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Special Report

Audit of the Macroeconomic Imbalance Procedure (MIP)

(pursuant to Article 287(4), second subparagraph, TFEU)

EUROPEAN COURT OF AUDITORS

Audit team

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ABBREVIATIONS AND ACRONYMS

AMR: Alert Mechanism Report

CSR: Country-specific recommendation

DG ECFIN: Commission Directorate-General for Economic and Financial Affairs

DG EMPL: Commission Directorate-General for Employment, Social Affairs and Inclusion

ECB: European Central Bank

EDP: Excessive deficit procedure

EIP: Excessive imbalance procedure

EPC: Economic Policy Committee of the Council of the EU

IDR: In-depth review

IMF: International Monetary Fund

MIP: Macroeconomic Imbalance Procedure

NRP: National reform programme

OECD: Organisation for Economic Cooperation and Development

SGP: Stability and Growth Pact

GLOSSARY

Economic Policy Committee (EPC): An advisory body to the Commission and the Council, set up by Council Decision 74/122/EEC of 18 February 1974. The EPC contributes to the Council's work of coordinating the economic policies of the Member States and the EU. It comprises two delegates from each Member State, two from the Commission and two from the ECB.

European Semester: The annual EU cycle of economic policy coordination. The Semester covers fiscal policies as determined by the Stability and Growth Pact, the prevention of excessive macroeconomic imbalances (under the MIP) and structural reforms in the context of the Europe 2020 strategy. It results in country-specific recommendations to Member States.

Europe 2020 strategy: The EU's agenda for growth and jobs for the current decade. The strategy identifies five headline targets, which are expressed through seven flagship initiatives. EU governments have set national targets to help achieve the overall EU targets, and report on them in their national reform programmes (NRPs).

National reform programme: A document produced annually which presents the Member State's policies and measures to sustain growth and jobs and reach the Europe 2020 targets.

Stability and Growth Pact (SGP): An agreement binding on all the EU Member States since 1997 (with reforms in 2005 and 2011) concerning implementation of the Maastricht Treaty provisions addressing the sustainability of Member State fiscal policies, essentially by maintaining public deficit and debt at acceptable levels.

EXECUTIVE SUMMARY

About the Macroeconomic Imbalance Procedure

I. The Macroeconomic Imbalance Procedure (MIP) was designed to address macroeconomic imbalances in the EU, as a response to the absence of policy tools to prevent the build-up of these imbalances prior to the 2008 crisis.

II. The MIP operates on an annual cycle. It begins with the publication by the Commission of an economic and financial assessment, known as the Alert Mechanism Report (AMR), which identifies Member States at risk of imbalances that require further analysis in the form of an in-depth review (IDR). The purpose of IDRs is to conclude whether imbalances are present in selected Member States, and whether they should be deemed excessive. Finally, on the basis of the IDR analysis, the Commission should propose country-specific recommendations (CSRs), which eventually will be adopted by the Council and issued to Member States to address their imbalances.

III. If imbalances are deemed 'excessive', the MIP Regulation envisaged that the Commission would propose that the Council activate an "excessive imbalance procedure" (EIP). This is an enhanced surveillance mechanism that includes the possibility of sanctions for euro-area Member States.

What we audited

IV. The main audit question was: "Is the MIP soundly based and adequately implemented?" We assessed the effectiveness of the Commission's implementation of the MIP during the period from 2012 to 2017.

What we found

V. Although the MIP is generally well designed, the Commission is not implementing it in such a way as to ensure the effective prevention and correction of imbalances.

VI. The Commission uses MIP-relevant CSRs as a key tool to address macroeconomic imbalances. However, implementation has been low. Although their implementation is the responsibility of Member States, there are also several weaknesses in the way they are designed by the Commission. No systematic link exists between the specific imbalances identified in the IDR and the proposed recommendations. In some cases CSRs are labelled as MIP-relevant although they are only remotely linked to macroeconomic imbalances, if at all, thus making it harder for Member States to take appropriate remedial action. In addition, MIP-CSRs do not sufficiently consider fiscal policy, even when it is relevant to non-fiscal imbalances. There is some inconsistency between CSRs for individual Member States and recommendations made for the euro area as a whole. Finally, the Commission sometimes sets a very challenging timeframe for the implementation of recommendations.

VII. We agree with the stakeholders we surveyed, who judge that the analysis in IDRs is of good quality and that imbalances are correctly identified. However, in recent years the IDRs have become progressively less visible in the Commission's reporting, where MIP-relevant analysis and policy advice are now less prominent after they have been integrated in the country reports, which primarily deal with the broad economic coordination of structural policies. The MIP has been further weakened by the Commission's decision-making process regarding the classification of imbalances by severity. While imbalances are identified at departmental level on the basis of clear technical criteria, the IDRs do not contain a clear assessment of their severity. The criteria underlying the final decisions taken by the College of Commissioners lack transparency.

VIII. It is noteworthy that the Commission has never recommended activation of the excessive imbalance procedure, despite the fact that, since the start of the MIP in 2012, several Member States have been identified as having excessive imbalances over a prolonged period.

IX. The first document in the process, the AMR, does not adequately facilitate the early identification of imbalances, since it uses indicators based on out-of-date data and moving averages which make it blind to recent events. Moreover, the text of the AMR is descriptive rather than analytical. Spill-over effects on other Member States and the euro-area dimension are not considered in much depth, although some improvements have been made in this regard.

What we recommend

(a) The Commission should systematically link MIP-CSRs to macroeconomic imbalances. The proposed measures should be sufficiently detailed, and should focus on policy actions to reduce imbalances in the short-to-medium term. Wherever possible, the Commission should make ex-ante and ex-post assessments of the impact of policy actions on imbalances.

(b) IDRs should provide a clear characterisation of the severity of the imbalances a Member State is facing. The Commission should enhance transparency by adopting, publishing and applying clear criteria for classifying imbalances. It should, unless there are specific circumstances, recommend the activation of an EIP when there is evidence that a Member State is facing excessive imbalances. If, in specific circumstances, the Commission uses its discretionary powers to refrain from taking this step, it should clearly and publicly explain its reasons.

(c) The Commission should provide a comprehensive and separately presented IDR with a length and level of detail that reflects the severity of the situation and the policy challenges. Instead of the scoreboard, the IDR should provide access to the country-specific variables actually used in the analysis.

(d) The Commission should systematically analyse the impact of fiscal policy on external imbalances and competitiveness and should use the MIP to make recommendations to Member States when fiscal issues directly affect external imbalances.

(e) The MIP process should give systematic consideration to policies with cross-country impacts that can enhance symmetric rebalancing within the euro area. MIP-CSRs should be consistent with recommendations for the euro area relevant to imbalances, including on the overall fiscal stance, when appropriate.

(f) The Commission should give greater prominence to the MIP in its communication with the public. In the context of effective communication, the relevant Commissioners should be available to parliaments of Member States, whenever the Commission has assessed imbalances as being excessive, so that they can explain the rationale for its decisions and corresponding policy recommendations.

INTRODUCTION

Economic rationale and legal framework

1. Before the 2008-2009 crisis, the EU's economic governance framework (the body of rules governing Member States' economic policies) focused on the sustainability of fiscal policies. It was essentially limited to keeping public deficit and debt under control. EU governance for non-fiscal policies was limited to the Treaty provisions on soft coordination of economic policies[1].

2. The crisis and its aftermath showed that the framework had not detected or prevented the build-up of macroeconomic imbalances. In several Member States, large capital inflows and unsustainable private sector credit expansion had resulted in a deterioration in external balances and competitiveness, over-investment in certain areas of the economy and excessive debt accumulation in the private sector. Ahead of the crisis, moreover, an unsustainable economic boom distorted the assessment of the underlying fiscal position, often making the situation appear better than it actually was. When the imbalances eventually triggered a painful adjustment, this spilled over to other Member States, thus jeopardising the financial stability and economic performance of the entire EU.

3. With the aim of preventing similar developments in the future and supporting policies for reducing imbalances stemming from the pre-crisis boom, a new mechanism known as the Macroeconomic Imbalance Procedure (MIP) was introduced in 2011 as part of that year's legislative 'six-pack'[2].

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[1] Articles 121 and 148 of the TFEU.

[2] A set of five EU regulations and a directive which entered into force on 13 December 2011. Three regulations concern enhanced budgetary and fiscal surveillance, while the directive seeks to harmonise fiscal frameworks in the Member States. The last two regulations concern procedures for the MIP and the enforcement of corrective actions.

4. The main legal basis for the MIP is Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances (referred to in this report as 'the MIP Regulation')[3].

5. The MIP applies to all EU Member States (except those receiving financial assistance from the EU under economic adjustment programmes) and has been applied since 2012 as part of the annual cycle of coordination and surveillance of economic policies.

6. Specifically, the MIP targets the detection, prevention and correction of 'imbalances' and 'excessive imbalances'. These terms are defined in Article 2 of the MIP Regulation:

(a) "'imbalances' means any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole;

(b) 'excessive imbalances' means severe imbalances, including imbalances that jeopardise or risk jeopardising the proper functioning of the economic and monetary union."

7. Article 4(3) of the MIP Regulation then defines the nature of imbalances:

(a) "internal imbalances, including those that can arise from public and private indebtedness; financial and asset market developments, including housing; the evolution of private sector credit flow; and the evolution of unemployment;

(b) external imbalances, including those that can arise from the evolution of current account and net investment positions of Member States; real effective exchange rates; export market shares; changes in price and cost developments; and non-price competitiveness, taking into account the different components of productivity."

[3] 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 (OJ L 306, 23.11.2011, p. 25).

8. The MIP Regulation thus provides for the dual objective of tackling imbalances affecting individual Member State economies, while also addressing the spill-over[4] effects on other Member States of the euro area and the EU.

9. The MIP is embedded in the European Semester, which is the framework introduced in 2010 for the broad coordination of economic policies across the EU. In addition to the MIP, the European Semester comprises measures implementing the Stability and Growth Pact (SGP), and structural policies aimed at boosting long-term growth in the context of the Europe 2020 strategy by meeting targets, the broad economic policy guidelines and guidelines for employment policies. The annual European Semester process culminates in the Commission's proposal to the Council of country-specific recommendations (CSRs) in all of these areas. Following their approval by the Council, Member States are expected to implement the recommendations.

10. Broadly speaking, the distinction between the MIP and SGP is this: the MIP is concerned with macroeconomic imbalances in general, while the SGP stops at fiscal sustainability. Moreover, once a Member State has satisfied the debt and deficit requirements, the SGP ceases to provide guidance on fiscal policy. For its part, the MIP Regulation envisages that policy responses to imbalances identified under the MIP may include fiscal and wage policy measures[5]. The two policy instruments are similar in that they give the Commission an enforcement role and therefore have both a preventive and a corrective element. However, the Commission does not have a similar enforcement role in the implementation of the Europe 2020 strategy.

11. The annual MIP process of identifying imbalances, assessing their severity and initiating corrections breaks down into stages. The process outlined in the MIP Regulation is

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[4] For a definition of spill-over, see ***<u>Footnote 30</u>***.

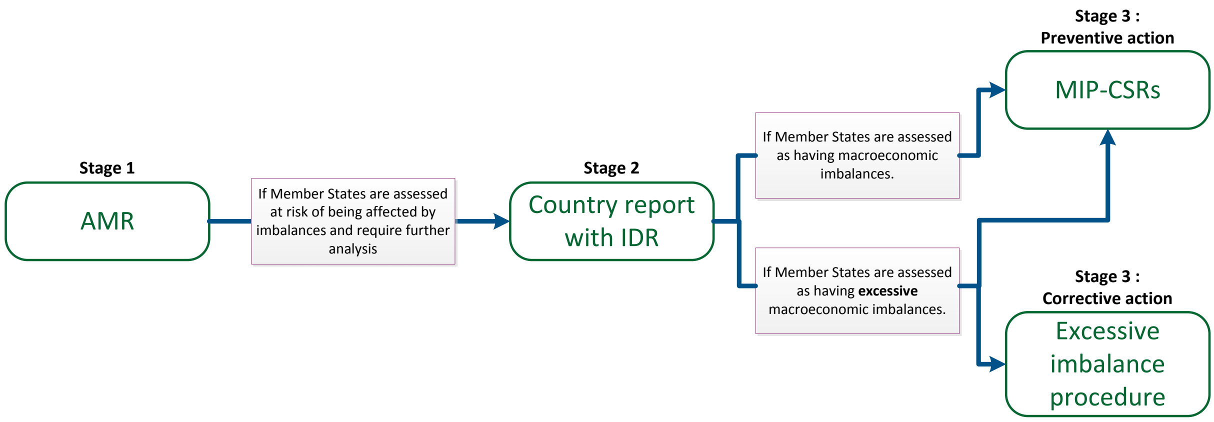
[5] Recital 20 to the MIP Regulation.

summarised in ***Figure 1*** (for more detail, see ***Annex I***), and the corresponding documents are listed in ***Annex II***.

Stage one: The Alert Mechanism Report

12. The first stage in the process is the publication of an Alert Mechanism Report (AMR). The main purpose of this is to identify Member States that the Commission considers at risk of being affected by imbalances and which therefore require further analysis in the form of an in-depth review (IDR: see stage two). The AMR uses a scoreboard of indicators chosen to highlight internal and external imbalances (see ***Annex III***)[6]. However, Article 3(2) of the MIP Regulation makes it clear that the decision to launch an IDR should not flow "from a mechanical reading of the scoreboard".

Figure 1 – Simple flowchart of the Macroeconomic Imbalance Procedure



Source: ECA.

6 The Commission also takes account of 28 auxiliary indicators as a source of complementary information (http://ec.europa.eu/eurostat/cache/Imbalance_Scoreboard/MIPs_AUX_EN_banner.html).

Stage two: In-depth reviews

13. IDRs consist of a detailed analysis of country-specific circumstances using a broad range of analytical tools (such as measures of trade linkages and exposures between Member States), country-specific qualitative information (such as product specialisation and wage-bargaining mechanisms) and, in many cases, variables different from those in the AMR scoreboard.

14. The Commission gathers information in the course of visits to the Member States. It is also obliged to consider any other information that the Member States have communicated as relevant. Finally, the Commission must take account of the Member States' policy intentions and any previous recommendations from the Council or the European Systemic Risk Board.

15. The MIP Regulation specifically requires IDRs to evaluate whether the Member State in question is affected by imbalances and, if so, whether these are excessive. The spill-over effects of national economic policies must also be considered. If the Commission identifies no imbalances, the MIP process ends for that Member State in that year. If imbalances are identified, depending on their severity the Commission will place the Member State in either the preventive or the corrective arm of the MIP.

16. Since 2015, IDRs have become part of the Commission's annual European Semester country reports. These include wide-ranging analytical assessments of the main structural issues affecting a Member State in areas such as taxation and expenditure, employment, public administration and the business environment, as well of the progress the Member State has made in the implementation of the CSRs and towards the Europe 2020 targets.

Stage three: Prevention and correction

<u>The preventive action</u>

17. If the Commission considers that a Member State has macroeconomic imbalances, it must inform the Council and the European Parliament. Acting on a proposal from the Commission, the Council may then address CSRs to the Member State to correct imbalances and prevent them from becoming 'excessive'(referred to in this report as 'the MIP-CSRs').

The CSRs are adopted in July and must be reviewed and, where appropriate, adjusted annually. To this end, there is a systematic and public assessment of progress in the implementation of CSRs published in an annex to the corresponding country report in February. To monitor the implementation of MIP-CSRs, the Commission is required to maintain permanent dialogue with the Member State authorities and the social partners and carry out information visits, usually once a year.

The corrective action: the excessive imbalance procedure

18. If the Commission considers the imbalances excessive, it is again required, by Article 7 of the MIP Regulation, to inform the European Parliament and the Council. Acting on a Commission proposal, the Council may then decide to activate an 'excessive imbalance procedure' (EIP), exposing the Member State to stricter requirements and monitoring, and ultimately, in the case of euro-area Member States, to the possibility of financial sanctions[7].

AUDIT SCOPE, OBJECTIVES AND APPROACH

Audit scope and objectives

19. The main audit question was "Is the MIP soundly based and adequately implemented?" Therefore, in this audit we assessed the effectiveness of the Commission's implementation of the MIP during the period from 2012 to 2017[8] as well as, where relevant, certain elements of the procedure's design. We examined the MIP in detail for a sample of four Member States (Bulgaria, Spain, France and Slovenia), covering other Member States, where appropriate, to a lesser degree[9].

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[7] See Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area (OJ L 306, 23.11.2011, p. 8).

[8] Our analysis ended with the publication of IDRs in February 2017 so did not cover the 2017 CSRs.

[9] See ***Annex IV*** for an explanation of our sampling methodology.

20. More specifically, we examined:

(a) the effectiveness of the implementation of the procedure based on the evolution of Member States' classification of imbalances and the reasons underlying the low implementation of MIP-CSRs;

(b) the process of classifying macroeconomic imbalances in Member States;

(c) the Commission's use of analytical tools and economic analysis to identify and assess imbalances, and the evolving presentation of the results;

(d) the appropriateness of the scoreboard and the AMR as a whole in the MIP.

21. We did not assess the appropriateness of the thresholds set for scoreboard indicators or the quality of the statistical data underlying them. Nor did we examine the procedure for evaluating progress in the implementation of MIP-CSRs[10].

22. Our audit criteria came from:

(a) regulatory requirements (in particular the MIP Regulation);

(b) the Commission's internal rules and procedures (e.g. instructions and guidelines);

(c) documents issued by a number of EU institutions and other international organisations (in particular the IMF and the OECD) or resulting from research to identify best practice.

23. This audit report is the second in a series that was planned to ensure substantial coverage of the EU's economic governance framework. The first report in the series, on the excessive deficit procedure (EDP)[11], was published in 2016.

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[10] The ranking for assessing the implementation of CSRs is presented in ***Annex V***. Our survey of EPC Members (see ***paragraph 24***) showed that they regarded the Commission's assessments as generally accurate (see ***Figure o in Annex VI***).

Approach

24. In March 2016, we sent an online survey to the members of the Economic Policy Committee (EPC) from Member States which had been subject to the MIP. The survey covered the period from the 2012 AMR to the 2016 IDRs. It comprised 46 questions, both qualitative and quantitative, on EPC members' views of the MIP. The survey closed in December 2016, by which time 19 out of 20 EPC members had responded. The survey results guided our audit work and are referenced in certain observations. Collated answers to the quantitative questions can be found in ***Annex VI***.

25. We interviewed staff from three Commission departments (DG ECFIN, DG EMPL and the Secretariat-General) and the private offices of the Commissioner for Economic and Financial Affairs, Taxation and Customs and the Vice-President for the Euro and Social Dialogue. We reviewed a range of Commission documentation, both in the public domain and internal records. We also met representatives of institutions involved in implementing and monitoring the MIP in selected Member States (see the list of institutions in ***Annex VII***).

26. We discussed the MIP with representatives of several organisations whose views were relevant to the audit (including the European Central Bank (ECB), the IMF, the OECD, the World Bank, the European Parliament and, in Germany, the Federal Ministry of Economic Affairs and Energy and the Federal Ministry of Finance). We also organised an advisory panel and sought for independent experts' advice.

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[11] Special Report No 10/2016 "Further improvements needed to ensure effective implementation of the excessive deficit procedure" (http://eca.europa.eu).

OBSERVATIONS

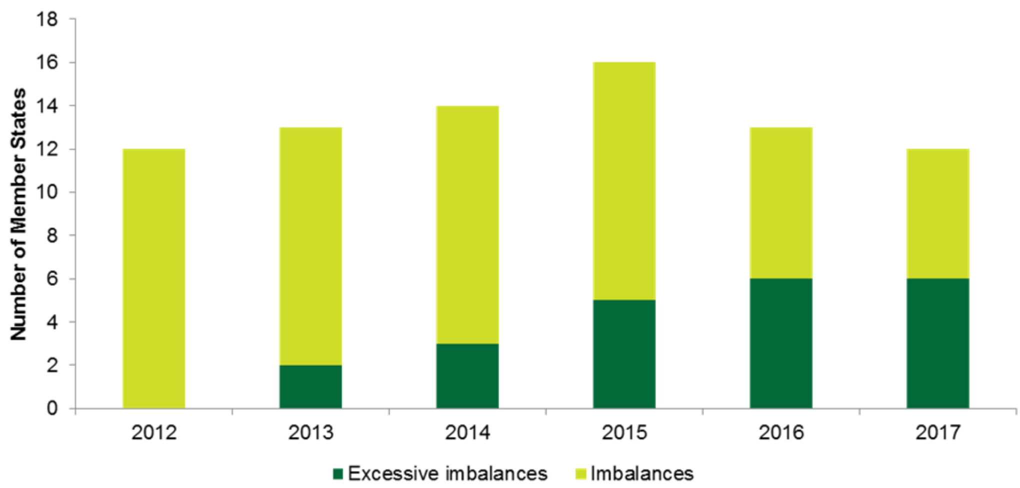
Member States are identified as having imbalances over several years, and corrective policies are under-implemented

27. This section looks at the evolution of the number of Member States in which imbalances have been identified since the introduction of the MIP. Then it shows the degree of implementation of MIP-CSRs as assessed by the Commission and considers the underlying reasons.

