Reform of the Macroeconomic Imbalance Procedure: a crucial contribution to EU economic governance reform

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In its "European Economic Governance" Communication of February 2020, which launched the economic governance reform process, the EU Commission noted that the main objectives of the policy regime, in addition to "ensuring sustainable government finances" include "avoiding macroeconomic imbalances (…) closer coordination of economic policies in particular in the euro area, and (…) promoting the convergence of economic performances among Member States." (European Commission 2020: 5).

These other goals have tended, though, to be sidelined in favour of a focus on the fiscal rules. This article considers a number of economic governance reform options, of varying degrees of ambition in legal and political terms, all of which have in common that they do not focus on changes to the fiscal rules in the narrow sense. Rather they seek to improve the functioning of another important element of the economic governance regime – the Macroeconomic Imbalance Procedure (MIP) – and/or to clarify the relationship between the MIP and the fiscal rules in the narrow sense.

**The MIP and its justification**

The MIP consists of two EU Regulations: 1176/2011 on the "prevention and correction of macroeconomic imbalances" and Regulation No 1174/2011 on "enforcement measures to correct excessive macroeconomic imbalances". The legal status of the MIP is discussed more fully….; here it is merely noted that, as secondary legislation, the MIP can be changed by means of the ordinary procedure, i.e. a qualified majority on the Council and a simple majority in the European parliament, provided primary legislation (notably the prohibition of excessive deficits) is respected.

In a nutshell the procedure is as follows (cf. European Commission 2016). The Commission is tasked with identifying imbalances or excessive imbalances in individual member states. It can propose appropriate economic policy measures. If endorsed by the Council these can be issued as recommendations to the member state concerned. Taking its cue from the Stability and Growth Pact (SGP), member states with imbalances are subject to surveillance under a preventive arm and, eventually, the Excessive Imbalance Procedure (EIP), as a corrective arm, which in the case of euro area members can lead to sanctions. In practice, however, sanctions have not been imposed. Unlike the SGP, however, there are no clear triggers for the various steps in the legal process. Countries are initially assessed against a scoreboard of quantitative indicators in an Alert Mechanism Report (AMR). This is not a mechanical process though, rather it acts as a filter to select countries for so-called in-depth review. These reviews form part of the European Semester process; recommendations under the MIP are issued as part of the country-specific recommendations.

The introduction of the MIP marked belated recognition of something that should have been anchored in the economic governance regime from the very outset. In a currency union – at least one

lacking well-developed redistribution and centralized stabilisation mechanisms – inflation rates in each member must not deviate systematically and substantially from one another. This is a crucial – arguably *the* – stability condition for monetary union (Koll/Watt 2018: 14ff.). Equal inflation rates mean that, given the centralised interest rates set by the central bank, real interest rates are equalised across the currency area. By the same token, real exchanges rates between the partner countries – assuming a starting point of equilibrium – remain broadly constant over the longer term. Divergences in domestic demand dynamics and price competitiveness are avoided. This avoids dangerous boom-bust cycles, limits movements in the external trade position (within the currency area), and avoids the build-up of external debt and of creditor-debt relationships between member states. As was seen in the wake of the euro crisis, these came close to poisoning the entire project of monetary integration.

Additionally, if unit labour costs increase at the same rate (again, over the medium term) as price inflation, the functional distribution of income remains constant, which promotes stability of spending and saving. Finally, if the inflation rate around which member states converge is the target rate of the central bank, the latter can provide support for economic activity and employment. This in turn minimizes the risk of "excessive" deficits and debts on the part of fiscal policy. It will also avoid the need for the monetary authority to take extraordinary measures to avoid the risk of deflation and persistent "low-flation" (Periera da Silva/Mojon 2019) – which also makes inter-country adjustment harder (Allsopp/Watt 2003, Bénassy-Quéré/Wolff 2020). The very close link between imbalances and fiscal outcomes (and thus fiscal rules) and economic performance more generally is apparent.

The monetary authority has an area-wide responsibility. Ensuring that domestic demand and price and nominal unit labour cost developments at national level are in accordance with growth and stability requirements is the responsibility of national actors. Outcomes result from the interaction between, above all, fiscal policy, decisions by wage and price-setters, but also macroprudential regulators. Wage and price setters influence price developments directly, while the fiscal and macroprudential policy determines them indirectly. The important role of central wage setting and thus of the social partners is often neglected compared with the role of fiscal policy. Blanchard even speaks of "the missing third leg of the euro architecture" (Blanchard 2018). Economists at the Bank for International Settlements have called for "consensus packages" as a result of cooperation between fiscal policy and social partners across the euro area to bring price developments in line with the ECB's price target (Pereira da Silva and Mojon 2019). The scope for such packages varies, depending on the institutional capacities and structures of different countries (Watt 2017: 82ff.)

What ultimately counts is that the MIP – but also the fiscal rules – must contribute to the observance of these overriding principles of a monetary union.

**Reform needs**

While the MIP has been less in the focus of public debate than the fiscal rules, several academic studies and analyses by European institutions, including the European Commission and the European Fiscal Board have identified serious weaknesses in the MIP. Most recently, the European Parliament, in a resolution passed with a large majority, called for reform, "Stress(ing) the importance of the Macroeconomic Imbalance Procedure (MIP) in detecting, preventing and addressing macroeconomic

imbalances in the EU", while noting that "its potential has not been fully exploited in such a way as to ensure the effective prevention and correction of imbalances" (European Parliament 2021: §49)

The MIP is frequently criticised because of its obvious asymmetry (e.g. European Commission 2020: 13, Bénassy-Quéré/Wolff 2020: 11, Dullien et al. 2020: 17): the selection of indicators in the scoreboard and the threshold values chosen – for instance, the choice of a -4% of GDP floor for current account deficits but a +6% ceiling for surpluses and, perhaps most egregiously, the fact that there is only an upper limit on nominal unit labour cost increases – draws policymakers' attention to, and adjustment pressure is placed one-sidedly on, deficit countries with above-average inflation. At the aggregate level this manifests itself as tendency towards an overall Euro area current account surplus (putting upward pressure on the euro and leading to conflicts with the non-Euro-area countries worldwide) and persistent low inflation.

The asymmetry criticism is closely related to the weakness that the MIP follows a country-by-country approach and pays too little attention to defining an overall stance for the euro area, and then clearly identifying the role to be played by different member states within that overall frame (European Commission 2020: 18, European Parliament 2021: §50, Bénassy-Quéré-Wolff 2020: 11)).

Somewhat related is the critic that the MIP confuses "competitiveness", in a general sense, with the specific problem of intra-EMU (or at least intra-EU) imbalances. In the scoreboard the real exchange rate is measured against a basket of international trading-partner currencies and is thus affected by movements in the external value of the euro over which countries have essentially no control and which are subject to short-term reversals. Meanwhile the fundamental issue of relative competitiveness – real exchange and also interest rates – *within* the monetary union is downplayed; worse, the lack of a threshold floor to nominal unit labour costs does not work towards achieving competitive balance, but rather unleashes a deflationary dynamic (Bénassy-Quéré/Wolf 2020: 13, Koll/Watt 2018: 18).

