

Anita Pelle – Marcell Zoltán Végh

# Monetary cooperation and monetary policy in the EU

From Economic policy coordination to European economic governance

Lecture 4

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# From Economic policy coordination to European economic governance

## Lecture 4

### In this lecture you will learn about:

- Economic policy coordination in the EU between 1997 and 2010
- Transition to European economic governance in 2010-2011
- The European semester
- The Macroeconomic Imbalance Procedure (MIP)

### Economic policy coordination 1997-2010

#### The Council

The main decision-making body of the European Union is the **Council**. The Council consists of the respective representatives of the 27(!) member states. In case of economy and finance related decisions, it is constituted of the ministers of economy and/or finance -> referred to as **ECOFIN**.

Depending on the issue under discussion, **the Council of the EU takes its decisions** by:

- **simple majority** (14 member states vote in favour)
- **qualified majority** (55% of member states, representing at least 65% of the EU population, vote in favour)
- **unanimous vote** (all votes are in favour)

Voting calculator: <https://www.consilium.europa.eu/en/council-eu/voting-system/voting-calculator/>

**Qualified majority** is the most widely used voting method in the Council. It's used when the Council takes decisions during the ordinary legislative procedure, also known as co-decision. About **80% of all EU legislation** is adopted with this procedure. The **blocking minority** must include at least four Council members representing more than 35% of the EU population.

**ECOFIN**: Economic and Financial Affairs Council configuration. The ECOFIN is responsible for EU policy in **three main areas: economic policy, taxation** issues and the regulation of **financial services**. It also prepares the EU's **annual budget** and takes care of the legal and practical aspects of the single currency, **the euro**. In addition, the ECOFIN Council **coordinates member states' economic policies**, furthers the convergence of their economic performance and monitors their budgetary policies.

The ECOFIN Council is made up of the **economics and finance ministers** from all member states. Relevant European Commissioners also participate in meetings. ECOFIN meetings generally take place once a month.

Soon after the introduction of the euro in 1999, it turned out that some questions are only relevant to Eurozone member countries, not for the whole of the EU -> the **Eurogroup** was formed, first informally. The Lisbon Treaty formalised the Eurogroup (in online voting calculator, “Only Eurozone countries participating” can be clicked).

### The Eurogroup

The **Eurogroup** is an informal body where the ministers of the euro area member states discuss matters relating to their shared responsibilities related to the euro. Its **main task is to ensure close coordination of economic policies among the euro area member states**. It also aims to promote conditions for stronger economic growth. The Eurogroup is also responsible for **preparing the Euro Summit meetings** and for their follow-up. The Eurogroup **elects its president for a term of 2.5 years** by a simple majority of votes.

The Eurogroup regularly discusses:

- the **economic situation and outlook** in the euro area
- the **budgetary policies** of the **euro area member states**
- the **macroeconomic situation** in the **euro area**
- **structural reforms** that have potential to increase growth
- matters related to maintaining **financial stability** in the **euro area**
- preparations for international meetings
- **euro area enlargement**

In addition, the Eurogroup may hold preliminary discussions on Council decisions that would apply only to the euro area member states. When the Council adopts such decisions, **only the ministers from the euro area member states vote at the Council**.

The Eurogroup also discusses the terms of **financial assistance for euro area countries** experiencing severe financial difficulties.

The Eurogroup usually meets once a month, on the eve of the Economic and Financial Affairs Council meeting.

History of the Eurogroup **timeline**: <https://www.consilium.europa.eu/en/history/?filters=2032>

Most important milestones:

- 1997 December: **Creation** of the Eurogroup
- 2004 September: **First permanent president** of the Eurogroup is appointed
- 2008 October: **Euro Summit** (regular meeting of the euro area heads of state or government) is born
- 2009 December: Protocol 14 to the **Lisbon Treaty enters into force** on 1 December 2009, setting out the role of the Eurogroup.

### The Stability and Growth Pact (SGP)

The Maastricht criteria include **two fiscal conditions**:

- budget deficit must not exceed 3% of the country's GDP
- gross national (government) debt must not exceed 60% of the country's GDP

The main idea behind the **Stability and Growth Pact**, adopted in 1997 and entering into force in 1999, was that these two fiscal conditions must be met also after joining the Eurozone, in order to guarantee the stability of the currency and the currency area as a whole.

