Journal of Central Banking Theory and Practice, 2013, 1, pp. 69-88
Received: 4 January 2013; accepted: 15 January 2013

UDC: 338.124.4(497-15)

Daniela Bobeva, PhD [1*]

** Director of International Relations at the Bulgarian National Bank*

Email: Bobeva.D@bnbank.org

The new EU Macroeconomic Imbalances Procedure and its Relevance for the Candidate Countries[2]

Abstract: The paper presents the main features of the new macroeconomic imbalances procedure (MIP) as well as the MIP scoreboard for the surveillance of macroeconomic imbalances. The main issues under review are the relevance to use the MIP scoreboard as a tool to assess the vulnerabilities and imbalances of the EU candidate countries and whether it is suitable for the candidate countries to use the scoreboard as an early warning tool and a benchmarking tool for the economic policy design. The analysis of the imbalances in the Western Balkan countries suggests that they are not linked to the crisis but more to the restructuring of the economy and the caching-up process. The relative resilience of the crisis proves the flexibility and capabilities for adjustment of those economies.

Key words: Macroeconomic imbalances procedure, scoreboard, imbalances, the Western Balkan countries

JEL classification number: E61, E66, H12

The recent economic crisis forced the EU institutions to search for instruments to strengthen the economic governance in the Member States in order to prevent further contingent impact and to prevent future crises. In the search for such instruments, the interest in mechanical instruments like scoreboards, dashboards, etc. gained its momentum. Scoreboards are a known instrument in the EU comparative analysis and furthermore in policy design. For example, the European

[1] The author would like to thank Mr. Dimitar Zlatinov for his support in the preparation of this paper.

[2] The views expressed in this paper are those of the author and should not be attributed to the BNB

Innovation Scoreboard (EIS) was constructed in 2000 to 'track and benchmark the relative innovation performance of EU Member States' covering 17 countries and using 16 indicators. The Consumer Markets Scoreboard is used to show which markets are malfunctioning and do not meet consumer expectations. It monitors market performance from the perspective of economic and social outcomes for consumers. It rather ranks and compares markets from the perspective of European consumers and it is published twice a year. Another EU scoreboard is the Industrial Performance Scoreboard which consists of indicators in five areas: productivity and skills; export performance; innovation and sustainability; business environment and infrastructure; and finance and investment. Taking into account these areas, the basis for the scoreboard were 30 or more indicators. The most recent EU scoreboard is derived from the reform of the economic governance in the EU and aims at identifying and monitoring risks related to macroeconomic imbalances. Maybe because this instrument is rather new there are still no studies on its usefulness and implications, neither any attempt to test it in the case of catching-up economies of the Western Balkans.

In this paper we present the main features of the macroeconomic imbalances procedure (MIP) scoreboard, the benefit for the EU member states and the rationale to use this instrument for the EU candidate countries as well as its methodology and results for the candidate countries. Two questions are raised in this paper: is it relevant to use the MIP scoreboard as a tool to assess the vulnerabilities and imbalances of the candidate countries, and is it useful for the candidate countries to use the scoreboard as an early warning tool and a benchmarking tool for the economic policy design. The report covers some of the EU applicant countries, namely Albania, Bosnia and Herzegovina, FYROM, Montenegro and Serbia[3].

We argue that the new alert mechanism does not take into account the specificities of the catching-up economies and its implications may be misleading for both the markets and the policy makers.

What is the macroeconomic imbalances procedure scoreboard

The recent economic crisis inspired a radical reform in the macroeconomic governance of the EU. The reform was introduced with a set of new rules, the so-called "Six-Pack" since it comprises six legal acts. Two of them established a totally new mechanism for surveillance of macroeconomic developments - the scoreboard for the surveillance of macroeconomic imbalances under the MIP.

