(How) Can EU Member States Influence their Performance on the MIP indicators?

A Literature Review

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Abstract

The MIP is a political process allowing the European Commission (EC) to analyze the macroeconomic health of individual MS and potentially sanction those among them that have failed to implement the recommendations approved within the framework of the European Semester. However, in a highly integrated economic bloc such as the EU, the extent of individual MS's ability to influence their own macroeconomic standing becomes questionable. This literature review therefore asks how and to what extent can the MS influence the economic outcomes measured by the MIP core indicators. Building on a review of the relevant literature reflecting on this question, it then proposes a matrix classifying the core MIP indicators along two dimensions: their ability to predict actual economic crises and MS capacity to influence those aspects of the national economy that are measured by the given MIP indices.

Introduction

The economic crisis of the late 2000s has served as a leading impetus for fostering a more complex system of EU economic governance with arguably greater influence of the EC. Since 2010, the Stability and Growth Pact has been strengthened with the Six Pack and the Two Pack. Among the new institutions introduced, the MS have also agreed to discuss their macroeconomic situation (and subsequently take action) within the framework of the MIP (European Commission 2019b). This review of macroeconomic conditions is a year-long process beginning with the publication of a report by the EC in which its experts identify MS in danger of macroeconomic imbalance. The so-called Alert Mechanism Report (AMR) relies heavily on the evaluation of the MS' economic standing measured through their position on a number of crucial macroeconomic indicators which are considered useful leading indicators of economic imbalances.

In line with the EU legislation on the European Semester, these indicators are divided into a group of 14 "core" MIP indicators and a much larger set of 28 auxiliary indicators. As to their substance, the core indicators may be further divided into three distinct clusters: indices for (i) external imbalances and competitiveness, (ii) internal imbalances (iii) the state of the labor market. While covering the aforementioned three areas with a number of additional indicators, the auxiliary indicators also extend the scope of the MIP exercise with data on (iv) social deprivation among the general populace. Table 1 below presents the MIP indicators used in 2019, dividing them between core and auxiliary, as well as between the substantial thematic areas they are related to.

Table 1. MIP indicators, as of 2019

Core Indicators	Measurement unit	Thresholds
External imbalances and Competitiveness		
Current account balance	3 year average (% of GDP)	-4 – 6 %
Net international investment position	% of GDP	-35 %
Export market share	5 year % change (% of world exports)	-6%
Nominal unit labor costs index	3 year % change (2010=100)	9% (EA) 12% (Non-EA)
Real effective exchange rate	3 year % change (42 trading partners)	±5% (EA) ±11% (Non-EA)
Internal imbalances		
Private sector credit flow, cons.	% of GDP	14%
Private sector debt, cons.	% of GDP	133%
Total financial sector liabilities, non-cons.	1 year % change	16.5%

continued

Core Indicators	Measurement unit	Thresholds
House price index	1 year % change (2015=100)	6%
Unemployment rate	3 year average	10%
General government gross debt	% of GDP	60%
Labor market		
Activity rate in 15-64 age cohorts	3 year change in pp	-0.2 pp
Long-term unemployment rate	3 year change in pp	0.5 pp
Youth unemployment rate (aged 15-24)	3 year change in pp	2 pp
Auxiliary Indicators	Measurement unit	
External imbalances		
Net international investment position excluding non-defaultable instruments	% of GDP	
Net trade balance of energy products	% of GDP	
Real effective exchange rates – euro area trading partners	3 year % change	
Export performance against advanced economies	5 year % change	
Terms of trade	5 year % change	
Export market share - in volume	1 year % change	
Financial market		
Gross non-performing loans, domestic and foreign entities	% of gross loans	
Household debt, consolidated (incl. NPISH)	% of GDP	
Consolidated banking leverage	Total asset/ total equity	
Current plus capital account (Net lending-borrowing)	% of GDP	
Labor market		
Employment rate	1 year % change	
Activity rate	% of total population aged 15-64	
Long term unemployment rate	% of active population aged 15-74	
Youth unemployment rate	% of active population aged 15-24	
Young people neither in employment nor in education and training	% of total population aged 15-24	
Housing market		
House price index (2015=100) - nominal	3 year % change	