The **Stability and Growth Pact (SGP)** is a set of rules designed to ensure that countries in the European Union pursue sound public finances and coordinate their fiscal policies.

The **preventive arm** of the SGP aims to ensure sound budgetary policies over the medium term by setting parameters for member states' fiscal planning and policies during normal economic times, while taking into account the ups and downs of the economic cycle. All EU countries are expected to reach their **medium-term budgetary objectives (MTOs)**, or to be heading towards them by adjusting their structural budgetary positions at a rate of 0.5% of GDP per year as a benchmark. MTOs are set to ensure sound fiscal health. They take into account the need to achieve sustainable debt levels while ensuring governments have enough room to manoeuvre and a safety margin against breaching the EU's fiscal rules. All countries are generally required to do more when economic conditions are favourable, so they can have more flexibility when conditions are tough. At the same time, the required pace of adjustment is reduced when economic conditions are unfavourable.

The **corrective arm** of the SGP ensures that member states adopt appropriate policy responses to correct excessive deficits (and/or debts) by implementing the **Excessive Deficit Procedure (EDP)**.

The SGP was **criticised** mainly because:

- if a country is in trouble, just prescribing / expecting fiscal discipline from the country will not solve any of its problems (that are most likely structural or, perhaps, cyclical);

- envisaging a penalty of having to pay a deposit (for Eurozone countries) or the risk of losing cohesion fund support (for EU members outside the Eurozone) does not help either but further aggravates the problem of the country already in fiscal imbalance.

In the **1999-2010** period, **economic policy coordination** was operating in the European Union. Its main elements were:

- **Stability and Growth Pact** (SGP) explained above
- **Convergence Programmes** (CPs): prepared by *countries* that have *not yet adopted the euro*. Main contents of CPs is how the country aims at *meeting the Maastricht criteria*.
- **Stability Programmes** (SPs): prepared by *countries* that have *already adopted the euro*. Main contents of SPs is how the country works on *continuing to meet the two Maastricht fiscal criteria*.
- **ECB Annual Reports** (ARs): prepared by the ECB yearly and assessing economic and financial performance in the Eurozone and the whole of the EU.
- **ECB Convergence Reports** (CRs): prepared by the ECB biannually (in every two years) or when requested by an aspiring country. It provides an assessment of the not-yet Eurozone member states of the EU in how they are on the way to meet the Maastricht convergence criteria.

The ECB's role was executed through preparing these reports.

## The evolution of the European economic governance

With the crisis it turned out that the original setup was not sufficient, refinement of the system was needed. This way the economic policy coordination was developed into **European economic governance**. The new system was launched 2011 (in fact, November 2010 with the first Annual Growth Survey).

The main governance tool is the European semester, and the new set of indicators are listed in the **Macroeconomic Imbalance Procedure** (MIP).

**Timeline:** The evolution of EU economic governance [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/timeline-evolution-eu-economic-governance\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/timeline-evolution-eu-economic-governance_en)

### Most important milestones:

- 2003: Commission and Council go to court
- 2010 November: Kick-off first 'European Semester'
- 2011 September: six-pack
- 2012 March: fiscal compact

## The European Semester

The **European Semester** provides a framework for the coordination of economic policies across the European Union. It allows EU countries to discuss their economic and budget plans and monitor progress at specific times throughout the year.