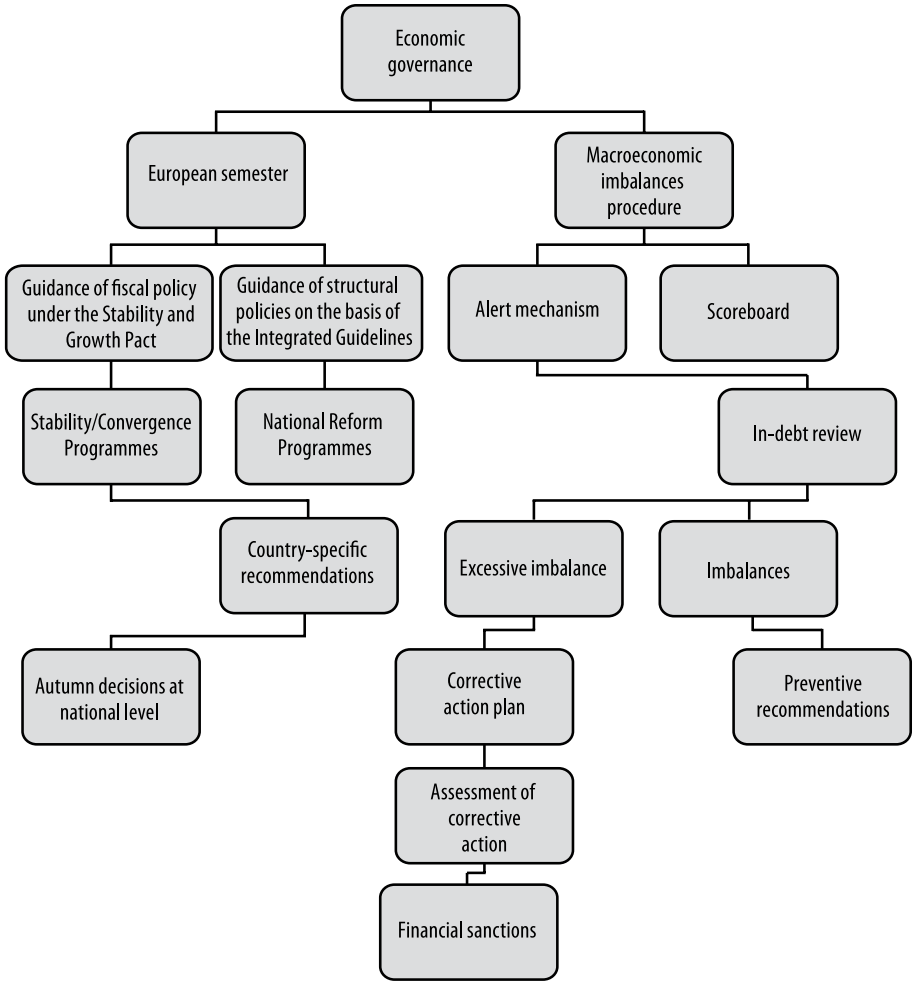
[3] For simplicity, these countries are to be referred to as the Western Balkan countries.

The MIP is a surveillance mechanism that has the ambitious aims to prevent and correct macroeconomic imbalances.

The scoreboard is a part of the MIP which includes:

- *alert mechanism* which facilitates the early identification and the monitoring of imbalances based on qualitative economic and financial assessment;
- *scoreboard* which comprises a set of indicators with indicative thresholds differentiated for euro and non-euro area MSs that are used in the early identification of external and internal imbalances;
- *in-depth review* which aims at determining whether the potential imbalances identified in the early-warning system are benign or problematic.

The EU Economic Governance structure



The initial screening of macroeconomic imbalances is mandated to the Alert Mechanism Report which identifies the countries whose developments warrant further in-depth analysis to determine whether imbalances exist. The alert mechanism of the MIP consists of an indicator-based scoreboard. The scoreboard includes indicative thresholds for the indicators to serve as alert levels and has upper and lower alert thresholds, unless inappropriate, which are differentiated for euro and non-euro area member states. In order to avoid automatic reading of the scoreboard, a procedure is established to complement the scoreboard with an in-depth analysis for the countries that were indicated by the scoreboard as experiencing imbalances. The nature of the imbalances and their gravity is subject to the follow-up in-depth analysis country by country. In the in-depth analysis, the European Commission proposes recommendations that aim to map the measures to correct or prevent imbalances.

As expected, the scoreboard was welcomed by all EU institutions. As pointed out by the European Systemic Risk Board (2011) the scoreboard (indicators and thresholds) will provide reliable signals of potentially harmful imbalances and competitiveness losses at an early stage and as recognized by the ESRB "the scoreboard plays an important role in communication". The ESRB emphasises that the scoreboard should be of high statistical quality, otherwise it may be misleading.

The ECB (2012) also welcomed the new procedure. It points out that the MIP will prevent excessive macroeconomic imbalances and will help diverging EU Member States to establish corrective plans before divergence becomes entrenched. The ECB also emphasized that the alert mechanism for the early detection of imbalances is based on a transparent scoreboard of indicators with alert thresholds for all EU Member States, combined with economic judgment. The judgment element of the scoreboard although necessitated by the complexity of the economic imbalances and the difficulty to assess them only on the grounds of a matrix of indicators, creates uncertainty and room for broad interpretation.

The transparency of the scoreboard is valued by the ECB as a strong advantage. The scoreboard has an important communication role since it provides signals of potentially harmful imbalances and competitiveness losses at an early stage of their emergence. If the scoreboard does not detect the risks correctly the signals it sends to the markets may be harmful.

The selection of indicators in the scoreboard took some time and was thoroughly discussed. Conceptually, it is not an easy task to choose the most relevant dimensions of macroeconomic imbalances and competitiveness losses. The scoreboard

consists of indicators which can monitor external and internal balances. It capitalizes on the research in the area of macroeconomic imbalances.

It is important how the scoreboard data will be interpreted. That is why, as stipulated in Regulation (EU) No 1176/2011, additional indicators may be taken into account while reading the scoreboard.

The procedure for macroeconomic imbalances started with 10 indicators and, in late 2012, another indicator was included which aims at detecting vulnerabilities of the financial sector. After a long discussion, it was decided to use the year-on-year changes in total financial sector liabilities with a threshold of 16.5% as an integrative indicator for the financial sector.