Member States generally remain in imbalance for several years

28. The number of Member States identified through the MIP as having macroeconomic imbalances rose steadily between 2012 and 2015 (from 12 to 16). Nevertheless, we acknowledge that this number has also increased due to the exit of several countries from economic adjustment programmes and the accession of Croatia to the EU. More recently, the overall trend has reversed, possibly reflecting the cyclical recovery of EU economies. However, the number of Member States with excessive imbalances has not fallen (see ***Figure 2*** and ***Annex VIII***).

Figure 2 – Number of Member States with imbalances

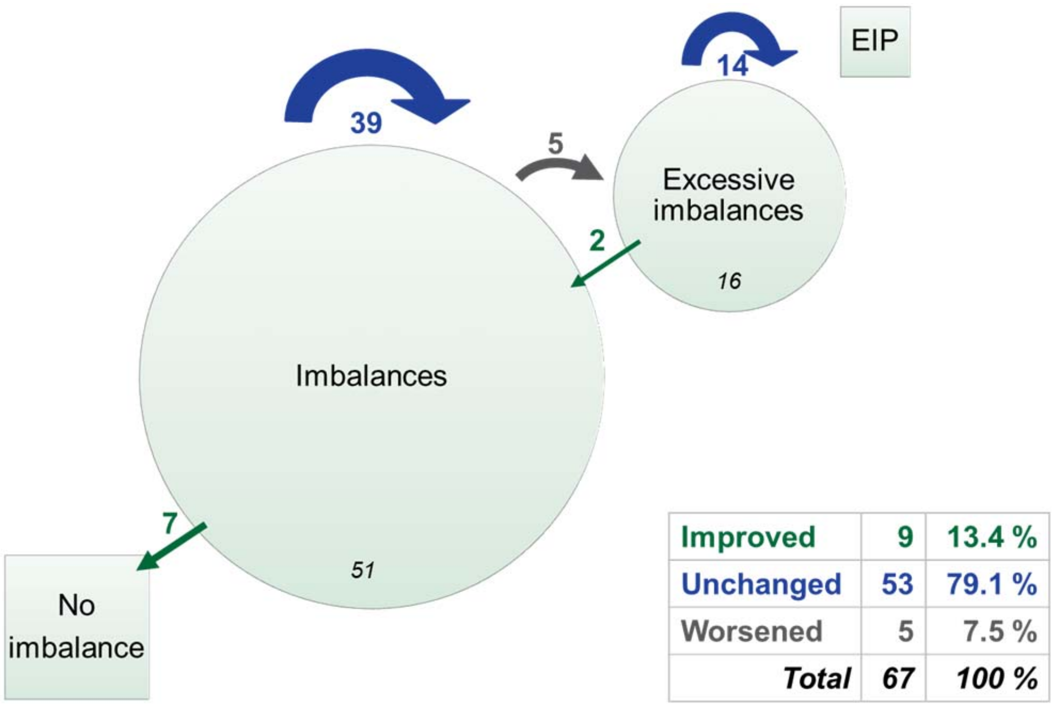


Source: ECA.

29. ***Figure 3*** shows that the classification of individual Member States has generally remained the same from one year to the next. Improvements have been relatively rare.

During the first five years of the MIP (2012 to 2016), a cumulative total of 67 Member States were identified as having imbalances (51) or excessive imbalances (16). In 39 of the 51 cases showing imbalances there was no change the following year, while five Member States were escalated to "excessive imbalances" and seven managed to correct their imbalances. Of the 16 Member States with excessive imbalances, only two managed to exit the category the following year.

<u>Figure 3</u> – Little change in classification, 2012-2017



Improved	9	13.4 %
Unchanged	53	79.1 %
Worsened	5	7.5 %
Total	***67***	***100 %***

NB: The arrows show how the classification of imbalances of Member States changed each year over the period: either it improved, it worsened, or it did not change at all. The sum of those movements equals 67.

Source: ECA.

30. This inertia can also be illustrated by looking at the 12 Member States for which imbalances were identified in 2012, the first year of the MIP. Six of the 12 have since drifted at some point into 'excessive imbalances' (Bulgaria, Cyprus, France, Italy, Slovenia and Spain). Only two of those six have managed to return to a 'regular' imbalance (Slovenia and

Spain), leaving the other four still in the 'excessive' category (four years in succession for Italy, three years for France and Bulgaria, two years for Cyprus[12]). No Member State with 'excessive' imbalances has ever been able to improve to the 'no imbalance' category. ***Annex VIII*** traces in full the classification of each Member State since 2012.

Despite frequent and intensive monitoring, the implementation of MIP-CSRs by the Member States has been low

A good standard of Commission monitoring

31. The MIP Regulation[13] requires the Commission to monitor the implementation of MIP-CSRs by, among other things, gathering information in Member States and maintaining a permanent dialogue with the authorities and the social partners. We found that, in the course of frequent information visits to Member States, the Commission held full and frank dialogue with a sufficiently wide range of stakeholders at national level.

32. In 2013, the Commission introduced 'specific monitoring' for Member States with excessive imbalances. This was extended in 2014 to selected euro-area Member States with imbalances of systemic relevance and, in 2016, to all Member States with imbalances. Specific monitoring currently consists of an annual information visit to each Member State followed by the publication of a progress report.

However, the implementation of MIP-CSRs by the Member States has been low

33. The Commission assesses the degree of CSR implementation using a qualitative ranking (see ***Annex V***). In 2017, the European Parliament drew on these assessments to evaluate the overall implementation of MIP-CSRs for the 2012-2016 period[14]. ***Figure 4*** summarises this

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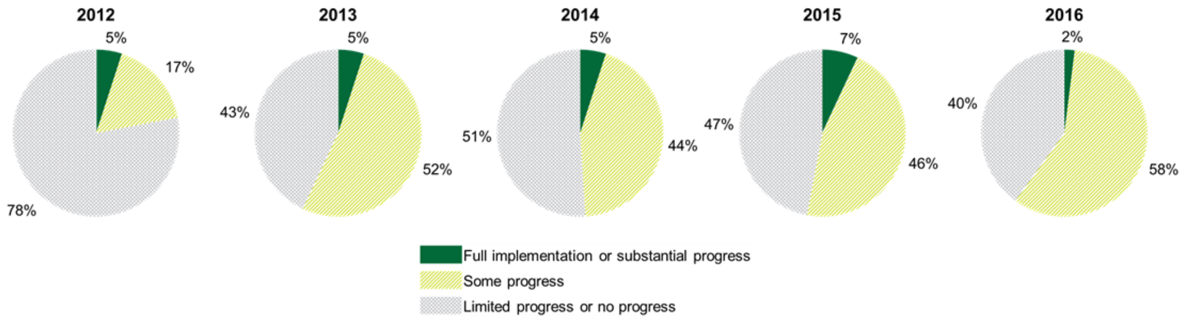
[12] From May 2013 to March 2016, Cyprus was under an economic adjustment programme.

[13] Article 13(1) and (2).

[14] In-depth analysis 'Implementation of the Macroeconomic Imbalance Procedure – state-of-play (June 2017)' - PE 497.739.

evaluation. We conclude that the implementation of MIP-CSRs has been persistently weak since 2012 as the share of fully or substantially implemented MIP-CSRs is extremely low[15].

Figure 4 – Implementation of MIP-CSRs issued from 2012 to 2016



Source: ECA based on European Parliament (Economic Governance Support Unit (EGOV)) and European Commission assessments.

Several weaknesses affecting the implementation of MIP-CSRs

34. The following weaknesses in the management of the MIP process have adversely affected the implementation of MIP-CSRs: (i) no systematic link between MIP-CSRs and imbalances; (ii) no systematic estimate of the impact of MIP-CSRs on imbalances; (iii) inconsistency of recommendations for the euro area as a whole with MIP-CSRs; (iv) a very challenging timeframe for the implementation of MIP-CSRs.

No systematic link between MIP-CSRs and imbalances

35. To promote national ownership, thus encouraging Member States to implement MIP-CSRs more diligently, it is essential to make it clear how the economic analysis and assessment of imbalances have led to specific policy recommendations. The Commission's

15 The Commission defines the category "some progress" in the ranking for the assessment of the implementation of CSRs as "the Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have yet been implemented and implementation is not certain in all cases." This level of implementation cannot always be seen as reducing imbalances with a reasonable probability.

own guidance states that IDRs should provide the analytical basis for formulating recommendations[16], but in practice, the link is not often obvious[17]. Our EPC survey confirmed this impression: when asked, "Is it clear which CSRs relate to the MIP?" only a quarter of EPC members answered "always clear" (see ***Figure g in Annex VI***). The link has been further obscured in recent years by the streamlining of both MIP-CSRs (see ***paragraphs 40 to 42***) and IDRs (see ***paragraphs 67 to 73***).

36. Firstly, the link is not often obvious or is very weak. This is because the Commission does not formulate its CSR proposals with a view to addressing specific imbalances, as required by Article 6(1) of the MIP Regulation. Instead, structural reforms are discussed with a Member State in the context of Europe 2020 before being included in the Commission's proposals, and may be labelled MIP-relevant even if only remotely linked to imbalances.

37. Moreover, in our analysis of the four selected Member States we found many CSRs that were wrongly labelled as MIP-relevant, since none of the recommended measures addressed imbalances identified in the IDR. See ***Box 1*** for examples.

Box 1 – Examples of a missing link between MIP-CSRs and IDRs

• CSR No 3/2016 to **France** addressed topics (apprenticeship, vocational training and unemployment benefit reforms) that were not MIP-relevant: not dealt with in the IDR section of the country report, nor mentioned in the MIP assessment matrix (see ***paragraph 68***), nor raised as a policy challenge related to the IDR in the executive summary of the country report. Similarly, the topics raised in CSR No 5/2015 and CSR No 5/2016 (reform of the French tax system), were not dealt with in the IDR section of the country report.

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16 European Commission Institutional Paper 039, November 2016, 'The Macroeconomic Imbalance Procedure – Rationale, Process, Application: A Compendium', p. 50.

17 The ECA's view is that the logical process would be from identification of imbalances to consideration of policy options (including estimates of effects) towards the specification of CSRs.

• CSR No 2/2013 to **Slovenia** addressed topics (long-term sustainability of the pension system; health care) to which there was no reference in the IDR.

• CSR No 1/2016 to **Bulgaria** raised matters (SGP targets; measures to improve tax collection and reduce the informal economy) not dealt with in the IDR section of the country report and not included in the MIP assessment matrix or highlighted in the executive summary. The topics raised in CSR No 1/2015 (SGP targets; tax collection; the shadow economy; cost-effectiveness of the healthcare system) were discussed in the 'Other structural issues' section of the country report and were therefore unconnected with the IDR.

• CSR No 9/2013 to **Spain** addressed topics (public administration reform; efficiency of the judiciary) not dealt with in the IDR. CSR No 2/2015 concerned savings bank reforms, an issue to which there was no reference anywhere in the country report.

38. ***Table 1*** indicates the extent to which CSRs are labelled as MIP-relevant. In 2016, over 80 % of CSRs addressed to Member States affected by imbalances, and all CSRs addressed to Member States with excessive imbalances, were labelled MIP-relevant. This over-labelling of CSRs as MIP-relevant has weakened the effectiveness and credibility of the MIP. This was corroborated by many of the stakeholders we met during information visits.

Table 1 – Share of CSRs labelled MIP-relevant among all CSRs for Member States with macroeconomic imbalances, 2012-2016

	Imbalances	Excessive imbalances	Total
2012	52.0 %		52.0 %
2013	63.3 %	94.4 %	70.5 %
2014	67.2 %	100.0 %	76.1 %
2015	87.2 %	92.9 %	89.6 %
2016	81.0 %	100.0 %	92.0 %

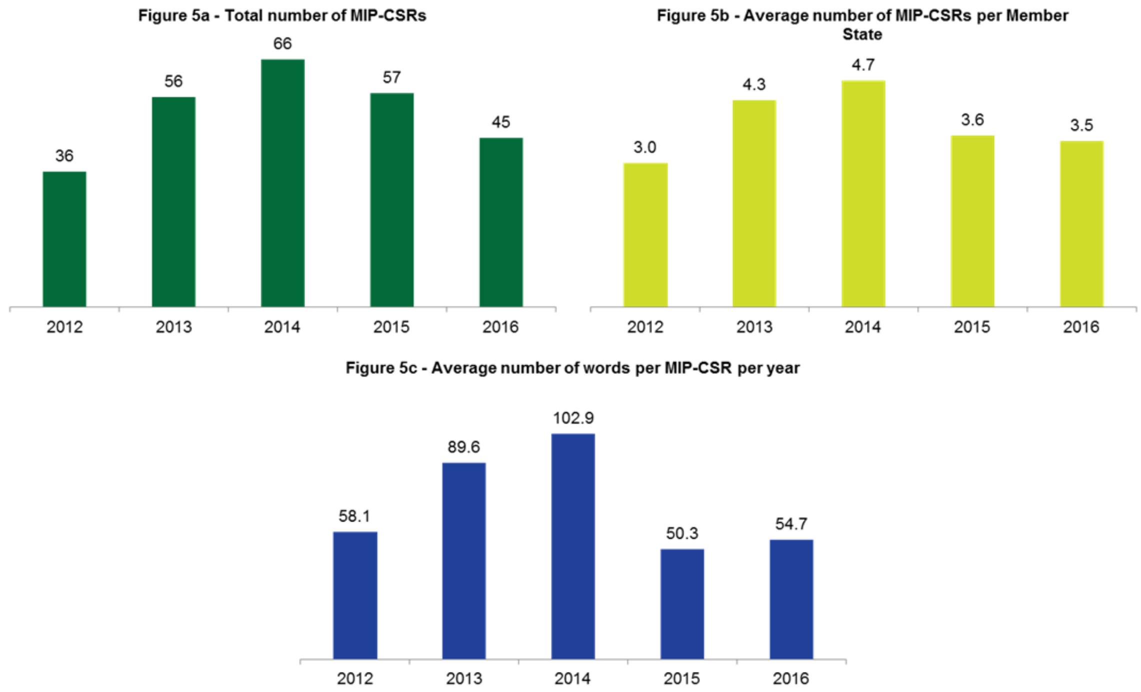
Source: ECA.

39. The second issue is that the streamlining of MIP-CSRs and IDRs has further obscured the link between the former and the identified imbalances.

40. Streamlining of the CSR process dates back to 2015, after Member States commented that the excessive number and length of CSRs had detracted from their sense of ownership and the effectiveness of implementation. The Commission has since reduced the annual number of MIP-CSRs. It has also reduced their average length by around 50 % (see ***Figure 5***).

41. The streamlining was generally viewed positively by EPC members (see ***Figure k in Annex VI***) and by many of the stakeholders we met during information visits. However, now that MIP-CSRs are shorter and worded in more general terms, they do not specifically address the imbalances identified in an IDR. Their general nature also makes it more difficult to assess how well they have been implemented and how much they may have contributed to eliminating imbalances. ***Box 2*** illustrates the impact of streamlining on selected MIP-CSRs for France and Spain.

Figure 5 – Number of MIP-CSRs and number of words per MIP-CSR, 2012-2016



Source: ECA.

<u>Box 2</u> – The impact of streamlining on MIP-CSRs for France and Spain

Streamlining has led to a reduction in the number and length of MIP-CSRs.

	2014		2016	
	France	Spain	France	Spain
Number of CSRs				
Total number of CSRs	7	8	*5*	*4*
Total number of MIP-CSRs	6	7	*5*	*4*
Number of words in MIP-CSRs				
Total	803	978	**280**	**227**
Average	134	140	**56**	**57**

Having been reduced in length, MIP-CSRs now also provide less detailed policy guidance.

2014	2016
France	
3. Simplify companies' administrative, fiscal and accounting rules and take concrete measures to implement the government's ongoing "simplification plan" by December 2014. Eliminate regulatory impediments to companies' growth, in particular by reviewing size-related criteria in regulations to avoid thresholds effects. Take steps to simplify and improve the efficiency of innovation policy, notably through an evaluation and if necessary an adaptation of the "crédit d'impôt recherche". Ensure that resources are focused on the most effective competitiveness poles and further promote the economic impact of innovation developed in the poles. 4. Remove unjustified restrictions on the access to and exercise of regulated professions and reduce entry costs and promote competition in services. Take further action to reduce regulatory burden affecting the functioning of the retail sector, in particular by simplifying authorisations for the opening of trade outlets and removing the ban on sales at a loss. While maintaining affordable conditions for vulnerable groups, ensure that regulated gas and electricity tariffs for household customers are set at an appropriate level which does not represent an obstacle to competition. Strengthen electricity and gas interconnection capacity with Spain; in particular, increase the gas interconnections capacity to fully integrate the Iberian gas market with the European market. In the railway sector, ensure the independence of the new unified infrastructure manager from the incumbent operator and take steps to open domestic passenger transport to competition before 2019.	4. Remove barriers to activity in the services sector, in particular in business services and regulated professions. Take steps to simplify and improve the efficiency of innovation policy schemes. By the end of 2016, further reform the size-related criteria in regulations that impede companies' growth and continue to simplify companies' administrative, fiscal and accounting rules by pursuing the simplification programme.
Spain	
6. Ensure an ambitious and swift implementation of Law No 20/1013 on Market Unity at all levels of administration. Adopt an ambitious reform of professional services and of professional associations by the end of 2014, defining the professions requiring registration in a professional organisation, and the transparency and accountability of professional bodies, opening up unjustifiably reserved activities and safeguarding market unity in the access to and exercise of professional services in Spain. Further reduce the time, cost and number of procedures required for setting up an operating business. Address unjustified restrictions to the establishment of largescale retail premises, notably through a revision of existing regional planning regulations. Identify sources of financing for the new national strategy for science, technology and innovation and make operational the new State Research Agency.	4. Accelerate the implementation of the law on market unity at regional level. Ensure implementation by the autonomous regions of the reform measures adopted for the retail sector. Adopt the planned reform on professional services and associations.

Source: ECA.

42. A further issue is that the discussion of policy options for tackling imbalances (the 'Policy challenges' section) has progressively disappeared from the IDR since this document was merged with the country report. Combined with the streamlining of MIP-CSRs, this has made it much more difficult for the reader to understand the rationale behind recommendations. ***Table 2*** compares the link between the IDR and the MIP-CSR No 3 for Bulgaria in 2014 and 2015, i.e. before and after streamlining.

Table 2 – Example of the weakened link between IDR and MIP-CSRs before and after streamlining

	MIP-CSR No 3 for Bulgaria in 2014 and 2015	
	IDR policy advice	**Commission proposals for country specific recommendations**
2014	´Policy challenges´ - Improving the efficiency and effectiveness of active labour market policies - Assessing the impact of existing active labour market policies, as well as introducing new measures - Linking the outcomes of the evaluation to future policy - Targeting measures to those most in need of activation and whose employability is highest. In this regard, the inactive young and the long-term unemployed low skilled people with work experience, as well as other vulnerable social groups identified	Improve the efficiency of the Employment Agency by developing a performance monitoring system and better targeting the most vulnerable, such as low-skilled and elderly workers, the long-term unemployed and Roma.
	- Improving Education and training practices appears important for the labour market; policies related to achieving sufficient participation, translated into higher educational attainment could be examined. Developing training and lifelong learning practices targeted at specific skills, which are or would be in demand on the labour market - Specific measures for the young could include programs aimed at increasing the educational attainment and improving their qualifications through targeted training. Reintegration measures for the long-term unemployed with work experience may include effectively linking social benefits to participation in training and subsidised employment. Programs relying on the social responsibility of businesses could also be examined.	Extend the coverage and effectiveness of active labour market policies to match the profiles of job-seekers, and reach out to non-registered young people who are not in employment, education or training, in line with the objectives of a youth guarantee .
	- Finding the right balance between active and passive measures - Increasing the effectiveness of social transfers […] to ensure adequate living standards for their recipients	In order to alleviate poverty, further improve the accessibility and effectiveness of social services and transfers for children and older people.
2015	´Executive summary´ - Weak labour market policies [...] may still price workers out of the labour market [...] - The lack of targeted education and training practices and active labour market policies may hinder labour market participation and employability of the workforce. ´IDR´ Improving the employability of young people not in employment, education or training (NEETs) remains a major challenge.	Develop an integrated approach for groups at the margin of the labour market, in particular older workers and young people not in employment, education or training.

