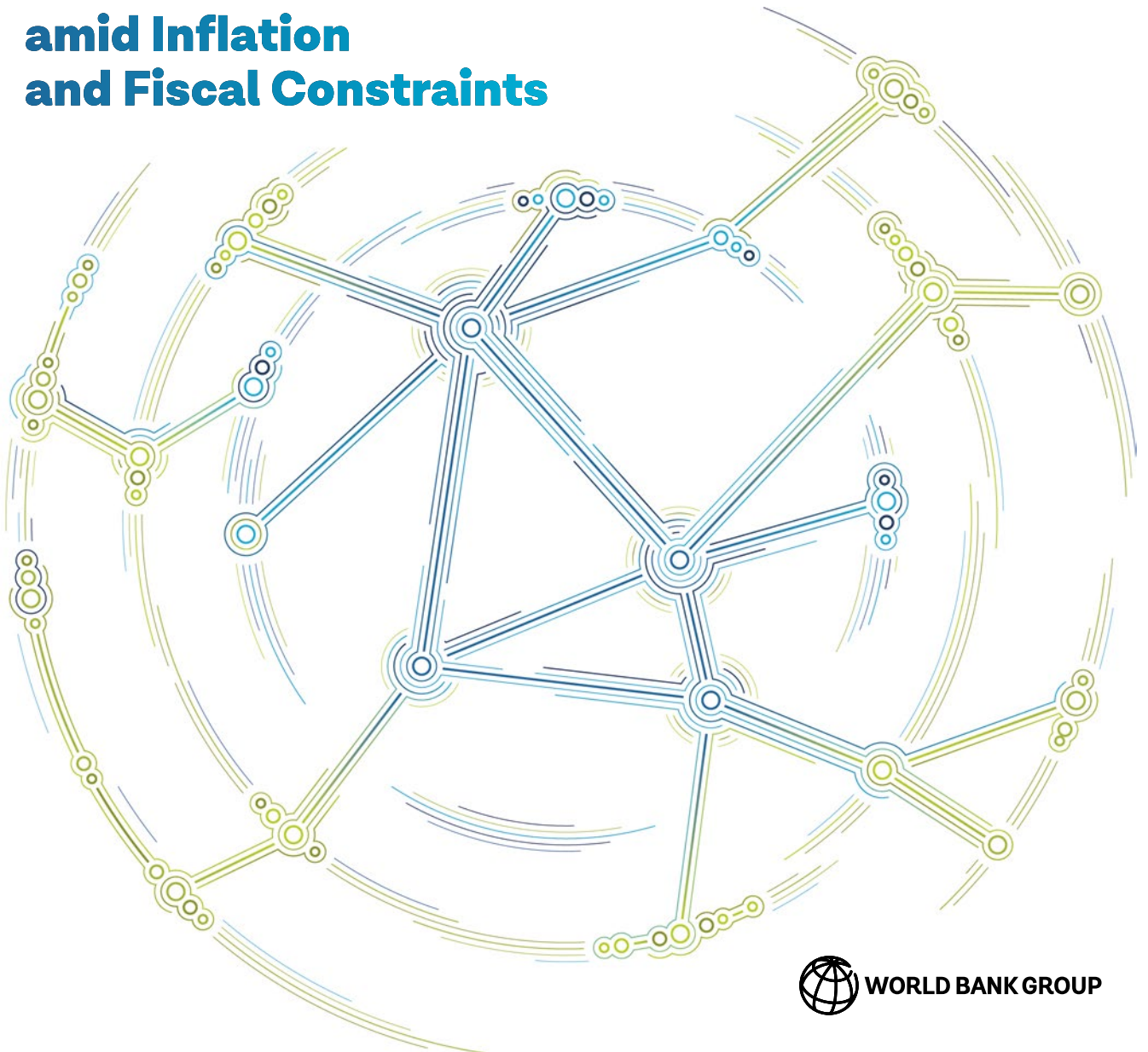**EU REGULAR ECONOMIC REPORT 10**

PART 1

# A Path to Inclusive Growth in the EU

## amid Inflation and Fiscal Constraints

WORLD BANK GROUP

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The data presented in this report
is as of November 1, 2024.

**WORLD BANK GROUP**

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# Abbreviations

| | | | |
|---|---|---|---|
| **EA** | Euro Area | **ICT** | Information and communication technologies |
| **ECB** | European Central Bank | **IRA** | Inflation Reduction Act |
| **ESI** | Economic Sentiment Indicator | **OIS** | Overnight Index Swap |
| **EU** | European Union | **PMI** | Purchasing Managers' Index |
| **FDI** | Foreign Direct Investment | **REER** | Real effective exchange rate |
| **FDP** | Forcibly Displaced Persons | **RER** | Regular Economic Report |
| **GDP** | Gross Domestic Product | **RFF** | EU Recovery and Resilience Facility |
| **GFC** | Global Financial Crisis | **SOE** | State Owned Enterprises |
| **GVCs** | Global Value Chains | **TFP** | Total Factor Productivity |
| **HICP** | Harmonized Index of Consumer Prices | | |

# Regional Groupings

**Central and Southeast Europe (CEE):**
Bulgaria (BG), Croatia (HR), Czech Republic (CZ), Hungary (HU), Poland (PL), Romania (RO), Slovak Republic (SK), Slovenia (SI)

**Northern Europe (NE):**
Denmark (DK), Estonia (EE), Finland (FI), Latvia (LV), Lithuania (LT), Sweden (SE)

**Southern Europe (SE):**
Cyprus (CY), Greece (EL), Italy (IT), Malta (MT), Portugal (PT), Spain (ES)

**Western Europe (WE):**
Austria (AT), Belgium (BE), France (FR), Germany (DE), Ireland (IE), Luxembourg (LU), Netherlands (NL)

# Executive Summary

Following an unprecedented tightening cycle that avoided both deep recession and widespread job losses, the EU economy seems poised for a "soft landing," with inflation edging closer to target. Growth in the EU slowed as expected in 2023, averaging a modest 0.4 percent amid an unprecedented decline in trade. Employment now shows tentative signs of recovery in 2024, but with key divergences across sectors, regions, and socioeconomic groups of the EU (Figure ES.1, panel a). Trade volumes contracted last year, marking the first such decline outside of an annual growth downturn, in part reflecting a slowdown in export growth amid a loss of export competitiveness due to elevated energy prices. Over the course of 2024, headline inflation (HICP) in the EU has continued its gradual deceleration, recording 2.8 percent year-on-year (y/y) growth in July, down from an average of 6.4 percent in 2023. Falling inflation, coupled with slow but still positive nominal wage growth, has reversed the real wage decline, bolstering consumer purchasing power. Yet risks remain, as the effects of monetary tightening may not have fully filtered through to households and businesses.

Despite easing inflation, historically high prices continue to strain Europe's poorest, many of whom are still recovering from the COVID-19 crisis. This ongoing pressure, coupled with tighter fiscal space, may limit support for vulnerable groups moving forward. By September 2024, consumer prices in Bulgaria, Croatia, Poland, and Romania had surged more than 24 percent since September 2021, driven largely by a staggering more than 35 percent rise in food prices. This escalation has eroded real wages, exacerbating poverty and food insecurity in the region. The burden has fallen disproportionally on the poor, who spend a larger share of their income on food. In Romania and Poland, the poorest decile of the population allocates as much as 51 percent and 38 percent of their expenditure to food, respectively, leaving them particularly vulnerable to price hikes. The disparity in spending patterns highlights the regressive impact of food price inflation, which poses a significant threat to the welfare of low-income households across the bloc.

Employment remains a cornerstone of poverty alleviation, yet many groups — particularly the less skilled and blue-collar workers — are struggling to recover from multiple recent shocks. Job growth and rising labor incomes, particularly for those at the lower end of the income distribution, contributed to approximately 44 percent of the total poverty reduction observed between 2016 and 2022. However, progress remains uneven. Less educated and blue-collar workers have yet to see their incomes recover from recent economic shocks (Figure ES.1, panel c). While labor markets across the EU have shown resilience, with overall employment rebounding, certain sectors and demographics continue to struggle. The disparities in employment recovery underscore the need for targeted policies to support the most vulnerable groups and ensure broader economic inclusion.

Across the four Central and Eastern European economies (4CEEs) analyzed more closely in this report — Bulgaria, Croatia, Poland, and Romania — the cost-of-living crisis and shifting employment patterns have compounded the burden on households in the bottom 40 percent of the income distribution (B40). Since 2019, employment in industries such as mining, quarrying, manufacturing, and agriculture — where many lower-income individuals work — has steadily declined, narrowing job opportunities for those with limited education or sector-skills specifically aligned with these sectors. Meanwhile, rising food prices are expected to worsen poverty and income inequality, particularly in rural areas. Simulations suggest that a 20 percent rise in food prices could temporarily increase the Gini index in Bulgaria and Croatia by 0.75 and 0.34 points, respectively, and short-term increases in poverty rates (Figure ES.1, panel d). The regressive impact of food inflation is stark: the poorest decile could see welfare reductions

of up to 10.3 percent, compared to just 2.6 percent for the richest. Combined with sectoral job losses, these pressures underscore the urgency of policies to mitigate inflationary shocks while creating better employment opportunities for vulnerable workers.

**Fiscal consolidation in the EU, after stalling in 2023 and 2024, is poised to gain momentum under the bloc's revamped Economic Governance Framework (EGF).** However, striking a balance between fiscal sustainability and inclusive growth remains a challenge, particularly against a backdrop of geopolitical and social pressures that continue to weigh on governments — many of which faced multi-level elections in 2024. The reactivation of the Excessive Deficit Procedure alongside the EGF is expected to test policymakers' ability to navigate fiscal consolidation pressures without depressing already-weak growth. While the new framework emphasizes investment and growth, meeting fiscal consolidation targets will require tangible measures on both expenditure and revenue fronts. Multiple pressures persist on the expenditure side, driven by rising defense spending, climate change impacts, and the green transition. Part 2 of this report explores the opportunities and policy challenges for the 4CEEs as they seek to navigate the shifting EU policy landscape and tap into trade opportunities arising from the green transition.

**FIGURE ES.1  Recent developments in the EU**

a. Growth in EU subregions
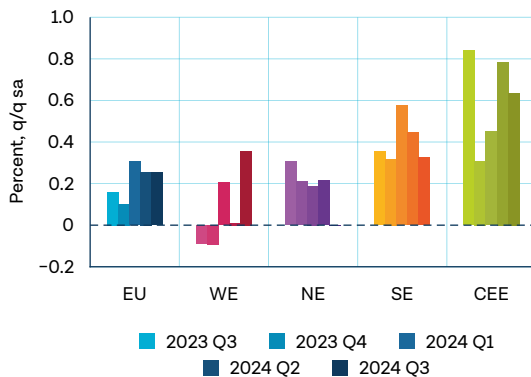
b. European Central Bank (ECB) policy rate change
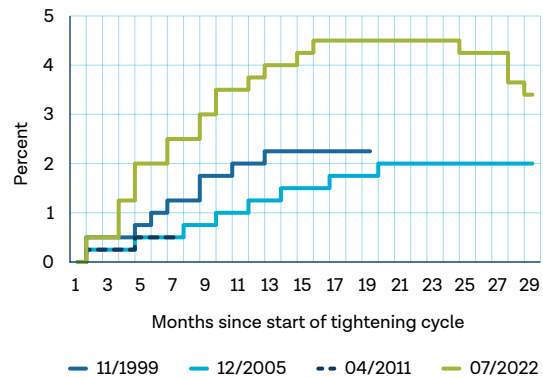
c. Employment growth index (2019Q3=100) by education level, EU27
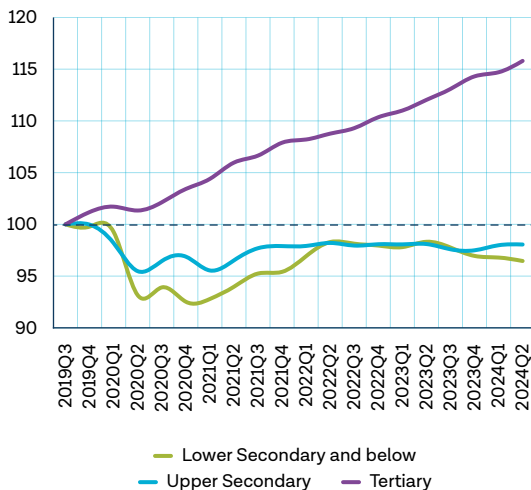
d. Simulated poverty rates, pre-shock vs post-shock food inflation scenarios, $6.85 poverty line (2017 PPP)
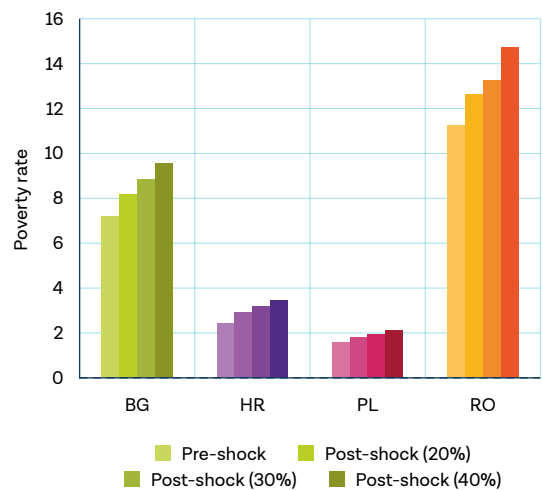
Chapter 1

# Recent Macroeconomic Developments

# After a sharp slowdown in 2023, the EU economy has shown signs of improvement in 2024

**Growth in the EU decelerated as expected in 2023, accompanied by an unprecedented decline in trade.** In line with previous World Bank projections,[1] overall GDP growth in the EU slowed down to 0.4 percent in 2023, reflecting tight credit conditions, dwindling exports, and elevated energy prices. Economic performance was especially weak in some large EU member states, such as Germany, with negative spillovers on bloc-wide activity. Trade volumes declined in 2023 for the first time outside of a year of economic recession, in part reflecting a slowdown in export growth amid a loss of export competitiveness due to elevated energy prices. However, as imports declined — especially for energy — the impact of net exports on growth remained positive. On the domestic demand side, private consumption growth slowed sharply amid still-high inflation, and investment weakened against a background of subdued business confidence and tight financial conditions.

**Growth appears to have bottomed out, with activity levels showing signs of firming in 2024, but with key differences across sectors.** After some weakness in 2023, services activity indicators suggest improvement in the first half of 2024, with activity supported by relatively robust labor markets. The Purchasing Managers' Index (PMI) for services suggests continued sectoral strength in the near term, with the Paris Olympics likely providing a temporary boost in the third quarter. However, this improvement has been somewhat offset by weaker-than-expected industrial activity, especially in manufacturing, as reflected in the sector's PMI. Goods trade in the first half of 2024 was also disappointing, with the contraction (in year-on-year terms) that started in September 2022 continuing into 2024, and forward-looking indicators pointing to sustained weakness.

**FIGURE 1.1** Contributions to EU Growth

a. By country grouping

b. By expenditure component
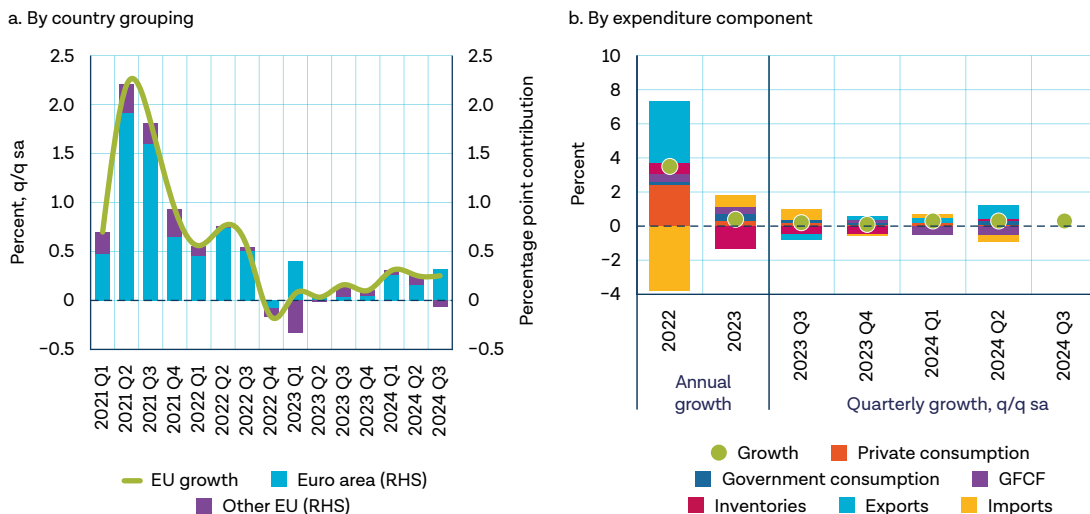


*Source:* Eurostat. Note: Quarterly growth seasonally and working day adjusted.

**Over the first three quarters of 2024, the strength of the recovery was uneven across EU member states.** Although most EU economies experienced growth in the first three quarters of 2024, its pace was subdued and its volatility higher in Northern Europe (NE) and Western Europe (WE) (Figure 1.2), owing in

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1   World Bank 2023a; World Bank 2024a.

part to the earlier loss in export competitiveness due to the energy price shock. In contrast, Central and Eastern European and Southern European countries experienced the most robust recovery, driven by strong domestic demand and enhanced investment due to the positive impact of the Recovery and Resilience Facility (RRF). Growth in Central and Eastern Europe has also been significantly higher than the EU average. This suggests a revitalized convergence, with countries such as Romania, Poland, and Croatia exhibiting higher growth potential than their longer-tenured EU counterparts.

**FIGURE 1.2** **Growth is rebounding in the EU, albeit unevenly**

a. Percent of economies expanding in q/q terms in EU subregions
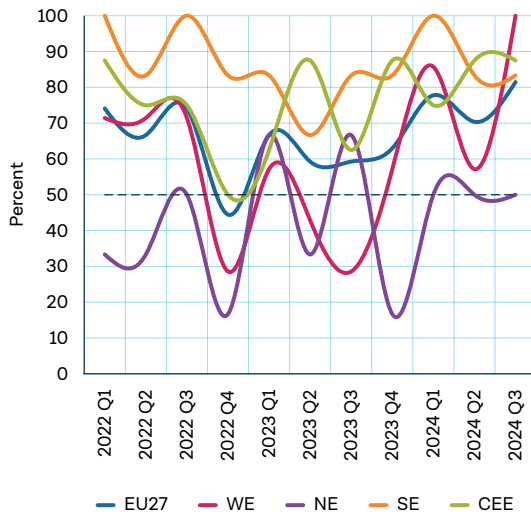
b. Growth in EU subregions
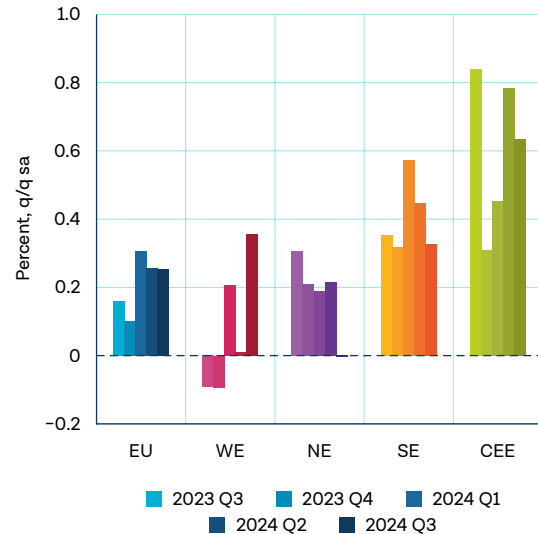


*Source:* Eurostat and WB calculations

*Note:* Panel b shows GDP-weighted growth. World Bank Q3 growth estimates for Belgium, Greece, Croatia, Cyprus, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, Finland. Oxford Economics Q3 growth estimates for Denmark, Bulgaria, Poland, and Romania.

**While indicators of business and consumer confidence in the EU have seen an uptick, as growth revived in early 2024 and inflation rates decline, they remain below long-term averages.** Consumer confidence is on an upward trend, but spending remains tempered due to persistently high real interest rates and diminished purchasing power caused by inflation. This prudence is evident in the rising trend of savings intentions, indicating households' desire to rebuild their financial safety nets. Business confidence has seen a modest uptick, but to a lesser degree than consumer confidence, with persisting sectoral disparities. The PMIs for construction and industry have remained below the 50 mark since mid-2022. Softer demand for durable goods is impacting essential manufacturing sectors such as machinery and equipment. Although demand for residential housing is weakening, infrastructure projects, supported by the Recovery and Resilience Facility, are providing support to the construction sector.

## After a historic tightening cycle, inflation is inching toward target

Over the course of 2024 headline inflation (HICP) in the EU has continued its gradual deceleration, standing at 2.1 percent y/y in September versus an average of 6.4 percent in 2023 (Figure 1.3). This decline stems from dissipating energy and food shocks, tight monetary policy, and fading supply-chain pressures. EU headline inflation is projected to decline further over 2025, although core inflation is set to

**FIGURE 1.3  EU headline inflation rate, broken down by contributors**
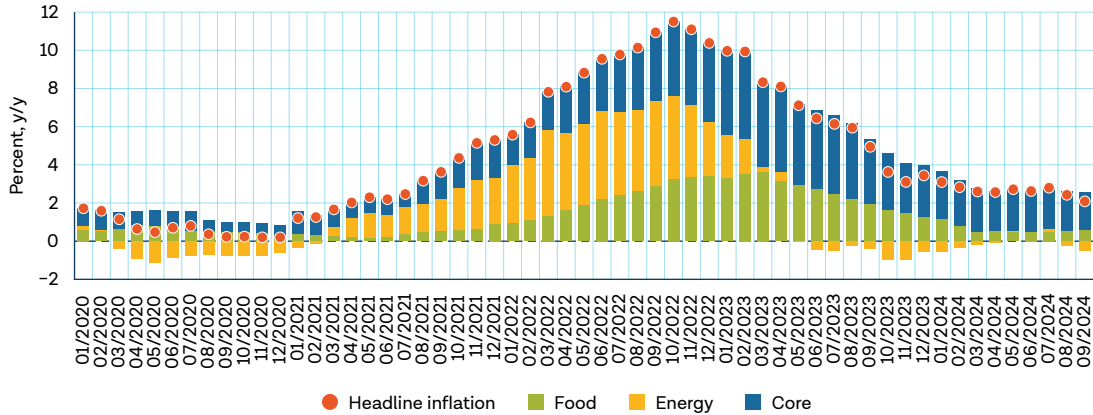


*Source:* Eurostat and WB staff calculations.

remain somewhat elevated, owing to catch-up wage growth and robust demand for services in the context of a tight labor market — with the unemployment rate standing at a historic low of 6 percent of the labor force. Nevertheless, inflation remains elevated in certain regions, particularly in CEE (Figure 1.4).