A different set of perceived weaknesses relates to the complexity and the internal coherence and relevance of the indicators in the scoreboard; see for example European Parliament 2021: §50, Bénassy-Quéré/Wolff 2020: 18ff., Dullien et al 2020: 18). The scoreboard in its latest vintage has 14 main quantitative indicators with thresholds, supplemented by no less than 28 auxiliary indicators (European Commission 2020b: 7ff.). The main indicators are grouped under external balance/competitiveness, internal balance and labour market indicators. The sheer number of main indicators, on paper of equal worth, makes it hard to clearly distinguish situations of genuine concern. A number of indicators are irrelevant to the issue of macroeconomic imbalances within the euro area (or EU). These include, the share of world exports. The inclusion of specific employment indicators - in addition to the overall unemployment rate[1] - has further muddied the waters: activity rates and youth and long-term unemployment rates improve and deteriorate with the business cycle but tell policymakers nothing about the existence of imbalances. Among the internal imbalance indicators house prices is a sectorally specific indicator, while the government debt ratio is part of the fiscal rules.

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[1] The unemployment rate is incorporated as one of the internal imbalance indicators. Here the problem is more the arbitrary threshold value of 10%. The gap between the actual and an "equilibrium" unemployment rate, or NAIRU, as in the Taylor rule for monetary policy is theoretically a meaningful indicator (on this in the context of the MIP cf. Priewe 2021). However, the difficulties of estimating the value in real time are well known.

Meanwhile what is arguably the most important single indicator – the divergence over time of inflation and thus, together with the permanent divergence in the real interest rate, the cumulative shift in the real exchange rate within the euro area since joining – is not adequately incorporated: as noted the indicator referring to the real effective exchange rate is against world trading partners and reflects the change over the last three years only, while nominal unit labour costs – which within monetary union do represent an indicator of the real exchange rate – are measured absolutely and not in relation to the average or a suitable benchmark.

Partly reflecting the plethora of indicators, there is a lack of transparency about the surveillance process that follows the evaluation in the scoreboard: the in-depth reviews of selected countries. The European Court of Auditors noted in its MIP analysis that the "classification of Member States with imbalances lacks transparency". There is no clear criteria for distinguishing between imbalances and excessive imbalances. The European Commission itself (2020a: 14) sees a need to improve the link between the MIP analysis and the policy recommendations it gives to member states, an evaluation shared by the European Parliament (2021: §50). The surveillance procedure becomes a bargaining game between the dedicated units in the European Commission and specialized parts of national bureaucracies, without public visibility or participation. In short, there is a lack of "ownership".

The Excessive Imbalance Procedure (EIP) which would require the delivery of a corrective action plan to be carried out within a pre-determined time frame – which would certainly lead to a political debate in the member state concerned – has so far never been activated. As this is only the first step towards sanctions – which can be imposed on euro area countries for repeated lack of compliance with the policy measures detailed in the plan – the MIP process has clearly shied well away from imposing constraining measures on member states (Bricongne/Turrini 2017).

All of the above factors contribute to a general assessment that the MIP lacks the "political traction necessary" (European Commission 2020: 13) and quite simply the effectiveness in steering member state behaviour. Analysis by Bénassy-Quéré/Wolff (2020: 14, 17) finds not only that compliance with MIP-inspired country-specific recommendations is limited and declining over time but also that there is no correlation between implementation rates of recommendations and imbalances. So, while imbalances have tended to diminish since the procedure was initiated, it is far from clear that this was due to member states following the recommendations.

Last but not least the relationship between the MIP and the fiscal rules is unclear and potentially inconsistent (Koll/Watt 2018: 12). The process of fiscal monitoring and that of monitoring imbalances are separate. Yet policy recommendations for the one will certainly affect outcomes for the other. And it is conceivable that recommendations under the two processes will be contradictory. As the European Fiscal Board (2019: 91) notes dryly "the implementation of the fiscal rules remains separate, also in organisation, from the MIP". The fact that the EIP has never been activated whereas the fiscal rules are perceived as much more legally binding – even if this is legally incorrect as both rely on provisions in secondary EU law – points to an imbalance in practice between the two processes in favour of the fiscal rules, although this is not justified from an economic point of view.

Besides the relationship to the fiscal rules, a lack of articulation with other processes and institutions has also been identified. Bénassy-Quéré/Wolff (2020) note that the European Financial Risk Board also has responsibility for assessing the risk of housing and credit bubbles, for instance. Both these

authors and Koll/Watt (2018: 25ff.) draw attention to the missing potential of greater articulation with the national productivity boards and the Macroeconomic Dialogue.

Finally, some criticisms made of the fiscal rules are relevant in the sense that a reformed MIP could potentially be used to improve policy outcomes. An example is the critique that the fiscal rules scarcely constrain countries in "good times", while tending to force countries into painful adjustment when times are hard (lack of symmetrical countercyclicality).

To summarise, there is a very substantial consensus among academic and policymaking observers that the MIP is, on the one hand, a vital part of the economic governance regime in light of the need to avoid macroeconomic imbalances, but that flaws in its operationalization and weak institutional embeddedness mean that it fails to a large extent to fulfil its potential and, in some respects at least, may exacerbate existing problems. In the words of the European Fiscal Board (2019: 91):

"The macroeconomic imbalance procedure (MIP) and the euro area fiscal stance were both introduced as important and innovative elements of the six-pack reform, but both have remained largely dormant in shaping policy (…).The MIP appears to have helped to make structural deficiencies in the economies of Member States more transparent, but the basic idea that it would be useful to consider the (im)balance between private savings and investment and hence the current external account when discussing fiscal issues and the associated sanctions for excessive imbalances has not been followed up. Furthermore, the implementation of the fiscal rules remains separate, also in organisation, from the MIP."


**BOX: THE ALERT MECHANISM REPORT 2021**

The relevance of the weaknesses of the MIP identified above are well illustrated by analysis of the most recent Alert Mechanism Report exercise, for 2021 (European Commission 2020c). The report runs to 75 pages and makes a plausible analysis of the economic policy challenges facing countries in the wake of the covid-induced economic downturn. A welcome development is that, given the uncertainties caused by the crisis, it attempts to make greater use of forward-looking indicators, which largely means focusing on values as forecasted in the European Commission's autumn economic forecast (European Commission 2020c: 14). Also positive is that the overall current account surplus is put into focus and Germany and the Netherlands identified as being by far the largest contributors.

Overall, though, the AMR can well be summarised with the metaphor of failing to see the wood for the trees. There is almost no focus on actual imbalances between member countries and little on issues in which decisions in one member state directly impinge on outcomes in others and so where there is a clear value added to European coordination and a strong rationale for constraining national policy choices.

For instance, the report notes that more and more countries risk overshooting the threshold on NULCs. While it recognizes that this is temporary (due to labour hoarding in the crisis), there is no attention to the fundamental issue of the accumulated, only partially corrected competitive imbalances from past years. Similarly, because the euro area current account is so heavily in surplus, member states that have lost relative competitiveness within the EMU do not show up on this

indicator, because they are also in small surplus or scarcely in deficit (pp. 15f.). The discussion of REERs and export share vis-à-vis the rest of the world is essentially a distraction.

There is a detailed discussion of various debt and asset price indicators, but the Commission runs through the countries without a clear picture emerging or an assessment of whether these are purely domestic matters or worthy of consideration also by the EU level.

Towards the end of the report (p.40) the conclusion pops out that "IDRs are warranted for 12 Member States: Croatia, Cyprus, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Romania, Spain, and Sweden." But there is little clarity as to the basis for this decision in the previous analysis. Much less is the situation of each of these countries in relation to the euro area average and thus to other member states set out clearly.

