

Economic convergence as the cornerstone of EMU resilience

Indicators, institutions and instruments

Clingendael Report

Yuri van Loon



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Abstract

The resilience of the Economic and Monetary Union is at the heart of current EU reform discussions. The recent proposal by the 14 French/German economists and the subsequent response has geared the discussion towards risk-sharing and risk-reduction. Reconciling risk sharing and market discipline is key and the French/German proposal provides concrete measures for improving EMU resilience. The issue of economic convergence is, however, a long term problem that needs further addressing in EMU reform discussions. Therefore, this report discusses the need of economic convergence, a specific focus on the type of convergence. In doing so it argues that a revisiting on economic structures and institutions is essential in furthering the (long-term) resilience of the EMU. Proper indicators and benchmarks that not only focus on policy outcomes, but mainly on institutions would be a step forward, combined with relevant EU-level instruments. Despite decision time looming for euro reform, it is important to look at the foundations of EMU resilience.

1 Introduction

In the run up to the Maastricht Treaty, there was a discussion on whether EU member states should first converge before joining the euro-project ('Kronungtheorie') or whether convergence would result after entering the euro. Now that an ambitious deepening of the Economic and Monetary Union (EMU) is on the agenda for some time now, we again see a divide over the order of deepening EMU first or whether first convergence should be a fact. In fact, the discussion is strikingly similar as in the past, with a focus on risk-sharing versus risk reduction. Given the current favorable economic situation, the European Commission and other European political leaders argue that there is a window of opportunity for EMU reforms that might soon close again. Among economists, there appears a broad consensus that the EMU in its current form is not resilient enough for future crises, yet the proposals on the table vary vastly in intent and outcome. In addition, there seems to be significant criticism on the European Commission proposals from various corners, and their ability to increase EMU resilience.

On December 6th 2017, the European Commission announced a policy package and roadmap for EMU reform with several measures, such as the introduction of an economy and finance minister, the establishment of a European Monetary Fund and a stronger link with the EU budget. The EC also aims to complete the Banking Union through the finalization of the European Deposit and Insurance Scheme (EDIS) and creating a fiscal backstop to the Single Resolution Fund.¹ Furthermore, in announcing its Multi-Annual Financial Framework (MFF) the European Commission announced two tools specifically for the EMU, the European Investment Stabilisation Function and the Reform Support Programme.² Are these proposals sufficient to enhance the EMU's resilience? Do we need a more fundamental reform package and is that politically attainable?

This policy brief aims to revisit the discussion on the need for economic convergence. The discussion on convergence is rather fragmented and tends to use different conceptions. Section 2 discusses whether convergence is an aim to be pursued and if so, what kind of convergence the EMU needs. Section 3 finds that the different types of convergence are often interchanged in the (academic) literature and as such aims to disentangle them. Subsequently, in section 4, the paper aims to assess to what extent economic convergence has taken place along different definitions through the graphs

1 European Commission (2017). *Completing Europe's Economic and Monetary Union- policy package*. Brussels: EC.

2 European Commission (2018). *A Modern Budget for a Union that Protects, Empowers and Defends - The Multiannual Financial Framework for 2021-2027*. Brussels: EC.

presented in the Annexes. Section 5 offers a brief discussion on EMU resilience and the role of convergence, with a particular focus on the institutional perspective. Lastly, the paper concludes with some preliminary suggestions for matching the EU's convergence needs in relation to convergence indicators, reintroducing institutions in the game and addressing potential new instruments in the context convergence developments and current EU reform discussions.

2 To what extent is convergence necessary for the Economic and Monetary Union?

The need for convergence in the EU is often taken as a given.³ Since the establishment of the Economic and Monetary Union, economists and policy makers identified convergence of Member State's economies as preconditions for the survival of the Euro. Convergence even already featured prominently in the Treaty of Rome as one of its principles (art. 2):

The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.⁴

Economically speaking, however, the need for convergence is not immediately evident given the wide interpretations of the concept. Convergence as discussed in the Treaty appears to imply a degree of harmonization that is politically not feasible and perhaps economically even not desirable. Optimum Currency Area theory, for example, argues that labor mobility, capital mobility, business cycle synchronization and a degree of fiscal risk sharing is necessary in order to counter economic shocks and ensure functioning currency mechanisms.⁵ That does not mean harmonization. Apart from the political and institutional difficulties (and related moral hazard problems) with setting up adequate fiscal risk sharing and stronger fiscal policy coordination, the economic literature is undecided on whether that would indeed lead to better economic performance. Labor mobility and capital mobility, on the other hand, do appear to result in increased market functions that can aid in alleviating (future) economic shocks. The comparison with the US is often made, not only because of the fiscal transfers, but largely because

3 Auf dem Brinke, A., Enderlein, H. & Haas J. (2016). *Why the Eurozone can't agree on convergence and how structural reforms can help*. Berlin: Jacques Delors Institute.

4 Treaty of Rome, 1957, p. 4.

5 Mundell, R.A. (1961). A Theory of Optimum Currency Areas. *The American Economic Review*, 51(4), pp. 657-665.

the US market plays a stronger role in absorbing economic shocks. As such, to enhance mobility by reducing (non-)tariff barriers to increase labor and capital mobility is the most straightforward, and at the same time, most controversial policy recommendation. Simply put, the reduction of these barriers would likely lead to convergence. However, in the context of the European social welfare states, national governments will compensate the 'losers' of such liberalization through redistributive policies and could put in place particular national institutions and instruments that might hamper future economic convergence and so protect the losers of liberalization.

The process of convergence, inextricably linked with discussions on general Europeanization processes as identified in the academic literature⁶, is at its core a domestic adaptation to the European context and implies a loss of sovereignty or room for maneuver of national governments to decide on their economic structures and policies. Coordination of economic policies is therefore a particularly politically charged process. The high salience of fiscal and economic policies in domestic politics has contributed to limited benchmarking (and if so, only on policy outcome) and limited success of convergence standards and progress. However, across policy discussions the idea that convergence needs to take place in order to make the Eurozone resilient persists. In their reflection paper, the Commission presents four main reasons why convergence is desirable, by warning for the effects of *divergence*. Firstly, economic divergence makes the single monetary policy less effective; secondly, it turns into lasting differences in structural growth; thirdly, there is (negative) spill over to other countries; and/or fourthly, it undermines citizens' trust in the EMU.⁷ A recent Bruegel paper seems to confirm the latter by finding a link between citizens' trust and divergence in (quality of) institutions.⁸

Despite agreements on the importance of convergence, less consensus exists regarding the types of convergence required and the institutions and instruments to bring about these various types of convergence. The economic policy coordination instruments (as addressed in section 5) have built on the basic indicators for convergence (Maastricht criteria) and have later expanded to include macroeconomic imbalances. In these indicators the structural/institutional aspect is often neglected, or purposefully avoided. A refocusing on structural and institutional indicators, in line with academic literature flowing from Douglas North⁹, although politically sensitive, would aid in furthering the debate on convergence and the resilience of the EMU.

6 See Cowles, M.G., Caporaso, J. & Risse, T. (2001). *Transforming Europe: Europeanization and domestic change*. Ithaca: Cornell University Press.

7 European Commission (2017), Reflection Paper on the Deepening of the Economic and Monetary Union, p. 12.

8 Demertzis, M. (2018). *Trust in the EU? The key obstacle to reform*. Retrieved from, <http://bruegel.org/2018/02/trust-in-the-eu-the-key-obstacle-to-reform/>.

9 North, D. (1991). Institutions. *Journal of Economic Perspectives*, 5(1), pp. 97–112.

3 Types of convergence: real, nominal, cyclical and convergence in economic structures

The concept of convergence is buzzing around in policy discussions on the EMU and the EU's economic governance. In a literature review on the concept of convergence three main types of convergence can be identified: cyclical, real and nominal convergence.¹⁰

Cyclical convergence is considered essential for an effective monetary policy, in order to prevent a “one size fits none” policy. By means of structural reforms the business cycles of Member States can become more aligned, enhancing the effectiveness of fiscal and monetary policy. Haas, Enderlein and Auf Dem Brinke have emphasized the need for cyclical convergence in order to have an effective economic policy through a monetary-fiscal policy mix. Cyclical convergence can be achieved through greater macro-economic policy coordination, e.g. by increasing government spending.¹¹ Other types of convergence are politically more demanding in that they, in the long run, require structural reforms or policies that have redistributory effects.¹² Cyclical convergence is, in comparison, short term and highly subject to confidence levels and government fiscal expenditure (and less so on regulatory policy or quality of institutions). For the purposes of this paper, it is left out of consideration.

Generally, a distinction is made between real convergence and nominal convergence. Real convergence concerns the (upward) equilibration of income and productivity. Nominal convergence is the broad umbrella term that ranges from economic parameters, and more specifically, the macroeconomic environment, such as inflation, government balances, but can also include structural and institutional parameters,

10 Auf dem Brinke, A., Enderlein, H. & Fritz-Vannahme, J. (2015). *What kind of convergence does the euro area need?* Gütersloh: Bertelsmann Stiftung and Jacques Delors Institut.

11 Corsetti, G., Luca, D., Jarociński, M., Mackowiak, B. & Schmidt, S. (2017). *Business cycle stabilisation in the Eurozone: Ways forward*. Retrieved from, <http://voxeu.org/article/business-cycle-stabilisation-eurozone>.

12 Auf dem Brinke, A., Enderlein, H. & Haas, J. (2016). *Why the Eurozone can't agree on Convergence and how Structural Reforms can help*. Berlin: Jacques Delors Institute.

leading to general confusion about the concept.¹³ In most policy and academic discussions only a limited set of nominal convergence indicators is used, mainly revolving around the Maastricht Criteria and less so on structural and institutional parameters.¹⁴

The assumption at the time of drafting the Maastricht criteria, that nominal convergence leads to real convergence has proven invalid, because 1) the identification of nominal convergence indicators has been too narrow or 2) other factors, such as political capital and related external pressure on national decision-making has not been sufficiently taken into consideration. In line with the assessment that structural reforms in Member States are necessary in order to enhance the resilience of the Economic and Monetary Union, some policy makers argue for convergence towards resilient economic structures.¹⁵ The convergence of resilient economic structures goes, or should go, beyond the usual nominal indicators that are used and focuses on institutions and policies that are often considered under the heading of 'structural reforms'. Convergence in economic structures has been gaining attention given the realization that the resilience of national economies is essential in an effective monetary union. It concerns the broad array of national institutions, including the quality of institutions, the effectiveness of governments and quality of regulation, the sustainability of policy. The Eurozone, more than real convergence or nominal convergence, needs convergence of economic structures. Aiming for economic convergence by focusing on domestic political and economic indicators, institutions and instruments offers a promising venue for making the EMU more resilient.