**FIGURE 1.4  EU inflation by region**

a. EU headline inflation by region
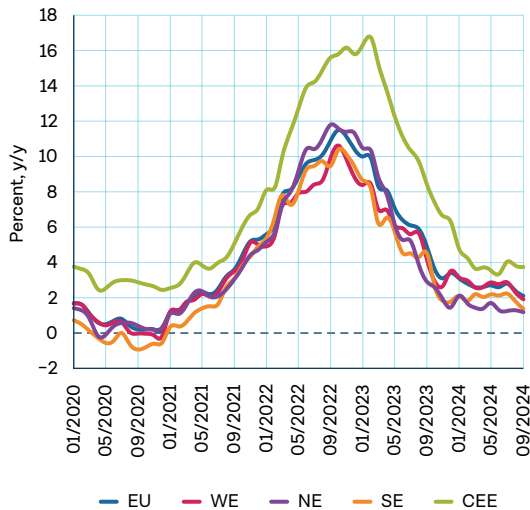
b. EU core inflation by region
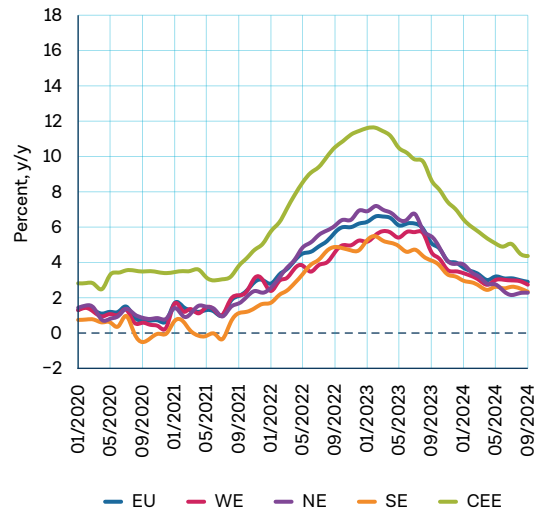


*Source:* Eurostat and WB calculations based on country weights.

**In the euro area, headline inflation decelerated in 2024, sitting within the ECB's medium-term target in October at 2 percent y/y.** This decline, at a time when the euro area has returned to quarterly growth, has opened the door to successive 25 bps cuts to the ECB's deposit facility rate in July, September, and October, bringing it down to 3.25 percent and with further gradual reductions expected over the coming quarters. The ECB is allowing its Asset Purchase Programme (APP) portfolio to decline at a measured and predictable pace by no longer reinvesting the principal payments from maturing securities; has started to reduce its holdings of Pandemic Emergency Purchase Programme (PEPP) securities by, on average, EUR 7.5 billion per month in the second half of 2024; and has seen banks repay funds borrowed under targeted longer-term refinancing operations. Thus, the size of the ECB's balance sheet continues to shrink from its peak in 2022.

**With inflation converging toward its target after a historic tightening cycle, the euro area seems poised for a "soft landing."** The latest ECB forecasts expect HICP inflation for the euro area to decelerate to 1.9 percent as of 2026, in a context of continued real GDP growth.[2] Nevertheless, the ECB would need to remain vigilant and not declare victory over high inflation too soon, as the last mile of the disinflation process may prove more difficult than anticipated. In particular, core inflation has somewhat surprised on the upside, coming in at 2.7 percent y/y in September (Figure 1.5). This is largely explained by stubbornly high services inflation which, largely as a result of solid catch-up wage growth, stood at 4.2 percent in August, substantially above its long-term historical average.

**Nominal wage growth is showing tentative signs of slowing down from its Q1 peak, with further normalization of wages expected over the coming quarters.** This hinges on the assumption that nominal wage growth is partially absorbed in unit profits to buffer the pass-through to consumer prices. However, the risk remains that wage pressures prove more potent, as firms remain well-positioned to largely pass higher labor costs onto consumers. The continued risk of a wage-price spiral is evident in Belgium, for example, where core inflation is above the euro-area average and wages are indexed to inflation; and in the Netherlands and Germany, where nominal wage growth is relatively strong, with a lagged response due to negotiated wage-agreement outcomes in a tight labor market with a relatively high vacancy rate. If wage pressures prove more stubborn than anticipated, the disinflationary process could be slower.

**FIGURE 1.5** Euro area headline (HICP) and core inflation



Source: Eurostat and ECB.

**On the other hand, monetary tightening may not have been fully passed through to households and businesses yet, which would limit future demand.** Delays in pass-through may have increased compared with previous tightening cycles, especially since deposit rates for households have not increased proportionally to policy rates, and mortgages have longer fixed-rate terms.[3] Such transmission lags could lead to a stronger cooling of future demand than currently anticipated, despite preliminary reductions to policy rates. This implies that risks around the path of inflation remain two-sided, with the additional possibility that labor markets and price pressures cool in a more pronounced manner than currently projected. Therefore, maintaining a relatively restrictive stance for too long risks otherwise avoidable harm. This also suggests that the fiscal stance should be such that it does not add to domestic price pressures, and fiscal authorities act with restraint with regard to discretionary fiscal support.

**Thanks to higher interest rates, the profitability of European banks markedly improved in 2023 and remained high as of mid-2024.** The most important driver of bank profitability was rising net-interest income, reflecting a significant widening of net-interest rate margins. In addition, increases in net fee and commission income and in trading income contributed to offsetting a rise in operating costs. Asset quality in the banking system is high, but pockets of vulnerability remain, especially in commercial real estate and SME loans.

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2   ECB (2024), September 2024 Macroeconomic Projections (https://www.ecb.europa.eu/press/projections/html/index.en.html#:~:text=September%202024,-At%20a%20glance&text=Inflation%20is%20projected%20to%20increase,feeds%20through%20to%20consumer%20prices.)

3   ECB, 2024; IMF, 2024

**Although lending interest rates have started to drop, bank lending has so far failed to rebound, due to further tightening of credit standards and lower demand.** In the euro area, credit growth remains subdued amid weak demand, linked primarily to the cost of borrowing. In the 4CEEs, household demand for housing loans has picked up (especially in Bulgaria) and interest in consumer loans has increased, due to broad improvement in the financial position of households and demand for financing for the purchase of durable goods. Growth in credit to non-financial corporations was somewhat muted, with low demand for working-capital loans and moderate growth in investment loans. The latter are expected to pick up, because of the projected increase in capital expenditure associated with the energy transition and releasing the access to EU funds. The financing pattern of non-financial corporations relying strongly on trade credit for financing their activity in some countries (e.g., Romania, Bulgaria) generates vulnerabilities. Even though trade credit can help firms manage cash flows over the short term, especially during periods of tight financial conditions, it is generally costlier and riskier compared to bank financing.

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**BOX 1.1** **The diverging paths of productivity growth in the EU and the US**

**In recent years, there have been growing concerns about the competitiveness of the EU economy, especially vis-à-vis the US.** In part, these were exacerbated by the pandemic and the spillovers from the Russian Federation's invasion of Ukraine.[a] While the drivers of this trend are complex, several aspects are worth highlighting.

**First, when the US economy emerged from the pandemic, it was about 9 percent larger in real terms than pre-pandemic, while the EU economy was 4 percent larger.** There is emerging evidence that since the pandemic, the US has experienced significantly stronger labor productivity growth than EU countries, which may in part be attributable to differences in policy responses to the pandemic. For instance, the European response had a stronger focus on within-industry labor retention, while the US focused more on income support with stronger labor reallocation incentives.[b] Moreover, the EU lacks the degree of capital market integration that can channel savings towards productive investment to the same degree as in the US. Structurally smaller household exposure to equity markets in the EU relative to the US has precluded European households from reaping the wealth benefits of recently bullish markets. Finally, the latest global monetary tightening cycle, which saw interest rates rise sharply, likely dampened household balance sheets more severely in Europe than in the US, as a market preference for fixed-rate mortgages helped shield American households.

**FIGURE B1.1.1** GDP per hour worked in USD (index: 1995 = 100)
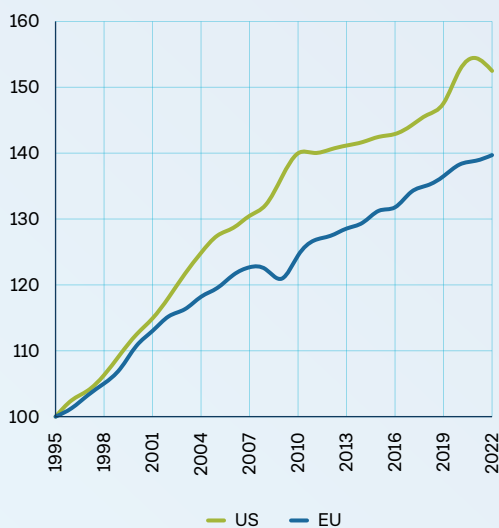


Source: OECD

**Second, spillovers from the Russian Federation's invasion of Ukraine, especially through high energy prices, caused a strong deterioration of the EU's terms of trade, affecting the competitiveness of energy-intensive industries.** Notably, while energy prices in the EU have fallen considerably from their late-2022 peaks, electricity and industrial gas prices are still substantially higher than in the US and China.

**Beyond recent shocks, however, EU competitiveness had already been under pressure for decades.** GDP per hour worked in US$ terms grew substantially less in the EU than in the US between 1995 and 2022 (Figure B1.1.1), and the EU-US productivity gap predates the global financial crisis.[c] Potential causes of weaker productivity growth in Europe include: relatively rigid labor markets, more limited access to finance, the structure of EU firms, the EU's industrial composition, the regulatory environment, more limited creation and adoption of disruptive digital technology, and the EU's de facto market fragmentation.

**Reigniting productivity growth is key to promoting the EU's competitiveness and raising its standards of living.** A comprehensive package of structural reforms is needed to restore productivity growth in Europe.[n] It is important that policymakers carefully weigh trade-offs and act with restraint in promoting strategic autonomy and protectionist measures that may harm longer-term prospects. The recent report on the Future of European Competitiveness identifies three key challenges.[d] First, EU companies face weaker foreign demand, as well as rising competitive pressure from non-European companies. In this regard, EU R&D investment lags substantially behind other advanced economies, there has been a notable decline of European firms represented in the Fortune 500, and only four of the world's top-50 tech companies by market capitalization are European. Second, energy prices in the EU remain high, and need to be contained in a structural manner without compromising, delaying, or disincentivizing the green transition. Third, the EU's high degree of trade openness leaves it exposed to the risk of further deglobalization and to the effects of trade policy interventions by its competitors.

a. Lopez-Garcia and Sforzi, 2021; Strauss et. Al, 2024; Schnabel, 2024; Li and Noureldin, 2024.
b. ECB, 2024; FED, 2024; World Bank, 2023.
c. van Ark, O'Mahony, and Timmer, 2008; Bergeaud, 2024.
d. Draghi, M., 2024. The Future of European Competitiveness Part A: A competitiveness strategy for Europe, European Commission. Belgium.

The EU's current account position improved in 2023 and over the first half of 2024, primarily due to import contraction. The fall in import prices, including both energy and non-energy commodities, supported an improvement in the goods trade balance, with Northern Europe and Western Europe recording the largest average gains (Figure 1.6). The goods trade balance remains negative in Southern Europe and Central and Eastern Europe, but the deficit reduced substantially in 2023 relative to 2022, and dropped further in 2024H1; the same regions show a considerable surplus in services trade, above pre-pandemic averages, driven by growing exports in the tourism sector. While primary income positions have remained stable, they were the principal contributors to the current account deficits in CEE in 2023, largely due to investment income dynamics.

**FIGURE 1.6** **Current account positions**
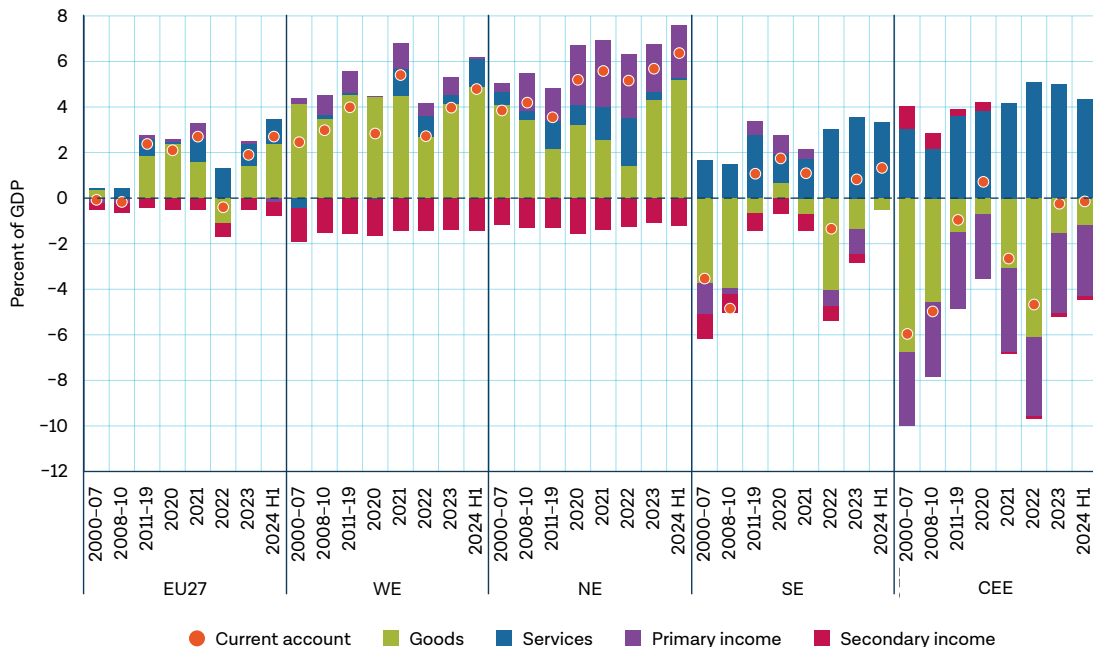


*Source:* Eurostat and WB calculations
*Note:* Weighted by euro chain-linked volumes GDP

# Fiscal consolidation has stalled, highlighting the importance of the revised EU fiscal framework

**Fiscal consolidation stalled in 2023, leading to an increase in the number of EU countries at risk of entering the Excessive Deficit Procedure (EDP), including several major economies within the Eurozone.** Weakened economic activity impacted tax collection, while the prevailing high-interest rate environment has partially offset the withdrawal of pandemic-related spending measures and the reduced fiscal impact of lower energy inflation. On average, the CEE region reported the largest deficits in 2023, having historically enacted some of the most procyclical fiscal policies in the EU. CEE also faces the most significant risk under the EDP, with 5 out of 8 countries experiencing fiscal deficits above 3 percent of GDP (Figure 1.8). The fiscal position continued to show signs of deterioration in the first half of 2024, with more than half of the countries in Western Europe (WE) and Southern Europe (SE) experiencing a worsening of the fiscal deficit compared to the second half of 2023.

**FIGURE 1.7** Fiscal balance evolution in EU subregions
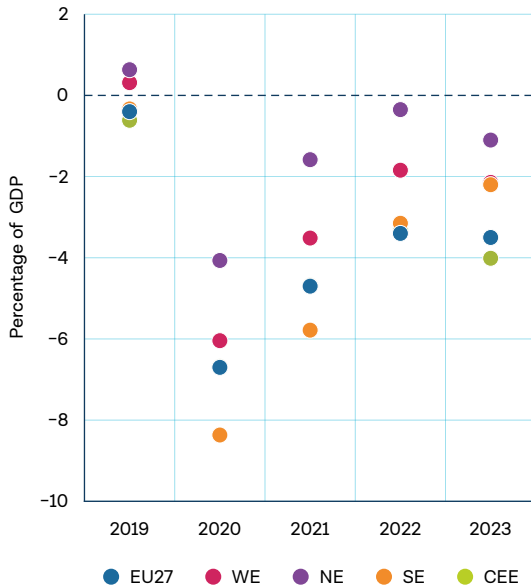


*Source:* Eurostat, World Bank calculations
*Note:* Unweighted average across countries

**FIGURE 1.8** Number of countries with fiscal deficits above 3 percent of GDP, by EU subregion
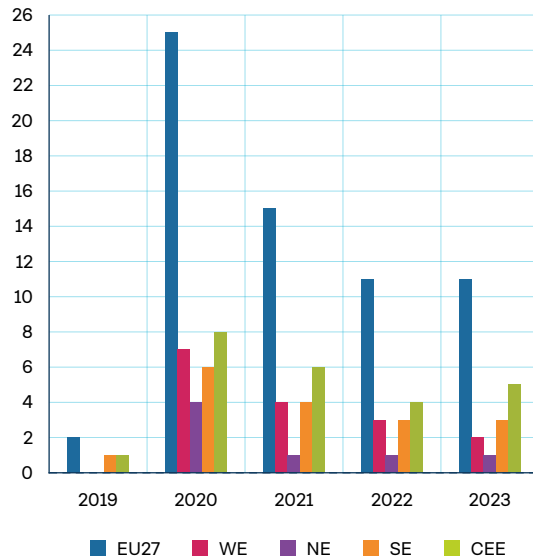


*Source:* Eurostat, World Bank calculations
*Note:* Unweighted average across countries

**High fiscal rigidity highlights challenges to expenditure-driven fiscal consolidation.** Over the past two decades, the average share of highly rigid expenditures (compensation of employees, social transfers, and interest payments) in total public spending in the EU27 has hovered around 71 percent (Figure 1.9). While fiscal rigidity decreased to 67 percent in 2021, the reduction was driven by a growth in spending on non-rigid components, such as subsidies and intermediate consumption. As of 2023, Central and Eastern Europe and Northern Europe recorded the lowest levels of fiscal rigidity in the EU, reflecting the increasing contribution of capital spending to total expenditure — thanks in large part to substantial investments under the RRF. Conversely, Western Europe reported the highest levels of fiscal rigidity, which can be attributed to a larger share of spending on social transfers and weaker public investment. A sustainable reduction in fiscal rigidity over the medium term must be accompanied by revenue and other expenditure efficiency measures, to minimize the risk of reducing the fiscal deficit through excessive cuts to public investment.

**FIGURE 1.9** Fiscal rigidity 2019 – 2023

a. Highly rigid expenditure items
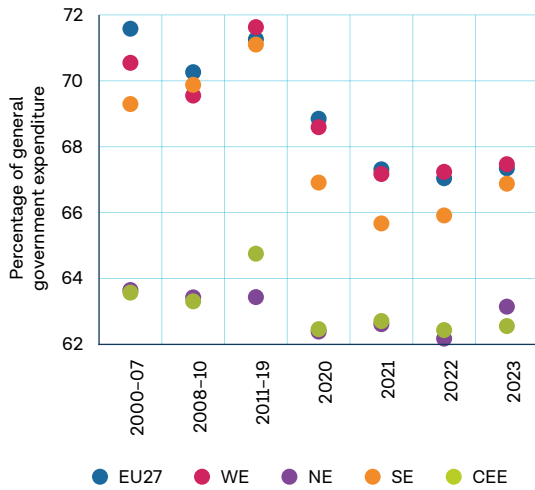
b. Contributions to change in general government expenditure
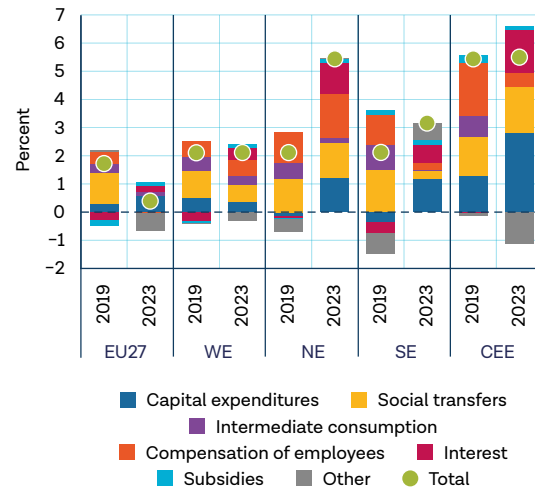


*Source:* Eurostat, World Bank calculations

*Note:* Unweighted average across countries; Social transfers include social benefits other than social transfers in kind and Social transfers in kind — purchased market production.

**Fiscal revenues underperformed in 2023, while expenditure levels remained elevated compared with pre-pandemic figures.** Revenues from indirect taxes, as a percentage of GDP, decreased on average in 2023, reflecting the impact of lower energy prices, falling imports, and weakened economic activity. The most pronounced decreases were observed in Southern Europe, particularly in the countries experiencing the steepest drop in economic growth. Social contributions benefited from an improving labor market, while rising wages helped curb the decline in direct tax revenues. EU funds bolstered public investments, which saw an uptick in 26 out of 27 EU member states. Additionally, interest expenditure rose in an environment of high interest rates and increasing nominal debt, with the highest interest expenditure-to-GDP ratios registered in Southern Europe and Central and Eastern Europe.

**FIGURE 1.10** **Underperforming fiscal revenues and elevated expenditures**
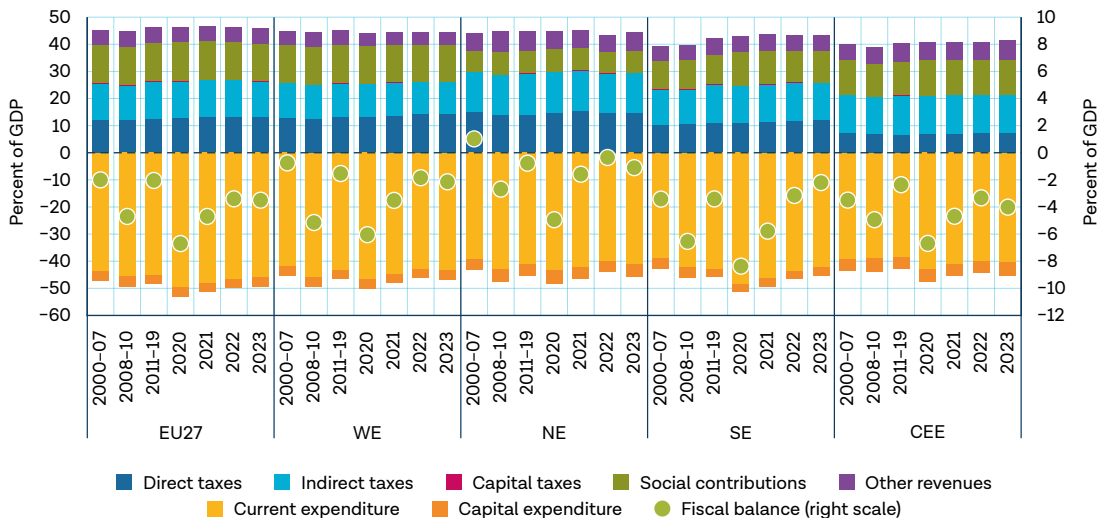


*Source:* Eurostat, World Bank calculations

*Note:* Unweighted average across countries

**The public debt-to-GDP ratio continued to fall in 2023 but remains, on average, above pre-pandemic levels, pointing to significant vulnerabilities.** High nominal GDP has mitigated some of the effects of elevated interest rates and persistently high primary deficits, supporting a 1.7 percentage point average decrease in the public debt-to-GDP ratio. However, the ratio remains above pre-pandemic levels in 19 of the 27 EU member states, with the smallest average adjustments observed in Central and Eastern Europe. Debt ratios are still above 60 percent in 13 member states, and exceed 100 percent in five of them, predominantly in Southern Europe. Public debt-to-GDP ratios are showing weak signs of trend reversal in 2024Q2, with 17 out of the 27 EU member states reporting a decrease.