continued

Auxiliary Indicators	Measurement unit
Residential construction	% of GDP
Foreign direct investment	
Foreign direct investment in the reporting economy – net inward flows	% of GDP
Foreign direct investment in the reporting economy – stocks	% of GDP
Competitiveness	
Real GDP	1 year % change
Gross fixed capital formation	% of GDP
Gross domestic expenditure on R&D	% of GDP
Labor productivity	1 year % change
Unit labor cost performance relative to euro area	10 year % change
Social deprivation	
People at risk of poverty or social exclusion	% of total population
People at risk of poverty after social transfers	% of total population
Severely materially deprived people	% of total population
People living in households with very low work intensity	% of total population aged 0-59

Source: European Commission (2018a; 2018b)
Notes: cons.=consolidated

The findings based on this battery of macroeconomic indicators may provide the EC the necessary justification for initiating an in-depth review of the economic situation of those MS that are found to be potentially heading towards macroeconomic imbalance. The result of these in-depth reviews may be a statement that (i) there is no imbalance in the economy, (ii) there are imbalances in the economy, (iii) there are excessive imbalances or (iv) excessive imbalances that require corrective actions to be taken (European Commission 2019a). Table 2 provides a historical overview of in-depth reviews initiated within the framework of the MIP and their outcomes since 2012, when the first round of macroeconomic reviews took place.

As can be seen in Table 2, macroeconomic imbalances and excessive macroeconomic imbalances have been rather common during the first decade of the European Semester. In effect, there have only been eight MS that have so far never been identified as being in a state of economic imbalance or excessive

imbalance.[1] In the meantime, several EU nations have been found to have macroeconomic imbalances throughout the whole period between 2012 and 2018. Taking a more detailed look at the temporal distribution of imbalances identified by the European Commission, there has been a moderate decline in the number of countries implicated in macroeconomic imbalances since 2014. While in 2014, 16 nations were either in a state of macroeconomic imbalance or excessive imbalance, this number decreased in 2015-2017 to 11.

Table 2. The conclusions of In-Depth reviews, 2011-2019.

MS / Year	2012	2013	2014	2015	2016	2017	2018	2019
AT								
BE	MIB	MIB	MIB	MIB				
BG	MIB	MIB	MIB	EMIB	EMIB	EMIB	MIB	MIB
HR[1]	-		EMIB	EMIB	EMIB	EMIB	EMIB	MIB
CY	EMIB				EMIB	EMIB	EMIB	EMIB
CZ								
DK	MIB	MIB	MIB					
EE								
FI	MIB	MIB	MIB	MIB	MIB			
FR	MIB	MIB	EMIB	EMIB	EMIB	EMIB	MIB	MIB
DE			MIB	MIB	MIB	MIB	MIB	MIB
EL[2]	EAP	EAP						EMIB
HU	MIB	MIB	MIB	MIB				
IE[2]	EAP	EAP	MIB	MIB	MIB	MIB	MIB	MIB
IT	MIB	MIB	EMIB	MIB	EMIB	EMIB	EMIB	EMIB
LV								
LT								
LU								
MT		MIB						
NL		MIB	MIB	MIB	MIB	MIB	MIB	MIB
PL								
PT[2]	EAP	EAP	EMIB	EMIB	EMIB	EMIB	MIB	MIB
RO[2]	EAP	EAP	MIB	MIB				MIB
SK								
SI	MIB	EMIB	EMIB	MIB	MIB	MIB		
ES	EMIB	EMIB	MIB	MIB	MIB	MIB	MIB	MIB
SE	MIB	MIB	MIB	MIB	MIB	MIB	MIB	MIB
UK	MIB	MIB	MIB	MIB				

Sources: European Commission (2014a); Communication from the Commission on the European Semester, several issues.
Notes: EAP= Economic Adjustment Program; EMIB=Excessive Macroeconomic Imbalance Procedure; MIB=Macroeconomic Imbalance Procedure.

