



Policy coordination in the EU and responses to the crisis

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Outline

- What is policy coordination?
- To what extent has policy coordination in the euro zone failed?
- Institutional vacuum
- Institutional steps (i.e. objectives and tools) taken to address lack of coordination in the area of fiscal policy and structural reform on labour, product and financial markets

What is policy coordination?

- It was about similar policies (SGP)
- But it is also about divergent policies (e.g. country-specific conditions in the 2005 SGP Reform, recent interest in competitiveness divergences and differentiated exit strategies)
- In sum, policy coordination is about *interaction effects* across countries (**horizontal**) or domains (vertical)

Horizontal coordination

- Coordination between home and foreign fiscal policies
- Coordination between home and foreign structural reform on labour, product and financial markets

The Greek debt crisis and policy coordination

- The Greek debt crisis reveals underlying weaknesses in economic policy coordination, as it brings to light a clear-cut divide between debtor and creditor countries in the euro zone.

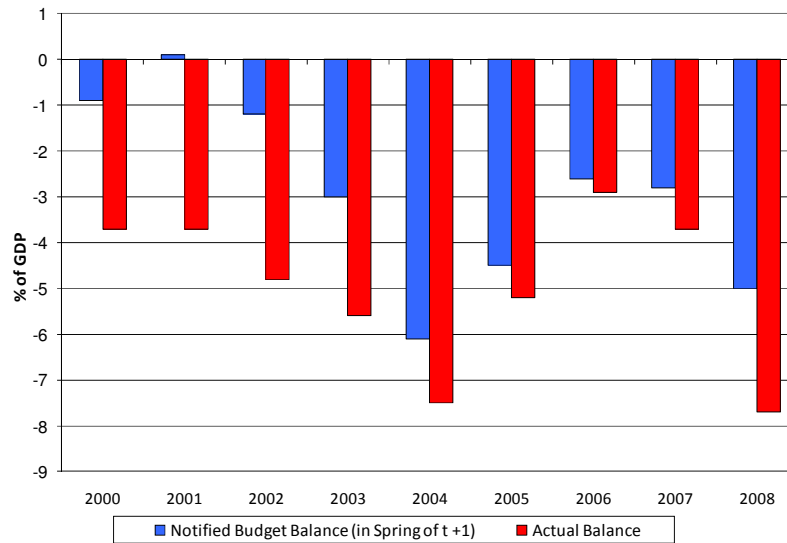
To what extent has economic policy coordination failed?

- There are clear differences in fiscal behaviour across member countries
- There are clear differences in competitive performance across member countries

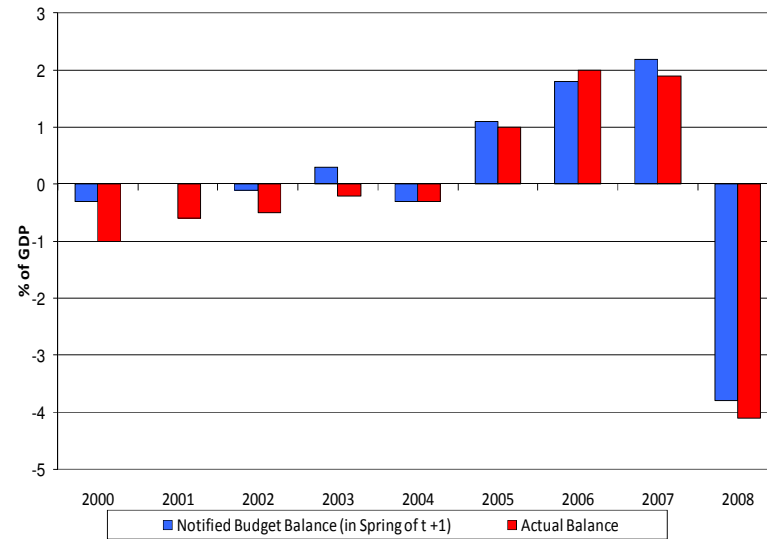
Fiscal behaviour

Chart 1 Notified vs. actual deficits

Greece (a)