The MIP Scoreboard Indicators

Indicator	Threshold
3 year backward moving average of the current account balance as percent of GDP	+6% of GDP and -4% of GDP
net international investment position as percent of GDP	-35% of GDP
5 years percentage change of export market shares measured in values	-6%
3 years percentage change in nominal unit labour cost	+9% for euro-area countries +12% for non-euro-area countries
3 years percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 35 other industrial countries	-/+5% for euro-area countries -/+11% for non-euro-area countries
private sector debt in % of GDP	160%
private sector credit flow in % of GDP	15%
year-on-year changes in house prices relative to a Eurostat consumption deflator	6%
general government sector debt in % of GDP	60%
3-year backward moving average of unemployment rate	10%
year-on-year changes in total financial sector liabilities	16.5%

The inclusion of one indicator that summarises the financial sector performance is arguable since it will ignore the complexity of this sector and may be misleading. Moreover, the selected indicator does not take into account the different levels of development of financial sectors in the EU member states and will "penalise" catching-up financial markets like those of the new members of the EU, in which financial intermediation is still catching up and needs more dynamics.

The scoreboard includes both stock and flow indicators aiming at capturing the accumulation of imbalances over time as well as detecting short-term risks. The regulation which sets up the rules of the scoreboard envisages that the composition of the indicators may evolve over time. The EC underlines that while assessing the imbalances it also takes into account (although it is not clear how) other indicators – GDP growth, gross fixed capital formation, net lending/borrowing, FDI inflows, labour productivity, employment, etc.

The MIP Scoreboard data transformation

Indicators	Formulas for data transformation
3 year backward moving average of CURRENT ACCOUNT BALANCE as % of GDP	$\frac{\left(\frac{CA}{GDP}\right)_t + \left(\frac{CA}{GDP}\right)_{t-1} + \left(\frac{CA}{GDP}\right)_{t-2}}{3} * 100$
NET INTERNATIONAL INVESTMENT POSITION as % of GDP	$\frac{NIIP_t}{GDP_t} * 100$
% change (3 years) of REAL EFFECTIVE EXCHANGE RATE with HICP deflators relative to 35 other industrial countries [(a)]	$\frac{(REER\_HICP\_35)_t - (REER\_HICP\_35)_{t-3}}{(REER\_HICP\_35)_{t-3}} * 100$
% change (5 years) in EXPORT MARKET SHARES	$\frac{\left(\frac{EXP_c}{EXP_{world}}\right)_t - \left(\frac{EXP_c}{EXP_{world}}\right)_{t-5}}{\left(\frac{EXP_c}{EXP_{world}}\right)_{t-5}} * 100$
% change (3 years) in NOMINAL UNIT LABOUR COST [(b)]	$\frac{(ULC)_t - (ULC)_{t-3}}{(ULC)_{t-3}} * 100$
y-o-y % change in DEFLATED HOUSE PRICES [(c)]	$\left(\frac{\frac{HPI_t}{DEFL_t} - \frac{HPI_{t-1}}{DEFL_{t-1}}}{\frac{HPI_{t-1}}{DEFL_{t-1}}}\right) * 100$
PRIVATE SECTOR CREDIT FLOW as % of GDP [(d)(e)]	$\frac{PSCF_t}{GDP_t} * 100$
PRIVATE SECTOR DEBT as % of GDP [(d)(e)]	$\frac{PSD_t}{GDP_t} * 100$
GENERAL GOVERNMENT DEBT as % of GDP	$\frac{GGD_t}{GDP_t} * 100$
3 year backward moving average of UNEMPLOYMENT RATE	$\frac{(UR)_t + (UR)_{t-1} + (UR)_{t-2}}{3}$

Note: without financial sector indicator

The data used for the calculation of the scoreboard should be comparative and of high quality which is already possible for the EU member states since they have harmonised their macroeconomic statistics. The calculation is based on an interactive database for the indicators of the scoreboard and additional 'reading' indicators (see the EC Scoreboard data platform).

What are the first lessons from the implementation of the MIP in the EU member states?

The first alert Mechanism Report (AMR) was released in February 2012 and marked the first step in implementing the surveillance procedure for the prevention and correction of macroeconomic imbalances. The main conclusion of this report is that the Commission decided to go to the second step of the procedure namely to prepare a further in-depth analysis in order to examine the imbalances for the following Member States: Belgium, Bulgaria, Denmark, Spain, France, Italy, Cyprus, Hungary, Slovenia, Finland, Sweden and the United Kingdom. Having in mind that the procedure does not apply to the so-called programme countries (Greece, Ireland, Portugal, Romania and Latvia) which are under enhanced economic surveillance of their economic situation and policies and they are not examined under the macroeconomic imbalances it seems that only few of the Member States are not considered as experiencing macroeconomic imbalances which may be excessive and should be addressed. Actually, the alert mechanism is confirming the well-known vulnerabilities and potential risks, of which some have already materialized.