13 Auf dem Brinke, A., Enderlein, H. & Fritz-Vannahme, J. (2015). *What kind of convergence does the euro area need?* Berlin: Jacques Delors Institut.

14 Vandenbroucke, F. (2017). *Structural Convergence vs. Systems Competition: Limits to the Diversity of Labour Market Policies in the EMU*. Brussels: European Commission.

15 European Political Strategy Centre (2017). *Reinventing Convergence: Towards Resilient Economic Structures*. Brussels: High-level Policy Conference. https://ec.europa.eu/epsc/events/reinventing-convergence-toward-resilient-economic-structures_en.

4 State of play: levels of convergence

In the Annex a significant number of indicators are listed with a selection of 9 founding Eurozone members (with the exception of Greece, that joined in 2001), taking into account different economic institutions and geographical spread. This policy brief has selected a number of indicators from the World Governance Indicators, the OECD Product Market Regulation Index, the World Competitiveness Index, the AMECO dataset, the Macroeconomic Imbalances Scoreboard from the European Commission and the Sustainable Governance Index. The trends on the different categories often go back more than 20 years and give an overall indication on the levels of convergence across the Eurozone. Many reports assessing convergence have already appeared^{16,17,18,19}, and many have propagated a specific type of convergence. This policy brief is by no means an exhaustive list of convergence indicators, and much more indicators can be used. However, generally, the indicators do point at the fact that over the long term many important indicators, regardless of the typology, have not converged.

Nominal convergence (annex II)

In a great number of databases, ranging from Product Market Regulation (OECD) to the Global Competitiveness Index as well as European Commission and Eurostat datasets various trends can be discovered. Not surprisingly, there appears to be regional convergence with countries that appear more similar to each other in terms of administrative tradition or varieties of capitalism.²⁰ Clubs of countries based on this typology tend to stay in the same range of outcomes (while not always necessarily converging either), meaning, the groups stay in similar distances and have in recent years not significantly converged.

16 E.g. Diaz del Hoyo, J.L., Dorrucchi, E., Heinz, F.F. & Muzikarova, S. (2017). *Real convergence in the euro area: a long-term perspective*. Frankfurt: ECB.

17 Gros, D. (2018). *Convergence in the European Union: Inside and outside the euro*. Brussels: CEPS.

18 Alcidi, C., Núñez Ferrer, J., Musmeci, R., Di Salvo, M. & Pilati, M. (2018). *Income Convergence in the EU: A tale of two speeds*. Brussels: CEPS.

19 Auf dem Brinke, A., Enderlein, H. & Joachim Fritz-Vannahme (2015). *What kind of convergence does the euro area need?* Gütersloh: Bertelsmann Stiftung and Jacques Delors Institut – Berlin.

20 Hall, P. A. (2012). The Economics and Politics of the Euro Crisis. *German Politics*, 21(4), pp. 355-371.

Starting points of these discussions are often nominal indicators (annex II) such as inflation (figure 1), government debt (figure 2) and deficit (figure 3). The government deficits, due to a variety of reasons are converging within the norms of the Stability and Growth Pact. During the crisis and leading up to the crisis the differences between countries have remained significant, although the high pressure from markets and the political agenda has most likely contributed to the overall improvement of the government balances. Related nominal indicators, such as interest rates (figure 4, part of the Maastricht criteria) and the composite GCI indicator on macroeconomic environment (figure 5) also show significant differences between Northern and Southern countries. However, across the board there seems to be different national responses, with differences within Northern and Southern countries also increasing.²¹

Real convergence (annex III)

The real convergence, expected under neoclassical economic theory, has not occurred: from 1970-2010 there has not been a real per capita income convergence in the EU.²² Instead there appears to be club convergence within the EU that is, for real income convergence, not related to EMU membership. Despite Central and Eastern European Countries showing higher real income growth this was not sufficient to eliminate cross-country real income per capita differences.²³

Indicators related to real convergence, such as convergence in (disposable) income, shows that convergence is not taking place. In the years leading up to the economic and financial crisis a certain degree of convergence took place, particularly when taking into account some Eastern European Eurozone members, but during and after the crisis differences persist. Also in sub groups, such as Germany, Netherlands, Finland, no clear trend can be identified, although they do continue to remain well above the Eurozone average.

There appears to be no evidence of productivity convergence among euro area countries at the aggregate level and only little indications of sectoral convergence. While overall manufacturing has not converged, at the lower level of aggregation some manufacturing sub-industries suggest the opposite. Concerning the service sectors, the empirical results indicate convergence in transport and communication, financial services and non-market-services.²⁴

21 Van Loon, Y. (2018). *EMU resilience through convergence*. Clingendael: State of the Union report.

22 Hall, P. A. (2014). Varieties of Capitalism and the Euro Crisis. *West European Politics*, 36(6), pp. 1223-1243.

23 Ibid.

24 European Central Bank (2015). *Real Convergence in the Euro Area: Evidence, Theory and Policy Implications*. In ECB Economic Bulletin.

Also some other macroeconomic data, such as current account balance (figure 14) and net (international) investment position (figure 13) show a mixed image. All Eurozone members under review are showing a current account surplus, but large differences remain between the Netherlands, Germany versus the others. Even the Netherlands and Germany, traditionally strong export countries, showed significant divergence in current account balances during the crisis, after which they aligned again. The international investment position of the reviewed countries also remains largely stable.

Data on disposable income, Unit Labour Costs (ULC) and Real Exchange Rate are often featured in the competitiveness literature. Taking the definition from the Global Competitiveness Report, competitiveness is “a set of institutions, policies, and factors that determine the level of productivity of a country”.²⁵ Figures 6-11 show that while significant differences continue to persist, the North and South divide on some indicators is slightly decreasing. The gap increased in years before the crisis, with particularly Germany having decreased their ULC, however, now the more northern countries are increasing their ULC. France, Italy and Belgium remain rather stable and Portugal, Spain and Greece are becoming more competitive.

Convergence of economic structures (annex IV)

In certain competitiveness indicators, such as product market regulation, or government effectiveness there appears to occur some club convergence. Countries with a particular close approximation and that appear to share similar traditions in employee-employer relations, technology-driven economies are converging towards each other.

The Global Competitiveness Report is often used to compare national competitiveness. In comparison with other (emerging) economies, the Eurozone members as a whole appear to be declining in the international ranking. The index, as used here, shows the performance of countries on a number of categories (and subcategories) and ranks them from 1-7 (see figure 15-23).

The Product Market Regulation by the OECD (figure 24-28) shows a more complex image. However, in the area of PMR most countries across the OECD have seemed to have converged. The index scale is from 0 to 6 (0 being least restrictive, 6 being most restrictive). Several indicators, have seen significant reforms over the years, becoming overall less restrictive. The OECD report on the PMR is also fairly positive over the least restrictive Product Markets, which should not be all that surprising given increased globalization and the European internal market.

25 World Economic Forum (2017). *The Global Competitiveness Report 2017–2018*. Retrieved from, <http://reports.weforum.org/global-competitiveness-index-2017-2018/>.

A more recent indicator, the Sustainable Governance Index, shows a mixed image with relative progress in the governance indicator (figure 32). The economic and social policies, that look at labor market reforms for example, continue to portray vastly different images, despite relative optimism about some of the structural reforms in Southern European Member States.²⁶ The trend for convergence is perhaps too recent to draw more concrete conclusions on this indicator, but also the SGI appears to indicate vast, continuing, differences between economic and social policies, as well as governance indicators such as executive capacity. While not necessarily portraying the traditional North-South divide as is often indicated.

26 The Lisbon Council (2017). *The 2017 Euro Plus Monitor: Into a Higher Gear*. Retrieved from, <http://www.lisboncouncil.net/publication/publication/145-the-2017-euro-plus-monitor-into-a-higher-gear.html>.

5 Discussion: EMU resilience through convergence in economic structures

The establishment of the Maastricht convergence criteria is perhaps now the foremost example where the multi-level institutional framework (through the establishment of a strong monetary union and a weak, underdeveloped economic union) did not address the structural weaknesses of national economies and the EMU as a whole. The Maastricht convergence indicators are concrete, nominal, indicators focused on inflation, government deficits and debts.

In areas where the EU has increased its scrutiny, such as the fiscal policies under the SGP we can see a convergence in the past years that is generally attributed to SGP. Also the Macroeconomic Imbalance Procedure appears to have some impact²⁷, although certain imbalances continue to persist.²⁸ These policies mainly focus on a limited set of nominal (SGP) and real (MIP) convergence targets and do not necessarily address resilient economic structures. Only through the Country-Specific Recommendations, which continues to see a poor track record of implementation in Member States²⁹, some policy recommendations are made but largely in general, abstract terms.

The Lisbon Process, Europe2020, the EuroPlus Pact, but also legally more binding rules and procedures such as the Macroeconomic Imbalance Procedure or the Stability and Growth Pact have focused on policy *outcomes*. Education levels had to improve, government deficits had to be balanced or labor productivity had to be improved, how the outcome was achieved was up to the national government because of their national competency. The structural and institutional aspects, that can be linked to literature on administrative tradition, path dependency or (from a more political economy perspective) varieties of capitalism literature, are parts of national institutions and have largely been avoided in the debate on making the EMU more sustainable.

27 Bricongne, J. & Turrini, A. (2017). *The EU Macroeconomic Imbalance Procedure: Some impact and no sanctions*. Retrieved from, <http://voxeu.org/article/eu-macroeconomic-imbalance-procedure-some-impact-and-no-sanctions>.

28 European Commission (2017). *Alert Mechanism Report 2017*. Brussels: European Commission.

29 Hradisky, M. (2018). *Implementation of the 2017 Country-Specific Recommendations*. Brussels: European Parliament.

The thematic discussions and the final agreements on a common corporate tax base and a certain degree of harmonization of pension schemes in the Eurogroup discuss more structural and institutional issues in convergence and are steps in addressing structural problems, and ultimately structural convergence towards best practices in the Eurozone. However, to what extent will these thematic discussions take root in national decision-making? To what extent can these discussions be further institutionalized and form a structural dialogue on potential weaknesses in national economies?

