an overall neutral policy stance, taking into account continued temporary and targeted support to households and firms (subject to State Aid rules) most vulnerable to energy price hikes and to people fleeing Ukraine. All Member States should expand public investment for the green and digital transitions and for energy security, including by making use of the RRF, other EU funds and REPowerEU.

Heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023. On 3 March 2021, the Commission concluded that the deactivation of the general escape clause of the Stability and Growth Pact should be conditional upon the state of the EU and euro area economy, recognising that it will take time for the economy to return to more normal conditions and that the decision on the deactivation or continued application of the general escape clause should be taken as an overall assessment of the state of the economy with the level of economic activity in the EU or euro area compared to pre-crisis levels as the key quantitative criterion.²² In the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances, the state of the EU and euro area economy has not returned to more normal conditions. Moreover, the decision on the continued application or deactivation of the general escape clause should also consider the need for fiscal policy to be able to respond appropriately to the economic repercussions of Russia's military aggression against Ukraine, including from energy supply disruptions. The continued activation of the general escape clause in 2023 will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability. The general escape clause does not suspend the Stability and Growth Pact. It allows for a temporary departure from the normal budgetary requirements provided that this does not endanger fiscal sustainability in the medium term. In autumn 2022, the Commission will re-assess the relevance of proposing to open excessive deficit procedures based on the outturn data for 2021. In spring 2023, the Commission will assess the relevance of proposing to open excessive deficit procedures based on the outturn data for 2022, in particular taking into account compliance with the fiscal country-specific recommendations addressed to the Member States by the Council. Based on the above considerations, and given the implications of heightened uncertainty and strong downside risks on the economic outlook for the EU and euro area as a whole, the Commission considers that the Union is not yet out of a period of severe economic downturn. On this basis, the conditions to maintain the general escape clause in 2023 and to deactivate it as of 2024 are met. The Commission invites the Council to endorse this conclusion to provide clarity to Member States. The Commission will provide orientations on possible changes to the economic governance framework after the summer break and well in time for 2023.

²² COM(2021) 105 final

Continuing to ensure public debt sustainability remains important for many Member States. Medium- and long-term fiscal sustainability challenges largely reflect the significant deterioration of structural budgetary positions, which added to existing pre-crisis debt vulnerabilities in several countries. The challenge of rising expenditure on pensions, health care and long-term care because of an ageing population needs to go hand in hand with ensuring adequacy of pension and other social benefits. Putting pension systems on a sustainable footing from both a fiscal and social perspective will require further reforms to lengthen careers and making labour markets more inclusive. Improving the fiscal sustainability of health care and long-term care requires improving their efficiency, while at the same time ensuring their adequacy and accessibility.

Concerted efforts should continue to step up the fight against aggressive tax planning and tax evasion²³. These together with shifting the tax burden away from labour and towards supporting the twin transition are policies that prevent distortions of competition, treat taxpayers fairly, safeguard public finances, and ensure sustainable and job-creating growth. Spillover effects of taxpayers' aggressive tax planning strategies among Member States call for coordinated action on national policies to complement EU legislation. Working hours by low-income and second earners are particularly responsive to changes in after-tax wages. On the contrary, certain other taxes, in particular recurrent property taxes and consumption taxes, are less distortive and would allow for a tax shift from labour, while taking into account the distributional impact. Moreover, environmental taxes reduce negative externalities such as pollution, thus helping to achieve the EU's environmental targets.

Box 1: Update on surveillance under the Stability and Growth Pact

As part of the spring 2022 European Semester package, the Commission has adopted a report under Article 126(3) TFEU for 18 Member States. These consist of Belgium, Bulgaria, Czechia, Germany, Greece, Spain, France, Italy, Latvia, Lithuania, Hungary, Malta, Estonia, Austria, Poland, Slovenia, Slovakia and Finland. For all these Member States except Finland, the report assesses their compliance with the deficit criterion. In the case of Lithuania, Estonia and Poland, the report was prepared due to a planned deficit in 2022 exceeding the 3% of GDP Treaty reference value, whereas the other Member States had a general government deficit in 2021 exceeding 3% of GDP. In addition, for Belgium, France, Italy, Hungary, Slovakia and Finland the report assesses compliance with the debt criterion in 2021 based on outturn data.

