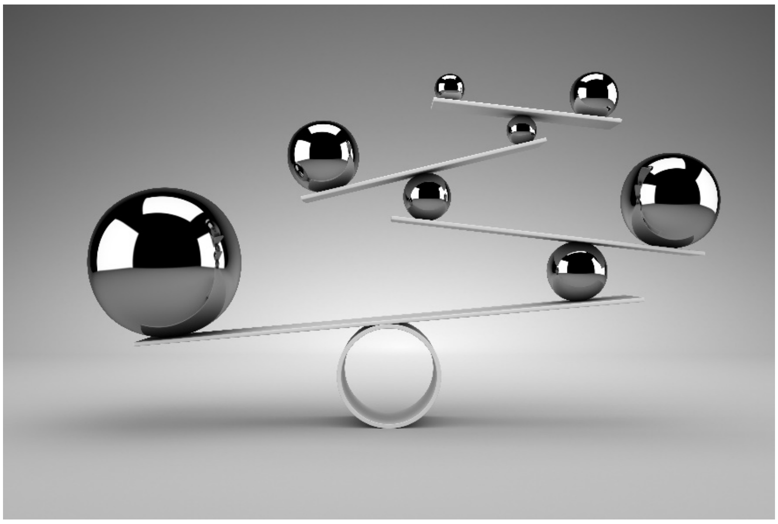
The Macroeconomic Imbalance Procedure

An introduction



IN-DEPTH ANALYSIS

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The macroeconomic imbalance procedure is one of the newest additions to the EU's wider economic governance framework. This publication aims to explain the rationale, legal framework, elements and steps of the procedure in simple terms, and to give a flavour of the academic and institutional debate around it.

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Executive summary

Before the onset of the sovereign debt crisis, the rules adopted in the context of the European Union's economic governance framework were primarily focused on public finance. The crisis showed, however, that external and internal imbalances were critical in triggering crises and consequent needs for financial assistance. Moreover, their impact spilled over to other Member States, thus jeopardising the financial stability and economic performance of the entire EU.

To prevent similar developments in the future, a new mechanism – the macroeconomic imbalance procedure – was introduced in 2011. It has three main phases:

- *The detection of imbalances*. This takes place through a set of indicators that allow the benchmarking of a Member State's position on a number of aspects relevant to the assessment of macroeconomic risks. The Commission includes its analysis in the alert mechanism report, published in the context of the European Semester every year in the autumn;
- *The identification and analysis of imbalances*, through the in-depth reviews carried out by the Commission for the countries selected in the alert mechanism report. Following this step, the Commission proposes to the Council to adopt and address to the Member States country-specific recommendations in policy areas covered by the procedure (still a preventive measure);
- If countries with excessive imbalances are identified, the Council, upon a recommendation of the Commission, may launch the corrective arm of the macroeconomic imbalance procedure, the excessive imbalance procedure. Recommendations in the context of this procedure are implemented by means of a corrective action plan submitted by the Member State concerned and, in case of non-compliance, financial sanctions may apply for euro-area Member States.

Like other areas of EU economic governance, the macroeconomic imbalance procedure has been examined from diverse perspectives by academia and EU institutions alike. Issues raised by academics include the capacity of the procedure to avert a sovereign debt crisis or its capacity to alert the EU with regard to a possible forthcoming one (a pertinent matter amid the economic crisis caused by the coronavirus pandemic); the benefit of the scoreboard as an early warning signal; the added value of the procedure as a surveillance tool versus the surveillance performed by the International Monetary Fund; and the lack of ownership of the procedure; as well as a host of other issues.

Similarly, the procedure has been assessed by the European Court of Auditors and recently by the Commission. The European Central Bank and the Council have also taken the opportunity to address issues relating to the procedure, notably the lack of its full implementation.

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1. What is the macroeconomic imbalance procedure?

1.1. Introduction

Prior to the sovereign debt crisis, the rules adopted in the context of the European Union's economic governance framework[1] primarily focused on keeping public deficit and debt under control.[2] While the EU also required Member States to conduct their economic policy also taking the other Member States into account, this coordination was achieved through Council recommendations, none of which are binding or associated with sanctions.[3]

During the crisis, however, external and internal imbalances – which were not taken into account by the framework – were found to be key factors in triggering crises among a number of Member States and in forcing them to seek financial assistance.[4] Worse, their impact spilled over to other Member States, thus jeopardising the financial stability and economic performance of the entire EU.[5]

To prevent similar developments from taking place in the future, a new mechanism, known as the macroeconomic imbalance procedure (MIP), was introduced in 2011. Its origin is a 2008 European Commission report that observed significant imbalances in the economies of the euro-area Member States and made the case for greater economic policy coordination.[6]

The macroeconomic imbalance procedure was designed to complement other EU surveillance processes, such as that in the context of the stability and growth pact,[7] to avoid the accumulation of risks outside the public sector[8] in the short and medium term.

The main rationale for a supranational surveillance mandate builds on the fact that macroeconomic imbalances in one Member State have relevance also for other Member States:

- *first*, given the deep trade and financial links among Member States, the economic policies of highly integrated Member States are a matter of common concern, as they may result in spillovers and have cross-border repercussions;[9]

1 The rules adopted in the context of the European Union's economic governance framework were the relevant provisions built into both the Maastricht Treaty and secondary legislation.

2 Audit of the Macroeconomic Imbalance Procedure (MIP), European Court of Auditors, January 2018, p. 10.

3 Christian Scheinert, Understanding the macroeconomic imbalance procedure – Origin, rationale and aims, Briefing, EPRS, European Parliament, April 2017.

4 Some of the Member States that became covered by financial assistance programmes, such as Latvia, Ireland and Spain, had had a good track record in terms of respecting the SGP rules before the crisis unfolded.

5 Audit of the MIP, p. 10.

6 See EMU@10 Successes and challenges after ten years of Economic and Monetary Union, European Economy papers, European Commission, 2008: 'But beyond budgetary surveillance, there is a clear need to broaden surveillance to address *macroeconomic imbalances*. Developments within Member States, such as the growth of current account deficits, persistent inflation divergences or trends of unbalanced growth, need to be monitored given that the occurrence of spillover effects and the growing interdependence of euro-area economies mean these developments represent a concern not just for the country in question but for the euro area as a whole'.

7 Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and Council Directive 2011/85/EU, SWD(2020) 210 final, European Commission, February 2020.

8 Agnès Bénassy-Quéré, 'Making the European semester more efficient', conference proceedings, ECB Forum on Central Banking, June 2017.

9 Typical examples are policies in one country that can potentially have relevant effects on the macro-financial stability, competitiveness or trade balances of its partners. Supranational surveillance and coordination are thus required to take into account the presence of spillovers.

- *second*, if left unaddressed, macroeconomic imbalances may compromise the proper functioning of the monetary union and the common policies and institutions of the EU;[10]
- *third*, the emergence of major macroeconomic imbalances in one country (e.g. external debt, household debt, corporate debt) may lead to the insolvency of large financial institutions, to sovereign debt crises or to difficulties in maintaining exchange rate arrangements, potentially leading to a loss of market access and the need to trigger financial assistance.[11]

1.2. Legal framework of the macroeconomic imbalance procedure

The macroeconomic imbalance procedure rests on Articles 121 and 136 of the Treaty on the Functioning of the European Union (TFEU), as well as on two regulations of the Council and the European Parliament (Regulations (EU) 1176/2011 and 1174/2011 – for details, see below).

Article 121 TFEU relates to economic policy coordination and constitutes the legal basis for Regulation 1176/2011. According to Article 121(1), 'Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council, in accordance with the provisions of Article 120'. Furthermore, Article 121(3) provides that, 'In order to ensure closer coordination of economic policies and sustained convergence of the economic performances of the Member States, the Council shall, on the basis of reports submitted by the Commission, monitor economic developments in each of the Member States and in the Union as well as the consistency of economic policies with the broad guidelines referred to in paragraph 2, and regularly carry out an overall assessment. For the purpose of this multilateral surveillance, Member States shall forward information to the Commission about important measures taken by them in the field of their economic policy and such other information as they deem necessary'.

Article 136 TFEU allows for economic policy measures specific to the euro area and constitutes the legal basis for Regulation No 1174/2011. According to the Article, 'In order to ensure the proper functioning of Economic and Monetary Union, and in accordance with the relevant provisions of the Treaties, the Council shall ... adopt measures specific to those Member States whose currency is the euro: (a) to strengthen the coordination and surveillance of their budgetary discipline'.

Based on those Treaty articles, the macroeconomic imbalance procedure framework is founded on two regulations. The first, **Regulation (EU) No 1176/2011** of 16 November 2011 on the prevention and correction of macroeconomic imbalances, provides for the surveillance procedure and is addressed to all EU Member States. The second, **Regulation (EU) No 1174/2011** of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, defines the enforcement mechanism, including potential sanctions.

In line with the logic of the stability and growth pact,[12] the MIP involves two types of action: preventive and corrective. Accordingly,

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[10] For instance, persistent competitiveness divergences tend to reduce the effectiveness of the single monetary policy in pursuing price stability and stabilisation objectives, and could, over time, affect the extent to which Member States are able to fulfil single market commitments.

[11] The Macroeconomic Imbalance Procedure Rationale, Process, Application: A Compendium, European Economy Institutional Papers, European Commission, November 2016.

[12] Council Regulations (EC) No 1466/97 and (EC) No 1467/97. For more information, see Angelos Delivorias, 'The Stability and Growth Pact', forthcoming.