Overall, the AMR for 2021 is a useful snapshot of the economic situation in EU member states, but not an analysis of imbalances and spillovers within the euro area/EU and thus of threats to balanced economic development, much less still a blueprint for clearly assigned policy counter action by individual member states whose combined action serves to right the European economic ship.

**END OF BOX**

**Reform proposals**

Based on the analysis of deficiencies in the MIP process, we consider what reforms could be implemented to remedy them. Broadly speaking the discussion moves from easily implementable, technical "fixes" to more ambitious reform proposals. For clarity of exposition, the reform proposals are treated here separately. In practice, however, a combination of reforms would likely be the best approach.

**Symmetry of the scoreboard**

The simplest reform would be mechanistically to correct the asymmetries baked into the existing scoreboard. Three key changes are:

| Indicator | Existing threshold(s) | New thresholds |
|---|---|---|
| Current account balance, % GDP | -4%/+6% | -4%/+4% |
| Net external investment position, % GDP | -35% | -35%/+35% |
| Nominal unit labour costs, over 3 years, % change | +9% (+12% non € area) | +/-9% (+/-12% non € area) |

The REER indicator used in the scoreboard – as noted, this includes trade with a substantial number non-EU countries – is already expressed in a symmetric way (+/-5% over 3 years and +/-9% for non € area countries). The remaining nine indicators are one-sided in the sense that they have only one threshold, setting an upper limit on the rate of increase (in house prices, private debt, financial sector liabilities and in three indicators of job market deterioration) or levels (private sector credit

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flow and debt, and government debt – in each case as a % of GDP – and the unemployment rate). However, for these indicators it is either not economically intuitive to introduce a downside threshold at all, or it is far from clear what numerical value should be chosen. The concept of symmetry is hard to apply here. It is better to reconsider the role of such indicators more fundamentally (see the next sub-section).

Such a reform is legally undemanding. Not even a change in secondary EU legislation would be required. The Commission can make changes to the details of the Alert Mechanism as it sees fit, as long as this does not traduce the "spirit" of the two MIP regulations. However, political opposition among surplus countries such as Germany and the Netherlands might have to be overcome. It would correct the most obvious deficiency of the MIP and increase its perceived legitimacy with a potentially positive effect on "ownership". However, because the Alert Mechanism is only a filter device for in-depth reviews, rendering its key indicators symmetrical is a minimal step.

**Simplification and streamlining of the scoreboard**

A further-reaching reform would involve more substantial changes to the Alert Mechanism to reduce its complexity and focus on matters of genuine cross border concern. This can be achieved by some combination of reducing the number of indicators, introducing some form of prioritization and changing the definitions.

Bénassy-Quéré/Wolff (2020) examine a streamlined indicator with six variables and show that it would generate at least equally reliable results in terms of crisis prediction, while reducing complexity. The variables are: current account, net international investment position, change in unit labour costs, credit growth, government debt and unemployment

Dullien et al. (2020: 17f.) go further, suggesting that the Alert Mechanism should focus on three main indicators: inflation (as measured by the GDP deflator, not the HICP inflation rate, to remove the impact of import prices), unit labour costs (in each case symmetrically around the ECB target, operationalized as 1.9%[2]) and the current account (+/- 3% GDP). Other indicators, without thresholds, can be incorporated as contextual indicators and are thus depreioritised. Table 1 presents, for the euro area-12 countries, a simple ex post exercise showing when the annual figures (3-year averages are not taken) exceed +/-1%point of 1.9%, for price and unit labour cost and +/-3% points of GDP (with respect to zero) for the current account.

Because it is benchmarked around the ECB target and a balanced current account, an advantage of this approach, beyond its simplicity, is that it indicates the desired overall policy stance for the euro area (broadly more restrictive policy in the run-up to the euro crisis, more expansionary since then). It performs quite well at identifying the appropriate individual "contributions" by member states. The pre-crisis "periphery" receives clear signals in favour of a more restrictive policy stance. Germany is flagged for expansionary policies, consistently on at least two out of three indicators from 2004-2005.

**Table 1: Indicative change in policy stance based on a simple 3-indicator alert mechanism**

[2] Not until July 2021 was the target – officially: the definition of price stability – formalised as symmetrical around 2%. For most of the period considered it was "close to but below 2%".

| | | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Price defla | 0,60 | 2,01 | 1,98 | 1,64 | 1,85 | 1,91 | 2,08 | 2,26 | 1,93 | 1,91 | 0,53 | 1,89 | 1,81 | 1,96 | 1,27 | 0,98 | 1,33 | 1,92 | 1,83 | 1,63 | 1,66 | 1,69 | 1,64 | 1, |
| Belgium | NULC | 3,48 | 1,97 | 3,66 | 4,13 | 2,00 | 1,77 | 1,79 | 3,55 | 3,53 | 3,68 | 1,08 | 1,47 | 3,14 | 3,13 | 2,44 | 0,96 | 0,15 | 0,58 | 1,90 | 1,79 | 2,10 | -1,16 | 4,34 | 0, |
| | CA | 5,10 | 4,31 | 4,54 | 6,28 | 5,98 | 4,89 | 3,93 | 4,16 | 4,46 | 1,72 | 2,82 | 2,23 | -1,01 | 1,04 | 1,80 | 1,45 | 1,38 | 0,56 | 0,70 | -0,75 | 0,32 | 0,73 | 0,60 | 0, |
| | Price defla | 0,34 | -0,43 | 1,30 | 1,38 | 1,32 | 1,12 | 0,41 | 0,40 | 1,77 | 1,02 | 0,65 | 1,07 | 1,50 | 1,96 | 1,88 | 1,85 | 1,33 | 1,35 | 1,67 | 2,19 | 2,58 | 1,43 | 1, | |
| Germany | NULC | 1,14 | 1,62 | 1,97 | 1,23 | 1,75 | 0,32 | 0,36 | 1,07 | 1,02 | 2,27 | 0,35 | 2,58 | 2,98 | 2,65 | 1,92 | 2,88 | 2,79 | 2,30 | 2,60 | 2,90 | 3,00 | -0,78 | 2,81 | 2, |
| | CA | -1,40 | -1,76 | -0,33 | 1,92 | 1,43 | 4,55 | 4,71 | 5,87 | 6,95 | 5,65 | 5,96 | 5,87 | 6,26 | 7,21 | 6,57 | 7,39 | 8,65 | 8,68 | 8,97 | 7,55 | 7,26 | 6,23 | 6,55 | 6, |
| | Price defla | 4,35 | 6,91 | 6,88 | 5,22 | 3,93 | 0,50 | 3,08 | 3,46 | 1,22 | -0,40 | -4,67 | -2,96 | 1,35 | 2,30 | 1,33 | 0,01 | 7,60 | 1,01 | 1,64 | 0,31 | 3,15 | 0,50 | 1,69 | 1, |
| Ireland | NULC | 4,96 | 7,92 | 7,95 | 5,05 | 6,53 | 5,18 | 5,27 | 4,40 | 5,74 | 3,88 | -1,16 | -2,54 | -0,84 | 1,32 | -0,48 | 0,92 | 1,96 | 2,48 | 2,92 | 2,61 | 3,55 | 2,30 | 3,66 | 2, |
| | CA | -0,04 | 0,61 | 0,18 | 0,25 | 0,49 | -0,10 | -3,54 | -5,35 | -6,51 | -6,24 | -4,66 | -1,19 | -1,64 | -3,39 | 1,55 | 1,07 | 4,40 | -4,20 | 0,49 | 6,00 | -11,35 | 5,66 | 0,16 | -1, |
| | Price defla | 3,62 | 1,59 | 3,47 | 3,35 | 3,45 | 3,06 | 2,24 | 3,50 | 3,42 | 4,34 | 2,57 | -0,18 | 0,96 | -0,28 | -1,97 | -1,95 | -0,29 | -0,58 | 0,39 | -0,10 | 0,19 | -1,36 | 0,44 | 0, |
| Greece | NULC | 6,51 | 5,17 | 5,65 | 10,70 | 7,62 | 4,37 | 8,50 | 3,08 | 4,59 | 3,65 | 3,09 | -3,60 | -3,44 | -3,86 | -8,32 | -4,45 | -0,57 | -3,69 | 1,49 | 1,77 | 0,99 | -1,04 | 0,29 | 0, |
| | CA | -6,52 | -9,02 | -9,26 | -8,80 | -10,96 | -8,68 | -9,50 | -12,29 | -15,58 | -15,85 | -12,50 | -10,34 | -9,43 | -4,36 | -1,90 | -1,23 | -1,30 | -1,86 | -1,48 | -3,15 | -1,70 | -6,17 | -6,44 | -4, |
| | Price defla | 2,54 | 3,33 | 4,11 | 4,08 | 3,93 | 3,88 | 4,10 | 3,98 | 3,42 | 2,25 | 0,14 | 0,15 | -0,02 | -0,11 | 0,40 | -0,22 | 0,55 | 0,32 | 1,30 | 1,19 | 1,39 | 0,68 | 1,09 | 1, |
| Spain | NULC | 1,90 | 3,26 | 2,84 | 3,59 | 2,69 | 3,86 | 3,35 | 4,22 | 4,26 | 7,09 | 3,95 | 2,14 | 0,32 | -0,45 | 1,28 | 0,29 | 0,57 | -0,59 | 0,74 | 1,02 | 2,08 | 1,86 | 0,00 | 0, |
| | CA | -3,24 | -4,38 | -3,88 | -3,73 | -5,48 | -7,25 | -8,85 | -9,43 | -8,90 | -4,09 | -3,66 | -2,72 | 0,09 | 2,04 | 1,70 | 2,03 | 3,18 | 2,77 | 1,93 | 2,12 | 1,85 | 2,52 | 2, | |
| | Price defla | 0,20 | 1,55 | 2,01 | 2,07 | 1,86 | 1,62 | 1,94 | 2,16 | 2,56 | 2,37 | 0,07 | 1,07 | 0,95 | 1,16 | 0,78 | 0,58 | 1,14 | 0,52 | 0,52 | 0,95 | 1,23 | 2,85 | 0,48 | 1, |
| France | NULC | 1,96 | 2,31 | 2,29 | 3,14 | 2,82 | 3,39 | 3,01 | 2,78 | 2,42 | 2,67 | 1,57 | 2,94 | 2,58 | 2,35 | 1,67 | 1,28 | 1,03 | 1,32 | 1,97 | 1,73 | -0,16 | 5,52 | -1,63 | -0, |
| | CA | 2,90 | 1,37 | 1,84 | 1,56 | 1,25 | 0,89 | 0,15 | 0,04 | -0,49 | -0,68 | -0,39 | -0,81 | -1,18 | -1,16 | -0,98 | -1,23 | -0,50 | -0,60 | -0,71 | -0,85 | -0,82 | -2,98 | -2,78 | -1, |
| | Price defla | 1,54 | 1,79 | 3,03 | 3,27 | 3,15 | 2,67 | 2,01 | 2,12 | 2,48 | 2,40 | 1,68 | 0,44 | 1,61 | 1,55 | 1,15 | 0,91 | 0,93 | 1,13 | 0,73 | 1,03 | 0,71 | 1,25 | 0,96 | 1, |
| Italy | NULC | 2,69 | 2,24 | 2,87 | 3,36 | 4,34 | 3,55 | 2,93 | 2,52 | 2,45 | 3,64 | 2,21 | 2,70 | 1,17 | 0,31 | 1,26 | -0,02 | 0,98 | 0,10 | 0,62 | 2,08 | 1,53 | 0,94 | 0,55 | 0, |
| | CA | 0,80 | -0,27 | 0,15 | -0,50 | -0,79 | -0,48 | -0,88 | -1,48 | -1,37 | -2,80 | -1,89 | -3,30 | -2,83 | -0,23 | 1,10 | 1,90 | 1,42 | 2,59 | 2,54 | 2,49 | 2,96 | 2,88 | 3,05 | 2, |
| | Price defla | 5,80 | 2,17 | 0,46 | 1,68 | 2,68 | 2,95 | 4,20 | 7,04 | 1,49 | 3,88 | 1,40 | 3,62 | 4,77 | 2,56 | 1,70 | 2,74 | 0,18 | 0,77 | 1,72 | 2,51 | 3,39 | -0,25 | 1,37 | 1, |
| Luxembourg | NULC | 4,50 | 5,55 | 3,23 | 3,91 | 1,35 | 3,91 | 3,81 | 4,19 | 4,17 | 2,76 | 1,70 | 1,91 | 1,90 | 1,81 | 2,32 | 3,50 | 1,81 | 0,77 | 2,97 | 3,28 | 1,67 | -5,34 | 2,26 | 1, |
| | CA | 5,46 | 6,62 | 8,12 | 7,61 | 3,17 | 7,06 | 9,26 | 1,36 | 9,07 | 5,64 | -2,10 | 4,97 | 1,13 | -0,33 | -1,38 | -1,04 | 0,30 | 0,16 | -0,88 | -0,03 | 2,19 | 0,82 | 1,24 | 1, |
| | Price defla | 1,28 | 3,42 | 4,18 | 3,77 | 2,17 | 1,20 | 1,99 | 2,56 | 2,07 | 2,31 | 0,22 | 0,94 | 0,19 | 1,45 | 1,28 | 0,25 | 0,77 | 0,45 | 1,26 | 2,44 | 2,96 | 1,94 | 1,28 | 1, |
| Netherlands | NULC | 4,38 | 5,84 | 3,31 | 5,05 | 4,02 | 2,72 | 1,69 | 1,52 | 3,20 | 3,97 | 2,84 | 0,80 | 2,45 | 2,31 | 1,89 | 1,67 | -0,24 | 1,23 | 1,00 | 1,84 | 2,85 | 2,43 | 1,32 | 1, |
| | CA | 5,15 | 6,33 | 4,31 | 4,90 | 6,10 | 6,58 | 5,20 | 7,44 | 5,34 | 4,26 | 5,61 | 7,04 | 8,64 | 10,24 | 10,07 | 9,52 | 6,30 | 8,06 | 10,82 | 10,84 | 9,95 | 8,36 | 8,05 | 7, |
| | Price defla | 0,26 | 1,36 | 1,95 | 1,15 | 1,31 | 1,74 | 2,54 | 1,89 | 2,22 | 1,96 | 1,89 | 0,87 | 1,83 | 2,05 | 1,62 | 2,18 | 2,30 | 1,85 | 0,86 | 1,71 | 1,73 | 1,98 | 1,89 | 1, |
| Austria | NULC | 1,93 | 2,29 | 1,50 | 2,09 | 1,72 | 2,06 | 2,03 | 3,08 | 2,96 | 3,30 | 1,64 | 1,09 | 2,05 | 2,69 | 2,20 | 1,87 | 1,95 | 2,38 | 1,63 | 2,91 | 2,80 | 1,13 | 0,52 | 1, |
| | CA | -2,36 | -0,69 | -0,84 | 2,08 | 1,53 | 1,88 | 2,03 | 2,80 | 3,34 | 4,22 | 2,35 | 3,33 | 2,16 | 1,91 | 1,88 | 2,47 | 1,85 | 2,86 | 1,50 | 1,40 | 3,00 | 2,28 | 2,92 | 3, |
| | Price defla | 3,37 | 3,42 | 3,72 | 4,19 | 3,43 | 2,40 | 3,33 | 3,18 | 2,97 | 1,74 | 1,10 | 0,64 | -0,27 | -0,39 | 2,25 | 0,70 | 2,02 | 1,72 | 1,51 | 1,81 | 1,68 | 2,20 | 1,27 | 1, |
| Portugal | NULC | 5,15 | 5,97 | 4,17 | 3,56 | 3,18 | 3,27 | 4,70 | 1,84 | 3,45 | 2,62 | 2,40 | 2,05 | -1,87 | -3,08 | 3,48 | -1,82 | 0,32 | 1,20 | 2,29 | 3,89 | 3,48 | 0,62 | 2,25 | 1, |
| | CA | -8,79 | -10,81 | -10,09 | -8,58 | -6,65 | -8,21 | -9,79 | -10,04 | -9,71 | -12,17 | -9,77 | -10,34 | -5,06 | -1,77 | 1,03 | -0,14 | -0,01 | 0,64 | 1,00 | 0,25 | 0,15 | -0,88 | -0,49 | -0, |
| | Price defla | 0,93 | 1,64 | 3,30 | 0,94 | 0,19 | 0,60 | 0,93 | 0,92 | 2,75 | 3,04 | 1,77 | 0,32 | 2,62 | 2,97 | 2,56 | 1,63 | 1,62 | 0,09 | 0,58 | 1,88 | 1,78 | 1,55 | 1,67 | 1, |
| Finland | NULC | 3,40 | 3,78 | 3,65 | 1,66 | 2,11 | 3,49 | 3,38 | 3,29 | 3,20 | 4,24 | 2,11 | 2,05 | 3,42 | 2,74 | 1,41 | 0,94 | 1,43 | 0,91 | -1,10 | 1,28 | 1,35 | 2,11 | 0,99 | |