The Commission does not propose to open new excessive deficit procedures in spring 2022. The COVID-19 pandemic continues to have an extraordinary macroeconomic and fiscal impact that, together with the current geopolitical situation, create exceptional uncertainty, including for designing a detailed path for fiscal policy. On these grounds, the Commission considers that a decision on whether to place Member States under the excessive deficit procedure should not be

²³ In December 2021, the Commission presented a key initiative to stop the use of shell entities for tax purposes. The aim of the proposal ("UNSHELL") is to ensure that entities in the European Union that have no or minimal economic activity are unable to benefit from any tax advantages. In December 2021, the Commission also adopted a proposal for a Directive for the implementation of a global minimum level of taxation (Pillar 2) in the EU. The proposal sets out rules to ensure a minimum level of taxation for large multinational enterprises and large-scale domestic groups, thus contributing to both fair taxation and a sound business environment. Once the Directive is adopted by the Council, it will aim to put a floor on excessive tax competition between jurisdictions.

taken. As regards Member States with a debt ratio above the 60% of GDP reference value, the Commission considers, within its assessment of all relevant factors, that compliance with the debt reduction benchmark would imply a too demanding frontloaded fiscal effort that risks to jeopardise growth. Therefore, in the view of the Commission, compliance with the debt reduction benchmark is not warranted under the current exceptional economic conditions.

Romania is the only Member State under an excessive deficit procedure, based on the pre-pandemic developments. On 3 April 2020 the Council decided that an excessive deficit existed in Romania based on planned excessive deficit in 2019. In its latest recommendation of 18 June 2021, the Council asked Romania to put an end to the excessive deficit situation by 2024 at the latest. Romania's general government deficit in 2021 and the fiscal effort in 2021 are in line with those recommended by the Council. Therefore, the procedure is kept in abeyance.

The Commission will reassess Member States' budgetary situation in autumn 2022. The monitoring of debt and deficit developments will continue on the basis of the 2022 autumn Economic Forecast and the 2023 Draft Budgetary Plans to be submitted by euro area Member States by 15 October 2022. In autumn 2022, the Commission will reassess the relevance of proposing to open excessive deficit procedures.

With the recovery during 2021, macroeconomic imbalances have overall started to recede again. Economic growth, together with appropriate and ambitious policy action, is expected to further reduce macroeconomic vulnerabilities. In particular, a swift implementation of the RRP and of the REPowerEU plan will enhance potential growth, increase the resilience of the EU economies, and thereby help address vulnerabilities in the years ahead. In the context of the Macroeconomic Imbalances Procedure, the Commission has identified macroeconomic vulnerabilities related to imbalances and excessive imbalances in 10 out of the 12 Member States for which an in-depth review was carried out. Box 2 summarises the findings regarding macroeconomic imbalances in the Member States; Appendix 4 provides more details on them.

Box 2: Macroeconomic imbalances in the Member States

The Commission has assessed the existence of macroeconomic imbalances for the 12 Member States selected for in-depth reviews in the 2022 Alert Mechanism Report. All those Member States had been identified with imbalances or excessive imbalances in the last annual cycle of surveillance under the Macroeconomic Imbalances Procedure.

The assessment of macroeconomic vulnerabilities is marked by a strong economic recovery from the COVID-19 crisis in a context of rising uncertainty in face of the surging energy and commodity prices and other impacts from the Russian aggression of Ukraine. Private and public debt levels are easing as the economy rebounds from the crisis. Nonetheless, in many cases they remain above their pre-COVID-19 levels, reflecting the sharpness of the economic contraction in 2020, and the measures taken to support the economy. External rebalancing remains incomplete: the current accounts of large net-debtor countries with significant cross-border tourism sectors have improved, but remain below their pre-COVID-19 levels, while large current account surpluses in some Member States persist despite some temporary reduction during the pandemic. House prices are growing at their fastest pace in over a decade. The

banking sector weathered the pandemic crisis well, although some risks might emerge as moratoria on debt repayments have ended and temporary support measures are withdrawn.

Overall, vulnerabilities are receding and are falling below their pre-pandemic levels in various Member States; justifying a revision of the classification of imbalances in two cases.

The policy agenda embedded in the RRP, as well as past policy action support further adjustment and stronger fundamentals for the concerned economies, delivering prospects for a continued narrowing of vulnerabilities. Economic growth will support further adjustment but countries marked by low potential growth could face challenging dynamics. Inflationary pressures are rising and tighter financing conditions and exchange rate volatility may weigh on debt servicing. This is a particular risk where private or public debt is held in foreign currencies, and where refinancing needs are substantial.

- Ireland and Croatia are no longer experiencing imbalances. In Ireland, debt ratios have declined significantly over the years and continue to display strong downward dynamics. In Croatia, debt ratios have declined significantly over the years and continue to display strong downward dynamics.

- Greece, Italy, and Cyprus continue to experience excessive imbalances.

- Germany, Spain, France, the Netherlands, Portugal, Romania, and Sweden continue to experience imbalances.

Appendix 4 details the country-specific aspects for the 12 concerned Member States.