Interfering with sensitive national policy areas such as labor and housing markets can cause the necessary upheaval when coming from the Eurogroup or the Ecofin council: these are political forums. Also in the European Semester, with the emphasis on structural reforms of Member States and the establishment of the Structural Reform Support Service are steps in enhancing structural/institutional reforms. Also the OECD has launched significant initiatives in economic policy coordination. Nevertheless, over the years limited progress has been made in structural indicators, as evidenced by e.g. the world competitiveness index and the product market regulation (see annex IV).

Alternative pathways for convergence, such as independent fiscal institutions, national productivity boards as explored under the Five Presidents Report could provide more scrutiny towards national economic policies. The EU has made long strides during the economic and financial crisis in increasing policy coordination and enhancing existing institutions.³⁰ Seeing that convergence across the board of a wide number of indicators remains limited (see annexes), the Eurozone needs a stronger development of governance structures both at the national and European level that are aimed at convergence. A risk-reducing facility, while valuable in crisis management, does not fundamentally address the core problem: namely, continuing different policies, economic structures and outcomes of national economies and a lack of solid institutions and instruments to address these problems on a, if need be, European level.

The policy brief has set out to identify certain long term trends and challenges related to (economic) convergence. One of the core understandings after reviewing these trends is the complexity of the problems related to convergence. Nine countries have been examined, but even within those nine countries large differences persist, look at Germany (East-West) or Italy (North-South). It's OK to be different. Nevertheless, the differences in economic structures will have lasting effects on the future developments across the Eurozone that will continue to undermine the stability of the Eurozone. In other words, weak economic structures, regardless of whether they become more alike with other Eurozone countries will continue to undermine Eurozone resilience and need to be addressed.

30 Dorrucchi, E., Ioannou, D., Mongelli, P.F. & Terzi, T. (2016). *The four unions "PIE" on the Monetary Union "CHERRY": a new index of European Institutional Integration*. Frankfurt: European Central Bank.

6 Conclusions and further considerations

Using a variety of indicators based on different conceptions of economic convergence, this policy brief identifies persisting differences between North and Southern European countries across the board. In the limited time series under review here there appears to occur a certain degree of club convergence. However, national differences in certain indicators, or their underlying causes (a failing banking sector or a competitiveness problem causing government deficit) are reason to be cautious with overgeneralizations, continuous and enhanced monitoring and inspection in national (structural) institutions and policies remains necessary.

The current economic governance structure of the Economic and Monetary Union faces several reform challenges and has several key questions that need to be addressed in relation to competitiveness and convergence of national economies. Convergence needs to take place more fundamentally and ensure that Member States possess resilient economic structures based on principles of good governance. Convergence standards, and the many indicators and procedures in place, result in a lack of focus on policy priorities. The Commission has made efforts in streamlining the CSRs, as well as reducing their number, but more can be done.

The important paper on reconciling risk sharing with market discipline³¹ provides an excellent framework in creating incentives for national governments to bring their Own House in Order. That involves the re-establishment of the (credibility of) the no-bail out clause. However, more can be done to provide sticks and carrots in further enhancing economic institutions/structures that create sustainable growth and a more resilient EMU. The main question remains: are the current proposals sufficient to enhance the EMU's resilience or do we need a more fundamental reform package? And is that politically attainable?

Grand designs on the ideal Economic and Monetary Union are politically unattainable and also lead to vastly different proposals. The expression "What happens when you put 10 economists in a room? You'll get 11 opinions" is all too true in discussions on EMU reform. The proposal by the German-French economists therefore seems to focus on the immediate problems in ensuring the survival of the EMU in the next crisis. For the long

31 Bénassy-Quéré et al. (2018). *Reconciling risk sharing with market discipline: A constructive approach to euro area reform*. Centre for Economic Policy Reform.

term, more structural dialogue and measures addressing the institutional weaknesses (in the broad sense) in Member States and the Union as a whole is necessary: going back to the basis.

The window of opportunity that politicians have identified is perhaps not closing as rapidly as one might think. Long strides have been made to make the EMU more resilient in the past years, now perhaps there is a unique opportunity to think about and propose more sustainable, resilient systems to fixing the long-term problems in the EU and the EMU. Below some final considerations and recommendations as a prelude to that discussion:

- Ensure a stronger role for the EU budget as the oil for the machine and aid to existing initiatives. That involves a more flexible use of the new European Semester instruments as proposed by the EC in its new MFF proposal.³²
- More structural dialogue between the Member States on policy coordination and (national) policy discussions in combination with different (EU) policy and fiscal tools. The European Commission should move away from merely monitoring and could introduce further incentives in reforms through use of the budget or assistance with technical expertise.
- Cohesion and structural funds, as economic theory and past experiences have shown, do not appear to have a decisive effect on regions catching up. Stronger complementarity is necessary and a shift of these funds to developing stronger economic structures/institutions. Use structural funds in the EU MFF for capacity building and institutions building based on the principles of good governance. The introduction of a linkage with Rule of Law values and sound financial management with the Cohesion funds is therefore a good development.
- The economic convergence indicators should focus more on long-term developments of economic structures/institutions. This could be taken into account in European Semester reforms. Often the root of fiscal deficits or macroeconomic imbalances lies with national economic institutions and therefore they should be taken into account as well. Therefore, the newly devised instruments through the EU budget should aid national political decisions if aimed at economically inclusive and enhancing structures/institutions (which includes proper accountability and principles of sound financial management).
- Use the format of the Eurogroup, with a full-time President, to address national structural reforms in a comprehensive fashion. This will not replace the European Semester, rather it will form an additional format for discussion structural reforms and problems related to proper market functioning on a peer-review basis.

32 European Commission (2018). *A Modern Budget for a Union that Protects, Empowers and Defends - The Multiannual Financial Framework for 2021-2027*. Brussels: EC.

- Further exploit the establishment of a network of Independent Fiscal Institutions and National Productivity Boards. Increase public visibility and public scrutiny of these institutions, and therewith, national ownership. Let these networks operate in addition to the European Semester and strong peer review in the Eurogroup.

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Annex II: Nominal convergence indicators (Maastricht criteria)

Figure 1. Inflation. Source: AMECO Database. Adapted by author.

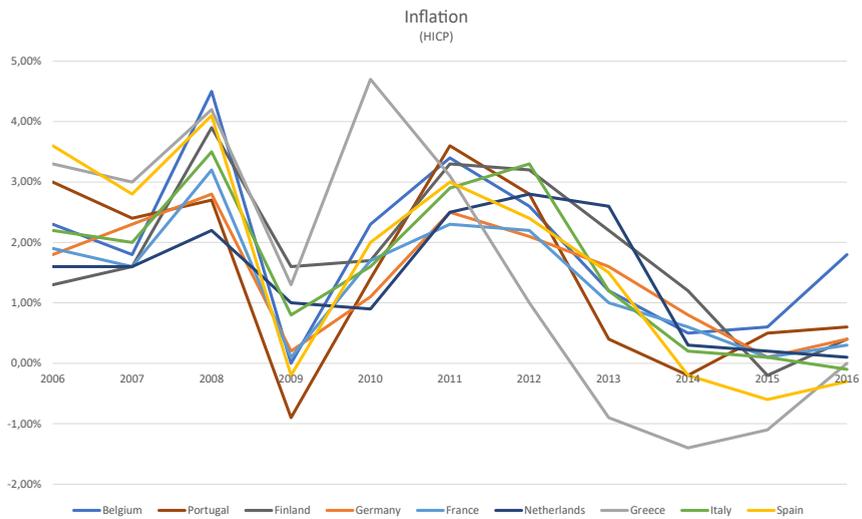


Figure 2. General government consolidated gross debt. Source: AMECO Database. Adapted by author.

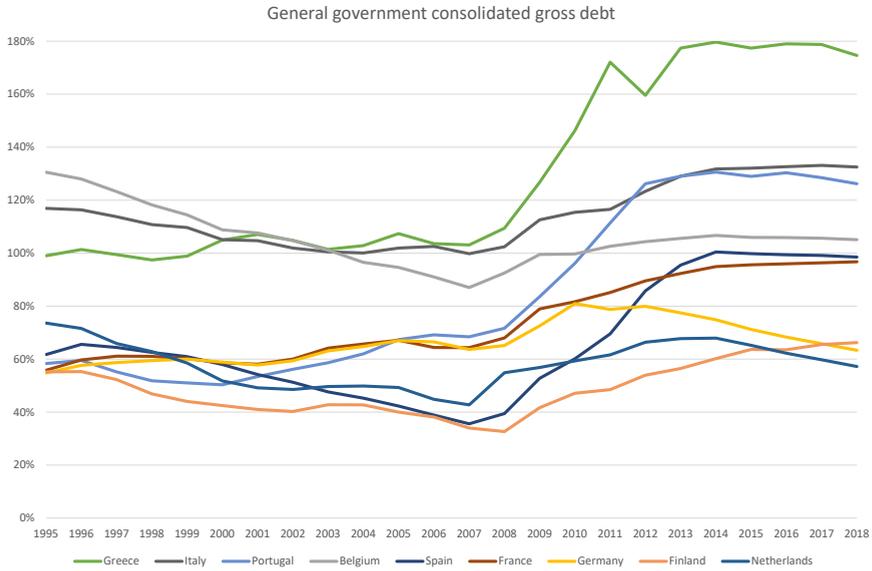


Figure 3. Net lending (+) or net borrowing (-): general government. Source: AMECO Database. Adapted by author.

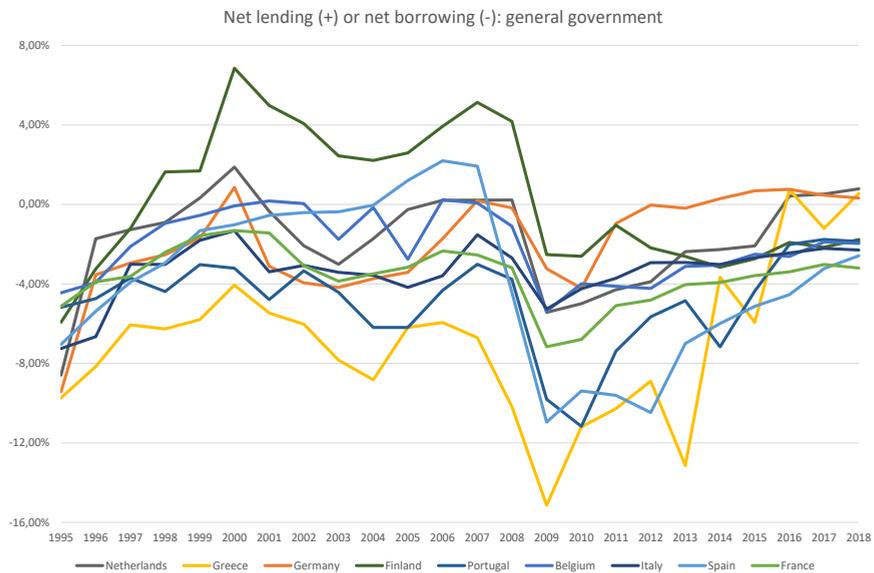


Figure 4. Long-term interest rates on government debt. Source: European Central Bank. Adapted by author.