[1] These include Austria, the Czech Republic, Estonia, Latvia, Lithuania, Luxemburg, Poland and Slovakia.

In the latest round of macroeconomic evaluations by the European Commission in 2018, a diverse group of 13 MS had to be covered by an in-depth review, including countries such as France, Germany, Bulgaria, Romania and Greece. These in-depth reviews have in some cases confirmed the presence of macroeconomic imbalances (e.g. Belgium, Croatia and France), while in other cases have concluded that the macroeconomic imbalances in question have been *excessive* (e.g. Cyprus and Italy).

This literature review evaluates to which extent, according to the existing scholarly literature, can MS of an ever more integrated European economic space influence their economies' performance on the MIP indices. Second, it outlines a matrix classifying the MIP indicators along two dimensions: their predictive power and the ability of MS to take effective action to influence their economies' performance on a given indicator. Due to their complexity, the answers provided to these two questions in the extant scholarly literature may remain inconclusive. However, the survey and juxtaposition of conflicting views is a necessary step in our own autonomous research process on these topics.

1. Member States as economic agents in the MIP

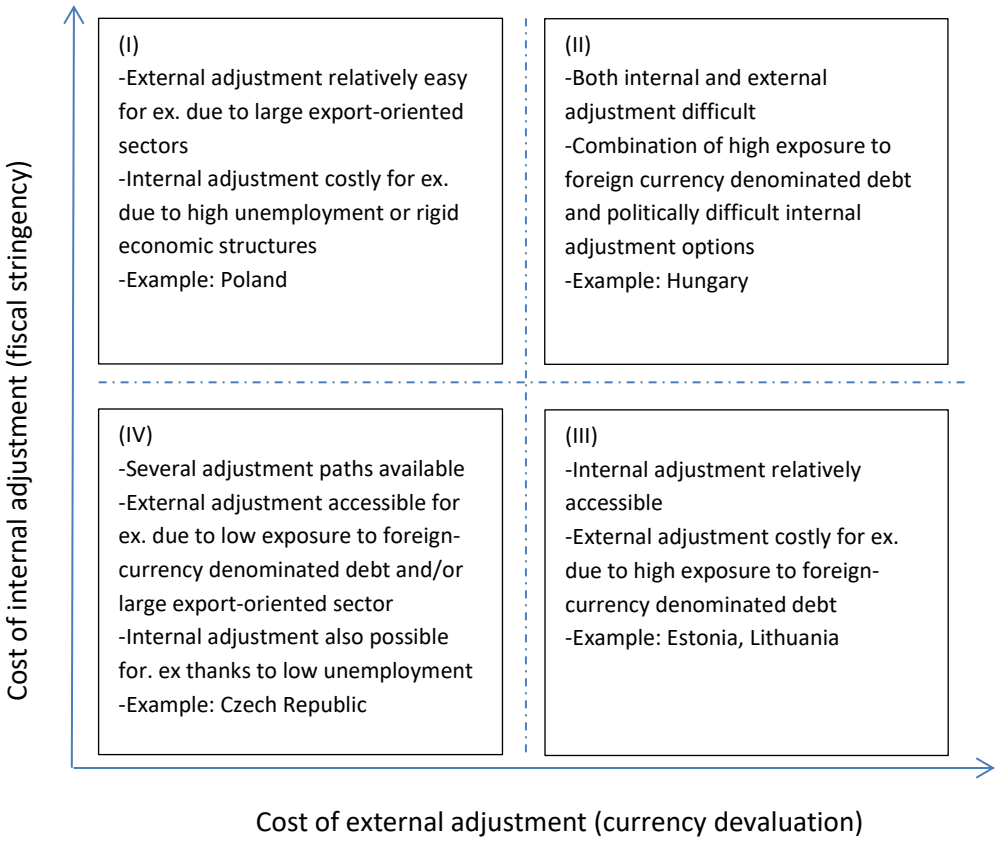
1.1 Internal imbalance indicators

As already discussed in the introductory section, the MIP relies on a relatively broad range of variables that can be divided into three larger groups: indices of internal imbalances, external imbalances and competitiveness indicators, and labor market indicators. The set of internal imbalance measures includes (i) general government gross debt (ii) private sector credit flow and (iii) private sector debt, all three measured as a percentage of the country's nominal GDP, the year-on-year change in (iv) the house price index and in (v) total financial sector liabilities, as well as (vi) the average unemployment rate calculated from data for the last three years (see Table 1).