5. A JOINT EFFORT BETWEEN EU INSTITUTIONS, MEMBER STATES AND STAKEHOLDERS

The constructive dialogue with Member States as well as the strengthened inter-institutional dialogue at European level will continue throughout the European Semester process. The intense policy dialogue on the RRP allowed the Commission and Member States to strengthen and deepen their cooperation, which ensured broad ownership and is set to continue during the implementation phase of the plans. The resumption of country reports and CSRs offers a further opportunity to broaden the inter-institutional and bilateral dialogue building a common understanding of evolving challenges and policy priorities. A continuous exchange on social and economic developments in the European Union is ensured by the biannual Macroeconomic Dialogue at political and technical level between the Council, the Commission and representatives of the European social partners. The Commission will also continue its close dialogue with the European Parliament on key social and economic developments, and will continue to engage with the European Parliament before each key stage of the annual coordination cycle.

The successful implementation of the European Semester and the RRF rests on the systematic involvement of social partners and other stakeholders at both EU and national levels. The active involvement of stakeholders, through dedicated regular meetings is important throughout all the stages of the European Semester and the RRF implementation process. The Commission calls on all Member States to engage actively with their social partners, local and regional authorities and other stakeholders, notably representatives of civil society organisations, through regular exchanges, drawing on the successful application of the partnership principle in

cohesion policy programming and implementation. This helps to jointly identify challenges, improve policy solutions, and ensures broader ownership of the economic and social policy agenda, including the implementation of the CSRs. The Commission will make use of the existing fora under the European Semester to inform and involve social partners also on the implementation of the RRF. In the course of the year, the Commission will also adopt a Communication and a proposal for a Council Recommendation on strengthening the social dialogue at EU and national level.

6. CONCLUSION

Tackling continuous and newly emerging challenges will be crucial to ensure the resilience of European economies and societies and inclusive and sustainable growth. With the reintroduction of country reports and country-specific recommendations, the new cycle of the 2022 European Semester focuses on a sustainable and inclusive recovery based on the implementation of ambitious RRPs and the four dimensions of competitive sustainability as our compass for policy action, all in line with the UN Sustainable Development Goals. At the same time, Russia's invasion of Ukraine, and the impact on Member States' economies is a stark reminder of Europe's strategic challenges. The case for a rapid energy transition away from fossil fuels has never been stronger. Further decisive steps are needed towards fostering economic and social resilience, ensuring the EU's security of energy supply and reducing our dependencies on fossil fuels from Russia well before 2030.

Beyond continuing to implement the RRPs, Member States should take action to implement the 2022 CSRs, which reflect remaining and emerging challenges, taking into account the REPowerEU plan. This year's streamlined country reports identify those challenges that are only partially or not addressed by the RRPs along the four dimensions of competitive sustainability, including the additional reform and investment needs that can support the implementation of the REPowerEU plan. The assessment of outstanding and emerging challenges therefore provides the backing for the Commission's 2022 CSRs proposal. Once adopted by the Council, these recommendations will have a central role for the new and dedicated REPowerEU chapters in Member States' RRPs, in line with the relevant Guidance, and they provide an orientation about further measures needed in the context of the REPowerEU plan.

The Commission calls on the European Council to endorse and on the Council to adopt the Commission proposals for the 2022 CSRs. The Commission also calls on Member States to implement the recommendations fully and in a timely manner, in close dialogue with their social partners, civil society organisations and other stakeholders at all levels.

APPENDIX 1 – OVERVIEW OF THEMATIC AREAS COVERED IN CSRs

Broad Category	Green Transition				Digital transition, productivity and single market								Employment, social policies and fairness										Macroeconomic stability								Institutional resilience							
Policy areas	Renewable & energy infrastructure	Energy efficiency	Climate adaptation	Environment & resource management	Transport	Digital connectivity, infrastructure & market functioning	Digitalisation of business	Digitalisation of public administration	Business environment (incl.SME policies)	Single market, competition & state aid	State-owned enterprises	Public procurement & concessions	Research & Innovation	Labour market	Active labour market policies	Equal opportunities	Wages & wage setting	Skills, continuous VET & adult learning	Early childhood education & care	Education (General, initial VET & Higher education)	Pension systems and active ageing	Poverty, social inclusion & social protection	Regional development & local public services	Healthcare	Long-term care	Budgetary framework and fiscal governance	Tax Policy	Tax administration, tax evasion & avoidance	Financial services and financial stability	Access to finance & growth financing	Anti-money laundering	Housing	Private sector debt & insolvency framework	Public administration	Corruption	Quality of Law Making	Justice System	
AT																																						
BE																																						
BG																																						
CY																																						
CZ																																						
DE																																						
DK																																						
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NL																																						
PL																																						
PT																																						
RO																																						
SE																																						
SI																																						
SK																																						