**FIGURE 1.11** **Public debt-to-GDP ratio decreased across the board but remain elevated**
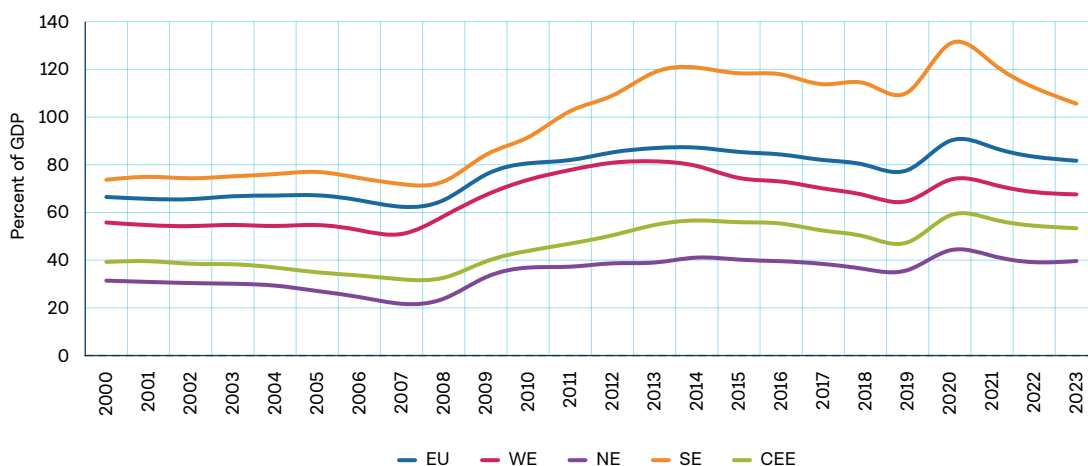


*Source:* Eurostat, World Bank calculations
*Note:* Unweighted average across countries

**BOX 1.2** **The reformed EU fiscal framework**

**The reformed EU fiscal framework aims to create a robust and adaptable system to handle future economic challenges by emphasizing simplicity, transparency, national ownership, and effective enforcement.** It seeks to ensure fiscal sustainability while promoting sustainable and inclusive growth across the EU. National medium-term fiscal structural plans are central to the framework, strengthening national ownership by integrating reform and investment policies within a common EU framework. The new fiscal framework includes the possibility for member states to extend the adjustment period from four to seven years, by committing to growth-enhancing reforms and investments. Enforcement is strengthened by the requirement for annual progress reports and a control account to monitor deviations.[a]

**The reformed EU fiscal rules, which came into effect in April 2024, represent a significant shift from the previous framework.** Under the new framework, the focus has shifted from strict numerical targets to a more nuanced approach that emphasizes debt sustainability. This is achieved through country-specific debt sustainability analyses (DSAs) and the establishment of a single operational target based on public expenditure. This target is designed to ensure that, barring any new budgetary measures, a member state's debt ratio will be either on a downward trajectory or maintained at prudent levels below 60 percent of GDP over the medium term.

**The new rules also introduce additional safeguards for countries with higher levels of debt or deficit.** These include requirements for a minimum yearly reduction in the debt ratio, and improvements in the structural primary balance. The aim is to prevent backloading (whereby adjustments are postponed to later years), and to ensure that countries with structural deficits make consistent efforts to improve their fiscal positions.

**To foster stronger national ownership, member states are now required to design medium-term fiscal structural plans that outline their fiscal targets, reforms, and investments.** These plans are assessed by the

European Commission and endorsed by the Council, ensuring that they align with common EU criteria. The integration of fiscal, reform, and investment objectives into a single medium-term plan is expected to streamline the process and enhance the effectiveness of national strategies, while promoting sustainable debt reduction, fostering a green, digital and resilient economy and enhancing the EU's competitiveness.

**Countries in Central and Eastern Europe will face the most significant requirements for fiscal adjustment.** The requirements will be particularly demanding for countries with a high current primary deficit, such as those in the CEE region, although in most such countries the public debt-to-GDP ratio stands below 60 percent (in comparison, Southern Europe has, on average, higher debt ratios). Conversely, countries that maintain a primary balance surplus can adjust more gradually if they commit to implementing specific investment and reform measures that support fiscal sustainability and growth.

a. European Commission, https://economy-finance.ec.europa.eu/document/download/0aaf8190-b9fe-46b2-9dac-912b98bef0da_en?filename=ip295_en_0.pdf.

**FIGURE B1.2.1** Fiscal adjustments under the reformed EU fiscal framework
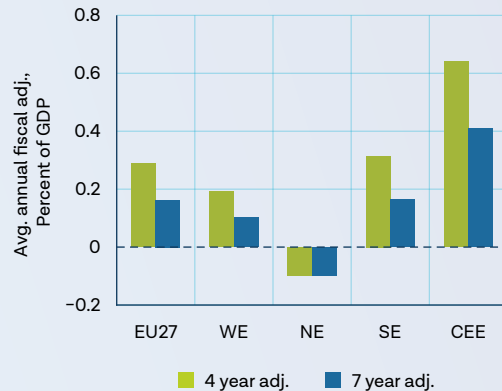


*Source:* World Bank calculations based on Darvas, Z., L. Welslau and J. Zettelmeyer (2024) 'The implications of the European Union's new fiscal rules', Policy Brief 10/2024, Bruegel

*Note:* Unweighted average across countries

Income convergence across the EU has accelerated, but primarily because of underwhelming per-capita-income growth in some of the major high-income member states (Figure 1.12). The pace of catch-up, measured by the gap in GDP-per-capita growth between the EU average and the 16 member states with lower-than-average income levels, has accelerated after the pandemic, from an average of 1.1 percentage points during 2015–2019 to 2.5 percentage points during 2021–2023. In 2023, the convergence trend accelerated, with 15 out of the 16 lower-income member states recording higher per-capita-income growth than the EU average. However, within-country divergence increased after the pandemic, as inflationary pressures hit poorer households harder (see next section).

**FIGURE 1.12** EU income convergence displays signs of accelerating
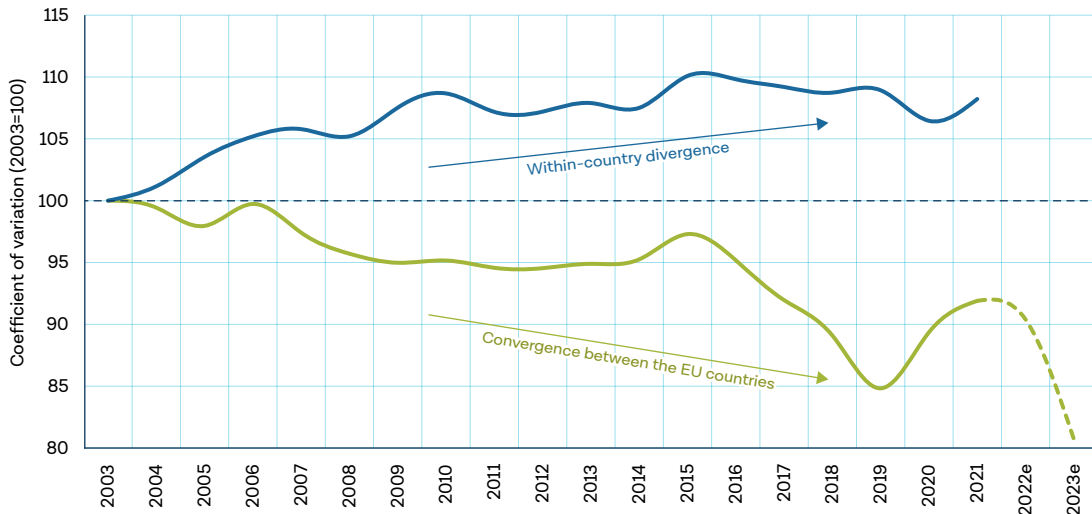


*Source:* World Bank calculations using Eurostat

*Note:* Computations based on Real GDP per capita in PPS for the EU27 countries

# Recent Labor Market, Poverty, and Inclusion Trends

# From struggle to stability: The resilience of the EU labor market to the COVID-19 crisis and Russian Federation's invasion of Ukraine

**The EU's labor markets have shown remarkable resilience in the face of challenges posed by the COVID-19 pandemic and the energy and cost-of-living crisis resulting from the Russian Federation's invasion of Ukraine.** Despite a significant decline in labor force participation and employment during the pandemic, there was a robust rebound in employment afterward (Figure 2.1). Swift and substantial policy measures, enacted at both the EU and national levels, have mitigated the impact of the pandemic on unemployment, despite the unprecedented economic contraction. Russia's invasion of Ukraine and the associated energy and cost of living crisis seem to have had relatively limited short- and medium-term impacts on labor market indicators. Compared to the third quarter of 2019, both employment and labor force participation rates have increased by 2.7 and 2.3 percentage points (pp), respectively, while the unemployment rate has seen a slight decline of about 0.5 pp. This showcases the resilience of the EU's labor markets and underscores the adaptability of its workforce. Varying labor market trends have been observed across EU subregions during this period, with the labor force participation rate growing most rapidly in WE and CEE, followed by SE, while growth remains sluggish in NE.

**While employment across most sectors has rebounded, recent shocks continue to cast a shadow over some sectors, notably manufacturing, agriculture, and administrative services.** Since 2019, nearly all major industries have seen increases in employment levels (Figure 2.2). However, the employment rebound has not been homogeneous, with a noticeable reallocation of employment across sectors. Some sectors have substantially surpassed their pre-pandemic levels; for instance, information and communication, utilities and real estate activities, experienced notable growth in employment from the third quarter of 2019 to the second quarter of 2024, with increases of about 28.4, 20.3 and 13.9 percent, respectively. On the other hand, the agricultural sector witnessed a decline of approximately 19.9 percent in employment during the same period, followed by service activities (5.8 percent) and manufacturing (2.7 percent) (Figure 2.3). Some of these trends are indicative of longer-term structural shifts toward non-routine cognitive tasks, expansion in globally innovative sectors requiring skill-intensive labor, and the acceleration of these trends during the COVID-19 pandemic, which was a time of increased digital investment.[4] For example, the decline in agricultural employment predates the pandemic, partly due to the consistent growth of the services sector, which has created more job opportunities outside of rural areas.

**FIGURE 2.1** **EU's labor market has shown resilience to multiple shocks**

Changes in labor force participation, employment, and unemployment rates, EU27, 2019Q3 – 2024Q2
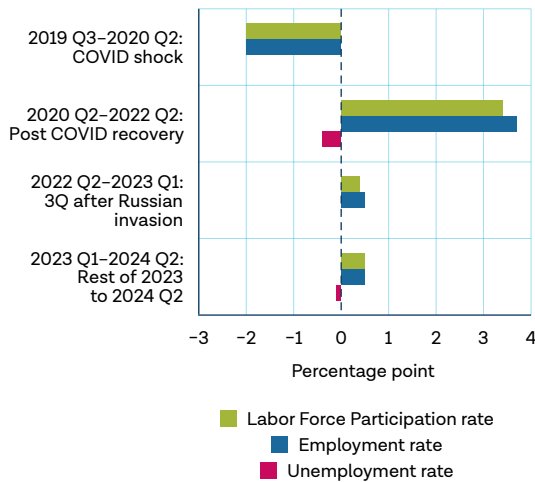


*Source:* World Bank calculation based on Eurostat (lfsi_emp_q and une_rt_q), 2019Q3 – 2024Q2.

*Note:* Participation and employment rates are calculated for individuals aged 15 to 64, while unemployment rates are determined for individuals aged 20 to 64. These figures are derived from the seasonally adjusted Labor Force Survey series.

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4  Eurofound, 2022.

**FIGURE 2.2** EU's sectoral employment dynamics post-shocks

Employment growth by sector, EU27, 2019 Q3 – 2024 Q2
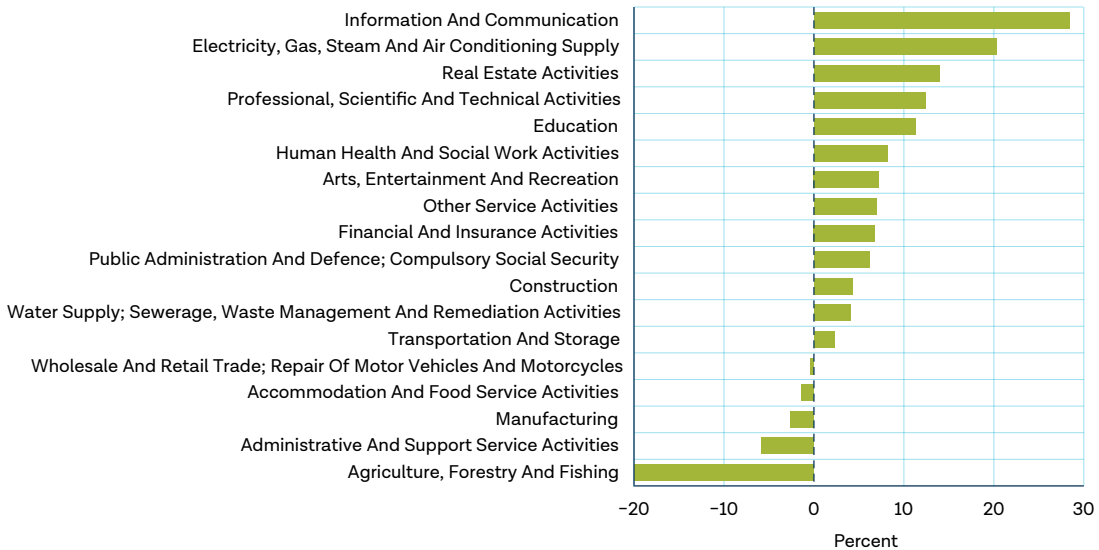


*Source:* World Bank calculation based on Eurostat (lfsq_egan22d), 2019 Q3 – 2024 Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the unadjusted Labor Force Survey series. Adjusted series by sectors of economic activity are not available.

**FIGURE 2.3** Impact of the pandemic
and Ukraine conflict on employment, most affected sectors

Employment growth by sector and subperiod, EU27



*Source:* World Bank calculation based on Eurostat (lfsq_egan22d), 2019 Q3 – 2024 Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the unadjusted Labor Force Survey series. Adjusted series by sectors of economic activity are not available.

The overall improvement of key labor market indicators masks a starkly uneven path of recovery for specific subgroups, with employment gains concentrated among highly educated workers. Uneducated individuals emerged as the most vulnerable group, experiencing the steepest decline in employment during the pandemic, and after some recovery, their employment levels dropped again following the Russian Federation's invasion of Ukraine, extending their struggle for stability (Figure 2.4). In fact, after the two shocks, they are still grappling to reach the employment levels seen prior to the pandemic (Figure 2.5). This underscores the profound and enduring impact of these shocks on the most vulnerable segments of

the workforce. Conversely, high-skilled employment has demonstrated remarkable resilience, remaining robust in the face of adversity. This divergent trajectory in employment recovery has had a profound consequence: the widening of the employment gap among workers with varying educational backgrounds.

**FIGURE 2.4** Less-educated workers face significant challenges

Employment growth by education, EU27, 2019 Q3 – 2024 Q2



*Source:* World Bank calculation based on Eurostat (lfsi_educ_q), 2019Q3–2024Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the seasonally adjusted Labor Force Survey series. "Lower secondary" refers to less than primary, primary, and lower secondary education; "upper secondary" comprises upper secondary and post-secondary non-tertiary education; while "tertiary" denotes tertiary education.

**FIGURE 2.5** Inequality in employment trends has been increasing over time
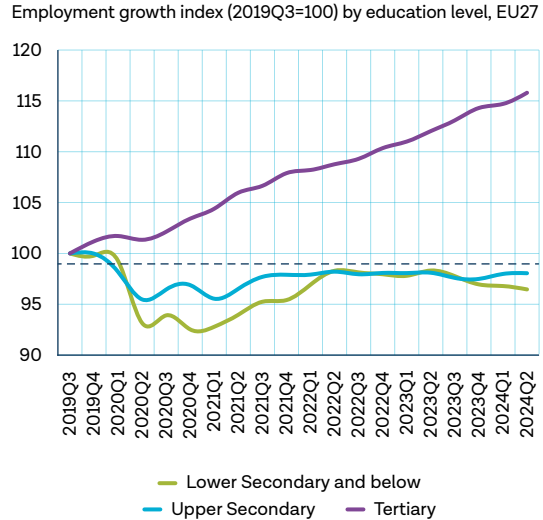
Employment growth index (2019Q3=100) by education level, EU27



*Source:* World Bank calculation based on Eurostat (lfsi_educ_q), 2019Q3–2024Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the seasonally adjusted Labor Force Survey series. "Lower secondary" refers to less than primary, primary, and lower secondary education; "upper secondary" comprises upper secondary and post-secondary non-tertiary education; while "tertiary" denotes tertiary education.

**The pace of employment recovery for less educated workers shows significant variation across subregions, with NE approaching full recovery.** The substantial decline in employment experienced by the less educated was not uniform across regions (Figure 2.6). In NE, despite a sharp downturn during the COVID-19 pandemic, the employment levels for workers with primary education in Q2 of 2024 were around 2 percent lower than pre-crisis levels. That is not the case in other regions, where such workers still grapple with employment levels more than 5 percent below their pre-crisis levels. This discrepancy underscores the acute vulnerability faced by this group in certain regions.

**Employment levels for blue-collar workers, irrespective of their skill level, have yet to rebound to pre-pandemic levels, in contrast to a full recovery among white-collar workers — suggesting a polarization in employment growth.** Heterogeneity also exists across skill levels.[5] Low-skill blue-collar workers faced the most significant employment decline during the pandemic, and while they have seen notable improvements during the recovery, their employment rates still lag behind pre-pandemic levels (Figure 2.7). Additionally, high-skill blue-collar workers experienced employment declines with minimal gains during the recovery period. Conversely, white-collar workers (especially those highly skilled have not only regained pre-pandemic employment levels but even surpassed them. One of the key contributors to

---

5  Obtaining reliable and detailed data on skills presents challenges, as a comprehensive measure of skills should encompass basic education and training. To address this, we use ISCO data on occupations, a common practice for the EU, sourced from Eurostat. This classification aggregates occupation categories from the ISCO 88 classification into four groups: White-collar high-skilled; White-collar low-skilled; Blue-collar high-skilled, and Blue-collar low-skilled.

job polarization is the increased technological change in response to the pandemic[6] that may disproportionately impact middle-skill workers (Autor & Dorn, 2013), who are often high-skill blue-collar workers.

**FIGURE 2.6** Regional disparities persist in employment recovery among less educated workers

Employment growth index (2019Q3=100) by subregion, workers with lower secondary and below
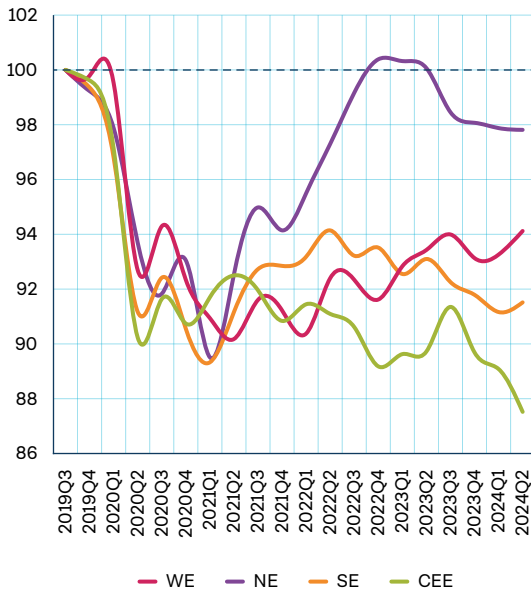


*Source:* World Bank calculation based on Eurostat (lfsi_educ_q), 2019Q3 – 2024Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the seasonally adjusted Labor Force Survey series. "Lower secondary" refers to less than primary, primary, and lower secondary education. Germany is excluded due to a lack of data for 2020.

**FIGURE 2.7** Polarization of job opportunities and unequal employment recovery

Employment growth index (2019Q3=100), by occupation, EU27
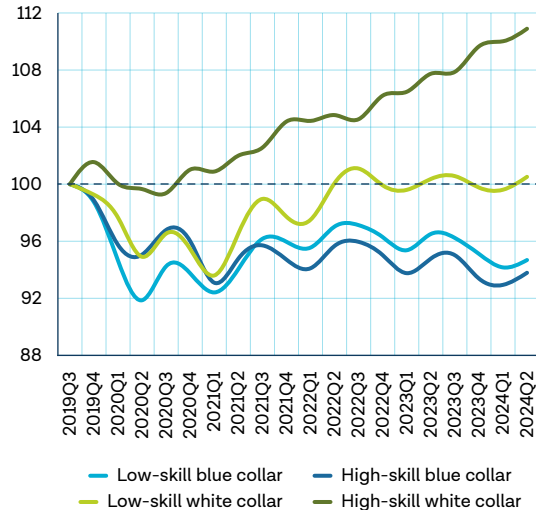


*Source:* Eurostat (lfsq_egais), 2019Q3 – 2024Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the unadjusted Labor Force Survey series. Low-skill blue collars (ISCO codes 8 and 9) include plant and machine operators and assemblers and elementary occupations; High-skill blue collars (ISCO codes 6 and 7) include skilled agricultural and fishery workers and craft and related trades workers; Low-skill white collars (ISCO codes 4 and 5) include clerks and service workers and shop and market sales workers; High-skill white collars (ISCO codes 1,2 and 3) include legislators, senior officials and managers, professionals and technicians and associate professionals. The figure excludes employment in the armed forces and non-responses.

**The employment landscape has undergone a heterogeneous evolution in response to the challenges posed by recent shocks, particularly the youth.** The pandemic impact was stark and widespread, with both full-time and part-time employment experiencing substantial declines across genders (Figure 2.8). However, in 2021 signs of recovery emerged. This recovery was particularly pronounced for female full-time workers, who bounced back and consistently surpassed pre-pandemic employment levels since 2021, with levels around 6 percent higher in the second quarter of 2024. In contrast, part-time employment took longer to recover for women, with recent data showing a return to pre-COVID levels. One demographic group that faced significant challenges during the pandemic was young workers aged 15 – 24 (Figure 2.9). They experienced a sharp decline in employment opportunities of about 10 percent during COVID-19. This is a particular concern as it is more likely that young labor market entrants will carry long-lasting scars of recessions due to disrupted career development. For instance, on average, workers entering the labor market in a recession experience an initial reduction in their earnings of about 10 to 15 percentage points.[7] Despite these initial setbacks, there has been a notable resurgence in employment among this group, with current levels surpassing those recorded before the pandemic.