The MIP Scoreboard 2011

Year 2011	External imbalances and competitiveness						Internal imbalances				
	3 year average of Current Account Balance as % of GDP	Net International Investment Position as % of GDP	% Change (3 years) of Real Effective Exchange Rate with HICP deflators	% Change (5 year) in Export Market Shares	% Change (3 years) in Nominal ULC	% y-o-y change in deflated House Prices	Private Sector Credit Flow as % of GDP	Private Sector Debt as % of GDP	General Government Debt as % of GDP	Uneployment rate - 3 year average	% y-o-y Change in Total Financial Sector Liabilities non-consolidated
Thresholds	-4/+6%	-35%	±5% & ±11%	-6%	+9% & +12%	+6%	15%	160%	60%	10%	16.5%
BE	-0.3	65.7	-0.5	-10.2	6.2	-0.1	11.6	236	98	7.8	4.7
BG	-3.4	-85.6	3.1	17.2	20.3	-9.0	-6.7	146	16	9.4	5.6
CZ	-3.0	-49.3	0.3	8.4	3.3	0.0	2.5	78	41	6.9	3.8
DK	5.0	24.5	-1.7	-16.9	4.7	-4.9	-2.2	238	47	7.0	4.7
DE	5.9	32.6	-3.9	-8.4	5.9	1.4	4.8	128	81	6.9	2.1
EE	2.8	-57.8	0.8	11.1	-6.2	3.3	6.8	133	6	14.4	-4.4
IE	0.0	-96.0	-9.1	-12.2	-12.8	-15.2	4.0	310	106	13.3	-0.6
EL	-10.4	-86.1	3.1	-18.7	4.1	-5.1	-5.5	125	171	13.2	-3.4
ES	-4.3	-91.7	-1.3	-7.6	-2.1	-10.0	-4.1	218	69	19.9	3.7
FR	-1.6	-15.9	-3.2	-11.2	6.0	3.8	4.0	160	86	9.6	7.3
IT	-2.9	-20.6	-2.1	-18.4	4.4	-2.0	2.6	129	121	8.2	3.8
CY	-8.4	-71.3	-0.9	-16.4	8.8	-8.5	16.1	288	71	6.6	-0.2
LV	3.1	-73.3	-0.6	23.6	-15.0	4.9	-2.5	125	42	18.1	-4.5
LT	0.0	-52.6	3.6	25.2	-8.4	2.4	-0.8	70	39	15.6	8.9
LU	7.5	107.8	0.8	-10.1	12.5	1.5	2.5	326	18	4.8	11.3
HU	0.6	-105.9	-3.3	-2.8	3.7	-4.1	6.4	167	81	10.7	-2.6
MT	-4.3	5.7	-3.0	11.7	5.8	-2.3	2.2	210	71	6.8	1.4
NL	7.5	35.5	-1.6	-8.2	5.8	-4.0	0.7	225	66	4.2	7.2
AT	2.2	-2.3	-1.0	-12.7	5.9	-8.0	4.1	161	72	4.4	-0.3
PL	-4.6	-63.5	-10.9	12.8	4.3	-5.7	7.1	80	56	9.2	4.4
PT	-9.1	-105.0	-1.9	-9.5	0.9	-3.6	-3.2	249	108	11.9	-0.7
RO	-4.3	-62.5	-2.4	22.8	12.9	-18.9	1.8	72	33	7.2	4.3
SI	-0.4	-41.2	-0.3	-6.1	8.3	1.0	1.9	128	47	7.1	-1.3
SK	-2.1	-64.4	4.3	20.9	4.4	-5.6	3.3	76	43	13.4	1.2
FI	0.6	13.1	-1.3	-22.9	9.1	-0.3	4.6	179	49	8.1	30.8
SE	6.6	-8.3	3.9	-11.6	1.2	1.0	6.3	232	38	8.1	3.6
UK	-2.2	-17.3	-7.1	-24.2	8.1	-5.4	1.0	205	85	7.8	8.5

The next step was to prepare in-depth reviews for the proposed countries. The analysis again confirmed that these countries faced macroeconomic imbalances and they needed to be corrected and closely monitored. The main conclusion from the analysis is that "each of the twelve countries has imbalances which are not excessive but need to be addressed nonetheless. Spain and Cyprus have serious imbalances, which are not excessive but need to be addressed urgently. The next most significant imbalances are in Slovenia and Hungary"(EC, 2012). Although not envisaged in the Regulation, the European Commission announced a kind of ranking for the countries according to the level of risks for their economies. This public message itself fuels the negative market perceptions about those countries warning investors about the risks there and thus could further deteriorate the situation. The use of public communication on the MIP as a tool to put pressure on national authorities and encourage the policy responses could be limited.

One of the possible positive inputs of the scoreboard and the related MIP is the formulation of policy recommendations. The recommendations under the preventive arm of the Macroeconomic Imbalance Procedure form a part of the package of country-specific recommendations put forward by the Commission for adoption by the Council under the European Semester. The implementation of the recommendations will be monitored closely and on an ongoing basis by the Commission services. Moreover, there will be peer pressure from other EU member states as the recommendations will be endorsed at the highest political level. In addition, the close scrutiny by financial markets is a strong incentive for governments to pursue structural reforms and to tackle unsustainable economic developments. Finally, it should be noted that in the country-specific recommendations, macroeconomic imbalances are addressed with the aim of avoiding their becoming excessive.

The first round of the macroeconomic imbalances procedure revealed several unclear elements that need further elaboration. This concerned the application of the sanctioning mechanism (financial sanction up to 0.1% of GDP). It is envisaged only for the euro area countries and only in cases where the member states concerned do not undertake sufficient measures in response to the existing imbalances. In such cases, those countries are placed under an Excessive Imbalance Procedure. In the first round of in-depth assessments in 2012, although severe imbalances were identified, no country was put under the procedure. This fact begs the question of how strong the imbalances should be in order to activate the procedure.

