

Brussels, 04.11.2011  
Ares (2011)

Dear Jan,

Re : Treatment of current account deficits and surpluses in the EIP

As soon as the legislative package on economic governance enters into force (expected in mid-December 2011), the Commission will immediately implement the new Excessive Imbalances Procedure (EIP). Based on an economic reading of early-warning scoreboard indicators, the Commission shall in its Alert Mechanism Report identify Member States where macroeconomic imbalances potentially exist for further in-depth analysis.

To this end, and following extensive technical preparations, the Commission has finalised its suggestions for the design of the initial scoreboard, and we are awaiting feedback from the Council and European Parliament. In this context, several national authorities have sought clarification on one particular dimension of surveillance under the EIP, namely the approach which the Commission will use when considering countries with large and sustained current account deficits and surpluses.

As I stated in a Declaration to the plenary session of the European Parliament, the Commission will rigorously implement the Regulation on the prevention and correction of macroeconomic imbalances, and in particular the provisions regarding surveillance of countries with current account deficits and surpluses. This means that surveillance under the EIP shall encompass all Member States, but that a greater degree of urgency is required in countries with large current account deficits and competitiveness losses. Moreover, the Regulation makes clear that the choice of indicators in the early-warning scoreboard shall be conducive towards promoting competitiveness in the EU.

The Regulation thus provides for a graduated approach to surveillance. Policy recommendations can be addressed to a Member State under the preventive arm of the EIP (Article 121.2) when imbalances are at the early stage of emergence. However, policy recommendations can be addressed to Member States under the corrective arm of the EIP (Article 121.4 and which eventually could lead to sanctions for euro area countries) when imbalances are severe and when they jeopardise, or risk jeopardising, the proper functioning of the economic and monetary union. Thus, the activation of the corrective arm is not only determined by the magnitude of the macroeconomic imbalance, but also critically by the existence or risk of negative spillovers on other euro area countries. In particular, the risks of large negative spillovers are much more prevalent for current account deficits. This is because large and persistent current account deficits raise concerns about the sustainability of external debt of a country and can pose solvency risks, and is especially worrying if combined with sustained losses of cost competitiveness and export market shares. Under such circumstances, it may be appropriate to make full use of the corrective arm of the EIP.

Jan VINCENT-ROSTOWSKI  
President of the Ecofin Council

The scoreboard indicators shall not be interpreted mechanically. Consequently, a breach of an indicative threshold for the current account deficit/surplus or any other indicator in the scoreboard does not automatically trigger an in-depth study or a move towards policy recommendations.

Regarding surveillance of current account surpluses, it should be noted that persistent surpluses are justified if they are the result of the competitiveness of enterprises in functioning markets, and depending on the structural features of the economy that determine saving and investment, e.g. countries with an ageing population may find it opportune to save today (i.e. run current account surpluses) to avoid a drop in consumption in the future. Nevertheless, it is possible that large and persistent current account surpluses can be caused by market failures or policy settings that constrain domestic demand and investment opportunities. When the latter is the case, reforms that help strengthen domestic demand and growth potential can be welfare enhancing for the Member State concerned. However, unlike current account deficits, large and sustained current account surpluses do not raise concerns about the sustainability of external debt or financing capacity that affect the smooth functioning of the euro area, which are key criteria for triggering the corrective arm of the EIP.

The overarching long-term economic policy objective for EU Member States is to promote growth, in particular through enhancing competitiveness and productivity. This is the optic that the surveillance on macroeconomic imbalances will use when considering the need to correct large macroeconomic imbalances that have accumulated over the past decade. A solution to external imbalances cannot consist of policies which undermine the competitiveness of a Member State in the global economy. All efforts to improve competitiveness and trade performance are to be supported, and it is important that wages and productivity are aligned over the medium term.

The economic policy priority is to focus on countries with large productivity and competitiveness problems in particular if they are reflected in large external deficits and potentially unsustainable external positions.

I am copying this letter to Ms. Sharon BOWLES MEP, Chairwoman of the European Parliament's ECON Committee.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Bill Reel". The signature is fluid and cursive, with a long horizontal stroke at the end.

Copy: Sharon BOWLES, MEP