General government gross debt is one of those indicators of internal imbalances that national governments can influence directly. Nonetheless, despite direct control over fiscal policy, the ability to carry out internal adjustment through reducing government debt varies widely across the EU (Walter 2013; 2015). In order to classify national governments based on their ability to carry out internal or external adjustment, Walter (2015) proposes a two-by-two matrix of national vulnerability profiles. The two axes of the matrix are the costs of the two types of adjustment strategies to the incumbent government. The four possible categories include (i) high cost of internal adjustment and low cost of external adjustment, (ii) high cost of both internal and external adjustment, (iii) low cost of internal adjustment and high cost of external adjustment, and (iv) low cost of both internal and external adjustment. Figure 1, adopted from Walter (2015), describes these four categories and provides

concrete examples of Central and Eastern European (CEECs) that belonged to these groups during the 2008-2009 financial crisis. Importantly, Euro-Area nations are left only with internal adjustment as currency devaluation is no longer an option for members of a monetary union (Frieden and Walter 2017).[2] In summary, while EU Member States have the most direct influence on the development of their general government debt, there are significant limitations to the actual leeway domestic political actors have over fiscal deficit and debt. The flexibility of this fiscal space is inversely related to the unemployment rate (see Walter 2015).

Figure 1. Vulnerability profiles and examples of CEECs in each category during the 2008-09 crisis



Source: Walter (2015).

Unemployment is the second internal imbalances indicator that Member States can influence through policies within their prerogative. Beyond fiscal expansion (or restraint) which has been discussed above, and which may have significant political costs (Lewis-Beck 1986; Anderson 2000; Bengtsson 2004; Bosco

[2] While leaving the monetary union would again allow currency devaluations, public opinion studies have shown that popular support for the euro has been relatively high even during the economic crisis. This holds even for Greece, whose membership in the Euro Area has so far required the most significant fiscal consolidation efforts (Roth, Jonung, and Nowak-Lehmann 2016; Dinas et al. 2017).

and Verney 2012; Fetzer 2019; c.f. Giger 2010; Arias and Stasavage 2019), nation states can improve unemployment levels by implementing an efficient mix of labor market policies. Such a mix usually includes both active labor market policies (for a systematic review, see Card, Kluve, and Weber 2018), and relatively modest unemployment benefits (Murtin and Robin 2018). Including specific labor-market policies targeting disadvantaged demographic groups, such as the youth is also important, especially in those European labor markets that have labor markets dominated by the insider-outsider divide (Lindbeck and Snower 1988; 2001). However, as will be discussed later on, it is difficult to tackle youth unemployment with active labor market policies alone.

Another, though much more controversial approach to lowering unemployment relies on state interventions into wage setting. Part of the scholarly literature argues against increases in the statutory minimum wage because, as the canonical fully-competitive labor market theory goes (e.g. Lee and Saez 2012), it may result in lower employment and higher unemployment at the lower end of the wage distribution. Nevertheless, the empirical literature has so far presented mixed results (e.g. Gindling and Terrell 2007; Meer and West 2013; Dube, Lester, and Reich 2016; Grossmann, Jurajda, and Smolka 2019; Cengiz et al. 2019; Manning 2013), with many studies finding little or no effect of the minimum wage on labor demand. It appears that, at our current state of knowledge, government policies aimed at influencing labor demand through the wage level may have rather uncertain outcome. No general policy recommendation applicable across all European polities can therefore be made.