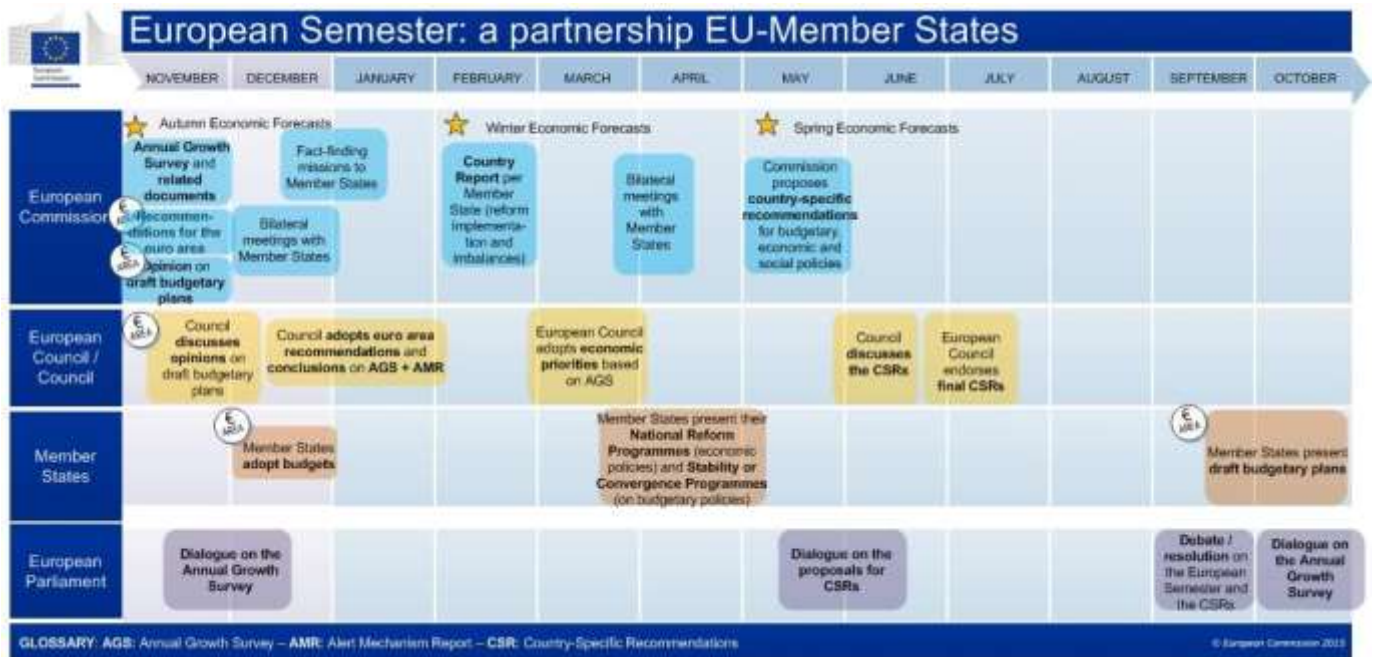
### Goals of the European Semester:

- ensuring sound public finances (avoiding excessive government debt)
- preventing excessive macroeconomic imbalances in the EU supporting
- structural reforms, to create more jobs and growth
- boosting investment

**Role of the Commission:** Each year, the Commission undertakes a detailed analysis of each country's plans for budget, macroeconomic and structural reforms. It then provides EU governments with country-specific recommendations for the next 12-18 months. It also monitors EU countries' efforts towards the *Europe 2020* targets.

**Role of the Council:** The Commission proposals are endorsed and formally adopted by the Council.

**Role of EU governments:** Any policy decisions in response to the country-specific recommendations are made by the national government in question, based on whatever action they deem appropriate.



[https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:The\\_European\\_Semester.jpg](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:The_European_Semester.jpg)



## The Macroeconomic Imbalance Procedure (MIP)

The **Macroeconomic Imbalance Procedure (MIP)** aims to identify, prevent and address the emergence of potentially harmful macroeconomic imbalances that could adversely affect economic stability in a particular member state, the euro area, or the EU as a whole.

Its main arms are:

- **Monitoring**
- **Prevention**
- **Correction**

**New elements** of MIP compared to SGP:

- budget deficit is no more included
- three categories (external, internal, labour market imbalances)
- much more indicators, more refined surveillance