 = policy area covered in the country-specific recommendations

APPENDIX 2 - PROGRESS IN THE IMPLEMENTATION OF THE COUNTRY-SPECIFIC RECOMMENDATIONS

The 2022 European Semester cycle takes stock of the Member States' policy action taken to address structural challenges identified in the country specific-recommendations (CSR) adopted since 2019. Following the establishment of the Recovery and Resilience Facility (RRF) as a central tool to deliver EU and national policy priorities, the 2022 CSR assessment takes into account the policy action taken by the Member States to date ⁽²⁴⁾, as well as the commitments undertaken in the recovery and resilience plans (RRP), depending on their degree of implementation. Therefore, the assessment reflects the current early stages of implementation of RRP only, rather than the level of progress that could be achieved assuming a full implementation of the plans ⁽²⁵⁾. In line with the scope of the RRF, the 2022 CSR assessment focuses on the 2019-2020 CSRs (multiannual assessment). The assessment also includes the assessment of 2021 CSRs which only relate to fiscal policy (annual assessment).

Figure 1: Current level of implementation of 2019-2020 CSRs

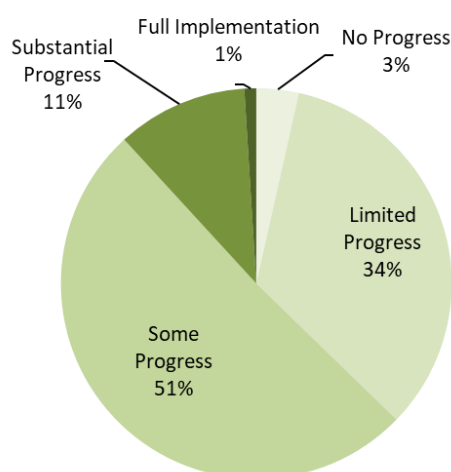
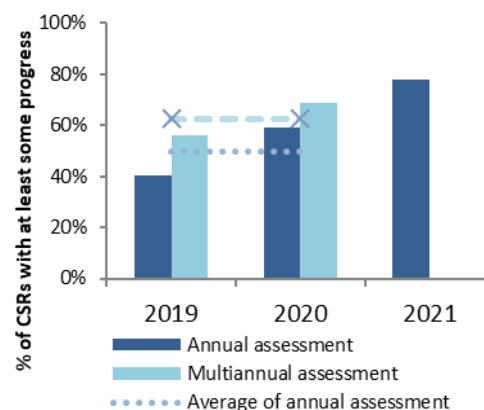


Figure 2: Implementation of 2019-2021 CSRs: annual assessment in each consecutive year versus implementation to date



Note: The multiannual assessment looks at implementation of 2019-2020 CSRs from the time the recommendations were first adopted until publication of this Communication. The 2021 CSRs only relate to fiscal policy.

²⁴ Including policy action reported in the National Reform Programmes, as well as in the RRF reporting (bi-annual reporting on progress with the implementation of milestones and targets and resulting from the payment request assessment), with the exception of Member States which, by the cut-off date of this Communication, have not yet submitted a recovery and resilience plan or whose plan has not been approved (Hungary, Poland, the Netherlands).

