

## VI. Conclusions

After a decade of increasing divergence, the global economic crisis has triggered a partial rebalancing of current accounts. The rebalancing is partly structural but also partly temporary and could be partially reversed with the recovery. It has been associated with some improvements in underlying domestic imbalances, particularly in terms of balance sheets in the private sector of current account deficit countries and some house price corrections. However, some new imbalances have emerged in the form of surging unemployment that call for determined policy action that facilitates labour reallocation and boosts labour productivity. Structural weaknesses in private sector demand in surplus countries also appear to largely persist. Furthermore, except for Ireland, convergence in current accounts has so far been associated with only moderate rebalancing of relative prices.

Overall, while the crisis has reduced some underlying imbalances, the need for substantial adjustment remains. It should involve a rebalancing of relative prices and demand across Member States.

Competitiveness divergences and underlying imbalances are a matter of common concern for euro-area Member States and warrant appropriate and timely policy measures. Determined action would reduce the social costs of unwinding euro-area imbalances. It would also facilitate the smooth functioning of EMU. A coordinated approach will contribute to attaining this objective.

Coordination will clearly be beneficial in achieving the objective of a smooth adjustment because of substantial trade and financial linkages. A common approach to addressing imbalances would reduce the adjustment difficulties of each individual country compared to a situation, where countries would act in an uncoordinated way. Moreover, a coordinated approach would be associated with fewer,

potentially distorting side effects on comparatively balanced economies in the euro area.

The policy response should be comprehensive, tailored to the specific needs of each Member State and cover measures in a range of areas: budgetary and wage policies, labour markets, product and service markets and the financial sector.

Action is required in all euro-area Member States. In the horizontal terms of reference adopted on March 15, the Eurogroup explicitly acknowledged the need for action in both current account deficit and surplus countries (see Box VI.1). As the terms of reference line out, the nature, importance and urgency of the policy challenges differ significantly depending on the countries considered.

Given vulnerabilities and the magnitude of the adjustment required, the need for policy action is particularly pressing in Member States which have accumulated large current account deficits and large competitiveness losses. These countries need to undertake the necessary relative wage and price adjustments and facilitate the reallocation of resources from the non-tradable to the export sector. In countries with fiscal imbalances, this adjustment should go hand-in-hand with sizeable fiscal consolidation.

Action is also needed in Member States that have accumulated large current account surpluses. In these countries, policies should aim to identify and implement structural reforms that help in strengthening domestic demand.

The crisis has underscored the need for reforms and co-ordination across Member States. A coordinated and ambitious policy response would ease the necessary adjustment processes but would also boost the euro-area's long-term growth prospects.

*Box VI.1: Conclusions of the Eurogroup - Surveillance of intra-euro-area competitiveness and macroeconomic imbalances*

On 15 March, the Eurogroup Ministers discussed the issue of divergences in competitiveness and macroeconomic imbalances within the euro area. A consensus emerged both on the analysis of the situation and on necessary policy responses by all Member States.

All euro-area Member States are facing important policy challenges to address the economic, budgetary and financial implications of the crisis and to pave the way for sustainable growth. This requires policy action geared at mitigating the impact of the crisis on potential output and employment, boosting productivity growth and ensuring sustainable public finances. An additional challenge arises from the existence of large competitiveness and current-account differences among euro-area countries. A smooth adjustment is important for the recovery and, more generally, for the smooth functioning of EMU.

Competitiveness divergences and current-account imbalances increased steadily in pre-crisis years and have in most cases largely persisted throughout the crisis. They have been underpinned by the build-up of a range of domestic economic imbalances in some Member States, including inter alia high (public and private) debt, structural weaknesses and housing bubbles in some current-account deficit countries, as well as persistent weakness in domestic demand in some surplus countries.

Competitiveness divergences and underlying imbalances are a matter of common importance for euro area Member States and warrant appropriate and timely policy measures. Determined action would reduce the social costs of unwinding euro area imbalances as well as the risks related to a market-driven correction. It would also facilitate the smooth functioning of EMU. A coordinated approach will contribute to attaining this objective.

The policy response should be comprehensive, tailored to the specific needs of each Member State and cover measures in four key areas: budgetary and wage policies, labour markets, product and service markets and the financial sector. Measures targeted at boosting labour productivity and potential growth, improving resource allocation by the financial sector and ensuring sustainable public finances would be beneficial in all Member States as they would help to correct imbalances and to underpin the recovery.

Action is required in all euro-area Member States, but the nature, importance and urgency of the policy challenges differ significantly depending on the countries considered. Given vulnerabilities and the magnitude of the adjustment required, the need for policy action is particularly pressing in Member States showing persistently large current-account deficits and large competitiveness losses.

These countries need to undertake the necessary relative wage and price adjustments and facilitate the reallocation of resources from the non-tradable to the export sector. In countries with fiscal imbalances, this adjustment should go hand in hand with sizeable fiscal consolidation. Countries where weaknesses in the fiscal framework contributed to fuelling external imbalances in the past should take steps to control primary expenditure and increase the effectiveness and efficiency of public finances. But action is also needed in Member States that have accumulated large current-account surpluses. In these countries, policies should aim to identify and implement structural reforms that help in strengthening domestic demand. Finally, in Member States that suffer from structural weaknesses in their export performance without incurring large current account deficits, there is a need to improve both price and non-price competitiveness.

Ministers commit:

- to address the issue of competitiveness divergences and macroeconomic imbalances swiftly and effectively;
- to put in place an ambitious and comprehensive policy response covering appropriate measures in four broad areas: budgetary and wage policies, labour markets, goods and services markets and the financial sector;
- to make sure that the agreed policy response is coordinated in the euro area, designed to address the specific vulnerabilities and needs of each country and facilitates the smooth functioning of EMU; and
- to review progress made on a regular basis.

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