The other vague issue is the criteria pursuant to which the member states that incur imbalances are selected for the in-depth analysis. Basically this is the score-

board which shapes up the selection, however, according to the European Commission, the selection is not based on mechanical reading of the indicators but on qualitative assessment of some of them. However, it remains unclear which ones of scoreboard indicators have the highest weight when the EC makes assessment that a MS experiences serious imbalances. Those uncertainties of the application of the scoreboard need further attention having in mind the importance of the scoreboard for the market perceptions.

The calculations of the scoreboard for the Western Balkan countries

The scoreboard is the only instrument in the EU for assessing macroeconomic imbalances. It is probable that it will be used as a broader instrument to detect imbalances. Indication for this is the 2012 convergence report of the European Central Bank, where in Chapter 3 "the scoreboard indicators (including in relation to the alert thresholds) are presented for all countries covered in this Report, thereby ensuring the provision of all available information relevant to the detection of macroeconomic imbalances that may be hampering the achievement of a high degree of sustainable convergence as stipulated under Article 140(1) of the Treaty. Notably, the EU Member States with derogation that are subject to an Excessive Imbalance Procedure can hardly be considered as having achieved a high degree of sustainable convergence as stipulated by Article 140(1) of the Treaty" (ECB, 2012). Obviously, the ECB is using the scoreboard **as a criterion for the sustainability of convergence**. Such a concept goes beyond the Treaty criteria for convergence as in Article 140 paragraph 1 of the Treaty, the criteria and factors on which the ECB shall assess and report the progress towards sustainable convergence made by the member states with derogation are specified fully and explicitly. Any generalization of the factors as well as inclusion of new indicators to assess the member states` convergence may only be used for practical reasons and may not lead to the broadening of the list of the explicitly set factors in legislation. Furthermore, the MIP based on a secondary legislative act, on one hand, and the assessment of economic convergence, on the other hand, are two separate procedures and despite the possible interaction between them, they cannot be merged into one.

Since the ECB considers the scoreboard as an important assessment instrument for convergence, it is possible that it could be utilized for the assessment of the candidate countries' economies. That is why it is beneficial to calculate the indicators of the scoreboard and to test the results for those countries.

The first issue with the application of the scoreboard as regards the EU applicant countries is the problem with the statistical input. There are fundamental limitations that make this exercise incomplete and therefore not well grounded:

- neither data for all indicators are available, nor for all countries;
- there are significant differences in the data sources and definitions in the EU applicant countries and, therefore, there are doubts about the comparability of the data used;
- there are no long time series of the data available.

The ECOFIN data portal AMECO provides statistical data but only for some of those countries and some of the indicators. The use of different sources may yield less comparable results across countries, as well as being more subject to controversy.

There are data available for the calculation of five out of 11 indicators, namely:

- 3-year backward moving average of current account balance as a % of GDP;
- Net international investment position as a % of GDP;
- Percentage change (5 years) in export market shares;
- General government debt as a % of GDP;
- 3-year backward moving average of unemployment rate.

The data limitation does not give the opportunity to calculate the scoreboard indicators in full. Therefore, all results from the calculations have to be interpreted with caution, especially if used as a tool for public communication.

Current account balance

One of the main indicators for assessing external imbalances in the MIP scoreboard is the current account deficit/surplus. It is calculated as a 3-year backward moving average of the current account balance as a % of GDP. The scoreboard envisages an asymmetrical threshold of 4% for the deficit and 6% for the surplus. This "intelligent symmetry" is not well justified although it allows recognizing both current account surpluses and deficits as imbalances that pose risks of negative spillover effects.

Since the IMF statistics provides for a good quality internationally comparable data this indicator of the macroeconomic imbalances scoreboard could be calculated for the Western Balkan countries.

Current account balance as a % of GDP (+6/-4%)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Albania	-1.6	-1.5	-4.6	-5.1	-5.4	-5.0	-5.2	-7.4	-10.4	-13.2	-13.5	-12.6
Bosnia and Herzegovina	-7.5	-9.6	-12.6	-16.6	-17.7	-17.5	-13.7	-11.9	-10.9	-10.4	-8.7	-6.9
FYROM	-4.4	-3.9	-6.2	-6.9	-7.2	-4.9	-3.7	-3.4	-6.8	-8.9	-7.3	-3.9
Montenegro	n/a	n/a	n/a	n/a	n/a	-10.2	-18.4	-29.2	-40.5	-39.9	-34.9	-24.6
Serbia	n/a	n/a	-4.2	-6.0	-9.2	-9.4	-10.4	-11.7	-15.9	-14.9	-12.0	-8.0

Methodological note: 3-year backward moving average of CAB as a % of GDP
Source: IMF

The scoreboard results suggest that high and persistent current account deficits for all countries and in most of the periods all the countries are incurring excessive deficits, never balances and surpluses. The current account has recorded large swings over the past decade in most of the Western Balkan countries: Montenegro 40.5%, Bosnia and Herzegovina 17.9%, Serbia 15.9%, Albania 13.4%, and FYROM 8.9%.

