7 The 2017 macroeconomic imbalance procedure and implementation of the 2016 country-specific recommendations

On 22 February 2017 the European Commission published the European Semester Winter package which includes the conclusions reached following the application of the macroeconomic imbalance procedure (MIP), as well as an assessment of the progress with reforms in each Member State since the adoption of the relevant country-specific recommendations (CSRs) in July 2016.

Outcome of the 2017 MIP assessment by the European Commission

The MIP was introduced in 2011 and is now in its sixth year of application. It seeks to prevent the emergence of harmful macroeconomic imbalances in EU countries and to correct them where they are excessive. Following a screening exercise in autumn each year on the basis of a set of indicators, the European Commission conducts in-depth reviews of selected countries (included in the annual country reports) to assess the severity of any imbalances. If such imbalances are found to exist, the Member State concerned receives policy recommendations from the Council of the European Union – based on recommendations by the European Commission – under the preventive arm of the procedure. Where the imbalances are found to be excessive, the excessive imbalance procedure (EIP) may be initiated following a recommendation to the Council by the Commission.[43] Under this corrective arm of the procedure, a corrective action plan must be provided to explain how the excessive imbalances will be addressed. In the event of repeated failures to provide an adequate plan, or if an approved plan is not complied with, the Council may impose financial sanctions on the euro area country in question.

In its assessment, the European Commission identified six countries with excessive imbalances: Bulgaria, France, Croatia, Italy, Cyprus and Portugal (see Table A). Excessive imbalances have been identified in each of these countries, with the exception of Cyprus, since 2015. Cyprus was added to this list in 2016, after exiting its economic and financial adjustment programme in March of that year. Looking back over a longer period, the number of countries assessed by the Commission as having excessive imbalances has increased each year since 2012, and only stabilised this year (see Chart A). This trend has to some extent been driven by countries whose economic adjustment programmes have ended and which have therefore been automatically reintegrated into the regular EU surveillance processes. While the adjustment programmes have helped to reduce imbalances, overall vulnerabilities in those countries remain high and therefore close monitoring is still essential. Nevertheless, even allowing for such "automatic" inclusions, the number of countries in the "excessive imbalances" category has not declined. This

[43] See Recital 22 of Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances.

appears to be consistent with the finding from the assessment of the implementation of CSRs made in 2016 (see below) that reform remains slow despite the challenges faced by these countries. Only Spain and Slovenia have managed to move out of the “excessive imbalances” category, while Italy has now been included in it for the fourth year.

Table A

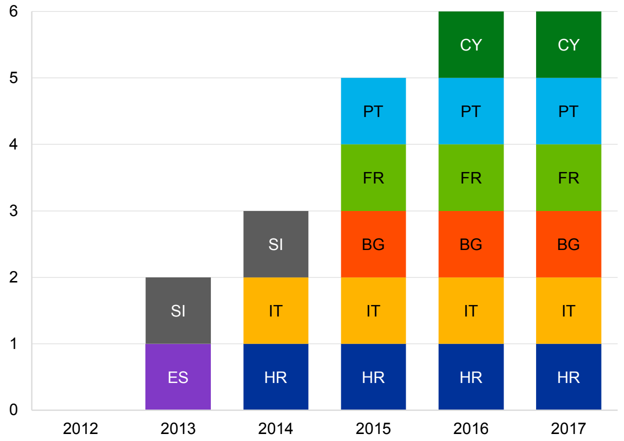
The Commission's conclusions on the 2017 macroeconomic imbalance procedure

(1) No imbalances				(2) Imbalances		(3) Excessive imbalances		(4) Excessive imbalances and application of the corrective arm (EIP)	
2016		2017		2016	2017	2016	2017	2016	2017
BE*	HU*	BE	HU	DE	DE	BG	BG	-	-
CZ	MT	CZ	MT	IE	IE	FR	FR		
DK	AT*	DK	AT	ES	ES	HR**	HR		
EE*	PL	EE	PL	NL	NL	IT	IT**		
LV	RO*	LV	RO	SI	SI	PT**	PT**		
LT	SK	LT	SK	FI		CY	CY**		
LU	UK*	LU	UK	SE	SE				
			FI*						

Source: European Commission.
Notes: * These countries were each the subject of an in-depth review in 2017. The remaining countries in column (1) were assessed in the alert mechanism report – which is the first stage of the MIP – as having no imbalances. ** In the cases of Italy, Cyprus and Portugal, the Commission will specifically review whether their respective National Reform Programmes contain sufficiently ambitious policy measures. If satisfied that this is the case, the Commission will not invoke the corrective arm of the MIP in relation to that country. The same approach was applied to Croatia and Portugal in 2016.

Chart A

Increase since 2012 in the number of countries with excessive imbalances



Source: European Commission.
Notes: The chart shows those countries assessed by the European Commission as having "excessive imbalances" in each year. A country subject to an economic adjustment programme enters the MIP automatically once that programme ends. In 2012 no country was assessed as having excessive imbalances.