- Regulation No 1176/2011 envisages **preventive** action for countries identified to have imbalances. MIP-relevant country-specific recommendations are issued to address imbalances and foster adjustment, and the implementation of the recommended policies is subject to a process of specific monitoring;
- for countries with excessive imbalances, the Council, upon a recommendation of the Commission, can recommend policy action in combination with an enhanced surveillance procedure. This is referred to as the 'excessive imbalance procedure (EIP)' in Regulations No 1176/2011 and No 1174/2011, and corresponds to the **corrective** arm of the MIP.[13]

1.3. Who is involved?

The macroeconomic imbalance procedure is implemented through the broad involvement of the Commission services. The Commission's Directorate-General for Economic and Financial Affairs is the main provider of the analysis in the alert mechanism report and, to a large extent, of the in-depth reviews (IDRs),[14] and plays a coordination role in certain aspects of surveillance. Given that the policy challenges linked to macroeconomic imbalances are also rooted in structural policies, key analytical inputs to in-depth reviews are received from other directorates-general as well. The Secretariat-General of the Commission coordinates the European Semester as a whole.[15]

Eurostat contributes to the harmonised production of data used in the context of the macroeconomic imbalance procedure and provides expertise regarding the statistical quality of indicators and their availability. In addition to the EU's statistical authority, the Member States' national statistical institutes and authorities and the European System of Central Banks (ESCB) also contribute to the generation of relevant statistics.

The Commission works in close cooperation with the relevant **Council** committees throughout each macroeconomic imbalance procedure cycle.

Between the months of November of one year and June of the next, the Economic Policy Committee (EPC) discusses the results of the alert mechanism report, in-depth reviews and country-specific recommendations. The EPC provides technical feedback on the conclusions of the alert mechanism report, on the in-depth reviews and on the practice followed by the Commission in implementing the MIP, and holds thematic discussions on MIP-related topics. Here, of particular relevance to the procedure is the Working Group on the Methodology to assess Lisbon-related structural reforms (LIME).[16] Among other things, the working group assesses the appropriateness of the alert mechanism report's scoreboard indicators and thresholds, and of the procedure's auxiliary indicators. It also works on the analytical frameworks underpinning the implementation of the procedure and in particular on methodologies that can contribute to detecting external and internal imbalances and to identifying their nature and degree of severity. Yet again, it analyses the nature of the on-going rebalancing and identifies effective policy responses. It discusses technical and

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[13] The European Commission's compendium notes that the distinction between preventive and corrective action in the MIP 'is not based on a different aim of surveillance (preventing versus correcting imbalances) but on the extent of activation of surveillance'. See The Macroeconomic Imbalance Procedure – Rationale, Process, Application: A Compendium, European Economy Institutional Papers, European Commission, November 2016, p. 17.

[14] For more detailed information on the various stages on the procedure, please see below.

[15] Angelos Delivorias and Christian Scheinert 'Introduction to the European Semester Coordinating and monitoring economic and fiscal policies in the EU' EPRS in-depth analysis, December 2019.

[16] LIME 'was set up to drive forward the development of methodological approaches to track, analyse and model structural reforms carried out in the context of the Lisbon strategy'.

analytical aspects of the in-depth reviews in preparation for subsequent economic policy committee discussions.

Lastly, the Commission recommendations for the issuance of country-specific recommendations are discussed in other Council committees (Economic and Financial Committee, Employment Committee) before the Council adopts its final recommendations.

The Commission keeps the **European Parliament** informed of the results of the application of Regulation No 1176/2011 and interacts with representatives of the social partners. The Commission and the Council keep the Parliament informed in the context of their regular economic dialogue (Article 14 of the Regulation). In particular, the Commission reports annually to the Parliament on the application of the Regulation and on updates to the scoreboard, if any. The Commission also presents its findings to both the Council and the Parliament in the context of the European Semester (Article 15 of the Regulation). Regular meetings between the Commission, the Council and EU social partner representatives take place in the context of the tripartite social dialogue and the macroeconomic dialogue, where economic surveillance is discussed among other topics.

2. How does the macroeconomic imbalance procedure work?

A useful summary of the MIP procedure, as well as a flow chart retracing the steps involved in it, can be found in the European Parliament Economic Governance Unit's overview of the procedure.[17]

In simplified terms, the procedure has three main stages:

1. Detection of imbalances:[18] The Commission analyses economic developments across Member States and selects those Member States that potentially face the risk of macroeconomic imbalances, to be further investigated as a subsequent step in in-depth reviews (IDRs). The conclusions on the selection of Member States are communicated to the Parliament, the Council, and the European Economic and Social Committee (EESC) and made public in the alert mechanism report (AMR) every year in autumn. The Council discusses and assesses the alert mechanism report. The Eurogroup discusses the report as far as it relates to euro-area Member States.

2. Identification and analysis of imbalances:[19] The Commission carries out in-depth reviews for the Member States selected in the AMR. The conclusions made in the in-depth reviews regarding the existence and gravity of imbalances are separately communicated to the Parliament, Council and Eurogroup, and made public. The Council discusses the in-depth reviews and their conclusions.

As part of this *preventive action*, the Commission proposes to the Council the adoption of country-specific recommendations (CSRs) to be addressed to the Member States concerned in policy areas covered by the macroeconomic imbalance procedure. Country-specific recommendations related to the macroeconomic imbalance procedure are part of the broader set of country-specific recommendations made in the European Semester. The Commission and the Council monitor the actions taken in response to country-specific recommendations.

3. Excessive imbalance procedure:[20] The Council, on the recommendation of the Commission, may launch the excessive imbalance procedure – the *corrective* arm of the macroeconomic imbalance procedure – for countries identified as having excessive imbalances. Recommendations are implemented by means of a corrective action plan (Article 8 of Regulation No 1176/2011) submitted by the Member State concerned. The Council, on a recommendation of the Commission, may endorse the corrective action plan and monitor its implementation (Article 9 of Regulation No 1176/2011). The assessment of corrective action by the Member State is provided in Article 10 of Regulation No 1176/211. In case of non-compliance, financial sanctions for euro-area Member States may apply based on Articles 3-5 of Regulation No 1174/2011. Conversely, in case the Council considers that the

[17] Alice Zoppè, The Macroeconomic Imbalance Procedure – Overview, At a glance, Economic Governance Support Unit, European Parliament, May 2019. For further information on the implementation of the procedure in the context of the European Semester, see Alice Zoppè, Implementation of the Macroeconomic Imbalance Procedure: State of play, In-depth analysis, Economic Governance Support Unit, European Parliament (regularly updated).

[18] Articles 3 (alert mechanism) and 4 (scoreboard) of Regulation (EU) No 1176/2011.

[19] Articles 5 (in-depth reviews) and 6 (preventive action, essentially recommendations) of Regulation (EU) No 1176/2011.

[20] Articles 7 to 12 of Regulation (EU) No 1176/2011 and Regulation (EU) No 1174/2011.

Member State is no longer affected by excessive imbalances, it abrogates the recommendations issued and the procedure is closed.

2.1. The alert mechanism report

The publication of the alert mechanism report (AMR) is the initial step of the macroeconomic imbalance procedure. Its aim is to screen EU Member States for potential macroeconomic imbalances and to identify which of them should be analysed further in an in-depth review.[21]

The alert mechanism report is issued as a Commission communication each year in the autumn, at the beginning of the European Semester, simultaneously with the annual sustainable growth strategy,[22] the document that sets out the main economic policy priorities for the EU for the following year.

The Commission report takes into account a scoreboard, i.e. a set of indicators that allow to establish the situation of Member States with regard to a number of aspects relevant for the assessment of macroeconomic risks.

2.1.1. Details of the scoreboard

The scoreboard[23] for the surveillance of macroeconomic imbalances includes 14 headline indicators: five for *external imbalances*, six for *internal imbalances* as well as three for employment.[24] This list is complemented by 28 auxiliary indicators, which allow a better understanding of the risks and help fine-tune the policy recommendations made in the course of the macroeconomic imbalance procedure. The indicators in the scoreboard are read against thresholds.

External imbalance indicators

External imbalances may arise from the evolution of a Member State's current account and net investment position, the real effective exchange rates, the share of world exports and the nominal unit labour cost. The following five indicators were selected to be part of the scoreboard.

Current account balance

The current account provides information about a country's transactions in goods and services with the rest of the world, as well as its primary and secondary income.[25] It is a flow indicator that is

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21 The selection of Member States for an in-depth review follows a prudent approach: the alert mechanism report has systematically indicated that in-depth reviews are to be prepared for all Member States identified as having had imbalances in the preceding year.

22 Until the end of 2018, 'annual growth survey'.

23 The information in this sub-section has been primarily obtained from the European Commission's occasional paper, Scoreboard for the surveillance of macroeconomic imbalances, published in February 2012, and its staff working document, Completing the Scoreboard for the MIP: Financial Sector Indicator, SWD(2012) 389 final, published in November 2012. For a view of the current (June 2020) scoreboard, see Alice Zoppè, Implementation of the Macroeconomic Imbalance Procedure: State of play - January 2020, Annex I.

24 These are the activity rate, the long-term unemployment rate and the youth unemployment rate.

25 Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances, press release, Eurostat, 21 November 2018.

calculated as the three-year backward moving average[26] of the current account balance,[27] expressed as a percentage of GDP. It is one of the most significant early warning indicators.[28]

The indicative thresholds are +6 % (surplus)[29] and -4 % (deficit).[30] With regard to the asymmetry between surplus and deficit, the Commission notes that a greater degree of urgency is required in countries with large current account deficits, given that surpluses and deficits pose different types of economic policy challenges.[31]

The Commission further notes that current external imbalances should not necessarily cause concern if they result from 'changes in underlying structural characteristics and the related adjustment in saving and investment decisions of economic agents'.[32] However, they can be a sign of an excessive imbalance[33] and can often reflect other types of imbalances.[34]

Given that the current account is an important determinant of changes in the net international investment position (see next indicator), each imbalance position has to be assessed jointly with the level of the outstanding foreign debt/credit of the economy.

Net international investment position

The net international investment position (NIIP) shows the difference between an economy's external financial assets and liabilities at a given point in time and thus provides an aggregate view of its net financial position versus the rest of the world. It is a stock indicator and is used with the current account balance to perform a stock-flow analysis of external positions.[35]

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26 The average over three years is used so as to take into consideration short-term fluctuations of the annual figures.