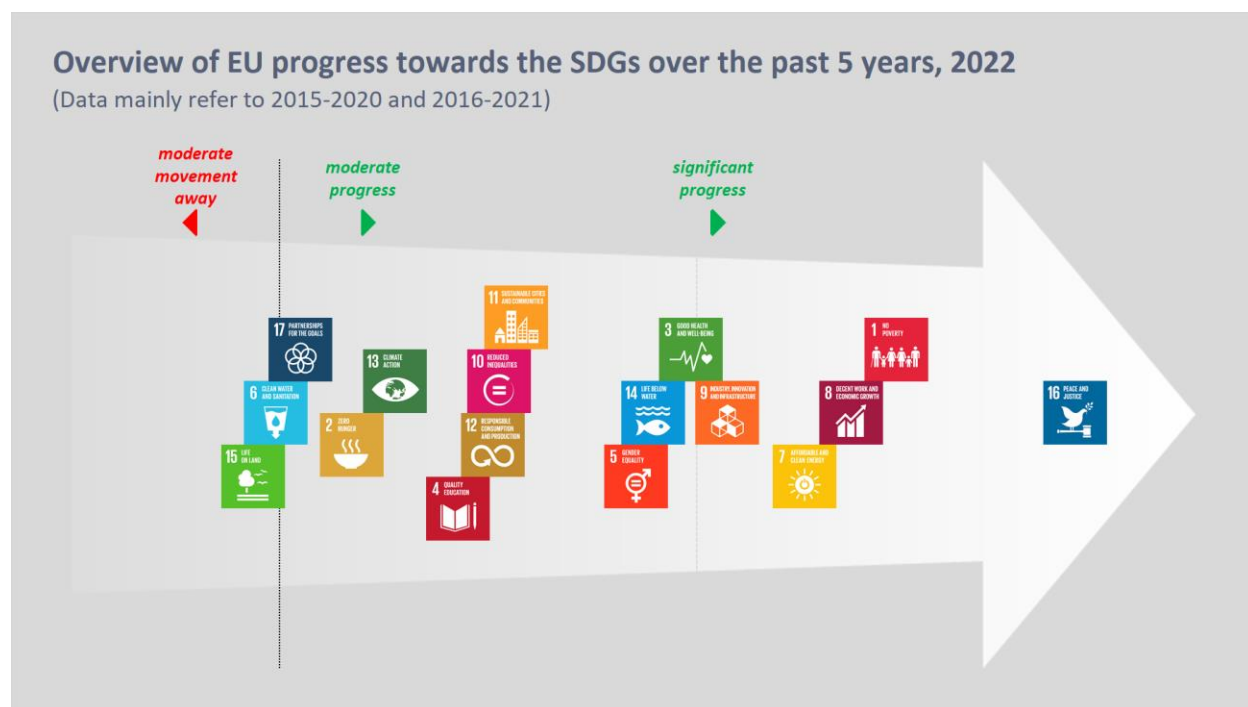
²⁵ Member States were asked to effectively address in their RRP all or a significant subset of the relevant country-specific recommendations. For the RRP adopted by the cut-off date of this Communication, relevant CSRs are those adopted by the Council in 2019 and 2020. The CSR assessment presented here takes into account the degree of implementation of the measures included in the RRP and of those done outside of the RRP at the time of assessment. Measures foreseen in the annexes of the adopted Council Implementing Decisions on the approval of the assessment of the RRP which are not yet adopted nor implemented but considered as credibly announced, in line with the CSR assessment methodology, warrant "limited progress". Once implemented, these measures can lead to "some/substantial progress" or "full implementation", depending on their relevance.

From a multiannual perspective, at least some progress has been achieved with the implementation of 63% of the 2019-2020 country-specific recommendations (see Figure 1). Compared to last year's assessment, sizeable additional progress has been achieved regarding both 2019 CSRs of a structural nature and more crisis-oriented 2020 CSRs. However, reform implementation differs significantly across policy areas. In particular, Member States have made most progress over the recent years in access to finance and financial services, followed by anti-money laundering and business environment. On the other hand, progress has been particularly slow on pension systems, single market, competition and state aid, and housing.

Progress with the implementation of the recommendations adopted in 2021 has been sizeable. Member States have made at least “some progress” in almost 80% of the recommendations addressed to them in July 2021, which had only been issues with regard to fiscal policies (Figure 2).

The results of the 2022 CSR assessment, together with those of past years, will be available in June on the Commission website.

APPENDIX 3 – EU-WIDE PROGRESS ON SDG IMPLEMENTATION



Note: The figure above shows the pace at which the EU has progressed towards each of the 17 goals over the most recent five-year period according to the selected indicators. The method for assessing indicator trends and aggregating them at the goal-level, as well as more detailed analyses are available on the Eurostat website: [Overview - Sustainable development indicators - Eurostat \(europa.eu\)](https://ec.europa.eu/eurostat/tgm/table.do?tab=main&init=1&language=en&code=sdg-overview).

As in previous years, the EU has made the strongest progress towards fostering peace and personal security within its territory and improving access to justice and trust in institutions (SDG 16) in the observed period (overt the past five years and up to 2021). Significant improvements were also achieved on economic growth and the labour market (SDG 8), which rebounded in 2021 after the onset of the COVID-19 pandemic, and on innovation and infrastructure (SDG 9). Progress towards reducing poverty and social exclusion (SDG 1) has also been significant but available data partly refer to the period up to 2019 only, and therefore do not fully reflect the impacts of the COVID-19 pandemic. Progress was also made on clean and affordable energy (SDG 7) but this development was strongly affected by the 2020 remarkable reduction in energy consumption, as a result of COVID-19 related restrictions on public life and ensuing lower economic activity. Figures also do not yet cater for latest energy developments related to the Russian invasion of Ukraine.

The EU has also achieved good progress towards the goals on health and well-being (SDG 3), life below water (SDG 14) and gender equality (SDG 5). Less progress was made towards sustainable cities (SDG 11), reduced inequalities (SDG 10), responsible consumption and production (SDG 12), quality education (SDG 4), climate action (SDG 13) and zero hunger and sustainable agriculture (SDG 2). On clean water and sanitation (SDG 6) and global partnerships for the goals and governance (SDG 17), over the latest years for which data is available, the EU has been on a neutral path, showing a combination of almost equal sustainable and unsustainable developments. On the contrary, there was a slight backtrack on life on land (SDG 15), which reflects the fact that ecosystems and biodiversity remain under pressure from human activities.