In conclusion to the above overview on policy instruments that can potentially influence employment and unemployment, it is important to pay attention to the linkage between (un)employment levels and the government's fiscal space. Lowering unemployment, which governments can achieve gradually by implementing sound labor-market policies, may provide more fiscal leeway for the government to either carry out necessary investment into public infrastructure or, alternatively, lower government gross debt.

The internal imbalance indicators also include two measures of private sector exposure to financial market volatility. These include consolidated private sector debt stock and credit flow. The ability of MS governments to influence these is clearly smaller than its capability to take action against rising government indebtedness or unemployment. However, there still exist specific policies that support either passive or active deleveraging in the private sector.[3] As for private corporate debt, government policies increasing inflation and (nominal) output growth may support a passive deleveraging process (European Commission 2014b). Active deleveraging can be efficiently influenced using macro-prudential

[3] Active deleveraging is mostly done through a contraction of the balance sheet through higher debt repayments than debt take-up in nominal terms. Passive deleveraging is understood as a contraction of debt levels relative to the GDP, while net debt flow can still remain positive (European Commission 2014b).

policies, such as debt-to-income caps and loan-to-value caps (e.g. Claessens, Ghosh, and Mihet 2013; Cerutti, Claessens, and Laeven 2017). In addition, a stronger bankruptcy framework and a tax system incentivizing the write-off of bad debt may also be helpful (Brooks and Pradhan 2015).

According to the official Eurostat (2019) definition, total financial sector liabilities include "Currency and deposits, Debt securities, Loans, Equity and investment fund shares/units, Insurance, pensions and standardised guarantee schemes, Financial derivatives and employee stock options and Other accounts payable" (Eurostat 2019). These components can be influenced by domestic policies only to a limited extent and only in the mid- to long-run (e.g. the introduction of mandatory funded pension schemes). Importantly, the MIP indicator in this case measures year-on-year volatility, with a threshold of 16.5 percent. It is therefore the stabilization of the amount of liabilities that policies should target, which makes this task even more complicated.

As mortgages constitute a major component of private household debt (Zabai 2017), household exposure to debt is also closely linked to the state of the housing market. In case of an insufficient rental housing market, the government should consider promoting the development of rental housing in order to curb mortgage take-up by households. A more robust rental housing market can also help increase internal labor mobility within MS, allowing the reallocation of the labor force from high-unemployment regions to those with a buoyant labor market.

Besides the development of rental housing, price development on the housing market, which is the last of the six indicators of internal imbalances, can to some extent be efficiently influenced by the macro-prudential policies decided at the MS level (Claessens, Ghosh, and Mihet 2013; Hartmann 2015; International Monetary Fund 2018), which serve as a tool to manage housing demand. More restrictively set loan-to-value requirements and loan-to-income or debt service-to-income ratios curtail the demand for real estate, Although a thorough evaluation of these policy instruments can be done only once there is enough data for the whole economic cycle (International Monetary Fund 2018), the empirical literature indicates that they are efficient in limiting the consequences of major boom-bust cycles on the real estate market, among others, by helping to keep under control the housing prices (e.g. Claessens, Ghosh, and Mihet 2013).

1.2 External imbalances and competitiveness indicators

This class of MIP indicators includes five metrics: (i) the current account balance, which, according to the current formulation of the MIP may indicate imbalances both when it is significantly negative (a negative balance exceeding 4 percent of the GDP) or significantly positive (a positive balance exceeding 6 percent

of the GDP), (ii) the net international investment position of the MS, (iii) the five-year-change in its export market share, (iv) the three-year-change in unit labor costs and (v) the three-year-change in the real effective exchange rate.

The current account development of EU MS has gained considerable attention since the Eurozone became operational and even more so since the economic crisis of the late 2000s. The diverging trajectory of the EMU's core nations and its periphery has gained attention as an important indicator showing that the EMU is far from being an optimal currency area (Santis and Cesaroni 2016). In effect, the large current account deficit in some EMU countries (and large surpluses in others) has been identified by part of the literature as a highly reliable indicator of imbalances within the EMU that must ultimately lead to financial crises (Brancaccio 2012).