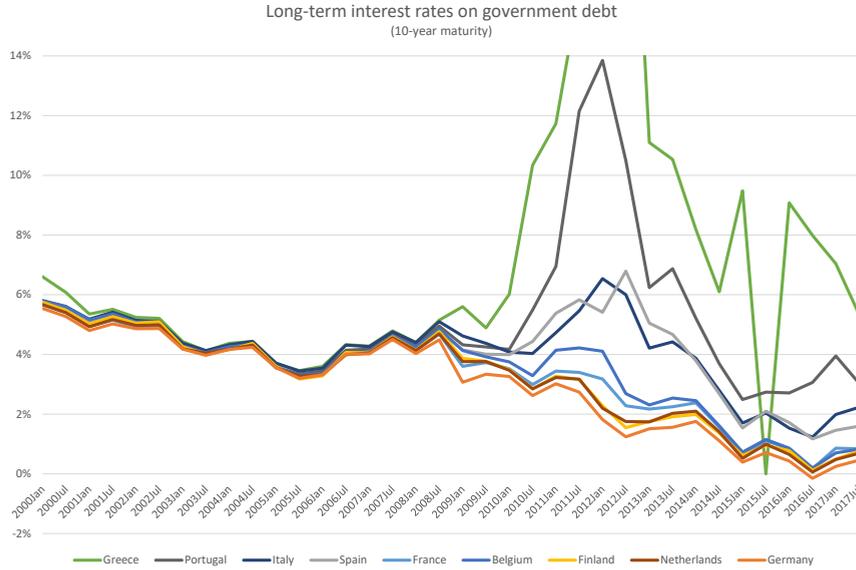
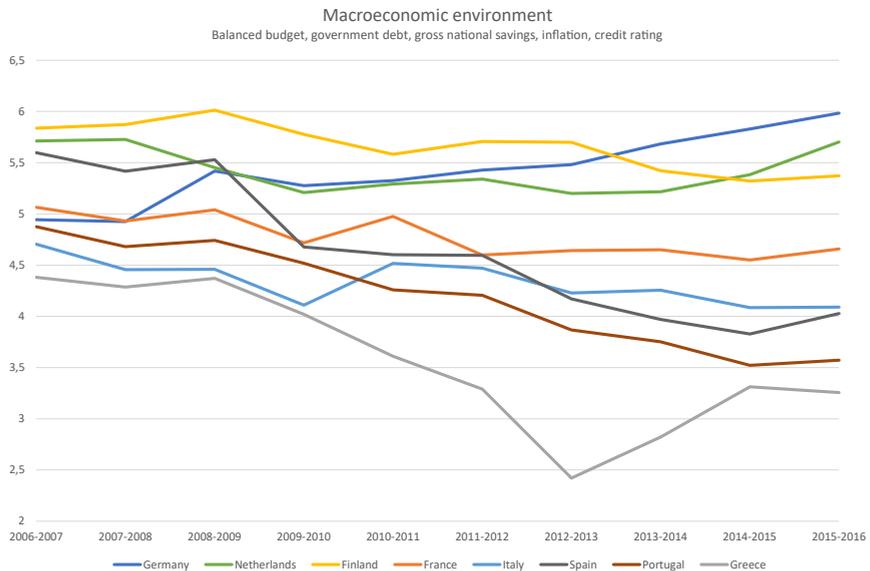


Figure 5. Macroeconomic environment. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.



Annex III: Real convergence indicators

Figure 6 Gross national disposable income per head of population.
Source: AMECO Database. Adapted by author.

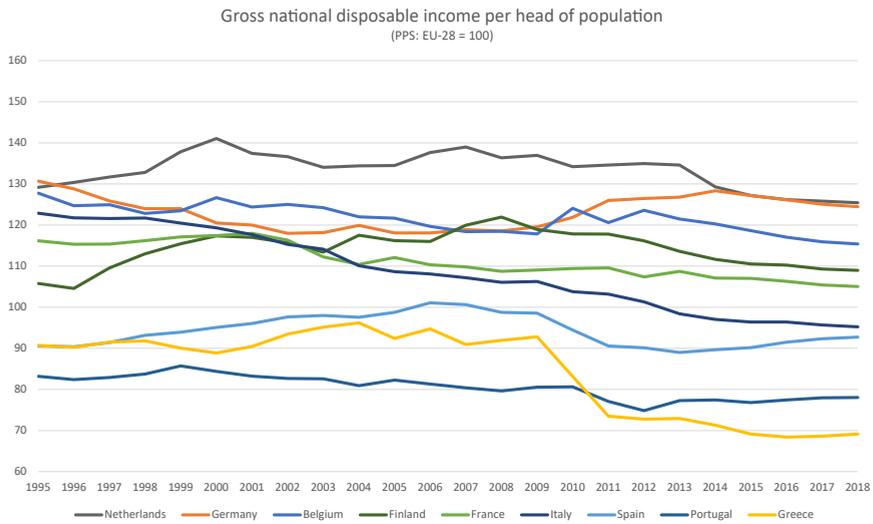


Figure 7 Real effective exchange rates, based on unit labour costs.
Source: AMECO Database. Adapted by author.

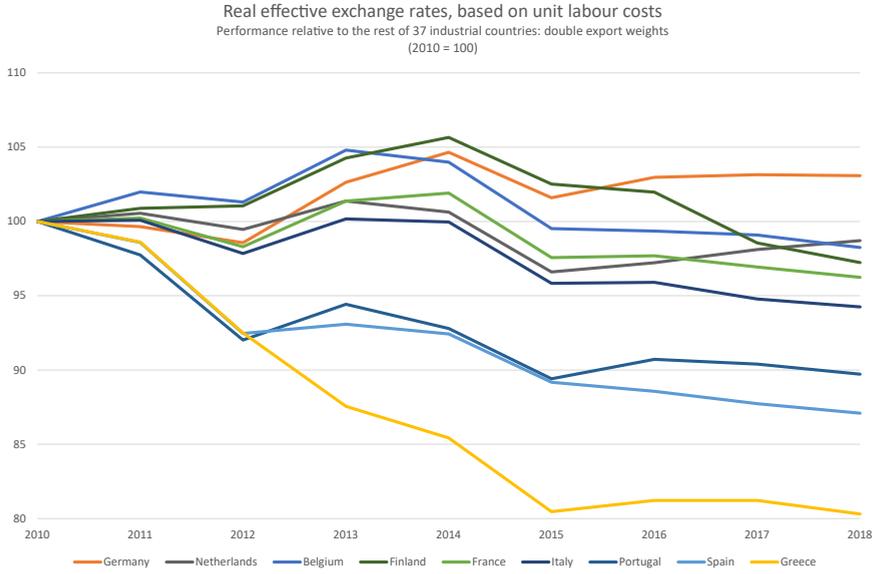


Figure 8 Real effective exchange rate, 42 trading partners.
Source: MIP statistical annex 2017. Adapted by author.

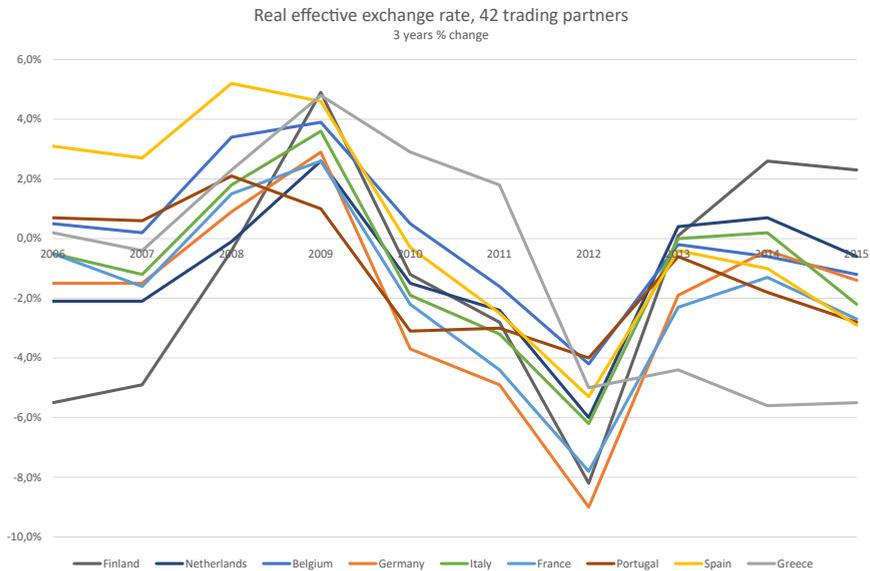


Figure 9 Nominal unit labour cost index. Source: MIP statistical annex 2017. Adapted by author.

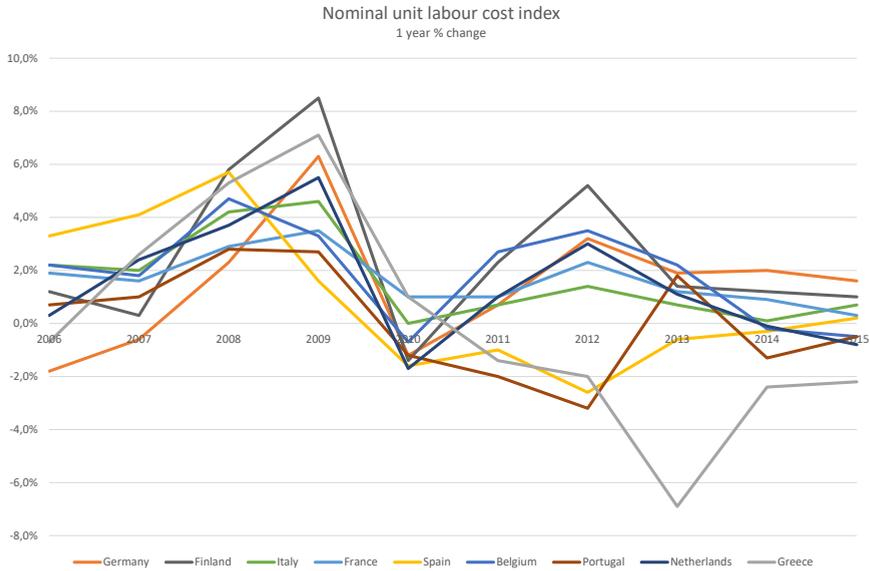


Figure 10 Unit labour cost performance relative to Euro area. Source: MIP statistical annex 2017. Adapted by author.