27 Data on the current account balance are derived from the balance of payments statistics. These data have the advantage of being quickly available and of allowing to decompose external imbalances by counterpart area.

28 See Jeffrey Frankel and George Saravelos, 'Can leading indicators assess country vulnerability? Evidence from the 2008–09 global financial crisis', NBER Working Paper, June 2010. After reviewing over 80 papers on early warning indicators, the authors note that '... foreign exchange reserves, the real exchange rate, the growth rate of credit, GDP and the current account are the most frequent statistically significant indicators'.

29 The upper value of the threshold is set at +6 %. The Commission notes that 'the upper quartile of the distribution of the three-year backward average of current account balances corresponds to +2 %. To this an additional 4 % margin has been added in line with the "intelligent symmetry" approach to current account balances'.

30 This threshold value is broadly in line with the evidence from the empirical literature on balance of payment crises and sustainability of current account imbalances. For example, in the third chapter of the International Monetary Fund's 2007 World Economic Outlook, it is noted that – on average – past current account reversals in advanced countries started when the current account deficit stood at about 4.1 % of GDP.

31 In particular, unlike current account deficits, large and sustained current account surpluses do not raise the same concerns about the sustainability of external debt and financing capacities, two factors that can affect the smooth functioning of the euro area.

32 Member States in a catching-up phase often run current account deficits, as investing in productive activities increases the prospects of future income. Similarly, Member States with an ageing population may find it opportune to save today, i.e. run current account surpluses, to avoid a drop in consumption in the future.

33 A high current account deficit can be worrisome if the volume of borrowing is such that it leads to an unsustainable external debt position. Similarly, a high current account surplus may be considered worrisome when it reflects weaknesses in domestic demand.

34 Excessive credit expansions in some Member States led to rapid asset price increases and fed back into large external imbalances.

35 For example, highly negative NIIPs typically result from persistently high current account deficits. For more information, see Saverio Lenzi and Alice Zoppè 'External Imbalances in the Euro Area' European Parliament EGOV unit briefing (regularly updated).

The indicator is expressed as a percentage of GDP – to allow for cross-country comparability – and the indicative threshold is -35 %.[36] The reason the threshold is only negative is that large positive external asset positions are not a priori considered to be problematic for a Member State or the functioning of EMU.

Real effective exchange rate

The real effective exchange rate (REER) captures the price and cost competitiveness of a country relative to its principal competitors in international markets. Like the current account balance, this indicator is considered to be a statistically significant predictor of the incidence of economic crises.[37]

The scoreboard indicator is the percentage change over three years of the real effective exchange rate.[38] The indicative threshold is equal to +/–5 % for euro-area Member States and +/–11 % for non-euro-area Member States, respectively.[39] Significant deviations of the REER from the thresholds indicate that prices have grown out of line with productivity for some time without compensation via the nominal exchange rate, in other words, that the Member State has lost labour cost competitiveness with respect to its trading partners.[40]

While the indicator focuses on exchange rates and prices, it does not account of several aspects of competitiveness such as product quality, overhead costs or marketing efficiency. Therefore, it is complemented by other scoreboard indicators such as export market shares.

Export market share

The share of world exports (or export market share) captures the value of exports of goods and services of a country compared to the value of total world exports, i.e. the extent to which a country's exports are able to keep up with the changes in the global export volume.[41] The idea is that a country might lose shares of export markets not only if its exports decline but also if they do not grow at the same rate as world exports, because, for instance, it did not exploit new market opportunities or sharpened comparative advantages in newly traded products.[42]

The scoreboard indicator is the percentage change of a country's export market shares over five years,[43] with a lower indicative threshold of -6 %.[44] The total world export data are based on

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36 Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances, Eurostat, 2018. The Commission notes that it is difficult to establish a level of net external assets that can be considered risky, and economic literature attempting to do this is rather scarce. This is due to the fact that next to the absolute level of net foreign liabilities, it is in particular the composition of both gross assets and liabilities in terms of types or maturities that determines the overall vulnerability of a country's external position.

37 See Frankel and Saravelos, op. cit.

38 REER are based on the harmonised index of consumer prices (HICP), where available. For (non-EU) trade partners without an HICP methodology, the respective headline consumer price index (CPI) is used.

39 The differentiation of thresholds between euro-area and non-euro-area Member States reflects i) nominal exchange rate variability; and ii) the trend appreciation in catching-up Member States. See also Luis A.V. Catão, 'Why Real Exchange Rates?', IMF Finance & Development, September 2007.

40 Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances', Eurostat, 2018.

41 Orsolya Csortos and Zoltán Szalai, 'Assessment of macroeconomic imbalance indicators, *Magyar Nemzeti Bank Bulletin*, October 2013.

42 Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances, Eurostat, 2018.

43 Given the high volatility of year-on-year changes in view of idiosyncratic trade shocks, it was decided to use a long assessment period so as to better reflect structural losses/gains in export performance.

44 Taking into consideration that, in the context of the macroeconomic imbalance procedure, the key concern is the detection of Member States with deteriorating competitiveness positions given by unsustainable losses in export market shares, no upper threshold has been considered.

International Monetary Fund (IMF) data, while the source of data for individual countries is the balance of payments.

Unit labour cost

The indicator is defined as the ratio of labour cost to labour productivity – that is, the ratio of compensation per employee to real GDP per person employed. It measures the average cost of labour per unit of output and is calculated as the percentage change over three years.[45] The indicative thresholds are +9 % for euro-area Member States and +12 % for non-euro-area countries, respectively.

A rise in an economy's nominal unit labour costs corresponds to a rise in labour costs that exceeds the increase in labour productivity. In this context, an increase in the indicator – especially if it is accompanied by a rise in the current account deficit or a decline in the export market share – reflects a decrease in the given economy's competitiveness.[46]

When interpreting this indicator, the analysis is complemented with the scoreboard indicators on competitiveness and trade (the real effective exchange rate, the current account balance and the export market shares).

Internal imbalance indicators

House price index

The indicator is the ratio between the house price index (HPI)[47] and the national accounts deflator for private final consumption expenditure.[48] It measures inflation in the housing market relative to inflation in the final consumption expenditure of households and non-profit institutions serving households. The scoreboard indicator is the year-on-year growth rate[49] of the deflated house price index, and the indicative threshold is equal to 6 %.

The rationale for including an indicator on housing price developments is that large movements in real asset markets can affect the real economy through a variety of channels and can be an important source of macroeconomic imbalances, resulting in crises.[50]

Private sector debt

The recent financial crisis pointed to the fact that excessively high private sector debt implies risks for growth and financial stability and increases the vulnerability to economic shocks. While the Commission notes that there is still no firm evidence from the literature on an optimal level of debt

45 Macroeconomic Imbalance Procedure Scoreboard - A broad set of indicators for early detection of macroeconomic imbalances, Eurostat, 2018.

46 Csortos and Szalai, 'Assessment of macroeconomic imbalance indicators' 2013.

47 Eurostat's HPI captures price changes of all residential properties purchased by households (flats, detached houses, terraced houses, etc.), both new and existing, independently of their final use and their previous owners.

48 For more information on private final consumption, see the European Central Bank's statistical data warehouse.

49 As part of the economic reading of this scoreboard indicator, real house price growth over longer time periods will also be considered, as a complement to the short-run indicator. To this end, three-year average price growth rates are used as an additional indicator.

50 *Rising* real asset prices can affect household consumption spending through a wealth effect in the form of real estate valuations. Moreover, rising real estate prices relative to construction costs can stimulate housing construction through higher profitability. On the other hand, a sudden *decline* in property prices renders investment less attractive and reduces the profitability of the construction sector. As a result, investment may dry up and contribute to an economic slowdown.

in the economy, it is of the view that high debt levels represent a vulnerability per se and, as such, must be monitored.

Private sector debt is the stock of liabilities held at the end of the year by three sectors of the economy: i) non-financial corporations;[51] ii) households; and iii) non-profit institutions serving households. The 'private sector debt' indicator is the above stock of liabilities as a percentage of GDP, and the threshold is currently set at 160 %.

Private sector credit flow

When choosing the indicators for the scoreboard, the Commission noted that a wide body of economic literature identifies quickly expanding credit as one of the best predictors of financial or banking crises. In addition, boom and bust cycles in asset markets have been historically associated with large movements in monetary and credit aggregates. Lastly, there is a potentially important link between credit growth and rising external imbalances.

The private sector credit flow (i.e. transactions) indicator represents the net amount of liabilities that the sectors 'non-financial corporations', 'households' and 'non-profit institutions serving households' have incurred through the year. The indicator is the flow counterpart of private sector debt (which is a stock indicator). The instruments taken into account are debt securities[52] and loans. Data are expressed as a percentage of GDP,[53] and the threshold is 15 %.

General government sector debt

The EU debt crisis has shown that the overall indebtedness of a Member State is very relevant and that there are important linkages between private sector debt and general government debt. This indicator, however, is not used to monitor risks associated with unsustainable public finances – given that such risks are already covered by the stability and growth pact – but is considered together with the indicator on private debt, to offer a broader picture of Member States' indebtedness.[54]

The scoreboard indicator is general government debt as a percentage of GDP, defined under the excessive deficit procedure as the total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government.[55] The MIP indicator is expressed as a percentage of GDP.[56] The threshold is 60 %, the same as under the stability and growth pact, as a separate indicative threshold for public debt under the macroeconomic imbalance procedure was deemed to be confusing.

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51 The non-financial corporations sector includes both private and public corporations. Referring to the proposed indicator as 'private sector debt' may, therefore, be partly misleading, as it also includes public non-financial corporations (which are market producers). However, in the absence of a more refined indicator, this definition is used.

52 Securities other than shares.

Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances, Eurostat, 2018.

54 The Commission notes that during the selection process of the indicators, consideration was given to dropping the public debt altogether and instead having an indicator on the total level of indebtedness, with a cumulated threshold of 160 % plus 60 %. However, this could be wrongly interpreted in that a high level of government sector debt can be in some way compensated by a low level of the non-financial private sector debt (and vice versa).