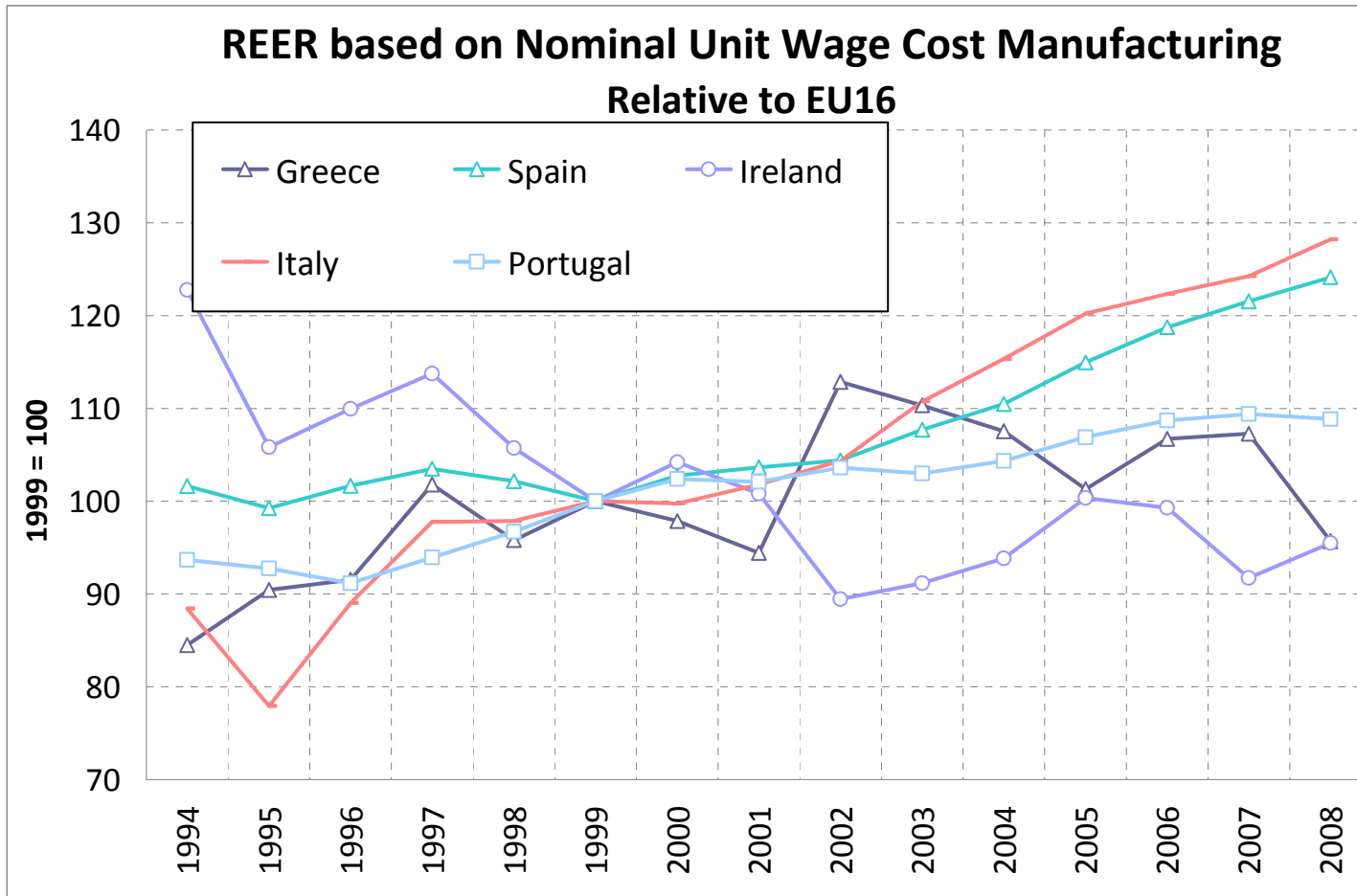


Spain (b)



Source: Bruegel calculations based on EU Commission.