APPENDIX 4 - FINDINGS OF IN-DEPTH REVIEWS OF MACROECONOMIC IMBALANCES IN EU COUNTRIES

Imbalances or excessive imbalances have been identified in 10 out of the 12 Member States for which an in-depth review was carried out. The in-depth review (IDR) analysis looks at the gravity of the imbalances, their recent and prospective evolution and related policy responses. Relevant spillovers and the systemic cross-border implications of imbalances are also taken into account.

After sharp increases in 2020, private and government debt ratios are resuming their path of gradual reduction in most cases. The increases in private sector and government indebtedness that were driven by the sharp drop in GDP and the needed measures to cushion the fallout of the COVID-19 pandemic were on the whole limited to 2020. Indebtedness levels are now easing as the economy rebounds. However, the reductions have so far been limited in size and debts remain substantially above their pre-COVID-19 crisis levels in some cases. Reductions in government debt ratios have been particularly small and reflect the important support that fiscal policies continued to deliver to the economy in 2021. Private debt developments have been more varied across Member States, with some visible declines.

Going forward, economic growth spurred by a swift implementation of the Recovery and Resilience Plans will support further deleveraging but risks are present. The uncertainty surrounding the economic outlook is elevated, in particular due to Russia's invasion of Ukraine. Inflationary pressures are rising and tighter financing conditions and exchange rate volatility may weigh on debt servicing by corporations, households and governments. This is a particular risk where debt is denominated in foreign currencies, where interest rates are variable and where financing needs are higher. At the same time, higher inflation eases debt-to-GDP ratios via denominator effects. Structural shifts and labour shortages can result in wage acceleration, which may raise competitiveness concerns. A swift implementation of the Recovery and Resilience Plans (RRPs) and the REPowerEU plan will enhance potential growth and increase the resilience of the EU economies. This is of particular importance for countries marked by low potential growth as it can help address their vulnerabilities in the years ahead, including those relating to high indebtedness.

External positions are improving again. The current accounts of large net-debtor countries with significant cross-border tourism sectors have started to improve but remain below their pre-crisis levels. The expected continuation of the recovery of international travel should support further strengthening, but there are risks of disruptions from Russia's invasion of Ukraine. Large current account surpluses in some Member States persist, with marginal changes, due to the excess of savings over investment, while higher energy import prices are expected to reduce the current accounts of nearly all Member States. Most of the large negative net international investment positions started to improve in 2021 supported by GDP growth and improved current accounts, and are expected to improve further this year and next. The inflow of Recovery and Resilience Facility (RRF) funds will support the external position in a number of cases over the coming years.

House prices have continued growing strongly, with buoyant demand meeting constrained supply. Real house prices have further accelerated in most Member States in 2021, in some cases recording their fastest growth in a decade. Supply constraints that were already present

before the pandemic can be expected to persist over the coming years. Expectations of tightening financing conditions in recent months may have resulted in some frontloading of purchase decisions, further fuelling price increases. Where price increases have occurred alongside high – and rising – household indebtedness, households and lenders may display increased vulnerability to downward corrections of house prices.

The banking sector weathered the pandemic crisis well and is showing increased strength, benefitting from past reforms. Member States with high legacy non-performing loans continued to reduce them, sometimes substantially so. Nonetheless, non-performing loans could still increase as the full impact of the end of moratoria on debt repayments and the withdrawal of temporary support measures related to the COVID-19 pandemic becomes visible. Finally, a worsening of the economic outlook can also raise issues for banks' balance sheets, while higher interest rates should help banks' profit margins. In Member States with a strong banks-government nexus, increased financing costs for the sovereign may also pose a risk for banks.

Table 1: FINDINGS FROM IN-DEPTH-REVIEWS BY MEMBER STATE

	Outcome of the 2021 IDRs	Outcome of the 2022 IDRs
No imbalances	-	HR, IE
Imbalances	DE, ES, FR, HR, IE, NL, PT, RO, SE	DE, ES, FR, NL, PT, RO, SE
Excessive imbalances	CY, EL, IT	CY, EL, IT

Member States no longer experiencing imbalances

Croatia, identified with imbalances in 2021, is found to experience no imbalances. Important progress has been made in reducing private indebtedness and net external liabilities. General government debt remains high but has resumed the downward trajectory that delivered marked improvements before the pandemic. The banking sector remains stable and liquid, with a decreasing non-performing loans ratio. Potential output growth has increased, building on strong policy action, and a further strengthening based on a strong implementation of the RRP can address remaining vulnerabilities.²⁶ On current forecasts, both private and government indebtedness are expected to continue falling with the external position strengthening further benefiting also from the RRF funds.