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6    Eurofound, 2022.

7    Wachter, T. V., 2020.

**FIGURE 2.8** Female full-time workers: recovery surpassing pre-pandemic levels since 2021

Employment growth index by type of employment and gender (2019 Q3=100), EU 27, 2019 Q3 – 2024 Q2
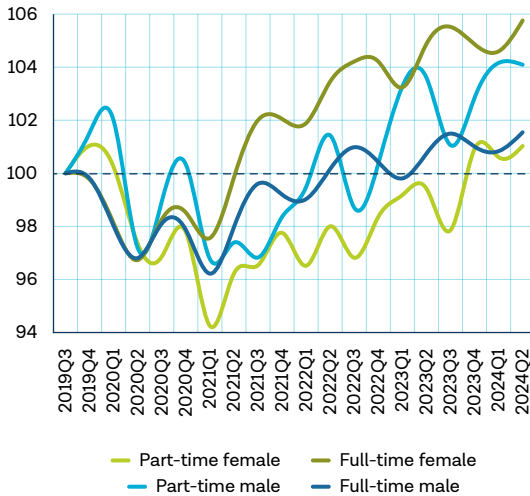


- Part-time female
- Full-time female
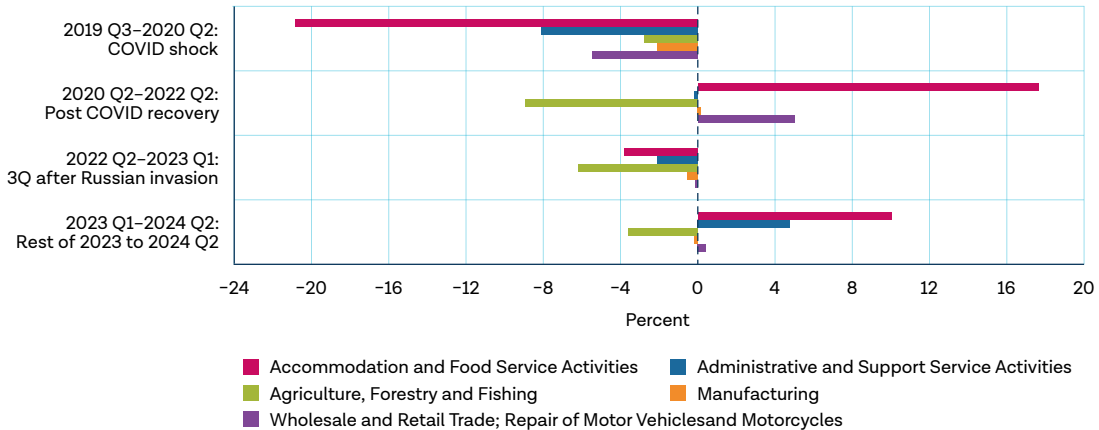- Part-time male
- Full-time male

*Source:* World Bank calculation based on Eurostat (lfsq_epgais), 2019 Q3 – 2024 Q2.
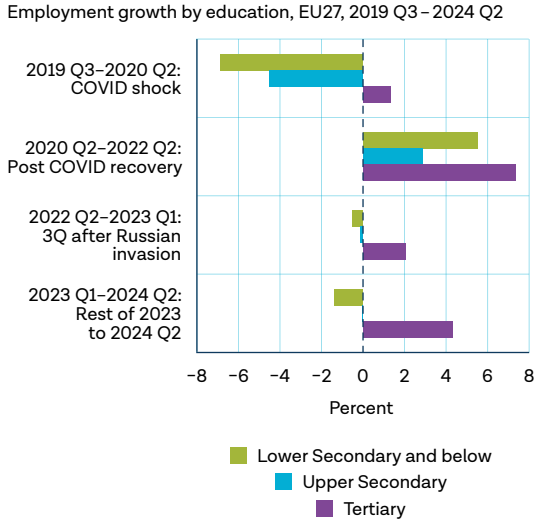
*Note:* Total employment series are calculated for individuals aged 15 to 64, derived from the unadjusted Labor Force Survey series. No adjusted series are available for any type of job.

**FIGURE 2.9** Young workers faced COVID-19 job losses but rebounded stronger

Employment growth index by age and gender (2019 Q3=100), EU 27, 2019 Q3 – 2024 Q2



- Young Female
- Old Female
- Young Male
- Old Male
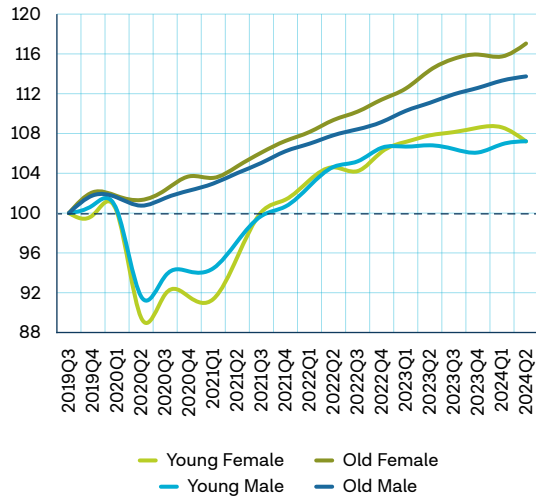
*Source:* World Bank calculation based on Eurostat (lfsi_empq), 2019 Q3 – 2024 Q2.

*Note:* Total employment series are calculated for individuals aged 15 to 24 (young) and 55 to 64 (old), derived from the seasonally adjusted Labor Force Survey series.

**Surging vacancies tighten the EU labor market in the post-pandemic period, but more recently, labor market conditions have loosened.** In the post-COVID recovery phase, the uptick in job openings supported by the removal of pandemic containment measures and the reopening of economic activity created a more challenging landscape for businesses seeking to fill positions despite the concurrent rise in labor force participation rates. Job vacancies surged across the EU27 and various European subregions, while the number of unemployed individuals remained relatively stable. This led to a tightening of the labor market, with more firms willing to hire workers out of a declining unemployment pool (Figure 2.10).

**FIGURE 2.10** Surging vacancies tighten EU labor market in the post-pandemic period, with slightly loosening labor market conditions recently

Labor market tightness, 2019 Q3 – 2024 Q2, EU27 and subregions



- EU
- WE
- NE
- SE
- CEE
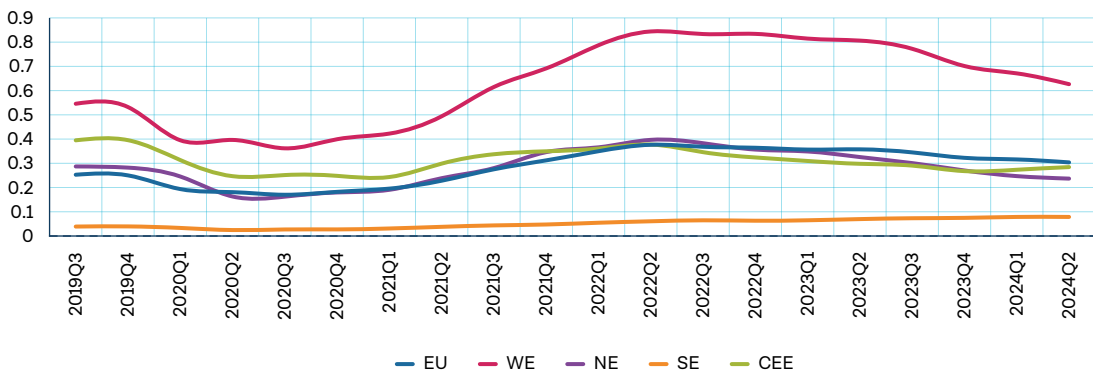
*Source:* World Bank calculation based on Eurostat (jvs_q_nace2 and une_rt_q), 2019Q3 – 2024Q2.

*Note:* Labor market tightness is calculated as the ratio of job vacancies in the service, industry, and construction sectors to unemployed individuals aged 20 to 64, excluding the primary sector, international organizations, and household activities. These figures are derived from seasonally adjusted LFS data, ensuring consistency despite time series breaks, with data unavailable for Italy and Estonia.

Consequently, firms have found themselves compelled to offer higher wages to attract workers, particularly in we, where the tightening of the labor market was most pronounced. Labor market tightness has slightly decline recently, likely due to the economic slowdown after the Russian Federation's invasion of Ukraine. However, it remains well above pre-pandemic levels in most regions (i.e. we and se) likely due to sustained labor demand from firms rather than lower labor supply from the population or labor mismatches.[8]

**With easing inflation and sustained nominal wage increases, the real wages — after a sustained decline — are showing signs of improvement.** While nominal hourly labor costs have steadily risen across most eu countries (leading to a roughly 19 percent increase in real wages since 2019 Q3), the purchasing power of wages has eroded due to the rapid inflationary pressures (i.e., real wages decreased by nearly 21 percent as a result of higher prices), particularly evident since the third quarter of 2021. Consequently, real wages have dropped by over 2 percent since the beginning of the pandemic.[9] Recent developments indicate that real wages have recovered over the past year as inflationary pressures have eased (Figure 2.11). Several eu countries have observed annual growth in real wages since 2019. Nevertheless, real wages in most Western and Southern European countries continue to lag their 2019 levels (Figure 2.12). In contrast, in Northern Europe real wages are slightly above, and in Central and Eastern Europe there is robust real wage growth, consistent with their tighter labor markets after the pandemic. Furthermore, statutory minimum wages have undergone a substantial increase between 2019 and 2024, averaging a remarkable 28 percent real increase across the bloc on average. This upward adjustment has contributed

**FIGURE 2.11  Despite a tight labor market, real wages declined mostly due to inflation**

Real wage growth index (2019 Q3=100), 2019 Q3 – 2024 Q2, EU27
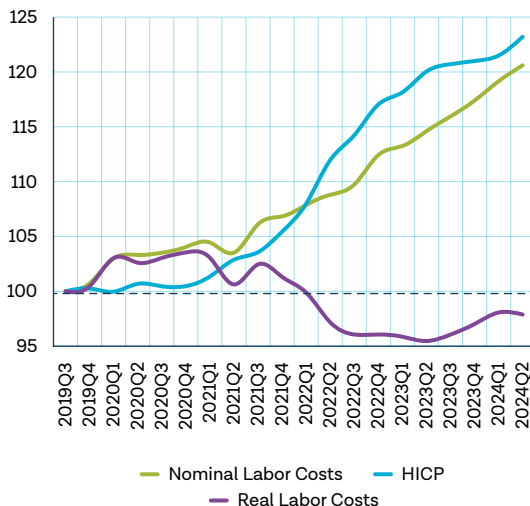


*Source:* World Bank calculation based on Eurostat (lc_lci_r2_q and prc_hicp_midx), 2019Q3 – 2024Q2.

*Note:* Real labor costs are derived by deflating the labor cost index with the HICP index, which represents a consumer basket typical of the entire EU. Labor costs encompass wages and salaries across the services, industries, and construction sectors.

**FIGURE 2.12  Real wages have recovered in Central and Eastern Europe**

Percentage change in prices and nominal and real labor costs, 2019 Q3 – 2024 Q2, EU27 and subregions
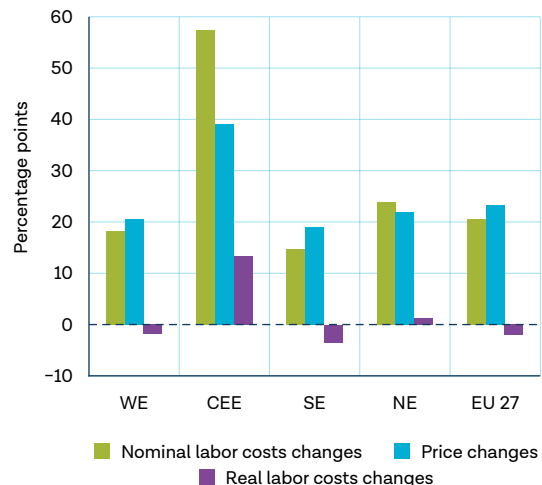


*Source:* World Bank calculation based on Eurostat (lc_lci_r2_q and prc_hicp_midx), 2019Q3 – 2024Q2.

*Note:* Real labor costs are derived by deflating the labor cost index with the HICP index, which represents a consumer basket typical of the entire EU. Labor costs encompass wages and salaries across the services, industries, and construction sectors.

8   European Commission, 2023.

9   The changes in real wages result from changes in both nominal wages and prices. To discern the impact of these factors individually, we calculate the Shapley value of the marginal contribution of each component to the change in real wages. In other words, we alter nominal wages while keeping prices constant and then adjust prices while holding nominal wages steady. When nominal wages change, maintaining prices at a constant level, there is a 19 percent increase in real wages. Conversely, adjusting prices while keeping nominal wages unchanged leads to a 21 percent reduction in real wages. The combined effect yields a net change of approximately -2 percent in real wages since 2019 Q3.

to stronger wage growth among lower-paid workers. Considering the significant role inflation has played in the evolution of real wages, the escalation of prices has emerged as a pressing issue, especially for vulnerable households. As such, the following section delves deeper into the distributional impact of rising prices, with a particular focus on food inflation.

**In 2022, the working poor (B40)[10] in four Central and Eastern European economies (4CEES) were predominantly concentrated in a few key sectors.** In all four countries, around one-fifth of the employed poor worked in the mining, quarrying, manufacturing, electricity, gas, and water sector. The wholesale and retail trade sector also employed a substantial portion of the B40, with 18 percent in Bulgaria, 16 percent in Croatia, 12 percent in Poland, and 14 percent in Romania. Agriculture, forestry, and fishing were prominent sectors, especially in Poland (24 percent) and Romania (38 percent). The construction sector also had a notable share of B40 workers, in Bulgaria (14 percent), Croatia (10 percent), Poland (8 percent), and Romania (12 percent). Additionally, accommodation and food service and transportation and storage were important sectors for B40 employment across these countries, albeit with varying shares. The second part of this report explores the manufacturing opportunities in the green value chains, showcasing the importance of export-related jobs in Romania, Bulgaria, Croatia and Poland.

**Employment trends since 2019 across 4CEES show a consistent decline in key sectors where the poor work, namely the mining and quarrying, manufacturing, and agriculture sectors.** Quarterly data from 2019Q3 to 2024Q2 shows that during this period, mining employment fell sharply in Bulgaria (-62.5 percent) and declined across all countries except Croatia, which had no initial employment data. Manufacturing declined moderately, particularly in Bulgaria (-13.8 percent) and Romania (-5.6 percent). Agriculture experienced significant reductions, especially in Romania (-49.8 percent) and Bulgaria (-26.3 percent). In contrast, the wholesale and retail trade sector displayed mixed results, with employment decreasing in Poland (-2.6 percent) but increasing in Bulgaria (1.9 percent), Croatia (2.8 percent) and Romania (4.6 percent).

**Despite employment losses in the sectors where the poor (B40) are overrepresented, real wages in these sectors continue to rise.** Using nominal labor costs adjusted for inflation as a measure of real wages, they have increased across specific sectors. For example, from 2019Q3 to 2024Q2, manufacturing real wages grew from 8.9 percent in Poland to 33.2 percent in Bulgaria. In the wholesale and retail trade sector, they ranged from 8.6 percent in Poland to 38.1 percent in Bulgaria. In the construction sector, they ranged from 7.8 percent in Poland to 42.3 percent in Bulgaria. This growth is driven by several factors, like tighter labor markets and stronger firm demand, which have pushed wages upward. Furthermore, labor costs can be inflated by the negative employment growth of low-educated workers, that result in relatively more high-educated employees and a higher average cost per worker, leading to an increase in the labor cost index without widespread wage growth.

**Even though there are no official estimates to adequately capture dynamics of labor market indicators and labor income among the Roma population, unofficial estimates indicate that access to the labor market remains low.[11]** The 2021 Household Budget Survey for Romania and the 2021 National Survey on Income and Living Conditions for Bulgaria reveal significant labor market disparities between Roma and non-Roma populations. In Romania, there are large gaps in labor force participations between Roma and their non-Roma counterparts, particularly among the group with secondary education or more

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10  Working poor refers to workers living in households with incomes at the bottom 40 percent of the income distribution.

11  Ethnicity identifiers are not common in household surveys. In Bulgaria, while ethnicity information is collected for the Survey of Income and Living Conditions (SILC), this information is not collected in labor force survey (LFS) data. Therefore, we rely on the latest SILC to construct labor income and key labor market indicators, though comparability with official estimates from LFS are not possible. In Romania, there is no formal ethnicity identifier in the HBS, but Roma is one of the categories in the nationality question.

(around 12 percentage points). If participating in the labor market, they are less likely to be employed, with unemployment gaps oscillating around 13 percentage points. When employed, the monthly labor income of a Roma individual age 25 – 64 with primary or less education is only 60 percent the income of the non-Roma counterpart. In Bulgaria, the outcomes are similarly stark, with labor force participation gaps of 7 percentage points among those in working-age with secondary or more education, and employment gaps of around 10 percentage points. Estimates from FRA 2021 also suggest large differences in labor market outcomes among these two groups. The exclusion of Roma in the EU and enlargement countries is a complex issue rooted in socio-economic factors, discrimination, and ineffective policies. Despite EU efforts to address Roma marginalization through frameworks and integration strategies, implementation has been challenging.[12] Due to limited access to high-quality data[13], research on Roma inclusion to support evidence-based policies remains scarce, and reliable data on Roma-focused programs are needed.[14]

**The current societal benefits resulting from the inclusion of the Roma community could be substantial in the EU.** Investing in the education, skills, and meaningful integration of the young and expanding Roma populace can yield significant economic advantages, especially in aging countries like those in the EU. Ensuring Roma inclusion entails enabling them to access equal social and economic prospects as the broader population. This encompasses not only ensuring that both male and female Roma attain comparable levels of education as the general population but also facilitating their access to equivalent economic opportunities. Attaining complete Roma inclusion would lead to heightened labor productivity, increased tax revenue, and ultimately reduced social protection expenditures for Roma households. Presently, Roma exclusion can translate into lost earnings within EU countries (see Box 2.1 for Details).

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**BOX 2.1** **The economic benefits of Roma inclusion**

**Roma inclusion is important from the standpoint of social justice and human rights, but also from an economic perspective.** It is crucial to emphasize the economic rationale for supporting social inclusion, highlighting the notion that failing to undertake efforts to foster inclusion is ultimately more costly.[a] The current societal expenses resulting from Roma exclusion can be considerable, encompassing implications like diminished productivity growth, reduced fiscal revenue, and heightened social assistance spending.

**The exclusion of the Roma workforce from the labor market can translate to significant losses in productivity, as shown by evidence from other countries.** Prior World Bank research examined the overall economic benefits of social inclusion experienced by the Roma population in Serbia. The findings indicated that if the Roma population of working age were to attain the same employment rates and labor earnings as the general population, the potential gains from higher productivity alone could vary from €314 million to €1.28 billion annually, representing approximately 0.9 percent to 3.5 percent of Serbia's gross domestic product (GDP) in 2017.[b]

**Furthermore, Roma exclusion results in fiscal losses, including reduced tax revenues and increased social assistance expenditure.** Enhancing equal labor market opportunities can generate fiscal savings by increasing tax revenue and reducing social assistance spending. These gains would be seen in higher social contributions, income tax payments, and corporate tax revenues due to higher productivity. Additionally, there would be savings through reduced social protection payments for working-age individuals, excluding pensions. For

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12  Iusmen, 2018.

13  Ethnicity is typically excluded from nationally representative household surveys, and administrative data are rarely disaggregated by ethnicity. Additionally, Roma individuals may not wish to self-identify as Roma, leading to undercounting in census data and under sampling in household surveys.

14  Robayo-Abril and Millan, 2019.

Serbia, previous evidence suggests potential fiscal benefits ranging from €78.1 million to €317.0 million (equivalent to 0.5 percent to 2.1 percent of government expenditure in 2017) resulting from increased tax revenue and reduced social assistance spending.[c]

**Quantifying the overall economic benefits of Roma inclusion is challenging.** This difficulty arises from the uncertainties in estimating the size of the Roma population, which can vary significantly between official Census figures and unofficial estimates, such as those from the Council of Europe and others. Additionally, household surveys often lack ethnicity identifiers, making it harder to gather accurate data. Furthermore, economic models rely on various assumptions, and the parameters used for the Roma population may differ substantially from those used for the general population.

**We focus on modeling one key aspect: how increasing the educational attainment and labor force participation rates of the working-age Roma in Bulgaria and Romania from 2022 to 2030 can help mitigate the decline in their labor force, ultimately benefiting the overall labor force in these countries.** The overall labor force decline is driven by adverse demographic trends, such as population aging and outmigration. A shrinking working-age populations and labor force in these countries is a major concern; as more individuals reach retirement age, there are fewer working-age people available to fill jobs. This can lead to a shortage of skilled workers, economic slowdown, increased pressure on social security systems, and ultimately hinder economic growth. We chose these countries given the larger shares of Roma population and the availability of some ethnicity identifiers in the household surveys. Our approach relies on information on labor market outcomes from the available household surveys, population estimates from various sources (Census 2021, households surveys and Council of Europe), and UN Population projections (See Annex B for details).

The baseline and policy scenarios are described below.

- **Baseline:** This scenario assumes that the Roma will maintain the same low educational attainment and labor force participation rates currently observed, with no additional inclusion efforts from 2022 to 2030. As a result of a shrinking working-age population, the size of the labor force among the Roma is projected to decline, consistent with UN population projections (see Figure B2.1.1, panel a).

- **Scenario 1:** This scenario assumes higher labor force participation rates among the Roma based on age and education, without adjusting their educational attainment levels. Specifically, it anticipates a yearly increase of 1.6 percentage points in LFP among working-age (25–64) Roma across all education levels from 2021 to 2030. This increase helps stabilize the labor force, compensating for reduced growth in the working-age population (see Figure B2.1.1, panel b).

- **Scenario 2:** In this scenario, we assume that the Roma have higher human capital, resulting in an increased share of Roma in the high-skill group. However, their labor force participation rates remain unchanged. More educated Roma are likely to engage more in the labor market, which could lead to a higher proportion of educated individuals within the labor force. Despite this, the overall labor force still declines due to an aging population; however, a larger share of the remaining labor force is more educated and, therefore, more productive (see Figure B2.1.1, panel c).

- **Scenario 3:** This scenario combines elements from Scenarios 1 and 2, assuming both higher human capital and increased labor force participation rates among the Roma. In this scenario, labor force participation increases sufficiently to offset the decline in the working-age population, while also increasing the proportion of better-educated individuals within the Roma labor force. This scenario is the most beneficial for counteracting adverse demographic trends, as it results in a larger, more educated Roma workforce, ultimately translating to higher productivity (see Figure B2.1.1, panel d). Similar results are obtained in Romania.