Source: ECA.

43. Finally, the lack of a link or justification between IDRs and MIP-CSRs from 2016 onwards is not consistent with what the Commission declared in its communication to the European Parliament, the Council and the European Central Bank of October 2015. To improve

transparency and follow-up within the MIP, the Commission stated at that time that it would "[…] also present explicit justification of decisions taken, including regarding country-specific recommendations linked to the Macroeconomic Imbalances Procedure […]" and "[…] better explain the link between the nature of imbalances and how they are addressed in the country-specific recommendations"[18].

No systematic estimate of the impact of MIP-CSRs on imbalances

44. The Commission does not generally provide ex-ante or ex-post estimates of the economic impact of MIP-CSRs on imbalances. This is understandable only in cases where there are inherent difficulties in credibly quantifying some of the impacts due to the nature of the recommended policy measures (e.g. AQR or stress tests for the banking sector, improved coordination and efficiency of public services), or the fact that any impact will be long-term (educational and labour market reforms).

45. The few exceptions are references to outside studies assessing the effects of structural reforms on gross domestic product (GDP)[19] [20], and the one-off exercise in staff working documents on Member States' 2014 national reform programmes (NRPs)[21]. Estimating the

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18 COM(2015) 600 final of 21 October 2015 'Communication from the Commission to the European Parliament, the Council and the European Central Bank on steps towards Completing Economic and Monetary Union', p. 9.

19 The 2015 country report for Spain (p. 59) notes that, "given relatively high forward linkage effects, the price moderating effect through profit margin compression of a competition-enhancing reform in professional services is likely to benefit the rest of the economy," and references a Commission study ('The Economic Impact of Professional Services Liberalisation', European Economy Economic Papers 533, September 2014) on the effects of regulatory barriers in four professions in the EU from 2008 to 2011.

20 In its first 'Review of progress on policy measures relevant for the correction of macroeconomic imbalances' for France in 2014, the Commission recounts the findings of a 2014 OECD study on the effects of reforms undertaken and announced by the French government since 2012.

21 The Commission used a macroeconomic model (Quest) to estimate how structural reforms in a given Member State would affect growth if the Member State narrowed the gap with the average of the three best EU performers on key economic indicators.

economic impact on imbalances would better indicate which recommendations are most relevant and likely to prove effective.

46. Moreover, certain recommendations may offset the impact of others, and here it may be possible to provide a reasonable estimate. This is the case of budgetary recommendations and other CSRs with a fiscal impact. For example, MIP-CSR No 1/2013 to Spain, a Member State under the EDP, concerned pursuing the fiscal adjustment recommended by the Council to ensure correction of the country's excessive deficit. At the same time, MIP-CSR No 4/2013 addressed the need to "reinforce and modernise public employment services to ensure effective individualised assistance to the unemployed". The Commission did not estimate whether the cost of hiring the staff needed to provide individualised support to over six million jobseekers was consistent with the fiscal constraints it called for in its first recommendation.

Inconsistency with euro-area recommendations

47. Since 2012, the Commission has also proposed recommendations for the euro area as a whole. After adoption by the Council, these are addressed to the Eurogroup of finance ministers; accordingly, no EU body bears formal responsibility for their implementation.

48. There is no system in place at the Commission to ensure consistency between euro-area recommendations and CSRs for euro-area Member States.

49. One example of the problem relates to the Commission's recommendations on the euro area's fiscal stance[22]. When monetary policy is facing difficulties in reducing interest rates, managing the fiscal stance is important for ensuring sustainable growth in aggregate demand. However, it is beyond the SGP to influence the fiscal stance of a Member State once it has reached compliance with the stability criteria. The MIP therefore provides a

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[22] The fiscal stance is an estimate of the voluntary impulse induced by fiscal policy.

framework in which to address fiscal recommendations relevant for the euro area as a whole.

50. In November 2016, the Commission recommended a positive fiscal stance in order to boost recovery in support of the ECB's monetary policy[23]. This recommendation was not consistent with the fiscal requirements set in the CSRs issued to euro-area Member States some six months previously, which implied a moderately restrictive fiscal stance for the euro area as a whole for 2017 and 2018. As the outlook for GDP growth had not worsened during those six months, there was no reason for the inconsistency. There is no effective mechanism to ease the tensions that might arise between what is fiscally desirable for the euro area and the sum of fiscal CSRs to Member States.

Very challenging timeframe for the implementation of MIP-CSRs

51. The Commission has stated that it expects MIP-CSRs to be implemented within 12 to 18 months. As this forecast is often too optimistic, it skews the implementation statistics. Many MIP-CSRs are complex and require a response from a large number of stakeholders. Numerous MIP-CSRs are repeated year after year and thus recorded as not implemented. The Commission's practice contrasts with that of the IMF and OECD, both of which structure their policy advice along more thematic lines. In this connection, see ***paragraph 78***.

52. This difficulty was, to some extent, corroborated by the replies to the EPC survey question "Are the CSRs for your Member State realistic?" Some 53 % of respondents considered them "realistic", 26 % "somewhat unrealistic" and 11 % "not at all realistic" (see ***Figure j in Annex VI***). The main reason given for deeming CSRs unrealistic was the very challenging timeframe for implementation.

[23] COM(2016) 727 of 6 November 2016.

The classification of imbalances lacks transparency, and the EIP has never been activated

53. This section looks at the logic and the process behind the Commission's assessment of the severity of imbalances.

The system of categories has typically been complex and subject to change

54. The MIP Regulation envisaged that Member States would be evaluated as having either no imbalance, imbalances or excessive imbalances.

55. However, in 2012 the Commission established five categories. These were expanded to six in 2013. A different set of six was used in 2014. The categories were differentiated by the severity of imbalances and the degree of monitoring required. Finally, the categories were reduced to just four in 2016 (see ***Table 3***). Most of the stakeholders we spoke to welcomed the reduction on the basis that it had simplified the procedure.

Table 3 – Evolution of imbalance categories, 2012-2017

<table>
<tr><th>2012</th><th>2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th></tr>
<tr><td rowspan="2">No imbalance</td><td rowspan="2">No imbalance</td><td colspan="2">No imbalance</td><td colspan="2">No imbalance</td></tr>
<tr><td>DK, LU, MT</td><td></td><td>AT, BE, EE, HU, RO, UK</td><td>FI</td></tr>
<tr><td rowspan="2">Imbalances, which are not excessive but need to be addressed
BE, BG, DK, FI, SE, UK</td><td rowspan="2">Imbalances, which deserve monitoring and policy action
BE, BG, DK, FI, MT, NL, SE, UK</td><td colspan="2">Imbalances, which require monitoring and policy action</td><td colspan="2" rowspan="5">Imbalances</td></tr>
<tr><td>BE, BG, DE, FI, NL, SE, UK</td><td>BE, FI, NL, RO, SE, UK</td></tr>
<tr><td rowspan="2">Serious imbalances, which are not excessive but need to be addressed
FR, HU, IT, SI</td><td rowspan="2">Imbalances, which require monitoring and decisive policy action
FR, HU, IT</td><td colspan="2">Imbalances, which require monitoring and decisive policy action</td></tr>
<tr><td>HU</td><td>DE, HU</td></tr>
<tr><td rowspan="2">Very serious imbalances, which are not excessive but need to be urgently addressed
CY, ES</td><td rowspan="2"></td><td colspan="2">Imbalances, which require specific monitoring and decisive policy action</td></tr>
<tr><td>ES, FR, IE</td><td>ES, IE, SI</td><td>DE, ES, FI, IE, NL, SE, SI</td><td>DE, ES, IE, NL, SE, SI</td></tr>
<tr><td rowspan="3"></td><td>Excessive imbalances requiring continuous strong policy action (specific monitoring)
ES</td><td colspan="2" rowspan="2">Excessive imbalances, which require specific monitoring and decisive policy action</td><td colspan="2" rowspan="2">Excessive imbalances</td></tr>
<tr><td rowspan="2">Excessive imbalances requiring urgent policy action (specific monitoring)
SI</td></tr>
<tr><td>HR, IT, SI</td><td>BG, FR, HR, IT, PT</td><td>BG, CY, FR, HR, IT, PT</td><td>BG, CY, FR, HR, IT, PT</td></tr>
<tr><td>Excessive Imbalance Procedure</td><td>Excessive Imbalance Procedure</td><td colspan="2">Excessive imbalances, which require decisive policy action and the activation of the Excessive Imbalance Procedure</td><td colspan="2">Excessive imbalances with corrective action plan (Excessive Imbalance Procedure)</td></tr>
</table>

Source: ECA.

56. Since 2013, the different classifications have in common the presence of a category where excessive imbalances are identified but the Commission has never proposed activation of an EIP in these cases. This possibility is not explicitly provided for in the MIP Regulation (see ***<u>Box 3</u>***). It is not clear from the Commission's documentation where the practice of identifying excessive imbalances but not recommending the activation of an EIP came from, and it appears to have been decided at political level. So far, the Commission has always avoided recommending activation of the EIP with no clear rationale (see ***<u>paragraph 63</u>***).

<u>Box 3</u> – When should the EIP be activated?

Article 2 of the MIP Regulation defines only 'imbalances' and 'excessive imbalances'.

From Article 7(1), on the opening of the EIP: "If, on the basis of the in-depth review referred to in Article 5, the Commission considers that the Member State concerned is affected by excessive imbalances, it shall inform the European Parliament, the Council and the Eurogroup accordingly." Article 7(2) then states that the Council "may" activate the procedure, indicating that this is subject to the Council's discretion.

However, the Commission considers that it enjoys power of discretion as to whether to recommend the EIP even if it considers that a Member State is affected by excessive imbalances. It reportedly bases this interpretation on Article 121(4) Treaty on the Functioning of the European Union, which reads as follows:

"Where it is established, under the procedure referred to in paragraph 3, that the economic policies of a Member State are not consistent with the broad guidelines referred to in paragraph 2 or that they risk jeopardising the proper functioning of economic and monetary union, the Commission may address a warning to the Member State concerned."

The link between analysis and category of imbalances is not always clear

57. Article 5(2) of the MIP Regulation states that the IDR should "include an evaluation of whether the Member State […] is affected by imbalances, and of whether these imbalances constitute excessive imbalances". This implies that the Commission must produce a clear link between the economic analysis and the chosen category of imbalances.

58. In practice, the IDRs do not include any conclusion on the classification of imbalances for Member States. Instead, this is contained in the accompanying communication by the Commission. In addition, we found that the recommended conclusions on imbalances are not always clearly based on the analysis carried out in the corresponding IDR. For example:

(a) In 2015, following a recommendation from DG ECFIN, Bulgaria's status was moved up three levels from 'imbalances which require monitoring and policy action' to 'excessive imbalances which require specific monitoring and decisive policy action'. The decision to do so was largely based on a single bank failure in 2014 and the Commission's resulting fears for financial stability. The classification was maintained in 2016 although that year's IDR showed that none of the financial risks identified in 2015 had materialised.

(b) In 2015, following a DG ECFIN recommendation to escalate the procedure, France was moved up one level to 'excessive imbalances which require specific monitoring and decisive policy action'. In our view, however, the IDR had not identified *significant* year-to-year changes in the factors underlying the assessment. At the same time, although France was also under the EDP (the corrective arm of the SGP), this was not escalated even though the word 'excessive' only appeared in the IDR in relation to fiscal deficits.

(c) The 2016 IDR for the United Kingdom (under the EDP since 2008) concluded that there were no imbalances, and the 2017 AMR for the United Kingdom did not even require an IDR. This was despite reference in the 2016 IDR to a persistently large current account deficit (the largest that year in the EU) and continuous growth in house prices since 2013 from already inflated levels.

59. The situation was exacerbated in 2017, when fully-fledged IDRs were replaced by 'summaries' in country reports (see ***paragraph 69***).

60. The timing of publication suggests that the tasks of analysis and classification are also functionally separate. In 2012, 2014 and 2017, the IDRs and the communication announcing the classification were published on the same day, whereas in 2013 and 2016 the IDRs were published first and the imbalance classification was published two weeks later. In 2015, the imbalance classification was published one day before the IDRs.

In late phases, the process is political rather than technical

61. The Commission currently has a multi-stage process for classifying imbalances. Firstly, Commission staff sends written advice to the Commissioner for Economic and Financial Affairs regarding the classification of each Member State which has been subject to an IDR. We found that these suggestions provide clear technical advice and are consistent between countries and over time.

62. After consideration of this advice by the Commissioner's private office and, since 2014, that of the Vice-President for the Euro and Social Dialogue (who has joint responsibility for the MIP) a draft communication is sent for scrutiny to all the Commissioners' private offices and finally to the College of Commissioners itself for adoption.

63. Between 2012 and 2016, certain Member States were identified as having excessive imbalances on 16 occasions. However, the College has never sent an EIP proposal to the Council. During our audit, the Commission produced little evidence which would explain why the College did not propose the EIP.

64. The systematic non-activation of the EIP has reduced the credibility and effectiveness of the MIP. This is also the view of a number of stakeholders, which report that non-activation has undermined the procedure in terms both of its ability to address imbalances and of its deterrent value. The Five Presidents' Report[24] also suggests a full use of the MIP, including the activation of the EIP. Also the ECB has stated that "full and effective use of all

[24] 'Completing Europe's Economic and Monetary Union', a report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, June 2015, p. 8: "[MIP's] corrective arm should be used forcefully. It should be triggered as soon as excessive imbalances are identified and be used to monitor reform implementation."

instruments available under the MIP – including its corrective arm – is needed" and repeated this message on several occasions[25].

65. Other stakeholders suggest that using the EIP in circumstances which were not clear-cut would also affect its credibility, and that it should be reserved for use only in very obvious circumstances.

66. The MIP Regulation fully entrusts the Commission with classifying imbalances. However we detected several shortcomings in the way this is done:

(a) Firstly, we were shown no evidence that the College and private offices have a formal procedure for considering the DG ECFIN advice and documenting their exchanges.

(b) Secondly, prior to 2017 the draft communication on imbalances was circulated very late to the College. This breached the Commission's internal rules, which are supposed to ensure that the College has given its decisions appropriate consideration.

(c) Thirdly, there is at present no clear written guidance on the circumstances in which the Commission would decide to propose activation of the EIP.

The prominence of IDRs has considerably decreased over time. Analytical quality remains good, but some key aspects of IDRs need improvement

67. This section looks at the evolving presentation of IDRs and the quality of the Commission's analytical tools and economic analysis to identify and assess imbalances.

The prominence of IDRs has considerably decreased over time

68. The boundaries between IDRs and the annual country reports have become increasingly blurred. The Commission has sought to streamline its analysis and policy advice to Member

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[25] ECB, Economic Bulletin, Issue 2, March 2017, Box 7, p. 63. For other statements, see Economic Bulletin, Issue 2, March 2015, Box 5, p. 48 and Economic Bulletin, Issue 2, March 2016, Box 8, p. 57.

States under the broad European Semester umbrella of policy coordination. However, merging IDRs with country reports has reduced the focus on the MIP and its distinct objective of detecting and preventing imbalances.

69. For the first three years, the IDR was a stand-alone document mainly provided by DG ECFIN, with contributions from DG EMPL and other directorates-general. In 2015, it became section 2 of the country report, the remainder of which is the result of an analysis that was previously included in a (now discontinued) staff working document assessing the Member State's NRP in the context of the European Semester. As a result of the merger, the 'policy challenges' section of the IDR (a summary of key macroeconomic challenges and possible responses) was dropped. Moreover, the titles used in country reports are now standardised and therefore do not reflect the severity of imbalances in the Member State concerned.

70. In 2016 the loss of the 'policy challenges' section was partially addressed by the addition of an 'MIP assessment matrix', a useful table that summarises the main findings of the IDR. However, the table does not provide any indication of possible measures for addressing the challenges identified in the IDR.

71. The format of country reports was further modified in 2017: as well as shortening them overall, the Commission restricted the IDR to the MIP assessment matrix and a brief statement of the main findings (section 3). Details of all the main issues, including macroeconomic imbalances, affecting the Member State are to be found by theme in section 4 'Reform priorities'. An asterisk in the title indicates topics that are relevant to the MIP and which contribute to the summary in section 3.

72. These changes in format were driven by the Commission Secretariat-General, whose importance in the process has grown over time. The Secretariat-General now also guides the production of country reports through country teams organised across all Commission

departments. DG EMPL now provides a greater share of the analytical input[26], in particular on employment and social developments, and the IDR/country report has become less of a DG ECFIN product. Stakeholders report that these developments have reduced the visibility of the MIP.

73. Since the merger, the communication on IDRs has been replaced by a far broader communication on country reports. To counter this problem, in June 2015 DG ECFIN published an overview of that year's IDR findings[27] to highlight developments that were common across countries and linked to the changing economic landscape. However, no such overview was published in 2016 or, to date, in 2017.

74. The analysis of macroeconomic imbalances is now part of the overall analysis of structural issues in a Member State. Imbalances have thus been shorn of the prominence they had when the IDR was a separate document. This makes it difficult to distinguish short-term (imbalances) from long-term (growth) issues.

75. Summing up, efforts to streamline the European Semester have reduced the visibility of the MIP. However, effective communication is central to public understanding of the procedure and the challenges that macroeconomic imbalances pose to Member States. Enhanced communication is also needed to improve national ownership of the MIP. This view was repeatedly emphasised by stakeholders during our information visits.

Despite a good standard of analysis, some aspects of IDRs need improvement

76. In November 2016, five years after the introduction of the MIP, DG ECFIN published a paper entitled 'The Macroeconomic Imbalance Procedure – Rationale, Process, Application: a Compendium'. To a large extent, the Compendium draws on analytical material presented

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[26] The Macroeconomic Imbalance Procedure – Rationale, Process, Application: a Compendium, Box 3.1, p. 34.

[27] Occasional Paper 228, Macroeconomic Imbalances - Main findings of the in-depth reviews 2015.

to Council committees or previously published in various formats. The consolidation of the entire framework in this publication, though late, is welcome as it has helped Member States and other stakeholders to understand the MIP and, in particular, the rationale for certain decisions.

77. The Compendium describes some analytical tools that DG ECFIN uses in the assessment of macroeconomic imbalances. However, it could be further improved by the inclusion of information on the tools used by the Commission in other recurring analyses of, for example, the stability of the banking system, MIP-relevant developments in the labour market and the quality of labour market policies.

78. The standard of analysis in IDRs has generally been good, according to stakeholders and experts who we consulted. The Commission takes into account all country-specific circumstances and other relevant information provided by Member States. Some Member States saw a need to improve the sharing of information, and the Commission has recently made efforts in this regard.

79. Our EPC survey confirmed these findings. The vast majority of respondents (89 %) described the quality of their Member State's IDR as 'good', with 11 % choosing 'average'. None described the quality as 'very good', 'poor' or 'very poor' (see ***Figure d in Annex VI***). Compared with similar reports by peer institutions, 68 % of EPC members opted for "no difference", 26 % said better, and 5 % said that the IDRs were worse (see ***Figure u in Annex VI***). All respondents agreed that the IDRs took account of relevant country-specific information (53 % 'to a great extent' and 47 % to some extent', see ***Figure e in Annex VI***).

80. Compared with the reports of other international organisations (IMF, OECD), which use a 'thematic' approach, the IDRs often touch on the same issues year after year. Even allowing for the fact that some imbalances are persistent and cannot be ignored, this often results in repetitive analysis with little added value and a message which remains broadly the same from one year to the next.