55 The stock of government debt is equal to the sum of liabilities, at the end of the year, of all units classified within the general government in the categories: currency and deposits, debt securities, and loans.

56 Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances, Eurostat, 2018.

Unemployment rate

The unemployment rate is the number of unemployed persons[57] expressed as a percentage of the labour force.[58] The scoreboard indicator is based on the Eurostat labour force survey; it is the three-year backward moving average[59] and has an indicative threshold of 10 %.

The indicator is intended to monitor high and persistent rates of unemployment, which may be a signal for a build-up of imbalances, pointing to inefficient allocation and weak utilisation of resources available in the economy, as well as to lack of adaptability of the economy.[60]

The eleventh indicator

The alert mechanism report of February 2012 was based on the scoreboard with the 10 aforementioned indicators. While the first report already captured a number of financial issues,[61] the Parliament and the Council supported the Commission's intention to add to the scoreboard an additional indicator aimed at better capturing the interlinkages between the real economy and the financial sector.

Growth rate of financial sector liabilities

The indicator for the total financial corporations sector liabilities measures the evolution of the sum of all liabilities of (and thus the exposure to potential risks) in the financial corporations sector. Those include currency and deposits, debt securities, loans, equity and investment fund shares, insurance, pensions and standardised guarantees, financial derivatives and employee stock options, and other accounts payable.[62] The indicator was added based on the observation that financial crises are often preceded by turbulence evolving in the financial sector.[63] Data are expressed as a one-year percentage change.

Employment indicators

In 2015, the headline scoreboard was expanded further to incorporate indicators on employment developments. While the inclusion of these variables in the scoreboard does not have legal implications and therefore cannot trigger further steps under the procedure,[64] it allows to gain a broader understanding of the social consequences of macroeconomic imbalances.

Activity rate

According to the definitions of the International Labour Organization (ILO) for the purposes of labour market statistics, people are classified as employed, unemployed (see next indicator) or economically inactive.[65] The labour force is the sum of employed and unemployed persons.

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57 Unemployed persons are persons aged 15 to 74 who fulfil all the three following conditions: they are without work during the reference week; they are available to start work within the next two weeks and they have been actively seeking work in the past four weeks or have already found a job to start within the next three months.

58 The labour force is the total number of people employed and unemployed.

59 Given the focus on the adjustment capacity of the economy and the ability of labour markets to reallocate labour resources, the average over the last three years is preferred to yearly figures, which are strongly influenced by short term volatility.

60 Csortos and Szalai, 'Assessment of macroeconomic imbalance indicators', 2013.

61 Such as the private sector credit flow, the private sector debt and the public sector debt.

62 Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances', Eurostat, 2018.

63 Csortos and Szalai, 'Assessment of macroeconomic imbalance indicators', 2013.

64 See the Council conclusions on the Alert Mechanism Report 2016.

65 Inactive persons are those who, during the reference week, were neither employed nor unemployed.

The *activity rate* is the percentage of the labour force aged 15 to 64 in the total population of the same age group.[66] The scoreboard indicator is the three-year change in percentage points, with an indicative threshold of -0.2 percentage points.[67]

Long-term unemployment rate

As previously mentioned, the unemployment rate is the number of unemployed persons as a percentage of the labour force. The *long-term* unemployment rate is the number of persons unemployed for 12 months or longer as a percentage of the labour force. The scoreboard indicator is the three-year change in percentage points, with an indicative threshold of 0.5 percentage points.[68]

Youth unemployment rate

The youth unemployment rate is the number of unemployed 15- to 24-year-olds as a percentage of the labour force of the same age group. The scoreboard indicator is the three-year change in percentage points, with an indicative threshold of 2.0 percentage points.[69]

Auxiliary indicators

Completing the reading of the scoreboard, there is a list of 28 complementary auxiliary indicators, which 'allow a better understanding of the risks and help fine-tuning the policy recommendations that fall under the scope of the MIP'.[70]

The reading of the scoreboard

The Commission is of the view that, while any indicator exceeding its threshold must be taken into account in the overall analysis, this has no immediate and direct implications for alert mechanism report outcomes (notably for selecting the Member States to be subjected to an in-depth review). Similarly, the number of variables exceeding the threshold has no direct implications on the reading of the scoreboard. The economic reading of the scoreboard seeks to detect the presence of one or several of the following configurations:

- large and growing stock imbalances[71] (e.g. a high current account deficit leading to the accumulation of already high external financial liabilities);
- interlinked stock imbalances[72] (e.g. a highly indebted government sector with limited capacity of absorbing financial sector risks, linked to excessive private debt);
- stock imbalances underpinned by trends in the real economy[73] (e.g. a large stock of net foreign liabilities, matched by worsening competitiveness and trade performance; high levels of private indebtedness, coupled with sustained growth in housing prices).

66 The data source is the quarterly EU labour force survey (EU LFS) covering the resident population in private households. Macroeconomic Imbalance Procedure Scoreboard – A broad set of indicators for early detection of macroeconomic imbalances, Eurostat, 2018.

67 Macroeconomic Imbalance Procedure – Information on indicators, Eurostat.

68 ibid.

69 ibid.

70 The list includes such diverse indicators as non-performing loans as a % of gross loans, household debt (as a % of GDP), or people at risk of poverty or social exclusion. Macroeconomic Imbalance Procedure – Information on indicators, Eurostat.

71 This is the case in which indicators capturing financial positions (e.g. debt levels above prudent values) are coupled with strong upward dynamics revealed by 'flow' variables.

72 In this case, financial positions appear simultaneously imbalanced for several sectors of the economy.

73 This is a case where high debt levels coupled with developments in the real economy aggravate the prospects for debt sustainability.

The scoreboard analysis also aims to track the evolution (worsening or unwinding) of existing imbalances.

Finally, the scoreboard helps to track employment and social developments, thus making a link with the necessary adjustment process: the adjustment to imbalances often implies reduced domestic demand dynamics and a worsened labour market situation.[74] The ensuing weakness in the labour market can translate into high levels of youth joblessness or long-term unemployment. Tracking these developments helps to identify social challenges that need to be addressed by policy.

2.1.2. Procedural aspects

The Commission is in charge of the preparation of the scoreboard.[75] It is also in charge of preparing the (annual) alert mechanism report based on the scoreboard. It must make this report public, as well as submit it to the Council, the Parliament and the EESC.[76]

The Council discusses the alert mechanism report and the Eurogroup discusses the report as far as it relates to euro-area countries.[77] Usually, the Council adopts its conclusions in February of the subsequent calendar year. Its conclusions are taken into account by the Commission in the preparation of in-depth reviews.

At the technical level, the Commission interacts with Council committees (in particular, the Economic Policy Committee) and their working groups.

2.2. The in-depth review

The in-depth review (IDR) is an analytical document that is generally[78] drawn up for the subset of Member States identified in the alert mechanism report. It primarily seeks to identify possible imbalances and to assess their nature and severity, while targeting the specific challenges facing the Member State under review.[79] The IDR is carried out from the perspective of the individual Member States and has a medium-term horizon, but it also takes into account the economic developments in the EU as a whole. It seeks to highlight the origin and implications of the main macroeconomic trends that could be identified as imbalances, by pointing to the conditions that have given rise to them and the most significant events (e.g., policy shocks, external shocks, etc.) that have marked the recent history of the Member State under review.

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74 For instance, this is the case when banking crises or the unwinding of housing market bubbles curb credit growth, or when large stocks of debt imply protracted deleveraging.

75 Recital 12 of Regulation (EU) No 1176/2011. The recital continues that the Commission should moreover 'closely cooperate with the European Parliament and the Council when drawing up the scoreboard and the set of macroeconomic and macro-financial indicators for Member States'.

76 Article 3 of Regulation No 1176/2011.

77 Article 3(5) of Regulation No 1176/2011.

78 The Commission notes that in-depth reviews can also be prepared for Member States not selected in the alert mechanism report, in the event of unexpected significant economic developments that require urgent analysis.

79 This is the opposite of what happens in the alert mechanism report, where the focus spans the whole spectrum of possible macro-financial risks.

The IDR uses information from a large number of sources[80] and multiple analytical tools, in order to i) refine the determination of alert levels for key macroeconomic variables;[81] ii) examine more closely the main features of the observed trends; iii) assess causal links and interactions among macroeconomic variables; and iv) assess ex ante the implications of economic shocks and ongoing trends.

The outcome of the in-depth review is the Commission's conclusion concerning the existence of imbalances and their categorisation. On the basis of the analyses made in the in-depth review, the Commission communicates the outcome to the Parliament, the Eurogroup and the Council.

2.2.1. Identification of macroeconomic imbalances

Given that the definition of imbalances provided in Regulation No 1176/2011 is quite broad,[82] the Commission uses certain additional elements that help isolate relevant imbalances. According to those elements, imbalances from the point of view of the macroeconomic imbalance procedure involve the presence of unsustainable trends[83] or situations of vulnerability[84] that lead to the lack of 'proper functioning' of an economy[85] and can potentially affect the performance of the whole euro-area or the EU, and are subject to supra-national economic surveillance.[86]

2.2.2. Assessing the severity of imbalances

Regulation No 1176/2011 requires that in-depth reviews not only identify imbalances, but also assess them with regard to their severity (excessive – i.e. potentially more harmful – or not). This assessment takes into account i) the gravity of imbalances, i.e. the likely magnitude of risks involved;[87] ii) their evolution, i.e. whether they display any tendency to further aggravate or to correct;[88] iii) the policy response in terms of enacted or planned policies to remedy those imbalances; iv) spillover effects;[89] and v) the national and supranational economic context in which those imbalances exist, as well as its evolution.

[80] The Commission gathers information in the course of visits to the Member States. It also considers any other information that the Member States have communicated as relevant.