**These estimates suggest that implementing policies to enhance both educational attainment and labor force participation among the Roma could yield significant benefits.** By focusing on inclusion efforts, not only can the decline in the Roma labor force be mitigated, but the overall productivity and economic contributions of this group can also be substantially improved.

**FIGURE B2.1.1** **Projected numbers of working-age Roma in the Labor Force, Bulgaria, Baseline vs. Policy Scenarios (2022-2030)**

a. Baseline: No increase in LFP and human capital among Roma

b.Scenario 1: Increasing LFP among Roma

c. Scenario 2: Assume higher human capital stocks among Roma

d. Scenario 3: Assume higher human capital stock and labor force participation among Roma



Low-skill   High-skill
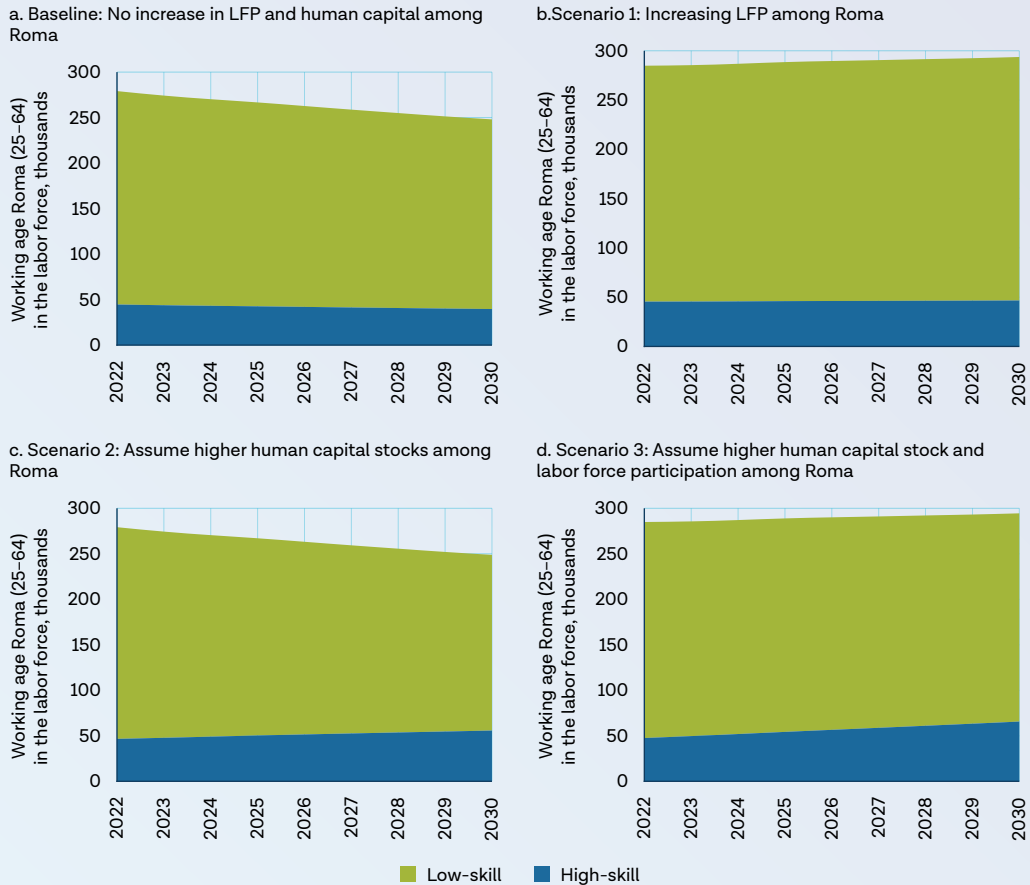
*Source:* Own estimates based on Bulgaria, 2021 National SILC (2020 Income year). Low-skill is defined as having a primary education or less, while high-skill is defined as having a secondary education or more.

**Addressing the rising expenses associated with pensions, healthcare, and long-term care necessitates an expansion of the active population.** Leveraging the Roma population, characterized by a high birthrate, can aid in replenishing the working-age demographic. However, this is contingent on providing sufficient opportunities for Roma to acquire human, physical, and social capital, and to participate in the labor market. Presently, the disparities between the Roma and the general population are substantial, necessitating a comprehensive effort to bridge these gaps.

a. Robayo-Abril, M & Natalia Millan, 2019. "Breaking the Cycle of Roma Exclusion in the Western Balkans," World Bank Publications—Reports 31393, The World Bank Group.
b. World Bank, 2015. "Roma in Serbia, A Generation of Opportunities: The Economic and Fiscal Benefits of Roma Inclusion in the Western Balkans." Background paper, World Bank, Washington, DC.
c. World Bank (2015).

# Poverty and inclusion trends: Significant progress but some challenges going forward

The EU has made significant strides in poverty reduction. The poverty rate, defined as the percentage of the population living on less than $6.85/day in 2017 PPP, has halved from approximately 4 percent in 2009 to less than 2 percent in 2022,[15] and more than 7 million people have been lifted out of poverty (Figure 2.13). Reflecting this remarkable achievement, the share of those vulnerable to economic shocks (orange area) and potentially falling into poverty[16] has decreased significantly from about 10 percent to less than 5 percent of the population. Moreover, the percentage of the population considered middle- or upper-class[17] has notably increased over these years (gray area). Similar positive trends have been observed in the anchored AROP (at-risk-of-poverty) measure (fixed in 2019), with poverty rates decreasing from around 21.5 percent to 14.1 percent across the region during the same period.[18]

Countries that initially had higher levels of absolute poverty tend to experience faster poverty reduction. From 2009 to 2022, several EU countries, notably Lithuania, Latvia, and Estonia, experienced a strong reduction in absolute poverty (Figure 2.14). The decrease in poverty is positively associated with their initial poverty levels. This pattern of unconditional poverty convergence indicates that poorer EU members are catching up with wealthier ones. This means that over time, as economic growth occurs, lower-income countries tend to catch up with higher-income countries in terms of poverty levels, regardless of other influencing factors, and the pattern is partly related to the GDP per capita convergence mentioned in section 1. However, the rate

**FIGURE 2.13  Poverty and Vulnerability have decreased substantially in the EU**

Evolution of economic classes, EU27, 2009–2022



Income > US$14/day
Income Between US$6.85/day and US$14/day
Income < US$6.85/day
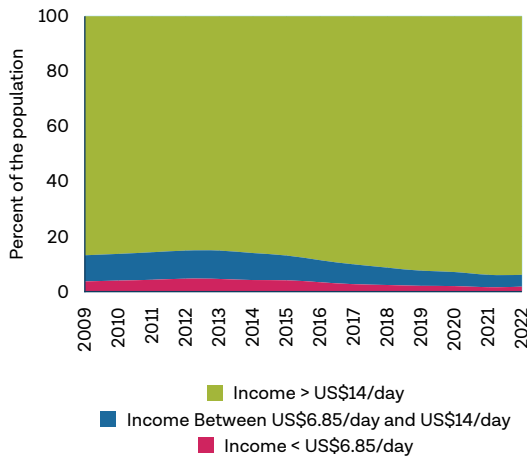
*Source:* World Bank calculation based on EU-SILC 2010–2023.

*Note:* The figure excludes Germany, for which microdata is not available. Netherlands is also excluded in 2022, as microdata was not available. We define those at risk of falling into poverty as those whose incomes are between US$6.85/day and US$14/day.

**FIGURE 2.14  The evolution of poverty shows unconditional convergence across the EU**

Poverty rate change between 2009 and 2022 and initial poverty rate in 2009
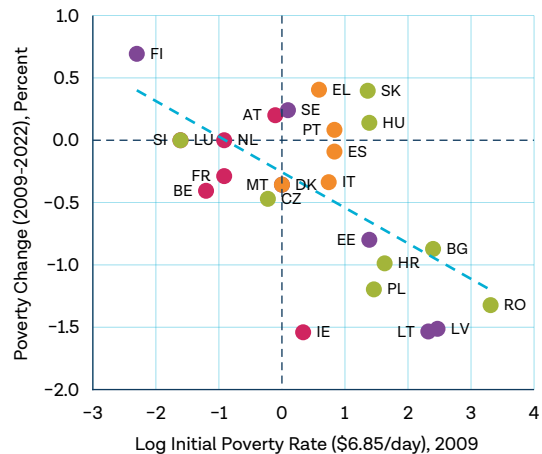


*Source:* World Bank calculation based on EU-SILC 2010 and 2023.

*Note:* We use the 6.85 USD 2017 PPP poverty line to compare by periods and across countries.

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15  2022 refers to the income reference year based on the 2023 EUSILC-survey year. No more recent estimates are available.

16  Vulnerability to poverty is defined as those living with US$6.85–$14 per day in 2017 purchasing power parity prices. This is an operational measure developed by the World Bank.

17  Identifying a middle class is challenging within a country and even more so in a global or regional context. Different approaches give rise to wildly differing estimates and understandings of the middle class. Therefore, we do not distinguish between the middle and upper classes. There is underreporting of income at the top and under coverage of richer households in household surveys.

18  The anchored AROP for the EU excludes Germany, for which microdata is not available.

of convergence is not uniform. Countries like Romania (ʀᴏ) and Latvia (ʟᴠ), which had higher initial poverty rates, show the most significant reductions in poverty. In contrast, Bulgaria, despite starting from high poverty levels in 2009, has made slightly less progress in reducing poverty compared to other ᴇᴜ countries with similar initial income levels. Considering the differentiated impacts of the war in Ukraine across countries, regions, and population subgroups, it is essential to continue monitoring convergence dynamics over time.

ᴇᴜ member states have also witnessed inclusive growth, leading to a substantial reduction in inequality across the region. Over the span of thirteen years, from 2009 to 2022, the Gini index exhibited a notable decline, from approximately 36.7 to less than 32.1 (Figure 2.15). This positive trend in poverty and inequality reduction has been driven by an increase in the income of the less well-off. Economic growth has been slightly pro-poor, with income for the bottom 40 percent of the population on the income distribution growing at an annualized rate of over 3.3 percent between 2016 and 2022 on average (Figure 2.16). This growth outpaced the average population's income growth by approximately 0.3 percentage points on average over the same period. This trend towards more equitable income growth, with faster increases among the less well-off, has been observed across most ᴇᴜ member states, contributing significantly to poverty reduction. Some countries, such as Bulgaria, Romania, Ireland and Spain have achieved large, shared prosperity premiums.[19] Moreover, the prosperity gap, defined as the average factor by which incomes must be multiplied to attain a prosperity standard of $25, has decreased in most ᴇᴜ countries. In particular, Bulgaria and Romania have experienced notable reductions, with Bulgaria's prosperity gap dropping from 3 in 2015 to 1.4 in 2022, while Romania's dropped from 3.9 to 1.7 in the same period.

**FIGURE 2.15  The EU has witnessed a marked reduction in inequality**

Evolution of income inequality, EU27, 2009 – 2022
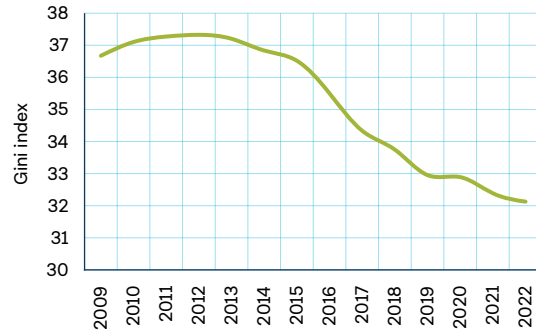


*Source:* World Bank calculation based on EU-SILC 2010 – 2023.

*Note:* The figure presents the Gini index (adult equivalent) of disposable income for the EU27, excluding Germany. The 2022 estimate also excludes Netherlands. A Gini index equal to zero means perfect equality, while a Gini index equal to 100 means complete inequality.

**FIGURE 2.16  Most EU countries witnessed substantial income growth among the less well-off**

Annualized growth in income per capita for the bottom 40 percent and the overall population (percent), EU27, 2016 – 2022



■ Growth B40     ● Mean growth
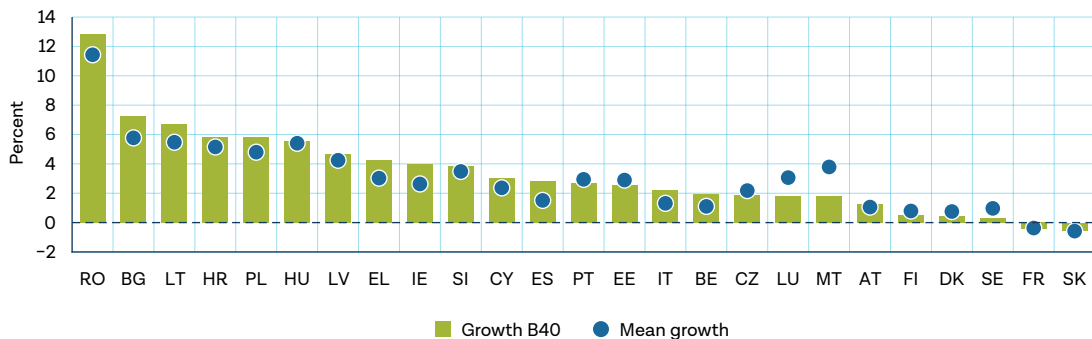
*Source:* World Bank calculation based on EU-SILC 2017 and 2023.

*Note:* "Growth B40" represents the average annualized growth of per capita income for the bottom 40 percent, while "Mean growth" represents the average annualized growth rate of per capita income for the entire population. The figure excludes Germany, for which microdata is not available.

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19  The Shared Prosperity Premium is defined as the difference between the annual income growth of the bottom 40 percent and the mean income growth of a country.

**Expanding employment opportunities and rising labor income have significantly contributed to poverty reduction in recent years, but almost one-tenth of all workers across the EU27 remain at-risk-of-poverty.** As in most economies, labor is the most important income source for European households. Labor earnings constituted a primary income source for the poor that year, with approximately one-third of the lowest quintile's income stemming from labor incomes. Job opportunities and earnings saw considerable growth, particularly among those at the bottom of the income distribution, contributing to approximately 44 percent, on average, of the observed poverty reduction between 2016 and 2021 using the anchored AROP line of 2019. Despite these advancements, labor-market challenges remain, prompting a deeper exploration of labor-market dynamics. In the 2022 income year, 8.3 percent of all EU-27 workers aged 18 – 64 lived in households that were at risk of poverty.[20]

**Since 2009, Bulgaria, Croatia, Poland, and Romania have significantly reduced the proportion of their population that sits at the lower levels of the EU's income distribution, although substantial gaps persist.** Following their integration into the EU, most of the population of these countries fell into the EU's bottom 40 percent by income: the proportion stood at 96 percent of the population in Romania, 87 percent in Bulgaria, 75 percent in Poland, and 72 percent in Croatia (Figure 2.17). By 2022, these countries had improved their economic conditions, with the proportion of individuals living at the bottom of the EU's income distribution ranging from 45 percent in Poland to 76 percent in Romania. Despite these advances, further efforts are required to overcome persistent spatial disparities within the EU and foster economic convergence throughout the EU.

**FIGURE 2.17** **Most individuals in Bulgaria, Croatia, Poland, and Romania are at the lower end of the EU's income distribution, but there have been steady improvements over time**

Share of the population of each country in the EU's bottom 40
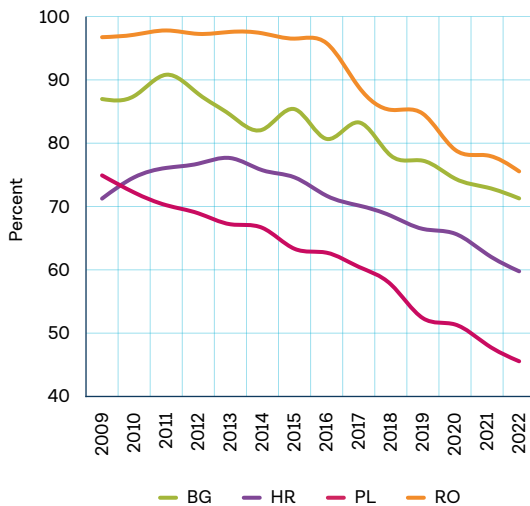


*Source:* World Bank calculation based on EU-SILC 2010 and 2023.

*Note:* The figure provides a relative comparison over time of the proportion of individuals (adult equivalent) in each country who are among the bottom 40 percent of the population in 26 EU countries (EU27 excluding Germany).

**Going forward, the sectoral shifts in employment and the cost-of-living crisis could have adversely impacted the bottom 40 percent of households (B40) in four Central and Eastern European economies (4CEEs).** As shown in section 2.1, since 2019, there has been a steady decline in employment within key sectors such as mining, quarrying, manufacturing, and agriculture, where many lower-income individuals work, limiting job opportunities for the B40, particularly for those with lower education or skills relevant to these industries. Additionally, inflation is expected to disproportionately affect poorer households, as their spending primarily focuses on essentials like food and utilities, which experienced some of the steepest price increases.

**After the economic rebound in 2021, the escalation of food prices has emerged as a pressing concern for households in the region, particularly those on lower incomes.** In recent years, there has been a notable uptick in inflation, leading to a detrimental effect on real wages. By September 2024, consumer prices in the four countries considered in this analysis — namely Bulgaria, Croatia, Poland, and Romania — had surged by over 24 percent compared

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20  Source: Eurostat, https://ec.europa.eu/eurostat/databrowser/view/ilc_iw01/default/table?lang=en

to before the inflation crisis in September 2021 (Figure 2.18). This steep price rise can primarily be attrib-
uted to the rapid inflation in food prices during the same period, resulting in an increase of more than
35 percent in these four EU countries. The escalation in food prices is expected to have worsened pov-
erty and compromised food security.[21]

**FIGURE 2.18**  **Food and energy prices have experienced a significant cumulative rise in recent years**

Evolution of prices (index), January 2019 – September 2024



a. Bulgaria

b. Croatia

c. Poland

d. Romania

HICP index:  — Total  — Food  — Energy
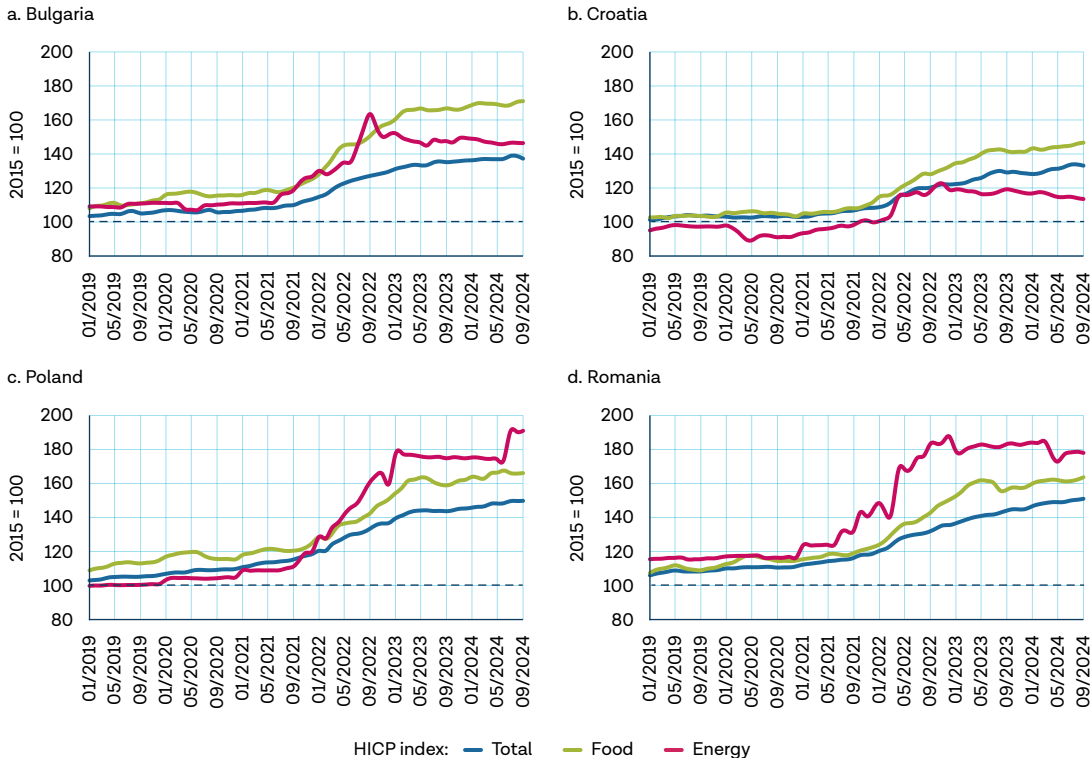
*Source:* Eurostat (prc_hicp_midx), 2019 M1 – 2024 M9. "Food" includes food and non-alcoholic beverages, and energy includes
electricity, gas and other fuels.

**Despite the recent reduction in food inflation, it remains a critical issue for the poor, as current price
levels are still historically high.** The poor, already struggling to recover from the economic fallout of the
COVID-19 crisis, were hit again by the inflationary shock, creating a chain of setbacks that hinder a return
to pre-pandemic conditions. Going forward, the poor may continue to face challenges in managing high
cost of living costs, compounded by the likelihood of tighter fiscal space, which could further constrain
social assistance programs and limit support for vulnerable populations.

**Households' vulnerability to higher prices depends not only on price increases but also on income and
consumption patterns.** Given that the harmonized index of consumer prices (HICP) monitors the expens-
es associated with a representative basket of goods, the index provides a reasonable estimate of the infla-
tion experienced by an average household. As such, overall inflation and food inflation may not accurate-
ly mirror the inflation experienced by the less well-off, as their spending habits diverge from those of the

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21  Energy prices have also risen significantly in recent years, especially in Poland and Romania. The distributional effects of
these higher energy prices have already been analyzed in the previous EU RER (https://www.worldbank.org/en/region/eca/
publication/eurer#:~:text=The%20EU%20Regular%20Economic%20Report,countries%20(EU%2DCEE)). Consequently, this
analysis now shifts its focus to the poverty and distributional impact of higher food prices in these four countries.

average household. The less well-off spend a larger share on food, which creates a challenge to cope with higher prices. For instance, in Romania, the first decile allocates approximately 51 percent of its expenditure to food, whereas in Poland, it is around 38 percent (Figure 2.19). In contrast, those in the top decile in these countries spend only about 25 and 13 percent of their overall expenditure on food items, respectively. Consequently, it is foreseeable that the poorest decile would consistently experience higher food inflation rates compared to the average population and the wealthiest decile. This implies that food inflation has the potential to result in more significant welfare losses for low-income individuals, rendering them more vulnerable to these types of shocks. Given that a substantial portion of their income is allocated to essentials, the less well-off have limited flexibility to navigate through food price hikes.