Competitive performance



Institutional vacuum

- Art.121 is entirely devoted to the coordination of economic policies beyond the mere enforcement of budgetary discipline
- Yet, this pillar was much softer than the fiscal one based on art.126.
- The possibility of issuing a recommendation under the BEPGs has been used once only and without effect

Institutional steps

- *March 2010 European Council*: establishment of task force for economic policy coordination
- *May 2010 EU Commission communication*: set of measures to improve economic policy coordination for crisis prevention and management

Objectives

- Reinforce compliance with the SGP
- Extend surveillance beyond budgetary positions to macroeconomic and competitiveness imbalances making use of art.136

Tools

- MS should act also in good times
- MS should reform national fiscal frameworks
- Reinforce compliance with debt criterion
- Task force for economic policy coordination
- European Semester for policy coordination
- Scoreboard to detect unstable positions
(bubbles, exchange rate misalignments, etc.)

Objectives:

- Reinforce compliance with the SGP
- Extend surveillance to macroeconomic and competitiveness imbalances under art.136

Tools:

- MS should act also in good times
- MS should reform national fiscal frameworks
- Reinforce compliance with debt criterion
- European Semester for policy coordination

Response to crisis (2008)

Monetary policy:

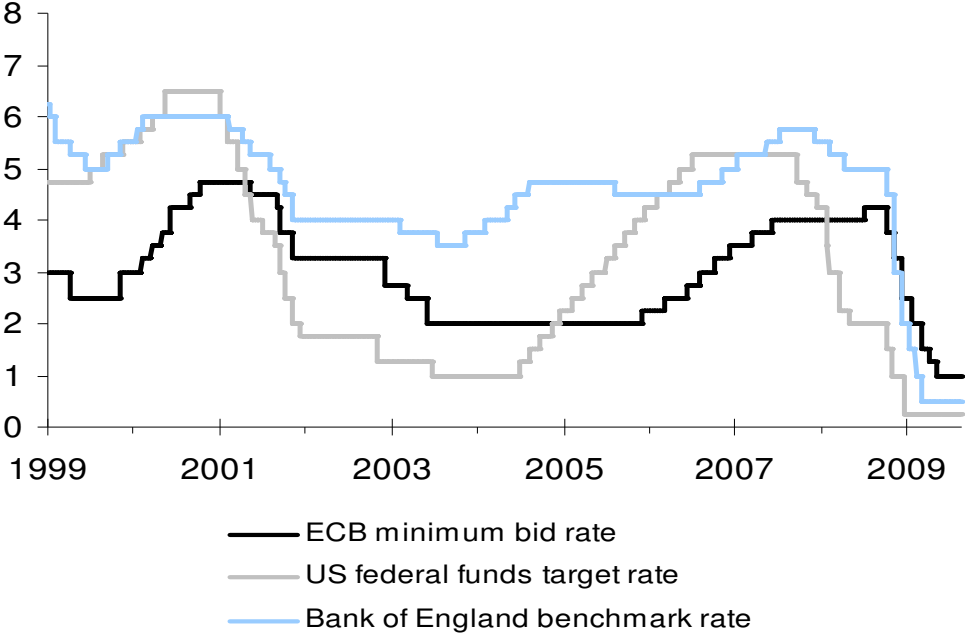
- In October 2008 the ECB cuts interest rate down to 3.75% in a coordinated move with other central banks

Fiscal policy:

- In December 2008, the EU Council approves the European Economic Recovery Plan (2% of GDP over 2009-2010)