[81] While the scoreboard includes the same indicative thresholds for all Member States, economic theory and empirical evidence indicate that thresholds are likely to be highly country-specific. The Commission provides the case of government debt sustainability as a relevant example.

[82] Imbalances are defined as 'any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential to affect adversely the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole'.

[83] For instance, the rapid accumulation of external liabilities or major and protracted competitiveness losses. A typical root cause of unsustainable trends is the presence of distortions or incorrect expectations that prevent a prompt and smooth correction by markets. The typical case is that of asset market bubbles.

[84] Such as highly leveraged financial positions or high stocks of external debt.

[85] Hence, a problem that merely consists of disappointing economic performance (e.g., a period of growth below potential) does not appear sufficient to qualify per se as an imbalance.

[86] Hence, minor issues of mostly local relevance (e.g., a housing bubble of limited geographical scope) may not be considered imbalances in the context of the MIP.

[87] Large flow variables suggesting unsustainable trends, or vulnerabilities underpinned by large stock variables or stock variables that manifest themselves in combinations, or that are compounded by flow trends in the real economy are considered, *ceteris paribus*, of a higher gravity.

[88] For instance, the assessment of large current account deficits needs to take into account whether deficits are already in the process of shrinking for non-cyclical reasons and if a forward-looking assessment suggests that a further reduction is foreseen.

[89] Given that the aim of the macroeconomic imbalance procedure is also that of identifying, preventing and correcting situations that could be harmful for the euro area or the European Union as a whole.

2.2.3. Identification of policy challenges and recommendations

Following the identification of imbalances, the Commission informs the Council thereof and may propose recommendations to it on how to correct these imbalances. These recommendations are addressed in the framework of the European Semester country-specific recommendations or during the excessive imbalance procedure.

2.2.4. Updating the assessment of imbalances

Member States identified as having imbalances are continuously monitored.[90] Member States already identified as having imbalances are subject to an alert mechanism report and an in-depth review. As a result of this continuous process of analysis and monitoring, the assessment of imbalances can be revised over time, and consequently, the imbalances can be classified into a lower or a higher category.[91]

2.3. Recommendations and monitoring

Monitoring policy measures to address the imbalances allows to evaluate the remaining challenges and the specific policy needs and gaps, as well as to formulate recommendations in the context of the procedure. These steps are carried out for all Member States receiving country-specific recommendations in the context of the European Semester.[92] Regular contact with policy authorities permits a continuous update of the assessment of policy progress, and feeds into revised policy recommendations.[93]

2.3.1. Preventive action (Article 6 of Regulation No 1176/2011)

In Regulation No 1176/2011, preventive action refers to a system of surveillance that applies to countries that are found to experience imbalances. Surveillance envisages recommendations issued in the framework of the European Semester and monitoring of action taken.

According to Article 6 of the above-mentioned regulation, whenever the Commission considers that a Member State has macroeconomic imbalances, it must inform the Council, the Eurogroup and the Parliament. Following a recommendation from the Commission, the Council may then address recommendations to the Member State experiencing imbalances. Recommendations in the context of the procedure constitute policy guidance pertaining to a relatively broad range of policy domains, which helps to address the imbalances that have been identified, building, among other things, on the findings of the in-depth review. Article 6(2) requires the Council to inform the Parliament of its recommendations and to make them public. Article 6(3) states that 'the recommendations of the Council and of the Commission shall fully observe Article 152 TFEU (health protection) and shall take

90 Specific monitoring is a form of intensified dialogue between the European Commission and the national authorities. For more information, see the relevant Commission webpage.

91 Indeed, Article 6 of Regulation (EU) No 1176/2011 stipulates that the Council will review its recommendation annually in the context of the Semester. According to the Commission, in principle, the criterion used for deciding whether to change the category is the presence of significant changes in the factors underlying the assessment of macroeconomic imbalances. If, for example, the identification of imbalances has previously led to policy recommendations, compliance with those recommendations is an important element to decide whether to escalate or de-escalate the procedure. See also see Alice Zoppè, Implementation of the Macroeconomic Imbalance Procedure: State of play, op. cit. p. 11.

92 The process applies to all Member States receiving country-specific recommendations, independently of whether those are made in the context of the macroeconomic imbalance procedure or are considered to be of relevance to it.

93 This contact includes missions and bilateral meetings in Brussels between representatives of the Member States concerned and the Commission services' country teams.

into account Article 28 of the Charter of Fundamental Rights of the European Union'. Article 6(4) states that 'the Council shall review its recommendation annually in the context of the European Semester'.

2.3.2. Corrective action

If the Commission considers the imbalances excessive, it is again required, under Article 7 of Regulation No 1176/2011, to inform the Parliament and the Council. Acting on a Commission proposal, the Council may then decide to activate an excessive imbalance procedure, exposing the Member State to stricter requirements and monitoring, and ultimately, in the case of euro-area Member States, to the possibility of financial sanctions.

Opening the excessive imbalance procedure (Article 7 of Regulation No 1176/2011)

Article 7(2) of Regulation No 1176/2011 stipulates that the Council, on a recommendation from the Commission, may adopt a recommendation that: i) establishes that excessive imbalances exist; (ii) identifies the nature and implications of the imbalances, iii) specifies a set of policy recommendations to be followed; and iv) indicates a deadline by which the Member State concerned must submit a 'correction action plan'. The Council may make its recommendations public.

The corrective action plan, its assessment and endorsement (Article 8 of Regulation No 1176/2011)

Corrective action plans are drafted by the Member States' authorities. The plan sets out the specific policy actions the Member State concerned has implemented (or intends to implement), as well as a timetable for those actions.[94] The plan must also take into account the economic and social impact of the policy actions and be consistent with the integrated guidelines (the broad economic policy guidelines and the employment guidelines).

According to Article 8(2) of Regulation No 1176/2011, the Council, on the basis of a Commission report and recommendation, assesses the Member State's plan within two months of its submission. If the Council considers the plan sufficient, it endorses it by way of a recommendation listing the specific actions that are required and setting deadlines for the implementation and assessment of the identified measures. If, however, the Council considers the plan insufficient, it adopts a recommendation to the Member State concerned, asking for the submission of a new plan within two months.

If two successive proposals for a corrective action plan are deemed insufficient, then a fine may be imposed for euro-area Member States (see below).

Monitoring and assessing corrective action (Articles 9 and 10 of Regulation (EU) No 1176/2011)

The Member State concerned prepares and presents to the Council and the Commission progress reports on the implementation of the recommendation.[95]

[94] The regulation does not specify the time horizon of the plan. The Commission notes that, while it may need to extend over a medium-term time frame, the policy actions contained in it need to be specific, which means that it cannot be very long either.

[95] The frequency of those reports is determined in the Council recommendation endorsing the corrective action plan.

The implementation of the corrective action plan is monitored by the Commission, which may organise enhanced surveillance missions. In this context, for euro area – or ERM II[96] – Member States, it acts in liaison with the ECB. Where appropriate, it also involves social partners and other national stakeholders during those missions.

In the event of major changes in economic circumstances, the Council, on a recommendation by the Commission, may amend its recommendation under Article 8(2) and, where appropriate, invite the Member State concerned to submit a revised corrective action plan. This plan is again subject to an assessment, following the same procedure mentioned above.

On the basis of a Commission report, the Council assesses whether corrective action has taken place in accordance with its recommendation within the prescribed time frame. If it considers that the Member State has not taken corrective action, based on a Commission recommendation, it adopts a decision establishing non-compliance, as well as a recommendation setting new deadlines for corrective action.[97] In addition, the Council informs the European Council and makes public the conclusions of the missions carried out by the Commission. Non-compliance for euro-area countries may lead to sanctions (see next section).

If, on the other hand, the Council considers that corrective action has been taken, the procedure is then held 'in abeyance', and the Council makes public the reasons underlying its decision. Moreover, monitoring continues, according to the schedule set in the Council recommendation.

Enforcement mechanism

For euro-area Member States, Regulation (EU) No 1174/2011 complements Regulation (EU) No 1176/2011 by setting a sanctions regime. Financial sanctions apply in case of lack of corrective action[98] by the Member State, or in case of repeated submission of an insufficient corrective action plan.[99]

In case of two successive Council decisions establishing lack of corrective action, an annual fine is imposed and assigned to the European Stability Mechanism. The yearly amount of deposits and fines is 0.1 % of GDP in the preceding year. On the one hand, if the Member State does not take the required corrective action, it pays a fine for each year of inaction. On the other hand, in case corrective action is taken before the expiration of the year in which a deposit has been made or a fine has been applied, sanctions are lifted and amounts returned to the Member State concerned *pro rata temporis*.

The adoption of sanctions is done by reversed qualified majority voting in all cases for deposits and sanctions. Under this procedure, a Commission recommendation to impose a sanction on a Member State is deemed to be adopted unless the Council decides by qualified majority voting[100] to reject

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96 For the smooth operation of the single market, it is important that Member States that have not yet adopted the euro avoid excessive fluctuations in their exchange rates with the euro. The framework to manage the exchange rates between EU currencies is provided by the EU's exchange rate mechanism: [ERM II]. Participation in the ERM II is also one of the convergence criteria for entering the euro area. Currently, the ERM II includes the Danish krone, the Bulgarian lev and the Croatian kuna.

97 This recommendation is adopted automatically within 10 days unless rejected by qualified majority voting.

98 Article 3(1) of Regulation No 1174/2011 states that an interest-bearing deposit shall be imposed to Member States that have not taken corrective action according to the Council.

99 Article 3(2) of Regulation No 1174/2011 states that an annual fine is imposed when two subsequent corrective action plans have been considered insufficient by the Council.

100 Given that Regulation (EU) No 1174/2011applies to euro-area Member States, only they participate in the voting. In addition, the Member State concerned does not participate in the voting.

the recommendation within 10 days. The rationale behind this procedure is that it makes it very difficult for Member States to form a blocking majority because of the high majority threshold.