**FIGURE 2.19  Food inflation can affect the less well-off relatively more**

Household consumption expenditure on food and nonalcoholic beverages (percent consumption)
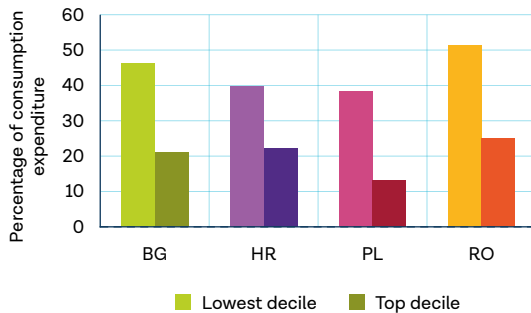
*Source:* World Bank calculations using harmonized HBS data. Note: Years are: Bulgaria 2019, Croatia 2017, Poland 2019, and Romania 2019.

**Households confront the significant task of safeguarding themselves against sudden price fluctuations that could deeply affect their financial stability.** In Romania and Croatia, over 40 percent of survey participants expressed their inability to manage unforeseen expenses in 2022 — the highest share among EU countries (Figure 2.20). In Poland, approximately 30 percent struggled significantly. The situation was more severe for those on lower incomes. In Romania and Croatia, roughly 80 percent of individuals earning less than 60 percent of the median equivalized income found themselves ill-prepared to handle unexpected financial burdens, while in Poland, the corresponding percentage exceeds 45 percent.

**FIGURE 2.20  Many poor households are vulnerable to shocks as they are unable to face unexpected expenses**

Economic strain, inability to face unexpected financial expenses, 2022
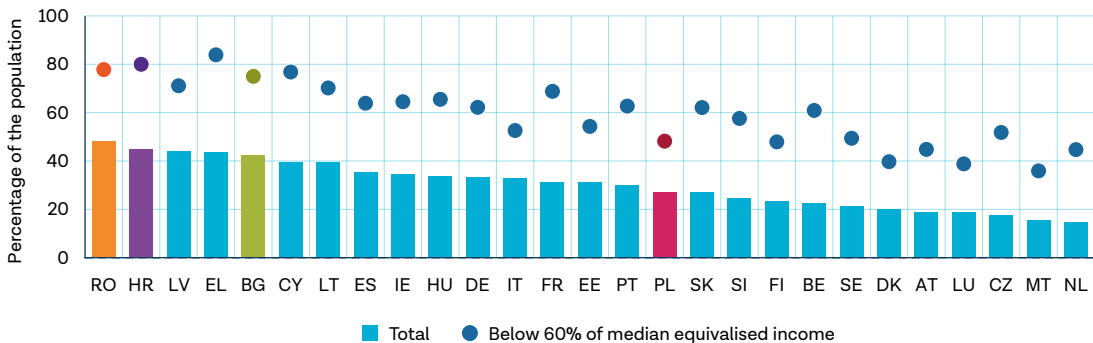
*Source:* Eurostat (ILC_MDES04), 2022.

**The impact of rising food prices disproportionately affects the less well-off.**[22] According to microsimulation findings (see Box 2.2 for details), the direct short-term consequence of food price inflation is welfare reduction across all four countries. A hypothetical food price hike of approximately 20 percent (a

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22  The simulations are not direct observations, but rather estimates representing our best assessment of the potential poverty and distributional impacts of rising food prices. These figures should be viewed as best estimate of what might have occurred under specific assumptions, and several channels of transmission cannot be modeled (see Box 2.2 for details).

baseline scenario) is anticipated to result in a short-term increase in poverty rates — measured at the upper-middle-income poverty line of $6.85/day in 2017 PPP terms — of 0.25 pp in Poland and 1.4 pp in Romania (Figure 2.21). The increases in poverty rates become even more pronounced with hypothetical food price increases of 30 and 40 percent. In the former scenario, poverty rates increase range from by 1.7 pp. in Bulgaria to and 2 pp. in Romania. In the latter scenario, these rates climb from 2.4 pp. to 3.5 pp. in both countries, respectively.

**FIGURE 2.21** Food inflation could lead to significant increases in poverty

Simulated poverty rates, pre-shock vs post-shock food inflation scenarios, $6.85 poverty line (2017 PPP)
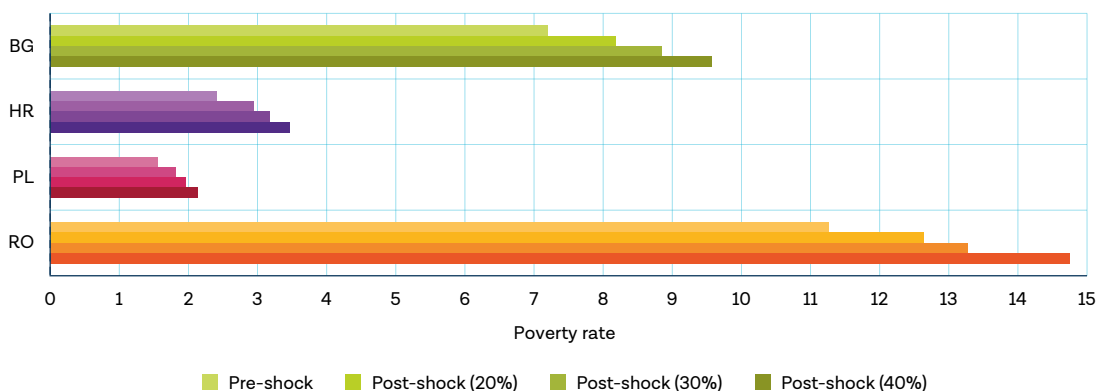


*Source:* World Bank staff simulations based on HBS-2019 and EUSILC-2020 for Bulgaria and Romania, while for Poland is based on HBS and EUSILC of 2019 and for Croatia is based on HBS-2017 and EUSILC-2020 surveys.

*Note:* Welfare is estimated in U.S. dollars using 2017 PPPs in all countries. "Pre-shock" refers to poverty rates before food prices increase, and "Post-shock" refers to a simulated poverty rates after food price increases of 20 percent, 30 percent, and 40 percent. The figure does not assume government support.

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**BOX 2.2** Simulating the distributional impact of rising food prices

**This section examines the welfare implications of escalating food prices and explores potential government responses.** To assess the distributional effects of higher food costs, this analysis relies on the most recent rounds of household surveys conducted in Bulgaria, Croatia, Poland, and Romania, specifically the Household Budget Surveys and EU-SILC. This data enables an examination of food expenditure patterns across different demographic and income groups.

**The analysis evaluates changes in the overall consumer surplus in response to increases in food prices.**[a] As such, the results of these simulations should be interpreted as short-term marginal welfare impacts.[b] Recognizing that some households can adjust their food consumption in response to price fluctuations, we consider a price elasticity of food demand of –0.25 for households above the third decile of the income distribution, and of zero for households below the third decile.[c] Additionally, the simulations can be further refined to account for any government transfers received by households.[d]

**Given the data limitations, it is not possible to take into account within-country spatial variation in prices, which could be an additional source of distributional impacts.** Unfortunately, there are no subnational Consumer Price Indexes (CPIs) in the four EU countries considered. Subnational data, especially for food CPIs, would be valuable for a more granular understanding of regional disparities and convergence in economic conditions.

**The simulations account only for the consumption impact of rising food prices, overlooking households' role as food producers.** This provides a partial picture of the overall effects, as it does not capture the potential benefits some households might experience through increased income from food production. Consequently, the analysis may underestimate the positive impact higher food prices could have on producer-consumer households.

**Furthermore, the simulations do not account for any behavioral changes, and capture first-order effects, meaning the direct, immediate impacts without factoring in any secondary or adaptive responses that might occur over time.** This means we do not model how consumers might adjust their spending patterns by substituting towards other goods in response to rising food prices. This limitation restricts the analysis to the direct effects of price increases without considering how individuals or households might adapt to mitigate these adverse welfare impacts.

Annex A presents more details on the methodology.

a. Deaton, A. 'Rice prices and income distribution in Thailand: A non-parametric analysis', Economic Journal, Vol. 99, (1989) pp. 1–37.
b. Ferreira, F., A. Fruttero, P. Leite, and L. Lucchetti. 2013. "Rising Food Prices and Household Welfare: Evidence from Brazil in 2008." Journal of Agricultural Economics. 64 (1), 151-176.
c. Freund, Caroline, and Christine Wallich. 1996. "The welfare effects of raising household energy prices in Poland." The Energy Journal, Vol. 17, No 1, pp. 53-77.
d. Ferreira et al., 2013.

**Rising food prices exacerbate income inequality.** Certain demographic groups are simulated to experience more significant impacts from rising food prices. For instance, in Poland, Croatia, and Romania, rural households are particularly vulnerable to this shock.[23] A 20 percent rise in food prices is projected to temporarily increase the Gini index by 0.75 and 0.34 in Bulgaria and Croatia, respectively (Figure 2.22).[24] Income inequality increases even further with food price increases of 30 percent and 40 percent. The increase in inequality is the result of an asymmetric impact on welfare across the entire income distribution. On average, welfare impacts are notable, ranging from a 4.4 percent decline in Poland to a 7.5 percent decline in Romania (Figure 2.23).[25] However, these impacts exhibit a regressive pattern in all countries, with welfare reductions ranging from approximately 10.3 to 7.7 percent in the poorest decile and from about 5 to 2.6 percent in the top decile.

**Existing social transfer programs could alleviate the negative welfare impact of economic shocks.** Simulations show that the adverse effects of higher food prices on the extreme poor (those in the first decile) can be partially mitigated through government interventions. For instance, increasing the Guaranteed minimum income (GMI) benefit transfers serves as a coping measure to mitigate the income reduction experienced by the less well-off (Figure 2.23). However, since these transfers

**FIGURE 2.22  Income inequality is expected to increase in the absence of government measures**

Simulated changes in income inequality—measured by the Gini index—due to food inflation



*Source:* World Bank staff simulations based on HBS-2019 and EUSILC-2020 for Bulgaria and Romania, while for Poland is based on HBS and EUSILC of 2019 and for Croatia is based on HBS-2017 and EUSILC-2020 surveys

*Note:* Welfare is estimated in U.S. dollars using 2017 PPPs in all countries. "Post-shock" refers to a simulated increase in inequality rates after food price increases of 20 percent, 30 percent, and 40 percent. The figure does not assume government support.

23  However, simulations do not consider households as food producers, which may lead to an overestimation of the rural impact.

24  The Gini index is a statistical measure of inequality that ranges from 0 to 100, where higher values represent a higher degree of equality.

25  The price change incidence curve (Ferreira et al. 2012) depicts the percentage reduction in income at each percentile of the income distribution and is equivalent to the growth incidence curve developed by Ravallion and Chen. 2003. 'Measuring pro-poor growth', Economics Letters, Vol. 78 (pp. 93–99.).

predominantly target individuals with lower incomes, most of the mitigating impact occurs within the first decile of the income distribution in most countries, with limited benefits for the other income groups. Most of the new poor that result from higher food prices would not be covered by these programs. As such, increasing benefits for existing beneficiaries would effectively bolster their income but leave a significant portion of the population without protection. Expanding the coverage to assist the newly impoverished could effectively contain the rise in poverty rates. However, it is not always simple to expand coverage, as it may also potentially contribute to increased inequality among those in poverty. Section 3 provides a further discussion on the role of the social protection systems in tackling policy challenges going forward.

**FIGURE 2.23** **Household income is expected to fall along the welfare distribution**

Percentage reduction in income at each decile of the income distribution from food price shock and increase in GMI



Deciles of welfare distribution

— Food Shock (20%)   — Increasing GMI
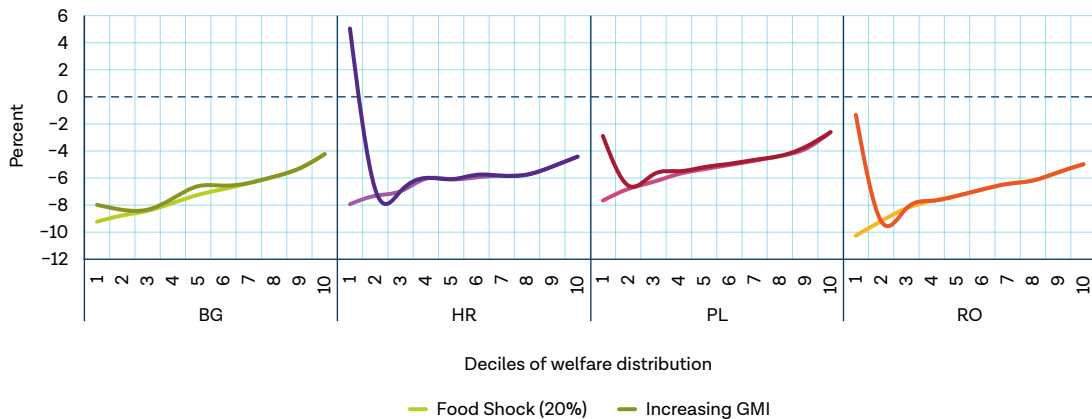
*Source:* World Bank simulations based on most recent surveys.

*Note:* Welfare is estimated in U.S. dollars using 2017 PPPs. The figure shows the simulated welfare percentage changes after the food price increases. "Food Shock (20 percent)" refers to a simulated impact after a food price increase of 20 percent, while "Increasing GMI" refers to the impact after expanding GMI benefits by 50 percent. For GMI identification, the variable "social exclusion not elsewhere classified" from the EU-SILC is used.

**Financial inclusion can also help alleviate the impact of unexpected shocks.** Access to financial services allows individuals and businesses to save money securely, send and receive payments, and access investment opportunities. It promotes the inclusion of different groups, such as women and rural populations, and empowers low-income individuals by providing tools to manage their finances and invest in education, healthcare, and small businesses, thereby improving their livelihoods. Financial inclusion also helps low-income families manage risks and shocks, such as medical emergencies, natural disasters, and/or higher prices.

**In the European countries considered, the share of individuals with a financial account has steadily increased between 2011 and 2021, although the less well-off still face substantially lower ownership rates.** Before the rise in inflation, account ownership rates for the poorest 40 percent ranged from 57 percent in Romania to 94 percent in Poland in 2021 (Figure 2.24). A large share of Roma does not have a bank account,[26] contributing to their vulnerability. Despite the improvement in ownership rates since 2011, the gap with the richest 60 percent has decreased in Poland along, among the countries considered. Moreover, access to accounts in Croatia, Poland, and especially Bulgaria and Romania, is much lower than in the Euro area. Expanding the access (and use) of financial services to the less well-off may be a relevant tool to tackle the unequal distributional impacts of shocks.

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26 FRA, 2022.

**FIGURE 2.24** Account ownership has increased significantly, yet disparities persist

Ownership of Account or use of mobile-money service provider for in selected EU countries, 2011–2021
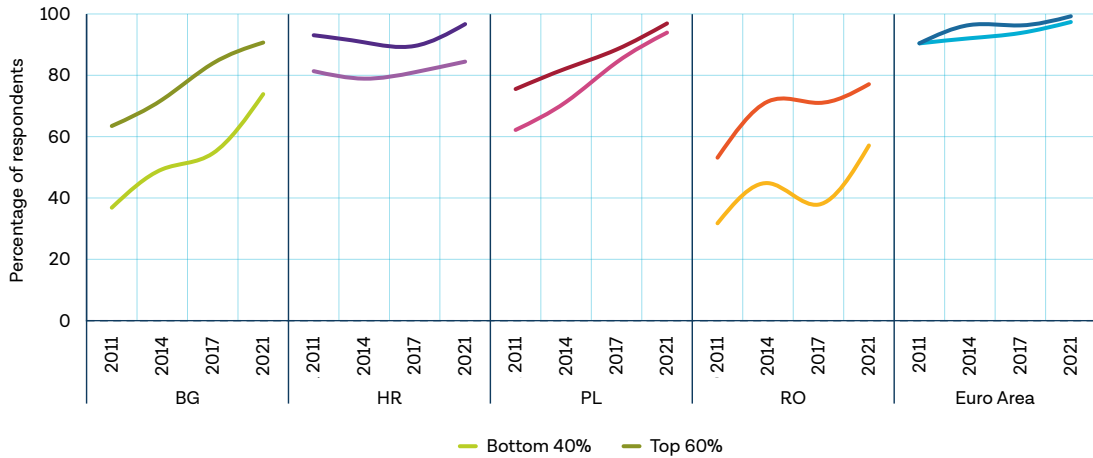


*Source:* Global Findex Database. More recent data is not available.

*Note:* This figure shows the percentage of respondents who report having an account (either individually or jointly) at a bank or another type of financial institution, or who report personally using a mobile money service in the past year.

**The less well-off borrow relatively less from financial institutions, and the gap has increased over time.** Loans can help individuals smooth consumption, particularly during challenging economic times. However, borrowing rates remain low, especially among the less well-off. In 2021, the loan rates for the poorest 40 percent ranged from less than 15 percent in Romania to almost 30 percent in Poland, while for the richest 60 percent of the population, the rates ranged from about 22 percent in Bulgaria to about 40 percent in Croatia. Moreover, the gap in borrowing rates between these groups has been increasing over time, even in the Euro area (Figure 2.25).

**FIGURE 2.25** Borrowing has increased, though it remains low, and the gaps have widened

Respondents who report borrowing any money or using credit card in selected EU countries, 2011–2021
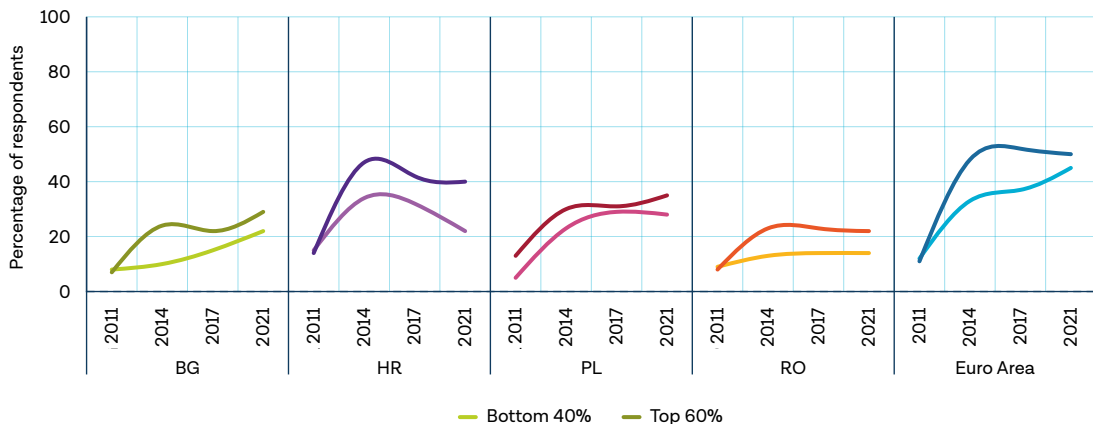


*Source:* Global Findex Database. More recent data is not available.

*Note:* This figure shows the percentage of respondents who report borrowing any money from a bank or another type of financial institution or using a credit card in the past year.

**Lack of access to financial instruments can hinder poor households' ability to cope with unexpected shocks and overcome hardships, affecting their investment opportunities.** In 2021, over 37 percent of the poorest individuals in Bulgaria, Croatia, Poland, and Romania were worried about not being able to pay

for medical costs in case of a serious illness or accident. Similarly, more than 20 percent were concerned about being unable to pay education fees in Poland and Bulgaria. Moreover, the gap between the poorest and the richest 60 percent was substantial and higher than in the Euro area in most cases (Figure 2.26).

**FIGURE 2.26** **The less well-off worry that they will not be able to access basic services**

a. Verry worried about not being able to pay school fees or fees for education, selected EU countries, 2011 – 2021
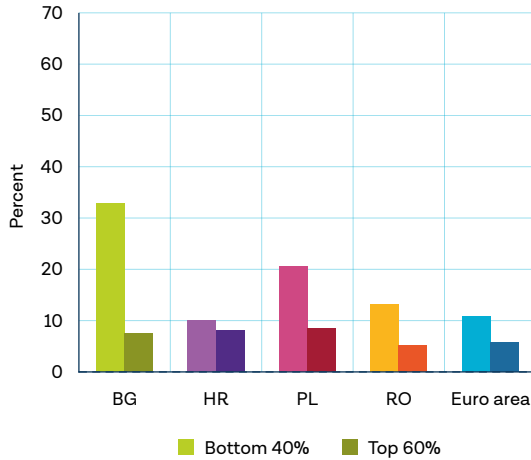
b. Verry worried about not being able to pay for medical costs in case of a serious illness or accident, selected EU countries, 2011 – 2021
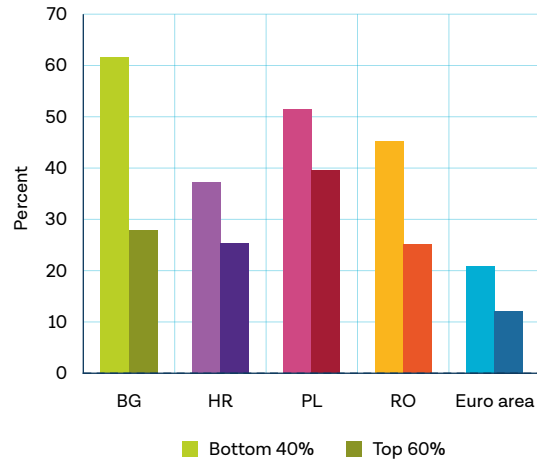


Bottom 40%    Top 60%

Bottom 40%    Top 60%

*Note:* This figure shows the percentage of respondents who report having an account (either individually or jointly) at a bank or another type of financial institution, or who report personally using a mobile money service in the past year.

*Source:* Global Findex Database.

*Note:* This figure shows the percentage of respondents who report borrowing any money from a bank or another type of financial institution or using a credit card in the past year.