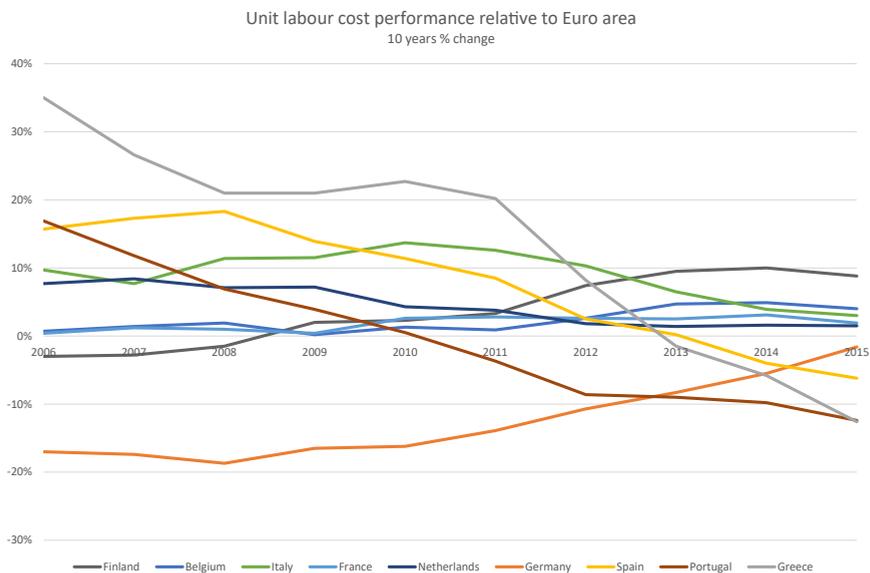


Figure 11 Gross domestic product at current prices. Source: AMECO database. Adapted by author.

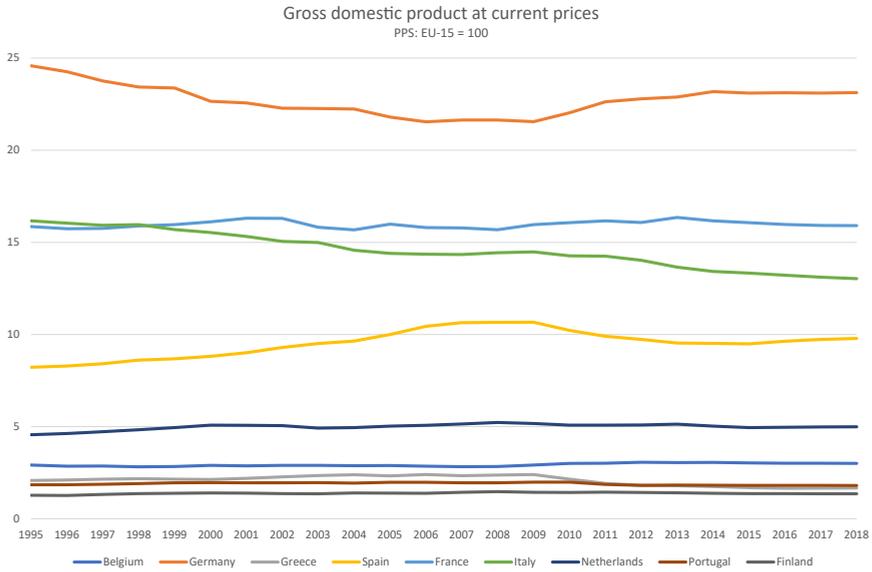


Figure 12 GDP growth. Source: Eurostat. Adapted by author.

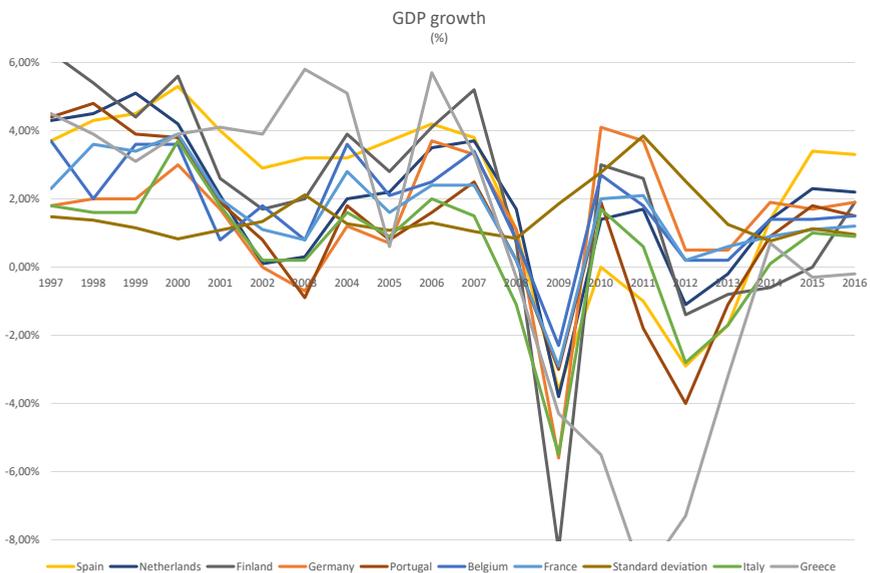


Figure 13 Net international investment position. Source: MIP statistical annex 2017. Adapted by author.

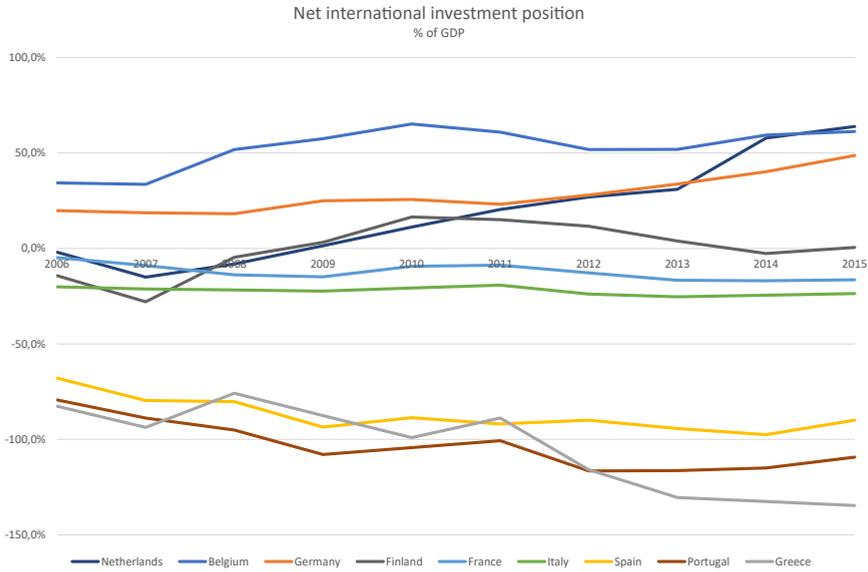
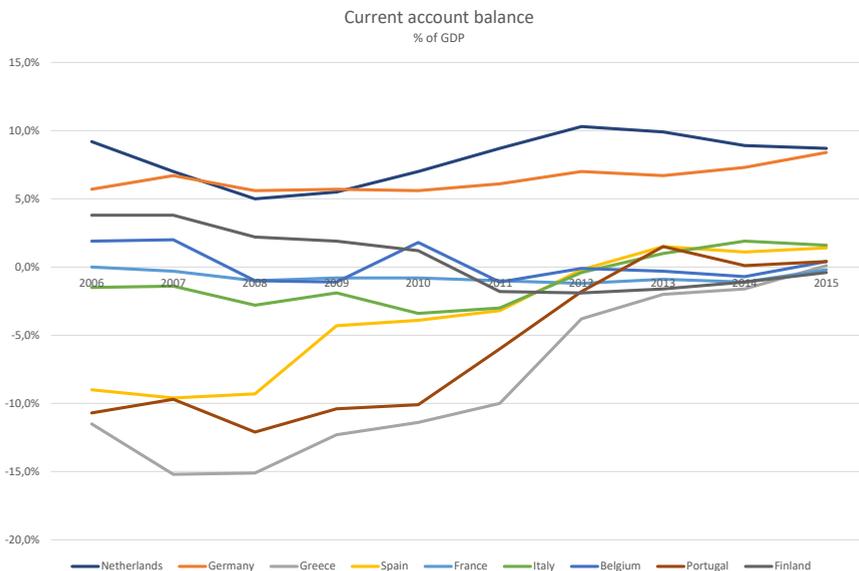


Figure 14 Current account balance. Source: MIP statistical annex 2017. Adapted by author.