81. The MIP Regulation requires the Commission to take into account the "deep trade and financial interlinkages between Member States and the spill-over effects of national

economic policies"[28]. The Commission has developed a number of economic tools[29] to address these aspects.

82. However, the analysis of spill-overs[30] is often weak. In the four selected Member States it was applied somewhat inconsistently. For example, until 2014 only passing consideration was given to sovereign contagion[31] (a spill-over from outside) in Slovenia. In Bulgaria, there was no consideration of the general market conditions for the country as a small Member State outside the euro area. Ignoring spill-overs leads the Commission to focus excessively on developments intrinsic to a Member State.

83. Since 2015, there has been a policy of including mention of outward spill-overs in the IDRs of the five largest euro-area Member States. This is a welcome development.

84. Inward spill-overs were mentioned in all IDRs in the sample for all years, although the coverage and depth varied. For example, sovereign contagion was not considered in great detail even in 2012 and 2013, when sovereign spreads[32] were particularly high.

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[28] Article 5(2) of the MIP Regulation.

[29] The Commission has developed a number of relevant economic assessment techniques. For example, these include assessments of cross-country wage developments as well as financial flows.

[30] A spill-over is a development in one Member State which has an impact on the economies of one or more other Member States. Inward spill-overs refer to the impact on a given Member State from another or others. Outward spill-overs refer to the impact from a given Member State to another or others.

[31] Sovereign contagion is when adverse movements in a country's borrowing costs move in a correlated fashion with those of another.

[32] A sovereign spread is the difference in percentage points a country faces in its borrowing costs compared to a benchmark. In the euro area, the benchmark is usually German Government borrowing rate.

85. To conclude on spill-overs, the analytical tools used are not consistently part of the country analysis. There has been some improvement, however, most specifically through the publication of the MIP assessment matrix from 2016 onwards.

86. In general, IDRs do not assess how fiscal policy affects external imbalances. The only Member State given a comprehensive assessment so far is Germany, which enjoys a large current account surplus. However, there has been no similar analysis for countries with a structural current account deficit, a large negative net international investment position or problems of competitiveness (see ***Box 4***). On the fiscal front, IDRs are mainly limited to a short discussion of public-sector debt developments.

Box 4 – External imbalances and fiscal policy

The Commission made a thorough analysis of Germany's current account surpluses in its 2015 and 2016 IDRs, and concluded that the country should use its fiscal space (its capacity to spend more without breaching the SGP criteria) to enhance domestic demand and increase public investment. In 2016, the Council toned down the Commission's proposal by deleting the part of the recommendation on the fiscal space.

In 2017, the IDR section of the country report on Germany also contained an analysis[33] of the positive spill-over effects that an expansionary fiscal policy would have on the euro area. The Commission again urged Germany to use fiscal tools, both to rebalance its current account and to help other countries rebalance their external deficit. The reference to the impact of fiscal policies on external imbalances and competitiveness was an important development.

Despite the above, the Commission has not analysed the connection between fiscal policy and weak external balances in other systemic Member States (notably Spain and France), nor has it recommended that they tighten their fiscal policy to favour external rebalancing.

[33] SWD(2017) 71 final 'Country report - Germany 2017 - including an in-depth review on the prevention and correction of macroeconomic imbalances', Box 3.1, p. 18.

The 2015 IDR for Spain assessed as permanent the improvement in the headline current account. In doing so, it neglected important cyclical components, such as the depreciation of the euro, ECB measures that had helped to drive down interest rates on external debt, and reduced import costs owing to a much lower oil price. In its 2016 IDR the Commission took advantage of the improvement in the headline external balance to avoid discussing the evolution of the structural current account. The large negative net international investment position was repeatedly mentioned as a problem, but no link was made to Spain's fiscal policy, which was already expansionary despite the recent return to growth at a faster pace than the potential output growth rate.

In its 2017 IDR for France, the Commission identified competitiveness weaknesses and the declining market share of exports to key trading partners, but did not analyse the possibility of using fiscal policy to promote external rebalancing and move resources toward the tradeable sector.

87. In the cases of Slovenia and Bulgaria, we found weaknesses in the analysis of imbalances and the resulting policy recommendations (see ***<u>Box 5</u>***).

<u>Box 5</u> – Examples of weaknesses in the analyses of imbalances

➢ On the topic of labour market reform, the 2013 IDR for Slovenia warned that the hike in the minimum wage would have a significant negative impact on jobs, possibly delaying employment recovery, increasing pressure on wages once economic growth resumed, and hence risking a further drop in competitiveness. In the 2013 Communication announcing the classification, the minimum wage increase was given as one of the reasons for toughening Slovenia's MIP classification to 'excessive imbalances'.

A number of facts suggest the need for the Commission to show greater caution in its assessment:

• The magnitude of the impact was based on a paper[34] which used data from 2008 to estimate only constant elasticity of labour demand. Other research[35] available at the same time suggested that the impact of increasing the minimum wage would be much smaller.

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[34] IMAD Working Paper No 3/2010 'Estimation of the Impact of the Minimum Wage Rise in Slovenia'.

• The Commission did not take into consideration the breakdown by sector of employees benefiting from the minimum wage to understand the impact on employment and overall competitiveness.

• The impact assessment for Slovenia was very different to that for other comparable Member States experiencing higher increases in the minimum wage, wider employee coverage and similar ratio minimum wage/average wage (e.g. Bulgaria).

The gloomy employment forecast for Slovenia did not ultimately materialise, leading the OECD to conclude[36]: "The outcomes remain consistent with the predictions of a (modest) negative impact".

➢ The 2013 IDR for Slovenia claimed that state-owned banks suffer from "frequently sub-optimal corporate governance" and concluded that "privatisation would help to address manifest corporate governance deficiencies", but without giving any concrete examples of these governance problems.

➢In its 2015 IDR for Bulgaria, the Commission noted that domestically-owned banks "have charged, on average, higher interest on the corporate loans they were granting", and reasoned that "this profile indicates differences with the rest of the banking system" not only "in the average credit quality of borrowers", but also in "management standards, credit underwriting practices, the type of collateral and the underlying risk of the portfolio". Again, no further analysis or evidence was given to support this inference.

The Commission continued with the observation that domestically-owned banks had reported better asset quality than their foreign-owned peers, and expressed concerns about the effectiveness of banking supervision. While this fact might reflect poor reporting practices and the risk of hidden losses, it still does not support the conclusion regarding differences in management standards, underwriting and collateral.

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35 Bank of Slovenia, Price Stability Report, April 2010, Box 2.2.

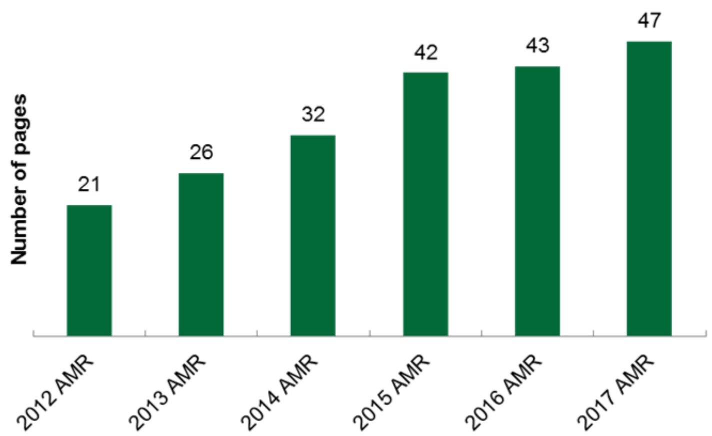
36 OECD, 'Connecting people with jobs: The labour market, activation policies and disadvantaged workers in Slovenia', 2016, p. 52.

The AMR and the scoreboard play a limited role in the MIP

88. This section looks at the added value of the AMR in the MIP and the characteristics of the scoreboard to facilitate an early identification of imbalances.

89. The AMR has more than doubled in length since the start of the MIP (see ***Figure 6***).

Figure 6 – Length of the AMR, 2012-2017



Source: ECA.

90. However, there has been no corresponding improvement in the quality of the assessment, as the document is still largely descriptive[37]:

(a) the first part of the AMR mainly describes common trends across economies and how the various scoreboard indicators have evolved. It does so without considering the implications of these developments (spill-over effects or causal factors) in greater depth, and without seeking to identify the drivers of any trends;

(b) the second part of the AMR merely consists of a description of the scoreboard and a short country-by-country assessment of imbalance risks and adjustments.

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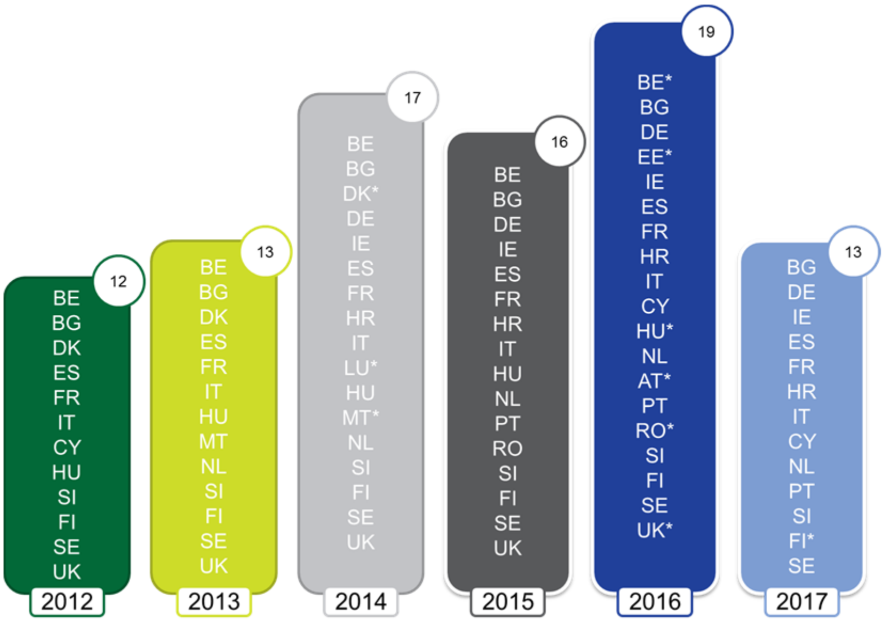
[37] However, we welcome the addition of a box entitled 'The euro-area dimension of macroeconomic imbalances' in the 2016 and 2017 AMRs.

91. The AMR's immediate usefulness for identifying Member States at risk of being affected by imbalances necessitating an IDR has been neutralised by the Commission's practice of making IDRs mandatory for Member States that were identified as having imbalances in the previous year (see ***Annex IX***). The inertia this brings to the process is illustrated in ***Figure 7***.

Figure 7 – Member States subject to an IDR (2012-2017)



NB: The asterisks denote Member States assessed with 'no imbalance' in the year of the IDR.

Source: ECA.

92. The AMR scoreboard is poorly designed to facilitate the early identification of (worsening) macroeconomic imbalances:

(a) it is backward-looking, being based on data that is two years old;

(b) many indicators are either moving averages or stock variables (see ***Table 4***), making them slow to adjust or to reflect recent developments.

Table 4 – **Indicators calculated as a moving average and stock variables, 2014-2017**

Characteristic	Indicator
3-year moving average	Current account balance (% of GDP)
	Real effective exchange rate (42 trading partners, HICP deflator)
	Nominal unit labour cost index (2010=100)
	Unemployment rate
	Activity rate (% of total population aged 15-64, percentage points)
	Long-term unemployment rate (% of active population aged 15-74, percentage points)
	Youth unemployment rate (% of active population aged 15-24, percentage points)
5-year moving average	Export market share (% of world exports)
Stock variables	Net international investment position (% of GDP)
	Private sector debt, consolidated (% of GDP)
	General government gross debt (% of GDP)

Source: ECA.

93. Some important indicators relevant for the detection of imbalances are not explicitly included in the scoreboard. Examples include inflation, corporate profitability and non-performing loans.

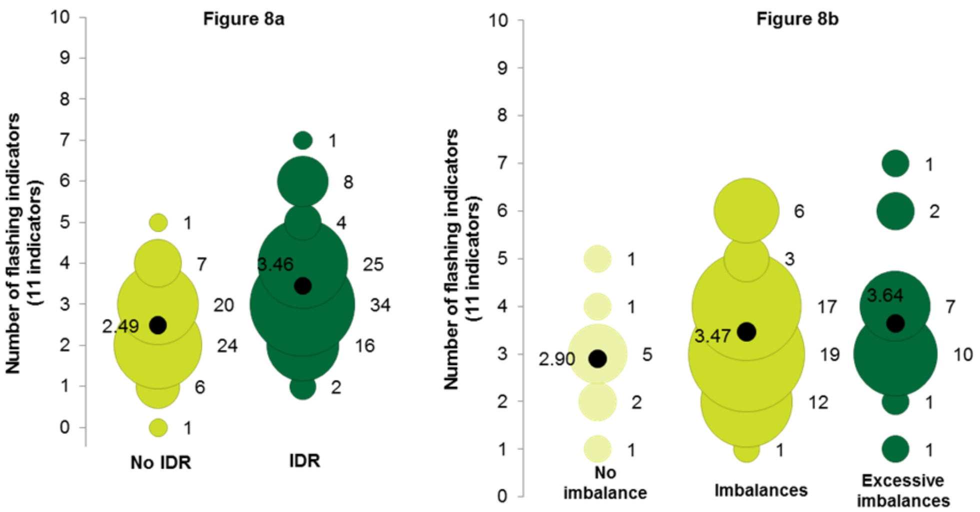
94. The scoreboard has been revised on numerous occasions, changes being made to the number, type and presentation of indicators. It was last revised in 2016, when three social indicators[38] were promoted from 'auxiliary' status to the headline scoreboard. However, these three indicators are mutually highly correlated, and they are of little use in the early identification of imbalances since they reflect the *consequences* of economic disruption. Both the EPC survey respondents (see ***Figure c in Annex VI***) and a large majority of stakeholders expressed the view that they have not improved the scoreboard.

95. The scoreboard is of limited value at the AMR stage and none thereafter. As would be expected, we found a direct link between the number of 'flashing' indicators (those exceeding the threshold value) and both the decision to issue an IDR and the classification of imbalances. However, in both cases the statistical relationship is very weak (see ***Figure 8***)

[38] The activity rate, the long-term unemployment rate and the youth unemployment rate.

confirming that the decision to issue an IDR does not flow mechanically from the scoreboard. Moreover, the Commission does not use the scoreboard indicators for its analysis in IDRs but relies on a wider set of analytical tools as well as more up-to-date data[39].

Figure 8 – Relationship between the number of flashing indicators and (a) the issue of IDRs; (b) the classification of imbalances, 2012-2017



Note: The black dots represent the mean. The category 'Excessive imbalances with EIP' is not shown as no Member States have yet been put in this category.
Source: ECA.

96. Despite its limited role in decision-making, discussions with stakeholders revealed that the scoreboard gets a good deal of public attention because the number of flashing indicators can be easily communicated. However, non-expert readers may not obtain a complete picture of the nature and detail of imbalances in a Member State if they rely on the number of flashing indicators rather than reading through the whole IDR. The inclusion

[39] For unemployment, IDRs refer to the tables 'Key economic, financial and social indicators' (present in the IDR since 2014) and 'Labour market and social indicators' (since 2015); for the current account they refer to specific details for the previous year. The IDR analysis of the financial sector uses a wide range of additional variables (e.g. deposit rates, trend and spread of lending conditions, net interest margins, bank profitability).

of the scoreboard as an annex to the country report since 2016 may reinforce the mistaken impression that it is central to assessing the severity of imbalances.

CONCLUSIONS AND RECOMMENDATIONS

97. Our overall conclusion is that, although the MIP is generally well designed, the Commission is not implementing it in a way that would ensure effective prevention and correction of imbalances. The Commission therefore needs to substantially improve certain aspects of its management of the MIP. A recent step forward was addressing the issue of spill-over effects of tight fiscal policy in some Member States at times of depressed output in the euro area.

Implementation of MIP-CSRs

98. The implementation of MIP-CSRs by the Member States has been low (see ***paragraph 33***).

99. It is only after drafting CSRs that the Commission decides which are MIP-relevant. Even then, this labelling is not appropriate in some cases because the link with the IDR analysis is at best partial or remote. Recommendations labelled as MIP-relevant are often a mix of measures addressing structural issues concerning potential growth and those addressing macroeconomic imbalances in the short to medium-term. Sometimes the MIP-CSRs are not even related to macroeconomic imbalances (see ***paragraphs 35 to 38***; ***43***).

100. Following streamlining in 2015, MIP-CSRs are now shorter and worded in more general terms than before. This has made it more difficult to assess their implementation and their contribution to the elimination of imbalances. The timeframe for their implementation is very challenging (see ***paragraphs 39 to 42***; ***51 to 52***).

101. Finally, there is no systematic ex-ante or ex-post assessment of the economic impact of MIP-CSRs (see ***paragraphs 44 to 46***).

Recommendation 1

(i) The Commission should systematically link MIP-CSRs to macroeconomic imbalances identified in the IDR. The measures included in MIP-CSRs should be sufficiently detailed for their implementation to lead to a substantive and noticeable reduction in imbalances.

(ii) The Commission should also clearly distinguish between MIP policy actions designed to reduce imbalances in the short-to-medium term with a view to avoiding crises, and reforms aimed at preventing the accumulation of imbalances by boosting potential growth in the long term.

(iii) Wherever possible, the Commission should make ex-ante and ex-post assessments of the impact on imbalances of the policy actions set out in MIP-CSRs.

(iv) The Commission should provide a realistic timeframe to facilitate the implementation of the MIP-CSRs.

These measures should be in place for the 2019 MIP cycle (starting autumn 2018).

Classification of imbalances

102. The IDRs themselves do not include any conclusion on the classification of imbalances for Member States. Moreover, the link between the economic analysis in the IDR and the classification of imbalances is not always clear. The problem has worsened since fully-fledged IDRs were replaced by 'summaries' in country reports (see ***paragraphs 57 to 60***).

103. The Commission's departments use a clear set of criteria for proposing to the College how imbalances should be classified. However, the audit evidence suggests that there is a lack of formal process for decision-making at political level and that the Commission sometimes breaches its own internal rules (see ***paragraphs 61 to 62***; ***66***).

104. The Commission has never proposed activation of the EIP, although it has considered doing so on several occasions. The Commission's interpretation of the MIP Regulation is that a diagnosis of excessive imbalances does not necessarily require it to propose activating the EIP (see ***paragraphs 63 to 65***).

Recommendation 2

(i) As required by the MIP Regulation, in the IDRs, the Commission should provide a clear characterisation of the severity of the imbalances a Member State is facing.

(ii) The Commission should adopt, publish and apply clear criteria and processes for the classification of imbalances.

(iii) Unless there are specific circumstances, the Commission should recommend the activation of an EIP when there is evidence that a Member State is facing excessive imbalances, particularly where there is a high risk of instability, the imbalances are persistent or have had spill-over effects, or remedial actions has been unsatisfactory. If in specific circumstances, the Commission uses its discretionary powers to refrain from taking this step, it should clearly and publicly explain its reasons.

These measures should be in place for the 2019 MIP cycle (starting autumn 2018).

(iv) In the context of the 2019 MIP review, the Commission should propose amendments to the MIP Regulation to codify the circumstances in which the Commission would not recommend activation of an EIP even when it has concluded that a Member State is facing excessive imbalances.

Characteristics of IDRs

105. Since 2015, IDRs have been gradually subsumed into country reports, which primarily deal with the broad economic coordination of structural policies, and the boundaries between the two documents have become increasingly blurred. In 2017, detailed analyses of all the main issues concerning a Member State were brought together in a single section of the country report, where they are divided by theme and an indication is given of the topics that are relevant to the MIP (see ***paragraphs 68 to 72***).

106. These developments have reduced the visibility of the MIP and made it increasingly difficult to identify MIP-relevant challenges. The shrinking of IDRs has weakened still further the link between the economic analysis and both the classification of imbalances and the resulting MIP-CSRs (see ***paragraphs 59***; ***73 to 75***).

107. Moreover, the scoreboard is not crucial to the IDR but its inclusion, since 2016, as an annex to the country report gives the impression that it is (see ***paragraphs 95 to 96***).