Policy rates

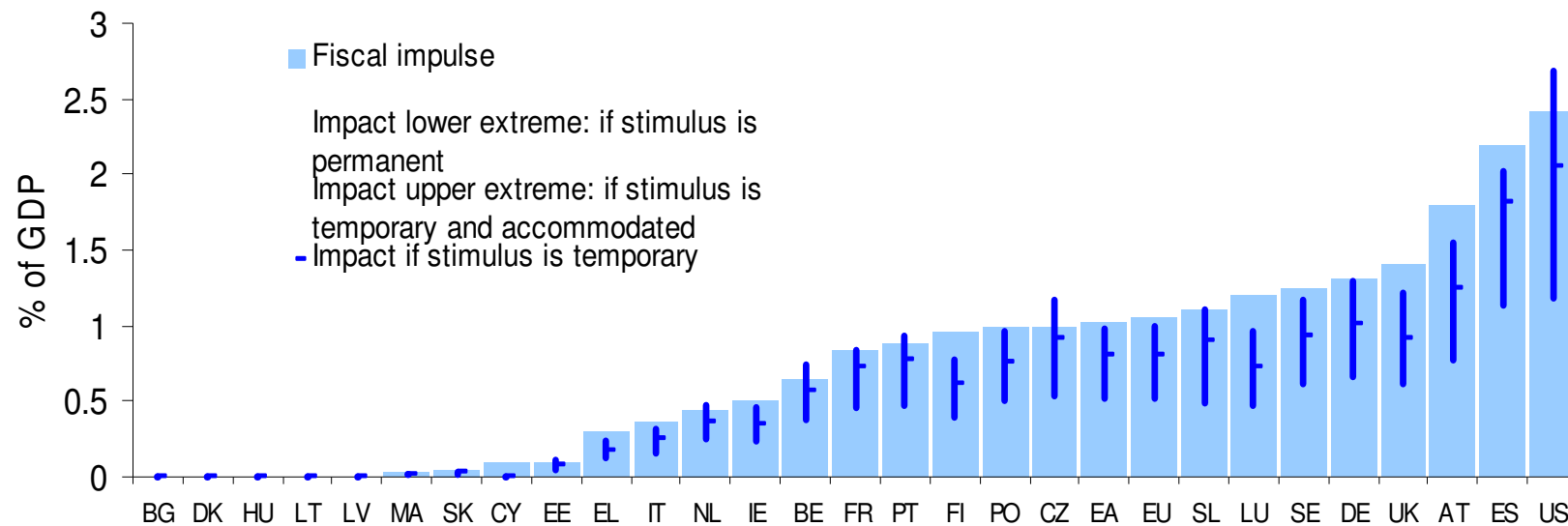
% *Graph III.2.4: Central bank policy rates*



Source: Reuters EcoWin

Fiscal stimulus (2009)