As in the previous year, the Commission has again identified imbalances (although not excessive) for Germany, Ireland, Spain, Netherlands, Slovenia and Sweden. By contrast, in the case of Finland the Commission closed the procedure after concluding that the imbalances identified last year were no longer present, owing (among other things) to strong policy measures implemented by the government to recover competitiveness.

While one can observe an increase in the number of countries with no imbalances in 2016, it does not follow that their endeavours to implement reforms should cease. Most euro area countries are still far from achieving best practice in terms of well-functioning labour and product market policies.[44] Empirical work also suggests that there is a strong link between higher quality institutions and both higher resilience to shocks and higher growth performance.[45] Such countries thus require further reforms to increase their resilience and competitiveness.

Despite having identified excessive imbalances in six countries, the European Commission is not proposing at this stage to activate the excessive imbalance procedure (i.e. the corrective arm of the procedure). Since the creation of this procedure it has been the view of the ECB that the MIP tools – including the full corrective arm of the procedure – should be fully employed in relation to those countries with excessive imbalances. This has also been explicitly called for by the five Presidents in their 2015 report.[46] The use of such tools is desirable not only in order to increase the economic prospects of the relevant country itself, but also to help facilitate economic adjustment processes inside the euro area and reduce euro area-wide vulnerabilities. It is thus in the interest of the euro area as a whole.

Although the Commission has not for the moment activated the corrective arm, it has announced that three of the countries with excessive imbalances (Italy, Cyprus and Portugal) have been asked to propose particularly ambitious policy measures in their National Reform Programmes (which are to be submitted by April 2017). In the event that those programmes do not contain the required policy measures, the excessive imbalance procedure could be opened in May. For each country which it has assessed as having an imbalance or an excessive imbalance, the Commission will conduct a specific monitoring mission appropriate to the severity of the imbalance.

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44 "Increasing resilience and long-term growth: the importance of sound institutions and economic structures for euro area countries and EMU", *Economic Bulletin*, Issue 5, 2016.

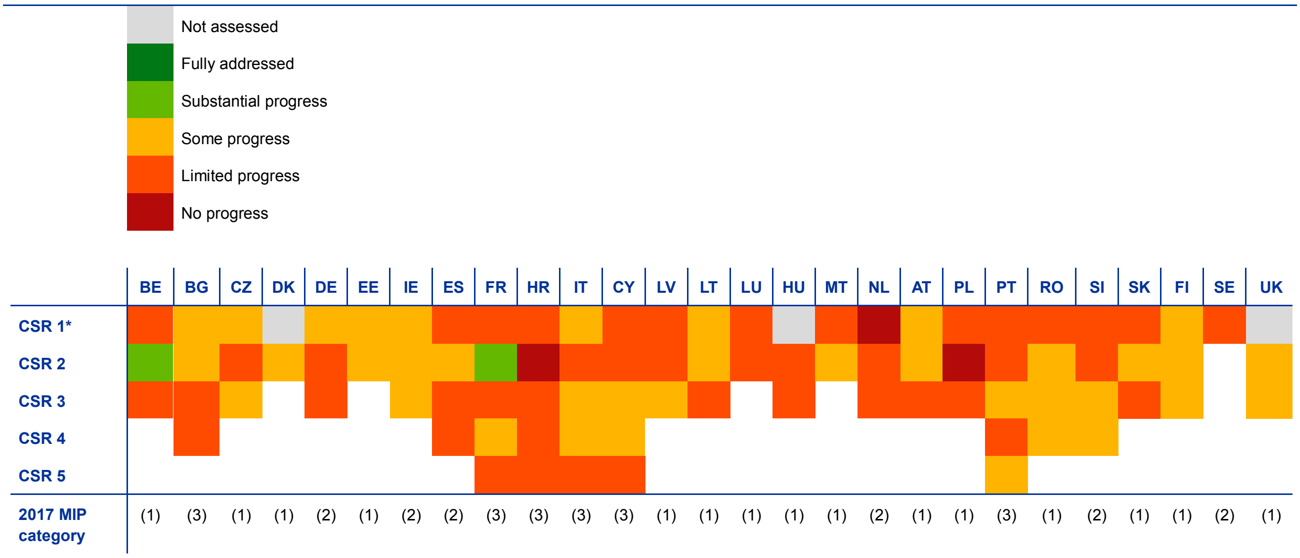
45 ibid.