The 2011 scoreboard indicates that only FYROM is under the threshold of 4% current account deficit of the GDP. A positive tendency for all economies is that current account deficits continue declining in the most recent period. The risks for the economies experiencing current account deficits could be reduced if it is financed by the FDI and also by capital transfers (including remittances). In most of the countries, the high current account deficits were covered by the FDI before the crisis so they did not pose substantial risks for the economy. This means that exceeding the threshold of this indicator of the macroeconomic imbalances scoreboard should not be regarded as excessive as much as it is covered by the FDI and current transfers.

The traditional economic thinking suggests that these facts indicate high external imbalances that may pose risks for the reviewed economies. However, such a mechanical interpretation of the scoreboard does not take into account that countries in the catching-up phase often run current account deficits as investing in productive activities in response to changes in underlying structural characteristics and attracting foreign capital.

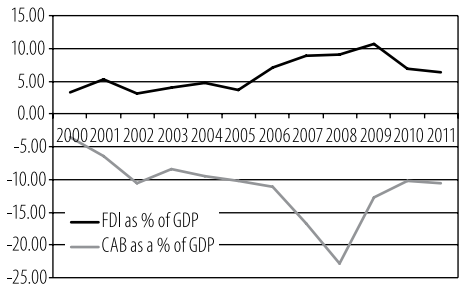
The conventional theory also suggests that running high current account deficit is one of the main vulnerabilities of the catching-up economies. Moreover, since the imbalances were accumulated before the crisis, some could argue that those imbalances were the major cause for the recent economic crisis that also hit the region. However, it is worth mentioning that all countries under review experi-

enced some corrections of the current account deficits since the beginning of the crisis.

If the rule of the scoreboard is followed and its indicators are looked at not from a mechanical point of view but rather on the basis of an in-depth analysis involving other relevant indicators, the results may be interpreted differently. The growth model of the countries from the Western Balkans as well as the catching-up economies is characterized by a strong FDI-driven demand. It is a result of the openness of those economies as well as of their attractiveness related to the low production costs, non-rigid labour markets, lower level of taxation and the unsaturated markets. In the early post-socialist period, owing to the lack of accumulated national capital, poor market economy experience and the lacking entrepreneurial skills, FDI was the main instrument for economic reforms and also for accelerating economic growth. FDI is also an indicator of the openness of those economies and their ability to attract foreign capital.

The interconnection between FDI and the current account was broadly analyzed in the literature (see the references). The consolidated data for the catching-up economies included in this analysis suggest a very strong relationship between FDI and the current account deficit.

Graph 1: Average FDI and CAB ratio to GDP for the Western Balkan countries



Source: UNCTAD and IMF

It is evident that the increase of the FDI impacts strongly cover the current account deficits, the larger the FDI inflow, the bigger the current account deficit. It is also strongly related to the high economic growth that these countries experienced during 2006-2010. However, the current account divergences between the countries under review narrowed during the crisis owing to the substantial drop in FDI, which is certainly an important factor for a decrease in the current account deficits. Another contributing factor to this adjustment is the observed progress in the exports. The sharper drop in the private sector demand and the related contraction of the import helped the current account deficits self correction.

Countries which entered the crisis with large current account deficits have experienced pronounced corrections due to a sharp drop in the private sector demand

and the contraction of imports. As mentioned above, the deficits of all countries under review were largely financed by exceptionally strong FDI inflows. The crisis halted major capital inflows, including FDI, and led to a quick correction of the deficits. The adjustment did not happen only because of the reduced imports but also because some of the countries` featured continued growth in exports.

Looking ahead the main question is whether the current account in the region will widen when the economy recovers and FDI resumes. Certainly, current account deficits in the region narrowed but still they are high and it is not clear whether they will return to the pre-crisis extremely high levels. If the FDI resumes in the scope of the pre-crisis volumes most probably the current deficit will widen again. The growth model should be linked to large inflows of FDI and q high FDI growth has the potential to accelerate fast catching-up. That is why this imbalance should have established sufficient buffers against these risks.

Net international investment position (NIIP)

The other indicator of the scoreboard is the net international investment position (NIIP). The NIIP records the net financial position (assets minus liabilities) of the domestic sectors of the economy versus the rest of the world. Using data available it could be calculated not for all countries and for all periods on the basis of the IMF statistics as a % of GDP. The threshold is set at -35%.

NIIP as a % of GDP (-35%)	2005	2006	2007	2008
Albania	n/a	n/a	-15.9	-25.2
Bosnia and Herzegovina	-32.9	-31.2	-35.3	-44.5
FYROM	-39.2	-37.8	-43.2	-46.6
Montenegro	n/a	n/a	n/a	n/a
Serbia	n/a	n/a	n/a	-60.4

Source: IMF

The NIIP was at negative levels that exceeded the thresholds for Bosnia and Herzegovina and also FYROM and Serbia, while kept under the threshold in Albania. The available data suggest that high current account deficits have impacted the negative NIIPs. In general, the funding of the current account deficit of the countries under review shows a generally positive profile.

Countries with high and persistent current account deficits such as the catching-up economies accumulated losses in measures of price and cost competitiveness

in the years preceding the crisis. In some cases, the wage growth exceeded productivity growth inducing increases in unit labour costs.

There were economic assessments including those of the IMF that determined overheating signals in some of the economies in the region, especially Montenegro (IMF, 2011), Albania (Liperi, 2000; IMF, 2010), Bosnia and Herzegovina (IMF, 2009), and Serbia (Gardo, 2009). The crisis, however, interrupted these developments and helped the adjustment of the catching-up economies.