Data source: AMECO, own calculations. Notes: Red cells suggest the country should adopt a more restrictive, green cells a more expansionary stance. Based on +/- 1 %point cuts-offs for the GDP deflator and nominal unit labour costs around a central value of 1.9%, and a current account surplus/deficit exceeding +/-3% of GDP in the current year

France emerges from this analysis as something of a bellwether for the euro area as a whole. Some of the smaller core countries (BENELUX and Finland) receive mixed signals in the early part of the period: the current account surplus suggests expansionary, the two price indicators restrictive policies. These findings suggest issues with overreliance on the current account. This tends to lag by several years changes in price competitiveness and in the fiscal stance, with its impact on volumes, and to then be persistent, sending the same signal year after year. Due to a lack of data the overall current account is used; to our knowledge a current account position vis-à-vis only European trading partners is not available and would need to be calculated (or estimated) by the Commission.

Regarding the period since 2011 the indicator set overwhelmingly signals a need for expansionary policies. It is notable, though, that for Germany and the Netherlands, this comes, as expected from the current account, but not systematically from the two price-competitiveness indicators. The signal for expansionary policies after the crisis in countries such as Greece and Portugal, based on the deflationary trend in those countries, ignores the need to correct for past imbalances. This serves as a reminder that the focus on current rates of price and wage inflation, examined annually, can be misleading. While the current rate of change of the GDP deflator and NULCs provides a timely indicator of the direction of price competitiveness (and real interest rates) and has something of an advance warning characteristic, it essentially starts the clock anew every year. It is insensitive to past accumulations of excessive or inadequate price competitiveness. This constitutes a serious drawback.

A solution to this problem, in principle, is to use a measure of the real exchange rate, and determine the gap between the actual exchange rate and some measure of the equilibrium value; see the discussion in Bénassy-Quéré/Wolff (2020: 19) and Couharde et al. (2017). However, such methods require, among other things, estimates of the output gap – which are well-known from the debate on structurally adjusted fiscal deficits to be highly problematic as a policy guide. A pragmatic solution for euro area countries is to use index values for the price level starting from when the country joined the euro, benchmarked against an index for the ECB target inflation rate.

Tables 2 and 3 show the results of an ex post analysis for the 11 original euro area members plus Greece. The figures are calculated as the index of nominal unit labour costs (Table 2) and of the GDP deflator (Table 3) minus an index based on the ECB target rate of inflation (set at 1.9% p.a.). The

corridor for the permitted deviation initially increases (in all cases symmetrically) in increments of +/- 1.5 percentage points a year until it reaches 9 percentage points; from 2005 the corridor is constant. The widening initial corridor takes account of the fact that countries take time to deviate substantially from the benchmark. Both the pace at which it widens and the selected medium-term maximum (9 %-points) were selected by trial and error and give plausible results on past data. Other values to be applied to incoming data could be selected, rendering the "alert mechanism" more or less sensitive.

|       | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|-------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| BE | 0 | -1,60 | 0,41 | 1,17 | 0,07 | -2,80 | -3,93 | -3,77 | -4,26 | -0,81 | 0,46 | -2,70 | -1,70 | -0,60 | -0,90 | -3,65 | -7,45 | -9,30 | -9,55 | -10,29 | -10,51 | -6,89 | -12,94 |
| DE | 0 | -1,01 | -2,95 | -3,97 | -4,59 | -7,19 | -9,80 | -13,90 | -16,30 | -15,79 | -11,28 | -14,88 | -16,90 | -15,61 | -15,49 | -16,19 | -16,12 | -17,12 | -18,09 | -17,08 | -15,58 | -12,45 | -16,42 |
| IE | 0 | 1,16 | 5,09 | 3,94 | 7,80 | 7,88 | 11,03 | 13,87 | 17,83 | 26,38 | 18,27 | 4,67 | -2,20 | -3,80 | -4,73 | -12,97 | -34,16 | -32,48 | -38,09 | -43,26 | -45,06 | -51,07 | -59,62 |
| EL | 0 | -0,36 | -0,45 | 7,01 | 8,54 | 8,51 | 16,91 | 13,92 | 15,13 | 19,92 | 27,52 | 24,34 | 26,24 | 22,88 | 10,99 | 6,07 | -0,75 | -3,22 | -6,24 | -6,74 | -8,92 | -1,32 | -7,49 |
| ES | 0 | 0,97 | 1,25 | 2,55 | 3,06 | 4,70 | 6,18 | 8,32 | 10,69 | 16,26 | 15,63 | 12,13 | 7,54 | 1,83 | -1,48 | -4,10 | -6,71 | -10,34 | -12,17 | -13,40 | -13,01 | -8,89 | -12,87 |
| FR | 0 | -0,77 | -0,53 | 0,39 | 0,55 | -0,69 | -0,56 | -0,71 | -1,16 | -0,10 | 1,71 | 0,59 | -0,67 | -0,37 | -1,24 | -2,85 | -5,04 | -6,73 | -8,32 | -9,69 | -13,05 | -9,40 | -14,14 |
| IT | 0 | -1,68 | -0,95 | 1,34 | 4,46 | 5,29 | 5,68 | 6,45 | 6,64 | 9,63 | 13,73 | 11,61 | 10,00 | 10,35 | 8,81 | 6,59 | 5,27 | 2,94 | -0,04 | -0,15 | -0,86 | -2,14 | -2,52 |
| LU | 0 | 0,78 | 5,44 | 6,73 | 6,47 | 7,45 | 9,36 | 10,70 | 8,99 | 18,13 | 26,05 | 22,22 | 23,24 | 27,75 | 26,14 | 26,44 | 24,10 | 20,37 | 25,05 | 28,80 | 31,22 | 33,05 | 29,95 |
| NL | 0 | 1,23 | 1,93 | 4,86 | 5,76 | 3,70 | 1,50 | -0,29 | 0,05 | 2,01 | 6,43 | 2,72 | 2,23 | 3,36 | 1,95 | -0,40 | -4,13 | -5,27 | -7,51 | -7,36 | -5,88 | 3,04 | -1,29 |
| AT | 0 | -2,01 | -3,00 | -4,64 | -5,21 | -7,29 | -8,36 | -9,06 | -10,09 | -8,32 | -5,00 | -7,27 | -8,81 | -7,63 | -7,01 | -6,82 | -7,42 | -7,82 | -9,31 | -9,31 | -8,65 | -3,94 | -8,88 |
| PT | 0 | 2,43 | 4,64 | 6,10 | 7,60 | 6,41 | 8,28 | 6,89 | 5,84 | 6,90 | 8,18 | 4,44 | -0,60 | -6,86 | -7,53 | -11,49 | -14,09 | -15,78 | -14,26 | -14,72 | -5,26 | -8,28 | |
| FI | 0 | -1,76 | -1,11 | -1,86 | -3,52 | -5,52 | -5,39 | -6,29 | -8,27 | -4,29 | 2,90 | -1,49 | -0,85 | 3,10 | 2,71 | 1,39 | -0,04 | -4,51 | -11,32 | -10,80 | -11,16 | -12,32 | -14,74 |
| EA-12 | 0 | -0,71 | -0,88 | -0,14 | 0,40 | -0,70 | -1,16 | -2,25 | -2,79 | -0,62 | 2,44 | -0,50 | -2,32 | -2,31 | -3,34 | -5,09 | -7,04 | -8,70 | -10,49 | -10,73 | -10,99 | -8,03 | -12,00 |