Annex IV: Convergence in economic structures

Figure 15 Quality of Institutions. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

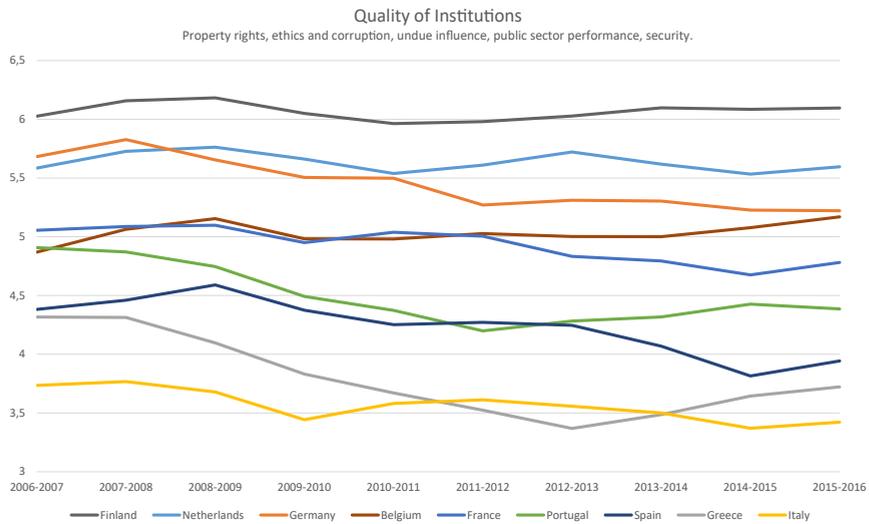


Figure 16 Health and primary education. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

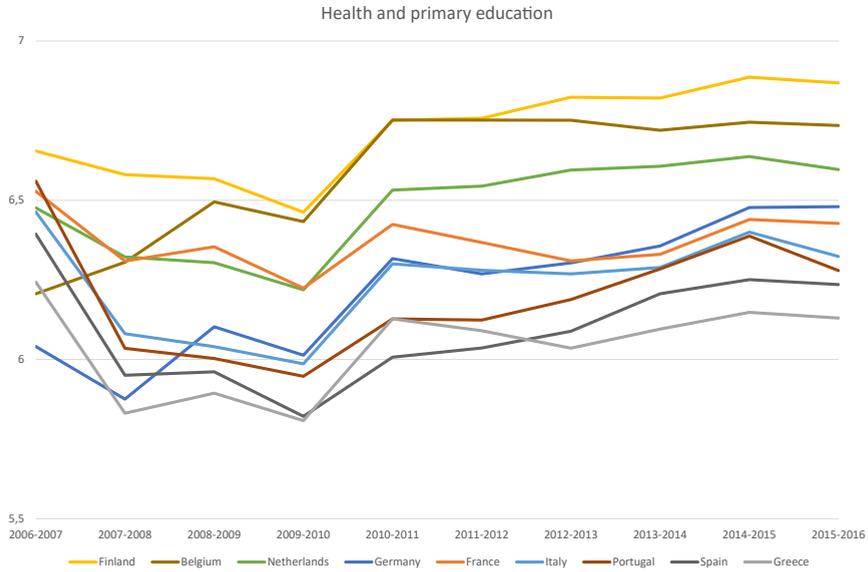


Figure 17 Higher education and training. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

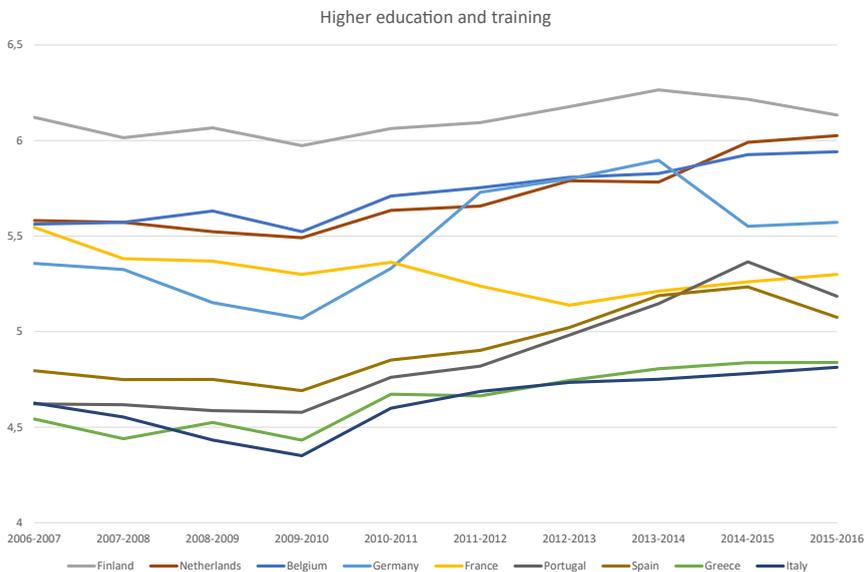


Figure 18 Goods market efficiency. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

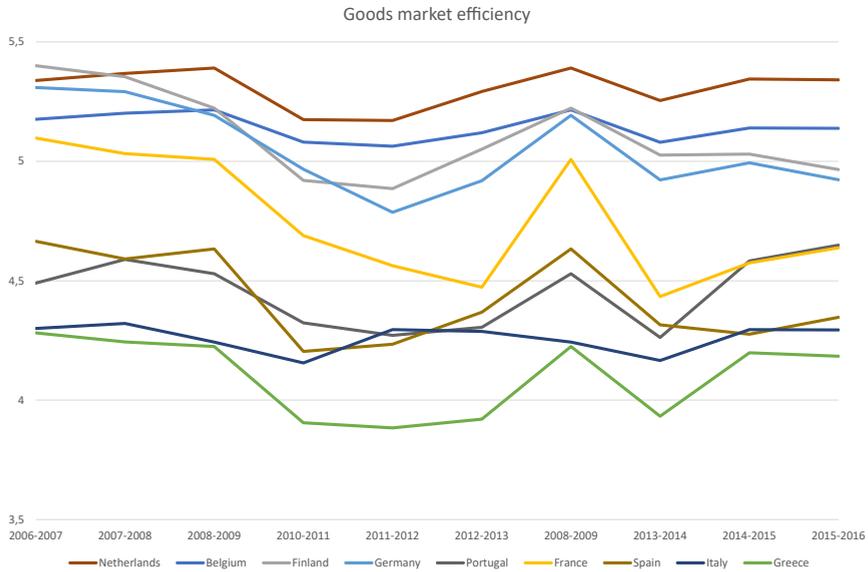


Figure 19 Labor market efficiency. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

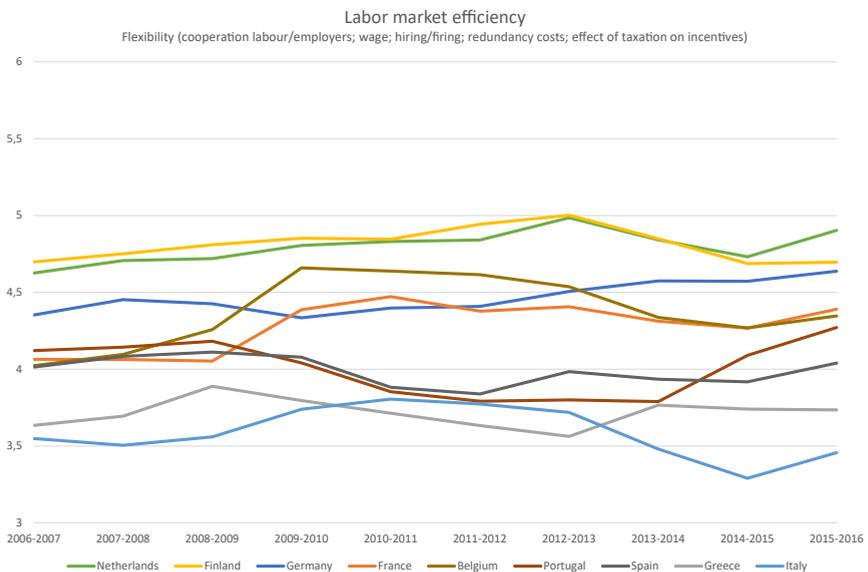


Figure 20 Financial market development. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

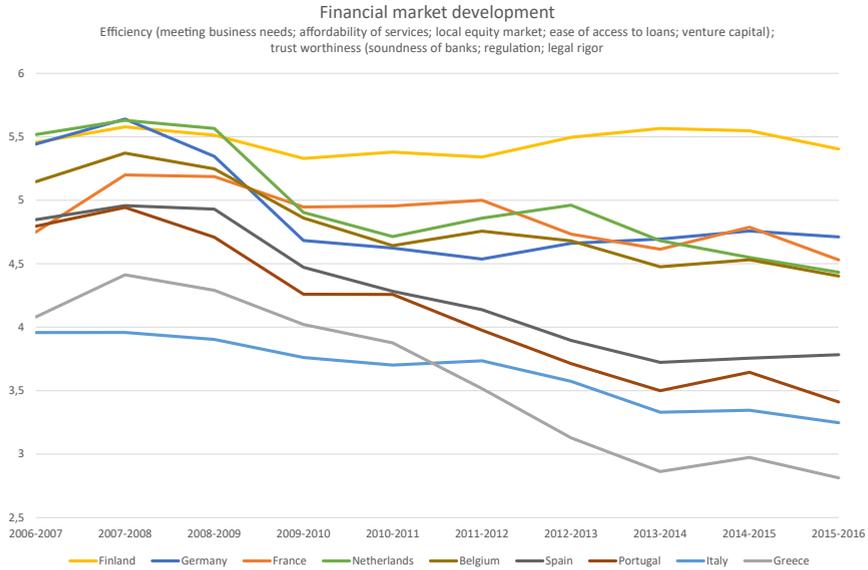


Figure 21 Technological readiness. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

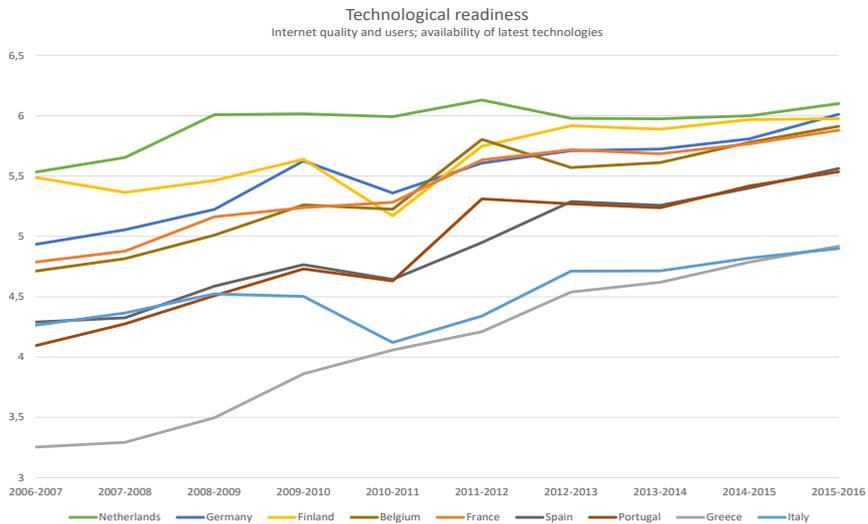


Figure 22 Internet quality and user. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

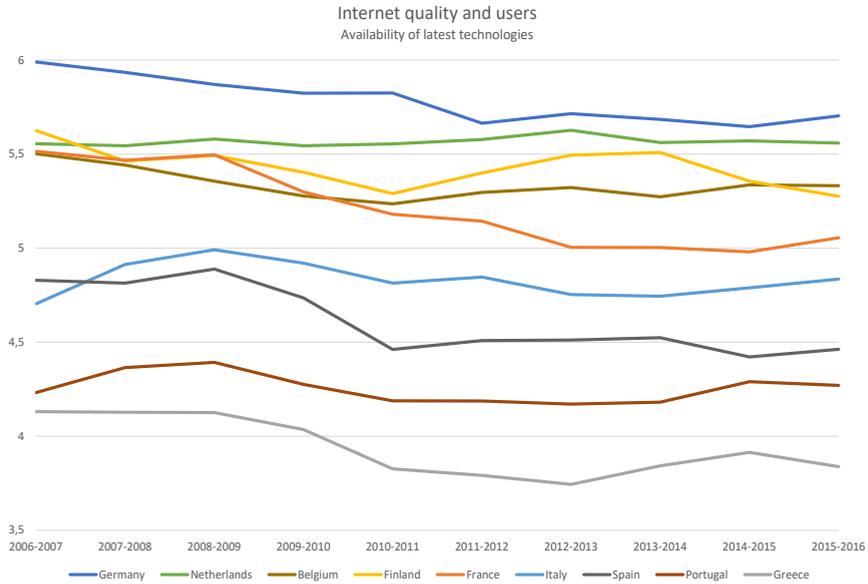


Figure 23 Innovation. Source: Global Competitiveness Report, World Economic Forum. Adapted by author. 1 = lowest, 7 = highest.