Recommendation 3

(i) In order to provide a clear assessment of the severity of the macroeconomic imbalances facing a Member State and ease identification of the most suitable response, the Commission should provide a comprehensive and separately presented IDR with a length and level of detail that reflects the severity of the situation and the policy challenges.

(ii) The Commission should not publish the scoreboard with the IDR but should provide access to database with the country-specific variables actually used in its analysis.

These measures should be in place for the 2019 MIP cycle (starting autumn 2018).

Acknowledging the impact of fiscal policy on external imbalances and competitiveness

108. Despite some repetition from year to year, IDRs generally contain a good standard of analysis. However, the impact of fiscal policies on external imbalances is not always part of the analysis or taken into account in the formulation of MIP-CSRs, even when an IDR has identified imbalances in external positions which are strongly linked to fiscal policy. The Commission is aware of these linkages but generally considers that fiscal issues are covered by the SGP. However, the SGP is limited to fiscal sustainability, does not consider the effects of fiscal policy on external imbalances and is silent on the fiscal policy of Member States which meet their sustainability criteria (see ***paragraphs 78 to 80***; ***86 to 87***).

Recommendation 4

Where appropriate, the Commission should systematically analyse the impact of fiscal policy on external imbalances and competitiveness in IDRs, and should use the MIP to make recommendations to Member States when fiscal issues directly affect external imbalances. This should apply both to Member States with large current account surpluses and to those with large deficits.

This measure should be in place for the 2019 MIP cycle (starting autumn 2018).

Euro-area dimension

109. The MIP is too focused on individual economies and not enough on spill-overs. As a result, MIP-CSRs do not sufficiently promote policy actions with a beneficial impact on other Member States or encourage symmetric rebalancing within the euro area (see ***paragraphs 81 to 85***).

110. CSRs are not always consistent with the Commission's recommendations for the euro area as a whole (see ***paragraphs 47 to 50***).

Recommendation 5

(i) The Commission should, through the MIP process, give systematic consideration to policies with cross-country impacts that can enhance symmetric rebalancing within the euro area.

(ii) The Commission should make MIP-CSRs consistent with recommendations for the euro area relevant to imbalances, including on the overall fiscal stance, when appropriate.

These measures should be in place for the 2019 MIP cycle (starting autumn 2018).

Visibility and communication of the MIP

111. Effective communication is crucial in order to enhance public awareness of the MIP and its distinct objective of detecting, alleviating and preventing macroeconomic imbalances, together with the challenges that imbalances pose to Member States. Enhanced

communication is also needed to improve national ownership of the MIP (see ***paragraphs 1 to 6***; ***54 to 56***; ***68 to72***; ***88 to 91***; ***94 to 96)***.

Recommendation 6

The Commission should give greater prominence to the MIP by:

(i) increasing its references to the procedure in communication with Member States;

(ii) making the relevant Commissioners available to parliaments of Member States, whenever the Commission has assessed imbalances as being excessive, so that they can explain the rationale for its decisions and corresponding policy recommendations.

These measures should be in place for the 2019 MIP cycle (starting autumn 2018).

This Report was adopted by Chamber IV, headed by Mr Baudilio TOMÉ MUGURUZA, Member of the Court of Auditors, in Luxembourg at its meeting of 28 November 2017.

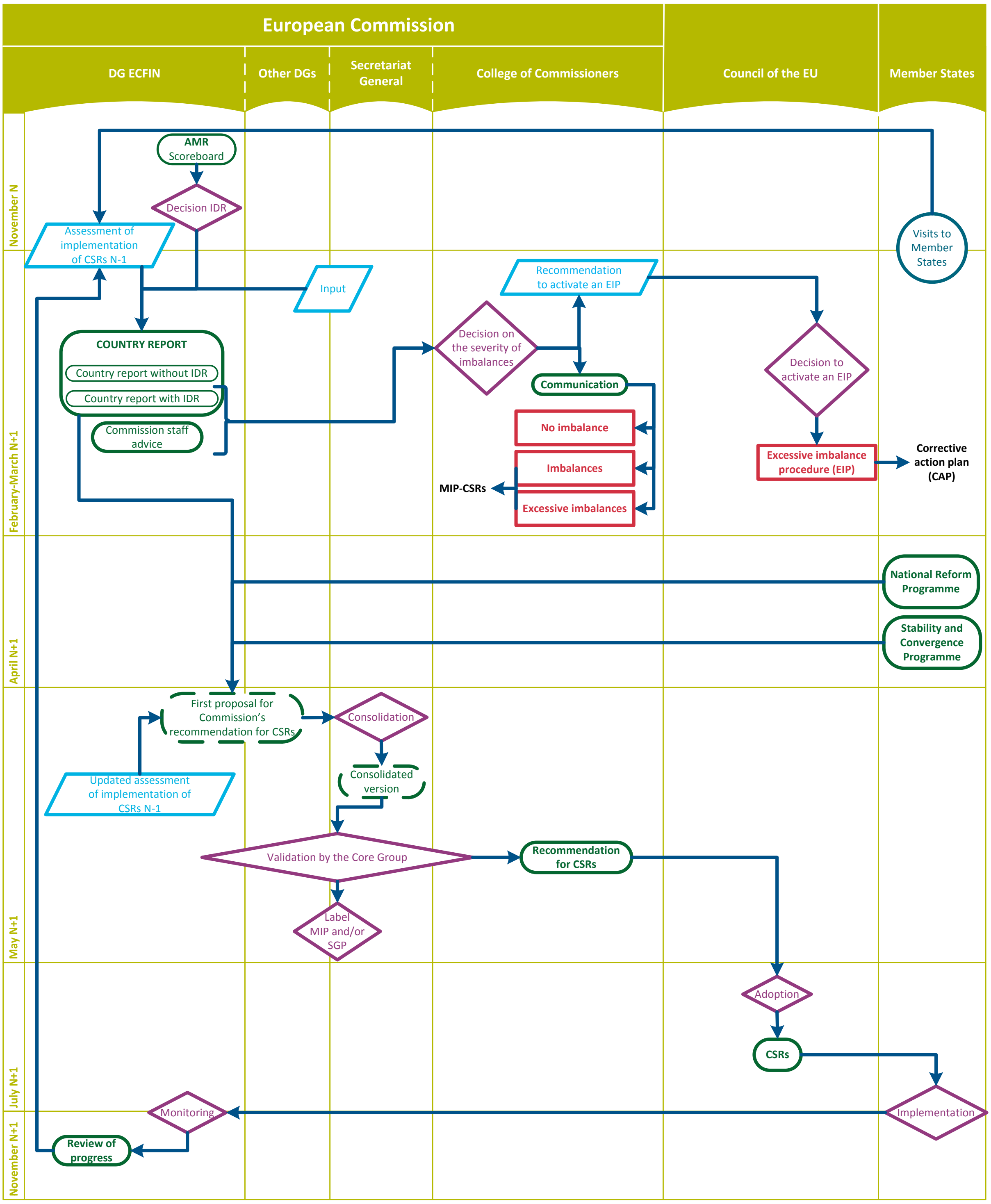
For the Court of Auditors

Klaus-Heiner LEHNE

President

ANNEX I

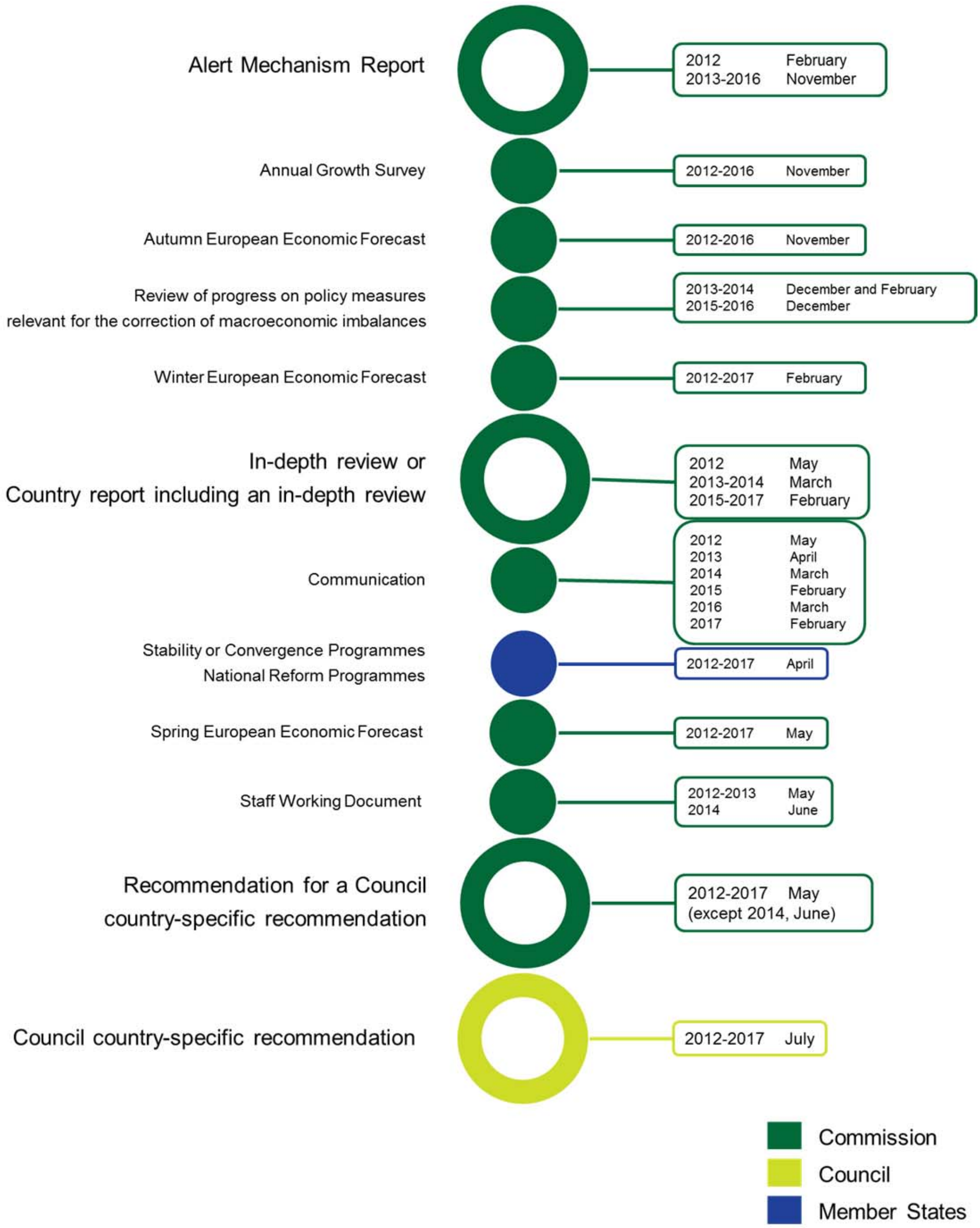
Detailed flowchart of the Macroeconomic Imbalance Procedure



Source: ECA.

ANNEX II

List of published documents that are relevant to the MIP



Source: ECA.

ANNEX III

Current set of headline indicators

Indicators	Indicative thresholds
Current account balance, % of GDP (3--year average)	-4/6%
Net international investment position (% of GDP)	-35%
Real effective exchange rate, 42 trading partners, HICP deflator (3--year % change)	±5% (euro area) ±11% (non-euro area)
Export market share, % of world exports (5-year % change)	-6%
Nominal unit labour cost index (2010 = 100) (3-year % change)	9% (euro area) 12% (non-euro area)
House price index (2010 = 100), deflated (1-year % change)	6%
Private sector credit flow, consolidated (% of GDP)	14%
Private sector debt, consolidated (% of GDP)	133%
General government gross debt (% of GDP)	60%
Unemployment rate (3-year average)	10%
Total financial sector liabilities, non-consolidated (1-year % change)	16.5%
Activity rate - % of total population aged 15-64 (3-year percentage point change)	-0.2pp
Long-term unemployment rate - % of active population aged 15-74 (3-year percentage point change)	0.5pp
Youth unemployment rate - % of active population aged 15-24 (3-year percentage point change)	2pp

Source: ECA.

ANNEX IV

Selection of Member States for the audit sample

The sample was based on the first four years of the MIP and a shortlist of Member States which excluded:

- Member States for which no IDR was issued in the first four years:
    - Member States under an economic adjustment programme, where were not considered for the MIP during the programme period: Ireland, Greece, Cyprus, Portugal, Romania;
    - Member States for which the AMR concluded, in at least one year, that they were not affected by, or at risk of being affected by, imbalances: Czech Republic, Denmark, Germany, Estonia, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Austria, Poland, Slovakia;
- Member States for which the assessment was stable: Belgium, Hungary, Finland, Sweden, United Kingdom;
- Croatia, which only recently joined the European Union.

This left Bulgaria, Spain, France, Italy and Slovenia.

As France and Italy were selected for the EDP audit and share a number of characteristics (larger, long-standing Member States in the euro area), we decided to exclude one of them. France was chosen because of greater variation in its assessment for imbalances.

The final list was a representative sample of large and small Member States, both in and outside the euro area.

Although small, the sample of four Member States accounted for approximately one quarter of the population and GDP of the EU.

ANNEX V

Qualitative ranking for assessing the implementation of CSRs

The Commission uses the following categories to assess the implementation of CSRs:

- *Full implementation:* The Member State has adopted and implemented measures that address the CSR appropriately.
- *Substantial progress:* The Member State has adopted measures, most of which have been implemented.
- *Some progress:* The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have yet been implemented and implementation is not certain in all cases.
- *Limited progress:* The Member State has announced some measures to address the CSR, but these appear insufficient and/or their adoption/implementation is at risk.
- *No progress:* The Member State has neither announced nor adopted any measures to address the CSR.

ANNEX VI

Survey of EPC members

Figure a - 3. Do you feel that the Scoreboard is effective in facilitating the early identification and monitoring of imbalances for the economy of your country?

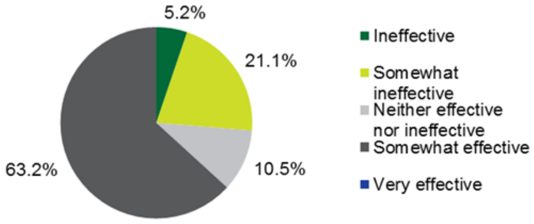


Figure b - 5. The AMR includes economic analysis per Member State in addition to the Scoreboard indicators. In your opinion, is this AMR analysis effective in identifying Member States that may be affected by macroeconomic imbalances?

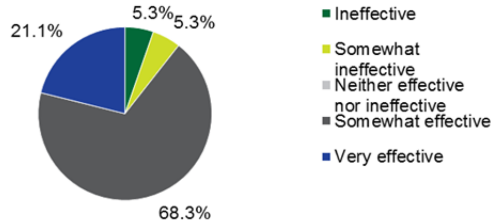


Figure c - 7. The 2016 Scoreboard included three new employment indicators. How much do you agree with the statement: 'The addition of three new employment indicators has improved the analytical capacity and communication power of the Scoreboard'

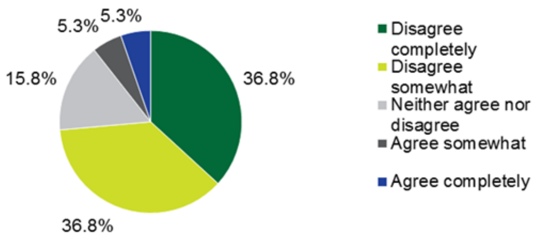


Figure d - 9. How do you assess the quality of the analysis in the IDR by the Commission for the economy of your Member State?

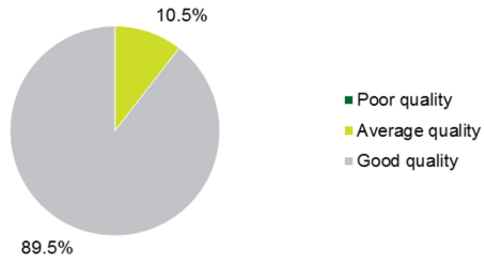


Figure e - 10. In the IDRs for your Member State, to what extent is relevant country-specific information taken into account?

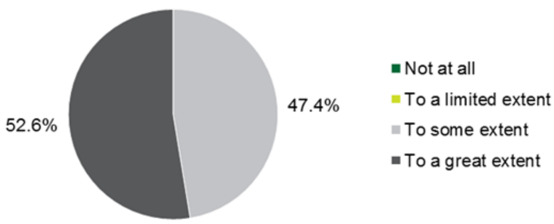


Figure f - 11. The Commission classifies each Member State in terms of the degree of imbalances they are facing. How accurate has this classification been in your view for your Member State?

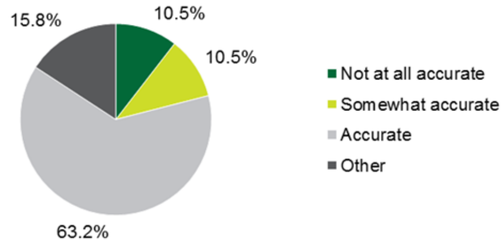


Figure g - 13. Is it clear which CSRs relate to the MIP?

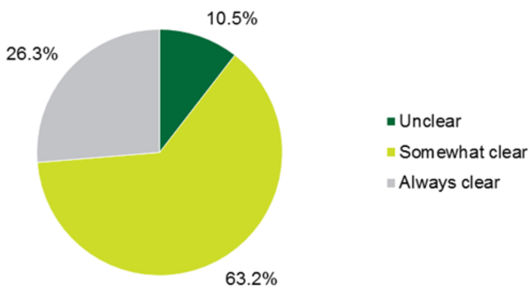


Figure h - 14. For your Member State, are the MIP-relevant CSRs consistent with the economic analysis and policy challenges identified in the IDR?

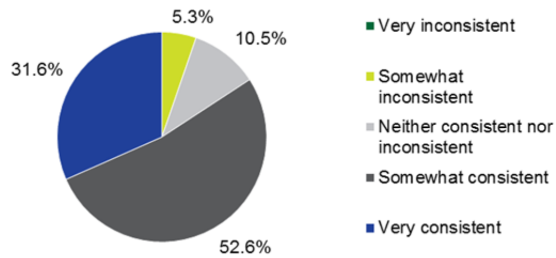


Figure i - 15. Do you think that MIP-relevant CSRs issued to your Member State are too specific or too general?

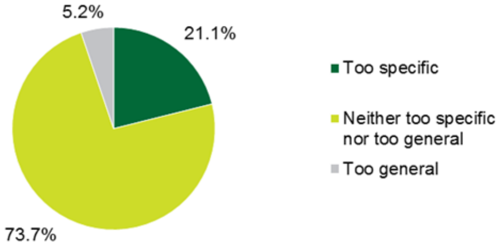


Figure j - 17. Are the CSRs for your Member state realistic? (ie, are they achievable?)

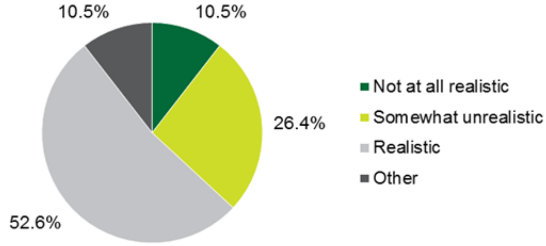


Figure k - 19. The number and detail of CSRs were reduced in 2015. Was this a positive development?

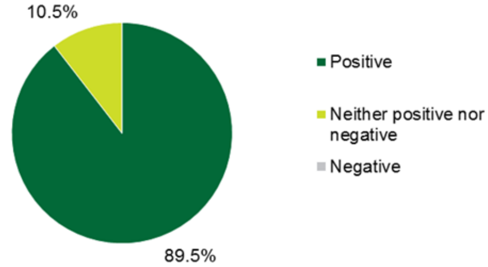


Figure l - 21. Changes are sometimes made to CSRs between a proposal by the Commission and adoption by the Council. Do you feel that Member States are treated equally in this process?

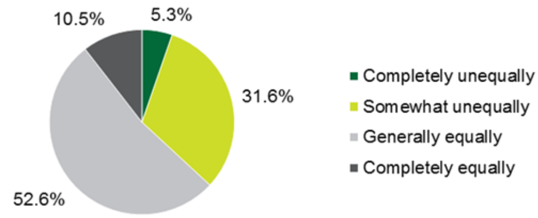


Figure m - 23. Is this process of changing CSRs transparent?