Chapter 3

# The EU outlook remains weak in the near term, and downside risks continue to dominate

# The EU economy is expected to pick up, albeit from weak levels of activity

**After a sharp slowdown in 2023, a consumption-led recovery remains in the baseline, supported by real disposable income growth and tight labor markets, accompanied by a gradual loosening of financial conditions.** Growth is forecast to firm only slightly in 2024, to 0.7 percent,[27] supported by an ongoing recovery in real incomes but dampened by still-subdued investment, particularly for housing, and export growth. As a result, manufacturing activity is anticipated to remain weak in the near term. Consumer spending is expected to edge higher in 2024, as inflation declines and wages continue to rise, albeit at a more moderate pace than before. Having said that, the European Central Bank (ECB) forecasts the overall contribution of household consumption to the outlook to be a bit weaker than earlier projected. This is explained by somewhat weaker incoming data as well as recent survey data pointing to still subdued consumer confidence and stubborn household savings intentions. Savings remain above pre-pandemic levels given the absence of notable dissaving of pandemic-induced savings, with a large share of the savings accumulated by the richest households in illiquid assets.[28]

**As headwinds from earlier shocks fade, growth is anticipated to outpace that of potential output — which should help close the negative output gap — with the pickup driven in large part by private consumption.** Growth is forecast to pick up in 2025, to 1.4 percent, as the recovery in export and investment growth gathers pace, with the latter benefiting from lower policy rates and the absorption of EU funds but still constrained by elevated political uncertainty. Export growth is anticipated to improve alongside global trade (though not without risks)[29], but to remain somewhat subdued by historical standards amid slight euro appreciation and lingering competitiveness issues. Nevertheless, private consumption is expected to underpin the strengthening in growth as it continues to benefit from a resilient labor market and,

**FIGURE 3.1** Euro area output gap estimates
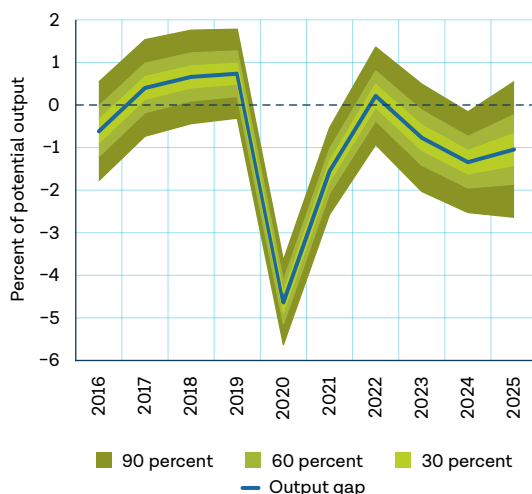


*Source:* Kilic Celik, Kose, Ohnsorge, and Ruch (2023). Based on the multivariate filter model of Kilic Celik et al. (2023).

eventually, from firming consumer confidence as real wages catch up, albeit at a slower pace than before. In 2026, economic activity is projected to expand at a relatively stable pace of 1.3 percent, slightly above potential growth estimates as reforms under the EU's NextGenerationEU plan start to bear fruit, with growth benefiting from rising green and digital investments. Private consumption is set to remain an important driver of growth as household spending and savings continue to normalize. Over the near term, the cyclical pick-up in growth, which is anticipated to outpace that of underlying potential growth, should help narrow the negative output gap (Figure 3.1).[30]

**The negative impact of earlier monetary policy tightening is anticipated to gradually ease over the forecast horizon.** The impact of the monetary policy tightening that took place between December 2021

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27  Euro area growth is subject to further revisions, and will be re-estimated for the World Bank's January 2025 edition of Global Economic Prospects.

28  ECB 2023.

29  World Bank 2024.

30  Kilic Celik, Kose, Ohnsorge, and Ruch (2023).

and September 2023 continues to feed through to the real economy, affecting the growth outlook — particularly for 2024. Although the ECB has started to cut its policy rates — first in June and then again in September of 2024 — the impact of these cuts will feed through the economy gradually, with credit conditions only materially loosening later in the forecast horizon given the lag in monetary policy transmission.

**In addition to the end of the monetary tightening cycle, fiscal policy is assumed to be slightly less of a drag on growth than under previous projections.** The fiscal stance (measured as the change in the cyclically adjusted primary balance) is expected to be in slightly expansionary territory over the forecast horizon despite the withdrawal of a large part of energy and inflation support measures, on account of slower than previously projected consolidation. However, the fiscal assumptions underlying ECB and European Commission forecasts are surrounded by considerable uncertainty pending the announcement of 2025 budget plans (DBPs) in most euro area countries and the implementation of the revised economic governance framework. The baseline only takes into account planned and announced fiscal policy measures and fiscal plans. While needed from the fiscal and debt sustainability perspective, a further fiscal tightening under the EGF — especially for countries in Excessive Deficit Procedures (EDPs) –presents a downside risk to baseline growth in the short term.

**The disinflation process is anticipated to continue, with inflation reaching the target by the end of 2025, albeit at a slower pace than before amid sustained pressure on core inflation.** Overall, the ECB projects average annual headline (HICP) inflation to slow from 5.4 percent in 2023 to 2.5 percent in 2024, 2.2 percent in 2025, and 1.9 percent in 2025. However, core inflation has been revised up marginally for both 2024 and 2025, to 2.9 percent in 2024, 2.3 percent in 2025, and 2.0 percent in 2026. Core inflation has been somewhat more persistent than expected, owing in part to stubbornly high services inflation. Nevertheless, the ECB expects a gradual slowing in core inflation over the forecast horizon, with wage growth and other cost pressures easing. Profit growth has declined notably and is assumed to partially buffer the pass-through of labor costs to prices, especially this year. Nominal wage growth has started to decline from elevated levels by a bit more even than anticipated, as the impacts from inflation compensation pressures due to a tight labor market fade. Labor cost pressures are expected to moderate alongside an improvement in labor productivity. Despite the projected pickup in labor projectivity growth, the level of productivity per person employed is anticipated to remain below the 2000 – 19 average over the next few years[31]. Still, the envisioned improvement to labor productivity growth could be curbed by structural factors, including the gradual reallocation of economic activity towards the services sector, the cost of the green transition, lingering impacts from the energy price shock, slower-than-expected adoption of new technologies, and a worsening of demographic trends.

## Risks to the EU outlook remain tilted to the downside

**Globally, risks to the outlook have become somewhat more balanced, given the continued resilience of the global economy to high financing costs but remain tilted to the downside amid heightened uncertainty** (Box 3.1). Worsening conflicts or escalating geopolitical tensions could have adverse impacts on global growth through commodity markets, trade, and financial linkages. Further trade fragmentation amid resurgent inward-looking policies carries the risk of additional disruptions to trade networks, supply chains, and economic activity. Conflict-related disruptions to oil supply from the Middle East could result in sizable oil price increases — in a more severe scenario, this could stall progress on global

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31 ECB 2024.

disinflation this year. Globally, trade policy uncertainty has risen to levels higher than those in other years with major elections since 2000. Among new trade-distorting policies, the use of subsidies has risen sharply since the pandemic. Advanced-economy interest rates are expected to remain well above 2000 – 19 average levels. Persistent core inflation in these economies could see interest rates remain higher for longer, substantially lowering global growth in 2025 by forestalling anticipated monetary easing and tightening financial conditions.

**BOX 3.1** **Global outlook**

**Global growth is expected to remain steady in 2024.** According to the June 2024 edition of the Global Economic Prospects, global growth is projected to hold steady at 2.6 percent in 2024, despite flaring geopolitical tensions and elevated financing costs, before edging up to 2.7 percent in 2025 – 26 alongside modest expansions in trade and investment. Following several years of overlapping negative shocks, the forecasts indicate signs of a stabilizing global economy. By historical standards, however, the global outlook remains subdued; growth in both advanced economies and EMDEs is expected to grow at a slower pace over the forecast horizon compared to the decade before the pandemic.

**High-frequency indicators point to firming global activity, although with increasing divergence across sectors.** The global composite Purchasing Managers' Index (PMI) has remained in expansionary territory since October 2023, with a pickup in services activity offsetting a further decline in the manufacturing sub-index. The gap between global services and manufacturing outturns by August 2024, was the largest in over a year. The weakening in manufacturing activity has been broad based, with PMIs in China, United States and the Euro area in contractionary territory for most of the year. Global headline consumer inflation decelerated at 3.5 percent in 2024 and is expected to continue easing (in line with average inflation targets), amid softening core inflation and modest decline in commodity prices. Latest incoming data point to global median headline inflation continuing its downward trajectory, easing at 3.4 percent (y/y) in August 2024.

**Global trade is projected to pick up after pronounced weakness last year.** Global trade is expected to expand by 2.5 percent in 2024, and 2.4 percent in 2025, after nearly stalling in 2023. By historical standards, however, global trade growth in 2020 – 24 is set to register as the slowest half decade of growth since the 1990s. Global goods trade has shown signs of recovery in 2024, after a sharp contraction in 2023, with volumes increasing by 1.8 percent (y/y) in June, driven by strengthening growth in emerging market and developing economies that offset the continued contraction in most advanced economies. Services trade growth continued to moderate in 2024, after increasing by 9 percent in 2023, reflecting a slowdown in travel services. Despite a sharp increase in maritime transit and freight rates amid the ongoing disruptions in the Panama and Suez Canals, these elevated rates have not significantly increased supply chain pressures or global delivery times, partly due to the frontloading of imports into the United States in anticipation of potential global trade disruptions. Nevertheless, the number of implemented trade policy interventions restricting trade remains five times higher than the 2010 – 19 average, although slightly lower than in 2023, weighing on global trade.

**Global financial conditions have generally eased since 2023.** By mid-2024, the United States began reducing policy rates amid softening labor markets and easing inflation. Market expectations for U.S. policy rates for 2025 – 26 have been revised down significantly since June, narrowing the divergence in economic activity with other advanced economies. Reflecting these developments, the U.S. dollar in September has depreciated by 5 percent since June, which has alleviated some pressure for EMDE currencies. Risk appetite remains robust in advanced economies and EMDEs with strong credit ratings, while financial stress concerns remain acute in about 40 percent of EMDEs with weak credit rating or in high debt distress. In China, risk appetite remains subdued amid weak domestic demand and a sluggish recovery in the property sector.

**Global commodity prices have continued to ease in 2024, reflecting improving supply conditions and softer-than-anticipated global industrial activity.** Brent crude oil prices have fluctuated this year, surpassing US$90/bbl in April in the context of escalating tensions in the Middle East, but have declined to US$73/bbl by September, as slowing economic activity and reduced oil consumption in China, combined with softening U.S. growth, put downward pressure on prices. In response to declining oil prices, OPEC+ members recently announced a delay to the planned unwinding of voluntary cuts for at least two months. The price of European

natural gas has declined by 25 percent compared to last year, averaging $10/mmbtu so far this year, reflecting robust production, mild winter weather, and elevated inventories. However, recent data points to a pick-up in prices by 20 percent (m/m) in August, highest level this year, reflecting some supply disruptions and concerns about further gas flow disruptions from Russia through Ukraine. Agriculture prices have remained broadly stable so far in 2024, reflecting robust global supply and record high production for some grains. Metal prices have also remained somewhat stable as weaker commodity demand for real estate in China is offset by firming global industrial demand. However, gold prices reached another record high in August, at nearly US$ 2,500 per ounce, due to strong demand from central banks and heightened geopolitical tensions.

**FIGURE B3.1.1** Global Indicators

a. Global growth
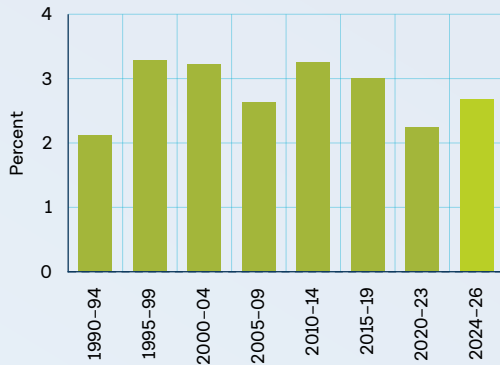
b. Goods trade growth
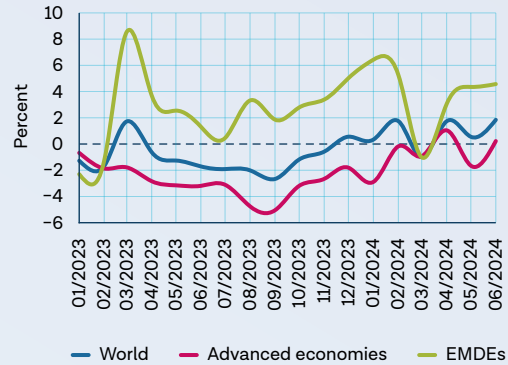
c. Global PMI
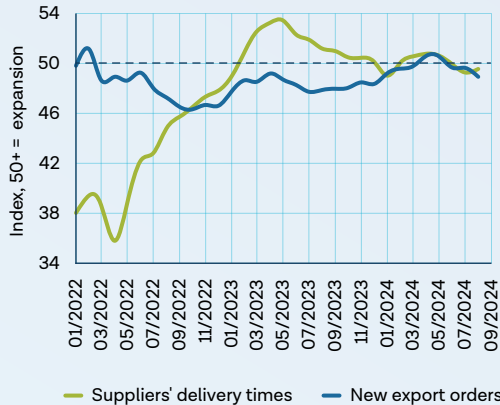
d. Global manufacturing PMI and oil prices
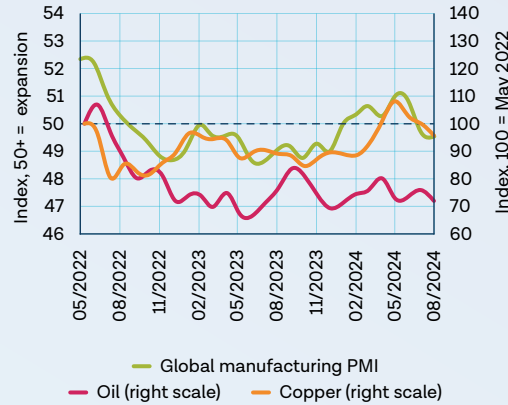
*Sources:* Bloomberg; CME; CPB Netherlands Bureau of Economic Analysis; Federal Reserve Bank of St. Louis; Haver Analytics; World Bank.

*Notes:*
Panel a: GDP aggregates calculated using real U.S. dollar GDP weights at average 2010–19 prices and market exchange rates.
Panel b: Panel shows year-on-year percentage change of goods trade volumes. Last observation is February 2024.
Panel c: Readings above (below) 50 indicate expansion (contraction). Last observation is April 2024.
Panel d: Monthly average oil prices indexed to May 2022 = 100, except for last observation which is the month-to-date average until April 15th, 2024. Last PMI observation is April 2024.

The EU outlook remains subject to considerable downside risks, many of which stem from external factors and could compound lingering weakness in longer-term drivers of growth. The materialization of a number of risks — including an escalation of armed conflict and broader geopolitical risks, greater trade fragmentation and trade policy uncertainty, and tighter than expected credit conditions — could exacerbate the ongoing adverse impacts on growth.

**The EU economy remains exposed to the risk of worsening armed conflict and geopolitical tensions, continuing to put pressure on prices.** Risks related to armed conflict have increased sharply given the ongoing conflict in the Middle East, attacks on vessels in the Red Sea, a marked deterioration in security conditions in parts of Sub-Saharan Africa, and Russia's ongoing invasion of Ukraine. Since a fraction of goods to and from the EU transit the Red Sea, further disruptions could lift manufacturing PPI and core goods CPI by a peak impact of 3.7 percentage points and 1.1 percentage points — this would translate into a 0.3 percentage point increase in headline inflation and a 0.4 percentage point increase for core inflation (Figure 3.2, panel a).[32] The EU economy could also face negative spillovers from adverse effects on global commodity markets (Figure 3.2, panel b). If the conflict in the Middle East intensifies, it could trigger disruptions to the global supply of oil and cause large commodity price spikes, potentially undermining efforts to bring inflation back to target in EU economies. Furthermore, uncertainty around the evolution of Russia's invasion of Ukraine poses continued risks to commodity markets — including for oil products and grains — and regional security. Moreover, some of the challenges posed by conflicts could be compounded in the longer term by wider geopolitical tensions, which could result in commodity, finance, trade, and labor markets becoming increasingly segmented into regional blocs. Historically, periods of heightened geopolitical risks have been associated with large adverse effects on economic activity.[33]

**FIGURE 3.2** **Geopolitical impacts on shipping costs**

a. Eurozone: Estimated Impacts from Shipping Costs

b. Brent oil prices under conflict-related oil supply disruption scenarios
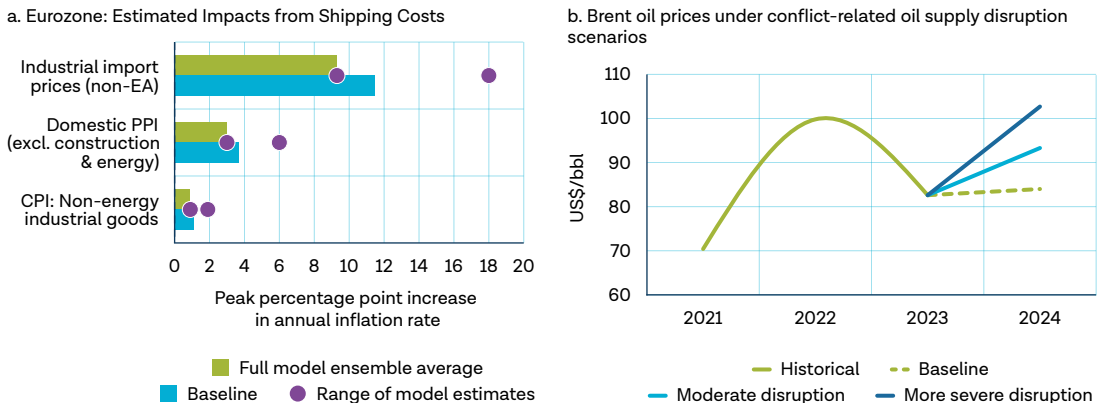


*Sources:* Oxford Economics and WB Global Economic Prospects (June 2024). Chart b. The blue dashed line indicates baseline forecasts for the price of Brent oil, expressed as annual average. Orange and red lines depict outcomes under moderate and more severe conflict-related disruptions to oil supply, occurring in mid-2024.

**The EU economy, which is already facing a protracted period of weakness in trade and manufacturing, could be impacted by further trade fragmentation.** A further proliferation of trade restrictions presents a substantial downside risk to EU growth prospects, especially given the bloc's openness to global trade, financial, and investment flows. Historically, global supply chains have facilitated technological diffusion, enabling rapid economic convergence and poverty reduction.[34] Following Russia's invasion of Ukraine, trade and FDI flows between countries in geopolitically distant blocs have already declined considerably compared to flows between more closely aligned countries.[35] Moreover, policies aimed at reducing dependence on specific suppliers do not necessarily achieve diversification, as these policies could lead to stronger indirect linkages as trade is diverted via other countries, resulting in more complex and less efficient supply chains.[36] Reconfiguring supply chains is costly and can result in welfare losses as firms devote

32  Oxford Economics 2024.

33  Caldara and Iacoviello 2022.

34  World Bank 2020.

35  Blanga-Gubbay and Rubínová 2023; Gopinath et al. 2024.

36  Freund et al. 2023.

resources to search for alternative suppliers.[37] At the same time, decarbonization may give rise to growing market demand for specific technologies, providing opportunities. Part 2 of this report explores some of this potential from the individual member states perspective, taking the regional policy shifts as given.

**Heightened trade policy uncertainty and a further weakening of the multilateral trading system — both of which may follow from escalating trade-restrictive measures — could also have adverse effects on EU growth.** In the near term, increased trade policy uncertainty could slow business investment.[38] In the longer term, less efficient supply chains could decrease returns on capital, posing headwinds for productivity growth — which is already relatively weak in the EU compared to other advanced economies, namely the United States. Over time, multinationals may elect to near-shore by outsourcing some manufacturing processes to nearby countries — even if such decisions would otherwise not be optimal — because of declining expectations that trade tensions will be resolved.[39] While such developments may reflect strategic considerations, there is a risk they also embed norms that erode benefits from globalization — such as the depth and efficiency of global markets — and slow the dissemination of beneficial technologies.

**Political uncertainty — both abroad and domestically — could also negatively impact trade and thus EU growth prospects.** Growing public support for more inward-looking policies and an increasingly divided political landscape pose additional risks in the context of the large number of elections scheduled for this year. Globally, countries holding parliamentary or general elections in 2024 account for about 60 percent of global GDP. Indeed, trade policy uncertainty has reached an unusually high level relative to previous years of major elections around the world since 2000. Election outcomes could lean toward greater protectionism, such as increased tariffs and subsidies, which could hinder trade and FDI. This would exacerbate emerging trends. For instance, the number of trade-distorting policies at the global level has already tripled compared to the pre-pandemic period. Among these policies, the use of subsidies has surpassed contingent trade-protective measures as governments have become more interventionist in pursuing industrial policy objectives. These policies can lead to inefficiencies through increased fragmentation of production processes and idle capacity, as well as by encouraging the entry of inefficient firms.[40]

**FIGURE 3.3**  **Global trade policy uncertainty and increasing distortions**

a. Global trade policy uncertainty in years with major expansion

b. Trade-distorting policy measures affecting goods trade
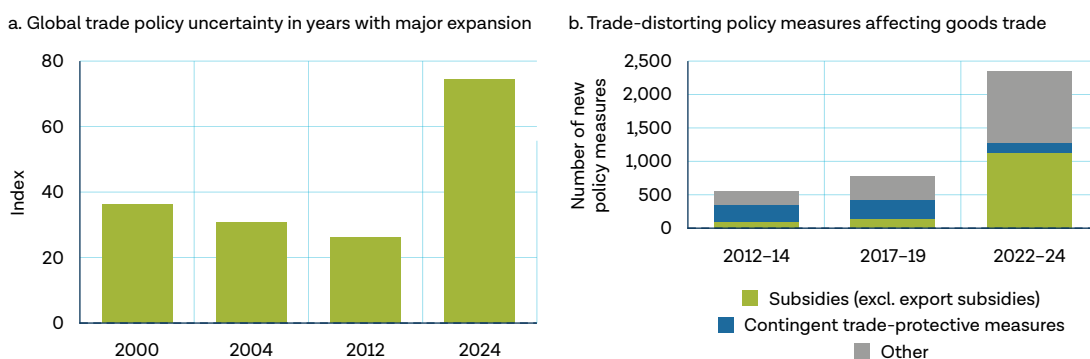


*Source:* a. Caldara et al. (2020); World Bank. b. GTA (database); World Bank.

*Note:* Chart a. shows the average trade policy uncertainty index in the first five months of each year in which elections were held in countries cumulatively representing more than 30 percent of global GDP. Last observation is May 2024. Chart b. shows implemented interventions that discriminate against foreign commercial interests. Contingent trade-protective measures include trade defense instruments such as safeguard investigations and anti-circumvention, antidumping, and countervailing measures. Subsidies cover state loans, financial grants, loan guarantees, production subsidies, and other forms of state support, excluding export subsidies. Adjusted data (for reporting lags) as of May 30, 2024.