Ireland, identified with imbalances in 2021, is found to experience no imbalances. Important progress has been made in reducing government and private indebtedness as well as net external liabilities, both before and since the pandemic. The reductions of the debt ratios remain significant, albeit smaller, when national output is adjusted for the effects of the operations of multinational enterprises registered in Ireland. Both private and government indebtedness are

²⁶ The commitments of Croatia in the context of the ERM II participation will be assessed by the Commission and the ECB in their respective areas of competence in due course.

expected to continue falling, with the external position strengthening further. Irish banks continued reducing their non-performing loans ratio. High house price growth continues to be a challenge for housing affordability, but risks to macroeconomic stability appear contained so far. While its direct impact might be limited due to its comparatively small size, the RRP has the potential to help strengthen the fundamentals of the economy further.

Member States experiencing imbalances

France is experiencing imbalances. Vulnerabilities relate to high government debt and weak competitiveness, which have cross-border relevance, in a context of low productivity growth. The COVID-19 crisis brought about a sizeable increase in the already high government debt, but with the economic recovery, the government debt-to-GDP ratio edged down in 2021 and is forecast to keep falling this year and next, while remaining well above its pre-pandemic level. Private indebtedness has kept growing in recent years and is exceeding prudential levels, although risks relating to increased corporate indebtedness are somewhat mitigated by a parallel build-up of liquidity buffers. Underlying productivity dynamics have remained stable over time. Exports market shares, which had broadly stabilised in earlier years, decreased sharply during the pandemic with key export sectors being severely hit but a sizeable recovery is projected for 2022 and 2023. Cost competitiveness, as well as productivity, are set to benefit from recent and upcoming reforms, including a continued strong implementation of the RRP.

Germany is experiencing imbalances. Vulnerabilities relate to a persistent large current account surplus, which reflects subdued investment relative to savings, and has cross-border relevance. The current account surplus declined only slowly until 2020, and increased in 2021. It remains well beyond the levels suggested by the country's fundamentals, reflecting consumption restraint and persistently subdued investment. Corporate investment has remained below the pre-pandemic level and corporations have continued to post strong net savings. Residential investment has gradually increased from a low level but supply still falls short of housing demand. Existing barriers, including administrative ones, constrain public and private investment. The current account surplus is likely to remain elevated even if expected to decline somewhat in 2022 on account of higher commodity prices. Recent announcements to promote investment are promising and the RRP is geared towards addressing investment bottlenecks. Still, further resources and efforts to tackle investment bottlenecks as well as thorough implementation are key for promoting investment further.

The Netherlands is experiencing imbalances. Vulnerabilities relate to high private debt and a large current account surplus, which carry cross-border relevance. From a sector perspective, high savings and low domestic investment of non-financial corporations are the main structural drivers of the high and persistent current account surplus, which is well beyond the levels suggested by the country's fundamentals and increased further in 2021. Part of the external surplus and its recent dynamics are linked to operations of some large multinational corporations. Going forward, the surplus will likely remain high as its main drivers remain in place. Private sector debt remains high on account of both high household debt and corporate debt, the latter partly on account of intra-group cross-border debt of multinationals. High household debt makes households more vulnerable to shocks, given that strong house price increases have contributed to rising debt and house prices appear to be overvalued. Household debt is expected to remain elevated in light of continued house price growth and of distortions in the housing market that

favour debt-financed home ownership in combination with a shortfall in housing supply. Limited policy steps have been taken but more needs to be done.

Portugal is experiencing imbalances. Vulnerabilities relate to high private, government and external debt in a context of low productivity growth. Non-performing loans have fallen considerably from high levels. After a temporary reversal in 2020 due to the COVID-19 crisis, those vulnerabilities resumed their downward trajectory in 2021. The current account balance turned negative in 2020 and 2021, mainly due to the pandemic-driven shock in the tourism sector, while the net international investment position improved considerably already in 2021, even beyond its pre-pandemic level. The private sector and government debt-to-GDP ratios resumed their downward trends in 2021 but remain above pre-pandemic levels and the former is still exceeding prudential levels. Going forward, private, government and external debts are expected to continue narrowing on the back of economic growth. The external position will also directly benefit from the RRF funds. Policy progress has been made to address imbalances and a successful implementation of the RRP can help in further narrowing them, but policy challenges remain.

Romania is experiencing imbalances. Vulnerabilities relate to external accounts, linked to large fiscal deficits, and to competitiveness issues that are re-emerging. The high current account deficit further worsened in 2021 and is not forecast to improve this year or next. Large fiscal deficits pre-date the COVID-19 crisis and have driven up the current account deficit which poses risks to external debt sustainability. Sovereign borrowing costs have increased since early 2021. The expected acceleration in wages could weigh further on cost competitiveness. Nominal depreciation could mitigate competitiveness losses but add to inflationary pressures and increase the burden of serving debts in foreign currencies, which are significant for the government and the private sector. The negative net international investment position is expected to remain below its pre-pandemic levels. The external position is expected to benefit from significant RRF funds but external financing can otherwise become more challenging amid tighter global financial conditions. Recent policy initiatives, including the successful implementation of Romania's RRP, can address some vulnerabilities, still further action is needed to improve competitiveness and potential growth.