### MIP Scoreboard indicators (2020 AMR)

Indicator	Unit	Thresholds	Data source
Current account balance (% of GDP)	3 year average	4%/+6%	Eurostat
Net international investment position	% of GDP	-35%	Eurostat
Real effective exchange rate (42 trading partners, HICP deflator)	3 year % change	±5% (EA) ±11% (non-EA)	DG ECFIN
Export market share (% of world exports)	5 year % change	-6%	Eurostat, IMF
Nominal unit labour cost index (2010=100)	3 year % change	9% (EA) 12% (non-EA)	Eurostat
House price index (2015=100), deflated	1 year % change	6%	Eurostat
Private sector credit flow, consolidated	% of GDP	14%	Eurostat
Private sector debt, consolidated	% of GDP	133%	Eurostat
General government gross debt	% of GDP	60%	Eurostat
Unemployment rate	3 year average	10%	Eurostat
Total financial sector liabilities, non-consolidated	1 year % change	16.50%	Eurostat
Activity rate (% of total population aged 15-64)	3 year change in p.p.	-0.2 pp	Eurostat
Long-term unemployment rate (% of active population aged 15-74)	3 year change in p.p.	0.5 pp	Eurostat
Youth unemployment rate (% of active population aged 15-24)	3 year change in p.p.	2.0 pp	Eurostat

Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), and International Monetary Fund data, WEO (for world volume exports of goods and services)

### MIP Auxiliary indicators (2020 AMR)

Indicator	Unit	Data source
Real GDP	1 year % change	Eurostat
Gross fixed capital formation	% of GDP	Eurostat
Gross domestic expenditure on R&D	% of GDP	Eurostat
Current plus capital account (Net lending-borrowing)	% of GDP	Eurostat
Net international investment position excluding non-defaultable instruments	% of GDP	Eurostat
Foreign direct investment in the reporting economy – net inward flows	% of GDP	Eurostat
Foreign direct investment in the reporting economy - stocks	% of GDP	Eurostat
Net trade balance of energy products	% of GDP	Eurostat
Real effective exchange rates – euro area trading partners	3 year % change	DG ECFIN
Export performance against advanced economies	5 year % change	Eurostat/OECD
Terms of trade	5 year % change	Eurostat
Export market share - in volume	1 year % change	Eurostat /IMF
Labour productivity	1 year % change	Eurostat
Gross non-performing loans of domestic and foreign entities	% of gross loans	ECB
Unit labour cost performance relative to euro area	10 year % change	DG ECFIN
House price index (2015=100) - nominal	3 year % change	Eurostat
Residential construction	% of GDP	Eurostat
Household debt, consolidated (incl. NPISH)	% of GDP	Eurostat
Consolidated banking leverage, domestic and foreign entities	total assets/total equity	ECB
Employment rate	1 year % change	Eurostat
Activity rate	% of total population aged 15-64	Eurostat
Long term unemployment rate	% of active population aged 15-74	Eurostat
Youth unemployment rate	% of total population aged 15-24	Eurostat
Young people neither in employment nor in education and training	% of total population aged 15-24	Eurostat
People at risk of poverty or social exclusion	% of total population	Eurostat
People at risk of poverty after social transfers	% of total population	Eurostat
Severely materially deprived people	% of total population	Eurostat
People living in households with very low work intensity	% of total population aged 0-59	Eurostat

Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), the European Central Bank (Consolidated banking leverage and Gross non-performing loans), and International Monetary Fund data, WEO (for world volume exports of goods and services)

eurostat

### Categorisation of imbalances in the Macroeconomic Imbalance Procedure (MIP)

PREVIOUS CATEGORIES	STREAMLINED CATEGORIES
No imbalances	No imbalances
Imbalances, which require policy action and monitoring	
Imbalances, which require decisive policy action and monitoring	Imbalances
Imbalances, which require decisive policy action and specific monitoring	
Excessive imbalances, which require decisive policy action and specific monitoring	Excessive imbalances
Excessive imbalances with corrective action	Excessive imbalances with corrective action