The Commission may propose to reduce or cancel the deposit or the fine. This can happen under 'exceptional circumstances' or following a reasoned request by the Member State and within 10 days from the Council's decision to impose a sanction.

2.4. Closing the excessive imbalance procedure

The excessive imbalance procedure is closed when the excessive imbalances are corrected. According to Article 11 of Regulation No 1176/2011, the Council, based on a Commission recommendation, abrogates any existing EIP-related recommendation as soon as there is evidence pointing to the correction of the excessive imbalances.[101]

Irrespective of whether the existing EIP-related policy recommendations were fully executed, the correction of the imbalances is sufficient for the abrogation of existing recommendations and the closing of the EIP. Conversely, the full execution of policy recommendations addressed by the Council is sufficient to put the procedure in abeyance, but not sufficient for closing of the EIP.

For an overview of the surveillance of the three Member States – Cyprus, Greece and Italy – that were assessed as experiencing excessive macroeconomic imbalances in the context of the 2019 European Semester cycle and the macroeconomic imbalance procedure, see the recent paper by the Economic Governance Unit of the European Parliament.[102]

[101] The article states that 'the Council, on a recommendation by the Commission, shall abrogate recommendations issued under Articles 7, 8, or 10 as soon as it considers that the Member State concerned is no longer affected by excessive imbalances'.

[102] Alice Zoppè, Member States with Excessive Macroeconomic Imbalances, Briefing, Economic Governance Support Unit, European Parliament, (regularly updated).

3. Debate around the macroeconomic imbalance procedure

3.1. Academic

3.1.1. Could the procedure have helped to avert the current crisis? Or help anticipate the next one?

In their 2011 paper,[103] Sebastian Essl and Alfred Stiglbauer test whether the scoreboard approach in the MIP was designed in a way that would have allowed to anticipate the current crisis. They focus on the period 2005-2007[104] and conclude that their exercise 'would thus suggest that the scoreboard indicators would indeed have been capable of predicting euro area countries' vulnerability to crises'.

Similar conclusions were reached by Alexander Kriwoluzky and Malte Rieth, who, by examining a longer time period, find – among other things – that the introduction of the MIP has led to fewer breaches of the indicators relative to the current account balance, private sector debt and credit flow.[105]

Looking forward, Lorenzo Codogno[106] notes that, while spotting the next crisis is a tough exercise, the MIP can contribute to reducing the areas of weakness and the macroeconomic trends that may prove to be unsustainable. In that context, the reduction of structural weaknesses through policy action has likely already benefitted the resilience of Member States' economies and that of the EU/euro area to external or internal shocks.

Agnès Bénassy-Quéré and Guntram Wolff[107] also conduct a simulation to examine whether the scoreboard could have alarmed the Commission appropriately over the 1999-2016 period. They find that for the EU Member States (28 by the end of that period), the simulation predicted correctly 81.3 % of the crises that took place over that period, but at the same time 89.9 % of the alarms emitted were fake.[108] While the results are encouraging, the authors investigate whether the same (or better) results could be obtained with a smaller set of indicators. They find that a simplified scoreboard composed of six indicators[109] would correctly detect 100 % of forthcoming crises while keeping the proportion of alarms unchanged.

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103 Sebastian Essl and Alfred Stiglbauer, 'Prevention and Correction of Macroeconomic Imbalances: the Excessive Imbalances Procedure', *Monetary Policy & the Economy*, Oesterreichische Nationalbank (Austrian Central Bank), Q4 2011.

104 The authors specify that 'the timeframe for the data was deliberately limited to the 2005–2007 period in order to evaluate the scoreboard's potential and its ability to anticipate the current crisis'.

105 Alexander Kriwoluzky and Malte Rieth, How has the macroeconomic imbalances procedure worked in practice to improve the resilience of the euro area?, In-depth analysis requested by the ECON committee of the European Parliament, April 2020.

106 Lorenzo Codogno, Macroeconomic Imbalances Procedure: has it worked in practice to improve the resilience of the euro area?, In-depth analysis requested by the ECON committee, European Parliament, February 2020.

107 Agnès Bénassy-Quéré and Guntram B. Wolff, 'How has the macro- economic imbalances procedure worked in practice to improve the resilience of the euro area?', Bruegel Policy Brief requested by the ECON committee of the European Parliament, March 2020.

108 The simulation scoreboard issued 129 alarms, only 13 of which were followed by a crisis, and three crises were missed.

109 Those indicators are: current account, net international investment position, change in unit labour costs, credit growth, government debt and unemployment.

3.1.2. Theoretical issues around the MIP

Jens Boysen-Hogrefe et al.[110] are of the view that the theoretical foundation of the MIP is insufficient. According to the authors, the concept of 'macroeconomic imbalance' remains unclear and the concept of 'competitiveness' is not suitable in the context of macroeconomic analysis on a country level, as it makes the procedure prone to misinterpretation. They furthermore note that monitoring of macroeconomic developments would ideally consist of a systematic screening of economic institutions aimed at detecting dysfunctional conditions that might obstruct market mechanisms from working.

Yet again, the authors argue that a proper crisis analysis and crisis theory are missing. The link between real-economy misallocation of resources and financial market destabilisation is not appropriately clarified. Instead, lack of policy coordination is identified as a principal cause of the recent crisis without specific argumented support. From a theoretical perspective, improvement of the scoreboard indicators should concentrate on including symptoms related to financial excesses.

Similarly, Damian Chalmers notes that 'the legal definition of both the [post-crisis] framework's parameters and internal features is weak, thereby allowing more space for political discretion and disagreement'.[111]

Fritz Scharpf notes[112] that the two macroeconomic imbalance procedure regulations extend the Commission's supervision, control, and sanctions powers to an undefined range of national policy areas, without any reference to the division of EU and national competences. Moreover, the Parliament has consented to the establishment of a discretionary authority, but does not and could not have a role in the execution of that authority. With regard to the excessive imbalance procedure, the author questions its efficacy, both when the problem is one of excess demand or of insufficient demand.[113]

3.1.3. The scoreboard as an early warning signal

Csortos and Szalai examined the scoreboard indicators of the alert mechanism report to see whether the indicators perform the same way in the case of all EU Member States and in the case of the 10 Member States that joined in 2004. The authors found that, due to different levels of development and macroeconomic characteristics, it may be justified to apply different thresholds for all the EU Member States and the newly joined ones. Secondly, they came to the conclusion that the indicators applied by the Commission often do not prove to be good early warning indicators by themselves; however, these indicators' forecasting ability may improve considerably if different types and

110 Jens Boysen-Hogrefe, Klaus-Jürgen Gern, Dominik Groll, Nils Jannsen, Stefan Kooths, Martin Plödt, Björn van Roye, Joachim Scheide and Tim Schwarzmüller, 'The European procedure for preventing and correcting macroeconomic imbalances – evaluation of past experience and possible reform approaches' (publication in German, only the summary in English, Kieler Beitrage zur Wirtschaftspolitik, 2015.

111 Damian Chalmers, 'The European Redistributive State and a European Law of Struggle', *European Law Journal*, Vol. 18(5), August 2012, pp. 667-693.

112 Fritz W. Scharpf, 'Political Legitimacy in a Non-optimal Currency Area', MPiFG Discussion Paper 13/15, Max-Planck Institut für Gesellschaftsforschung, October 2013. The author further explains that 'The Parliament has adopted the Six Pack regulations establishing the institutional framework of the Excessive Deficit and the Excessive Imbalance Procedures. But it did not and could not adopt general rules defining either the domain of national competences to be controlled or the type of measures and the conditions under which they could be imposed'.

113 Fritz W. Scharpf, 'Political Legitimacy in a Non-optimal Currency Area', 2013.

numbers of indicators are applied for each Member State and different thresholds are used according to its level of development.[114]

Similarly to Csortos and Szalai, Martina Kämpfe and Tobias Knedlik[115] start from the premise that the experience of central and eastern European Member States during the global financial crisis and during the consequent EU sovereign debt crises has been largely different from that of other EU Member States – due among other things to the structural differences these 'catching-up economies' present as compared to the rest of the EU. They therefore look at the specifics of this group of Member States and evaluate from that angle the appropriateness of a 'one-size-fits-all' scoreboard in the context of the macroeconomic imbalances procedure. They conclude that, for many of those Member States, thresholds for some indicators have been set too loosely in the Commission's scoreboard,[116] while thresholds for other indicators have been set too tightly.[117]In addition, some indicators could be added to the scoreboard to better track imbalances for those Member States,[118] while some others that are currently included in it could be dropped,[119] given that they cannot predict fiscal stress in those Member States well.

Jens Boysen-Hogrefe et al.[120] find that while a number of indicators[121] are particularly helpful for early crisis detection both from the theoretical and the empirical perspective, the unemployment rate and the unit labour costs indicator are empirically and theoretically useless and should be eliminated from the scoreboard. On the other hand, additional variables that are theoretically well founded and found to be relatively good predictors of crises include the deviation of the short-term interest rate from the natural rate; real stock prices; and a measure of sectoral concentration of investment activity. In this context, the authors note that the transformation of some indicators into deviations from a trend can improve predictive power significantly. Also, a combination of indicators may be considered in order to improve the quality of the signals.

In a 2018 report, Szilárd Erhart et al.[122] synthesise previous studies and examine whether the MIP is a useful early warning signal. They show that the predictive power of the MIP scoreboard had, at the time of writing the report, been limited. They note, among other things, that a difficulty in using the procedure as an early warning signal is potential endogeneity, 'since the European Commission plays both the role of the economist and of the institutional actor who can influence evolutions'.[123] More generally, they note that establishing effective early warning systems is a difficult analytical and policy challenge, as i) vulnerabilities are time and place dependent; and ii) early warning

[114] Csortos and Szalai, 'Assessment of macroeconomic imbalance indicators', 2013.

[115] Martina Kämpfe and Tobias Knedlik, 'The appropriateness of the macroeconomic imbalance procedure for Central and Eastern European countries', IWH Discussion Papers, Leibniz-Institut für Wirtschaftsforschung Halle, 2017.