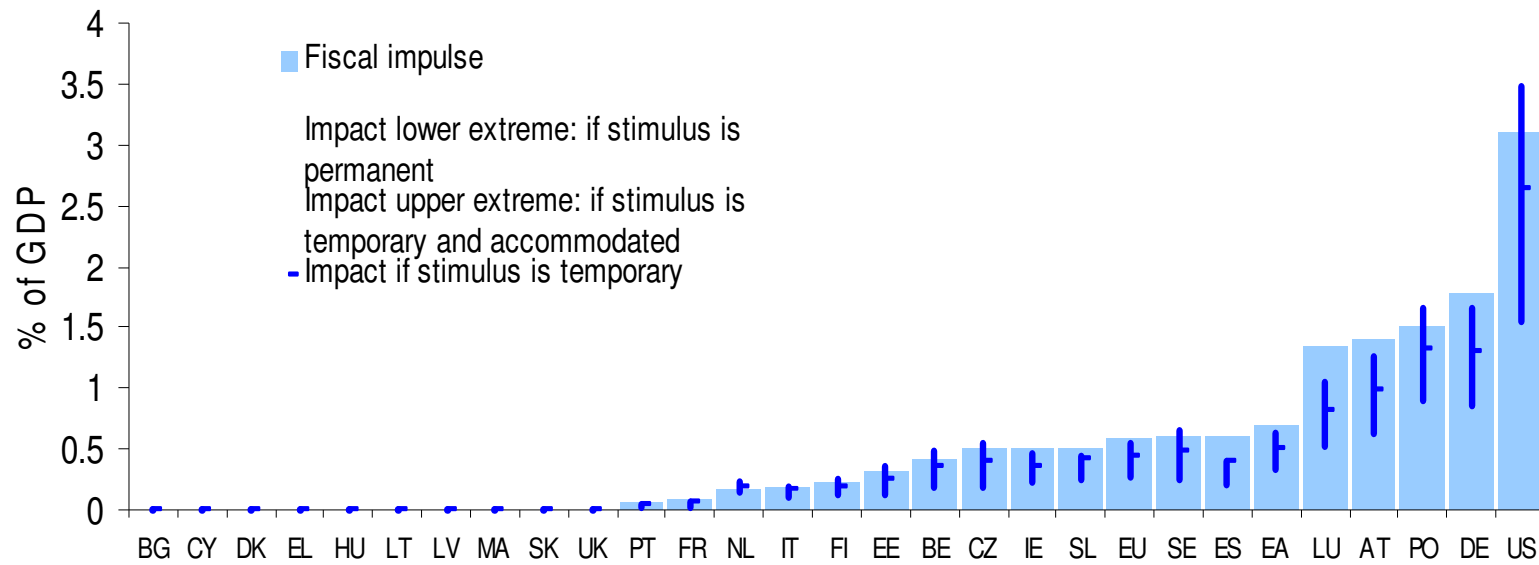
Graph III.2.7: Fiscal stimulus in 2009



Note: See Box III.2.1 for explanation. Source: European Commission.

Fiscal stimulus (2010)

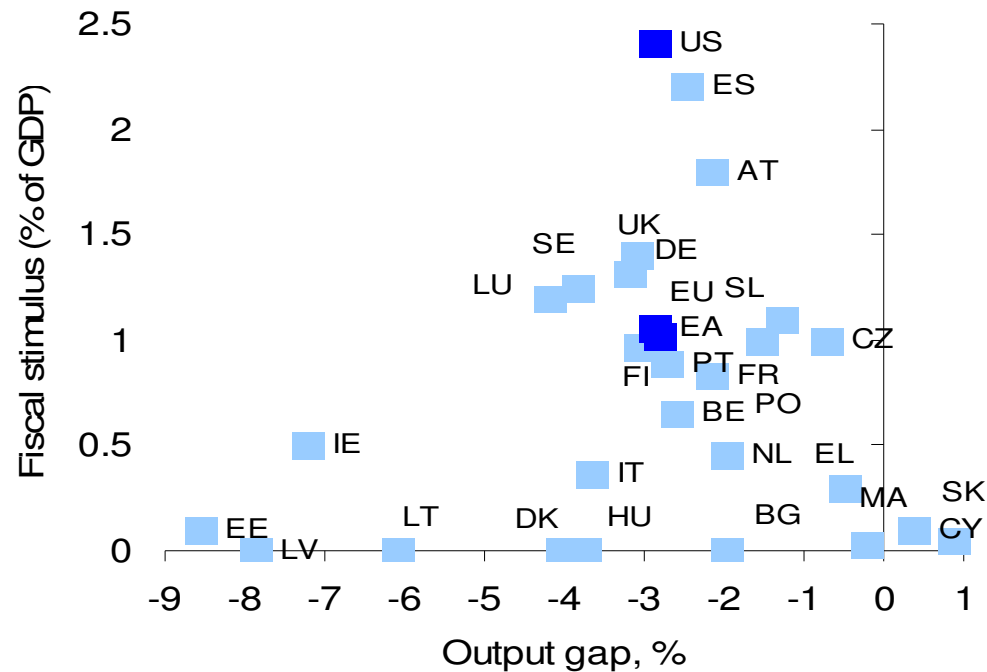
Graph III.2.8: Fiscal stimulus in 2010



Note: See Box III.2.1 for explanation. Source: European Commission.

Fiscal stimulus and output gap

Graph III.2.9: Output gap and fiscal stimulus in 2009



Source: European Commission.

Response to the crisis (2010)

Rescue package:

- On 9 May, the ECOFIN Council approved a comprehensive package of measures to preserve financial stability in Europe
- The package consists of two elements: i) the European Stabilization Mechanism, and ii) the Special Purpose Vehicle
- The European Stabilization Mechanism allocates EUR 60bn to euro-zone members through the medium-term financial assistance envisaged by art.122
- The Special Purpose Vehicle is a package of resources worth EUR 440bn allocated to euro-area countries through intergovernmental negotiations

The Commission communication

Objectives:

- Reinforce compliance with the SGP
- Extend surveillance to macroeconomic and competitiveness imbalances under art.136

Tools:

- MS should act also in good times
- MS should reform national fiscal frameworks
- Reinforce compliance with debt criterion
- European Semester for policy coordination