Spain is experiencing imbalances. Vulnerabilities relate to high external, government and private debt, in a context of high unemployment, and have cross-border relevance. In 2021, debt-to-GDP ratios resumed their declining trends observed before the pandemic and are forecast to fall further this year and next. The current account records a small surplus and the net international investment position has reached its best reading since the mid-2000s. Yet private debt remains higher than before the COVID-19 crisis, still exceeding prudential levels, while the high government debt-to-GDP ratio remains well above its pre-pandemic level. Non-performing loans continued to decrease, but some risks remain especially in energy-intensive sectors and those that were previously hit hard by the COVID-19 crisis. Unemployment started to decrease again in 2021, but labour market segmentation and youth unemployment remain high, although past and recent labour market reforms and the continued implementation of the RRP will help address Spain's remaining vulnerabilities.

Sweden is experiencing imbalances. Vulnerabilities relate to high and rising house prices and high household indebtedness. In 2021, house prices moved further away from fundamental values with supportive financial conditions continuing to fuel housing demand. High household

debt exposes Sweden to the risk of adverse shocks and a disorderly correction of housing prices, with potential harmful implications for the real economy and the banking sector. Private debt has risen further, a large share of which is concentrated in real estate, both commercial and housing, and most of household mortgage debt is at variable interest rates. Policy measures have not sufficiently addressed vulnerabilities relating to housing debt and potential house price overvaluations. Tax incentives for debt-financed housing remain, along with shortages in supply and identified shortcomings in the functioning of the rental market. Measures in the RRP only address the vulnerabilities in a partially satisfactory manner.

Member States experiencing excessive imbalances

Cyprus is experiencing excessive imbalances. Vulnerabilities relate to high government and private debt, large current account deficits and a still high stock of non-performing loans. The government and private debt-to-GDP ratios declined again thanks to a strong economic rebound in 2021. Non-performing loans of the banking sector declined substantially thanks to large sales of such loans to credit acquiring companies but remain high. The current account deficit is large despite an improvement in 2021, and moreover is projected to widen in 2022 and only slowly narrow thereafter, thereby not ensuring a prudent net international investment position over the medium term. Government and private debt-to-GDP ratios are expected to further improve, in part on the back of economic growth. However, the economic outlook for 2022 is surrounded by heightened uncertainty related to the impact of Russia's invasion of Ukraine in view of particularly sizeable trade of services exposures. If implemented timely and effectively, the RRP has the potential to contribute to a significant reduction of vulnerabilities, but additional policy action is warranted.

Greece is experiencing excessive imbalances. Vulnerabilities relate to high government debt, incomplete external rebalancing and high non-performing loans in a context of low potential growth and high unemployment. The government debt-to-GDP ratio resumed its decline, which is projected to continue thanks to improving budgetary outcomes and economic growth. The current account deficit still reflects the incomplete recovery from the sharp fall in foreign tourism in 2020 and is expected to remain clearly negative this year and next. The net international investment position remains also largely negative, to a substantial extent reflecting government debt mostly held by official sector creditors. It may however improve expressed as a share of GDP thanks to economic growth and inflows of significant RRF funds. Despite substantial progress, the share of non-performing loans remains high and hampers banks' ability to provide credit to firms and households. Relevant measures have been taken to facilitate economic adjustment and the unwinding of vulnerabilities. The successful implementation of the RRP represents a major opportunity to address vulnerabilities and enhance potential growth.

Italy is experiencing excessive imbalances. Vulnerabilities relate to high government debt and weak productivity growth, in a context of labour market fragilities and some weaknesses in financial markets, which carry cross-border relevance. Persistent low productivity growth has been a key factor behind Italy's protracted weak GDP growth, which has dampened government debt deleveraging, dented employment opportunities and impacted banks' balance sheets. The government debt-to-GDP ratio started to decline in 2021 and is forecast to further decline but remains a risk for fiscal sustainability, the financial sector and economic growth. Despite improvements in the labour market, low participation rates persist. Significant improvements have been achieved in reducing non-performing loans, although the sovereign-bank nexus

reinforced over the COVID-19 crisis and remains a challenge. In addition, the banking sector may face challenges as the impact of the phasing-out of temporary support measures in response to the pandemic crisis fully unfolds. The RRP is addressing vulnerabilities, including by spurring competitiveness and productivity. Nonetheless, the growth-enhancing effect of investment and reforms is likely to take time to unfold and crucially depends on swift and sound implementation.