**Table 3: Indicator of "real exchange rate deviation", based on GDP deflator, €A-12 countries**

|       | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|-------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| BE | 0 | 0,11 | 0,20 | -0,07 | -0,12 | -0,11 | 0,09 | 0,50 | 0,55 | 0,57 | -1,05 | -1,07 | -1,21 | -1,16 | -1,97 | -3,19 | -3,98 | -4,03 | -4,21 | -4,66 | -5,09 | -6,35 | -6,88 |
| DE | 0 | -2,39 | -3,03 | -3,61 | -4,27 | -5,16 | -6,83 | -8,54 | -8,84 | -10,07 | -10,32 | -11,90 | -13,05 | -13,75 | -13,95 | -14,24 | -14,56 | -15,53 | -16,49 | -17,09 | -17,04 | -17,77 | -18,52 |
| IE | 0 | 5,01 | 10,43 | 14,42 | 17,13 | 15,72 | 17,49 | 19,85 | 19,32 | 16,56 | 8,01 | 1,90 | 1,24 | 1,77 | 1,07 | -1,39 | 6,06 | 4,93 | 4,65 | 2,44 | 4,30 | 0,83 | 0,24 |
| EL | 0 | -0,31 | 1,29 | 2,83 | 4,58 | 5,97 | 6,48 | 8,49 | 10,52 | 13,82 | 14,96 | 12,43 | 11,39 | 8,64 | 3,52 | -1,55 | -4,45 | -7,77 | -9,88 | -12,68 | -15,15 | -19,83 | -23,06 |
| ES | 0 | 1,43 | 3,74 | 6,16 | 8,55 | 11,02 | 13,89 | 16,77 | 19,08 | 19,92 | 17,87 | 15,79 | 13,42 | 10,88 | 9,01 | 6,22 | 4,46 | 2,34 | 1,55 | 0,57 | -0,16 | -1,37 | -2,73 |
| FR | 0 | -0,35 | -0,24 | -0,07 | -0,12 | -0,42 | -0,39 | -0,11 | 0,64 | 1,19 | -0,98 | -1,99 | -3,18 | -4,14 | -5,61 | -7,36 | -8,46 | -10,36 | -12,31 | -13,76 | -14,89 | -14,72 | -16,93 |
| IT | 0 | -0,11 | 1,04 | 2,51 | 3,90 | 4,84 | 5,06 | 5,42 | 6,21 | 6,94 | 6,80 | 5,06 | 4,78 | 4,41 | 3,50 | 2,25 | 0,99 | -0,04 | -1,65 | -2,84 | -4,43 | -5,51 | -7,15 |
| LU | 0 | 0,27 | -1,20 | -1,45 | -0,66 | 0,46 | 3,00 | 8,96 | 8,62 | 11,26 | 10,83 | 13,29 | 17,46 | 18,73 | 18,79 | 20,39 | 18,15 | 16,76 | 16,80 | 18,08 | 20,83 | 21,94 | 22,92 |
| NL | 0 | 1,52 | 3,91 | 6,00 | 6,42 | 5,75 | 5,96 | 6,85 | 7,19 | 7,83 | 5,85 | 4,75 | 2,66 | 2,13 | 1,37 | -0,77 | -2,27 | -4,24 | -5,17 | -4,54 | -3,17 | -2,51 | -2,50 |
| AT | 0 | -0,54 | -0,50 | -1,29 | -1,93 | -2,14 | -1,49 | -1,53 | -1,20 | -1,15 | -1,19 | -2,44 | -2,56 | -2,42 | -2,82 | -2,52 | -2,04 | -2,15 | -3,60 | -3,93 | -4,24 | -5,41 | -6,33 |
| PT | 0 | 1,52 | 3,43 | 5,95 | 7,77 | 8,49 | 10,35 | 12,12 | 13,69 | 13,74 | 12,94 | 11,51 | 8,82 | 5,91 | 6,49 | 4,98 | 5,24 | 5,08 | 4,63 | 4,59 | 4,44 | 5,24 | 4,51 |
| FI | 0 | -0,26 | 1,16 | 0,18 | -1,63 | -3,04 | -4,14 | -5,27 | -4,44 | -3,25 | -3,46 | -5,38 | -4,63 | -3,42 | -2,67 | -3,06 | -3,48 | -5,94 | -7,47 | -7,57 | -8,24 | -8,73 | -9,13 |
| EA-12 | 0 | -0,53 | 0,05 | 0,62 | 0,97 | 0,99 | 0,94 | 1,03 | 1,58 | 1,64 | 0,52 | -1,00 | -2,08 | -2,89 | -3,77 | -5,04 | -5,74 | -7,09 | -8,33 | -9,19 | -9,65 | -10,33 | -11,54 |

Source: AMECO, own calculations. Notes to Tables 2 and 3: Red cells suggest the country should adopt a more restrictive, green cells a more expansionary stance. Based on a widening corridor of +/- 1.5, 3, 4.5, 6, and 7.5 %-points for the years 2000-2004 and of +/- 9 %-points from 2005 for the deviation between the index of nominal unit labour costs (Table 2) and the GDP deflator (Table 3) and a benchmark 1.9% annual increase

Just as with Table 1, an immediate advantage of the use of an appropriate central benchmark – rather than benchmarking member states only relatively to each other – is that the need for an aggregate somewhat restrictive stance in the pre-crisis period and a pronounced expansionary stance following the crisis is readily apparent. Cursory inspection suggests that the outcomes are qualitatively similar whether the nominal unit labour cost or GDP deflator basis is used. Because the GDP deflator is less volatile than NULC, the indicator flashes less frequently. This could be offset by narrowing the corridor slightly. For some member states, though, there are not inconsiderable differences.