Harkmann and Staehr (2018) investigate the main determinants of the current account balance in CEECs, and find that membership in the monetary union divides these nations into two specific groups: while the current account balance of nations with a fixed exchange rate depends heavily on external factors and their domestic economic conditions play a very limited role, the domestic conditions of members with a floating exchange rate has a much more pronounced influence on their current account position (Harkmann and Staehr 2018). In the case of the "floaters", the current account balance is driven by domestic economic conditions proxied by the output gap, the net international investment position and GDP per capita. By contrast, the current account balance of the "fixers" depends significantly on the mean current account balance of the core Euro Area nations, the mean output gap of the core Euro Area countries and the growth rate of the real effective exchange rate (Harkmann and Staehr 2018; see also Bollano and Ibrahimaj 2018). Of these three major determinants, the domestic policies implemented by small CEE economies can meaningfully influence only the real effective exchange rate. Addressing the current account deficit therefore appears as a lengthy process with no short-term fixes.

As far as significant current account surpluses are considered, policies aimed at increasing wages and consumption may be part of the re-balancing strategy. However, as Horn (2017) notes, more expansive fiscal policy may also be needed to balance out the current account in case of its excess surplus. While the implementation of policies aiming at higher wages and government spending may be welcome by influential domestic stakeholders (e.g. the voting public, trade unions, government suppliers) a more relevant question is whether current account surpluses should be interpreted as a sign of imbalance at all. Gros and Busse (2013) emphasize that large current account surpluses can be important from the perspective of the MIP only if they are proven to cause negative spill-over effects in the rest of the EU/EMU. While this argument rests on good foundations, as an increase in demand for foreign goods in

the surplus-countries would certainly help those EU nations that are struggling with current account deficits (see also Hobza and Zeugner 2013), it remains a question why MS with a surplus should deliberately take action to balance their current accounts by decreasing a current-account surplus.[4]

Just as the current account surplus, the net international investment position of an EU Member State has to be evaluated with care. The imbalance threshold for this indicator is set at -35 percent of the GDP for all EU MS, but as Domonkos et al. (2017) demonstrate, one size does not fit all countries equally. Post-socialist countries such as the Slovak Republic have accumulated significant FDI, which helped to foster higher employment, lower unemployment and an overall more productive economy. Their net international investment position might have deteriorated in the process, but FDIs have provided badly needed capital for the post-socialist economies of Central and Eastern Europe. While a deteriorating net international investment position might indicate imbalances in mature Western economies, the same is not true for CEECs seeking to attract FDIs (Domonkos et al. 2017). Given these circumstances, the net international investment position is at best an indicator complementing other core indicators whose interpretation is more straightforward.

The change in world export market share of the MS helps indicate a potential deterioration in the competitiveness of the national economy. The European Commission notes in its 2016 compendium on the MIP indicators that a declining share in the world export market shows a national economy may be unable to keep pace with the evolution of the global economy (European Commission 2016) and may be losing competitive advantage. As trade policy is primarily a prerogative of the European Commission, this MIP indicator cannot be *immediately* influenced by policy action on the MS level. Nevertheless, there still is a wide range of policies within the authority of the MS that might influence world export market share, albeit more slowly than traditional trade negotiations. These include investment aid policy seeking to attract FDI, the promotion of research and development (e.g. Damijan, Kostevc, and Polanec 2010; Freel, Liu, and Rammer 2019), as well as efficient economic diplomacy (Rose 2007; Lederman, Olarreaga, and Payton 2010; Broocks and Van Biesebroeck 2017). These policy instruments might be used to actively influence both export share and international investment position.

Of the external imbalances and competitiveness indicators, it is the three-year-change in the nominal unit labor costs index that MS can influence most directly through the compulsory payment wedge and the wage policy of the public sector.[5] According to the official MIP thresholds, this indicator's

[4] However, a possible reason for taking action against large current account surpluses might be the political costs of a weaker European Economic Area.