37  Grossman, Helpman, and Redding 2024.

38  Caldara et al. 2019, 2020.

39  Alessandria et al. 2024.

40  Barwick, Kalouptsidi, and Zahur 2024; Bown 2023.

In the ᴇᴜ, headline inflation continues to ease toward central bank targets, but interest rates remain restrictive and a number of external shocks, as outlined above, could disrupt the ongoing disinflation process. Given that ᴇᴜ inflation is projected to steadily moderate over the forecast horizon, central banks are assumed to gradually ease monetary policies in the remainder of 2024 and 2025 to prevent real interest rates from becoming unduly restrictive. Even so, policy rates in 2025- 26, especially in the euro area, are expected to remain markedly elevated compared to recent decades, at more than the 2000 – 19 average. Moreover, if inflationary pressures endure for longer than envisaged, policy rate cuts may be fewer or postponed, leaving monetary conditions tighter than in market-derived expectations and baseline forecasts. Higher-for-longer interest rates, alongside a higher path for inflation (if unmatched by nominal wage growth), would reduce real incomes and dent consumer spending in the ᴇᴜ. If short-term interest rates are higher than anticipated, bond yields would likely rise, exerting an additional drag on activity. Reduced risk appetite, which could accompany an inflation-driven shift in rate expectations, would tighten financial conditions further. For ᴇᴜ countries outside of the euro area, inflationary pressures arising from potential currency depreciations could prompt more restrictive monetary policies than assumed in the baseline, trigger capital outflows, and derail nascent recoveries.[41]

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**BOX 3.2**  **Avoiding the risk of missing opportunities of RRF**

**The EU economy entered the COVID-19 pandemic following a decade of growth disappointments, reflecting damage from various crises and structural headwinds.** Long-term growth expectations were repeatedly downgraded in the wake of the global financial crisis (GFC) and the euro area debt crisis.[a] By 2019, ten-year-ahead forecasts for EU growth fell to 1.4 percent—well below the 2 percent annual average over 2002 – 07 and broadly in line with the weakness that followed the GFC over 2010 – 19. Growth prospects also deteriorated alongside a slowdown in the fundamental drivers of long-term growth, including investment, labor productivity growth, improvements in education and health, and working-age population growth.[b]

**The EU MS have a chance to limit the potential impact of fiscal consolidation on growth — and avoid another decade of growth disappointments — by maximizing the use and impact of the RRF.** Despite the adverse impact of multiple overlapping shocks in recent years on near-term growth prospects, substantial EU investments and reforms under NGEU and national RRPs held the promise of lifting potential output growth (EU RER 8). NGEU is the EU's €800 billion (5 percent of EU 2022 GDP) temporary recovery instrument to support the economic recovery from the coronavirus pandemic and build a greener, more digital and more resilient future. The centerpiece of NGEU is the Recovery and Resilience Facility (RRF), which is an instrument of grants and loans to support reforms and investments totaling €723 billion at 2022 prices (4.5 percent of EU 2022 GDP). Climate and digitalization objectives are featured prominently, with at least 37 percent of the expenditure allocated to climate objectives and 20 percent of total investment allocated to digital transformation. NGEU, through a package of reform milestones and investments, is anticipated to spur investment projects across several sectors, including construction and power generation.

**As estimated by EU RER 8, the combined impact of reforms under a package of structural and NGEU reforms could meaningfully boost—in some cases double—the potential growth and foster inclusion, in the four selected countries on which the analysis focused.**[c] Successfully implemented reforms that offset the drag from a shrinking labor supply, support an inclusive recovery by improving the quality of human capital, strengthen institutional quality, and aim for ambitious green and digital investment targets are estimated to be able to boost average potential growth over 2022 – 30. Assuming the range structural and NGEU reforms are enacted—thus improving investment and TFP growth, lifting human capital, and offsetting some of the drags from adverse demographic trends—potential growth estimates for the euro area could reach 1.4 percent over 2022 – 30, versus about the 1 – 1.2 percent without such reforms; this would represent an improvement relative to the 2010s, where potential growth was estimated at about 0.9 percent. In the four EU countries—Bulgaria, Croatia, Poland, and Romania—the combined reform package was estimated in EU RER 8 to raise potential growth to 4.6 percent in Bulgaria (versus 2.3 percent baseline), 3.2 percent in Croatia (versus

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41  Arteta, Kamin, and Ruch (2022).

1.7 percent), 4 percent in Poland (versus 2.8 percent), and 5.2 percent in Romania (versus 3.7 percent). At these rates, potential growth would about double from the baseline in Bulgaria and Croatia and would outpace growth during the EU accession period of 2002–07 in Poland and Romania.[d]

**However, many EU member states have experienced reform delays, which could represent a missed opportunity in terms of lifting long-run growth, and leave resources on the table at the time of critical fiscal consolidation needs.** The RRF entered into force in February 2021 and is available for member states to access until end of 2026, which means they have only about two more years left to achieve the milestones/targets needed to gain access to these funds. After a slower-than-expected start, absorption of RRF grants is expected to increase over 2024–25. For the EU as a whole, absorption of RRF grants is set to reach 0.4 percent of GDP in 2024 (from 0.3 percent in 2023) and to 0.5 percent of GDP in 2025 (European Commission Forecast: Spring 2024). Although reform progress has been made in some areas—including improvements in justice vis-a-vis speedier legal trials (Italy), narrowing school drop-out and tertiary educational attainment gaps (Italy) with euro area, investments in education (Spain, Portugal), and workforce participation (Greece)—other reforms have stalled somewhat more broadly, including those related to digitalization (especially of public services, especially in economies with ICT staff shortages), the sustainability of public pension systems, labor force participation, and tax reforms. Additionally, the outcomes related to some NGEU legislation have not materialized yet, in part related to partial implementation and slow execution. In many economies, PISA scores have not materially improved, overall and female labor force participation rates have continued to lag the euro area average, labor matching has remained a challenge as indicated by the vacancy-to-unemployment rate ratio, and competition indicators, such as the Control Risk business environment score, have not budged.

a. Kose, Ohnsorge, and Sugawara (2021).
b. Dieppe (2020).
c. The Oxford Economics' Global Economic Model is a global semi-structural macroeconomic projection model (here Oxford Economics 2023). The model comprises a system of error-correction equations that determine the rate of convergence of various economic indicators to their respective theory-motivated equilibrium levels and includes detailed specifications for almost 90 countries. Please refer to EU RER 8 Part 2 for additional details.
d. However, since EU RER 8, which did not incorporate the full impact of Russia's invasion of Ukraine, baseline estimates have been re-estimated. In Bulgaria, potential growth has remained broadly in line with earlier estimates, averaging 2.3 percent over 2022–30. In Croatia, potential growth has been lifted from 1.7 percent to 2.9 percent, in part reflecting improvements on the supply side, especially as related to the labor market, and euro area membership. In Poland, potential growth has edged down from an estimated 2.8 percent to 2.4 percent, reflecting initial delays to NGEU reforms and pronounced spillovers from the invasion. In Romania, the estimate for potential growth has also been revised down from 3.7 percent to 2.4 percent, partly reflecting a reassessment of TFP growth.

# Policy challenges

**The implementation of the revised Economic Governance Framework will test policymakers' ability to balance fiscal and growth sustainability trade-offs.** The implementation of the EGF, together with the resumed EDP, is expected to lean on intensive dialogue between the member states and the EC, and between the technical experts and politicians. While the new framework aims to ensure focus on investment and growth, the fiscal consolidation targets will require concrete expenditure and revenue measures. Multiple pressures from the expenditures side remain, including from additional defense spending—that again add short-term fiscal pressure but could boost long-term EU GDP growth; to climate change, that presents major fiscal challenges, with more frequent extreme weather events imposing financial burdens on governments. In this context, managing the green transition remains critical with both public and private green investment essential for transitioning to a sustainable economy. Although the transition may increase fiscal costs, carbon-pricing mechanisms, like carbon taxes, could help off-set expenses by generating much-needed revenue. [42] Policy uncertainty is expected to decline with the

42  Please see the EU RER 7: Green Fiscal Policies for some options.

multi-level 2024 EU elections increasingly behind, hopefully allowing for a renewed focus on the sustainable and inclusive -growth friendly revenue agenda.

**Despite declining headline inflation in 2024, domestic price pressures remain strong, particularly in the services sector, cautioning against monetary policy unwinding too quickly.** Additional pressures arise from wages, as the pass-through of higher wages into producer prices is typically stronger in the services sector. Real wages have also yet to fully recover in some EU countries to the levels seen prior to the pandemic.[43] Delays in digital and green transitions may reduce labor productivity, further limiting firms' ability to absorb rising unit labor costs. Additional pressure may arise from growing interest rate divergence, potentially pushing EUR/US$ closer to parity and adding to inflationary pressures. However, the euro is less weak on a trade-weighted basis.[44]

**In the EU, several countries introduced in-kind support measures, like food vouchers, to address increasing food prices, as well as tax and non-tax measures, such as reduced VAT rates or price caps, to manage energy and food inflation.** For instance, in June 2022, the Romanian government launched the "Support for Romania" program to help offset increased food costs. This program includes distributing food vouchers available initially from June to December 2022 and subsequently extended throughout 2023.[45] In Bulgaria, the monthly ceiling for (voluntary) food vouchers for employees — which are exempted from income tax and social security contributions — have been increased more than two times, from BGN 80 previously to BGN 200 per month (per employee) effective start-2022, as an anti-crisis measure. This has incentivized an increasing number of employers to start offering such vouchers as a fringe benefit to their employees. In Bulgaria, amendments to the Corporate Tax Law (Article 209a), approved by the National Assembly, introduced electronic meal vouchers beginning January 1, 2024.[46] Moreover, the governments also implemented several measures to support households and firms from energy inflation, including tax relief and non-tax measures like subsidies, VAT reductions and exemptions and energy price caps (World Bank, 2024). To address rising energy and food prices, the Croatian government introduced price caps on electricity and gas in 2021, followed by expanded measures in 2023, including a reduced VAT on energy products, lower fuel excise duties, and increased social benefits for disadvantaged groups. An export ban on natural gas was also implemented to secure domestic supply.[47] Although largely untargeted and with a significant fiscal cost (about 1.5 percent of GDP in 2023), these interventions helped protect households' incomes. Most measures are set to phase out by 2024.

**Household resilience to rising energy and food prices largely depends on the effectiveness of the policy response.** By offsetting some costs, policies like food vouchers or price caps can in principle help households maintain a basic standard of living without sacrificing other essential needs. However, some measures are more effective than others mitigate the immediate impact of inflation on households. In Romania and Croatia, although preferential VAT rates tend to reduce poverty, they are not well targeted towards poor households overall, and wealthier individuals benefit considerably from them. Given their size, the implicit energy subsidies implemented in 2022 in Romania help alleviate poverty by enhancing the population's purchasing power; however, wealthier individuals benefit considerably, as shown by

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43 ECB 2024.

44 ING 2024.

45 The program targets vulnerable groups, including pensioners and individuals with moderate to severe disabilities whose net monthly income is below a specified threshold, as well as families with two or more children, single-parent households below an income threshold, guaranteed minimum income recipients, and homeless individuals, according to existing legislation.

46 These tax- and contribution-free vouchers are redeemable at a network of approved merchants. Since January 1, 2024, employers can issue these meal vouchers electronically, either as physical cards or virtual tools, due to an amendment to the Corporate Tax Law (Article 209a), approved by the National Assembly, introduced electronic meal vouchers beginning January 1, 2024.

47 See 2023 Country Report — Croatia- https://economy-finance.ec.europa.eu/system/files/2023-05/HR_SWD_2023_611_en.pdf

their low progressivity.[48] In Bulgaria, long-standing electricity subsidies are less progressive but larger than all direct transfers. Therefore, they reduce poverty but contribute minimally to inequality reduction.[49] The effectiveness of food vouchers has not been evaluated in the recent fiscal incidence analysis conducted in both countries, due to the difficulty of assigning a monetary value to this in-kind food assistance. International evidence on cash vs. in-kind transfers for food assistance shows mixed results. While cash transfers are often favored, many beneficiaries — especially food-insecure households and those in high-price areas — prefer in-kind aid, which protects against price volatility.[50] Studies also indicate that cash recipients maintain nutritious diets without misusing funds, suggesting limited need for in-kind aid. However, cash and in-kind transfers impact local economies differently: in-kind transfers tend to reduce food prices, benefiting consumers, whereas cash transfers can raise prices, which may reduce their overall value, especially in remote areas.[51]

**Effective social safety nets are also vital for protecting low-income households from food inflation, particularly in the short term.** Our policy simulations in section 2.2 show that expanding the benefit generosity of well-targeted social assistance programs helps to offset income losses among lower-income groups. Well-targeted programs such as food vouchers or cash transfers, which directly address immediate needs, tend to be more effective than universal measures because they direct resources to those who need them most. When designing these policies, it is important to consider fiscal constraints, focusing on cost-efficient and adequate support. Targeted interventions help reduce fiscal strain while providing substantial aid to the most vulnerable populations. By prioritizing vulnerable groups and practicing fiscal discipline, governments can protect low-income households from the negative impacts of rising food prices without exceeding their budgets.

**The effectiveness of the policy measures also depends on how social protection systems and the tax system adjust benefits and tax thresholds to reflect inflation.** Social protection systems with irregular or infrequent updates to benefit levels or eligibility thresholds often struggle to provide timely support during inflation spikes, leaving households without adequate adjustments. Similarly, the tax system not always adjust to reflect that change in real income due to price rises. Inflation can unintentionally alter taxes when tax system parameters are set in fixed nominal terms without adjusting for inflation. The lack of indexation and lack of adjustment of the parameters in the tax system can worsen the impact of high prices, making regular and responsive indexation crucial for maintaining purchasing power and meeting essential needs. Some countries have recently implemented good examples of social protection reforms, but there is still scope for improvement (Box 3.3).

**Implementing effective social safety nets and well-targeted policy responses are crucial for helping low-income households manage rising food and energy costs amid inflationary pressures.** Countries across the EU have adopted a range of policy measures, such as food vouchers, price caps, and VAT reductions, to alleviate these pressures. However, the long-term success of these measures depends on careful balancing of fiscal constraints, targeted assistance, and regular adjustments in social protection systems. Ensuring that tax and benefit systems adjust to inflation can help maintain households' purchasing power and mitigate the unintended effects of rising costs. By learning from current policies and incorporating evidence-based practices, EU member states can continue to refine their approaches, protecting the most vulnerable populations and supporting sustainable economic resilience.

48  Romania CEO, forthcoming.

49  Robayo and Cabrera, 2024.

50  Hirvonen & Hoddinott, 2020; Gadenne et al., 2021.

51  Cunha, 2014.

**BOX 3.3** Recent social protection reforms in Romania, Bulgaria, Poland and Croatia

**Romania has implemented significant reforms to the GMI program, aimed at enhancing social protection and reducing poverty.** The new regulations introduced the Minimum Inclusion Income Program (VMI) with single eligibility criteria and an increased Social Reference Indicator (SRI) for indexation. This reform had effects on benefits such as support allowances for families with children, guaranteed minimum income (GMI), and unemployment benefits. In 2022, state allowances increased following the SRI adjustment and starting in 2023 they have been provided as fixed nominal amounts. These changes reflect Romania's commitment to improving its social safety net amid ongoing economic challenges, yet the broader coverage reduces progressivity. The implementation of the Minimum Inclusion Income Program (VMI) and adjustments to the Social Reference Index (SRI) are expected to enhance the progressivity of child benefits and contribute to greater poverty reduction.[a] However, despite introducing the Social Reference Indicator (SRI) in 2008 to index benefits, the country has not consistently adjusted benefits with inflation. Certain benefits have been subject to ad-hoc changes, leading to imbalances in benefit values and reduced effectiveness.

**Bulgaria expanded social support and updated the indexation of benefits in recent years.** Before 2022, the social assistance scheme had limited coverage and was not adjusted for inflation, minimizing its impact on poverty reduction. In 2022, a reform aimed to expand social support by increasing the income threshold to 30 percent of the relative poverty line and adjusting for age, health, and social status. Benefits are now indexed to the relative poverty line, aligning with median income changes. However, restrictive eligibility thresholds compared to a Bulgarian food basket suggest the need for further improvements, such as anchoring programs to an absolute poverty line or basic consumption basket, to enhance the effectiveness of guaranteed minimum income and indexed benefits.[b]

**Poland faces ongoing challenges in enhancing the equity and efficiency of its social protection system.** Poland, along with 13 other EU countries, updates its minimum income thresholds intermittently, whereas 10 countries have automatic indexation to keep pace with inflation. Current rules only require review every three years, potentially leaving thresholds stagnant during rapid inflation, limiting support for households. Despite a range of benefits, the focus on non-means-tested cash benefits has limited redistributive effects and coverage gaps for the working poor. Minimum-income programs, for instance, reached only half of those in legal poverty in 2021, with fragmentation and overlaps across numerous family benefits. Poland must address coverage gaps to improve equity by expanding targeting capacity, possibly through a social registry.[c]

**Croatia is aiming to increase the adequacy and transparency of social benefits under the Croatian Recovery and Resilience Plan.** This reform aims to enhance the adequacy and transparency of social benefits for the most vulnerable groups, thereby reducing inequalities. Key aspects include merging existing benefits into a single, streamlined program to improve coverage and fairness while reducing administrative burdens. This initiative is part of the National Plan against Poverty and Social Exclusion 2021–2027, which targets a reduction in the at-risk-of-poverty rate to below 15 percent and seeks to improve the living conditions of those facing severe material deprivation. The reform will involve changes to the legal framework, including the newly adopted Social Welfare Act. By the end of 2024, the plan includes increasing the guaranteed minimum benefit, integrating it fully with other social benefits, enhancing evaluation and monitoring effectiveness, and introducing indexation for future benefits.[d] These measures are designed to support vulnerable groups more effectively and reduce poverty.

a. Romania CEQ, forthcoming.
b. Robayo and Cabrera, 2024.
c. Poland SCD Update.
d. https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility/croatias-recovery-and-resilience-plan/croatias-recovery-and-resilience-supported-projects-reforms_en#increasing-the-adequacy-and-transparency-of-social-benefits

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# Methodology for estimating direct welfare impacts of food inflation

## Direct Welfare Impacts

To estimate the welfare impact of relative changes in food and energy prices, following Freund and Wallich (1995), we adjust the welfare aggregate to account for the loss in purchasing power (PPP loss) because households spend a larger share of the total expenditure on food and energy. Following the methodology used by Freund and Wallich (1995) and the Balancing Act (2013), the impact of the change in prices on the share of consumer surplus as a percentage of total household expenditures can be calculated as:

$$\Delta CS/E = (S_0\,(P_1 - P_0)\,/\,P_0)\,(\varepsilon + \varepsilon\,(P_1 - P_0)\,/\,P_0 + 1) \tag{1}$$

where $S_0$ is the initial budget share before the price change, $\varepsilon$ is the price elasticity of demand, and $P_1$ and $P_0$ represent the initial and final relative prices.

**TABLE A.A.1** Assumption of price elasticities by income deciles

| Income deciles | Price elasticity of food and energy |
|---|---|
| 1–3 | 0 |
| 4–10 | -0.25 |

We implement this approach using the available household budget surveys and EU-SILC surveys in the 4 EU countries. First, we estimate the food and energy shares using the country's household budget surveys (HBS) by dividing and imputing them for each household in the EU-SILC by assuming a one-to-one relationship between consumption and income deciles. To do so, we assume the same share across households in the same decile. Then, we estimate the change in consumer surplus for each household in the EU-SILC using (1), given the estimated shares, (b) a range of price elasticities (decile dependent), and (3) the relative food and energy prices from Eurostat Harmonized Indices of Consumer Prices (HICP) over the period 2019 – 2022. Finally, we use the PPP losses to estimate one counterfactual income distribution for the observed change in food prices and another for the observed change in energy prices.

**Some caveats apply.** It is important to note that this approach would not explicitly account for households' ability to be both producers and consumers of food. It also does not incorporate indirect and general equilibrium effects.

Lucchetti, Robayo-Abril, & Delgado-Prieto, L. (forthcoming) provide more details on the methodology.

ANNEX B
# Estimating the cost of Roma exclusion

The methodology for estimating the cost of Roma exclusion is outlined below.

**Step 1:** Obtain Roma population estimates for Romania and Bulgaria from the 2021 Population Census data. These estimates differ from the Council of Europe's unofficial estimates due to underreporting in the Census.

Even though there are no recent reliable estimates of the size of the Roma population in Romania and Bulgaria, official estimates suggest that this ethnic minority may represent between 3 and 4.1 percent of the population, respectively, in 2021. Despite these official figures, Council of Europe estimates suggest a much larger Roma population for both countries, with average estimates at 10.2 percent of Bulgaria's population and 9.2 percent of Romania's population. These differences are because Census data allows for ethnic self-identification, but there is likely significant underreporting of individuals of Roma ethnicity.

The 2011 and 2021 Census data for Bulgaria and Romania also reveal a decline in both the total population and the Roma population compared to 2011. In Bulgaria, the total population dropped from 7.36 million in 2011 to 6.52 million in 2021, with the Roma population decreasing from 325,343 to 266,720, representing a slight decrease from 4.4 percent to 4.1 percent of the total population. Similarly, Romania saw its population shrink from 20.12 million in 2011 to 19.05 million in 2021, with the Roma population falling from 619,007 to 569,500, accounting for 3.0 percent of the total in 2021, down from 3.1 percent in 2011.

**TABLE A.B.1  Roma population according to different sources**

| Country | Total population estimate based on Census (2011) | Total population estimate based on Census (2021) | Roma population estimate based on Censuses | | | | Roma population estimate based on Council of Europe (2012) | | | |
| | | | Official national statistics (2011 Census data) | Official national statistics (2021 Census data) | percent of total population (2011 Census data) | percent of total population (2021 Census data) | Minimum estimate | Maximum estimate | Average estimate | Average estimate as a percent of total population |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Bulgaria | 7,364,570 | 6,519,789 | 325,343 | 266,720 | 4.4 | 4.1 | 700,000 | 800,000 | 750,000 | 10.2 percent |
| Romania | 20,121,641 | 19,053,815 | 619,007 | 569,500 | 3.1 | 3.0 | 1,200,000 | 2,500,000 | 1,850,000 | 9.2 percent |

**Step 2:** Estimate the total Roma population, overall, and by age cohorts and educational attainment using household surveys (2021 HBS for Romania and 2021 SILC for Bulgaria) since this detailed information is unavailable in the Census. Age groups are 0 – 25, 25 – 64, and 65+, with educational attainment categorized as low (primary or less) and high (secondary or more).

**Step 3:** Estimate labor force participation rates by age, education, and ethnicity from the 2021 household surveys. Use these rates to estimate the labor force stock among working-age (25 – 64) Roma by educational attainment.

**Step 4:** Estimate employment rates for the working-age Roma (25 – 64) by age and education, then estimate the corresponding employment stock.

**Step 5:** Project future labor force stocks for 2022 – 2030 using UN Population growth rates by age. Since population projections by ethnicity are unavailable, repeat Steps 2 and 3, assuming the same labor force participation and employment rates by group.

**Step 6:** Calculate net flows, which represent changes in the number of people entering and leaving the labor force by age and ethnicity between consecutive years.

**Scenario analysis:**

- **Baseline:** Assume the same educational attainment and labor force participation rates among Roma population in 2022 – 2030 as in 2021 (no further improvements in additional Roma inclusion).

- **Scenario 1:** Assume higher human capital stock among Roma with unchanged labor force participation rates.

- **Scenario 2:** Assume higher labor force participation rates among Roma by age and education, adjusting for educational attainment.

- **Scenario 3:** Combine Scenarios 1 and 2, assuming both higher human capital and labor force participation rates.