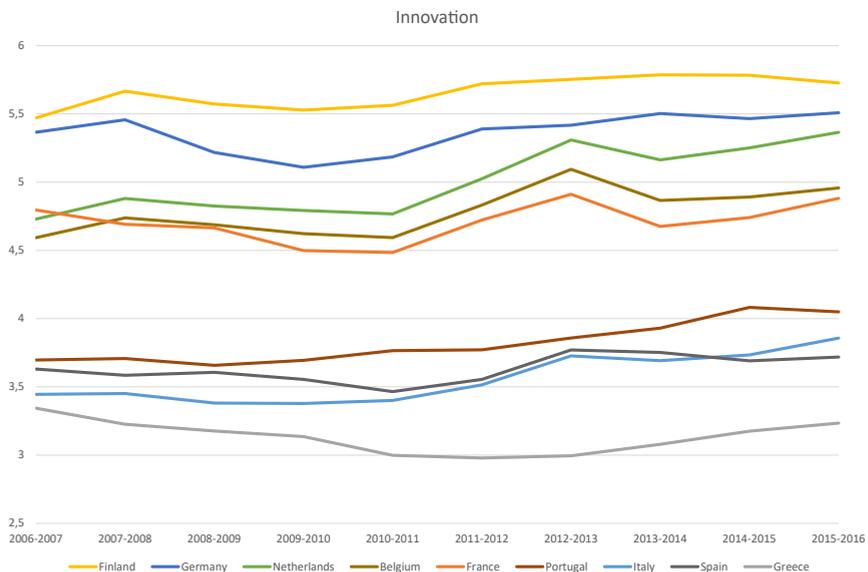


Figure 24 Product Market Regulation. Source: OECD. Adapted by author.
0 = least restrictive, 6 = most restrictive.

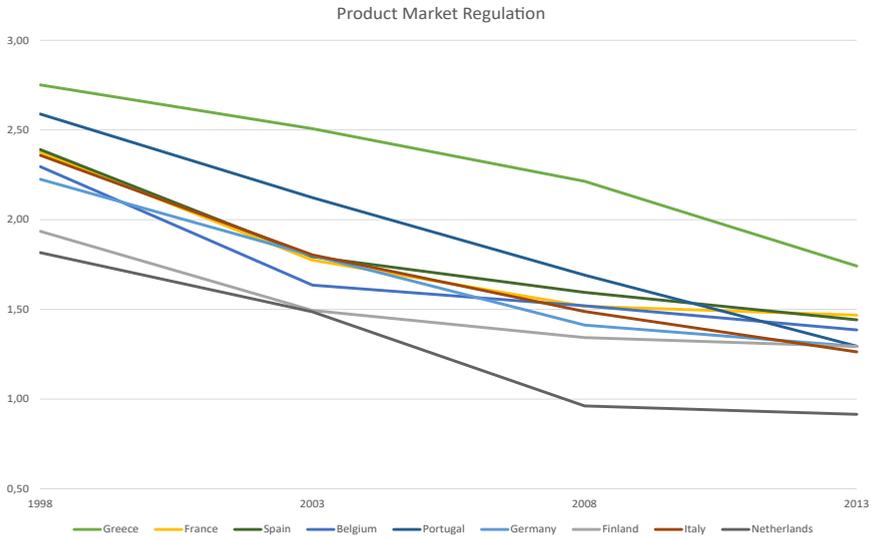


Figure 25 Product Market Regulation: Barriers to entrepreneurship. Source: OECD.
Adapted by author. 0 = least restrictive, 6 = most restrictive.

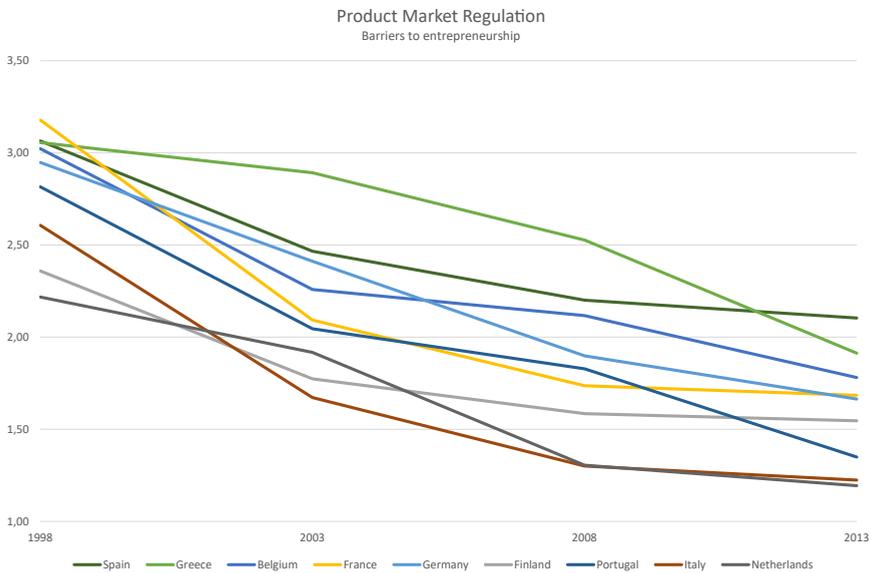


Figure 26 Product Market Regulation: Complexity of regulatory procedures.
 Source: OECD. Adapted by author. 0 = least restrictive, 6 = most restrictive.

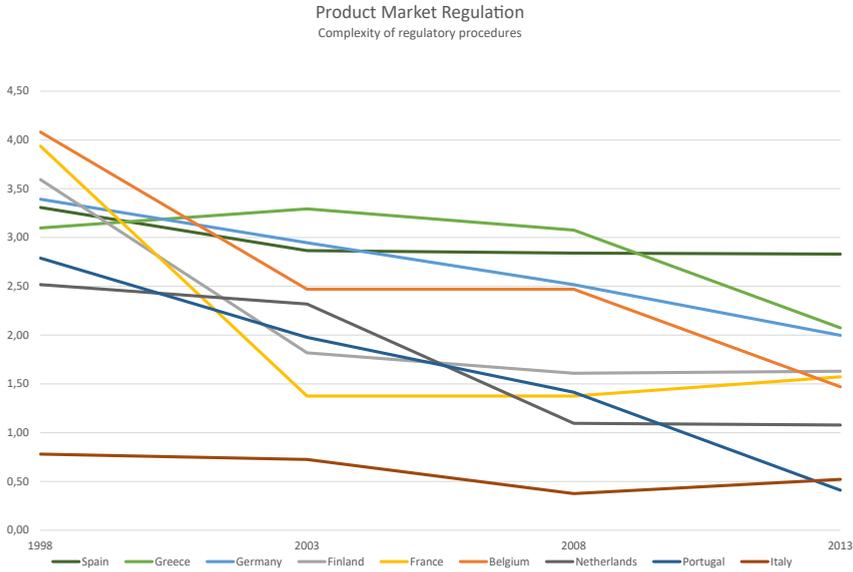


Figure 27 Product Market Regulation: Administrative burdens on startups.
 Source: OECD. Adapted by author. 0 = least restrictive, 6 = most restrictive.

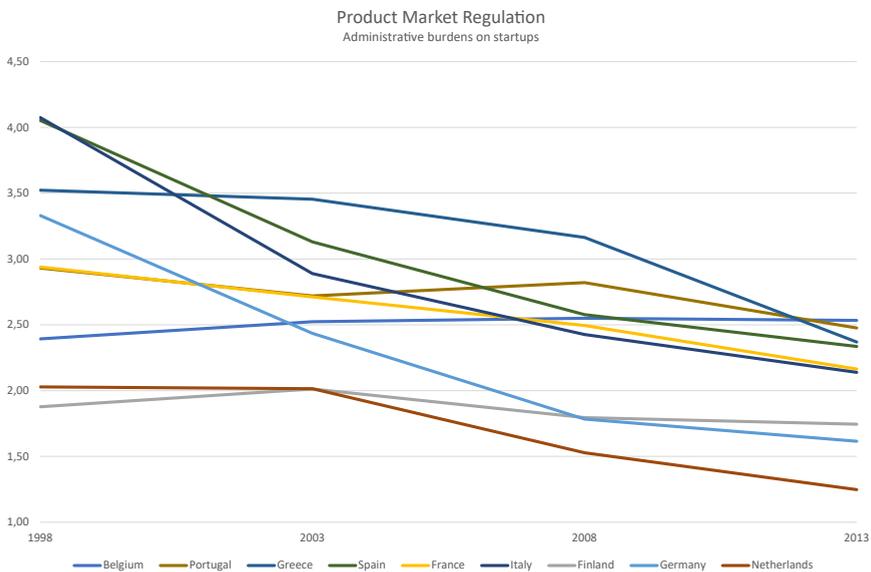


Figure 28 Product Market Regulation: Regulatory protection of incumbents.
Source: OECD. Adapted by author. 0 = least restrictive, 6 = most restrictive.