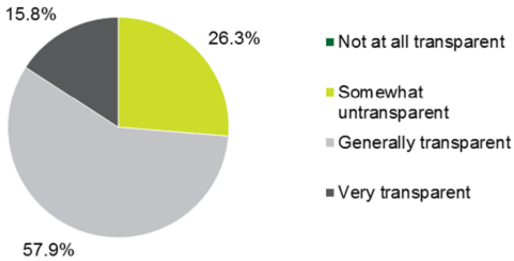


Figure n - 25. Do the Council's changes result in better-formulated CSRs?

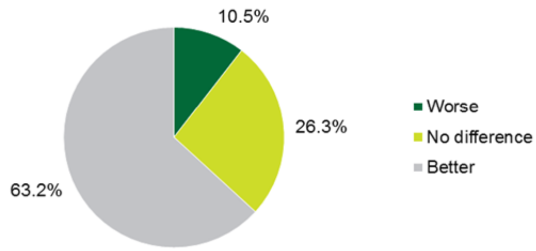


Figure o - 27. Is the Commission's assessment of CSR implementation accurate?

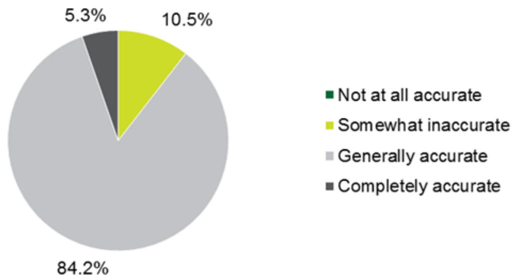


Figure p - 29. In your opinion, is the IDR/CR for your Member State easy to read? (having clear assessments and conclusions)

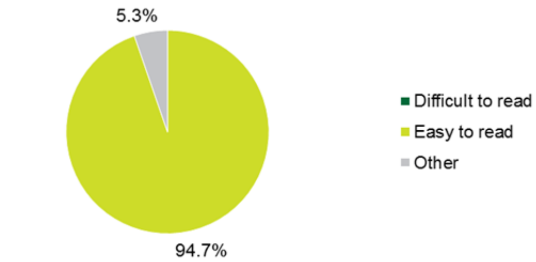


Figure q - 31. Does the IDR/CR for your Member State convey its messages in a concise way?

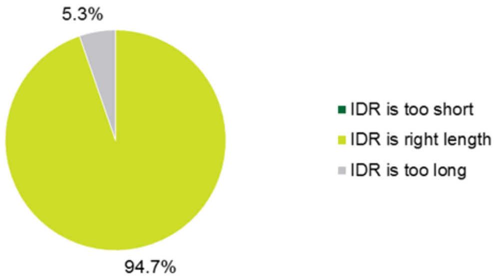


Figure r - 33. Is the IDR/CR for your Member State comprehensive?

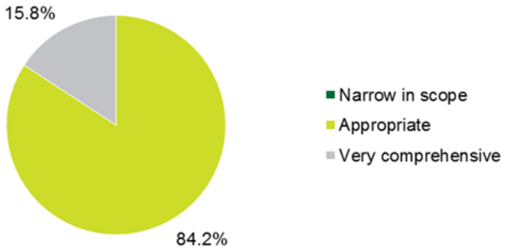


Figure s - 34. Do you find any part of the IDR/CR redundant or irrelevant?

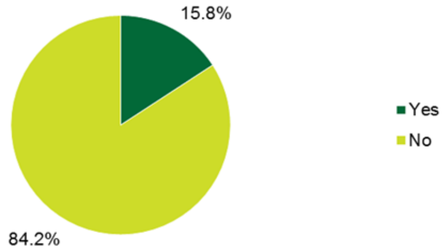


Figure t - 36. How would you evaluate the overall impact of the MIP on the policy debate in your Member State?

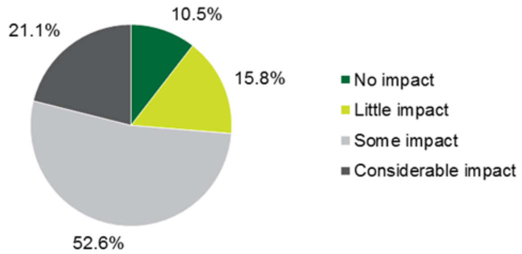


Figure u - 38. How would you rate the Commission's CR/IDR in terms of overall quality in comparison with similar reports published by other international institutions (IMF, OECD,…)?

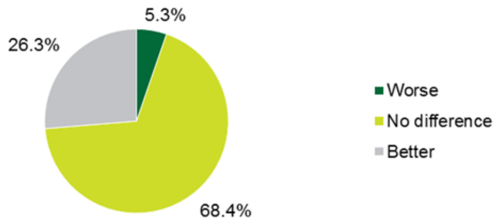


Figure v - 40. Is the European Commission's view more or less important for policy-making at domestic level in your country than before the MIP entered into force?

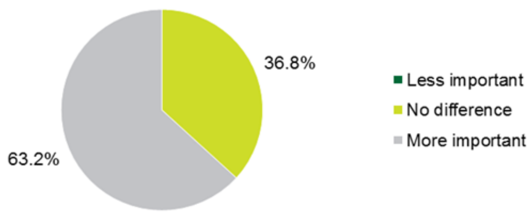


Figure x - 44. The MIP has been in force for nearly five years. What is your overall impression of its effectiveness?

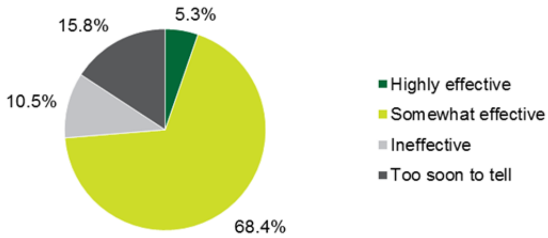
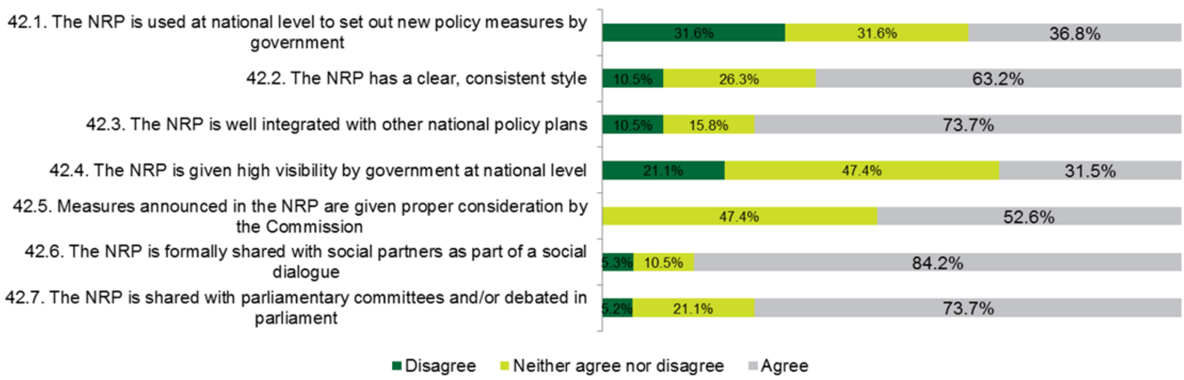


Figure w - 42. The national reform programme (NRP) is the opportunity for the member state to set out its MIP-relevant policy measures.
Please set out how much you agree with the following statements



Source: ECA.

ANNEX VII

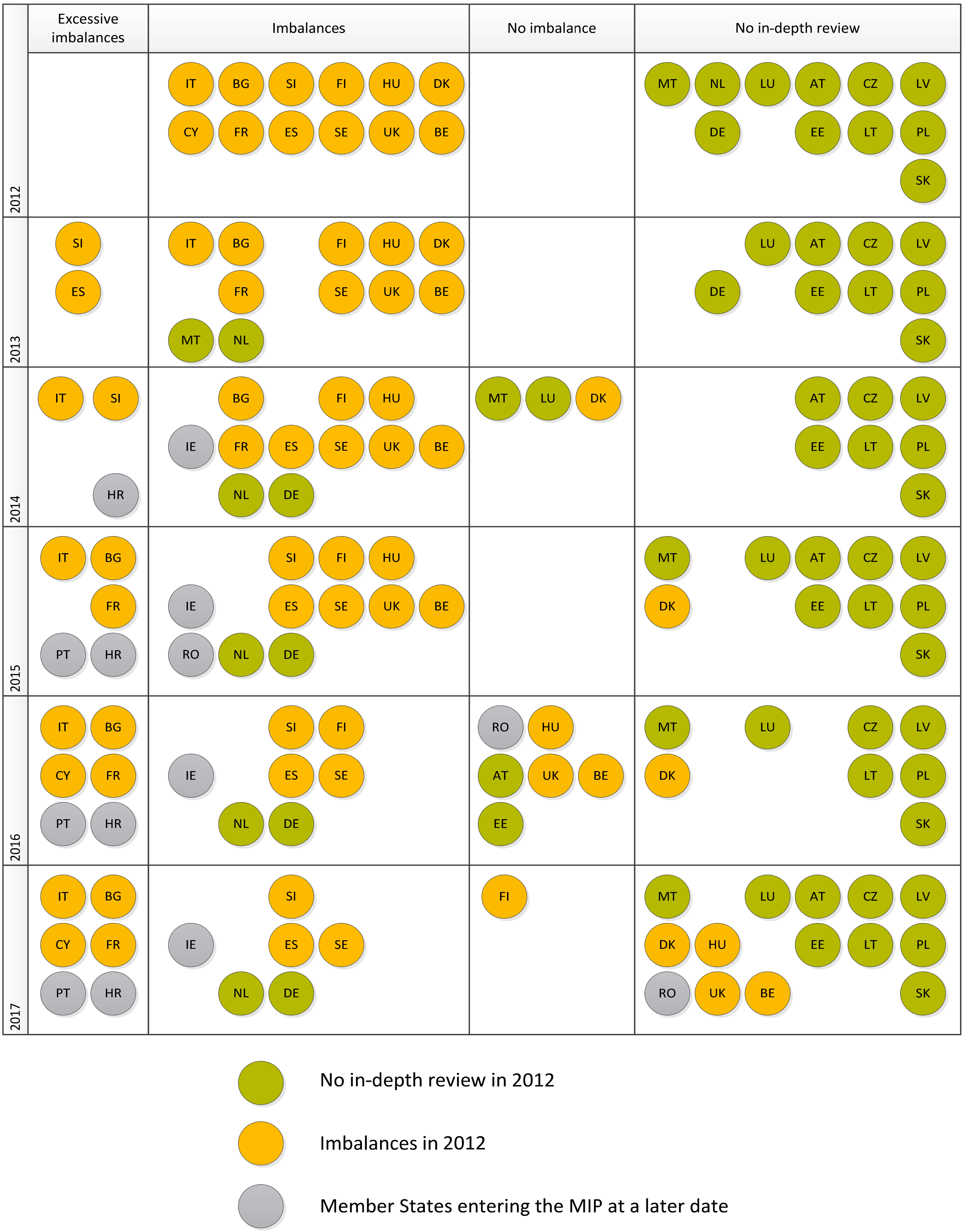
Visits to Member State authorities and other entities

	Supreme Audit Institution	Representation of the European Union	Ministry of Finance	Fiscal Council	Central Bank	Labour Ministry	Chamber of Commerce and Industry	Others
Bulgaria	✓	✓	✓	✓	✓	✓	✓	Ministry of Education and Science, IME, ABB
France	✓	✓	✓	✓	✓	✓		Secretariat General for European Affairs, MEDEF, CFDT, France Strategie, Conseil d'Analyse Economique, OFCE, Coe-Rexecode
Slovenia	✓	✓	✓		✓	✓	✓	IMAD, Slovenian Sovereign Holdings
Spain	✓	✓	✓	✓	✓			Economic Cabinet of Presidency, Ministry of Economy, CEOE, Cepyme, FEDEA, FROB

Source: ECA.

ANNEX VIII

Evolution of the classification of Member States, 2012-2017



Source: ECA.

ANNEX IX

Number and type of in-depth reviews

	2012-2017	%
IDRs concluding at the **existence** of imbalances	80	88.9
IDRs concluding at the **non-existence** of imbalances	10	11.1
Total	***90***	***100***

2013-2017			Year 2				
			IDR			No IDR	
			Imbalances	Excessive imbalances	No imbalance	No IDR	Economic adjustment programme
Year 1	IDR	Imbalances	39	5	7	0	1
		Excessive imbalances	2	14	0	0	0
		No imbalance	0	0	0	9	0
	No IDR	No IDR	3	0	3	39	0
		Economic adjustment programme	2	2	0	0	12
		New country in the EU	0	1	0	0	0
Total			***46***	***22***	***10***	***48***	***13***

Source: *ECA.*

REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE EUROPEAN COURT OF AUDITORS

"AUDIT OF THE MACROECONOMIC IMBALANCE PROCEDURE (MIP)"

EXECUTIVE SUMMARY

V. The Macroeconomic Imbalance Procedure (MIP) was introduced in the midst of the 2008-2009 economic and financial crisis, with a view to strengthen EU macroeconomic surveillance in areas not covered by the Stability and Growth Pact (SGP).

The events following the 2008-2009 financial crisis underscored the necessity of strengthening macroeconomic surveillance in aspects beyond fiscal policy. Macro-financial and macro-structural aspects driving the accumulation of both external (e.g. large current account imbalances) and internal imbalances (excess debt accumulation or the building up of housing bubbles) revealed themselves as key factors in triggering balance of payment crises and debt crises, and the need for financial assistance in some cases.

MIP surveillance endeavours both to avoid the accumulation of unsustainable trends or vulnerabilities and to ensure a proper adjustment of existing imbalances. The MIP was introduced in a period in which a number of Member States were already undergoing a process of unwinding of existing imbalances. Hence, the aim of the MIP in the first years of its implementation was especially that of monitoring the correction of imbalances and issuing recommendations aimed at adjusting policy frameworks in order to make adjustment effective and durable while containing social costs. MIP surveillance covered a broad set of policy areas and was enhanced by greater EU economic surveillance. Recommendations in the framework of the preventive arm of the SGP, the Europe 2020 strategy, the Broad Economic Policy Guidelines, the Employment Guidelines, and the MIP, were integrated into a single package of Council Country Specific Recommendations (CSRs), and aligned into a common European Semester.

Despite the mainly corrective objectives of MIP surveillance during its first years of implementation, the Excessive Imbalance Procedure (EIP) has never been launched. For countries for which excessive imbalances were identified, the Commission, rather than recommending the Council the immediate launch of the EIP, aimed first at raising policy commitments in line with the challenges identified. To that purpose, it issued more detailed and time-bound CSRs, and put in place an intensified process of specific monitoring of the policy response, while keeping open the possibility of initiating the EIP at a later stage.

As reported in the Communication on the 2014 review on the MIP, the experience with the first years of application suggests that the procedure helped raise awareness of challenges and created a basis for consensus towards policy responses. The application of the MIP was subject to incremental learning and feedback, and reinforced by a continuous dialogue between the Commission and the Council, with convergence towards more stable practices. The evidence also suggests that MIP surveillance was associated with stronger progress with the implementation of policy recommendations, despite the fact that policy action was in many cases not sufficient to ensure satisfactory progress in terms of tackling underlying challenges. The 2014 review underscored the necessity of enhancing the transparency and improving the Communication on the MIP implementation.

An effective implementation of the MIP is among the priorities of the Commission, as indicated in the June 2015 report "Completing Europe's Economic and Monetary Union" by Jean Claude

Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schultz, and in the October 2015 Commission Communication "On Steps towards completing Economic and Monetary Union".[1] An effective MIP will require first of all a transparent and stable framework, where the rationale underlying the decisions taken in the context of the MIP is clearly communicated. The follow-up to the identification of excessive imbalances should imply an adequate activation of surveillance, to ensure a sufficiently strong policy response in line with the challenges. With a view to better take into account the euro-area dimension in the activation of the MIP, euro-area considerations have been better integrated into the analysis and the recommendations of the Commission.

In early 2016, the Commission published an MIP Compendium.[2] The Compendium presents the MIP rationale, illustrates MIP legal and procedural aspects, discusses principles, criteria and analytical frameworks used in MIP implementation, and reviews MIP application in practice. By doing that, the MIP Compendium provides a collection of relevant information that helps understanding what the MIP is, how it works, how its application has evolved since its introduction. That publication aims at contributing to a transparent implementation of the MIP, in line with the 2014 Communication on the MIP review and the October 2015 Commission Communication "On Steps towards completing Economic and Monetary Union". Another step in the direction of increased transparency was the practice of summarising the in-depth reviews (IDRs) findings in devoted MIP assessment matrices in the IDRs since 2016.

VI. In general, the evidence indicates that countries under MIP surveillance received more CSRs and had a higher compliance rate compared with CSRs not linked to the MIP. The survey conducted by the European Court of Auditors among members of the Economic Policy Committee (EPC) reveals that only about 10% of the members interviewed consider the MIP ineffective. In any case, Member States are expected to implement all CSRs, MIP- and non-MIP-relevant.

The Commission is of the opinion that the design of MIP-relevant CSRs was consistent with the objective of addressing the identified imbalances, and this is a shared view by members surveyed in the European Court of Auditors' questionnaire, although there is room for improving communication.

CSRs on public finances in the context of the SGP have been indicated as MIP-relevant for countries where high public debt is an element that contributes to the identification of imbalances or where the reduction of fiscal deficits contribute to the correction of large current account deficits identified as part of the imbalances. In Member States with current account surpluses, IDRs have analysed the links between a number of fiscal measures and the external position. For those countries a number of CSRs measures of fiscal nature that potentially contribute addressing large surpluses have been indicated as MIP relevant.

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[1] COM(2015) 600 final of 21 October 2015 ‘Communication from the Commission to the European Parliament, the Council and the European Central Bank 'On steps towards Completing Economic and Monetary Union'’.

[2] ‘The Macroeconomic Imbalance Procedure. Rationale, Process, Application: A Compendium’ (European Commission, 2016).

The statement that there are inconsistencies between MIP-relevant CSRs and euro area recommendations stems from the fact that the need of consistency between euro-area recommendations and MIP CSRs apply only to countries that receive CSRs that are at the same time MIP-relevant and for which there is a pertinent euro area recommendation. Not all euro-area recommendations are pertinent to the MIP, as their scope is broader. Not all countries receive MIP-related recommendations, as some countries are not under MIP surveillance. Not all countries receive CSRs emanating from euro-area recommendations, as they have no relevant challenges or they have no need to carry out specific policies or there are constraints that justify not having CSRs.

VII. The integration of IDRs in country reports allowed overlaps to be reduced and has not prejudiced the clarity of the IDR assessment. That has supported a stronger interaction with the Member States and relevant stakeholders, enhancing understanding and ownership of challenges and adjustment efforts.

The IDRs report the evidence and the arguments underpinning the decisions on the categorisation of MIP imbalances. The IDR conclusions are not reported in the IDR themselves; but in a Commission Communication accompanying the IDRs. This is justified as IDR conclusions, according to the regulation, must take into account the general context, systemic aspects, interdependencies among countries, and therefore need to be based on the overall reading of the IDR package.

The Commission does not share the view that the decision making process has weakened the MIP. The Commission (in the sense of the College of Commissioners and the Commission's services) acts as a whole when taking decisions in the context of the MIP, and the Regulation sets the requirements for the Commission as a whole.

For decisions falling under the MIP, as with other decisions, Commissioners receive direct advice from the services that fall under their responsibility and indirectly from the other Commission services through the other Commissioners and respective private offices. The College can exercise its prerogative of not following the services' advice, as it is not legally bound to follow such advice, and is not required to provide justifications when it does not do so.

VIII. The Commission is not bound to recommending the launch of the Excessive Imbalance Procedure for Member States identified with excessive imbalances.

IX. The scoreboard should be based on variables of high quality data. Forecast and preliminary data are not used for that reason.

A number of variables whose behaviour is particular volatile in the Alert Mechanism Report (AMR) scoreboard are averaged over three years to avoid reflecting mostly temporary developments.

The AMR provides a starting point for assessing the evolution of variables that deserve closer monitoring in the MIP context, namely in the IDR. The AMR is not conceived as an early warning system, which is consistent with the fact that the AMR indicators are not made of the most updated preliminary data or forecasts.

(a) Please see the Commission replies to the conclusions and recommendations below.