At the country level, in the early stages of EMU the indicator sends a timely warning to peripheral countries[3] that they are losing competitiveness. In the case of Greece the GDP deflator-warning comes rather late. Austria receives an early signal that a looser policy stance is appropriate (although only on the NULC measure). As expected, Germany, from 2005/6, would, under the NULC indicator be under constant pressure to permit faster demand and nominal wage growth; using the GDP deflator the warning comes later. Noteworthy is that, on this indicator, after 2012/13 none of the peripheral countries would have been recommended to stay on the path of further wage deflation. Rather the adjustment burden would have been on the core countries; some combination of fiscal

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[3] Clearly Luxembourg – the smallest member state in the sample, and with a well-established tendency to be an outlier, due amongst other things to large numbers of cross-border commuters – is ill-served by this indicator set and requires a country-specific analysis.

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and incomes policies would have been more expansionary (Horn et al. 2017), the aggregate (wage) inflation rate would have been higher, the burden would have been taken off the shoulders of the ECB.[4] At the same time, the problem identified using current annual rates – that peripheral countries receive a post-crisis signal for expansionary policies, neglecting the accumulated adjustment need – is avoided.

Belgium, Finland and particularly the Netherlands, which in Table 1 get mixed messages from the price/wage and current account indicators receive a clear and intuitive economic signal on this cumulative indicator. Especially in the case of the Netherlands, with its large high-sea ports, possibly also Belgium and Finland, the current account (vis-à-vis all trading partners) may be a distorted and thus unsuitable indicator for the MIP.

Of course there are potential pitfalls in using and interpreting such a simple indicator. It assumes that initial exchange rates reflected some sort of equilibrium. In 1999 current accounts were very small by subsequent standards, so this may be considered reasonable. However, when initial price levels differ substantially, there may be a case for making allowances for some price-level convergence. An in-depth economic analysis might suggest the need to "rebase" one or more countries to take account of this. Countries entering the euro can be incorporated taking the start year as their basis. The RER deviation band used here seems intuitive and is appropriate to past euro area data, but could of course be altered in the light of ongoing experience. In a more stable and integrated currency union the band should arguably be somewhat narrower.

In terms of a single summary indicator, this simple measure of exchange-rate deviation – which, it is recalled, is equivalent to the cumulative NULC deviation – seems to have many strengths. The European Fiscal Board (and also among academic commentators Bénassy-Quéré/Wolff 2020) come down in favour of the current account as the decisive measure, arguing that it captures the extent of any imbalance between domestic saving and investment. We return to this issue in the section on relationship between MIP and the fiscal rules.

What is clear is that no simple quantitative indicator can be simply applied in a mechanical way. A combination of the three symmetric indicators in Table 1 and a measure of the accumulated deviation of the real exchange rate – possibly a more sophisticated version than the two sketched here – together offer a relatively comprehensive assessment, offsetting drawbacks of single indicators. The current account is, ultimately, the arbiter of whether a country is saving more than it invests and thus accumulating assets – and so its trade partners are taking on debt - or vice versa, but it is a lagging and sluggish indicator ("end-of-pipe"). The current rates of domestic price inflation and nominal unit labour costs provide a timely indicator of the current "temperature" of the economy and its current policy stance. Referring to both keeps a weather eye on functional distribution issues[5]. The indicator of cumulative deviations in the real exchange rate takes into account past developments and indicates a probable need for adjustment in the current and coming periods.  All three indicators are benchmarked to sensible long-run goals for the euro area in aggregate: price stability as defined by the central bank (and thus economic growth at potential) and a balanced current account, i.e. internal and external balance. They guard against race-to-the-bottom dynamics and inappropriate world-economic benchmarks which should be left as an issue for the external

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[4] It goes without saying that this is a static and descriptive analysis. If a reformed MIP along these lines had induced desired shifts in the policy stance, the outcomes in subsequent years would have been different.
[5] It is recalled that the GDP deflator can be decomposed into a wage, profit and tax component.

value of the euro (and risk conflicts with non-euro trading partners). They provide a meaningful quantitative and relatively simple assessment. Country-specific factors – such as the case of Luxembourg or the Netherlands – can be taken into account in the in-depth review.

Essentially the same conclusions apply as in the previous sub-section. The scoreboard can, in principle be changed by technocratic decision. A far-reaching streamlining of the scoreboard, particularly the inclusion of a measure of intra-EMU accumulated deviation of nominal unit labour costs or of the GDP deflator, i.e. a measure of the change in the within-area real exchange rate, would, of course, require political support to be built up. The scoreboard would remain a filter for the in-depth review. But the much greater focus and symmetry would make the AMR a much more powerful and also visible tool, increasing transparency and ownership. Benchmarking to economically sound area-wide criteria would quite simply generate better outcomes.

**Fewer, less prescriptive but more binding CSRs**

The country-specific recommendations under the European Semester emanate from multiple processes. The first reform step should be to separate those from the MIP from other recommendations. The MIP recommendations should be clearly targeted towards avoiding or correcting imbalances and avoiding spillovers between countries, rather than trying to initiate more general (supposed) improvements to economic policy via "structural reforms". Provision of child-care facilities and intra-household taxation are important, but they are not areas in which the EU should be constraining member state economic policy competence. Worse, they risk breeding contempt for recommendations which are in the "general interest" of the EU.

The MIP recommendations to member states should be such as to be consistent with the overall stance required for the euro area as a whole. This should be set out in the section of the CSR's dealing with the euro area (cf. Bénassy-Quéré/Wolff 2020: 33). The recommendations should primarily identify the contribution in terms of outcomes expected from each member state. Following the principle underlying EU Directives, member states should be permitted as much leeway as possible as to how they achieve given objectives. They are best placed to do so and EU intervention should only be as constraining as necessary (subsidiarity). This is key to enhance ownership and compliance.

For instance, countries needing to reign in current account deficits/surpluses and reduce/boost wage and price inflation can use a range of fiscal and other tools. Countries with highly coordinated wage bargaining systems, or a strong role for government-set minimum wages can deploy such "incomes policy" tools (Watt 2017: 79ff.). Those with highly decentralised systems will rely on fiscal policy and the workings of the Phillips Curve.

Given such a stripped down (and symmetrical) approach, there should be much less reluctance to invoke the so far unused EIP. Under the EIP member states themselves have to draw up an action plan with a timetable for specific interventions to correct specific imbalances. In this way policy discretion is left to the member states, but constraints can be imposed where they are needed to reign in negative and promote positive spillover effects.

In his context it is worth noting that the disbursement of Recovery and Resilience Fund money is linked to at least a proportion of financed projects addressing a country's CSRs. Experience will show to what extent this approach works well in practice. But the principle – withdrawing "carrots" for

serious non-fulfilment of agreed courses of action – rather than seeking to impose financial penalties ("sticks"), which has manifestly failed with regard to the fiscal rules and has never even been tried under the MIP, would appear to be the way forward to improving compliance. A precondition is, as set out, that CSRs are only issued to the extent necessary to achieve EU policy objectives; here: maintaining internal and external balance.