Source: European Commission

eurostat



Macroeconomic Imbalance Procedure (MIP) Scoreboard 2018

Year 2018	External imbalances and competitiveness					Internal imbalances					Employment indicators <sup>1</sup>			
	Current account balance - % of GDP (3 year average)	Net international investment position (% of GDP)	Real effective exchange rate - A2 trading partners, IACP deflator (3 year % change)	Export market share - % of world exports (5 year % change)	Nominal unit labour cost index (2010=100) (3 year % change)	House price index (2015=100), deflated (1 year % change)	Private sector credit flow, consolidated (% of GDP)	Private sector debt, consolidated (% of GDP)	General government gross debt (% of GDP)	Unemployment rate (3 year average)	Total financial sector liabilities, non-consolidated (1 year % change)	Activity rate - % of total population aged 15-64 (3 year change in ppt)	Long-term unemployment rate - % of active population aged 15-74 (3 year change in ppt)	Youth unemployment rate - % of active population aged 15-24 (3 year change in ppt)
	-4.0%	-3.5%	±1% (EA) ±15% (H00-EA)	4%	0% (EA) 12% (H00-EA)	9%	14%	133%	60%	10%	11.5%	-0.2 ppt	0.5 ppt	2 ppt
Belgium	0.3	41.3	5.8	-1.5	3.7	1.0	8.8	178.6	100.0	7.0n	-2.8	1.0	-1.5	-4.3
Bulgaria	4.0	-26.2	3.8	13.4	18.3p	4.5	3.9	95.0	22.3	6.3	6.8	2.2	-2.6	-8.8
Czechia	1.2	-23.5	11.8	11.9	13.5	8.1p	5.3	79.7	32.5	3.0	7.4	2.8	-1.7	-5.9
Denmark	7.5	48.5	2.8	-1.5	4.0	3.5	2.4	199.4	34.2	5.6	-4.7	0.9	-3.6	-1.6
Germany	8.0	62.0	5.3	3.1	5.6	5.1	8.6	182.4	61.9	3.8	2.0	1.0	-0.8	-1.0
Estonia	2.1	-27.7	7.7	9.8	14.3	2.1	3.7	181.5	9.4	8.0	8.9	2.4	-1.1	-1.2
Ireland	2.3	-165.0	2.2	77.4	-2.8	-9.3	-7.8	223.2	63.8	7.0	5.1	0.8	-3.2	-6.4
Greece	-0.2	-143.3	3.6	8.9	1.4p	1.3e	-1.1p	115.3p	181.2	21.5	-5.0	0.4	-4.6	-8.0
Spain	2.6	-60.4	-4.1	4.6	0.7e	5.3	6.8p	133.9p	97.6	17.4	-2.2	-0.8	-5.5	-14.0
France	-0.6	-16.4	4.5	-0.2	2.4e	1.5	7.9p	148.9p	96.4	8.5	1.6	0.8	-3.8	-4.0
Croatia	2.4	-57.9	4.2	22.9	-2.4e	4.8	2.3p	94.0p	74.8	10.9	4.6	-0.8	-6.8	-18.9
Italy	2.6	-4.7	3.2	9.3	2.7	-1.8	1.8	197.0	134.8	11.2	-0.1	1.6	-3.7	-6.1
Cyprus	-4.6	-120.8	1.8	19.5	-0.4p	0.2	8.4p	282.0p	100.8	18.8	9.3	1.1	-4.1	-12.8
Lithuania	0.6	-48.0	6.4	8.6	14.7	8.8	-1.2	79.3	36.4	8.8	-3.0	2.0	-1.4	-4.1
Luxembourg	-0.1	-31.0	6.4	3.5	16.5	4.8	4.3	58.4	34.1	7.1	8.2	3.2	-1.9	-5.2
Luxembourg	4.9	-59.9	3.3	18.7	7.9	4.9	-3.5	186.5	21.0	5.6	-2.0	0.2p	-0.5	-2.5
Hungary	2.1	-152.0	2.0	8.4	12.4	10.9	4.3	88.3	70.2	4.3	-0.2	3.3	-1.7	-7.1
Malta	8.9	62.7	4.8	24.0	3.2	5.1p	7.5	128.6	45.8	4.1	2.3	5.9	-1.3	-2.5
Netherlands	8.6	70.7	3.2	1.7	3.9p	7.4	4.5p	241.9p	52.4	4.0	-3.3p	0.7	-1.8	-4.1
Austria	2.2	3.7	4.8	3.9	4.7	2.2	3.9	121.0	74.0	5.5	1.7	1.2	-0.3	-1.2
Poland	-0.5	-55.8	8.1	25.8	8.1e	4.3	3.4	78.1	48.3	5.0	3.0	2.0	-2.0	-9.1
Portugal	0.0	-105.8	3.1	9.4	5.3p	8.9	-6.1p	154.3p	122.2	8.1	8.7	1.7	-4.1	-11.7
Romania	-3.3	-44.1	-0.7	23.7	33.8p	1.9	1.9p	47.3p	35.0	5.9	3.3	1.7	-1.2	-6.5
Slovenia	5.5	-18.9	2.6	28.4	6.1	7.4	1.3	70.8	70.4	6.6	4.1	3.2	-2.5	-7.5
Slovakia	-2.4	-68.1	2.8	3.2	10.8	5.8	3.0	46.9	49.4	8.1	8.9e	1.6	-3.8	-11.8
Finland	-1.4	-2.0	3.0	-3.0	-2.6	-0.2	1.8	142.1	59.0	8.3	18.9	2.1	-3.7	-5.4
Sweden	2.8	10.3	-4.0	-8.3	7.8	-3.0	8.0	283.0	28.8	6.6	-2.9	1.2	-0.3	-3.6
United Kingdom	-4.3	-10.5	-13.8	-3.8	7.8	0.7	5.3	188.1	85.3	4.4	-0.6	1.0	-0.5	-3.2