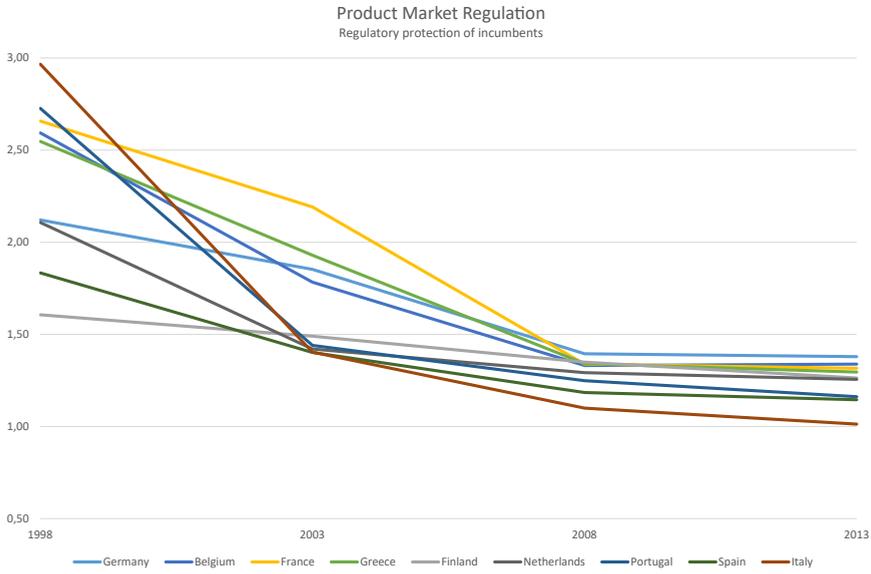


Figure 29 Policy Performance. Source: Sustainable Governance Indicator.
1 = lowest, 10 = highest

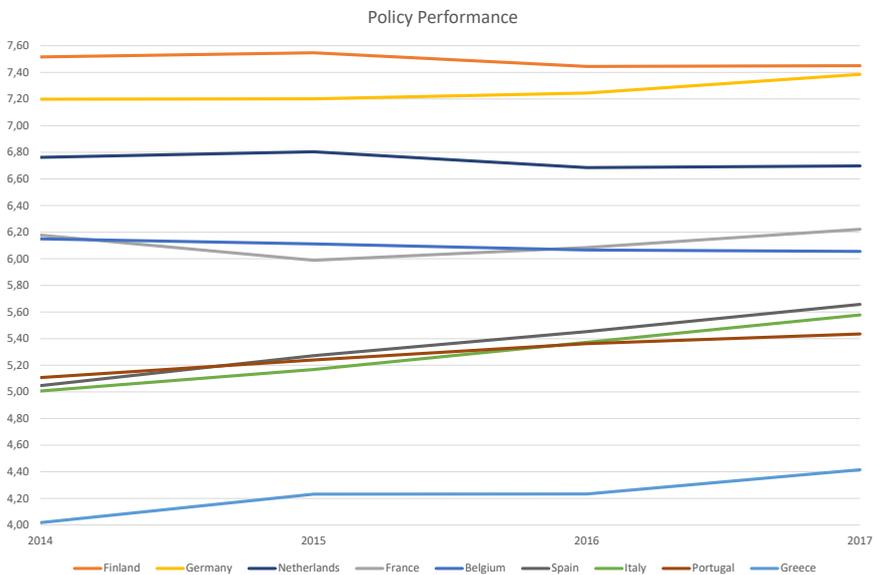


Figure 30 Economic Policies. Source: Sustainable Governance Indicator.
1 = lowest, 10 = highest

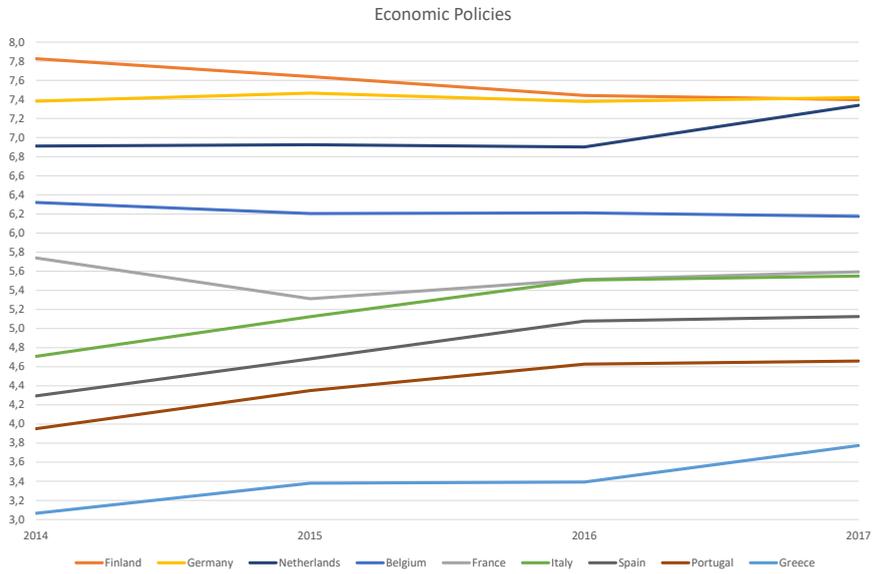


Figure 31 Social Policies. Source: Sustainable Governance Indicator.
1 = lowest, 10 = highest.

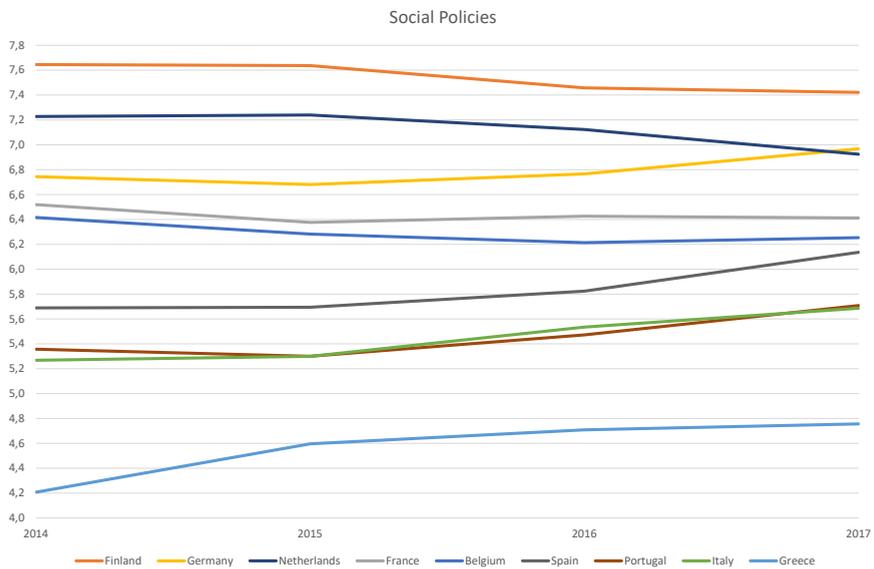


Figure 32 Governance. Source: Sustainable Governance Indicator.
1 = lowest, 10 = highest.

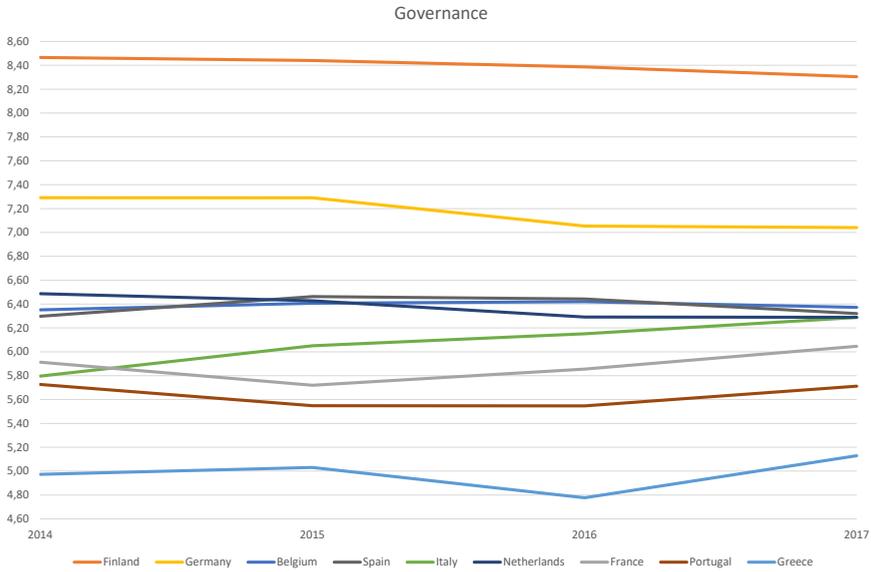


Figure 33 Executive Capacity. Source: Sustainable Governance Indicator.
1 = lowest, 10 = highest.

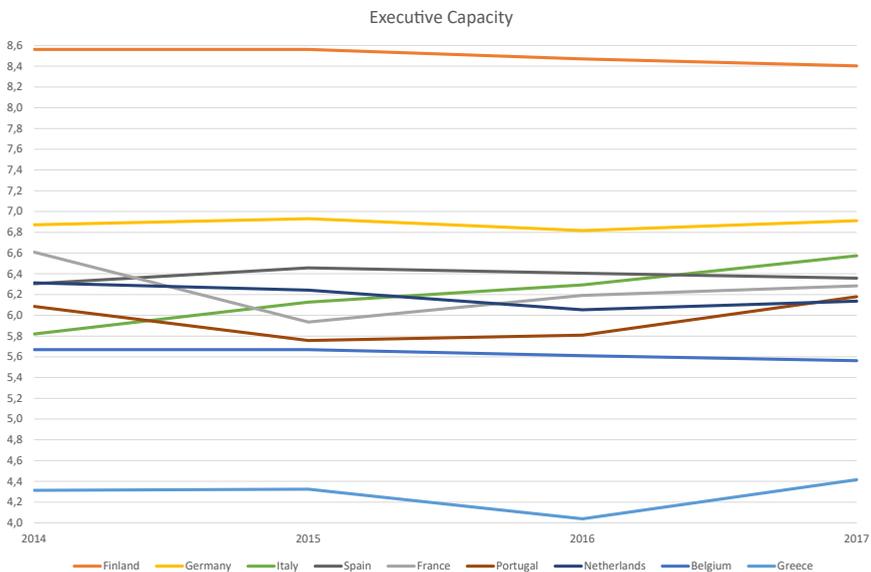


Figure 34 Executive Accountability. Source: Sustainable Governance Indicator.
1 = lowest, 10 = highest.