Export Market Share

Another indicator of the MIP scoreboard is the export market share calculated as a 5-year percentage change of a national export as a per cent of the world export. The indicator aims at capturing structural losses in competitiveness. Negative changes in the share of the world export of goods and services points to important structural weaknesses in competitiveness. The threshold is set at -6%.

Export market shares (-6%)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Albania	59.1	241.3	164.6	62.8	59.2	28.7	35.9	39.8	36.6	58.0	31.9	12.8
Bosnia and Herzegovina	n/a	n/a	23.8	28.9	30.1	28.9	49.9	39.8	33.3	26.6	8.2	0.0
FYROM	-33.3	-72.1	-69.5	-44.4	-43.1	-15.9	-12.0	-6.8	-1.5	-28.2	-16.7	-9.4
Serbia and Montenegro	-21.8	-22.1	-26.8	61.4	84.2	48.6	n/a	n/a	n/a	n/a	n/a	n/a

Methodological note: % change (5 years) of national export as a % of world export
Source: UNCTAD

The calculations suggest a large divergence among the countries and also an extensive dynamic of this indicator. FYROM alone is loosing the market share at a rate well exceeding the threshold. It is difficult to capture a clear trend as regards the fluctuation of this indicator but the data confirm that most of the countries gain export market shares. Improving export performance in a situation of a weaker global demand is pronounced in almost all catching-up economies, including the new EU member states (Estonia, Slovakia, Bulgaria, Latvia, Lithuania, Poland, and Romania). The recorded gains in export market shares may be associated with improved productivity and depreciating real effective exchange rates. Export market shares in the Western Balkan countries especially are driven by the increase of the countries' exports volume but also by the growth of total world exports in goods and services which have almost doubled in the period 1994-2007. The low production costs in those countries may also play a role in strengthening the price competitiveness.

General government gross debt

The general government gross debt indicator of the scoreboard is inspired by the respective convergence criteria. The indicator for general government debt offers a broader picture of country indebtedness as there are important linkages between the private sector and the general government debt. Moreover, a high public debt increases the overall macroeconomic vulnerability of a country and weakens its room of manoeuvre to deal with crisis. The indicator is calculated as a percent of GDP with a threshold of 60%.

General government gross debt as a % of GDP (60%)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Albania	69.6	65.9	65.5	60.7	57.4	57.8	56.7	53.4	54.7	59.3	57.8	58.6
Bosnia and Herzegovina	34.7	35.2	31.2	27.6	25.6	25.5	21.4	32.8	31.1	36.0	39.4	40.3
FYROM	47.9	48.8	42.9	37.9	35.6	39.5	32.0	24.0	20.6	23.8	24.2	27.7
Montenegro	n/a	n/a	75.7	40.3	45.3	38.6	32.6	27.5	31.9	40.7	42.4	46.9
Serbia	241.7	114.5	81.2	77.8	65.4	56.3	43.0	35.6	34.2	38.1	46.5	50.1

Source: IMF

All the countries in the region are below the threshold which implies low perceived sovereign and financial sector risks and high state creditworthiness. One of the reasons is that those countries were not experiencing banking crisis and no public money were used for the rescue of banks. On top of that, most of them have not borrowed from the IMF and other sources during the crisis. Serbia, FYROM, Albania, Montenegro even reduced their public debt as compared to 2002, although the public debt for all the countries slightly increased as compared to the pre-crisis levels. The countries try to keep their budget deficits low whilst being fiscally prudent, which should be clearly emphasized.

Unemployment rate

Another indicator in the MIP scoreboard is the level of unemployment which threshold is set at 10%. The indicator is intended to monitor a potential mismatch of resources and general lack of adjustment capacity in the economy.

Unemployment rate (+10%)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Albania	17.6	17.2	16.3	15.7	15.1	14.5	14.1	13.7	13.2	13.1	13.3	13.5
Bosnia and Herzegovina	31.5	31.1	31.1	31.1	31.1	31.1	31.1	30.4	27.8	25.5	24.9	26.3
FYROM	32.9	31.6	31.4	33.0	35.3	37.0	36.8	36.1	34.9	33.6	32.7	31.9
Montenegro	n/a	n/a	n/a	n/a	n/a	n/a	n/a	26.4	21.9	18.4	18.5	19.5
Serbia	12.7	12.5	12.9	14.2	16.7	19.1	21.0	20.7	18.4	17.0	17.4	20.6

Methodological note: 3-year average
Source: IMF and AMECO

The countries run high and persistent levels of unemployment, exceeding the threshold for all the periods under review. By all means the countries reach record high unemployment rates – the unemployment in FYROM has always picked up at around 30%, in Serbia most of the time it was more than 20%, while in Montenegro it was rather volatile but still close to 20%.

Unemployment is certainly a result of intensive structural changes but it also could be caused by an ineffective social and production structure. The ongoing adjustment is resulting in high unemployment and a decrease of employment. The data suggest that the high unemployment is not only on the back of the recent crisis but results from structural changes in employment as the less qualified find it more difficult to get a job. The record high unemployment rates were reported long before the crisis. The crisis though added to unemployment partly due to the reduction of some high-growth sectors such as construction and related sectors.