Figures highlighted are the ones at or beyond the threshold. Flags: b: Break in series; d: Definites others; e: Estimated; p: Provisional.

1) For the employment indicators, see page 2 of the MIP 2018. 2) House price index e = estimate by HCB for EL. 3) Nominal unit labour cost: HR, d: employment data use national concept instead of domestic concept. 4) Unemployment rate for BE: revision in the survey methodology. 5) In Total financial sector liabilities for GR, derivatives are estimated.

Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), and International Monetary Fund data, WEO (for world volume exports of goods and services)

Source of tables: [https://ec.europa.eu/eurostat/statistics-explained/index.php/The\\_Macroeconomic\\_Imbalance\\_Procedure\\_%28MIP%29\\_introduced](https://ec.europa.eu/eurostat/statistics-explained/index.php/The_Macroeconomic_Imbalance_Procedure_%28MIP%29_introduced)



Source: [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/european-economy-explained/graphs-economic-topics/european-semester-2018-macroeconomic-imbalances-and-government-deficits\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/european-economy-explained/graphs-economic-topics/european-semester-2018-macroeconomic-imbalances-and-government-deficits_en)

## Questions for self-study

1. What is ECOFIN? And the Eurogroup? What is the difference between the two?
2. What criteria was the Stability and Growth Pact (SGP) examining (exclusively)?
3. Why was the SGP criticised?
4. Please introduce the following tools of economic policy coordination: Stability Programmes, Convergence Programmes, ECB Annual Reports, ECB Convergence Reports.
5. What was the ECB's role in economic policy coordination before the crisis?

6. How is the European Semester set up? What tools does it include? Who does what in the European Semester?
7. What is the role of the European Semester in the forming of national budgets?
8. What does the term Macroeconomic Imbalance Procedure (MIP) cover? What is its main aim?
9. What are the new elements of the MIP compared to the SGP?
10. What are the main arms of MIP? How are these connected to the European Semester?
11. What does the abbreviation MTO refer to? What does it cover?

## References:

Voting calculator: <https://www.consilium.europa.eu/en/council-eu/voting-system/voting-calculator/> (-> qualified majority, blocking minority)

ECOFIN: <https://www.consilium.europa.eu/en/council-eu/configurations/ecofin/>

Eurogroup: <https://www.consilium.europa.eu/en/council-eu/eurogroup/> (-> history, president, members, how it works...)

History of the Eurogroup **timeline**: <https://www.consilium.europa.eu/en/history/?filters=2032>

SGP: [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact_en)

ECB Annual Reports: <https://www.ecb.europa.eu/pub/annual/html/index.en.html>

ECB Convergence Reports: <https://www.ecb.europa.eu/pub/convergence/html/index.en.html>

Timeline: The evolution of EU economic governance [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/timeline-evolution-eu-economic-governance\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/timeline-evolution-eu-economic-governance_en)

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MIP: [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/macroeconomic-imbalance-procedure\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/macroeconomic-imbalance-procedure_en)

MIP monitoring, prevention, correction: [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction_en)

MTO (under MIP preventive arm): [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/preventive-arm/medium-term-budgetary-objectives-mtos\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/preventive-arm/medium-term-budgetary-objectives-mtos_en)