<u>INTRODUCTION</u>

4. The MIP legal framework consists of Regulation (EU) 1176/2011 on the "prevention and correction of macroeconomic imbalances", and Regulation (EU) 1174/2011 on "enforcement

measures to correct excessive macroeconomic imbalances," which were adopted under provisions of the Treaty on the Functioning of the European Union ('the Treaty' or 'TFEU') dealing with economic policy coordination (Articles 121 and 136 TFEU). Regulation (EU) 1176/2011 outlines the procedure, while Regulation (EU) 1174/2011 details an enforcement mechanism based on pecuniary sanctions applying only to euro area Member States.

8. The MIP aims at strengthening the EU economic governance on the front of macro-financial stability broadening beyond budgetary surveillance to include a framework to prevent excessive macroeconomic imbalances and to help the Member States affected to take corrective action before divergences become entrenched.

The main rationale for a supra-national surveillance mandate builds on the fact that macroeconomic imbalances in one Member State have relevance also for other Member States. This is due not only to the fact that in highly integrated economic areas economic developments in one Member State spill-over to other countries, but also to the fact that, if left unaddressed, macroeconomic imbalances may compromise the proper functioning of the monetary union and the Union's institutions and its common policies, such as the Single Market. Thus, under the MIP, imbalances are evaluated not only from a national perspective, but also from the viewpoint of the implications for the euro area and the Union as required by the MIP Regulation.

10. In the case of the SGP the preventive arm aims at taking measures to prevent the breach of "Maastricht" fiscal thresholds, while the corrective arm aims at ensuring a prompt correction once a breach occurs and an excessive deficit is identified. The preventive arm therefore extends beyond the headline deficit and debt requirements. Sanctions for the enforcement of the SGP corrective arm are foreseen in the case of euro area Member States if there is a repeated breach of the requirements under the procedure.

In the case of the MIP, both the preventive and the corrective action aim at the prevention and correction of imbalances. The corrective action addresses imbalances of a higher severity and its enforcement may make use of sanctions in case of a repeated breach of the requirements under the procedure for euro-area Member States.

Both Regulation (EU) 1176/2011 and the preventive arm of the SGP share the same legal basis in the Treaty (Articles 121 and 136 TFEU). The Treaty basis for the corrective arm of the SGP is Article 126 TFEU.

The Europe 2020 strategy is not a surveillance procedure comparable with the MIP or SGP. It is a strategy made of EU actions, targets and the integrated use of surveillance procedures. Surveillance in addition to SGP and MIP is carried out in the framework of the Broad Economic Policy Guidelines (based on Article 121 TFEU, a legal basis shared with the MIP) and the Employment Guidelines (based on Article 148 TFEU).

OBSERVATIONS

29. The classification of imbalances is characterised by a certain degree of stability as it may take several years for imbalances to correct, notably but not only those that involve high debt levels.

33. The quoted Parliament document (Implementation of the Macroeconomic Imbalance Procedure – state-of-play (June 2017)' - PE 497.739) neither reports an overall negative assessment on the implementation of MIP-related CSRs since 2012 nor concludes that the latter has been persistently weak. The following wording is found in that document regarding implementation of MIP-related

CSRs. "The level of recommendations not implemented at all or very limitedly is increasing since 2014".

Figure 4 indicates that the share of "full implementation or substantial progress" and "some progress" was over 50% in 2013, 2015 and 2016.

It is not clear what benchmark or expectation supports this statement. A possible benchmark could be the compliance with non-MIP-related CSRs. Available evidence indicates that in general CSR implementation has been stronger for MIP-related CSRs (see, e.g., MIP Compendium).

Another possible benchmark could be the perception in Member States, how effective are CSRs in eliciting policy action. The questionnaire held by the European Court of Auditors and addressed to the members of the Economic Policy Committee (EPC) indicates that only about 10% of the respondents consider that MIP surveillance was ineffective.

MIP Member States also received in general a higher number of CSRs compared with other Member States.

34. See Commission reply to paragraph VI.

35. As regards the title above paragraph 35, the Commission points out that a link between MIP-CSRs and imbalances is ensured. See Commission’s replies to this paragraph, paragraph VI. and Box 1.

Each CSR contains a number of recommendations, including those with the purpose of addressing imbalances. Depending on the actual composition of the CSRs in terms of specific measures recommended, the recitals in the legal documents reporting the CSRs indicates which CSRs are MIP-relevant. By established practice, the CSRs indicated as MIP-relevant are those including any number of measures specifically addressed to the correction of imbalances identified for countries under MIP surveillance. The practice by the Commission and the Council since the entry into force of the MIP has been to highlight which CSRs are fully or partly relevant for the MIP in the recitals introducing the CSRs.

In some cases, imbalances can be addressed by means of a wide range of policies. For instance, improving competitiveness may require policies to improve labour productivity, to increase the efficiency of energy generation and reduce energy costs, to prevent excessive labour cost growth, etc. Hence, it may happen that CSRs relating to, for instance, training, energy, or wage formation are all indicated as MIP-relevant, despite having a relevant role in itself beyond that of addressing MIP-related challenges because of a direct or indirect link to the underlying MIP challenge that may not always appear straightforward.

Overall, already in 2016, only about 10% of the surveyed members of the EPC found unclear which CSRs related to the MIP, with the other 90% finding it always or somewhat clear.

37. The examples in Box 1 do not adequately support this observation for the reasons stated below.

Box 1

First bullet point: On the CSRs to France: Elements like apprenticeship and training can be considered as playing a role in the formation of workforce skill, which contributes to competitiveness, an MIP-related challenge for France.

Second bullet point: On the CSRs to Slovenia: The pressure that the ageing population puts pressure on the sustainability of the pension and long-term care systems of Slovenia are mentioned in the executive summary of the country report.

Third bullet point: On the CSRs to Bulgaria: Turmoil in the Bulgarian banking sector in the summer of 2014 and the consequent support by the public budget were behind the sharp deterioration of the fiscal situation in 2014. In 2015, there was a clear risk of further measures being needed to support the sector. The link between fiscal and financial sector situation, as well as the major financing challenge for the government was explained in Chapter 1 of the 2015 country report (pages 8-9), where a cross-reference to the IDR section (Chapter 2, paragraphs 2.1 and 2.2) can also be found.

The currency board regime in Bulgaria effectively makes the government its only lender of last resort. Thus, all costs for liquidity and capital provisions to the banking sector, including the deposit guarantee scheme, had to be borne by the government. This makes the fiscal CSR also highly relevant for macro-financial stability and the MIP.

The Bulgarian authorities also recognised the risks for macro-financial stability. In 2016, the government borrowed additional funds and included provisions for extraordinary borrowing in the budget in case the financial sector needed to be supported. This clearly shows their recognition of the risks involved and agreement of the relevance to macro-financial stability.

For all those reasons, CSR 1 in 2015 and 2016 were considered as MIP-relevant.

Fourth bullet point: On the CSRs to Spain: The recital (17) for the mentioned 2016 CSR states that "The highly decentralised setting [of the Spanish administration] calls for an enhanced coordination between the various public administrations, both to reduce costs and to limit the administrative burden on companies and households." The country report further explains that a more efficient public administration can contribute to sound public finances, thus addressing the imbalance of high debt, and to the reduction of the administrative burden on companies, thereby improving competitiveness and (total factor) productivity (p. 78).

As for the 2015 CSR: The savings bank sector reform is covered in the spring 2015 Post-Programme Surveillance (PPS) Report (pp. 17-20);

For Spain, the MIP monitoring has been carried out also in coordination with the Post-Programme Surveillance, especially in what refers to the financial sector. This is another reason why the CSRs are not restricted to issues covered in the IDRs; e.g. issues also covered in the PPS report (see Occasional Paper 193, May 2014, Chapter 4 for financial sector reform).

38. If part of the CSR is relevant for the MIP, the whole CSR is labelled as MIP-relevant. This is a prudential criterion adopted because of its objectivity. However, the monitoring and assessment of compliance applies only to the MIP-relevant part and this has been applied on a consistent way.

39. The reduction of the number of CSRs reflects also the evolution of the imbalances and what that implies for the need of policy action.

The number of MIP-CSRs has been reduced to a smaller extent as compared to non-MIP-CSRs. Please see figures for 2015 and 2016 in the last rows of Table 1.

41. See also Commission reply to paragraph 35.

42. Although the ‘Policy challenges’ section was not included, since 2016 the inclusion of the MIP assessment matrix in the country report has created a link between the state of play with the correction of imbalances, policy progress and policy gaps.

43. An important step has been taken since the October 2015 Communication with the inclusion of the MIP assessment matrix in country reports since 2016.

44. The Commission does not systematically quantify the impact of CSRs for a number of reasons, notably:

- The effects of measures depend also on the specific way Member States chose to implement and comply with the CSRs as they leave discretion to Member States on how to proceed in order to comply with them.

- The link between policy instruments and imbalances can be affected by various factors, so that outcomes may not always be easily under the control of policy makers.

- Exhaustive ex-ante impact assessments are subject to large uncertainty and depend on assumptions, including on behavioural changes by other players and stakeholders. For the same reason recommendations by other comparable international institutions are not systematically underpinned by quantifications.

- Some CSRs are not suitable for quantification because they cannot be modelled as parametric change in available models (think of reforms enhancing governance). Thus, a full assessment of the package of CSRs would risk being incomplete or unbalanced as not all CSRs could be covered but only the subset that are suitable for quantification.

Nevertheless, some quantifications of possible measures have been presented for specific cases and the Commission aims at carrying out such exercises whenever feasible.

46. It is important to take into account that there is no contradiction between budgetary recommendations and other recommendations with fiscal impact because the budgetary recommendations are not formulated in such a way to preclude a re-composition of spending or revenues consistent with the other CSRs.

48. There are euro area recommendations that concern areas that are outside the MIP scope. Not all Member States receive MIP-relevant CSRs. Not all Member States are directly concerned by a specific euro-area recommendation, as the challenges identified there are not shared in an equal way by all euro area Member States. The need for consistency between euro area recommendations and MIP-CSRs apply only to Member States that are concerned by a euro area recommendation pertinent to MIP issues and at the same time receive an MIP-related CSR in the same area.

49. The MIP cannot be used to provide fiscal recommendations erga omnes. As per the MIP Regulation, MIP-related recommendations can only be issued to Member States identified with imbalances. MIP-related recommendations may include fiscal measures if pertinent with the aim of addressing the imbalances identified in the Member State concerned.

50. These observations are not MIP-relevant.

51. The appropriateness of the timeframe can only be assessed against the exact requirements of the CSRs. Due consideration has to be given also to the possible urgency of action to comply with MIP-CSRs.

The wording and focus of the CSRs may change from one year to the other to take account of latest developments on issues that continue to be relevant for macroeconomic stability. It is also the case that sometimes measures were taken but not sufficiently to address the imbalance at stake.

54. As regards the title above paragraph 54, the Commission points out that the system of categories has remained stable over the last number of years. Please see Commission reply to paragraph 55.

55. The system of six categories has remained stable between 2013 and 2015; the change in wording between 2013 and 2014 concerned only the fact that the practice of specific monitoring, introduced in 2013 shortly after IDR conclusions and immediately applied, was mentioned in the categorisation of imbalances starting from 2014.

56. The identification of excessive imbalances does not coincide with the launch of the Excessive Imbalance Procedure.

Box 3

Article 1(1) of Regulation (EU) 1176/2011 sets out "detailed rules for the detection of macroeconomic imbalances, as well as the prevention and correction of excessive macroeconomic imbalances within the Union". As recital 9 of the Regulation makes clear, the specific rules established for that purpose are laid down in order to "supplement the multilateral surveillance procedure referred to in paragraphs 3 and 4 of Article 121 TFEU".

Against that background of the purpose of the Regulation it is not for the Parliament and the Council, as the co-legislators adopting secondary legislation in the form of the Regulation, to remove from the Commission discretion held by it under primary law in the form of Article 121(4) TFEU.

Article 7(2) of Regulation (EU) 1176/2011 does not create a new power or procedure. It defines the conditions under which an existing Treaty-based power (Article 121(4) TFEU or the multilateral surveillance procedure) is to be exercised in the particular frame of the MIP. The Commission is not therefore bound to initiate the procedure once certain circumstances arise since under Article 121(4) TFEU the monopoly of initiative of the Commission, that the Treaties otherwise guarantee, remains intact. The Commission keeps its discretion to initiate or not to initiate the procedure. An act of secondary legislation could not deprive the Commission of that power of discretion as designed by the Treaties. Recital 22 of Regulation (EU) 1176/2011 – that states that "if severe macroeconomic imbalances are identified (…) an excessive imbalances procedure should be initiated (…)" – must be read against that background. It does not impose an obligation on the Commission to present a recommendation, but expresses the political desideratum of the co-legislator to make things in a particular way.

58. IDR conclusions are contained in a Communication for the following reasons:

First, consistency on the classification across the various Member States has to be ensured and that implies that an IDR cannot be read in isolation.

Second, the MIP categorisation needs to take into account of systemic aspects, including spill-overs and the overall context (see Article 5(2) of Regulation 1176/2011 and MIP Compendium, page 48). Such an assessment is based on the reading of the whole package of IDRs and on relevant information.

Third, Article 5(2) Regulation 1176/2011 is to include but is not limited to the elements specifically set out in the first sentence of that provision. The Commission is required to take account of a series of other factors that are also set out in Article 5(2) (economic developments in the Union and the euro area; origin of imbalances; prevailing economic circumstances; Council recommendations or invitations under the SGP and European Semester; policy intentions of the Member State under review). Moreover, the co-legislators' choice to use in the first sentence of Article 5(2) the word "include" (as opposed to, for example "consist of") shows that the Commission is permitted to take other elements into consideration. There is no requirement that the assessment of imbalances at a certain point in time only takes into account information included in the latest produced IDR, as relevant information could be contained in other public documents (e.g. previous IDR issues, AMR, forecasts).

(a) In the case of Bulgaria, there was a preventive aspect to those categorisations, having in mind Article 2(1) of Regulation 1176/2011: "(…) developments which are adversely affecting, or *have the potential adversely to affect*, the proper functioning of the economy of a Member State (…)" (our italics). If (some) action is taken to address the Commission's recommendations, it is a natural and good outcome that the risk it pointed to did not materialise, which is exactly how preventive processes work.

Failure to restore confidence in the banking system and curb deposit withdrawals in June 2014 would have exacerbated the liquidity crisis and risked turning it into a solvency crisis. The supervisory body's failure to detect significant problems in the country's fourth largest bank pointed to shortcomings in financial sector supervisory practices and in oversight of concentration risk. While the immediate risks had subsided in 2015, the underlying causes had not yet been addressed at the time of publication of the IDR. The 'excessive imbalances' categorisation was deemed necessary to spur decisive action by the authorities to tackle the underlying causes of the problems and minimise the possibility of such situations re-emerging in the future.

Deterioration in overall macro-financial stability is also evidenced by sharply increased budget deficit as the result of the government's support for the financial sector and even a sharper increase in government debt to ensure funding for possible further financial sector measures. Consequent credit-rating downgrades, typically associated with higher funding costs, were another confirmation of significant vulnerabilities and risks.

The same conclusion was reached by the IMF (Art IV staff report): The failure of Corporate Commercial Bank (KTB) last summer exposed shortcomings in Bulgaria's supervision and crisis management frameworks, while also highlighting the link between financial and fiscal risks under the currency board. Decisive action is needed to improve financial sector supervision and secure confidence in the banking system.

(b) The categorisation of France in the MIP was escalated in 2015 given the insufficient policy response. As pinpointed in the IDR, that compounded the risks stemming from the deterioration in both cost and non-cost competitiveness, coupled with poor corporate profitability, and from the high and rising French indebtedness in a context of low economic growth and low inflation.

The systemic risk for the euro area was another factor leading to the re-categorisation to excessive imbalances given the French economy's strong trade and financial linkages with other Member States.

In all, this decision was not merely based on public finances considerations. Instead, it involved a broader assessment of the country's economic performance and prospects, the policy action taken, and the risks for other euro area economies.

(c) The risks had not clearly risen from March to November 2016, which made it unnecessary to review the March 2016 IDR assessment that the UK was not being affected by imbalances.

60. The timing of the publication of the chapeau Communication has no relation with the consistency of the categorisation of imbalances with the content of IDRs.

61. As regards the title above paragraph 61, the Commission points out that the decision making process of the Commission is based on a large amount of analytical and technical work performed by the Commission services. The College of Commissioners and the services act as a whole. The analytical and technical work is an integral part of the final decisions. This is corroborated by the fact that more than 70% of the Member States consider that the MIP classification is either “accurate” or “somewhat accurate” (see figure f of the ECA survey in Annex VI).

Moreover, 94.7% of Member States consider that the overall quality of CR/IDR is at least on par with technical reports published by other international institutions (IMF, OECD,…), while 26.3% considers it is even better (see figure u of the ECA survey in Annex VI). The Regulation sets the requirements for the Commission as a whole and the Commission is the auditee of this audit.

The College of Commissioners and the services act as a whole. Commissioners receive direct advice from the services that fall under their responsibility and indirectly from the other Commission services through the other Commissioners and respective private offices. The College keeps the prerogative of not following the services' advice, is not legally bound to follow it, and is not required to provide justifications.

In addition, the College may take other elements into consideration, in addition to the services' advice on the specific issue, which in some cases may become available only after the analyses are carried out.

In general, the fact that judgement is exercised also by the Members of the European Commission and not only by the concerned services is not necessarily an indication that the procedures are politicised but that the Commissioners and their private offices contribute to the assessment of the substance, complementing the assessment provided by the services in some instances.

64. The Commission has a different assessment. In its October 2015 Communication "On steps towards Completing Economic and Monetary Union", the Commission stated that "the Commission will ensure appropriate follow-up to the identification of excessive imbalances. This requires economic judgement and active engagement with Member States to tackle their specific challenges and ensure domestic ownership of reforms. The Commission will stabilise the categories, clarify the criteria guiding its decision, and better explain the link between the nature of imbalances and how they are addressed in the country-specific recommendations. (…) The Excessive Imbalance Procedure can be opened in case of insufficient commitment to reforms and lack of effective progress in implementation, and will be used in case of severe macroeconomic imbalances that jeopardise the proper functioning of the economic and monetary union, like those that led to the

crises. The Commission will also invite greater Council involvement in the specific monitoring of countries with excessive imbalances for which the Excessive Imbalances Procedure is not activated."[3]

Since the publication of the October 2015 Communication, the Commission has fulfilled the commitments made there. The implementation of the MIP has become more transparent, with positive acknowledgements by Member States.

The severity of imbalances has reduced in most Member States, which justifies the non-activation of the Excessive Imbalance Procedure since the October 2015 Communication.

66. The Commission decision-making process in the context of the MIP fully respects the internal rules of the Commission.

(a) This observation does not seem pertinent as it is not MIP-specific and there is no relation between the procedural matters observed by the ECA and the merit of the final decisions. Moreover, the classifications involve deliberation between various Commissioners and their offices over the phone and via meetings and other means of verbal communication. The urgency, the political and potential market sensitivity do not justify a hard trail of detailed minutes of each and every discussion between various parties for each and every Member State for which an IDR has been conducted.

See also Commission reply to paragraphs 61-62.

(b) The rules of procedure providing that documents should be circulated a certain number of days before the meeting of the College should ensure that the Members of the Commission can properly prepare and engage in the decision-making. These rules are established in the sole interest of the Members of the College. This means that the Members can renounce on the respect of the deadline if they consider that they can prepare within a shorter period of time. This is not unusual and certainly not in breach of the Commission's internal rules. The late submission of any document did not in any way impact the merit or validity of the decision.

(c) Codified ex-ante criteria on the opening of the Excessive Imbalance Procedure would not be recommendable as judgement is needed to take into account that macroeconomic imbalances are multi-faceted and complex phenomena taking evolving forms and concerning a wide range of areas and policy instruments. That is why room for judgement, in addition to rules, is included in surveillance mechanisms and why Regulation 1176/2011 does not codify the definition of imbalance or excessive imbalance.

68. The merging of IDR and non-IDR analyses helped reducing overlaps that could occur between IDR and Staff Working Documents.

[3] COM(2015) 600 final of 21 October 2015 ‘Communication from the Commission to the European Parliament, the Council and the European Central Bank 'On steps towards Completing Economic and Monetary Union''.