[116] Those indicators are: export market shares, private sector debt, private sector credit flows, government debt, long-term unemployment and youth unemployment.

[117] This primarily concerns indicators measuring external positions but also those measuring unit labour costs, house prices, financial sector liabilities, and activity rates.

[118] For example, productivity growth and domestic demand.

[119] The unemployment rate and the house price index.

[120] Jens Boysen-Hogrefe et. al., 'Das europäische Verfahren zur Vermeidung und Korrektur makroökonomischer Ungleichgewichte – Auswertung der bisherigen Erfahrung und mögliche Reformansätze', 2015.

[121] Namely real house prices, credit flow to the private sector, private sector debt and total debt of the financial sector.

[122] Szilárd Erhart, William Becker and Michaela Saisana, The Macroeconomic Imbalance Procedure - From the Scoreboard and Thresholds to the decisions, Technical report by the European Commission's Joint Research Centre, October 2018.

[123] The authors note that 'to take a polar case, if the European Commission identifies an imbalance with an associated flash in the scoreboard, issues a recommendation that is followed by a country, and implemented with full progress, hence the signal will appear as "false alarm" since no crisis appears whereas the procedure, in this case, is 100 % efficient on its preventive side'.

indicators may fail to trigger action in due time, because policy makers are resistant to act on vague warnings in good times. The authors also find that introducing two-sided thresholds for some flow variables in the scoreboard – e.g. real house prices, unemployment and private sector credit flow – could help to identify imbalances both ex ante and ex post.

3.1.4. The MIP vs IMF surveillance

Manuela Moschella[124] compares the MIP to the IMF's surveillance. She notes that, while surveillance in the context of the MIP might appear at first more effective than in the context of the IMF,[125] closer inspection shows that it might not be so, because of three reasons. The first is that, despite the efforts to facilitate the activation of sanctions through the use of reverse qualified majority voting, this new majority is confined to the corrective stage of the surveillance process. As such, it does not apply for the Council discussion of the alert mechanism report, which serves as the basis to select those Member States for which in-depth reviews are to be made.

The second is that, experience with the stability and growth pact has shown that, while sanctions exist in the letter of the procedure, they might never be applied. Furthermore, as there are no mechanisms to prevent arbitrariness in the application of sanctions, this can create the possibility for political interference. Lastly, the predominant focus of the procedure on single countries' macroeconomic developments may lead it to miss important systemic aspects such as the build-up of imbalances that concern a group of countries together.

Bénassy-Quéré and Wolff[126] also check the consistency of EU recommendations with those of the IMF and the OECD. They find that, while the three institutions cover a broad array of policies and are broadly consistent, the IMF is more prone than the OECD to delivering recommendations concerning macroeconomic policies, which makes it closer to the country-specific recommendations. However, the country-specific recommendations are less clear with regard to the financial sector than are the IMF's recommendations.

3.1.5. Lack of ownership

Zsolt Darvas and Alvaro Leandro[127] examine country-specific recommendations in the context of the European Semester during the 2012-2014 period and find that the rate of implementation of recommendations related to the stability and growth pact (SGP) is typically higher than the implementation of recommendations related to the macroeconomic imbalance procedure.[128] The authors further note that, even though SGP recommendations have the strongest legal basis, the average 44 % implementation rate cannot be regarded as high, while the MIP implementation rate is even lower, suggesting that the European Semester is not particularly effective in enforcing the EU's fiscal and macroeconomic imbalance rules.

[124] Manuela Moschella, 'Monitoring Macroeconomic Imbalances: Is EU Surveillance More Effective than IMF Surveillance?', *Journal of Common Market Studies*, February 2014.

[125] This, according to the author, is because the MIP remedied some well-known limitations that characterised IMF surveillance, including 'the lack of clear and practical advice, the limited knowledge of domestic policies and the reluctance to activate sanctions to induce corrective action'.

[126] Agnès Bénassy-Quéré and Guntram B. Wolff, 'How has the macro- economic imbalances procedure worked in practice to improve the resilience of the euro area?', Bruegel Policy Brief requested by the ECON committee of the European Parliament, March 2020.

[127] Zsolt Darvas and Alvaro Leandro, 'Naughty students or the wrong school: why is the European Semester proving ineffective', Bruegel Blogpost, November 2015.

[128] 44 % on average in the 2012-2014 period, versus 32 % in the same period.

Bénassy-Quéré and Wolff[129] note that a counter-argument often made in response to these numbers is that Member States tend to implement recommendations with some delay (e.g. after two or three years), especially since many reforms require several years to be legislated and implemented. The authors explored this argument for Germany and the Netherlands, and saw that i) over time, the two Member States still had relatively low implementation rates; and ii) recommendations were repeated year after year, (even if with slight changes of the formulation), which tends to suggest that implementation rates remain weak even a few years after the recommendation is first received.

With respect to the excessive imbalance procedure, Boysen-Hogrefe et al.[130] point to international experience, which suggests that 'ownership' may be more important than institutional incentive mechanisms for the successful implementation of reform programmes.

To increase ownership of the process, Codogno proposes[131] to increase the transparency of methodologies, to set up national productivity boards in all countries, and to adopt other measures for making the policy debate more explicit and evidence-based at the level of national governments, parliaments and public.

3.1.6. Other issues

Examining the elements of the procedure separately, Boysen-Hogrefe et al.[132] note that the in-depth reviews should have a stronger focus on macroeconomic developments that have the potential to trigger a crisis, and that the country-specific recommendations should better reflect concerns over macroeconomic imbalances. Regarding the relationship between the various elements of the procedure, they note that many policy initiatives suggested in the in-depth reviews that directly relate to macroeconomic imbalances as monitored by the scoreboard, have not been included in the country-specific recommendations.

Codogno[133] notes further that resilience to shocks cannot be addressed only through changes in the macroeconomic structure of the euro area economies. While taking into account the euro-area dimension more explicitly[134] could be considered as a first step to improve results in the near term, advances in other areas would be required, and especially in terms of a euro-area fiscal capacity and the sharing of risk.

3.1.7. The complexity of the MIP

Bénassy-Quéré[135] notes that economic governance in the euro area has become extremely complex, which reduces national ownership: 'national governments and parliaments already find it difficult

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[129] Agnès Bénassy-Quéré and Guntram B. Wolff, 'How has the macro- economic imbalances procedure worked in practice to improve the resilience of the euro area?', Bruegel Policy Brief requested by the ECON committee of the European Parliament, March 2020.

[130] Jens Boysen-Hogrefe et. al., 'Das europäische Verfahren zur Vermeidung und Korrektur makroökonomischer Ungleichgewichte – Auswertung der bisherigen Erfahrung und mögliche Reformansätze', 2015.

[131] Lorenzo Codogno, Macroeconomic Imbalances Procedure: has it worked in practice to improve the resilience of the euro area?, 2020.

[132] Jens Boysen-Hogrefe et. al., 'Das europäische Verfahren zur Vermeidung und Korrektur makroökonomischer Ungleichgewichte – Auswertung der bisherigen Erfahrung und mögliche Reformansätze', 2015.

[133] Lorenzo Codogno, Macroeconomic Imbalances Procedure: has it worked in practice to improve the resilience of the euro area?, 2020.

[134] That is, the spillovers, complementarities and trade-offs, as well as the differences among individual countries in terms of their economic structure.

[135] Agnès Bénassy-Quéré, 'Making the European semester more efficient', conference proceedings, ECB Forum on Central Banking, June 2017.

to master the SGP rulebook; when it comes to the MIP, which is a multidimensional process, they generally have at best a vague understanding of it'. This situation, according to the author, makes the implementation of a coherent macroeconomic strategy very difficult in the euro area, and the lack of readability also contributes to citizens' perplexity.

Regarding the macroeconomic imbalance procedure in particular, Bénassy-Quéré notes that as a result of long-term structural issues, it has become complex and blurred. As a solution, the author proposes to refocus the procedure on its initial objective, i.e. preventing the build-up of macroeconomic imbalances that could degenerate into a severe crisis. Moreover, in order to improve the overall readability of the scheme (and its appropriation by national governments and parliaments), she proposes to use the current account as a flagship indicator (the role the fiscal deficit plays in the context of the stability and growth pact).

3.1.8. Recent contributions

David Bokhorst notes[136] that the MIP should not be interpreted as a legalistic or mechanistic instrument;[137] that the Commission has interpreted its mandate within the MIP very widely[138] and, as a result, has diffused its political force; that the MIP has evolved with regards to its governance and content;[139] and that there continues to be genuine intellectual disagreement about appropriate policies, their implementation pace and the value of certain indicators. At the same time, the author notes that the procedure has made it possible to increase the monitoring dimensions of Member States and the information they have on one another, thereby enabling them to become more resilient than if they had solely trusted the financial markets. Also, the MIP plays a role as a new knowledge infrastructure that helps Member States to understand economic and financial phenomena that are still the subject of debate (e.g. wage coordination in the euro area).

3.2. Institutional

3.2.1. European Court of Auditors

In early 2018, the European Court of Auditors (ECA) published an audit of the macroeconomic imbalance procedure, in which it assessed the effectiveness of the Commission's implementation of the procedure during the 2012-2017 period.

The ECA notes that, while the macroeconomic imbalance procedure is broadly well designed, it has the following particular weaknesses.

Member States are identified as having imbalances over several years, and corrective policies are under-implemented

Despite frequent and intensive monitoring, the implementation by the Member States of country-specific recommendations made in the context of the MIP has been low. This is partly due to the following weaknesses in the management of the MIP. First of all, there is no systematic link between

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[136] David Jonas Bokhorst, 'Governing imbalances in the economic and monetary union: A political economy analysis of the macroeconomic imbalance procedure', 2019.

[137] The MIP acts as a technocratic, evidence-based procedure, which addresses political issues, creating tensions that oblige the Commission to be careful not to overstep its boundaries.