[5] The nominal unit labor costs index is calculated as the ratio between compensation per worker and productivity (i.e. gross domestic product) per worker (European Commission 2018a).

development may signal an imbalance if it increased in the relevant three-year-window by more than nine percent for Euro-Area members and more than twelve percent for non-Euro-Area MS. By definition, such a development indicates that the aggregate compensation of employees in the given economy does not evolve in line with the economic fundamentals, and is most likely growing faster than aggregate labor productivity, proxied by the gross domestic product. The compensation of employees includes, among others, the gross wage, employers' social security contributions, the payroll tax, as well as other non-financial benefits. Clearly, government provisions on compulsory wage-related taxes and contributions, but also mandatory benefits have a non-negligible impact on the aggregate compensation of employees.[6] Therefore, this is one of those MIP indicators that MS can to some extent meaningfully influence, especially if there is some fiscal space available for lower taxes on wage.

For the purposes of the MIP, the real effective exchange rate is calculated as the weighted exchange rate of a currency against a basket of 42 currencies of major developed and emerging economies. This *nominal* effective exchange rate is subsequently deflated using a trade-weighted price or cost deflator in order to reach the *real* effective exchange rate (European Commission 2014c). While the real effective exchange rate is not identical for all members of the European Monetary Union, as the trade weights are specific for each country, membership in a monetary and customs union limits the ability of MS to directly influence their effective exchange rate through currency devaluation or customs and trade policy.

1.3 Labor Market Indicators

The three labor market indicators that constitute the third category of core MIP indices include (i) the activity rate, (ii) the long-term unemployment rate and (iii) the youth unemployment rate. While all three are closely related to the core unemployment rate indicator (see Subsection 1.1), influencing these indices by public policy may be somewhat more challenging than the more general unemployment indicator. This is due mostly to the specific nature of the groups that these metrics refer to.

Caliendo, Künn and Schmidl (2011) and Caliendo and Schmidl (2016) find that active labor market policies targeted at youth unemployment have rather limited positive effect. According to their review of the scientific evidence, it is only job search assistance that has a discernible positive impact while other types of active labor market policies (training included) has either mixed or even a negative impact

6 Nevertheless, as Felipe and Kumar (2014) discuss in greater length, it is questionable if unit labor costs are a helpful indicator for measuring an economy's productivity. After some simplifications, it is just the reflection of income distribution between labor and capital (Felipe and Kumar 2014; see also Storm and Naastepad 2015). However, to counter this argument, too low capital share on income will likely lead to a fall in investment and innovation (Thimann 2015), which in turn leads to a structural lack of competitiveness.

on the job-market situation of unemployed youth (Eichhorst, Hinte, and Rinne 2013; c.f. Speckesser, Gonzalez, and Kirchner 2019). Another recent meta-analysis by Kluve et al. (2019) has found that labor market activation programs targeted specifically at the Youth are moderately effective. The variance in their effectiveness is associated with a number of domestic economic and institutional features: they recommend that youth employment programs integrate more interventions and services in order to meet the needs of a heterogeneous group of jobseekers. Related to this, the profiling of participants for better service targeting and the involvement of non-public actors is likely to increase the positive effects of youth employment interventions. Finally, youth employment programs work better in middle- and low-income countries than in high-income countries. Nevertheless, the authors also find evidence that policy-makers in high-income nations can increase the effectiveness of these policies by setting up performance-based rewarding for service providers (Kluve et al. 2019).

Long-term unemployment is most likely a manifestation of deep structural misalignments between the skillset of the working age population and demand for skills on the labor market. As Bentolila, García-Pérez and Jansen (2017) note in their study of Spain's long-term unemployment, economic growth alone is not likely to solve this structural problem. However, a recent meta-analysis of the literature on active labor market policies shows that these policies might actually be somewhat more efficient in the group of long-term unemployed than in the general populace (Card, Kluve, and Weber 2018). An important policy that complements the implementation of active labor market policies is the timely identification of registered jobseekers at risk of becoming long-term unemployed through early profiling. These profiling tools help increase the efficiency labor market policies (Štefánik and Gerbery 2015; Desiere, Langenbucher, and Struyven 2019). Overall, both long-term and youth unemployment rates are variables that may be difficult to influence by policy instruments available to the MS. They may require adjustments in employment-protection legislation, active labor market policies, and the introduction of advanced tools, such as the early profiling of registered jobseekers.