The experience suggests that IDR has remained identifiable in the current format (also thanks to the MIP matrix and IDR summary chapter), and overlaps between the IDR and the non-IDR Country Report parts eliminated.

The Council (ECOFIN) conclusions on the IDRs and implementation of the 2016 CSRs welcomed the integrated analysis and stressed the need to keep IDR analysis well identifiable and transparent within the country reports.

74. A section in the country report provides the overall assessment with the state of play with the analysis of prevention and correction of imbalances. The in-depth analysis is carried out in thematic sections, and all elements of analysis pertinent to the IDR are indicated.

The survey conducted by the ECA among members of the EPC reveals that none of the Members interviewed consider the IDR/CR to be narrow in scope (Figure r in Annex VI) nor the IDR too short (Figure q in Annex VI).

The optimal amount of analysis and length it has taken in the IDR/CR has to be seen against accumulated analysis, for instance published in previous IDRs/CRs and remaining gaps.

75. See Commission reply to paragraph 68.

80. The IDRs are bound to be centred on imbalances, which is not the case of other country-specific reports. That includes detecting them and also informing on the correction of imbalances detected earlier on.

82. State-of-the-art modelling approaches have been followed for the analyses of spill-overs.

IDRs have systematically analysed outward spill-overs from large euro area Member States since 2015, as spill-overs are likely to be of a larger magnitude if emanating from large economies. Additional analysis of inward spill-overs and outward spill-overs is included where relevant, on the basis of actual or expected developments entailing possibly important cross-border effects.

It is important to acknowledge that certain type of spill-overs (e.g. contagion effects via financial market confidence) can be modelled only on the basis of assumptions and conjectures and have limitations.

The economic analysis presented in the IDRs is also based on the latest macroeconomic forecasts, which, by design, take general market conditions into account, including possible sovereign conditions reflecting contagion from outside.

84. See Commission reply to paragraph 82.

85. See Commission reply to paragraph 82.

86. Fiscal policy is monitored in the framework of the SGP. The evolution of government debt is monitored also in the framework of the MIP, in IDRs, including from a forward-looking perspective. That includes countries where high public debt is an element that contributes to the identification of imbalances or where the reduction of fiscal deficits contribute to the correction of large current account deficits identified as part of the imbalances.

In a number of Member States with large public debt, implications arising from increased spreads on government debt have been analysed.

In Member States with current account surpluses, IDRs have analysed the links between a number of fiscal measures and the external position. For them a number of CSRs of fiscal nature that potentially contribute addressing large surpluses have been indicated as MIP-relevant.

Box 4

Fourth paragraph: The cyclically-adjusted current account, i.e. the current account adjusted for output gaps at home and abroad and thereby reflecting the fall in domestic demand in Spain. The cyclically-adjusted current account as computed by the Commission reached -1.2% of GDP in 2014 (figure from 2015) from -9.2% of GDP in 2008, which suggests that much of the improvement is independent of cyclical positions (IDR/CR 2015).

Fifth paragraph: In the case of France, unlike the case of Germany, the key source of risks of imbalances is not reflected in the external position. Nevertheless, fiscal consolidation is part of the MIP analyses and France is clearly recommended to tighten its fiscal policy also as a means of rebalancing its external sector.

87. Box 5 does not adequately support this observation; see replies to Box 5.

Box 5

First arrow: The Commission 2013 MIP status decisions were presented and explained in the relevant Communication of April 2013: the risks arising from minimum wage policies are briefly mentioned, but this is not among the main reasons (pp. 9-10).

First bullet point: The elasticity of labour demand is a parameter that is stable over time and does not need to be estimated every year. The differences in results reflect also differences in assumptions, namely lack of impact on wages above in the minimum wage in the case of the quoted reference.

Second bullet point: The minimum wage is analysed in the Slovenian IDR under the title “Competitiveness and export performance” which clarifies the focus of the analysis. The IDR states "the minimum wage was pushed well above the basic wages negotiated in some sectoral collective agreements, even for tasks requiring medium education".

Third bullet point: Analytical assessments in the IDRs are country specific. The conditions in Slovenia in 2013 and in Bulgaria in 2016 are not closely comparable.

Second arrow: Other international institutions such as the IMF share the Commission analysis regarding the relatively weaker position of State-owned banks, see e.g. Art. IV conclusions of 17 January 2014.

Third arrow: The analysis points to a difference in return on assets between the two groups of banks. The Commission then inferred a number of reasons that could have led to that outcome. This is complemented later in the report with an analysis of asset quality statistics, showing that domestically-owned banks report better asset quality.

90. There are no clear arguments to state that there was no improvement in the quality of the analysis in the AMR. As a matter of fact, over time the AMR has been enriched by additional analysis and information.

Nearly 90% of the EPC members found the AMR analysis effective in identifying Member States that may be affected by macroeconomic imbalances (answers to question b of the survey to EPC members as included in Annex VI of this report) – which is the purpose of the AMR.

91. The selection of the first set of Member States to be analysed in an IDR was fully operated by means of AMR analysis.

The prudential practice of issuing an IDR for Member States already identified with imbalances to assess the evolution of the imbalances and their possible correction implied that a majority of IDRs were the result of imbalances already identified.

Nonetheless, the AMR still played a role in selecting countries for an IDR despite no imbalances were identified already.

As the number of Member States identified with imbalances falls, the decision to open IDRs increasingly depends on AMR analysis.

The prudential practice of issuing and IDRs for all countries for which imbalances are already identified is undisputed, as it avoids the risk of missing IDRs when needed. That practice, coupled with the often slow evolution of relevant economic variables underpinning imbalances inevitably leads to a certain degree of stability of the set of countries selected for IDRs; it also creates an element of consistency over time.

92. The MIP scoreboard is not mainly aimed at providing an early warning system. It serves as a filtering device for detecting prima-facie cases of possible imbalances deserving further investigation and provides the possibility of tracking the evolution of indicators suggestive of the building up of risks. It aims at a broad coverage of risks to macroeconomic stability rather being focused on predicting crises of a very specific type.

The scoreboard is maintained, updated and modified by the Commission services in consultation with the Council and the Parliament. Technical work on the scoreboard is carried out by Council Committees, notably the Economic Policy Committee of the ECOFIN Council and its LIME Working Group.

(a) The AMR scoreboard does not use preliminary data or forecasts. Stable statistics are only available with a delay.

(b) Averaging permits reducing the risk that the reading of some indicators would depend on temporary fluctuations.

93. There is a tension between including all potential relevant variables in the scoreboard and keeping the scoreboard parsimonious as required by Regulation 1176/2011.

Inflation would be highly correlated with variables present in the scoreboard, namely the growth rate in unit labour costs and real house price changes, thereby not adding major additional information.

Non-performing loans data on a comparable basis were not available until recently (the first public data were released by the ECB in 2015).

94. The inclusion of those indicators allows for a better understanding of the social consequences of imbalances, including during their correction, thus helping fine-tune MIP recommendations.

The inclusion of these variables into the scoreboard did not change the focus of the MIP, which remains aimed at preventing the emergence of harmful macroeconomic imbalance and ensuring their correction.

95. The number of "flashing" indicators is not the main element that drives AMR analysis. As per the MIP Regulation, the reading of the scoreboard is not mechanical and additional relevant information is taken into account.

See also Commission reply to paragraph 92.

CONCLUSIONS AND RECOMMENDATIONS

97. The forthcoming review of the MIP application by the Commission pursuant to Regulation 1176/2011 (Article 16) will be carried out in 2019. Its results will be public and discussed with Member States and other stakeholders. This would also constitute the ideal moment for a revision of the framework, which would better take place in a comprehensive, organic and consistent way with the follow up exercise to the 2019 review. The European Court of Auditors' recommendations will be duly taken into consideration. The Commission is of the opinion that the implementation of the recommendations should take into account the 2019 MIP review, but will seek to start implementation of some of the measures already in the cycle 2018/19, in particular concerning recommendations 3.ii, 4, 5 and 6.

98. See the Commission reply to paragraph 33.

99. Each CSR contains a number of recommendations, including those with the purpose of addressing imbalances. Depending on the actual composition of the CSRs in terms of specific measure recommended, the recitals in the legal documents reporting the CSRs indicates which CSRs are MIP-relevant. As explained in the reply to paragraph 38, by established practice, the CSRs indicated as MIP-relevant are those including any measure specifically addressed to the correction of imbalances identified for countries under MIP surveillance.

CSRs indicated as MIP-relevant contain in all cases measures that help addressing imbalances. As explained in the reply to paragraph 35, the range of such measures is sometimes wide, and those measures may have simultaneously an impact that goes beyond the prevention and correction of imbalances. In light of those considerations the link between measures and imbalances is less straightforward in some cases.

100. The appropriateness of the timeframe can only be assessed against the exact requirements of the CSRs. Due consideration has to be given also to the urgency of action to comply with MIP-CSRs to avoid that imbalances evolve into severe crises if left unaddressed.

101. The Commission does not systematically quantify the impact of CSRs for a number of reasons, notably: their effects depend also on the specific way Member States chose to implement and comply with the CSRs; the link between policy instruments and imbalances can be impacted by various factors; some CSRs are not suitable for quantification which implies that an assessment based only on the subset of measures that are more easily quantifiable would provide an unbalanced picture; exhaustive ex-ante impact assessments are subject to large uncertainty and depend on assumptions.

Recommendation 1

(i) The Commission accepts the recommendation.

CSRs are already formulated in such a way to address the identified imbalances. There could be room for making the link clearer in Commission documents.

CSRs leave a degree of discretion to Member States on how to proceed in order to comply with them, so as to ensure ownership of the measures and reforms by the Member States. It is not obvious that a more detailed recommendation has a stronger impact on imbalances.

(ii) The Commission accepts the recommendation.

(iii) The Commission accepts the recommendation.

As stated in the Commission reply to paragraph 44, the Commission does not systematically quantify the impact of CSRs for a number of reasons, notably:

- The effects of measures depend also on the specific way Member States chose to implement and comply with the CSRs as they leave discretion to Member States on how to proceed in order to comply with them.

- The link between policy instruments and imbalances can be affected by various factors, so that outcomes may not always be easily under the control of policy makers.

- Exhaustive ex-ante impact assessments are subject to large uncertainty and depend on assumptions, including on behavioural changes by other players and stakeholders. For the same reason recommendations by other comparable international institutions are not systematically underpinned by quantifications.

- Some CSRs are not suitable for quantification because they cannot be modelled as parametric change in available models (think of reforms enhancing governance). Thus, a full assessment of the package of CSRs would risk being incomplete or unbalanced as not all CSRs could be covered but only the subset that are suitable for quantification.

Nevertheless, some quantifications of possible measures have been presented for specific cases and the Commission aims at carrying out such exercises whenever feasible.

(iv) The Commission accepts the recommendation, with the understanding that the standard European Semester deadlines for the implementation of CSRs apply, with possible, adequately justified exceptions, for cases where at the time when the recommendation is issued it is already clear that standard deadlines would be unrealistic for a specific measure.

See Commission reply to paragraph 97.

102. The conclusions on the classifications of imbalances are contained in a Commission Communication that accompanies the IDRs, and is based on IDR analysis. The MIP classification of a specific Member State is determined mainly by IDR analysis but also other aspects are taken into account and that is consistent with Regulation 1176/2011:

- To ensure cross-country consistency in the assessment, IDR conclusions must take into account the whole package of IDRs. Moreover, the MIP categorisation takes into account of systemic aspects (see Compendium, page 48). Such an assessment must necessarily be based on the reading of the whole package of IDRs.

- Article 5(2) of Regulation 1176/2011 provides that the Commission in its assessment takes account of a series of factors (economic developments in the Union and the euro area; origin of imbalances; prevailing economic circumstances; Council recommendations or invitations under the SGP and European Semester; policy intentions of the Member State under review).

- There is no requirement that the assessment of imbalances at year t only takes into account information included in the IDR produced at time t, as relevant information could be contained in other public documents (e.g. previous IDR issues, AMR, forecast).

- The Commission deliberates on the IDR as well as on other aspects before deciding on categories.

The necessity of taking into account those aspects, and in particular the whole package of IDRs, justifies the practice or reporting IDR conclusions for all MIP countries in a devoted Communication.

103. The MIP Regulation sets the requirements for the Commission as a whole. See also Commission replies to paragraphs 61 and 66.

104. As stated in the Commission reply to Box 3, Article 1(1) of Regulation (EU) 1176/2011 provides that the Regulation sets out "detailed rules for the detection of macroeconomic imbalances, as well as the prevention and correction of excessive macroeconomic imbalances within the Union". As recital 9 of the Regulation makes clear, the specific rules established for that purpose are laid down in order to "supplement the multilateral surveillance procedure referred to in paragraphs 3 and 4 of Article 121 TFEU".

Against that background of the purpose of the Regulation it is not for the Parliament and the Council, as the co-legislators adopting secondary legislation in the form of the Regulation, to remove from the Commission discretion held by it under primary law in the form of Article 121(4) TFEU.

Article 7(2) of Regulation (EU) 1176/2011 does not create a new power or procedure. It defines the conditions under which an existing Treaty-based power (Article 121(4) TFEU or the multilateral surveillance procedure) is to be exercised in the particular frame of the MIP. The Commission is not therefore bound to initiate the procedure once certain circumstances arise since under Article 121(4) TFEU the monopoly of initiative of the Commission, that the Treaties otherwise guarantee, remains intact. The Commission keeps its discretion to initiate or not to initiate the procedure. An act of secondary legislation could not deprive the Commission of that power of discretion as designed by the Treaties. Recital 22 of Regulation (EU) 1176/2011 - that states that "if severe macroeconomic imbalances are identified (…) an excessive imbalance procedure should be initiated (…)" - must be read against that background. It does not impose an obligation on the Commission to present a recommendation, but expresses the political desideratum of the co-legislator to make things in a particular way.

Recommendation 2

(i) The Commission accepts this recommendation.

(ii) The Commission does not accept this recommendation.

The reasons for the classification of imbalances are published in the Commission Communication that accompanies the IDRs and the Commission agrees that the reasons behind the eventual classification of imbalances should be clear. The processes followed for the analyses of imbalances are regularly discussed with Member States in Council committees and have been published in the recent MIP Compendium.

The Commission has made public a number of principles that are followed in the identification and assessment of imbalances in the MIP Compendium and enhanced the transparency of that assessment in IDRs by means of MIP assessment matrices.

The adoption of ex-ante decision rules for the classification and assessment of macroeconomic imbalances is not recommendable as these issues require judgement as the issues to be analysed are multi-faceted, complex and evolving in light of the economic context. Consistently, Regulation 1176/2011 does not codify the definition of imbalance or excessive imbalance.

(iii) The Commission accepts the recommendation to enhance the communication on why the EIP is not recommended.

See Commission reply to paragraph 97.

(iv) The Commission does not accept this recommendation.

The Commission wishes to underline that codified criteria on the triggering of the Excessive Imbalance Procedure would not be recommendable as a meaningful assessment of imbalances and their follow up require judgement as macroeconomic imbalances can have many different sources, take evolving forms and concern a wide range of areas and policy instruments and require taking into account a long list of country-specific and cross-country elements. The introduction of such criteria would also not conform the spirit of Regulation 1176/2011, which does not codify the notion of imbalance or excessive imbalance.

105. The merging of IDR and non-IDR analyses helped reducing overlaps that could occur between IDR and Staff Working Documents. The experience suggests that IDR has remained identifiable in the current format (also thanks to the MIP matrix and IDR summary chapter), and overlaps between the IDR and the non-IDR country report parts eliminated.

106. As long as the necessary analysis of imbalances is carried out and adequately articulated and communicated the separation or integration of IDRs in the country report is immaterial.

Recommendation 3

(i) The Commission accepts the recommendation.

The Commission agrees that IDR analysis need to have the possibility of being sufficiently developed and articulated to fill relevant analytical gaps.

The Commission disagrees that more severe imbalances necessarily require analytical documents of longer size as this depends also on whether analytical gaps have been filled in previous analysis.

The Commission is also of the view that the integration of the IDRs in the country reports helped reducing unnecessary overlaps and does not imply a less clear communication of IDR analysis.

(ii) The Commission accepts the recommendation of not publishing the scoreboard with the IDR.

The publication of country-specific scoreboard variables in IDRs is not required by the Regulation and the role of the scoreboard is mainly in the selection of countries for IDRs, not in IDR analysis itself.

The Commission accepts informing on providing access to datasets used in IDR analysis.

See Commission reply to paragraph 97.

108. IDR analysis includes aspects relating to public finances. MIP surveillance is conducted taking into account surveillance in the context of the SGP in line with Regulation 1176/2011, and ensuring consistency. CSRs on public finances in the context of the SGP have been indicated as MIP-relevant for Member States where high public debt is an element that contributes to the identification of imbalances in a particular country, or where the reduction of fiscal deficits contribute to the correction of large current account deficits identified as part of the imbalances. In countries with current account surpluses, IDRs have analysed the links between a number of fiscal measures and the external position. For those Member States a number of CSRs measures of fiscal nature that potentially contribute addressing large surpluses have been indicated as MIP-relevant.

Recommendation 4

The Commission accepts this recommendation.

The Commission will continue implementing MIP surveillance taking into account surveillance in the context of the SGP in line with Regulation 1176/2011, and ensuring consistency between the two processes.

See Commission reply to paragraph 97.

109. State-of-the-art modelling approaches have been followed for the analyses of spill-overs.

The analysis has systematically analysed outward spill-overs from large euro area countries, as spill-overs are likely to be of a larger magnitude if emanating from large economies. Additional analysis of inward spill-overs and outward spill-overs is included where relevant, on the basis of actual or expected developments entailing possibly important cross-border effects.

It is important to acknowledge that certain type of spill-overs (e.g. contagion effects via financial market confidence) can be modelled only on the basis of assumptions and conjectures and have limitations.

Recent editions of the AMR have systematically discussed the euro area dimension of imbalances. IDR conclusions make reference to spill-over and systemic considerations for a number of Member States.

110. The statement that there are inconsistencies between MIP-relevant CSRs and euro area recommendations stems from the fact that the need of consistency between euro area recommendations and MIP-relevant CSRs applies only to Member States that receive at the same time CSRs that are at the same time MIP-relevant and for which there is a pertinent euro -area recommendation. Not all euro-area recommendations are pertinent to the MIP, as their scope is broader. Not all Member States receive MIP-related recommendations, as some Member States are not under MIP surveillance. Not all Member States receive CSRs emanating from euro-area recommendations if they have no significant challenges or if they have no need to carry out specific policies, or if there are constraints that justify not having a CSR.

Recommendation 5

(i) The Commission accepts this recommendation and considers that it is already implementing it.

The MIP implementation already takes into account euro area systemic aspects and the context for rebalancing, and those considerations have provided a rationale for MIP imbalances classification and recommendations.

(ii) The Commission accepts this recommendation.

MIP-related CSRs are issued only to countries identified with imbalances. MIP-related CSRs need to be consistent with pertinent MIP-relevant euro-area recommendations. MIP-related CSRs may include fiscal measures if need to address the imbalances identified in the Member State concerned. The MIP cannot be used to provide fiscal recommendations erga omnes. The Commission considers that consistency with the euro area recommendation on the fiscal stance is appropriate only if justified on the basis of the imbalances identified for the Member State concerned.

See Commission reply to paragraph 97.

Recommendation 6

The Commission accepts this recommendation and is already taking steps to implement it.

See Commission reply to paragraph 97.

Event	Date
Adoption of Audit Planning Memorandum (APM) / Start of audit	31.5.2016
Official sending of draft report to Commission (or other auditee)	28.9.2017
Adoption of the final report after the adversarial procedure	28.11.2017
Commission’s (or other auditee’s) official replies received in all languages	15.12.2017

We examined the European Commission's implementation of the Macroeconomic Imbalance Procedure, which aims to identify, prevent and address macroeconomic imbalances that could adversely affect economic stability in a particular EU country, the euro area, or the EU as a whole. We found that although the MIP is generally well designed, the Commission is not implementing it in a way that would ensure effective prevention and correction of imbalances. The classification of Member States with imbalances lacks transparency, the Commission's in-depth analysis despite being of a good standard has become less visible and there is lack of public awareness of the procedure and its implications. We therefore, make a number of recommendations to the Commission to substantially improve certain aspects of its management and to give greater prominence to the MIP.

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