[138] The Commission has placed many Member States under the procedure and has linked 81 % of their country-specific recommendations to the procedure.

[139] While in the first years the Commission's approach was perceived as rigid, it has recently adopted a more interactive approach (allowing for more input and seeking consensus), which is thought to have increased the ownership of the procedure.

country-specific recommendations in the context of the MIP and imbalances. On the one hand, the Commission does not, in the country-specific recommendations, make any proposals to address specific imbalances. On the other, many CSRs have been found to be wrongly labelled as MIP-relevant, since they did not address imbalances identified in the in-depth review. Secondly, in the context of the MIP, the Commission does not usually[140] provide ex-ante or ex-post estimates of the economic impact of country-specific recommendations on imbalances.

In addition to the above, there is no system in place at the Commission to ensure consistency between euro-area recommendations and country-specific recommendations for euro-area Member States. An example given here is the 2016 Commission recommendation for a positive fiscal stance for the euro area, which was at odds with the requirements set in the country-specific recommendations previously issued to euro-area Member States.[141]

Lastly, the Commission has a very challenging timeframe for assessing the implementation of MIP-CSRs (12–18 months). Given that many CSRs are complex and require a response from a large number of stakeholders, this timing is not realistic and results in skewing the implementation statistics.

The classification of imbalances lacks transparency, and the excessive imbalance procedure has never been activated

The ECA notes that the system of categories of imbalances has typically been complex and subject to change.[142] Furthermore, the link between analysis and category of imbalances is not always clear.[143] Lastly, in late phases, the process is political rather than technical, which results in the systematic non-activation of the excessive imbalance procedure. This, in turn, reduces the credibility and effectiveness of the MIP.

The prominence of in-depth reviews has considerably decreased over time

For the first three years, the in-depth review was a stand-alone document. The ECA notes, however, that the Commission has sought to streamline its analysis and policy advice to Member States under the broad European Semester umbrella of policy coordination. As a result, as of 2015, the in-depth review became section 2 of the country report. This merging of in-depth reviews with country reports has reduced the focus on the MIP and its distinct objective of detecting and preventing imbalances. This is a problem, because effective communication is central to public understanding of the procedure and the challenges that macroeconomic imbalances pose to Member States and, as such, a vital component towards ensuring national ownership of the procedure.

140 The ECA notes that outside studies assessing the effects of structural reforms on GDP and a one-off exercise in staff working documents on the Member States' 2014 national reform programmes constitute an exception to this.

141 For more information on this highly debated issue, see Alice Zoppè 'The Euro area fiscal stance', Economic Governance Support Unit Briefing, September 2019.

142 Regulation (EU) No 1176/2011 stipulates that Member States would be evaluated as having either 'no imbalances', 'imbalances' or 'excessive imbalances'. However, in 2012 the Commission established five categories, which were increased to six in 2013. A different set of six was used in 2014. Finally, the categories were reduced to just four in 2016.

143 The Court noticed that, in practice, the in-depth review does not include any conclusions on the classification of imbalances for the Member State concerned. Instead, such conclusions are contained in the accompanying communication by the Commission. In addition, the authors found that the conclusions on imbalances are not always clearly based on the analysis carried out in the corresponding in-depth review.

The alert mechanism report and the scoreboard play a limited role in the procedure

The ECA notes that, while the alert mechanism report has more than doubled in length since the macroeconomic imbalance procedure started being applied, there has been 'no corresponding improvement in the quality of the assessment, as the document is still largely descriptive' (common trends across economies, description of the scoreboard and country-by-country assessments). Moreover, making in-depth reviews mandatory for Member States that were identified as having imbalances in the previous year risks neutralising the alert mechanism report's immediate usefulness for identifying Member States at risk of being affected by imbalances necessitating an in-depth review.

Recommendations

Given the aforementioned weaknesses, the ECA recommended that the Commission substantially improve certain aspects of its management of the MIP, as follows:

- the Commission should systematically link MIP-CSRs to macroeconomic imbalances. The proposed measures should be sufficiently detailed and should focus on policy actions to reduce imbalances in the short to medium term. Wherever possible, the Commission should make ex-ante and ex-post assessments of the impact of policy actions on imbalances;
- the in-depth review should provide a clear characterisation of the severity of the imbalances a Member State is facing. The Commission should enhance transparency by adopting, publishing and applying clear criteria for classifying imbalances. It should, unless there are specific circumstances, recommend the activation of an EIP when there is evidence that a Member State is facing excessive imbalances. If, in specific circumstances, the Commission uses its discretionary powers to refrain from taking this step, it should clearly and publicly explain its reasons;
- the Commission should provide a comprehensive and separately presented in-depth review with a length and level of detail that reflect the severity of the situation and the policy challenges. Instead of the scoreboard, the in-depth review should provide access to the country-specific variables actually used in the analysis;
- the Commission should systematically analyse the impact of fiscal policy on external imbalances and competitiveness and should use the MIP to make recommendations to Member States when fiscal issues directly affect external imbalances;
- the MIP process should give systematic consideration to policies with cross-country impacts that can enhance symmetric rebalancing within the euro area. MIP-CSRs should be consistent with recommendations for the euro area relevant to imbalances, including on the overall fiscal stance, when appropriate;
- the Commission should give greater prominence to the MIP in its communication with the public. In the context of effective communication, the relevant Commissioners should be available to parliaments of Member States, whenever the Commission has assessed imbalances as being excessive, so that they can explain the rationale for its decisions and corresponding policy recommendations.

3.2.2. European Central Bank

In numerous economic bulletins, the European Central Bank has mentioned that despite the persistence of excessive imbalances in some Member States, the excessive imbalance procedure has never been triggered since its introduction. It has further noted that 'Applying all available tools –

including activating the corrective arm of the procedure for countries with excessive imbalances – could increase the procedure's effectiveness and credibility'.[144]

Another point that the ECB emphasises is the low level of implementation of country-specific recommendations and the lack of decisive policy action by countries with excessive imbalances to improve the implementation of their country-specific recommendations.[145]

3.2.3. Council

In its conclusions on the in-depth reviews and the implementation of the 2015 country-specific recommendations,[146] the Council noted the Commission's plans with regard to specific monitoring of recommendations by the Council to all Member States concerned by imbalances, to ensure enhanced surveillance of the policy response to the imbalances identified. In this context, it invited the Commission to outline a proposal for the concrete timing and content of this monitoring, as well as its coordination with other surveillance procedures (e.g. post-programme surveillance) to avoid duplication.

In its conclusions on the in-depth reviews and the implementation of both the 2015 and the 2016 country-specific recommendations,[147] the Council underlined that the macroeconomic imbalance procedure should be used to its full potential and in a comprehensible way,[148] including with the excessive imbalance procedure applied, where found appropriate by the Commission and the Council. In its conclusions for 2017, it added that whenever the Commission concludes that a Member State is experiencing excessive imbalances, but does not propose to the Council the opening of the excessive imbalance procedure, it should clearly and publicly explain its reasons.[149]

3.2.4. European Commission review

In February 2020, the Commission published a report on the application of the six-pack and two-pack regulations.[150] This report is the initial input to a wider discussion expected to take place on the current economic governance framework.[151]

The Commission notes that the macroeconomic imbalance procedure has had a positive impact, because it has: contributed to raising awareness about the relevance of macroeconomic imbalances and related challenges; helped focus and prioritise the domestic policy debates; and lastly, provided a comprehensive framework for dialogue.

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144 See, for example, ECB Economic Bulletin, Issue 2/2019, or 'The European Commission's 2018 assessment of macroeconomic imbalances and progress on reforms' in the ECB Economic Bulletin, Issue 2/2018.

145 See, as an example, Nico Zorell's paper, 'Country-specific recommendations for economic policies under the 2019 European Semester', within the ECB Economic Bulletin, Issue 5/2019.

146 Council conclusions on in-depth reviews and implementation of the 2015 Country Specific Recommendations, May 2016.

147 Council conclusions on in-depth reviews and implementation of the 2016 Country Specific Recommendations, May 2017.

148 In the Council conclusions on In-depth reviews and implementation of the 2018 Country Specific Recommendations, the phrasing changed to 'and in a transparent and consistent way, ensuring Member States' ownership of the procedure'.

149 The Council adopted its conclusions on in-depth reviews in 2018 and reviewed the implementation of the recommendations in 2017.

150 European Commission report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and Council Directive 2011/85/EU, SWD(2020) 210 final, Brussels, February 2020.

151 See relevant Commission webpage.

With regard to the fact that the excessive imbalance procedure has never been launched, the Commission explains that thus far, rather than immediately recommending to the Council to launch the excessive imbalance procedure, its first aim has been to raise Member States' policy commitments in line with the challenges identified, and to strengthen monitoring. For such cases, it has proposed country-specific recommendations – more numerous, more detailed and sometimes time-bound. In addition, it has increased its vigilance, by monitoring policy commitments, including those in the national reform programmes, and their subsequent implementation, while making clear that launching the EIP remained an option.

3.3. Outlook

When the Commission published its report, the coronavirus outbreak had not yet been declared a pandemic. Since then, the EU economy has experienced significant turmoil and the EU governance framework has been adapted (albeit temporarily) to adjust to this situation and cushion the blow. As a result of the crisis, the public consultation period accompanying the aforementioned report has been extended and the Commission promised that it will actively return to the review exercise when the immediate challenges have been addressed.

Once the coronavirus-related emergency is over, and in light of the results of the review, the EU may revise its economic governance framework, including the macroeconomic imbalance procedure, to make use of the experience gained including in the current adverse conditions.

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What is the macroeconomic imbalance procedure? What are the elements of its scoreboard? Once those elements are taken into account, how does the procedure evolve in the wider context of the European Semester? This paper attempts to put these elements in context and provides an introduction to the subject, as well as a flavour of the debate driven by academia and European institutions, in view of the general discussion on European economic governance, taking place in 2020 and 2021.

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