The activity rate, defined as the ratio of the sum of employed and unemployed (but searching) people in the 15-64 age group and the total population aged 15-64 is to a large extent an outcome of the labor market policies discussed earlier in this review. However, there are several other important types of policies that influence the activity rate. These include old-age retirement policy (Hairault, Sopraseuth, and Langot 2010; Sabatier and Legendre 2017). Hairault, Sopraseuth and Langot (2010) as well as Sabatier and Legendre (2017) have shown that distance to the statutory retirement increases older workers' propensity to stay active in the labor market, which leads to higher overall activity rate. An important extension to this argument is that empirical research has not linked higher retirement age to a lower employment rate of young workers (e.g. Kalwij, Kapteyn, and de Vos 2010; Böheim 2019).

Given these considerations, activity rate should in general be considered one of those indicators that MS can still successfully influence through policy instruments that fall within their competence.

2. A proposal for an MS Control–Predictive Power Matrix

The preceding chapter has evaluated the capacity of EU MS to influence the position of their economies in the core MIP indicators. This section is dedicated to outlining the contours of a matrix categorizing the core MIP indicators along two axes: (i) their predictive power concerning economic crises (ii) MS control over their economy's performance on the given indicators. While the latter dimension is evaluated using the information presented in Section 1 of this review, for the former classification, the study relies on Domonkos et al.'s (2017) empirical analysis. In their quantitative enquiry, the authors have used logit models to investigate the predictive power of MIP indicators on economic crises. These have been defined as events whereby the national economy has reached an output gap below -2 percent of the GDP.

Figure 2 provides an initial classification of the 14 MIP indicators along the aforementioned two criteria. Current account balance is divided into current account deficit and surplus as these two appear to diverge in their predictive power to a considerable degree.

Figure 2. The MS Control–Predictive Power Matrix

MS control§	Small	moderate	substantial
substantial	*General gross gov't debt*		*Activity rate*
moderate	*Aggregate unemployment rate* *Private sector credit flow* *Housing price index*	*Nominal unit labor costs*	
small	*Current account surpluses* *Long-term unemployment rate* *World export market share* *Total financial sector liabilities*	*Net int'l investment position* *Youth unemployment rate* *Private sector debt stock*	*Current account deficits* *REER*
			Predictive power†

Source: §Section 1; †Domonkos et al. (2017).

According to the initial classification proposed in Figure 2, it is only government debt and the population's overall activity rate that governments can influence more substantially. Of these two variables activity rate has proven to be a consistently good predictor of possible crisis events (Domonkos et al. 2017). While general gross government debt can be directly influenced by government

action, it has limited predictive power concerning economic crisis events. Out of those variables that governments can influence to a moderate extent, the development of net unit labor costs seems to have the best predictive power concerning economic crises. The largest group of the 14 indicators falls into that category of variables which MS can influence to a small degree. Among these, current account deficit and the real effective exchange rate have a strong empirical link to the likelihood of crisis events in the economy. However, both of these variables fall largely outside the influence of the MS, especially of those that have already joined the Euro Area and therefore do not have an autonomous monetary and trade policy.

Conclusion

This review has provided an overview of the recent literature on government policies that may influence the position of national economies of EU MS on the 14 core MIP indicators. The review has been followed by a proposal for a classification of the MIP core indices along two dimensions: (i) their predictive power and (ii) MS capacity to influence the performance of their national economies on the given indicators.

The study classifies most MIP indicators as falling outside the reach of domestic policy-makers acting on the level of the MS. The development of aggregate unemployment rate, private sector credit flow, housing price index and nominal unit labor costs can be influenced by domestic policies to a moderate degree. Gross government debt and the activity rate in the 15-64 age group can be affected to a substantial degree using domestic policies on the national level.

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