46 Juncker, J.-C. et al., *Completing Europe's Economic and Monetary Union*, June 2015.

Assessment of the implementation of the 2016 country-specific recommendations

Overall, EU Member States have taken insufficient steps to implement reforms in response to the CSRs made in 2016 (Table B). The European Commission has concluded that the overwhelming majority – more than 90% – of reform recommendations have been followed by only “some” or “limited” progress in implementation, while just two (out of around 90) CSRs have been substantially implemented, and none have been fully implemented. This weak reform momentum stands in stark contrast to the finding that the number of countries with excessive imbalances has not fallen. Despite their greater vulnerability, the six countries identified last year as having excessive imbalances did not on average – with the exception of France – achieve significantly higher implementation rates than the average EU Member State. This is particularly surprising in the case of Portugal and Croatia, as these countries committed themselves to an ambitious reform agenda in 2016, following which the Commission decided not to apply the EIP.

Table B
The Commission's assessment of implementation of the 2016 country-specific recommendations

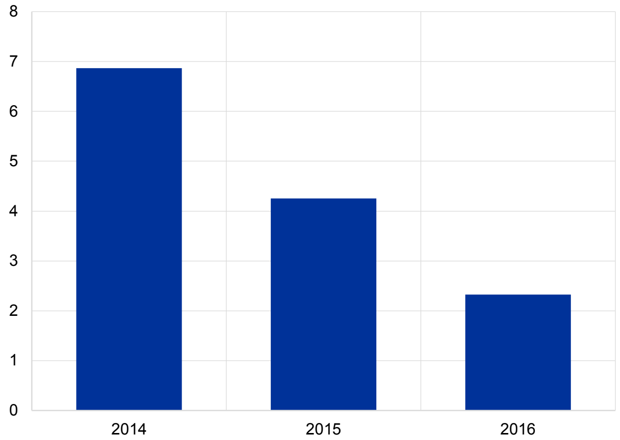


Source: European Commission.
Notes: * CSR 1 assessment excludes compliance with the Stability and Growth Pact which will be assessed by the Commission in spring 2017.
Greece (GR) was not included in the EU semester in 2016 because it is engaged in an economic adjustment programme, has therefore not received any CSRs. “No progress” means that the Member State has not credibly announced nor adopted any measures to address the CSR. This also applies if a Member State has commissioned a study group to evaluate possible measures. “Limited progress” means that the Member State has either announced certain measures but these only address the CSR to a limited extent and/or has presented legislative acts in the governing or legislator body but these have not yet been adopted and further substantial non-legislative work is needed before the CSR will be implemented and/or has presented non-legislative acts, but with no further follow-up in terms of the implementation which is needed to address the CSR. “Some progress” means that the Member State has adopted measures that partly address the CSR, and/or has adopted measures that address the CSR, but a fair amount of work is still needed to fully address the CSR as only a few of the adopted measures have been implemented. “Substantial progress” means that the Member State has adopted measures that go a long way in addressing the CSR and most of which have been implemented. “Fully addressed” means that the Member State has implemented all measures needed to address the CSR appropriately. “Not assessed” applies to cases in which CSR 1 pertains mostly or exclusively to the Stability and Growth Pact (see above).
For the 2017 MIP category labels see Table A.

Chart B

Decline in share of fully addressed CSRs or those where substantial progress has been made in implementation

(percentages)



Source: European Commission.
Note: The chart shows the share of overarching CSRs (as opposed to their detailed elements) which have been fully addressed, or where substantial progress has been made in implementation, in each year (see Notes to Table B for detailed definitions of "fully addressed" and "substantial progress").

Looking back at the implementation of CSRs during the past three years, reform efforts have continued to weaken despite the fact that the number of CSRs has fallen. Last year the Commission concluded that most countries had made only "some" or "limited" progress in implementing the CSRs made in 2015. This year, the number of cases where "substantial progress" has been made or where CSRs have been "fully addressed" is even lower (see Chart B). The Commission's decision to significantly reduce the number of CSRs made in 2015 in order to allow Member States to focus on key priority issues of macroeconomic and social relevance did not produce the desired effect of increasing reform efforts.

Overall, Member States have implemented proportionally fewer recommendations on product market policies than on labour market policies. According to the Commission's assessment, the implementation of product market reforms was particularly weak when viewed in comparison with other policy areas (e.g. labour market reforms). Examples of product market-related CSRs include calls for Member States to: (i) lower barriers preventing new firms from entering network industries (energy, transport, communication, etc.); (ii) open up closed professions; and (iii) improve regulatory frameworks in order to foster competition. Improvement in all of these areas is key to achieving stronger productivity growth and fostering investment.

Full and effective use of all instruments available under the MIP – including its corrective arm – is needed to increase the momentum of reform. The further slowdown observed in the implementation of reforms is in sharp contrast to both the need to address major vulnerabilities that continue to exist in many euro area countries and the need to increase resilience. The poor track records of countries in this regard suggest that policy commitments made by Member States in their National Reform Programmes and repeated calls by the Commission for decisive action are insufficient to evidence and enforce reform. The tools available under the corrective arm of the MIP are well suited to improving reform efforts, thereby increasing the resilience of individual countries and enhancing the functioning of Economic and Monetary Union.