It is the task of the European Commission to draw up CSRs and so it has discretion as to their coverage and detail. There are no legal barriers to more focused CSRs with a greater emphasis on compliance. The EIP is on the statute book; whether or not it is triggered is a political question. Legally, tying disbursement of joint funds to the fulfilment of CSRs is, in principle, uncontroversial; however, as with the RRF, political majorities need to be built.

**Deepen the relationship with other institutions**

The MIP can be strengthened by clarifying and deepening the relationship with other existing EU institutions.

The European Systemic Risk Board is tasked with identifying financial risks and monitoring macroprudential policies. For this reason, the recommended removal of the financial indicators from the MIP scoreboard would not mean that important issues such as house price developments disappear from the policymaker radar screen. ESRB recommendations, though, are only weakly linked to national CSRs. It would be better for the ESRB to issue its own CSRs, on a timescale aligned with the European Semester process. Coordination with the MIP could be achieved by a mixed Commission/ESRB delegation meeting with national macroprudential authorities, as proposed by Bénassy-Quéré/Wolff (2020: 32).

Watt/Koll (2018) and Dullien et al. 2020 call for a reorientation of the national productivity boards that were set up following a Council recommendation in 2016, and their better coordination with the MIP. These expert consultative bodies, while originally envisaged to examine issues of competitive balance, mostly address in practice a supply-side agenda, examining ways to boost national productivity. While valuable, there is no clear European value-added here. Boards act autonomously, setting their own agendas and methodologies (Bénassy-Quéré/Wolff 2020: 33), and there is no EU-level institution that seeks to coordinate their analyses or recommendations in order avoid negative cross-border spillovers (e.g. competitive races to the bottom) and encourage positive spillovers. Such a European-level institution could be established, or the mandate of the European Fiscal Board could be expanded to that end (Koll/Watt 2018: 25, who propose renaming the productivity boards Advisory Boards for Macroeconomic Convergence, and Dullien et al 2020: 19). Both fora, on national and Euro area level, need in any case the mandate and competence to monitor compliance with the overriding target of keeping national inflation rates close to the overall price stability target, thus preventing macroeconomic imbalances, or adjusting current rates so as to correct imbalances that have built up.

These authors also underline the positive role that could come from strengthening the existing EU Macroeconomic Dialogue. This view finds political support in the recent European Parliament (2021: §61) resolution. At EU level this institution brings together representatives of fiscal policy, the social partners, the ECB and the EU Commission, i.e., all the actors responsible for the policy mix (fiscal,

incomes, monetary and macroprudential policies) needed to avoid and correct imbalances. Whereas the productivity boards need a European "roof", the MED needs national "foundations" institutions at national level that parallel the EU MED so as to establish the necessary articulation between national and European level. In addition, a specific MED for the euro area is needed, where - unlike the existing dialogue -, all finance ministers should be present.

Deliberations of both the expert-advisory productivity boards and the policy-oriented MEDs should be centred round the analysis and design of policy mixes that are appropriate to the institutional characteristics of the country in question and designed to ensure balanced, tension-free growth trajectories.

These institutional developments would not require changes to primary legislation, but would require changes to existing, or new, institutional mandates via secondary legislation. Reforms in this broad direction have been called for in a resolution of the European Parliament (2021: §57, 61). Institutional development along these lines would go a considerable way to enhance the visibility, "ownership" and effectiveness of the (reformed) MIP.


**Clarifying the relationship between MIP and the fiscal rules**

A constant theme in discussions of the economic governance regime is the need to avoid inconsistencies and promote synergies between the MIP and the fiscal rules; see the literature cited above.

One issue that arises from the previous discussion is: What would be the implications for the relationship if the MIP were to be materially strengthened by implementing some of the proposals set out previously? At first sight it might seem that strengthening the MIP will invite serious tensions with the fiscal rules. But this is not necessarily so. Assume, for the moment, that the fiscal rules remain unchanged (worst case). Situations can be easily envisaged where a conflict can occur: in particular a country can be constrained by debt or deficit rules to run contractionary fiscal policies although, on the basis of below-target inflation or a current account surplus, expansionary policies are indicated by the MIP. While such conflicts cannot be ruled out, in practice by encouraging balanced economic growth at inflation rates close to the ECB target, in a symmetric way, and thus reducing the risk of corrective crises, a reformed MIP would contribute to the reduction over time of debt-to-GDP ratios. Thus the likelihood of countries coming up against the constraints of the fiscal rules is reduced. By constraining countries in "good times", a reformed MIP would complement the (existing) fiscal rules by achieving what they, as is widely recognized, have not managed to do.

This point is all the more relevant given that the fiscal rules themselves are to be reformed. A sensibly designed expenditure rule, for example, as proposed in this study, would make fiscal policy more symmetrically counter-cyclical (at least on the spending side). Conflicts between the MIP and reformed fiscal rules, at least in terms of the current fiscal stance, are thus unlikely in such a context. MIP reform – much of which is legally undemanding and likely less a bone of political tension between member states – could serve as a useful precursor of reforms of the fiscal rules. It is true, though, that this may not be the case considering the legacy of past debt. Countries are obliged to adjust towards a medium-term objective which can be in tension with cyclical stabilization concerns. Fiscal-rule reforms are likely to reduce, but not remove this adjustment pressure.

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How might a potential conflict be defused? The EFB has tabled a proposal to make an explicit link between the fiscal rules and the MIP. Specifically, the EFB (2019: 55) proposes to do so "by regulating the speed of adjustment towards the MTO in relation to Member States' macroeconomic imbalances. For example, Member States with large private debts and current account deficits could be required to speed up their adjustment towards the MTO or even to achieve a higher MTO. Conversely, Member States with persistent current account surpluses could be allowed to slow down their adjustment towards the MTO or to aim for a lower MTO."

For those countries for which macroeconomic imbalances have been identified, this would amount to a partial and time-limited override of the fiscal rules. This would follow, at a lower level, the same logic as the suspension of the fiscal rules during the pandemic. The Council would ascertain that an exceptional circumstance – here the existence of substantial and persistent macroeconomic imbalances – pertain for a given set of countries. These would then be permitted to deviate from an adjustment path otherwise prescribed by the fiscal rules and follow instead a trajectory agreed by the Council.

This approach has been endorsed politically by the European Parliament (2021: §51f.). It would stop well short of subsuming the fiscal rules under an overall economic-policy coordination centred around the MIP, although from a purely economic point of view this would be preferable. The proposal would amount to a temporary override of the fiscal rules for specific countries, for which agreement would need to be sought on a case-by-case basis on the Council. Depending on the precise operationalisation, such an override can be granted more or less easily with respect to the seriousness of the imbalance problem facing the country. But given that the fiscal rules are not about to be pushed aside in favour of a new framework, the EFB proposal would go some way – depending on the precise modalities perhaps a considerable way – way to anchoring the MIP within the economic governance framework.

The asymmetric wording of the EFB proposal should be noted, however. Deficit countries are "required", surplus countries "allowed" to deviate from their adjustment path. The MIP-SGP link only makes sense if the constraint on both sets of countries is the same. Besides this, the degree of discretion enjoyed by the Commission and the Council in this process would need to be determined. Lastly, while the EFB mentions the current account and private debts as imbalance indicators, the assessment should be driven by the scoreboard – in which we have proposed that the accumulated NULC/GDP deflator position compared to a price-stability benchmark should be a decisive factor – in determining whether countries are suffering from imbalances or not.


**Conclusion**

To be added….


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