Unfortunately, there are no full and comparable data to calculate the unit labour costs that is important for the assessment of the economic developments and the related imbalances. As to the prospects of this indicator since the economic recovery will take time, a complete and sustainable rebalancing cannot be expected in a short run.

Conclusions

The attempt to calculate the MIP scoreboard indicators faced a lot of difficulties in collecting the relevant data and also some methodological problems. Employing this early warning instrument only on the basis of (i) limited number of indicators and; (ii) without an in-depth analysis of the entire economy may be misleading.

The thresholds set do not fully accommodate the specifics of the catching-up economies or their specific monetary regimes that impact the overall policy mix.

The results of calculating the five indicators of the MIP scoreboard reveal a lot of similarities in the imbalances pattern between the countries under review. This supports the view that catching-up economies exhibit common macroeconomic developments related to the nature of the process itself. **Montenegro** displays indicator values above the indicative thresholds in the areas of the current account developments and unemployment while the calculation of the export market share and net international investment position faces some methodological difficulties and is not available. The **Serbian** economy exceeds the thresholds of the following indicators: unemployment, net international investment position and current account deficit. **FYROM** economy also exhibits substantial imbalances in all indicators except the public debt and current account.[4] The **Albanian** economy grows fast and builds up imbalances in the current account and unemployment. **Bosnia and Herzegovina** shows indicators values beyond the threshold in three out of the five indicators - current account, unemployment and net international investment position.

The MIP Scoreboard 2011 for the Western Balkan countries

Year 2011	External imbalances and competitiveness				Internal imbalances	
	3-year average of Current account balance as % of GDP	Net International Investment Position as % of GDP**	% change (5 years) in Export market shares	% change (3 years) in nominal ULC	General government debt as % of GDP	3 year average of Unemployment
Thresholds	-4%/+6%	-35%	-6%	+9%/+12%	60%	10%
Albania	-12.6	-25.2	12.8	-	58.6	13.5
Bosnia and Herzegovina	-6.9	-44.5	0.0	-	40.3	26.3
FYROM	-3.9	-46.6	-9.4	18.8	27.7	31.9
Montenegro	-24.6	-	-	-	46.9	19.5
Serbia	-8.0	-60.4	-	-	50.1	20.6

** Comparable data available as of 2008.

Source: IMF, UNCTAD, AMECO

The analysis of the imbalances suggests that they are not linked to the crisis but more to the restructuring of the economy and the caching-up process. The relative resilience of the crisis proves the flexibility and capabilities for adjustment of those economies. Nevertheless, the imbalances need to be monitor carefully. The paradox is that the values of the indicators suggest that the countries experienced

[4] The unit labour cost indicator is calculated for FYROM and its value also exceeds the threshold.

more severe and persistent imbalances before the crisis and the recent turmoil helped wind up some of the imbalances.

The correction of significant imbalances that have built up over the past decade is a part of the economic governance but not the only one. The most important goal of economic policy is to resume economic growth and sustain public finances as well. It seems that those goals are hard to achieve in parallel. It is of utmost importance for the caching-up economies to grow fast. The creation of imbalances could be then compensated by a prudent fiscal policy and structural reforms and therefore creating buffers that will protect the economy from the risks built on the back of the imbalances.

References

1. European Central Bank (2012), *Convergence report*
2. European Commission (2012), *Alert Mechanism Report: Tackling macroeconomic imbalances in the EU*
3. European Commission (2012), Commission staff working document Industrial Performance Scoreboard And Member States' Competitiveness Performance and Policies, SWD (2012) 298, A Europe 2020 Initiative, 2012 edition
4. European Commission (2012), Press release, 30 June 2012
5. European Commission (2013), *Alert Mechanism Report*
6. European Parliament and European Council (2011), Regulation (EU) No 1176/2011 of 16 November 2011 on the prevention and correction of macroeconomic imbalances
7. European Systemic Risk Board (2011), *Views of the ESRB on the Envisaged Scoreboard Indicators Relevant for Financial Market Stability*
8. Fry, M. J. (1995), *Foreign Direct Investment, Other Capital Flows and Current Account*, World Bank
9. Gardó, S. (2009), *Preserving Macrofinancial Stability in Serbia: Past Legacies, Present Dilemmas and Future Challenges*, Oesterreichische Nationalbank, Foreign Research Division
10. Ghosh, A., Ramakrishnan U. (2012), *Current Account Deficits: Is There a Problem?*, IMF
11. International Monetary Fund (2009), Bosnia and Herzegovina: Request for Stand-By Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bosnia and Herzegovina, *IMF Country Report*, *226*(09), IMF
12. International Monetary Fund (2010), Albania 2010. Article IV Consultation - Staff Report; Staff Statement; Public Information on the Executive Board Discussion; and Statement by the Executive Director for Albania
13. International Monetary Fund (2011), Regaining a footing after the crisis, Montenegro-2011 Article IV Consultation, Preliminary Conclusions of the Mission February 21
14. Liperi, O. (2000), Overheating or overcooling of Albania, *Monitor*
15. Mencinger, J. (2008), *Direct and Indirect Effects of FDI on Current Account*, EIPF and University of Ljubljana
16. Oxford (2007), Montenegro: Fund detects signs of overheating, *Oxford Analytica*